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Managing Global Transitions

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The Editor's Corner

The journal continues focusing on the transition research and emphasizing the openness to different research areas, topics, and methods, as well as international and interdisciplinary research nature of scholarly articles published in the journal. The current issue covers topics of transition process, corporate crises, exchange rates regime, trust and commitment, and intercultural interaction.

In the first paper of this issue Cezar Scarlat and Eugen I. Scarlat have developed the bi-dimensional matrix model of the transition process. In the second paper, Drago Dubrovski examined management mistakes and presented them as a cause of corporate crises, a thing which can be of an importance in the countries in transition. The focus of the third study by Romulus-Catalin Damaceanu is the relation between the exchange rates regime and international trade. In the fourth paper, Barbara Čater examines trust and commitment in professional service marketing relationships in business-to-business markets and finds a positive relationship between trust and affective commitment and a weak negative relationship between trust and calculative commitment. In the last – fifth paper, Pirkko Pitkänen presents research findings based on a case study that focuses on intercultural interaction issues in private sector workplaces in Finland.

Boštjan Antončič
Editor

Theoretical Aspects of the Economic Transition: The Case of Romania

Cezar Scarlat
Eugen I. Scarlat

For Romania, as for all other ex-communist countries from Eastern Europe, the transition from the rigid centrally planned economic system to the free-market economy, fair competition based, was an amazing experience. From the academic standpoint, the economic reform was a huge research opportunity, as well as having extremely important practical consequences. Based on the case of Romania, the authors have developed an original, bi-dimensional matrix model of this transition process (Scarlat Model), emphasizing the typology of four basic economic systems. Managerial aspects are underlined – both for economic systems and transition process – as well as some stability considerations. Two features of the transition strategy are presented: the transition path and duration of the process. Special attention was paid to assessing the moment by when the economic transition ends. Analysis of the transition path – based on the theory of deterministic chaos (i. e. short-run predictability) – has led to interesting results: a comprehensive research on the evolution of the Romanian currency exchange over a period of sixteen years (1990–2005) revealed three intervals in the Romanian recent history of economic transition and confirmed the diagnostic of transition end. The general model is applied in the case of Romania and some interesting findings are presented, but it is also fully applicable to all Eastern European countries and not only Romania. The EU accessing process is a different type of transition – rigorously planned, regulated and monitored.

Key Words: economy model, economic transition, transition path, deterministic chaos, EU accession
JEL *Classification:* P21

Introduction

In 1989, the seemingly solid system of centrally planned economy collapsed. The revolutionary changes that started in Poland demolished the

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whole Soviet-style command economic system of Eastern Europe and the Soviet Union itself. Dramatic changes in the economic systems of these countries followed, but the scientists were not prepared for such a moment: there was no valid theory of economic reform to rely on – as there was no such precedent. Within the empty space of the economic theory in this respect, the fall of communism has given way to a variety of strange, archaic, alternate and even 'informal' and 'parallel' forms of management and enterprise – as the entrepreneurial energy existed but it was not properly channelled (Dana and Dana 2003).

As Aligica describes (2006), the raise of the *new institutionalism* is one of the most significant reactions of the economic reform experience.

A comprehensive World Bank report (World Bank 2004) evaluates the World Bank assistance in 26 countries in Europe and Central Asia. After 1989, the transition countries 'have undertaken massive reforms of their economic systems, transforming institutions, processes, attitudes, and fundamental concepts of individual and organisational behaviour'. Considering its complexity, the development of an 'easy-to-understand' but working model of economic transition is a considerable challenge.

The economic reforms have had significant impact in all sectors and important research efforts have been made to clarify, explain or solve problems related to the transition processes. Even gender issues were such a subject (Homlong and Springler 2006) – in order to identify the quality and quantity of female labour participation in such processes.

Based on the authors' experience and research during more than fifteen years of transition from a centrally planned economy toward a free-market economic system, an *original model of the economic systems and transition* was developed.

More or less authorised voices speak knowingly about 'privatisation', 'economic reform' or 'transition toward market economy' and – more recently – the European Union. In spite of their actuality, they often generate questions and are even confusing.

The proposed model allows for clear definitions, and possible transition strategies are analyzed. The role of government is emphasized, as well as the key-role of the public administration in the process of accession to the European Union.

The economic and transition model, which is proposed by the authors as a conceptual framework, is bi-dimensional. Types of ownership (state/private) and management (centralized/decentralized) are considered. Consequently, the resulting 'two by two matrix' reveals four types of economic systems – among them the centrally-planned economy and the free-market economic system. The major advantage of this model is its analytical potential. The different transition strategies are presented and the position of a certain economic system, on its path toward the free-market economy, at a certain moment, can be easily identified. The topic of this paper is very actual, extremely important and relevant to the current state of knowledge for – at least – two reasons:

- The proposed transition model is both theoretical and practical (explanatory) as well as being an investigation tool (Ardelea and Scarlat 1991; Scarlat 1994; 1999; 2001; 2003a; Scarlat and Curaj 2004).
- The research conducted in Romania, the analysis of time series of certain macroeconomic indicators (such as the exchange rate) during the transition period or the transition path, from the standpoint of deterministic chaos (i. e. short-term predictability), has revealed interesting characteristics (Scarlat 2005; Scarlat, Stan, and Cristescu 2007a; 2007b) and was in accordance with the other estimations about the end of transition.

Some of the conclusions of the research might be applicable to other transition economies as important decision support tools.

Economy Model

Using a political economy approach, and based on different criteria (political structures, 'What is a good society?' and the pace of implementing the transition policies), Marangos (2005; 2006) has identified and developed five alternative models of transition: Shock Therapy, the Neoclassical Gradualist model, the Post-Keynesian model of transition, the Pluralistic Market Socialist, and the Non-Pluralistic Market Socialist model of transition (the Chinese model). These models are associated with alternative institutional development processes – i. e. the decision depends on what institutions are considered to be more efficient: institutions produced by state intervention or market-generated. The neoclassical gradualist model maximizes the social welfare under the given internal and external constraints (Marangos 2006). Unfortunately, this meritorious and complex typology presents definition elements of both economic transition (as shock therapy) and economic system (others), which might be confusing.

Definitely, an economic system is described by a certain number of features: more features, more information and – finally – the system is better described. The issue is to investigate the possibility of characterising (any) economic system by a *minimum number* of parameters, in order to simplify the analysis as much as possible (but they still describe the system completely). The point is to find the *most important features.* The basic assumption is that any economic system can be characterised by two major features, considered as determining features:

- The type of ownership that could be, basically, state ownership or private ownership (the intermediate or mixed ownership is accepted).
- The type of management adopted by businesses/organisations active within the economic system.

We agree to define the management type as centralised if all the vital decisions are made at the macroeconomic level (government), and the decentralised management, where decisions are made at the microeconomic (organisation) level (intermediate forms of management are also accepted).

The result of these assumptions is the two-dimension (matrix) model presented in figure 1. Validity of the model's assumptions is proved by the fact that all the important types of economic systems are described fairly completely. While the association 'private ownership' & 'decentralised management' is typical of the democratic countries' 'market economy' (quarter I), the association 'state ownership' & 'centralised management' defines 'the command economy' or centrally planned economy of the communist/socialist countries (quarter III). Analysing the model with combinatorial techniques, two more associations are shown: 'private ownership' & 'centralised management' (quarter II), defining the economy of monopoly and 'state ownership' & 'decentralised management' (quarter IV), introducing the so-called 'social-market' economy.

It is important to avoid the confusion between 'centrally planned economy' and 'planned business activity' – core of the modern free-market economy. Unfortunately, such confusions were frequently presented in Romanian newspapers and mass media, right after 1990. Another trap to be avoided: the modern free-market economy *is not* the old 'market' economy dominated by powerful monopolies (economy of monopoly).

The free-market economic system is superior to the centrally planned economy for two reasons, at least: *motivation* (as a result of private ownership) and *flexibility* (as a result of decentralized management).

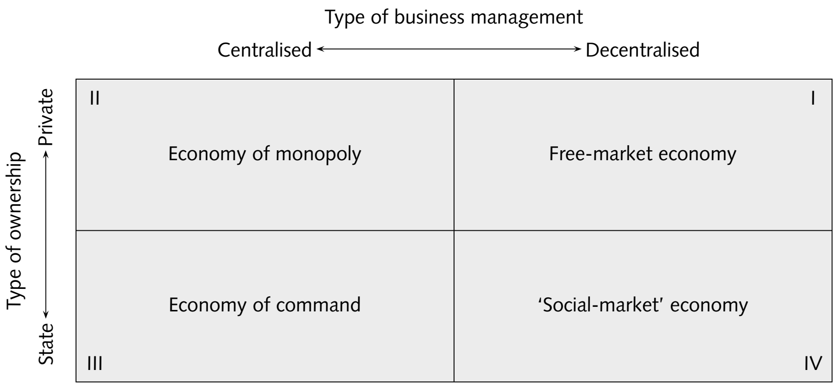

FIGURE 1 The matrix model of four basic types of economic systems

STABILITY AND MANAGEMENT CONSIDERATIONS

From the management standpoint, the description of the proposed model (Scarlat's Model) starts from two basic prerequisites:

- private ownership, opposed to the public one, generates motivation;
- decentralisation, determines the flexibility of management systems and processes.

On the other hand, the basic management principle states that *the owner makes the decisions (regardless of who are the owners – individuals, businesses or the government).* This situation is met in quarters I and III, which corresponds to relatively stable systems. Any other situation means conflicts or potential conflicts between the owner and decision maker (quarters II and IV). This explains the relatively short life of economic (and political) systems corresponding to quarters II and IV. The failure of centrally planned economies (quarter III) is not because of management conflicts but mostly due to rigidity, poor motivation and low efficiency. It is interesting to underline the unstable character of the economic models belonging to quarters II and IV. Contradiction between the private ownership and centralised management (quarter II) will have serious effects like economic and social unbalance, excessive and immoral revenue sharing and, finally, the danger of significant unemployment.

The opposition between state ownership and decentralised management (as much as it is possible) leads to the property's depreciation through poor efficiency, as a result of the back interest, with a major negative consequence, inflation (quarter IV).

A different situation, wherein the frames of private ownership and free competition principles are broken and/or replaced by the centralised command mechanisms, is that of the war economy (Germany, Italy, and Romania, during World War II). By laws and/or decrees, the economy's direction is accomplished by the state both at macro and, somehow, microeconomic levels. The state targets all the nation's resources in order to sustain the war efforts. During the crisis this strategy can lead to results that are superior to those from quarter I. But in normal times it hinders initiative and dynamism, placing the economy behind the free markets.

It is also important to analyze the relation between company management and ownership, by quarters.

- Quarter I. Interest aroused by private ownership and managerial flexibility results in elastic and efficient management. Under the necessity of free-market circumstances, governed by the principles of the demand-supply balance and fair competition, the necessity of a fast market information transfer appears. Extensive and intensive use of information technology becomes a management tool.
- Quarter II. There is private ownership motivation, but also centralised leadership that creates over-sized structures with slow reaction time and a long information circuit. Quite rigid and disadvantageous management is the result. This can be improved by using information systems.
- Quarter III. Management is imposed from outside the system. The economy is of 'command' type but the company is deprived of a basic managerial function: 'decision-making'. That is ultra-centralised, the communication channel is long, and information is distorted and weakened through a bureaucratic chain with non-existent feedback. In the few situations where it appears, it does not contribute to the decision making. The lack of motivation increases the system's immobility.
- Quarter IV. Accepting that a company is allowed to make decision: state ownership rejects that kind of motivation. The result is a formal management. The information systems are used in an inefficient way, as well.

TRANSITION PROCESS

A successful transition process from communism to democracy and/or market economy may be a tool for the economic development of a country (Bitzenis 2007). The free market economy's superiority (through motivation, adaptability and flexibility, and progress, and finally through productivity and efficiency) is practically proved as well, confirmed by the social and historical dynamics of economic systems. At least for economic reasons, as the free-market economic system is more efficient than the centrally planned one, the transition to free-market economy is a must.

Since the late 1990s, a rich literature has been developed, screening the various aspects of the transition. The prestigious journal *Post-Communist Economies* (formerly *Communist Economies and Economic Transformation*) has published, systematically, interesting articles on various economic sectors, in different transition countries such as: Azerbaijan (Sabi 1997), Bulgaria (Mihaylova and Howe 1998), Croatia (Cengic 1996), (East) Germany (Hölscher 1997), Hungary (Mihalyi 1996), Poland (Kaminski 1998), Romania (Hunya 1998), Russia (Magomedov 1998), Kazakhstan and Uzbekistan (Abazov 1997), Ukraine (Ishaq 1997; Hirschhausen 1998). The critical issue of economic development is important for each individual country as well as for an entire region – it could be either Central Asia or Eastern Europe (Brzeski and Colombatto 1999).

Over the last decade, comparative and multi-country studies were conducted. Such a research completed in four countries from Central and Eastern Europe (Romania, Bulgaria, Czech Republic, Hungary) has identified several areas of concern for the very dynamic sector of small and medium-sized enterprises (SMEs), active internationally: lack of appropriate financial instruments, difficult access to market intelligence, lack of professionalism within the business support infrastructure (Lloyd-Reason et al. 2005). At the other extreme, there are numerous examples of successful economic development, SMEs-based. Analysing the Vietnamese economy, Harvie (2004) concludes that SMEs are job creators, which contribute to sustainable economic development by efficient allocation of resources, expand the exports, achieve a more equal distribution of incomes, and assist the rural and regional development.

Actually, the 'Scarlat Model' demonstrates that SMEs are the ideal actors to play on the stage of free-market economy: SMEs are totally private and decentralized decision makers.

The Scarlat Model can be used to analyze the economic transition as well. The transition process – from centrally planned economy to the free-market economy – means simultaneous privatisation and decentral-

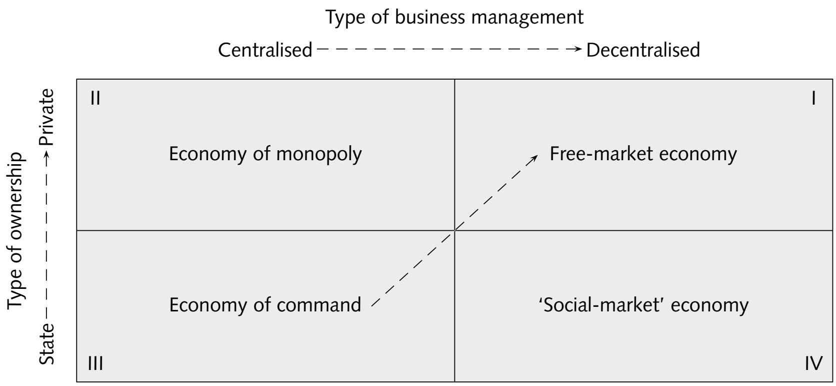

FIGURE 2 The transition model: From centrally planned economy to the free-market economy

isation of the business management (figure 2). The adopted legal acts in Romania (the Reorganisation of the State Owned Enterprises Act, the Corporations Act, the Act of Land) target all the transition aspects mentioned before.

The fundamental problem is choosing and justifying the optimal strategy, defined by:

- Duration and speed of transition ('shock' or 'gradual' transition).
- Transition path (trajectory).
- Privatisation techniques – as an essential component of the transition and economic reform.
- Transition management and strategy – as a result of all the above.

As far as duration/pace of transition is concerned – either 'shock therapy' or 'gradual transition' – the champions of each of them might have their arguments. However, ten years of transition offer enough hard evidences – as some countries have opted for 'shock' while most of them (as Romania) have decided to follow the 'gradual' path (Giannaros 2000).

The proposed model allows for analysing all these aspects. For example, regarding the transition path, the model's analysis reveals three types of trajectories, at least:

1. Direct transition (quarters III ⟶ I); theoretically the most advantageous but requires an outstanding managerial effort.
2. Transition through quarter 2 (quarters III ⟶ II ⟶ I), which is potentially high unemployment generative.

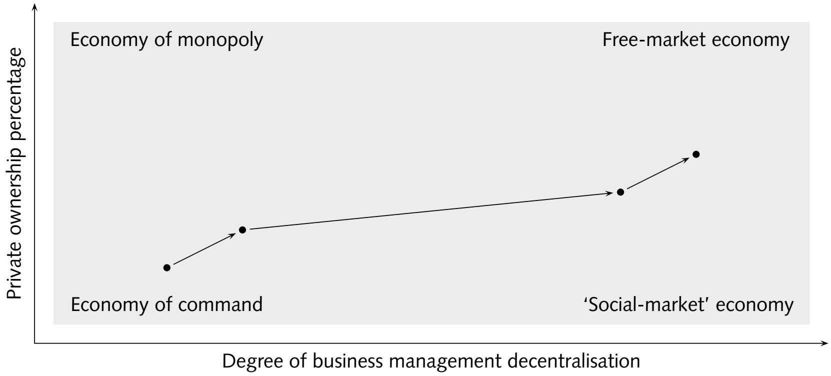

FIGURE 3 The model of the transition path of the Romanian Economy

3. Transition through quarter IV, threatened by inflation (quarters III ⟶ IV ⟶ I).

It is important to mention that these three types are just basic trajectories. Bitzenis (2007) has introduced nine general reform paths of transition.

If the economic criterion (inflation avoidance) is overwhelming, variant (2) will be chosen meaning prioritising the privatisation. If the social criterion (lowest possible unemployment) prevails, (3) will be followed and companies will become fully autonomous.

From the theoretical, managerial standpoint, transition should be as short and straight as possible. Prolonging the transition through unstable statuses (quarters II and IV) induces stresses and leads to a drop in economic efficiency, or else a decrease in the speed of the economic reform process.

As mentioned before, the split between private/state or centralized/decentralized is pretty rigid. The model can be improved, considering both ownership and decentralisation as having continuous variation: ownership percentage and degree of decentralisation. The proposed model – slightly modified (figure 3) – allows for investigating the real path followed by Romania on its way to a free-market economy.

The overall survey on the Romanian economy and business environment allows us to conclude that most of the legal framework is in place and the business is very active. According to a detailed survey conducted and published back in 2004: 'Romania does not request a transition period or impairment of law and states that it will be possible to fully enforce the *acquis* after the accession' (Fuerea et al. 2004, 29).

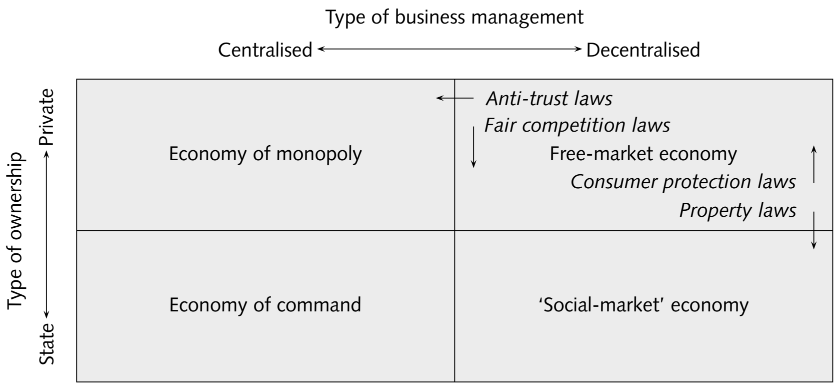

FIGURE 4 The role of government: The legal environment development and protection

ROLE OF THE GOVERNMENT

As we have seen, the match between ownership and management in quarter I is only the background for an efficient economic system. For countries in transition – as Romania – the government is less and less an economic actor but a crucial rule maker. After the transition management role, the government must play another essential role: the guard and the guarantor of the free-market economic system. In order to maintain the viability of the free-market economy system, its borders should be safely defended by (figure 4):

- 'anti-trust' regulations (antimonopoly) in order to discourage the movement back to quarter II,
- laws for property protection and limitation of nationalisation processes that should not allow access towards quarter IV,

as well as measures of stability within the system:

- fair competition legislation, and
- laws for consumers' protection.

To all these, the legal framework for environment protection is a *sine-qua-non* condition for sustainable development.

During its EU accession process, Romania had to pay attention to all these aspects as follows (Fuerea et al. 2004):

- *Fair competition:* 'In this field [...] legislation is harmonized with similar European legislation. There is a high proportion of compatibility with EU legislation regarding the regulation of corporate agreements, dominant position abuse and the control of economic concentrations.'

- *Consumer protection:* 'In conclusion, the degree of concordance between the Romanian legislation and *acquis* [...] is estimated to be relatively high since all measures taken by Romania are fully compatible.'
- *Environment protection:* in this area, Romania still has 'to promote a normative measure to support the local budgets in creating/improving the environment infrastructure.'

Justification of those measures lies in the fundamental principles of the free-market economy: open competition, balance between the demand and supply, and company autonomy.

As far as the private sector is concerned, the government plays an important role, too. The 'privatization' process is only one of the ways to create a significant private sector in the economy:

- privatisation of the former state-owned enterprises,
- creation of new private firms – small business start-ups, mostly (which started right after December 1989),
- restitution of the properties confiscated by the communist regime between 1945 and 1985.

This is why the 'creation of the private sector' syntagm – which is strongly recommended to be used – reflects the real-life processes better than the word 'privatization'.

The Romanian government took action in all the above directions. Only the pace was different. As an example, the major steps for property restitutions are chronologically displayed in table 1. Similar investigations can be performed for other means to create the private sector. The Romanian Statistics Authority periodically provides data in this respect.

It has to be emphasized that the government has to be the referee of the economy game, not a player. But its role and implication are sometimes rather difficult to assess, mainly in transition economies. For example, in Czech Republic, the influence of the government in the economy was higher than what the government officially conceded during the 1990s (Kreuzbergova 2006). So-called 'banking socialism' has meant the indirect control of the recently privatized companies by the government-controlled banks.

TABLE 1 Property restitution acts in Romania

Act number/year	Restitution object
18/1991	Land for agriculture (less than 10 ha)
82/1992	Urban pieces of land
1/2000	Forests, land larger than 10 ha
10/2001	Buildings (restrictive)
247/2005	Most of the properties

Too much involvement of the government in the economy means less economic freedom. The Heritage Foundation and Dow Jones & Company, Inc. is annually publishing – since 1995 – the world ranking of economic freedom, according to the 'index of economic freedom', which is based on some tens of independent variables, grouped in 10 broad factors of economic freedom, strongly influenced by the government policy.

The economic freedom 'encompasses all liberties and rights of production, distribution, or consumption of goods and services. The highest form of economic freedom provides an absolute right of property ownership, fully realized freedoms of movement for labour, capital, and goods, and an absolute absence of coercion or constraint of economic liberty beyond the extent necessary for citizens to protect and maintain liberty itself. In other words, individuals are free to work, produce, consume, and invest in any way they please, and that freedom is both protected by the state and unconstrained by the state' (Beach and Kane 2007, 38). It should be noted that the absence of government coercion or constraint must also include a sense of liberty as distinct from anarchy.

The 2007 Index of Economic Freedom ranks Romania on 67th place (compared to 92nd place in 2006) in a global list of 161 countries (Kane, Holmes, and O'Grady 2007). The position corresponds to the considerably large group of 'moderately free-countries' – where the majority of former communist countries are ranked. The lower the position, the greater the level of government interference in the economy, and the less economic freedom the respective country enjoys.

END OF TRANSITION

The question of 'when the transition process ends' (Scarlat 1999) is doubly important: not only for the sake of theory, but for practical reasons as well (just think about the status of 'functional market economy' according to which the candidate countries for EU accession were assessed).

On the other hand, Kumar (2006) finds that there is a strong correlation between world trade and a well-established market economy such as in the USA, Japan and countries in EU, while there is a small correlation between the world trade and a transitional economy such as Russia. In other words, the 'functional market economies' have better established import and export transactions and, consequently, economic welfare.

The Scarlat model is able to offer a reliable answer to the sensitive question of 'when the transition process ends'. In theory, by the time when the private ownership is prevailing and the business management is dominantly decentralized, then the free-market economy system is in place (figure 2). In practice, during the transition process, it is necessary to measure both the private ownership percentage and degree of business management decentralisation (figure 3). When more than 50% in both of them (or a different but higher than 50% privatisation and/or decentralisation target) is reached, then the process of *economic transition towards the free-market economy* is considered over.

While the percentage of private ownership is relatively easy to calculate, based on regular statistics (see, for example, figure 5, which depicts the Romanian case for its privatization target), the degree of business management decentralisation is rather difficult to assess.

In any case, a coherent set of criteria for assessing the degree of decentralisation has to be developed. Such a set of criteria should include vital decisions at the company level – such as decisions on: company mission and strategy, budget, company suppliers and clients, pricing policy, personnel policy (number, structure, salaries, hiring and firing), investments, acquisitions and mergers, insolvency and bankruptcy. Further research on this issue is to be completed and eventually published.

There are also other standpoints, methods and/or information sources that could be used to assess, conventionally, the point in time when the economic transition gets – conventionally – to its end. The question is, somehow, rhetorical – because … the transition never ends: the economic system – even after reaching the 'free-market economy' quadrant – is not rigid, it is continuously evolving (within the same quadrant, hopefully). Several approaches mostly used to diagnose and identify that moment when the economic transition is conventionally over are mentioned below.

- *The* political *approach* (altough it also considers a complex of elements): the transition is over when the EU sentences it – in Country

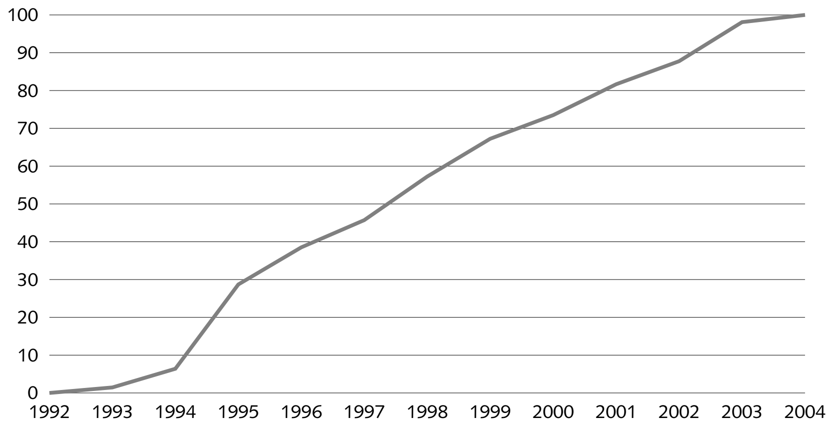

FIGURE 5 Privatisation dynamics in Romania, 1992–2004

Report – and considers the economic system as a 'functional market economy'. For Romania, this happened by the end of 2003: 'Romania can be considered as a functional market economy once the good progress made has continued decisively' (European Commission 2003, 7).

- *The* economic *approach:* the economic transition is over when the country's yearly GDP reaches the pre-transition maximum level. The Romanian economy has reached this value in the years 2002–2003, according to WB and UN estimates, respectively, at market prices, current prices, in USD (see United Nations Common Database at http://unstats.un.org/unsd/cdb). It is significant that countries, which were forced to follow reform paths in belligerent and/or violent forms, have reported limited economic growth and 'not only lag behind the other transition countries in the region, but also, as of today, have not even reached the levels they had attained in 1989' (Bitzenis 2007).
- *The* management *approach:* the economic transition is completed at that point in time when the strategic objectives are reached (in terms of GDP, private sector dimension, etc). For example: the privatisation target was achieved by 2003 (figure 5).
- *The* econo-statistics *approach:* based on time-frequency series analysis, which will be further discussed.

As all the above may present cross – influences, a correlated approach is recommended. In the case of Romania, the different approaches con-

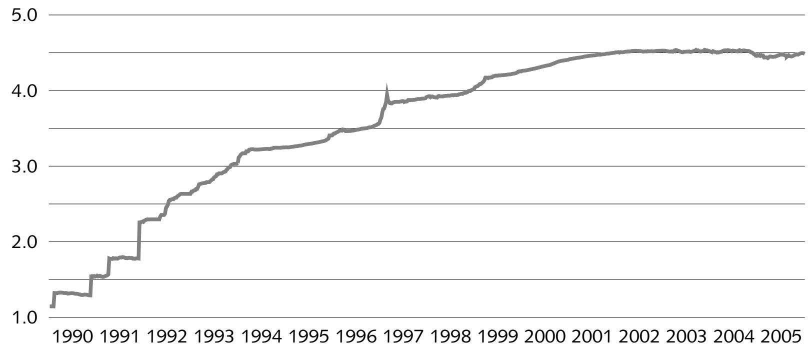

FIGURE 6 Time evolution of the ROL/USD exchange rate, at logarithm scale (based on the data published on the National Bank of Romania web site, www.bnr.ro)

verge to indicate that economic transition reached its end by 2002–2003. This conclusion will be supported by the conclusions of the next section.

Analysis Tools for the Transition Path

The transition process was not linear. Besides its trajectory and duration, it is interesting to assess when the transition ends and identify if other elements have occurred on the transition path. There are also more sophisticated tools to analyze the transition path, behavioural patterns and specific features. For example, from the point of view of the deterministic chaos (i. e. short-run predictability), the analysis of time series might lead to interesting results. A time series might be anything between randomness and determinism; in turn, the determinism might be chaotic (i. e. sensitive to initial conditions) or classic (non sensitive).

The research methodology is based on the analysis of the time series of macroeconomic indicators, by statistical methods; the macroeconomic indicator chosen: the US dollar (USD) exchange rate. The figures were collected based on the daily values reported by the Romanian central bank (Banca Nationala a Romaniei) over a period of sixteen years of Romanian recent history: 1990–2005.

This period includes the interval used previously for presenting the privatisation process: 1992–2004 (figure 5). A comprehensive research was conducted on the evolution of the Romanian currency exchange rate (ROL) with respect to the US dollar (USD). Figure 6 depicts the overall evolution. The logarithm scale was used because of large variations of the indicator (up to 104).

The analysis was performed taking into consideration three criteria:

- System complexity (this is not necessarily the whole economy, but part of it, as monetary system).
- Sensitivity to initial conditions (as a pointer of the predictability).
- Persistence of the evolutionary trend (indicating the similitude with the random-walk behaviour, i. e. the lack of deterministic predictability in favour of probabilistic predictability).

In the nonlinear dynamics theory, the corresponding quantities for the above mentioned criteria are the correlation dimension, the largest Lyapunov exponent (Bask 1996) and the Hurst coefficient (Tsonnis et al. 2001).

The degree of complexity of the underlying system is quantitatively given by the correlation dimension referring to the minimum number of variables that is needed to replicate the dynamic system. The last one is the same with the dimension of the (strange) attractor characterizing whichever one of the topological-equivalent systems (Takens 1981). It is worth noting that the number of variables that replicates the system is fractional, according to the theory of the strange attractors (Kantz and Schreiber 1997).

The sensitivity to initial conditions could explain the spreading diversity of the present – day economic systems, even if they were starting from quite similar prerequisites. This is a basic feature of the chaotic systems. Hence, one way of revealing the existence of deterministic chaos in a time series is to measure the degree of divergence of nearby orbits in the phase-space. Such divergence $\delta(t)$ can be measured by the Lyapunov exponents λ, and the presence of at least one positive exponent is taken as indicating to what extent the evolution is predictable over a specific time range (Rosenstein 1993):

$$\delta(t) \cong \delta(0) \cdot e^{\lambda t}. \tag{1}$$

As far as concerns *the persistence of the evolutionary trend,* the Hurst exponent is an additional pointer for making the distinction between randomness and causality; besides, its value of 0.5 separates the persistent and anti-persistent evolutionary trends (Stanley and Mantegna 2004). It is defined by the time evolution of the root-mean-square fluctuation of the averaged displacement over all possible positions t_0 (the bars indicate the average):

$$\left\{\overline{[x(t_0+t)-x(t)]^2} - \left[\overline{x(t_0+t)-x(t)}\right]^2\right\}^{\frac{1}{2}} \sim t^H \tag{2}$$

The values of the Hurst exponent (H) range between 0 and 1. A value of 0.5 indicates a true random walk (a Brownian time series). In a random walk there is no correlation between any element and a future element. A Hurst exponent value $0.5 < H < 1$ indicates 'persistent behaviour' (e. g. a positive autocorrelation). If there is an increase from time step $i - 1$ to i, there will probably be an increase from i to $i + 1$. The same is true for decreases: a decrease tends to follow a decrease. A Hurst exponent value $0 < H < 0.5$ indicates a time series with 'anti-persistent behaviour' (or negative autocorrelation): an increase tends to be followed by a decrease, or conversely, a decrease will be followed by an increase. This behaviour is sometimes called 'mean reversion'.

Some results of the research conducted in Romania are further presented. The analysis of the transition path – using all the above criteria – has revealed three intervals, as follows (figure 7):

I. 1990–1997

II. 1998–2001

III. 2002–2005.

Obviously, the three intervals are splits of the diagram depicted in figure 6.

Interval I (1990–1997) is characterized by simple underlying dynamics and low fractal dimension, weak sensitivity to initial conditions, and a very aggressive, positive long-run trend. After the social and political events that provoked the fall of the totalitarian regime, the inertia of the total deterministic evolution of the economy of command that had been legally operated until the end of 1989 prolonged the effect for several more years, when the economy diminished to work as a 'national holding', and both the lack of an adequate institutional feed-back and the social pressure led to political decisions of maintaining the exchange rate at artificial constant values. Thus, the accumulation of the demand pressure upon the slow-developing supply led to an increased import of goods; the insufficient feed-forward of a weak monetary system could not balance the long response time of production, and explosive corrections occurred in the form of stepped jumps of the exchange rate ROL/USD (see figure 7a). The exchange rate is deterministic and 'very' predictable from the long-run perspective (short-run understood), with a lot of angular points. The main features of this time interval are summarized in table 2.

Interval II (1998–2001), as figure 7b shows, is characterized by increased correlation dimension, i. e. more complex dynamics, and clear positive values for the largest Lyapunov exponent. All the usual hypotheses for chaotic dynamics are fulfilled, and this is the domain with significant functional changes toward the open market economy. The positive long-run trend continues, but the averaged relative variation per year of the exchange rate is a hundred times lower (72.27% compared to 7264.29% for interval I). The exchange rate remains predictable both from the short- and long-run perspective (table 2), exhibiting a much smoother curve.

The interval III (2002–2005) – see figure 7c – is closer to the random walk behaviour, as pointed out by the anti-persistence of the short run trend. It might be a chaotic deterministic, with a higher volatility than the previous one, or stochastic, or mixed; in order to decide in this matter, further analysis is necessary. To simplify, we only mention here that the evolution remains of causal type. For the purpose of this paper, it is important that there are arguments to state that the transition seems to come to its end by the end of 2001 due to at least two reasons: the first is the disappearance of the long-run trend and, consequently, the beginning of the steady state regime, and the second is the complexity of the structure revealed by the fractal dimension of interval III. As stated in the literature (Schwartz and Yousefi 2003), a free market economy in a steady state regime contains a strange attractor with a correlation dimension around 4.5, and that is the case for Romania (table 2). The exchange rate predictability is weak, with small deviations from the nearly horizontal baseline (excepting a significant fall in March 2005 – see figure 7c). This is the consequence of the new settled macroeconomic equilibriums, very sensitive to the environmental stimuli, but also with high capacity to recover the functional 'working points'.

Significantly low predictability is consistent with the long run behaviour, which in fact has no trend, and the curve approaches a random walk appearance (figure 7c). In a steady-state-running economy, as mentioned by other authors, a positive real part of the largest Lyapunov coefficient seems to be normal. Moreover, the greater the correlation dimension, the more complex the economic system (and the monetary policy of the Central Bank).

The Romanian transition trajectory seems to be of the type III $\longrightarrow$ IV $\longrightarrow$ I. A smaller Lyapunov exponent is consistent with a higher degree of short run predictability in an economic system; for the first period, the exchange rate is predictable from the long run perspective (posi-

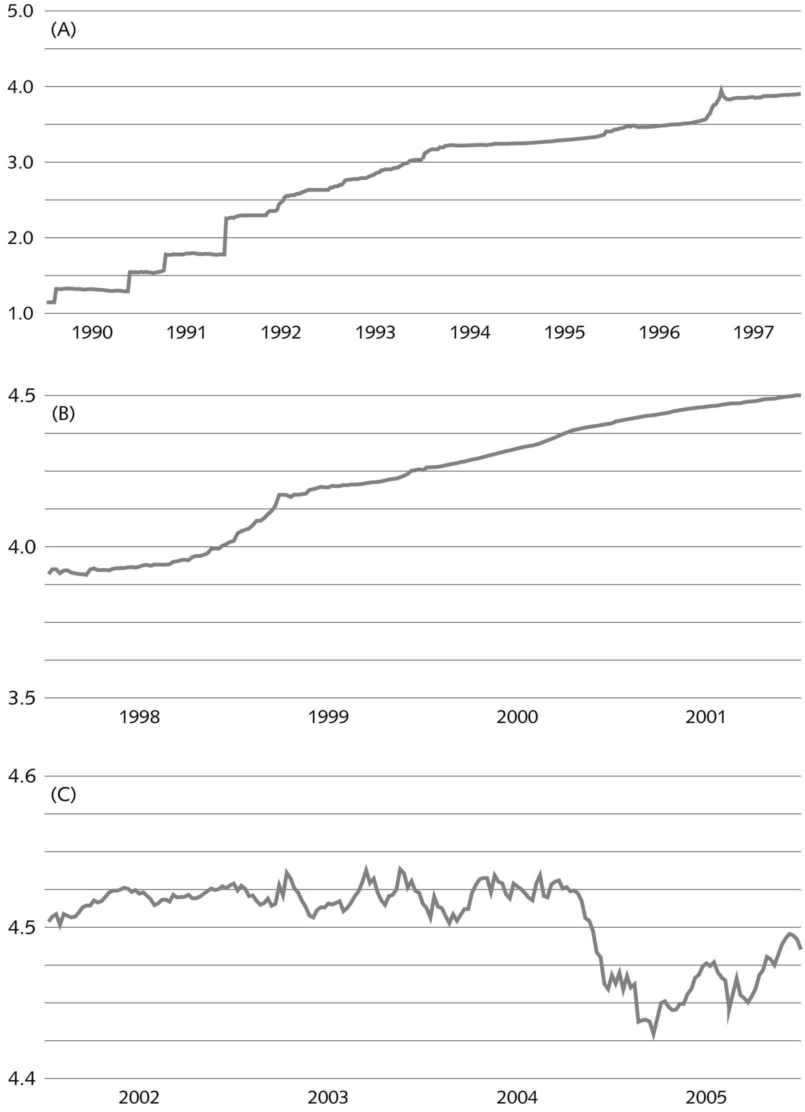

FIGURE 7 The dynamics of the three intervals of the transition period (1990–2005) – the evolution of the USD exchange rate against Romanian ROL

tive trend). The smaller Lyapunov exponent characterizing the period of structural changes indicates smaller sensitivity to the initial condition together with a non-randoml evolution toward a more complex system characterizing the steady-state-regime.

Overall, it is important to note that time series analysis indicates the

TABLE 2 The three time intervals and their characteristics (based on the evolution of USD exchange rate against Romanian ROL)

Characteristics	Interval I	Interval II	Interval III
Time range	1 January 1990–31 December 1997	1 January 1998–31 December 2001	1 January 2002–31 October 2005
Complexity (system dimension)	1.74	3.09	4.45
System sensitivity to initial conditions	Weak	Strong	Strong
Trend	Persistent	Persistent	Anti-persistent
Type of predictability	Long-run, deterministic	Long-run, chaotic deterministic	Short-run, chaotic deterministic

end of 2001 as the end of the transition process – which confirms the previous conclusion (end of transition process in Romania: 2002–2003).

Open Closing: EU Accession Process – A Different Type of Transition

As the EU accession is a transition process itself, Romania – like other Eastern European countries – has been 'in transition process' twice. Fortunately, the transition to the 'functional' free-market economy is naturally connected to the EU accession process (Scarlat and Richevaux 2006). Several impact studies were conducted in Romania under PAIS (Pre-Accession Impact Studies): PAIS I (2001–2002), PAIS II (2003–2004), PAIS III (2005–2006). Overall, the PAIS studies were intended to provide recommendations to the Romanian Government to support negotiations with the European Commission.

Under PAIS I (Scarlat, Popescu, and Warner 2002) primary and secondary research (desk research and formal face-to-face interviews) was conducted. The main objective of the study was to provide an overview of the institutional requirements for implementing the *acquis communautaire* in Romania and to provide a set of recommendations.

Most of the above issues and recommendations were presented to the RIA International Conference in Sofia (Scarlat 2003b). As these recommendations were acknowledged by the Conference participants coming from ex-communist countries, it means that *this set of recommendations are applicable not only to Romania but to most of the ex-communist,* EU *accession countries.*

The studies conducted under PAIS II (Fuerea et al. 2004) confirmed that Romania – like other EU candidate countries in economic transition

– is aiming at a 'mobile target': harmonization of the Romanian legislation with the *acquis communautaire* is based on two processes (transposition of the Community legislation into the Romanian legislation and rendering compatible the national normative measures which transpose the *acquis* with the provisions of the Community legislation). The research revealed that the concordance degree of the Romanian legislation with the EU legislation (in force in 2002) was approximately 75%. The problem is that the *acquis* covers more than 90,000 pages (out of which about 20,000 are continuously being amended!)

The EU *accession process was a different type of transition – not only planned but rigorously regulated and monitored. Following the* EU *accession, the* EU *integration process is a different topic, both quantitatively and qualitatively different.*

Conclusions

- The general economy model that was presented ('Scarlat Model') is a useful analysis framework to discuss the transition features – mainly its path but also transition duration, delays, priorities (privatisation vs. decentralisation) – ultimately the transition strategy.
- The sophisticated research tools applied for transition path analysis, based on the theory of deterministic chaos, lead to revealing results: in the case of Romania, three neatly distinct intervals were identified and described. According to its transition policy and development strategy, the Romanian transition trajectory seems to be of the type III (centrally planned economy) ⟶ IV ('social market' economy) ⟶ I (free-market economy).
- Despite several improvements still expected to be made, the basic structural changes towards a functional market economy in Romania were implemented up to the end of 2001. It is important to note that time series analysis indicates the end of 2001 as the end of the transition process – which confirms the previous conclusion (end of transition process in Romania: 2002–2003).
- This model was applied in the case of Romania but it is fully applicable to all Eastern European countries and not only Romania. In this case, interesting comparative analyses might be performed.

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Management Mistakes as Causes of Corporate Crises: Countries in Transition

Drago Dubrovski

A corporate crisis can be defined as a short-term, undesired, unfavourable and critical state in a company which has derived from both internal and external causes and which directly endangers the further existence and growth of the company. Although the state of crisis in the company can be affected by various interrelated external and internal causes, which as to intensity and appearance vary by company, the essence of the causes surely lies in the management of the company. During the period of transition all types of explained management mistakes could be found in Slovene corporate systems. Despite the fact that the hypothesis of an existing pattern of management mistakes which follows the changes in political and economic environment cannot be completely reliably confirmed, some outlines of such a pattern are in spite of all to be seen. If there is really a more or less valid pattern of management mistakes in corporate crises, and these mistakes appear differently with regard to changes in the political and economical environment in countries in transition, this could help decision makers to form a more grounded choice in the process of appointing new crisis or restructuring managers, every time according to their most appropriate competencies.

Key Words: crisis, internal causes, management mistakes, restructuring, transition, Slovenia
JEL *Classification:* M10

Introduction

From business practice and academic literature it is well known that management mistakes can be a prevailing internal cause of corporate crisis. However, the management mistakes are usually treated as a homogeneous group, neglecting that they are actually deriving from different bases, circumstances and periods. A classification of management mistakes is sometimes recommended, especially when crisis solving or radical changes are needed in a company in order to improve the chances for further existence and faster development.

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In this empirical and comparative article we tried to find and form a pattern of management mistakes characteristic for a country in transition. Based on several empirical researches and the author's own strategic management and restructuring consultancy practice in 55 companies from various branches in Slovenia from 1994–2006, working also as crisis management, some managerial implications are formed as a conclusion to the paper. Despite the fact that the hypothesis of an existing pattern of management mistakes which follows the changes in the political and economic environment cannot be completely reliably confirmed, some outlines of such a pattern are in spite of all to be seen.

This article starts with an explanation of definitions of some individual categories needed, which follows in the empirical part. A connection between management mistakes and corporate crisis is explained. On the basis of theoretical background and summaries from empirical findings, the concluding remarks are formed, together with applicable recommendations for business practice and further theoretical researches by using the case of Slovenia, which could also be applied in many related countries in transition.

Crisis and its Characteristics

In everyday reports, various professional studies, entrepreneurial and corporate papers one can often encounter quotes about natural disasters, various conflicts, business difficulties of larger and smaller proportions affecting companies, particular industries and even countries, which are, in one way or another, linked to crises. A crisis is an often used term for difficult, dangerous and future decisive situations and refers to an extremely wide area of natural, social, economic and mental processes (e. g., political crisis, economic crisis, financial crisis, oil crisis, environmental crisis, moral crisis, crisis of art, crisis of values, health crisis, middle-age crisis, etc.). In colloquial language the term crisis most often has a predominantly negative connotation, since it is connected to most varied unpleasant situations, and difficulties.

In regard to our debate we are interested in a company crisis (i. e. corporate or organisational crisis), referring to business or non-profitable and manufacturing or service organisations.

A crisis is inseparably connected to contemporary companies (organisations). With the rise of complexity of companies, which is interactively connected to various social spheres, the possibilities for the emergence of a crisis rise again, while the range of causes that can lead to a crisis also rises. If all other crises are added to this domain, we may consent that a crisis is as 'inevitable as death and taxes' (Fink 1986, 67) in today's business. 'Sooner or later, every business will be confronted with a crisis of some type. Its ability to manage the crisis successfully can mean the difference between survival and disaster.' (Spillan 2003).

When talking about a company crisis, a crisis can be defined as a short-term, undesired, unfavourable and critical state in the company which has derived from both internal and external causes and which directly endangers the further existence and growth of the company (Dubrovski 2004b; cf. Barnett and Pratt 2000; Barton 1993, 2; Buchalik 2004, 30; Fink 1986, 15; Heath 1998, 13; Kraus and Becker-Kolle 2004; Lerbinger 1997, 4; Mitroff, Pauchant, and Shrivastava 2006, 51; Moore and Seymour 2005, 31; Neubauer 1999, 8; Roux-Dufort 2003, 51; Slatter 1987, 61; Smith 2006, 7).

It is exactly from the indicated characteristics of critical circumstances, in which the management might find itself, that particularities of managing a company in crisis differ from the 'classical' strategic management. Crisis management is of short-term nature, by all means, when the survival of the company must be given priority in comparison to developmental objectives. Crisis management, therefore, is a particular part of the contemporary strategic management, characteristic of a company in serious difficulties, when the afore – mentioned characteristics of emergency circumstances are to be accounted for. Due to ever rising turbulences in the internal and external environment, the 'classical' management actually acquires a rising number of characteristics of crisis management.

Hart, Heyse, and Boin (2001) point out that the practice of crisis management has significantly changed during the recent period, which is indicated by the following characteristics (cf. Boin and Lagadec 2000): the society has transitioned from the industrial into a more risky one, globalisation enables a more rapid and simplified movement of products, services, technology, people and information, therefore, in the environment of such a complex network of links the level of risk increases; if the level of safety in the society increases, the people and institutions become more vulnerable when something unpleasant, dangerous happens; instead of a heroic answer to a crisis, multi-domain and cross-border measures are required (a crisis affects both the local and the regional as well as the national level, occasionally the multinational as well); instead of episodic measures during a crisis, a continuous crisis management is to be developed (preventive and curative treatment and learning from the crisis).

A crisis, therefore, is an initiator and orienteer of rebuilding a company. Most often, a prior solution of an acute crisis, which could lead a company not only backwards but even into a downfall, is a precondition for the achievement of renewal of a company. Successful renewal of a company is often a consequence of a previous severe crisis, since reconstructing the corporate processes and structures that enable efficient and successful operation would not have taken place if the company had not been forced to change the (less successful) methods of operation and strategic orientations.

Here, referring to the supplied and stated definition of a crisis, a crisis usually emerges due to an intertwined impact of external and internal causes, and an analysis of these and of their connectivity is of key significance for healing, i. e. for overcoming crisis.

Symptoms are to be Detected and Causes of Crisis Resolved

SYMPTOMS OF CRISIS

Symptoms are signals which point to or predict a crisis. Their timely detection and response by the company, with proper actions and activities, can abate consequences the of an already present crisis or even prevent it. It is, therefore, of extreme importance not to overlook, disregard or underestimate these signals, although they are not to be substituted with the actual causes of the crisis. Symptoms of the crisis, one may say, simultaneously permit various causes of the crisis; they signal – at the same time – the crisis, yet without being the cause of its origin.

Symptoms occur in different areas and often appear to be combined and linked together. It is very important to take into account that there is a time gap between their emergence and occurrence (process, appearance) towards which these signals point. Due to this, it is all the more more dangerous if the company does not perceive these warning signals or disregards them. When the signals are perceived, they are to be analyzed and interpreted in order to determine causes for the emergence of the events which indicate them, and to do away with or abate the causes by using proper measures and approaches.

In real life situations, many unsuccessful attempts are made to solve a crisis due to an inappropriate approach at the very beginning (Augustine 2000, 3; Platt 1998, 133). Numerous assessments of crisis presence and the measures required to solve it are based solely on various analyses of accounting reports (balance sheet, statement of condition, statement of financial flows and consequently derived indicators), while overlooking the fact that the accounting reports be a solely recorded consequences of past decisions and it is not necessary that the accounting reports are trustworthy reflection of the present state of conditions in the company. The accounting reports are absolutely necessary for the analysis of the present position of the company, however, they are not sufficient to reach the decisions for solving a potential state of crisis.

Perception of clear and underscored symptoms of a crisis cannot, in principle, represent a problematic task in case of a thorough and sufficiently well skilled management (Roux-Dufort (2003, 23) indicates the following equation of a crisis: 'crisis = accumulation of ruined equilibriums + ignorance of management', pointing out the insufficient 'vigilance' of management). Most often, even continuous and direct communication with personnel and with the representatives of organisations from the environment and repeated presence in the key locations of the corporate process (visits to consumers and suppliers, warehouse inspections, inspections of the manufacturing process, etc.) should be sufficient and can have a beneficial impact, among other factors, on the motivation of the employees (the so called management by walking-around). An accurate interpretation of the causes for the emergence of a crisis and possibilities for its removal is, indeed, a more complex task.

In the period of emergence of a crisis the management plays a vital significant role in regard to timely and sufficiently watchful perception of the symptoms indicating a potential crisis. If the management does not react to these symptoms or reacts incorrectly, the crisis is almost inevitable.

CAUSES OF CRISIS

In comparison with symptoms, on the other hand, which only point to the state of crisis, the causes are actually 'responsible' for the present position. When talking about crisis solving, one must consequently analyze and do away with its causes without focusing on its symptoms. The analysis of proper causes of occurrence of a certain state is of extreme importance since it identifies those areas (processes, appearances, events) the effects of which must be restrained and reduced. Addressing the wrong causes means further useless waste of time, money and effort, which only intensifies the state of crisis.

In spite of the fact that the literature states various classifications of the causes of crises (some sources are e. g. Bellinger (1962, 58), Buth and Hermanns (2004), Kraus and Becker-Kolle (2004, 15–16), Mitroff, Pauchant, and Shrivastava (2006, 51), Müller (1986), Pate (1999, 55), Richardson (1994), Slatter (1987, 25–55), Turner and Pidgeon (1997), Wildemann (2004, 193)), it is nevertheless possible to say that the definitions of the causes are, more or less, similar but differ in their terminology, time when they were drafted, the domain that they refer to and the type of business which is predominant.

The causes of emergence of crises may be divided into: external, and internal.

The external causes of crises are usually those that have emerged in the environment of a company, while the latter had no significant influence on their emergence. Therefore, they are frequently denominated as objective or exogenous. The internal causes, on the other hand, are those that have emerged within a company and, hence, are denominated as subjective and endogenous.

The external causes, therefore, are certain changes in the environment of a company that have not been timely recognised by the latter and have not been timely and appropriately reacted to. The same change in the environment can have an unfavourable and retarding symbol for one company, while having a favourable and accelerative indication for another. Since the change is the only constant in today's life and business, crises actually continuously emerge.

Even state aids can be classified among the external causes, in spite of the fact that the budgetary funds were particularly intended for resolving or preventing crises, if the management of a company does not prepare or accept appropriate measures due to the external funds received, but seems satisfied with cosmetic corrections, which can only postpone the emergence of a crisis (more on this in the last section).

Examples of the internal causes can be found in the following domains (Dubrovski 2004a, 37–38):

- improper competences of the management,
- retarding organisation,
- uncompetitive market position,
- problems in the personnel management domain,
- over-expensive production,
- neglected financial function,
- inefficient informational system, etc.

The listed causes are to be treated as a helping-tool in analysing the position of a company, since it must accounted for that each company, along with its processes, products, history and the involved participants, represents a peculiar corporate system and, therefore, must also be studied as such.

For the emergence of a crisis the management frequently 'blames' a particular individual, i. e. the last event (actually the trigger) that is merely the last drop over the brim; the reasons for the crisis are to be sought in all other drops that have filled the glass to the top. The motive is the direct effective cause, while the crisis actually emerges on its basis. The motive can be lesser, in principle a less significant event that triggers a chain reaction of all other impacts, whereas their roots (causes) might extend for many years back into the past. As well as in regard to symptoms, it must be pointed out that the motive is not the fundamental cause for the crisis but the cause is still to be discovered. Resolving the crisis, therefore, must not be orientated exclusively towards the motives, since these would not have been fatal if the factual causes that had brought about the culmination of problems, i. e. the crisis itself, had not been previously present.

An analysis of the true causes for the emergence of a certain state is of extreme significance, since those domains (processes, phenomena, events), regarding which the effects are to be limited or done away with, are identified by utilising the analysis. Dealing with erroneous causes represents a further useless loss of time, money and efforts, which only makes the critical situation even more acute.

Although the external causes play the key role for the emergence of a corporate crisis in many cases, those that emerge within a company itself nevertheless predominate. The external environment, in principle, represents the aggregate of uncontrollable variables that have to be adjusted to by the company, along with its internal processes, structures, strategies and the marketing mix, which represent the aggregate of controllable variables. If a company does not adjust to the external variables, then it may be possible that the internal causes exist for this reason. Or to put it differently: potential external causes of a crisis can be successfully eliminated by internal changes (adjustments) in the company.

It was already pointed out in defining a crisis that, in principle, both internal as well as external causes, when intertwined, brought about a critical situation (the so called multi-causability of a crisis or also 'polymorphous phenomenon' according to Hensen, Desouza, and Kraft

(2003)). Mellahi and Wilkinson (2004) state that the organizational failure is connectively influenced by environmental factors (technological uncertainty, regulatory changes, economic changes), ecological factors (density, size, age, industry life-cycle), organizational factors (management tenure, homogeneity and successions, past performance) and psychological factors (managerial perceptions). According to Hamilton and Micklethwait (2006, 1) the main causes of failure can be grouped into six categories: poor strategic decisions; overexpansion and ill-judged acquisitions; dominant CEOs; greed, hubris and the desire for power; failure of internal controls at all levels from the top downwards; and ineffectual or ineffective boards.

When the management merely analyzes the causes it, almost without exception, overestimates the external causes while underestimating the internal ones, which is reasonable since the latter are a direct criticism of the same management up to the point in time in question. Therefore, in the case of a detailed analysis of the causes, an objective and neutral, – with regard to the implementer –, overview of the causes must be certainly prepared, which may be most effectively carried out by skilled consultants, owners, debtors, industrial experts and others, and not be left to the existing management.

Researches also show that people tend to overestimate their own influence on successes while they blame failure on external uncontrollable factors (Mellahi and Wilkinson 2004).

The key cognition in this part of the debate is that the analysis of the causes of a crisis must not be left solely to the views of the (existing) management, since its selection of causes can lead to a wrongful resolution of the crisis, which only deepens the latter.

Management Behaviour in the Crisis Evolution Process

In regard to a company, the consequences of a crisis are visible both internally as externally. Generally they can be classified into two groups:

- worsening of the indicators of the business performance (profitability),
- altered behaviour of the involved participants.

Decline causes managers to dislike and avoid one another, conceal information, and deny responsibility. Secrecy, blame, isolation, avoidance, lack of respect, and feelings of helplessness create a culture that makes an already bad situation even worse. Once a company is caught in this spiral, it is hard to simply stop and reverse direction (Kanter 2003). In a stressful situation managerial inflexibility usually increases (Slatter 1987, 67) and shortens the time horizon (short-term values become more important).

When a company faces a critical state, in most cases the behaviour of internal (employees, the management, unions) and external participants (owners, debtors, suppliers, competitors, consumers, state institutions) alters, representing different reactions (even serious conflicts) to such a state of the company.

Even in a normally operational company natural contradictions in expressed interests (e. g. employees and owners, insured and uninsured creditors) exist and are balanced (counter-weighted) in normal circumstances. Thus the company actualises the interests of all participants. In an acute crisis the balances are lost, since each participant attempts to secure its own interests that can only be achieved by the way of violating the interest domain of another participant. Contradictions, therefore, extremely strengthen during an acute crisis, and the divergence of interests is more intensified. Regarding their role and position, not all participants of a company have the same interest nor the same power or influence. Since individual participants attempt to achieve different benefits, their interest behaviour is also different, both inside the company as well as outside it, or generally in regard to it.

This cognition is of key importance for crisis healing projects and must not be neglected nor underestimated by the crisis management in any case. The emphasised divergence of interest, which is characteristic of the period when a severe (acute) crisis emerges, even further complicates the already demanding internal and external relations of the company. Besides this, it must be accounted for that each interest group has its own indicators, criteria and time frames for judging the successfulness of the crisis healing project, which is particulary significant in the crisis healing phase.

Since the management cannot be directly blamed for the emergence of a crisis, in connection to the mentioned guidelines for operating in critical circumstances, the focus must be two key problems that are directly connected to the level of successfulness, both of preventing crises as well as healing crises:

- measures are starting to be carried out too late when the possibilities of a favourable outcome are very limited;

TABLE 1 A pattern of management contribution in different phases of crisis development

Phases of crisis development	Contribution of management	
	Positive	Negative
Crisis emergence	Successful leadership	Unsuccessful leadership
Crisis identification	Facing real causes of serious problems and taking actions to suppress these causes	Overlooked or neglected symptoms, self-deception
Crisis healing	Immediate, deep and radical use of the right combination of crisis management measures	Lack of realism, passiveness, dealing with inappropriate causes or failure to take right measures
Crisis resolution	Performing revolutionary methods of changes to reach a company renewal (restructuring, reengineering)	Erroneous, untimely or insufficiently integral or radical measures

- measures are begun to be carried out insufficiently generally and radically, thus not relieving an acute crisis which even indicates the down-fall of a company.

If the new management is successful at healing the crisis, the prior management – which personally often experiences this success as a failure – attempts to devaluate the latter, so that the prior state of affairs is represented as non-problematic or the possible achievement of the company as a consequence of its efforts in the previous period.

The management, therefore, may actually aggravate to the development of crisis in:

- the phase of emergence (unsuccessful leadership),
- the phase of crisis identification (overlooked or neglected symptoms, erroneous causes),
- the phase of stopping the negative trends (lack of realism, passiveness, dealing with inappropriate causes or failure to take measures),
- the phase of crisis resolution (erroneous, untimely or insufficiently integral or radical measures).

The emergence and development of a crisis can be significantly influenced by the management, regardless of whether the critical period had been strated predominantly by the internal or external causes (table 1).

Types of Management Mistakes

The emergence of a crisis is influenced jointly, i. e. parallel and in an intertwined manner by both the internal and external causes (events, phenomena and processes). Very few critical circumstances exist that are an exclusive consequence of the first or the second type of causes.

Although the state of crisis in the company can be affected by various interrelated external and internal causes, which as to intensity and appearance vary by company, the essence of the causes surely lies in the management of the company (Clarke, Dean, and Oliver 2003; DiNapoli and Fuhr 1999, 6; Hamilton and Micklethwait 2006, 1; Kraus and Gless 2004, 116; Müller 1986, 376; Platt 1998, 16–17).

The above assertion is confirmed by various researches and even more by empirical data deriving from analyses of individual cases. According to Bibeault's studies (1982, 35), in 70% of cases the problems can be attributed to internal causes and, among the latter, the management predominates. Platt (1998, 16–17) mentions the analysis of causes of 1,335 companies, based on opinions of crisis managers, official receivers, bankers and other creditors, according to which 87% of causes for the failure of companies are attributed to internal causes, with 'inefficient management' in the first place (lack of capital and over-extensive indebtedness follow). Such a cause was also indicated in the first place by the research of the consulting house PriceWaterhouseCoopers (DiNapoli and Fuhr 1999, 6). Similar findings are mentioned by Müller (1986, 367) and the Australian study (Clarke, Dean, and Oliver 2003), which hold that a corporate crisis is actually a 'crisis of the management', since, according to them, the management is the most significant cause for the crisis. Müller even quotes the German banker Hermann J. Abs that bad sectors do not exist, but poorly led companies (Müller 1986, 617). In the context of the same findings can be placed the analysis from 30 years ago by Argenti (1976, 123), which stresses that the very 'bad management' is the point of departure for all other causes that could have even been prevented by a 'good management'. Otherwise, Argenti cites 12 different causes of crises, while, as already mentioned, the inappropriate management occupies the first position. Kraus and Gless (2004, 116) point out that at least 2/3 of corporate crises originate from mistakes of the management both at the operative level (internally) as well as in strategic guidance (externally).

Management mistakes can be divided into three groups:

- different acting of the management which proves to be inadequate or less appropriate, regarding the perceived problem (wrong or bad business decisions, mismanagement),
- omission of the correct and timely acting when any decision is made, despite the fact that actions are necessary (stoppage or redirection of negative flows, lost opportunities, etc.),
- immoral behaviour (unethical decisions, abuses, deceptions, accounting scandals, criminal offences).

While the erroneous managerial decisions (e. g. unelaborated investments into new technologies, a takeover of a company), which can be influenced by external causes, are visible, ascertainable and provable, the omission to act, on the other hand – which was necessary in a particular moment – is less ascertainable, although this very group can be considered as the most dangerous causer of crises. Hartley (2005, 2) divides management mistakes into two main groups: mistakes of omission (no action was taken) and mistakes of commission (bad decision, wrong actions taken, etc.). Evaluation of the successfulness of the management will often be possible in a longer period by a comparison with the competition or with the average of the industry, while actually one can never ascertain whether a hypothetically different management would have been more successful in the same circumstances. What does e. g. an overlooked business opportunity taken by the competition mean? What does developmental (technological and programme) passiveness mean? What does unpreparedness for carrying out fundamental interventions into inefficient structures and processes mean? All these cases are not about erroneous business decisions, but about a lack of whatsoever decisions and practices that can trigger a severe crisis as a consequence of their adoption of an erroneous decision.

Sheppard and Chowdhury (2005) pointed out that there are four essential points one needs to know in order to understand organizational failure:

- failure is not typically the fault of either the environment or the organization, but rather it must be attributed to both of these forces, as failure is the misalignment of the organization to the environment's realities;
- because failure involves the alignment – or misalignment – of the organization and its environment; it is, by definition, about strategy;

- because failure deals with strategy, we can make choices to accelerate it or avoid falling into its clutches;
- because organizational failure can be avoided even after a decline – rapid or prolonged – the ultimate failure of the organization really stems from a failure to successfully execute a turnaround.

In business literature regarding mistakes of the management various theoretical debates can be found on the question of how such mistakes came about. On the one hand, classical industrial organization and organization ecology scholars have typically assumed a deterministic role of the environment and argued that managers are constrained by exogenous industrial and environmental constraints leaving them with little real strategic choice, and hence the managers' role should be ignored. Sometimes a change is hard to predict and it heightens uncertainty for key organizational members. Criticism is related with the question of why it is that firms in the same industry facing the same industry-level constraints fail while others succeed. In addition, studies have demonstrated that performance is determined by the firm strategy more than by the industry.

On the other hand, the organization studies and organizational psychology literature take a more voluntaristic perspective and argue that managers are the principal decision makers of the firm and, consequently, their actions and perceptions are the fundamental cause of organizational failure. Critical remarks of the latter are connected with over-reliance on internal factors (Mellahi and Wilkinson 2004).

Mistakes are a constitutive element of the process of strategic management and, due to an unpredictable and turbulent environment, will always exist. There is no 'right' or 'wrong' in making business decisions – decision-making is not like mathematics where you can prove that something is 'right'. Business decision-making is far more situational – the right decision today is really just the 'best decision' based on the current situation, what is known, and what the options are' (Kow 2004). Omissions of the correct and timely acting are of key importance for further development of a company, when measures, activities, developmental programmes and so on are not being carried out, which represents a loss of opportunities that would enable further existence, i. e. a more rapid growth, while simultaneously the competition is taking advantage of the same opportunities and increasing its power at the cost of the inactive company. 'Even the most successful organizations make mistakes but survive as long as they maintain a good 'batting average' of satisfactory decisions' (Hartley 2005, 333).

Empirical Findings

THE CASE OF TRANSITION PERIOD IN SLOVENIA

The period of transition has caused similar macro-economic consequences in all transitional countries. At the beginning of the transitional period the countries lost markets in Eastern Europe and in the Balkans, which initially led to a decline in GDP and a higher unemployment rate. Such circumstances led to a decreased aggregate demand and supply, i. e. to stagnating economies. The companies from transitional countries, sometimes facing deep crises, were forced to refocus their operations towards the markets of the EU, which required integral and drastic restructurings. A rapid and expansive privatisation of companies, in state ownership, was the primary objective of all socialist countries, since it was expected that the privatisation and autonomy of companies would trigger an increased interest both on the part of the labour force and on the part of the management for improvements in efficiency and successfulness of ventures.

Slovenia, according to numerous indicators, is completing the transitional period that began in 1991 with the formal emancipation from the prior federal country of Yugoslavia and was followed by the formal transition from the socialistic social order, by the transition from the one-party party system to the pluralistic parliamentary system and the transformation of the state (social, public) ownership into the private (the process of privatisation).

The political changes had profound economic impacts, particularly for those industries and companies that were entirely or predominantly oriented to the relatively favourable Yugoslav market, which was practically completely closed in that period due to the events that followed the disintegration of Yugoslavia. Therefore, the managements, which were not accustomed to highly competitive environments typical of global markets, were forced to seek substitutive markets actually 'over-night', whereas superior quality, attractive prices and an appropriate marketing approach had to be provided. It can be concluded from the stated excursus that the position of an individual company within an industry must be monitored from the perspective of the circumstances in the industry, which can be identical to the economic conditions in the region or the country; it may also be better or even much worse.

Profound revolutionary changes both on the domestic as well on the world scale (globalisation) had brought tremendous pressures on the existing management. At that time, extensive manufacturing orientation dominated, typical of all socialistic economies, a spontaneous (ad-hoc) approach prevailed in comparison to a planned and systematic one. There was a deficit in knowledge in other domains (primary marketing) and a poor acquaintance with the international trade (varied among industries), since most of the transactions were carried out in the internal (ex-Yugoslav) market.

Consequently, the first stage of the transition (1991–1996) was characterised not so much by erroneous (bad) management decisions but predominantly by omissions to act, i. e. preparations for and carrying out measures for an integral strategic restructuring (programme-market, developmental-technological, manufacturing, financial, personnel, organisational, informational, etc.). A lack of experience and knowledge in the field, sometimes also a lack of political will, prevented a more successful restructuring of numerous Slovene companies that either ceased operating or underwent a perspectiveless agony with the help of state aids.

According to the German model (Treuhandanstalt), the Fund for Development was established in Slovenia that became the owner of 98 companies, employing 56,000 people, i. e. 10% of all employees. The aggregate loss of these companies, which was defined as irresolvable without state aids, amounted to approximately 1 billion EUR. Until the end of 1993 new management replaced the prior ones in 70% of the cases. Since the new temporary 'state' managers were insufficiently skilled, a series of numerous *erroneous strategic managerial decisions* were taken in these companies, while in certain instances even *immoral deeds* were not a rarity. In the companies, which had been in one way or another taken under the state umbrella, *omissions of acting* did not dominate, since the temporary managers were forced to carry out any measures available; however an abundance of wrong or bad decisions followed as a consequence of insufficient skilfulness and unorganised operation that could have been avoided in many cases. Mistakes of the management were 'covered' by the additional state aid.

After a relatively short period of independence many companies faced a new shock when Slovenia became a member of the European Union in 2004 (rules of the EU were actually effective even before, as of the Stabilisation-Associational Agreement), once again differently experienced among industries and individual companies. Likewise, the story from the beginning of the transition was repeated once more when many companies did not adjust their operations to the new circumstances (omissions of management to act), although, due to the bitter experiences from the past, there were considerably fewer such failures (the reason can also be found in the private ownership of the companies). Those industries which had been in a more or less healthy state due to the protectionisms – again having various origins regarding both the Slovene as well as the former Yugoslav market space where these companies were dominant (e. g. food-processing industry) – reacted worst. By the accession to the EU, Slovene companies lost their competitive advantages in those markets in comparison to other EU countries.

Types of Mistakes – Is there a Distinctive Pattern?

During the period of transition all types of management mistakes could be found in Slovene corporate systems, which is not surprising, or contradictory to the other economic environments. The influence (extent)of these errors differed during individual periods and with regard to the characteristics of the external and the internal environment, where individual companies operated, thus, fundamental typical patterns evolved.

One can ascertain that the omissions of the correct and timely acting played the key role during the period of transition and erroneous decisions; on the other hand they continued, to a lesser extent, while such decisions predominated in cases when the company was receiving significant state aids. The mistakes, are, indubitably, a constitutive part of the management process. Where the environment is more turbulent, as was true for Slovenia, there were greater possibilities for mistakes that, in regard to the dramatic changes in the environment, were generally not 'too extensive' . If a company operates in an industry which is characterised by a high, above average, growth rate, then the mistakes or troubles that would represent a severe critical situation in a poorly positioned industry would not have lethal impact. This means that the subjective decision (the internal cause) was directly connected to the events in the environment (the external cause). Simplified, it is still true that a company, operating in a stagnating industry, must make more key decisions in a short time period and often without an appropriate support, which, all together, only increases the possibilities for mistakes.

In the second period of the economic part of the transition the objective for Slovene companies was to increase primarily their competitiveness, i. e. the value productivity and to catch-up with the developed countries. According to the value-added per-employee indicator (27,000 EUR), the Slovene processing industry is lagging behind the average of the EU-25 40% (2005), although this varies among industries. Regarding the fact that Slovenia was the most developed accession country, according to most indicators at the point of accession, a comparison with the 'older' members (the EU-15) would show a lag of 2 to 4 times.

Slovene companies, therefore, will have to boost the development of products incorporating a higher value added, which, once more, demands complete commitment and skilfulness of the management. On the average, an insufficient part of the developmental, innovative component in products and services of producers is one of the key problems of the Slovene economy.

International comparisons indicate that the intensity of restructuring in the processing industry in Slovenia in the second half of the 1990s was higher than in the eleven out of thirteen countries of the EU (for Ireland and Spain the data are missing) and slower compared to the three transitional countries, for which the data (UMAR 2002, 24) are available (Hungary, the Czech Republic, Slovakia). Although the value added per employee has increased in real terms, the contribution deriving from factual successful restructuring of companies is far lower, since quite a few large unsuccessful companies have disappeared in this period and their absence from statistics had a significant influence on calculation of the average. Since the value added in real terms is also rising in the EU, Slovenia's lagging according to this indicator is not decreasing, taking into account the afore – mentioned influence of the 'failed' companies. This practically means that it cannot achieve the EU-25 average by an evolutionary change. The solution, therefore, can be sought in a revolutionary change of the economic structure that is ever more being characterised by sophisticated services. Simultaneously this solution is to be sought in abandoning and outsourcing the unprofitable mass non-sophisticated production in individual industries, as well as in individual companies, where transition into narrower market segments and market niches represents a real opportunity, likewise in a revolutionary manner. Exactly at this point a danger lurks again that the restructurings are not sufficiently rapid, integral and radical, i. e. *the danger of omission of the correct and timely acting* appropriate and timely reactions by management, which, due to a required compensation of the lagging regarding the developed countries, is actually necessary.

TABLE 2 A pattern of management contribution in the Slovene transition period

Period	1991–1996	1997–2003	2004–
Key features	Lost markets, stagnation, deep crises	Programme-market restructuring, state aid	EU integration, higher value added is needed
Prevailing management approach	Spontaneous, ad hoc approach, lack of strategic management	Introduction of planned approach with basic elements of strategic management	Planned, systematic approach, further development of strategic management
Prevailing management methods	Crisis management	Restructuring projects	'Classical' strategic management
Prevailing types of management mistakes	Omissions of the correct and timely acting	Wrong or bad decisions; immoral behaviour	Omissions of the correct and timely acting

When considering crisis management less critically, there are often opinions to be heard that the latter is typical only of periods of the so-called transition of the economy, when the weak companies that are allegedly in need of crisis management are presupposed to go bankrupt, while only the successful companies, not operating according to the principles of crisis management, are to survive, therefore, the significance of the latter will diminish. Unfortunately, both the international and the domestic experience indicate differently. If, presumably, Slovenia completed its 'period of transition' with the accession to the EU, then the period of severe crises in companies has not ended, on the contrary, for many the latter has just begun due to this very reason. A significant lagging of the Slovene processing industry behind the average of the EU-25 (even more of the EU-15) indicates that the Slovene management will be forced to make rapid and often radical and environmentally appropriate moves in the future, when there will be increasingly less space for management mistakes that could have been kept secret during the period of transition (table 2).

Because the environment for conducting business is becoming ever more complex and turbulent, crises become ever more complex, interrelated and interdependent as well (Boin and Lagadec 2000). Even small deviations from the initial guidelines may lead to a rapid escalation of the problems. Therefore, the measures for remedying the crises are becoming more demanding and extensive.

MANAGERIAL IMPLICATIONS

In the economic perspective of transition, the management in Slovenia played one of the key roles, since they had to operate in circumstances characterised by the domestic as well as the foreign environment, both rapidly and drastically changing (globalisation). Beside numerous successful restructurings of companies, all types of management mistakes occurred, which were characterised by certain peculiarities in the transitional period. While the extent of *immoral behaviour* can be suppressed on the longer run by a greater assertion of moral codes, on the one hand: 'one natural way to facilitate moral outcomes is through organizational cultures where certain principles, norms, and values are internalized and fully motivating' (Smith 2005), and by a more efficient control, better accounting standards and even penal policy on the other, the *erroneous behaviours (wrong or bad decisions)* by the management can be reduced by their greater skilfulness regarding the complex processes of restructuring and catching-up with the competition. *The omissions of the correct and timely acting* of the management, on the other hand, can be prevented by a decreased influence of the state.

The omissions of the management, as one of the groups of mistakes, are otherwise problematic for identification (whether a different management would have been more successful during the same period), therefore, strategic alternatives ought to be pointed out, where even the supervisory body (board) can have a significant consulting role. This body, however, needs to be properly qualified. If management mistakes take place during a period of emergence of a crisis, then the mistakes are not to be given opportunity during the period of crisis healing. The greater the political influence, the less frequently are management mistakes are less frequent visible, since a wider consensus of the participating sides is usually reached prior to making decisions, while the influence of omissions of the management is greater. The state aid, therefore, must not be an abetment to the management for the strategic decisions not to take place. The lesser the political influence, the more activities will be required, whereas the mistakes can be more frequent but still less fatal than the potential passiveness (the failure to act).

Thus, the hypothesis, that the omissions of the correct and timely acting of the management during the transitional period may be more dangerous for a company – since they are more vital for the existence and the development compared to the classical mistakes – is confirmed in basic outlines, taking into consideration the related categories as they are explained and understood in this article. The omissions are only more visible in the longer run and often scientifically not possible to confirm. The companies or industries, lagging behind the competition or the previously set developmental objectives, cannot afford omissions to act even for the potential cost in the form of mistakes. If there is really a more or less valid pattern of management mistakes in corporate crises, and if these mistakes appear differently with regard to changes in the political and economical environment in countries in transition, this could help decision makers to adopt a more grounded choice in the process of appointing new crisis or restructuring managers, every time according to their most appropriate competencies.

By taking into account many limitations of the mentioned confirmed hypothesis there remains a lot of space for further and deeper researche.

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The Exchange Rate Regime and International Trade

Romulus-Catalin Damaceanu

The study of the relation between the exchange rates regime and international trade is done using an inter-disciplinary vision that contains knowledge from four different disciplines: economics, history, mathematics and computer sciences. In the case of pure theory of international trade, there is made an abstraction of the fact that international trade is done using money. The theoretical analysis of international trade including the monetary factor deals with static equilibrium and linear models. We conceived a macroeconomic model of the world economy and used this model to make three simulation experiments. The conclusion of these experiments is that a broader exchange rate band has a negative impact over the volume of world trade. This conclusion is confirmed by the historical analysis.

Key Words: historical analysis, macroeconomic modelling, simulation of international trade, design of exchange rate regime experiments
JEL *Classification:* F47, C99

Introduction

An important factor of the international trade volume is the level of exports and imports prices. These prices also depend on the value of exchange rates. As consequence, the exchange rates regime has a major influence over the international trade volume. The relation between the exchange rate regime and international trade is bivalent. International trade, in its turn, has a major influence over the exchange rates regime. Under certain conditions, the international trade evolution can determine the changing of exchange rates regime by the central banks. This happens, in the most cases, when the central bank has not enough reserves to maintain a certain exchange rates regime. The study of the inter-conditional relation between the exchange rates regime and international trade is done using an inter-disciplinary vision that contains knowledge from four disciplines: economics, history, mathematics and computer sciences.

The analysis of the complex relation between the exchange rate regime

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and international trade is done based on the following *methodological principles:*

1. Analysis of the pure theory of international trade.
2. Analysis of the main theoretical approaches of international trade taking into consideration the monetary factor.
3. A historical analysis of the relation between the exchange rates regime and international trade.
4. Mathematical modelling of relation between the exchange rate and the international trade.
5. Simulation of the correlation between the exchange rate and international trade using experiments.

The classical economists were the first to elaborate a theory of international trade (Smith 1962; Ricardo 1959). This theory was a reaction to the mercantilist conception in contradiction with the liberal doctrine that stressed the importance of individuals and considered the nation just as the sum of its inhabitants. The theory of international trade was improved by the Hecksher-Ohlin model (Heckscher 1919; Ohlin 1933). Paul Samuelson and Ronald W. Johnson transformed the classical model of international trade into one with three factors of production, two goods and two countries that use neoclassical production functions (Samuelson 1971; Jones 1971). The most recent theoretical conceptions are those that use the notion of intra-industrial trade. In the case of all these theories, there is made an abstraction that international trade is done by using money.

The connections between the variations of exchange rates and the international trade flows are described using the following theories: the elasticity theory, the absorption theory, the J curve theory, the Mundell-Fleming theory, the monetarist theory and the neoclassical theory (Mundell 1962; 1963; Fleming 1962; Walras 1954; Marshall 1923; Burr 1960).

The hystorical analysis shows us that, over time, the nations have used the following types of exchange rates regimes:

1. the fixed exchange rates regime (FIX), when the central bank maintains the exchange rate between the national currency and the reference currency in a relatively narrow pegging band of ± 1% in comparison with the target level of exchange rate;
2. the floating exchange rates regime (FLT), when the central bank make no interventions on the foreign currency markets;

TABLE 1 The average rate of growth obtained under the three regimes

Regime	Monetary system	Rate of growth of world trade	Rank
FIX	Gold standard	4.1	III
	Bretton Woods	8.1	I
FLT	Inter-war period	2.1	IV
CTR	Present monetary system	5.0	II

NOTE Data calculated and updated from Damaceanu 2005.

3. the controlled exchange rates regime (CTR), when the exchange rate is determined by the interaction between the intervention of the state and the relation between demand and supply.

The average rate of growth of world trade obtained under these types of regimes is presented in table 1.

Based on the data of table 1, we can conclude that the highest rate of growth of world trade was obtained during the fixed exchange rate regime of the Bretton Woods system; in second place is the rate obtained for the controlled exchange rates regime; in third place is the rate obtained during the gold standard, and the lowest rate is obtained during the inter-war period.

The rest of the paper is organized as follows: the second section describes the macroeconomic model of the world economy used to simulate the relations between the exchange rate regime and international trade, the third analyses the simulation results and the fourth section presents the conclusions.

The Model of the World Economy

The macroeconomic model that we are going to use is associated with a world economy with $m = 2$ national economies NE_1 and NE_2. The objective of this model is to simulate world trade under the following exchange rates regimes: the floating exchange rates (FLT), the fixed exchange rates regime (FIX) and the controlled exchange rates regime (CTR_p), where p is the pegging band of $\pm p$ ($p \neq 0.1$) in comparison with the target level of exchange rates.

Our model takes into consideration the next simplifying assumptions:

- The equations of the model are stable: the parameters do not change during the period of simulation.
- There are no anticipations connected with the evolution of the exchange rates and no speculations on foreign currency markets.

- There are no commercial barriers.

The model is structured in the next objects:

$$WE \longrightarrow NE_1 \longrightarrow FCM_{1,2}$$
$$\longrightarrow NE_2 \longrightarrow FCM_{2,1},$$

where WE is the world economy, NE_i is the national economy with the number $i \in \{1, 2\}$, and $FCM_{i,j}$ is the foreign currency market of economy NE_i where is traded the currency of economy NE_j; $i \neq j$; $i, j \in \{1, 2\}$.

The non-linearity of model is given by the variable $ICB_{i,j,t}$ that quantifies the intervention of central bank on the foreign currency market.

THE EQUATIONS OF OBJECT *WE*

The object WE contains two variables: the world exports X_t and the world imports M_t. Thus, the world exports X_t evaluated in the currency of the economy NE_1 are determined by the next equation:

$$X_t = X_{1,t} + X_{2,t} \cdot er_{1,2,t}, \tag{1}$$

where $X_{i,t}$ represents the aggregated exports of economy NE_i, and $er_{i,j,t}$ is the exchange rate between the currencies of economies NE_i and NE_j, $i \neq j$, $i \in \{1, 2\}$.

The world imports M_t evaluated in the currency of economy NE_1 are determined by the next equation:

$$X_t = M_{1,t} + M_{2,t} \cdot er_{1,2,t}, \tag{2}$$

where $M_{i,t}$ represents the aggregated imports of economy NE_i, $i \in \{1, 2\}$.

THE EQUATIONS OF OBJECTS NE_i

We can express the variation in time of the average level of prices of economy NE_i using the next relation:

$$p_{i,t} = p_{i,t} - 1 + a_i \cdot (D_{i,t-1} - S_{i,t-1}), \tag{3}$$

where $a_i \geq 0$ is a parameter that quantifies the elasticity of prices, $D_{i,t}$ is the aggregated demand of economy NE_i, and $S_{i,t}$ is the aggregated supply of economy NE_i.

$D_{i,t}$ has four components:

- the aggregated consumption $C_{i,t}$;
- the aggregated investments $I_{i,t}$;
- the governmental spending $G_{i,t}$;

- the aggregated exports $X_{i,t}$.

$S_{i,t}$ has the next elements:

- the aggregated output $Y_{i,t}$;
- the aggregated imports $M_{i,t}$.

Equation (4) determines, from the mathematical point of view, the aggregated demand $D_{i,t}$ as being the sum between the aggregated consumption $C_{i,t}$, the aggregated investments $I_{i,t}$, the governmental spending $G_{i,t}$ and the aggregated exports $X_{i,t}$:

$$D_{i,t} = C_{i,t} + I_{i,t} + G_{i,t} + X_{i,t}. \tag{4}$$

Equation (5) expresses the aggregated supply $S_{i,t}$ as being the sum between the aggregated output $Y_{i,t}$ and the aggregated imports $M_{i,t}$:

$$S_{i,t} = Y_{i,t} + M_{i,t}. \tag{5}$$

We can describe the variation of the aggregated consumption $C_{i,t}$ in function of average level of prices $p_{i,t}$, of available income $YD_{i,t}$ and of interest rate $ir_{i,t}$ using the equation:

$$\begin{aligned} C_{i,t} = {} & C_{i,t-1} - c_{p,i} \cdot (p_{i,t-1} - p_{i,t-2}) \\ & + c_{yd,i} \cdot (YD_{i,t-1} - YD_{i,t-2}) \\ & - c_{ir,i} \cdot (ir_{i,t-1} - ir_{i,t-2}), \end{aligned} \tag{6}$$

where $c_{p,i} \geq 0$ is the elasticity of consumption in function of price, $c_{yd,i} \in [0, 1]$ is the elasticity of consumption in function of available income, and $c_{ir,i} \geq 0$ is the elasticity of consumption in function of interest rate.

Equation (7) describes the variation of investments $I_{i,t}$ in function of average level of prices $p_{i,t}$, of the variation of the aggregated demand $D_{i,t}$ and of the interest rate $ir_{i,t}$:

$$\begin{aligned} I_{i,t} = {} & I_{i,t-1} - i_{p,i} \cdot (p_{i,t-1} - p_{i,t-2}) \\ & + i_{d,i} \cdot (D_{i,t-1} - D_{i,t-2}) \\ & - i_{ir,i} \cdot (ir_{i,t-1} - ir_{i,t-2}), \end{aligned} \tag{7}$$

where $i_{p,i} \geq 0$ is the elasticity of investments in function of price, $i_{d,i} \in [0, 1]$ is the elasticity of investments in function of aggregated investments, and $i_{ir,i} \geq 0$ is the elasticity of investments in function of interest rate.

Equation (8) describes the variation of the governmental spending $G_{i,t}$ in function of the budgetary surplus or deficit $BG_{i,t}$:

$$G_{i,t} = G_{i,t-1} + BG_{i,t-1}. \tag{8}$$

Equation (9) shows us that the variation of the output $Y_{i,t}$ is determined by the variation of the aggregated demand $D_{i,t}$, by the variation of the aggregated inputs of capital coming from abroad $IK_{i,t}$ - especially the direct foreign investments made in the frame of economy NE_i, and by the variation of prices $p_{i,t}$:

$$\begin{aligned} Y_{i,t} = {} & Y_{i,t-1} + y_{d,i} \cdot (D_{i,t-1} - D_{i,t-2}) \\ & + y_{ik,i} \cdot (IK_{i,t-1} - IK_{i,t-2}) \\ & - y_{p,i} \cdot (p_{i,t-1} - p_{i,t-2}). \end{aligned} \tag{9}$$

where $y_{d,i} \in [0, 1]$ is the elasticity of output in function of demand, $y_{ik,i} \in [0, 1]$ is the elasticity of output in function of inputs of capital from abroad, and $y_{p,i} \geq 0$ is the elasticity of output in function of price.

Equation (10) describes the available income $YD_{i,t}$ as being equal with the difference between the aggregated output/income $Y_{i,t}$ and the aggregated taxes $T_{i,t}$:

$$YD_{i,t} = Y_{i,t} - T_{i,t}. \tag{10}$$

Equation (11)describes the variation of taxes $T_{i,t}$ in function of the variation of output $Y_{i,t}$:

$$T_{i,t} = T_{i,t-1} - t_{y,i} \cdot (Y_{i,t-1} - Y_{i,t-2}), \tag{11}$$

where $t_{y,i} \in [0, 1]$ is the elasticity of taxes in function of income.

The value of budgetary surplus of deficit $BG_{i,t}$ is determined by:

$$BG_{i,t} = BG_{i,t-1} + T_{i,t} - G_{i,t}. \tag{12}$$

Equation (13)describes the variation of the interest rate $ir_{i,t}$ in function of the difference between the monetary demand $MD_{i,t}$ and supply $MS_{i,t}$:

$$ir_{i,t} = ir_{i,t-1} + b_i \cdot (MD_{i,t-1} - MS_{i,t-1}), \tag{13}$$

where b_i is the elasticity of interest rate.

Equation (14) describes the monetary demand using the simple Keynesian specification that specifies the money requested for transactions and for speculative purposes (Keynes 1936). Under these conditions, the monetary demand $MD_{i,t}$ is determined by the variation of aggregated supply $S_{i,t}$ and of interest rate $ir_{i,t}$:

$$MD_{i,t} = MD_{i,t-1} + md_{s,i} \cdot (S_{i,t-1} - S_{i,t-2}) - md_{ir,i} \cdot (ir_{i,t-1} - ir_{i,t-2}), \tag{14}$$

where $md_{s,i} \in [0,1]$ and $md_{ir,i} \geq 0$ are the elasticity of monetary demand in function of supply of goods and services and, respectively, of interest rate.

Equation (15) shows us the way in which the monetary supply $MS_{i,t}$ variates in function of aggregated supply $S_{i,t}$ and of interest rate $ir_{i,t}$:

$$MS_{i,t} = MS_{i,t-1} + ms_{s,i} \cdot (S_{i,t-1} - S_{i,t-2}) + ms_{ir,i} \cdot (ir_{i,t-1} - ir_{i,t-2}), \tag{15}$$

where $ms_{s,i} \in [0,1]$) and $ms_{ir,i} \geq 0$ are the elasticity of monetary supply in function of supply of goods and services and, respectively, of interest rate.

Equation (16) shows us that the balance of payments $BP_{i,t}$ is determined by the sum between the current account balance BCi, t and the capital account balance $BK_{i,t}$:

$$BP_{i,t} = BC_{i,t} + BK_{i,t}. \tag{16}$$

Equation (17) determines the current account balance $BC_{i,t}$ as being the difference between the aggregated exports $X_{i,t}$ and the aggregated imports $M_{i,t}$:

$$BC_{i,t} = X_{1,t} - M_{i,t}. \tag{17}$$

Equation (18) determines the capital account balance $BK_{i,t}$ as being the difference between the inputs of capital $IK_{i,t}$ and exits of capital $EK_{i,t}$:

$$BK_{i,t} = IK_{i,t} - EK_{i,t}. \tag{18}$$

Equation (19) determines the value of aggregated exports $X_{i,t}$ as the sum of exports $X_{i,j,t}$ made by the economy NE_i to the others economies, where $j \neq i$:

$$X_{i,t} = \sum X_{i,j,t}. \tag{19}$$

Equation (20) determines the value of the aggregated imports $M_{i,t}$ as being the sum of imports $M_{i,j,t}$ made by the economy NE_i from the others economies, where $j \neq i$:

$$M_{i,t} = \sum M_{i,j,t}. \tag{20}$$

Equation (21) calculates the value of aggregated inputs of capital $IK_{i,t}$ as being the sum of inputs of capital $IK_{i,j,t}$ coming from abroad, where $j \neq i$:

$$IK_{i,t} = \sum IK_{i,j,t}. \tag{21}$$

Equation (22) calculates the value of aggregated outputs of capital $EK_{i,t}$ as being the sum of outputs of capital $EK_{i,j,t}$ destined abroad, where $j \neq i$:

$$EK_{i,t} = \sum EK_{i,j,t}. \tag{22}$$

THE EQUATIONS OF OBJECTS $FCM_{i,j}$

The exchange rate $er_{i,j,t}$ represents the price of one monetary unit of economy NE_j evaluated in the currency of economy NE_i. The value of exchange rate $er_{i,j,t}$ is determined by the next factors: the foreign currency demand $CD_{i,j,t}$; the foreign currency supply $CS_{i,j,t}$; the value of the central bank intervention $ICB_{i,j,t}$ – this last factor appears only when the central bank selects the regimes *FIX* or CTR_p, and the exchange rate $er_{i,j,t}$ exits from the permitted floating band.

We can express from the mathematical point of view the dynamics of exchange rates $er_{i,j,t}$ by the equation:

$$er_{i,j,t} = er_{i,j,t-1} + c_{i,j} \cdot (CD_{i,j,t-1} - CS_{i,j,t-1} + ICB_{i,j,t}), \tag{23}$$

where $c_{i,j} \geq 0$ is a parameter that quantifies the elasticity of exchange rate.

The foreign currency demand $CD_{i,j,t}$ represents the total value of currencies bought on the foreign currency market $FCM_{i,j}$. $CD_{i,j,t}$ is generated by the next factors: the value of imports $M_{i,j,t}$; the value of exits of capital $EK_{i,j,t}$. $CD_{i,j,t}$ is expressed by equation:

$$CD_{i,j,t} = M_{i,j,t} + EK_{i,j,t}. \tag{24}$$

The foreign currency supply $CS_{i,j,t}$ is the total value of currencies destined to be sold on the market $FCM_{i,j}$. $CS_{i,j,t}$ is generated by the value of exports $X_{i,j,t}$ and by the value of inputs of capital $IK_{i,j,t}$. $CD_{i,j,t}$ is determined by:

$$CS_{i,j,t} = X_{i,j,t} + IK_{i,j,t}. \tag{25}$$

When the central bank selects the regime *FLT* of floating exchange rates and $r_{i,j} = 0$ then we do not have interventions on the market $FCM_{i,j}$ and

$$ICB_{i,j,t} = 0.$$

When the central bank selects the regime *FIX* of fixed exchange rates ($r_{i,j} = 1$) or the regime CTR_p of controlled exchange rates ($r_{i,j} = 2$) and the exchange rate $er_{i,j,t}$ has the tendency to exit the floating band then we have an intervention on the market $FCM_{i,j}$ in order to sell or buy currencies and to modify the exchange at the target level $er^*_{i,j}$. When the central bank buys currencies then $ICB_{i,j,t} > 0$ and when it sells then $ICB_{i,j,t} < 0$.

To determine the value of $ICB_{i,j,t}$, we start from equation (25) and we fix the exchange rate $er_{i,j,t}$ at the target level $er^*_{i,j}$. As a consequence, we have:

$$er^*_{i,j} = er_{i,j,t-1} + c_{i,j} \cdot (CD_{i,j,t-1} - CS_{i,j,t-1} + ICB_{i,j,t}). \tag{25'}$$

This is equivalent with:

$$ICB_{i,j,t} = \frac{1}{c_{i,j}} \cdot (er^*_{i,j} - er_{i,j,t-1}) - CD_{i,j,t-1} + CS_{i,j,t-1}. \tag{25'}$$

If the exchange rate $er_{i,j,t}$ is being maintained in the floating band then the central bank does not make interventions on the market $FCM_{i,j}$ and:

$$ICB_{i,j,t} = 0.$$

In the case of buying currencies, the reserve $R_{i,j,t}$ of the central bank is growing, and, in the case of selling currencies, the reserve $R_{i,j,t}$ is becoming smaller. In the second case, the reserve $R_{i,j,t}$ might prove insufficient to accomplish the intervention on the market $FCM_{i,j}$. This happens when we have the next relation:

$$R_{i,j,t-1} + ICB_{i,j,t} < 0.$$

By using equation (25), we have:

$$R_{i,j,t-1} + \frac{1}{c_{i,j}} \cdot (er^*_{i,j} - er_{i,j,t-1}) - CD_{i,j,t} + CS_{i,j,t} < 0.$$

In this case, the value of $ICB_{i,j,t}$ is equal with:

$$ICB_{i,j,t} = -R_{i,j,t-1}.$$

Taking into consideration all these possible cases, we can determine the value of $ICB_{i,j,t}$ by the nonlinear equation:

$$ICB_{i,j,t} = \left| \begin{array}{l} 0, \text{ if } r_{i,j} = 0. \\ 0, \text{ if } r_{i,j} = 1 \text{ and } er_{i,j,t-1} \in (0.99 \cdot er^{*}_{i,j}, 1.01 \cdot er^{*}_{i,j}). \\ 0, \text{ if } r(i,j) = 2 \text{ and } er_{i,j,t-1} \in ((1 - p_{i,j}) \\ \qquad \cdot\, er^{*}_{i,j}, (1 + p_{i,j}) \cdot er^{*}_{i,j}). \\ \frac{1}{c_{i,j}} \cdot (er^{*}_{i,j} - er_{i,j,t-1}) - CD_{i,j,t-1} + CS_{i,j,t-1}, \text{if } r_{i,j} = 1, \\ \qquad er_{i,j,t-1} \in (-\infty, 0.99 \cdot er^{*}_{i,j}] \cup [1.01 \cdot er^{*}_{i,j}, +\infty) \\ \qquad \text{and } R_{i,j,t-1} + ICB_{i,j,t} \geq 0. \\ -R_{i,j,t-1}, \text{if } r_{i,j} = 1, er_{i,j,t-1} \in (-\infty, 0.99 \cdot er^{*}_{i,j}] \\ \qquad \cup\, [1.01 \cdot er^{*}_{i,j}, +\infty) \text{ and } R_{i,j,t-1} + ICB_{i,j,t} < 0. \\ \frac{1}{c_{i,j}} \cdot (er^{*}_{i,j} - er_{i,j,t-1}) - CD_{i,j,t-1} + CS_{i,j,t-1}, \text{if } r_{i,j} = 2, \\ \qquad er_{i,j,t-1} \in (-\infty, (1 - p_{i,j} \cdot er^{*}_{i,j}] \cup [(1 + p_{i,j}) \\ \qquad \cdot\, er^{*}_{i,j}, +\infty) \text{ and } R_{i,j,t-1} + ICB_{i,j,t} \geq 0. \\ -R_{i,j,t-1}, \text{ if } r_{i,j} = 2, er_{i,j,t-1} \in (-\infty, (1 - p_{i,j} \cdot er^{*}_{i,j}] \\ \qquad \cup\, [(1 + p_{i,j}) \cdot er^{*}_{i,j}, +\infty) \\ \qquad \text{and } R_{i,j,t-1} + ICB_{i,j,t} < 0. \end{array} \right. \tag{26}$$

The next equation calculates the value of reserve $R_{i,j,t}$:

$$R_{i,j,t} = R_{i,j,t-1} + ICB_{i,j,t}. \tag{27}$$

Using the principle of generalized gravitation equation (Bergstrand 1989), we can consider that the value of exports $X_{i,j,t}$ is determined by the next factors: the output $Y_{i,t}$, the output $Y_{j,t}$, the exchange rate $er_{i,j,t}$ and the difference $p_{i,t} - p_{j,t} \cdot er_{i,j,t}$ between internal prices and foreign prices. From the mathematical point of view, the influence of these factors over $X_{i,j,t}$ can be described by:

$$\begin{aligned} X_{i,j,t} = {} & X_{i,j,t-1} + x_{y,i,j} \cdot (Y_{i,t-1} - Y_{i,t-2}) + x_{yf,i,j} \cdot (Y_{j,t-1} - Y_{j,t-2}) \\ & + x_{er,i,j} \cdot (er_{i,j,t-1} - er_{i,j,t-2}) - x_{p,i,j} \cdot (p_{i,t-1} - p_{j,t} \cdot er_{i,j,t}), \end{aligned} \tag{28}$$

where $x_{y,i,j} \in [0,1]$ is the elasticity of exports in function of national output, $x_{yf,i,j} \in [0,1]$ is the elasticity of exports in function of foreign output, $x_{er,i,j} \in [0,1]$ is the elasticity of exports in function of the exchange rate, and $x_{p,i,j} \in [0, 1]$ is the elasticity of exports in function of the difference between the national and the foreign prices evaluated in the national currency.

The imports $M_{i,j,t}$ are equal with the exports $X_{j,i,t}$ multiplied by the exchange rate $er_{i,j,t}$:

$$M_{i,j,t} = X_{j,i,t} \cdot er_{i,j,t}. \tag{29}$$

In the case of exits of capital $EK_{i,j,t}$, we will apply the same principle of generalized gravitation equation, completed with the theory of capital flows. The origins of this last theory can be found in the time of gold specie standard, when an increase of internal interest rate was seen as a way of stimulating the inputs of gold from abroad (Artis and Lewis 1991). The modern theory of capital flows states that in a world with two countries A and B, the others factors remaining unchanged, we can write the variation of external liabilities of country A like this:

$$dF_A = I_A + f_A(ir_A, ir_B),$$

where F_A is the value of liabilities, dF_A is the variation of liabilities (a capital flow), ir_A and ir_B are the interest rates of countries A and B, and I_A is the component of F_A that does not depend on interest rates. It is supposed that $dF_A/dir_A > 0$ and $df_A/dir_B < 0$.

Under these circumstances, the exits of capital $EK_{i,j,t}$ are determined by: the output $Y_{i,t}$, the output $Y_{j,t}$, the exchange rate $er_{i,j,t}$ and the difference $ir_{i,t} - ir_{j,t}$ between internal interest rate and foreign interest rate. The influence of these four factors over $EK_{i,j,t}$ can be described, from the mathematical point of view, by:

$$\begin{aligned} EK_{i,j,t} = {} & EK_{i,j,t-1} + ek_{y,i,j} \cdot (Y_{i,t-1} - Y_{i,t-2}) \\ & + ek_{yf,i,j} \cdot (Y(j, t-1) - Y(j, t-2)) \\ & - ek_{er,i,j} \cdot (er_{i,j,t-1} - er_{i,j,t-2}) \\ & - ek_{ir,i,j} \cdot (ir_{i,t-1} - ir_{j,t-1}), \end{aligned} \tag{30}$$

where $ek_{y,i,j} \in [0, 1]$ is the elasticity of exits of capital in function of national output, $ek_{yf,i,j} \in [0, 1]$ is the elasticity of exits of capital in function of foreign output, $ek_{er,i,j} \in [0, 1]$ is the elasticity of exits of capital in function of exchange rate, and $ek_{ir,i,j} \in [0, 1]$ is the elasticity of exports in function of difference between the national and the foreign interest rates.

The inputs of capital $IK_{i,j,t}$ are equal with the exits of capital $EK_{i,j,t}$ multiplied by the exchange rate $er_{i,j,t}$:

$$IK_{i,j,t} = EK_{j,i,t} \cdot er_{i,j,t}. \tag{31}$$

Analysis of simulation results

We make three simulation experiments:

- $EXP1$ will simulate the world trade under the regime FLT;
- $EXP2$ will simulate the world trade under the regime FIX;
- $EXP3$ will simulate the world trade under the regime $CTR_{0.02}$.

To make such experiments, I used the application LSD - (Laboratory for Simulation Development, see Damaceanu 2006) for the implementation of the mathematical model in the simulation macrolanguage LSD. This application was developed by Marco Valente in the frame of the project IIASA, Vienna, conducted by Prof. G. Dosi and upgraded at DRUID, Aalborg, in the frame of a research program conducted by Prof. E. S. Andersen (Valente and Andersen 2002).

In order to make a comparative analysis, all three experiments will have the same values for the input variables and parameters with the exception of the parameters $r_{i,j}$ (tables 2, 3 and 4). In addition, the period of simulation will be the same: from $t = 1$ to $t = 90$.

In table 5, we have the evolution in time of variables $X(t)$ and $M(t)$ under the three regimes:

$$FLT\colon \{r_{1,2} = 0, r_{2,1} = 0\};$$

$$FIX\colon \{r_{1,2} = 1, r_{2,1} = 1\};$$

$$CTR_{0.02}\colon \{r_{1,2} = 2, r_{2,1} = 2, p_{1,2} = 0.02, p_{2,1} = 0.02\}.$$

If we compare the total value of world trade obtained under these three regimes of exchange rates, we observe that the biggest value ($\sum X_t = 12672.63$ and $\sum M_t = 12672.55$) was obtained under the regime FIX, in second place is the world trade ($\sum X_t = 12649.37$ and $\sum M_t = 12648.13$) obtained under the regime $CTR_{0.02}$ and in the last place is the world trade ($\sum X_t = 12562.95$ and $\sum M_t = 12561.95$) obtained under the regime FLT.

The conclusion of these three experiments is that a broader exchange rate band has a negative impact over the volume of the world trade.

Conclusions

Based on historical and experimental analysis, we can tell that a fixed or a relative narrow pegging exchange rate regime can assure a faster growth of international trade with the condition that the national economies

TABLE 2 The input variables and parameters for the objects NE_1 and NE_2

NE_1	NE_2	NE_1	NE_2
$p_{1,0} = 9.83$	$p_{2,0} = 9.91$	$yd_1 = 0.01$	$yd_2 = 0.01$
$p_{1,-1} = 9.84$	$p_{2,-1} = 9.92$	$yp_1 = 0.01$	$yp_2 = 0.01$
$a_1 = 0.01$	$a_2 = 0.01$	$yik_1 = 0.01$	$yik_2 = 0.01$
$D_{1,0} = 487.52$	$D_{2,0} = 945.79$	$YD_{1,0} = 355.55$	$YD_{2,0} = 812.83$
$D_{1,-1} = 488.69$	$D_{2,-1} = 946.57$	$YD_{1,-1} = 356.75$	$YD_{2,-1} = 813.62$
$S_{1,0} = 480.08$	$S_{2,0} = 946.38$	$T_{1,0} = 41$	$T_{2,0} = 94$
$S_{1,-1} = 481.25$	$S_{2,-1} = 947.14$	$ty_1 = 0.01$	$ty_2 = 0.01$
$C_{1,0} = 174.43$	$C_{2,0} = 357.03$	$BG_{1,0} = 9.0$	$BG_{2,0} = 6.0$
$C_{1,-1} = 174.42$	$C_{2,-1} = 357.02$	$ir_{1,0} = 1.01$	$ir_{2,0} = 1.14$
$cp_1 = 0.01$	$cp_2 = 0.01$	$ir_{1,-1} = 1.00$	$ir_{2,-1} = 1.15$
$cyd_1 = 0.01$	$cyd_2 = 0.01$	$b_1 = 0.01$	$b_2 = 0.01$
$cir_1 = 0.01$	$cir_2 = 0.01$	$MD_{1,0} = 518.22$	$MD_{2,0} = 980.51$
$I_{1,0} = 223.53$	$I_{2,0} = 407.23$	$mds_1 = 0.01$	$mds_2 = 0.01$
$I_{1,-1} = 224.75$	$I_{2,-1} = 408.05$	$mdir_1 = 0.01$	$mdir_2 = 0.01$
$id_1 = 0.01$	$id_2 = 0.01$	$MS_{1,0} = 518.12$	$MS_{2,0} = 980.61$
$iir_1 = 0.01$	$iir_2 = 0.01$	$mss_1 = 0.01$	$mss_2 = 0.01$
$ip_1 = 0.01$	$ip_2 = 0.01$	$msir_1 = 0.01$	$msir_2 = 0.01$
$G_{1,0} = 32$	$G_{2,0} = 88$	$IK_{1,0} = 93.52$	$IK_{2,0} = 47.55$
$Y_{1,0} = 396.55$	$Y_{2,0} = 906.83$	$IK_{i,-1} = 93.49$	$IK_{i,-1} = 47.51$
$Y_{1,-1} = 397.75$	$Y_{2,-1} = 907.624$		

within the world economy are functional in the sense of not having an economic crisis.

On the other hand, a national economy in crisis should choose a floating exchange rate or a relatively broader pegging regime because, under these conditions, these regimes proved to assure better economic performances. The experience of Eastern and Central Europe demonstrates that these regimes helped to pass the critical periods while the experience of Argentina was eloquent because this country suffered a dramatic economic crisis under the regime of monetary council anchored to the US dollar.

It seems that the future international monetary system will be one in which euro and US dollar will be the pillars of the system. In the present days, the dramatic variations of exchange rates between these two

TABLE 3 Variables and parameters for the objects $FCM_{1,2}$ and $FCM_{2,1}$

$FCM_{1,2}$	$FCM_{2,1}$	$FCM_{1,2}$	$FCM_{2,1}$
$er^{*}_{1,2} = 1$	$er^{*}_{2,1} = 1$	$xy_{1,2} = 0.01$	$xy_{2,1} = 0.01$
$r_{1,2} \in \{0, 1, 2\}$	$r_{2,1} \in \{0, 1, 2\}$	$xyf_{1,2} = 0.01$	$xyf_{2,1} = 0.01$
$p_{1,2} = 0.02$	$p_{2,1} = 0.02$	$xer_{1,2} = 0.01$	$xer_{2,1} = 0.01$
$er_{1,2,0} = 1$	$er_{2,1,0} = 1$	$xp_{1,2} = 0.01$	$xp_{2,1} = 0.01$
$er_{1,2,-1} = 1$	$er_{2,1,-1} = 1$	$EK_{1,2,0} = 47.55$	$EK_{2,1,0} = 93.52$
$c_{1,2} = 0.01$	$c_{2,1} = 0.01$	$eky_{1,2} = 0.01$	$eky_{2,1} = 0.01$
$CD_{1,2,0} = 141.07$	$CD_{2,1,0} = 141.07$	$ekyf_{1,2} = 0.01$	$ekyf_{2,1} = 0.01$
$CS_{1,2,0} = 141.07$	$CS_{2,1,0} = 141.07$	$eker_{1,2} = 0.01$	$eker_{2,1} = 0.01$
$R_{1,2,0} = 500.00$	$R_{2,1,0} = 1000.00$	$ekir_{1,2} = 0.01$	$ekir_{2,1} = 0.01$
$X_{1,2,0} = 47.55$	$X_{2,1,0} = 93.52$		

TABLE 4 The parameters $reg_{i,j}$ in the case of experiments *EXP*1, *EXP*2 and *EXP*3

*EXP*1	*EXP*2	*EXP*3
$r_{1,2} = 0$	$r_{1,2} = 1$	$r_{1,2} = 2$
$r_{2,1} = 0$	$r_{2,1} = 1$	$r_{2,1} = 2$

TABLE 5 The evolution of world trade under the regimes *FLT*, *FIX* and $CTR_{0.02}$

t	*FLT*		*FIX*		$CTR_{0.02}$	
	$\sum X_t$	$\sum M_t$	$\sum X_t$	$\sum M_t$	$\sum X_t$	$\sum M_t$
$t \in [1, 10]$	1410.63	1410.63	1410.63	1410.63	1410.63	1410.63
$t \in [11, 20]$	1412.26	1412.26	1412.26	1412.26	1412.26	1412.26
$t \in [21, 30]$	1413.32	1413.32	1413.32	1413.32	1413.32	1413.32
$t \in [31, 40]$	1410.89	1410.89	1410.89	1410.89	1410.89	1410.89
$t \in [41, 50]$	1402.94	1402.92	1405.20	1405.19	1402.94	1402.92
$t \in [51, 60]$	1389.88	1389.76	1405.35	1405.34	1400.37	1400.33
$t \in [61, 70]$	1375.84	1375.49	1405.11	1405.09	1398.82	1397.93
$t \in [71, 80]$	1368.75	1368.25	1405.06	1405.05	1400.15	1399.99
$t \in [81, 90]$	1378.43	1378.11	1404.80	1404.79	1399.98	1399.86
Total	12562.95	12561.64	12672.63	12672.55	12649.37	12648.13

currencies have generated negative effects regarding international trade transactions. My opinion is that these problems can be solved by selecting a controlled exchange rates regime with a relatively narrow pegging band.

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Trust and Commitment in Professional Service Marketing Relationships in Business-to-Business Markets

Barbara Čater

This paper examines two very important concepts in marketing relationships – trust and commitment – whereby commitment is regarded as consisting of three components: affective, calculative and normative. The context of this study is professional services in a business-to-business market, more specifically the marketing research industry in Slovenia. The results show that trust in the marketing research provider and its work is very high among interviewed clients. The clients also appear to be affectively committed to the relationship with the provider, whereas calculative and normative commitment are low. The study's results confirm the positive influence of trust on affective commitment and the weak negative influence of trust on calculative commitment.

Key Words: trust, affective commitment, calculative commitment, normative commitment, business-to-business markets
JEL *Classification:* M31, M39

Introduction

In the last 20 years a significant change has occurred in the way companies in business-to-business markets approach their suppliers and buyers (Morris et al. 1998; Håkansson and Snehota 1998; Håkansson et al. 2004). Firms are increasingly looking to have fewer, yet more intense relationships with their partners (Geyskens et al. 1998). In most exchanges in the business-to-business market, achieving a sale is not the completion of a single effort but an event taking place within a broader endeavour to build and maintain a long-term relationship with the customer and ensure that sales keep coming. Therefore, the main research question is what influences the customer's willingness to remain with the existing supplier and further to advance the relationship by investing in strengthening ties with the supplier (Gounaris 2005). Within this broader research stream, trust and commitment are two highly interrelated concepts (Kumar et al. 1995) which stimulate a relational bond between the supplier and the customer.

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Han et al. (1993) found that both buyers and sellers in business-to-business markets see trust as being by far the most important factor of a good relationship. Companies began to realise that in order to be competitive in the market one has to be a trusted co-operator (Morgan and Hunt 1994). The need for trust arises in any supplier-client marketing relationship characterised by a high degree of risk, uncertainty, and/or a lack of knowledge or information on the part of the interacting party (Mayer et al. 1995). This need for trust is particularly important in service industries, where risk and uncertainty are increased to the extent that the client is unable to examine a service before purchase (Parasuraman et al. 1985).

Besides trust, researchers recognise commitment as a central ingredient of establishing and maintaining long-term relationships (Dwyer et al. 1987; Geyskens et al. 1996; Gundlach et al. 1995; de Ruyter and Wetzels 1999; Håkansson and Snehota 1995; Kim and Frazier 1997b; Rylander et al. 1997; Tellefsen and Thomas 2005). Commitment is also one of the most common dependent variables used in buyer-seller relationship studies (Wilson 1995). While researchers agree on the importance of this construct, there are differences in its conceptualisation. Most proposed relationship models in marketing have conceptualised and operationalised commitment as a global construct. However, researchers observing relationships in organisational and social psychology have pointed out three distinct motivations (affective, calculative/continuance and normative) that underlie the desire for continuity (Allen and Meyer 1990; Adams and Jones 1997) and over the last decade some researchers (Kumar et al. 1994; de Ruyter and Semeijn 2002; de Ruyter and Wetzels 1999; de Ruyter et al. 2001; Gilliland and Bello 2002; Gounaris 2005; Bansal et al. 2004; Berghäll 2003; Kim and Frazier 1997a; 1997b; Kelly, 2004) have transferred this framework to marketing relationships. Geyskens et al. (1996) pointed out that using the general expression 'commitment' to describe any of the three very different components creates confusion in the interpretation of theories, models and empirical findings related to commitment. At the same time, it limits our understanding of this problem and the variability of relations between the components of commitment and determinants and consequences of commitment studied in the literature (Kelly 2004; Kim and Frazier 1997b).

Geyskens et al. (1998) in their meta-analysis of studies about trust pointed out that the overwhelming emphasis has been on developing and testing new theory rather than on establishing empirical generalisations. Thus, despite this extensive research no consensus has been established about the relationship between trust and other variables. The purpose of this study is to work towards establishing empirical generalisations by researching the relationship between trust and the components of commitment in professional services in business-to-business markets in a post-transitional economy. Although the relationship between trust and commitment measured as a one-dimensional construct has been over-researched and the results are almost unanimous (Geyskens et al. 1999), relatively little attention has been paid to relationships between trust and the components of commitment. In addition, almost all studies were conducted in the contexts of developed Western countries and there is a lack of studies in transitional or post-transitional economies examining commitment as consisting of three components and relating it to other relationship variables.

Trust and Commitment in Marketing Relationships

Trust is an essential relationship model building block and has often been defined as a belief that one relationship partner will act in the best interests of the other (Wilson 1995). It has also been referred to as the key element of successful relationship development (Naudé and Buttle 2000; Goodman and Dion 2001). Geyskens et al. (1998, 225) on the basis of a meta-analysis of studies about trust pointed out that most studies in marketing build on interpersonal research and define trust as 'the extent to which a firm believes that its exchange partner is honest and/or benevolent' or some variant thereof. Two definitions of trust very often cited are those by Moorman et al. (1992) and Morgan and Hunt (1994). Moorman et al. (1992, 82) define trust as 'a willingness to rely on an exchange partner in whom one has confidence'. According to Morgan and Hunt (1994, 23), trust exists 'when one party has confidence in an exchange's partner reliability and integrity.' Their definition is similar to that proposed by Moorman et al. (1992) except that Morgan and Hunt leave out 'willingness' because they believe it does not add value to the definition. Doney and Cannon (1997, 36) built on social psychology literature and similarly defined trust as the 'perceived credibility and benevolence of a target of trust'.

This study adopts the definition of Moorman et al. (1992) who studied trust in relationships between suppliers and buyers of marketing research services. An important aspect of their definition is the concept of trust as a belief, feeling or expectation about an exchange partner, which can be judged from the partner's expertise, reliability and intentions. This definition reflects two components of trust: credibility and benevolence. Credibility reflects the buyer's belief that the supplier has sufficient expertise to perform the job effectively and reliably. Benevolence reflects the extent of the buyer's belief that the seller's intentions and motives are beneficial to the buyer even when new conditions arise about which a commitment was not made (Ganesan 1994). Geyskens et al. (1998) also pointed out trust in the partner's honesty, which is one firm's belief that its partner is reliable, stands by its word, fulfils its promises and is sincere.

Commitment implies the importance of the relationship to the relationship partners and their desire to maintain the relationship in the future (Wilson 1995). Dwyer et al. (1987, 19) defined it as 'an implicit or explicit pledge of relational continuity between exchange partners'. Moorman et al. (1992, 316) similarly proposed it is 'an enduring desire to maintain a valued relationship'. What is common to the different definitions of commitment is that commitment is characterised by a disincentive to replace relationship partners (Young and Denize 1995).

Researchers have used a 'more is better' approach when studying commitment in marketing relationships (Fullerton 2003) and have focused on the common construct of commitment assuming that it is better for a company to have more committed buyers. This approach works if we define commitment as a construct directed at the identification and attachment that bonds a customer to the company (Morgan and Hunt 1994). However, marketing academics and practitioners now realise that commitment is a complex multidimensional construct that includes numerous components. On the basis of findings from the context of interpersonal relationships and organisational behaviour, Kumar et al. (1994) noted that (attitudinal) commitment consists of different components that have different influences on marketing relationships. These components are: affective commitment, calculative/continuance commitment and normative commitment. All these components of commitment pertain to psychological states but they originate from different motivations for maintaining a relationship (Geyskens et al. 1996). Allen and Meyer (1990) suggested we should understand affective, calculative/continuance and normative commitment as components and not types of commitment because the different levels of each can be present in the relationship between the employee and the organisation.

Affective commitment in marketing relationships, similarly as in the employee-organisation relationship, originates from identification, common values, attachment, involvement and similarity (Bansal et al. 2004; Fullerton 2003; Geyskens et al. 1996; Gruen et al. 2000). Affectively committed customers also continue the relationship because they like the provider and enjoy working with it (Fullerton 2005a; 2005b; Geyskens et al. 1996). On the other hand, *calculative (continuance) commitment* stems from the perceived structural constraints that bind a company to its partners and reflects some kind of negative motivation for continuing the relationship (Geyskens et al. 1996). It presents some kind of constraining force that develops in the presence of high switching costs or a perceived lack of alternative providers and binds the customer to the company out of need (Bansal et al. 2004; Fullerton 2003; 2005). *Normative commitment* reflects a force that binds a customer to the provider due to a perceived obligation (Bansal et al. 2004). Hackett et al. (1994) pointed out that this attitude develops on the basis of the internalisation of normative pressures that are used before or after entering the relationship. People who act morally feel they 'have to' act in a certain way because this is their obligation or duty (Etzioni 1988). Kumar et al. (1994) stated that a normatively committed firm continues the relationship because it feels it should do so due to moral imperatives.

Development of the Hypotheses

Several empirical studies have discovered the positive influence of trust on commitment that was measured as a global construct (Moorman et al. 1992; Morgan and Hunt 1994; Goodman and Dion 2001; Perry et al. 2002; Friman et al. 2002; Lohtia et al. 2005; Rodriguez and Wilson 2002; Tellefsen and Thomas 2005; Walter and Ritter 2003). Because many of the unidimensional conceptualisations of commitment in marketing research contexts have in fact tapped the affective dimension of commitment we already have some evidence that trust might act as a driver of this type of commitment. Researchers who conceptualised commitment with two or three components have discovered the positive influence of trust on affective commitment (Geyskens et al. 1996; Wetzels et al. 1998; de Ruyter et al. 2001; de Ruyter and Wetzels 1999; Wetzels et al. 2000; de Ruyter and Semeijn 2002; Gounaris 2005). Studies have also shown that trust has a positive influence on normative (de Ruyter and Semeijn 2002) and a negative influence on calculative commitment (Geyskens et al. 1996; Wetzels et al. 1998; Wetzels et al. 2000; de Ruyter et al. 2001; de Ruyter and Wetzels 1999; de Ruyter and Semeijn 2002; Gounaris 2005). Trust leads firms to focus on a 'positive' motivation to stay in the relationship because of a feeling of connectedness and identification with each other and less on calculative reasons for staying with the supplier (de Ruyter et al. 2001). With a lack of trust it is unlikely that the partners would be affectively committed (Geyksens et al. 1996). When trust is low, firms more thoroughly examine and monitor the behaviour of their counterpart and probably base their decisions as to whether to continue or end the relationship on the calculation of direct benefits and costs (Geyskens et al. 1996). When trust increases, there are fewer reasons to continue the relationship on the basis of calculative commitment (de Ruyter et al. 2001). Therefore, the following hypotheses are formulated for the relationships between trust and the components of commitment:

H1 *Trust positively influences affective commitment.*

H2 *Trust negatively influences calculative commitment.*

H3 *Trust positively influences normative commitment.*

In the second step we propose relationships between components of commitment in order to test if there is any interaction among these components. Researchers in the area of organizational psychology and marketing relationships have found a positive and strong correlation between affective and normative commitment (Bansal et al. 2004; Kelly 2004; Kumar et al. 1994; Meyer et al. 2002) and a moderate positive correlation between normative and calculative commitment (Kelly 2004; Kumar et al. 1994). On the other hand, researchers have found mixed results regarding the relationship between affective and calculative commitment. While Kelly (2004) found this correlation to be positive, Kumar et al. (1994) found no correlation between these two components. In this study we build on the results of Kumar et al. (1994) and we propose that these two components of commitment are not correlated. Therefore, the following hypotheses are proposed for the relationships between the components of commitment:

H4 *Affective and normative commitment are positively correlated.*

H5 *Affective and calculative commitment are not correlated.*

H6 *Calculative and normative commitment are positively correlated.*

Research Design

OPERATIONALISATION OF THE VARIABLES AND DATA GATHERING

Variables for the model were operationalised on the basis of operationalisations from past research with some modifications and developments based on nine in-depth interviews with clients of marketing research providers conducted in the exploratory phase in November 2004–January 2005. Commitment was measured on the scale of Kumar et al. (1994) for three components of commitment that was developed on the basis of Allen and Meyer's (1990) scale drawn from organisational psychology. Trust was operationalised with the modification of scales proposed by Moorman et al. (1992), Doney and Cannon (1997) and Gounaris and Venetis (2002). Respondents were asked to express their agreement with a given statement using a seven-point Likert-type scale (from 1 – not at all true, to 7 – completely true). All variables except two were measured in a positive direction. Two variables for trust that had a negative direction were reversely scored in the further analysis. After a scale refinement in line with five experts' opinions the questionnaire was tested on ten members of the population.

The context of this study is the marketing research industry in Slovenia. The context of marketing research was chosen because it provides a good representation of professional services and includes a wide continuum of marketing relationships from transactions to partnerships, therefore providing the desired variability of relationships (Tellefsen and Thomas 2005). Data were gathered from managers who are responsible for marketing research in each of the client firms. In order to ensure variability in the marketing relationships included in the survey the respondents evaluated their relationship with the agency that carried out their most recent research project, as in the Moorman et al. (1992) research. They were instructed to answer questions about the specific relationship and to keep in mind not only the last research but also the entire relationship they had experienced with that provider. The sample framework included 230 companies that were clients of marketing research agencies. Data collection started in March 2005, and by the end of July 2005, 150 telephone interviews had been completed so the response rate was 65.2% (Churchill and Iacobucci 2005).

DATA ANALYSIS

The set of items for each construct was initially examined using exploratory factor analysis (varimax rotation) to identify items not belonging to the specified domain. Items with a loading of less than 0.55 and/or cross-loadings greater than 0.35 were discarded. Exploratory factor analysis revealed four components (eight variables loaded on the trust component, four on affective commitment, three on normative commitment and two on calculative commitment). To present the results of clients' trust and commitment, univariate statistical analyses of variables (the calculation of arithmetic means and standard deviations) were performed (tables 1, 2, 3 and 4). Data were analysed using the SPSS 13.0 statistical package.

Further, to test the proposed hypotheses, confirmatory factor analysis was performed and a structural model (with trust as an exogenous variable and components of commitment as endogenous variables) was tested. The analysis was carried out using the LISREL 8.72 statistical package. During confirmatory factor analysis we trimmed the model by discarding items for each construct where necessary in order to ensure the best fitting model. In the final model there were four measurement variables for trust, four measurement variables for affective commitment, three measurement variables for normative commitment and one measuring variable for calculative commitment. The only problematic variable was calculative commitment, where we decided to use only one indicator that had the highest average value as a representative measure of this construct. The goodness-of-fit indices for the CFA were within an acceptable range. The model has a statistically significant value of chi-square ($\chi^2 = 69.38$, $df = 49$, $p = 0.029$), but the proportion between the chi-square value and degrees of freedom ($\chi^2/df = 1.42$) is within an acceptable range. Other measures of absolute fit (the root mean square of error of approximation (RMSEA) = 0.053, the standardized root mean square residual (SRMR) = 0.065 and GFI = 0.928) indicated an acceptable fit, as well as incremental fit measures (NFI = 0.944, NNFI = 0.975, AGFI = 0.885) and parsimonious fit measures (CFI = 0.981) (Bollen 1989; Hoyle 1995). We then tested the item and construct reliability (table 5). All items were reliable and all values for composite reliability were above the critical limit. According to a complementary measure for construct reliability, average variance extracted, all constructs demonstrated good reliability. Further, both convergent and discriminant validity (assessed by the procedures proposed by Anderson and Gerbing 1988) were supported.

Results

SAMPLE CHARACTERISTICS

The majority of companies that responded to the questionnaire were providers of business services (24.7%), followed by manufacturing (23.3%) and trade companies (22%). The rest were providers of services for consumers (12.7%), services for both companies and consumers

(11.3%), while 6% came from other industries. Altogether, 40.7% of the companies had up to 50 employees; there were 24.7% of companies with 101–500 employees and 21.3% of companies with over 501 employees, while there were fewer companies with 51–100 employees (13.3%). Among the studied relationships (with the agency that performed the last research project) most relationships are two to four (42.2%) and five or more (42.2%) years old. There are 15.6% of relationships that had lasted up to two years. The average duration of a relationship is 4.4 years. We also examined what is the value share of projects done by this provider among all research projects carried out with outside suppliers of marketing research. The average value share of research projects conducted by the studied agency is 76.1%. This means that the majority of respondents had described their relationship with their most important provider of marketing research.

TRUST

Respondents on average indicated a high level of trust in the research agency (table 1). They more than agreed that they can trust that the research agency will execute research with methodological rigour (mean 6.35; standard deviation 0.93), that it will keep their data confidential (mean 6.32; standard deviation 0.88) and that it will plan research with expertise (mean 6.05; standard deviation 1.03). These results show that clients see their provider as credible. They also trust in the agency's honesty (mean 5.93; standard deviation 1.38), that it provides them with credible information (mean 5.85; standard deviation 1.03) and that it keeps its promises (mean 5.72; standard deviation 1.25). However, it seems that the high level of trust is partly a consequence of clients' involvement in the research process. Respondents indicated somewhat less agreement with the statements that they would be willing to let the researcher make important decisions without their involvement (mean 5.56; standard deviation 1.28) and that they trust the researcher would do the job correctly if not monitored (mean 5.61; standard deviation 1.24). One possible explanation here could be that the clients are not completely convinced of the providers' benevolence.

COMPONENTS OF COMMITMENT

The respondents on average rated the variables measuring affective commitment the highest of all the components (table 2). They expressed the greatest agreement with the statement that they continue to work with

TABLE 1 Descriptive statistics for variables measuring trust

Variable	Mean	Std. dev.
If I or someone from my department could not be reached by our researcher, I would be willing to let my researcher make important research decisions without my involvement (trust1).	5.56	1.28
If I or someone from my department were unable to monitor my researcher's activities, I would be willing to trust my researcher to get the job done right (trust2).	5.61	1.24
I can trust that the agency will plan the research with expertise (trust3).	6.05	1.03
I cannot trust that the agency will execute research with methodological rigour (R) (trust4).	6.35	0.93
I can trust that the agency will keep our data confidential (trust5).	6.32	0.88
This agency keeps the promises it makes to our firm (trust6).	5.72	1.25
This agency is not always honest with us (R) (trust7).	5.93	1.38
We believe in the information that this agency provides us with (trust8).	5.85	1.03

NOTES Variables trust4 and trust8 were reversely coded. The results pertain to the reversely scored item.

the agency because it is pleasant working with them (mean 5.52; standard deviation 1.32), followed by staying with this agency because they genuinely enjoy their relationship (mean 4.83; standard deviation 1.56), because they are attracted to the things the agency stands for as a company (mean 4.77; standard deviation 1.54), and because they like working with the company (mean 4.63; standard deviation 1.58). For all the measured variables of affective commitment the mean scores are above 4, which means that the respondents have on average more than a neutral attitude to the statements.

On the other hand, the calculative commitment in the examined relationships was relatively low (table 3). Respondents on average rated statements expressing calculative commitment between 'not at all true' (1) and 'partly not true' (3). Of two calculative commitment variables that were retained in the analysis they on average indicated the greatest agreement with the statement that they stay with this research agency because it is too difficult to change it due to a lack of good alternatives (mean 3.02; standard deviation 1.93). To a lesser extent, they agreed that they continue the relationship due to necessity, since no feasible alternatives exist (mean 2.31; standard deviation 1.93).

The respondents indicated an even lower normative commitment to

TABLE 2 Descriptive statistics for variables measuring affective commitment

Variable	Mean	Std. dev.
It is pleasant working with the agency, that's why we continue to work with them (acom1).	4.59	1.52
Our decision to remain a client of this company is based on our attraction to the things the agency stands for as a company (acom2).	3.82	1.60
We want to remain a client of this agency because we genuinely enjoy our relationship with the agency (acom3).	3.63	1.56
Because we like working with the agency we want to remain their client (acom4).	3.65	1.60

TABLE 3 Descriptive statistics for variables measuring calculative commitment

Variable	Mean	Std. dev.
Right now, staying with the agency is a matter of necessity since no feasible alternatives exist (ccom1).	3.28	2.24
It is too difficult to switch to another agency because of the lack of good alternatives; therefore we are staying with the agency; otherwise we'd consider leaving (ccom4).	3.10	2.21

TABLE 4 Descriptive statistics for variables measuring normative commitment

Variable	Mean	Std. dev.
Employees who work with the agency would feel guilty if we dropped them as a supplier (ncom1).	1.77	1.09
We feel a sense of duty to remain a client to this agency (ncom2).	2.05	1.24
Even if it were to our firm's advantage, we feel it would be dishonourable if we were to leave the agency (ncom4).	1.71	1.10

their research providers (table 4). On average, they did not agree that they continue to work with this provider because they feel a sense of duty to do so (mean 2.34; standard deviation 1.51) and that employees who work with this agency would feel guilty if they dropped them as a supplier (mean 2.28; standard deviation 1.54). The lowest level of agreement was expressed with the statement that it would be dishonourable if they were to leave the agency even if it were to their firm's advantage (mean 1.79; standard deviation 1.17).

HYPOTHESES TESTING

The final structural equation model includes the exogenous latent variable trust and endogenous latent variables affective, calculative and normative commitment. With the exogenous variable trust we can explain

45.0% of the variance in affective commitment, 5.83% of the variance in the normative commitment and only 1.15% of the variance in calculative commitment. Affective commitment is therefore relatively well explained by the independent variable, while calculative and normative commitment are not. The fit indices for the overall model are within an acceptable range. Like with the measurement model, the structural model also has a statistically significant value of the chi-square test ($\chi^2 = 79.96$, $df = 49$, $p = 0.008$), but the proportion between the chi–square value and degrees of freedom is within an acceptable range ($\chi^2/df = 1.63$). All other relevant fit indices are also within an acceptable range (RMSEA = 0.060; standardised RMR = 0.084; GFI = 0.918; AGFI = 0.877; NFI = 0.937; NNFI = 0.970; CFI = 0.976). The analysis with LISREL revealed, that among components of commitment, trust positively influences affective (standardised coefficient 0.67) and normative commitment (standardised coefficient 0.24), while it has no statistically significant effect on calculative commitment (standardised coefficient –0.11). H1, H2 and H3 are therefore supported.

Results revealed a positive correlation between affective and normative commitment (standardised coefficient 0.35), while there was no statistically significant correlation between affective and calculative commitment (standardised coefficient –0.10) and normative and calculative commitment (standardised coefficient 0.11). H4 and H5 are therefore supported, while H6 is not supported.

Conclusions and Implications

The purpose of this paper was to work towards establishing empirical generalisations by researching the relationship between trust and the components of commitment in professional services in business-to-business markets in a post-transitional economy. First, trust and commitment were examined and then relationships between trust and components of commitment and relationships among the components of commitment were tested. The results show that trust in research providers in the examined context of Slovenia is high. Clients on average believe their research providers are credible (have sufficient expertise to perform the job effectively and reliably) and benevolent (the provider's intentions and motives are beneficial to the client). These results are in line with findings from the in-depth interviews with clients. Since the results of marketing research projects are used as an input for decision-making, and due to the high degree of risk and uncertainty connected

TABLE 5 Overall CFA for the modified measurement model ($n = 150$)

Construct and indicators	(1)	(2)	(3)
Trust (exogenous variable)		0.85	0.62
I can let my researcher make important research decisions without my involvement (trust1).	0.88 (12.91)	0.78	0.22
I would be willing to trust my researcher to get the job done right without monitoring (trust2).	0.81 (11.31)	0.65	0.35
I can trust that the agency will plan the research with expertise (trust3).	0.66 (8.65)	0.44	0.56
We believe in the information that this agency provides us with (trust8).	0.71 (9.56)	0.51	0.49
Affective commitment (endogenous variable)		0.85	0.59
It is pleasant working with the agency, that's why we continue to work with them (acom1).	0.76 (10.30)	0.57	0.43
Our decision to remain a client of this company is based on our attraction to the things the agency stands for as a company (acom2).	0.72 (9.56)	0.51	0.49
We want to remain a client of this agency because we genuinely enjoy our relationship with the agency (acom3).	0.85 (12.18)	0.72	0.28
Because we like working with the agency we want to remain their client (acom4).	0.76 (10.30)	0.57	0.43
Calculative commitment (endogenous variable)		1.00	0.00
It is too difficult to switch to another agency because of the lack of good alternatives; therefore we are staying with the agency; otherwise we'd consider leaving (ccom4).	1.00	1.00	0.00
Normative commitment (endogenous variable)		0.77	0.54
Employees who work with this agency would feel guilty if we dropped them as a supplier (ncom1).	0.72 (8.66)	0.52	0.48
We feel a sense of duty to remain a client to this agency (ncom2).	0.90 (10.78)	0.80	0.19
Even if it were to our firm's advantage, we feel it would be dishonorable if we were to leave the agency (ncom4).	0.55 (6.54)	0.30	0.70

NOTES Table columns are as follows: (1) completely standardized loading (t-value); (2) construct and indicator reliability, (3) variance extracted and error variance.

to this kind of purchase, clients stressed trust as the key element of the relationship with the marketing research provider. They also named the absence of trust as one of the main reasons for discontinuing a relationship. Therefore, we can assume that clients continue to work only with the providers they trust. Moorman et al. (1992) similarly concluded that trust is one of the most important factors influencing the use of marketing research because it decreases the perceived uncertainty and vulnerability connected to the use of marketing information.

Results on commitment revealed that the clients of marketing research agencies continue their relationship with their providers mostly for affective reasons (feeling good in the relationship), while calculative (seeing no alternatives) and normative (feeling obligation to stay) reasons do not play an important role. The research also shows that calculative and especially normative commitment levels are very low among the majority of companies. These results are in line with the findings from the in-depth interviews. The interviewed clients indicated that they continue relationships due to affective reasons; calculative reasons are less present, while they feel no normative/moral commitment to their research provider. These results also coincide with results from other developed Western contexts where the majority of researchers only studied affective and calculative commitment and did not even include normative commitment in their models. Meyer and Allen (1997) pointed out that normative commitment could be stronger than affective commitment in collectivistic cultures that stress strong social bonds and obligations and in cultures with high uncertainty avoidance and where loyalty is an important value. The majority of studies of the components of commitment were carried out in developed Western cultures that do not have these characteristics, which can explain why this construct does not appear in the majority of commitment models.

The findings concerning the relationships between the components of commitment are mostly in line with the results in other contexts. We supported the hypothesis about positive correlation between affective and normative commitment; however, in our case this correlation was weak, while other studies (Bansal et al. 2004; Kelly 2004; Kumar et al. 1994; Meyer et al. 2002) found a moderate to strong correlation between these two constructs. In line with the proposed hypothesis there was no correlation between affective and calculative commitment, which is in line with Kumar et al. (1994), but contrary to Kelly (2004). Lastly, in line with Kelly (2004) and Kumar et al. (1994) we proposed a positive correlation between normative and calculative commitment, while the results show this correlation is not statistically significant. Since we measured only motivation to continue the relationship due to lack of alternatives (variables measuring calculative commitment based on switching costs had to be discarded during exploratory factor analysis), our results pertain only to that part of calculative commitment and are therefore not directly comparable to results of those past studies that included both.

The findings concerning the relationships between trust and affective commitment are in line with the results of studies performed in the contexts of developed countries that discovered the positive influence of trust on affective commitment (Geyskens et al. 1996; Wetzels et al. 1998; de Ruyter et al. 2001; de Ruyter and Wetzels 1999; Wetzels et al. 2000; de Ruyter and Semeijn 2002; Gounaris 2005) and on commitment that was measured as a global construct implicitly tapping the affective dimension (Moorman et al. 1992; Morgan and Hunt 1994; Goodman and Dion 2001; Perry et al. 2002; Friman et al. 2002; Lohtia et al. 2005; Rodriguez and Wilson 2002; Tellefsen and Thomas 2005; Walter and Ritter 2003). The outcomes also confirm the proposed positive influence of trust on normative commitment (de Ruyter and Semeijn 2002). On the other hand, the results do not confirm the proposed negative influence of trust on calculative commitment that was found by researchers in the context of developed countries (Geyskens et al. 1996; Wetzels et al. 1998; Wetzels et al. 2000; de Ruyter et al. 2001; de Ruyter and Wetzels 1999; de Ruyter and Semeijn 2002; Gounaris 2005). In our research this influence was too weak to be statistically significant. The reason could again be in the earlier explained measuring of calculative commitment. The results of this study therefore add towards establishing empirical generalisations about trust and commitment by indicating that the relationship between trust and the components of commitment in professional services in the examined post-transitional economy is similar to that in the cultures of the developed Western economies. The only hypothesis that was not supported is about the relationship between trust and calculative commitment. Therefore, we cannot claim that a higher degree of trust in a relationship leads to a lower degree of motivation to continue relationship due to lack of alternatives.

Besides theoretical implications, this study also offers implications for marketing research providers. Since clients place a very high level of importance on the credibility, benevolence and honesty of the research providers they work with, we could say these factors can literally make or break a relationship. Marketing research firms should therefore continue to provide quality and reliable services that clients can trust; they should be sincere and fulfil promises. Providers should also convince clients of their benevolence so that clients would not feel they have to monitor the research process so closely. Regarding the components of commitment, trust leads to a high level of affective commitment or, in other words, a strong desire to maintain a relationship. Researchers (Kumar et al. 1994; Gounaris 2005; Wetzels et al. 1998) found that the consequences of affective commitment are superior to the consequences of calculative and normative commitment. While affective commitment creates positive intentions that help to maintain and strengthen relationships, calculative commitment has just the opposite effects on behavioural intentions. Creating affective commitment is therefore the most important because it has the strongest effect on the customers' intentions to continue the relationship and consequently on the provider's revenues. Managers of marketing research providers should keep this in mind when crafting their firms' approach to marketing strategy.

This study shows only one part of the whole picture and many opportunities thus exist for future research. Since there are other factors that influence the development of relationship commitment (e. g. satisfaction, social ties, co-operation, communication etc.), future research should relate those factors within the framework and test their relationships with the components of commitment. Special attention should also be paid to examining the antecedents of calculative and normative commitment because trust, as one of the most important relationship factors in professional services, apparently does not play a major role in their development. In addition, scales for measuring these two constructs should be further refined. Last but not least, this framework could be tested in other contexts of professional services in the Slovenian market or in another post-transitional or transitional economy to see if differences exist compared to developed economies that have not undergone major changes in the past few years.

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Intercultural Competence in Work: A Case Study in Eastern Finnish Enterprises

Pirkko Pitkänen

This paper presents the research results of a study that focused on intercultural interaction issues in private sector workplaces in Eastern Finland. The results show that the current challenges caused by the globalisation pressures in the realm of economics behoves work communities to review their personnel training and management practices: the work communities as a whole should be helped to deal with increasing cultural diversity. Although the number of workers with foreign backgrounds has increased in Eastern Finland, so far, there have been only a few attempts to restructure the working practices in an effort to take into account the demands of increasingly diverse working contexts. In all participating companies the mainstream people were the norm. It was common that Finnish language proficiency was seen as a necessary but not yet sufficient qualification for work. In addition, knowledge of the practices of Finnish working life, as well as training and working experience acquired in Finland were desired.

Key Words: cultural diversity, intercultural competence, private sector work, East Finland

JEL *Classification:* F, A

Introduction

It is obvious that the large-scale international movement of labour is one of the future challenges caused by the globalisation pressures in the realm of economics. Peter Koehn (2006, 22) writes: 'Looking forward the future, the most likely population scenario will involve more people, more population movement, more displacement – both internally and internationally . . .' (see also Helton 2002, 14). Labour migration, in particular, is becoming increasingly global due to the economic restructuring which is making hanging onto a job everywhere precarious (Portes, Guarnizo, and Landolt 1999, 227). On the other hand, in many Western countries, an ageing population means that there will be a shortage of labour. A cross-border movement of labour provides many opportunities but it also entails many challenges. In work communities, the emergence of national and cultural diversity may lead to divergent working practices and

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provoke confusing or even conflicting interaction situations. This paper seeks to provide empirically validated knowledge that is needed to enhance prerequisites for successful intercultural interaction in culturally diverse workplaces.

The everyday experiences of intercultural work will be reported by the managers and personnel of ten Eastern Finnish private sector enterprises. Eastern Finland represents a traditionally ethno-culturally homogeneous region currently characterized by increasing multinational economic collaboration and international mobility of labour: today the companies are finding themselves more and more involved in situations where people from diverse national and/or cultural backgrounds and speaking different languages are working side by side. Demographic pressures have an important part to play here. It is expected that by the end of the current decade an insufficient work-force will be a real problem in Finland as the baby boomer generations born after World War II reach the age of retirement (Forsander 2002; Forsander et al. 2004). It is anticipated that this generational shift will take place in Finland earlier than in other European countries, and in eastern (and northern) parts of Finland earlier than in the rest of the country.

Even now, many Eastern Finnish companies are increasingly seeking qualified professionals from abroad in order to replace ageing employees. According to a survey focusing on the experiences of intercultural work among private sector managers (Pitkänen and Atjonen 2002; 2003),[1] almost half of the Eastern Finnish managers estimate that there will be a need for targeted foreign labour force recruitment by the end of the present decade. The survey also revealed that today the Eastern Finnish private enterprises are typically rather monocultural by nature. It was quite uncommon for a company to employ foreign personnel. On the other hand, quite a number of enterprises did have diverse and extensive international co-operation.

At the same time as the recruitment of foreign labour is seen as a partial solution to finding qualified workers, about 40 percent of the immigrants living in the eastern parts of Finland, especially refugees and so-called ethnic return migrants from the former Soviet Union,[2] are unemployed (Pitkänen and Atjonen 2002; Pitkänen and Hacklin 2005). Moreover, it has been observed that if immigrants do find employment, they are likely to be placed in the lower echelons of the labour market hierarchy. Advancing to a job that corresponds to one's education and work experience is especially difficult for first generation immigrants who suffer from a lack of Finnish language proficiency and the cultural competencies needed in Finnish working life. (Forsander and Alitolppa-Niitamo 2000; Forsander 2002; Pitkänen and Hacklin 2005.)

Despite the increase in the number of foreign residents in Finland, very little is known about how to learn to work together with people from other countries (and cultures), and how the employees of foreign origin can be helped to adapt to their new work environments. The way intercultural interaction and collaboration succeeds is of central importance in striving to alleviate the impending labour shortage by making use of the human potential, both of the foreigners who are already in the country and of those recruited from abroad. It has become apparent that the increase in cultural diversity is giving way to work environments in which the training and management practices of the past no longer function. This paper presents a study focusing on the recognition of cultural diversity in working contexts, and on the current needs for personnel training in enhancing intercultural competence in work. The key question addressed was as follows: What kind of experiences and attitudes are there among private sector managers, human resource management (HRM) personnel, and employees of foreign or Finnish background towards cultural diversity in the work community? I will start by introducing the context of the study and by discussing the different dimensions of intercultural competence. Then I will introduce the research procedure and the main research results. Finally, the discussion section will summarise the paper.

The Context of the Study

In order to understand the research context, it is crucial to remember that when other Western European countries, from the 1950s to the 1970s, attracted labour migrants to their factories and later on into the service sector, Finland was virtually untouched by immigration. However, since the 1990s, the relative number of immigrants has increased in Finland more rapidly than in any other Western European state. (Paananen 1999, 46; Lepola 2000, 23–24.) While in the middle of the 1970s the total number of foreign citizens living in Finland was around 10,000, at the end of 2006 the number was almost 122,000. Only eight percent of all the foreign residents in Finland are living in the eastern provinces (North and South Karelia, North and South Savo, and Kainuu), whereas around half of them have settled in or near the Helsinki area. Accordingly, while the percentage of foreign citizens in the whole population in Helsinki is eight, in the eastern regions it is only one (in the whole country the percentage is almost three). (Pitkänen and Hacklin 2005; see the Population Register Centre web site, http://www.vaestorekisterikeskus.fi.)

Not only has the number of immigrants changed but also the policy regarding their reception. Until the late 1990s, the predominant ideology underlying the Finnish immigration policy was *assimilationist,* with the expectancy that members of ethnic minority groups should become culturally absorbed and be indistinguishable from the mainstream of Finnish social and cultural life. In recent years, the general principles of the Finnish system for receiving immigrants have undergone a significant change. In 1997, the Finnish government ratified the Programme on Immigration and Refugee policy. According to the programme, *pluralism* is being viewed as the goal for integrating foreign newcomers. This implies that while sharing the values and norms of the mainstream culture foreign residents should have an opportunity to maintain and develop their own cultural characteristics. At the same time, they should have equal opportunities to participate in the economic and social life of the host society. (Matinheikki-Kokko and Pitkänen 2002, 48–73; see the Finlex web site, http://www.finlex.fi.)

So far, immigration to Finland has mainly come through marriage, humanitarian reasons, or the so-called ethnic return migration, whereas labour migrants have made up a significantly smaller group than in most other industrialized countries. However, an ageing population means that there are demands for labour force which can partially be met by work-related migration. This has created a need to revise Finnish immigration policy. In October 2006, the Finnish Government approved a new Immigration Policy Programme. The purpose of the programme is to actively promote work-related immigration, in particularly from outside the European Union and European economic area. The programme also emphasises the utilisation of the existing labour force in conjunction with the development of work-related immigration policy. Moreover, politics of difference have been introduced in which people's rights to their ethnicity, cultural heritage and language are part of everyone's human rights. The aim is to promote the development of a pluralistic, multicultural and non-discriminatory society (see the Ministry of Labour web site, http://www.mol.fi).

Likewise in Eastern Finland, targeted foreign labour recruitment is arriving on the public agenda (see the Regional Council of Pohjois-Savo region web site, http://www.pohjois-savo.fi). All the eastern provinces, North Karelia, South Karelia, North Savo, South Savo and Kainuu, are located near the Russian border. Accordingly, the largest group of immigrants consists of people of Russian background; more than half of the foreigners living on the area are Russian-speaking. Most of them have come to Finland for family reasons, or they are Ingrians and thus regarded as returnee migrants. Other newcomers are of Estonian and Swedish origin (mostly returnees), or humanitarian migrants coming mainly from Iraq, Bosnia-Herzegovina, or Afghanistan. (See the Register Office web site, http://www.maistraatti.fi; Pitkänen and Hacklin 2005.)

Regarding the forthcoming demographic shift in Eastern Finland, the age structure among the foreigners living in the area is very auspicious: the share of working age population (15–64 years) is almost 80 percent. Besides, their educational background is in many cases very good: many of them have university degrees or intermediate grade qualifications. Even so, almost half of them are unemployed. Immigrants of Russian origin form the largest group of jobseekers: in 2004 more than half of all job applicants were Russian-speaking immigrants. (Pitkänen and Hacklin 2005.)

According to Pitkänen and Atjonen (2002) the main stumbling blocks in the employment of foreigners can be found at the attitudinal level. The above-mentioned survey among Eastern Finnish managers showed that, although the managers' experiences of foreign employees were mainly positive, negative experiences and attitudes were also expressed, mainly with reference to Russian-speaking employees. The most favoured groups of foreigners for employment include migrants from Scandinavian or Western European countries, Estonia or the US, while employees with Russian or African backgrounds were the least welcome. (Pitkänen and Atjonen 2002, 37–43.)

Learning to Become Interculturally Competent

In studying the challenges caused by cultural diversity at work, we need to be able to understand what processes come into play when people with different cultural backgrounds interact with one another. It is obvious that intercultural interaction as an everyday experience requires special competence to manage anxiety caused by cultural differences in interaction with people who see the world from perspectives which may be different or even in conflict with one's own personal values and beliefs. Firstly, a necessary, though insufficient, ingredient of intercultural competence is the acquisition of cultural[3] knowledge. Knowledge is a form of cultural capital, and its possession empowers. One of the greatest resources and sources of empowerment is access to the kind of knowledge that is culturally accurate and has instrumental value when put into practise.

Further, in a culturally diverse environment, there is a need for critical self-reflection. This entails familiarity with foreign cultures, but also an awareness of one's own cultural starting points. Culture can be regarded as a mental set of windows through which all of life is viewed. It varies from individual to individual within a cultural context, but shares important characteristics with its members. In particular, culture is not something we are born with, but rather it is *learned.* If culture is learned, then it is also *learnable.* Much of what is learned about one's own culture is stored in mental categories that are recalled only when they are challenged by something different. But how do the windows differ from culture to culture? The following question arises: How can an outsider learn to recognise what is essentially transparent to the individual member of a culture? (Beamer and Varner 2001, 3.)

Jack Mezirow (1991) states that a process of questioning basic cultural assumptions and habitual expectations is possible by examining why and how we constrain the way we see ourselves and other people. This self-reflection can result in altered meaning perspectives. This kind of change or revised interpretation of cultural ways is often the result of efforts to understand different cultures with customs that contradict our own presuppositions. When we have an experience which cannot be assimilated into our meaning perspectives, either the experience is rejected or the perspective changes to accommodate the new experience. When we change significant meaning structures, i. e., our meaning perspectives, we change the way we view, and act toward, the world. Mezirow believes that this process may lead to a more inclusive world view. (Mezirow 1991, 168; see also Taylor 1994.)

Although necessary, the awareness of cultural multiplicity and diversity is not yet sufficient for true intercultural competence, but these skills have to be underscored by ethical consideration and cultural sensitivity. To achieve all this, there is a need for intercultural dialogue in which the reasonableness and validity of different life forms are being judged and examined. (Bennett 1995, 259–265.) Intercultural encounters are by their nature phenomena which contain numerous variables and are difficult to predict. These often include the ability for managing anxiety caused by cultural differences in interaction with colleagues who see the world from perspectives which may be different from or even in conflict with one's own personal values and beliefs.

Research Procedure

The study presented here focused on ten Eastern Finnish private sector enterprises with personnel from different ethnic backgrounds.[4] The general character was a qualitative *case study* approach to attain an understanding of the characteristics of intercultural encounters in work. The group of respondents consisted of managers and HR managers ($n = 13$),[5] as well as of employees of foreign origin ($n = 14$) and their Finnish colleagues ($n = 11$). The relations between employees and their supervisors were a focus of examination, along with peer relations among employees.

The research data were gathered in 2003–2004 through semi-structured interviews in two large, five middle size and three small companies.[6] The participating workplaces represented industrial and service branch enterprises (catering business, supermarkets). The foreigners working in the companies were mainly of Russian origin. The list of other countries of origin included mainly European (Poland, Romania, Ireland, Italy, the Netherlands) and African (Ghana, Somalia) countries. The number of foreign personnel in the companies taking part in the study varied between 1 and 7.

The interviewing style was structured when answers were sought to common questions covering the experiences, attitudinal engagement and activities of the respondents. The respondents, however, were encouraged to express themselves freely while the general direction and shape of the interviews was maintained. The key questions addressed were as follows: What are the goals and prevailing practices of the company's strategy for managing cultural diversity? What are the experienced and expected advantages and challenges related to the increase in national/cultural diversity? Further, in order to find out how different actors in the work environments can learn to become interculturally competent, I aimed to discover what kind of culturally based conceptions and practices the participants of diverse intercultural encountering situations adhere to. Have they experienced culturally conflicting situations? What are the origins of these conflicts? How have the conflict situations been (or should have been) solved? The final aim was to find out what kind of personnel training would be needed in order to attain the intercultural competence relevant in culturally diverse private sector workplaces.

Experiences of Intercultural Work

In this present study, language difficulties and communication issues in general appeared to be the factors most clearly complicating the daily interaction and collaboration in culturally diverse companies, especially in small and middle size customer services. Some managerial respondents were also afraid of intercultural misunderstandings, as customers had complained of the poor Finnish language skills by employees of foreign origin. On the other hand, they appreciated the ability of foreign personnel to use their mother tongues; e. g., the employees of Russian background were used as interpreters and translators. Moreover, for the service branch, questions like politeness, etiquette, hierarchy, and so on, appeared to be the major challenges (cf. Hofstede, 1997), while in the large industrial companies used to operating in wide international contexts the workers' familiarity with foreign countries was seen as an entirely valuable asset. These companies had lots of experiences of foreign personnel and were used to dealing with intercultural communication issues in their day-to-day work. As the following quotation shows, etiquette or other formality issues did not cause any major problems:

> What comes to mind is that often your first association on these multicultural issues is the etiquette. Are you allowed to bow now and nod and shake hands and what kind of flowers and everything, so all that has like lost its meaning.
>
> *Male* HR *manager, large industrial enterprise*

Still, among employees of foreign background, politeness and hierarchy were felt to be confusing in the relations between managers and their subordinates. Knowing when it was appropriate to address the managers formally was especially difficult for many newcomers; they were not used to calling their superiors by their first names. A position where the superior was a female person was embarrassing to those male employees originally from countries with different gender roles than in Finland. In some cases, male employees had felt it was difficult to work under female managers.

Although in some cases the use of religious symbols had caused confusion, most respondents estimated that different religious backgrounds did not have any special effects on the everyday collaboration. Instead, headaches often mentioned were the adherence to given schedules and the conceptions of time in general (cf. Hampden-Turner and Trompenaars 2000, 295–343; Trompenaars 1995, 21–28). Further, the employees' attitudes towards hygiene had caused trouble for managerial respondents; in some cases, foreign employees were characterized as untidy. On the other hand, those managers who had been living abroad might evaluate the excessive cleanliness among Finnish personnel very critically. A manager (catering business) who had been working abroad for several years was disturbed by the excessive cleanliness of employees of Finnish origin: 'In Finnish restaurants we have some kind of cleaning mentality. Like, I should clean this place! So I have said that Finnish people are too much dish-oriented while they should be client-oriented.'

Almost all the managerial representatives of the participating companies highlighted the importance of adapting the proficiency of foreign labour to fit into Finnish working life. Many of them seemed to have suspicions of foreign qualifications and exams. As a consequence, in almost all companies taking part in the study the employees of foreign origin were over-qualified for their present tasks. Some kind of mistrust indicates the fact that, in almost all cases, the foreign workers had started their work as trainees. These research results concur with earlier studies conducted in Finland. According to the studies carried out by Paananen (1999), Forsander and Alitolppa-Niitamo (2000), Forsander (2002), and Pitkänen and Atjonen (2002), the market-value of work experience and education acquired abroad is rather low in Finland. Instead, working experience attained in Finland is very valuable when trying to convince an employer of the adequacy of a foreigner. Thus, as Forsander and Alitolppa-Niitamo (2000) stress, training jobs and other 'entry jobs' are very important first steps in the career of a foreigner: in order to obtain employment that corresponds to his/her education and previous work experience a foreigner needs to acquire working experience attained in Finland.

However, there is a high risk that these 'entry jobs' will become permanent. Also in the present study, some employees of foreign origin reported such experiences. Some of their comments were very critical; especially employees originally from Western European countries were very dissatisfied with their careers. These persons had come to Finland for family reasons, and were not different from Finns in external appearance. Nevertheless they had experienced discrimination or even racism either in their workplaces or in Finnish society. A male employee from the Netherlands characterised his experiences as 'racism you cannot see but you can feel'. His frustration was exacerbated by the fact that the company had hardly ever utilised his language skills, education or previous work experience. Another male respondent, originally from Italy, complained that after working in the same company for twenty years he advised and counselled his younger Finnish colleagues, but still got a lower salary than those youngsters who just had graduated. He was bitter when a Finn, who had been working in the company for a much shorter time than he, was chosen as his new boss. Actually, it appeared that in many cases a Finnish worker was seen as a model for a good employee, and a foreign employee was supposed to be like a Finn (cf. Paananen 1999, 127; Alasuutari and Ruuska 1999, 199–214; Anttonen 1998). No wonder that some newcomers tried to be more Finnish than their Finnish colleagues. This was especially common among Ingrians, who often look like Finns and can speak Finnish. Further, these respondents believed that also other foreigners should assimilate into the Finnish way of life.

When the managerial respondents assessed foreign personnel they often accentuated 'proper' *[oikea]* personal characteristics and a 'proper' attitude toward the work. When they used the word 'proper', they referred to an ethnically Finnish person: to something normal and natural, to something that required no further explanations:

> The attitude must be proper. Must be properly oriented at attitudinal level, meaning that you truly want to work.
>
> *Male manager, medium-sized department store*

Edward Hall points out in his book *Beyond Culture* (1977) that the closer something is to seeming true, the less aware we probably are of its cultural origin. Our own culture seems normal to us; it is just the way things are. Here seems to be hidden a major challenge for the participating companies: Finnishness is *implicitly* seen as a norm. The role of cultural self-evidences is of crucial importance here. It is extremely difficult for a person who has immigrated to Finland to identify such culturally based self-evidences. It is also possible that the mainstream personnel do not see these difficulties at all; they do not understand that people with different cultural backgrounds may see issues in different ways. As long as everything goes in a traditional way, the familiar daily routines do not call for any change and, thus, for additional mental resources. (Lehtonen, Löytty and Ruuska 2004, 142.) The situation is different when cultural diversity increases in the work community. Not only newcomers but also the mainstream people are involved in an acculturation process which may be felt to be more or less stressful. A common reason for this stress is that, due to the change, there is a need for both learning and discarding learning: 'learning off' what one has learned during the initial enculturation process (Pitkänen 2005, 141–144).

In fact, one new member of the community with a different cultural background already creates a need to review the traditional working practices. Some colleagues may consider foreign newcomers troublesome for this very reason: the newcomers disturb the easiness which their cultural self-evidences entail. If these familiarities are shaken one can try to bear up by clinging to the old and familiar (Lehtonen et al. 2004, 142, 175–176). One way of asking questions is to notice that another culture goes about things differently from the way we expect. Sometimes a newcomer with a marginal point of view may help the mainstream people to perceive and interpret a phenomenon in a way which helps to see their blind spots (see Forsander et al. 2004, 47–48, 71; Hall 1997).

In order to intervene in puzzling situations, there is a need to perceive, and maybe anticipate, the circumstances that may cause stumbling blocks for intercultural interaction. It seems that if the participants in interaction situations come from very different cultures, there is a high likelihood that their initial understanding of that event will differ. As a consequence, the behaviours evoked by these situational representations are likely to differ, so that the participants' responses to the same behaviour setting may disconfirm one another's expectations. Coordinating behaviour effectively becomes difficult, and attention must be shifted towards negotiating shared meanings about the situation if the relationship is to continue. (Smith and Bond 1993, 176.) The first step in effective intercultural learning is the understanding and acceptance of differences. This does not mean we have to agree with another's cultural viewpoint, or that we have to adopt the values of another culture. Rather, it means that we need to examine our priorities and determine how we all can best work together, being different. (Hall 1977; Beamer and Varner 2001, 5.)

Nonetheless, we should not ignore the persons' own responsibility for their performance. We are both similar *and* different: we share several capacities and needs, but different cultural backgrounds as well as individual characteristics define and structure them differently. Thus, people do not fail in their work because of mere cultural differences or succeed because they share the culture or language of the dominant group. Individual factors are also important. Some representatives of the participating companies pointed out that immigrants or ethnic minorities do not comprise any homogeneous groups, rather when assessing people's personal characteristics one should take into consideration the similarities and differences both between and within the groups (cf. Lehtonen and Löytty 2003, 7–13). Besides, when talking about national backgrounds some respondents mentioned that personal characteristics are not determined by national or ethnic borders. An HR manager of a large industrial enterprise stated that foreign workers are individuals just like Finnish workers. He said:

> Sometimes they might be considered as personal characteristics. Saying that he is from there, labelling him according to his background, even if as a Finn he could be the same, who knows. But if the person is a bit extraordinary, people say that it's because he is from there.

Some HR managers assumed that the foreign employees have, and *should* have capacities and characteristics they felt were missing among Finnish staff, like a positive attitude and language skills. Asked what kind of foreigner he should employ, the manager of a supermarket answered: 'Well, I would expect and demand the same qualities as from a Finn, an employee of Finnish origin. And then, what else he can offer in addition to that is of course, his language skills.' Ethnically and culturally diverse personnel could also be seen as a valuable resource. The research showed that some managers had experienced that an ethnically and culturally diverse staff can, at its best, function as a *primus motor* for innovative processes, as different practices and habits can open their eyes for new kinds of opportunities. The HR manager of a large industrial company was convinced that the recruitment of culturally diverse staff had resulted in an increased number of innovations:

> I would see that it's just a big advantage having people who think in a different way. Automatically it gives like a positive opportunity to learn something new, to get something developed or something like that to be done. Already the fact of calling into question the job we're currently doing. Often these kinds of things start new development projects.

Especially in those large companies which were operating internationally, multinational personnel was seen as a resource to develop the prerequisites for international activities. The managerial respondents also mentioned other benefits due to the increasing foreign staff. It was mentioned that language skills and cultural awareness had improved among the whole personnel. Some said that service-mindedness had increased with the growing multinational and multicultural personnel. Especially in the service branch, the multicultural personnel were primarily assessed from an image-centred perspective. The manager of a middle-size supermarket which characterized itself as 'youthful, fresh and reformist' was convinced that, in the eyes of their customers, foreign personnel were 'such a great asset'. Instead, according to the representative of another unit of the same company the attitude towards foreign staff was clearly more doubtful. The following quotation shows that the working context and potential focus groups were seen as crucial points:

> If we're thinking about the fact that we are living in an area with high unemployment rates, one can be thinking that I am unemployed here and there's a that kind of person working, a foreigner. Has he taken my hours, my bread [...] What are, like, the clients' slants on foreigners and so their, like, bitterness towards them, caused by the high unemployment rates of the area.

It is obvious that the increase in cultural diversity is giving way to new work environments in which the management practices of the past no longer function. In their daily work, managers and HRM personnel need to give additional support to foreign and ethnic minority personnel. This may be necessary in order to equalise them with the rest and to integrate them into their work organisations as well as into the host society. Training is also a strategically important sphere in the work of providing people with equal opportunities for their future. But first of all, successful intercultural collaboration presupposes *goodwill:* a real motivation to make the collaboration function. One Eastern Finnish HR manager summarised this philosophy as follows: 'It can be said that a certain philosophy of goodwill is closely linked to our working culture and [...] that we are trying to create the atmosphere of trust and solidarity. Sometimes it works, sometimes not.'

Discussion

On the basis of the study presented it can be said that in the most of the participating Eastern Finnish companies the human resource policy was rather *assimilative* while, in Finland, in the last decade the general tendency has been towards an integrative policy implying *cultural diversity* and *pluralism.* In no participating enterprise has the increase in national and/or cultural diversity led to real institutional changes. In particular, the managers of the small companies estimated that working in a conventional way is the only real option. Instead, the managerial respondents of the large internationally oriented companies stressed that an ability to recognize and manage a diverse workforce is a precondition for successful multinational operations. In those enterprises, it was estimated that an attainment of intercultural competence is becoming increasingly indispensable.

Changes in the world economy have made business not just more international but also more interdependent. A key issue is how the training and management practices should be reshaped in response to the increasing globalisation pressures. It has become apparent that global companies may play a pioneering role in this process. The research results show that diversity management issues have remained rather alien to the realities of Eastern Finnish working contexts (cf. Trux 2002). In particular, the small and middle size companies are only *awakening* to the fact that they could benefit from the foreign employees' competences on intercultural issues, and that positive diversity management, which enables each employee to give his or her best, is vital for achieving an overall productive and competitive workforce (see Richardson 2005, 63–75). This means that ignoring diversity is no longer an option.

In all working contexts the mainstream people were the norm. It is evident that this kind of human resource strategy fails to provide the representatives of minority cultures with equal opportunity and, thus, to prevent their exclusion. In a culturally diverse environment it is not enough that all people are to be treated the same, rather the achievement of equal opportunities for the representatives of ethnic minorities presupposes *culturally responsive treatment.* Thus, the management of diversity should become an issue of concern. A common belief among the managerial respondents was that equal treatment can overcome the inequalities that exist in the work organisation. This may be true in a culturally homogeneous environment where people share broadly similar norms, motivations, social customs and patterns of behaviour. Equal rights here mean more or less the same rights, and equal treatment involves more or less identical treatment. The principle of equality is therefore relatively easy to define and apply, and discriminatory deviations from it can be identified without much disagreement. This, however, is not the case in a culturally diverse context. Equality consists in equal treatment of those judged to be equal in relevant respects. In a culturally diverse environment, people are likely to disagree on what respects are relevant in a given context, what response is appropriate to them, and what counts as their equal treatment. Thus, once we take cultural differences into account, equal treatment does not mean identical but differential treatment, raising questions as to how we can ensure that it is really equal across cultures and does not serve as a mask for discrimination or privilege. (Parekh 2000, 242, 261–62; Pitkänen 2003; 2006, 92–115.)

In a culturally diverse work environment, significant culturally based differences may exist, not only in the relationships between managers and employees, but also among majority and minority employees. Therefore, the work communities *as a whole* should be helped to deal with increasing cultural diversity. This perspective defines a work organisation as a set of practices which define individuals as more or less competent community members. In addition to linguistic competences, intercultural competence includes other dimensions, such as cultural awareness and cultural sensitivity. Although day-to-day interaction and collaboration at work can provide a good context for learning for becoming interculturally competent, personnel training practices should also be reshaped. In this present study it was common that, although Finnish language proficiency and cultural knowledge were seen as necessary prerequisites, they were not yet seen as sufficient qualifications for work. Training and working experience attained in Finland were desired, whereas qualifications acquired outside Finland were assessed very critically.

Finally, attitudinal changes are needed: instead of ethnocentric short-term policy there is a need for rethinking of the ethical basis of today's world. A change from an ethnocentric worldview to global awareness requires significant attitudinal changes (Hall 1977; Beamer and Varner 2001, 5). In order to avoid ethnocentrism, we should, in one way or another, step outside our own cultural circle to see our systematic blindness. If we succeed in doing this, it may help in relating our thinking to the fact that our way of life does not represent the one and only way of living or world of values and norms, but only one among many. The ultimate aim is to make an emotional commitment to the fundamental unity of all human beings and, at the same time, accept and appreciate the differences that exist between people of different cultures. The fact however is that intercultural interaction is not easy; we are all culturally based and culturally biased. Often there is a need for some kind of intercultural transformation. According to Taylor (1994), a person who is successful at working through and learning from daily intercultural interaction experiences has the potential to become interculturally competent (see Mezirow 1991, 167). This may lead to an understanding that, as human beings, we all are both natural and cultural beings, sharing a common human identity, but in a culturally mediated manner. Comparisons between cultures can help one to see different cultural practices as solutions and answers to the same kind of problems in human life. This presupposes multicultural awareness and dialogue with others in order to outline alternative perspectives, and to analyse the interpretation of one's own standing in different perspectives. (Mezirov 1991, 168; 1995, 6; Taylor, 1994.)

Notes

1 A questionnaire was sent to the managers of 717 private enterprises employing a minimum of 10 people.
2 Since the collapse of the Soviet Union, around 25,000 Ingrians have immigrated to Finland. Most of them are descendants of Finnish people who were incorporated into the Soviet Union at the end of the Second World War when part of the eastern district of Finland was annexed by the USSR.
3 By 'culture' I refer here to the way of life, including the assumptions and values of which people are not always conscious.
4 This study formed part of a wider research project, Learning Intercultural Competency in the Workplace, which was being carried out in 2003–2006, and was funded by the Academy of Finland and the Finnish Work Environment Fund (see www.uta.fi/learn).
5 Except for one foreign manager, all the managerial respondents were of Finnish origin.
6 In this data collection, I was assisted by Ms Hannele Ojalehto and Ms Sanna-Mari Pöyry. All interviews were recorded and transcribed.

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