Reasons Why it is Beneficial
to Invest in Republic of Kosovo

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Abstract: The purpose of this paper is to examine the role of Foreign Direct Investment (FDI) in economic development through the development of the country that has the potential sectors. The effect of technology in these sectors had risen sector and area that until then had remained neglected. The paper investigates the impact of foreign direct investment (FDI) in economic growth using detailed sectoral FDI in Kosovo during the period 2000-2013. Sectors considered are: Agribusiness, Tourism, forestry, services, manufacturing, mining, energy, construction, wholesale and retail trade, hotels and restaurants, transport, telecommunications and other sectors. The negative effect of extractive industries in creating income and environmental pollution in Kosovo is not surprising. FDI in manufacturing industries by stimulating exports generate more income. FDI are likely to repatriate their profits but are likely to increase employment. To ensure legal protection for foreign investors, have signed an agreement with the Agency Multilateral Investment Guarantee (MIGA), the avoidance of double taxation, taxes are the lowest in Europe. Investment Promotion Agency of Kosovo (IPAK), the level of government makes the promotion of Kosovo. As a developing country taking the time information is more difficult but efforts in this direction are great.

Keywords: Foreign direct investment; economic growth; potential sectors; Kosovo

1. Introduction

Kosovo has achieved a significant progress in many areas of its development, increasing hope to people of Kosovo for a better life after the declaration of independence on 17 February 2008. Every aspect of life and economy is taking positive direction as: increase of political stability, increase of the level of security, stable economy with continuous growth, supplementation of the legislation, reduction of corruption and organized crime, salary increase etc.

Regional cooperation initiatives, creation of a regional common market, elimination of customs tariffs, and elimination of trade barriers as well as providing of new perspectives has made the gloomy assessments for Kosovo be replaced with good news. Kosovo faces a number of social and economic problems, because:

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- Donations to capital investment have been slowed;

- Limited banking system in Kosovo which lacks to support serious investment;

- Lack of financial markets and securities;

- Poor public infrastructure;

- High rate of unemployment (30.9 %).[1]

Kosovo institutions continue to work on meeting the standards required for membership in the European Union. Foreign investments in Kosovo are not sufficient to fully meet the economic needs of Kosovo. FDI to developing countries are considered too important because of their positive and multilateral effects. FDI in developing countries increased from about 1 billion U.S. dollars in 1990 to about 12 billion U.S. dollars in 1998. FDI is likely to increase in favor of developing countries after 2004, Asian countries are an example which tend to dominate worldwide with their products.

At this level of globalization Kosovo finds itself well-positioned through infiltration not only in the EU countries but farther. Due to establishment of modern infrastructure, both inside and outside it, road link with the region[2] through Kosovo - Albania road, Kosovo already has its Adriatic port through which it connects to shipping[3].

All these distinguish Kosovo as an attractive country with investment opportunities for each investor of different sectors. During 2012 are estimated to have been invested € 232 million, whereas the total number of foreign companies operating in Kosovo amounts to about 5018.[4]

2. The Theoretical and Empirical Aspect of Economic Growth

There is no such a powerful conclusion yet that FDI impact on GDP growth, although most countries encourage their inflows. In the most optimistic view FDI provide links with the rest of economy. As a general definition FDI means international movement of goods and services for investment purposes, where the foreign investor has the control over the investment asset. Hirschman has noted that the presence of two or more industries creates sufficient demand to surpass the threshold required for creation of new industries which in their programs create the

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[1] Unemployment rate of youth (aged 15-24) 55.3%. Whereas according to informal assessments unemployment in Kosovo is 45.50%.
[2] Connection with Albania through the constructed highway.
[3] With time distance of only two hours.
[4] Kosovo Statistics Agency, Ministry of Trade and Industry, 2013.

network of companies from raw material to final product. Rodriguez - Clare assumes that firms in developed economies with higher wages want to take advantage of cheaper labor overseas by establishing a plant in the host country thus creating positive effects on employment in the host country. Economic growth in some Asian countries was driven by investment and exports instead of consumption by the industrial sector and the massive use of resources and energy.[1]

Borensztein et al. (1998) finds that FDI is an important tool for adoption of new technologies, contributing more to growth than domestic investment. In addition many authors find a positive link between economic growth and human capital.[2]

Bulasubramanyam et al. (1996) examined the relationship between FDI and growth in the context of different regimes of trade policy, export and import promotion. Bengo et al. (2003), states that a country can benefit FDI if there is a satisfactory level of knowledge in the use of modern technology. Volatility of FDI is also dependent on regulation of financial markets (De Gregrio and Guidotti, 1995; Alfaro et al, 2004; and Durham 2004).

While, in terms of economic sectors, which of them has more effect on GDP growth, is a question that many authors have analyzed (e.g. Alfaro et al. 2004; Bengoa and Sanchez - Robles, 2003; Durham, 2004; Hsiao and Shen, 2003; Li and Liu, 2005, and Lipset, 2006) and came up with different conclusions, emphasizing in some cases that the primary sector has a limited impact on the economic growth compared with other sectors.[3]

Nevertheless Kosovo has an important mining sector; it has attracted less FDI, though studies show that attracting FDI in the mining sector has a negative effect on economic growth. It therefore remains an open question for Kosovo, whether priority should be given to this sector in the future.

Kosovo needs investments in energetic technology[4], as it possesses large reserves of lignite as well as major pollution problems.

As an energetic source it is competitive in the region if well-designed institutions eliminate bad rules. Investment regimes have become quite liberal in developing countries and therefore have a negative imbalance between benefits and costs of FDI in the long term.[5]

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[1] Wilton Park Conference WP881. 2007.Title: Report on Willton Park Conference 881.China's Rapid Economic Growth: Internal ImpactT, External Implications, pp. 2-11.
[2] Borensztein et al. argues that, in order to gain positive effects (technological), host economies should have educational capacities.
[3] This was stated by Alfaro (2003) and Vu et al. (2006) during his analyses in the primary sector.
[4] Investments in technology (see Agosin, 1996; Riveroset al, 1996;Chudnovskyetal, 1996).
[5] Agosin MR (1996) dealt with this problem too.

Initially, FDI can provide new capital allowing additional investments on both human and physical capital, which might be too profitable for developing countries (Caves, 1996). Balasubrahmaniyam et al. (1996) states that FDI can increase export if the country is promoted and trade openness is essential for the growth effects of foreign investment.

3. Performance of Vital Indicators of the Economy in Kosovo

Regarding the vital indicators of the economy in 2013 Kosovo performed better than in 2012, but not satisfactory to address the most sensitive issues as the youth employment, which constitute over half of its population.

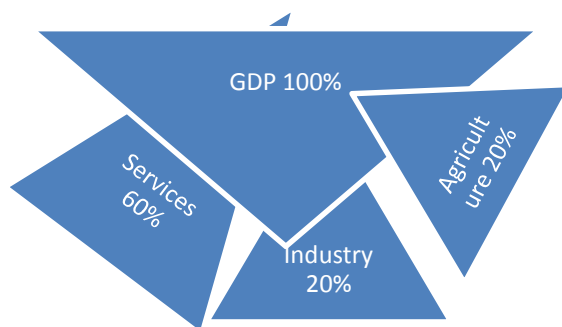Orientation in trade is not a good solution.

Diagram 1. GDP – Division in sectors

Source: KSA, 2012 (by the author)

GDP in Kosovo has this participation as a percentage of revenue from these sectors: agriculture 20%, industry 20%, services 60%. KSA, 2012 (by the author).
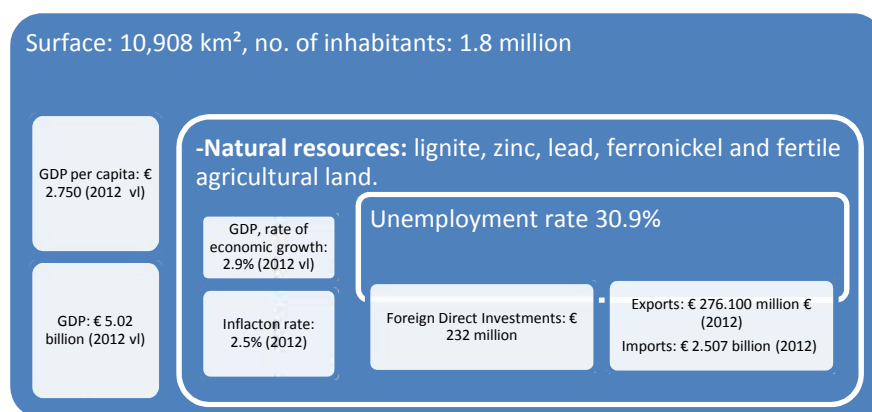

Diagram 2. Statistics of the vital indicators in economy

Based on diagram 2, Kosovo in 2012 reached a value of about 2.8 billion euros in trade flows. Main trade partners are the EU countries with participation of about 39% for export and to about 39% for import, as well as the CEFTA countries which participate with 37% for export and 34% for import compared to the total of 2012.[1]
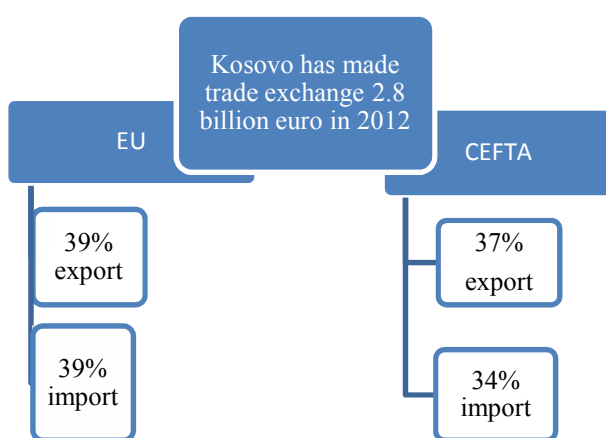
Kosovo has made trade exchange 2.8 billion euro in 2012

EU

39% export

39% import

CEFTA

37% export

34% import

Diagram 3. Kosovo trade exchange

KSA, 2012 (by the author)

Reasons to invest in Kosovo - Kosovo as a country, in the heart of the Balkans, is a bridge among the neighboring and region countries, not only physically but also as a broadcaster of positive human values.

Benefits of potential foreign and local investors are large beginning not only from numerous natural resources but also human ones which can absorb new technology and knowledge brought by investors.

Some of the benefits when you invest in Kosovo are: low taxes, rich resources and supportive business environment. Kosovo is a flower that has just started to give her first nectar and benefits both to the investor and the population of Kosovo will be high. Investing in Kosovo means having an interest in sustainable investment in the long term.

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[1] KSA, CBK, 2013.

Diagram 4. Promoting a positive image for Kosovo

By the author

According to diagram 4, the economy of Kosovo is dominated by the service sector, which sector is estimated with a very good performance. But in the long term if the economy of Kosovo does not take radical measures to subsidize other sectors, especially agriculture and manufacturing, will impact on the balance of payments to be negative due to the import of natural capital which remains in stocks without being activated, since their owners have neither concrete plans nor state support to finance through cheaper loans, donations, or rapid legal support procedures for privatization. On the other hand there is the possibility of repatriation of revenue from this sector as the investors are mainly foreigners. An opportunity of this sector to move presents another obstacle, as if not handled well by the government; they can invest their profits elsewhere or run away from Kosovo.

The aspect of security[1] in Kosovo for Foreign Investors creates conditions for their stay to be long, but they must not lose time in implementing a strategy which

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[1] Kosovo is a signatory of the International Convention on Safety of investors (MIGA), with an admirable political stability in the region, keeping in mind that only 14 years after the last war, has established rules and laws for foreign investors which treat them equally with internal investiture.

combats the negative sides that are present in society such as corruption, poor law implementation, greater commitment to work with entrepreneurial people, a better infrastructure, sustainable energy and water, low interest rates in banks.[1]
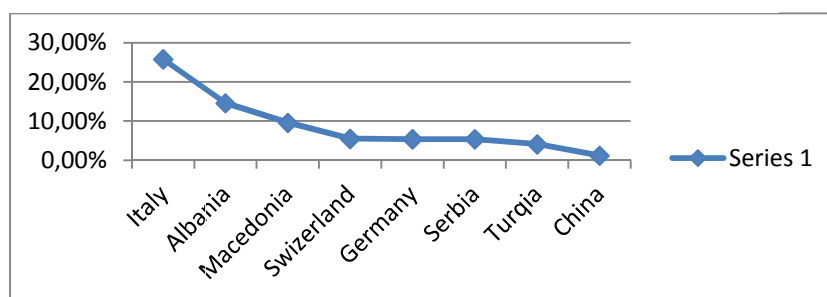

Chart 1. The main export partners, according to statistics of Kosovo, 2012
(formulated by the author)

Main export partners: Italy (25.8%), Albania (14.6%), Macedonia (9.6%), Switzerland (5.5%), Germany (5.4%), Serbia (5.4%), Turkey (4.1%), China (1.2%).
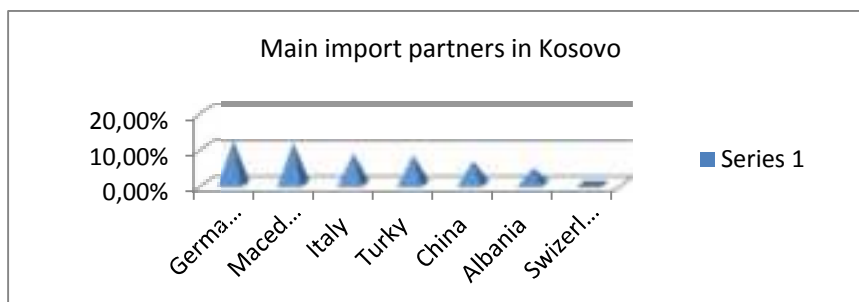

Chart 2. Main import partners in Kosovo, 2012.
(Kosovo Statistics, 2012, by the author).
Source: Kosova Statistics, 2012. (By the author)

The main import partners: Germany (12.1%), Macedonia (11.5%), Serbia (11.1%), Italy (8.5%), Turkey (8.0%), China (6.4%), Albania (4.4%), Switzerland (0.9%).[2]

Imported goods: machinery and transport equipment (21%), manufactured goods (20%), fuel (16%), food and live animals (16%), chemicals (10%) etc.

Goods exported: processed goods (56%), raw materials (25%), food and live animals 6%, fuel 4%, machinery and transport equipment (3%), etc.[1]

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[1] All the banks that operate in Kosovo, 90% of them with foreign capital, offer loans with the highest interest rates in Europe (8 % business loans to 13.7 %).
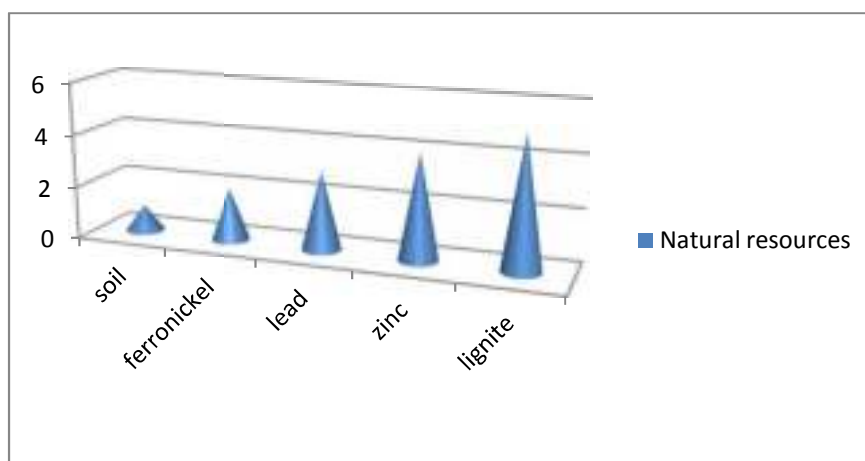[2] ASK/KSA, 2013.

Chart 3. Natural resources in Kosovo, KSA, 2012 (by the author)

Kosovo has large reserves of lignite, zinc, ferronickel, and sufficient base fertile land to develop the mining sector, energy and agriculture.

According to the data in Table 2, 5018 foreign companies are operating in Kosovo bringing 232 million euros.

Most of the companies come from the region especially from Albania.

Table 1. Distribution of foreign investment companies by sectors of the economy

No	Sector	No. of companies	% in total
1.	Trade	1952	38.9%
2.	Production	791	15.8%
3.	Service activities	764	15.2%
4.	Construction	607	12.1%
5.	Tourism and catering	350	7.1%
6.	Transport	181	3.6%
7.	Financial sector	141	2.8%
8.	Telecommunication	121	2.4%
9.	Health care	68	1.3%
10.	Education	43	0.8%
TOTAL		5018	100%

Source, Ministry of Industry and Trade, 2012. Elaborated by the author

According to Table 1, the trade sector leads with 1952 companies or 38.9%, followed by the manufacturing sector, service activities, construction, tourism and

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[1] ASK/KSA, 2014.

catering and the rest oriented in sectors which do not create directly but indirectly contribute to the general welfare.

4. Foreign Direct Investments in Kosovo and further

Foreign Direct Investments in Kosovo since 2005 have continued to be an important source of capital flows and economic development.

Based on data from the Central Bank of Kosovo, Foreign Direct Investments include investments of foreign individuals and institutions in the local economy, if the investment makes the investor owner of more than 10% of the capital of an enterprise.

Growth of FDI in million euros over the last decade has changed according to Table 2.

Table 2. FDI inflows: 2005-2011 (million euro-net)

Host economies	2005	2006	2007	2008	2009	2010	2011
World	782 673	1 164 682	1 534 682	1 208 931	802 041	936 640	1 085 242*
SEE	3 870	7 885	9 384	8 663	5 446	3 109	4 745*
Albania	213	259	481	663	717	793	742
R. Kosovo	107.6	294.8	440.7	366.5	287.4	365.8	393.9

Source: UNCTAD, WIR11 and Global Investment Trends Monitor No. 8, Albanian Bank, *UNCTAD.CBK. 2012.

According to data in the table, the world investment performance in 2011 has a growing trend after the negative trend in 2010, but not forgetting that they are far away from the flows of 2007. This can be seen if we make analysis even for SEE, Albania or for Kosovo only that the peak of FDI was made in 2007. So the negative trend started in developed countries due to the economic crisis of 2008 has not saved the developing countries and those in transition by creating a serpentine path of negative effects of the crisis.

Foreign Direct Investment (FDI) measured by euro in Kosovo has been fluctuating over the past 10 years. In late 2007, the value of FDI reached 440.7 million euros, which is the highest value achieved during the period of analysis. The lowest value was reached in 2005, where the amount of foreign direct investment was only 107.6 million euros. Remittances and FDI to the third quarter of 2013 have continued an upward trend. This is an important indicator of the foreign investors'

confidence in a country, and they are in the same growing trend because Kosovo is improving the economic and political environment.

FDI in 2012 reached 178.4 million euros and up to September 2013, the value of FDI reached to 204.9 million euros, representing an annual growth of 14.8 percent. This increase in FDI is mainly generated by reinvested profits of companies operating in Kosovo, which increased by 46.1 percent, reaching a value of 66.9 million euros. Shareholder capital, which in the structure of FDI has the largest share, has increased by 8.1 percent and reached a value of 93.0 million euros.

Other investments, which are mostly inter-company loans, declined by 4.3 percent and reached a value of 45.0 million euros.[1]

5. FDI according to Main Economic Sectors

Regarding the contribution in economic development in Kosovo in the past 10 years, trade has been the greatest contributor, which can be seen by large imports and small exports, showing a not very hopeful state for a dynamic development, sustainable growth and employment. Therefore a number of measures have been taken by the government to stimulate the economy of particular sectors such as the manufacturing, agribusiness but no effects for now.

Even bank lending observed under particular economic sectors, are clearly seen the more beneficial sectors, commerce 52 %, manufacturing 11 %, construction 10 %, financial services 6 %, agriculture 4 %, other 17 %. The building and production sector is seen to have had a low credit reflection. The dominance of trade in Kosovo means that domestic sector is weak so it must be oriented to the foreign investiture, who upon their arrival in Kosovo would affect increasing productivity in local firms through the chain network which would be established through provision of experience, employment increase, provision of modern technology, the network of sub-contractors, financial intermediaries, trainings etc.

Economic growth for the short term will automatically be higher thanks to capital inflows, but these entries should be directed to profitable sectors to ensure a long-term economic increase, which sectors the investor wants to possess. Investiture in Kosovo seeks assets knowing that it would find strategic sectors for investment. Kosovo also has a comparative advantage in the primary and energy sectors, which sectors a foreign investor needs to know to invest. Given that we are a country in transition that needs foreign capital, knowledge and above all integration in the global network, then we must create a stable climate for doing business. As a

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[1] According to CBK 2014, Quarterly Assessment of Economy No. 5, Quarter IV/2013, p.19.

country that a decade ago started from scratch[1], we have a positive performance of GDP during 2013, which indicates strengthening of economic activity in the country since Kosovo continues to have the lowest public debt in the region with only about 9.0 percent of GDP. Investments, which have a 24.3 percent share of GDP, despite neutral impact on real GDP, the nominal growth of 3.9 percent in 2013 is satisfactory.[2]

By the end of 2013, FDI grew by about 12 percent and reached the level of about 258 million euros. According to this survey[3], wholesale and retail trade reported poorer performance compared with expectations, while the manufacturing sector and that of services reported a better performance.[4]

Sectors with higher inflows of FDI during the period 2000 to June 2012 are: banking, transportation and telecommunication, real estate, construction mining. From table 3 it can be seen the activity of Kosovo economic sectors in percentage up to 2012.

Table 3. Foreing Direct Investment in Kosovo – by economic activity (inflow) in percentage, 2007/Q2-2012, CBK.

Description	To-Tal percentage	Financial services	Production	Real estate	Transport & Telecommu-nication	Electricity	Mining	Construction	Processing industry	Other
2007	100	23.1	9.0	7.1	29.3	0.6	9.4	1.2	8.0	11.4
2008	100	34.9	6.0	16.8	13.8	4.5	4.7	3.7	8.5	13.3
2009	100	25.5	17.1	14.9	7.4	2.9	2.4	12.0	2.4	35.4
2010	100	77	78.4	44.5	16	0.5	11.1	99.6	27.40	35.4
2011	100	52.5	51.3	65.2	24.9	0.0	3.0	137.1	2.3	81.3
2012 /Q2	100	17.5	14.6	73.5	9.2	0.1	00	53.1	1.7	30.6

Based on the latest data from the Central Bank is shown that in terms of sectors, from January to September 2013, FDI are concentrated in the real estate sector

[1] Considering the last war in 1999, which had destroying consequences on physical and human capital in Kosovo.

[2] CBK, Report of Financial Stability Number 4, January 2014, pp. 25.

[3] KSA, 2013.

[4] CBK, Report of Financial Stability Number 4, January 2014, pp. 25.

(33.4 percent), construction (17.0 percent), transportation and telecommunications (14.6 percent), financial services (10.9 percent), etc.

Therefore, it is the time when we should be promoting Kosovo, because we have many sectors that have a comparative advantage with other countries in the region. Regarding the cheap labor force and education, it is an indicator that foreign technology invested in Kosovo by Kosovo citizens can be used without additional expenses. Data available for the economic structure by activity are only for the period 2006-2011, but taking into account the economic structure of the country, it is expected that changes for 2012 and 2013 are marginal. Based on changes in the structure of imports as well as the other indicators such as registration of new businesses, FDI, loans from banks for certain sectors, etc. could be suggested that the processing and manufacturing industry, agriculture, construction, and real estate can be increased, while the trade sector is expected to decline. These developments in 2013 are supported by surveys of KCC about the perception of the business climate for enterprises in Kosovo.

According to this survey, wholesale and retail trade reported poorer performance compared with expectations, while the manufacturing sector and the services reported better performance. If we take the FDI performance by countries we will see that more and more countries that have a large market and a stable economic performance are investing in Kosovo. It is also reflected positively in Kosovo, as a healthy Investiture in the long term is likely to reinvest back the capital gains in Kosovo.

Table 4. FDI in Kosovo – by countries (net), in million euros, years 2007-Q2/2012)

Year	Total	AT	DE	SI	GB	CH	TR	NL	AL	LU	RS	Other
2007	440.7	35.4	48.1	56.2	116.2	9.7	5.4	41.2	3.4	13.1	0	112.0
2008	366.5	51.3	44	44.3	36.6	31.1	23.8	22.5	21.9	6	5.5	78.5
2009	287.4	15.5	75.2	50.8	6.2	22.7	14.5	25.1	23.3	8.3	0.6	55.2
2010	365.8	21.1	91.5	34.0	38.9	35.1	4.9	14.5	20.3	0.4	0.4	104.7
2011	393.9	19.6	66.6	16.2	80.1	30.9	34.7	14.2	11.2	0.5	0.4	117.8
6/2012	1854.3	142.9	325.4	201.5	278	129.5	83.3	117.5	80.1	28.3	6.9	468.2

Source: BQK, ASK, 2012.

According to the table until the second quarter of 2012, states with better performance are Austria, Germany, Slovenia, Great Britain, Switzerland, Turkey, Norway, Albania and Luxembourg, while Serbia is present only symbolically. Whereas countries that dominate the participation of FDI in Kosovo and which tend to be dominant in the future are Turkey with 72.8 million euros, followed by

Switzerland with 31.6 million euros, Albania with 18.3 million euros, Germany with 13.4 million, etc.

Given Kosovo collaboration with countries that have higher economic activity in 2013 and 2014 the external sector of the economy is expected to continue its positive performance.

6. Policy for Successful Investments in Kosovo

In successful investment contribute clever policies in certain areas. The framework of these policies in Kosovo is on the right track. Successful policies are shown as follows:

  a) Investment policy, quality;
  b) Competition policy;
  c) Corporate Governance;
  d) Public Governance;

While the most unsuccessful policies are shown:

  a) Infrastructure and financial sector development,
  b) Trade Policy,

Although priority is given to infrastructure construction, financial sector development, but always remembering trade policy, Kosovo remains fragile in these points and it must develop and improve further through promising projects and non-restrictive measures of the private sector.

While effective policies in financial sector facilitate enterprises and entrepreneurs to realize their investment ideas within a sustainable environment.

Also the trade policy (policy in relation to goods and services) can support investments to benefit from economies of scale by increasing productivity and return rates on investment.

In Kosovo operates the Investment Promotion Agency (KIPA), governmental agency, the Economic Initiative for Kosovo (ECIK) in Vienna that develops activities: seminars, advertising investments, conferences, exhibitions, site internet. Activities are centered in three areas (see Figure 1):
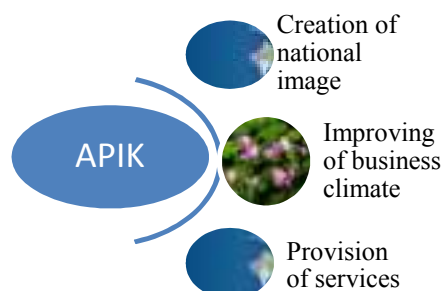
Figure 1. Activity of Investment Promotion Agency in Kosovo (APIK)

Multinational Investment Guarantee Agency (MIGA) guarantees investments in Kosovo up to 20 million euros value.

7. Amid a Gloomy Assessment and Good News for Kosovo

Kosovo has not completely developed the market economy and the emission of money (euro) is not made in it. Few large companies are spread across international markets and they are with joint capital. Banking system is 89 percent of foreign capital and it dictates the interest rates. There is an increase in banking services but there is no sign of economic recovery because over 56 percent of credits are directed in trade. Inflation is moderate due to the exchange rate of the euro and Kosovo has exploited this advantage because it has its own cash.

Kosovo has close trade relations with the European Union countries, region and US. It imports from the EU but as well as from distant China. It has constitutionally defined to be a liberal state (Kosovo Constitution, Article 10), but political barriers (EU disintegration) have prevented the integrated global network investment but it despite that it has realized importation of the advanced technology.

The stagnation of economic development requires reforms in the banking system (interest rate reduction, soft loans for businesses, etc.). The Central Bank will soon define interest rates for commercial banks to increase entrepreneurial activity in the country through loans that can cover the interest with their profits. Kosovo savings are favorable for growth if they are aimed to be invested within Kosovo. It still lacks a social security network even though there is a Pension Savings Fund. Within five years health insurance is likely to operate since many people save for

old age, education of children etc. This will encourage people to save but also to consume. Kosovo's attempt to reduce the deficit by promoting exports through tax and subsidizing the manufacturing sector and agriculture seems to have effects in long terms. The rural-urban division in Kosovo as it existed before the occupation, now more and more is being matched, caring not to remain behind. There are no administrative and legal differences between rural and urban areas including land management, attitude, education, social benefits.

Education, especially primary education is compulsory, free textbooks to encourage parents to send children to school. But health still has remained a challenge, as the lack of a health care scheme. Industry needs to be developed as well as agribusiness to improve the income to the villagers. Infrastructure is underway and it is improving communication and transportation of goods and passengers. There should be set up research centers in remote agricultural areas which would help to modernize working practices and improve productivity. Villagers must be offered an assurance beginning first with a low level of pension being increased after three to five years to ensure health facilities. There is progress towards institutionalization but stability and the continuing need for economic growth remain the main concern in Kosovo.

A radical change will be seen if Kosovo is integrated in international organizations (free movement of people and capital). Although economic growth is stable and positive, it is associated with unstable institutions, frequent elections, corruption and fragile operation of the law. Various government departments use the funds for construction of good offices, salaries similar to neighboring countries, but there are political influences between the servers and civil servants. Performance monitoring is increasingly becoming more realistic after a computing logistics in the workplace. Further reforms in the economy would push the government to be involved in providing services in social welfare management, corruption and law enforcement. The more is GDP generated the greater are the chances to obtain FDI, therefore preferential policies that are being implemented, as industrial free zones, lower taxes etc. are in favor of investors.

8. Potential Sectors in Kosovo in the Context of FDI

Energy and Mines - Kosovo has abundant underground resources, with 14,700 million tons, it ranks the fifth in the world for coal reserves from which it also produces the largest amount of electricity. Kosovo in 2008 produced 4,738 billion kWh and has spent 5,156 billion kW / h electricity.[1]

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[1] KSA(Kosovo Statistical Agency), MTI(Ministry Trade and Industry), CBK(Central Bank of Kosovo), 2013.

Reserves of this mineral, used as the main source of energy production in Kosovo, estimated to last for 650 years, with the pace of current extraction. Besides lignite, Kosovo is also rich with zinc, lead, gold, cadmium and bismuth, bauxite, nickel, etc.

Agriculture and Livestock - Kosovo is rich in agricultural land, 53 percent of the total surface is arable land. Currently agriculture sector contributes only with 19 percent in Net Domestic Product.

Vineyards - growth of grape and wine production is an old tradition in Kosovo. During the golden years the wine industry, in Orahovac only, had a production capacity of up to 50 million liters a year. In 1989 in Orahovac, wine exports reached 40 million liters[1] which was mainly distributed in the German market.

Construction - the construction industry has recently become one of the most important sectors in the economy of Kosovo. This sector continues to be a great economic potential for Kosovo, taking into account the need for construction of new settlements and road infrastructure.

Textile Industry - Textile sector was the second largest in Kosovo. In this sector there is plenty of room for investors to come back once again and penetrate the Kosovo region.

Tourism - Tourism potential of Kosovo is closely linked to the geographical position of Kosovo, resorts such as Brezovica and Sharr Mountains are good and interesting opportunities for investors. Besides Brezovica, other mountains used for winter tourism are The Cursed Mountains (Albanian Alps) situated in western Kosovo.

Banking system - The banking sector in Kosovo is estimated among the sectors with the best performance in the economy. The commercial banking sector comprises 10 banks. Commercial banks offer the full package of banking services and represent the largest financial sector, characterized by an increased level of financial intermediation.

9. Conclusion

The year 2000 was a turning point in the course of normal life for the people of Kosovo, which for many European countries was turning year for FDI. This is an indication of how far Kosovo was compared to the countries of the region but also how close it is to these countries after a decade. Optimism and vitality that characterizes the people of Kosovo is an example in the Balkans. But what was actual at that time? Challenges that privatization passed made the investment

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[1] KSA, 2012.

decrease in 2004. A progress was made in 2007[1], at the same time the level of GDP was positive (moderate economic growth), and average wages were leveled with neighboring countries. A bad situation in the flow of FDI is even today, over 55 % of FDI are trade oriented, bypassing production. Mutual interaction between FDI and the unemployment rate is negative (investors who have bought assets and have not activated them), and in terms of interaction FDI / GDP, it is positive regarding inflows (imports of modern technology and know-how).

Foreign Direct Investments are hope for Kosovo with an unemployment rate among the highest in Europe. Previous literature generally found a positive effect of FDI on economic growth, but it had many conflicting opinions. There will be a faster economic growth in Kosovo when the country will have reached a new phase of development that will even promote the sustainable social, political and environmental growth. Kosovo must continue promotion of exports, industrial production, domestic consumption, efficient use of energy and environmental protection. Social welfare, political stability and the rule of law would affect the growth of capital inflows. When a positive climate and image is created for Kosovo then an increase of FDI inflows can be expected in the mining sector, energy, telecommunications, agribusiness, tourism, manufacturing industry, construction, production etc. While the sector of services has reached the highest peaks of attracting investment and has less to do in the future. This optimism derives from the fact that Kosovo has educated and the youngest labor force in Europe.

Knowledge of foreign languages, numerous natural resources, key geographical position in the Balkans, and the tradition of hospitality to strangers, suitable climate for agribusiness for eight months a year, the construction site, people with a language and culture of ancient tradition are offers that are valued by investors. National willingness to fight organized crime, corruption and lack of the rule of law, which is a prerequisite to integration in the European Union, is becoming reality.

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Factors Affecting Corporate

Cash Holding of Non-Financial Firms in Pakistan

Atif Kafayat[1], Khalil Ur Rehman[2], Farooq M. [3]

Abstract: The previous researches explore the question of why firms hold cash. But there are few researches done in developing countries like Pakistan. The need for cash is characterized by its policies of firms regarding capital structure, working capital requirements, cash flow management, dividend payments, and asset management. In this paper, the impact of these factors is normally analyzed under the framework of Tradeoff theory, Pecking Order Theory and Free Cash Flow Theory. This paper focuses on determining the level of corporate cash holdings of non-financial Pakistani firms, and cash holding requirement among different industries. The data is set for period of 2008-2012 by using the data of 40companies and 6 industries. The findings of the study support the theories. Which show that firm size, net working capital, leverage, Capital Expenditure and Dividend significantly affect the cash holdings of non-financial firms in Pakistan.

Keywords: cash holding; net working capital; Firm Size; leverage; Capital Expenditure; Dividend

JEL Classification: G3

1. Introduction

This paper examines the determinants of corporate cash holdings in context of Pakistan. Financial managers need cash to pay for labor and raw materials, to buy fixed assets, to pay dividend and many other day to day business activities. Since cash do not itself earn any interest so business need to hold for taking trade discounts (by paying early), maintain credit rating and to meet other profitable activities. Under the perfect market there are no incentives for the firm to hold cash, if firm want to invest it can find the fund in the market at a cost which is the function of its risk and profitability of project. But under the imperfect market the

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internal and external funds are no longer in perfect substitutes so many theoretical factors enlighten the motives for corporate cash holdings. The transaction costs assume to be the major determinants of cash levels and firms with the higher marginal cost for cash were expected to hold more cash.

The basic question regarding cash holding is to know the consequences of cash holding. Do the firm capital expenditure effect on holding cash decision. So it is the important factors to determine that what factors motivate managerial cash holding in decision? What value do shareholders place on the cash that firms hold, and how does that value differ across firms? When manager try to hold cash do they really care about shareholders wealth or about their personal well-being as well? What are the major factors that affect the manager decision for holding cash? Is there any difference between cash holding among different industries?

The three theoretical models provide guidance regarding determinants of cash holding. Firstly the trade of model hypothesis focuses on marginal cost and marginal benefit of holding cash. Secondly the pecking order theory of Myers and Majluf suggest that firm used cash on requirement of retained earnings and investment needs. Finally Jensen's free cash flow or agency cost which view that manager have incentives to hold cash to increase the amount of assets under their control.

2. Literature Review

Olpher, Pinkowitz, Stulz and Willaimson (1999) were the first to thoroughly investigate the determinants of corporate cash holdings. They consider two broad focuses of holding cash first the trade off theory which focuses on cost and benefit of holding cash and the other one is financing hierarchy theory which states that level of cash holdings depend on profitability. They find that firms with strong growth opportunities, higher business risk and smaller size hold more cash. On the other hand large firm and high credit-rating firms tend to hold less cash. However they find little evidence that suggest managerial entrenchment as a motive for holding cash.

Nicolas Couderc (2004) In their research the data taken from Canada, France, Great Britain, and USA. They focus on the link between cash holdings and firms' profitability, by implementing a bivariate profit model. A negative correlation is drawn between these two variables; a firm with more cash is likely to perform worse than other firms. Cash holdings are increasing on firm's size, cash flow level, cash flow variability, and decreasing on indebtedness, investment rate, and liquidity of the balance sheet.

Hofmann (2006) examined the determinants of corporate cash holdings of non-financial firms in New Zealand. His findings suggest that the main determinants of

corporate cash holdings in New Zealand are firm's growth opportunities, the variability of its cash flows, leverage, dividend payments, and the availability of liquid asset substitutes. While growth opportunities and the variability of cash flows are positively related to cash holdings, large dividend payments and liquid asset substitutes indicate lower cash holdings.

Habib and Amin (2006) conducted the research corporate cash holding in the context of Bangladesh. Their research based on the tradeoff theory, pecking order theory and free cash flow theory. Their research finds many evidence regarding trade-off and pecking order theory. However no support is found for the free cash flow theory. The variables in the research are dividend payment, investment opportunity, liquid asset substitutes, leverage, size, cash flow uncertainty, debt maturity, inside ownership. Mean, Median, S.D, Correlation, Univariated, Regression are the method used in their research. Their result shows that liquid asset substitutes and leverage are negatively related to corporate cash holdings. While dividend paying and firm with larger cash flow holds more cash.

Afza and Adnan (2006) conducted a research in Pakistan their focuses is on tradeoff model, pecking order theory and free cash flow theory. The data collected from KSE from 1998-2005 The findings of the study shows that firm size, cash flow, cash flow uncertainty, net working capital, and leverage significantly affect the cash holdings of non-financial firms in Pakistan. They use cash, size, MTB, NWC, Leverage, Dividend as variable. They have applied mean, median, standard deviation, t-test, Beta approaches. Their result support pecking order theory free cash flow and trade off model.

Faulkender and Wang (2006) focus on the cross-sectional variation in the marginal value of corporate cash holdings that arise from differences in corporate financial policy. The variables include Firm size, Long-term bond rating, and Commercial paper rating while the approaches used are Payout ratio and regression approaches. They find that the marginal value of cash declines with larger cash holdings, firms with stronger growth opportunities, riskier cash flows, and more limited access to capital markets hold higher cash balances.

3. Methodology

To determine the variables that affect the managerial cash holding decision in the context of Pakistan following regression is used

$$CASH = \beta_0 + \beta_1 SIZE_i + \beta_2 NWC_i + \beta_3 LEVERAGE + \beta_4 CAPEX + \beta_5 DIVDEND$$

Where, variables are represented by

CASH   = $\dfrac{\text{Cash and cash equivalents}}{\text{Net Assets}}$

SIZE   =   Natural logarithm of Total Assets

NWC   = $\dfrac{\text{Current assets – Current Liabilities}}{\text{Net assets}}$

LEVERAGE   = $\dfrac{\text{Total Debt}}{\text{Total assets}}$

CAPEX = $\dfrac{\text{(Current Fixed Assets – Previous Fixed Assets) + Deprecation}}{\text{Net Assets}}$

3.1. Variables

The variables that are used in research include cash as a dependent variable while dividend, leverage, size, networking capital and capex are independent variables.

Cash

The dependent variable is cash and it is the sum of cash in hand and bank and marketable securities divided by net assets.

Net Working Capital

The net working capital is also the major factor that affects the holding of cash for the firm. NWC is current asset minus current liabilities divided by net assets.

Size

Size is another significant variable that affects cash holdings. According to trade-off theory raising funds is less expensive for larger firms they are expected to hold less cash. The pecking order theory suggests that larger firms are more successful hence they should have more cash after controlling their investments. Size is the natural logarithm of total assets.

Leverage

According to trade-off theory leverage increase the probability of bankruptcy firm with the higher leverage are expected to hold more cash. On the other hand to extend that leverage ratio acts as a proxy for the ability of the firm to issue debt it would be expected that firms with higher leverage would hold less cash. The pecking order theory tells that debt grows when investment exceeds retained earnings and falls when investment is less than retained earnings. The previous researches show a negative relationship between leverage and cash holdings. The agency cost theory tells that highly leverage firms are suggest to capital market

scrutiny, manager discretion to destroy value through cash accumulation is less likely for higher levered firms. Leverage is total debt divided by total assets.

Capital Expenditure

The capital expenditure means the investment made by the firm in their assets for the certain period. The researches show that theories having more capital expenditure hold more cash. The CAPEX is defined as net fixed asset of current year minus net fixed asset of previous year plus depreciation and divided by net assets

Dividend

According to Trade-off theory the firm that currently pays dividend can raise additional fund by cutting dividend instead of going to the market, hence dividend payer are expected to hold less cash. Dividend is basically taking the value of one company if a company pays dividend in a year otherwise take it zeros.

3.2. Hypothesis

The conclusions from previous researches shows that firm size, growth opportunities, cash flows, leverage, dividend and the probability of financial distress impact cash holdings. The hypothesis that was developed is on the basis of theoretical models. Following are the hypothesis that we use in this research

Hypothesis 1a: Cash holdings are positively related to firm size.
Hypothesis 1b: Cash holdings are negatively related to firm size.

Hypothesis 2a: Cash holdings are negatively related to the leverage.
Hypothesis 2b: Cash holdings are positively related to the leverage.

Hypothesis 3a: Cash holdings are positively related to CAPEX
Hypothesis 3a: Cash holdings are negatively related to CAPEX

Hypothesis 4a: Cash holdings are positively related to dividend payments.
Hypothesis 4b: Cash holdings are negatively related to dividend payments.

Hypothesis 5a: Cash holdings are positively related to Net Working Capital.
Hypothesis 5b: Cash holdings are negatively related to Net Working Capital.
3.3 Sample and Descriptive Statistic

A sample of 40 public limited companies listed at Karachi Stock Exchange (KSE) is selected over a period of five years (2008-2012). The required data had been taken from the firms' websites. Financial firms have been excluded from the sample for the obvious reason that the factors determining their cash requirements are altogether different from the non-financial firms. The variables used to evaluate

the cash holdings of the firms in this research include size of the firm, cash flow, capex, leverage, and dividend payments. Table 1 presents descriptive statistics of the variables. The table 2 describes the significant level, standard error and beta of the variables. Table 3 presents the dependence level of the independent variable on dependent variables. Table 4 shows the multiple correlations between the dependent variable. Table 4 presents the relationships between the variables. Table 5 shows the industry wise analysis.

4. Results

Table 1. Descriptive Statistics

Variables	Mean	Std. Deviation	N
CASH	.0799	.0990	200
NWC	.1654	.1858	200
SIZE	6.6810	.5742	200
LEVERAGE	.1367	.1632	200
CAPEX	.0383	.3377	200
DIVIDEND	.9100	.2869	200

The table 1 descriptive statistic shows the mean and standard deviation of the variables and provides the general over view of the data. The mean cash ratio over the sample is 7.99% which is considerably fine for the non-financial firms. While the cash ratio in US firms' 17% reported by Opler et al European firms' cash ratio is 14.8% reported by Ferreira and Vilela. Its standard deviation show that on the average each value lie at the distance of 0.099 units from the center part of the data and the total number of observation (N) are 200. The leverage ratio 13.6% show that Pakistani firms use lesser amount of debt to finance their assets as compared to developed countries (26.1% in US firms and 24.8% in European Countries)

Table 2. T-Test Analysis

Variables	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	-.166	.081		-2.051	.042
NWC	-.128	.036	-.240	-3.570	.000
SIZE	.029	.012	.171	2.526	.012
LEVERAGE	-.120	.041	-.198	-2.918	.004
CAPEX	-.042	.019	-.144	-2.179	.031
DIVIDEND	.050	.023	.146	2.237	.026

The table 2 describes the significant level, standard error, T value and beta of the variables. Here B are the slope coefficients that indicates that if we increase one unit change in the independent variable (NWC) then dependent variable will change -0.128 unit. Standard error represents on average each value lies at a distance of 0.036.

T is the test statistics value and it is calculated as T= B/Std Error

The last column indicates whether the variables are playing any significant role in change in Dependent variable or not if value of any variable is less than 0.05 then it's playing significant role otherwise they are not playing any significant role. In the table the variables are significant means playing significant role in the change of dependent variable this result is according to previous researches.

The NWC is negatively and significantly related to cash is consistence with trade off theory of cash holdings which predicts that firms with more liquid assets other than cash should hold less cash as these assets can be used as cash substitutes. The Size is positive and significant related to cash follow the pecking order theory which reveal that large firm hold more cash while this result contrast to trade off theory which predicts that raising fund is relatively less expensive for larger firms they are expected to hold less cash. The leverage is negatively and significantly related to cash, trade off, pecking order and agency cost theory of cash holding all predict a negative relation. Trade off theory suggest that leverage ratio acts as a proxy for the ability of the firm to issue debt it would be expected that firms with higher leverage would hold less cash. The pecking order theory tells that debt grows when investment exceeds retained earnings and falls when investment is less than retained earnings.

The agency cost theory tells that highly leverage firms are suggest to capital market scrutiny, manager discretion to destroy value through cash accumulation is less likely for higher levered firms. The Capex is negatively and significantly related to

cash which reveal the high capital expenditure firm has less cash holding. The Dividend is positively and significantly.

Table 3. R Square Analysis

R	R Square	Adjusted R Square	Std. Error of the Estimate
.425	.181	.159	.091

The table show the multiple correlations between the dependent variable is 0.425 which is not too much high correlation but it is positive correlation. R square indicates that in the dependent variable variation due to independent variables (DIVIDEND, SIZE, CAPEX, NWC, and LEVERAGE) is 18% and remaining 82% is due to independent variables which is not included in the regression model. Adjusted R square indicated that 16 % variables variation is in the dependent variables if we take into account the all the regression coefficients and then due to single variable there will be 16 % change will be in the dependent variable. Standard error indicated that on the average each value at the distance of 0.091for the estimated regression line.

Table 4. Correlation

VARIABLE	CASH	NWC	SIZE	LEVERAGE	CAPEX	DIVIDEND
CASH						
NWC	.268					
SIZE	.105	-.164				
LEVERAGE	-.230	-.201	.209			
CAPEX	-.188	-.021	-.117	.090		
DIVIDEND	.176	.092	-.011	-.041	-.013	

The above table 4 is about the correlation about the two variables now if we see the correlation between CASH and NWC it is 0.268 so there is positive correlation as sign of the value is positive. And as the one variable (CASH) is increasing or decreasing the other variable (NWC) is increasing or decreasing. As the value of correlation value is near to 1 or -1 it means it is highly correlated and the positive or negative sign indicates whether the two variables are moving in the same direction (positive correlation) or on the opposite direction (negative correlation). There found to be a positive relationship of Cash with NWC, Size and Dividend. There is a negative relationship of Cash with Leverage and Capex. The NWC have positive relation with dividend while it has a negative relation with size, leverage and capex.

5. Conclusion

The corporate cash holding is determined by three theoretical models trade off model which describe that firms hold cash by weighing the marginal cost and marginal benefits. The pecking order theory suggests that cash is used as buffer between retained earnings and investment needs. The free cash flow view that managers have incentive to hold cash to increase the amount of assets under their control. The empirical research in developed country supports these models, but there is less information available about determinant of cash holding in developing countries. The overall result indicates that all the variables in the model are significant in defining the cash levels of Pakistani firms. Firm size, is positively associated with the cash levels of the firm. This result indicates that larger firms hold more cash, this result support the pecking order pattern of financing the investments. Leverage is found be negatively related to corporate cash holdings this result supports trade-off theory, pecking order theory and agency cost theory. Nwc is positively related to cash which show that if firm's requirement for nwc is more it would hold more cash. While capex is found to be negatively related to cash holding reveal that firm having more cash holding would have less cash holdings. The positive relation of dividend with cash holding shows that dividend payers are expected to hold more cash and this result if against the tradeoff theory, the reason for this in case of Pakistani firms is that the firms not pay dividend of regular basis.

The industry analysis shows that every industry in Pakistani context has different need for holding cash. The industries cash holding depend differently on independent variable i.e. nwc, leverage, size, capex and dividend. The future researches should explore the impact of corporate cash holdings by including other independent variable by including different industries and also explore the effect of cash holding on firm's performance.

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Corporate Governance and Financial Performance of Banks: Evidence from Nigeria

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Abstract: Banks are the backbones of any economy therefore it is of immense importance for economies to possess a healthy and buoyant banking system with effective corporate governance practices. In Nigeria, the Central Bank replaced the past governance codes with the CBN code (2012). Therefore this study examines corporate governance and financial performance in Nigerian banks, using this new code. The main issues in this study are: what is the relationship between board size and financial performance of banks in Nigeria? What is the effect of the proportion of non- executive directors on the financial performance of banks in Nigeria? To what extent is the corporate governance disclosure of banks in Nigeria in compliance to CBN governance code (2012)? Does a relationship actually exist between banks that disclose on corporate governance and their financial performance in Nigeria? These questions were answered by examining the yearly-published reports of the listed banks in Nigeria. In examining whether or not there is a relationship between corporate governance and the financial performance of the banks, this research employed the regression analysis method to determine the relationship. However, the variables that were employed for corporate governance are: board size, board composition (the ratio of non-executive directors to total directors), and corporate governance disclosure index. Variables used in this study for examining the financial performance of these banks were the financial accountant measure for performance.

Keywords: Corporate Governance; Board Size; Agency Theory

JEL Classification: G21; G30; G34; G38

1. Introduction

The idea of corporate governance is mostly common to banks and multinational firms. Corporate governance has been an item of great importance on the policy agenda in most developed countries for many years now. Further to this, the idea of corporate governance is steadily gaining huge recognition in the African continent. Several recent activities have led to the increased pursuit in effective corporate governance policies in all nations. The case of having effective governance policies gained universal recognition from a period of absolute ambiguity after series of

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high profile collapses led to significant interest. The rise in company failures and increased fraudulent activities in recent time have led to significant pursuit in terms of literature and study of governance principles to determine best codes of practices that will improve company performance and going concern. A significant element in the pursuit of an effective corporate governance system is the responsibility bestowed on the board of directors of the company. The board is in place to supervise and monitor the activities of management and also determine the strategic position of the company. The board appraises and approves management proposals, and they are the first and most significant check for effective governance practices in the firm (Brennan, 2006 and Jonsson, 2005). The agency theory which has also been employed in this research is widely regarded as the genesis for any argument on matters of corporate governance (Jensen and Meckling, 1976). Various corporate governance structures have been suggested to combat and mitigate against this agency problem that seem to exist between the agent and the owners. The governance structures suggested by the agency theory involve size of the board, composition of the board, CEO pay performance sensitivity, directors 'shareholding and shareholder right.

Generally, banks are the backbones of any economy; therefore it is of immense importance for economies to possess a healthy and buoyant banking system with effective corporate governance practices. Poor corporate governance may could have a significant impact on any economy, it can lead to bank failures while on the long run impact on the public's trust on an economy's banking system efficiently manage its assets and liabilities. A bank's assets and liabilities involve its customers' deposits and if these funds are not efficiently managed could lead to a liquidity crisis. It is constantly debated what the right mix of governance structure (size of the board, composition of the board and directors shareholdings) is. Das and Gosh (2004), argued that how a company performs is dependent on how effective these corporate governance structure is and therefore makes this area one for further research. Although, this area has been highly researched in the developed economies to determine the effect of this governance structures on performance, it has rarely been researched in terms of Africa and Nigerian banks based on past literatures reviewed. As a result of this lapses that occur ignoring the events in the banking industry in Nigeria for past recent years, this study seeks to eliminate the gaps and disconnects that exist in corporate governance literatures. However, the following are the objectives of this paper, to determine if a relationship exists between size of the board and financial performance of banks in Nigeria, to determine if the proportion of non- executive directors has an effect on the financial performance of banks in Nigeria. Also to determine the corporate governance disclosure of banks in Nigeria in compliance to CBN governance code (2012), and to appraise if there is a relationship between banks that disclose and comply on corporate governance and their financial performance in Nigeria.

2. Theoretical Framework for Corporate Governance

Rashid (2011) argued that there are various theories that can be used to explain corporate governance conventions and also the issues that arise as a result of these conventions. Various theories have been employed in explaining these governance conventions; these theories include the agency theory, stakeholder theory and stewardship theory. Sanda, Mikaila and Garba (2005) also identified these three theories as the main and most significant theories of corporate governance and they are explained further respectively below.

2.1. Agency Theory

The agency theory can be tracked way back to Adam Smith (1776) and his explanation of main issues that arises as a result of separation of ownership and control of a business. He was of the opinion that managers of funds cannot be expected to have a very watchful eye like the owners or providers of funds. Also, he opined that oversight and extravagant behavior will always persist in the management of the activities of a firm (Smith, 1776).

Jensen and Meckling (1976) established this relationship as an agreement involving at least two parties. The two parties usually involved are the principal and the agent. The principal usually the provider of the fund employs the agent (usually the managers) to perform and run the company on their behalf. Included in the contractual agreement, the principal will bestow upon the agent decision-making authority. However, the agency problem arises because managers are after their selfish interests and individuals are generally opportunist. The managers (agent) who are put in control of the affairs of the organization may not always consider the best interest of the owners and firm and may pursue their self-activities to the detriment of the welfare of the principals (Sundaramurthy, 1996). As a result of these agency problems, the principal might end up incurring costs known as Agency costs. This Agency cost is a value loss to the shareholders and usually involves the cost of monitoring the activities of managers so that goal congruence can be achieved between shareholders and managers. Jensen and Meckling (1976) suggested that agency costs include the cost of monitoring, bonding costs, and residual loss. The effect of this agency theory is that one can only try to mitigate against this agency problem when the board is composed largely by non-executive directors (independent and dependent) who will be able to control the activities of managers and thereby maximize shareholders' wealth (Rashid, 2011; Kaymark & Bektas, 2008 and Luan & Tang, 2007). The theory also suggests that the role of the chairman and the role of the CEO should not be occupied by the same person as this can limit the monitory role bestowed on the board of directors and can also have a negative impact on the performance of the firm. It was suggested that the reason for limit in the monitory role by the board will be loss of board

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independence as a result of CEO duality (Elsayed, 2007 and Kang &Zardkoohi, 2005). This theory is based on the belief that there is a basic conflict of interest between the owners and managers of the company (Kiel & Nicholson, 2003).

Stewardship theory is a contrast or a direct opposite to the agency theory and this theory adopts a more idealistic view of humans. This theory is based on a model and believes of the agent not being a self-opportunist but a steward that perceives greater utility in the interest of the principal and the organization as a whole. The theory assumes that a significant correlation exist between the firm's success and the manager's satisfaction. This trade-off is achieved by the steward admitting that working towards achieving company's and collective goals will lead to self-actualization. The theory argues for the post of Chief Executive Officer and Chairman to be held by the same person. Therefore, control lowers the motivation of steward and weakens motivational attitude (Davis et al., 1997). Stewardship theory poses that stewards are likely to ignore selfish interests in order to pursue the best interest of the firm. Donaldson and Davis (1991) observed that when a steward has been in a company for so long, the steward and the firm becomes one entity. Instead of using the firm for their own selfish interest, the stewards seems to be more in ensuring the continuous existence and long term success of the firm because they now see the firm as an extension of themselves.

2.2. Linkage between Corporate Governance and Firm Performance

Exceptionally sound corporate governance practice is meant to improve corporate performance by blocking the control of the company by the significant shareholders and encouraging improved decision making in the process. In return to improved governance practices, the value of the firm may react immediately to informationshowingimproved corporate governance practices. It should be noted thatmaterial reportbacking the link or association between the disclosure and compliance to corporate governance and firm performance is scarce (Imam, 2006). This implies there should be no existence or possibility for managers or significant shareholders to expropriate the resources of the firm. This should in return to better management of resources and improve performance. Also providers of funds will be easily attracted and would also want to invest in companies with good management of resources, good performance with effective governance practices, itmight likely lead to lower costs of capital, which can further improve the performance of the company. Also, good governance practices tend to attract potential stakeholders like employees because they will also want to be linked and work with such companies, as they see such company to be healthy, profitable and has a going concern than firms with no or less governance.

It should also be noted that there are some advantages for the economy as a whole with good governance practices. This will lead to a financial stable and sustainable economy because of necessary actions in place to mitigate against systematic risk.

Also, good corporate governance tends to be the starting point for a fair and just society. A company with poor corporate governance tends to be the building blocks for fraudulent activities and in the long run leading to corporate failures. A limit on the exploitation of the less significant shareholders and less fraudulent activities between the large organisations and political power can lead to a suitable condition for these so called little and more equitable income distribution (Iskander and Chamlou, 2000). According to a research conducted by McKinsey and Company (2002) cited in Adams and Mehran (2003), the study showed that most investors in Malaysia showed the desire to pay more for the shares of a good governance company. The research also showed that the investors were ready to pay a mean premium within the limit of 20% to 25%.

3. Model Specification

This paper made use of the econometric model of Miyajima et al (2003) as employed by Coleman and Nicholas- Biekpe (2006) to determine the relationship between performance and governance practices. The model is therefore stated below as;

$Y_{it} = \beta_o + \beta_1 G_{it} + \beta_2 C_{it} + e_t$

Based on this research, the above model has been adjusted to examine the relationship that exists between performance of banks and corporate governance practices in Nigeria. Two simple models have been developed for performance variables and the corporate governance variables. Below are the models;

Model 1

$ROE_{it} = \beta_o + \beta_1 BSZE_t + \beta_2 BCOMP_t + \beta_3 CGDI_t + \beta_4 FSZE_t + \beta_5 DBT_t + e_t$ (1)

Model 2

$ROA_{it} = \beta_o + \beta_1 BSZE_t + \beta_2 BCOMP_t + \beta_3 CGDI_t + \beta_4 FSZE_t + \beta_5 DBT_t + e_t.$ (2)

Where:

ROE and ROA represents firm performance variables which are: Return on assets and Return on equity for banking firms at time t.

BSZE stands for Size of the Board; Composition of the Board is proxied by BCOMP which is explained as the proportion of non-executive directors to total size of the board, while CGDI represents Corporate Governance Disclosure Index.

FSZE represents firm size and for the purpose of this study, log of assets was used because the values are widely spread; DBT represents gearing (debt). These two variables are the control variables.

e_t, the error term which account for other possible factors that could influence ROE_{it} and ROA_{it} that are not captured in the model.

4. Data Analysis and Results

A descriptive analysis was used to give a summary result of the variables. This was followed with a correlation analysis to measure the degree of association between different variables under consideration. Lastly, the regression analysis was used to determine the impact of the corporate governance variables on performance.

Descriptive Analysis

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	60	-1.1	0.37	0.028	0.224
ROE	60	-2.0	1.6	0.015	0.456
BSZE	60	7.0	20.00	14.53	2.52
BCOMP	60	0.50	0.92	0.615	0.07
CGDI	60	0.72	1.0	0.88	0.078
FSZE	60	8.15	9.43	8.89	0.31
DBT	60	0.00	0.97	0.35	0.21

Source: Authors' Computation, (2013)

From Table 1 it can be seen that the 15 listed banks included in this research generates Return on Equity (ROE) of about 1.5% and there is a standard deviation of 45.6%. This means that the value of the ROE can deviate from mean to both sides by 45.6%. The maximum and minimum values of ROE are 160% and -200% respectively. However, a Return on Asset (ROA) of 2.8% was generated on the average, with a minimum and maximum percentage of -110% and 37% respectively. Also with regards to ROE and ROA, it can be seen that there is a wide deviation between banks. Also for the banks studied, the average board size is about 15 and a deviation of 2.52 which signifies that banks in Nigeria have a relatively similar board size. The maximum and minimum board sizes are 20 and 7 respectively. In addition, the average proportion of non-executive directors on the board is about 62% with a deviation of 7%. The average CGDI is 0.88 and this can deviate to both sides by 7.8%. The bank with the highest level of disclosure has 100% and that with the least has 72%. Also it can be seen that in terms of firm size which is shown by the value of asset base for the banks, they are of relatively similar sizes with a maximum and minimum 9.43 and 8.15 respectively and most of the banks are less dependent on debt in their capital structure with a mean of 0.35.

Correlation Analysis

The correlation analysis measures the degree of association between the governance variables and performance variables i.e. whether or not the governance variables will improve performance. Figure 4.4 and 4.5 presents the correlation results for all the variables reviewed in this study.

Table 2. Correlation Result for Model 1 (ROA)

Covariance Analysis: Ordinary

Date: 09/09/13   Time: 15:51

Sample: 1 60

Included observations: 60

Correlation Probability	ROA	BSZE	BCOMP	CGDI	FSZE	DBT
ROA	1.000000					

BSZE	0.152335	1.000000				
	0.2453	-----				
BCOMP	0.147201	-0.147753	1.000000			
	0.2617	0.2599	-----			
CGDI	0.285055	0.110295	0.232649	1.000000		
	0.0273	0.4015	0.0736	-----		
FSZE	0.170919	0.453236	-0.307185	0.162736	1.000000	
	0.1916	0.0003	0.0170	0.2141	-----	
DBT	0.147843	-0.213096	0.319456	0.283542	-0.203510	1.000000
	0.2596	0.1021	0.0128	0.0281	0.1189	-----

Source: Authors' Computation, (2013)

From the correlation result in table 2 above for ROA, the board size has a positive weak correlation with ROA with a correlation coefficient of 0.15. This means the ROA improves as the board size increases but this increase is not much and it is also not significant with a p-value of 0.24.

Also, the board composition has a weak positive correlation with ROA. Therefore as the proportion of non-executive directors to executive directors increases, ROA improves but this variable is not significant with a p-value of 0.26.

The corporate governance disclosure index is positively correlated at 0.285 and it is also significant at 5%. This might indicate that banks that disclose more governance issues seem to perform better.

The two control variables firm size and gearing also seem to be positively weakly correlated to ROA and these two variables are also not significant at 5%. This can mean the size of a bank measured by its asset base tends to improve performance and gearing also tends to improve performance.

Table 3. Correlation Result for Model 2 (ROE)

Covariance Analysis: Ordinary
Date: 09/09/13   Time: 16:17
Sample: 1 60
Included observations: 60

Correlation Probability	ROE	BSZE	BCOMP	CGDI	FSZE	DBT
ROE	1					

BSZE	0.187287	1				
	0.1519	-----				
BCOMP	0.060928	-0.147753	1			
	0.6438	0.2599	-----			
CGDI	0.114592	0.110295	0.232649	1		
	0.3833	0.4015	0.0736	-----		
FSZE	0.269285	0.453236	-0.307185	0.162736	1	
	0.0375	0.0003	0.017	0.2141	-----	
DBT	-0.111617	-0.213096	0.319456	0.283542	-0.20351	1
	0.3959	0.1021	0.0128	0.0281	0.1189	-----

Source: Authors' Computation, (2013)

From the correlation result in table 2 above for ROE, the board size has a positive weak correlation with ROE with a correlation coefficient of 0.187. This means the ROE improves as the board size increases but this increase is not much and it is also not significant with a p-value of 0.15.

Also, the board composition has a very weak positive correlation with ROE. Therefore as the proportion of non-executive directors to executive directors increases, ROE improves with a correlation coefficient of 0.06 but this variable is

not significant with a p-value of 0.64.The corporate governance disclosure index is very weakly positively correlated at 0.11 and it is also not significant at 5% with a p-value of 0.38. This might indicate that banks that disclose more governance issues might just seem to perform a little better than others but this value is not significant. The firm size measured by its asset base seems to be weakly positively correlated to ROE and also significant at 5% with a p-value of 0.03. This might mean the size of bank tends to improve ROE. The gearing measured by debt to equity is negatively correlated to ROE with a correlation coefficient of -0.11. This means as value of debt to equity increases, it has a negative effect on performance (ROE). This variable is not significant at 5% with a p-value of 0.39.

Regression Result

In this section, the panel data regression analysis is used to investigate the impact of corporate governance on banks' financial performance using return on equity and return on asset. Table 4 and 5 presents the regression results for all the variables reviewed in this study.

Table 4. Regression Result for Model 1 (ROA)

Dependent Variable: ROA

Method: Least Squares

Date: 09/09/13   Time: 15:49

Sample: 1 60

Included observations: 60

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-1.866851	0.985331	-1.894643	0.0635
BSZE	0.009170	0.012828	0.714809	0.4778
BCOMP	0.423273	0.453872	0.932582	0.3552
CGDI	0.534164	0.400604	1.333395	0.1880
FSZE	0.111240	0.108438	1.025843	0.3095
DBT	0.110819	0.148104	0.748251	0.4576

R-squared	0.131027	Mean dependent var	0.028255
Adjusted R-squared	0.050567	S.D. dependent var	0.224061
S.E. of regression	0.218322	Akaike info criterion	-0.111049
Sum squared resid	2.573891	Schwarz criterion	0.098386
Log likelihood	9.331462	Hannan-Quinn criter.	-0.029127
F-statistic	1.628469	Durbin-Watson stat	1.497498
Prob(F-statistic)	0.168199		

Source: Authors' Computation, (2013)

The regression result is shown in table 4. The regression equation employed ROA as its dependent variable and board size, board composition, corporate governance, firm size and debt as independent variables. Firm size and debt are control variables.

The result shows that all these independent variables are not significant in explaining effect on bank's profitability in terms of ROA, even though there is a relationship between the dependent variable and the independent variables; it seems not to be significant because of the p-value which confirms the relationship between the variables could be as a result of random events. The r-squared clarifies this further by indicating that about 13% of the variation in ROA is accounted for by these independent variables.

Board size has a positive effect on bank's profitability, one unit increase in board size will increase the ROA by the coefficient and vice versa, reaffirming the fact that the larger the board size, the better the performance.

Board composition also improve profitability, one unit increase in the ratio of non-executive directors to total directors will increase the ROA by the coefficient. Thereby, increase in the number of non-executive directors sitting on the board, the better the financial performance in terms of ROA.

The corporate governance disclosure index follows the same trend in terms of affecting profitability as board size and board composition. This thereby indicates that a bank that tends to disclose more on governance issues is more likely to perform better than a bank that discloses less.

The firm size and leverage both have a positive relationship with ROA. For the firm size, increase in bank's asset base should lead to improved profitability and this should be the case if the banks make maximum use of its assets. For leverage, increase in debt in its capital structure should lead to improved profitability, which could mean banks with more debt tend to perform better.

Table 5. Regression Result for Model 2 (ROE)

Dependent Variable: ROE
Method: Least Squares
Date: 09/09/13   Time: 16:13
Sample: 1 60
Included observations: 60

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-4.421382	2.026675	-2.181594	0.0335
BSZE	0.011488	0.026385	0.435405	0.6650
BCOMP	1.130007	0.933545	1.210447	0.2314
CGDI	0.335306	0.823981	0.406934	0.6857
FSZE	0.378309	0.223040	1.696150	0.0956
DBT	-0.249095	0.304627	-0.817706	0.4171
R-squared	0.112451	Mean dependent var		0.015063
Adjusted R-squared	0.030271	S.D. dependent var		0.456010
S.E. of regression	0.449055	Akaike info criterion		1.331299
Sum squared resid	10.88914	Schwarz criterion		1.540733
Log likelihood	-33.93896	Hannan-Quinn criter.		1.413220
F-statistic	1.368348	Durbin-Watson stat		1.776561
Prob(F-statistic)	0.250714			

Source: Authors' Computation, (2013)

The regression result is shown in table 4. The regression equation employed ROE as its dependent variable and board size, board composition, corporate governance, firm size and debt as independent variables. Firm size and debt are control variables.

The result also shows the same result as that of ROA, that all the independent variables are not significant in affecting bank's profitability in terms of ROE, even though there exist a relationship between the dependent variable and the independent variables, it seems not to be significant because of the p-value which confirms the relationship between the variables could be as a result of random events. The r-squared clarifies this further by indicating that about 11% of the variation in ROE is accounted for by these independent variables.

Board size has a positive effect on bank's profitability; one unit increase in board size will increase the ROE by the coefficient and vice versa. This follows the same pattern as ROA.

Board composition also improve profitability, one unit increase in the ratio of non-executive directors to total directors will increase the ROE by the coefficient. Board composition seems to have the most influence on ROE amongst all the variables. This result is consistent with that observed above in ROA.

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The corporate governance disclosure index follows the same trend in terms of affecting profitability (ROE) as that of ROA above. A bank that tends to disclose more on governance issues is more likely to perform better than a bank that discloses less.

The firm size has a positive relationship with ROE. An increase in bank's asset base should lead to improved profitability. This result is consistent in the two models with firm size having a positive relationship on profitability (ROA and ROE).

The Gearing (leverage) has a negative relationship with ROE; increase in debt in a bank's capital structure would lead to reduced profitability which could mean banks with no or less debt tend to perform better in terms of ROE.

5. Conclusion and Recommendations

The first objective of the study was to examine the relationship between board size and financial performance of banks in Nigeria. The study found board size both in terms of ROA and ROE has a positive relationship with the variables. This result tend to be consistent with Coleman and Biekpe (2006), they observed a positive relationship exist between firm performance and board size. This also contradicts Manas and Saravanan (2006), they conducted a research on listed banks in India and discovered that there is no presence of a relationship between the size of the board and the performance of the banks. This could imply that the large board size leads to better decision-making as result of the availability of wide range of expertise.

The second objective of the study was to examine the effect of the proportion of non- executive directors (board composition) on the financial performance of banks in Nigeria. The study found board composition in terms ROA and ROE follows the same trend as board size with a positive relationship.

This is consistent with Sang-Woo and Lum (2004), reported that there is the existence of a positive relationship between having a significant proportion of non-executive directors on the board and return on investment. This also contradicts Sanda, Mukaila and Garba (2005), examined companies quoted on the Nigerian stock exchange to examine this relationship and came to conclusion that there is no relationship between the variables. This could imply that the non-executive directors perform its advisory and monitoring function, thereby reducing or eliminating the agency conflicts.

The third objective of the study was to determine the corporate governance disclosure of banks in Nigeria in compliance to CBN governance code (2012). The study found a high level of compliance to CBN corporate governance code (2012)

by all the banks reviewed over the period and this could be the reason of improved disclosure and transparency in Nigerian banking industry.

The fourth objective of the study was to determine if there is any significant relationship between the level of corporate governance disclosure and the financial performance of banks in Nigeria. The study found that corporate governance disclosure has a positive relationship with the two performance proxies. This implies that a bank that tends to disclose more on governance issues in line with the CBN code (2012) is more likely to perform better than a bank that discloses less.

Other findings from descriptive analysis show that the average board size is about 15 among the listed banks in Nigeria. This is consistent with the suggestions of Coleman and Biekpe(2006) that a board size of 12 to 16 is appropriate. Also, it was noticed that the average proportion of non-executive directors on the board (board composition) among the listed banks in Nigeria is about 62%, which is in line with the CBN code (2012) where it was stated, "the number of executive directors shall not exceed 40% of the entire board size". Lastly, although a mean disclosure of 0.88 was achieved in terms of corporate governance disclosure, the banks disclosed fully on items 2-7, 10-12, 14-17, 20, 23, 25, 27 and 31-32 (see appendix 2 for governance code).

Also the regression analysis of the study shows that the independent variables employed only account for about 11-13% of the variations in the dependent variables; therefore more other appropriate variables should be considered for future studies.

Lastly, future studies could examine other sectors since this study covers the banking sector. It would be of great benefits to have a picture of corporate governance roles in other sectors or organizations.

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Accounting and Auditing

Nexus between Returns in Commodity Market and Equity Market:
A Case of Indian Steel Industry

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Abstract: There has been a rapid expansion in the commodities market in the recent past due to the sharp rise in appetite of institutional investors or financial institutions for commodities for asset management purpose. Commodities markets are demonstrating an ever-increasing volatility due to structural shifts in supply and demand sides leading to wide price swings. This volatility is puzzling researchers, academicians, and portfolio Managers who try to understand the volatility to design transmission mechanisms. The article attempts to examine the relationship between the steel price in commodity market and equity share price of steel industries. The article also attempts to examine association between CNX metal index with spot market steel price, spot market commodity metal index and Nifty index. The method used is primarily regression analysis. It has been found that the variables individually are having comparatively lesser impact on CNXMIR but jointly they are explaining 73% of total variation.

Keywords: Commodity market returns; CNX metal index returns; Nifty Index returns

JEL Classification: G11; G12

1. Introduction

Commodities derivative markets along with financial derivatives markets are currently growing by leaps and bounds. There has been a sharp increase in the prices of energy and metal commodities in the recent past. In recent years, commodity markets have experienced a rapid growth in liquidity and an influx of investors who are attracted to commodities purely as investments (financial assets and securities), rather than as a means to support "real" economic activity via the hedging of risks (Vivian and Wohar, 2012 p. 395). The size of the commodity market is large compared to the size of physical market. Round the world there are fifty major commodity exchanges trading in nearly ninety commodities. Commodities markets are demonstrating an ever-increasing volatility due to

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structural shifts in supply and demand sides leading to wide price swings. There has been a rapid expansion in the commodities market in the recent past due to the sharp rise in appetite of institutional investors or financial institutions for commodities for asset management purpose. Non-professional participants are also testing the waters that increase the volatility. Increasing investment levels have flowed into the commodity market between 2006 and 2010 which spurred a debate as to whether speculation might have caused excessive increase in the cost of primary commodities and their volatility Tang & Xiong (2010). Volatility of commodity price is significant like exchange rate or interest rate volatilities.

Though commodity and stock markets are influenced by different factors and work in different dynamics, research proved the inverse relationship between commodities market and Treasury bond prices which in turn has an impact on the stock price. It is proved that movement of energy commodities have an impact on the stock prices. The relationship between the commodities and stock market prices is important to investors, policy makers, industry and economy of the country as a whole. However, the dependent structure of the stock market and commodity market is not studied frequently. In this paper, we contribute to the emerging empirical literature dealing with the relationships between commodity and stock markets. In specific we studied the impact of commodity price on the stock market price of the companies which use this commodity as a raw material in their manufacturing process. A firm that is using the commodity as an input see its stock price fall due to the increased costs that lower profits (Bary,1996; Doherty, 1999; Haines, 1997; Tufano, 1998). Conversely the slowdown in production affects the raw materials markets as well.

Increase in the commodity price lead increase in the cost of goods sold of companies which use this specific commodity as an input in the manufacturing process. This in turn reduce the profitability of these companies. Hence most companies follow the practice of hedging against the price risk of the commodity or pass on the commodity price increase to their customers there by reducing the effect on the profitability. Hence volatility of commodity price has a direct impact on the operating earnings of the company in which the commodity the used as an input or output factor **provided** these costs or revenues are significant and are not passed over to other companies or hedging is done. Profitability has a direct impact on the stock price of the companies.

Since steel is an important commodity we focus our on the impact of spot price of steel on the stock price of steel industries.

2. Review of Literature

Bannister and Forward (2002) observed that the history of U. S. stock and commodities prices has been illustrated by repeated super cycles resembling the patters of U. S economy. Rogers (2004) identified that a high negative correlation existed between the two markets over the past 140 years and they alternated the price leadership with 29-32 years cycles.
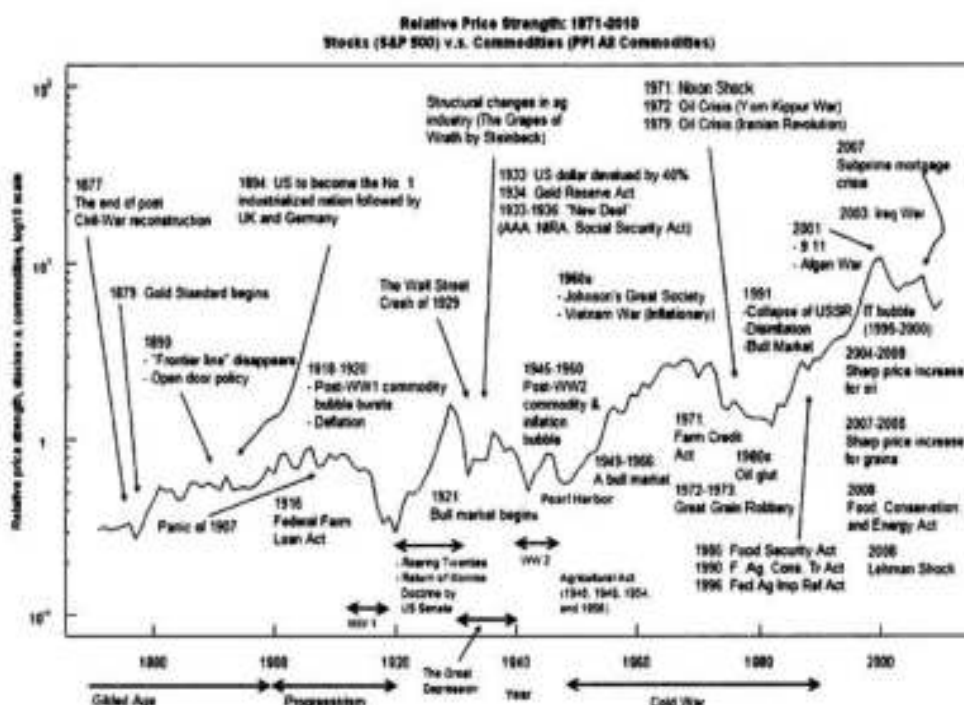

Chart 1. Relation between stock and commodity prices

Source: (Bannister and Forward, 2002)

Johnson, Robert (2009) established the relation between commodities market and stock market by empirically proving that "those stock markets of south American countries are highly affected by changes in commodity after controlling for changes in exchange rates, interest rates, and North American stock market changes". Nobuyoshi Yamori (2011) finds that 'there existed a negative or almost zero correlation between equity and commodity markets up to 2006; it increased significantly after the financial crisis in 2008" Considerable research has been done by Floros (2010), Athanasios (2010), Coleman (1996), Fung (1999), Joukivolle (1995), and Koutmos (1996) to study the lead lag relationship between commodities market and stock market.

An inverse relationship between return and volatility is observed in the commodity markets as compared to the stock markets. This implies that if the commodity market returns are negatively correlated with those of traditional financial assets, the introduction of commodities in those portfolios may result in the diversification of risks. Thus, an investor can take full advantage of the unique statistical properties of commodity investments by adding commodity assets to a financial-only portfolio. (Sheeba Kapil, Kanwal Nayan Kapil, 2010)

The existing empirical research regarding commodity and stock price nexus is mixed in nature. Chong and Miffre (2010) study the stock-commodity correlation from 1981 to 2006 and find that it has fallen over time and is decreasing in equity volatility. Kat and Oomen (2006) showed that the behavior of the correlation of commodities with stocks over the business cycle differs by commodity. Examining the period from 1991 to early 2008, Büyükşahin*et al*. (2011A) conclude that the stock-commodity correlation has not increased over time. According to Reuters stocks and commodities which were highly correlated earlier are becoming less and less correlated or 'decoupling'. "American Airlines exhibited a significant exposure with regard to the price of oil" Bilson (1994). Volvo Cars however is not significantly affected by the changes in the prices of oil or non-energy commodities. Oxelheim and Wihlborg (1995). "It's a common assumption that the average individual investor has zero allocation to commodities" says Matthew Carvalho, director of investment research at Loring Ward, a financial-advisory firm in San Jose, Calif. "But most investors have some indirect exposure to commodities through the stock market."

3. Objectives

1. To identify the impact of price movement of steel in commodity market on share price movement of their dependent industries where the risk is not passed over by hedging creating a steel price index for selected companies in steel industry

2. To identify whether commodity market can serve as a lead indicator for the stock price of the companies using the commodity as input.

3. To study the impact of commodity market returns on NIFTY returns

4. Methodology

4.1.   Data Sources

Spot prices of steel have been taken from official website National spot exchange (http://www. nationalspotexchange. com). Data for Commodity metal index in spot market has been collected from Multi Commodity Exchange Website (http://www. mcxindia. com) and data of share prices of different steel companies and CNX metal index has been collected from NSE website (http://www. nseindia. com).

4.2.   Study Period

The time period chosen for the study is from 17th March 2010 to 28th March 2013 daily data. This period has been chosen as the reform process started from 1991 though; liberalization began in eighties but gained momentum only in 1990s.

4.3.   Techniques Used

Since Metals and minerals are intensively used in a number of sectors such as infrastructure, construction and manufactures and, Steel production is 20 times higher as compared to production of all non-ferrous metals put together, we attempt to study the impact of spot price of steel on the stock market price of industries which use it as a raw material. For our study we have collected daily prices of steel and MCX metal index in spot market and share prices of major steel industries & CNX metal index. . To prepare a steel index we have calculated daily returns of 5 major steel industries Vis a vis SAIL (Steel Authority of India Ltd.), Tata Steel, JSW steel Ltd, Jindal Steel and Power Ltd and Bhushan Steel Ltd. Simple average of their daily returns has been considered as steel index.

Returns are calculated with the formula $LN(cl_t/cl_{t-1})$. Where LN is natural logarithm and cl is the day's closing price. The returns are then averaged to get steel index. The five companies chosen are SAIL, Tata Steel, Jindal Steel and Power and Bhusan. The other variables are Return on Stock Market, MCX Metal Index and CNX Metal Index. The returns are calculated using the same procedure stated above.

In the second stage unit root tests are performed for testing for the existence of stationarity amongst the variables using Augmented Dicky Fuller (ADF) test.

In the third stage variables are tested for the existence of multi collinearity.

In the fourth stage, Cointegration amongst the pairs of variables is performed using Johansson's test for cointegration and Engel Granger Causality is examined.

In the fifth stage VAR/ VECM Model is used to examine the inter relationships and lags in the model.

5. Results and Discussion

5.1.   Linkages between Commodity Market Returns, Spot Market Returns, Nifty, CNX Metal Index and MCX Metal Index in Steel Industry in India

The variables used in the model are: Commodity Market Returns (CMR), Spot Market Returns (SMR), CNX Metal Index (CNXMI), Nifty Index (NI) and MCX Metal

In order to pre-empt the possibility of running spurious regressions, the time series properties of variables used in the analysis was tested. The time series uni-variate properties were examined using ADF test. All the variables were found to be stationary at levels i. e. I (0), the reason may be that they are already transformed to logarithms and returns are calculated for all the variables. The results of ADF test are summarized in the table 1 below:

Table 1. Results of ADF Unit Root Test

Variable	t-Statistic	Prob.
CNX MI	-25. 02	0. 0000*
NIR	-25. 70534	0. 0000*
CMR	-28. 00646	0. 0000*
SMR	-26. 17140	0. 0000*
SIR	-26. 30508	0. 0000*

Note: * Significant at 0. 01 level. ADF test includes intercept and slope for variables in levels while for the variables in first difference the intercept is included. Lag length has been chosen based on Schwartz crieteria. ADF values are compared with Mc Kinnon critical values.

The second stage in the empirical analysis is the computation of cointegration test. Two or more variables are said to be cointegrated if they share common trends i. e. they have long run equilibrium relationships. According to Engel and Granger (1987), if a set of non-stationary variables are co-integrated then it follows that the variables will come back to equilibrium in the long run. The results of Johanson's cointegration test are summarized in the table 2 below:

Table 2. Cointegration Results

Unrestricted Cointegration Rank Test (Trace)				
Hypothesized		Trace	0. 05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob. **
None *	0. 206208	683. 5778	69. 81889	0. 0001
At most 1 *	0. 186060	518. 9218	47. 85613	0. 0001
At most 2 *	0. 174586	372. 1377	29. 79707	0. 0001
At most 3 *	0. 155935	235. 3343	15. 49471	0. 0001
At most 4 *	0. 148313	114. 4624	3. 841466	0. 0000
Trace test indicates 5 cointegrating eqn(s) at the 0. 05 level				
* denotes rejection of the hypothesis at the 0. 05 level				
**MacKinnon-Haug-Michelis (1999) p-values				
Unrestricted Cointegration Rank Test (Maximum Eigenvalue)				

Hypothesized		Max-Eigen	0. 05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob. **
None *	0. 206208	164. 6560	33. 87687	0. 0001
At most 1 *	0. 186060	146. 7841	27. 58434	0. 0001
At most 2 *	0. 174586	136. 8034	21. 13162	0. 0001
At most 3 *	0. 155935	120. 8719	14. 26460	0. 0001
At most 4 *	0. 148313	114. 4624	3. 841466	0. 0000
Max-eigenvalue test indicates 5 cointegrating eqn(s) at the 0. 05 level				
* denotes rejection of the hypothesis at the 0. 05 level				
**MacKinnon-Haug-Michelis (1999) p-values				

The results show that there is high level of cointegration amongst the variables used. Both the tests show significant results and therefore of VAR/VECM methodology is used which captures short term dynamics amongst the variables.

5.2.   VAR/VECM Model for Spot Market Return (SMR) and MCX Index Return (MCXIR)

VECM Model for spot market index return on steel and MCX Index Return was fitted to study the impact of commodity market returns on MCX returns. The results are tabulated in the table 3 below

Table 3. VECM Model for SMR and MCXIR

Standard errors in ( ) & t-statistics in [ ]		
Cointegrating Eq:	CointEq1	
SMR(-1)	1. 000000	
MCXIR(-1)	0. 714242	
	(0. 08288)	
	[8. 61781]	
C	-0. 001555	
Error Correction:	D(SMR)	D(MCXIR)
CointEq1	-0. 661796	-0. 552361
	(0. 06141)	(0. 07530)
	[-10. 7765]	[-7. 33538]
D(SMR(-1))	-0. 242507	0. 362880
	(0. 05676)	(0. 06960)
	[-4. 27236]	[5. 21377]

D(SMR(-2))	-0. 176755	0. 276545
	(0. 04901)	(0. 06009)
	[-3. 60663]	[4. 60194]
D(SMR(-3))	-0. 075989	0. 133293
	(0. 03703)	(0. 04540)
	[-2. 05236]	[2. 93600]
D(MCXIR(-1))	0. 353729	-0. 490026
	(0. 04384)	(0. 05375)
	[8. 06906]	[-9. 11627]
D(MCXIR(-2))	0. 262929	-0. 377863
	(0. 03944)	(0. 04836)
	[6. 66727]	[-7. 81431]
D(MCXIR(-3))	0. 101568	-0. 203824
	(0. 03021)	(0. 03705)
	[3. 36178]	[-5. 50193]
R-squared	0. 457129	0. 455642
Adj. R-squared	0. 451746	0. 450245

The results show that spot market is significantly influenced by its own first, second and third lags and also with the lagged values of MCXIR. All the t values are significant. But the significance is gradually declining. Similarly MCX returns are also influenced by the lagged returns of spot markets. The R^2 of 45% reveals that almost 45% of variation in SMR is explained by its own lagged values and by the lagged values of MCXIR.

5.3. VAR/VECM Model for Spot Market Return (SMR) and Nifty Index Return (NIR)

VECM Model for spot market returns on steel and Nifty Index Return was fitted to study the impact of commodity market returns on Nifty returns. The results are tabulated in the table 4.

The results show that NIR is not having significant impact on spot market returns of steel (SMR) but SMR has got significant impact of NIR with a all the three days lags and its own lags as well. NIR also has got significant impact of its own lagged values as well as of SMR.

Table 4. VECM Model for SMR and NIR

Vector Error Correction Estimates		
Cointegrating Eq:	CointEq1	
SMR(-1)	1. 000000	
NIR(-1)	0. 736165	
	(0. 07372)	
	[9. 98584]	
C	-0. 001249	
Error Correction:	D(SMR)	D(NIR)
CointEq1	-0. 487747	-0. 681642
	(0. 06004)	(0. 07810)
	[-8. 12434]	[-8. 72827]
D(SMR(-1))	-0. 363310	0. 450247
	(0. 05786)	(0. 07527)
	[-6. 27909]	[5. 98204]
D(SMR(-2))	-0. 245783	0. 262364
	(0. 05083)	(0. 06612)
	[-4. 83571]	[3. 96817]
D(SMR(-3))	-0. 110661	0. 111221
	(0. 03833)	(0. 04986)
	[-2. 88740]	[2. 23087]
D(NIR(-1))	0. 254680	-0. 341949
	(0. 04153)	(0. 05403)
	[6. 13194]	[-6. 32911]
D(NIR(-2))	0. 201121	-0. 194526
	(0. 03704)	(0. 04819)
	[5. 42956]	[-4. 03705]
D(NIR(-3))	0. 126100	-0. 164685
	(0. 02841)	(0. 03695)
	[4. 43908]	[-4. 45666]
C	9. 16E-06	-6. 14E-06
	(0. 00033)	(0. 00043)
	[0. 02759]	[-0. 01421]
R-squared	0. 422239	0. 422527
Adj. R-squared	0. 416511	0. 416801

5.4. VAR/VECM Model for Spot Market Return (SMR) and Steel Index Return (SIR)

VECM Model for spot market returns on steel and Steel Index Return was fitted to study the impact of commodity market returns on Steel Index returns. The results are tabulated in the table 5 below.

Table 5. VECM Model for SMR and SIR

Cointegrating Eq:	CointEq1	
SMR(-1)	1. 000000	
SIR(-1)	17. 85255	
	(1. 25024)	
	[14. 2793]	
C	0. 018245	
Error Correction:	D(SMR)	D(SIR)
CointEq1	0. 001343	-0. 060049
	(0. 00181)	(0. 00422)
	[0. 74322]	[-14. 2342]
D(SMR(-1))	-0. 738089	-0. 031547
	(0. 03668)	(0. 08565)
	[-20. 1204]	[-0. 36832]
D(SMR(-2))	-0. 501659	-0. 064302
	(0. 04199)	(0. 09803)
	[-11. 9484]	[-0. 65593]
D(SMR(-3))	-0. 240490	-0. 058362
	(0. 03666)	(0. 08559)
	[-6. 56074]	[-0. 68190]
D(SIR(-1))	-0. 021302	0. 083396
	(0. 02772)	(0. 06471)
	[-0. 76860]	[1. 28873]
D(SIR(-2))	-0. 007594	0. 071429
	(0. 02261)	(0. 05280)
	[-0. 33586]	[1. 35294]
D(SIR(-3))	-0. 004321	0. 043297
	(0. 01613)	(0. 03765)
	[-0. 26795]	[1. 14984]
C	1. 19E-05	-1. 26E-05
	(0. 00035)	(0. 00081)
	[0. 03414]	[-0. 01547]
R-squared	0. 366658	0. 494072
Adj. R-squared	0. 360378	0. 489056

The results prove that SIR has does not have significant impact from SMR. T Values of all the coefficients are not statistically significant. SIR also doesn't have any significant impact from SMR.

5.5.   Multiple Regression Model

In the last stage a multiple regression was fitted to know the impact of return on spot market, return on MCX index and nifty index on commodity markets. The results are summarized in the table 6, 7 and 8 below. The results show that commodity market CNXIR is having significant impact of returns in other markets like Nifty Returns, Spot Market Returns and MCX Metal Index. Before undertaking any muti-variate analysis it is necessary to test for multi-colinearity. Multi colinearity test for all the variables used is given in table 7. The VIF is approximately close to 1 which means absence of any multi collinearity problem in the data.

Table 6. Results of Multiple Regression Analysis

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	. 901(a)	. 811	. 810	. 007196579267859

a Predictors: (Constant), NIR, SMR, MCXIR, SIR

Table 7. ANOVA(b)

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	. 159	4	. 040	767. 274	. 000(a)
	Residual	. 037	713	. 000		
	Total	. 196	717			

a Predictors: (Constant), NIR, SMR, MCXIR, SIR
b Dependent Variable: CNXIR

Table 8. Coefficients(a)

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-. 001	. 000		-2. 626	. 009		
	SIR	. 288	. 017	. 377	17. 343	. 000	. 561	1. 783
	SMR	-. 059	. 033	-. 030	-1. 812	. 070	. 990	1. 010
	MCXIR	. 108	. 028	. 064	3. 895	. 000	. 968	1. 033
	NIR	. 889	. 033	. 589	27. 201	. 000	. 563	1. 776

a Dependent Variable: CNXIR

The results reveal that commodity market returns index (CNXIR) is significantly dependent on Steel Index Returns (SIR), MCX Index Returns (MCXIR) and Nifty Index Returns (NIR). R-square of 90% shows the strength of relationship. It also shows the impact of other returns on commodity markets is instantaneous rather than lagged one and all the markets together are influencing commodity market returns.

6. Findings of the Analysis

➢ From the VECM Model of SIR and SMR it is proved that SIR has significant impact from SMR (-1) but other coefficients are not statistically significant. The overall R^2 for SIR has come to 0. 49 which implies that almost 49% of variation in SIR is explained by SMR.

➢ From the VECM Model of NIR and SMR it is proved that NIR is not having significant impact on spot market returns of steel (SMR) but SMR has got significant impact on NIR with a lag of one day.

➢ From the VECM model of MCXIR and SMR we can conclude that spot market is significantly influenced by its own first, second and third lags and also with the lagged values of MCXIR. All the t values are significant. But the significance is gradually declining. Similarly MCX returns are also influenced by the lagged returns of spot markets. The R^2 of 45% reveals that almost 45% of variation in SMR is explained by its own lagged values and by the lagged values of MCXIR.

➢ The multiple regression analysis shows that commodity market returns index (CNXIR) is significantly dependent on Steel Index Returns (SIR), MCX Index Returns (MCXIR) and Nifty Index Returns (NIR). R-square of 90% shows the strength of relationship. It also shows the impact of other returns on commodity markets is instantaneous rather than lagged one and all the markets together are influencing commodity market returns

7. Limitations of the Study

1. The analysis in the project has dealt only with a particular sector, i. e. , Steel Industry. Other commodities and its relevant industry have not been taken into account.

2. This research is limited to Spot market only and may or may not be applicable to future market.

3. The result of this research may or may not be applicable to other industries.

4. Analysis in this report is limited to Indian commodity and equity exchanges. Price movement at international exchanges has not been taken into account. Hence, the findings of this research may or may not be applicable to global market.

8. Conclusions

It is found from the analysis that the variables individually are having comparatively lesser impact on CNXMIR but jointly they are explaining 73% of total variation. There are other factors also like inflation, exchange rate volatility, hedging etc which also has got and impact on CNXMIR.

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Activity Based Costing and Product
Pricing Decision: the Nigerian Case

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Abstract: This paper examined activity based costing and product pricing decisions in Nigeria so as to ascertain whether activity based costing have the ability to enhance profitability and control cost of manufacturing firms. Towards this end, a multiple correlation and regression estimation technique was used in analyzing the data obtained in the study. The study found that activity based costing affects product costing and pricing decision. In addition, the results showed that improved profitability and cost control can be achieved by implementing activity based costing approach by manufacturing firms. The implication is that traditional costing approach fails in many pricing situations by arbitrarily allocating indirect cost and activity based costing helps in allocating indirect cost accurately. Thus, it was recommended amongst others that activity based costing need to be practiced, maintained and implemented by manufacturing firms since it has a broad range of uses for a wide variety of company functions and operations in the area of process analysis, strategy support, time-based accounting, monitoring wastage, as well as quality and productivity management.

Keywords: Activity Based Costing; Traditional Costing; Manufacturing Firms; Nigeria

JEL Classification: D4

1. Introduction

There are vast literatures in management accounting that offers many paradigms of big companies that have given up traditional methods and applied a new method known as 'Activity-Based Costing' (ABC). These business firms have discovered that many products that are manufactured generate losses and not profits due to the phenomenon that traditional costing arbitrarily allocates indirect cost. Cooper and Kaplan (1998) opine that activity based costing is used as a tool for understanding product cost and profitability based on the production or performing processes by manufacturing firms. This paper contends that activity based costing approach captures the economies of the production process more closely and accurately than traditional costing system, thereby providing more "precise" cost data for business firms. Additionally, activity based costing has predominantly been used to support

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strategic decisions such as pricing decision, outsourcing, identification and measurement of process and improvement initiatives. Thus, the focus of this study is basically on one aspect of strategic decision – 'pricing decision' of products. Towards this end, this study examined activity based costing and product pricing decision in the manufacturing industry of Nigeria. The remaining part of this paper is divided into four (4) sections: 2.Review of Literature, 3.Methodology, 4.Results and Discussion and 5.Conclusion and Recommendations.

2. Extant Literature

Several studies have examined activity based costing and product pricing decision in different countries with diverse techniques. The diverse techniques of investigation have yielded dissimilar results, sometimes sharply dissimilar, sometimes modestly. In developing economies like Nigeria, such issues have not been vastly explored in the management accounting literature. The reason for this could be that many big manufacturing firms believe that traditional costing system is still the best as compared to activity based costing system. For instance in a study by Hutton et al. (1996), they found that many cost reduction programs carried out in an activity based costing environment are inappropriate for manufacturing firms. Contrarily, a survey study by Krumwiede (1998) of some manufacturing firms in U.S. found evidence that the direction and level of importance of activity based costing varies by stage due to many factors. The study showed that a high quality information system may lead to rejecting activity based costing before adoption or abandoning it after implementation has started. Bromwich and Hong (1999) studies showed that without activity based costing; the cost systems give correct signals in decision making, such as in pricing, in altering the product portfolio, in make or buy and outsourcing decisions and in cost management. Furthermore, Marinus and Bouwman (2002) investigated the improvement in financial performance that is associated with the use of Activity-Based Costing and the conditions under which such improvement is achieved. Confirmatory factor analysis and structural equation modeling technique were used to investigate the relationship between ABC and financial performance. The study found that internal auditors furnish information regarding company financial performance, extent of ABC usage, and enabling conditions. Innes et al. (2000) assessed the changes which have occurred in the ABC adoption status of companies over a recent five year period in two UK manufacturing firms. The study showed that for the ABC users, some comparative information is provided on the nature of the ABC systems in use, their designers, the uses to which they have been putting and the levels of success and importance which participants attribute to them are of significant value to manufacturing firms. Thus, ABC significantly affects product pricing decision.

Roztocki (2001) examined the use of the Integrated ABC-and-EVA Information System for the management of new technology projects. The study found that there are advantages associated with integrating Activity Based Costing with Economic Value Added, especially in measuring financial performance. In addition, the study showed that activity based costing and economic value added has positive impacts on project costing. Kerr and Larson (2002) investigated whether ISO and activity based costing are two useful tools for logisticians. The study found that relatively few firms are using both ISO and ABC. They suggested that practicing logisticians view ISO and ABC as separate initiatives. In addition, the study showed that both of these tools can support efforts to improve customer service and/or reduce total costs. Bjornenak and Mitchell (2002) analyzed activity based costing literature which has been accumulated in the UK and USA accounting journals over the fourteen year period since the first articles on ABC emerged. The evidence used both longitudinal and cross-sectional approach to gain insights into how ABC started, how it has been communicated, how it has been researched, how it is constituted, how it has generated attention and how it has developed and changed. The study found that activity based costing is better off than traditional costing method practiced by manufacturing firms.

Roztocki and Weistroffer (2005) proposed a framework for evaluating information technology investments, integrating value chain analysis with activity-based costing and fuzzy logic. The study proposed method that is particularly useful for businesses in emerging economies, where an uncertain economic environment is often combined with a lack of dependable, historical accounting data. The study found that activity based costing is useful for businesses in emerging economies. Feridun and Al-Khadash (2006) investigated the link between the practice of Activity Based Costing, Just-in-Time and Total Quality Management as strategic initiatives and improvement in corporate financial performance of 56 industrial shareholding companies in Jordan. The study found that 26.8% of the companies used at least one of the strategic initiatives. The awareness level of the importance of using the strategic initiatives is found to be significantly high among financial managers, but such awareness is not reflected in the implementation of these initiatives.

Askarany et al (2007) studies explored the implementation level of activity based costing as compared to traditional based costing system for the past two decades. The study found that the level of implementation of ABC is still lower than those of traditional management accounting techniques. The study concluded that traditional management accounting techniques are unable to satisfy the users of such techniques in terms of providing them with timely and detailed information. Askarany and Yazdifar (2007) used the results of two survey studies to explore the most important contextual factors influencing the implementation of activity based-costing across firms. The finding suggests that the relatively low implementation of

ABC across firms implies that decision makers remain unconvinced whether ABC's advantages supersedes traditional costing techniques to an extent that is high enough to pursue them to implement ABC in practice.

Anand et al. (2005) studied activity-based cost management practices followed by India firms. The aim is to understand whether India firm practices cost management in a value-chain analytic framework. The study found that firms who have adopted ABC were significantly more successful in capturing accurate cost information for value chain analysis and supply chain analysis vis-a-vis the firms who had not adopted ABC. Sharma and Gupta (2010) studies signified that in the present scenario of cut-throat competition, both on price and quality, increasing consumer demands and product differentiation, the traditional costing system has become obsolete and even have led to strategic failures in many organizations when various costs especially the overheads, are incorrectly allocated to product lines. Their study showed that activity-based costing is a definite improvement over the traditional methods on the premise that the costs are allocated on the basis of activities rather than products and it can effectively contribute to the top managerial decision-making process. Askarany et al. (2012) applied the innovation diffusion theory to examine organization size, industry and location on the decision to adopt activity based costing. The results revealed that organizations are more likely to adopt ABC when they attach a high level of importance to the relative advantages offered by innovations, are large. The thoughts in the management literature are that of the superiority of activity based costing over traditional costing vice-versa. Moreover, empirical evidence suggests that there are relatively few cases of research on activity based costing and product pricing decision in emerging economies like Nigeria. However, this present study tried to take a stand towards ascertaining whether activity-based costing have the ability to capture accurate data that can influence product costing, pricing decisions, enhanced profitability as well as improvement in cost control of manufacturing firms in Nigeria.

3. Methodology

This study was carried out in Nigeria to see whether activity-based costing have the ability to capture accurate data that can influence product costing, pricing decisions, enhanced profitability as well as improvement in cost control of manufacturing firms. The study is designed to follow a quantitative method.

3.1. Method of Data Analysis

In order to ascertain the effect of activity based costing on product pricing decision of manufacturing firms in Nigeria, a multiple correlation and regression analysis

were employed. The analysis was done via the Statistical Package for Social Sciences (SPSS). Data was collected from primary source (questionnaire).

3.2. Model Specification

The empirical model in this study takes product costing, pricing, profitability and cost control as the independent variables and activity based costing as dependent variable. The empirical model of the study is given as:

$$\textbf{ABC}_i = \beta_0 + \beta_1\textbf{PCP}_i + \beta_2\textbf{PROF}_i + \beta_3\textbf{CM}_i + \textbf{U}_t$$

Where:

ABC_i	=	Activity Based Costing
PCP_i	=	Product Costing and Pricing
$PROF_i$	=	Profitability
CC_i	=	Cost Control
U_t	=	Error Term
$\beta_0, \beta_1, \beta_2, \beta_3$	=	Regression coefficients

4. Results and Discussion

This section presents the results from the SPSS Software. The analysis were done in sections, first was the descriptive statistics, followed by correlation analysis. The regression analysis concludes this section.

Table 1. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Dev.
PCP_1	517	2.00	4.00	3.8790	1.2993
PCP_2	517	1.00	4.00	3.1091	1.1848
$PROF_1$	517	1.00	4.00	3.2994	1.4949
$PROF_2$	517	1.00	4.00	3.5122	1.4040
CC_1	517	4.00	4.00	4.7019	1.0484
	517	1.00	4.00	4.5133	1.8484
CC_2	517	4.00	4.00	3.5029	.58484
	517	1.00	4.00	3.5551	.74848
ABC_1	517	3.00	4.00	4.7019	.75875
ABC_2	517	2.00	4.00	3.4921	1.0303
ABC_3	517	1.00	4.00	3.9991	.91920
ABC_4	517	1.00	4.00	4.3202	1.3030
ABC_5	517	2.00	4.00	4.0230	1.0030
ABC_6					
ABC_7					

Source: SPSS Output

From table 1 above the minimum value of the mean for the dependent variable of activity based costing is 3.1 with a standard deviation of 1.18 and the maximum value of the mean is 4.7 with a standard deviation of 1.05. This positive high mean value indicates that most respondents agree that activity based costing enhances product costing and pricing decisions. In addition, the mean and standard deviation for the independent variables (product costing and pricing, profitability and cost control) were with seven items on five point Likert scale. Since the mean score for all the seven items is greater than 3.0, it could be argued that activity based costing enhances product costing and pricing decisions.

Table 2. Pearson Correlation

	ABC_i	PCP_i	$PROF_i$	CC_i
ABC_i Correlation	1			
Sig. (2-tailed)				
N	517			
PCP_i Correlation	.195	1		
Sig. (2-tailed)	.087			
N	517	517		
$PROF_i$ Correlation	.378**	.382*	1	
Sig. (2-tailed)	.003	.015		
N	517	517	517	
CC_i Correlation	.657	.387**	.437**	1
Sig. (2-tailed)	.000	.001	.004	
N	517	517	517	517

Source: SPSS Output

**. Correlation is significant at the 0.01 level (2-tailed).

*. Correlation is significant at the .005 level (2-tailed).

The table below shows the results of the Pearson correlation analysis among the variables. From table 2, of the total of three explanatory variables tested in this study, there is a significant correlation between the three of the independent variables (product costing and pricing, profitability and cost control) and the dependent variable (activity based costing). The correlation between product costing and pricing and activity based costing has a very week value. Based on the results in the table above, there are positive relationships between activity based costing and most of the independent variable; these shows that most of the variables used in the model are supported.

Table 3. ANOVA Result (Goodness of Fit Statistic)

	Model	Sum of Squares	df	Mean Square	F.	Sig.
1	Regression	19.246	7	4.840	77.341	.000[a]
	Residual	23.424	510	.447		
	Total	27.423	517			

Source: SPSS Output

a. Predictors: (Constant), PCP, PROF, CC
b. Dependent Variable: ABC

The multiple regression analysis was used to examine whether one or more independent variables influence the variation on dependent variable. The functional relationship between variables in this study is therefore, activity based costing as a function of product costing and pricing, profitability and cost control. However, to show how well the model containing those of three explanatory variables actually explains the variations in the dependent variable, i.e. activity based costing, it is necessary to test it through goodness of fit statistics. In table 3 above, it is observed that the independent variables give a significant effect on the dependent variable, where f-value is 77.341 with p-value of less than 0.05 (i.e. $p<0.000$) indicating that, overall, the model used for the study is significantly good enough in explaining the variation on the dependent variable. To ensure the statistical adequacy of the model, the goodness of fit can also be measured by the square of the correlation coefficient also called R^2.

Table 4. Goodness of Fit through R Square (Model Summary)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.925[a]	.852	.743	.54312

Source: SPSS Output

a. Predictors: (Constant), PCP, PROF, CC

As shown in table 4 above, both R^2 and adjusted R^2 measure the fitness of the model i.e. they measure the proportion of the variation in dependent variable explained by the model. But since adjusted R^2 is the modification for the limitation of R^2 the value of the adjusted R^2 is considered to measure the fitness of the model. In the table above, the value of adjusted R^2 is 0.743, indicating that the independent variables in the model explained 74% variation on the dependent variables. Thus, we can understand that the model of the study is providing a good fit to the data. This outcome empirically indicates that the independent variables in this study are the major determinants of activity based costing. Furthermore, the result of the

regression model revealed that there exist a significant relationship between the independent variables and dependent variable.

Table 5. Regression Analysis on Activity Based Costing

Variables	Coefficients	t-statistic	Prob.
Constant	4.214	8.358	.000
Product Costing and Pricing	.098	2.726	.008
Profitability	.122	2.642	.010
Cost Control	.174	2.495	.015

Source: SPSS Output

As shown in table 5 above, of the three explanatory variables tested in this study, product costing and pricing (p-value=0.008), profitability (p-value=0.01) and cost control (p-value= 0.015), were statistically significant at 5 percent or lower. The result also reveals that there is a positive relationship between all the independent variables and activity based costing.

5. Conclusion/Recommendation

There is a vast literature establishing results across different countries on the effect of activity based costing on product pricing decision. This study examined activity based costing on product pricing decision of manufacturing firms in Nigeria. The conclusion reached is that activity-based costing serve as a product pricing decision tool. This is because it provides financial support data structured in a fashion fundamentally different from accounting data provided in the books of accounts. In addition, activity based costing enhances profitability and leads to improvement in cost control of manufacturing firms in Nigeria. This is because activity based costing help in tracing what initiates the costs and where to apply efforts to curb inflationary costs and this can be of particular value in tracking new products. Thus, activity based costing have effect on product pricing decision. Based on the above, it was recommended that activity based costing need to be practiced, maintained and implemented by manufacturing firms. This is because activity based costing methods have a broad range of uses for a wide variety of company functions and operations in the area of process analysis, strategy support and time-based accounting, monitoring wastage, as well as quality and productivity management. Majority of the studies have examined the effect of activity based costing on product pricing decision in different countries. Future research need to be conducted on the "Benefits and Challenges Associated with Activity Based Costing in different countries".

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Tourism and Sustainable Development

Measures Concerning Sustainable Consumption in Hotels

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Abstract: The present work analyses the measures adopted in hotel industry with the purpose to obtain a sustainable consumption through a comparative approach of Romanian and Italian hotels, by highlighting the similarities and the differences between them. Consequently, we used the questionnaire as a research instrument, in order to gather the primary data, which were processed by the help of SPSS program. The results obtained emphasised the measures applied most often in the tourist units investigated for sustainable consumption. Therefore, we noticed that the measures concerning the reduction of water consumption are most often adopted by the management systems of the tourist units analysed, both in Romania and in Italy. The measures concerning the efficient administration of waste are less applied in the Romanian hotels. As for the Italian hotels, among the measures for sustainable consumption, the least adopted are the ones referring to the reduction of pollution emissions.

Keywords: sustainable consumption; efficient administration; reduction of consumption.

JEL Classification: Q53; L83; M10

1. Introduction

In the whole world, the hotels, no matter their location, comfort or customers, consume important quantities of resources in order to satisfy the consumers' demand of services-tourists, and to maintain the operation standards.

The resources consumed are extremely diverse (IHRA&UNEP, 1995):

- building materials used for the realisation of these (new or restored) objectives;

- water, which can be potable or not;

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- equipment and installations contained in the buildings, in order to give them the destination of service providers for hotels, food, entertainment etc.;

- materials and equipment necessary for current operation: furniture, bed sheets, crockery, cutlery, detergents, cleaning materials, advertising materials, etc.;

- food, drinks, ingredients, semi-canned products, etc.

From this point of view, hotels are units with high efficiency for sustainable consumption, because, as we mentioned above, there are high concentrations of production and consumption in hotels, and, at the same time, they are among the main factors responsible for the damaging effects on the environment.

Consequently, the responsible approach should be an essential preoccupation even from the moment of the initial design, or when capital modernizations/repairs are necessary.

The hotels are huge generators of waste coming from the daily operation, from the building materials used for modernization, repairs, painting, from the technological processes of the kitchens, laundries, technical and maintenance department; from the daily cleaning processes of the production areas, of the common ones, and of the customers' rooms, and also from the areas where the personnel work (Nistoreanu, 2003).

The success of sustainable consumption depends on the way this waste is administered. The personnel have an important role, but need to be trained, motivated, and supervised in the realisation of their daily work tasks. Tourists have also an important role, participating actively in the realisation of this objective.

In what concerns the reduction of carbon emissions for sustainable consumption in hotels, the key element is the existence of ecological policies concerning the purchasing process (Walmsley, 2011). For example, hotels from the Scandinavian area always had an activity with an ecological objective, extending this practise also to the service providers, by making them sign "service providers' declarations" by which they agree to observe the sustainability policies (Draper and Murray, 2008).

Water is one of the most used resources in hotel industry: in customers' rooms – for washing; in toilets – for cleaning; in restaurants – for cooking, washing the food, the dishes, etc.; circulating cooling agent in air conditioner installations; in swimming pools, for watering green areas and sport fields, for fire extinguishing. However, by adopting certain measures, sustainable consumption can be obtained.

In conclusion, sustainable consumption does not necessarily involve giving up the quantity, rather to change the consumer's behaviour, even if, in some cases, the absolute volume of consumption is the most important (Stoian, 2005).

2. Research Methodology

The purpose of the research is to highlight the main measures concerning sustainable consumption, adopted in Romanian and Italian hotels.The objectives of the research aim to identify the measures undertaken by hotel managers for efficient waste administration, reduction of pollution emissions and reduction of water consumption.

In order to realise our purpose, we chose the *research through enquiry*, because it assures a great flexibility, and the data and information are obtained quicker than by other methods. In the elaboration of the research instrument - the questionnaire - we established the types of questions, which are closed questions (both dichotomous – with two predetermined answering variants, and multichotomous – with several predetermined answering variants), and questions with scale answers. The data obtained from the questionnaire were processed with the help of SPSS.13 program.

The sampling implied the set-up of the research unit, that is Romanian hotels (the North-East region comprising the counties: Bacău, Botoşani, Iaşi, Neamţ, Suceava, Vaslui) and Italian ones (Veneto in North-East Italy – the provinces Belluno, Padova, Rovigo, Treviso, Venice, Verona, Vicenza). As far as the selection process is concerned, we opted for a non-aleatory method based on accessibility. The sample size is of 92 touristic units, 49 Romanian ones (NE region) and 43 Italian ones (Veneto region), respectively. According to the comfort category, most hotels are 3*** and 4**** ones and employ from 10 to 249 people. We gathered the data personally at the touristic units from the research area chosen and we interviewed the managers of those units.

3. Research Results

In the tables and figures below, realised for a clearer presentation, **item** (Q) – represents the encoding of the measure adopted, and corresponds to the number of the question from the questionnaire, and **%** - represents the hotels in which that measure is applied. Consequently, the measures adopted by tourist units for sustainable consumption refer to:

3.1. Efficient Administration of Waste

Efficient administration of waste is realised in the tourist units investigated in several ways (table 1).

Table 1. Measures concerning efficient administration of waste

Efficient administration of waste	Item	Measures	Romania (%)	Italy (%)
Reduction of waste	Q20_1	Monitoring the types and quantity of waste	22.4	83.7
	Q20_2	Identification of possibilities of waste reduction	16.3	69.8
	Q20_3	Existence of systems for waste reduction, reuse and recycling	4.1	65.1
	Q20_4	Training the employees and the guests for the selective collection of waste	18.4	79.1
	Q20_5	Use of reusable toiletry and receptacles	46.9	41.9
Reduction of organic waste	Q21_1	Maceration and transformation of waste into compost	5.6	32.4
	Q21_2	Donation of waste to local farms	0	14.7
	Q21_3	Sale to interested companies.	0	23.5
Waste water treatment	Q22_2	Existence of an individual water treatment plant	0	14.0
Recycling	Q23_1	Paper, cardboard	81.6	93.0
	Q23_2	Plastic	24.5	88.4
	Q23_3	Glass	55.1	90.7
	Q23_4	Polyethylene packaging	6.5	54.8
	Q23_5	Aluminium	6.1	76.7
	Q23_6	Cooking oil, fats from the kitchen	30.4	80.5

Source: Data obtained in SPSS

The measures concerning efficient administration of waste are presented graphically in the figure below (figure 1).
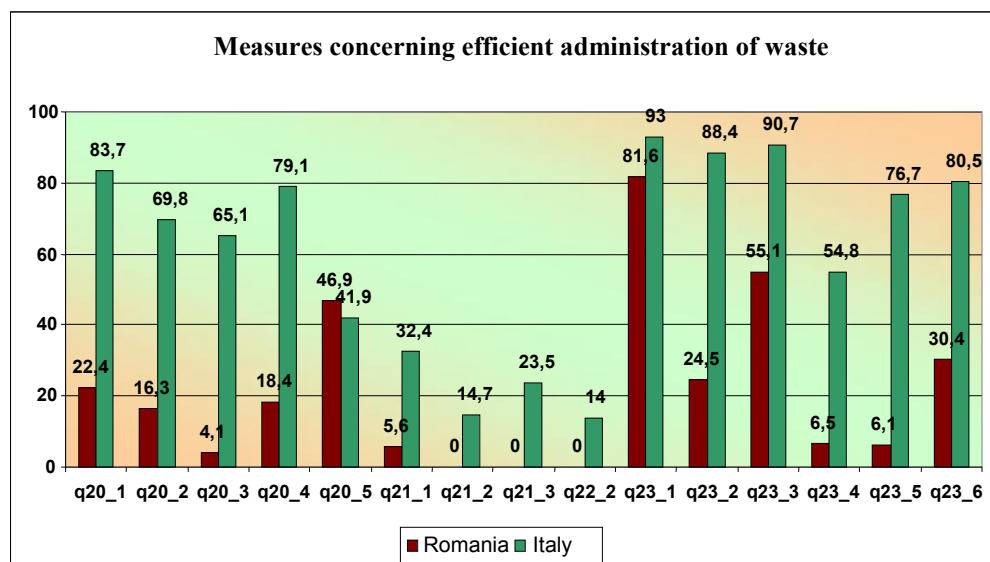
Figure 1. Measures concerning efficient administration of waste
Source: Data obtained in SPSS; Table 1

Italians pay much more attention to the efficient administration of waste than Romanians. In what concerns waste reduction, in 83.7% of the hotels there is a careful monitoring of the types and quantity of waste, in 69.8% of the hotels the possibilities to reduce them were identified, and in 65.1% of the hotels there are systems of waste reuse or recycling, while in Romania there is a waste monitoring on types and quantity in just 22.4% of the hotels. In some of the tourist units, the organic waste is macerated and transformed into compost (32.4% in Italy, and 5.6% in Romania), donated to some local farms, or sold to the interested ones (just in Italy). Also, in 14% of the Italian hotels there are waste water treatment plants.

Another important aspect for an efficient administration of waste, which occurred in 79.1% of the Italian hotels and in 18.4 % of the Romanian hotels under the present analysis, is the special attention paid to train the employees regarding the selective collection of waste, and even the guests are invited to do the same. In what concerns recycling, both in Romania and in Italy, paper, cardboard and glass are the first to be recycled – of course in much higher proportion in the Italian hotels, where plastic, aluminium or kitchen oil/fat resulted from technological processes are also recycled; the polyethylene packaging are recycled in over 50% of the Italian tourist units investigated.

3.2. Reduction of Pollution Emissions

Another important aspect for sustainable consumption is the reduction of pollution emissions. Usually, the levels of recommendable emissions and solutions are

established after the study of impact over the environment. A few measures are presented in the following table (table 2).

Table 2. Measures concerning the reduction of pollution emissions

	Item	Measures	Romania (%)	Italy (%)
Reduction of pollution emissions	Q24_1	Encouraging the employees and the guests to use bicycles	10.2	20.9
	Q24_2	Paying a tax to compensate for pollution emissions	0	54.8
	Q24_3	Existence of devices measuring emissions of carbon dioxide	0	2.0
	Q24_4	Promotion of local public transportation	0	55.8
	Q24_5	Offering discounts to the persons travelling by train	0	2.0
	Q24_6	The guests could compensate CO2 emissions by donations for ecological projects	0	11.6

Source: Data obtained in SPSS

The results synthetized in the table above are highlighted by the following figure (figure 2):
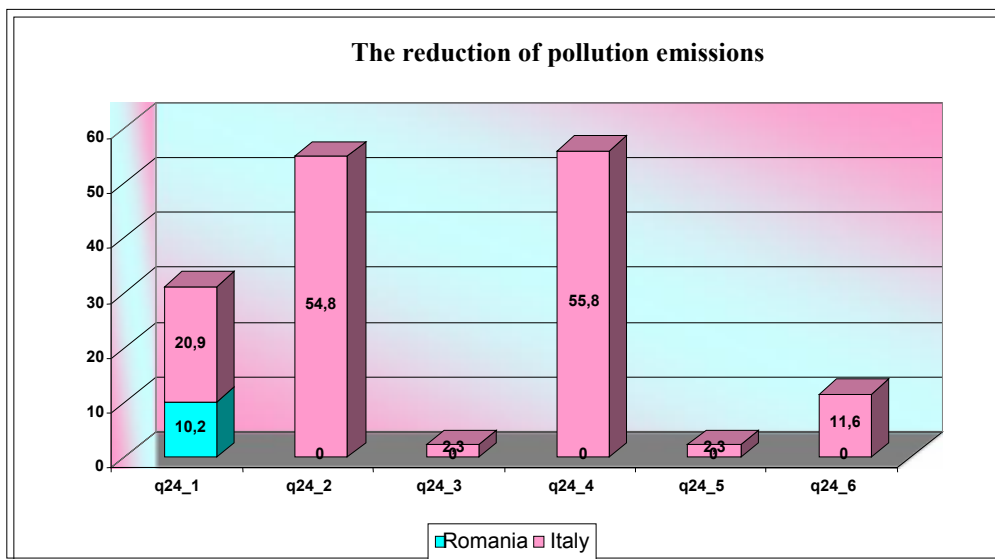
Figure 2. Measures concerning the reduction of pollution emissions

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In what concerns the reduction of pollution emissions, in the Romanian hotels such measures are almost inexistent; the only measure, even if hard to believe, refers to the encouragement of the employees to use bicycles.

Unlike Romanian managers, Italian managers are more interested to reduce pollution emissions. Consequently, they promote local public transportation (in 55.8% of the hotels investigated), offering free tickets to the guests, 54.8% are willing to pay a tax to compensate pollution emissions, and in 11.6% of the hotels, even the guests could compensate CO_2 emissions by donations for ecological projects, and by the use of bicycles for employees and guests.

3.3. Reduction of Water Consumption

Besides a good monitoring of water consumption, an adequate maintenance of the equipment and a serious training of the personnel, water consumption could be also reduced by other methods, presented below (table 3) and found in the tourist units investigated.

Table 3. Measures concerning reduction of water consumption

Reduction of water consumption	Item	Measures	Romania (%)	Italy (%)
Use of different methods of reduction of water consumption	Q18_1	Devices of reducing the water flow	71.4	62.8
	Q18_2	Devices of aeration of water flow	57.1	53.5
	Q18_3	Sensor provided batteries and urinals	30.6	16.3
	Q18_4	Waste water recycling systems	0	14
	Q18_5	Systems of collection of rain water	6.1	25.6
	Q18_6	Sensors of humidity for the irrigation systems	0	30.2
	Q18_7	Announces, posters inviting the guests to save the water	55.1	67.4

Source: Data obtained in SPSS

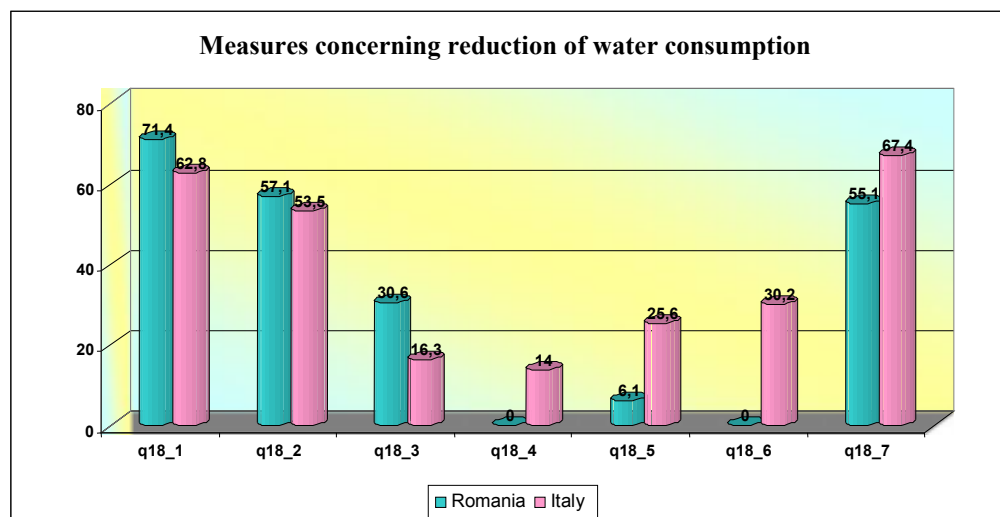The situation is illustrated in the following figure (figure 3)

Figure 3. Measures concerning reduction of water consumption

As we can see from the table and from the figure presented above, in the Romanian hotels certain devices of reduction or aeration of the water flow, as well as sensor provided batteries and urinals in public baths are a little more used than in the Italian hotels. However, Italians installed waste water recycling systems in 14% of the hotels investigated, systems of collection of rain water (25.6% of the hotels), and sensor based irrigation systems (30% of the hotels).

Also, both in the Romanian hotels (55.1%) and in the Italian ones (67.4%), posters and announcements are inviting the guests to save the water.

4. Conclusion

All the hotels, no matter how small they are, are a burden for the environment, because they consume water, energy and raw materials to provide services for the tourists; they use harmful substances like chlorine bleachers; they generate waste and they produce polluting domestic water and gas emissions; many of the purchased products have an impact over the environment, associated with the way they are produced, used and eliminated.

Consequently, any tourist unit, either an internationally famous company or a family business, should be interested in sustainable consumption, applying as many measures as possible, according to the identity, particularities, and other elements characteristic to the area.

The policy of every hotel should be based on the real demand of the consumers of tourist services, on the customers' implication in putting these measures into

practise, as an active and conscious part, together with the personnel of the unit. However, no matter the measures adopted by a hotel for sustainable consumption, they should be treated as seriously as possible, permanently followed with the same concern like the financial indicators or the degree of occupation.

A responsible involvement should be based not only on the maintenance of the operation standards, but also on the reduction of unjustified water, energy or fuel consumption, as well as on the efficient administration of waste. This preoccupation will definitely lead in time to special results. These results can be measured both by comparing the consumption to other periods of time, and by the observation of the customers' reaction towards the friendly attitude of the personnel concerning the environment.

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Sustainable Strategies for Destination Management

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Abstract: Sustainability becomes a primary concern for international destinations. The aim of this research is to analyse the development of a destination and its sustainability in terms of economic sustainability. For the purpose of this research, initially the knowledge and research on sustainability in the context of tourism with a focus on economical dimension is discussed. Further, the importance of sustainability for destinations is explained. This is followed by a discussion on Turkey in terms of economic sustainability. As such a SWOT analysis is conducted for Turkey. Therefore, it is intended to draw a roadmap for tourism planners operating in this country for a better understanding of the concept of sustainability for their success. Finally, recommendations are drawn on the wellbeing and sustainability of the destinations in the conclusion.

Keywords: SDM; Economic Sustainability; Destination Management Organization

JEL Classification: M10

1. Introduction

Since, tourism has been increasingly important for destinations due to its economic and social contributions, providing its sustainability becomes a primary issue for both the decision makers and the principals. This concern stemmed from the industry's rapid growth and development in the course of last decade. However, the rapid growth experienced in the industry resulted in a fierce competition among the destinations. Unfortunately the interest in the destinations to develop their tourism industry resulted in unplanned and unhealthy further unsustainable approaches in development. This problem can be solved by educating the local authorities, entrepreneurs, civil institutions and the public. By doing so, a general understanding of tourism and sustainability together can be created.

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2. Sustainability

The original definition of sustainable development was provided by the Brundtland Commission, in Our Common Future as development that meets the needs of the present without compromising the ability of future generations to meet their own needs (World Commission on Environment and Development 1987). The concept of sustainability clearly covers the environment, people and economic systems. There are problems in tourism such as spread of diseases, pollution, cultural deterioration, opportunity cost, dependency on other countries, regional inflation, big seasonal changes in demand, tendency for importing foreign goods and lack of specialized people in tourism. Those problems are in general cultural, social and environmental. In the development of tourism there are new tourism approaches. Ecotourism, community-based tourism, ethical tourism, pro-poor tourism andsustainable tourism are some of those new approaches in order to solve the problems. Sustainability which is set forth to solve some of these problems is explained as a notion that at its most basic encapsulates the growing concern for the environment and natural resources, though sustainability has also had increasing resonance in social and economic issues (Mowforth&Munt 2003). This concern is stemming from the necessities which are the outcomes of rapid growth in the world tourism market.

The environmental pollution compels both the community and the market to organize themselves according to environmental issues. Especially since the new millennia sustainable architecture and sustainable energy sources are in demand. In order to consume less and to endure more, sustainable materials and strategies are gathered up. Sustainability is showing itself in different spheres of life. From the perspective of tourism, the issue of sustainability has become a necessity. Tourism is taking into account sustainable plans and developments. With ongoing concern for the environment in general, tourism has to be able to keep alive the destinations. Consuming behavior is included in tourism activities but it is possible to preserve while consuming. The understanding of sustainability is what brings this preserving mentality to touristic activities.

The discussion over environment, development and sustainability are under debate in contemporary tourism. The concept of sustainability is open to different interpretations. Activists and communities are after saving the environment while sustainability becomes for some corporations an issue of selling their products with promoting their concern for the environment (Mowforth&Munt 2003). For instance one of the leading German tourism company TUI wouldn't work with the companies which aren't sustainable in their applications. With an inclination towards a continuous, prosperous tourism in general, the future of the world, its sources and human-made sources have to be taken care of. Re-cycling, re-use and preserving natural sources must be emphasized for the implantation of sustainability. The impact of tourism, consumer behavior, tourism demand and its

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future have an impact on the future of both tourism and the destination hence have an indirect effect on tourists and the local residents.

It is accepted that the motivations for touristic activities are diverse. Moreover it is impossible to predict exactly the tourism demand and its future although tourist psychology and motivations are well analyzed. We can only determine the possible boundaries but cannot predict what will happen within those boundaries. Nevertheless tourist demand and behavior is not predictable, their touristic activity has impact on environment. Environmental Assessment (EA) which is in CEQ-NEPA Regulation seeks to combine different data resources to understand how tourism development affects environment. Within the impacts of tourism, social, cultural and environmental ones are of concern for the sustainability approaches. Those impacts indicate the problematic outcomes of tourism which will abolish with sustainability procedures. The principles of sustainable tourism are the outcomes of tourism considerations and its effect in general.

In the principles of sustainable tourism, we can mention ecological, social, cultural and economic sustainability. Ecological sustainability which aims to minimize the effect of tourist activities to environment, ecotourism is a related concept and means a tourism designed to take advantage of a region's natural attractions while providing income to local residents and leaving the region little changed from its pre-tourism conditions (Reece 2010). Social responsibilities towards environment in general, societies in specific are fulfilled. The concern of sustainable development and that of ecotourism are showing resemblance. In that sense it is useful to keep in mind what ecotourism is and how can we evaluate it. Social sustainability is a vital aspect in the sense that it is about the link between host community and the tourists. It is an issue whether the host communities are capable of managing the touristic activities in a long run. Sustainability is also applicable to abstract notions such as culture. The cultures of the touristic destinations are in need of sustaining their own culture. This is an ideological issue and has been part of sustainability in general. Cultural values of the tourism destinations have to be preserved. Another words it is deteriorating to introduce cultural values of the destinations as touristic objects only. Although, culture is a dynamic issue and is open to interactive changes, preserving cultural values are as crucial as keeping the environment clean and safe. Natural beauties and historical values need to be well presented and visited without making degrading like a consumable object.

Economic Sustainability

Sustainability can only be successful if it takes full account of the nature in general, the social life, economic activities, natural resources, human made remnants in specific. Without preserving every aspect of nature, none of them will stay sustainable. Economic aspect clearly seen in UNWTO's sustainable tourism

definition: "Tourism that takes full account of its current and future economic, social and environmental impacts, addressing the needs of visitors, the industry, the environment and host communities" (UNWTO, 2014). There is a growing global concern about the ability of the earth's environment and resources to sustain the continued expansion of economic activity, including tourism (Page 2013). This concern begins to be dominant with the observed effects of climate changes. The economic necessities have also forced decision-makers to encourage tourism development without considering principles of development and sustainable development (Tosun, 2001). It is not only an ideological action but it is economically profitable and necessary to take into account sustainable approaches.

Economic sustainability comes from the fact that touristic activity is an economic activity in many ways. Tourists add value, spend time pleasantly and contribute to their cultural and personal developments and at the same time engage in economic activity. For the dwellers and workers in the destination, this activity is a way of economic gain. With sustainable development of the destinations, their tourism economy will develop and quality of life (QOL) of the visitors and the host community will increase accordingly. If this process of growing is done with seeking direct gains and without thinking the future of the destinations, economic development eventually will terminated. The consequences can be irreversible. Misuse of the natural resources will come to a point of exhaustion.

The tourism destinations with all its natural resources and cultural heritages have also an economic value. Indeed, economic sustainability is about finding possible answers to the question; how can we meet the *economic* needs of the present without diminishing *economic* opportunities of the future (Ikerd, 2012). Suppliers, host, government regulations, competition are in need of handling with having sustainability in mind. Stakeholders should begin their efforts by identifying their target consumers, or those segments of the population who are most likely to be profitably served (Reece, 2010). If a destination aims to see itself as a tourism destination and wants to gain economic advantages, it needs to define itself as a destination and needs to develop its tourism activities with the idea of sustainability in mind. If considering a long term economic advantages, this principle is vital. Policies and mindsets need to be synchronized, have to be sustainable at first. This issue is not just a new trend or a matter of taste likewise a new economic market, but it is a philosophical concept that needs to be placed in our lives. Government and other policy-makers are responsible for deciding and specifying the resources and touristic activities.

Tourist satisfaction is predominantly related with the condition of destinations. Tourist may visit a place several times and immediately perceive positive and/or negative changes. When s(he) don't get pleased with his/her experiences s(he) will not prefer to come back. Sustainability is very crucial for keeping the destination as it is without preventing positive development like quality of life (QOL) of the

related parties. In planning phase of the destinations it is essential to keep tourists' profile in mind. For the sake of determining the direction of the touristic activities, the resources of the destinations and the tourist profile have to be well known.

Sustainability has to be a mindset, basic understanding and business philosophy in order to create a sustainable sphere. Economic sustainability enables destinations to provide tourists' need. This general view of economic sustainability is closely related with destination management. This management represents a tourism strategy which deals with the destination with aiming a long enduring improvement.

3. Strategic Destination Management Organizations

Destination management organization (DMO) is the outcome of an aim to have a high market share within the worldwide tourism. Destination Marketing Organizations (DMOs) has three responsibilities; first of all it encourages groups to hold meetings, conventions, and trade shows in the city or area it represents. Secondly, it assists those groups with their meetings and meeting preparations. Last but not least it encourages tourists to visit and enjoy historical, cultural, and recreational opportunities that the destination offers (Fenich 2012). Strategic and operational management, resource endowment, and providing transparent information about performance all significantly influence the success of DMOs (Volgger & Pechlaner 2013). DMOs success is not directly affected from mediatic sources.

DMOs are working for increasing the flow of tourists to their specific destination. Tourism is a competitive area, it needs a fruitful management. Destination Management Organizations (DMO) have all the necessary information about the defined destination and by integrating and coordinating all the related accommodation, logistic services, entertainment, F & B establishment and technical support, not only support and manage to build up the image and brand of the destination but also help to promote and communicate to the target groups and consumers (Tavmergen & Aksakal, 2004). Their target is promoting a sustainable destination competition; sustainability plays a role in their aim.

In general DMO's have a check-list which is for building a successful tourism management (GACB, 2005). DMOs must conduct a visitor-demand study. This study should aim to find out about tourists' identity and their expectations & preferences. The purpose of their trip, length of stay and touristic activities should be observed. The reason of touristic visits, the preferable places for the tourists and the resources of the destination are identified. In relation with these points the destination's attractiveness will be elaborated. A SWOT analysis will be a helpful tool for strategic decisions. Being a sustainable and an eco-friendly community and

the image of that community are subjects of DMOs. Developing and implementing destination marketing plan will involve making researches about the destination resources, identifying visitor segments, determining responsibilities and tourism economy and hiring an expert to make market research.

Sustainable development is the most prominent discourse that aims at reconciling economic development with the rising needs of environmental protection (Mori, 2013). There are at least four ways to interpret tourism in the context of sustainable development: a sectoral view-point such as economic sustainability of tourism; an ecological viewpoint emphasizing the need for ecologically sustainable tourism; a viewpoint of the long-term viability of tourism, recognizing the competitiveness of destinations; and a viewpoint accepting tourism as part of a strategy for sustainable development throughout the physical and human environments (Coccossis, 1996). For those interpretations of tourism, a SWOT analysis will be a helpful study tool.

4. Method

The study is to reveal the success story of Turkey on the basis of secondary data. Further, a SWOT analysis is conducted for Turkey. As a part of the strategic planning to identify the strengths, weaknesses, opportunities and threats before constitute a formulation of a strategy (Roth and Washburn, 1999). In this study I aim to develop strategies for Turkey which has rapid improvement as a tourism destination.

5. SWOT Analysis

Turkey's tourism receipts reached to 32.3 billion USD by 2013 (TUIK, 2014). Tourism is a significant part of Turkey's economy, particularly in İstanbul.

According to the Global Destination Index, Istanbul ranks as the sixth most popular destination in the world and became European Capital of Culture in 2010. It is highly possible for a place like Istanbul to have scattered attraction places. Each of these destinations has to be evaluated separately. In short, destination places are needed to be organized economically according to their touristic activity and capacity.

Table 1. Country's Strength as a Sustainable Tourism Destination

• Growth rate of general tourism industry in Turkey, which is usually the double of the annual global figures.
• Logistically speaking easy accessible country.
• International price competitiveness
• Convenient accessibility within the country through the international transportation network.
• Numerous natural resources and existence of cultural, natural, historical, archaeological, religious and commercial attractions.
• Growing level of sustainable tourism awareness within the country.
• Positive consumer perception of country in travel market.
• Potential for growth and differentiation of sustainable tourism
• Increasing sustainable tourism investments and developments throughout the country.
• Countries improved image among organizations and associations in international arena as a result of string of successful events (e.g., Eurovision Song Contest, Formula 1 etc.)
• Greater affordability and value for money compared with its competitors.
• Local efforts that promote the country in the world market.

Table 2. Country's Weaknesses as a Sustainable Tourism Destination

• Insufficient budget for promoting and marketing Turkey as a sustainable destination.
• Excessive bureaucracy and red tape implemented by many Turkish organizations.
• Insufficient crisis management, disaster mitigation plans.
• ınsufficient coordination among relevant bodies.
• Shortage of skilled human resources specific to sustainable DMO.
• Negative images of Turkey in the media link to negative events.
• Inadequate application of sustainable tourism management principles
• Low price for tourism packages and services, leading to an image as a cheap destination (Bulu, 2001). Doesn't fit in well with goals to achieve sustainable tourism management.
• Lack of creative and tailor-made strategies for Turkey
• Lack of coordination, communication among different sub-sectors
• Environmental degradation and pollution affecting natural resources

Table 3. Potential Opportunities for Turkey related to Sustainable Destination Management

• Growth in global sustainable destination management and the demand for its services.
• Expansion of sustainable destination management in the world market.
• Statistics and researchers that indicate the demand for leisure travel services are likely to remain stable despite turbulent economies and global crisis (Yesawich, 2008). Especially if you are planning with social responsibilities in mind.
• Changing demographic and psychographic profiles of sustainable destination management market and sustainable destination management trends that are suitable for Turkey's sustainability product.
• Expanding economic relations between Turkey and other countries as result of countries greater integration into the global economy.
• Growing international demands for trips to Turkey
• Creation of new source and destination market as a result of European enlargement and Turkey's role in these developments (Turkey is the candidate of European Union and is part of European Customs Union.)

Table 4. Potential Threats for Turkey related to Sustainable Destination Management

• Increasing competition in the Sustainable Destination Management (SDM)
• Global financial crisis which affects businesses to cut down travel costs.
• More sophisticated customer expectations (e.g., top quality, luxury, comfort but at the same time highly sustainable expectations).
• Over dependence on technology leading to the demolish sustainable services
• Increasing supply of sustainable SDM around the world.
• Increases in more competitive offers with lower price, driving prices down
• Growing regional competition in SDM
• Environmental degradation, pollution, their effects on tourist attractions.
• Ongoing political clashes and wars in the bordering regions and political instability in Turkey.
• Increases in natural and man-caused disaster ranging from earthquakes, tsunamis, potential pandemics of infectious diseases (e.g., avian flu, terrorists attacks, coal mine workers tragedy).

Several strategies are suggested below, taking into consideration Turkey's strength in SDM as well as opportunities that need to be taken advantage of. This method is adapted from a strategic audit conducted for Club Med (School of Business and Public Management, The George Washington University 1997).

Table 5. Strategies involving strength and opportunities

• The use of new strategic marketing tools to appeal to new markets.
• Expanding existing markets and penetrating new markets by using the differential advantages of Turkey's SDM.
• Establishing a suitable method for SDM in Turkey in order to produce a coherent package. It is also possible to develop new partnership with other nearby destinations.
• Attractive new market segments by using existing products, developing a well trained work force, using product differentiation and introducing new products via appealing promotional strategies.
• Using Turkey's cultural and historical attractions to develop a unique image.
• Stressing new products features such as new technologically complete sustainable facilities in promotional messages.

Table 6. Strategies involving weaknesses and opportunities

• Overcoming any negative aspects of Turkey's image and eliminating inconsistent marketing message by focusing on opportunities link to the growing SDM.
• Cooperating with international environmental groups and implementing training to improve environmental sensitivity to overcome environmental problems.
• Improving levels of quality and technology of current facilities (e.g., marinas) and developing new facilities & need infrastructure
• Reducing red tape and increasing the speed with which administrative procedures are undertaken.

Table 7. Strategies involving strengths and threats

• Using the new management techniques, unique products, strategies and new partnership to compete
• Building loyalty among SDM for Turkey by focusing on the countries differential advantage.
• Utilizing all the elements of modern services marketing to offer a variety of SDM to tourists.

Table 8. Strategies involving weakness and threats

• Overcoming the negative image associated with the region (as a result of political instability, high frequency of natural and man-cause disasters) by using cutting edge crisis, management tools and developing a stable disaster preparedness plan.
• Developing fresh promotional campaigns on an ongoing basis to improve Turkey's sustainable destination image above its competitors.
• Keeping up-to-date on professional and academic developments relevant to SDM via trade and scientific publications.
• Fully utilizing all elements (not just the prices) of the marketing mix to promote and market Turkey as a SDM, and especially focusing on sustainable quality.
• Implementing sustainable management techniques to overcome environmental problems.

6. Conclusions and Recommendations

Turkey has been successful in establishing itself as a destination for SSS (sea, sun, sand) tourism, but its share of SDM doesn't reflect the same level of success. However, although Turkey's tourism sector is in the development stage, it promises to have a significant positive impact on the economy. It is important to note, however, the feature prospects of SDM in Turkey depend on a range of internal and external influences, some of which are country-specific, such as geographic location and regional affiliation, while others are more generic. Several recommendations are made below which can help to ensure the successful SDM for Turkey. In order to effectively penetrate the SDM, Turkey needs to continue to develop the infrastructure. It must also upgrade the standard of existing infrastructure and facilities. Turkey needs to promote its unique cultural and historic attractions as part of SDM to add, appeal and value its offer and to successfully compete in the market. It must also continue to make significant marketing and promotion efforts for SDM. New and creative marketing and SDM strategies should be implemented in order to take advantage of opportunities in SDM, while overcoming potential threats. For example, in its promotional and sales efforts Turkey should stress its differential advantages over its competitors referred to its numerous and unique untouched natural, cultural, historical and commercial assets. In this context, considering the variety of attractions that Turkey offers visitors, it needs to promote special tours to its activities, not only to enrich its SDM but also participants' experiences. A somewhat related matter, CRM and one to one marketing efforts also have to target particularly niche markets through individual attention to repeat visitors, thereby building brand loyalty.

Throughout all of Turkey's SDM efforts, the importance of maintaining the highest standards of quality needs to a high priority. The application of quality management techniques is also important to a company the sectors efforts to assure repeat visitation and brand loyalty. It is essential for Turkey to identify and document quality standards and implement continuous improvement strategies to its service standards for more effective competition, particularly given the fact that its competitors include numerous developed SDM around the world.

Finally it is strongly recommended for Turkey to develop disaster preparedness and crisis management plans, in order to be equipped to overcome potential threats to the growing SDM.

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Financial, Public and Regional Economics

Local Decentralisation and Economic Growth in Nigeria

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Abstract: The current global drive towards devolution of financial resources and responsibilities has been increasingly justified on the basis that greater transfers of these financial resources and responsibilities to sub-central governments are theoretically expected to deliver greater economic efficiency in the provision of public goods and services and hence greater economic growth. There is a mixed result on these theoretical expectations across earlier empirical literatures. Using the instrumental variables (IV) technique of analysis with the recent data from Nigeria for the period 1970-2013, this study found no robust significant effect of the decentralisation of spending or revenue on growth of real GDP per capital in Nigeria. The implication of this to the policy makers is that when it comes to the determinants of improved economic activities, decentralisation either fiscal expenditure or revenue side would not be instrumental to economic growth possibly because of existence of endemic corruption among politicians in Nigeria.

Keywords: Local Decentralisation, sub-central government, economic growth, Nigeria

JEL Classification: C3; H77

1. Introduction

Nigerian and other African governments have undergone repeated decentralisation reforms as many developing countries have a mandate to decentralize aspects of their public finance and concurrently, there has been a considerable debate in the developed countries such as the United State and OECD countries in the recent years on the merits of such fiscal decentralization. Much of these recent movements devolving of revenue collection and expenditure to local authorities have been driven by belief that fiscal decentralization enhances government efficiency in the public sector, cut the budget deficit, enhance service delivery and economic growth as first expressed by Tiebout (1956) and others studies like Oates (1972; 1999), Xie et al (1999). Generally, such transfer of fiscal power, responsibility and resources to lower tiers of government allows for even regional development in terms of provision of public goods and services to meet local needs and this will in turn reduce poverty level and promote overall economic

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performance. This is because government at lower levels have informational advantages over the central government concerning the improved and efficient resource allocation (Oates, 1972) and therefore they are in a better position to identify and deliver the kind of public goods and services that match local preferences and needs and over time efficiency gains will lead to the development of local as well as national economy at large.

Other scholars however, have challenged the significance of the economic efficiency of fiscal decentralization on service delivery of local government, reduction of poverty level and economic growth and development. They are of opinion that the informational advantage claimed by local government may not be significant because the central government may appoint its representatives to local offices where they purposely to gain the knowledge about local preferences under fiscal centralized system, so the government at the centre delegates and not devolves of fiscal responsibilities as in the case of fiscal decentralization. Even the central government can also involve worker at sub-central governmental level during the decision making process, this will influence resource allocative efficiency. The local government officials are not adequately trained most especially in the developing countries, this is because they are not elected into office through a democratic election and if they are, there is still the problem of availability of greater incentive to process information (World bank, 1995). It has also been argued that the control of macroeconomic and in particularly corruption at lower levels of government would be more difficult as it gives room for politicians to embezzle public funds (Suleiman, 2009).

Following this theoretical disagreement is the empirical estimation which tends to be ambiguous and inconclusive as a result of differing results. For example, while a strand of argument asserts confidently for single-country studies there exist positive and significant relationship between fiscal decentralisation and economic growth(Nguygen and Anwar, 2011) that fiscal decentralisation does not have economic impact because of the benefits derived from economies of scale in the provision and delivery of public goods (Thieben 2000), the study of Davoodi and Zou (1998) concluded that fiscal decentralisation is negatively correlated to economic activity in developing countries but has no significance in developed countries compared with findings of Prud'homme (1995) who argued that fiscal decentralisation is fundamentally suitable for developed countries and also compared with the conclusion of Enikolopov and Zhuravskaya (2003) which revealed significantly positive effect of fiscal decentralisation for developing countries alone. The evidence is that the link between decentralization and growth is not straightforward and is largely influenced by country specificities, as well as process design. Despite this, 63 of 75 transition and developing economies with populations of 5m people are either have granted or in the process of granting fiscal decentralization policy by transferring financial resourses and responsibilities to

local government. (Woller and Philips, 1998; Rodriguez-Pose and Kroijer, 2009)

Obviously, whether or not there is any significant growth and efficiency gained associated with fiscal decentralization can never be settled merely on theoretical grounds alone. It must be subjected to rigorous empirical analysis (World bank, 1995) which is the thrust of this study. Most of the existing studies on the subject matter have been narrowly concerned with analysing the trend of intergovernmental relations within the limited context of political economy or using merely narrative and descriptive analysis to establish differential or unequal allocation of revenue and functions among tiers of government (see for example Suberu 1991, Akindele and Olaopa 2002) and impact of such on the Nigerian economy. And this has equally led to the review with a view of finding appropriate revenue formula in Nigeria which is one of the most decentralized countries in the continent. This methodology is grossly inadequate in analyzing Fiscal Decentralization-Economic Growth nexus (World Bank, 1995) which is scarcely explored (Breuss and Eller, 2004) most especially in developing country and hence this study.

Moreover, several studies have employed Ordinary Least Squares (OLS) estimation technique to empirically examine the impact of fiscal decentralisation on economic growth despite the fact that a number of studies have identified the possibility of reverse causality and endogeneity among fiscal decentralisation and economic growth (see for example, Adefeso and Saibu 2014, Jin, et al. 2005, Thiessen (2003), Martinez-Vazquez and McNab 2003, Xie et al. 1999, Zhang and Zuo 1998). Specifically, Adefeso and Saibu (2014) and Martinez-Vazquez and McNab (2003) argue and concluded that reversal causality exists because efficiency and other benefits derives from fiscal decentralisation emerge as countries grow and develop. However, existing literature does not control for this endogeneity and this has made the OLS estimates to be biased and not consistent. This study departs from other studies by catering for the problem of endogeneity through the application of Two-Stage Least Square (TSLS) on the over-identified equations. The remainder of the paper is structured as follows: Section 2 focuses on Empirical Literature Review surrounding the fiscal decentralisation and economic growth nexus. Theoretical Framework and Methodology are discussed in section 3 and the study is wrapped up by section 4 which focuses on empirical results and concluding remark.

2. Empirical Literature Review

The following table provides the summary of conflicting results of the main studies on fiscal decentralisation and economic growth nexus on time series analyses up till date.

Table 2.1. Summary of Single Country Empirical studies on the Fiscal Decentralisation Policy and Economic Growth nexus

Studies	Countries	Period	Main results
Hammond, Tosun (2009)	United State	1970-2000	Revenue decentralisation is positive for income growth in metropolitan areas (10% increase in centralisation decreases growth by 0.28%), but has no effect overall
Qiao et al. (2008)	China	1985-1998	Fiscal decentralisation has enhanced growth but the relationship between the two variables is non-linear.
Akai, Nishimura, Sakata (2007)	United State	1992-1997	Non linear, humped-shaped relationship between fiscal federalism and growth. The optimal degree of fiscal decentralisation is higher than what is observed for the revenue-share, hence the US would gain in terms of growth from more fiscal decentralisation on the revenue side.
Hammond, Tosun (2006)	United State	1970-2000	Relatively weak or negative relationship in non-metropolitan areas as opposed to positive impact in metropolitan areas.
Solle-Olle, Esteller-More (2006)	Spain	1977-1998	
Cantarero, Perez Gonzales (2009)	Spain	1985-2004	Fiscal decentralisation is positive for road and educational investment and capital stock, and should therefore be beneficial to growth.
Huang, Cheng (2005)	China	1996-2004	No relationship between expenditure decentralisation and growth. Positive relationship between revenue decentralisation and growth.10% increase in revenue decentralisation adds 0.5% to GDP per capita growth. No evidence of non-linearities.

Zhang and Zou (1998)	28 Chinese Provinces	1987-1993 Annual Data	The direct effect of fiscal decentralisation on growth has been negative. But squared terms suggest non-linear, U-shaped relationship. In highly centralised countries, fiscal decentralisation decreases growth; however this effect becomes smaller with higher decentralisation; and above a certain threshold additional decentralisation is beneficial for regional growth. Decentralization of expenditure to the provinces reduces growth of real GDP per capita.
Lin and Liu (2000)	28 Chinese Provinces	1970-1993 Annual Data	Revenue decentralization by 10% increases growth of real GDP per capita by 2.7%-points (5% signif-cance level)
Carrion-i-Silvestre et al. (2008)	Spain	1980-1998	Fiscal decentralisation has a positive effect both on regional and national economic growth. The effect of the expenditure side is stronger than the revenue side.
Malik, Hassan, Hussain (2006)	4 province of Pakinstan	1971-2005	Both the expenditure share and the own revenues share have a positive and significant effect on growth (estimated oefficients are 0.54 and 0.62 respectively.
Jin, Qian and Weingast (2005)	29 Chinese Provinces	1982-1992 Annual Data	When grants are included in SCG revenues the effect of revenue decentralisation is however found to be negative (-0.17) but insignificant.
			Expenditure decentralization by 10% increases growth of real GDP per capita by 1.6%-points (10% significance level)
Akai, Nishimura, Sakata (2004)	50 states of United State	1992-1997	Fiscal decentralisation has positive effect on economic growth and negative effect on economic volatility.
Akai, Sakata (2002)	50 states of United States	1992-1996	Decentralisation has a positive impact on state gross product. Increase in expenditure decentralisation by 10% increases growth by 1.6-3.2 percentage points.
Qiao, Martinez	28 Chinese	1985-1998	

Vazquez and Xu (2002)	Provinces		Expenditure decentralization increases growth of nominal GDP per capita significantly (5% significance level)
Feltenstein and Iwata (2005)	Central Level in China	1952-1996	Fiscal decentralization has adverse implications for macroeconomic stability but tends to increase growth
Jin and Zou (2005)	30 Chinese Provinces	1979-1999	Divergence between local expenditures and revenue (i.e. centralization) increases growth
Zhang and Zou (2001)	29 Chinese Provinces	1987-1993, annual data	Decentralization reduces economic growth
Zhang and Zou (2001)	16 Indian States	1970-1994	Decentralization increases economic growth
Desai, Freink-man and Gold-berg (2003)	80 Russian Regions	1996-1999	Decentralization has a positive but non-linear effect on growth
Naumets (2003)	24 Ukrainian Oblasts and Autonomous Republic of Crimea	1998-2000	Not robust negative impact of own revenue decentralization on growth of real gross value added
Xie, Zou and Davoodi (1999)	Central Level in the USA	1951-1992	No significant impact of expenditure decentralization on growth of real GDP per capita
Akai and Sa-kata (2002)	50 US States	1992-1996, Cross-Section of Average Growth Rates, Panel with Annual Data	Expenditure decentralization by 10% increases growth of GDP per capita by 1.6-3.2%-points (robust 10% significance levels)
Stansel (2005)	314 US Metro-politan Areas	1960-1990	Higher fragmentation is associated with significantly higher growth in (log) real per capita money income.
Berthold, Drews and Thode (2001)	16 Laender	1991-1998	Higher horizontal and vertical grants significantly reduce growth of nominal GDP per capita
Behnisch, Buttner and Stegarescu (2002)	Central Level in Germany	1950-1990	Increase of federal share of expenditure in total expenditure has positive effect on German productivity growth
Gil-Serrate and Lopez-Laborda (2006)	17 Spanish Autonomous Communities	1984-1995	Revenue control decentralization has a positive effect on decentralization
Feld, Kirch-gassner, and Schaltegger (2004, 2005)	26 Swiss Can-tons	1980-1998	Tax autonomy and tax competition are not harmful for economic growth
	Both cross-		There is no evidence of direct link

Feld, Schnellenbach (2009)	country and within-country		between fiscal decentralisation and growth
Akai and Sa-kata (2002)	50 US States	1992-1996, Cross-Section of Average Growth Rates, Panel with Annual Data	Expenditure decentralization by 10% increases growth of GDP per capita by 1.6-3.2%-points (robust 10% significance levels)
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Feld, Kirch-gassner, and Schaltegger (2004, 2005)	26 Swiss Can-tons	1980-1998	Tax autonomy and tax competition are not harmful for economic growth
Feld, Schnellenbach (2009)	Both cross-country and within-country		There is no evidence of direct link between fiscal decentralisation and growth

Source: Author collection (2014)

3. Theoretical Framework and Methodology

The theoretical model of fiscal decentralisation and economic growth assumes without loss of generality, three levels of government namely federal, state and local. Fiscal decentralisation level is the spending by sub-national governments as a fraction of the total government spending. For instance, fiscal decentralisation increases if spending by state and local governments rises relative to spending by the federal government. Barro (1990) presents the production function where the interaction between private capital and public services are elegantly captured. This simple model explores a link between public services and economic growth. In this model, the government uses income tax revenues to finance public services which are considered to be inputs to private production. It is this complementarity between public services and private capital that creates a potentially positive

linkage between public services and economic growth in the model. The models specifically shows that spending on public services which enhance the productivity of the private capital or firms that creates a potentially positive linkage between public services and economic growth in the model as shown below:

$$y = Ak^a g^b \dots\dots\dots\dots\dots 1$$

where y stands for economic growth, k is the private capita and g is the publicly provided services. a, b, c and d measure parameter efficiency.

This study however departs from Barro model and follows Davoodi and Zou (1998) by assuming that public spending is carried out by three levels of government namely: federal, state and local. Assume that k represents private capital, g is the total public spending on the provision of public services and it is the composition of f, federal government spending, s, state government spending and l, local government spending. i.e.

$$g = f + s + l \dots\dots\dots\dots\dots 2$$

The resulted production function is Cobb-Douglas production function exhibits constant return to scale as specified below:

$$y = k^a f^b s^c l^d \dots\dots\dots\dots\dots 3$$

where $a + b + c + d = 1$ and $0 < a, b, c, d < 1$, $0 < b < 1$, $0 < c < 1$, $0 < d < 1$. The total government spending, g, among different levels of government takes the following form:

$$f = \pi_f g, \qquad s = \pi_s g, \qquad l = \pi_l g \dots\dots\dots\dots\dots 4$$

where $\pi_f + \pi_s + \pi_l = 1$ and $0 < \pi_i < 1$ for $i = f$, s, and l. π_f is the share of federal government in total spending, π_s and π_l are the share of state and local government in total spending respectively. The consolidated government spending g is financed by a flat output tax at rate τ:

$$g = \tau y, \qquad \tau = g/y \dots\dots\dots\dots\dots 5$$

in order to derive the long-run growth rate of the economy, the analysis of the decision made by the private sector is crucial. Taken the government's decisions on τ as given, a long-lived representative individual who maximizes his discounted utility,

$$Max\ U = \int_0^\infty \frac{c^{1-\sigma}-1}{1-\sigma} e^{-pt} dt \dots\dots\dots\dots\dots 6$$

where c is the consumption of the public goods and services produced in this economy; σ is the inverse of the intertemporal elasticity of substitution and p is the

rate of time preference. The dynamic budget constraint the consumer faces is:

$$\acute{k} = \frac{dk}{dt} = (1 - \tau)y - c \equiv (1 - \tau)\,k^a\,f^b\,s^c\,l^d - c \quad \text{.................................7}$$

given the total government spending g, a constant tax rate τ, and the shares of spending by different levels of governments m_i's, where i = f, s, l. The representative agent's choice of consumption is determined by equation 6 subject to equation 7 and the government's budget allocation. The consumer then chooses optimally the consumption path $\{c(t): t \geq 0\}$ and path of the capital stock $\{k(t) : t \geq 0\}$ which characterised balanced growth path. The consumer's optimal allocation of resources is derived through Hamiltonian:

$$L = \left(\frac{c^{1-\sigma}-1}{1-\sigma}\right) + \lambda\left[(1 - \tau)k^a\,f^b\,s^c\,l^d - c\right] \quad \text{..8}$$

$$\frac{dL}{dc} = 0 \Rightarrow c^{-\sigma}\,e^{-pt} = \lambda \qquad \text{..9}$$

$$\frac{dL}{dk} = -\frac{d\lambda}{dt} \Rightarrow \lambda\left\{(1 - \tau)\,\tfrac{1}{\phi}\,ak^{a-1}\,f^b\,s^c\,l^d - c\right\} \quad \text{...............................10}$$

$$\frac{dL}{d\lambda} = \frac{dk}{dt} \Rightarrow (1 - \tau)k^a\,f^b\,s^c\,l^d - c \quad \text{..11}$$

The solution for per capital growth rate of the economy along balanced growth path is given by

$$\frac{\acute{y}}{y} = \frac{1}{\sigma}\left\{(1 - \tau)\tau^{1-\frac{a}{a}}\,a m_f^{b/a}\,m_s^{c/a}\,m_l^{d/a} - \rho\right\} \quad \text{.............................12}$$

The equation above shows that long run growth rate per capital output of the economy which is the measure of economic growth is a function of the tax rate and the shares of spending by different levels of government and exogenous factor. This forms the basis for the empirical examination of the relationship between fiscal decentralisation and economic growth and a country is more fiscally centralized if m_f has higher value as noted in the literature.

Given a share of total government spending in GDP and if the actual allocation diverges from the growth-maximizing expenditure share, some reallocation of public spending among three levels of governments will be growth-enhancing. This can be shown by maximising equation (9) while choosing m_f, m_s and m_l subject to the $m_f + m_s + m_l = 1$. The growth-maximising government budget shares are simply the following:

$$m_f^* = \frac{b}{b+c+d} \quad \text{...13}$$

$$m_s^* = \frac{c}{b+c+d} \quad \text{...14}$$

$$m_i^* = \frac{d}{b+c+d} \quad \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots 15$$

It is therefore, clear that the growth-maximising spending shares are equal to the ratios of individual productivity over the aggregate productivity and as long as the existing government budget shares do not correspond to growth-maximizing shares, the growth rate and hence economic growth can always be increased without altering the total budget's share in GDP.

3.1. Model Specification

The simultaneous regression equation that will be estimated on Nigerian economy using annual data from 1970 to 2013 are pooled from statistical bulletin published by Central Bank of Nigeria and African Development Indicator is specified below:

$$g_t = \delta_0 + \delta_1 m_t + \delta_2 \tau_t + \delta_3' x_t + \varepsilon_{1t} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots 16$$

$$m_t = \beta_0 + \beta_1 g_t + \beta_2 P_t + \varepsilon_{2t} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots 17$$

where t is the number of time periods, α, δ_1, δ_2 are scalar parameters while δ_3' is a vector. g_t is the average growth rate, m_t is the measure of fiscal decentralisation and τ_t is the tax rate. x_t is a vector of control variables which are health expenditure, human capita and openess, P_t is the public burrowing theoretically, that there is positive relationship between degree of decentralisation and public borrowing rate of sub-nationals (Treisman, 2000) and ε_{1t} and ε_{2t} is the disturbance term that is assumed to be serially uncorrelated and orthogonal to the explanatory variables. The focus of this research are the coefficients δ_1 and β_1 which may be positive or negative and statistically significant given the conventional arguments in favour or against of average growth rate and fiscal decentralization policy respectively.

The consequences of ignoring the endogeneity problem discussed briefly in section 1 as this study has noticed in numerous studies is that the estimated result will be baised and inconsistent because error term of such equation is correlated with the explanatory variable of the equation. In other to overcome the econometric problems of endogeneity from equation 13 and 14 which are structural equation of the simultaneous equations model where g_t and m_t are the endogenous variables and x_t vector and P_t are strictly exogenous variables, the study estimate an over identified equation using the method of Two-Stage Least Square (TSLS).

3.2. Multivariate Cointegration Analysis and Error Correction Modeling

The cointegration analysis is fairly common and is well documented in the studies like Banerjee, et. al 1993; Hylleberg and Mizon 1989; Engle and Granger 1987; Johansen 1988; Johansen and Juselius 1990. Only summary is provided for here. According to Johansen (1988), multivariate cointegration model is based on the error correction representation given by:

$$\Lambda\, Y_t = \mu + \sum_{i=1}^{\rho-1} \alpha_i\, \Delta\, Y_{t\text{-}i} + \beta\, Y_{t-1} + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots 18$$

Where Y_t is an (nx1) column vector of ρ variables, μ is an (nx1) vector of constant terms, α and β captured coefficient matrices, Δ is a difference operator, and $\varepsilon_t \sim$ IID(0, σ^2). The coefficient matrix β is known as the impact matrix, and it contains information about the long-run relationships. Johansen's methodology requires the estimation of the VAR equation (3) and the residuals are then used to compute two likelihood ratio (LR) test statistics that can be used in the determination of the unique cointegrating vectors of Y_t. The cointegrating rank can be tested with two statistics: the trace test and the maximal eigenvalue test.

4. Empirical Results and Concluding Remark

Analysis of the time series data employed in this study tend to exhibit either a determistic and/or stochastic time trend and are therefore non stationary at level; i.e., the variables in question have, means, variances and covariances that are not time invariant except expenditure on health and public burrowing. Direct application of OLS or GLS to non-stationary data produces regressions that are misspecified or spurious in nature (Engle and Granger, 1987). We therefore, subjected the variables for a unit root test using an Augmented Dickey-Fuller test (ADF) (Dickey-Fuller,1981) and Philip-Perron test (Philip-Perron, 1988). The results of this stationarity tests at level show that most of the variables are non stationary at level. We then difference the variables once in order to carry out stationarity tests on the differenced variables, the results of this confirmed stationarity as shown in the table 2 below:

Table 2. Result of the Unit Root Tests based on Augmented Dickey-Fuller Test

Series	Level	1st Difference	Order of Integration
Log g	-0.971543	-3.901088	I(1)
Log m (expenditure side)	-2.271678	-8.203590	I(1)
Log m (revenue side)	-3.497761	-8.846321	I(1)
Log T	-1.481866	-7.008466	I(1)
Log P	-4.600091		I(0)
Log hc	-1.902905	-4.391112	I(1)
Log opens	-3.054406	-7.334921	I(1)
Log health	-4.617369		I(0)

Note: All variables and symbols are defined earlier.

Source: Author computation (2014)

This shows that most of the variables involved are integration of order 1. The next step is to test for the existence of a cointegration relationship among the variables

using the Johansen Cointegration approach described above. The Johansen Cointegration test result indicates the existence of cointegration between variables employed. The maximum trace statistics reject the null hypothesis of no cointegration at 5 per cent level.

Table 3. Two Stage Least Square Estimation

Dependent Variable: Growth Rate of Per Capital GDP

Variables	OLS	OLS	IV	IV
C	*-4.65415**	*-5.0585**	*-4.6542***	*-5.05848**
D(log m) Expenditure side	*-0.03407*		*-0.03407*	
D(log m) Revenue side		*-0.10378*		*-0.10378*
D(Log t)	*0.28017****	*0.23512****	*0.28017****	*0.23518****
D(Log hc)	*0.10330*	*0.15352*	*0.10330*	*0.15355*
Log health	*0.36374***	*0.39505**	*0.36374***	*0.39505**
D(log opness)	*-0.00548*	*0.00369*	*-0.00548*	*0.003685*
No. of Observation	*44*	*44*	*44*	*44*
Adj R²	*0.39098*	*0.4065*	*0.39099*	*0.4788*
D.W	*1.6980*	*1.6265*	*1.6980*	*1.6265*

Note: *, ** represent 5%, 10% level of significance, *** represents both 5%, 10% level of significance

Source: Author Computation (2014)

In term of statistical significance, fiscal decentralisation measure either at expenditure side or revenue side is statistically insignificant in all the regressions while other explanatory variables like for example tax rate and health which are statistically significant and positively correlated with economic growth. This empirical result is supported by the study of Woller and Philips (1998) which failed to find any strong and systematic relationship between fiscal decentralisation and economic growth in the developing countries. Other literatures that arrived at this conclusion include Xie, Zou and Davoodi (1999), Nauumets (2003), Bodman and Ford (2006). This study therefore concludes that fiscal decentralisation is not instrumental to economic growth in Nigeria.

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Analysis of the Structure Ratios of the Funding Sources

Maria Daniela Bondoc[1]

Abstract: The funding sources of the assets and liabilities in the balance sheet include equity capitals and the debts of the entity. The analysis of the structure rates of the funding sources allows for making assessments related to the funding policy, highlighting the financial autonomy and how resources are provided. Using the literature specializing in economic and financial analysis, this paper aims at presenting these rates that focus, on the one hand, to reflect the degree of financial dependence (the rate of financial stability, the rate of global financial autonomy, the rate of on-term financial autonomy) and on the other hand the debt structure (the rate of short-term debts, the global indebtedness rate, the on-term indebtedness rate). Based on the financial statements of an entity in the Argeş County, I analysed these indicators, and I drew conclusions and made assessments related to the autonomy, indebtedness and financial stability of the studied entity.

Keywords: debts; capitals; financial autonomy; funding sources

JEL Classification: D22; G32

1 Introduction

The normal course of the activity of each company requires the provision of the financial sources for covering or constituting the economic means of the entity. Depending on their origin, these sources can be own, attracted or borrowed sources.

A comparative presentation of the own, attracted, and borrowed sources highlights the advantages of each and every funding source separately (Burja, 2006, p. 87). Own sources are safe funding sources, they determine the financial autonomy of companies and eliminate the risk of fortuitous withdrawal of capitals. The main advantage of the attracted sources is that they are non-onerous, but at the same time they are unsafe. Their size and chargeability depend on the characteristics of the operating cycle. The borrowed sources have the advantage of mobility for the harmonization of the requirement to be financed from own and attracted sources.

In the analysis of the financial position of the company, financial statements have a

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crucial role– as a highly important tool in the management process, and they are necessary both for substantiating decisions on the allocation and usage of funds, as well as for the organization of the control on the implementation of the decisions made.

Based on the information in the balance sheet, the rates of the structure of the funding rates can be determined, "allowing for the assessment of the financial policy of the company and providing specific information with a more complex significance than the asset structure rates" (Păvăloaia & Păvăloaia, 2009, p. 404).

The structure of the assets and liabilities is influenced by many factors including: the nature of the performed activity, technical and economic factors, legal factors, circumstantial factors, the nature of the relationship with the partners (suppliers and customers), the size of the company. (Buglea, 2005, p. 169-170)

2 Research Methodology

The research methodology involved using methods of collecting research data, comprising all the methods I used to collect data and information related to the funding sources of an entity listed at the stock exchange: methods of studying normative acts and accounting documents or other kinds of documents, involving examinations from various points of view, in relation to the purpose and objectives of the research; the case study method, which was used to research the evolution of the structure rates and its implications on he financial autonomy of he company. The paper also included the use of methods for quantifying the data from the performed research, in order to process and interpret the results, and also to structure the data, make comparisons, etc.

In order to illustrate the analysis of the rates of the structure of the funding sources, we used the financial statements as at 31 December 2012 of an entity in the Argeş County, namely S.C. Electroargeş S.A., whose NACE code is 2751 manufacture of electric domestic appliances[1] (_).

3 Rates reflecting the Financial Stability and Autonomy

In order to determine the total liability (Pt) I summarized the required information, taken from the balance sheet of S.C. Electroargeş S.A. as at 31 December 2012, and the absolute change and the change index of each indicator in Table 1.

The total liability (Pt) is calculated by adding the following items:

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[1] The financial statements were accessed online at
http://www.bvb.ro/Bilanturi/ELGS/ELGS_A_2012.pdf.

- permanent capitals (Cp), comprising equity capitals (Cpr), medium- and long-term debts (Dtml) and provisions (Pv)

$$Cp = Cpr + Dtml + Pv;$$

- the short-term debts (Dts), i.e. the amounts that must be paid within one year;
- deferred incomes (Vav).

Thus, the formula for the calculation of the total liability is:

$$Pt = Cp + Dts + Vav$$

Table 1 summarises the information required to determine the value of the total liability of the analysed entity, based on which the rates of the structure of the funding sources will be determined.

Table 1. Information required to determine the total liability

It. no.	Indicators	Symbol	2011	2012	Δ (RON)	I (%)
1.	Equity capitals	Cpr	26,260,086	44,904,146	18,644,060	171.00
2.	Medium- and long-term debts	Dtml	0	0	-	-
3.	Provisions	Pv	0	99,588	99,588	-
4.	Permanent capital	Cp	26,260,086	45,003,734	18,743,648	171.38
5.	Short-term debts	Dts	19,975,509	22,559,118	2,583,609	112.93
6.	Deferred income	Vav	160,613	81,202	-79,411	50.56
7.	Total liability	Pt	46,396,208	67,644,054	21,247,846	145.80

Source: Balance sheet of S.C. Electroargeş S.A. as at 31.12.2012

The rate reflecting the financial stability and autonomy are:
- the rate of financial stability;
- the rate of global financial autonomy;
- the rate of on-term financial autonomy.

a. The rate of financial stability (*Rsf*) reflects the relationship between the permanent capital steadily available for the company and the total liability of the company, and is determined as a percentage ratio between the permanent capital (*Cp*) and the total liability (*Pt*):

$$Rsf = \frac{Cp}{Pt} \cdot 100$$

If the rate of financial stability in he current period is higher than the one in the baseline period ($Rsf_1 > Rsf_0$), it shows an increase in the share of the permanent capital in the total funding sources, which highlights an increase in relative measures of the stable sources compared to the temporary sources. In the opposite situation, when the rate of financial stability in the current period is lower than the one in the baseline period ($Rsf_1 < Rsf_1$), it shows a decrease in the share of the permanent capital in the total liability, which reflects a decrease in relative measures of the stable or permanent sources compared to the short-term debts.

We believe that an increase in the rate of financial stability reflects a favourable situation if the increase in the permanent capital compared to the total liability is due to the increase in the equity capital in a higher pace than the long-term debts (Păvăloaia & Păvăloaia, 2009, p. 405).

This indicator reflects the share of the capital steadily available for the entity, for a period of at least one year. A ratio reaching more than 50 % is considered to be acceptable (Corduneanu & Miloş, 2009).

The indicators required to determine and analyse the rate of financial stability are presented in Table 2.

Table 2. Indicators required for the analysis of the rate of financial stability

It. no.	Indicators	Symbol	2011	2012	Δ (RON)	I (%)
1.	Permanent capital (RON)	Cp	26,260,086	45,003,734	18,743,648	171.38
2.	Total liability (RON)	Pt	46,396,208	67,644,054	21,247,846	145.80
3.	Rate of financial stability (%)	Rsf	56.60	66.53	9.93	117.54

Source: Calculated based on the balance sheet of S.C. Electroargeş S.A. as at 31.12.2012

We can see that the rate of financial stability increased in the analysed period by 9.93%, which indicates an increase in the share of the permanent capital in the total funding sources, thus illustrating an increase in relative measures of the stable sources compared to the cyclical or temporary sources. This evolution is determined by the increase in the permanent capital by 71.38% in a higher pace than that of the increase in the total liability by 45.80%.

The predominance of the permanent capital in the finding sources (more than 50%

and increasing in the accounting period 2012 compared to 2011) provides the entity with safety through financing stability.

b. The rate of global financial autonomy (*Rafg*) reflects the share of the equity capital (*Cpr*) in the total funding sources, i.e. in the total liability (*Pt*):

$$Rafg = \frac{Cpr}{Pt} \cdot 100$$

If $Rafg_1 > Rafg_0$, this shows an increase in the global financial autonomy, due to the change in the equity capital in a higher pace than the total resources or liabilities of the company ($I_{Kpr} > I_{Pt}$).

If $Rafg_1 < Rafg_0$, there is a decrease in the global financial autonomy, as a result of the change in the equity capital in a lower pace than the total liabilities ($I_{Kpr} < I_{Pt}$).

The rate of global financial autonomy is influenced by the financial policy of the business entity and by the conditions under which it carries out its activity. We believe that a level of more than 30% of this rate would reflect financial balance, therefore at least one third of the total funding sources would be own sources.

In order to determine the global financial autonomy I summarised the required information in Table 3.

Table 3. Indicators required to analyse the rate of global financial autonomy

It. no.	Indicators	Symbol	2011	2012	Δ (RON)	I (%)
1.	Equity capitals (RON)	Cpr	26,260,086	44,904,146	18,644,060	171.00
2.	Total liability (RON)	Pt	46,396,208	67,644,054	21,247,846	145.80
3.	Rate of global financial autonomy (%)	Rafg	56.00	66.38	10.38	118.54

Source: Calculated based on the balance sheet of S.C. Electroargeş S.A. as at 31.12.2012

The rate of global financial autonomy increased in 2012 compared to 2011 by 10.38%, representing a percentage increase of 18.54%, which reflects financial balance (the rate has, in both accounting periods, levels higher than 30%). This evolution is due to the increase in the equity capital in a higher pace (by 71.00%) than the total liabilities (by 45.80%). If the company benefits from the leverage (the economic rate of return is higher than the interest rate), its financial autonomy enables it to resort to bank loans.

c. The rate of on-term financial autonomy (*Raft*) reflects the share of the equity capital in the permanent capital. It is calculated as a percentage ratio between the

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equity capital (*Cpr*) and the permanent capital (*Cp*):

$$Raft = \frac{Cpr}{Cp} \cdot 100$$

We believe that a business entity has ensured its financial autonomy when its rate of on-term financial autonomy is at least 50 %. The evolution of the rate of on-term financial autonomy depends on the ratio between the growth rate of the equity capital, which shows an uptrend if the activity is profitable, and the growth rate of the medium- and long-term debts, which show a fluctuating trend depending on how loans are obtained and on the rescheduling of their repayment.

Table 4 shows the indicators required to analyse the rate of on-term financial autonomy.

Table 4. Indicators required analysing the rate of on-term financial autonomy

It. no.	Indicators	Symbol	2011	2012	Δ (RON)	I (%)
1.	Equity capital (RON)	Cpr	26,260,086	44,904,146	18,644,060	171.00
2.	Permanent capital (RON)	Cp	26,260,086	45,003,734	18,743,648	171.38
3.	Rate of on-term financial autonomy (%)	Raft	100	99.78	-0.22	99.78

Source: Calculated based on the balance sheet of S.C. Electroargeş S.A. as at 31.12.2012

The rate of on-term financial autonomy decreased in the analysed period by 0.22%, but its level remained significantly higher than 50%, which shows that S.C. Electroargeş S.A. has ensured its financial autonomy (even 100% in the accounting period 2011). Its slight decrease (by 0.22%) is determined by the more accelerated increase in the permanent capital (by 71.38) compared to the equity capital (increasing by 71.00%).

4 Rates Reflecting the Debt Structure

The debt structure highlights the shares of the various types of debts in the permanent capitals or in the balance-sheet liabilities.

For a detailed analysis, it is necessary to break down the categories of debts on analytical structure rates of short-term debts and long-term debts such as: the rate of the short-term, or long-term financial bank debts, the rate of the short-term, or long-term commercial debts, rate of the short-term or long-term debts to employees, etc. (Achim, 2010, pp. 279-280).

In order to reflect the structure of the debts (short-term, medium-term and long-term, and of the total debts) we will determine the following indicators at the studied entity:

- rate of short-term debts;
- rate of on-term indebtedness;
- rate of global indebtedness.

a. The rate of short-term debts (*Rds*) is calculated as percentage ratio between the short-term debts and the total liabilities:

$$Rds = \frac{Dts}{Pt} \cdot 100$$

Table 5. Indicators required to analyse the rate of short-term debts

It. no.	Indicators	Symbol	2011	2012	Δ (RON)	I (%)
1.	Short-term debts (RON)	Dts	19,975,509	22,559,118	2,583,609	112.93
2.	Total liabilities (RON)	Pt	46,396,208	67,644,054	21,247,846	145.80
3.	Rate of short-term debts (%)	Rds	43,05	33.35	-9.70	77.47

Source: Calculated based on the balance sheet of S.C. Electroargeş S.A. as at 31.12.2012

The rate of short-term debts decreased in the analysed period by 9.70%, which indicates a percentage decrease by 22.53%, as a result of the fact that the short-term debts changed by a lower percentage than the total liabilities, and therefore the unfavourable influence of the increase in the debts by 12.93% is offset by the favourable effect of the increase in the total sources by 45.80%.

b. The rate of on-term indebtedness (*Rdt*) is determined as percentage ratio between the medium- and long-term debts (*Dtml*) and the permanent capitals of the business entity (*Cp*):

$$Rdt = \frac{Dtml}{Cp} \cdot 100$$

Based on the practical experience, the specialized literature recommends that the level of this rate should not exceed 50% in order to avoid jeopardizing the financial autonomy of the entity.

Given that S.C. Electroargeş S.A. does not record debts payable in a period exceeding one year (*Dtml*=0), its rate of the on-term debt was null in the analysed

period ($Rdt = 0$).

c. The rate of global indebtedness (Rig) is calculated as percentage ratio between the total debts (Dt) and the value of the total liabilities (Pt):

$$Rig = \frac{Dt}{Pt} \cdot 100 = \frac{Dts + Dtml}{Pt} \cdot 100$$

It is recommended that the global indebtedness should not exceed 70%, and the increase in the two rates shows an increase in the indebtedness, signifying a decrease in the financial autonomy.

Table 6. Items required calculating total debts

It. no.	Indicators	Symbol	2011	2012	Δ (RON)	I (%)
1.	Medium- and long-term debts	Dtml	0	0	-	-
2.	Short-term debts	Dts	19,975,509	22,559,118	2,583,609	112.93
3.	Total debts	Dt	19,975,509	22,559,118	2,583,609	112.93

Source: Calculated based on the balance sheet of S.C. Electroargeş S.A. as at 31.12.2012

Given that the entity did not record debts payable in a period exceeding one year (*Dtml*), the rate of global indebtedness (*Rig*) is equal to the rate of short-term debts (*Rds*), being below the recommended level of 70%, which confirms a good financial autonomy, also reflected by other rates that were previously determined.

5 Conclusions

The rates of the structure of the funding sources analysed based on the balance sheet of S.C. Electroargeş S.A. Curtea de Argeş show a good financial autonomy of the entity because the global financial autonomy is increasing and reflects the high share of equity capitals in the financing sources, and the financial stability is ensured by the predominance of the permanent capitals in the total value of the liabilities. The indebtedness was reduced, and the entity did not resort to medium- and long-term loans in the analysed periods.

In the process of analysing the funding sources we can determine *the rate of bank loans* compared to the total debts or compared to the total capital, as well as *the rate of the operating debts* compared to the total debts or compared to the total liabilities of the company. The analysis of the debts or liabilities of the company

can also be detailed taking into account certain criteria used to group them (Radu, Cârciumaru, Bondoc, 2008, p. 232). Thus, depending on the nature of the liabilities*,* we can distinguish between liabilities related to the operating cycle and non-operating obligations, and depending on the maturity term of the liabilities, we can distinguish between short-term debts (less than one year), medium-term debts (between 1 and 5 years), and long-term debts (over 5 years).

These analytical rates may be a starting point for the further research in a future paper.

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Financial Intermediaries and
Economic Growth: The Nigerian Evidence

Oba Efayena[1]

Abstract: This study seeks to examine the role of financial intermediaries and to find out whether financial intermediaries impact on economic growth in Nigeria. The study adopts the Harrod-Domar growth model which states that economic growth will proceed at the rate which society can mobilize domestic savings resources coupled with the productivity of the investment. The study employed the use of secondary data for the period 1981 to 2011 which were sourced from the CBN statistical bulletin. Nigerian banks being the dominant financial intermediaries, loans credits and advances from banks were used as proxy for the independent variable. Gross domestic product (GDP) was used as proxy for economic growth. Using the technique of correlation analysis in determining the association between loan credits and advances, and the GDP, the study reveals a relatively high positive correlation between financial intermediaries and economic growth in the Nigerian economy. The study recommends that Nigerian banks should lend higher proportion of their loanable funds to small and medium enterprises (SMEs) and should invest in information technology and human capital.

Keywords: Financial intermediaries; economic growth; Gross domestic product; correlation analysis

JEL Classification: O47

1. Introduction

Financial intermediaries, all over the world play crucial roles in the development and growth of the economy. An economy is made up of fund raisers and fund suppliers. Financial intermediaries are those institutions in the financial market that mediate between the fund raisers and the fund suppliers. They carry out intermediation between surplus and deficit units of the economy.

The role of financial intermediaries in intermediating between fund raisers and fund suppliers has been exemplified in various finance literature. Several studies have dwelt on the role of financial intermediaries (Benston & Smith, Jr., 1975; Holmstrom & Tirole, 1998; Gromb & Vayanos, 2010; Araiyo & Minetti, 2007). Some studies concentrate on the impact of financial intermediation on the financial

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system (Anad and Subrahmanyam, 2008). Other studies focus on the impact of financial intermediation on economic growth, and the impact of economic growth on financial intermediation (Nieh et al. 2009; Odhiambo, 2011). However the main focus of this paper is on the relationship between financial intermediaries and economic growth. This paper would concentrate on banks because Ikhide (1997) asserts that the financial system in Nigeria is mostly dominated by the banking sector.

The basic question that this paper would answer is: Do better functioning financial intermediaries exert a causal influence on economic growth? What is the Nigerian evidence?

The remainder of this paper is structured as follows: Section 2 focuses on literature review; section 3 is research methodology; section four is the presentation and analysis of results; and section five is discussion and conclusion.

2. Review of Related Literature

Role of Financial Intermediaries

Fund suppliers cannot loan money directly to fund raisers, nor can fund raisers borrow money directly from fund suppliers. These transactions had to be done conveniently through financial intermediaries. They facilitate the exchange of funds between fund surplus units and fund deficit units. According to Thompson (1982) financial intermediaries help to bridge the gap between borrowers and lenders by creating a market in two types of security, one for the lender and the other for the borrower. Financial intermediaries, through financial intermediation, allow funds to be channeled from those that might not put them to use to those that would put them to productive use. The general name for the services supplied by financial intermediaries is financial intermediation. This implies that financial intermediaries are middle participants in the exchange of financial assets.

There are various types of financial intermediaries. These consist of depository intermediaries, contractual intermediaries, and Investment intermediaries. Depository intermediaries consist of commercial banks, thrifts, mutual savings banks, savings and loan associations, and credit union. Investment intermediaries are made up of investment companies and finance companies. They specialize in both money and capital market funds, which include treasury bills, commercial bank certificates of deposit, long term loans (debentures), and stocks. Contractual intermediaries consist of insurance companies and pension funds. They create instruments that form a contractual relationship with the buyer. These instruments consist of insurance plan, savings, annuity, pension, and loan privileges.

Gershenkron (1962) stated that banks are the largest financial intermediaries that effectively finance industrial expansion in developing countries. Banks are the largest financial intermediaries in the Nigerian economy. According to Schumpeter (1911) bank financial intermediation does not only entail creation of a pool of investible funds, it also involves allocating funds effectively.

Financial intermediaries perform five functions:

1. Pooling the resources of small savers: banks for example, pool many deposits and use these to make large items. Insurance companies collect and invest many small premiums in order to pay fewer large claims. Mutual funds accept small investment amounts and pool them to buy large stock and bond portfolios.

2. Providing safekeeping, accounting, and payment mechanisms for resources: Banks are obvious example for the safekeeping of money in accounts, keep records of payments, deposits and withdrawals and the use of debit / ATM cards and cheques as payment mechanisms.

3. Providing liquidity: Financial intermediaries can easily and cheaply convert an asset to payment. They make it easy to transform various assets into a means of payment through ATMs, cheques, debit cards etc.

4. Diversifying risk: Financial intermediaries assist investors diversify in ways they would be unable to do on their own. Banks for instance spread depositors' funds over many types of loans, so that the default of any one loan does not put depositors' funds in jeopardy.

5. Collecting and processing information: Financial intermediaries are experts at collecting and processing information in order to accurately gauge the risks of various investments and to price them accordingly. The need to collect and process information comes from a fundamental asymmetric information problem inherent in financial markets.

Financial Intermediaries and Asymmetric Information

Financial markets have a lot of asymmetric information. Borrowers and debt / stock issuers know much more about their likelihood of success than potential lenders and investors. Asymmetric information causes one group with better information to use this advantage at the expense of the less-informed group. Asymmetric information can cause financial markets to function inefficiently or even break down completely. However financial intermediaries use their size and expertise to minimize them.

Asymmetric information can be of two types. It can be due to adverse selection and moral hazard. The problem of adverse selection arises before a financial asset is bought or sold. The worst candidates (adverse) are more likely to be selected for the transaction. People who are bad credit risks are more likely to try to get a loan than those who are good credit risks. Banks are however, experts at assessing credit risk and distinguishing the good from the bad. The problem of moral hazard arises after the loan is made. The risk that the borrower of a loan may misuse the loan (immoral) and be unable to pay is known as moral hazard. Banks are experts in monitoring and enforcing lending contracts in order to minimize the moral hazard problem.

Previous Studies on the Role of Financial Intermediaries

Several theoretical models posit that financial intermediaries mitigate the costs associated with information acquisition and the conduct of financial transactions (Benston and Smith, Jr., 1975). Other studies show that financial intermediaries make provision for insurances and risk sharing (Allen and Gale, 1997, 2004), stimulates the funding of liquidity needs through credit lines (Holmstrom and Tirole, 1998), and aid the creation of specialized products (Benstom and Smith, Jr. 1975). Several studies have dwelt on the significance of financial intermediation. However there are mixed feelings about it. Some argue that it facilitates the efficiency of the financial system (Gromb and Vayanos, 2010; Anad and Subrahmanyam, 2008), others argue that it is a means of carrying out monetary policy (Benston and Smith, Jr. 1975). Still others argue that financial intermediaries through financial intermediation stimulate the restructuring and liquidation of distressed firms (Araujo and Minetti, 2007).

Financial Intermediaries and Economic Growth

King and Levine (1993), citing Schumpeter (1911), state that, "the services provided by financial intermediaries – mobilizing savings, evaluating projects, managing risks, monitoring managers, and facilitating transactions – are essential for technological innovations and economy". This statement motivated King and Levine to empirically test the logic behind this statement. This statement also motivated others into studying the relationship between finance and economic growth.

King and Levine (1993) conducted a pooled cross-country time series survey of eighty countries for the period 1960-1989 with a view to establishing the relationship between financial development and economic growth. Four variables were used as proxy for financial development: financial depth; relative importance of specific financial institutions; proportion of credit allocated to the private sector, and the ratio of claims on the non-financial private sector. On the other hand four

variables were used as proxy for economic growth: long-run real per capital GDP; the rate of physical capital accumulation, the ratio of domestic investment to GDP; and residual measure of improvement in the efficiency of physical capital allocation. This study showed that the four indicators of financial development were positively and statistically related to growth and other indicators of growth.

Odedokun (1998), using a cross-country data analysis of 71 less developed countries (LDCs) for the period 1960 to 1980, found that, even though financial intermediation promotes economic growth, the growth-promoting effects were more pronounced in the low-income countries. Two models were developed for this study, with growth as the dependent variable, while the independent variables include: labour force growth; Investment-GDP ratio; real export growth; and financial depth. Using ordinary least squares (OLS) and Generalized Least Squares (GLS) techniques, the study showed a strong positive relationship between financial intermediation and economic growth.

Hao (2006) carried out a study to establish the association between financial intermediation and economic growth, using a country-specific data from China, over the period 1985 to 1999, and post 1978 reform period. The study employed the use of linear model which expressed economic growth as a function of lagged economic growth, and financial development indicators (banks, savings, and loan-budget ratio). The study finds that financial intermediation has a causal effect and positive impact on growth through the channels of households' savings mobilization and substitution of loans for state budget appropriations.

3. Research Methodology

Model Specification and description of variables

This paper examines the impact of loanable funds on the Nigerian economy by applying the Keynesian principle of economic growth, specifically, the Harrod-Domar principle. The Harrod-Domar growth model states that economic growth will proceed at the rate which society can mobilize domestic savings resources coupled with the productivity of the investment (Somoye, 2002).

Harrod-Domar growth model

$$Y = f(K) \text{ (Output is a function of the capital stock)}$$

$$Y = \text{Output}$$

$$K = \text{Capital}$$

The following model was specified for this study:

$$Y = f(X)$$

Where,

Y = Gross domestic product (GDP) at current basic prices. This was used as proxy for economic growth (the dependent variable).

X = The ratio of bank loans and advances to GDP. This was used as proxy for financial intermediaries (the independent variable).

Data

Data for this study are purely secondary data. Data for the variables were gathered from CBN Statistical Bulletin for the period 1981 to 2011.

Hypothesis

The following hypothesis stated in the null form was tested in this study.

H_0: There is no significant relationship between the value of deposit money bank loans and advances and Gross domestic product (GDP)

Statistical Analysis

This study employed the technique of correlation analysis to test the relationship between bank credit and advances, and the GDP. The strength of the relationship is always measured by the coefficient of correlation, r, whose values range from -1 to +1; -1 is indicative of a strong inverse relationship while +1 is indicative of a strong positive relationship. The formula for the calculation of coefficient of correlation is shown below:

$$r = \frac{\sum xy - \frac{(\sum x)(\sum y)}{n}}{\sqrt{\left[\sum x^2 - \frac{(\sum x)^2}{n}\right]\left[\sum y^2 - \frac{(\sum y)^2}{n}\right]}}$$

4. Data Presentation and Analysis

This section presents the data and carries out a statistical analysis of the data.

Table 1. Data of commercial bank credit (banks' loans and advances, and GDP)

Year	Loans and Advances (N' million)	GDP (N' million)	Loan to GDP rat. X%
1981	8582.9	47619.66	18.02
1982	10275.3	49069.28	20.94
1983	11093.9	53107.38	20.89
1984	11503.6	59622.53	19.29
1985	12170.2	67908.55	17.92
1986	15701.6	69146.99	22.71
1987	17531	105222.84	16.66
1988	19561.2	139085.3	14.06
1989	22008	216797.54	10.15
1990	26000.1	267549.99	9.72
1991	31306.2	312139.74	10.03
1992	42736.8	532613.83	8.02
1993	65665.3	683869.79	9.6
1994	94183.9	899863.22	10.46
1995	144569.6	1933211.55	7.48
1996	169437.1	2702719.13	6.27
1997	385550.5	2801972.58	13.76
1998	272895.5	2708430.86	10.08
1999	322764.9	3194014.97	10.11
2000	508302.2	4582127.99	11.09
2001	796164.8	4725086	16.85
2002	954628.8	6912381.25	13.81
2003	1210033.1	8487031.57	14.26
2004	1519242.7	11411066.91	13.31
2005	1976711.2	14572239.12	13.56
2006	2524297.9	18564594.73	13.59
2007	4813488.8	26657317.67	23.3
2008	7799400.1	24296329.29	32.1
2009	8602867.5	24794238.66	34.7
2010	8848081.7	33984754.13	26.0
2011	7400028.3	37543654.7	19.7

Source: CBN Statistical Bulletin, 2011

Table 2. Data Computation

X	Y	X^2	Y^2	XY
18.02	47619.66	324.7204	2267632018.52	858106.27
20.94	49069.28	438.4836	2407794239.72	1027510.72
20.89	53107.38	436.3921	2820393810.46	1109413.17
19.29	59622.53	372.1041	3554846083.60	1150118.60
17.92	67908.55	321.1264	4611571163.10	1216921.22
22.71	69146.99	515.7441	4781306226.06	1570328.14
16.66	105222.84	277.5556	11071846057.67	1753012.51
14.06	139085.3	197.6836	19344720676.09	1955539.32
10.15	216797.54	103.0225	47001173350.05	2200495.03
9.72	267549.99	94.4784	71582997149.00	2600585.90
10.03	312139.74	100.6009	97431217287.27	3130761.59
8.02	532613.83	64.3204	283677491907.27	4271562.92
9.6	683869.79	92.16	467677889674.64	6565149.98
10.46	899863.22	109.4116	809753814708.77	9412569.28
7.48	1933211.6	55.9504	3737306897053.40	14460422.39
6.27	2702719.1	39.3129	7304690695667.96	16946048.95
13.76	2801972.6	189.3376	7851050339071.86	38555142.70
10.08	2708430.9	101.6064	7335597723400.34	27300983.07
10.11	3194015	102.2121	10201731628584.10	32291491.35
11.09	4582128	122.9881	20995896916741.40	50815799.41
16.85	4725086	283.9225	22326437707396.00	79617699.10
13.81	6912381.3	190.7161	47781014545351.60	95459985.06
14.26	8487031.6	203.3476	72029704870176.70	121025070.20
13.31	11411067	177.1561	130212448024497.00	151881300.60
13.56	14572239	183.8736	212350152970458.00	197599562.50
13.59	18564595	184.6881	344644177489144.00	252292842.40
23.3	20657318	542.89	426724773319294.00	481315501.70
32.1	24296329	1030.41	590311616968112.00	779912170.20
34.7	24794239	1204.09	614754270729039.00	860360081.50
26	33984754	676	1154963513276550.00	883603607.40
19.7	37543655	388.09	1409526008232830.00	739609997.60
488.44	**227374788**	**9124.3952**	**5084878377027720.00**	**4861869781.00**

Computation of r

$$r = \frac{4861869781 - \frac{(488.44)(227374787.8)}{31}}{\sqrt{\left[9124.3952 - \frac{(488.44)^2}{31}\right]\left[5084878377027720 - \frac{(227374787.8)^2}{31}\right]}}$$

r = 0.57904

Results

The coefficient of correlation is 0.579. This indicates that there is a positive correlation between deposit money bank loans and advances and GDP. In other words, the relationship between the variables is relatively high. The study rejects the null hypothesis that there is no significant relationship between the value of deposit money bank loans and advances and GDP in the Nigerian economy. This implies that financial intermediaries, specifically banks, impact on the economic growth in Nigeria.

5. Discussion and Conclusion

This paper looked into the relationship between financial intermediaries and the growth of the Nigerian economy. The paper looked into various studies on the role of financial intermediaries and its relationship to economic growth. The result of the statistical analysis shows a fairly high positive coefficient of correlation between **loans and advances** by banks to the economy and the **GDP**. The implication of this is that a rise in bank loans and advances would be associated with a rise in GDP.

This study is consistent with the findings of King & Levine (1993) who concluded that, "The data are consistent with the view that financial services stimulate economic growth by increasing the rate of capital accumulation and improving the efficiency with which economies use that capital" (p. 735). However this study is not consistent with the findings of DeGregorio & Guidotti (1992). They found negative correlations between finance development and economic growth, when they restricted their sample to Latin American countries. Their result is not surprising because banks in Latin America, although active lenders were not prudent in lending. Many banks became vulnerable and fragile and consequently suffered corporate collapse (DeGregorio & Guidotti, 1992). These factors of vulnerability and fragility were not captured in the variables used by King & Levine (1993).

One important question that this study needs to address is: Do bank loans and advances really cause economic growth in Nigeria? However we cannot really infer causality because there may be other factors (omitted variables) driving both financial development and economic growth. The propensity of households in the economy to save may actually be the factor affecting long term economic growth. Also the level of credit may trigger anticipation of a future economic growth which may actually be an indicator of economic growth but not the cause of it. To interpret the positive correlation between our variables we need to identify the mechanism through which financial intermediaries (bank loans and advances) affect economic growth. Rajan and Zingales (1998) were able to identify the mechanism through which financial intermediaries affect economic growth. By facilitating the reallocation of funds from fund surplus units to fund shortage units who need such funds for investment opportunities, financial intermediaries are able to reduce the transaction costs of saving and investing. This in turn lowers the overall cost of capital in the economy. Financial intermediaries also help to mitigate the problem of moral hazard and adverse selection. However for financial intermediaries (Banks) to contribute more positively to economic growth, they should give attention not only to the quantity of their loans and advances but also to the level of their financial efficiency. Nigerian banks should therefore be repositioned to meet the competitiveness in the 21st century. To this end the paper recommends the following:

1. Banks should be made to lend a higher proportion of their loanable funds to small and medium enterprises (SMEs)

2. The need for strong corporate governance

3. The Central Bank of Nigeria (CBN) should enforce regulatory policies to discourage unorthodox practices by some banks

4. Banks should invest more in both information technology and human capital to meet the ever growing competitive environment.

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Exchange Rate and
Trade: J-curve in European Union

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Abstract: The EU economy is experiencing a severe recession amid the global crisis, and although in other regions began to appear mild signs of recovery, in EU countries are recorded a continuously worsening. In many European states, the economic contraction is a consequence of the decrease in net exports component of GDP. The aim of the article is to analyze the situation in which the EU chooses to devalue its currency to increase exports. We found that, the depreciation of the Euro, has no influence on exports and that in EU, it is not expressed a J-curve effects.

Keywords: euro-dollar parity; devaluation; international trade

JEL Classification: F10; F11; F31

1 Introduction

The exchange rate is a factor influencing the economy, used by some states to correct certain imbalances produced as a result of the financial crisis, which "hit" in many countries previously considered to be infallible. The negative effects of the financial crisis are found in lower freight volumes involved in international trade as a result of changes in prices and sluggish demand.

Depreciated course helps, theoretically, on short term the exports - segment which supported the economy in crisis, enhancing competitiveness through price. In 2012, the exports stagnated and where this situation will continue or whether exports will return to negative territory, the economic growth in the EU this year is called into question, combined with a fragile recovery in consumption. A depreciation of the euro increases export competitiveness in terms of price, but the actual development of exports is mainly influenced by the evolution of external demand - which risks of loss / slowdown are still higher.

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To improve the current account of the balance of payments (trade) may be used to a slight devaluation of the national currency. However, the effect on the current account is not immediately successful. Devaluation would increase initially at time t0 the deficit because the imports and exports need time to adapt to the new relative prices. The devaluation would make imports more expensive and exports more efficient, so that after the adjustment period, which can last up to 2 years, the current account of the balance of payments will improve.

The purpose of this article is to explore whether the exchange rate depreciation improves bilateral trade between the European Union and the world. The data used in this study are monthly data covering the period 1999 (the year of onset of the euro) and 2013. To achieve the objective, we do a stationarity test using Augmented Dickey-Fuller method, then a Johansen cointegration test and in the end we use an OLS regression model.

2. Literature Review

The theory of "J-curve" has inspired many of the economic policies adopted in the 50s-70s, and even 80s. According to this theory, in a first phase, the devaluation will lead to a deterioration of the trade balance as exports under way and expressed in national currency get a smaller gain, while imports will be paid in foreign currency. Subsequently, it will increase the substitution of imports by domestic production, allowing recovery of the account balance (Auboin&Ruta, 2012; Bahmani-Oskooee&Mohsen, 2004; Detken, 2002; Meade, 1988; Rosensweig, 1988).

This phenomenon is characterized by a period in which the ongoing contracts, denominated in a particular currency, dominates the determinants of current account items. Over time, the new contracts, concluded after the exchange rate depreciation, begin to prevail, and the effects of devaluation or depreciation are visible. It is obvious that the existence of J curve depends on the extent to which trade is conducted under existing contracts (as opposed to purchases on spot markets), the extent to which there is a symmetrical use of the national currency and the exchange and the delays in signing contracts in their execution.

For devaluation to serve indeed to export recovery, it requires that companies have strong will and also the ability to conquer new markets. In the absence of these elements, it will not take advantage of the opportunity that is offered, and the balance long-awaited recovery will not happen entering into the vicious circle of depreciation. In these cases, there is a sequence of segments in the negative slope of the curve J. The initial trade balance does not improve, but there is an increasing negative value. These phenomena occur only if the structure of exports and imports of the country is such manner that makes price fluctuations to influence trade flows

only to a very small extent. In this case, the question is of quality international specialization (Bin, 2006; Gupta&Uma, 1999; Halicioglu, 2008; Onafowora, 2003; Šimáková, 2013).

Some economists believe that the volatility of exchange rate only produce negative effects, irrespective of the direction in which it occurs. The appreciation or depreciation effects are not sufficiently robust to be generalized in all countries. In addition, the companies record additional charges for protecting against currency risk, thereby reducing revenues partners involved in international trade. The existence of financial market instruments allows, in some degree, to achieve protection against exchange risks by paying a premium in accordance with contract value. Unfortunately, these tools are not widely used, many operators prefer not to protect against currency risk (Bahmani-Oskooee&Mohsen, 1985; Brada, 1992; Hsing, 2005; Rose, 1989; Tian, 2013).

Despite numerous studies on the J curve, few focus on the EU as an entity, many of them looking at only one European country.

Bahmani-Oskooee and Kutan (2009) made an extensive study in some European countries, especially those in Eastern Europe. Using monthly data from the period January 1990 to June 2005 and applying cointegration conditional method, the authors found empirical support for the J-curve only in Bulgaria, Croatia and Russia. For other countries, they found that are not characteristics of existence for J-curve.

Hsing (2009) examines the J curve for other EU countries: Croatia, Czech Republic, Hungary, Poland, Slovakia, Slovenia and the bilateral relationship with the U.S. The author concludes that the J-curve is not empirically confirmed for any of these six countries.

3. Empirical Results

The year 1999 marked a radical change in the economies of Europe, which have undergone economical and financial restructuring for the transition to the single currency. After this year, the European countries, once with the change of regime exchange rate, started a reform process aimed at full economic integration. One of the important components of European macroeconomic strategies was the exchange rate policy, the rate regime being free.
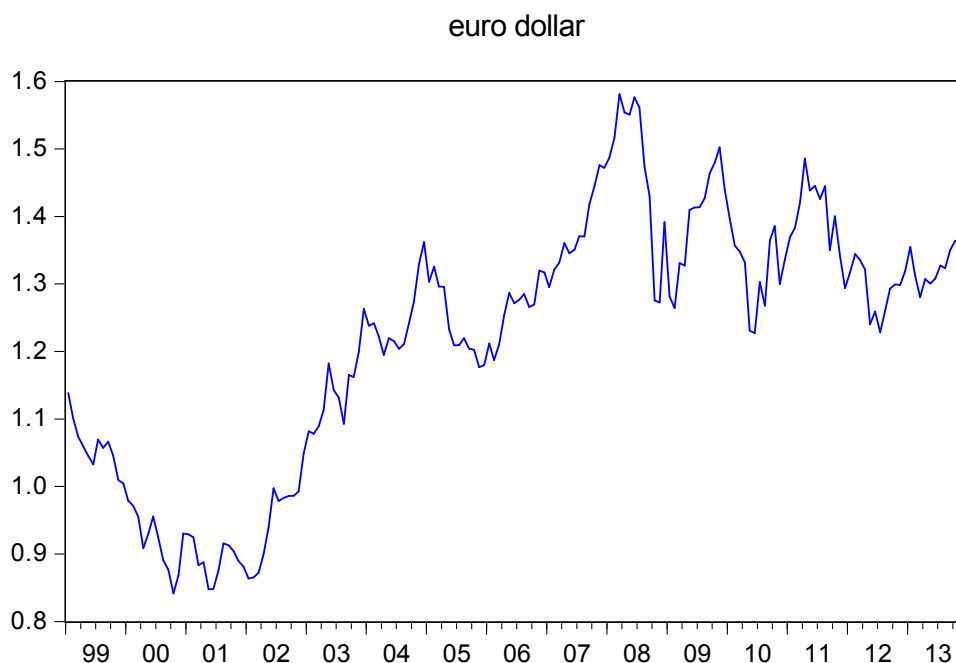
euro dollar

Figure 1. Exchange rate of euro-dollar January 1999-December 2013

Source: Own calculations according EUROSTAT data

The euro came into use starting on January 1, 1999. Basically, the euro has replaced the national currencies to move in all EMU countries and can be changed with any convertible currency. From this moment, the EU had to open borders to international capital through the liberalization of capital account.

The impact of a greater flexibility of the exchange rate implies a number of advantages and disadvantages. The EU has a number of advantages as a result of discouraging speculative inflows, more balanced distribution between operators gains and losses from foreign currency transactions, limiting the cost of central bank intervention, using an exchange mechanism compatible with inflation targeting. The major disadvantage derives from the decreasing predictability of euro and difficulties that arise when policymakers want to help the economy by lowering the exchange rate.

It should be noted that from the first moment of adopting the euro, the trade balance recorded deficits, the largest being in 2007-2008 on the expansion of imports and decreasing exports. During the same period, the euro began to depreciate sharply in relation with dollar. The evolution of EU imports and exports in the last five years was as follows:
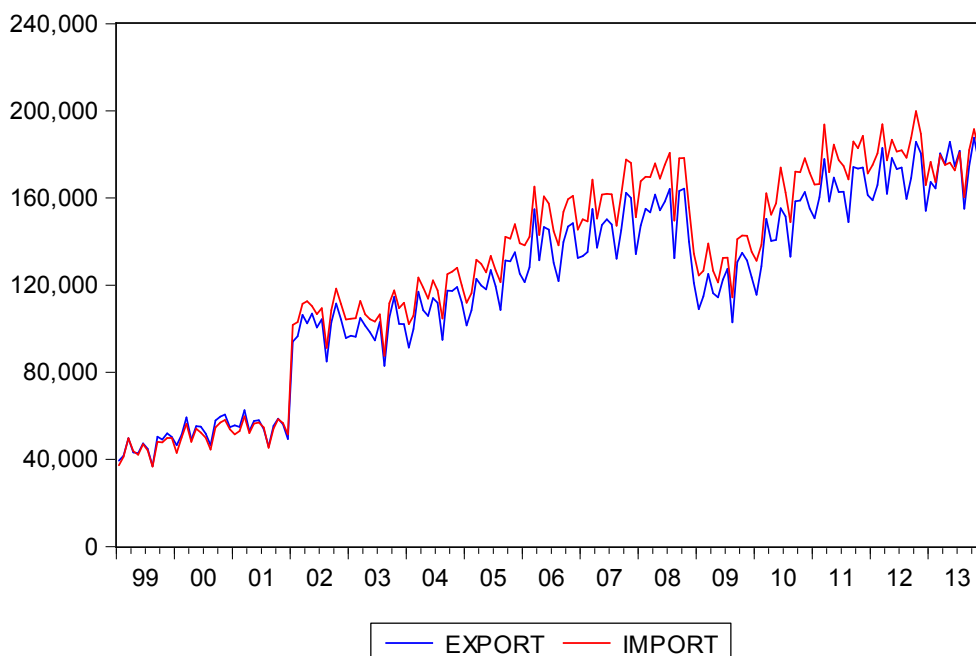
Figure 2. The evolution in EU trade balance 1999-2013

Source: Own calculations according EUROSTAT data

In the recent years, the EU trade balance was characterized by an increase in imports and a decline in exports. This deterioration was made largely on the fact that international trade partners of the EU bloc states were hit hard by the financial crisis, austerity and debt crisis.

4. Econometric Analysis

To determine the impact of the euro exchange rate on EU exports will be analyzed the regression between variable exports (dependent) and variable exchange rate (independent). The exports are variable outcome (is called exogenous or independent) and the exchange rate is the factor dependent or exogenous. The exports can be influenced by other factors, which are synthesized and represented into the final relationship as residual factors. Testing the relationship between the two variables mentioned is done for the period January 1999 - December 2013. The exports are expressed in monthly (million) and the exchange rate is given by the average monthly exchange rate of the euro against the dollar. Data are collected on the EUROSTAT website.

d(exports) = c + d(exchange rate euro_dolar)

To determine the stationarity of the two series, exports and exchange rate of euro_dollar, we used the Augmented Dickey-Fuller method. The results are presented below:

Table 1. The stationarity Test results for exports and exchange rate of euro_dollar series

Null Hypothesis: D(EXPORTURI) has a unit root				Null Hypothesis: D(USD_EURO) has a unit root			
Augmented Dickey-Fuller test statistic		t-Statistic	Prob.*	Augmented Dickey-Fuller test statistic		t-Statistic	Prob.*
		-5.741015	0.0000			-11.82872	0.0000
Test critical values:	1% level	-3.473672		Test critical values:	1% level	-3.472813	
	5% level	-2.880463			5% level	-2.880088	
	10% level	-2.576939			10% level	-2.576739	

Source: Own calculations according EUROSTAT data, using EViews7

As we can see, the two series are nonstationary but then become stationary by applying first differences of the original series.

In order to achieve the long-term relationship between the two variables, exports and exchange rate euro_dollar, they must be cointegrated. Below we present the Granger causality test results for the two previous series, d (exports) and d (euro_dollar).

Table 2. Test results for Granger causality between exports and euro_dollar series
Granger Causality Tests pairwise

Pairwise Granger Causality Tests

Null Hypothesis:	Obs	F-Statistic	Prob.
D(USD_EURO) does not Granger Cause D(EXPORTS)	154	0.64654	0.5253
D(EXPORTS) does not Granger Cause D(USD_EURO)		1.33681	0.2658

Source: Own calculations according EUROSTAT data, using EViews7

As we can see from the statistics associated to Granger test, the two sets influence each other.

Their integration in econometric analysis program, according to the model described, leads to the following results:

Table 3. Results of regression analysis of monthly average exchange rate EUR / USD and monthly value of exports for the period 1999-2013

Dependent Variable: D(exports)
Method: Least Squares
Sample (adjusted): 1 156
Included observations: 156 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.005060	0.002261	2.237397	0.0267
D(USD_EURO)	-0.050243	0.072531	-0.692714	0.0395
R-squared	0.300106	Mean dependent var		0.004990
Adjusted R-squared	0.200367	S.D. dependent var		0.028170
S.E. of regression	0.028218	Akaike info criterion		-4.285010
Sum squared resid	0.122619	Schwarz criterion		-4.245909
Log likelihood	336.2308	F-statistic		0.479852
Durbin-Watson stat	1.443559	Prob(F-statistic)		0.489532

Source: Own calculations according EUROSTAT data, using EViews7

The obtained relations shows a direct link between the exchange rate of the euro against the dollar and exports of EU bloc, the relationship between the two variables is given by the following formula: *exports=0.005060-0.050243*exchange rate*

The above relationship can be interpreted as follows: the increasing of exchange rate with one euro (currency depreciation), the exports increase by an average of 357,583,300 Euros.

However, the growth of exports is not sustainable in the long term without measures to increase competitiveness. The exchange rate depreciation can also manifest destabilizing macroeconomic effects, while the EU economy is characterized by a high degree of indebtness.

R-squared measures the accuracy with which the variable result is explained by the evolution of the variable factor, namely the measure of progress is the dependent variable explained by the independent variable. The value obtained show that 30% depreciation of the euro has implications for increasing the volume of exports, but their evolution is explained by other factors. Amid the financial crisis, the demand and international trade decreased, and currency exchange ratio was not a sufficient stimulus to influence international trade.

The link, significant weak, between the exchange rate and exports is reflected by the graphical representation of data points coordinates X (average trimestrial rates of exchange between the euro and dollar) and Y (exports expressed in million Euros) and line regression equation obtained from the econometric analysis results above. It is noted that the cloud of points with the highest density corresponds to a low rate of euro / dollar and the volume of exports.
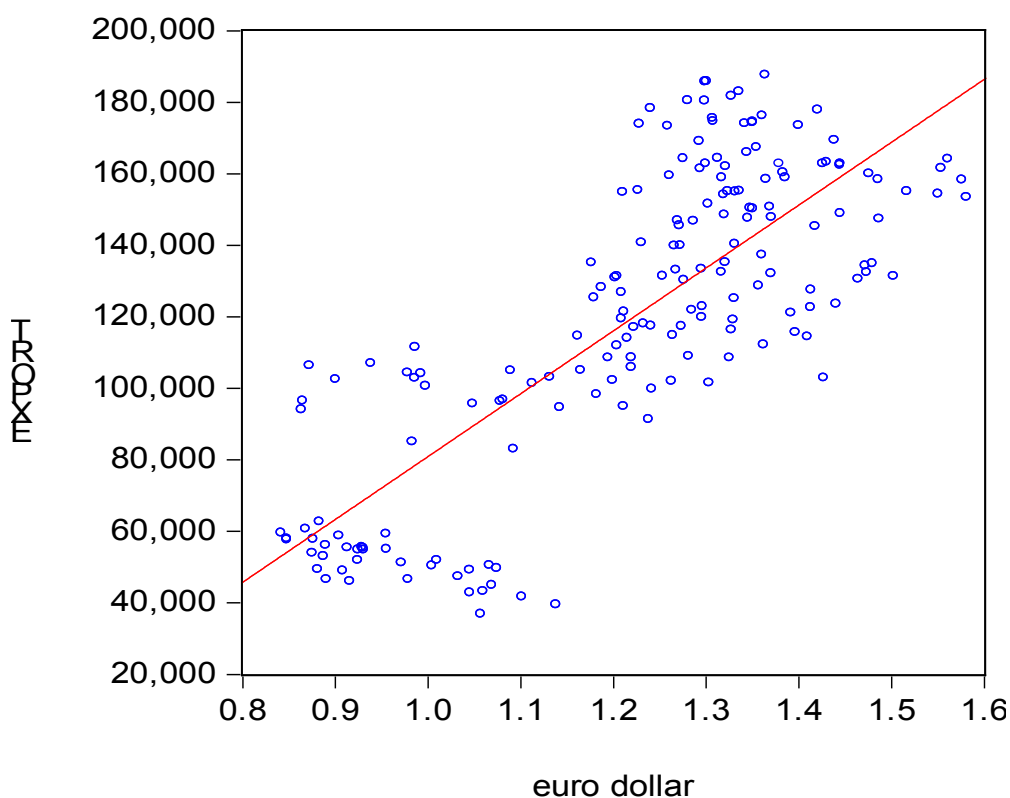

Figure 3. The relationship between the exchange rate of the euro-dollar against EU exports
Source: Own calculations according EUROSTAT data

The positioning of points in the above chart shows that currency depreciation does not correspond to a large volume of exports. The graphical representation allows us to see that the two variables is weak link statistically significant. However, we cannot remove the theory that a depreciation of the euro products can give price advantage to foreign products.

5. Conclusion

Given the outbreak of the international financial crisis, more and more states have raised the possibility of currency depreciation to boost exports. The free-floating currency regime and Central Bank intervention in the market and especially the speculators led to low volatility in euro. The analysis on the example of the EU shows that the depreciation of the euro has little influence on exports, not being able to completely eliminate the positive effects of devaluation on export volume growth without losing any observed adverse effects that could destabilize the European economy.

6. Acknowledgement

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Entrepreneurship

Entrepreneurial Call for Strategic Agility in Fast-Paced Business Environment

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Abstract: The 21st century came with blending of threats and opportunities of deep-rooted obstructions of fast-paced business environment. Research on strategic management has consequently increased and grabbed the attention of both academicians and strategic policy makers. The current study is therefore directed to analyze the multifaceted influence of entrepreneurial orientation on strategic agility and organizational performance. The study uses exploratory approach; primary data is collected from 323 professional working in private sectors in twin cities of Islamabad and Rawalpindi, Pakistan. The study found significantly positive relationship between entrepreneurial orientation and strategic agility, entrepreneurial orientation and organizational performance, and strategic agility and organizational performance. The study discusses important implications regarding entrepreneurs' deployment of entrepreneurial orientation and strategic agility for enhancing organizational performance.

Keywords: Entrepreneurial Orientation; Innovation; Competitive Aggressiveness; Autonomy; Strategic Agility

JEL Classification: L26

1. Introduction

Literature have been extensively grasping strategic management in both academic and business dialect due to exuberated contingencies between managerial practices inside the organizations and entrenched drastic impediments of this fast-paced business era. The reasoning behind this dilemma is the vitality of business environment leaving organizations adherent to continuously adjust according to the needs and demands of these evolving environmental uncertainties. Drucker (1958)

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argued that the managerial foremost and deep-seated prospect is the continuous development of organization as well as its employees.

Extending the idea it is suggested that entrepreneurs necessitate the utmost exploitation of entrepreneurial orientation so as to cope with environmental uncertainties. Kuratko et al. (1994); Kuratko et al. (1999); Kuratko and Hodgetts (2001) advocate that now days managers in their organizations incorporate various entrepreneurial activities to prevent environmental stagnancy because of a lot of problems they encounter such as increased number of rivals in the marketplace, obsoleteness of traditional modus operandi, lasting global competition, and the needs for innovation and advancements. In addition, for organizations coping with unforeseen business environmental changes have led to the evolution and conceptualization of strategic agility. According to Kidd (1994) agility is defined as the pro-activeness and rapidity of enterprise to heading on unanticipated and unpredicted changes. Another school of thought referred agility to be the successful and significant appliance for entrepreneurial competitiveness based on innovation, quality, flexibility, and speed for integrating reconfigurable managerial practices and other resources for confronting knowledge-rich environment so as to provide meaning driven products and services in fast-paced business environment (Yusuf et al., 1999). Many other researchers focused on speed and flexibility as the essential and foremost of components of agility (Gunasekaran, 1998; Sharifi and Zhang, 1999).

In sum, the premise is the appropriate deployment of entrepreneurial orientation as well as the entrepreneurial needs for strategic agility; resulting in overwhelming consequences on organizational competitiveness and higher organizational performance. Thus, the study aims to measure the multifaceted influence of entrepreneurial orientation on entrepreneurial strategic agility and organizational performance. Based on school of thoughts discussed above, the following research questions are central to this study:

1. Why is there a need for integrating entrepreneurial orientation with strategic agility in this fast-paced business environment?
2. What is the role of entrepreneurial orientation on organizational performance?
3. How entrepreneurial orientation and strategic agility improve organizational performance?

2. Review of Entrepreneurial Orientation & Strategic Agility

Research on entrepreneurial orientation and strategic agility is increasing in literature because of their realization and recognition in setting up strategic directions for entrepreneurs due to increased competition in the marketplace. Wiklund and Shepherd (2005) advocated that organizations that have incorporated

higher levels of entrepreneurial orientation possess greater ability to innovate and are more pro-active towards environmental uncertainties. Covin et al. (2006) defined entrepreneurial orientation as… "A strategic construct whose conceptual domain includes certain firm-level outcomes and management-related preferences, beliefs, and behaviors as expressed among a firm's top-level managers. Lumpkin and Dess (2001) associated entrepreneurial orientation to organizational engagements and endeavors for entrepreneurial activities and behaviors that are deemed to be the critical success factors for organizations. They categorized entrepreneurial orientation into five main dimensions such as innovativeness, risk-taking, pro-activeness, competitive aggressiveness, and autonomy.

Entrepreneurial innovativeness refers to the extent to which an organization is creative and unique in order to find out solutions to encounter prevailing threats (Knight, 1997). Thus, Morris and Kuratko (2002) proposed that entrepreneurial organizations are compelled towards taking higher risk because they give in higher returns through innovative offerings to targeted markets or niches. Autonomy refers to the core action taken by individuals or teams for carrying out a vision through completion. Competitive aggressiveness is the propensity of organizations to being able of confronting and challenging rivals and ultimately, improves organizational position. All the while, Lumpkin and Dess (1996) argued that this is the reason entrepreneurial organizations are more innovative and pro-active as they act in congruent to unpredictable changes in the marketplace. Hence, entrepreneurial orientation provides the fundamental basis for entrepreneurial strategic agility; resulting in twofold consequences on organizational performance.

Fliedner and Vokurka (1997); Overby et al. (2006) emphasized on the significance of strategic agility for organizational performance. They defined strategic agility as the momentous determinant of organizational success. Strategic agility is the speediness, flexibility, and ability of organizations to mitigate turbulent business hazards. In this context, linking strategic agility with entrepreneurial pro-activeness as Rauch et al. (2009) described it as organizational forward-looking perspectives and opportunity seeking characteristics to introduce new products and services in order to cope up with anticipated future demands and fast-paced competition. Similarly, Sharifi and Zhang (1999) argued that being pro-active and responsive towards changes taking place in the industry and exploiting opportunities in the marketplace are the main factors of agility. In addition, Sambamurthy et al. (2003) viewed strategic agility as an organizational dynamic capability to reconfiguring organizational resources in response to detecting external unanticipated changes. Many researcher including Goldman et al. (1995); Kidd (1994); Sharifi and Zhang (2001) supported the concept of agility and endorsed that strategic agility is ability of an organization to be responsive to the change and uncertainty in effective manners. Numerous studies conducted on organizational agility established links between organizational capabilities and organizational performance (Atuahene-

Gima, 2003). Researches on strategic agility including Charlene (2011); Patricia et al. (2006); Vandergriff (2006) emphasized on the significance of strategic agility on organizational performance. There has been a lot of research conducted and much literature is available on organizational agility and organizational performance. Entrepreneurs solely can't rely on either entrepreneurial orientation or strategic agility, but the integration of both is at the forefront for businesses to survive in such unpredictable environmental changes. Based on above-discussed literature the current study endeavors to measure the association of entrepreneurial orientation, strategic agility, and organizational performance. This study is unique in the context as it captivated the term in a strategic outer look and furthermore, it correlated entrepreneurial orientation and strategic agility together due to deteriorated fast-paced business environment to thrive organizational performance. The hypotheses in Table 1 can be developed based on previous theoretical discussion.

Table 1. Development of Hypotheses.

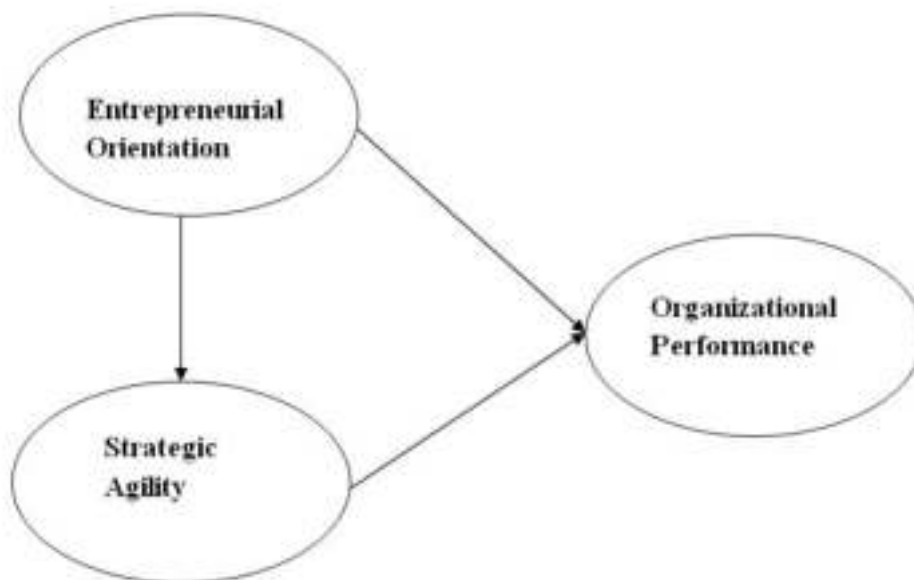| Hypotheses	Statements
H1 Organizational Performance is positively correlated with entrepreneurial orientation	
H2 Entrepreneurial orientation positively correlates with strategic agility	
H3 There is a positive correlation between strategic agility and organizational performance	

Figure 1. Entrepreneurial Orientation, Strategic Agility, & Organizational Performance

3. Research Methodology

3.1.   Sample and Sampling

The study is conducted to analyze the role of entrepreneurial orientation with mediating effect of strategic agility to enhance organizational performance. The current study is exploratory in nature and primary data is collected from professional working in corporate sector in twin cities of Islamabad and Rawalpindi, Pakistan. Researcher used convenience sampling technique for this research. A sample of 500 employees and survey questionnaire distribution process was personally administered by the research team. A total of 323 survey questionnaires were returned leaving a response rate of 65%.

3.2.   Measurement and Instrument

3.2.1. Dependent Variable

There are two dependent variables in this study. Firstly, strategic agility, which acted as a mediating variable in this study based on the above-discussed construct. Secondly, organizational performance. The instrument to measure strategic agility is adopted from Alzoubi et al. (2011). The instrument to measure strategic agility constitutes 28 items and is ranked on 5-point Likert scale (1 for Strongly agree and 5 for Strongly disagree). The instrument to measure organizational performance has been adopted from Li et al. (2008). The instrument contained 9 items and is ranked on 5-point Likert scale (1 for Strongly agree and 5 for Strongly disagree).

3.2.2. Independent Variable

The study is conducted to analyze the role of entrepreneurial orientation with mediating effect of strategic agility to enhance organizational performance. Thus, the independent variable is entrepreneurial orientation. The instrument for measuring entrepreneurial orientation is adopted from Li et al. (2008). The instrument contains 13 items and is ranked on 5-point Likert scale (1 for Strongly agree and 5 for Strongly disagree).

3.3.   Data Analysis

The data collected was initially fed into SPSS software and transformation of variables was done to make it usable for AMOS. Structural equation model (SEM) technique was used to analyse data and test hypotheses. The structural equation model is an important technique for identification of variables and development of theoretical model (Ali et al. 2010).

4. Results and Discussions

The study is conducted to analyze the role of entrepreneurial orientation with mediating effect of strategic agility to enhance organizational performance in corporate sector in Pakistan. The correlations analysis is produces in Table 2. Table 2 shows positive correlation between entrepreneurial orientation and strategic agility, entrepreneurial orientation and organizational performance, and strategic agility and organizational performance.

Table 2. Correlations

		EO	SA	OP
EO	Pearson Correlation	1	-	-
	Sig. (2-tailed)		-	-
	N	323	-	-
SA	Pearson Correlation	.872(**)	1	-
	Sig. (2-tailed)	.000		-
	N	323	323	-
OP	Pearson Correlation	.897(**)	.912(**)	1
	Sig. (2-tailed)	.000	.000	
	N	323	323	323

**Correlation is significant at the 0.01 level (2-tailed).

Table 3 shows very encouraging results. The value of P should be less than 0.05 in order to accept any hypothesis. All three value of P in Table 3 are well below than 0.05, therefore, we accept all of our hypotheses H1, H2, and H3. H1 refers towards the positive relationship between entrepreneurial orientation and organizational performance, which is confirmed by this analysis. H2 refers towards the positive relationship between entrepreneurial orientation and strategic agility, which is also confirmed by this analysis. Table 3 also confirms H3, which refers towards the positive relationship between strategic agility and organizational performance.

The results of reliability analysis are also very sound with 0.91 value of Cronbach's Alpha of all 3 variables of this study. Figure 2 describes the positive nature of the relationship among all the variables as shown in SEM.

Table 3. Regression weights.

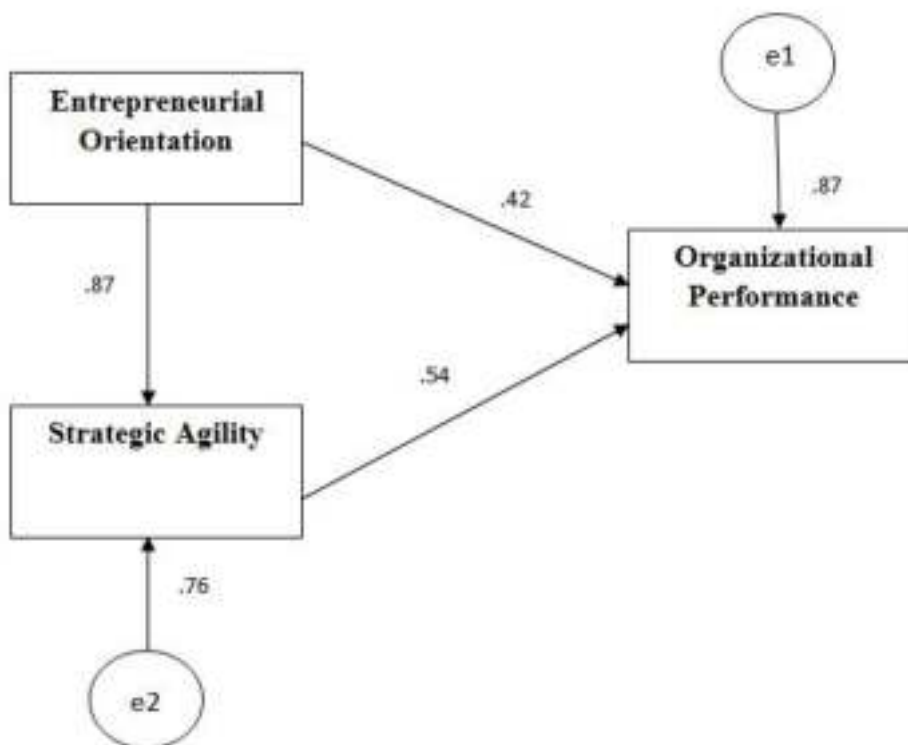| Hypotheses		Estimate	S.E.	C.R.	P	Decision
H1	OP < --- EO	0.309	.029	10.523	.000	Accept
H2	SA < --- EO	1.372	.043	31.956	.000	Accept
H3	OP < --- SA	0.251	.019	13.428	.000	Accept

Figure 2. Structural Equation Model

5. Conclusion

The study is conducted to analyze the role of entrepreneurial orientation with mediating effect of strategic agility to enhance organizational performance in corporate sector in Pakistan. It is the important study in the context that it provides additional and significant insights to management about the importance of entrepreneurial orientation and strategic agility in enhancing organizational performance in fast-paced business environment. The study found strong positive relationship between entrepreneurial orientation and strategic agility,

entrepreneurial orientation and organizational performance and strategic agility and organizational performance. These findings are very meaningful for both academicians and strategic decision-makers. It depicts that entrepreneurs can significantly enhance organizational performance through the deployment of entrepreneurial orientation and strategic agility in order to cope with this fast-paced business environment. The study also provides useful references for future research on this topic.

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International Economics

The Role of Urban Financial
Centers within the Economy of Global Cities

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Abstract: Nowadays, there is no doubt that state economy refers to city economy. In other words, the most part of a state's GDP is given by the urban environment, especially by capitals, which are often the economic engine of this environment. There are also cities having great economic importance abroad, beyond the state and even continental borders. These are the so-called global cities where the financial activities play an important role. There are a few cities (New York, London, Hong Kong etc.) centering financial activities which are influential for large geographic areas. This research highlights the importance of the financial sector within urban economy and, subsequently, how it consolidates the status of global city. These cities are the engine of the international financial system as they host the headquarters of the most important and famous international stock exchange markets, financial supervision institutions, law firms and consulting companies.

Keywords: urban economy; international financial centers; world cities

JEL Classification: G1; F6

1. Introduction

Nowadays humankind experiences certain economic interdependence which connects national economies and urban centers with each other. Global economy refers to city economy where the most dynamic and innovative urban centers gather ground and influence economic policies (Sassen, 1991). Cities are the engines which make their countries develop and they are also gates for their regions.

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Parag Khanna's (2010, p. 42) thoughts suggesting the same ideas may also be added here: "The twenty-first century will not be dominated by America or China, Brazil or India; the city will do this". Within a time when management is more and more difficult, Khana notices that it is cities, not states that become governance islands. Global cities – the most powerful and influent cities of the world – will represent the basis of the future world; a new world that will look like a network of different global cities. In other words, the globalization story is the same as the urbanization story.

Most researchers connect urban economy to commercial, industrial, financial and real-estate activities (Kindleberger, 1974, 1985; Gehrig, 1998). Previous economic segments are regarded as corresponding to the urban area creation by certain researchers (Smith, 2008; Lefebvre, 1991). Urban crowdedness appears as a result of the interactions between scale economies - that affect production - and market size. That is why only 100 cities provide 30% of the global economy and wholly concentrate the world innovation (Khanna, 2010).

More and more economists have been interested in studying urban economy and in the issue regarding the placement of the economic structure within the urban environment (Henderson, 1988; Krugman, 1991a; Becker & Murphy, 1992). Sometimes, for example in Krugman's (1991b) or Fujita and Thisse's (2000) cases, urban economy overlaps the process of urban crowdedness. The last two previously mentioned researchers, for example, argue that economic crowdedness appears when different economic units (restaurants, cinemas, stores etc.) try to sell similar products in a certain urban area, thus losing sight of the importance of the financial sector which is greater if the city is larger. Neglecting this aspect is striking, as Mainelli (2006) noticed that, according to the domain literature related to financial centers, concentration is important and leads to crowdedness.

An increase in the service sector and the growing need for highly-qualified people are fundamental characteristics of urban economies. The financial sector, which controls the most important cities of the world (Sassen, 2000, p.81), mostly requires highly-qualified people.

Starting from the premise that the financial sector is a growing domain which occupies more and more of the urban economy, this article tries to point out the place and the role financial centers have within city economy. The present analysis is also related to a second purpose, namely to highlight if there is any objective connection between the size and importance of financial centers and the status of global cities that some urban areas have; and, to what extent the importance of financial centers is as great as the importance of global cities. The question to be asked is: are there hierarchical similarities between financial centers and global cities?

The extraordinary global evolution of finance over the last thirty years has proved us that competition among the big world cities in order to control the main international cash-flow has grown (Poon, 2003). There is a lot of evidence that shows that the important financial centers are fighting for their primacy within the global hierarchy, acting like *capitals of the world* at the same time (Khanna, 2010). Among the most objective evidence we mention the overall focus of financial activities and productivity. A mere look at the latest hierarchies regarding the urban financial centers shows a real "fight" between London and New York. (Engelen & Glasmacher, 2013). These two cities, which – together with others – are considered capitals of the capital by Cassis (2006), concentrate the biggest volume of share investment, both by value and by the risk involved. From the historical point of view, the urban financial sector evolution places New York on the first position as the leader of global finances after the World War II. (Cetorelli & Peristiani 2013).

2. The Analysis of the Literature

2.1. The International Financial Centers

When thinking of financial centers, we recall the names of the large cities (Gehrig, 2000), where, according to Jarvis (2011) and Poon (2003), competition for money is bigger and bigger. Historically, in the eighteenth and nineteenth centuries a few large financial centers appeared in order to serve the regional and international markets regarding the volume of economic exchange. Their complexity has grown since that time. Frankfurt, Amsterdam, Florence, London, Milan, Paris, New York, Rome, Philadelphia, Torino, Venice, Shanghai and Zurich, appeared as leading financial and commercial centers (Fratianni, 2009).

There is no widely-accepted definition of *financial center*, but, generally speaking, a financial center must have the following characteristics (Ogloblina, 2012; Lennoo, 2007): to own stock markets, to host numerous international financial institutions, the headquarters of worldwide famous surveillance institutions, central banks, together with law firms and consultancy companies, all in the same location (Mainelli, 2006).

Financial centers have become a dynamic concept, with efficient strategies designed to obtain and keep the brand of financial center (Lennoo, 2007). Authors such as Engelen şi Glasmacher (2013) speak about the urban financial centers in terms of *financial modernities*, pointing out their importance for the city economy and innovation. Briefly, financial centers can be defined as locations where important financial institutions are gathered and where there is considerable mobilization and redistribution of financial resources (Ogloblina, 2012).

The Global Financial Centers Index (GFCI) sets three axes which determine the financial center profile: connectivity, diversity and specialization. According to GFCI, the first axis, *connectivity,* refers to how famous the financial center is worldwide and to what extent non-resident specialists consider that there is a tight connection between that financial center and other financial centers. *Diversity*, the second axis, refers to the number of activity sectors (financial mediation, insurance, fund administration etc.) within a financial center. The last axis, *specialization*, refers to the activities related to the sectors: investment management, insurances, professional services (redesigning the business model, access to funds, selling and buying assets etc.) (Yeandle & von Gunten, 2013).

A financial center is considered to be competitive due to a combination of indexes. These indexes were grouped by GFCI researchers as it follows: (1) the human resource, (2) the business environment, (3) market access, (4) infrastructure and (5) competitiveness (Yeandle & von Gunten, 2013, p. 32). We will briefly present each factor for better accuracy and understanding of the analysis method. For example, regarding *the human resources*, the urban financial center analysis takes into account the human development index (HDI), the purchasing power, life quality, number of graduates from the economic and juridical fields, the human security index etc.

For the *business environment*, the factors taken into account are: the ease of doing business index, the operational risk rating, the real interest rate, the economic increase rate of the city, profit tax, corruption perception, the city GDP or the taxation for employees. Market access means, in fact, the index of market access, stock market capitalization, value and amount of transacted stocks and bonds, amount of ongoing futures and options contracts, mutual fund assets and, last but not least, the external position of domestic and central banks.   Regarding *infrastructure*, the urban financial centers have to provide quality services such as: office centers both in and outside the city, efficient means of transport (by road, air or rail) and well-functioning IT logistics. The index of financial center *competiveness* is made of: the contribution and safety of direct foreign investment, the ratio between the city GDP and the national GDP, the innovation index, the price level and the global power city index, its global attraction. Obviously, there are other aspects in addition to these but we cannot approach them due to space reasons.

Financial centers are part of a hierarchical organization of finance, communications and management. In 2000, the International Monetary Fund divided financial centers into *international financial centers* (IFC), *regional financial centers* (RFC) and *offshore financial centers* (OFC) (Lennoo, 2007). IFC provide a wide range of financial services and are characterized by liquid markets (London, New York, Tokyo). Within these financial centers, international banks as well as important financial supervision institutions place their headquarters. RFC rely on well-

developed financial markets and infrastructure associated with internal economies and regional banks which make regional fund transfer possible. OFCs are much smaller and provide a limited range of services. These centers refer to those countries with a financial sector which is larger than the economy itself and the taxation system is more relaxed. Different OFC - financial services are designed for non-residents mainly.

Lately, the major events all over the world have influenced the status of IFC. Cetorelli şi Peristiani (2013) state that, due to the Soviet Union disintegration, China's turn to authentic market economy and the creation of the European single market, the markets have integrated very quickly, especially after 1990. These international changes motivated the traditional financial centers (New York, London), and a few new locations (Hong Kong, Singapore) were generated by the necessity of financial services in order to develop new businesses. Consequently, there are a few cities that can be considered international or global financial centers (Poon, Eldredge & Yeung, 2004): Paris, London, Frankfurt and Zurich – in Europe; New York, Chicago and Toronto in North America; Tokyo, Hong-Kong and Singapore – hosting the most powerful financial centers in Asia.

Why are financial centers so important for cities? Well, Sassen simply answers this by making a comparison. He states that, while industrial services can hardly survive, the financial ones make supernormal profit (Sassen, 2000). The presence of numerous financial services and their concentration in *localized forms* (Sassen, 2000) enhance their status of global cities.

2.2. Global Cities – Concept, Terminology, Characteristics

Going further, realizing the analytical connection between the financial centers and global cities means understanding the conceptual aspects which define global cities. However, we must mention that many supporters of global cities agree to the idea that the existence of a sophisticated financial complex is a precondition for global city appearance (Poon, 2003, p. 137).

So, what are global cities and what makes them remarkable? The first who makes this methodological and theoretical reference is the sociologist Saskia Sassen in his famous work *The Global City: New York, London, and Tokyo* which was first published in 1991. His concept was soon adopted and developed by researchers of different fields (Acuto, 2013; Mayaram, 2009; Brenner & Keil, 2006; Beaverstock, 2002; Child Hill & June, 2000; Abu-Lughod, 1999), as it was refering to a new reality. Some authors use terms such as *world cities* (Jacobs, 2013; Massey, 2013; Derudder & Witlox, 2011; Knox & Taylor, 1995) or *alpha cities* (Globalization and World Cities Research Network, 2014) in their works, which refer to the same reality described by Sassen.

Returning to Sassen's original ideas, he argues that after the '60s of the previous century, the economic activity started changing and, at the same time, global economy deeply influenced city life. The author's idea fits the classical pattern of the economy-space ratio. Global cities are those urban centers considered to be important knots in the economic world system. For example, the economy of New York is greater than the 46 national sub-Saharan economies together, and there are more tourists coming to Hong Kong than to India per year (Khanna, 2010). The economic power concentrates in global cities while the former production centers suffer (Sassen, 2000).

Although (as we have already noticed) the term has been launched by a sociologist, its origins are in geography and urbanism study. The concept is based on the interpretation according to which globalization is deeply created, facilitated and adopted in geographically strategic places for the global finance and commerce system functioning. Global cities are command centers as they mean power, sophistication, wealth and influence (A.T. Kearney, 2008). The urban centers that have the largest capital markets, elite universities, the most diverse and educated inhabitants, the largest multinationals and the most important international organizations, are connected with the rest of the world more than any other place and they are the real global cities.

According to A.T. Kearney (2008) company researchers, global cities are analyzed by paying attention to the following five dimensions: (1) the economic activity, (2) the human capital, (3) the information exchange, (4) the cultural experience and (5) the political commitment. Together, these five analysis components outline the hierarchy of the global cities.

Taking them on turn, as we did when classifying the financial centers, these five dimensions are composed as it follows. The economic activity is an indicator made of the value of the capital markets, the number of companies in Top Fortune Global 500 having their headquarters in the city and the amount of goods transiting the city. By human capital we mean aspects such as: how the city attracts different groups of people and talents, the number of immigrants within the city, the number of international schools and the percentage of residents who have university diplomas. The information exchange refers to the following aspects: how well news and information are spread in the city and to the rest of the world, the number of international mass-media offices, the amount of international news in the most important local newspapers and the number of internet subscribers. The fourth aspect, the cultural experience includes the number of attractions (not only the tourist ones) for foreign residents and for tourists, the number of major sports events hosted by the city and others. Finally, the last dimension that refers to the political commitment is made of the data referring to how a city influences the global politics and dialog plus the number of embassies, consulates, international

organizations, the relationships with other cities and the number of conferences hosted by the city.

The cities in this category are world leaders in fields such as: finance, politics and culture. Some of them are megacities of a developing world and their demand for resources urges them to establish close relationships with their neighbors and to provide services to more and more immigrants. A paradigm of the world we are living in finally appears, namely the fact that cities like Seoul, for example, have more things in common with Singapore or Hong Kong, than with smaller cities in South Korea (Mendoza Pena & Hales, 2012).

3. Methodological Explanations

This research is based on detailed analysis of the domain literature regarding the key-terms used in the text. Taking into account the latest research, we have also used the works about the two main concepts (global cities and financial centers) which places our research within the context of international financial reality.

Regarding the analysis of how important it is for the global city economy to concentrate the financial activities, we had to refer only to the first twenty global cities. Thus, the studies referring to the two classifications – global cities, on one hand, and international financial centers, on the other hand – include only a few cities. As for the global cities, Andres Mendoza Pena and Mike Hales's (2012) study includes only 66 cities, while 79 international financial centers are analyzed (Yeandle & von Gunten, 2013). We mention this in order to point out the importance that the cities presented in the two classifications have for the global economy, taking into account the fact that, at a global level, the number of cities (including those with hundreds of thousands of inhabitants) is impressive. We also had to focus our analysis to the most important global cities in order not to waste the essence of the topic by providing too many useless details. However, we are certain that the results of this study can also be applied to the other urban centers that are globally important.

The statistical data provided by the two studies (*2012 Global Cities Index and Emerging Cities Outlook* and *The Global Financial Centers Index 2013*) and by *Global Metro Monitor* (Istrate & Nadeau, 2012) were really helpful to us. The analysis of the information in the three sources generated interesting comparisons among the twenty global cities.

3.1. The Role of Financial Centers For The Urban Economy

Global Cities/ International Financial Centers Ratio

The first aspect of our discussion is centered on the ratio between global cities and the international financial centers. Thus, the table below shows a few critical aspects of the current analysis. First of all, a real connection between the importance of global cities and their financial sector can be noticed. Except for Los Angeles and Berlin, the first twenty global cities are very important for the international financial centers hierarchy. Moreover, New York and London "fight" for the first position not only regarding the global city hierarchy, but also regarding the financial supremacy where the American metropolis is behind the British one.

According to the data, Europe is the most important continent from the financial point of view, as 20 European cities are part of GFCI 2013 hierarchy. This time Zurich (5), Geneva (7) and Frankfurt (10) (Yeandle & von Gunten, 2013) are found together with London (1), Vienna (20), Paris (26), Brussels (46), Madrid (51) and Moscow (65) which are in the table. Even if they are among the most powerful and influential global cities, they are lower within the international financial hierarchy. One explanation is that, because they do not have a tradition and they are geographically close to the traditional ones, the most important financial flows and services have been taken over by the traditional ones.

The second place regarding the ratio between global cities and international financial centers is occupied by Asia. There are a few powerful financial centers here: Tokyo (6), Hong Kong (3), Seoul (9) and Singapore (4). For our analysis, the power of these cities is given by their GDP (both the total GDP and the GDP per capita). Tokyo is by far the most important international economic center due to its GDP which is $310 billion more than New York's GDP. The economic power of the Japanese metropolis is amazing by also considering the difference which separates it from New York, difference which almost equal to the GDP of cities such as Hong Kong ($350.4 bn.), Singapore ($327.2 bn.) or Boston ($320.7 bn.). Paradoxically, these cities have very important international positions from the financial point of view (Hong Kong – third position, Singapore – fourth position and Seoul – ninth position), two of them coming before Tokyo. The strategic advantage Hong Kong had in the '80s-'90s regarding the connection of the global capital to the Chinese market meant a rapid development of the economic sector, especially the finance (Lai, 2012).

The fact that Latin America is not present in any of the two hierarchies in the table – which could have contributed to the importance of the American continent – is compensated by the presence of New York, Los Angeles, Chicago, Washington, Boston, Toronto and San Francisco, all representing the Anglo-Saxon America. Among these urban areas, New York is relevant for its economic power, its financial importance and its global sphere of influence. Except for New York, other

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ten cities (Boston, Frankfurt, Hong Kong, London, Paris, Singapore, Sydney, Tokyo, Toronto, and Zurich) are considered to be *global leaders of finance* (Yeandle & von Gunten, 2013, p. 10), as they are involved in a wide range of financial activities and are connected to other financial centers.

Table 1. The twenty most important global cities

No	City	GDP (Bn. USD)*	Population (million)*	GDP per capita (USD)*	Business and Finance [% of the city economy]*	The place within the global city hierarchy (2012)**	The place within the international financial centers hierarchy (2013)***
1.	New York	1,210.3	19.1	63,238	40.3	1	2
2.	London	731.2	14.0	41,978	47.8	2	1
3.	Paris	669.2	12.4	53,881	47.4	3	29
4.	Tokyo	1,520.3	36.6	41,016	11.7	4	6
5.	Hong Kong	350.4	7.2	48,672	29.1	5	3
6.	Los Angeles	786.7	13.0	60,486	31.4	6	-
7.	Chicago	524.6	9.5	54,953	33.5	7	11
8.	Seoul	773.9	24.0	32,155	27.6	8	9
9.	Brussels	245.3	5.4	45,687	34.5	9	45
10.	Washington	415.2	5.8	71,536	37.8	10	14
11.	Singapore	327.2	5.2	62,573	26.1	11	4
12.	Sydney	205.1	4.5	45,377	55.8	12	15
13.	Vienna	179.8	3.3	47,841	28.0	13	23
14.	Beijing	427.2	21.1	20,275	19.5	14	58
15.	Boston	320.7	4.5	69,388	36.8	15	8
16.	Toronto	280.6	5.7	43,905	38.4	16	12
17.	San Francisco	306.6	4.4	68,974	34.7	17	13
18.	Madrid	254.0	6.5	40,007	30.1	18	41
19.	Moscow	520.3	11.6	44,774	29.0	19	45
20.	Berlin	145.3	4.3	33,311	35.8	20	-

* Global Metro Monitor; ** 2012 Global Cities Index and Emerging Cities Outlook; *** the Global Financial Centers Index

The second aspect of our analysis is focused on the importance of the financial sector for the internal economy of cities, and for this reason we need to look back at Table 1. The total percentage value of finance and businesses provides a new context for the city economy. In this context, obtaining financial flows becomes a priority for those urban areas that want to be command centers for the global economy.

Besides Beijing, with less than 20% in business and finance, all the other global cities' economy is based on finance and related sectors. The financial sector is the most important even in Los Angeles and Berlin, cities which are not included in the hierarchy of international financial centers: 31.4% for the first city and 35.8% for the second one. London (47.8%), Paris (47.4%) and New York (40.3%) are clear examples of the urban strategy for finance-based economic development.

According to a study of The Economist Intelligence Unit (2013), London is the most competitive city and the greatest financial center at the same time. London's financial clusters helped the city become a financial leader worldwide. *The City* cluster is a "financial city" and juridical center of Great Britain allocating about 7.7 million square meters to office spaces. It is considered a "home" for about 1600 companies from 60 countries and 42 activity sectors and more than 300 thousand employees work here, half of them activating in finance, banks, insurance and

accountancy. The *Canary Wharf* is the second important cluster, especially due to its large number of international banks, agencies and companies providing professional services (Barclays, Citigroup, Credit Suisse, Fitch Ratings, KPMG, Thomson Reuters, and J.P. Morgan) and having their headquarters here.

In the middle of the city, *London Stock Exchange (LSE)* is the most important European stock exchange and one of the biggest all over the world. The LSE status can be accessed only by certified investment and credit companies within the European economic area. LSE is made of two different stock markets: *Main Market (MM)* and *Alternative Investment Market (AIM)*. MM represents the symbolic market for listing shares, bonds and other financial titles of the largest famous companies. AIM is meant to help small and medium- seized companies to increase the capital they need in order to develop (Mionel, 2013).

Looking back at Table 1, we notice that the financial sector has obvious importance for the host-city economy. Mainly, the 47.8 percentage meaning the financial sector of the London economy represents $ 349.5 billion. The 47.4% of the Paris economy represent more than $ 317 billion. And for New York, the income provided by financial and business activities equals the fabulous sum of $ 487.6 billion.

New York is the second most important financial center of the world and also a traditional one. The US concentration of investment banks and their domination on the market left the other competing national financial centers behind (Sassen, 1999). According to Poon (2003), New York is a *financial supercenter* due to the dimension of the financial market on one hand, and, on the other hand, due to the ability of getting a solid informational basis that allows the global exploitation of information asymmetry. A better regulatory environment (Mainelli, 2006) connected to a high level of transparency can also be added.

Since the American dollar is the mainly used currency in international transactions and the internal market of the city is large, the New York monetary sector seems to be quite privileged. Even if it is on the second position in the hierarchy of international financial centers, New York still dominates the capital market made of the city institutional clusters such as the New York Stock Exchange (*NYSE*). NYSE has been superior to other American stock exchanges since the time of the telecommunication revolution in the middle of the nineteenth century. According to Cassis (2006), NYSE developed as the real American national financial market. We naturally add that nowadays New York functions as a real international financial market which is the symbol of the financial power this global city has.

The comparison between the urban economies of Tokyo and New York shows (as we have seen above) the superiority of the Japanese metropolis. But the contribution of the financial sector (which is quite important for Tokyo – $ 481.8 billion) is much bigger in New York. The Table 1 shows that the income given by

the financial sector of these two urban economies places the cities on the eighth and ninth positions in the total GDP classification in the third column. Moreover, if we compared the financial income to the income of some states, we would notice unequal income distribution and how concentrated financial services are in a few cities. The income of business and finance places New York and Tokyo before some states such as Argentina ($ 474.9 billion), Austria ($ 398.5 billion), South Africa ($ 384.3 billion), Thailand ($ 365.5 billion), Denmark ($ 313.6 billion) or Finland ($ 250.1 billion).

According to Global *Metro Monitor (2012)* report*,* the only economic fields which compete with the financial field regarding the income provided to the global cities are *the local/non-market services* and *commerce and tourism* together. Local/non-market services include: dump goods management, maintenance services, education, health and others. Regarding the internal economy percentage, with few exceptions, financial services are not outmatched by the local/non-market services. Here are some examples: New York (37.2%), London (15.2%), Paris (20.9%), Tokyo (15.3%), Hong Kong (18.5), Los Angeles (37.5%), Chicago (33%), Boston (38.7%), Beijing (35.3%) etc. Tourism and commerce, on the other hand, provide higher percentages than the financial sector only in Hong Kong (31.5%) and Moscow (37.2%).

Despite the fact that tourism holds a higher share of the internal economy than finance, Hong Kong is still the leading international financial center in Asia. Being placed on a higher position than Beijing and Shanghai within the Chinese internal competition and preceding the Singapore state-city, Hong-Kong remains an undeniable global leader in the finance and bank field (Lai, 2012). The *Hong Kong Stock Exchange (HKSE)* had a great contribution in reaching one of the three leading position and in staying in the world top of financial centers. Unlike the Shanghai Stock Exchange which mainly attracts local, generally small companies, oriented towards the internal Chinese market, HKSE focused on attracting large, internationally-oriented companies. Honk Kong's success is mainly due to HKSE's success. The stock exchange strategy proves courage and openness. The companies which are listed at the stock exchange are not only globally important, but they are also similar to the most dynamic and competitive companies, activating in specialized service fields (banks, insurances, telecommunications and informatics technology). At the end of 2012, there were 1547 companies listed at HKSE (World Federation of Exchanges, 2013). This large number of companies points out a few positive aspects of the Hong Kong Stock Exchange. It has a liquid market, capable of catalyzing important capital into convertible currency. It increases the international reputation for the transacted labels, which represents an advantage for the overseas labels expansion. The listing process is quite rigid and it stimulates the corporate governance and the assessment of the listed companies (Lai, 2012). The magnetism of the stock exchange is also reflected by the impressive density of the

financial service companies which form profile clusters that benefit from the rewards associated to this aspect. According to Jarvis (2011), Hong Kong has an impressive portfolio of licensed banks (more than 200, out of which 145 have foreign capital), including 69 which are among the first 100 in the world. Thus, specialists consider the bank sector in Hong Kong a developed and various one (classical bank deposits, financial titles, treasury activities, precious metal trade etc.) Finally, the data in the table show us that the total GDP of the first twenty global cities represents $ 10,179.1 billion, which is 14% of the world's GDP. The economic power of these global centers is based on the financial sector reaching an average of 33.71%. In other words, $ 3,430.9 billion are obtained only due to the financial activities in the twenty most important cities of the world.

4. Conclusions

Concentrating about 1/6 of the world GDP in only twenty urban centers (which are not necessarily the largest considering the population number), the global cities have been dealing with the world finance despite the obstacles created by the cyberspace. Although online transaction platforms and other such modern informatics instruments provide solutions for profit maximization, companies will need a command center, a headquarters which will manage all the activities. Consequently, the economic clusters in general and the financial ones in particular will not disappear but they will paradoxically consolidate and will gather more and more profile companies. Some of them enter the new market niches provided by their location and by certain increasing services within cyberspace. More concentrated financial activities lead to a diminished role of some financial centers or, more than that, to the disappearance of some very important international financial centers. Those that will keep their status by competitiveness and by quality services will have benefits. The income resulting from financial activities is more and more consistent so it could even exceed the 50% threshold of the urban economy in some cases. Considering all these, the international financial activities will definitely keep New York and London as leading financial centers due to their enormous concentration of resources and talents. They have the ability of "packing the capital in innovative ways" (Sassen, 1999) by working with their subsidiaries (in secondary cities) where they have exported certain financial services.

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