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## 2001

### Allied Academies Internet Conference

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# **Proceedings of the Allied Academies Internet Conference**

**2001**

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Co-Editors  
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# THE ACADEMIC FIELD OF FINANCE: THE CONTEXT AND STRUCTURE OF ITS PARADIGM

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## ABSTRACT

*The purpose of this paper is to provide an overview of the paradigmatic context of the current theories and controversies in mainstream academic finance. It identifies such a context first among paradigms and then within the identified paradigm. The paper, therefore, starts with the discussion of how worldviews underlie theories and controversies in general, and those of finance, in particular. It discusses how any worldview can be positioned on a continuum formed by four basic paradigms: functionalist, interpretive, radical humanist, and radical structuralist. Then, the paper looks at the finance theories corresponding to each paradigm. It notes that theories and controversies in mainstream academic finance, despite their apparent diversity, are founded on and associated with the functionalist paradigm. It also notes that the non-mainstream theories are underwritten by the other three paradigms. Then, the paper continues with the discussion of the hierarchical structure of paradigms. It discusses that it consists of three consecutive levels: paradigm; metaphor; and puzzle solving. It looks at a sample of prominent controversies in academic finance and notes that they belong to the substructure of the functionalist paradigm. Throughout, the paper emphasizes that, in the future, mainstream academic finance should benefit from the contributions of the other three paradigms.*

## INTRODUCTION

The purpose of this paper is to provide an overview of the paradigmatic context of the current theories and controversies in mainstream academic finance. It identifies such a context first among paradigms and then within the identified paradigm. The paper, therefore, starts with the discussion of how worldviews underlie theories and controversies in general, and those of finance, in particular. It emphasizes the role of paradigms in the development of theories in general, and those of finance, in particular. It discusses how any worldview can be positioned on a continuum formed by four basic paradigms: functionalist, interpretive, radical humanist, and radical structuralist. Then, the paper looks at the finance theories corresponding to each paradigm. It notes that theories and controversies in mainstream academic finance, despite their apparent diversity, are founded on and associated with the functionalist paradigm. It also notes that the non-mainstream finance theories are underwritten by the other three paradigms. Then, the paper continues with the discussion of the hierarchical structure of paradigms. It shows that it consists of three consecutive levels: paradigm; metaphor; and puzzle solving. It looks at two controversies in mainstream academic finance and notes that, despite their apparent diversity, they belong to the substructure of the functionalist paradigm. Throughout, the paper emphasizes that, in the future, mainstream academic finance should benefit from the contributions of the other three paradigms.

This paper crosses two existing literature; philosophy of social science and finance. More specifically, its frame of reference is Burrell and Morgan (1979) and Morgan (1980) and applies their ideas and insights to finance.

## **PARADIGMS**

Any adequate analysis of the role of paradigms, in social theory, must recognize the assumptions that underwrite that paradigm or worldview. Social theory can usefully be conceived in terms of four key paradigms: functionalist, interpretive, radical humanist, and radical structuralist. The four paradigms are founded upon different views of the social world. Each generates theories, concepts, and analytical tools which are different from those of the other paradigms.

Most mainstream academic finance theories are located within the bounds of the functionalist paradigm. They leave the other paradigms unexplored. Despite the apparent diversity in theories, the issues, which separate them, are of minor significance. The larger issues are rarely discussed, lying hidden beneath the commonality of perspectives and assumptions.

### **The Functionalist Paradigm**

The functionalist paradigm assumes that society has a concrete existence and follows a certain order. These assumptions lead to the existence of an objective and value-free social science which can produce true explanatory and predictive knowledge of the reality "out there." It assumes that scientific theories can be assessed objectively by reference to empirical evidence. Scientists do not see any roles for themselves within the phenomenon which they analyze through the rigor and technique of the scientific method. It attributes independence to the observer from the observed. That is, an ability to observe "what is" without affecting it. It assumes there are universal standards of science, which determine what constitutes an adequate explanation of what is observed. It assumes that there are external rules and regulations governing the external world. The goal of scientists is to find orders that prevail within that phenomenon.

Since 1950, a number of major theories and policies in finance have developed; namely: (1) Efficient market theory, (2) Portfolio theory, (3) Capital asset pricing theory, (4) Option pricing theory, (5) Agency theory, (6) Arbitrage pricing theory, (7) Capital budgeting policy, (8) Capital structure policy, and (9) Dividend policy.

Bettner, Robinson, and McGoun (1994) note that the common threads among theories in mainstream academic finance are:

1. There is a cause and effect mechanism underlying all nature and human activity (ontology);
2. It is known through the set of nomological connections between initial conditions and final outcomes (epistemology);
3. Human beings interact with each other and their society in accordance with this mechanism (human nature); and
4. Information regarding all natural and human activity can be acquired through observations and measurements unaffected by individual perceptual differences (methodology); (Page 3)

which lead to the conclusion that the current theories in finance are clearly based on the functionalist paradigm.

### **The Interpretive Paradigm**

The interpretive paradigm assumes that social reality is the result of the subjective interpretations of individuals. It sees the social world as a process which is created by individuals. Social reality, insofar as it exists outside the consciousness of any individual, is regarded as being a network of assumptions and intersubjectively shared meanings. This assumption leads to the belief there are shared multiple realities which are sustained and changed. Researchers recognize their role within the phenomenon under investigation. Their frame of reference is one of participant, as opposed to observer. The goal of the interpretive researchers is to find the orders that prevail within the phenomenon under consideration; however, they are not objective.

Bettner, Robinson, and McGoun (1994) discuss the interpretive research in finance and provide a set of examples. The following three examples are taken from that source:

O'Barr and Conley (1992) interviewed institutional money managers extensively to find out how they make decisions. Both authors are trained in cultural anthropology. They report that the supposedly quantitative, rational investment world is defined by its cultures, and its decisions reflect that culture, rather than the rigorous economics that most outsiders (and finance theories) expect.

Rosen (1990) critically analyzes numerous media statements of journalists and public finance figures during the market crashes of 1987 and 1989. He argues that the stock markets are part of the essence of how Americans define themselves. When they went into free-fall, completely contradicting the Efficient Markets Hypothesis and any other positivist explanation based upon past capital markets data, they threatened the very existence of the belief structure built by the American economy. Chaos faced Americans, and the cherished (and Nobel Award winning) models of finance had nothing to say about it. Rosen further emphasizes that ethnographic nature of his research by noting that he was and is a licensed stockbroker, and thus was a participant-observer, rather than a researcher removed from the events he investigates.

We can consider Frankfurter and Lane (1992), who argue that dividends are part of the maintenance of social order in the same way that potlatches used to function for the aboriginal tribes of British Columbia. (Pages 12-13)

### **The Radical Humanist Paradigm**

The radical humanist paradigm assumes that reality is socially created and sustained. It provides critiques of the status quo. It tends to view society as anti-human. It views the process of

reality creation as feeding back on itself; such that individuals and society are prevented from reaching their highest possible potential. That is, the consciousness of human beings is dominated by the ideological superstructures of the social system, which results in their alienation or false consciousness. This, in turn, prevents true human fulfillment. The social theorist regards the orders that prevail in the society as instruments of ideological domination.

The major concern for theorists is with the way the ideological domination occurs and with finding ways in which human beings can release themselves from constraints which existing social arrangements place upon realization of their full potential. They seek to change the social world through a change in consciousness.

Radical humanist research in academic finance is non-existent. Examples of radical humanist research, although not even mentioned in academic finance, are: Biewener (1999, 2000), Cullenberg (1994, 1997, 2000), Perelman (1987, 1993, 1999), and Tinker, Merino, and Neimark (1982).

Gordon (1996) states:

. . . many readers will find it hard to believe that a widely accepted theory is false . . . my search for an explanation has led to the conclusion that perhaps a "higher truth" is served by neoclassical theory. The great economic doctrine of our time . . . is not to be judged by the scientific merit of their description of the world . . . Neoclassical economics in the West and socialist economists in the Soviet Union both offer us Utopia here on this earth . . . The higher truth that may give empirical merit to both of these ideologies is that they serve as an inspiration and a framework for improving the performance of actual economic systems. (Page xiv)

Tinker, Merino, and Neimark (1982) state:

We use an alternative philosophical position . . . together within a historical review of the concepts of value to illustrate first, the partisan role played by theories and theoreticians in questions concerning social control, social conflict and social order; second, the ideologically conservative underpinnings of positive. . . theories; and last, some indications of alternative (radical) approaches to . . . policy. (Page 167)

### **The Radical Structuralist Paradigm**

The radical structuralist paradigm assumes that reality is objective and concrete. Scientists do not see any roles for themselves in the phenomenon under investigation. They use scientific methods to find the order that prevails in the phenomenon. This paradigm views society as a potentially dominating force.

For radical structuralists, an understanding of classes is essential for understanding the nature of knowledge. They argue that all knowledge is class specific. That is, it is determined by the place one occupies in the productive process. They believe that knowledge is more than a reflection of the material world in thought. It is determined by one's relation to that reality. Since different classes occupy different positions in the process of material transformation, there are different kinds of



knowledge. Hence class knowledge is produced by and for classes, and exists in a struggle for domination. Knowledge is thus ideological. That is, it formulates views of reality and solves problems from class points of view.

The literature in this area has been, historically, quite extensive, though not mentioned in mainstream academic finance. Some examples are: Gill (1999), Magdoff and Sweezy (1987), Sweezy (1942, 1994, 1997), Sweezy and Magdoff (1972).

Sweezy (1942) is concerned very largely with Marxian economics. It starts with labor theory of value, surplus value, accumulation of capital, formation of monopoly capital and imperialism, and the role of banks and financial institutions in this process. Sweezy states:

\*Banks and financial institutions have a strategic position in the issuance and sale of new securities. They play a peculiarly important role in the formation and merger of corporations. They appoint their own representatives to sit on the directorates of corporations and come to exercise a great influence in the policies adopted. The direction of this influence is always towards the abolition of competition and maximization of their profits. (Page 265)

Sweezy and Magdoff (1972) discuss different aspects of U.S. capitalism, such as corporate structure, inflation, credit, gold, and the dollar. The discussions are within the international context. The last chapter of the book is entitled, "The Age of Imperialism: The Financial Network," in which the role of finance is described. More specifically, it states:

The focal point of the network of economic relations between the great industrial powers and between these powers and the rest of the imperialist world is found in the concentrated financial power of the international money markets. . . . The financial power exercised through the banks and other institutions of the money market enables the industrialized nations to fend off or alleviate balance-of-payments difficulties; it is also the power which, directly or indirectly, keeps the underdeveloped countries in line as the raw materials suppliers. This does not happen as a plot or conspiracy; it results from the normal and self-defense behavior of capital. (Page 226).

## **EXPANDING THE USE OF FOCUS GROUPS IN THE NONPROFIT SECTOR**

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### **ABSTRACT**

*Nonprofit organizations are very important to the U.S. economy. It is estimated that there are over 1.5 million nonprofit organizations in the United States. This sector is growing rapidly with an average of 30,000 new organizations formed annually. The nonprofit sector retains approximately 25 million employees, as well as 93 million volunteers. Americans donated \$190 million to nonprofit organizations in 1999 (Mutz and Murray 2000). The current climate in the nonprofit sector is one of increasing competition due to the increasing number of options presented to donors and the decrease in funding by the government sector. As in any competitive market, nonprofit organizations need to focus on building and maintaining relationships with their multiple stakeholders. Traditionally few nonprofit organizations have had research budgets to acquire information on how to sustain relationships with stakeholders. Using focus groups is a cost effective and efficient method to understand and build relationships with stakeholders. This article explores the expanded role of focus groups in nonprofit organizations from a method of gathering data about stakeholders to a vehicle for communicating with stakeholders. The authors propose a field study that examines the use of focus group as a communication vehicle in U.S. nonprofit organizations.*

### **INTRODUCTION**

In the current competitive climate for funding, nonprofit organizations should be as concerned as for-profit organizations about stakeholder satisfaction. This satisfaction can be directly related to the branding of a nonprofit organization. (Campbell 1996). It is only recently that the concept of branding has been associated with nonprofit organizations. The main reason that these organizations are reticent to create and develop their brand image has been the cost of these activities. There also exist other issues that complicate nonprofit marketing strategies. First, nonprofits have multiple, and often non-financial objectives. Rather than the bottom line being financially driven, social profit is the goal. Social profit is best understood as a form of education, health, safety, cultural enrichment or some other benefit to individuals and the community (Gallagher and Weinberg 1991).

Marketing research procedures require that an organization have the resources to dedicate to marketing the organization. Most small nonprofit organizations must rely solely on volunteers to do whatever marketing gets done. The result is that nonprofit marketing for all but very large, established organizations is done without benefit of a formal strategy, an in-depth plan, or even evaluation criteria.

The competitive environment of nonprofit organizations also complicates marketing strategies because, in many cases, competitors for funding can also serve as collaborators striving for the same social goals. Finally, a further complication is that nonprofit organizations have multiple stakeholders; including customers who are may not be the ones who pay for the products or services provided (Kinnell and MacDougall 1997; Drucker 1990). These stakeholders include donors, volunteers, board members, employees, government agencies, private funding institutions, communities, the media, and, of course, customers or those who are being served. It is the development of relationships with various stakeholders who play multiple roles that is the focus of this paper. Specifically, this paper will discuss using focus groups as a facilitating tool for the development and stewardship of stakeholder relationships. Focus groups have a dual purpose in nonprofit organizations. The first function is the traditional role of gathering data to understand its stakeholders wants and needs. The second function is as a communication vehicle for the organization.

Businesses have long used focus group research as a tool to understand their customers and to better satisfy the wants and needs of those customers (Bruneau and Campbell 2000, Campbell and Bruneau 1998). This same method of research can be beneficial to nonprofit organizations in identifying the wants and needs of their many stakeholders. One particular advantage of focus groups is the relatively low cost of implementation.

### **USING FOCUS GROUPS TO GATHER STAKEHOLDER DATA**

Focus groups have been used in marketing research as a tool to gather data about consumers. Traditional uses of focus groups by for-profit organizations have included new concept testing, evaluating marketing communications, positioning a product and testing a product's usability. Focus groups are especially useful as a brainstorming mechanism. The role of focus group in collecting stakeholder data is very similar to those used in for-profit organizations. Focus groups with a nonprofit organization's stakeholders can be used to brainstorm the organization's vision, mission, goals, and objectives; to provide input into the organizations programs, and to understand why stakeholders contribute time or money to the organization.

### **Understanding Stakeholders' Attitudes And Values To Define The Organization's Vision, Mission, Goals And Objectives**

Strategic market planning consists of defining the organizations' vision, mission, goals and objectives. Stakeholders' input can be invaluable in aiding an organization in the strategic planning stage. For example, a mission works best if it is distinctive from other organizations. By cultivating a distinctive mission and developing an organization climate that reflects a personality, an organization stands out and attracts a more loyal group of members or contributors (Kotler and Andreasen 1996). Conducting focus groups with stakeholders can help organizations clarify what makes them distinctive from the stakeholders' viewpoint. New communication ideas may evolve from the stakeholders' opinions stated in their own words (Lauer 1996).

While fundraising is always important, the vision, mission, goals and objectives are often non-financial, particularly in small nonprofit organizations. Different stakeholder groups may have

varying opinions about what the non-financial outcome of the organization should be. Focus groups are an excellent way to discuss these diverse goals and objectives.

### **Utilizing Stakeholders' Input For Program Development/Evaluation**

Stakeholder input is crucial in the development of a nonprofit organization's programs and activities. Organizations often misinterpret the wants and needs of their stakeholders (Bowen 1999). Nonprofit organizations often do not realize the extent that they need stakeholder input in developing their programs (Yudelson 1988).

The executive staff and boards of many nonprofit groups consist of professionals who often feel that they have the capability of determining the needs of their stakeholders. The governing boards are used to interacting with people, deciding what they need and providing the service to meet those needs. Unfortunately, this focus on constituents' *needs* often ignores their *wants*. Marketing distinguishes between individual wants and needs. While people have general needs, they base their specific purchases on their wants. It is important that focus groups be conducted periodically to ensure stakeholders' wants and needs continue to be in accord over time.

Many nonprofit organizations rely on fundraising events to earn money. In planning these events, it is imperative to have stakeholders' input (Littlefield 2000). Focus groups with stakeholders can greatly help in planning the event. Through focus group research, the organization is able to assess the stakeholders' interests, time constraints and willingness to participate in the event. The event will have a much better likelihood of success if participants' opinions are considered.

Stakeholder input can also be important in evaluating the success of programs. Unlike businesses, where the success of an activity can be measured in terms of sales or profits, nonprofit organizations have less tangible measures of success. Focus groups conducted either during a program or after its completion can give the organization insight into the perceived success or failure of the program. This feedback can then be used designing future programs.

### **Determining Stakeholders' Motivation For Contributing To The Organization**

Why do individuals give to charity? This needs to be understood in order to conduct effective fund raising. Donors to organizations are varied in the size and type of donation that they make. Focus groups allow an organization to put a human face on its donors. An organization can learn from stakeholders, in their own words, what they believe about the organization, what they like or dislike about the organization, and why they donate to it (Fey 1995). Each type of donor will have multiple reasons for donating time or money to a nonprofit organization. Several potential reasons for giving have been identified by previous research. Focus groups can be used to analyze each donor market in terms of their reasons for their contributions. Knowing *why* stakeholders contribute to an organization helps in tailoring communications to that donor.

## **FOCUS GROUPS AS A COMMUNICATION VEHICLE**

In addition to the role of gathering stakeholders' opinions and ideas, focus groups should have a communication objective. During focus groups, stakeholders can be given information about the

nonprofit organization. The small group setting provides an excellent vehicle for two-way communication. Stakeholders can ask questions and clarify their opinions about the organization. Asking stakeholders to provide their opinions and ideas about various topics indicates that the nonprofit organization values their opinions. Thus focus groups are a method of cultivating stakeholders' loyalty to the organization.

### **Cultivating Stakeholders' Loyalty**

Because of the intense competition for donors' contributions, organizations should focus on fund development rather than merely fundraising (Drucker 1990). This distinction means that organizations must recognize that the donor is important to the organization not only because of the money or time donated, but because donors serve as advocates of the organization. While it may be costly and time consuming to establish donor relationships, once they are established, the cost of fundraising is actually reduced as the organization has a base of donors who do not need to be resold on the importance of the organization or the integrity of its cause. When a donor or volunteer feels included in and valued by the organization, he/she is likely to give monetary gifts of increasing amounts, remain dedicated over time, attract friends to the organization, and enhance the public perception of the organization (Mutz and Murray 2000).

Conducting focus groups with donors signals that the organization views the donors as important to the organization in many ways. Focus groups contribute greatly to the communication function as well as the research function (Lauer 1996). Conducting focus groups is a way for the staff of an organization to communicate how much they value the opinions of their stakeholders. In some cases, it is also an opportunity to inform the participants about certain aspects of the organization and to solicit their support.

### **CONCLUSION AND RESEARCH AGENDA**

For focus groups to be effective, they should be part of an ongoing marketing communications program (Lauer 1996). Rather than conducting a few isolated focus groups when the organization finds itself in financial trouble or in a crisis mode, focus groups should be included as part of the long-range planning process. A continuing focus group program can be an effective tool for building a strong reputation and gaining long-term stakeholder support. Conducting focus groups can provide insights to marketing management that, in turn, can help a nonprofit organization maintain service quality, keep donors satisfied and generate a dependable source of revenue (Borman and Lo 1995).

The authors believe that research on the use of focus groups by nonprofit organizations is potentially rich with important data to be uncovered. How many of the smaller nonprofit organizations currently conduct research on their stakeholders' opinions? Of those that do, are the specific goals of the research met? Are focus groups being used to merely collect data or is the dual function of focus groups as a data collection tool and a communications vehicle being implemented? What opportunities exist to capitalize on information focus groups provide? What are the barriers to conducting focus groups by nonprofit organizations? These questions will be addressed in a future research study that will combine qualitative and quantitative methodologies.

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# FROM COMPENSATORY BUYING TO COMPULSIVE BUYING: ASSESSING THE ROLE OF SELF-DISCREPANCY AND MATERIALISM

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## ABSTRACT

*It has been shown in a number of studies that consumers not only buy because they need a certain product but also because the shopping experience and the act of buying itself serves needs like diversion, self-gratification, sensory stimulation, physical activity, and aesthetic enjoyment. A further aspect of shopping is its function as a compensatory instrumentality for satisfying immaterial needs. The present paper examines the compensatory function of buying and its extreme manifestation buying addiction, which is most often referred to as compulsive buying. Despite often serious social, psychological and economic consequences, compulsive buying continues to be generally regarded as a somewhat marginal problem: "Oh yeah, my neighbor, she is a bit crazy about shopping. She's a shopaholic." Popular media portrayal of the issue has also tended to trivialize and sensationalize certain aspects of the behavior. The present paper examines the role actual/ideal self-discrepancies, materialism and ideal self-images play in compulsive buying behavior. Overall, the paper is situated in the field of altruistic marketing that emphasizes the study of negligent or problematic consumer behavior, and the development of treatment and preventive methods to reduce the maladaptive actions of consumers.*

## THE COMPENSATORY FUNCTION OF BUYING

Within a psychological context, compensatory consumption has been described as an inadequate attempt to obtain need satisfaction. It is an effort to make up for failure or weaknesses in one activity through excelling in another activity, which is a priori not more valuable or desirable (Gr nmo, 1988; Hilgard & Atkinson, 1967). In a sociological context, compensatory consumption is a reaction to threatened status, a way to make up for some lack or loss. It includes attempts to gain self-esteem by developing some quality other than the quality a person feels lacking. At the same time, the importance of the quality that is lacking is denied (Fairchild, 1968).

According to Gr nmo (1988) two types of compensatory behavior can be distinguished. People may a) engage in compensatory behavior because of resource poverty or b) because they are unconscious of their real, objective needs. In the first case, real needs and motives are known, but a lack of resources prevents people from taking adequate action to satisfy their needs. In the second case, all actions taken are necessarily inadequate because they are not motivated by real needs. Hence, not only an inconsistency between motive and action exists but also an inconsistency between need and motive.

Attempts to differentiate between real and artificial needs have been a topic of much discussion in the literature because the arguments that have been put forward are often value laden and judgmental. A reason for this is that needs are based on subjective rather than on objective observable experiences. Therefore, based on scientific grounds it is difficult to determine whether a need is real or whether it has been artificially created. As a way around this, Hondrich (1983) proposed to distinguish between real and artificial needs based on the outcome of the actions taken to satisfy the need. The outcome can be assessed by asking the following questions: Did the action lead to inadequate or adequate need satisfaction? What were the intended or unintended consequences of the need satisfaction process and what kind of effect did it have on the satisfaction of other needs? Within the context of consumption, one may ask: Am I satisfied with the product I have purchased or do I feel regret or guilt? Did I stay within my financial limits or have I violated financial constraints and put myself into debt at the risk of losing financial security? If one does feel regret and guilt because for instance one did not really need the purchased object, or that due the purchase one now can no longer buy other needed items, then the buying motivation was likely based on an inauthentic false need.

From a number of empirical findings (see for example Gr nmo, 1988; Kilbourne, 1991; Marcuse, 1964; or Scherhorn, 1994), it can be derived that individuals in consumer societies seem to heavily emphasize the consumption of objects as a reaction to a general lack of esteem, education, knowledge or self-actualization. Such attempts, however, are likely to fail because material objects can never be an adequate replacement for unfulfilled immaterial needs. A reason for this is that the inherent qualities of consumer products have little in common with the kind of satisfaction that is sought, even though the process of buying, the act of purchasing itself or the possession of material goods offer multifarious possibilities for compensation through the many symbolic meanings that are attached to them. Thus, they have the potential to function as a universal drug promising to alleviate the discomforts of life. Occasionally, shopping is used by many as a way to brighten up a sad day, as a reward for an achievement, to enhance one's self-perception or to relax a negative mood state (e.g., Kacen, 1998, Kacen and Friese, 1999). If buying however is used excessively as a means of compensation, it can develop into an addictive behavior with serious consequences for the individual. The behavior becomes problematic if consumers constitute their entire lives around the meaning of goods, and if they limit themselves to the products provided by the market as a means to maintain and to enhance their self-concepts.

According to conservative estimates, about 20% of the population in Western consumer societies use buying regularly as a means of compensation, 5% rely heavily on it for compensatory purposes (Scherhorn, Reisch & Raab, 1990), and 1-2% of these are addicted to it (Lejoyeux, Adès, Tassain & Solomon, 1996). Examining the Baby Bust generation in the US, born between 1965 and 1976, Roberts (1998) reported that 6% of this consumer group can be classified as addicted buyers. This means that buying for quite a few million individuals has become the focal point of life around which everything else revolves, often to the detriment of relationships, healthy bank balances and last but not least authentic personal happiness.



## **THE ROLE OF SELF-DISCREPANCIES IN ADDICTIVE BUYING**

Based on previous findings that addicted buyers have a lower self-esteem than average and show a low self-acceptance (e.g., d'Astous, 1990; Elliot, 1994; Lange, 1997), are less likely to be satisfied with themselves and often despise an important part of who they are (Scherhorn et al., 1990). Dittmar, Beattie and Friese (1996) proposed that this might have an effect on the subjectively felt gap between their actual and ideal selves, thus between who they perceive themselves to be now and who they would rather like to be.

Generally, the existence of a gap between one's actual and ideal self or between one's actual and ought self is not problematic. It is even desirable as such discrepancies serve as self-guides and have motivational consequences. If for example the ideal self entails a picture of oneself to be knowledgeable in conversational Spanish, then the actual self will feel motivated to undertake efforts toward achieving this aspired to self-definition. Such attempts can however only be successful if a person is committed to a particular self-definition. If this is the case, then self-definitional goals can take on the character of needs. Failure to satisfy these needs will result in substitute actions. This is likely to occur if attempts to achieve the self-definitional goal are disrupted (Wicklund & Gollwitzer, 1982). Another reason for failure might be that the self-definitional goal is too far away from a person's actual self-state. Based on these considerations, Dittmar et al. (1996) hypothesized that excessive buying might be a result of seeking self-completion via substitute actions, motivated by a large gap between the consumer's actual and ideal self-state. The results of their study support this thesis. Respondents who displayed higher addictive buying tendencies also had larger actual/ideal self-discrepancies than other consumers. The mean self-discrepancy scores for the two groups were 16 and 10.47 (possible scores ranged from 1 to 36). This difference was highly significant (for a description of the research design and methodology, see Dittmar et al., 1996). In other words addicted buyers are more likely to perceive that their actual self-state is far away from the kind of person they rather would like to be. This kind of self-discrepancy has been shown to negatively effect self-esteem and to result in dejection-related emotions like disappointment, dissatisfaction and sadness. (Higgins, 1987; Moretti & Higgins, 1990). Hence, the maladies experienced by addicted buyers like low self-esteem and depression might be related to their high actual/ideal self-discrepancies.

## **LINKS BETWEEN SELF-DISCREPANCY, MATERIALISM, AND ADDICTIVE BUYING**

Showing that a high actual/ideal self-discrepancy exists in addicted buyers, however, does not establish any causal link. Singer (1993, cited in Toates, 1996) for example has shown that high actual/ideal self-discrepancies are also present in cocaine addicts, who employ the drug as a form of self-medication against depressed moods. Cocaine addicts thus seem to have chosen a different compensation mechanism than addicted buyers for bridging the perceived gap between their actual and ideal self-state. A likely reason for this is that the two groups of addicts have been subjected to different kinds of key experiences. From addicted buyers we know that through childhood and other life experience they came to associate material goods with love, attention, happiness and/or

independence, and therefore they may prefer buying over other activities as their preferred means of compensation.

Whether the assumption that the use of buying as a preferred compensation mechanism in conjunction with high actual/ideal self-discrepancies leads indeed to an addiction to buying, can be tested by using a proxy measure denoting buying as a person's favored compensation mechanism (see also Dittmar et al., 1996). Here the Richin and Dawson's materialism scale including its three sub-scales were used (Richin & Dawson, 1992). The first step of the analysis consisted of a main-effects-only model with self-discrepancy and materialism entered as the predictor variables. In the second step, the presence, strength and nature of the interaction between materialism, the three subscales and self-discrepancy were assessed. An additional variable that needed to be taken into account was gender. In a first trial run of the model, the only interaction term that was significant was the interaction term for the centrality subscale. This effect is likely due to sampling artifact. When gender is added into the model, this effect disappears and the only remaining interaction term is the one for the overall materialism score. In addition, self-discrepancy by itself and the happiness dimension showed an independent effect on addictive buying as well. The final result of the regression analysis is presented in Table 1. The full model explains 39% of the variance in individuals' compulsive buying scores.

Table 1: Predictors of compulsive buying tendencies

Variable	$\beta$	SE ( $\beta$ )	stand. r	t-value	sig. t
Self-discrepancy	0.574522	0.144659	<b>0.25</b>	3.972	0.0001
Happiness (high/low)	6.646301	1.710194	<b>0.24</b>	3.886	0.0001
Gender	4.880980	1.497305	<b>0.16</b>	3.260	0.0013
Interaction term for Materialism	0.352714	0.129366	<b>0.21</b>	2.726	0.0068
(Constant)	14.111605	2.892815		4.878	0.0000
<b>Variables not in the equation:</b>					
Centrality (high/low)				0.492	0.6234
Success (high/low)				0.045	0.9642

As can be seen from the results, compulsive buyers seem to especially use material goods to compensate for negative mood states and for unsatisfactory life circumstances (measured by the happiness dimension). Since the centrality and success dimensions had no independent effect on addictive buying, it can be assumed that acquiring objects for the purpose of lending meaning to life (measured by the centrality dimension) or for projecting socially desired self-images as a sign of success and status (measured by the success dimension) appear to be of lesser importance to compulsive buyers. The finding that only the interaction term of the overall materialism score and not the interaction terms of the three subscales is significant supports the proposition that a generally high materialistic value orientation is an indicator for compulsive buyers choosing buying over other activities to compensate for the large gap that they perceive to exist between their actual and ideal self. In summary, it can be concluded that if both a high self-discrepancy and a materialistic value orientation are present, then there is a high risk for individuals to become addicted to buying.

Having established this, the next question to be answered is in what ways the actual/ideal self-discrepancies are manifested and whether the ideal images of addicted shoppers are different from those of non-addicted consumers. The analysis of 18 in-depth interviews with addicted buyers showed that their ideal images consisted exclusively of non-material desires like wanting to be more loved, more accepting of self, nice looking, smart, outgoing, more open to praise, more grounded, more assertive, more appreciated, less wanting to please other, more secure, more in control of life, wanting to find out who one is and wanting to feel complete. A vital conclusion that can be drawn from this is that the ideal images of addicted buyers are not vastly different from what most human beings desire. The reason for their larger self-discrepancy lies moreover in where they position their actual selves. If one takes the actual self of a perfectly happy individual as the baseline and sets it to zero, then the actual self-perceptions of addicted buyers are below the zero line. In other words, addicted buyers are not highly irrational dreamers who want to achieve ideal states that are far from what we all desire in order to feel happy and content with ourselves and our lives. Rather, they are profoundly unhappy individuals for whom buying serves emotional rather than utilitarian needs and who attempt through buying to restore a depleted sense of self.

### **SUMMARY**

As has been shown above and in previous studies, buying and material objects potentially provide individuals with recognition and approval; both offer an escape through fantasy, they allow acting out anger and aggression, they promise power and control, represent love, security, affection, independence and identity, create mood change, relieve anxiety, lift depression, and elevate self-esteem. Therefore, it is not surprising that individuals in consumer societies have 'discovered' buying as a means of compensation. The reason why some people become addicted to it is related to certain predispositions, which may be in part inherited and/or are induced by certain life experiences, mostly during childhood. If such predispositions occur in combination with the experience that objects and acts of consumption can serve as an ersatz for a missing parent, for love, affection, recognition or attention, it can be presumed that the preferred substitution mechanism for a perceived lack will be material goods and the associated shopping activities.

The problematic aspect is that the add-on benefits of buying will never satisfy the real underlying need of the addicted buyer. Firstly, material goods, although symbolically representing immaterial needs, can never be adequate substitutes for such needs. Secondly, as the driving force that motivates the addiction is often not consciously known, it is highly unlikely that the real needs that long for fulfillment are satisfied by the addictive behavior. If a basic need, however, is not satisfied, it will become the predominant need driving people to engage in compensatory behaviors.

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# **TAX INCENTIVES FOR INTERNATIONAL TRADE -THE EXTRATERRITORIAL INCOME EXCLUSION- A PRIMER FOR SMALL BUSINESS ENGAGING IN INTERNATIONAL TRADE**

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## **ABSTRACT**

A highly technical but important change to US tax laws now means that smaller businesses and entrepreneurs will enjoy the same incentives to engage in international trade as did large corporate entities. The benefit is not inconsequential as it can amount to a reduction of federal income taxes of 15-30% on eligible foreign-sourced income. This article reveals the benefit to firms that have less than \$5 million of eligible foreign earnings. This article reviews the changes to the IRS rules on Foreign Sales Corporations, describes the process for computing the tax savings, and describes the benefits that are now available to different business organizations.

## **INTRODUCTION**

Various tax entities and devices have been used over time to obtain certain tax advantages and/or incentives for activities involving foreign sourced income. The most recent entity, known as the Foreign Sales Corporation (“FSC”), has been in use in the United States since 1984, when the FSC regime was adopted into the tax code to offset criticisms of trading partners as to certain aspects of Domestic International Sales Corporations. Generally a FSC is a corporation organized in a foreign jurisdiction that maintains an office in a foreign country, has at least one foreign national on the board of directors, and was engaged in specific exporting activities (International Revenue Code Section 922). The FSC has been a significant tax saving device since part of the FSC income would be considered at least partially exempt from U.S. taxes as long as the income was foreign sourced.

The World Trade Organization’s interpretation of the FSC resulted in Congress changing the underlying statutes. One major change was that tax benefits of foreign commerce have now been expanded to individuals, partnerships, S-corporations, LLC’s, and other pass-through entities. In addition, several rather technical requirements otherwise required are waived for entities with less than \$5,000,000 in gross receipts, which makes the Act even more advantageous to the smaller entrepreneur.

## BENEFITS OF NEW LAWS

In general, eligible taxpayers are able to claim an automatic (i.e., no election is required) exemption of gross income from their 2000 (and forward) tax returns for an “extraterritorial income exclusion.” The exclusion, based variously on foreign-based income generated and certain elections taken by the taxpayer, could result in a reduction of approximately 15- 30% of a taxpayer’s amount owed in federal income taxes resulting from foreign-based income. However, if the entity is an *existing* FSC, it must elect to claim the Extraterritorial Income Exclusion. Many eligible beneficiaries of this new tax provision may be unaware of its existence. Taxpayers who were eligible and missed this tax benefit in FY 2000 (or beyond) should seriously consider amending their tax returns

### ELIGIBILITY AND COMPUTATION – SIMPLIFIED

To qualify for the Extraterritorial Income Exclusion, the taxpayer must be paying income taxes in the United States. This factor may significantly impact certain existing entities, such as foreign corporations. There are transitional provisions that provide specific instructions to businesses that have been taking advantage of the tax benefits under the FSC rules. The issue of transitional rules is beyond the scope of this paper. Assuming this most basic condition is met, Internal Revenue Code (“IRC”) § 114 sets the standards for the computation alternatives.

The Code is deceptive in its simplicity, which innocently notes “gross income does not include extraterritorial income” (Internal Revenue Code Section 114) *except* that calculation does not include “extraterritorial income which is not qualifying foreign trade income” (Internal Revenue Code 114 (b)). In other words, not all foreign income sources will be eligible for the exclusion.

Qualifying foreign trade income is defined by Internal Revenue Code section 941(a) as the gross income, if excluded, that reduces the taxable income of the taxpayer equal to the *greatest* of:

- 30% of the foreign sale and leasing income of the transaction (s). IRC §943(b)(1) states “...transaction means (i) any sale, exchange or other disposition (ii) any lease or rental and (iii) any furnishing of services.”
- 1.2% of the foreign trading gross receipts of the transactions(s). Foreign Trading Gross receipts must be (1) from the sale, exchange or other disposition of qualifying trade property (2) from the lease or rental of qualifying foreign trade property for use by the lessee outside of the United States (3) for services which are related and subsidiary to the sale, exchange, disposition, lease or rental of qualifying foreign trade property (4) for engineering or architectural services for construction projects located outside of the United States (5) or for the performance of certain managerial services for unrelated persons.” (Joint Comm. JCX-111-00 page 7 and IRC 942(a)(1)). Or
- 15% of the foreign trade income of the transaction. In other words, the foreign trade income- which is the net income (or taxable income). “...taxable income of the taxpayer attributable to foreign trading gross receipts of the taxpayer.” (IRC §941(b))

Gross income will have (non deductible) expenses apportioned to the excluded income since the calculation exclusion is dealing with *gross* income as opposed to *net* income. In other words,

there can be no deduction for expenses related to the excluded income (Internal Revenue Code section 114(c)). Each of the terms, predictably, involves a different situation, which will be described later. The Code gives the taxpayer the ability to *maximize* their potential exclusion.

When the business uses the extraterritorial income exemption, they are not to deduct any direct and overhead (not cost of goods sold) expenses apportioned to Extraterritorial Income. Similarly, the entity (or person) is not permitted any foreign tax credit (otherwise available) related to any extraterritorial income that is excluded. Prorating out any related deductible expenses prevents the taxpayer from realizing a double benefit from the exclusion. The deduction is not allowed as it would provide an illogical benefit to the taxpayer, as the gross income generated has already been excluded, therefore, those deductible expenses associated with or that generated the revenue should also be excluded (Internal Revenue Code (IRC) Section 114 (c)). Such expenses are generally calculated on a pro rata or apportioned basis.

The actual calculation requires that the expenses are “grossed up” or added back into the related qualified (net) income.

### FOREIGN TRADE INCOME

"Foreign Trade Income" is the taxable income of the taxpayer (determined without regard to the exclusion of qualifying foreign trade income) attributable to foreign trading gross receipts (Joint Committee on Taxation, JCX-111-00, p.10). As in most IRC provisions, this definition requires the understanding of yet other definition or term of art. "Foreign trading gross receipts" are defined as "gross receipts derived from certain activities in connection with qualifying trade property with respect to which certain "economic processes" take place outside of the United States" (Joint Committee on Taxation, JCX-111-00, p.10).

While rather technical in definition, in general the intention of Congress was to ensure that the excludable receipts are derived from foreign or trading activities as opposed to domestic-based earnings. The property or service being sold by the entity may not be for use in the United States. The revenue need not be from sale of products alone, as services and rental of property is also considered as part of the definition of foreign trading gross receipts. Part of the language of the Code is specifically designed to prevent obtaining of the tax benefits by manipulation of the manufacturing where the product is assembled or manufactured but ultimately selling the product domestically (i.e., shipping it to various non-domestic locations for assembly, only to ultimately bring the product back into the United States for domestic sale.)

Mathematically, Foreign Trade Income may be stated as:

(Qualified) Foreign Trading Gross Receipts  
Less: Cost of Goods Sold  
Equals: Gross Income  
Less: Direct Expenses  
Less: Apportioned Overhead Expense  
Equals: Foreign Trade Income (which is the eligible, but yet unadjusted for the exclusion, taxable net income associated with foreign activities).

## **QUALIFYING FOREIGN TRADE INCOME**

Qualifying Foreign Trade Income is the highest result of three specific calculations which ultimately result in the calculation of the "grossed up" foreign trade income. Each computation is composed of two sub calculations. In essence, statutorily determined percentages ranging of 1.2% of Foreign Trade Gross Receipts, 15% of Foreign Trade Income and 30% of Foreign Sale & Leasing Income are calculated, and then using those calculated values, disallowed expenses (direct expenses and apportioned overhead expense deductions associated with the just calculated income exclusion component) are calculated. These two calculations (calculated reduction of taxable income and "gross up" for disallowed expenses) then are combined. The result of this addition equals Qualifying Foreign Trade Income (the highest value being used).

The highest resulting calculated amount (and its calculated subsections) is then excluded from the entity's gross income, direct expenses, and overhead expense, resulting in the final taxable income of the entity. Effectively, the net taxable income is reduced by this exclusion factor, resulting in significant tax savings. The calculation can be (and is) extremely complicated, but the preceding serves as a rough overview of the process.

Qualifying foreign trade income's definition also includes a reference to a "transaction." Qualifying foreign trade income is defined as the gross income, if excluded, that reduces the taxable income of the taxpayer equal to the greatest of: 30% of the foreign sale and leasing income of the transaction (s); 1.2% of the foreign trading gross receipts of the transactions(s); or 15% of the foreign trade income of the transaction. The Code defines a "transaction" as (1) any sale, exchange or other disposition (2) any lease or rental; and (3) any furnishing of services (Internal Revenue Code §943(b)(1)). Such a definition of foreign trade income is and leads to a degree of uncertainty. For example, when does a sale or rental actually take place (or perhaps more precisely, when is it appropriately booked?).

## **SPECIFIC DEFINITIONS**

Foreign trading gross receipts are the gross receipts derived from certain activities in connection with qualifying foreign trade property with respect to certain economic processes that take place outside the US (Joint Comm. JCX-111-00, page 7). The receipts do not include gross receipts from any transaction whereby the goods or services are ultimately used in the U.S. or by any subsidy granted by the government where manufactured (Joint Comm. JCX-111-00, p. 7). As might be expected, foreign trading gross receipts must be segregated to be able to calculate the qualifying foreign trade income.

Qualifying foreign trade property is property manufactured, produced grown or extracted ("manufacturing test" per Internal Revenue Code Section 934 (a) (1) (A)) within or outside of the United States that is held primarily for sale, lease or rental in the ordinary course of a trade or business, for direct use, consumption or disposition outside of the United States ("destination test" found in Joint Comm. JCX-111-00, p. 7). In addition, no more than 50% of the value of the transaction is attributable to foreign content or other non U.S. value added. The rules provide that no more than 50 percent of the fair market value of such property can be attributable to the sum of (1) the fair market value of articles manufactured outside of the United States plus (2) the direct costs



of labor performed outside of the United States ("foreign content test"). The foreign content includes not only tangible content but also intangible content. The foreign content rule becomes exceptionally important if the item is partially assembled or constructed at various locations, domestic and foreign (Joint Comm. JCX-111-00. p 9). Certain products are specifically excluded from the definition of qualifying foreign trade property, such as oil and gas products, property in short supply, and certain intangible assets, such as a patent, copyright or goodwill. Thus, not every sale or rental, even if the product or service is otherwise export related, will not necessarily meet the qualifying tests established by the Code.

"Certain economic processes" (or foreign economic processes) compares foreign direct costs to total direct costs. Total direct costs in question are not limited to cost of goods sold. Total direct costs may include non-U.S. costs such as certain sales activities (such as soliciting customers outside the US) and actual foreign direct costs. If 50% of the direct costs are incurred outside the US, the test is met. Examples of such costs include advertising, processing of orders, transportation, determination of final invoice and receipt of payment, and assumption of credit risk (Joint Comm. JCX-111-00, p. 8). Maintaining such records may be a burdensome expense for a smaller taxpayer. Larger companies who are already taking advantage of FSC will find these rules are merely an extension of already existing FSC rules.

Previously, many FSC's had contracted with overseas entities to provide these services, which might create unacceptable extra costs to a smaller entity. Interestingly, it is now mandatory, if such another entity is used, that there is a written contract between the parties (Internal Revenue Code Section 942(b)). Such a written contract was not previously an explicit Code requirement.

Fortunately, for smaller businesses, the Code allows a most significant exception in cases where the foreign trading gross receipts are below \$5,000,000. This exception allows a tremendous opportunity for smaller entities to participate in the Extraterritorial Income Exclusion without satisfying the more technical requirements of the foreign economic processes requirements. Principally the tests of foreign sales activities and 50% of the total direct costs of the transaction; such tests which must be achieved annually. There is also an alternative 85% test not discussed herein (Internal Revenue Code § 942(b)). Thus, as long as the taxpayer's foreign trading gross receipts do not exceed \$5,000,000, the Code treats the taxpayer as having met the foreign economic processes requirement automatically and without the need for the taxpayer to perform the burdensome calculations and maintain the associated records/activities otherwise necessary. Note, however, that the \$5,000,000 exception applies to all "related persons." For example, in a partnership, the exclusion is compared to the entity at the partnership level, and thus, for example, if a three partner entity generated \$15,000,000 of foreign gross receipts, it could not be claimed that the three partners each aggregate separately \$5,000,000, or \$15,000,000 in gross receipts ( $\$15,000,000/3 = \$5,000,000/\text{partner}$ ) and be thereby be eligible for the exception.

Foreign Sales and Leasing Income is the amount of the taxpayer's foreign trade income (with respect to a transaction) that is properly allocable to activities (including rentals) that constitute foreign economic processes (Joint Comm. JCX-111-00, p.10). The committee's example notes that it is the profit from the sale of qualifying foreign trade property that is associated with foreign economic processes, such as sales activities, including the solicitation of the sale, advertising, transportation, etc. In this case, only direct allocable expenses are taken into account for calculation of the foreign trade income. Apportioned overhead expenses are ignored for this calculation.

An aggressive interpretation of what foreign sale and leasing income entails is that it represents all foreign income that satisfies the foreign economic process tests or is derived from leasing of qualified property outside of the U.S. This would mean exporters could potentially double the existing tax benefits. Stated differently, the \$35 in the above example could be vastly larger if the entity only exports its products and has no domestic activities. While it is not clear if this is the intention of the law, it certainly gives pause to consider such a situation. The FSC/DISC Tax Association & Council for International Tax Education have questioned this election's results particularly as relating to export companies. Taxpayers preparing returns in the 2000 tax year also were uncertain as to the proper election and ultimate result particularly if they were principally exporting companies. However, with the trade deficit problems of the U.S., perhaps the apparent inducement is intentional. Foreign Sales and Leasing Income is perhaps the hardest area to quantify and defend, and regulations do not yet exist to clarify certain uncertainties. However, it also represents a tremendous opportunity due to the high exclusion ratio if such a calculation can be justified and substantiated.

### **SUMMARY**

With the availability of the world wide web at a reasonable cost, many smaller firms have access to the world market. The recent change to the U.S. Federal Tax laws provides tax incentives to smaller firms that qualify for the extraterritorial income exclusion that were once only available to fairly large firms with sophisticated tax and foreign trade specialists. This article has not attempted to discuss exhaustively the Extraterritorial Income Exclusion- particularly existing larger entities nor FSC entity transition. Rather, we have attempted to concentrate on the basic structure of the new law as it might relate to the smaller entrepreneur who might otherwise not recognize the tax benefits of this Act. Small businesses that engage in international trade would be wise to take advantage of the Extraterritorial Income Exclusion.

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## **LET'S MAKE A DEAL - CYBERSPACE TO THE RESCUE**

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### **ABSTRACT**

*Disputing parties use traditional legal approaches in resolving disputes that are typically long, costly, and disastrous to the very nature of the original business transaction itself. Legal remedies, between the parties involved, are extremely inadequate and usually kill-the-deal and totally stifle whatever opportunities originally existed. The resolution of disputes can be a dilemma. The reality of living in a competitive "networking" business environment is that the dispute resolution system relied upon must be effective, efficient, add value and increase productivity, all of which leads to profit and prosperity. Alternative Dispute Resolution (ADR) approaches (non-judicial methods), such as negotiation, mediation, arbitration, and a number of hybrids have been successfully evolving for several decades and appear to meet many of the criteria alluded to above in resolving disputes when appropriately applied. ENTER CYBERSPACE and the added capability and capacity of using an additional tool in the ADR process, the INTERNET! This paper will present the attributes of an internet based dynamic Negotiation and Conflict Management Systems Model (NCMSM) that is designed to facilitate and enhance business transactions at its fundamental basis in assisting parties in developing techniques of building consensus, packaging deals, and monitoring outcomes.*

### **INTRODUCTION**

During its short existence the Internet has ventured into a myriad of endeavors with its potential being limited only by imagination. We are now experiencing the evolutionary process of the new and quickly changing Technology Age. It is not only alive and well, the fact is that it is expanding and progressing at an exponential rate. The future has arrived. Learning and experience curves are going wild. They are no longer the gradual horizontally rising types that go on for years, but, instead, they are now vertical. That is: intense and fast. To stay with the times requires lifelong learning and continuous action on the part of business and industry.

What does this mean? It means that we are eagerly waiting for and anticipating the next generation of technology; that ironically and factually is always a few months away and may drastically change the way we do things. This driving technology force is having a dramatic influence and impact on how we learn, play, work, interact with each other, and, specifically, on how we do business. The fact is that the Internet is not going away. It is here to stay, and then some. It is a factor we must live with and accept.

Disputes and conflicts are a fact of life. Roger Fisher of "Getting to Yes" fame states that "...conflict is a growth industry." So, disputes and conflict are not going away in a technology oriented society. Business transactions are a fact of life. President Calvin Coolidge's statement that "the business of America is business" has never been truer. So, business is here to stay also. Disputes, conflict, and business transactions are integral factors of life.

The problem has been and continues to be that disputing parties use traditional legal approaches in resolving disputes that are typically long, costly, and disastrous to the very nature of the original business transaction itself, including the indefinite termination of significant business relationships. Legal remedies, between the parties involved, are extremely inadequate and usually kill-the-deal and totally stifle whatever opportunities originally existed. Usually, traditional legal approaches are too late and the remedy is limited only to damages. The resolution of disputes can be a dilemma.

The reality of living in a competitive, market driven "networking" business environment is that the dispute resolution system relied upon must be effective, efficient, add value and increase productivity, all of which leads to profit and prosperity. In other words, the dispute resolution system is a cohesive and integrated feature of the basic business transaction itself. The well negotiated contract, with dispute and conflict resolution features built into it should be the controlling factors of the business transaction, and not after the fact legal remedies that are often too late and inadequate to save the business transaction. Alternative Dispute Resolution (ADR) approaches (non-judicial methods), such as negotiation, mediation, arbitration, and a number of hybrids have been successfully evolving for several decades and appear to meet many of the criteria alluded to above in resolving disputes when appropriately applied.

ENTER CYBERSPACE and the added capability and capacity of using an additional tool in the ADR process, the INTERNET! The attributes of an internet based dynamic Negotiation and Conflict Management Systems Model (NCMSM) that is designed to facilitate and enhance business transactions and to create workable contracts that are proactive ingredients of the business transaction itself and that are directed to problem solving and decision making techniques that arise during the life cycle of the effort. The fundamental basis in this instance is in assisting parties in developing techniques of building consensus, packaging deals, and monitoring outcomes.

Infrastructure of this systems approach includes specifically designed internet pages and forms, threaded asynchronous bulletin boards, chat rooms (instantaneous), internal pass word protected areas, data exchange capabilities, E-mail and listserve designs, video and audio streaming, video conferencing with digital signal going through internet to selected computers, and a trained facilitator. This process promotes preparation, brainstorming, using objective criteria, addressing the "interests" of all parties to the transaction, developing problem solving and decision making techniques, defining trust, accountability, and responsibility for specific actions, and "what-ever-it-takes" to make the deal work and to make a profit. In total, the whole process would be CHEAPER than the alternative – a long drawn out judicial fight. The formula here is to do it right in the first place.

The basics of this Internet based dynamic Negotiation and Conflict Management Systems Model is prescriptively described below. The fundamentals of this approach is to structure a process that is designed to successfully meet the specific needs of the "deal" being proposed. Other attributes of the design include: flexible provisions for making reasonable midcourse corrections; using the

Model as a management and monitoring tool for the life cycle of the "deal"; providing continuity of communication throughout the life cycle of the "deal"; including business law provisions and principles as an integral part of the process and "deal"; and building expectations of trust, reliability, accountability, responsibility and of fulfilling the contractual obligations during the life cycle of the "deal."

## **THE NEGOTIATION AND CONFLICT MANAGEMENT SYSTEMS MODEL**

Trained facilitator: (third party neutral) Key to implementing a successful Internet based ADR Model is in the selection of a well trained and experienced facilitator. The facilitator must have an understanding and familiarization of the business transaction being proposed. The task of the facilitator is to motivate, direct, and build consensus between/among the participants, and NOT that of authoritatively directing and controlling the business transaction itself. It must be a person who is sensitive to the behavioral aspects of a business transaction, understands the basics of human nature in the business environment, and appreciates the importance of bringing together parties for the purpose of consummating a "deal." The actual power of the facilitator is simply being able to bring parties together for the purpose of establishing consensus.

Pass Word Protected Internet Site: The first task is to establish a secure Pass Word protected Internet Site accessible on the World Wide Web (WWW). The design concept in this instance is to create a fundamentally standardized structure that has enough capacity, capability and flexibility for addressing the multitude of issues within the life-cycle of a business transaction, from packaging and "making-a-deal" through monitoring the progress and complexities of the "deal." The Site is maintained under the discretion and control of the facilitator. Obviously, the basic structure of this process is identified on the Home Page Internet Site by reviewing the various identified linkages through scrolling and clicking. The following is a suggested list of linkages: Announcements; Participants; Schedule and assignments; Notes/Memos; Working Area; Contract; Contract Monitoring; Data Discussion; Conference Room Area; Transcriptions; Video Streaming Facility; Audio Streaming Facility; Lounge and Instructions. A discussion of each of these areas and how they coordinate the process is beyond the scope of this paper.

Other Elements of the System: There are additional elements of the Negotiation and Conflict Management Model aside from the Internet Site that may be integrated into the "deal-making" process and that compliment the decision-making/problem solving requirement in "making-a-deal." These methods meet the realities of today's communication technology and allow participants the opportunity of selecting convenient modes of negotiation. Again, to bring continuity and trust to the system, the facilitator should have discretion and control whenever possible. This can be accomplished using the following methods of communication: Tele-conferencing; Video-conferencing; Limited Live; Listservs:

## **CONCLUSION**

We are living in a world that has expanded its networking capability exponentially every year for the past decade. The Global Economy has greatly expanded our capacity to compete in the market place at a faster pace than ever before in history. In a world of innovation, specialization and

niche markets have allowed small and medium sized companies to compete very effectively. The major problem is the need for streamlining the "Let's-make-a-deal" process to accommodate a fast paced, complex business transaction that is trustworthy and somewhat predictable as to outcome. The answer: ADR approaches are the most qualified and proven methods for resolving issues that consummate "deals."

To proactively address these issues, a basic Internet tool was structured to meet the challenges of making-a-deal, the dynamic Negotiation and Conflict Management Systems Model. The Model is essentially a series of facilitated negotiation techniques that foster and encourage deal-making. The fundamental criteria of the system is to involve the participants in an informal, but organized problem solving/decision making routine that ultimately contributes to consensus building and the making of a legitimate deal. The process values trust, responsibility, accountability, and a number of factors that promote long lasting business relationships and reasonable agreements. This process is not a substitute for business law principles and practices, but it is the fulfillment of applying business law principles and practices in the "deal" through ADR outcomes. The primary task of the ADR Model is to satisfy the interests and define expectations of the parties.

# **MICRO SYSTEMS, INC: FINANCIAL PLANNING AND STRATEGY IN THE SEMICONDUCTOR INDUSTRY**

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## **CASE DESCRIPTION**

*The primary subject matter in this case focuses on developing sales forecasts using an Exponentially Weighted Moving Average and Single Linear Regression in the highly cyclical DRAM industry. These sales forecasts, using sample data, are then used to develop an estimate for External Funds Needed (EFN) using the percentage of sales technique. The case is appropriate for a senior level, capstone finance class or for a first year graduate MBA course in finance. The case provides an excellent vehicle for exploring the need for cross-functional communication in developing an estimate of external funds needed to support the fast paced growth in the semiconductor industry. Students are asked to apply quantitative techniques they have/are learning to the task of sales forecasting and pro forma financial statements construction. This case also explores issues pertaining to forecasting accuracy, capital structure decisions, and risk analysis using Monte Carlo simulation in Excel. In addition, case provides opportunities for exploring the impact of growth by acquisition on a number of human resource issues such as training and recruitment.*

## **CASE SYNOPSIS**

*Wayne Wallace, CEO, of Micro Systems Incorporated (MSI) had just convened a meeting with his leadership team to discuss the future direction for MSI since finalizing the acquisition of all of Technology Incorporated's (TI) DRAM facilities including plants in Italy, Texas, and Singapore. His team consisted of Nick Simmons, CFO, Bill Reyes V.P. of Manufacturing, and Jean Thompson, Manager of Training and Education for MSI Technology, and Harry Doolittle, Director of Corporate Planning. The acquisition made MSI the only domestic producer of DRAM and the world leader in DRAM market share. The agenda for the meeting included discussions about MSI's expected growth in the coming years, and the implications this growth would have for each of the functional areas at MSI.*

*Nick Simmons was naturally concerned about the changes in MSI's capital structure caused by the combination of growth in the DRAM industry and the TI acquisition. The semiconductor industry was just recovering from the longest downturn in the industry's history. Bill Reyes noted that although they had acquired additional wafer fabrication and testing facilities from TI, most of the plants were currently operating at or near capacity. In addition, Bill was anticipating a need for approximately \$1 billion in capital spending during the next four quarters to update aging technology in the newly acquired facilities and begin an equipment conversion to the new 300 millimeter wafers that would reduce operating costs. Jean Thompson was next on the agenda. Her concerns centered on successfully integrating the different corporate cultures of TI, MSI, and the joint venture affiliates in Japan and Singapore.*

*At the end of the discussion, Wayne Wallace asked Harry Dolittle, Director of Corporate Planning, to provide CFO Nick Simmons with revenue estimates for the next four quarters. Nick has been charged with developing a set of pro forma financial statements that reflect the changes expected by the firm in the coming year in order to identify the external funds needed. This information will be used by the executive team to discuss the alternative capital structure plans.*

### **BODY OF THE CASE**

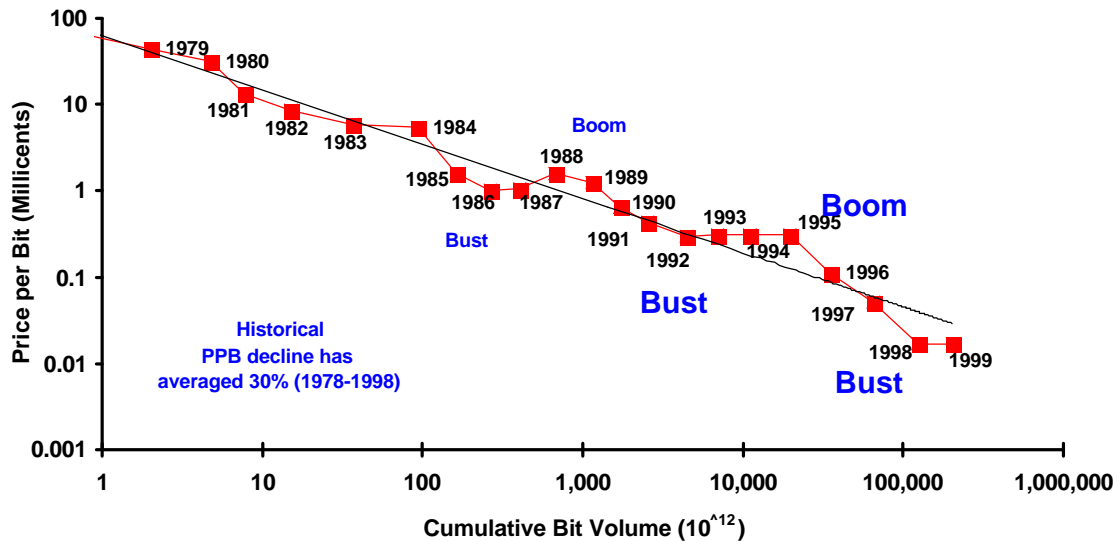
Wayne Wallace, CEO, of Micro Systems Incorporated (MSI) had just convened a meeting with his leadership team to discuss the future direction for MSI since finalizing the acquisition of all of Technology Incorporated's (TI) DRAM facilities including plants in Italy, Texas, and Singapore. His team consisted of Nick Simmons, CFO, Bill Reyes V.P. of Manufacturing, and Jean Thompson, Manager of Training and Education for MSI Technology. The acquisition made MSI the only domestic producer of DRAM and the world leader in DRAM market share. Under the terms of the agreement, TI received approximately 28.9 million shares of MSI common stock valued at \$881 million as of the closing date, \$740 million in notes convertible into an additional 12 million shares of MSI common stock, and a \$210 million subordinated note. In an October 1, 2000 press release the market value of the 6.5 percent convertible and subordinated notes was approximately \$836 million.

In addition to TI's memory assets, MSI received \$550 million in proceeds from financing provided by TI to facilitate the deployment of MSI's technology throughout the acquired business. As part of the transaction, MSI also received a 10-year royalty-free cross license agreement. The proceeds are less than previously announced as TI agreed to retain its Italian government-sponsored debt. As stated in a press release TI expects a before tax gain of approximately \$100 million on the sale, which will be deferred until the repayment of the TI-provided financing.

The agenda for the meeting included discussions about MSI's expected growth in the coming years, and the implications this growth would have for each of the functional areas at MSI. Nick Simmons was naturally concerned about the changes in MSI's capital structure caused by the combination of growth in the DRAM industry and the TI acquisition. The semiconductor industry was just recovering from the longest downturn in the industry's history. MSI's 10-year sales history is provided in Table 1. Figure 1 demonstrates the downward pressure on price per bit as well as the cyclical nature of the semiconductor business.



Figure 1: Price per Bit Cycles



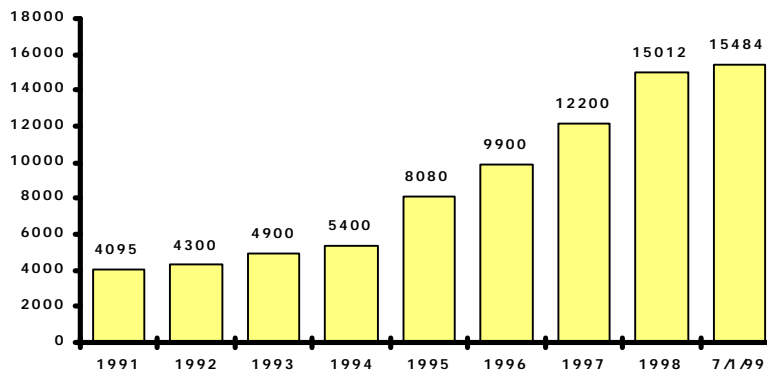
Source: ICI Status'99 1979-1997, Semico Research 4/99, 1998-2001

Given the volatility of the semiconductor industry and the capital intensive nature of this business, MSI had always been cautious in the use of financial leverage in its capital structure as indicated in the financial statement data given in Table 2. Now Nick felt that they were faced with the need for new funds to finance future growth and he asked Bill and Jean about their needs in the next fiscal year. MSI would have to make some tough decisions in the months to come about their capital structure.

Bill Reyes noted that although they had acquired additional wafer fabrication and testing facilities from TI, most of the plants were currently operating at or near capacity. In addition, Bill was anticipating a need for approximately \$1 billion in capital spending during the next four quarters to update aging technology in the newly acquired facilities and begin an equipment conversion to the new 300 millimeter wafers that would reduce operating costs. The equipment upgrades were consistent with MSI's mission of being the most efficient provider of semiconductor memory solutions with short cycle times, high yields, low production costs, and die sizes that are some of the smallest in the industry. Bill added that if forecasts for growth exceed existing plant capacity, MSI might also consider bringing the Spokane, Washington facility online, a facility that was moth-balled during the last industry downturn. This would require an additional billion dollars in capital spending. Reyes felt that MSI had been successful at reducing inventory over the past year and expected the level to vary in proportion to sales.

Jean Thompson was next on the agenda. Her concerns centered on successfully integrating the different corporate cultures of TI, MSI, and the joint venture affiliates in Japan and Singapore. She showed Simmons and Reyes Figure 2 and noted that the number of employees at MSI had been growing steadily throughout the 90's but the TI acquisition increased the number of employees to over 15,000 in 1999.

Figure 2: Employee Growth at MSI Technology



The growth in employee numbers was stretching MSI's training and education budget. In addition, key manufacturing managers had been detailed to overseas operations in order to instill the "MSI Way" of making DRAM. This left key positions to be filled at the Coeur d'Alene, Idaho facility in a tough labor market. In addition, MSI had always had a practice of promoting internal candidates but the sudden growth made that practice impractical. This meant that MSI had to develop new recruiting methods for acquiring talented college graduates and quickly integrating them into the organization. In order to recruit top students, MSI was forced to increase starting wages and offer signing bonuses. While this approach seemed to be working in terms of increasing the number of new college recruits, the practice created inequities and compensation gaps between new and veteran MSI employees that would have to be addressed to keep the strong team oriented environment.

In addition, Bill was concerned about a number of labor issues that emerged as a result of the acquisition that would have to be addressed if MSI was to maintain its position as the industry cost leader. The newly acquired Avezzano plant in Italy was unionized and worked traditional eight-hour shifts. The Coeur d'Alene facility used a system of 12-hour shifts that kept the fabs producing DRAM around the clock. Bill told the group that migrating to the Coeur d'Alene way of doing things was going to be difficult abroad. For example, the managers at the Avezzano plant told Bill that workers would not be able to go shopping after work since stores were not open in the evenings as they were in the U.S. As a result, they did not think the union would approve the new shifts. Bill was concerned that these labor issues would create upward pressure on MSI's traditionally low cost of goods sold.

### MSI TECHNOLOGY, INC.

MSI Technology, Inc., headquartered in Coeur d'Alene, Idaho, was founded and incorporated in 1978. Today, MSI is one of the world's leading producers in the semiconductor memory market. It achieved this status based on its leading edge process technologies and its ability to produce memory chips at a low manufacturing cost. MSI's memory solutions products are distributed worldwide to customers in a variety of industries such as computer and computer-peripheral manufacturing, consumer electronics, CAD/CAM, telecommunications, office automation, network and data processing, and graphics display. In an April, 2000 report, research analysts, de Dios and Associates, ranked MSI Technology, Inc. (MSI) second in the world for its DRAM megabit sales

(19%) ending 1999. In addition to DRAM, MSI produces SRAM, Synchronous SRAM and Flash memory chips.

According to Bill Reyes, Vice President of Manufacturing, MSI's success can be attributed to its core competencies, which are low cost manufacturing, process technology, flexibility and nimbleness to adapt to rapid market changes, and a dedicated, motivated workforce. These competencies have enabled MSI to produce some of the smallest die sizes in the semiconductor industry. Already ahead of its competition, MSI produces its DRAMs at 0.18 MSI line widths (a MSI is one millionth of a meter) and is moving forward with its 0.15 technologies. MSI's leading process technologies have enabled the company to produce a full range of memory technology solutions that are of high quality and are competitive in price and performance.

MSI Technology, Inc. has now grown to seven manufacturing facilities at sites in the U.S., Japan, Singapore, and Italy and has engaged in two joint ventures with manufacturing firms in Japan and Singapore. As MSI strives for the leadership role in the DRAM market, it is well aware of the critical success factors that drive the semiconductor industry.

## **INDUSTRY CHARACTERISTICS**

### **The Cyclical Nature of the Semiconductor Industry**

Throughout 1998 and 1999, the semiconductor industry faced three major problems: weak chip prices due to oversupply; a weakened Asian economy, and changing needs of the PC market. The memory chip business was the hardest hit during this slump. Memory chip sales in 1995 were \$40 billion, but dropped to \$30 billion by 1997. When the personal computer market was growing fast (1992-95), DRAM manufacturers invested heavily in plant capacity to meet the shortage, and were operating at higher margins on memory chip sales. However, this DRAM shortage and higher profit margins encouraged more competitors, especially from Asia, to increase capacity. Eventually, this buildup led to an oversupply of memory chips, which triggered the downward spiral of the market beginning in 1996. By 1997 there was a large oversupply of DRAM causing a dramatic decrease in chip prices. For example, in 1995 the average price for a 16-megabit DRAM was \$54, and a 64-megabit DRAM was \$225. In 1997-98, DRAM manufacturers were selling the chips at \$3.80 and \$13.80, respectively. At the same time there was a fall in DRAM prices, there was also a mounting concern with the depreciation of the Asian currencies relative to U.S. dollar. Asian competitors were able to slash labor and overhead costs which hurt U.S. domestic producers. This led to more export volume thereby hurting domestic pricing even more.

After the bleak years (1996-99) of falling prices, DRAM demand started to explode in the fall of 1999. World sales of all semiconductor products totaled \$14.56 billion at the end of February, 2000, which reflected a 33.4% increase from sales of \$10.92 billion in February, 1999.<sup>11</sup> However, DRAM sales for 1999 (\$20B) were only half as much as they were in the peak year of 1995. Industry analysts from Semico Research Corporation forecast a two-year growth trend that should reach \$28.3B, or a 40% growth, in global DRAM revenues. By 2001, the global sales are predicted to grow another 44% to a \$40.9B that will finally surpass 1995 peak revenues. As shown in Figure 4, IC Insights predicts DRAM sales will represent 77% of the entire memory chip market sales (\$84.2B) by 2002 compared to its 1997 actual market share of 68% on total memory chip sales of \$29.7

Billion. With expected demand growing intensely, DRAM manufacturers are now beginning to struggle to keep up with growing orders for 64- and 128-megabit chips.

Figure 4: Comparison of Worldwide Memory Market Sales for 1997-2002



[Source: IC Insights in (11)]

While there is presently enough capacity in the industry, the real problem now is the wrong process technology. Analysts from Semico Research Corporation suggest that memory makers will need to add new 0.18-micron processing capacity to boost unit volumes from existing wafer labs. The 128- and 256-Mbit DRAMS will require companies to push their most advanced technologies down to the 0.15 microns.<sup>3</sup> Furthermore, some industry experts feel that to get to the next generation of 256-megabit DRAM, manufacturers are going to have to move from 8-inch wafers to 12-inch wafers in order to increase yields and be cost effective. This demand for new process technologies will require DRAM manufacturers to ramp up their investments in 2000 and 2001 which could probably lead to another oversupply by end of 2002.

### Capital Intensive Industry

The DRAM market can best be characterized as a very capital-intensive industry coupled with rapid technology changes and a volatile demand led by the PC industry. The large manufacturing plants needed for production of DRAM chips cost about \$2 billion, and on average take about 18-24 months to build. To justify such a decision, a company must be able to predict the demand for the product two years in advance and must be able to sell DRAM for a sufficient period of time at a high enough price to cover investment costs. Added to this timeline is the factor of evolving technologies. Computer technology changes so fast that by the time a company has built a plant to produce a particular DRAM chip, the technology and the demand for that chip may be outdated. Also, if there is a surplus of chips on the market and prices decline, a company may not be able to cover the cost of building the manufacturing facility--let alone make a profit. According to Strategic Marketing Associates (January, 2000) capital expenditures by U.S. companies are expected to increase dramatically in year 2000. Currently, the U.S. is being outspent by Asia-Pacific as a whole, but

overall the U.S. semiconductor companies continue to lead every other country in the world in terms of spending. Because of the heavy investment and risk involved in manufacturing DRAM chips, DRAM manufacturers tend to be large, established companies. Many international companies are government-subsidized or rely on partnerships with other large companies.

Once the manufacturing facilities are built, DRAM manufacturers must make and sell extremely large quantities of chips in order for the investment to pay off. Eighty percent of DRAM production is sold to companies that buy in quantities of 5,000 to 120,000 units based on long-term contracts. The duration of the contracts can range from three months to a year, during which time the quantity purchased and the price are guaranteed. Having buyers commit to a long-term contract protect chip manufacturers from fluctuations in the DRAM market and ensures steady profits. DRAM manufacturers tend to limit their contract-based DRAM sales to well-established companies with whom they have developed long-term relationships. Companies sell the remaining 20 percent of their chips -- those not tied to contracts -- to smaller companies through various distribution channels. Again, this is to protect the DRAM manufacturers from fluctuations in pricing and to ensure economies of scale.

In the downturn of the DRAM market in 1996-99, MSI Technology, Inc. had correctly forecasted the oversupply problem that typically occurs on a five-year cycle. MSI responded to the oversupply of DRAM by placing a hold on building a new manufacturing facility in Spokane, Washington. By the end of 1999, industry analysts had positioned MSI to be the DRAM manufacturer to have the highest percentage of fabs at 0.15 microns in year 2000. By shrinking the die size to increase yield per wafer, MSI has been able to produce more DRAM at a lower cost than its competitors. All of these factors have been critical success drivers in the semiconductor industry.

### Competition in the DRAM Industry

Manufacturers seem to be the victims of their own success. When the industry makes profits, DRAM suppliers reinvest revenues, build fabrication facilities, and accelerate die shrinks to get more usable chips from the same wafer. When the industry has reached an oversupply from all the added capacity, then DRAM prices begin to fall. Table 3 is a list of the top 10 DRAM manufacturer based on revenues prior to the downturn of the DRAM market. Only MSI and Siemens show a positive percentage change in revenues between 1996-1997.

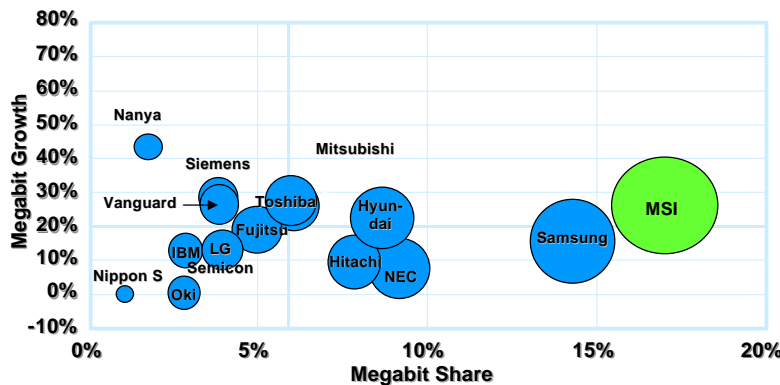
Table 3  
Rank of DRAM Suppliers 1996-97 [Source: In-Stat]

Rank	Company	1997 Revenue (billion \$)	1996 Revenue (billion \$)	% Change
1	Samsung	3,610	4,260	-15.2%
2	NEC	2,265	2,919	-22.4%
3	Hyundai	1,905	2,207	-13.7%
4	Hitachi	1,846	2,523	-26.8%

5	MSI	1,650	1,471	12.2%
6	LG Semicon	1,465	2,039	-28.0%
7	Technology Incorporated	1,440	1,574	-8.5%
8	Mitsubishi	1,215	1,330	-8.6%
9	Toshiba	1,167	1,833	-36.3%
10	Siemens	1,020	862	18.3%

Following the industry downturn from 1996-99, the positions of these DRAM producers shifted and some even were eliminated. Today, MSI and Samsung compete for the number one position. As shown in Figure 5, the 1998 market share data indicates MSI is the largest DRAM producer of 16- and 64- megabit DRAM, but 1999 data indicates MSI is number two overall.

**Figure 5:**  
**Competitive Map of Worldwide DRAM Market (After)**  
**Combined 16 and 64 Meg, Q1-1998**



Source: de Dios & Associates and Micron Market Research, June 1998

### The Strategic Decision

Wallace interrupted the discussion at this point to get the group to focus on a number of action items for the next meeting. "Nick, will you develop a set of quarterly pro-formas for next year so we can come up with an estimate of the external funds needed to finance the growth? Bill, Nick will need a capital budget that reflects the additional fixed assets we will need to meet our expected growth in the coming year. Jean and Nick will also need an estimate of your needs for training and recruitment supplements as well as any increases in wages that you believe are necessary to remain competitive in the job market. Let's get together next week to look at our needs for external funds and decide how to adjust our capital structure."

## TACTICS FOR RECESSION AND RECOVERY

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### ABSTRACT

*A primary economic indicator has already declared that the U.S. is in recession as on February 2001. Managers' responses during this downturn should be influenced by the cyclical nature of their industry and by the extent to which the roll of the recession is effecting their competitive environments. Depending on their situation, managers may find value in seven success tactics that benefited adopters during the decline phase of the last recession. They may also wish to take advantages of recovery tactics that can help to position their firms for the end of the recession when new competitive dynamics come into play. This paper explores the logic of these tactics and provides prominent examples drawn from corporate successes.*

### THE UNITED STATES IS IN A MANUFACTURING RECESSION

The first major indicator of a downturn in the economy is usually the monthly index of the National Association of Purchasing Management. A precursor to the more encompassing measures of the Gross National Product and the Leading Economic Indicators, the index fell to 42.2 for January 2001, a sixth consecutive sub-50 monthly report; the NAPM defines as its recessionary threshold as two consecutive sub-50 months. Because the manufacturing sector constitutes about 20% of the overall economy, the numbers indicate that its weakness is so severe that it can pull the national economy into a downturn. Other economic signs suggest that a severe downturn, if not a nationwide recession, has arrived. U.S. worker productivity, a measure of living standards, fell at an annual rate of 1.2% in the first quarter of 2001, the biggest drop in eight years. Unit labor costs jumped 6.3% for the quarter, the biggest increase since 1990.

This paper looks at recent recessions in an attempt to identify the tactics that executives have used – often in emerging entrepreneurial companies – to minimize negative impacts on their firms' performances. This topic is important because entrepreneurs have the same needs to forecast the future direction of the economy as do executives of larger firms, but they characteristically lack the resources to undertake extensive monitoring and interpretation of economic trends. Unable to afford specialized in-house economic talent, entrepreneurial executives often need to do their own economic forecasting. The insights presented in this paper are intended to provide these entrepreneurs with research and experience based information that can improve their ability to cope with economic downturns.

We begin with an overview of how downturns affect industries, before turning to eight tactics that have reduced the severity of the decline phase of a recessionary period on business profitability.

The focus then turns to success tactics that have directed some highly successful company turnarounds during the recovery phase of the economy.

### **HOW VULNERABLE IS AN INDUSTRY?**

A recession does not arrive at every location throughout the country at the same time. In fact, some locations often go largely unaffected. Similarly, some industries are hit first, others are hit harder. Therefore, even when national statistics show that a broad-based slowdown is occurring, entrepreneurial executives need to assess the extent to which their own industry is affected. The principal predictor of likely impact is the cyclical nature of the industry:

I. Cyclical Industries – The performance of a cyclical industry coincides with the phases of the business cycle. Therefore, in a recession a cyclical industry is characterized by stable or falling prices, a decrease in corporate spending, a decline in real earnings, excess production capabilities, and high unemployment. Examples of cyclical industries include jewelry and precious metals, auto makers, apparel and other textile products, red meat, paper and paperboard mills, computer manufacturing, home builders, real estate sales, hotels, airlines, media, and electronics. In the 1990-1991 recession, automobile manufacturers and their suppliers were among the hardest hit. Net income slipped 78% at Ford and 81% at Chrysler. To minimize losses, the carmakers reduced costs by closing plants, squeezing suppliers, and using special discounts to entice buyers.

II. Counter-Cyclical Industries – An industry that typically does well during a recession is a counter-cyclical industry. It is characterized by an increase in earnings, a rise in employment, an increase in consumer spending, and full utilization of its production facilities. These industries typically perform well in a recession because they provide the consumer with cost savings on a necessity product. Therefore, generic products and discount warehouses improve their profit performance as consumers seek to save money on necessary purchases.

III. Noncyclical Industries – A noncyclical industry does not follow any cycle. Its performance is unrelated to the state of the economy. During a recession, consumers will continue their expenditures on necessity products such as food and health care. In fact, health-care and drug companies claimed four of the top 10 spots on the American Stock Exchange at the trough of the 1990-1991 recession. Many health-care products are unaffected by a recession because of consumers' insensitivity to the cost of their care and the aging U.S. population.

### **SUCCESS TACTICS DURING ECONOMIC DECLINE**

Having roughly determined the extent to which their firm is vulnerable to recessionary impacts, given the cyclical nature of its industry, the economic health of its region, and the vitality of its suppliers and customers, entrepreneurial executives will want to consider eight tactics that improved strategic viability for businesses in the last recession. These success tactics include retrenchment, tightening credit, maintaining budgets, maintaining prices, increasing liquidity, reducing debt, deferring capital expenditures, and pursuing selective growth.

I. Retrenchment – The main goal of retrenchment is to stabilize a company's financially during the economic downturn so that it can be in position to recover from the recession. As a companion action, retrenching companies turn to entrepreneurial activities that increase revenues or



to efficiency initiatives that reduce operating expenses and increase profit margins. Retrenchment tactics are often the front half of a cut-and-build strategy in which the company cuts certain expenses and invests the savings in new priorities.

Retrenchment through cost and asset reduction proved to be a successful tactic that stemmed the decline of many firms in the 1990-1991 recession. Cost reductions included leasing rather than purchasing space, eliminating elaborate promotional activities, laying off employees, and eliminating perks. A retailer that successfully reduced costs to increased profits was Walgreen, the drug store chain. Walgreen's management trimmed SG&A expenses from 23.3% of sales in 1990 to 22.2% in 1991, helping to increase net income 10% in 1991. Asset reductions can involve selling nonessential outlets and equipment. Dress Barn, a retail women's clothing company, eliminated 22 stores at the onset of the recession. As a result of the cutbacks and asset reconfiguration, Dress Barn was able to post a 10% sales increase during the first half of 1992.

II. Tightening Credit – During the recession of 1990-1991, entrepreneurial executives found that an effective tactic to minimize the effects of the downturn was to tightened rather than loosened credit policies. Loosening credit might boost sales, but they come at the expense of liquidity if the debt sours. Tightening credit policies is also a way to increase a firm's liquidity during a downturn. Increased liquidity can enable the firm to take advantage of special deals that may occur due to recessionary effects on less prepared competitors or suppliers.

III. Maintaining Advertising Budgets – When faced with recession, companies are tempted to reduce advertising because it is immediately reflected in the bottom line. However, a study by the Strategic Planning Institute concluded that the companies that fared best in the two years after recessions had either held steady in advertising expenditures, or made moderate cuts during the recession (McLaughlin, 1990). The study found that advertising campaigns may be more effective during recessions because competitors may reduce their advertising. Thus, when many competitors reduced advertising budgets, toiletries maker Alberto-Culver increased its ad spending. Partly as a result, company profits were up more than 35% in 1992 (Jacob, 1992).

IV. Maintaining Prices – The temptation to cut prices to increase sales is tremendous. Budget conscientious consumers spend with increased reluctance during a recession and price considerations tend to overshadow attention on innovative features. However, price-cutting can be shortsighted. Reduced pricing may help to stabilize the number of units sold but if spending plans are not adjusted, profit margins can quickly turn negative (Garter, 1991). Instead of cutting prices immediately to maintain sales during the last recession, many managers found that prices should be reduced only as a last attempt to maintain cash flow.

V. Increasing Liquidity – The liquidity and flexibility of a company are increased when inventory levels and accounts receivables are reduced. Liquidity provides staying power in a recession. High cash can be a source of expansion funds when excess capacity gets absorbed by the recovery. Successful implementation of this approach is easily measured by calculating current ratios and comparing them with ratios calculated for other recent periods.

VI. Reducing Debt – Lower debt can reduce cash demands through smaller interest payments. Like reducing inventory and accounts receivable, reducing debt increases liquidity and helps provide flexibility and increased staying power. However, lowering debt decreases cash and thus, the company's flexibility. Lines of credit can also be revoked when paid-off, at times because of the bank's portfolio of loans rather than the condition of the company.

VII. Deferring Capital Expenditures – Reducing capital expenditures increases both available cash and the productivity of existing investment. Delaying capital expenditures enables the firm to get more from its existing facilities at a time when consumers may be more concerned with price than technological innovation. However, a potential disadvantage of delaying investment is that suppliers might not be able to furnish new equipment in a timely manner to allow entrepreneurs to take advantage of the recovery. The resulting delays in production can frustrate the company's clients and prompt them to go elsewhere.

VIII. Pursuing Selective Growth – The costs of pursuing selective growth opportunities are low since many competitors are "sitting in wait" for an economic recovery. Entrepreneurial executives want to consider taking advantage of opportunities that arise or can be created by a recession: 1.) Exploit competitors' problems. Economic downturns make many opportunities available. Many valuable employees are laid off or become disenchanted during a recession, 2.) Focus on long term goals. Take advantage of favorable interest rates. Refinancing existing debt or take on new low-priced debt when the recession seems to have bottomed out. 3.) Buy inimitable assets when they become available. Recessions can produce once-in-a-career opportunities to buy key property, buildings, or patents that would otherwise be unavailable.

### **SUCCESS TACTICS DURING ECONOMIC RECOVERY**

Following a recession, many businesses achieve impressive labor productivity improvements. During the recovery in 1991, increased productivity by firms led to a 75% gain in gross domestic product (GDP). In previous recessions, productivity improvements on average brought a 58% GDP increase in the year following the recession. These productivity gains led the way for corporate profits from U.S. production to increase by a third during the most recent recovery, from \$300 billion in 1992 to \$400 billion in 1993. When demand rebounds, businesses can boost productivity in the short term without hiring new workers. However, unless the rate of innovation accelerates, productivity growth eventually returns to its lower long-term trend. The experiences of a business following the 1990-1991 recession suggest that entrepreneurial executives can accelerate their firms' recovery by taking steps that improve productivity.

The most important idea behind recovery planning is that even when conditions are depressed, a company must make decisions based on the long haul. A recession must be treated as the short-term problem that it is. Recovery will come, eventually. Thus, the strategy that entrepreneurs develop or modify during the recession will determine their firm's participation in the nation's recovery. The best way for a business to prepare for growth following a recession is to maintain a focus on the long-term. In December 1990, *Fortune* magazine surveyed 200 executives. Of those surveyed, 38% expected to increase their capital spending in 1991, and only 27% expected to cut (May, 1991; 72). When consumer demand increases, businesses must have the necessary cash flow to finance growth in investments.

### **PREPARING FOR RECOVERY**

In preparing for economic recovery, a business's first step should be to assess its financial position. If the firm is in a serious financial bind, then it may focus on survival by generating short-

term revenues at the lowest cost. Conversely, if the firm's market position and profit structure are strong, it may have the opportunity to increase investment in advertising, new product introductions and added distribution to increase brand valuation and market share. Many U.S. manufacturers took to a defensive approach to the economic recovery that began late in 1991. They began by reducing their reducing break-even levels. Many companies found that they could trim costs by 10% of 15% a year through a series of small steps, including reducing the frequency of internal reports and meetings, and eliminating non-productive perquisites. One key to recovery was making cutbacks during recessions in ways that do not adversely affect the quality of the company's products. Firms that can enact only moderate cuts have traditionally survived recessions and realized stronger long-term sales and market share growth than competitors that made severe cuts (McLaughlin, 1990).

A firm's second step should be to revise its market segmentation and targeting to adjust for shifts in customer behavior (Pearce & Michael, 1997). The firm may refine its marketing mix to balance price reductions, advertising and promotions, and value pricing; product introductions and R&D cuts; and renegotiate contracts and sales reductions.

Opportunistic strategies are the result of managing with the next recession in mind. Entrepreneurial firms that have healthy cash flows, a well-defined market niche, ongoing quality programs, and stable or increasing sales volume are well positioned to gain competitive ground during recessionary periods. Options under this strategy include maintenance of R&D that other companies cannot afford, new products introductions to increase market presence, and hiring new staff who would be unavailable under more munificent conditions. As damaged companies begin to layoff employees, healthy companies may recruit their competitors' better personnel. A final opportunistic measure is horizontal integration – the purchase of competing companies.

### **KEEPING RECESSIONS IN PERSPECTIVE**

Many companies emerge from a recession as more efficient operations. They have laid-off surplus workers, closed inefficient plants, bought productivity enhancing equipment, and become more globally competitive. According to a survey of executives, a recession also produces a newly committed workforce, better communications in the office, faster response to the market, opportunities for those who stay, and a premium for talent.

Recessions play a vital role in an economy. From a national perspective, short-term losses of individual industries or companies often result in long-term gains for the economy from increased productivity. Recessions encourage organizations to wring out under-performing resources and to find innovative solutions to competitive demands. Those companies that can weather the period of recessionary turmoil often benefit from lower inflation and interest rates, along with the purging of excess inventory, corporate overhead, and marginal competitors. These changes help underwrite durable, non-inflationary growth for years to come. Therefore, it is a responsibility of an entrepreneurial executive to ensure that the company both outlasts the recession, and that it emerges stronger and more competitive than before.

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# THE CONSEQUENCES FOR BUSINESS OF GOVERNMENT ACTION IN AN ECONOMIC DOWNTURN

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## ABSTRACT

*A nationwide recession is impossible to predict, even for the US government. However, whether or not a recession is formally confirmed, the Federal Government acts on several fronts to reverse the decline. Managers who know how to monitor a changing economic landscape and who can correctly forecast the powerful impact of government responses to a recession on their business are in position to optimize. This paper reviews recent economic downturns in the United States and the Federal Government's responses to them to proffer crucial insights for managers when they face a recession.*

*By the end of the first quarter of 2001, a national recession in the US was threatening. However, the economic tealeaves are ambiguous. Time remains for economics-educated managers to use the forecasting capability of the federal government to aid them in designing their own strategies for building recession resistance and for benefiting from the special opportunities that economic downturns create in the marketplace.*

## THE NATURE OF RECESSIONS

Of the major indicators of a recession, the first to reflect a downturn in the economy is monthly index of the National Association of Purchasing Management. A precursor to the more encompassing measures of the Gross National Product and the Leading Economic Indicators, the index signaled that, as of January 2001, the US was officially in a recession in the nation's manufacturing sector. Other economic signs suggest that a severe downturn, if not a nationwide recession, has arrived. US worker productivity, a measure of living standards, fell at an annual rate of 1.2 percent in the first quarter of 2001, the biggest drop in eight years. Unit labor costs jumped 6.3 percent for the quarter, the biggest increase since 1990. Factory orders declined in the first quarter of 2001, and the overall economy grew at an anemic rate of only 1.2 percent.

Since World War II, the US has experienced eight economic recessions, defined as at least two consecutive quarters of falling Gross National Product. The most recent ended in 1991. The average recession during this period lasted 11 months and reduced real GNP by 2.6%. Each downturn wreaked havoc on the economic wellbeing of many elements of society. Thus, the majority of economists look suspiciously at the 10-year span since the last recession.

## **TOOLS FOR FORECASTING A RECESSION**

There are many variables to measure and evaluate in trying to discover the causes and effects that result in a recession. This extremely complicated process defies timely, simple or certain analysis. Therefore, the resources of the Federal Government are needed to undertake the task. The US Department of Commerce gathers and publishes statistical data on the GNP and other leading economic indicators to aid in the prediction and interpretation of recessions.

Perhaps the most popular and widely accepted methods for predicting an economic recession involve the examination of eleven leading, or foreshadowing, indicators of the overall trend of the economy. The data for the analysis of the Index of Leading Indicators (LEI) includes stock prices, commodity prices, consumer expectations, consumer goods orders, the money supply, the length of the work week, the number of order backlogs, the number of plant and equipment orders, the number of unemployment-insurance claims, the number of building permits being issued and the length of vendor delivery times. A recession is technically said to exist when the LEI has declined for three consecutive months (Sykes, 1993).

A lesser-known but more successful forecasting model is the experimental recession probability index (XRI). The XRI combines the coincident economic indicators (CEI) and the LEI. The CEI involves a weighted average of four factors: industrial production, real personal income less transfer payments, employee-hours in nonagricultural businesses and real manufacturing and trade sales.

Another econometric model is the Turning Point Recession Index (TPRI) which involves examining the peaks and valleys of the economic cycle (Henderson, 1994). TPRI attempts to forecast a recession by predicting a behavioral switch in the economy from an expansion to a contraction. The model has performed well except in predicting the 1990-1991 recession. Relating economic changes in 1990 to past economic fluctuations, which is what the TRPI does, allowed the 1990-1991 recession to escape detection by the TRPI method (Huh, 1991).

Simple predictors of recession also have supporters. For example, until 1991, a recession followed whenever short-term interest rates rose above long-term rates. When this happens there is an inverted yield curve. The yield curve shows interest rates along the maturity spectrum from 3-month Treasury bills to 30-year Treasury bonds. Interest rates reflect the price of money and reveal consumer expectations about growth and inflation and their preferences for saving versus spending. Therefore, when the yield curve has a positive slope, the public is expecting economic growth and higher interest rates. When the curve flattens or is inverted, the opposite occurs, the public expects the economy to weaken and fall into a recession. Unfortunately, because the yield curve was not inverted in 1990, many economists who relied on this approach failed to predict the recession.

Other analysts rely on consumer perceptions to gauge a recession. The Survey Research Center of the University of Michigan and the Conference Board publish monthly statistical indicators based on household perceptions of the economy. The Survey Research Center's consumer sentiment index reflects consumers' attitudes toward the economy and the job market, and their perceptions about purchasing durable goods. The Conference Board's consumer confidence index similarly measures consumers' attitudes toward the economy, job market and their own financial situation. When these measures reflect negative changes, a recessionary climate exists since consumer spending accounts for approximately two-thirds of the GNP.

Additional economic forecasts are available to managers that may provide predictions more specifically geared to their industry or geographic area. The National Association of Purchasing Managers (NAPM), Blue Chip Indicators, National Bureau of Economic Research, Chicago Purchasing Managers index, the ECRI Future Inflation Gauge, and government reports of construction spending, factory orders, worker productivity, layoffs, and housing starts.

## **INFLUENCES OF GOVERNMENT POLICY**

The goal of both fiscal and monetary policies is to maintain a balance between aggregate demand and production capacity by inducing business and consumers to alter their spending habits. Fiscal policy, determined by the President and Congress, can moderate or stimulate demand and provide incentives to work, save, and invest. Fiscal policy focuses on government outlays or taxes and is implemented either through automatic stabilizers or discretionary policy.

Automatic stabilizers are built-in mechanisms in the economy, put in place by the government to reduce the amount by which output will be impacted by changes in autonomous spending. Specifically, they act as economic buffers by automatically reducing taxes and increasing transfer payments, and they are an integral part of the government's overall fiscal policy. An important automatic stabilizer in the US economy is the progressive income tax.

Managers should consider the implications of the 2001 tax cut plan for their company. It will almost certainly stimulate business activity. The Bush Administration plan, with its across-the-board rate reductions, will be useful in putting dollars directly into the hands of consumers. Individual tax payers will receive a one-time \$300 check from the government that should reenergize spending. The initial, retroactive tax cuts should be especially beneficial for business since taxpayers know that tax refunds will be coming by midyear. Tax rate reductions in continue in subsequent years. Although there will be no change in the 15% tax bracket, the next three brackets will drop by three percentage points over the next five years, and the top bracket will be cut by 4.6 percentage points. Thus, Bush's ten year, \$1.35 trillion program provides some tax relief immediately that is designed to stimulate the economy and stave off recession, even though most of its effects will come long after the immediate recession threat is over.

The Federal Reserve, a quasi-independent federal agency, controls monetary policy through open-market operations that adjust the money supply and interest rates. These actions directly impact output and inflation. Business and consumers are particularly responsive to changes in the interest rate. A small decrease in interest rates has the potential to result in large increases in output and consumer income.

Monetary policy can be "expansionary" or "tight." Expansionary policies increase the money supply, which leads to lower short-run interest rates that stimulate investment, output, income, and spending. Investment in interest-rate-sensitive sectors such as banks and utilities also tend to jump favorably from decreases in interesting rates. Tight monetary policy is designed to control inflation. If economic growth exceeds the Fed's target of approximately 2.5%, action is taken to slow the growth. A decrease in the money supply increases interest rates. Consequently, firms will decrease production and supply, negatively influencing growth.

To reduce the impact of the recession, spending must be stimulated. Monetary growth aimed at the reduction of long-run inflation is usually more effective than changes in fiscal policy. Fiscal

policy alone is discouraged because increased government spending and tax cuts provide only short-run solutions and can lead to increased deficits in the long-run. Consumer opinion also favors a less intense use of fiscal policy. A 1990 consumer poll found that only one in four of those surveyed favored increased government spending to reduce the impact of the recession. In contrast, two-thirds advocated no increase in government spending (Wessel, 1990).

Consumer and business expectations can greatly influence the effectiveness of fiscal and monetary policy. However, if consumers and businesses view changes as temporary, as should be the case with a tax surcharge, behavior will be affected less dramatically. Similarly, if the policy is not viewed as immediately important, as might occur with a tax investment incentive, business will have little motivation to invest during a period of declining growth.

Policy considerations also have global components. A decrease in the US interest rate can positively impact the trade balance. Low interest rates stimulate a capital outflow. The falling demand for dollars decreases the currency's relative value. A depreciation of the exchange rate makes US goods less expensive compared with foreign goods, shifting demand toward US domestic goods as well as discouraging US consumers to substitute more expensive imports. These changes in consumer behavior positively impact domestic producers, leading to an increase in output and income. Thus, the government's recession policies impact consumer spending and interest rates, and impact trade and capital flows, thereby directly influencing the well being of the economy.

### **ACTIONS OF THE FEDERAL RESERVE**

The Federal Reserve Bank occupies a unique position in the US economy. The Fed's goal is to prevent inflation and promote long-term price stability as a strategy for achieving maximum long-run economic growth. The Fed acts on the economy by manipulating the Federal Funds Rate, the Required Reserve Ratio, and by selling and purchasing Treasury securities. Whether the actions have the desired effects is determined by the subsequent responses of banks, businesses, and consumers. Of the four main tools that the Fed has at its disposal – policy directives, Federal Funds Rate, M2 segment of the money supply, and total reserves held by banks – it tends to rely on a lowering of the Federal Funds rate when an economic downturn threatens. This rate is intended to lower other interest rates and in turn spur lending, investment, and housing starts. Although the Fed cannot directly set interest rates, banks almost universally follow the Fed's lead as signaled by reductions in the Federal Funds rate.

The Fed cuts interest rates when the economy shows signs of decline. Lower rates decrease the cost of capital for businesses, thereby improving profit margins and encouraging expansion. Simultaneously, lower interest rates spur economic activity by encouraging consumer spending, particularly on mortgages. Finally, lower interest rates tend to have a positive effect on stock prices by improving the attractiveness in comparison to bonds and other fixed-income investments. In January 2001, the Fed cut interest rates by a full percentage point in an attempt to stave-off a recession. It was the biggest rate reduction in a single month in Greenspan's 13-year tenure as Fed Chairman. The federal funds rate was reduced in May 2001, by one-half a point to 4.0%. This is the lowest of short-term market interest rates because it is the rate that banks charge each other on overnight loans. The Fed sets this rate by buying or selling government securities until the target level is achieved.



## **EMERGING FROM RECESSION**

Government initiatives, Federal Reserve Board actions, and monetary policy all impact managers' decisions during economic recovery from a recession. The Federal Reserve Board cut interest rates 18 times in attempting to accelerate the recovery from the 1990-1991 recession. These low short-term interest rates made borrowing more attractive, and thus increased sales for manufacturers. For example, the automobile industry reached a strong annual rate of 7.5 million cars in June 1992 after Ford and General Motors reported combined losses in the first quarter of 1991 of more than \$2 billion. Simultaneously, low interest rates encouraged corporations to streamline their balance sheets by removing high debt payments and replacing them with lower payments. For example, in 1992, Carnival Cruise Lines called a zero-coupon convertible paying an interest rate of 7.5% and replaced it with some bank borrowing and a \$100 million convertible paying 4.5% interest. Ryder System, a truck rental and leasing company, took advantage of favorable interest rates prompted by the recession to reduce its debt by \$1.2 billion between 1990 and 1992. By decreasing the debt on its balance sheet, Ryder managers could focus on the long-term and begin to determine the best future use of their companies' assets.

Managers' decisions during a recovery are also affected by the response of financial institutions to changes in interest rates. After recessions, many banks are extremely cautious about extending business loans. Opting for lower risk, they invest in default-free government securities. In 1992, commercial banks cut back on their commercial and industrial loans to businesses by \$28 billion, while they invested more than \$115 billion in US Treasury securities.

Managers must also be watchful for the tendency of financial institutions to slash the rate they pay depositors while scarcely lowering their lending rates to borrowers. Certificates of deposit that were paying 7.0% interest before the 1990-1991 recession were only paying about 3.0% in 1992. Such actions by banks lead to a decrease in disposable income for those who depended on their savings. With lower discretionary funds, these consumers shied away from corporate stock investments.

## **GOVERNMENT ALWAYS PLAYS A ROLE**

The actions of the Federal Government profoundly impact the formation, duration, and reversal of an economic downturn. Therefore, as managers improve their ability to anticipate major Government actions, they simultaneously heightened their ability to implement altered business strategies that best position their firms to deal with the vagaries of a recession. Managers who have thoroughly considered the impact of a recession and of the fiscal and monetary policy responses that the President, Congress and the Federal Reserve Board have available are better prepared to benefit from the opportunities that such policies and actions provide. Thus, the advantage before, during, and after a recession goes to the action-oriented managers who understand the nature, motivation and likely consequences of government action.

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# A MUTUAL FUND APPLICATION OF THE SPECIAL CONSTRAINED MULTIPARAMETRIC LINEAR PROGRAMMING MODEL

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## ABSTRACT

*In designing and managing an efficient portfolio of investments, diversification techniques used by individual investors range from the most simple and naive forms to more highly complex schemes requiring quadratic programming. Regardless of the technique employed, it is widely recognized that the primary goal of most individual investors is a common one, to achieve the maximum rate of return at the level of risk considered appropriate for the individual investor's portfolio. This research shows how the Special Constrained Multiparametric Linear Program (SCMLP) model can be used to maximize an individual investor's portfolio return while satisfying the investor's preferences toward other areas of importance such as, income, capital gains, dividends, and liquidity.*

## INTRODUCTION

While the risk to total return tradeoff is important, investors do exhibit individual preferences for other investment features as well. This fact is especially exemplified by the existence of so many different types of mutual funds (such as, maximum growth, balanced, and income). Some funds are designed to achieve high rates of return from capital gains by undertaking relatively significant risks. Others, however, concentrate on earning periodic cash income in the form of cash dividends and/or interest income while (supposedly) assuming a lower risk. There are even certain specialty type funds that permit individuals to participate in "socially responsible" funds, real estate funds, precious metal funds, and international funds, to name a few. Additionally, some mutual funds hold a greater percentage of cash in the portfolio than others depending on the investment climate prevailing at that time.

The "universe" of investments from which the individual investor may choose, for the purposes of this research, is limited to the mutual funds offered by the Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF). Accordingly, the different types of mutual funds serve as surrogate measures for the various types of investment opportunities an individual investor might consider for inclusion in his portfolio.

In addition, the SCMLP model is compared and contrasted to other widely accepted models used in the analysis of portfolios. In support of theoretical claims, a practical demonstration of the portfolio selection process using the SCMLP model is provided.

## **Theoretical Background**

The classical model for portfolio analysis was developed by Markowitz.[1] The theoretical substance of the Markowitz model is brilliant and is rightfully accepted in finance literature. However, its practical usage is limited by the following factors:

- (1) The quadratic programming solution procedure requires a considerable amount of computer time and space.
- (2) The complexity of the model makes it difficult to explain an individual user.
- (3) The Markowitz model uses only a measure of risk and-total returns as input and does not consider other individual preferences.

Various attempts have been made to overcome the practical problems posed by the Markowitz model. For instance, Burgess and Bey (1988) discuss the various techniques ranging from Markowitz's quadratic approach to Sharpe's single index model[2] to a simplified solution procedure developed by Elton, Gruber, and Padberg.[3] Burgess and Bey tell how the Elton, Gruber, and Padberg approach eliminates the need for a quadratic approach (Markowitz) and provides for a simple and practical ranking procedure using a reward to beta (from Sharpe's single index model) ratio. The significance of the Burgess and Bey article, however, was to demonstrate that the Elton, Gruber, and Padberg approach "is effective in estimating Markowitz efficient portfolio and can be an effective screening procedure for large number of securities." [4] Regardless of the simplification and effectiveness of the Elton, Gruber, and Padberg approach, individual references for investment factors other than risk levels and total returns are not taken into consideration in the portfolio selection process. The literature is also replete with articles on linear programming approaches to portfolio selection and optimization that can take into consideration the individual preferences of investors. (For example see: [5], [6], [7], [8], [9], [10]).

An article by Smith (1974) presents an arithmetic algorithm as a suggested approach to a quantitative solution of the problem of individual preferences in portfolio selection. As an example, he suggests that an individual investor first weight four attributes (liquidity, income, capital appreciation, and safety) according-to his preferences. Then the investor examines four asset types (savings account, corporate bonds, common stock, and real estate) as to their suitability with respect to each attribute. The final step is to weight the suitability measures for each asset with the preferences of the individual, attribute by attribute, in order to get an overall measure for that asset type. Each of the four attributes is desirable to the individual, hence, the weighted-suitability measure for each asset is an overall index of suitability based on the unique set of preferences.

However, by the author's own admission, many individual may not feel comfortable with a precise set of relative weights reflecting their preferences.[11] A more workable approach for making multi-asset portfolio decisions based on individual preferences can be derived using the SCMLP model. In contrast to the absolute numerical weights necessary in the approach used by Smith and in normal linear programming, the SCMLP formulation requires only that the investor order his preferences with respect to the attributes and that he define a ranking as to the suitability of each asset type with respect to each attribute. Details of the manner in which the SCMLP model works after these individual preferences have been ranked are explained in a later section of this research. It should be noted that the purpose of the demonstration is to show how the SCMLP model might be applied to the portfolio selection.

## A DIFFERENT DIVERSIFICATION TECHNIQUE: THE SCMLP MODEL

Wibker (1980) developed an algorithm for solving a special case of the Constrained Multiparametric Linear Programming problem. This Special Constrained Multiparametric Linear Program (SCMLP) allows the objective function coefficients in a linear program to be constrained in a manner similar to the decision variables. Wibker initially formulated the SCMLP as a quadratic programming problem. This type of formulation allows the decision variables and objective function coefficients to be determined simultaneously. Wibker then redefined an alternate procedure for solving the problem since quadratic programming is more time consuming and complicated than the simplex method [12]. The SCMLP model can be expressed as

$$\begin{array}{ll} \text{Maximize } & ct \\ \text{Subject to:} & At < b \\ & T > 0 \\ & Gc < d \\ & C > 0 \end{array}$$

The SCMLP model allows for the decision variables ( $t$ ) to be optimized while simultaneously solving for the coefficients in the objective function ( $c$ ). In relation to this study, the  $At < b$  represents the constraints placed on the decision variables ( $t$ ). The  $Cc < d$  represents the constraints placed on the coefficients in the objective function ( $c$ ).

The SCMLP model can be applied to many different types of problems in finance as well in other fields. However, in this research, the SCMLP model is demonstrated in the process of portfolio selection of mutual funds assuming individual investor preferences for liquidity, income appreciation and safety.

## A MUTUAL FUNDS APPLICATION OF THE SCMLP

Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF) offers an array of mutual funds for investors. According to TIAA/CREF's Mutual Fund Prospectus (13), the six mutual funds included in this study and their defined objective is presented below.

- 1) Money Market Fund – provides liquidity and stability of principal.
- 2) Bond Plus Fund – gives investors the potential for high current income.
- 3) Managed Allocation Fund – provides broad diversification and leaves the asset allocation decisions to TIAA-CREF's professional investment managers. This is a fund of funds that invests in the other TIAA-CREF Mutual Funds.
- 4) Growth and Income Fund – seeks capital appreciation and current income potential.
- 5) Growth Equity Fund – seeks to achieve high current returns by investing in the stocks of rapidly growing companies.
- 6) International Equity Fund – has the potential for above-average returns from investments in foreign stocks.

TIAA-CREF has added five additional mutual funds for investors. However, these five new choices were not included in this study since the funds have no previous performance record.

For the purpose of this application, the assumption is made that the investor has four preferences with regard to investing. The four preferences are liquidity (c1), income (c2), appreciation (c3), and safety (c4). The process begins by questioning the individual as to his relative preferences concerning the four attributes. The investor believes that  $c2 > c4 > c1 > c3$ . Thus, the investor believes that his preference toward income is greater than his preference toward safety; his preference toward safety is greater than his preference toward liquidity; and his preference toward liquidity is greater than his preference toward appreciation.

Next, the investor must examine the six mutual fund types as to their suitability with respect to each attribute. These variables are defined thusly,

Liquidity	Income	Appreciation	Safety	Mutual Fund
W1	X1	Y1	Z1	Money Market
W2	X2	Y2	Z2	Bond Plus
W3	X3	Y3	Z3	Managed Allocation
W4	X4	Y4	Z4	Growth & Income
W5	X5	Y5	Z5	Growth Equity
W6	X6	Y6	Z6	International Equity

where  $\{w_i = 1$ ,  $\{x_i = 1$ ,  $\{y_i = 1$ , and  $\{z_i = 1$ . The investor must use some simple ordering of his preferences with respect to each attribute and how the six mutual fund types correspond. For example, the investor believes that in regard to liquidity,  $w_1 \geq w_2$ . This would imply that the investor believes the Money Market fund is more liquid than the Bond Plus fund. The investor would proceed in this manner for each of the attributes with regard to how the six mutual fund categories would perform. This would create a set of constraints of the form  $A_t \leq b$ . The portion of the investor's nonconsumed wealth that he will want to hold in each mutual fund will be as follows.

$$\text{Money Market Fund: } w_1c_1 + x_1c_2 + y_1c_3 + z_1c_4 = \text{MM}$$

$$\text{Bond Plus Fund: } w_2c_1 + x_2c_2 + y_2c_3 + z_2c_4 = \text{BP}$$

$$\text{Managed Allocation Fund } w_3c_1 + x_3c_2 + y_3c_3 + z_3c_4 = \text{MAF}$$

$$\text{Growth \& Income Fund: } w_4c_1 + x_4c_2 + y_4c_3 + z_4c_4 = \text{G\&I}$$

$$\text{Growth Equity Fund: } w_5c_1 + x_5c_2 + y_5c_3 + z_5c_4 = \text{GE}$$

$$\text{International Equity Fund: } w_6c_1 + x_6c_2 + y_6c_3 + z_6c_4 = \text{IE}$$

MM is the percentage of one's nonconsumed wealth that should be invested in the money market mutual fund given the individual's preference for the four attributes and his perception of how the money market fund corresponds with respect to these attributes. The quantities BP, MAF, G&I, GE, and IE can be defined similarly.

Now define  $r_1$  to be the expected return on the money market mutual fund account,  $r_2$  to be the expected return on the Bond Plus fund,  $r_3$  to be the expected return on the Managed Allocation fund,  $r_4$  to be the expected return on the Growth & Income fund,  $r_5$  to be the expected return on the Growth Equity fund, and  $r_6$  the expected return on the International Equity fund. The individual

wishes to maximize his return on the assets he invests in subject to his preferences concerning each asset as to their suitability with respect to the various attributes. The problem can be stated as

$$\text{Maximize } r_1(\text{MM}) + r_2(\text{BP}) + r_3(\text{MA}) + r_4(\text{G\&I}) + r_5(\text{GE}) + r_6(\text{IE})$$

Subject to

$$G_c \leq d$$

$$C \leq 0$$

$$A_t \leq b$$

$$T \geq 0.$$

The constraints in the four attributes as defined by  $G_c \leq d$  must be reformulated in term of  $c_o$ . This set of constraints will be defined by  $Wc_o \leq h$ . Using these results the mutual fund mix problem is equivalent to the SCMLP problem.

$$\text{Maximize } c_o T t$$

Subject to

$$A_t \leq b$$

$$T \geq 0$$

$$Wc_o \leq h$$

$$C_o \geq 0.$$

Solving the SCMLP formulation of the mutual fund portfolio problem yields the optimal  $c_o$  and  $t$  that will maximize the individual's return on his investments. To determine what portion of his nonconsumed income should be invested in each asset category, it is necessary to convert  $c_o$  back to the original rankings on the attributes,  $c$ . Combing the  $c_i$ 's and the preferences with respect to the attributes and how the six mutual fund types correspond as given in  $t$  yields the quantities MM, BP, MA, G&I, GE, and IE. These quantities are the percentages of the investor's income to be allocated to each respective mutual fund.

## SUMMARY AND CONCLUSIONS

This research suggests how the SCMLP model may be used in the portfolio selection process. The SCMLP model is superior to other approaches in selecting portfolios if the individual investor has preferences for investment factors other than just total returns and risk, and allows the investor to simply rank his preferences rather than to assign absolute weights. The SCMLP model itself provides the optimal weights that satisfy the objective function subject to various constraints. The mutual fund application shown in this research is but an example of how the SCMLP model might be used in selecting portfolios of investments. In fact, the SCMLP model could be applied to the "real world" of investment advising. For instance, a stockbroker, trained in the use of the SCMLP, could interview a client to determine the client's investment objectives and preferences for various investment features. Then, using the client's ranking of his preferences, a portfolio could be designed to provide a general framework to help the client and broker to decide what mix of investments might be best. As conditions in the market or as the client's preferences change, the SCMLP model could be reformulated to determine if any adjustments in the portfolio should be made. As long as the individual investor has multiple preferences for different investment features and is not able to objectively quantify those preferences, the use of the SCMLP model certainly would enhance his decision process.

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# MANAGING ON-LINE CLASSROOMS: SUGGESTIONS FOR ASSESSING STUDENT PARTICIPATION AND PROVIDING TIMELY AND MEANINGFUL FEEDBACK

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## ABSTRACT

*On-line instruction is becoming more popular with students and faculty, alike. The rapid increase in this technology places instructors in the position of having to adapt teaching strategies. This article focuses on the importance of student participation in virtual classrooms and provides some strategies for evaluating student contributions in this environment.*

*The proper design and management of web-based courses is required to foster quality human interactions and cooperative learning in this setting. Starting with clear expectations for student participation instructors must communicate their standards for high-quality and frequent interactions in the virtual classroom.*

*Specific criteria for the assessment of student participation in course discussions must be established. Suggestions for evaluating individual discussion contributions include timeliness, thoughtfulness, accuracy of grammar and spelling, appropriate placement in the web-based classroom, conciseness, and the relevancy of comments to the particular discussion. A system for scoring these discussion components is provided along with the application of a spreadsheet format for aggregating grades. The importance of providing students with feedback concerning their performance in this area is discussed and a strategy for doing so is proposed.*

*Employers continue to emphasize the need for workers to have strong teaming skills. A strategy for incorporating peer evaluations into student participation grades in situations where teaming is emphasized in virtual environments is offered. Using a survey technique, students are able to provide input concerning the contributions of all team members. Once again, specific criteria for measuring student performance are offered, as is a strategy for collecting and accumulating these data.*

*As with conventional classes, discussions offer a valuable opportunity for students to share ideas, expand their own thinking, and demonstrate their understanding and ability to apply key concepts to the instructor. The establishment of clear expectations for student performance and specific criteria for evaluation, along with timely instructor feedback can facilitate high-quality interactions in virtual classrooms. The result of careful planning and meaningful evaluation of student contributions to virtual classrooms is likely to be a more rewarding experience for students and instructors, alike.*

## JASPER FASHIONS

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### CASE DESCRIPTION

*The primary objective of Jasper Fashions(JF) is estimation of the value of a privately-owned firm from two different perspectives: the buyer's and the seller's, and the case is best used in any course where the students have a solid background in valuation. This suggests that it is probably most appropriate in the upper-level undergraduate (where we primarily use it ) or first-year graduate course in corporate finance, or a strategic management class. An important secondary objective is to apply ratio analysis to help assess how effectively the company has been managed. In fact, the case can be used as a rather interesting exercise in ratio analysis, and the valuation issues could simply be discussed and not analyzed. Thus, JF could also be suitable for either a managerial accounting or a first corporate finance course, and we have used it this way also. Other objectives include the opportunity to explore financial forecasting, risk-adjusted discount rates and sensitivity/scenario analysis.*

*The required amounts of class time and student preparation depend on 1) the topics the instructor chooses to cover and 2) whether students have access to the template that accompanies the case. Certainly one class is ample for instructors who focus only on the ratio analysis of the firm, and student preparation should require a maximum of two hours. Allow an additional class to adequately cover the valuation aspects. Student preparation to cover all issues should run eight to ten hours without the template. Considerably less with it.*

### CASE SYNOPSIS

*This case is based on a situation involving a friend of the author's, and is especially suitable for role-playing and student presentations since the setting involves two partners, one who wishes to sell and the other who wants to buy. Thus one group of students could act as consultants to the buyer and the other the seller. The student-analysts need to understand how various assumptions affect the firm's value, and are challenged to develop "a defensible estimate" from their client's point of view. An important issue involves the management of the company. Has Jasper Fashions been efficiently run? If so, the past financials provide important information about future profitability. If not, then "reasonable and appropriate" adjustments must be made to develop a value estimate. And there is enough information to do this.*

*An interesting twist is that both buyer and seller have bargaining chips. There is evidence suggesting the firm could be managed more efficiently, which means the seller can argue for a price higher than the past financials warrant. Further, major apparel manufacturers are seeking acquisitions and JF seems to have the characteristics these firms are after. On the other hand, one*

*can argue the company has been efficiently run; plus an outside buyer would not have majority control which means JF could sell at a discount, especially since the remaining partner is rather difficult to deal with. In addition, the larger apparel manufacturers may simply be seeking “bargains” given the difficulties of running a smallish apparel company as a result of free trade legislation (like NAFTA).*

*The case has two Excel templates that contain pages relating to the computational questions listed in the Instructor’s Notes and is useful for performing sensitivity/scenario analysis so characteristic of real-world forecasts. One template is complete in that all the appropriate formulas have been entered. The other lacks a number of key formulas that the students must enter in order to use the template effectively. The Instructors’ Notes offers suggestions on how the case and templates might be used in both lower and upper level courses.*

# **THE ECONOMIC AND POLITICAL TRANSITION OF THE MEXICAN STATE IN THE THRESHOLD OF TWENTY FIRST CENTURY: FROM THE ENTREPRENEURIAL STATE TO THE STATE OF ENTREPRENEURS**

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## **1. INTRODUCTION.**

Mexico is a country highly centralized with a powerful government, no reelection and until recently, strong and open political competition. Since the independence of México and for the last two Centuries, the dominant political system has been authoritarian and presidentialist oriented. Starting with the emerging governments from the Mexican Revolution (1910-17), it settles a dominant party's dictatorship that monopolizes political representation and a deforming presidentialism, that Krauze has denominated the Imperial Presidency, which weaknesses faculties and duties of legislative power and subdue the judicial power. The forms of patriarchal power represented another feature of Mexican government before and after the Mexican Revolution.

## **2. THE MEXICAN ENTREPRENEURIAL, PRI-PRESIDENCIALIST STATE.**

Mexican economic nationalism emerged as a result of promoting public and private Mexican capital to avoid foreign investments, mainly from US. The Mexican State was characterized by a historical distrust of capitalism and a belief in the ability of the government to intervene and regulate economic affairs by explicit constitutional mandate (Grier and Grier, 2000: p. 245). However, a model of import substitution industrialization (ISI) favored private Mexican investments and also was understood to provide benefits to the population, since the 1930s and until the 1970s. The Mexican public sector formed by publicly owned corporations enlarged. In 1982 the state property enterprises produced 14% of gross national product (GNP), received net transfers and equal subsidies to 12.7 per cent of GNP and represented the 38 percent of investment in fixed capital.

In the name of great conquests of Mexican Revolution, during the times of the Mexican welfare state, organizations were constituted which grouped corporately militias, peasants, working class and popular sectors that evidenced the political control of state's party bureaucracy in power and the "charro" (Mexican horsemen) leaders. The "charrismo" (scornful term for union leaders) subdue workers to the rules of the official party, the Institutional Revolutionary Party or Partido Revolucionario Institucional (PRI). The workers are treated under pressures and threats of wage reduction and loss of employment, benefits, agricultural credit, traffic of urban and rural poverty, etc., to guarantee an important reserve of voters.

Although since 1929 all the Mexican presidents came from The Institutional Revolutionary Party (PRI), the economic policy continuity did not follow a regular and coherent pattern of policy making. Nevertheless, during the period of the hegemonic PRI, the government cultivated a degree of social consent that avoided levels of repression in such a situation that has been called the “perfect dictatorship”. In line with the so-called meta-constitutional powers, the President of Mexico was also the true head of the PRI and had as his duty the designation of national leaders and candidates for popular election. The Mexican president had both extensive constitutional and unwritten supra constitutional powers and committed to the retention of his political power during his mandate and the continuation of his power required to follow the “ritual” of choosing who was his successor.

As a ruling political party, in the sense that it dominated the country’s political life, the PRI held power in the federal executive branch of Mexican government during 71 years. It was the center of the Mexican political system through political control mechanisms of workers, peasants and popular sectors and organizations, such as “cuadillismo” (leadership), corporatism, etc. Also, institutional control mechanisms of electoral processes were enforced. The PRI’s corporatism bet to workers and peasants to whom it promoted but not liberated, guarantying them patrimonial rights and with the pretext of institutionalizing the Mexican Revolution, it was identified trickery with the causes of democracy and social justice. Its achievements in both assignments are very poor, although it maintained social stability. The President in turn appointed his successor trough phenomena known as “tapadismo” (Overcoat candidate) and the “dedazo” (the finger pointed) to signal who was the chosen.

Analists as Abascal and Macías (2000b) acknowledge three stages in the PRI’s evolution: Hegemonic, bipartisan, pluripartisan. The hegemonic stage goes from 1929 to 1979, the PRI dominates over the other political forces to which it was infinitely superior and maintains total control of political power. During the bipartisan stage, which goes from 1979 to 1985, the PRI maintains dominance over political parties from the opposition but lost positions in municipal and state governments in front of the National Action Party or Partido Acción Nacional (PAN). During the pluripartisan stage that goes from 1988 throughout the 2000, it opens the political competence between the PRI, PAN and the PRD (Partido de la Revolución Democrática or Democratic Revolution Party) and share the power in municipal and state governments.

The effectiveness of the “perfect dictatorship” according to Vargas Llosa, or to the presidential monarchy (Ortiz Pincheti, 2000) had an era of prosperity which coincides with the period of stabilized development, from 1940 to 1970 and the period of shared development, from 1970 to 1982. During both periods there had been great advancements in matters of social policy, although never poverty and social inequality were eradicated, it emerged a strong middle class which claimed spaces for political participation. The “perfect dictatorship” was underpinned by bloodshed from the less favored Mexicans. The State model which distributes power emerged from the Mexican Revolution enters into crisis and generates institutionalized violence.

After 22 years of monetary stability and sustained growth, at the final of the Echeverría’s period (1970-76), the peso (Mexican monetary unit) devalued, and economic crisis started and the constants tensions between entrepreneurs and government officials were crucial. The entrepreneurs founded the Consejo Coordinador Empresarial (Entrepreneurial Coordinating Council) to defend their interests from the intervening state. In 1982, President López Portillo nationalized the bank system in the middle of a generalized economic crisis caused by a fall of oil prices, the devaluation of the

peso, the increasing interest rates. The country declared practically in default of payments. This decision fractured the pact between the State and the entrepreneurs.

### **3. TRANSITION OF MEXICAN STATE: PRI-PRESIDENTIALIST NEOLIBERAL RESTRUCTURING.**

Much of Latin America experienced financial crisis in the 1980s and the mid-1990s. In Mexico, large economic crises occurred in 1976, 1982, 1987 and 1994-95, therefore economic crises have been repeated and intense with intervening periods of mild economic recovery. Mexicans suffered periods of dramatically high inflation and external imbalances, devaluation, currency flight, increasing unemployment and declining purchasing power.

In front of the pressures to Mexican creditors to guarantee payment of external debt, since the beginning of the eighties, it was instrumented the so-called “Washington Consensus” which imposes the infallible neoliberal rule of free market and a democratic system with free elections. Therefore, the “neoliberal agenda” which proposed structural adjustment programs and economic stability were imposed as the conditions to negotiate the Mexican “debt crises” of 1982, 1987 and 1994-95 by the international financial organizations such as the World Bank, the International Monetary Fund and the Interamerican Development Bank.

Thus, after the 1982 crisis, Mexico entered in a painful, distressful and controversial period of state restructuring, which implied the economic reorganization, national market openness, elimination of commercial barriers, elimination of price controls and subsidies, privatization of public enterprises and state property, reduction of social policy expenses, free money exchange. Also wide political reforms and administrative modernization. It was abandoned the import substitution model and it was called into question the economic intervention of the state.

The main thrust of the reforms encouraged in Mexico was to develop a competitive, broad-based export sector of nontraditional goods. Mexico joins the General Agreement on Trade and Tariffs (GATT) in 1986 and becomes a manufacture exporter. The reduction of state structure and faculties, privatization state owned enterprises and the economic deregulation, were the strategies adopted for the design of the Mexican State, as it were also for other states.

Starting with the implementation of these reforms to the Mexican State, this begins to lose its capacities and functions of nation state, although it maintains high indicators of intervention, in such a way that the reforms benefited to the owners of capital. These reforms to the structure of the Mexican State’s apparatus give sense to its transition and change from the welfare state model towards a neoliberal state model. This transition and change are understood in terms of Roitman as forms of behavior, loss of centrality in politics, loss in the building of wide citizenship, transformation of politics in one electoral technique, in a market problem. Also, in loss of the ethics and principles as the task of politics and the political, evidently appeared in Mexico during the government of Miguel de la Madrid (1982-88) and continued with Salinas de Gortari (1988-94), also with Zedillo (1994-2000) and now with Fox (2000-2006), (Aviles and Velazquez, 2000).

But the crisis of 82 also was meaningful for the “crisis of hegemony” which was present in the old alliance between the state and the entrepreneurs representing the national capital and the direct beneficiaries of economic policies based in the import substitution model. Nationalization of the bank

system was the event that provoked the rupture between the political and entrepreneurial hegemonic block and their representatives, the politicians and government officials from the party of the state and the fractions of the great capital. As it is said by Fazio (2000a), they were living in one tortuous lover relationship of subterranean blurred rinses, in dense shady deals and complicity networking.

With nationalization of the bank system, Mexican capitalists who felt were betrayed had broken the alliance with the political bureaucracy and redefined the strategy to their re-composition. Under the impulse of an intervening state but with a strong neoliberal technocrat orientation to benefit the owners of great capital, it was initiated the reinventing of the new Mexican State. This was based on a process of neo corporatist negotiation between the entrepreneurs and the government, building on mutual compromises and interests.

### **A. Economic and political impact of globalization upon the Mexican State.**

Under the influx of the PRI, the Mexican State initiated economic modernization and its insertion in globalization processes. As a response to the trends of economic globalization of markets and the technological revolution which advanced during the last two decades of the past century and with the pretext of cleaning economics, the Mexican State has privatized strategic enterprises of the public sector. Most of these privatized enterprises have been acquired by foreign investments that have penetrated already in all the economic sectors. The high concentration of capital in few corporations through privatization processes of public enterprises, have unchained the phenomena of political privatization.

In 1987 inflation achieved 159 per cent and a crack in the stock exchange devoured savers. In the interior of the PRI, a dissident group formed the Democratic Current (*Corriente Democrática*) that later split to form a new party, the Frente Democrático Nacional (National Democratic Front). President Miguel de la Madrid Hurtado (1982-88) is the first that stands questionings in his sixth and last governmental inform. The sixth of July of 1988, Salinas achieves power in the middle of a generalized crisis of legitimacy and total discredit for the fall of the system, which controlled results of the electoral contests, where irregularities and electoral fraud were present.

Salinas deepened the neoliberal reforms: public enterprises were liquidated, the economic openness was accelerated, free commerce agreements were signed with Chile, with United States and Canada (NAFTA), Venezuela and Colombia (Group of Three), Costa Rica, Nicaragua and Bolivia. Amendments to Constitutional Article 27 allowed investments in the Mexican countryside. The activism of the Mexican State during the Salinism allowed the transference of public enterprises to determined financial groups that maintained links of political complicity.

Programs of privatization of public enterprises in Mexico have been vast in approaches and to a certain point, successful in reduction of the role of one state that was interventionist in the economy. Mexico was the second in privatization in Latin America during the decade of the nineties when the government transferred to particulars, assets that amounted 31, 458 millions of dollars, that represented 20.4 percent of the total sale of state owned enterprises in Latin America. Privatization achieved an amount of 3, 160 millions of dollars in 1990, to increase to 11, 289 millions in 1991 and to total 6, 924 millions of dollars in 1992.

By June of 1992, the Mexican government had privatized 361 of around 1200 enterprises owned by the state. Privatization made during 1993 represented 2, 131 millions of dollars. In 1996

increased to 1, 526 millions of dollars, in 1997 increased to 4, 496 millions and in 1998 sales were 999 millions of dollars. A report from the World Bank signals that between 1990 and 1998, privatization of public enterprises achieved an amount of 154, 225 millions of dollars, amount only inferior to the balance of the total external debt of Mexico that was of 159, 959 millions of dollars in 1998.

The year in which the state has caught more for privatization was 1991 with a total of 11, 289 millions of dollars, while in 1998, Mexico caught 999 millions of dollars. The new government of Mexico plans to privatize airports, railways and in the energy sector, the oil and electrical industry.

The benefit of privatization has not been the greater to the Mexicans besides those defenders try to demonstrate the opposite. According to data of Salinas de Gortari (1988-94), privatization opened budget spaces to finance social expenses without running into fiscal deficit. The effects have not been overall satisfactory. Programs of privatization in Mexico had reduced the employment to half while production had increased in 54.3 percent besides a significant reduction in investments. A prior study of Galal et al. (1992) analyze performance after privatization of twelve companies in different countries, including Mexico, documenting that had incremented in 26 percent of profits in eleven cases and increment of benefits to workers in three cases only.

The 17<sup>th</sup> of December of 1993, Congress of United State approved the North America Free Trade Agreement (NAFTA). Reactions were not waiting too much. The First of January of 1994, the date in which the Agreement started to come into force, the indigenous people of the State of Chiapas upraised as the National Liberation Zapatista Army (Ejército Zapatista de Liberación Nacional). Quarrels, resentment and bitterness of political groups to the interior of the PRI conducted to assassination of the official candidate to the Presidency of the Republic and to the assassination of the General Secretary of the PRI. Although the conflictive situation and the serious problems, the economy did not disarrayed and Salinas give his sixth and last inform in 1994 with a victorious animosity. Zedillo arrives to the Presidency with the major democratic legitimacy given by the greatest number of votes given in his favor in the history of Mexico, 17 millions. But suddenly, after twenty-one days in power, Zedillo faced the worst economic crises in history of Mexico, the so-called December's Mistake.

Two years after privatization of Mexico's banking system, Mexico was forced to devaluate its peso in December 1994 which set off a macroeconomic crisis characterized by increased exchange rate volatility, devaluation of the peso followed by a financial sector crisis and bailout. The meltdown of the Mexican stock exchanges has lost half its value, and share prices for major Mexican companies quoted on Wall Street have dropped 75 percent in a few months. However, the deeper crisis in financial markets after it had been resolved the devaluation and the sovereign-default crises. The majority of governmental credits with a degree of not investment (case of Mexico), are characterized by weaknesses in governance. If local people and foreign investors fear the Mexican peso will be devaluated, they may convert pesos into dollars.

A new structure of sovereign debt during the Mexican crisis of 1994-95 has been widely studied to understand the way in which financial markets, governments and multilateral institutions respond to the new questions of governance. The Mexican crisis left as a teaching the problem to sustain fixed exchange rates in an environment of high mobility of international capital. Mexico did not recovered because it weak financial system became strong with the intervention of the International Monetary Fund (IMF). But because it had benefited with the increment of exports to



United States as a result of the North America Free Trade Agreement and the accelerated growth of the neighbor economy.

The economic crises through which the Mexican economy has passed, besides the institutional weaknesses to limit the range in social tissue have been the repercussions of the applications of the neoliberal economic policy and the key factors to deteriorate social governance. One of the most pervasive and disturbing aspects of economic crisis has been the effect of this policy on the most vulnerable population groups. In general terms, the economic policies implemented in the majority of Latin American countries present coincident features, although there are some differences in the design of the packs.

However, the motives and circumstances of different economic crisis by which it has pass through Mexico since 1976 to 1994-95 differ although they have been preceded by periods of high economic growth which could not be sustained by the imbalance they caused. The crisis of 1976 showed the limitations of the economic model, which considered that the economic growth depended of a major state intervention. The crisis of 1982 had its origin in the consideration that oil was the lever of economic development oriented toward an active policy of the state prepared to administer the abundance, which had derived in high degrees of external indebtedness and irrational expansion of the state.

Compared with the debt crisis of the eighties and with the Mexican crisis of 1994-95, also called the “Tequila effect”, both are considered to have as roots the financial imbalances of the public sector. Quite different was the later crisis, (Asia, Russia, South Africa, Brazil, etc.) which have its roots in financial imbalances of the private sector and which is the first financial crisis really considered as global that kick the economies of emergent markets. The Asian crisis exploded just after the crisis’s weaves of the Mexican peso had lowered. Therefore, it seems that financial crisis occur more frequently in the last years in emergent economies, such as it is the case of Mexico.

If it is controlled the democratic social development and the economic growth of emerging economies, these are not of more significance corrupts than the countries more developed. The pack of credits to Mexico from the International Monetary Fund in 1995 was a reward to corruption of bank credits with more risks. While more lend governments of other countries to Mexico, the bankers of other countries have more security to recover their credits. In reality, privatization of the bank system to financial groups emerged from the “steam” and complicity among investors and politicians who took advantage of international organizations financing channeled to the rescue of the debt crisis. However, their differences in crisis management took them into highly indebted economies, which had the opportunity to transfer invoices charged to society.

As a result of these events, in Mexico was initiated in 1995 a Program of Modernization of Public Management and the elimination of corruption, decentralization of public function and reorganization of intergovernmental relationships within the federal system. The monopoly of power and its discretional use maintained by some members in the structures of government is the main source of corrupt behaviors and impunity, thus it is required deep institutional reforms.

The program pretends to develop mechanisms to a major responsibility and accountancy to governmental agencies, in matter of management of public services, also to ensure a major disposition to establish associations with non-governmental organizations. It is necessary to consider those non-governmental organizations of human, political, labor, and citizen rights have sustained poor relations

with governments emanated from the PRI, which always treated to incorporate them while they wanted to be more independent, the base of credibility and impartiality before the citizens they represented.

In 1996, public and private investments in Mexico kept under the levels of the years seventies and eighties. Results of globalization processes confirmed that it has given in only one direction: the entrance of transnational and multinational enterprises, now denominated global enterprises or contemporary business, which in essence are foreign, they have taken in legal ownership the natural resources, land, etc., and leave few benefits. For example, the market value of General Electric calculated in 520, 250 millions of dollars, it is equivalent to the GNP of Mexico. In fact, 23 of the greatest transnational and multinational corporations have sales that amount a higher value that the GNP of Mexico. Neoliberal governments have showed their inefficiency to reduce pains from integration processes through negotiations more favorable that allow to take comparative and competitive advantages.

#### **4. DAMNED INHERITANCE.**

At the end of the period between the years 1982 and 2000 which marks the development and implementation of the Neoliberal state model in Mexico, the results are disastrous. Although the achievements in economic growth during the last four years, the Mexican economy shows several structural imbalances that were expressed in their correspondent fiscal deficit. As Lomas (2000a) affirms, the inheritance of President Zedillo also included the great pressure that the service of passives from financial rescue will exercise over public finances in the medium term range. Lamentable it is foreseeable that the present administration will inheritance to the next government a great quantity of compromises over the public finances and much more insufficiencies in the attention to the more sensible demands of population. The Zedillo's inheritance ascents to more that two billions (millions of millions in Mexico) in public debt, including the debts of the wasted Institute for the Protection of Bank Savings or Instituto para la Protección del Ahorro Bancario (IPAB).

##### **a. Interface government - companies.**

In Mexico, the main obstacles for the managers are the crime and the robbery, continued by an inadequate infrastructure offer, inflation, corruption and financing. However, companies that don't pay taxes exist

##### **b. Unjust distribution of income.**

The President Zedillo leaves a country with big differences in the distribution of income, a high wealth concentration in a minority and a majority in the poverty, which was increased from 40.5 to 45.5 million Mexicans according to estimates of the Cepal, of which 26 millions, mainly indigenous and rural, live in the misery. The contradictions of the growth polarize, according to Boltvinik, expert in the poverty and distribution of income in Mexico: "When the economic pattern continued up to now in Mexico is able to generate growth, it makes it accompanied by a growing concentration of income and an increment of the poverty among the strata more poor...the crisis of the 94 it produced a brutal impoverishment of the population...starting 1996, when it begins to recover the economy,

the income concentrates again....” In one period like the current one, in which the Mexican economy crosses for a peak when accumulating 18 serial trimesters of growth, the benefits go to a very reduced group of people: “down they only fall the crumbs” it sentences (González Amador and Castellanos, 2000).

The poverty increased from the 36 to 38 percent of the total of the Mexican homes in 1994 to 45 to 47 percent in 1998. With data of the National Survey of income-Expense in the Homes (ENIGH) of the National Institute of Statistic, Geography and Informatics (INEGI) among 1994 and 1998, the Mexican homes that live under the line of poverty, with a monthly entrance not bigger to 560 pesos to constant value of April of 1994, increased from 69 to 76 percent of the total. In general terms, the investigators coincide in that the poverty increased in more than 5 percent during the sexenio of Zedillo. This redounds in the formation of a society with big contrasts in the distribution of income, where 20 million Mexicans (the total population's 20%), they live under conditions of extreme poverty and more than 40 millions (the population's 40%), they live below the line of poverty.

In the last three sexenios the control of the inflation has been privileged above the increases to the contractual minimum wages, and therefore, of the level of the workers' life. The World Bank presents figures in those that 42 million Mexicans have salary levels below the twenty daily pesos, the equivalent of less than 2 dollars. Between 1974 and the 2000, the real wage of the workers had an accumulated deterioration of 72%. Only during the government of Zedillo a strong near accumulated loss was presented to 50 percent of the real wages, registering the lowest purchasing power in the last 18 years. With data of the Organization of the United Nations, the 64.5 of the population perceive two insufficient minimum wages to obtain the nutritional minima; the women sustain 40 percent of the Mexican homes with inferior revenues to those of the men until for 20 percent (Jiménez, 2000). More than half of Mexicans in age of being working work in the informal sector of the economy.

The gross internal product for inhabitant ascends to 7776 annual dollars, with a growth of 3.4 percent on the average annual, in the period 1964-1981. However, after 1982 it began the implementation of the model of the Neoliberal State in Mexico, the growth of the gross internal product fell. For the period of the Neoliberal State, which lasts since 1982 to 2000, the gross internal product for inhabitant 0.3 percent only grew on the average yearly. The National Survey of Income-expense in the Homes, carried out by the National Institute of Statistic, Geography and Informatics (INEGI) in the year 2000, it reports that the generation of the wealth increased in the last six years, but the distribution of the wealth became more inequitable, with alarming levels of deterioration.

10 percent of the richest homes in the country concentrate 38.11 percent of the national income. In the other end, the tenth part of the poorest hardly perceives 1.50 percent of the total, when in 1996 it was of 1.79 percent. The available monthly income by 10 percent of the poorest homes is 26 inferior percent to that of 1994, while for the tenth part of the most suitable homes the reduction has been of 20 percent (González Amador and Castellanos, 2000). The coefficient of GINI for the monetary income in 1992 was of 0.5086, in 1994 it was of 0.5137 and in the 2000 of 0.4889, which indicates a tendency to a decrease of the concentration of the national wealth, more however continues being high.

The quick economic growth has not rebounded in the improvement of the levels of the population's life, due to the inequitable distribution of income that impedes the transfer of

macroeconomic benefits. The higher rates of growth that reached four percent on the average of the gross internal product between 1996 and the 2000, have not contributed to the improvement of the well-being and standard of life of the family, because they contribute in 2.4 real% of the product per layer. According to analysis of The Financier (2000), of each peso (Mexican money) that was generated in the economy in the first trimester of the year, 0.07 cents corresponded the population of scarce resources, while the population with high levels of revenues obtained 50 cents.

The regional development has also been inequitable and unbalanced, subject to processes of economic separation that have been the result of the integration processes guided toward the markets of the North that the country lives from 1994 in that the Treaty of Free Trade was signed with North America.. This way, the Mexicans with lower revenues per layer concentrate on seven States of the Southeast of the country. They represent less than 10 percent of the national gross internal product, while with a similar population, six States of the North, they generate 23 percent of the national wealth. The pattern exporter of growth based on cheap manpower, only allows that a small group of companies benefits of the commercial treaties of Mexico with other countries

### **c. Weakness of governance.**

The weak governance in Mexico, for example, has its antecedents in the weaknesses of the economic, social, cultural, educational politicians, etc. and in the weaknesses of their institutions although in the past a strong presence of the Mexican State existed in the creation of institutions and of public policy. They are characterized as weaknesses of the governance: the official and private corruption, the traffic of influences, the corruption and inefficiency of the judicial organs, the influence drug cartels. Moreover, deficiencies in the internal security under the form of guerilla group operating in rural areas, and the violence in the big cities.

Governance deficit is related with the genuineness of the political system, which had its origin in the economic policies erroneously implemented by the elites that made the organizational design for the transition of the Mexican State. Mexico has lived populisms centered more in the expectations of illuminated rulers than in concrete proposals of national development by means of an institutional development. The Mexican State has been able to maintain its genuineness by means of a politics of partial social protection and future promises of more benefits that favor to the diverse social groups.

At the present time, the form in which it is visualized in Mexico, the installation of governance decreases to achieve the political normality. It is a concern to subordinate the electoral democracy to the governance of the system and not necessarily the democracy, such as it is expressed in the Political Constitution of United Mexican States. The Constitution defines democracy “not only as a judicial structure and a political régime, but as a system of life been founded in the constant economic, social and cultural improvement of the population.” The electoral democracy not only has as sufficient conditions, free and fair elections, but the electoral processes only spread to be freer and fairer when it is the culmination of a continuous democratic process and not when it is subordinated.

### **d. Political uncertainty and security of the property.**

For the case of Mexico specifically, a factor of the political risk consistently high (qualified as " BB ", non-investment degree) it is the quality of governance that embraces the quality of public

sector's institution; the efficiency of the government services and the government's capacity to establish the macroeconomic stability. In an analysis of dynamic factors, the estimate of the index of monthly national risk is decisive for the proportions of the imports to the reservations and the debt to the exports. In the national risk, the sociopolitical uncertainty is an important component.

An important aspect is to determine the uncertainties involved in the transfers of the regular governments in order to evaluate the possible uncertainties of the elaboration of the laws. The government's constitutional positions (as a result of the elections) they are usually accompanied by big changes in the rules and regulations that have an impact in the business.

With regard to the uncertainties of the application of the law, it is important to determine if the companies trust the abilities of the authorities of the State to protect the rights of property and to guarantee a predictive judicial process. The robbery and crime are serious problems that substantially can increase the costs of making business. There is not trust in that the authorities of the State protect to people and their property of criminal actions. The unpredictability of the judiciary presents a bigger problem for the operations of the business. The public insecurity in Mexico has placed to the country in a near situation to the chaos, surpassing to the institutions that were already the pillars of a system in decomposition, as the case of the PRI.

The governments priístas leave as balances those "wounds opened up in the national conscience" for the indigenous conflicts of Chiapas. The results are: increasing levels of poverty, the growth of the informal economy, the increment of the violence and public insecurity, corruption and impunity, the precarious conditions of micro, small and large enterprises and the deterioration of the countryside and farming sector.

In sum, the current problem of Mexico is to have a good macroeconomics but a bad microeconomics.

## **5. THE TRANSITION OF THE RÉGIME OF THE MEXICAN STATE: OF THE STATE MANAGER TO THE STATE OF THE MANAGERS.**

The pattern of party of State, and more concretely of the Mexican PRI-state it has been drained. The fall of PRI from the federal government and their loss of absolute majority in the Congress of the Union in the last elections is an event that constitutes a new stage that gives place to the alternation of the National Action Party in the Mexican political power. Contrary to the other alternations in the power that there has been in Mexico, this has been for the peaceful road and in an atmosphere of political stability, materializing the arrival of a party contrary to the one which used to held the power.

During the last four administrations has not been evident the transfer of power under conditions of economic and political stability. It was necessary the disappearance of the State - PRI. The last sexenio priísta coincides more with a party change than with changes of a political régime centered in a party of State and characterized by the hegemony of a political party. The hegemonic party was the PRI that held the power for a period of seventy one years, from 1929 to 2000. It served to sustain a presidential system with meta-constitutional powers, omnipotent about the other powers (legislative and judicial) and over the spheres of the economic life, politics, social and cultural.

Government's change implies agreed and not agreed accommodations among the political and economic interests. First, the President's relinquishment of constitutional powers and the system of

patronage established by the PRI to all the presidents who have emerged from its ranks. However, the party change in the government can maintain the same presidential structures whose more remote antecedents are in the Huei Tlatoani, or maximum Lord, military, civil and religious boss among our Aztec ancestors that then derived in a political culture. For a true change of political régime, it is necessary many reformatations and such structural transformations as agreeing reformatations to the Law of Public Administration to change the political culture and reformatations to the government régime. Also, to strengthen the Legislative power, to free the judicial power and to delimit the Executive power, especially in their attributions as government's boss and of boss of State.

In the last two decades, amid big financial crisis and with a neoliberal project of economic policy, it stopped the growth during the decade of the eighty and it was accelerated during the last four years of the ninety. It gave big imbalances and separations as a result in the economic processes and the dismantlement of the defense' mechanisms of the Mexican State. During the decadent stage of the system PRI-presidentialist, the corruption increased, the social cohesion was destroyed and the levels of poverty increased alarmingly. It concentrated the income "in favor of a minority that coincides in its composition and voracity with the elite of Creole inheritors and beneficiaries of the system of chaste of the colonial time and of the porfirista system." So, partly the defeat of the PRI like hegemonic party was due to the collective repulsion to an economic politics that has increased the levels of poverty, corruption and social violence. The PRI lost capacity of response in front of a more active civil society.

The last President of the PRI, Zedillo, "cut his finger" that it designated its successor and it inherited him the power, to open the tri-colored candidate's election. It was not able to brake the purchase and coercion machinery of the vote. But it disciplined to the most reactionary to impede that they stole the election again and then, when losing in the war in front of the other parties, to open the way to a democratic transition that re invents the system. In few hours it has transited from a régime of hegemonic party and authoritarian government, toward a more democratic system, concluding the process of democratic transition, handling over power in conditions of political normality and without uncertainty about the change of government or regime.

The transition occurred from monopartidism to democracy. However, this democratic transition is very questioned to a certain extent, because what has really been given is a party change in the power. In any transition, it is evident that the total abdication of those powers that have to do with the control of political process would have left power vacuums whose consequences would have been adverse. Still more, it is to be seen if the democratic system improves life conditions of Mexicans. Certainly, there is not a change of political régime, but the deepening of the neoliberal economic policy that has been already applying in Mexico since the middle of the eighties. It finishes the era of 71 years of the hegemonic party, the PRI, and it is expected that it also finish the era of the Mexican presidentialism.

The change of the sexenio and of political party in power under the same political régime, the same as the access form to the political power has been for the democratic road, what has modified the expectations and performance of the operation of the national public life. Partly these changes have been the result of the fill created by the political party that it came governing. However, it is highly questionable the form in that it was appealed to the "useful vote", and not to the "ethical vote of the principles and the projects." The voters had being conditioned that it was the change in the PAN and had being built a space of electoral market about a falsehood that was accepted. Although

they have explained reason and that “it didn't mean a contention dike at all to the neoliberalism but only to take out the PRI of The Pines” (Rodríguez Araujo, 2000).

For some skeptical critics what happens is a simple change in the form of making the things, more than in the content of the same ones. By all possible means viable along three years it was satanized the PRI and it was sold the depoliticized youth the idea of the necessity and possibility of the alternation in the political power to create them scenarios where multiplied opportunities of social mobility, education and employment.

The change of political party in the same régime represents a rupture of the old Mexican political system and continuity in the development processes according to the neoliberal pattern imposed by the interests of the transnational capital. This way, the change can be significant because it represents a final balance of a régime presidentialist and of its neoliberal economic model.

With the party change in the power finishes the era of the PRI, already well known as the era of the dinosaurs, with 22 presidents of the same party that covers a period of seventy one years. Members of the “revolutionary family”, with a style of governing patrimonialist where investiture and attributable public goods to the public position are considered personal property. As well as to the paternalism that facilitates the political control through the corporatist practices, clientele and corrupted of those who have less resources, but tied to chains of corruption and complicities. The corporate interests that conditioned the vote of the citizens also oppressed their political and human rights. It is interesting to analyze the changes of the antecedents of the presidents' careers being the first ones militaries who gave the power to the lawyers, then to give opportunity to the economists and finally a manager.

When opening up the alternation to the Presidency of the Republic, the end of the last sexenio priísta has been different to the last four sexenios that left as inheritance economic crisis and political deterioration, although the evident expressions of political decomposition, violence and corruption still persist. In the last two sexenios, that of the Presidents technocrats that privatized the politics, Salinas (1988-94) and Zedillo (1994-2000), they represented the two big local groups of officials and managers politically with being able to real. The two technocrat presidents had as characteristic to govern in function of personal focuses of the social and power relationships. Both had being able to give place to the emergency of complicity between the technocrats and the managers enlarging the relationship capital-politics, the men that hold the economic power, without respecting the rules of the system neither the correlation of social forces and politics.

The Mexican technocracy has been insensitive and indifferent to the social problems. Both, Salinas and Zedillo can be identified more than as rulers, as administrators or managers of the economic politics. The strategy on which they centered the implementation of the neoliberal model consisted on maintaining a reduced group of technocrat economists in a network of alliances and complicity with capitalist groups. These capitalist groups are those that Ortíz Pinchetti (2000a) denominated the nomenklatura, with insatiable financial interests and that they were the main beneficiaries of the model. In the strategy of Salinas, through supports to the PAN, it was lever up politically to their group of managerial and financial interest, in their top mega-negotiations with the group of Zedillo (Grove, 2000) in which they killed the PRI. The decentralization of the power begun for Salinas and deepened by Zedillo. They consolidated the neoliberal economic model.

Salinas first and later Zedillo, governed with authoritarianism to implant the economic policy imposed by supra national institutions and they were flexible in politics where they enlarged the

political freedoms with pragmatic approaches, provided they didn't contravene the economic politics. The principle is completed this way that all economic reformation without the political reformation is insufficient and it originates dangerous contradictions. The modernization project of the technocrat presidents, neoliberal and globalized, was promoted by the governments of the PRI. It also had to pay giving up power, because it has not been able to give benefits to most of the population, because it was sustained substantially in an economic order different to which guided the emanated governments of the Mexican Revolution.

In the sixth inform of Zedillo's government, the Deputy of the opposition Batres accuses him of seeking to be a "Robin Hood the other way around, all time that condemns the poor to give to the rich ones...." The neoliberal governments affirm, they have acted in way "wicked, anything moves them and their big works are their business that in some years allowed to enrich some" (Rodríguez López, 2000). But the unusual thing was that the same parliamentarian fractions of the PRI abandoned the old habit of leaving in their president's defense to criticize it recognizing mistakes and inefficiencies of their administration. The social dissent only can make to lose the project of neoliberal modernization, which supposes a period of measures of 25 year-old adjustment during which seek to conserve the power, based on the control of the income of the hard-working one and not of the capital.

Although it was privileged the stability and the renovation of the economic growth with high rates of gross internal product that reached 7.8 percent in the first trimester of the 2000, Zedillo closes the period priista without having completed their campaign promise, the so yearned one "well-being for their families." He also leaves dismantled public institutions that promoted the social well being. However, it is troublesome that the high rates of growth of the gross internal product are transitory and one cause more than the crises with high costs to those that we have gotten used in the past.

The decentralization of the power was initiated by Salinas and deepened by Zedillo. They consolidated a scenario of power shared with divided governments formed by the electoral advances of having left opponents to the PRI, which constitute the federal, state and municipal governments' real counterbalances. The consolidation of this new project of modernization that strengthens to the PAN, the natural relief that "it only seeks reformations in the level of the political administration that should suppose the neoliberal modernization" in accordance with Montemayor (2000). The PAN advances this way the neoliberal and globalizer project and it is opened the way to a federal and municipal administration in accordance with the "modernity."

This way, the PRI suffers an involution for the processes of adjustment of the project during these last 18 years. Among those that highlight its own ideological transformation to make comfortable to the neoliberal principles, completely opposed to the revolutionary ideology and which it converts to the modern stage of the Mexican Revolution. Montemayor (2000) argues that the PRI bet, for obedience, against itself. The project of modernization "it tunneled their structure and, mainly, the understood values of balance of forces and groups that participated in the previous Mexican political system." For the neoliberals, the adjustment measures taken during the last three governments from Mexico are correct and for the same thing, the conflicts of the country only come from the corruption and the inefficiency of governments' priistas.

Another reading of the fall of the régime of the PRI-State is the disfunctionality that reached the bureaucracy of the administrative apparatus. With high levels of corruption and inefficiency, with



an authoritarian and vertical structure that it only responded to the decisions presidencialistas but it showed its inability to give answer to the demands of the citizenship. To this type of organization of the public administration, according to Barboza Rodríguez (2000) “it obeys the generation of many useless works and an enormous waste. And, not few times, a sector builds what another destroys. The Mexicans only know about those “white elephants” for the dance of millions of pesos. The tangible benefits are null or poor when there are them.”

The XXI century it begins in Mexico with the new paradigm of government manager. The PAN wins the elections to the Presidency of Mexico in the 2000 with the charismatic Vicente Fox. He was the candidate that with a marketing campaign guided to emphasize the contradiction *régime-antirégimen*, it felt call to take out the PRI of The Pines, the presidential residence, giving this way had finished the end of the *régime* of the PRI and beginning a new cycle. Partly, people voted against the PRI more than in favor of Fox. Fox has said that its government will be of transition toward the new democratic *régime*. In their speech of August 2 when he received his Certificate of Elected President, Fox sustained emphatic: “I will head a government of plural transition and inclusive, capable, with vision of State and with high standards of honesty and quality” (Macroeconomics, 2000).

The endogamy of the Party-state in the power during 71 years had generating a perverse structure with big hang-ups that the Mexican society no longer tolerated. Fox was the beneficiary of the decisive vote of the excluded poor of the big urban centers and of those of the rural areas and natives stragglers that renounced of the PRI. However, the supposition was not completed that the “green vote” of the rural and excluded areas would decide the elections in favor of the PRI, although this party still obtained majority, but smaller than in the last federal elections of 1994. This electoral behavior had not shown previously because the voters also differentiate its vote for not granting all the power to a single party.

In these elections of the 2000, for the first time in 71 years, the PRI loses the presidency of the Republic, transcendental event for the political life of the country because it radically changed the political perspective and the national expectations. This defeat of the PRI like hegemonic political party in power, it is been of “the progressive destruction of the social cohesion: those norms and expressed and implicit pacts that maintained us together to the Mexicans. And this was due to the government's inclination to favor to the Creole oligarchy and the monopolized concentration of capital” according to Ortíz Pinchetti (2000).

On the other hand, Touraine (2000) argues that the result of the elections have just put an end to the long reign of the PRI. It had been able to prepare reinforcement of the political action and of the intervention of the State in a country whose growth has not reduced the social inequality. The economy grows but it doesn't distribute the benefits of the growth, that is to say, it generates wealth but it also generates poverty. The opposite, the reduction of the weight of the State, is announced although the public sector has been traditionally weak in Mexico. The insert of Mexico in the economy global files the options of the power of institutional change of the State.

It has opened up and overflows the Mexican political system for movements that guided by the change they give beginning to the protest and the public debate more than to a new political project, more however, this democratic project only understands each other from the politics' *despolitización*.

In fact, the political and economic project of Fox gives continuity to the project of the technocrats. More than to be a transition, because the only thing that one gives is not a change of political régime but of party alternation in the power, although the ideal thing had been the alternation with alternative, the necessary alternation in the government, given system the conditions of the parties. In any event, the political transition has been possible thanks to that the same neoliberal model has disarticulated to the civil society and the citizenship. What has passed in Mexico, according to several analysts is that “a democracy of type caudillista triumphed before a weakened left and in a mark of weak political parties and unstructured that reflect decadent and centralist elite rather” (Muñoz, 2000). However, it is highly questionable until where the traffic has been given to a democratic régime and the sepulchre of a régime dictatorial presidentialist.

More than continuity, the neoliberal pattern is deepened with the Fox' arrival to the presidency of Mexico who represents a third moment of the neoliberal economy impelled for Saline. Nevertheless, the technocrats have been hit politically by the managers, the new political class that emerges mainly of the local organizations of small and medium managers of the North that have wanted to liberate to the country of the corruption and of the clientelism of the party of State. The State Manager was being dismantled from the arrival from the technocrat economists to the power. Now with a manager like President from Mexico, the Mexican State has become a State of Managers that come the democracy like a good business, that is to say, the Coca-colaficación of Mexico, in reference to the managerial antecedents of Fox in the transnational one.

According to a Canadian managerial leader, for Fox, to govern Mexico won't be the same thing that to manage Coca Cola, but their managerial experience will help him a lot to make decisions (Inclán, 2000). The analyst Rubio (Jiménez Lazcano, 2000) describes the profile of Fox like “an evidently practical, pragmatic person that clearly adapts to the circumstances. He makes a very clear sense of his priorities and he makes a very clear sense of how to use and for what reason he wants to use each one of their people. And in that sense what we should wait is a very not very ideological person, very not very dogmatic and very adaptive to the environment that leaves presenting in each moment.”

It is paradoxical that in a country where more than the population's 60% it is poor, win the elections a right party that postulates the deepening of the neoliberal model responsible for the increase of the poverty. The arrival of Fox to the power, according to Fazio (2000a), it coincides with the consolidation of a concentration process and economic oligopolitization and political centralization in the taking of decisions.

With Fox the Mexican presidentialism transits from the autism to the democratic caudillism. The arrival of Fox to the Presidency of Mexico, according to Krauze (mentioned by Fazio, 2000b) it was the result of “a direct, immediate search, managerial to the power. Wines of new marketing in old wineskins of caudillism...a caudillism plebiscitary with messianic edges, very dangerous in a country to the one that he found difficult a lot the separation between the church and the State”. Nevertheless, the ghost of the presidentialism has not gone away with Fox in the presidency that has assumed attitudes of “commander” of the town because they are still present the behavior patterns that encourage it, overlapped in the existent lagoons in the Constitution. A true régime change implies a deep Reformation of the State with a new Constitution, and in those that the diverse force politicians delimit the presidential activity.

Fox is the first president manager arisen of the local elite that is revealed against the center of the country, representative of the option of the “electoralist stream” of the managerial elite inside the PAN. Especially the one denominated of the fraction of the North or “Group Monterrey”, with which has narrow bonds and that supported in the ideology of the new Mexican right, it is expressed in the pragmatic current or neopanism, opposed to the doctrine and the traditional orthodoxy. According to the ex leader and twice candidate Panista, Pablo Emilio Madero, nephew of the democratic antirreeleccionista Francisco I. Madero, “Vicente Fox Quezada's eventual victory in the presidential election would crown the agreement of a group of managers. In 1982, these managers decided, in a meeting in Cd. Juárez, Chihuahua, to infiltrate and to control the Party National Action (PAN) to obtain particular interests. A virtual ascent of the neopanism to the power constitutes a serious risk for Mexico because the pragmatic principle of the personal interest would reign and not of the very common one. And once like government would conquer them the temptation of the authoritarianism to eliminate opponents, what would generate national discouragement” (Ruiz Rocks, 2000).

The proposal of change of Fox is considered imprecise with regard to the proposal panista. According to Loaeza (Rivera, 2000) “The and the middle classes that are expressed in it are not reactionary, on the contrary. They want a political change, they like the modern society, they look toward the exterior. Although on the other hand, perhaps be for a smaller social inequality but not for an absolute equality, because that doesn't interest them. They have a vision anti equalitarian of the society, they do not have interest on equality but the freedom. Freedom with order that yes...the social justice is not a topic panista...”

Contrary to the doctrinal current, the ideology of the neopanism, with certain flashes of fascism, defends the “changarro” of the attacks of the official populism. With a focus that is distant much of the political social democracy with the calls to the “useful vote” that don't recognize differences in ideologies more than the simple impulse of subtracting the power of the Party of the State. And under the presentation of a “virtual party of the unit”, the political class is recomposed with the arrival from the managers to the formal power. The managers arrive this way to the political power from the managerial unions to those that belong, mainly of the North of the country, used as launching platforms.

Nevertheless that the neopanism fights the official populism, the decomposition of the Mexican political system was the main cause that with Fox a new populism anti parties arose. According to Touraine (2000), this political decomposition goes of the hand with the advance of the big world economic conglomerates. The one that is also expressed in an alternative in the case of Mexico “to the Mexican” that difficulty can be considered “like a real road for the creation of a true democracy.” But in the overflow of these political marks, the same as it is dangerous to already give priority to the fall of a régime hole of their substance, it is also dangerous to encourage the union this way already too strong between a vague populism and the economic liberalism. The resistance to this populist tendency that attacks at the same time to the political system and the intervening capacity of the State has to be organized from the popular movements. These popular movements have the capacity to manifest and to express the popular demands of the sectors less favored, in such a way that they really contribute to the renovation of the public life.

The transition to the new régime has not been so smooth and soft. The caciques that held the political and economic power don't resign to lose. The wounded PRI of death has entered in internal

disputes for the little power that is and the political groups rush however to the defense of their interests and their quotas of power with violent confrontations. The smoothness of the political transition makes suppose that it has been made a pact by those who maintain the real power.

## **6. THE CHANGE DE PARTY IN THE POWER: THE MEXICAN STATE OF THE MANAGERS IN THE NEW PERIOD BREAD - PRESIDENCIALIST.**

The arrival of the managers to the Mexican State means the displacement of the politicians of the formal power. In other words, what changes is the formal power, because the real power remains unalterable. The Mexican Council of Businessmen stops to be a group of pressure in the face of the power of the State, to become the speaker of the managers in front of the federal government, and to determine the national economic and political decisions. That is to say, the direct taking of the political power by the conservative groups that hold the hegemonic economic power and national neo-oligarchy subordinated to the interests of the transnational capitalism to exercise a new governance strategy. This strategy allows them the domain and direct control of the means for the achievement of their maximum benefits (efficiency), without having necessity to appeal to the inter mediation of a political class that got paid expensive the mediation of the arrangements of the production factors. This is the case between capital and work, for example. However, in the humanity's history, the achievement of the efficiency has not brought the social justice.

The new State of managers draws about to administer the existent order efficiently to guarantee to the capital transnational globalized the best conditions for its investments in Mexico. Already the general coordinator in economic matter of the transition team guaranteed “zero discrimination” for the Mexican entrepreneurs. On the other hand, the leader of one of the most powerful organizations of managers omens that the government of Fox will be friendlier with the productive sector. Fox has a clear vision of the necessities of a company, so that he can create wealth and more work sources (Becerril, 2000).

Fox represents the alternation in the government and he has noticed that the purpose of its public administration is to increase efficiency of the government's task until a good degree and to eliminate this way all that has to do with errors and corruption. “I will delimit the functions that subtract effectiveness to the government administration in damage of the whole society...we have to put an end to the political and administrative centralism and to promote the invigoration of our federalism to impel the development of the regions and the viability of the municipalities starting from their vocation, from their resources and of the expectations of their communities.” (Macroeconomics, 2000).

His project of reengineering the federal public administration follows more the advice of the World Bank. Based more on the pragmatism of changing the administration without changes in the laws, it is sustained in more horizontal and more flexible structures and in approaches of efficiency, effectiveness, opportunity, pragmatism and quality (Abascal and Macías, 2000a). The horizontal and flexible structure is articulated by a strategic planning reaching up to the 2025. It combines managerial approaches with experiences of the public sector. It is formed by super advisers and super managers that coordinate the works as regards human development, security and justice, equal opportunities, and renovation of government's institution, a general coordination, Czars

(anticorruption and borders). Also, secretaries of State in government, social development, labor, companies and industrial development, agriculture and country property.

On the other hand, the managers have declared (Becerril, 2000) that they are convinced that the new government will be “friendlier”. They request options for the participation of the investment deprived in the energy sector (electricity and petrochemical secondary), they reject that it seeks to recapture populist politicians and they trust in that the relationship is of proximity but they will be critical when Fox makes a mistake. It is clear that Fox will govern to the Mexican State with a focus on the New Public Management, as if it were the corporation “Mexico, CORP. that puts to it finishes off the petrochemical one and the electric sector to the globalized transnational capitals.

Fox's approach is frank and pragmatic. Madero qualifies Fox like “pragmatic, a man willing to throw ropes, to say big words, to buy votes, everything with such of winning the elections... fall in the pragmatism, and I worry about that for him is more important that pragmatic principle that the democratic principle... should have to see until where a government panista with Fox ‘would be willing to respect to the people of Mexico for opinions against those who are in the poder’... already in government could make the same thing, that is to eliminate those that are opposed...” (Ruiz Rocks, 2000). Fox's discourse is characterized by its open style and to break from the rigid protocol. Their frankness, businessman's style and their democratic genuineness, are points to their favor. Fox has the intention of making his government a dynamic promoter of development, vigilant on human rights and a pragmatic administrator of domestic policy (Churches, 2000).

As a good manager, its pragmatism to solve problems is its main asset to achieve the “agreement” to the one that aspires among all the sectors of the society. But also its weak point in the negotiations: it tries to sum up “minimum points of outburst” where all the political actors put on of agreement, simultaneously, in the economic and political matters. The proposals will be able to be questioned by a civil society and the legislative power in which a majority doesn't exist for some of the political parties. It will be easier than to achieve the cohabitation, to build the necessary consent before the lack of absolute control of a Congress that won't be unconditional. Fox has said in this respect “my government won't make decisions, overalls in economic matter that attempt against the interests of the majorities. Anything will be made without consent and much less to backs of the will of the Mexicans” (Macroeconomics, 2000). In this sense, there is consent among the diverse political forces to delimit the presidential power by means of the suppression of meta constitutionals abilities and the creation of the civil service of independent career to the executive's will.

But the pragmatism of Fox doesn't have ideological base. It cannot be expected the postulation of liberal values but a necessary escape of the cage priista, as it sentences Reyes Heróles (2000). Fox has declared that its government won't be of bitterness and it demonstrated moving away the demand interposed against who accused him of receiving the foreigner's money confirming certain rumors that partly came of the former president Salinas de Gortari (Hills M., 2000b).

The managerialism focus of the State considers the citizens as clients to who it is necessary to satisfy with services of total quality. The president exchanges the word client for that of citizen, with a vision in the one that for example, it is inappropriate to promote policies of indigenous community development. Disrespectfully, Fox has offered the indigenous people “vocho, changarro and tele” as answer to centuries of rebellions against the capitalist system for the injustices made against them. To the neoliberalism centered in the forces of the market, the natives are not consumers. Therefore, they are disposable and in the best of the cases a population to integrate or to assimilate

in the lowest layers in a work force without rights and subordinate them to the capital, as the proposal to train them to be “the foreigners' gardeners” made by Fox in campaign. The political analysts coincide in that “his proposals have been contradictory, sometimes retrograde, sometimes hopeful, but they still lack the coherence that would have a complete program, we would have to be critical before a possible new liberal version with some attenuation” (Ortíz Pinchetti, (2000b).

This way, the fractions integrated to the directing elite are recomposed with the managers to guarantee the continuity of the economic model, the dimensioning of a functional democracy these mates with the discipline of the market and the structural reinvention of the system. This allows a bigger reproduction of the capital and the deepening of the dominance instruments to mark more the differences and social injustices. But this democracy favored by an authoritarian system of free market is an hegemonic ideology of the elite of the transnational globalized capitalism that imposes the decisions in its own benefit. However, the real power remains under the same control of the transnational capitalist interests.

On the other hand, the PAN in the government will have to confront the waste of the President's figure like ruler. There are evidences that the style of governing of Fox will be less flexible in political and more authoritarian in economic politics that the previous presidents, although he affirms that are priorities the attention to the poor. Under this new different correlation of forces and with the same rules of separation of powers that establish their autonomy, the public matters are managed in more transparent form. The frauds to the public sector and the violence to the conflicts now have a treatment more attached to the Rule of the State and the citizenship can demand the right to the rendition of bills and the transparency. Establishing the material conditions for law and order will be one of the government's challenges.

The organization of the new political system will condition the economic politics. According to the analysis of Bendesky (in Castellanos, González and Hills, 2000) the macroeconomic peak of the country in that Fox receives and that it has been prolonged for more than four years “it is sustained by factors of the situation hidden in the macroeconomic bills as the high price of the petroleum, the entrance of foreign currencies that has reduced the dollar, and the dynamics of the economy of United States...can change its tendency and to make pay the costs to the whole Mexican society when it is in course the government of Fox.. Among them it would be an adjustment of the exchange rate, increase in the inflation, bigger external imbalance and inability to solve the topic of the poverty.” So the challenge is to maintain the economic stability, to increase the economic growth and to support the competitiveness and to increase the productivity of the economic agents.

The political transition will come harnessed to an economic reformation but there won't be a social advance. Structural economic reforms needed to modernizing the regulatory framework for general economic activity and the strengthening the functional structure of the financial system. Clip to the social expense in the education items and public health to lose weight the bureaucracy gradually by means of the transfer of these functions from the State to the private sector. Fox has said that will reduce government's cost, subjecting to a rigorous but gradual diet to the federal public administration in next six years. Changes to eliminate the padlock from 51% to the national investment to give bigger opening to the private investment and foreigner and the invigoration of the financial system.

Fox's government will be committed to an integral fiscal reform and to fiscal tightening disciplines. However, the International Monetary Fund (IMF) it recommended to maintain a “wise

fiscal politics to assure the continuity of their favorable growth and to avoid the risk of a overheating in their economy”, (Reuters, Notimex and Afp, 2000). A fiscal reformation that eroded the principle of solidarity, base of the federal pact that assists to the inequalities of regional development, sustains of the national development.

Privatizations and opening to the competition of the energy sector, especially to the electric and petrochemical industry, so that according to the same managers, “the country functions well...the entrepreneurs don't want to buy Pemex or CFE. As private sector what we want is that they allow us to compete, to participate in certain environments of these productive branches, to make them competitive at the international level...there is not necessary to put padlocks to the foreign investment so that it intrudes in the electricity and hydrocarbons. The only rules for the national capitals and foreigners should be a market economy, commercial opening and prices fixed by the international competition” (Becerril, 2000).

Amendments to Article Third of the Constitution to introduce the freedom of the teaching and with it the possibility to give the opportunity to the religious education in the schools. An streamlining labor legislation is also needed, to reform to article 123 to introduce a New Federal Law of the Work less protective of the rights of the workers, etc. To generate more employments and better wages, they are some of the new government's proposals. In sum, the deepening of the model of free market.

Under a focus of the New Public Management, the government of Fox intends to deepen in the decentralization of the decisions by means of the invigoration of federalism, a federalism post - PRI to transfer the state governments the resources, abilities and responsibilities. In economic matter, this accumulation of resources, abilities and decisions gave place to what Zaid denominated “the Presidential Economy.” The restructuring project and the federal government's reengineering are guided with an efficiency approach to the gradual weigh loss of the bureaucracy in order to optimize the resources and to reduce the costs of their operation.

The project of the government of Fox is located in 8 strategic areas. These are restructuring of the Secretary of Government, modifications in the procurement of justice and public security, redefinition of functions of the controlling public expense. Also, modernization and reformations to the energy industry (petroleum and electricity), redefinition of social development objectives, continuity of the economic project and reactivation of the foreign policy (Chávez, 2000a). In general terms the neoliberal economic policy prevalent is not rectified in the last 18 years, but rather a deepening of the same one. However, their project of restructuring of the federal public administration assures that “none of the current public servants will be left in the street without employment opportunities” (Chávez, 2000b).

The Reformation of the State, the decentralization of the functions and the reorganization of the government bureaucracy are inevitable to improve the democratization, governance, public administration and to impose the rule of law for the legality and justice. The challenge to organize the government consists on structuring a system of multi sector matrix management of public administration (Barboza, 2000). This can be done with a double purpose: to coordinate the sector's actions and to distribute in the structures of the local governments, attributions and abilities. Both have as purpose the reestablishment of the solidarity and the social cohesion and that they are also inclusive of the excluded social sectors of the benefits of the development.

The new government's main challenge will be the one of building new institutional structures that solve the problems of the new reality that it faces the managerial group in the power. As for

example, those institutions that impede the monopoly practices and that they sustain the governance of the Mexican society. This governance should be considered as a democratic mechanism that facilitates the relationships with the public powers in the processes of making decisions for the formulation and implementation of public relationships, and to establish a harmonious relationship among the three powers. In political matter, it highlights to consolidate the maturity of the electoral democratic processes, to achieve the political reconciliation among the diverse political forces, to foment the political and ideological plurality in the organs of the State, to impel the processes of decentralization, federalism and regional and municipal development.

The new institutions that emerge of the government's decentralized reorganization should be guided to satisfy the demands of the citizenship opening channels for social participation. Also, to enlarge the democracy by means of the recognition of its territorial environment and have structures characteristic of public organization. The direct election of the representatives, the assignment of abilities to the municipal government, the coercion capacity, the readiness of not labeled resources and the direct administration of local services.

With a weak fiscal structure, the financing of the basic functions of the State won't be possible. Other functions of the State will be transferred to the civil society and the market. The social expense will have a maneuver margin limited to support the social politics as regards education, health, public security and infrastructure. A public, lay, gratuitous education and based on the values and the quality, it will be the social politics' axis. Fox will have programs and mechanisms that reduce the poverty to settle down and achieve a fair distribution of the income, recover the real income and it is translated in benefits to the families, by means of the generation of employment opportunities, financing sources, training, etc., for all. Philanthropic societies and the Catholic church will take charge of to develop some of the functions before commended to the welfare State, when the separation in fact existed between the Church and the State, such as the social attendance to the excluded groups and excluded.

The proposal of the democratic capitalist model for the economies of market in Latin American countries needs to be revised in function of the results expressed in increment of the poverty. To recover the credibility in the government and its genuineness are some of the main challenges that has the next administration of Fox. The same as to reduce the high index of poverty by means of the creation of a million two hundred thousand new employment per year, to maintain the economic growth and the economic development. The correction of the social inequalities is required starting from the economic politics' reorientation. To approach political public that combats the inequality as regards education, of health and infrastructure and of housing, it is an inevitable topic

It is required a governing and rectifying action of the State to correct the inequalities, an economy that is social, a human economy, a humanistic politics in the economic sense with a high emphasis in the combat to the inequality. The economic politics should be guided to generate conditions of human life and only not to change the bias that gives to the market an indisputable hegemony and to guide certainly on productive bases, but to make responsible to the State from the combat to such inequalities. The economic politics has to become unified to reduce the poverty with measure proposals as the establishment of the Social Banking to support family and associative companies, as well as the creation of a pact salary government - employer - worker that allows recovering the purchasing power of the workers.



A political system is required that it reveals the public administration and it is frequently accountable to people in such a way that allows the rulers to be more near to their governed and open up to the social participation the design and the implementation of the public politicians. However, the conservative speech panista and managerial it only recognizes the social participation of non-governmental organizations of private attendance with philanthropic ends. Nevertheless that in this joint of party alternation in power, the civil society that had always maintained a conflicting relationship with a government that looked for its corporate control, now has the opportunity to participate in the design of the project of the country under a new relationship with the government.

However, a strong concern exists because certain threat signs and danger have been presented in the state governments of extraction panista, like in the cases of Jalisco, Chihuahua and New León. The governments panistas in these States have left negative antecedents of repression to critical civil organizations related with the defense of the human rights, labor, political and civic, and a lack of institutional answer before situations of violence when commitments were looked for. This print makes suppose the existence of a lowering profile of the government of Fox.

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# MODALITY PREFERENCES OF BUSINESS STUDENTS: IMPLICATIONS FOR THE TEACHING OF FINANCE

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## ABSTRACT

*This study researches the learning styles of business majors by using a unique instrument, the Business Modality Preference Inventory (BMPI). This diagnostic tool categorizes learning style preferences into the observational, receptional and participational domains. We find that based on a sample of one hundred and twenty eight students enrolled in the core finance course at regional university, ninety-eight students (approximately three-fourths of the total study) indicated a preferred primary style of learning. An inverse and statistically significant relationship was found between the indicator variable for gender and the participational primary modality. Among the five different business majors, marketing students were found to have a strong positive preference for the mixed, or combination, style of learning. The use of this preference survey in the beginning of a course allows the instructor to assess the composition of the learning styles in the course, adjust teaching methodologies and ultimately, increase the level of comprehension and student performance in the classroom.*

## INTRODUCTION

Academicians have known for decades that a student's potential for cognitive and affective growth is greatly influenced by the compatibility between their individual learning modality preference and the instructional environments they are exposed to (Barbe and Milone, 1981; Banks, 1973; McCarthy, 1981; Kirby, 1979; Trautman, 1979). In other words, students learn best when they are in situations that allow them to exercise their unique set of sensory perceptual strengths: visual, auditory or kinesthetic. The diagnosis and determination of these modality strengths is therefore crucial, for it can provide instructors in any field with valuable information for planning the learning environment and teaching strategies that will assist each student in the learning process. Professors in finance, however, might be even more pressed to ascertain the modality strengths of their students, because the difficulty level of most course work in the field might be overwhelming for those students who are left to learn outside their preferred modality. Surprisingly, however, an extensive review of the literature revealed only one study which investigated the differences in modality preferences among business students (Bierman and Buchanan, 1986), but unfortunately, it combined finance and economic majors, leaving a clear picture of either group unobtainable.

Another interesting omission in the literature occurred when it was discovered that though there were several inventories designed to diagnosis individual modality preferences, none were particularly suitable for business majors, because they failed to incorporate typical business curricula jargon and teaching strategies; an oversight that could potentially lead to a validity problem. However, even if the validity concern were overlooked, the inventories that do exist are often costly to obtain and difficult to administer and interpret without specific training. To eradicate these issues, this study develops a modality style inventory, specifically designed for business majors that is easy and efficient to administer and interpret.

It is apparent that additional research is needed in this area, particularly in light of the fact that colleges of business are making such diligent strides toward improving their teaching methods. The two purposes of this study are to design and implement a modality preference inventory specifically constructed for business majors and investigate finance students' preferred modality style.

### **ASSESSING MODALITY STRENGTHS**

The general diagnosis of individual modality preferences is rather simple to ascertain. In fact, many learners have a general feel for which style of learning they prefer - that which stresses the visual, the auditory or the kinesthetic - making it possible to simply ask for a show of hands as to how many learn best when they are "seeing", "hearing" or working "hands-on". For validity purposes, though, a more formal instrument should be used to assess modality preferences. The most familiar instrument is the Swassing-Barbe Modality Index (SBMI). This index simply requires subjects to recreate geometric shapes that are first presented visually, auditorially or kinesthetically. Regarded by many researchers as an adequate measuring tool, it is not without criticism. Specifically in regards to this study, the SBMI was found inappropriate because its' design was based at least in part on an individuals spatial ability, a conflicting variable for those who are non-spatial thinkers, rather than on a learners' self-analyzed preferences.

For this study, the Business Modality Preference Inventory (BMPI) was developed specifically for business majors. The instrument differs from other learning style inventories most significantly in the descriptors it employs to classify each modality and in the scenarios it sets for students to identify with. Rather than classifying each modality as either visual, auditory or kinesthetic, the terms observational, receptional and participational were chosen as descriptors because they complement current communication model terminology, as well as, practical business environment terminologies. Theoretically, students who identify themselves according to one or a mix of these modalities, can begin to think practically in terms of what his or her "real world" strengths might be, rather than ignoring the information under the impression that it is merely an academic or clinical piece of information. In other words, students are familiar with the notion that good business managers need to be able to observe co-workers abilities and the general status of the work environment; receive staff and peer communications; and participate in program designs and implementations.

The scenarios used to describe each modality differ from other learning style inventories in that they specifically use business related jargon and content appropriate situations to illustrate the perceptual preferences. For example, rather than asking the students to complete the following general question: "I study best if: (a) there are no distractions, (b) my friends study with me, or (c) I am physically active while I study"; the BMPI instead asks: "When learning a new computer

software program I prefer to: (a) read the manual, (b) listen to a friend tell me how to run it, or (c) work through the tutorial.” Theoretically, the specificity of the BMPI should work toward making the self-analysis more pointed and more valid.

## **METHODS**

The study was conducted at a regional Midwest public university. One hundred twenty eight students from five randomly selected Principles of Finance courses participated in the study. There were fifty-five females and seventy-three males. There were twenty-eight accounting majors (22% of the sample), twenty-three computer and information systems majors (18%), eighteen finance majors (14%), twenty-four marketing majors (19%) and thirty-five management majors (27%). The BMPI was administered to each student during the second week of class. The instrument includes a total of twenty-five incomplete sentences, each of which is followed by three different incomplete statements that represent either an observational, receptional or participational modality preference. The learner is instructed to read each incomplete statement and then to select the statement that most nearly reflects their preferred answer. The inventory takes approximately 30 minutes to administer and complete the scoring.

The internal reliability for the survey was measured by splitting the questions into two parts and computing the correlations between them. The correlations were all positive and statistically significant, indicating substantial reliability for the three scales used in the survey. For the observational modality, the correlation coefficient was 0.27 (p-value = 0.038). The correlation for the receptional style of learning was 0.28, with a p-value of 0.013. The participational modality with a correlation of 0.33 (p-value = 0.009), exhibited the highest reliability between the two halves of questions.

Pearson rho correlation coefficients were calculated between the following variables: the student's primary modality preference: observational, receptional, participational or mixed; with their gender and major field of study. Each student's strongest modality was labeled as primary, a mixed modality would occur when all three modalities were within five percentage points of one another. The first null hypothesis states that there will be no significant relationship between the student's primary modality strength as determined by the BMPI and gender. The second null hypothesis measures the relationship between business major and the BMPI.

## **RESULTS**

Ninety-eight of the one hundred and twenty eight students (77% of the sample) had a primary modality preference. Twenty-nine (23%) students were observational, fifty-five (43%) were receptional and fourteen (11%) were participational. The remaining thirty students (23%) indicated a preference for mixed modalities. Among the students with mixed modalities, eight indicated a slightly higher preference for observational (6%), twelve for receptional (9%) and ten showed a slightly higher score in participational (8%). Table 1 contains the frequencies of the modalities based upon gender and major.

Major	SEX	OBS	REC	PAR	MIX	Total
ACCT	F	4	6	1	5	16
	M	4	4	1	3	12
CIS	F	3	2	0	2	7
	M	3	7	4	2	16
FIN	F	3	7	0	0	10
	M	2	3	1	2	8
MKT	F	2	2	0	3	7
	M	1	7	3	6	17
MGT	F	2	10	1	2	15
	M	5	7	3	5	20
Totals		29	55	14	30	128

The highest raw score in one modality on the BMPI is twenty-five. The observational modality contained the highest raw score of twenty-one (84%), as well as a minimum score of one (4%), and an average score of approximately eight (31%). The receptional modality had the highest average score of slightly higher than ten (41%), while the participational modality had the lowest average score of around seven (28%). The relative spread of the three domains, as measured by the coefficient of variation, showed the receptional style having the smallest variability (Standard Deviation / Mean = 28.46%), the largest dispersion was in the observational domain (46.82%) and the middle value was found for the participational preference (39.35%). Table 2 contains the descriptive statistics for each modality.

Modality	Minimum	Average	Maximum	Standard Deviation	Coefficient of Variation
OBS	1.00 (4%)	7.73 (31%)	21.00 (84%)	3.62 (14%)	46.82%
REC	3.00 (12%)	10.16 (41%)	17.00 (68%)	2.89 (12%)	28.46%
PAR	1.00 (4%)	7.11 (28%)	15.00 (60%)	2.80 (11%)	39.35%

There was one statistically significant relationship between a student's gender and modality as measured by the BMPI. There was an inverse relationship between the dummy variable for gender

(one = Female, zero = Male) and the participational primary modality ( $\rho = -0.2031$ ,  $p$ -value = 0.0215), indicating that females dislike the participational learning mode. This result supports right brain/left brain hemisphericity research theory, which suggests that females are typically strong in the right hemisphere, so perhaps they should be expected to excel in verbal fluency and aural analysis.

One statistically significant relationship was found among the different business majors. For marketing majors, a strong positive preference for the mixed modality was indicated ( $\rho = 0.1595$ ,  $p$ -value = 0.0722). Perhaps, this is an indication of the marketing person's ability to adapt and adjust to the many different situations that typically occur in the marketing field. Conversely, among the finance majors sampled, the strongest dislike was for the mixed style of learning ( $\rho = -0.1177$ ,  $p$ -value = 0.1857), where none of the three primary modalities were preferred. For accounting majors, no real preference was shown for either the observational or participational domains, but a dislike for the receptional modality was shown ( $\rho = -0.0775$ ,  $p$ -value = 0.3843). The opposite of this was indicated for management majors, with a positive correlation between their major and the receptional style of learning ( $\rho = 0.0694$ ,  $p$ -value = 0.4361). The strongest result for the computer and information systems major appeared in the participational area. This major preferred the "hands-on" style, rather than seeing or hearing about a given topic ( $\rho = 0.0968$ ,  $p$ -value = 0.2772). Table 3 contains the Pearson correlation coefficients for all variables in the study.

	ACCT	CIS	FIN	MKT	MGT	OBS	REC	PAR	MIX
SEX	0.1515 (0.0878)	-0.1185 (0.1828)	0.1029 (0.2480)	-0.1339 (0.1317)	-0.0014 (0.9876)	0.0580 (0.5153)	0.1074 (0.2278)	-0.2031 <b>(0.0215)</b>	-0.0332 (0.7100)
ACCT		-0.2477 (0.0048)	-0.2141 (0.0153)	-0.2542 (0.0038)	-0.3246 (0.0002)	0.0748 (0.4016)	-0.0775 (0.3843)	-0.0643 (0.4706)	0.0641 (0.4720)
CIS			-0.1893 (0.0323)	-0.2248 (0.0107)	-0.2871 (0.0010)	0.0384 (0.6673)	-0.0363 (0.6842)	0.0968 (0.2772)	-0.0668 (0.4537)
FIN				-0.1943 (0.0280)	-0.2482 (0.0047)	0.0495 (0.5790)	0.1029 (0.2480)	-0.0698 (0.4340)	-0.1177 (0.1857)
MKT					-0.2947 (0.0007)	-0.1166 (0.1901)	-0.0531 (0.5519)	0.0241 (0.7876)	0.1595 <b>(0.0722)</b>
MGT						-0.0389 (0.6626)	0.0694 (0.4361)	0.0097 (0.9139)	-0.0498 (0.5768)
OBS							-0.4698 (0.0001)	-0.1897 (0.0320)	-0.2995 (0.0006)
REC								-0.3042 (0.0005)	-0.4803 (0.0001)
PAR									-0.1939 (0.0283)

## SUMMARY

Though the study failed to yield strong statistically significant results for all but the female and marketing major variables, this study nevertheless supports the hypothesis that college age students prefer different learning modalities. For example, when studied as one sample, the students reported

a 23% preference for the observational mode, a 43% preference for the receptional mode and an 11% preference for the participational mode. In addition, even though strong correlations between major and preference could not be shown, it was interesting to note that finance majors did not embrace the mixed modality style, while marketing students did. Further, the management students liked the receptional mode, but accounting students disliked this modality. Such a wide range in preferences does justify the one of the key assumptions of this paper, which maintains that students learning preferences should be determined and defined and traditional teaching methods should be redesigned to include each of the three learning modalities. The use of the Business Modality Preference Inventory can assist professors toward each of those endeavors.

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# AUTOMOTIVE MACHINE SHOP SUPPLIERS

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## CASE DESCRIPTION

*The primary subject of this case involves choice-based market segmentation utilizing a multinomial logit discrete choice model. A segmentation strategy based on buyers' likelihood of purchase is conducted and forms the basis for developing marketing strategies. Secondary issues include the estimation of the model with SPSS software, interpretation of key drivers of choice, resource allocation decisions, and the development of marketing strategy based on market information. The case difficulty is at a three level appropriate for juniors with at least a basic statistics course as a prerequisite. The case could be placed in marketing research or in marketing management as well as in graduate market analysis type courses. Typically, two class periods along with two to four hours of outside class student preparation are needed to teach the case.*

## CASE SYNOPSIS

*This case presents an overview of the wholesale distribution of automotive machine shop supplies and the dilemma the industry leader, Goodson Automotive Machine Shop Supplies, faced in maintaining its dominant market share. Entry of low priced competitors along with increasing costs of sales reps and catalogs heightened the need for strategic allocation of marketing resources and the need to re-examine Goodson's high quality/high price positioning strategy. An overview of the marketing research data collection process and the choice-based market segmentation technique Goodson undertook to reformulate their marketing strategy are provided. Data involving the buyers' most recent choice of a supplier in addition to demographic, geographic, psychographics, and behavioral segmentation variables are used to estimate the probability that a given buyer would select a particular supplier. Instructions on using SPSS's Cox Regression procedure to estimate this disaggregate choice model are presented. Buyers are then classified as "switchable" or "non-switchable" based on their choice probabilities, which are calculated using the model's logit coefficients in an Excel spreadsheet. Marketing strategies are then designed to attract the "switchable" segment of buyers based on the importance of key drivers of choice as suggested by the estimated logit coefficients. This case describes a real situation using hypothetical data.*

# **EMPLOYMENT RELATIONS CULTURE, HUMAN RESOURCE MANAGEMENT (HRM) PRACTICE AND ALTERNATIVE DISPUTE RESOLUTION (ADR): SOME NEW ZEALAND EXPERIENCES**

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## **ABSTRACT**

*The paper examines employment relations culture, human resource management (HRM) practices and alternative dispute resolution (ADR) in New Zealand.*

*New Zealand's employment relations system was established by the Industrial Conciliation and Arbitration Act (IC&A) 1894 which bound parties to a highly regulated framework. Only collectives could negotiate contracts of employment, which were predicated on conciliation leading to legally binding agreements. Where conciliation failed, the dispute was referred to arbitration.*

*This framework remained until the introduction of the controversial Employment Contracts Act (EC Act) 1991.*

*The EC Act changed New Zealand's employment relations culture. Conciliation and arbitration were replaced with legally binding contracts and a specialist employment jurisdiction. Opponents argued the Act would lead to an imbalance of power in favour of employers. Proponents claimed it would bring flexibility to the rigid system.*

*The resulting employment relations culture encouraged 'hard' HRM practices that focused on employee compliance. Dispute resolution was institutionalized through a specialist jurisdiction.*

*The election of the Labour-Alliance Coalition Government in 1999 saw the employment landscape re-drawn again for the second time in a decade with the Employment Relations Act (ER Act) 2000. The paper discusses the implications of the ER Act for HRM practices including alternative dispute resolution.*

*"The Lawyers have twisted it into such a state of bedevilment that the original merits of the case have long since disappeared from the face of the earth... We are always appearing, and disappearing, and swearing, interrogating, and filing and cross-filing and arguing ... and equitably waltzing ourselves off to a dusty death. It's about costs. That's the great question. All the rest, by some extraordinary means has melted way." (Dickens, 1854)*

## **INTRODUCTION: THE RISE OF HUMAN RESOURCE MANAGEMENT (HRM)**

The closing decades of the 20<sup>th</sup> century were difficult times for many western organizations as they searched for ways to enhance their competitiveness. One obvious way was to make better use of their people. Reviewing the topics that had pre-occupied American businesses between 1960-80, Kanter (1985) concluded that '*the majority of issues growing in importance concerned human resources . . .*' Beer et al (1984) maintained that a 'paradigm shift' had occurred '*regarding the*

*management of human resources in organizations.*' The traditional approach came in for considerable criticism with Guest (1987) arguing that human resources had become, *'too important to be left to the marginally placed personnel manager.'* Human resource management (HRM) had arrived.

Interest heightened as organizations faced increasing competition from the Asian economies (Dobbs-Higginson 1994), adopted new technologies (Millard et al 1992), grappled with the implications of more 'flexible' structures (Atkinson 1985), faced changes in the composition of the workforce (Sayers & Toulson 1995), and the dynamics of the new workplace resulting from the decline of unionism (Harbridge & Honeybone 1995). Management gurus urged organizations to learn from Japan Inc (Ouchi, 1981, Pascale & Athos 1982) and offered prescriptions for achieving 'excellence.' (Peters & Waterman, 1982)

New Zealand organizations were treated to a similar diet based on homegrown research. Inkson et al (1986) produced a pale version of Peters & Waterman's work which maintained that *'some of the management which go on in these companies are excellent.'* Sadly many of these examples of 'excellence' disappeared the following year with the Stock Market crash. Commenting on the results of a collaborative research project, Michael Porter concluded that New Zealand organizations needed to focus on their human resources needs;

*'New Zealand faces fundamental human resources challenges. We have not invested aggressively in creating pools of human resource skills needed to be internationally competitive.'* (Crocombe, Enright & Porter 1991)

The message seemed clear: people can make the difference.

### **THE 'STAKEHOLDER' PERSPECTIVE**

The 'Stakeholder' framework suggested that effective HRM policies were positively related with corporate success, which should be assessed in terms of the extent to which they:

- ! Lead to an increase in employee commitment
- ! Attract and retain employees with the required skills and competencies.
- ! Are cost effective in terms of wages, turnover, absenteeism, retention and training costs.
- ! Lead to a sense of congruence within the organization.

Central to this view is the notion of 'fit', for example, in terms of recruiting employees who 'fit' the organization's culture. Integration of HRM policies at every level is seen as critical for corporate success (Baird & Meshoulam 1988). Conflict on the other hand is anathema to HRM and is seen as a failure to effectively communicate the organization's 'vision.' As such, it needs to be managed but not by resorting to traditional adversarial methods, which are viewed as a legacy of a 'win-lose' mentality.

## EMPLOYMENT RELATIONS AND DISPUTE RESOLUTION

Deeks et al (1994) maintain that disputes negotiation at the enterprise level invariably takes place between parties who have some interest in maintaining an employment relationship. Mindful of the need to work together in the future, the parties may be more disposed to negotiation and mediation rather than resorting to formal adjudication.

A number of factors influence the respective party's approach to dispute resolution including:

- ! Whether the parties perceive it to be a 'win-lose' situation, a zero-sum game or, a 'win-win' situation where the overall size of the reward can be increased.
- ! The nature of the existing employment relationship. What degree of trust exists? What is the culture of the organization?
- ! What subsequent employment relationship do the parties want? Do they envisage an on-going relationship or, has the relationship been so irretrievably damaged? Is one of the parties looking to substantially re-structure the existing power balance?
- ! What are the risks and costs involved in the negotiation for both parties? What is the potential cost of failing to deliver a solution?
- ! What is the time frame? How quickly is an outcome required? What external factors impinge on the negotiation? What are the long-term implications flowing from the resolution?
- ! The complexity of the issues to be resolved (Deeks et al, 1994)

## CONVENTIONAL DISPUTE RESOLUTION

Conventional dispute resolution techniques have attracted considerable criticism for decades. Fisher & Ury (1982) maintain that to be effective, dispute resolution should be judged against three criteria. First, it should satisfy the legitimate interests of all parties. Second it should be efficient. Finally, it should improve or, at least do no further damage to the relationship between the parties. Conventional dispute negotiations they argue, fails to satisfy any of these criteria; '*Each side takes a position, argues for it, and makes concessions to reach a compromise.*' (Fisher & Ury, 1982)

The adversarial approach places parties in positions they are forced to defend, often at great cost. The process itself also thwarts agreement and even when reached, is often the result of a form of mathematical 'splitting of the difference' rather than a solution '*crafted to meet the legitimate interests of the parties.*' (Fisher & Ury 1982) The approach is costly in terms of time, effort and financial expenditure.

Finally, the adversarial approach fails to recognize the importance of the on-going relationship, often resulting in an irreparable breakdown between the parties leaving them '*dissatisfied, worn out, or alienated - and frequently all three*' (Fisher & Ury 1982).

## SEEKING A BETTER WAY: ALTERNATIVE DISPUTE RESOLUTION (ADR)

Alternative dispute resolution involves establishing an agreed process for resolving disputes other than those provided for by the specialist employment jurisdiction. Forbes (1995) claimed ADR

to be “*the most creative social experiment of our time.*” A change in attitude among the legal profession towards ADR is also apparent with research suggesting that, “*the cost of going to court is very expensive for a lot of people and it can be a long wait to a hearing. In contrast a mediator was often able to come up with innovative and creative solutions, while the Courts are constrained by the limitations of law.*”(Wedderburn, 1988)

Traditionally New Zealand’s employment law has included provision for alternative approaches to dispute resolution. The founding employment legislation, the Industrial Conciliation and Arbitration Act 1894 prescribed various forms of mediation and arbitration as an integral part of the specialist employment jurisdiction. The controversial Employment Contracts Act 1991 also encouraged the search for a ‘better’ way stating that disputants are, “*the persons best placed to resolve differences, and should be assisted to do so themselves*’ (EC Act 1991). Only where mutual resolution was either inappropriate or impossible would the dispute be referred to the Employment Tribunal that was established to provide a low-level mechanism for resolving disputes.

Critics of the EC Act however argue that institutionalizing mediation is a contradiction in terms and that any genuine attempt to develop effective mediation would have been mandatory at the workplace. Instead the dispute resolution system established by the EC Act was apriori and did little more than place a monetary value on a failed employment relationship (Skiffington, 1993).

### **ALTERNATIVE DISPUTE RESOLUTION AND THE EMPLOYMENT CONTRACTS ACT (EC ACT) 1991**

By the end of the 1980s, many New Zealanders appeared to have wearied of the reforms of the fourth Labour Government where almost every aspect of the economy had experienced major change, save one; the labour market. The National Government elected in 1990 set out to address this situation, committing itself to, ‘*reintroduce voluntary unionism, reform the law to allow employers and employees to jointly choose their own bargaining arrangements; be they workplace, enterprise or industry arrangements . . . allow employees to choose their own bargaining agents, be it union or otherwise, to represent them in industrial negotiations*’ (National Party, 1991). On 15 May 1991, the Employment Contracts Act (EC Act) came into force, re-shaping New Zealand’s one hundred-year-old employment relations landscape.

The EC Act replaced conciliation and arbitration with legally binding individual and collective contracts negotiated at the enterprise level. Pre-eminence was given to individualism, freedom of association and choice with the term ‘union’ noticeably absent from the legislation. The employment contract was viewed as a special form of contract with labour being simply another commodity in the process of production, ‘*no more than something of value*’ (Brook, 1990). Issues of equity in the contracting process were assumed to be resolved in the marketplace (Epstein, 1983). A specialist employment jurisdiction was established to oversee the process.

With regard to dispute resolution, the EC Act provided that parties to an employment contract might adopt the procedures set out in the First and Second schedule of the Act, or they could devise an alternative procedure that was “not inconsistent” with the requirements of the Act. Alternative dispute resolution procedures had to remain within the existing legal framework and usually involved mediation in the first instance, followed by arbitration.

Organizations wishing to establish their own alternative dispute procedure had to ensure that such a procedure was both 'effective' and 'not inconsistent' with the existing employment law.

### **MINIMUM REQUIREMENTS FOR AN ADR PROCEDURE UNDER THE EC ACT 1991**

Any organization considering developing its own alternative dispute procedure needed to ensure that it met minimum legal requirements that included:

- ! parties to the dispute were advised of the existence, the precise nature of the dispute and solution sought in writing as soon as practicable after the dispute arises.
- ! reasonable notice of any hearing
- ! all parties were informed of their right to representation
- ! the agreed alternative dispute procedure provide certainty as to the steps to be followed. The procedure should be in writing and copies supplied to all parties.
- ! to be "not inconsistent" with the procedure set out in the second schedule of the Act
- ! parties must meet to discuss the dispute. If they failed to reach a resolution the party invoking the procedure must give the other party, or parties a written statement setting out the nature of the dispute, the relevant facts of the dispute and solution sought.
- ! the employer is unable to provide the solution sought they must provide a written statement setting out their view of the facts and the reason why the solution will not be provided, within 14 days after the receipt of the written statement of the dispute. The requirement to exchange written statements may be waived by mutual agreement between the parties. If the matter is not resolved the party invoking the procedure may seek a further remedy as set out in the alternative dispute resolution procedure.
- ! decisions are made on merits
- ! full reasoned decisions by the adjudicating body should be made in writing and copies supplied to all parties to the dispute and provide reasonable certainty as to the steps to be followed
- ! procedures should be free from undue cost and legal technicality (EC Act 1991).

### **THE EMPLOYMENT CONTRACTS ACT 1991 AND HRM PRACTICES**

What influence did the EC Act have on the HRM practices that developed in the 1990s? How did the Act affect attitudes towards dispute resolution?

#### **'HARD' OR 'SOFT' HRM?**

Among the many attempts to understand HRM is the 'hard' and 'soft' approach (Storey, 1989). The 'hard' version stresses efficiency and effectiveness, where the role of HRM is to develop policies which enhance the achievement of the firm's business strategy. This view is fundamentally managerialist in that the policies and practices are seen to serve management's interests, stressing

outcomes such as employee performance, increased 'flexibility' and reduced labour costs. Based on unitarist assumptions, HRM is seen as critical to the promotion of a 'mutuality of interests' and the development of 'organization culture.' Conflict is viewed as an aberration since; '*it is in everyone's interest to have efficient production, high profits and good pay*' (Mackay & Johnson, 2000). Where conflict arose it was regarded as a failure to effectively communicate the organization's 'vision.' Unions are viewed as '*peripheral to the central relationship between an employer and his or her employees*' (Deeks, 1994), superseded by line-managers responsible for all aspects of employment relations.

The 'soft' approach on the other hand argues that people are not simply a cost to be minimized but are an organization's most valuable 'asset', its source of sustained competitive advantage (Legge, 1989). Such a view emphasizes the role of HRM in developing a competent, committed workforce.

During the decade of the EC Act, the HRM practices that emerged in New Zealand suggest that the 'hard' variant attained the ascendancy.

### HRM PRACTICES IN ACTION

A number of discernible 'hard' HRM practices emerged during this period.

i. The EC Act led to a fundamental shift in the balance of power, from unions and collective bargaining to employers and employment contracts. The resulting employment culture enabled the 'hard' variant to predominate despite '*the growth in the use of 'soft' HR rhetoric by HR managers and practitioners.*' (Mackay & Johnson, 2000). Drawing on UK experiences, Truss et al (1997) maintain that 'hard' HR practices are frequently found in firms using 'soft' HR language. The period of the operation of the EC Act was characterized by reference to 'partnership', 'empowerment' and 'teams' while at the same time, short-term economic difficulties were frequently 'solved' through restructuring and redundancies, aimed at cost reduction and one-off productivity gains. 'Downsizing' was used to reduce labour costs, suggesting that far from regarding employees as their most important long-term resource, many companies still saw them as short-term costs (Littler et al, 1997). Ironically, by the mid-1990s, many New Zealand industries were bemoaning an acute skill shortage brought about, in part, by the 'culling' of the previous decade and by the failure to invest in employee development.

In this climate, HRM practitioners frequently found themselves engaged in the rhetoric of employee development, a long-term imperative, while executing compliance strategies aimed at short-term economic gains.

ii. Opponents of the EC Act maintained that employment relations would become a battle field for lawyers and advocates, '*conducted through methods of formalism and disputes resolved by the Courts*' (Wilson, 2000 (b)). In this, they were largely correct. Ensuring employment practices were legally defensible and not likely to lead to an appearance at the Tribunal became a priority. Since few HRM practitioners were likely to be legally qualified to interpret the growing body of employment case law, they became dependent on specialist legal advice, either to forestall potential trouble or, to cope with it in the legal arena. The practice of employment law boomed.

For the HR manager, the potential for conflict began at the recruitment and selection stage where the emerging case law made it clear that selecting the 'wrong' person could not easily be remedied by a dismissal, since this was likely to lead to a claim of unfair dismissal at the Tribunal. A defense of 'inadequate performance' was also likely to be difficult to substantiate unless the organization could demonstrate a sound, well-documented performance appraisal system. Even then, the employer would be expected to provide evidence of 'performance managing' the alleged under-performing employee, through coaching and training.

In such an environment, HRM practitioners frequently found themselves preoccupied with the legalistic aspects of the employment relationship, looking for potential conflict and in the worst case scenario, defending their practices at the Tribunal. Although the initial aim of the Tribunal was to provide a low-level, informal mechanism for solving disputes, it soon developed into a highly legalistic forum, replete with lawyers, advocates and formalized process.

iii. The EC Act reduced the role of the union to that of '*being a representative or 'agent' of the worker or workers*' (Deeks et al, 1994). Employers might recognize the 'agent' but were under no obligation '*to bargain, or to bargain in good faith with the representative*' (Deeks et al, 1994). The EC Act placed no legal responsibility on the employer to act in good faith. Faced with a dispute, the employer could, and some did, present a 'take it or leave' stance and simply shunted any resulting disputes to the Tribunal. With a waiting time for a hearing of up to nine months, an employee taking a personal grievance was faced with a daunting struggle. In employment relations, the much-talked about 'playing field' was far from level.

In the unionized setting that existed prior to 1991, HR managers were accustomed to negotiating with on-site union representatives. After the implementation of the EC Act, union influence declined and 'union free' sites meant that many HR managers gained little experience of negotiating disputes to a successful conclusion at the enterprise level.

### **PLURALISM MAKES A COMEBACK: THE EMPLOYMENT RELATIONS ACT (ER ACT) 2000**

In November 1999 the Labour-Alliance Coalition Government led by Prime Minister Helen Clark replaced the National Government and lost no time in delivering on its' pre-election promise to repeal the EC Act. On 2 October 2000, the Employment Relations Act (ER Act) came into law.

Unlike the previous legislation, the ER Act acknowledges that there is an inherent imbalance of power between employee and employer and prescribes collective bargaining for addressing this situation.

The chief architect of the Act, The Minister of Labour, Hon. Margaret Wilson maintained the aim of the Act is to '*build productive employment relationships through the promotion of mutual trust and confidence*' and '*signals the Government's intention to bring fair dealing and a more balanced approach into the workplace.*' (Wilson, 2000 (a)). Where the EC Act focused primarily on developing an efficient labour market, the ER Act aims to build productive employment relationships.

The ER Act emphasizes the need to develop employment relationships rather than simply negotiating employment contracts and introduces into New Zealand's employment vocabulary the



North American concept of good faith bargaining. Mediation is the designated route for resolving conflict rather than relying on external adjudication. A new institution, the Employment Relations Authority (ERA) was established to investigate employment disputes in a non-adversarial setting. Unions are confirmed as legitimate parties to the employment relationship and employment contracts are replaced by individual and collective agreements.

## **FROM CONTRACT TO RELATIONSHIP**

The language of the new legislation signals a major change in philosophy, for where the EC Act stressed the contractual nature of the employment exchange, the ER Act talks of the employment relationship which is viewed as not simply an economic exchange but one that involves a social relationship. Consistent with this philosophy, agreements are to be arrived at by a process of negotiation rather than by the “take it or leave it” approach characteristic of the previous regime.

## **GOOD FAITH BARGAINING**

The Act introduces into the New Zealand employment relations’ vocabulary the concept of good faith bargaining which is not simply restricted to the bargaining table but applies to all matters between an employee and employer; collective bargaining, union/employee and employer interaction, union access to workplaces, consultation and changes to employment arising from outsourcing and sale of the business.

Bargaining in good faith means that the parties consider each other's proposals, respect each other’s choice of representatives, and provide full information necessary for bargaining.

To facilitate this relationship, the New Zealand Employers Federation (NZEf), the New Zealand Council of Trades Unions (NZCTU), the State Services Commission and the Government developed a generic Code of Good Faith to provide guidance to employers and unions in the application of good faith to the bargaining process. The Code lays down that parties to the bargaining must deal with each other in good faith and must not, directly or indirectly, do anything to mislead or deceive each other.

## **THE ROLE OF UNIONS**

The role of unions under the ER Act contrasts starkly with the previous legislation for where the EC Act deliberately isolated unions, the ER Act confirms their role as legitimate parties to collective bargaining. Unions have statutory rights of access to workplaces for bargaining, enforcement, and union business purposes. They must however be registered with a Registrar of Unions who must be satisfied that the union is a democratic organization of employees, accountable to its members, independent of employers (company unions), with rules that are not unreasonable, undemocratic; unfairly discriminatory or unfairly prejudicial, or contrary to law. The Registrar may investigate complaints over whether unions are fulfilling their obligations under the Act, and enforce these through the Employment Relations Authority.

## **BARGAINING ARRANGEMENTS**

The Act sets out to promote orderly collective bargaining where only employers and registered unions will be parties to collective agreements and must meet specific good faith obligations.

All agreements must:

- ! state the terms of the agreement;
- ! describe the coverage of the agreement;
- ! make provision for variations to the agreement during its term;
- ! be in writing; and
- ! have a maximum term of 3 years (Skiffington, 2000).

## **MEDIATION**

A key objective of the ER Act is to promote mediation as the central mechanism for resolving conflict at the workplace. To facilitate this, where requested, the Department of Labour provides a specialist nation-wide mediation service. While not compulsory, mediation is the first options to be explored before further action is under-taken.

## **THE EMPLOYMENT RELATIONS AUTHORITY (ERA)**

The Act established a new specialist lower level investigatory body to be known as the Employment Relations Authority (ERA) to investigate employment problems in a non-adversarial way. The ERA has the power to gather information, call evidence and investigate relevant matters. In an attempt to avoid the legalism that characterized the previous legislation, informality is emphasized and prior settlement is encouraged.

The Employment Court is retained but its role is restricted to the areas of torts and determining matters raised by the Registrar of Unions. For example, the adherence by unions to the registration requirements of the Act. The Court will also hear cases where the parties are dissatisfied with a determination of the Employment Relations Authority. However, this will not be in the form of an appeal, but as a full judicial hearing of the original problem. The Court of Appeal will hear appeals from a decision of the Employment Court, on points of law (Skiffington, 2000).

## **INDIVIDUAL AND COLLECTIVE AGREEMENTS**

Collective agreements set the terms and conditions of union members. Additional terms and conditions can also be negotiated on an individual basis, provided that these are not inconsistent with those of the collective agreement

For the first 30 days of employment, new employees who are not union members will be employed on the terms and conditions of the applicable collective agreement. After the 30-day period, if the employee has not joined the union, the employee may agree with their employer to any changes to their terms and conditions.

## STRIKES AND LOCKOUTS

The legislation provides for lawful strikes and lockout actions to be taken in pursuit of single or multi-party collective agreements after the expiry of an existing collective agreement and where the parties have been negotiating for at least 40 days.

## REMEDIES

Consistent with its' emphasis on maintaining the employment relationship wherever practicable, reinstatement becomes the primary remedy for grievances where this is sought by the complainant.

## HUMAN RESOURCE MANAGEMENT PRACTICES, ADR AND THE EMPLOYMENT RELATIONS ACT 2000

The ER Act signals a second change of direction in employment relations in New Zealand in a decade and presents a major challenge for HR practitioners. How will the ER Act affect HRM practices? Will it promote a growth of interest in ADR? Will the underlying principle of good faith bargaining compliment and promote ADR?

A number of outcomes seem possible.

- i. The Act might be expected to re-generate interest in 'soft' HRM practices. An obvious starting place is with the dispute resolution practices fostered by the *EC Act*. The ER Act requires that disputes be mediated at the enterprise level rather than being directed to an external jurisdiction. For this to happen however, employers will need to invest in 'in-house' mediation structures and processes, including dispute resolution training for their HR managers. And such procedures will need to be evaluated against the implicit criteria underpinning the ER Act, which are markedly different from those that applied during the last decade. These include: do the dispute resolution procedures satisfy the legitimate interests of *all* parties? Are the procedures conducive with the good faith provisions of the Act? Are the dispute resolution processes both efficient *and* effective? And are the procedures likely to lead to an improvement in the long-term employment relationship between the parties?
- ii. The employment culture associated with the EC Act emphasized employee compliance rather than development. The new Act calls for a change in direction in terms of prioritizing employee training, the development of 'soft' skills such as negotiation, communication and mediation, the building of employee-management relationships and focusing on human resource development (HRD) activities. The promotion of ADR is consistent with the basic aims of the ER Act.
- iii. The re-emergence of unions in larger enterprises will require HR managers to negotiate, at the enterprise level, on issues generated by the workforce. This again will mean negotiating in an employment relations' culture very different from that of the last decade. Disputes will

no longer be summarily shunted into the legal arena. Neither will management nor unions be able to stand behind the letter, but not the spirit, of the agreement and the parties will be expected to demonstrate that they have acted in good faith at all times. The Act envisages disputes being resolved at the workplace and only where this proves to be untenable will the parties be expected to call on the national mediation service.

## CONCLUSION

The decade of the EC Act fostered HRM practices primarily concerned with employee compliance. The ER Act envisages an employment culture where HR managers develop 'soft' HRM practices, particularly mediation and relationship building in the workplace.

Developing ADR procedures presents a challenge for HR managers for while, in theory, the EC Act made provision for the inclusion of alternative dispute resolution processes for personal grievances and disputes, it also prescribed stringent statutory requirements.

Developing agreed ADR processes under the ER Act provides advantages including faster dispute resolution, enhanced on-site employment relationships, reinforcement of workplace values by enhancing participation, communication, transparency and fostering a high trust work environment. On the debit side is the cost of equipping people with the requisite dispute resolution expertise, maintaining national records and ensuring consistent standards between enterprises. Additional costs involved in the provision of mediation and arbitration services need also to be considered.

The extent to which this may occur will depend on the acceptance of the need to change by senior management, HRM practitioners and unions. It will also depend on the government providing adequate funding for the nation-wide mediation service. Employers are likely to watch anxiously to see how major unions exercise their newfound freedom in the workplace.

The early signs are encouraging. The Employers and Manufacturers Association (EMA), the most trenchant critics of the new legislation, examining the performance of the Act's first six months of operation, concluded that '*The ERA has earned a pass mark despite early dire predictions.*' It rated the work of the Employment Relations Authority as '*excellent*', praised the action of the unions and acknowledged the new mediation service to be '*quick and efficient.*'

The ER Act provides the opportunity for HRM practitioners to make a positive contribution to re-building workplace relationships but to do this they will need to re-shape their practices to the new employment environment.

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