



From Knowledge to Wisdom

ISSN 1548-6591 (Print)  
ISSN 1935-9691 (Online)  
DOI:10.17265/1548-6591

# Journal of US-China Public Administration

Volume 11, Number 8, August 2014

David Publishing Company  
[www.davidpublishing.com](http://www.davidpublishing.com)

# **Journal of US-China Public Administration**

Volume 11, Number 8, August 2014 (Serial Number 106)



David Publishing Company  
[www.davidpublishing.com](http://www.davidpublishing.com)



**Publication Information:**

*Journal of US-China Public Administration* is published every month in print (ISSN 1548-6591) and online (ISSN 1935-9691) by David Publishing Company located at 240 Nagle Avenue #15C, New York, NY 10034, USA.

**Aims and Scope:**

*Journal of US-China Public Administration*, a professional academic journal, commits itself to promoting the academic communication about analysis of developments in the organizational, administrative and policy sciences, covers all sorts of researches on social security, public management, educational economy and management, national political and economical affairs, social work, management theory and practice etc. and tries to provide a platform for experts and scholars worldwide to exchange their latest researches and findings.

**Editorial Board Members:**

Andrew Ikeh Emmanuel Ewoh (Kennesaw State University, USA)  
Beatriz Junquera (University of Oviedo, Spain)  
Lipi Mukhopadhyay (Indian Institute of Public Administration, India)  
Ludmila Cobzari (Academy of Economic Studies from Moldova, Republic of Moldova)  
Manfred Fredrick Meine (Troy University, USA)  
Maria Bordas (Corvinus University of Budapest, Hungary)  
Massimo Franco (University of Molise, Italy)  
Patrycja Joanna Suwaj (Stanislaw Staszic School of Public Administration, Poland)  
Paulo Vicente dos Santos Alves (Fundação Dom Cabral—FDC, Brazil)  
Robert Henry Cox (University of Oklahoma, USA)  
Sema Kalaycioglu (Istanbul University, Turkey)

Manuscripts and correspondence are invited for publication. You can submit your papers via Web Submission, or E-mail to [managers@davidpublishing.com](mailto:managers@davidpublishing.com). Submission guidelines and Web Submission system are available at <http://www.davidpublishing.com>

**Editorial Office:**

240 Nagle Avenue #15C, New York, NY 10034  
Tel: 1-323-984-7526; 323-410-1082 Fax: 1-323-984-7374; 323-908-0457  
E-mail: [managers@davidpublishing.com](mailto:managers@davidpublishing.com); [public858@hotmail.com](mailto:public858@hotmail.com)

Copyright©2014 by David Publishing Company and individual contributors. All rights reserved. David Publishing Company holds the exclusive copyright of all the contents of this journal. In accordance with the international convention, no part of this journal may be reproduced or transmitted by any media or publishing organs (including various websites) without the written permission of the copyright holder. Otherwise, any conduct would be considered as the violation of the copyright. The contents of this journal are available for any citation, however, all the citations should be clearly indicated with the title of this journal, serial number and the name of the author.

**Abstracted / Indexed in:**

Chinese Database of CEPS, Airiti Inc. & OCLC  
Chinese Scientific Journals Database, VIP Corporation, Chongqing, P.R.China  
Database of EBSCO, Massachusetts, USA  
Google Scholar  
Index Copernicus, Poland  
Norwegian Social Science Data Services (NSD), Norway  
ProQuest/CSA Social Science Collection, Public Affairs Information Service (PAIS), USA  
Summon Serials Solutions

**Subscription Information:**

Print \$560    Online \$360    Print and Online \$680    (per year)  
For past issues, please contact: [shelly@davidpublishing.com](mailto:shelly@davidpublishing.com), [order@davidpublishing.com](mailto:order@davidpublishing.com)

David Publishing Company  
240 Nagle Avenue #15C, New York, NY 10034  
Tel: 1-323-984-7526; 323-410-1082. Fax: 1-323-984-7374; 323-908-0457  
E-mail: [order@davidpublishing.com](mailto:order@davidpublishing.com)



David Publishing Company  
[www.davidpublishing.com](http://www.davidpublishing.com)

# Journal of US-China Public Administration

Volume 11, Number 8, August 2014 (Serial Number 106)

## Contents

### Governance and Policy Strategy

- The Impact of Corporate Governance in the Financial Performance of Islamic Banks:  
Evidence From the GCC Region** 633

*Chaouki Bourakba*

- The Reforms in the Institutional Structure of the European Union in Compliance  
With the Lisbon Treaty** 642

*Aneta Stojanovska-Stefanova, Drasko Atanasoski, Zoran Temelkov, Snezana Bardarova,  
Oliver Filiposki*

- Administrative Innovation and Culture: Pillars of the Competitive Strategies in  
Horticultural Companies of Sinaloa** 650

*Luis Alfredo Vega Osuna, Izaguirre Fridizia Diaz de Leon, Sergio Alvarado Altamirano*

### Public Service and Social Perfection

- Agencification of Public Service Delivery in Nigeria: An Empirical Study of Selected  
Public Agencies in Lagos State** 664

*Jacob Olufemi Fatile, Omoniyi Victor Ajulor*

- What Could Be the “Imaginary Institution” of the City?** 679

*Olivier Lefebvre*

### Local Economic Development

- Economics and the Practice of Human Action: The Legacy of the Austrian School** 686

*Andrzej Janowski, Zofia Wyszowska*

- The Impact of Exchange Rate on the Growth of Nigerian Economy From 1960 to 2010** 693

*I. M. Shuaib, Ogedengbe A. Frank, Ekeria O. Augustine*

- Operational Efficiency, Credit Risk, and Profitability in the Banking Intermediation** 707

*Herry Achmad Buchory*



# The Impact of Corporate Governance in the Financial Performance of Islamic Banks: Evidence From the GCC Region\*

Chaouki Bourakba

Al-Imam Muhammad Ibn Saud Islamic University, Riyadh, Saudi Arabia

Through this paper, the author seeks to determine the relationship between the variables of corporate governance and financial performance of Islamic banks, where we dealt the corporate governance in the banking sector, where increasing the importance of corporate governance, due to their special nature, as the bankruptcy of banks not only affects the relevant parties from customers, depositors, and lenders, but also affects financial stability and then the economy as a whole. We dealt with the specificity of governance in Islamic banks, which face double governance: Anglo-Saxon Governance System and Islamic Governance System. The author measures the impact of corporate governance variables on financial performance through an empirical study on a sample of Islamic banks during the period of 2005-2012 in the GCC (Gulf Cooperation Council) region. The study has found that there is a very strong relationship between the variables of governance and financial performance of Islamic banks, where there is a positive relationship between return on assets (ROA) and the composition of the board of directors, the size of the board of directors, the number of committees in the council, as well as the number of members of the *Shariah* Supervisory Board (SSB), while it is clear that there is a negative relationship between ROA and concentration ownership variable.

*Keywords:* corporate governance, performance, Islamic banks

The events experienced by the global economy put the concept of governance on top of the interest of the business community and international financial institutions, since 1997—the date of the Asian financial crisis, through the scandal of “Enron” company in 2003, leading to the current financial crisis, all the crises highlighted the importance of corporate governance as a platform optimized for the treatment and prevention of crises.

A lot of researchers agree that corporate governance plays an important role in the development of the level of performance and reduces the degree of risk-related to administrative and financial corruption at the level of institutions and nations, too.

The applications of corporate governance are more important in the banking sector than other sectors, because banks include a set of elements and interrelationships that do not exist in other sectors and greatly affect the nature of the governance system.

---

\* The paper is financially supported by Muhammed Al-Rashed Chair for Islamic Banking Studies at Al-Imam Muhammad Ibn Saud Islamic University (IMSIU), Riyadh, Saudi Arabia.

**Corresponding author:** Chaouki Bourakba, Ph.D., assistant professor in banking, Faculty of Economics and Administrative Sciences, Al-Imam Muhammad Ibn Saud Islamic University; research fields: Islamic finance. E-mail: chawki62000@yahoo.fr.

This concept perhaps became more important and complex in Islamic banks because of the complex of banking operations which vary in form and substance from the conventional banking operations, in addition to the presence of two boards: the board of directors and *Shariah* Supervisory Board (SSB).

### **Problematic**

Through the above concept, we can put the following question:

What is the nature of the relationship between the variables of corporate governance and financial performance of Islamic banks?

### **Research Hypotheses**

To answer this question, we have formulated the following hypotheses:

- (1) There is a statistically significant relationship between the variables of corporate governance and financial performance of Islamic banks;
- (2) There is a positive relationship between the composition of the board of directors and committees of the council, and the return on assets (ROA);
- (3) There is a negative relationship among the size of the board of directors, the ownership concentration, and financial performance of Islamic banks;
- (4) There is no relationship between the number of members of the SSB and the financial performance of Islamic banks.

## **Corporate Governance in the Banking Sector**

### **The Concept of Corporate Governance in the Banking Sector**

The concept of governance from the banking perspective is the way of managing the affairs of the bank through the role of management and the board of directors; including influences on determining the objectives of the bank, taking into account the rights of creditors, and protecting the rights of depositors.

### **The Importance of Corporate Governance in the Banking Sector**

The importance of corporate governance is increasing in banks, compared with other institutions due to their special nature; because the bankruptcy of the banks not only affects the relevant parties of the customers, depositors, and lenders, but also affects the stability of other banks through various relationships existing between them known as interbank market, then affects the financial stability of the banking sector and the economy as a whole, especially after the global transformations that have occurred from globalization and technological developments and financial liberalization policies, which inevitably led to rise the size of the risk at the level of the banking sector (Ghazi Louizi, 2006, pp. 3-4).

The problem of governance is considered to be more complicated in the banking sector than other sectors, because banks have a set of elements that are not found in other sectors such as deposit insurance, management of systemic risk, estimation of capital for borrowers and internal control system, as well as the capital structure which is formed generally a large proportion of debt and a small percentage of equity, and the sources of funds in the bank to be mostly in the form of deposits required to be made available upon request by depositors, while the assets of the bank and loans are mostly in the form of medium and long term.

Accordingly, the monitoring are more stringent of banks compared with other institutions, where characterized by conflict of interests between the different parties intricately, then there must be a clear and

well system of governance that contributes to clarifying the rights and obligations of all concerned parties (Mehram, 2004, p. 5).

The well application of the principles of corporate governance in banks leads to increasing operational efficiency by reducing the costs of inputs and maximizing the profits of outputs, which allows an increase in the market value of the financial institution (Sebastian, 2007, p. 6).

### **Determinants of Implementation of Corporate Governance in Banks**

The good quality of the application of governance of bank depends on two sets of parameters (Fawzi, 2003, p. 4):

(1) Internal determinants: The rules and principles that determine the way of decision-making and the distribution of powers among the general assembly, the board of directors, and managers, leading to the reduction of conflict among the interests of these parties;

(2) External determinants: The organizational elements include the overall investment climate in the country, which includes laws regulating the market, the efficiency of the financial sector which provides the necessary funding for the projects and the degree of competitive of goods market and factors of production, the efficiency of regulatory institutions and investment companies in the capital markets and special items include stakeholders and private institutions and professionals from accountants, auditors, legal staff, and others.

### **The Role of Central Banks in the Activation of Corporate Governance in Banks**

The central banks are playing an essential role in activating and establishing governance at the level of the banks, through the procedures of banking supervision and prevention, and internal control enough to achieve adequate protection of the assets of financial and banking institutions and the rights of depositors, ensure the safety of its financial position, and strengthen their financial and administrative stability (Jean-Pierre, 2000, p. 7).

## **The Governance of Islamic Banks**

### **The Difference Between the Governance of Islamic Banks and Conventional Banks**

Islamic banks differ in form and content from traditional banks, which Islamic banks based on a set of principles that cannot be waived, or they lost their identities, and these main principles are:

- (1) The principle of profit and loss sharing;
- (2) The principle of trading on the basis of the property but not on the basis of debt;
- (3) The principle of commitment to the rules of Islamic *Shariah*.

While the traditional bank relies on the principle of pre-determined interest, so we find that the contracts which are based on the principle of participation in profit and loss are characterized by a high degree of risk compared with the contracts which are based on pre-determined interest, which requires fair and effective management and clear transparency in the rights and obligations of each party.

The principle of compliance with the Islamic law is not only seen as a matter of applying the principle of profits and losses sharing or non-financing of forbidden project, but also seen as a matter of the commitment of persons engaged in the bank to the principles of Islamic law in their behavior and their actions.

Through the composition of the basic elements of governance, the author finds that the traditional banks include four elements: the shareholders, board of directors, executive management, and other stakeholders. While we add the fifth element (SSB) to the Islamic banks which ensures the control of the compatibility of the



bank's activities with the principals of the Islamic law, so the system of governance in Islamic banks is different from the system of governance in traditional banks, and we can say that the Islamic banks are facing a double governance based on the principles of Anglo-Saxon corporate governance imposed by the non-Muslims shareholders, customers, and the international institutions, and the Islamic Governance System imposed by the Muslims shareholders and customers as well as *shariah* supervisory committee (Mohammed & Ahmad, 2002, p. 19).

### Characteristics of Governance in Islamic Banks

Governance in Islamic banks including the following characterizes:

(1) Islamic banks are obliged to apply more the principals of corporate governance to take into account the interests of investment depositors based on the principle of profit and loss sharing which means high degree of risk compared with the depositors in the conventional banks;

(2) The presence of double governance results from the presence of two different boards: the board of directors in order to monitor the administrative side of the bank, and SSB to monitor the Islamic side of the banking operations;

(3) The presence of two different aims in the same bank can increase the severity of conflict of interest, and of course, it may generate some difficulties in the activity of the Islamic bank.

## An Empirical Study on a Sample of Islamic Banks in the GCC (Gulf Cooperation Council) Region

### Variables of the Study

The model that includes a dependent variable is ROA, which reflects the financial performance of Islamic banks, and six independent variables reflect five of them on the key variables of corporate governance, which consist principally of composition of the board of directors variable which can be measured by the number of members independent of the council, the size of the board of directors variable, which is expressed through a number of managers in the council, a number of board committees variable, concentration of ownership variable, which is measured by the percentage of shares owned by major shareholders, the size of SSB, which is measured by a number of members, and the last one called variable of control is the size of the bank measured by the logarithm of total assets. It can be illustrated more in the following table (see Table 1).

Table 1

#### *Variables of the Study*

Type of the variable	The name of the variable	Symbol	Measurement
The dependent variable	Performance	ROA	Net profit/total assets
	The composition of the board of directors	BCM	The number of independent members of the board
	The size of the board of directors	BSZ	The number of managers in the council
	Board committees	CBD	The number of committees in the board of directors
	Concentration of ownership	OCN	Percentage of shares owned by major shareholders
	Size of the <i>Shariah</i> Supervisory Board	SSB	Number of members of the <i>Shariah</i> Supervisory Board
	The size of the bank (variable control)	SZE	Logarithm of total assets

### Measurement Model

To measure the impact of corporate governance variables in the performance of Islamic banks, correlation analysis method will be used according to the following equation:

$$ROA_{it} = \alpha_0 + \beta_1 BCM_{it} + \beta_2 BSZ_{it} + \beta_3 CBD_{it} + \beta_4 OCN_{it} + \beta_5 SSB_{it} + \beta_6 SZE_{it} + \epsilon_{it} \quad (1)$$

$ROA_{it}$ : the dependent variable that shows the financial performance of Islamic banks;

$\beta_1$ - $\beta_6$ : coefficients of independent variables;

$BCM_{it}$ : the number of independent members of the board;

$BSZ_{it}$ : the number of managers in the council;

$CBD_{it}$ : the number of committees in the board of directors;

$OCN_{it}$ : percentage of shares owned by major shareholders;

$SSB_{it}$ : size of the SSB;

$SZE_{it}$ : the size of the Islamic bank;

$\epsilon_{it}$ : random error.

### The Study Sample

The sample studied composed from 12 Islamic banks which have been selected on the basis of availability of data represented in the following table (see Table 2).

Table 2

#### *The Study Sample*

No.	Country	Name of bank	Period
1	Emirates	Dubai Islamic Bank	2005-2012
2		Abu Dhabi Islamic Bank	2005-2012
3		Emirates Islamic Bank	2005-2012
4		Sharjah Islamic Bank	2005-2012
5	Kuwait	Kuwait Finance House	2005-2012
6		Kuwait International Bank	2005-2012
7	KSA	Al-Rajhi Bank	2005-2012
8		Bank Al Bilad	2005-2012
9	Qatar	Qatar Islamic Bank	2005-2012
10		Qatar International Islamic Bank	2005-2012
11	Bahrain	Bahrain Islamic Bank	2005-2012
12		Shamil Bank of Bahrain	2005-2012

The data were obtained through the annual reports of Islamic banks under study and Zawya Company during the period of 2005-2012. We can summarize the evolution of the average variables of Islamic banks under study during the period of 2005-2012 in the following table (see Table 3).

Table 3

#### *Evolution of the Average Variables of the Study During the Period of 2005-2012*

	ROA	BCM	BSZ	CBD	OCN	SSB	SZE
2005	0.4	2	4	2	0.17	2.5	4.53
2006	0.5	3	5	2	0.19	3.5	5.04

Table 3 continued

	ROA	BCM	BSZ	CBD	OCN	SSB	SZE
2007	0.6	3	6	3	0.21	3.5	6.02
2008	0.4	3	6	3	0.25	4	6.24
2009	0.8	4	7	4	0.28	4.5	5.12
2010	0.6	6	9	4	0.31	5	6.64
2011	0.7	8	10	5	0.36	5.5	7.28
2012	0.6	8	10	5	0.35	5.5	8.59

This can be illustrated more in the following figure (see Figure 1).

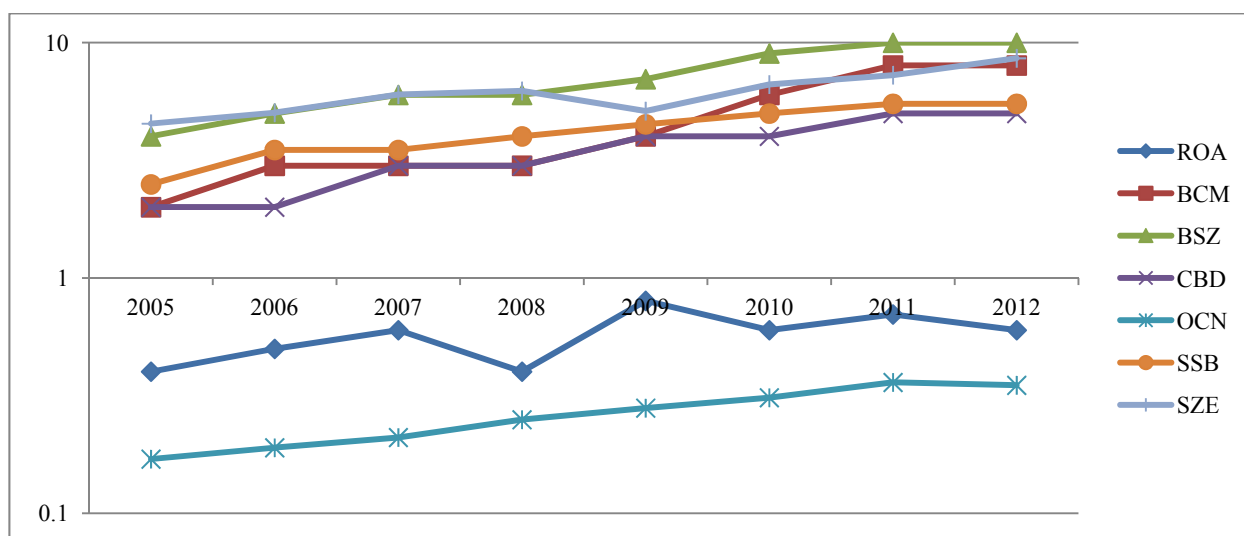


Figure 1. The evolution of the study variables during the period of 2005-2012.

### Statistical Data

Following Table 4 shows the most important statistical data for the variables used in the study, where it is clear that the average of dependent variable return on total assets (ROA) estimated at about 57%, and the average of composition of the board of directors variable (BCM) about 4.62, means an average of five independent members of the board of directors, meaning that there is an acceptable number of independent members, which increases the independence and transparency of the council, then increases the effectiveness of corporate governance.

Table 4

Statistical Data for the Variables of the Study

Variable	Lowest value	Greatest value	Average	Standard deviation
ROA	0.40	0.80	0.57	1.069
BCM	2.00	8.00	4.62	2.386
BSZ	2.00	5.00	3.50	1.195
CBD	4.00	10.00	7.12	2.295
OCN	0.17	0.36	0.26	0.072
SSB	2.5	5.5	4.25	0.123
SZE	4.53	8.59	6.18	1.331

As for the size of the board of directors variable (BSZ), it is clear that the average number of managers in the council is estimated at 3.5. As for board committees variable (CBD) estimated, the average number of committees in the board of directors is about seven committees, which is close to the average number of committees recommended by corporate governance rules.

For concentration of ownership variable (OCN), it is clear that the average proportion of shares owned by major shareholders is estimated at about 26% of the total stock, which means anyone exceeds 50%, a ratio showing the inability of the major shareholders to control the decisions of the bank and directed to their own interests, which helps on the application of the principles of corporate governance, then on the performance of the banks.

With regard to the size of the SSB variable, it is clear that the average number of members is estimated at about four members, which facilitates the work of SSB.

### Estimation of Parameters

Table 5 shows the results of estimating correlation function between the return on total assets, which reflects the financial performance of Islamic banks under study and corporate governance variables, the least squares method was used.

Table 5

#### *Estimation of Parameters*

Dependent variable: ROA				
Method: least squares				
Date: September 28, 2013 Time: 13:04				
Sample: 2005-2012				
Included observations: eight				
Variable	Coefficient	Std. error	T-statistic	Probability
C	0.763170	0.086734	8.798979	0.0720
BCM	0.019878	0.018890	1.052300	0.4838
BSZ	0.014649	0.034275	0.427384	0.7429
CBD	0.341764	0.041028	8.330054	0.0761
OCN	-7.602260	1.109676	-6.850885	0.0923
SSB	0.268057	0.054682	4.902080	0.1281
SZE	-0.114079	0.015003	-7.603836	0.0832
R-squared	0.995627	Mean dependent var		0.575000
Adjusted R-squared	0.969386	S.D. dependent var		0.138873
S.E. of regression	0.024298	Akaike info criterion		-4.926265
Sum squared resid	0.000590	Schwarz criterion		-4.856753
Log likelihood	26.70506	F-statistic		37.94270
Durbin-Watson stat	2.493449	Prob(F-statistic)		0.123636

### Results of the Study

Table 5 shows the estimated coefficients of the model, the value of the t-statistic, the standard deviation, and the probability of error, the results show that the value of the determination coefficient ( $R^2$ ) is estimated at 0.99, meaning that there is a very strong relationship between the ROA and the variables of corporate

governance, the results show that the coefficient Durbin-Watson has reached statistical value of 2.49, it is clear that there is no problem of autocorrelation.

Through coefficients of independent variables, it is clear that there is a positive relationship between ROA and all of: the composition of the board of directors (BCM), the size of the Board of Directors variable (BSZ), number of committees in the council variable as well as a number of the members of the *Shariah* Supervisory Board variable (SSB), while it is clear that there is a negative relationship between ROA and concentration of ownership variable (OCN), it means that the high percentage of shares owned by major shareholders decrease performance of Islamic banks.

### Conclusions

The importance of corporate governance is evident from its objectives, which is to achieve transparency, justice, and grant accountability of manager, then achieve protection for shareholders, taking into account the interests of employers and workers and reducing the abuse of power in the public interest, lead to the development of investment and savings, and maximize profitability of institutions.

The existence of an effective and capable system of providing trust and anti-corruption in the Islamic financial institutions will return them to further success, and will support the expansion of its operations, but that requires the support of the other departments related to governance within the financial institution such as management commitment, internal audit and legal department, as well as *sharia* supervisory committees of both internal and external types.

The application of the principles of corporate governance in Islamic banks is imperative through the analysis of the contracts and determining the terms and conditions carefully, both religious and organizational, including moving away from any fraud, foolishness, or tricked. Islamic banks will be efficient if managers succeeded in achieving two goals at the same time—a financial goal to meet the demands of shareholders and investors and a religious goal to conform the banking operations to the Islamic principles.

The empirical study has found the following results:

- (1) There is a positive relationship between the financial performance of Islamic banks (ROA) and the composition of the board of directors (the number of independent members);
- (2) There is a positive relationship between the financial performance of Islamic banks (ROA) and the size of the board of directors (number of director);
- (3) There is a positive relationship between the financial performance of Islamic banks (ROA) and the number of committees in the board of directors;
- (4) There is a positive relationship between the financial performance of Islamic banks (ROA) and the number of members of the SSB;
- (5) There is a negative relationship between the financial performance of Islamic banks (ROA) and the concentration ownership (the ratio of shares owned by major shareholders).

### References

- Fawzi, S. (2003). Assessment of corporate governance in Egypt. Working paper No. 82. The Egyptian Center of Economic Studies, Egypt.
- Ghazi Louizi. (2006). Impact of board of directors on the performance of Tunisian banks. Proceedings from *the 15th International Conference of Strategic Management*. June 13-16, Annecy/Genève.
- Jean-Pierre, P. (2000). The new financial stability emergency for central banks. *Bulletin of the Bank of France*, 84, 49-61.



- Matoussi, H., & Grassa, R. (2012). Is corporate governance different for Islamic banks? A comparative analysis between the GCC context and the SEA context. Working paper No. 734. Proceedings from *Economic Research Forum*. December, Egypt.
- Mehram, H. (2004). Corporate governance in the banking and financial services industries. *Journal of Financial Intermediation*, 13(1), 1-5.
- Mohammed, U. C., & Ahmad, H. (2002). Corporate governance in Islamic financial institutions. Occasional paper No. 6. Islamic Research and Training Institute (I.R.T.I), Islamic Development Bank.
- Rehman, R. U., & Mangla, I. U. (2010). Corporate governance and performance of financial institutions in Pakistan: A comparison between conventional and Islamic banks in Pakistan. *The Pakistan Development Review*, 49(4), 461-475.
- Sebastian, M. (2007). International and Mena wide trends and developments in bank and corporate governance, the institute of banking. Proceedings from *IFC: Corporate Governance for Banks in Saudi Arabia Forum*. May 22-23, Riyadh.

# The Reforms in the Institutional Structure of the European Union in Compliance With the Lisbon Treaty

Aneta Stojanovska-Stefanova, Drasko Atanasoski, Zoran Temelkov, Snezana Bardarova, Oliver Filiposki  
University Goce Delcev, Stip, Republic of Macedonia

The necessary adjustment to the political architecture in Europe is considered to happen with the Treaty of Lisbon. The treaty is an attempt to make adjustments to the decision-making process, ensuring democratic legitimacy, strengthening of the institutions, and enabling political action worldwide. With the Lisbon Treaty, a change has been made in the institutional structure of the European Union (EU). The Treaty of Lisbon brings together more than a half-century history of integration, which began with the decision for establishing the European Coal and Steel Community (ECSC) on April 18, 1951. The view on the whole, more than 50 years of integration, shows that the European unification process all the time is not out of the spirit of all issues related to the details of common goals and values, but goes in the direction of one political vision of: peace and prosperity, freedom and mobility, knowledge of democracy, populism and tolerant coexistence. The Treaty of Lisbon is in the way to improve the capabilities for action of the democracy in Europe.

*Keywords:* European Union (EU), Lisbon Treaty, institutional structure, veto

Attempts to unify the various European peoples preceded the modern states. From the very beginning, the European integration was not an aim as such, but an expression of policy managed by interests. This can only be understood if we recall of the situation in Europe after the Second World War.

Historical particular situation, characterized by the decline of European countries and the negative attitude toward the Soviet Union, which occurred shortly after the Second World War.

For this condition, there were foremost five motives that led Europeans to great experiment of integration:

(1) Desire for a new self-understanding: After nationalist delusions, Europe had to offer the opportunity for new mutual experiences. Democracy inclined Europe as an alternative to reject nationalist reign;

(2) Desire for security and peace: Specifically, the states were unable to prevent the Second World War and there was hope that united Europe would be more successful in this respect, and at the same time, would

---

Aneta Stojanovska-Stefanova, MSc, assistant, Faculty of Tourism and Business Logistics, University Goce Delcev; research fields: international politics and diplomacy. E-mail: aneta.stojanovska@ugd.edu.mk.

Drasko Atanasoski, Ph.D., assistant professor, Faculty of Tourism and Business Logistics, University Goce Delcev; research fields: international transport and logistics. E-mail: drasko.atanasoski@ugd.edu.mk.

Zoran Temelkov, Ph.D., assistant, Faculty of Tourism and Business Logistics, University Goce Delcev; research fields: banking and finance. E-mail: zoran.temelkov@ugd.edu.mk.

**Corresponding author:** Snezana Bardarova, MSc, assistant, Faculty of Tourism and Business Logistics, University Goce Delcev; research field: European law. E-mail: snezana.bardarova@ugd.edu.mk.

Oliver Filiposki, MSc, assistant, Faculty of Tourism and Business Logistics, University Goce Delcev; research field: insurance. E-mail: oliver.filiposki@ugd.edu.mk.

provide protection against the threat of communist expansion. Europe was supposed to be a community of peace;

(3) Desire for freedom and free movement for many years backwards, people have suffered under military conditioned limitations in terms of passenger traffic, goods, and capital. Therefore, it was quite understandable desire for free movement of the people, opinions, information, and goods;

(4) Hope for trade welfare: United Europe was supposed to introduce the people in a period of great economic stability and prosperity. The common market was supposed to strengthen the trade and enable an efficient economy;

(5) Expectations for common power: European countries, which before 1914 had been dominant for a long period of time on international plan, had dismembered during the two world wars. The new world powers, the USA and the USSR (Union of Soviet Socialist Republics), had established measures of new international power, which far more exceeded the capabilities of the smaller European countries. Western European countries were hoping that by political uniting that they will recover most of the power that had lost<sup>1</sup> individually.

The European Union (EU) is the largest confederation of independent states in the world, established under that name in 1992 by the Treaty on European Union (Maastricht Treaty). However, many aspects of the union existed before this year through a series of previous contracts, dating from 1951. The EU was created as a supranational and intergovernmental union (community) of 28 democratic states members.

EU activities cover all areas of public policy, from the health and economic policy to foreign policy and defense. However, the scope of its powers differs greatly depending on the given area. Depending on the area that is in question, the EU can represent:

- (1) Federation (e.g., in monetary affairs, agricultural, trade, and environmental policy);
- (2) Confederation (e.g., in the social and economic policy, consumer protection, and internal affairs);
- (3) International organization (e.g., in foreign affairs).

A key activity of the EU is the establishment and management of the common single market, consisting of a customs union, a single currency (which was adopted by 12 of the 28 member states), common agricultural policy, and the common fisheries policy.

The most important institutions of the EU are the: Council of the European Union, European Commission, European Parliament, and European Court of Justice. The EU members transferred a significant sovereignty to the EU—more than any other non-sovereign regional organization.

### **Structure of the Treaty of Lisbon**

With the signing of the Treaty of Lisbon on December 13, 2007, the heads of states and governments of the member states marked a new stage in the history of the constitutional formation of the system of shaping the EU/European Community (EC).

The treaty represents a temporary final point of a series of contractual legal attempts for reforms of the institutional structure of the EU<sup>2</sup>.

<sup>1</sup> Werner Weidenfeld and Wolfgang Wessels, 2009, "Europe from A to Z", Nomos Verlagsgesellschaft mbH & Co. KG, Baden-Baden, p. 20.

<sup>2</sup> Werner Weidenfeld and Wolfgang Wessels, 2009, "Europe from A to Z", Nomos Verlagsgesellschaft mbH & Co. KG, Baden-Baden, p. 354.

The Lisbon Treaty had changed the overall work of the EU. Declared aim of the treaty is to complete the process, started by the Treaty of Amsterdam and the Treaty of Nice with all the efficiency improvement and democratic legitimacy of the union and improvement of the coherence of its action.

The necessary adjustment to the political architecture in Europe is considered to happen with the Treaty of Lisbon.

The treaty is an attempt to make adjustments to the decision-making process, ensuring democratic legitimacy, strengthening of the institutions, and enabling political action worldwide.

With the Lisbon Treaty, a change has been made in the institutional structure of the EU.

### **Strengthening of the Key Positions in the Institutional Structure of the Union**

#### **The European Council**

According to the Treaty of Lisbon, the European Council proposes the candidate for President of the European Commission, and it is elected by the European Parliament.

The Council of the European Union is a legislative body of the EU, which represents the member states. One minister from each EU country is a member in it. The council is a main institution for decision-making within the EU. The presidency with the council rotates every six months. The meetings of the council are held in Brussels (Belgium), except in April, June, and October when the meetings are held in Luxembourg.

The council is one of the two legislative chambers in the EU, despite the European Parliament. The Council is composed of 28 national ministers, one from each country.

The council is the main decision-making body in the EU, adopts European laws, works together with the European Parliament on the legal regulation in a number of areas, coordinates extensive European policies of the member states, concludes international agreements between the EU and one or more states or international organizations, approves the budget of the EU together with the European Parliament, develops the common foreign and security policy of EU, based on guidelines set by the European Council, and coordinates the cooperation between the courts and police forces of different countries in terms of criminal activities.

#### **President of the European Council**

With the Lisbon Treaty, a permanent president of the European Council is created. The European leader becomes EU institution, but does not receive new authorities. With the establishment of the President of the European Council, its primary purpose is to provide preparation and continuity of the work of the council and to promote consensus among its members. New chairman shall be appointed for a period of two years and six months.

#### **EU High Representative for Foreign Affairs and Security Policy**

The creation of High Representative of the Union for Foreign Affairs and Security Policy is envisaged with the treaty which by the help of the European External Action Service should give face and voice of the EU in the international politics.

At the same time, the high representative is also a vice president of the European Commission and undertakes its tasks in the field of external relations and with the coordination of the external action of the union. The high representative is appointed by the European Council and has a mandate for five years. The task of the high representative is to preside over the Council of Ministers of Foreign Affairs. The Treaty of Lisbon

clearly defines the role of the EU in the area of common foreign and security policy. The decisions related with issues of defense will be made by unanimous vote of the 28 member states. The missions that EU undertakes outside its territory in order to preserve the peace, conflict prevention, and strengthening of the international security, in the context of the United Nations Charter. The Treaty of Lisbon expands the role of the EU disarmament operations, military advice, and support and assistance for recovery of the stability after conflict. It also creates an opportunity for strengthening of the cooperation among the member states that want to cooperate closely in the field of defense. The Treaty of Lisbon provides that the member states should give at disposal its civilian and military capacities to the EU, necessary for the implementation of the common security and defense policy and determines the role of the European Defense Agency. Introducing a solidarity clause (on voluntary base) when one member state is a victim of a terrorist attack or natural or human caused disaster (Konrad Adenauer Foundation, 2011, pp. 11-12).

### **Council of Ministers for Foreign Affairs**

The Council of Ministers for Foreign Affairs is chaired by EU High Representative for Foreign and Security Policy, while the principle of rotation is retained.

### **European Commission**

The Treaty of Lisbon has a stronger impact on the European Commission, aimed at strengthening of the functionality of this institution. Namely, the treaty envisages a reduction in the number of member of two thirds of the number of member states by 2014, i.e., to 18 commissioners, according to the current situation.

In performing their duties, the members of the commission are obliged to be completely independent of their national governments and to act only in the interests of the union.

And finally, the commission is the executive body of the union. It involves establishing of rules for the implementation of some articles of the treaty and for realization of the approved budget funds for the activities of the union.

The administrative staff of the commission is mainly located in Brussels (where the headquarters of the commission is), and a smaller part in Luxembourg.

### **President of the European Commission**

The Treaty of Lisbon provides strengthening of the rights of the European Commission President, his choice to perform the majority of the European Parliament, which increases its legitimacy.

The candidate for this position is proposed by the European Council, and it is elected by the European Parliament.

### **European Parliament**

The Lisbon Treaty increases the legitimacy of the union, but the democracy is strengthened through the increased legitimacy that European citizens give at direct elections. The treaty provides more active involvement in the work of the national parliaments of the member states.

The European Parliament is the parliamentary body of the EU. Together with the Council of Europe, it establishes the bicameral legislature of EU. This institution is considered as one of the most powerful legislative bodies in the world. The Parliament and Council of Europe form the highest legislative body within the EU. The parliament consists of 751 members, who are elected by the largest trans-national democratic electorate in the world and is the second largest electorate in the world, after India. The parliament is elected in



direct elections every five years since 1979. The elections are held in each EU member state individually, independently, or separately from the local or parliamentary elections in the mother country.

From 1970, the European Parliament together with the council has full control over the EU budget. The parliament has the responsibility to adopt the EU budget as a whole. The parliament also exercises democratic supervision of the European Commission, including the right of veto over the appointed president and the overall composition of the commission, including the right to vote no confidence on the commission. The European Parliament also practices a political oversight of all other institutions of the union. The members of European Parliament 2014 (MEPs) are representatives of the major European political parties, as well as the most important political parties in the member state.

Headquarter of the European Parliament is in Strasbourg, where the regular monthly meetings are held, four-day sessions, according to the protocol signed in Amsterdam. The Secretariat of the European Parliament is located in Luxembourg. This division of institutions has been a debate of a lot of investigators, who believe that the European Parliament should eliminate the system of two headquarters of the government.

The European Parliament is constituted by political groups organized at EU level, including:

- (1) European People's Party—Christian Democrats;
- (2) Social Democratic Party of Europe;
- (3) Alliance of Liberals and Democrats for Europe;
- (4) European Liberal, Democrat and Reform Party;
- (5) European Green Party;
- (6) European Free Alliance;
- (7) European Democratic Party;
- (8) Union of Europe of the Nations;
- (9) European United Left;
- (10) Democrats of EU.

### **Right to Petition**

One million citizens of the union who represent significant number of the member states may ask the European Commission to introduce proposals for legal acts in the legislative process.

### **Double Majority**

The Treaty of Lisbon provides significant expanding of the scope of application decided by qualified majority.

Formally from 2014, it will start to be implemented the double majority (55% of the members of the council, which currently represent at least 15 members, which cover collectively 65% of the population of the union) and vote in favor of the legal act.

### **Suspensory Veto**

The Treaty of Lisbon provides an opportunity to suspensory veto, which means that the members of the council may request from the council to proceed with negotiations, if they represent at least three quarters of the member states and from the population needed to create blocking minority. After the end of the transitional period, this threshold will be lowered to 55% from the member states.

### **The Reforms and Strengthening of the Parliamentary Rights in the Institutional Structure of the EU Under the Treaty of Lisbon**

The Lisbon Treaty designed to improve the functioning of the EU was signed on December 13, 2007, and on December 1, 2009, it entered into force.

Before its entry into force, there were disturbances in the European public for its acceptance in the Czech Republic and Ireland.

Namely, The President of the Czech Republic—Vaclav Klaus had signed the law on ratification of the agreement on November 3, 2009, after receiving guarantees that the map of European fundamental rights to the Lisbon Treaty will not apply in his country, not to allow any claims for restitution of property of Sudeten Germans, confiscated after the Second World War.

Another major hurdle before coming into force of the new EU treaty was its rejection in a referendum in Ireland in June 2008. The citizens of this country at the end, on October 3, 2009, approved the treaty, after Ireland received EU guarantees for the right to an exception in a few areas.

The Lisbon Treaty had created the position of a permanent president of the European Council for a term of 2.5 years. The heads of state and governments of the EU member states had elected the Belgian Prime Minister Herman Van Rompuy for the first president, who will take office on January 1. The Lisbon Treaty extends the powers of the High Representative of the European Union for Foreign and Security Policy, which *de facto* becomes Minister of Foreign Affairs of the Union. The function was elected, Britain's Catherine Ashton, who will manage the newly created office of EU foreign policy, will govern the union budget for foreign assistance and be vice president of the European Commission. The Euro-group, which brings together the member states that have introduced the euro, for the first time will be official and should elect a president for a term of 2.5 years, which may be extended. The European Court in Luxembourg has gained more powers and shall be entitled to its opinion and whether national laws of the 25 member states comply with the EU legislation. This provision shall not apply to the United Kingdom and Ireland. The European Commission from 2014 will have fewer members. At the moment, every state has a commissioner, but after five years, the number of commissioners will be limited to two thirds of that of the member states. The Lisbon Treaty increases seats in the European Parliament from 736 to 751. The Council of the EU in 2014 will continue to take decisions by a qualified majority, and each state will have as many votes as that are determined by the Treaty of Nice. After this, a new system of double majority voting will come into force, which requires appropriate decision to be supported by 55% of the member states, which represents 65% of the population.

The National Parliaments will receive a vote at the adoption of the European legislature. If one third of them reject a given legislative proposal, the European Commission will have to change it. The Lisbon Treaty sets as targets before EU, the introduction of a common energy policy and leading the fight against the climate change. The Lisbon Treaty contains important provisions in new series political areas to strengthen the EU's ability to fight international cross-border crime, illegal immigration, trafficking of women and children, weapons, and drugs. Today in the world, two new areas are particularly important.

(1) Climate change: The treaty gives priority to the goal of EU for promotion of sustainable development in Europe, based on the high degree of protection and improvement of the environment. The treaty stands for promotion at international level of the measures for solving the regional and global issues related to the

environment, especially climate changes. Strengthening of the role of the EU in relation to the climate changes will mean that Europe continues to be a leader in the fight against global warming;

(2) Energy: The agreement contains new provisions that will ensure good operation of the energy market, particularly in relation to the supply of energy and achieving energy efficiency and savings, as well as development of new and renewable energy sources.

For all member states, providing a source of energy is a key challenge for the future.

The Treaty of Lisbon confirms the EU's commitment to a united European policy for sustainable energy. It also provides a new basis for cooperation between member states in the field of sports, humanitarian aid, civil protection, tourism, and space researches. In terms of human rights, the Treaty of Lisbon recognizes the rights of freedoms and principles set out in the Charter of Fundamental Rights and the charter defines as legally binding.

The member states have signed the charter in 2000. Now it is legal binding. It means that when the EU proposes and enforces laws, it must respect the rights determined in the charter, and the member states must make the same when implementing EU legislation. The rights that should all enjoy include the protection of personal data, the right to asylum, equality before the law and non-discrimination, equality between men and women, the rights of the children and elderly people and important social rights, such as protection against unfair dismissal and access to social protection and social welfare. The Lisbon Treaty also allows the EU to accede to European Convention on Human Rights. The Convention and the European Court of Human Rights, which is responsible for the same, are the basis for protection of human rights in Europe (Konrad Adenauer Foundation, 2011, pp. 13-14).

The new European treaty introduces the possibility—one member state to leave the union under agreed conditions for the first time. One million EU citizens can ask the European Commission with petition to develop a draft law in a given area. The Lisbon Treaty increases the EU's competencies in the field of justice and interior affairs, including in the fight against crime and terrorism. It contains a clause by which the union and the member states jointly will respond in an attack or natural disaster in one of them.

### Conclusions

The Treaty of Lisbon brings together more than a half-century history of integration, which began with the decision for establishing the European Coal and Steel Community (ECSC) on April 18, 1951. The view on the whole, more than 50 years of integration, shows that the European unification process all the time is not out of the spirit of all issues related to the details of common goals and values, but goes in the direction of one political vision of: peace and prosperity, freedom and mobility, knowledge of democracy, populism and tolerant coexistence<sup>3</sup>.

The Treaty of Lisbon is in the way to improve the capabilities for action of the democracy in Europe. Together with the reforms of the Lisbon Treaty and the changes that were made in the institutional structure undoubtedly performed a substantial correction of the decision-making processes, the ensuring of democratic legitimacy, strengthening of the institutions, and enabling the political action worldwide.

---

<sup>3</sup> Werner Weidenfeld and Wolfgang Wessels, 2009, "Europe from A to Z", Nomos Verlagsgesellschaft mbH & Co. KG, Baden-Baden, p. 18.

### References

- Arter, D. (1993). *The politics of European integration in the twentieth century*. Aldershot: Dartmouth Publishing.
- Avery, G., & Cameron, F. (1999). *The enlargement of the European Union*. Sheffield: Sheffield Academic Press.
- Baun, M. (2000). *A wider Europe: The process and politics of European Union enlargement*. Oxford: Rowman & Littlefield.
- Bendeviski, T. (2001). *Law of European Union*. Faculty of Law Iustinianus Primus, University St. Cyrilus and Methodius, Skopje.
- Chrysoschooi, D. N. (1998). *Democracy in the European Union*. London: Tauris Academic Studies.
- Cooper, I. (2006). The watchdogs of subsidiarity: National parliaments and the logic of arguing in the EU. *Journal of Common Market Studies*, 44(2), 281-304.
- Konrad Adenauer Foundation. (2011). *Your guide to the Lisbon Treaty*. Skopje: Vinsent Grafika.
- Maleski, D. (2000). *International politics*. Faculty of Law Iustinianus Primus-Skopje, University St. Cyril and Methodius, Skopje.
- Mircev, D. (2006). *The Macedonian foreign policy 1991-2006*. Skopje: Az-Buki.
- Muller, W., Bergman, T., & Strom, K. (2003). Parliamentary democracy: Promises and problems. In *Delegation and accountability in parliamentary democracies*. Oxford: Oxford University Press.
- Raunio, T. (2005). Much ado about nothing? National legislatures in the EU Constitutional Treaty. *European Integration Online Papers (EIOp)*, 9.
- Shuman, R. (2009). *For Europe*. Skopje: Plus Produkcija.
- Wallace, H., & Wallace, W. (2000). *Policy-making in the European Union* (4th ed.). Oxford: Oxford University Press.
- Wallace, H., & Young, A. R. (1997). *Participation and policy-making in the European Union*. Oxford: Clarendon Press.

# Administrative Innovation and Culture: Pillars of the Competitive Strategies in Horticultural Companies of Sinaloa

Luis Alfredo Vega Osuna, Izaguirre Fridizia Diaz de Leon, Sergio Alvarado Altamirano  
The University of the West (Universidad de Occidente, U de O), Culiacán, Mexico

In contemporary times, a fundamental aspect for organization has been to achieve innovation through culture and approach to encourage the search and development of new ideas, new products, and new services; this is a key point to fulfill the competitive advantages which a company needs to be successful in the global market. The Sinaloa horticultural company has more than 100 years' history in the United States export market, and is presenting new challenges and demands from the market in order for it to achieve its permanence. The objective of this research is to identify and propose different strategies to implement management innovation, which in its essence is the one that coordinates, directs, and controls the human resource considering culture as an integral part, with a capacity to generate the spark and function as a motivating source which drives companies to consolidate and integrate supply chains.

*Keywords:* strategy, management innovation, culture

To survive in an adverse environment for the high number of competitors and products in the business world, it is necessary to develop strategies that give direction and strength to the organization (Porter, 1987a).

When developing an analysis of this situation, the interest in investigating the behavior of the horticultural market arises, as well as the planning of a comprehensive strategy to facilitate the Culiacan Valley growers to define their mission, vision, potential needs, and tastes that can be used to generate products and project resources required to achieve the goals and objectives; always emphasizing that planning must occur before the action (Ansoff, 1965).

The vegetable market is a complex and unstable industry, there is no certainty in trading prices most of the time, because there are several obstacles and constraints, among them, the large number of participants offering

---

**Corresponding author:** Luis Alfredo Vega Osuna, Ph.D., full-time research professor at the University of the West (Universidad de Occidente, U de O), Unit Culiacan and subject teacher at the Faculty of Accounting and Administration, Unit Culiacan, SNI (International System of Researchers) Level C; research fields: public administration, human resource management, public-private partnerships, finances, and international and national marketing. E-mail: luisalfredo86@yahoo.com.mx.

Izaguirre Fridizia Diaz de Leon, Ph.D. in organizational studies from the Autonomous Metropolitan University (Universidad Autonoma Metropolitana, UAM), full-time research professor at the University of the West (Universidad de Occidente, U de O), currently serves as Head of Research and Postgraduate Studies Unit of U de O in its Guasave unit, belongs to the National Research System Level I; research fields: public administration, public policy, and business relations. E-mail: ridzia.izaguirree@udo.mx.

Sergio Alvarado Altamirano, Ph.D. in organizational studies from the Autonomous Metropolitan University of Iztapalapa in Mexico City, research professor at the University of the West (Universidad de Occidente, U de O), currently serves as Director of Planning and Evaluation of this university, part of the National Research System Level I of the National Council for Science and Technology in Mexico (CONACYT); research fields: public administration, public policy, and human resource management. E-mail: Sergio.alvarado@udo.mx.



an oversupply of a product, which leads to a decrease in revenue and an increase in the difficulty of marketing the product with better expectations. Furthermore, according to Sandoval (2010) and Elizalde (2010), this sector has been funded for many years by the dealers to develop their productive activities, which has led to a high dependency and has caused a decline in profit margins, creating the potential risk of being eliminated from such activity by the entry of new competitors from Central America.

According to this type of situation, the horticultural company has begun to show symptoms of a decrease in sales, productivity, loss and difficulty to recover the investment, a decline in prices, insecurity and uncertainty to market the products in the various types of market and reduced profit margins.

Against this background, Elizalde (2010) and Rodriguez (2003) agree that the principal issues in the horticulture business are precisely of commercial and production order, because there is a lack of evolution regarding the market behavior and technological alternatives that are available for the development and creation of new products. Some of the major trade problems are: volatility in vegetable prices, broad distribution channel, the existence of a mark to improve the standard positioning of this type of products, the lack of funding, and lack of organization in this type of activity. With regard to the production problems, the use, development, and application of technology have been applied only to improve primary production without further inclusion of the research and development of new technology in products with a higher added value; additionally, there is no integrated planning of production that includes each of the producers in the region to avoid oversupply nor a program that encourages and stimulates productivity sector.

According to this context, Rivas (2002), Gereffi (2001), and Rodriguez (2003) agree that there should be built new forms of marketing, since in most small and medium horticultural companies, the traditional organization type is predominant, which is characterized by its centralization, vertical structure, and marketing and production conventional system (without investigating other marketing options), which leads to a negative impact on the development and growth of the company, jeopardizing its existence by not to consider the new demands and needs presented by the global environment, which according to some theorists, a new form of organization should adapt a structure to identify the needs posed by the market with respect to the global evolution.

Sinaloa has unduly neglected the issue of organization in the productive and marketing activities, since market trends constantly change and maintaining national leadership is a must, Sinaloa and its traditional companies must develop strategies that are designed to adapt quickly and make necessary adjustments to deliver the quality, not only of the product but also of the service adding a customer commitment to provide the highest quality vegetables, improving their production processes by providing a more organic design. All of these decisions will translate into a customer intimacy that will facilitate the identification of new market opportunities to improve income levels and positioning of the Sinaloa horticultural products companies.

### **Development**

According to Mintzberg (1997), there are two types of strategies: Those related to integral planning that considers the development of goals and objectives, which are aimed at setting the direction of the company; and those related to the execution, which are very important because if this last point is not achieved, the principal purpose of planning will never be fulfilled, in other words, the guiding actions that lead to the organization

acceptance will not happen, therefore, the organization will not have the opportunity to continue in the market (Porter, 1987a).

Quinn (1977) agrees with Mintzberg's idea of a strategy that not only contains a comprehensive planning including mission, vision, goals, and objectives, but also incorporates the unknown (the risk that every development supposes). This idea allows us to see that attitude, will, and desire to move forward against the unexpected are keys in the strategies development process of new markets and consumer trends (Santos Vijande & Alvarez Gonzales, 2008).

Hax and Majluf (1993) state that the strategy includes all activities involved in the organization, hence, the strategy is related to: the planning development, mission, vision, objectives, institution's goals, action programs, priorities in the allocation of resources to establish the budget, long-term strategy development, threats solution, opportunities answering, and defines employees' salaries and investments.

The world is constantly changing, as a consequence, it is essential that strategies also suffer modifications and changes (Drucker, 1974), but if the objective of a company is to improve and position itself, a strategy guided by the main plan is required. Mintzberg, Quinn, and Voyer (1997) see the strategy as the pattern or plan that integrates the goals and policies of an organization, and determine the coherent sequence of actions, they mention five points: (1) a plan or guide; (2) pattern of behavior in the past; (3) formulation and monitoring of details and routes (when, where, and how); (4) positioning the great vision of the company; and (5) a maneuver to outwit opponents and adversaries. All of these concepts proposed by Mintzberg, Quinn, and Voyer can should be interrelated and complemented.

The competitive strategy is like the search for a favorable competitive position in the industry, the fundamental arena in which competition occurs (Porter, 1987a). In other words, the competitive strategy tries to establish a profitable and sustainable position, in order to consolidate the deference that determines the competition in which the organization operates.

Without a strategy, it would be complicated for the horticultural companies to address effectively, as the strategy indicates the path to be followed, based on comprehensive planning, setting goals and objectives, implementing actions to achieve the goals, distributing resources, and using the information of the environment to achieve the objectives and goals (Hax & Majluf, 1993).

Mintzberg, Ahlstrand, and Lampel (1998) suggest that the strategy can be carried out according to the perspectives that had. Therefore, they suggest the following schools for their formation: (1) design: conception; (2) planning: formal; (3) positioning: analytical; (4) business: visionary; (5) cognitive: mental; (6) learning: emergent; (7) power: negotiating; (8) culture: collective; (9) environmental: recreational; and (10) configuration: transformation.

The design school<sup>1</sup>, in its classical model, emphasizes the evaluation of external situations such as threats and opportunities, and internal situations such as strengths and weaknesses of the organization, so that when a strategy has been identified, it can be evaluated through consistency, consonance, advantage, and feasibility. Based on the above, Mintzberg et al. (1998) show how difficult it is to anticipate anything, but at the same time, they mention the importance of not being afraid to the unknown and learning from our weaknesses, since these activities can give us an idea of what to expect from future events.

---

<sup>1</sup> The origins of the design school could be attributed to Philip Selznick, of the University of California (Berkeley), with his papers about administrative leadership; and Learned, Cristen, Andrew, and Outh, of Harvard University with their book: "Commercial Norm" (Mintzberg et al., 1998).

In the positioning school<sup>2</sup>, it is argued that the position of the economy in the market should be defined in the present or in the future, so that the strategies must be tailored to each organization. It also states the need for matching specific tools for each strategy (Mintzberg et al., 1998). Consequently, Mintzberg et al. (1998) point out that Porter discusses external factors and finds five environmental forces: threats to new members, treatment of the power of the signature suppliers, treatment of power of the signature buyers, threats of substitute products, and intensity of the rivalry among firms. Based on the above, these forces indicate why a company adopts a particular strategy and gives origin to generic factors or internal forces.

The positioning school contributes to create research lines, it also seeks to establish whether you want to enter a global or regional market for its great competition, taking into account the size and structure of the company to compete in large markets (Mintzberg et al., 1998). On the other hand, the business school is aimed to form strategies as a visionary process, which consists in creating leader aimed strategies, since the leader is the person in charge of developing mental, intuition, judgment, intelligence, experience, and ability processes to generate awareness, in order for the vision to be formed (Mintzberg et al., 1998).

Entrepreneurial strategy can be deliberate or emergent. There, strategies are formulated and articulated through centralization of leadership, in a controllable and predictable environment, intentions exist as a personal view of a single leader, adapted to new opportunities under the personal control of the leader and are located in a niche protected by its environment. In the second one, the collective vision of the organization's members is involved, and it is controlled through strict rules that everyone must comply, in this strategy, members of the subunits do not maintain a real cohesion with the rest of the organization, here is a partial control of the actions of the organization, the last leader controls every aspect of the strategic process, i.e., who is or will be controlled (Mintzberg et al., 1998).

The cognitive school is known for strategy formation as a mental model. The strategies are considered based on experience and attitudes. From the above, Mintzberg et al. (1998) note that two major branches arise in the cognitive school: objective and subjective, the former is more positivist, how men see things, while the second is more about the interpretations of the way men perceive their environment.

The learning school states that knowledge is something acquired over time, most often taught by someone. Since individual creativity is very important in any working group, it is defined as relevant and actionable information based on individual experiences. In the subjective sense, tacit knowledge against explicit knowledge is based on intuition and decisions determined in the basic sense, while the explicit knowledge is codified and structured, based on rational feeling, therefore, here the directors are considered as creative artists, with tacit knowledge. The challenge is how to use them (Mintzberg et al., 1998).

At the power school, the strategy is understood as a process of negotiation and its formation as an open process of influences. The power goes beyond the purely economic and market competition, but in its legitimacy. Power relations happen in two branches: micro and macro. In the micro, the game of politics and illegitimate is power. In the macro, it is the power of the organization, out of the self-interest, and more in the relationship with other organizations. Here is where corporate strategy, strategic alliances, and strategic sources arise (Mintzberg et al., 1998).

---

<sup>2</sup> It appears in the 80s. It is not entirely separate from the schools of planning and design, but it makes the distinction that this school puts limits on strategies in given situations. Although Porter tries the strategic content in his book "The Competitive Strategy", he was not the only one, nor the first. The first studies were made in Purdue University Krannert Business School, by Dan Schendel and Hatten Kent (Mintzberg, Ahlstrand, & Lampel, 1998).

The school culture is composed essentially of the interpretations of a world and the activities and artifacts that reflect. Mintzberg et al. (1998) indicate that organizations have strong cultures, characterized by a set of settled assumptions, protected by a network of cultural artifacts, including the way people behave toward each other, history, the language used, and others. They also indicate how national cultures influence the way the environment is interpreted, creating different strategic responses by the same company in different countries, and demonstrating the impact of national cultures in the structure, the style of decision making, and how resources available to the culture is obtained.

Just as these schools, the environment is also exposed by Mintzberg et al. (1998). Here they argue that the contingency theory arises, taking into account one factor to study the atmosphere or environment. This school has a complete picture of the formation of the strategy in the balance, which helps describe the environments facing strategies. Although other schools have not forgotten the environment which is not addressed as fully as the positioning, it is assumed in an economical way, focusing it on industry, competition, and market. Meanwhile, in the cognition, it also talks about this factor, but in relation to experience, to learn from him.

Some scholars believe that the leadership and organization are subordinate to the environment, because they can take control. These scholars identify its dimensions at four points: (1) stability, which can be dynamically stable; (2) complexity, from simple to complex; (3) diversity, integrated diversified; and (4) hostility, munificent to hostile (Mintzberg et al., 1998).

The school of the configuration is based on the organization and the surrounding context as configuration. This school sets two aspects, states or models and ideal types, from which is based on distinct periods, occasionally interrupted by some transformation processes and quantum leaps sorted in a patterned sequence in time, by a conceptual design or formal planning, which takes the form of plans or models, positions or perspectives in their own situation (Mintzberg et al., 1998).

This school gives the opportunity to Mintzberg (1984; 1991) of proposing the following types of organization: (1) business: simple and young organization, with an informal and flexible structure; (2) organization as a machine: with high-scheduled operations, work with highly specialized and well defined hierarchies; (3) professional organization: high professionalism, highly decentralized structures, giving independence to professional development; and (4) diversified organization of independent units: with multiple branches or structured division.

In addition to the previous classification, the following types of organizations can also be found: (1) the organization as adhocracy: contemporary industries based on experts from different areas and with a matrix structure, based on the figure line—oriented staff and clients; (2) missionary organization: dominated by a strong culture, with division of labor, specialized and small distinction among managers, staff and groups of operators; and (3) political organization: based on a power system with elements of domination, generally developing during periods of transformation (Mintzberg et al., 1998).

Each school has a specific weight and the type of strategy required will depend on the situation. In a purely cultural issue, the culture school presents as something essential to encourage and motivate the organization to pursue strategies that lead to suit market demands.

Table 1 summarizes each of the schools listed by Mintzberg et al. (1998).

Table 1

*Description of the Different Administration Schools' Characteristics Presented by Mintzberg, Ahlstrand, and Lampel*

School	Word that describes each school	Characteristics
Design	Conception	Face the unknown and always look for challenges
Planning	Formal	Analyze strengths and weaknesses, develop plans and strategies, program activities, implementation, and reviewing
Positioning	Analytic	Analyze the actual and future demand
Business	Visionary	The exclusive formation process of the leader, by mental means, intuition, judgment, intelligence, experience, and ability
Cognitive	Mental	Builds mental schemes from the surroundings
Learning	Emergent	Knowledge is acquired through time, since it is defined by relevant information, based on experiences
Power	Negotiation	It refers to open processes and not only to the economic, but to the legitimacy
Cultural	Collective	It is a group of suppositions, protected by a red of cultural devices that include history and language
Environmental	Creative	It positions the environment as one of the three forces in the process, leadership, and organization
Configuration	Transformation	It refers to the organization and the context as configuration

*Note.* Source: the authors' elaboration, extracted from M. Hitt, R. Ireland, and R. Hoskisson (1999).

### Generic Strategies

To base the acting on a single type of approach is limited, what is more correct is to analyze and pick each of the most relevant parts of each school. Thus, Mintzberg (1997) analyzes the four strategies proposed by Igor Ansoff (1965): market penetration, product development, market development, and market diversification. However, since these strategies were not completely understood, Porter (1979) included a list of known generic strategies, in which the cost leadership and differentiation highlight the most. Nevertheless, these two lists were incomplete. On the one hand, Igor Ansoff looked to expand the business or company; and on the other hand, Porter sought the identity of the company. Mintzberg (1997) had the concern of reorganizing these approaches into five major groups: (1) location in a core business; (2) differentiation of the modular business; (3) development of the core business; (4) expansion of the core business; and (5) review of the core business.

These groups are described in Table 2, considering their classification and what constitutes each one.

In conclusion, the generic strategies can be classified into two groups: those aimed at focusing on customers and the other which focuses on competitors. The first ones seek to highlight product features and the others focus on achieving other levels of competition, possibly in two ways: by finding competitive factors such as price or quality; and also by making companies look to secure their competitive position through special relationships with environmental agents. Such strategies are called relational, since they intend to reduce competition and increase their competitive based security associations with elements of the environment, all of these can be done through partnerships with producers, integration with producers and distributors, networking, thereby achieving favorable positions that allow the company to achieve higher levels of competitiveness (Mintzberg, 1997).

This last part is considered by Porter (1987a) as one of the most prominent to develop long-term and more permanent competitive advantages, because any advance in the application and development of technology, any progress in re-engineering to reduce costs and make more flexible organization, price differentiation, and image quality can easily be acquired by a rival or competitor, erasing the competitive advantage in an immediate way,

while they consolidate and share those benefits in order to consolidate even more organizations to the demands of the market (Zarur, 2008). Porter (1987b) points out that the strategy gives the company the opportunity to change the rules of competition in its favor and that, competitive forces are in function of the structure of the industry in which the organization operates. Meanwhile, Gilbert and Strebel (1991) estimate that industries offer varied competitive opportunities; therefore, as a consequence, strategies change from one industry to another. In order for the industry to identify strategies that can lead it to develop a competitive advantage, Porter (1987a) proposed three major steps: (1) definition of the industry and extensive knowledge of itself; (2) identification of possible actions or competitive moves, identifying the characteristics of the industry competitors and the competitive advantages of the business system where it is found; and (3) selection of generic strategies.

Table 2

*Description of the Strategies Groups Presented by Henry Mintzberg*

Strategies groups	Oriented	Types	Description
Location of a core business	Focused on the competition	Operation stages: They are classified in primary, secondary, and tertiary	1. Upwards current: strong in capital and technology 2. Intermediate: different materials for one product 3. <i>Corrientes abajo: gran variedad de productos</i>
Differentiation of the core business	To clients	Differentiation strategies Range strategies	Differentiation: distinction of products based on price, image, quality, and design Range: expansion to new markets
Core business elaboration	To clients and competition	Business participation in new markets	Through the positioning, the marker developing strategy, and the new products development strategy
Extension of the core business	To competition and clients	There are three ways: vertical, horizontal, and a combination of both	Vertical: integration of the productive chain from front to back Horizontal: It refers to the gathering of an activity not directly related to the productive chain
Rethinking of the core business	To competition	Integration, diversification, and the combination of both	Integration: It incorporates the productive chain integration in the final stage of commercialization and the beginning stage of the suppliers Diversification: It incorporates a different business not related with the productive chain Combination of both: It includes a combination of diversification and integration

*Note.* Source: the authors' (2012).

In addition to these steps, Gilbert and Strebel (1991) indicate the generic actions that lead to perceived value or to the low cost and the stages of development of the industry. Companies combine these actions with other strategies that will help them be placed in a superior competitive position. Hence, two types of generic strategies are identified: one-dimensional, which is based on a continuous action replay, whether it is perceived as a high value or low cost distribution. In the high value, strategy is common for companies to use very short life cycles, while companies with very long cycles often use the strategy of low distribution costs. The other generic strategies are the change of pace ones, which mention that the success of a strategy depends on the proper planning of the sequence of actions. They are directed to overcome the disadvantages of the previous strategies.

### Strategies for Competitiveness

In recent decades, competition has increased with the abandonment of commercial protectionism by some governments. Consequently, the use of the term competitiveness has increased, achieving used in a business,

industry, or country, but without a clear definition of that term. As the semantics of the word, competitiveness is the result of the term competition, sometimes they are used in the same situations, although both of the concepts have different meanings. Competence is related to the commercial rivalry, while competitiveness is the intensity of a competition in a particular market or sector. In microeconomics, competition involves rivalry, rival firms reducing costs and selling larger volumes to achieve maximum benefit (Morales & Pech, 2000). Porter (1987a) suggests that competition provides the actions that the company should take to help their performance, such as innovations, a cohesive culture, or good implementation.

There are different types of competition: perfect, imperfect, not based on price and illegal. The perfect competition appears when there are many buyers and sellers, unable to influence the price separately. The second one, the imperfect competition is when any buyer or seller can influence the price (i.e., monopolies and oligopolies). The third one, the competition that is not based on price, companies compete not only on price, but also with the quality of their products and advertising. Finally, illegal competition, also called “wild”, lies in pricing below cost to eliminate industry competitors (P. Wonnacott & R. Wonnacott, 1985).

The Organization for Economic Co-operation and Development (OECD) (1995) states that business competitiveness is its competition strength, when the lowering of prices is able to materialize and provide quality products or services with relationship with the nearest competitor. Some authors focus on the search for the mechanisms that make a company competitive, such as Morales and Pech (2000, p. 53), who describe competitiveness at a business level, as the ability to have some attributes that enable superior business performance and give some kind of advantages over its competitors, thanks to the creation of valuable products.

Suárez (2000a) proposes four types of competitiveness for a company: (1) genuine automation, obtained through a strategy whose technological content has some degree of automation or scheming and whose environmental impact is zero or positive; (2) unsustainable, achieved when the technology base or scale machine is automated to some extent, but pollutes and wastes resources; and (3) spurious, which has as a manual process technology base or wasteful polluter and finally limited, which likewise has a manual technological base, the process and product are controlled.

In relation to the competitiveness of nations, researchers like Müller Galindo and García Martínez (1997) try to define it. They have even built a map, which is a network of concepts involved with the term related to competitiveness: the global structural power and national/regional development of countries or regions seeking development through integration into the world.

However, Porter (1979) explained that there is no compelling definition to explain it. He provides some characteristics: (1) macroeconomic phenomenon driven by variables such as exchange rates, interest rates, and budget deficits; (2) competitiveness, according to the cheap and abundant labor; (3) competitiveness, in relation to the abundance of natural resources; (4) competition in terms of economic policy that encourages; and (5) national competitiveness generated by differences in management practices, including in management-labor relations, not being any of those explanations satisfactory to build a terminal definition of national competitiveness.

Instead of defining national competitiveness, the determinants of productivity and growth rates are sought by centralizing its application not only in the global economy, but also in their economic sectors. As Porter argues that the competitiveness of a sector depends on four basic forces: the threat generated by the entry of new competitors, the power of bargaining with suppliers, the power of bargaining with customers, and the

threat of substitute products or services. This triggers the fight between existing competitors, establishing the profitability of a sector, so Porter (1979) ends up saying that the prosperity of a country depends on the continuing efforts of all sectors to innovate and improve in search of competitive advantage.

Porter (1987b) also notes that the competitive advantage is the center of a company's performance in competitive markets, causing success or failure as a result of the value you can create for your customers. This "value" can be translated into lower prices and exclusive benefits through a process of differentiation, giving the product unique features that appeal to consumers, or example image, brand, and service, among others. He argues that the two types of competitive advantages—lowering costs and differentiation, along with actions to achieve them, lead to three generic strategies to improve the performance of the company in the industry: cost leadership, differentiation, and focus.

Bradenburger and Nalebuff (1996) point out that any company in the market economy has three groups of people: customers, complementary workers, and suppliers; as well as a type of enemy, the competitors, which need to be tackled, something that is not always true because many times it can group with competitors, through alliances and other forms will fight the customers and suppliers, not to agree the results of treatment. To sum up, everything is a combination of cooperation and competition between competitors and friends, so that an increasing number of companies work together to gain a competitive advantage, presenting the cooperation strategies as an alternative to acquire it.

For Hitt, Ireland, and Hoskisson (1999), partnerships are a fundamental cooperative strategy in which resources, capabilities, and core competencies are combined to cover shared development, production or distribution of goods or services, classifying them as: (1) collective strategic alliance of two or more companies that establish an independent company, in which each shareholder owns similar parts; (2) strategic capital alliance, embodied in a new company, whose owners have different percentages of capital; and (3) strategic alliances, which are not capital, founded by agreements with a company to supply, manufacture or distribute goods or services without share capital.

### **Culture Focused on Developing Strategies**

Organizations use strategies to provide management guidance for their actions to achieve the objectives and goals. However, the formulation of the strategy is different between organizations, mainly among the ones of different size. The strategies of large companies are more deliberate, they are closer to the formulation of plans that guide the actions; while the small and medium enterprise strategies focus more on patterns, that is, since it is not formal and fully conscious formulation, basically it can be seen by the history of the company, rather than by the presence of a formal document, written in the strategy (Suarez, 1997).

According to United Nations Educational, Scientific, and Cultural Organization (UNESCO) (1982), culture gives the man the ability to reflect on itself, it helps to find, understand, and generate ethical responsibility in order to engage with the work. M. Harris (2000) mentions that culture refers to the total lifestyle, socially acquired by people, including forms and styles of thinking, feelings, and acting, and Giddens (1999) states that culture is related to the values sharing a particular group, they agree on the rules and material goods they produce.

Davis and Newstrom (1999) point out that cultures are important because they provide an organizational identity, a vision, a source of stability, and continuity for organizations, provide sense of security, help interpret what happens in the organization, and encourage and motivate employees. Davis and Newstrom (1999) argue



that organizational culture refers to a system of shared meaning among its members and that it helps to distinguish one organization from the other. There are seven characteristics that distinguish one culture to another: innovation and risk taking, attention to detail, results orientation, people orientation, team orientation, energy, and stability. It is inferred that culture plays a key role as the spark required for an engine to begin working. This means that most farmers keep following the traditional production and marketing processes, that over time, the changes in the markets (Schumpeter, 1934) regarding the emergence of new market niches and new consumer habits related to the incorporation of women to work activities, make new types of needs to arise, which are missed by horticulturists at local, national, and international levels.

### **The Administrative Innovation**

Innovation should not be seen as an outcome, but as a process where internal and external actors are involved, and above all, human behavior, firstly passing from an early generation of a new idea in the philosophy of sustained work, then through culture, so it allows to introduce and implement in each of the steps of the administrative activities (Kanter, 1999).

According to Damanpour and Evans (1996), management innovation is inferred as the kind of strategy that occurs in the social system of an organization, implementing an idea for a new product or a new service to distribute resources or structuring tasks, authority and rewards. This definition helps to understand that innovation involves administrative culture as an essential part to create an environment that, on one hand, can facilitate brainstorming, and on the other hand, allows to enter and run in each of the parties involved, the process of production and marketing enterprises.

### **Feedback of Administrative Innovations**

With the description of this figure, the authors realize that there must be a cultural relationship regarding the motivation to initiate new ways of working, the goals and objective definition in short, medium, and long term allow to create the appropriated climate and environment to begin giving direction and guidance to the organization, all in order to start the process of innovation and to develop strategies in its two main phases (the creation of the idea and its implementation).

In this part, you need to know the main types and classifications of strategies presented by Porter, Igor Ansoff, and Mintzberg, being the most important one which refers to the various schools of strategic thinking.

According to Porter (1987a), when a company develops a cost leadership, it is allowed to manage its market price, so the company can acquire the advantage of being the most competitive; the differentiation occurs when a product is new and incorporates certain attributes that give a significant level of differentiation in the market so that the product can be more striking and dominant than other products in the same area. This differentiation can occur in the image, product presentation, brand development, and ways to promote the product.

Businesses today need to have a suitable mindset able to change, because the markets do not allow distribution of more of them; however, it requires changes in production processes, management structure, diversification of products, the introduction and development of new products, and the introduction of new technology.

In horticulture, there must coexist a new cultural mindset that allows producers to be gathered, in order for

them to achieve the competitive advantage of focus or with other agricultural associations, because they have large investments in infrastructure and technology, however, they have only managed to avoid profitability, since they have improved their production, but the market is flooded with products, thereby achieving lower utility rates to such a degree that they cannot even cover their costs.

Rueda (1999) states that there are basically two ways in which companies can partner in Mexico: (1) confederations of cameras, starting from the second decade of the 20th century, multiplying in the following; and (2) groups, such as credit unions, unions to purchase inputs, producer cooperatives, and business integrators.

With the Figure 1, developed by Suárez (1997), we can understand each of the generic strategies that allow achieving these comparative advantages.

According to Suárez (1997), Sinaloa horticultural companies should develop generic strategies that facilitate the process of achieving competitive advantages.

The following Figure 2 presents a relationship of the suitable strategies for horticultural companies in Sinaloa.

In Figure 2, it is easy to observe that the Sinaloa's horticultural farmers have an option to accomplish competitive advantages and address adverse changes in globalization and post modernity stage (Zarur, 2008), which is reflected in the integration of economic activities of production chains, based on the strategies for expanding core businesses proposed by Mintzberg (1997).

<p>a) Strategies to locate the core of a business.</p> <ol style="list-style-type: none"> <li>1. Upwards current</li> <li>2. Intermediate</li> <li>3. Downwards current</li> </ol> <p>b) Strategies to distinguish the core of a business.</p> <ol style="list-style-type: none"> <li>4. Suppliers</li> <li>5. Process development</li> <li>6. Product development</li> <li>7. Distribution and service</li> <li>8. Support</li> </ol> <p>c) Differentiation strategies</p> <ol style="list-style-type: none"> <li>9. Of price</li> <li>10. Of image</li> <li>11. Of support</li> <li>12. Of quality</li> <li>13. Of design</li> <li>14. Of no differentiation</li> </ol> <p>d) Range strategies</p> <ol style="list-style-type: none"> <li>15. No segmentation</li> <li>16. Segmentation</li> <li>17. Strategic niche</li> <li>18. Acquisition of clients</li> </ol>	<p>e) Strategies to expand the core of the business.</p> <ol style="list-style-type: none"> <li>19. Entering</li> <li>20. Market development</li> <li>21. Geographic expansion</li> <li>22. Product development</li> </ol> <p>f) Strategies to expand the core of a business</p> <ol style="list-style-type: none"> <li>23. Integration</li> <li>24. Diversification</li> <li>25. Entrance and control</li> <li>26. Combine</li> <li>27. Outcome</li> </ol> <p>g) Strategies for the redesign of the core business</p> <ol style="list-style-type: none"> <li>28. Redefinition of the company</li> <li>29. Recombination of the Company</li> <li>30. Relocation of the core</li> </ol> <p>The strategies, f) close the beginning of the core distinction to begin with the new tour with g) and a).</p>
---	---

Figure 1. Generic strategies. Source: the authors', with data from Suarez (1997).

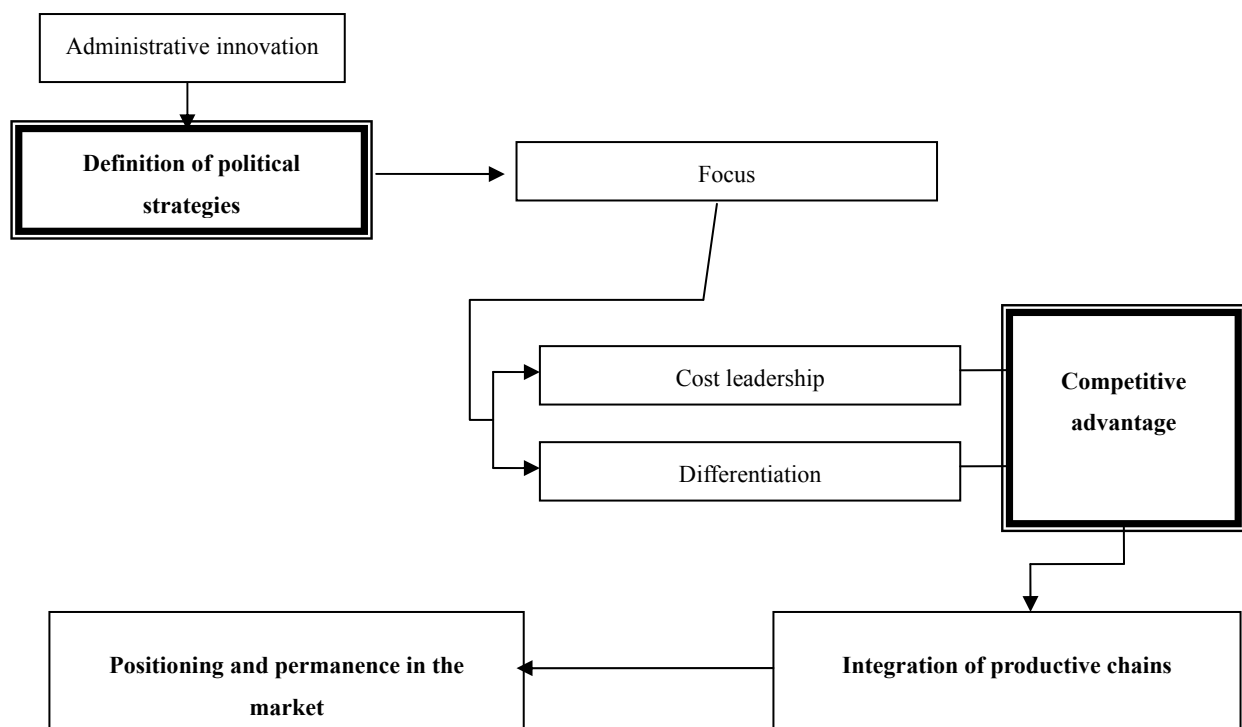


Figure 2. Strategic proposal scheme applied to the Sinaloa horticultural company. Source: Suarez (1997).

## Conclusions

It is important to mention the importance that the development of new strategies to strengthen the company as a leading organization in constant change has in the business world. As well as, the emergence of new market segments where consumer groups with special characteristics such as gender, income level, ways of thinking, culture, and background are considered relevant to the school differentiation of core business given by Mintzberg (1997).

This is the reality that the farms and fresh products live in Sinaloa (Elizalde, 2010); consumer habits are continually changing, as families, especially housewives who recently have joined work activities, do not have enough time to cook, which affects the consumption of fresh vegetables. As a consequence, this leads to the emerging necessity of a new kind of meal demanded by the market: processed food made from fresh vegetables.

According to Santos Vijande and Álvarez Gonzales (2008), innovation comes from the concern and cultural predisposition to create an enabling environment for the development of climate activities: firstly, the customer-oriented, in order to initiate new products according to future needs, and anticipate demand; secondly, the pursuit of continuous improvement, eliminating idle resources; and thirdly, standardization of products, reducing the ambiguity in the design of tasks and reducing costs.

In this definition, a cultural bias gives the spark to ignite the new path that requires the organization to face the great challenges that require precise positioning in the market is included.

If this process of order, thought and structure can be recognized, it will be closely linked with the concept of management innovation; since, its main part focuses on the desire to set a course in the process of activities which integrated planning where the only source that can provide is the strategy. It is proposed that

horticulturists seek unity and integration from productive chains, based on the strategy of expanding core businesses through which they can create another market for their fresh products (processed foods), which can range from making tomato sauce to the development of a special sauce for enchiladas and Mexican dishes, among others; these will facilitate the development of a brand that not only can be placed in the processed product market, but also in the fresh products market as well, in order for all of these activities to generate strength in the brand positioning in the local, national, and international markets (Mintzberg, 1997).

Finally, this work may be supplemented by further study of the concept of administrative innovation applied to agribusiness, so the culture of integration aimed at improving the country's rural regions can be promoted. In addition, it is important to develop studies about the new requirements in local, national, and international markets, in order to design strategies for expanding core businesses in the search for new markets.

### References

- Ansoff, H. I. (1965). *Corporate strategy: An analytic approach to business policy for growth and expansion*. Nueva York: McGraw-Hill.
- Bradenburger, A., & Nalebuff, B. (1996). *Co-opetition*. New York: Currency-Doubleday.
- Damanpour, F., & Evan, W. (1996). Organizational innovation and performance: The problem of organizational lag. *Administrative Science Quarterly*, 29(3), 392-409.
- Davis, K., & Newstrom, J. (1999). *Human behavior at work*. México: McGraw Hill.
- Drucker, P. (1974). *Management: Tasks, responsibilities, practices*. Nueva York: Harper & Row.
- Elizalde, R. (2010). *Vegetables' production and marketing competitiveness in the state of Sinaloa 1989-2009*. Culiacán, Sinaloa, México: CAADES.
- García de Leon, S. (1993). *The micro, small and medium industry of Mexico and their challenges*. Mexico: Diana.
- Gereffi, G. (2001). The supply chain and analytical framework for globalization. *Development Problems*, 32(125), 1-12.
- Giddens, A. (1999). *A runaway world: The effects of globalization on our lives*. Buenos Aires: Taurus Publishing House.
- Gilbert, X., & Strebel, P. (1991). *Development of the competitive advantage*. México: Dolmen Publishing House.
- Harris, M. (2000). *The contemporary American culture: An anthropological view*. Madrid: Alianza Publishing House.
- Hax, A., & Majluf, N. (1993). *Company management with a strategic vision*. México: Dolmen.
- Hitt, M., Ireland, R., & Hoskisson, R. (1999). *Strategic management concepts competitiveness and globalization*. México: International Thomson.
- Kanter, R. (1999). *When a thousand flowers bloom: Structural, collective and social conditions for innovations in organizations*. Greenwich: Jai Press.
- Koontz, H., & Weihrich, H. (1998). *Management, a global perspective*. México: McGraw Hill.
- Mintzberg, H. (1984). *The structure of organizations*. España: Ariel.
- Mintzberg, H. (1991). *Mintzberg and management*. Madrid, Spain: Ediciones Díaz de Santos.
- Mintzberg, H. (1997). Generic strategies for the location, differentiation and development the core business. In H. Mintzberg, J. Quinn, and J. Voyer (Eds.), *The strategy process: Concepts, contexts, and cases* (brief edition). México: Prentice Hall.
- Mintzberg, H., Ahlstrand, B., & Lampel, J. (1998). *Strategy safari: A guided tour the wilds of strategic management*. New York: The Free Press.
- Mintzberg, H., Quinn, J., & Voyer, J. (1997). *The strategy process: Concepts, contexts and cases* (brief edition). México: Prentice Hall.
- Morales, M., & Pech, J. (2000). Competitiveness and strategy: Focus on core competencies and resource-based approach. *Accounting and Administration*, 197, 200-230.
- Müller Galindo, L., & García Martínez, J. (1997). *Management basics*. Mexico: Trillas.
- OCDE (The Organization for Economic Co-operation and Development). (1995). *Small and medium-sized enterprises: Technology and competitiveness*. Mexico: Oxford University Press.
- Porter, M. (1979). *Being competitive: New contributions and conclusions*. Spain: Deusto.
- Porter, M. (1987a). *Competitive advantage, creating and sustaining performance top*. México: Continental Publishing House.
- Porter, M. (1987b). *Competitive advantage*. Mexico: CECSA.

- Quinn, J. B. (1977). Strategic goals: Process and politics. *Sloan Management Review*, 19, 21-37.
- Rivas, T. (2002). New forms of organization. *Management Studies*, 18(82), 13-45.
- Rodríguez, J. (1997). *Applying strategic planning to small and medium businesses*. México: ECAFSA.
- Rodríguez, J. (2003). *Globalization, modernity and postmodernism organizational*. Culiacán, Sinaloa, México: Universidad de Occidente.
- Rueda, I. (1999). The micro, small and medium enterprises in Mexico: Importance, environment, partnership and subcontracting. In Ruedas and Simon (Eds.), *Partnership and cooperation of the micro, small and medium enterprises*. México: Unam, IIEC, Miguel Ángel Porrúa.
- Sandoval, C. V. (2010). *The crisis of agricultural specialization pattern in Mexico*. Retrieved from <http://www.refundación.com.mx>
- Santos Vijande, M. L., & Álvarez Gonzales, L. I. (2008). Effects of total quality management in transforming the technological and managerial innovation. *Journal of Economics and Business*, 11, 33-65.
- Schumpeter, J. A. (1934). *The theory of economic development*. Boston: Harvard University Press.
- Stoner, J., & Freeman, R. (1992). *Administration*. México: Prentice Hall.
- Suárez, T. (1997). The management process in small business. *Accounting and Management*, 186, 53-62.
- Suárez, T. (2000a). The strategy, technology and competitiveness in small and medium industrial enterprises (PMI). *Administrative Sciences, Theory and Praxis*, 2(1), 15-40.
- Suárez, T. (2000b). Small business (PE) and organizational studies (EO). *Administration and Organization*, 2(4), 9-24.
- UNESCO (United Nations Educational, Scientific, and Cultural Organization). (1982). Mexico city declaration on cultural policies. Proceeding from *the World Conference on Cultural Policies*. August 6, Mexico.
- Wonacott, P., & Wonacott, R. (1985). *Economy*. México: McGraw-Hill.
- Zarur, A. E. (2008). *New markets: Strategy and competitiveness*. Mexico: Autonomous Metropolitan University.

# Agencification of Public Service Delivery in Nigeria: An Empirical Study of Selected Public Agencies in Lagos State

Jacob Olufemi Fatile, Omoniyi Victor Ajulor  
Lagos State University, Lagos, Nigeria

There have been efforts to establish agencies as part of a strategy to improve service delivery world-wide. In Nigeria, agencies have also been established at both the national and state levels. The Lagos State Government has also established various agencies to fulfill different government functions in the state. After many years, the activities of these agencies have improved the delivery of services to the people in Lagos State, but there is still much to be done. This is why this study examines agencification of public service delivery in Nigeria with reference to Lagos State. The study uses mixed methods and triangulated data to achieve the research objectives. Questionnaire was used to collect data from service users and departmental officials. Face-to-face interviews were conducted with key officials of the selected agencies. Key documents were also reviewed. The findings reveal: lack of human resources capacity, inadequate financial management skills, and poor management of service providers, and the environment of the people of Lagos State are not considered in the conception and the implementation of the service-delivery-driven agencies. The study therefore recommends that agencification of public service in Lagos State as conceived if properly implemented can contribute to effective public service delivery.

*Keywords:* agencification, citizens, service delivery, policies

Agencification of public service delivery is in fashion. It is certainly not a new thing, but it seems to have increased in recent years (Wettenhall, 2005). Two decades of new public management has placed agencification high on the agenda of administrative policy-makers. However, agencification has been one of the enduring themes of public administration. The use of agencies has become an increasingly common feature of public management in a wide range of political settings, and the establishment of agencies is seen as an important aspect of “the regulatory state” (Egeberg & Trondal, 2010, p. 2).

Sulle (2011) explains that agencification has become fashionable and every country has implemented it in its own way. He cited the examples of Canada (1993), Japan (1998), and Sweden. However, Larbi (1998) argues that agencification was promoted in Sub-Saharan African countries through programmes that were sponsored by the international financial institutions like the World Bank, the International Monetary Fund (IMF), and other Western donors, and in forms of technical and financial support.

Agencification has signified a transfer of government activities to agency type organization vertically

---

**Corresponding author:** Jacob Olufemi Fatile, Ph.D., senior lecturer, Department of Public Administration, Faculty of Management Sciences, Lagos State University; research fields: public administration, intergovernmental relations, comparative development studies and governance. E-mail: jacobfem@yahoo.com.

Omoniyi Victor Ajulor, Ph.D., lecturer Grade I, Department of Public Administration, Faculty of Management Sciences, Lagos State University; research fields: public administration, public policy, and local government. E-mail: ajulorvictor@yahoo.com.

specialized outside ministerial departments. Related to the new public management movement, governments across continents have established agencies at arm's length from ministerial departments in order to take care of certain regulatory and administrative tasks (Pollitt, Talbot, Caulfield, & Smullen, 2004; Verhoest, Peters, Bouckaert, & Verschuere, 2004). Agencies are popular organizational forms in contemporary administrative reforms and have expanded in number and importance over the past decades. Agencies are organizational forms that ensure better usage of expertise than ordinary public administration organizations. They serve as promoters of technocratic decision-making and functioning. However, there are certain unintentional effects of agency model. Coordination and policy coherence gaps may raise the questions of political accountability and provoke robust political interventions.

Agencification is based on a quite simple idea. Just like other modern public management reforms, i.e., decentralization, contracting-out arrangements, and management by results, it rests on the classical distinction between policy formation and policy implementation. The idea is that policy formation should be handled by slimmed and trimmed "core executives", while policy implementation should be carried out by professional executive agencies with considerable managerial freedom, and it has extensive duty to report to the executive core of the results of their performances.

Agencification of public service delivery aims at increased efficiency, strengthened and clarified responsibility and accountability lines, enhanced professional administration, and a more service oriented administration placed closer to citizens as well as strengthening the politicians' ability to steer the administration (Organization for Economic Co-operation and Development [OECD], 2005). Recently, there has been an attempt to revitalize service delivery and employ innovative organizations to deliver services to citizens. The reform has introduced agencies as a new public organization. These agencies have been put in charge of creating and managing organizations responsible for providing high-quality public services to citizens.

In Nigeria, agencification as part of new public management reforms gathered momentum in 1999 during the regimes of former president Olusegun Obasanjo. There was critical review of practices and procedures in every Ministry and Department of Government, with the aim of introducing and inculcating modern management techniques and procedures so as to rapidly increase their productivity and service delivery to the public (Federal Republic of Nigeria, 2001). The 1999 Constitution of the Federal Republic of Nigeria had provided for a service oriented public sector at federal and state levels (Federal Republic of Nigeria, 1999). Agencies have also been established at both the national and state levels. Many of these agencies now implement the key function of the ministries and departments. The effort of the governments among others is to find new and creative ways to deliver services to the citizens at a faster pace by ensuring the separation of policy-making and implementation functions. Such separation enables government departments to focus on developing policies and providing strategic direction while the agencies are tasked with the implementation of such policies and the direct provision of the services to citizens.

Lagos State is one of the 36 states in Nigeria. The introduction of the new public management techniques in the state public service led to the establishment and proliferation of agencies in the state. There have been agencies before the public management reforms, but these agencies were not proactive enough to meet the needs of the people like the agencies we have today. The new agencies were established with the new public management orientations which necessitate that customer or the clients should be made king in the process of

service delivery in the state. This was emphasized in the Lagos State Government Public Service Management Guidelines for Implementing Service Charters provided by the state government in 2010. The charter states that,

A Service Charter is a public document that informs clients about the Ministries, Departments and Agencies (MDA)'s services, outlines citizens' rights and responsibilities as well as relevant avenues for communication. It specifies standards of service delivery in the form of a series of commitments, entitlements, or promises upon which customers can expect and demand quality service as a right; and to which they can have recourse when service fails.

After many years, the activities of these agencies have improved the delivery of services to the people in Lagos State, but there is still much to be done. This is why this study examines agencification of public service delivery in Nigeria with specific reference to some selected public agencies in Lagos State.

### **Factors Responsible for the Establishment of Agencies in Lagos State**

Different factors led to the establishment of agencies from the various ministries under study in Lagos State. Many agencies were developed in the Ministries of Transport, Works and Infrastructure, Environment and Finance. These agencies were created for effective and efficient service delivery. Prior to the creation of agencies in Lagos State, there were challenges ranging from lack of human capacity and financial management skills. There were fragmentation and duplication of institutional responsibilities among various agencies at three levels of government and lack of inter agency coordination among these various bodies as well as absence of documented standard procedures for the technical and economic evaluation of programmes and projects among others.

The Ministry of Transport was unable to rise up to the challenge of inadequate transportation system in the mega city. The transport system being operated by the state government was characterized by high level of fragmentation, inadequate regulation, and indiscipline among the operators of the city transportation service. In general, there was absence of well articulated government policies as well as legal and strategic framework for the transport sector.

Also, before the establishment of these agencies, Lagos was adjudged as one of the dirtiest capital cities in the world. It faced a broad range of environmental issues for its rapidly growing population. The rate of migration in the city is faster than the city can cope with, leading to the problems of solid waste management, water portability, sewage system management, and drainage issues. Food, soil, air, and water contamination thus became serious environmental concerns in Lagos State.

In the area of finance, the incessant review of revenue capacity of all revenue units is a major challenge which has negatively impacted on efficient tax collection. Most of the tax authorities in Lagos State local government areas lack the desired institutional capacity to administer tax system effectively. The bulk of tax was paid by only the employees and less privileged individuals in the state. Enahoro and Olabisi (2012) argue that politicians, the rich, the professionals, and the privileged individuals were not equitably taxed. Another problem of tax administration is centered on inadequate personnel in terms of quantity and quality. The shortage of qualified tax personnel is partly responsible for poor enforcement. The sharp and dishonest practices by some tax officials, especially at the local government level, pose a serious threat to tax administration in Lagos State.

The Ministry of Works equally faced with problem of bad roads network, poor housing scheme, collapsed buildings, and unregulated procurement (Enahoro & Olabisi, 2012). It is in the light of these overwhelmed



challenges, that agencification of delivery of public services became necessary. Consequently, Lagos State adopted a methodological policy reform to improve the efficiency and effectiveness in the delivery of public services to the people by creating agencies from the existing government ministries and departments. In 2010, a charter was put in place in form of guidelines for implementing the changes in service delivery. The document sets out broad guidelines for developing, monitoring, and implementing Service Charters. It is designed primarily to assist management of MDAs, staff of Service Delivery Units, staff of Management Services and Reforms Directorate, members of Ministerial Service Charter Committees, and frontline staff to gain deeper understanding and to be conversant with the dynamics of customer-centred service through setting and monitoring service standards and commitments contained in MDA Service Charters.

In the new arrangement under agencification, planning and consultation with the stakeholders are the bedrock. The reasons for this are to do the following: improving a specific service, developing a new product or service, general policy development, and future plans, setting up an ongoing, consultative forum, resolving conflicts, educating and informing stakeholders, identifying their views, needs, values, or concerns; obtaining feedback about propositions, contemplated or intended actions/decisions or situations before, during or after implementation. The expected outcomes are new services, improved services, or service standards, remediation or recovery, an agreed plan, information on services, organizational policy, and organizational strategy.

In creating effective organizational, legal, and institutional capacities for the planning and management of the various agencies, the state made policies based on critical appraisal of several sectors policy documents. These documents set the tone and direction for the societal impact and results aimed at being achieved by the government through its strategic development of the various agencies. These documents were also reviewed with a background objective of creating a conducive environment that would encourage private sector involvement and invest in public agencies thereby ensuring affordable public services. For example, the high policy documents reviewed with focus on sections that deal with the transport sector are:

- (1) Lagos State Economic Empowerment Development Strategy (LASEEDS);
- (2) Lagos State Economic Advancement Programme—Ten Point Agenda;
- (3) Ehingbeti Economic Forum;
- (4) Existing legal frame work as it relates to the transport sector;
- (5) Others include Ministry of Transport with Ministerial Responsibilities and Lagos Urban Project Report.

These policies led to strengthening of existing and the creation of additional agencies with the relevant legal framework to provide institutional support for enhancing effective discharge of the various programmes and operating the transport sector properly in the state. These policy documents and legal instrument guide the goals, programmes, projects, and activities of the ministries and its agencies since 1999. It is pertinent to point out that the creation of the legal regime to regulate institution was deliberate in order to build institutional capacities for the planning and management of the various agencies of the state transport system. In order to implement these policies, goals, and objectives, many agencies were created with different degree of autonomy in the state (Lagos State Public Service Management Charter, 2010).

### **Objectives of the Study**

The central aim of the study is to examine agencification and public service delivery in Lagos State. Other specific objectives include:

- (1) To evaluate the performance of public sector organizations in Lagos State since the agencification of public service delivery;
- (2) To examine the influence of agencification of public service delivery on transparency and accountability in Lagos state's public sector;
- (3) To determine the extent to which agencification has encouraged the participation of professional in enhancing productivity in public service delivery in Lagos State.

### **Research Questions**

The study is based on the following research questions:

- (1) Has the performance of public sector in Lagos State changed since the agencification of public service delivery?
- (2) Could agencification of public service delivery influence transparency and accountability in Lagos State public sector?
- (3) To what extent has agencification encouraged the participation of professionals in enhancing productivity in public service delivery in Lagos State?

### **Research Hypotheses**

The study is based on the following research hypotheses:

- (1) The agencification of public service delivery has not improved the performance of public sector organizations in Lagos State;
- (2) Agencification of public service delivery has no influence on transparency and accountability in Lagos State public sector;
- (3) The participation of professionals in the agencification of public service delivery does not enhance productivity in Lagos State public sector.

### **Conceptual and Theoretical Framework**

The term "agency" received a multitude of meanings depending on the organizational culture, legal system, and political system. There is lack of a uniform definition which complicates research into agencification, both within and between countries (Bouckaert & Peters, 2004). By "agency", we mean an administrative body which is formally separated from a ministerial or cabinet-level department, and which carries out public tasks at a national level on a permanent basis, is staffed by public servants, is financed mainly by the state budget, and is subject to public legal procedures. Agencies are supposed to enjoy some autonomy from their respective ministerial departments as regards decision-making. However, the respective ministers normally keep the political responsibility for agencies' activities (Pollitt & Talbot, 2004). Agencies are an organizational form that ensures better usage of expertise than ordinary public administration organizations. They serve as promoters of technocratic decision-making and functioning.

An agency is an organization that is at an arm's length from the hierarchy of the central ministry. It is involved in service provision, regulatory function, or adjudication. Employees of the agency are public servants, and might not necessarily be bureaucrats. The government finances this body legally. However, some agencies might generate their own revenue. In either case, it is answerable to the ministry for its financial situation. Such bodies are also legally bound to some legislative body of government (Pollitt & Talbot, 2004).

Agencification is a process which new agencies are created or which existing agencies are given more autonomy. Generally, the term “agencification” means the process of recreating a ministry or government department into a more purposeful result oriented public organization. It is a specific and output focus task (Verschuere, 2007). Agencification thus signifies a transfer of government activities to bodies vertically specialized outside ministerial departments (Pollitt et al., 2004; Verhoest et al., 2004). Agencification in transition countries usually means the creation of new autonomous bodies for new functions or a significant increase in the autonomy of existing legally separate bodies on either an individual or a collective basis.

Agencification is further considered as being aimed at strengthening the politicians’ ability to steer the administration. It is seen as a way of hiving off smaller, recurrent, and technical matters into executive agencies while politicians have more time for steering “big” and “important” matters. According to James (2005), autonomous public organizations are more efficient than the normal department units. Sulle (2011) argues that agencification of the public service delivery frees the public sector from unnecessary rigid bureaucratic rules which are seen as the source of inefficiency in public service delivery. It is generally expected that agencification of public service will bring innovation, flexibility, and effective use of resources to achieve the expected result. Thynne (2006) quoted in Sulle (2011) explains that the agencies creation takes different forms: (1) it may be by splitting up ministries or major department into separate and task-specific units; (2) it may be a creation or the merging of different units in the department; and (3) it may also be as a result of establishing a new agency within the ministry. Whatever the case may be, it must be backed with necessary laws that are applicable to such type of agency created. The laws range from constitution, legislation, executive order, decrees, edicts, etc.

The process of agency formation has been justified by some theories. However, there cannot be one best theory to explain the phenomenon (Pollitt et al., 2004). Agency theory has influenced many academic disciplines: economics, management, political science, and sociology. According to Pollitt et al. (2004), there are three central elements which make up the core of the agency programme:

- (1) Structural separation and/or the creation of task specific organizations;
- (2) Managerial autonomy in making decisions concerning personnel and financial management through target setting, monitoring, and reporting;
- (3) Managerial accountability over personnel, finance, and other management matters.

These three elements—structure, autonomy, and accountability, capture the essence of the agency model as it has surrounded the globe. Structural separation involves splitting up public organizations through horizontal and vertical specialization whether inter- or intra-organizational. By structural separation, we mean the splitting up of larger bodies into a parent body and various subordinate agencies. This has mostly been applied to splitting up ministries into a core central body and several agencies carrying out specific tasks (Bouckaert & Peters, 2001).

The agency model introduces a horizontal and vertical structural separation within or across organizations. Structural separation involves the splitting up of larger bodies into a “parent” body and various subordinate agencies. The vertical changes tend to create more autonomous agencies while horizontal specialization based on the principle of single purpose organization makes less independent organizational unit to deal with only such functions as ownership, regulation, purchasing, and provision (Christensen & Laegreid, 2001; Bouckaert & Peters, 2001).

The second element of agency model is the managerial autonomy in making decisions. This pattern of managerial autonomy is assigned to the actors of these executive agencies, for them to make decisions independently (wholly or partially) related to personnel, administrative, and financial resource allocations. Autonomy is also granted at the policy framing level. Boston, Martin, Pallot, and Walsh (1996) see the inclusion of managerial models as related to the ideas to further devolution and delegation of authority and autonomy. The idea of letting the managers manage free from the bureaucratic and political constraints is believed to improve the efficiency and effectiveness of executive agencies. This means having the freedom to manage their budgets, make their own decisions, operate on commercial accounting principles, and reinvest their surpluses (Bouckaert & Peters, 2001). The problem of controlling agencies and leaving them a significant degree of autonomy for the performance of their tasks is a key issue of the agency model.

The third element of the agency model is the idea of steering and control system which means any system of setting targets for and reporting on the activities of an agency and involves performance management, cost-cutting, and budgetary discipline. The increased use of performance indicators represents an attempt to quantify the activities of public organizations more extensively, while *ex post* scrutiny and auditing are mechanisms of connecting and comparing goals and actual results. The main idea is that good results should be rewarded and poor results should be punished (Bennett, 1997). The agencies are not independent in any absolute sense, but are quasi-autonomous entities and the ministries which will normally use different forms for control and steering to constrain the agencies' autonomy.

### **Research Method**

This study adopts qualitative and quantitative method. First, it reviews the literature on public and public service reforms. As the time frame available for this study, it would not allow for in-depth study of the establishment of all agencies in Lagos State. The selection of some selected agencies was primarily guided by the functions that the agencies are set up to perform.

The study is limited to four ministries in Lagos State (environment, transport, works and infrastructural development, and finance). The choice of the four ministries is instructive for two reasons. Firstly, they show the symptoms of trends, processes, dynamics, major innovations, and best practices in terms of service delivery. Secondly, time and funding did not allow the authors to expand the study to other ministries and agencies in Lagos State.

### **Population and Sample**

The population here refers to the component of the Lagos State Civil Service or called "staff strength". The study covers the whole civil service of Lagos State, and it was restricted to four ministries which are Ministry of Works and Infrastructure, Ministry of Environment, Ministry of Transport, and Ministry of Finance. A total of 10 agencies were selected. These include: (1) Ministry of Transport—Lagos Motor Vehicle Administration Agency (MVAA), Lagos State Transport Management Agency (LASTMA), and Lagos Metropolitan Area Transport Authority (LAMATA); (2) Ministry of Works and Infrastructures—Lagos Building Investment Company (LBIC) and Lagos State Public Works Bureau (LSPWB); (3) Ministry of Environment—Lagos State Waste Management Agency (LAWMA), Lagos State Garden and Parks (LSGP), and Lagos State Signage and Advertisement Agency (LASAA); and (4) Ministry of Finance—Lagos Internal Revenue Service (LIRS) and Lagos State Land Bureau (LSLB).

The estimated population of workers in the sampled population stood at 9,950 and a simple random sampling technique was used in selecting respondents from each of the selected agencies with a simple fraction of 7.17% bringing the sample size to 713 (see Table 1).

Table 1

*Selected Ministries/Agencies in Lagos State With Estimated Study Population and Sample Size*

Ministries	Agencies	Estimated population	Sample size
Transport	Lagos State Motor Vehicle Administration Agency (MVAA)	600	43
	Lagos State Transport Management Agency (LASTMA)	1,500	108
	Lagos Metropolitan Area Transport Authority (LAMATA)	1,250	90
Works and infrastructure	Lagos Building Investment Company (LBIC)	300	21
	Lagos State Public Works Bureau (LSPWB)	1,400	100
	Lagos State Waste Management Agency (LAWMA)	1,950	140
Environment	Lagos State Garden and Parks (LSGP)	300	21
	Lagos State Signage and Advertisement Agency (LASAA)	1,050	76
Finance	Lagos Internal Revenue Service (LIRS)	1,300	93
	Lagos State Land Bureau (LSLB)	300	21
Total		9,950	713

### Participants and Procedure

The study employed the survey method of research. The survey instruments are questionnaire and in-depth interview. The questionnaire has 29 items which were administered to a sample of 713 respondents obtained using stratified sampling technique. The stratified sampling was used to ensure that different groups in the population are adequately represented in the sample. The population was divided into senior and junior staff categories. Purposive sampling was employed to select specific functionaries that are critical for the study across the various agencies.

All the respondents involved in the study are employees working in the various agencies in Lagos which play a vital role in the socio-economic development of the country. A list of all the agencies was compiled from Lagos State Ministry of Information.

A pilot study was conducted to test the reliability of the research instrument. The research instrument was administered to five respondents drawn from Lagos State Environmental Protection Agency (LASEPA), the result of the pilot test was subjected to Statistical Package for Social Science (SPSS) computation and the Cronbach alpha value of 0.864 was obtained (see Appendix I). The reliability co-efficient of 0.70 or higher is considered to be appropriate in most social science research situation.

Questionnaire was administered to the 713 respondents, as stated as follows: 43 respondents drawn from Lagos State Vehicle Administration Agency (MVAA), 108 respondents from Lagos State Transport Management Agency (LASTMA), 90 respondents from Lagos State Metropolitan Area Transport Authority (LAMATA), 21 respondents from Lagos Building Investment Company (LBIC), 100 respondents from Lagos State Public Works Bureau (LSPWB), 140 respondents from Lagos State Waste Management Agency (LAWMA), 21 respondents from Lagos State Garden and Parks (LSGP), 76 respondents from Lagos State Signage and Advertisement Agency (LASAA), 93 respondents from Lagos Internal Revenue Service (LIRS), and 21 respondents from Lagos State Land Bureau (LSLB).

The questionnaire was attitudinal in nature and developed by the researchers. It is divided into two parts. The first part seeks demographic information such as sex, age, educational qualification, marital status, and service age. The second part was measured on a five-point Likert-type scale, measuring two concepts: agencification and public service delivery.

In-depth interview was conducted with general managers, deputy general managers, managing directors, deputy managing directors, directors, and deputy directors in each of the selected agencies as well as some randomly selected citizens who are customers of these agencies.

Secondary data were sourced from relevant textbooks, academic journals, newspaper cuttings, official documents, and publications of the agencies which are published periodically as well as office records.

### Analysis of Data

The responses to the questions in the questionnaire provided the basis for the following analysis. To analyse the data, descriptive statistical technique (including adjusting descriptive tables, frequency and simple percentage), factor analysis, regression analysis, and correlation coefficient were used. All the statistical analysis was conducted by using SPSS 18.0 for Windows. Content analysis of responses from interview was done.

Hypothesis 1: The introduction of agencification has not improved the performance of public sector organizations in Lagos State.

### Factor Analysis

A factor analysis was performed to identify the introduction of agencification as it will improve the performance of public sector organizations in Lagos State. The table shows KMO (Kaiser-Meyer-Olkin) measure of sampling adequacy. The rule of the thumb is that the KMO coefficient must be greater than 0.5 for samples selected to be deemed adequate. The value in table is 0.720 which confirms the suitability of the data from this measure for factor analysis. The authors also use the Bartlett's test of sphericity to determine the test of independence to know if the introduction of agencification has improved the performance of public sector organizations in Lagos State. The Bartlett's test gave a value of 0.000 which is less than 0.05, this means that the authors reject the hypothesis and accept that the introduction of agencification has improved the performance of public sector organizations in Lagos State (see Table 2).

Table 2

*KMO and Bartlett's Test of Introduction of Agencification and Performance of Public Sector Organizations in Lagos State Variables*

KMO and Bartlett's test		
KMO measure of sampling adequacy		0.720
	Approx. chi-square	2,011.998
Bartlett's test of sphericity	Df	36
	Sig.	0.000

*Note.* Source: SPSS Output (2014).

Hypothesis 2: Agencification of public service delivery has no influence on transparency and accountability in Lagos State.

A factor analysis was performed to identify agencification of public service delivery as it will influence on transparency and accountability in Lagos State. The table shows KMO measure of sampling adequacy. The rule of the thumb is that the KMO coefficient must be greater than 0.5 for samples selected to be deemed adequate. The value in table is 0.843 which confirms the suitability of the data from this measure for factor analysis. The authors also use the Bartlett's test of sphericity to determine the test of independence to know whether the agencification of public service delivery has influenced on transparency and accountability in Lagos State or not. The Bartlett's test gave a value of 0.000 which is less than 0.05, this means that the authors reject the hypothesis and accept that agencification of public service delivery has influenced on transparency and accountability in Lagos State (see Table 3).

Table 3

*KMO and Bartlett's Test of Agencification of Public Service Delivery on the Effect of Transparency and Accountability in Lagos State*

KMO and Bartlett's test		
KMO measure of sampling adequacy		0.843
	Approx. chi-square	1,764.337
Bartlett's test of sphericity	Df	28
	Sig.	0.000

Note. Source: SPSS Output (2014).

Hypothesis 3: The participation of professionals in public service delivery does not enhance productivity in the public sector.

The table depicts that a positive relationship between the participation of professionals in public service delivery enhances productivity in the public sector. The coefficient of determination ( $R^2$ ) is 0.315. This indicates that the participation of professionals in public service delivery only accounts for 31.5% of the variation in productivity in the public sector, while the remaining 69.5% in the productivity in the public sector is explained by other factors mentioned above. Also, a brief look at the adjusted  $R^2$  value of 31.4% indicates that after removing the effect of insignificant regressor (participation of professionals in public service delivery), about 69.6% variation in the productivity in the public sector is still not accounted for by participation of professionals in public service delivery. This value is low indicating that the participation of professionals in public service delivery inconsequential contributes to the productivity in the public sector. This means that the style of leadership among agencies in Lagos State is not participatory enough. Since the productivity of the public sector is not attributed to the directors but also the low level managers and employees (see Table 4).

Table 4

*KMO and Bartlett's Test of the Participation of Professionals in Public Service Delivery*

Model summary				
Model	R	R square	Adjusted R square	Std. error of the estimate
Dimen 1 Sion 0	0.561 <sup>a</sup>	0.315	0.314	0.56247

Notes. <sup>a</sup> predictors: (constant), participation of professionals in public service delivery. Source: SPSS Output (2014).

The table depicts the results of the statistical of significance of the regression analysis. This tests the null

hypothesis that correlation coefficient  $R$  in the population equals 0 (Pallant, 2007). The larger the  $F$ -ratio, the more the variance in the dependent variable is explained by the independent variable. In this study, the  $F$ -ratio (ANOVA) is 327.211, thereby indicating that the model is highly significant at the 0.000 level as compared with the level of significance of 5%. This implies that the participation of professionals in public service delivery enhances productivity in the public sector (see Table 5).

Table 5

*Statistical Significance of Regression Analysis on Participation of Professional in Public Service Delivery*

ANOVA <sup>b</sup>						
Model		Sum of squares	Df	Mean square	F	Sig.
1	Regression	103.520	1	103.520	327.211	0.000 <sup>a</sup>
	Residual	224.939	711	0.316		
	Total	328.459	712			

Notes. <sup>a</sup> predictors: (constant), participation of professionals in public service delivery; <sup>b</sup> dependent variable: productivity in the public sector. Source: SPSS Output (2014).

As revealed in the table, the regression coefficient of the participation of professionals in public service delivery is 0.545 while that of the constant is 1.671. These coefficients are statistically significant at 5% level. This means that the participation of professionals in public service delivery enhances productivity in the public sector. This assertion is correct as the  $t$ -value of participation of professionals in public service delivery and the constant are well above +2 (see Table 6).

Table 6

*T-Values of Participation of Professionals in Public Service Delivery*

Coefficients <sup>a</sup>						
Model		Unstandardized coefficients		Standardized coefficients	T	Sig.
		B	Std. error	Beta		
1	(Constant)	1.671	0.108		15.450	0.000
	Participation of professionals in public service delivery	0.545	0.030	0.561	18.089	0.000

Notes. <sup>a</sup> dependent variable: productivity in the public sector. Source: SPSS Output (2014).

## Discussion of Findings

The purpose of this study is to examine agencification and public service delivery in Nigeria: an empirical study of selected public agencies in Lagos State. The findings from Hypothesis 1 revealed that agencification of public service delivery has improved the performance of public sector organizations in Lagos State. The finding corroborated with the findings of studies carried out by Sulle (2008) and Batley (2004) shows that agencification was an attempt to overhaul civil service management systems, practice, and performance culture so as to have a meritocratic and a well performing public service. After all, the government may not have that capacity to develop the most relevant performance objectives. Agencies are more trusted to play this role because they have been in the fields in which they operate. They therefore know better what works in the ground.

The result of Hypothesis 2 confirmed that agencification of public service delivery has influenced on transparency and accountability in Lagos State public sector. In line with this finding, OECD (2005, p. 108) stated that agencification increased efficiency, strengthened and clarified responsibility and accountability lines,



which brings about a more service oriented administration placed closer to citizens. Miroslav (2002) in his study explains that the major problem of core ministries is that accountability frameworks/mechanisms for executives within the civil service are not strictly monitored or followed and this has resulted in inefficiency in service delivery. He also noted that accountability framework is often taken over by the political heads.

The result of Hypothesis 3 shows that the participation of professionals in the agencification of public service delivery enhances productivity in Lagos State public sector. This finding adds to the testament of Pollitt et al. (2004) that creation of autonomous agencies led by professional managers is an idea antithetical to bureaucratic system. In the same vein, OECD (2005) noted that agencification increases efficiency through a more encouraged and professional administration, and a more service oriented administration which placed closer attention to the citizens. This is also in agreement with the idea of Aisha and Muhammad (2010) that policy formation should be handled by slimmed and trimmed “core executives”, while policy implementation should be carried out by professional executive agencies with considerable managerial freedom and an extensive duty to report to the core of the results of their performances.

The findings of the study reveal that there is lack of human resources capacity, inadequate financial management skills, and poor management of service providers, and the environment of the people of Lagos State is not considered in the conception and the implementation of the service-delivery-driven agencies.

It is further discovered through personal interviews conducted with senior officials of these agencies that the level of corruption among the agencies officials is still very high. Many officials were said to have been summarily dismissed as a result of allegation of bribery and corruption against them. For instance, the LASTMA officials often indulge in extortion to free the committal from traffic offences. It has also been alleged that the officials of Kick Against Indiscipline (KAI) in the Ministry of Environment are highly corrupt. Moreover, the findings of the study reveal that many people could not benefit from some of the services being provided by these agencies, because the cost of such services is highly prohibitive.

Finally, due to scarcity of resources, many areas in the state are not adequately covered in the area of provision of service delivery by the agencies. Respondents interviewed claimed that there is over-concentration of service delivery on the Lagos Island against the mainland areas.

### **Concluding Remarks**

Agencification can be considered as a good move intended to address the inadequacies of urban local governance and to tap the advantages of new public management doctrines. The current mode of operations indeed has traces of elements such as a more “hands-on” management where more active control is visible from top managers wielding discretionary power to affect decisions, there are some explicit performance indicators in terms of city cleanliness, road maintenance, and law enforcement which may suggest a focus on value for money when technically evaluated (Gerald & Kyohairwe, 2012).

Creation of the autonomous bodies studied, revolved around two main reasons: One is the international trend and policies of international financial institutions; the other is to provide a professional goal-oriented environment to the agencies, thus rendering insulated regulation and monopoly control and to enhance efficiency of the service delivery organizations in various policy sectors.

The study therefore recommends that the styles of leadership adopted in each of these agencies should be more participatory so as to engender efficient service delivery to the citizens of the state. In addition, based on the findings of this study, it is recommended that more agencies should be created from some core ministries in

the state that are still highly inefficient in the provision of service delivery to the populace. This will encourage the participation of more professionals with considerable managerial freedom, and consequently improve productivity in the public sector. Government should reduce urban and rural unemployment by creating additional agencies which can improve service delivery system in the state.

Cases of corruption have maligned the image of most of these agencies. Widespread malpractice and corruption have often been reported among the officials of these agencies. This is one of the reasons why Nigeria is adjudged as one of the most corrupt nations of the world. Therefore, more anti-corruption institutions should be established to prosecute all cases of corruption and bribery among the officials of these agencies.

### References

- Aisha, R., & Muhammad, Z. I. J. (2010). Agencification in Pakistan: A comparative study of regulatory and service delivery agencies. Proceedings from *the EGPA Conference*. September 7-10, Toulouse, France.
- Araújo, J. F. F. (2000). Improving public service delivery: The crossroads between agencification and traditional bureaucracy. Proceedings from *the International Research Symposium on Public Management IV*. September 3-6, IRSPM, Barcelona.
- Batley, R. (2004). The politics of service delivery reform. *Development and Change*, 35(1), 31-56.
- Bennett, C. J. (1997). Understanding ripple effects: The cross-national adoption of policy instruments for bureaucratic accountability. *Governance (An International Journal of Policy and Administration)*, 10(3), 213-233.
- Boston, J., Martin, J., Pallot, J., & Walsh, P. (1996). *Public management: The New Zealand model*. Auckland: OUP.
- Bouckaert, G., & Peters, G. (2004). Ministries, agencies and other structures: Alternative models of linkage and performance. Proceedings from *the International Research Symposium on Public Management IV*. IRSPM, Barcelona.
- Brodsgaard, K. E. (2011). *Globalization and public sector reform in China*. China: Routledge.
- Christensen, T., & Laegreid, P. (2001). New public management: The effects of contractualism and devolution on political control. *Public Management Review*, 3(1), 73-94.
- Christensen, T., & Laegreid, P. (2004). Governmental autonomisation and control: The Norwegian way. *Public Administration and Development*, 24(2), 129-135.
- Egeberg, M., & Trondal, J. (2010). Agencification and location: Does agency site matter? *Public Organization Review*, 11(2), 97-108.
- Eisenhardt, M. K. (1989). Agency theory: An assessment and review. *Academy of Management Review*, 14(1), 57.
- Enahoro, J. A., & Olabisi, J. (2012). Tax administration and revenue generation of Lagos State government, Nigeria. *Research Journal of Finance and Accounting*, 5(3), 155.
- Federal Republic of Nigeria. (1999). *The 1999 Constitution of Federal Republic of Nigeria*. Lagos: Federal Government Press.
- Federal Republic of Nigeria. (2001). *Guidelines on public service reforms*. Lagos: Federal Government Press.
- Gerald, K. K., & Kyohairwe, S. B. (2012). Organizational puzzles of agencification: A Kampala city council authority case, Uganda. *The Journal of African & Asian Local Government Studies*, 12(3), 18-34.
- Holmes, M., & Shand, D. (1995). Management reform: Some practitioner perspectives on the past ten years. *Governance (An International Journal of Policy and Administration)*, 8(4), 551-578.
- Hood, C. (1995). The new public management in the 1980s: Variations on a theme. *Accounting, Organizations and Society*, 20(2-3), 93-109.
- James, O. (2005). Performance target for executive agencies and public sector externalities in the UK. In G. Drewry (Ed.), *Contracts, performance measurement and accountability in the public sector*. Amsterdam: IOS Press.
- Lagos State Government. (2010). *Lagos State public service management charter*. Lagos: Government Printers.
- Larbi, A. (1998). The new public management approach and crisis state. UNRISD discussion paper No. 112. Geneva: United Nations Research Institute for Social Development.
- Majone, G. (1994). The rise of regulatory state in Europe. *West European Politics*, 17(3), 139-167.
- Miroslav, B. (2002). Understanding the waves of agencification and the governance problems they have raised in central and eastern European countries. *OECD Journal on Budgeting*, 2(1), 121-139.
- OECD (Organization for Economic Co-operation and Development). (2005). *Modernizing government: The way forward*. Paris: OECD Publishing.

- Pallant, J. (2007). *SPSS survival manual: A step by step guide to data analysis using SPSS for Windows* (3rd ed.). Crows Nest: Open University Press.
- Pinto, R. F. (1998). Innovations in the provision of public goods and services. *Public Administration and Development*, 18, 387-397.
- Pollitt, C., & Talbot, C. (2004). *Unbundled government: A critical analysis of the global trend to agencies, quangos and contractualisation*. London: Routledge.
- Pollitt, C., Bathgate, K., Caulfield, J., Smullen, A., & Talbot, C. (2001). Agency fever? Analysis of an International Policy Fashion. *Journal of Comparative Policy Analysis: Research and Practice*, 3(3), 271-290.
- Pollitt, C., Talbot, C., Caulfield, J., & Smullen, A. (2004). *Agencies: How governments do things through semi-autonomous organizations*. Houndmills: Palgrave Macmillan.
- Rizwan, A., & Jadoon, M. Z. (2010). Agencification in Pakistan: A comparative study of regulatory and service delivery agencies. Proceedings from *the EGPA Conference*. September 7-10, Toulouse, France.
- Sulle, A. S. (2008). Executive agencies in Tanzania: A descriptive analysis. Paper prepared for the cost action: Comparative research into current trends in public sector organizations. June 3-4, (CRIPO) Utrecht University.
- Sulle, A. S. (2011). *Agencification of public service management in Tanzania: The causes and control of executive agencies*. Retrieved from [http://soc.kuleuven.be/io/pubpdf/Sulle\\_2011\\_PhD\\_Tanzania.pdf](http://soc.kuleuven.be/io/pubpdf/Sulle_2011_PhD_Tanzania.pdf)
- Thynne, I. (2003). Making sense of organizations in public management: A back-to-basics approach. *Public Organization Review*, 3(3), 317-332.
- Thynne, I. (2006). Statutory bodies: How distinctive and in what ways? *Public Organization Review*, 6, 171-184.
- Verhoest, K., Peters, B. G., Bouckaert, G., & Verschuere, B. (2004). The study of organizational autonomy: A conceptual review. *Public Administration and Development*, 24(1), 101-118.
- Verschuere, B. (2004). Autonomic and behavioral responding to concealed information: Differentiating defensive and orienting responses. *Psychophysiology*, 41, 461-466.
- Verschuere, B. (2007). The autonomy—Control balance in Flemish arm's length public agencies. *Public Management Review*, 9(1), 107-133.
- Wettenhall, R. (2005). Agencies and non-departmental public bodies: The hard and soft lenses of agencification theory. *Public Management Review*, 7(4), 615-635.

### Appendix I

Reliability statistics	
Cronbach's alpha	N of items
0.864	28

### Appendix II

#### Agencies in Lagos State

- (1) Lagos State Residents Registration Agency
- (2) Lagos Metropolitan Dev. & Governance Project
- (3) Lagos State Motor Vehicle Administration Agency
- (4) Lagos State Traffic Management Authority
- (5) Lagos Building Investment Company
- (6) Lagos State Emergency Management Authority
- (7) Lagos State Waterways Authority
- (8) Health Facility Monitoring & Accreditation Agency
- (9) Lagos State Internal Revenue Services
- (10) Lagos State Metropolitan Area Transport Authority
- (11) LAGBUS Asset Management Limited
- (12) Lagos State Number Plate Production Agency
- (13) Lagos State Drivers Institute
- (14) Agricultural Input and Supplies Authority, Ojo
- (15) Agency for Mass Education

- (16) Lagos State HIV/AIDS Control Agency
- (17) Lagos State Urban Renewal Authority
- (18) Lagos State Physical Planning and Dev. Authority
- (19) Lagos State Environmental Protection Agency
- (20) Lagos State Waste Water Management Agency
- (21) Lagos State Accident and Emergency Centre
- (22) Lagos State Task Force on Env. & Special Offences
- (23) Lagos State Infrastructure Maint & Reg. Agency
- (24) Lagos State Signage and Advertisement Agency
- (25) Lagos State Lands Bureau
- (26) Lagos New Towns Development Authority
- (27) Lagos State Planning & Environmental Monitoring Authority (LASPEMA)
- (28) Lagos State Infrastructural Maintenance & Regulatory Agency
- (29) Lagos State Signage and Advertisement Agency (LASAA)
- (30) Lagos State Parks & Gardens
- (31) Lagos State Water Regulatory Agency
- (32) Lagos State Procurement Agency

# What Could Be the “Imaginary Institution” of the City?

Olivier Lefebvre

Olivier Lefebvre Consultant, Paris, France

In his book *The Imaginary Institution of Society*, the French philosopher Castoriadis wanted to explain the radical change of societies and their diversity; the social imaginary matters, and explains social change. But what is it today? The Castoriadis's answer is mainly a criticism of the imaginary of the bureaucratic society (perfect anticipations). He hoped more autonomy. In the paper, it is proposed this interpretation of the imaginary of the city: The main myths are personal strength, chance (here the reference is Ulrich Beck's book *The Risk Society*), and individual happiness (the reference being the works of the French philosopher Lipovetsky). One is able to explain the discrepancy between public policies (including city planning) and the real social needs. It exists because the doctrines used lag behind the “social imaginary significations”. The concerned fields are the beauty of cities, spatial segregation, women in the city, environment, drugs, etc.

*Keywords:* social imaginary, values, culture, social needs, risk society

In his book *The Imaginary Institution of Society*, the French philosopher Castoriadis tried to explain social change thanks to social imaginary. One shall describe the intellectual backdrop of the Castoriadis's works and set out his hypothesis. Then one shall propose a hypothesis on the social imaginary “establishing” the city of today. The main myths are personal strength, chance, and individual happiness.

One concludes on the discrepancy between public policies, including city planning and the real social needs. The used doctrines lag behind the social needs because these needs depend on “social imaginary significations”, they are elusive and always changing. Concerned fields are the beauty of cities, spatial segregation, women in the city, environment, drugs, etc.

## The Intellectual Backdrop of the Castoriadis's Works

### The French Tradition in Sociology

The French sociological tradition starts from Durkheim. These authors were very much influenced by anthropology. They took myths and culture very seriously, but they seem today unable to explain modern societies. This can be illustrated by examples of famous books. The celebrated Mauss's essay *The Gift* is brilliant but of no help to explain modern societies. The Bourdieu's book *Distinction: A Social Critique of the Judgment of Taste* insists on the stratification of the French society and describes the signs allowing to distinguish upper and lower status. But as early as the 1920s, the American sociologist Sorokin warned that occidental societies are mixed for centuries, due to vertical and horizontal mobility. Today, all is shared: tastes, fashion, spectacle, etc. (Lipovetsky, 2013). And there is the equalizing effect of risk, since often public goods are concerned, pollution, security, health, etc. (Beck, 2008). In the same way, Bourdieu states that the

---

**Corresponding author:** Olivier Lefebvre, Ph.D., consultant, Olivier Lefebvre Consultant; research fields: communication, information technologies, and social space. E-mail: o.lefebvreparis05@orange.fr.

domination of men on women is fixed in culture and language. But he is unable to explain why women struggle for new rights. They are often successful (Lipovetsky, 2006).

The books of Roger Caillois remain very interesting. In his book *Man and the Sacred*, he states that periodical feasts allowing breaking taboos are a necessity for societies, to re-establish their values. And he concluded that today these feasts should be replaced by inevitable wars. But in modern societies, there are many feasts that are not (too much) violent. For instance, kitsch is a feast breaking the rules of the formatting of tastes by brands and advertising (Lipovetsky, 2013). In another book *Man, Play and Games*, he stated the universality of game, taking four shapes: Agon (competition), Alea (chance), Mimicry, and Ilinx (vertigo). He warns that there are excess and abuse. But in modern societies, everyone plays games.

The choice made is “general deregulation” (Lipovetsky, 2013). In some cases, society opposes its own players, the regulators, to players who deserve control (finance, telecommunications, health, etc.). Even the cities play games: Agon (competition) and Mimicry (when mid-sized cities imitate the most famous large cities). For instance, cities in China bet on economic growth whatever the consequences on environment are, while Boulder (Colorado) in the USA bets on struggle against any pollution<sup>1</sup>. However, in this book written in the 1950s, Caillois gives an explanation on modern societies: The cult of stars (through media, movies, fashion, etc.) is described, thanks to mimicry and the author anticipates the “democratic imaginary”. In a competitive and egalitarian society, the hopes of everyone are never achieved, but the cult of stars allows feeling as successful as those at the top.

Another interesting book is the Régis Messac’s essay *The Detective Novel and the Influence of Scientific Thought*. The author quotes Edgar Poe: “The universe is a plot of God”. All things are linked together, since everywhere and always there are causes and effects. It is the myth of serendipity. The detective uses his extraordinary abilities to break the enigma. Here, that the French sociological tradition explains more culture than society appears. On society, Messac says only this: Time in the detective novel is linear, as it is in all the novels, except Proust’s *In Search of Lost Time* (since in this novel, at the end, the main character becomes a writer, achieving his quest). One can compare with the Siegfried Kracauer’s book *The Detective Novel*. He extends the scope of his topic to society. The detective novel displays the realm of the ratio. That is to say, the capitalist society works and it is enough, the human fails but this is forgotten and the question of the influence of ethics on law is not posed.

The last example is the book of the sociologist Fauconnet—*The Responsibility*. He states that myths and values (or culture) are the causes of law. Decades before the publication of the famous book of Michel Foucault—*Discipline and Punish*, he shows the awkward dilemmas of any theory of law. However, this book is forgotten. Even if the idea of the influence of myths and values on ethics and law is very much relevant, there is no word in the book on the role of media, the power of opinion, the egalitarian ideal, etc.

One concludes that the French sociological tradition (between the two world wars) rightly insisted on myths and values, their impact on society, but failed to describe social change and the modern society<sup>2</sup>.

<sup>1</sup> Sometimes, some games seem too violent, and a majority appears which obtains the ban. A real foe of games is... mathematics, since when mathematics discover the winning strategy, a game loses any interest (Caillois, 2012).

<sup>2</sup> An example of a French author who was very clear sighted on culture is Stendhal. He prophesized that should the expansion of liberty continue, art would satisfy the most popular tastes. Liberty meant the liberty of the press, for him. He was very impressed by the sense of liberty among Americans. He quoted Alexis de Tocqueville who spoke of “imaginary liberty” when describing the United States. Stendhal saw the first impact of technology on art. Photography started at this time. The painters began to buy their colors (before they made them themselves). The famous treatise on color in painting of the chemist Chevreul dates from 1839.

### The Discovery of the Consumer Society

The consumer society was anticipated by the Frankfurt School and discovered in the USA after the Second World War. One can quote the Kracauer's book *The Salaried Masses* and other books on popular culture, life in metropolises and movies. Adorno wrote books on cultural industries. The discovery of the consumer society dates from the David Riesman's book *The Lonely Crowd*. One can also quote the Vance Packard's essays on marketing, waste, and the tastes of American people (pets, statuses, social climbing, etc.) and the very rich, etc. In France, the ideas of MacLuhan were popularized and modernity was described in the books of the sociologist Edgar Morin—*The Spirit of the Time* (on popular culture), *The Stars*, and *Cinema or the Imaginary Man*.

### The Castoriadis's Thesis

Castoriadis explains radical social change thanks to the social imaginary. All our actions, ordinary or extraordinary involve “social imaginary significations”. These social imaginary significations make up a “magma” which is coherent at some time. This explains the “specificity” of a given society. The magma is also “arbitrary”, meaning that it changes in a way which is not determined.

In the Castoriadis's works, there are these characteristics:

(1) He abandoned Marxism because the law of decreasing profits is not observed (he was also an economist);

(2) Being also a psychoanalyst, he abandoned Freudianism because this theory does not explain the diversity of societies. But he kept the hypothesis of Oedipus complex, which explains the socialization of the individual. The infant is submitted to a constant flow of images and representations, and “selects” some of them to make up his (her) personality (character, vocation, etc.). The coherence of the “magma” grants that the social roles are consistent. For instance, in our society, characterized by technological change, vocations like innovation (in a technological field), technician and financier are coherent;

(3) The Castoriadis's thesis is not merely a return to the “totality” of Marcel Mauss. He criticized the “inherited thought” as being deterministic. He wanted to save the idea that social change is not determined, but “arbitrary”, or unpredictable. He hoped an evolution of society toward more autonomy, rejecting “heteronomy”. Indeed, according to Castoriadis, it is uneasy to “guess” or “interpret” how the magma (of imaginary social significations) changes. He criticized the myth of the “bureaucratic society”, the perfect anticipations. Perfect anticipations are impossible. Unpredictable events can always occur, as it has been stated by Taleb in his famous book *The Black Swan*. The most serious prospective will only propose scenarios without any given probability, which cannot cover all that is possible. In technical terms, one can propose two scenarios with unknown probabilities  $p_1$  and  $p_2$ , and  $p_1 + p_2 < 1$ . It is “imprecise information”. Add to this, the theory on optimal decision in the context of imprecise information is only a mathematical theory in progress. The consequence is that complex modeling (in prospective) is uneasily understood by opinion (also, it is sensitive to imaginary significations). To take an example, the scenarios of the IPPC (Intergovernmental Panel on Climate Change) are uneasily understood by opinion. But the “precautionary principle” is more understandable, being a qualitative reasoning (and corresponding to some imaginary signification, prevention from the worst environmental risks);

(4) Castoriadis did not forget economy. There are two ontologies. One is practical, economic, and codified thanks to logics. It is thought and action, codified and deterministic. This ontology is ensemblist/identitarian.

The other ontology is historical/social, submitted to the social imaginary<sup>3</sup>. The myths are “shored up” in economy and practice. Society and social change are explained only when one considers the two ontologies<sup>4</sup>. Economy is not just to use tools in accordance with some codified knowledge, to extract subsistence from nature. There are symbolic aspects and the social imaginary matters. It is obvious if one considers the tools used to work. It is also apparent if one considers the surplus. Otherwise, the question of how the surplus is used would be not answered. In the past, the surplus was used to build palaces, temples, etc. A current example is that we accept the destruction of environment by economy. We should be aware of that and find remedies. But it involves some change in the social imaginary;

(5) Of course, what Castoriadis forecast (or hoped) for society did not occur. Instead of revolution and its agents (the workers councils), there was the opinion directed society, instead of participation, there was sharing and a division of labor more and more sophisticated, instead of autonomy, there were rights which are granted only if opinion feels concerned, instead of the end of privileges, there was the appearance of new privileges (like visibility). But Castoriadis understood the role of social imaginary and the end of the influence of any transcendent doctrine. The influence of any transcendent doctrine means heteronomy. On the opposite, autonomy involves the self-creation of society.

### **What Could Be the “Imaginary Institution” of the City**

There is no clear method to “interpret” the social imaginary (concerning the city). One could have recourse to analysis of cinema, since it is the art of our time (Lipovetsky, 2013). In his two books on cinema, *From Caligari to Hitler: A Psychological Theory of German Film* and *Theory of Film: The Redemption of Physical Reality*, Kracauer shows the metropolis as the place where meetings occur, allowing anyone to construct his (her) life<sup>5</sup>. All depend on chance. Kracauer commented the Grune’s movie *The Street* several times. The main character is fascinated by the street, representing risk and chance, but finally prefers security at home. If myths are “shored up” in economy, chance should be accepted as a kind of value. Chance is everywhere in the economy of today: deregulation, refusal of the “too big to fail” and venture capital. Regulation is required only when the failure of some actors will trigger other failures (effect of contagion). In the Taleb’s words, antifragility requires exposure to risk. According to Lipovetsky, other myths are individual happiness and success, and equality. It is the consequence of an individualistic and democratic revolution in the 1970s and 1980s, generating the “second modernity”. Many movies show the narratives which concern individuals, the dramas they live, the particular problems they meet, and the dilemmas they cope with, etc. There are still privileges, but they are not popular. For the opinion, it matters only equality and meritocracy. The abilities of any individual are tested: He (she) has to achieve success (here one sees that myths are “shored up” in practice and economy) and also happiness. One concludes that personal strength, chance, individual happiness and success, and equality are important myths (in cities). Other myths exist like femininity, manliness, childhood, maturity, nature and technology, etc., but are subordinate to the most important myths.

<sup>3</sup> One can take the example of ethics and law (not dealt with by Castoriadis). The historical/social ontology determines ethics. And theory of law is in accordance with ethics and submitted to the ensemblist/identitarian ontology. Theory of law is part of codified knowledge (called *Legein* by Castoriadis). The difficulty of theory of law is explained by the opposite characters of the two ontologies.

<sup>4</sup> In the detective novel, according to Messac, the ensemblist/identitarian ontology explains society. Therefore, crime is only an enigma to be broken. If we take into account the historical/social ontology, crime has to be ethically judged. It is the point of view of Fauconnet.

<sup>5</sup> This includes anomic people who need to meet persons to share ideas and projects. They meet them in the city.



### The Discrepancy Between Authorities’ Policy and Social Needs

The “imaginary social significations” matter and it is difficult to interpret them. Therefore, their consequences are uneasily understood. That is why there is a discrepancy between the authorities’ policies (including city planning) and the real social needs.

This problem has two aspects:

(1) According to Lipovetsky, we have to create a sustainable consumer society, and this project is replete with double binds. Production has to be abundant, but not polluting, eaters should be satisfied, but not fat, (hyper)consumption requires using natural resources but they should be preserved, information technologies should develop but individual liberty being preserved (it is the stake of data privacy), etc. In a few words, the (hyper)modern society requires quality of life;

(2) When science and technology create new devices, this diffusion generates unexpected social effects<sup>6</sup>. Sometimes opinion, which is worried about some risk, makes a narrative (concerning the risk) of its own, neglecting all that was said by experts in the past. The consequence is that decisions follow. It is the appearance of a “risk community” (Beck, 2008). Examples in Germany are sulfur disseminated in the atmosphere by plants and the decision to end nuclear production of electricity after the Fukushima accident.

Some examples can be quoted:

(1) Beauty of cities. We are at the time of “artist capitalism” (Lipovetsky, 2013). Beauty is required everywhere in large cities. At least, ugliness is banned. Elias Canetti in his book *Crowds and Power* remarks that metamorphosis is an attribute of power. Therefore large cities, playing the game of Agon (competition), wanting to be models and to trigger dreams, are tempted to create new quarters. It is spectacular, in particular when a mega-event occurs in the city. There is a trend for large cities to be covered with building sites lasting years. What about the quality of life for those living in these cities?

(2) Spatial segregation. According to Lipovetsky, what matters is not all the people living in the prestigious and nice places existing in the cities. That matters is that youngsters can go to these places, wearing Nikes or Pumas, to have fun there. Finally, what matters is jobs (for the youngsters). Of course, all the places in cities have to be well equipped, which allows provision of basic services. But social mixing should be bearable, provided that youngsters have jobs and have access to consumption (since it is their real desire). Indeed, spatial segregation has a bad effect according to Jane Jacobs. Those needing advices (to cope with adversity) are away from those able to give these advices. And this matters, according to Lipovetsky, today ethics is not forgotten but it has to be painless because it involves narcissist people (Lipovetsky, 2000). It is better if there are fewer obstacles (that is to say, if those needing advices are near those able to give advices);

(3) Women in the cities. As there is a strong demand of nurseries, municipalities (and sometimes firms) provide them. It allows women working while having and raising kids. Perhaps in doing so, one favors a society of single men and women raising kids (Beck, 2008). Often women who do not work and divorce, raising one or several kids, fall into poverty. They are numerous, benefitting from social assistance. It is a consequence of the strong “egalitarian imaginary”. Women want to be equal to men, working while having kids.

---

<sup>6</sup> Drones are an example. Of course, they are useful to achieve many tasks (surveillance, safety, agriculture, mapping, etc.). But hostile uses are possible. Already a drone has been used to provoke a crowd: In 2014, a football competition between Serbia and Albania stopped, because a drone displayed a provocative symbol.

Beck forecasts a “war between genders” as a consequence of this strong women’s desire for equality;

(4) Environment. Municipal authorities have the choice between two policies, preserving environment or not. Of course, the choice is political and electoral. Many cities are active in this field: clean public transportation, attrition of car traffic, reduction of carbon dissemination in the atmosphere, public gardens and even measures in favor of biodiversity, etc. They have made up a world association. Indeed, the artificiality of the city has won (at least in large cities). Nature is a myth subordinate to the myth of individual happiness, which is achieved thanks to hyperconsumption. That is to say, some “natural products” are good for health, landscapes provide *décor* for holidays, remote places allow nice movies, etc. Nature is more a strong myth in many mid-sized cities. All this has bad consequences if we consider the future. Opinion should take seriously the stake of saving the planet, in particular when global warming is concerned;

(5) Drugs. Today, opinion has not made some clear choice, concerning drugs. In general, repression is approved, but this could change. Let us recall that there are two shapes of liberalization: decriminalization (sales of drugs are not punished) and legalization (sales of drugs are licit and organized under the control of the state). For instance, two states in the USA, Colorado and Washington have liberalized drugs. Another stake is “supervised injection sites”, which are permitted in several European countries (Germany, The Netherlands, etc.). It is controversial. In some cities, people refuse the opening of such sites. Here one sees myths in conflict. On one side, the myth of the second modernity being individual happiness, all that allows individual happiness, including use of drugs, should be permitted. On the other side, the myth dating from the first modernity is self-control (Lipovetsky, 2013). Using drugs is disapproved because it is a lack of self-control since health is supposed to be destroyed. Lipovetsky quotes the criteria of women’s beauty. It remains thinness, which means self-control.

### Conclusions

One has insisted very much on the works of authors like Castoriadis or Kracauer, who knew and analyzed the first modernity. This is justified, because the second modernity is only the accentuation of the features of the first modernity, individualism, search for happiness and equality (Lipovetsky, 2013).

One concludes examining the role of technology.

At the time of the first modernity, technology was one of the main myths, since it was the means to achieve an abundant production and win shortage. Today (at the time of the second modernity), technology is more a myth submitted to other ones like individualism and happiness. Technology is valued as a means to achieve health, beauty, allowing nice trips and attractive spectacles, etc. An example is when a drone flies among birds, shooting images of them and the ground.

The first to study life in the metropolises (authors like Simmel and Benjamin) noticed that people living in cities are submitted to “shocks”. The citizens parry the shocks thanks to indifference, blunting or snobbery (or coquetry) according to Simmel. According to Benjamin, the remedy to shocks is... shocks, which can be found in movies or architecture in glass. Today, new ways to look at the physical reality appear: drones shooting images, special effects and visual effects in movies, computer graphics, creation of imaginary worlds generated by computers for videogames, cameras fixed on the bodies of sportsmen or animals and 3D television or movies, etc. Perhaps there is the appearance of a new “perception” of the urban environment by citizens, allowing overcoming the “shock” of urban life (Fuzessery, 2008).

An example is the serious game—Blockholm, organized by the municipality of Stockholm. They use the

virtual platform of a very popular videogame—Minecraft. It allows building “blocks” to obtain a virtual environment, in which the player plays the game (there are several modes, the player has to survive, or to win monsters, etc.). A player playing the game Blockholm acquires a plot and builds the building he wants on it. The virtual environment replicates the site of Stockholm. The result will be a kind of virtual Stockholm. The most beautiful buildings will be converted into mock-ups and shown in an exhibition (Majury, 2014). It is taking into account the imaginary dimension of the city. The result of this serious game could show the dreams triggered by some city, which are expressed in the buildings imagined by the players.

It is an example of exploring the imaginary dimension of the city (in the field of architecture). More generally, the “reflexive modernity” (Beck, 2008) requires examining the “social imaginary significations” of the city and their consequences. It is a condition to remove the discrepancy between authorities’ policies and real social needs.

### References

- Beck, U. (2008). *La société du risque: sur la voie d'une autre modernité (Risk society: Towards a new modernity)*. Paris: Flammarion.
- Bourdieu, P. (1979). *La distinction: critique sociale du jugement (The distinction: A social critique of the judgement)*. Paris: Editions de Minuit.
- Caillois, R. (2012). *Les jeux et les hommes (Man, play and games)*. Paris: Gallimard.
- Castoriadis, C. (1999). *L'institution imaginaire de la société (The imaginary institution of society)*. Paris: Editions du Seuil.
- Fauconnet, P. (2010). *La responsabilité (The responsibility)*. Dijon: EUD.
- Fuzessery, S. (2008). *Le choc des métropoles: Simmel, Kracauer, Benjamin (The shock of metropolises: Simmel, Kracauer, Benjamin)*. Paris: Editions de l'Eclat.
- Jacobs, J. (2012). *Déclin et survie des grandes villes américaines (The death and life of great American cities)*. Marseille: Editions Parenthèses.
- Kracauer, S. (2001). *Le roman policier: un traité philosophique (The detective novel: A philosophical treatise)*. Paris: Payot.
- Kracauer, S. (2010). *Théorie du film: la rédemption de la réalité matérielle (Theory of film: The redemption of physical reality)*. Paris: Flammarion.
- Lipovetsky, G. (2000). *Le crépuscule du devoir: l'éthique indolore des temps démocratiques (The twilight of duty: The painless ethics of democratic times)*. Paris: Gallimard.
- Lipovetsky, G. (2006). *La troisième femme: permanence et révolution du féminin (The third woman: Perennity and revolution of the feminine)*. Paris: Gallimard.
- Lipovetsky, G. (2013). *L'esthétisation du monde: la vie au temps du capitalisme artiste (Esthetizing the world: Life at the time of the artist capitalism)*. Paris: Gallimard.
- Majury, C. (2014). *Imagination made real in Stockholm Geoinformatics* (Vol. 1, pp. 10-12). Emmeloord, The Netherlands: C Media B.V.
- Messac, R. (2011). *Le “detective novel” et la pensée scientifique (The detective novel and scientific thought)*. Amiens: Encrage.
- Morin, E. (1982). *Le cinéma ou l'homme imaginaire: essai d'anthropologie sociologique (The cinema or the imaginary man: An essay of sociological anthropology)*. Paris: Editions de Minuit.
- Taleb, N. (2010). *Le cygne noir: la puissance de l'imprévisible (The black swan: The impact of the highly improbable)*. Paris: les Belles Lettres.
- Taleb, N. (2013). *Antifragile: les bienfaits du désordre (Antifragile: Things that gain from disorder)*. Paris: les Belles Lettres.

# Economics and the Practice of Human Action: The Legacy of the Austrian School

Andrzej Janowski  
WSKM Konin, Konin, Poland

Zofia Wyszowska  
Bydgoszcz University of Technology, Bydgoszcz, Poland

Economics is the youngest of all sciences. Its task is to identify the secondary consequences, but it requires a perception of general consequences, including effects which are brought by an implemented or proposed economic policy not only to a certain special interests in short periods of time but also to a general interest for long periods, which somewhat contradicts the assumptions of many economic doctrines. Thus, the current state of economics or management science is difficult to be called autonomic. Economists “have opened” the domain previously reserved for “hard indicators” on the human aspects of the assessment of effectiveness. What is more, the discovery of regularity in the sequence and independence of market phenomena, in particular, a markdown role of the “invisible hand of the market” and “government interventionism” put into question the validity of the dogmas of traditional British or American schools, as a consequence of the operation of schools with the teaching of economics. This paper is the attempt to show the failure of the most popular scientific economical schools, including neoclassical ones in the area of human performance, comparing with Austrian School principles.

*Keywords:* activity, effectiveness, human action, management, praxeology

Philosophers have searched targets that God or nature had tried to implement in the cycle of human history for a long time (Bochenski, 1993). They have also tried to identify the laws that govern the evolution and destiny of the human race. However, even these ancient thinkers did not hold any ideological constraints, they had to admit the futility of their efforts, which constituted a derivative of inappropriate research methods, which were based on the assumption of holism humanity or other similar concept of one nation, race, or church. Then they arbitrarily set purposes for which the previously selected communities should strive and how to assess affordability of mentioned purposes. Consequently, there was not obtained a methodically correct answer which determinants had oriented, behaving differently individuals to act together to achieve a result of relentless progress toward evolution.

Therefore, it was introduced in the way of desperation of a “divine factor” (Topolski, 1984)—any inaccuracies or inconsistencies have been sanctioned by the intervention of gods or divine revelation and the

---

**Corresponding author:** Andrzej Janowski, Ph.D., Headmaster of Banking and Insurance Department, WSKM Konin, Konin, Poland; research field: HRM effectiveness. E-mail: [andrzej.j@poczta.fm](mailto:andrzej.j@poczta.fm).

Zofia Wyszowska, Doc. Sc. (Econ.), professor, Dean of Management Faculty, Bydgoszcz University of Technology, Poland; research fields: strategic management, human capital, and competitiveness. E-mail: [zofia.wyszowska@cps.pl](mailto:zofia.wyszowska@cps.pl).

prophets sent by God (Janowski, 2007) and saints leaders who introduced order and harmony. They also used the “spirit of world” and the “spirit of the nation”. Other concepts assumed the existence of “forces of nature” affecting human being to unknowingly follow a path designated to him by nature.

However, other philosophers were more realistic. They did not try to guess the intentions or divine nature. They thought that you should search the human aspects in the context of government activity. Their intention was to establish the principles of political activity and technology skills to run the country. They were also based on speculation ambitious plans for the reconstruction of society. The simplest of them was derivative from systematization of historical experience, however, almost all scholars of this period were completely convinced that there was no experience of regularity and variation phenomena similar to human reasoning, in the sequence of natural events. The researchers did not look for laws governing human cooperation, because it assumed that a person can organize society according to its own plan. If social conditions do not meet the objectives of the reformers, if the inability to implement their utopia has been proven, the blame for the failure of the project was attributed to “moral defectiveness” of man. Social problems were seen as ethical, therefore, it was necessary to create an ideal society, the existence of good princes and valuable citizens. With righteous men, any utopia might look forward to implementation.

The discovery of the inevitable independence of market processes broke down the basics of this concept. Confused advocates have to face a new image of society. They saw that there was amazement that there is another context in which it can be perceived, human actions were launched than a reflection between good and evil, honesty and dishonesty. The succession of events has been dominated by the regularity of phenomena to which man must adapt to succeed. It was a pointless approach to social facts as a censor who approves or rejects the views defined in terms of their consistency with the arbitrarily designated standards and subjective judgment of their value. Someone needs to study the laws governing human behavior in a manner characteristic of physics determining the laws of nature. Human activity, including social cooperation is seen as an object of research with established relationships, not normative discipline in defining things as they are, in fact, it was a revolutionary statement, with very serious consequences for knowledge, philosophy, and social activity.

Over the next years, the effects of this radical change in the methods of inference were very limited because people believed that they refer only to a limited segment of human activity area—market relations. Proponents of classical economics encountered an obstacle in the implementation of their research, which they could not rule out or defeat—an obvious contradiction of values. Theory, in the section on determining the value was defective and forced to limit the scope of their study. Until the 19th century, political economics remained a science of “economic” aspects of human activity, the theory of wealth and selfishness. It corresponded to human behavior only in the area known as the profit motive, while other factors accounted for only a supplement. The transformation of thought, initiated by the classical economists, found acclaim among modern advocates of economic subjectivism that convert market prices as the main theory of human choice. However, researchers have failed to prove the correctness of the transition from the postulate of the classical theory of its subjective equivalent for a long time, by substituting a more satisfactory market exchange assumptions less. The general theory of choice and preference goes far beyond the horizon, which included a range of economic problems, significantly limited by the economists starting with Cantillon (Jevons, 1881), Hume (Hume, 1965), Smith (Lowe, 1954), and ending with Mill (Mill, 1869). The perception of human activity in this approach is much broader than just economically determined and focused on the purchase of movable

and overall improvement in material well-being. It is a theory which takes into account every aspect of human activity. Choosing determines all human decisions, and it is not only derived from a wide range of material goods and services—all human values are additive and the objectives and means, both material and ideological, sublime and essential, noble and despicable, are arranged in one row and subordinate to the decision to choose the best solution, at the expense of the rejection of others. Thus, no aspect of human activity, both in terms of setting goals and avoid risks, is not outside the range of interest, is a unique element—specific scale of gradation and preference.

In addition to the political economy of the classical school, there is a general theory of efficient human action—praxeology. Economic and catallactic problems here are embedded in the overall context of the research and none of the economic solutions does not allow the proper determination of human behavior in terms of making choices, economics becomes a part of a more universal science—praxeology (Espinosa, 1890).

### **Epistemological Aspects of the General Theory of Human Action**

In the current study, any previous solution seemed to be problematic. This represented a significant departure from the traditional system of perception of knowledge. Practitioners and academics encountered problems when trying to mention classification theory and assign it to a specific context. However, on the other hand, they were convinced that previously used catalog of knowledge did not require reconstruction or extension. It was believed that the catalog is complete and if economists were not able to adjust their views to it, it meant that they applied economics in an abnormal way, inadequate to the identified problems. Equating their academic disputes of pedantic professors, an utter lack of understanding of the importance of the debates focused on the fact, scope, and logical character of economics. In “Methodenstreit” (Menger, 1871) between Austrian economists and the Prussian Historical School—a self-proclaimed “intellectual guardian of the Hohenzollern Palace” and American industrialism represented by J. Bates Clark, there was a discussion concerning the effectiveness of particular procedures. The main problem was the epistemological principles of science of human action and its logical equity. Starting from an epistemological system, in which it was difficult to fit praxeological way of thinking, and ending on the logic that the assumption was perceived as only through scientific empiricism and history. As a result, many authors have tried to negate the value and utility of praxeology, as economic theory. Supporters of historical recognition sought to convert its economic history, and the positivists recommending the substitution of “illusory” social sciences adaptation to structures and patterns of Newtonian mechanics. Both schools were characterized by compliance mentioned in the context of a radical rejection of all the achievements of economic thought.

The radicalism of the acute criticism *skomasowanej* economists was, however, soon surpassed by the universal nihilism. From ancient times, people’s thinking, speaking, and acting assumed constancy and immutability of human intentions as an unquestionable fact, and all research on this assumption. The dispute about the epistemological character of economics, writers, for the first time in the history of the human species, also questioned the previous axiom. Marxists asserted that human thinking is determined by membership in the class, and each class has its own separate logic. The product of this kind of thinking can be nothing more than an “ideological guise of” selfish class interests, and the task of “sociology of knowledge” is to unmask philosophies and scientific theories and to demonstrate their “ideological emptiness”. Economics presented as a product of the bourgeoisie and the economists determined flatterers of capital. Only a socialist utopia of a classless society could replace true “ideological lies”.

This polylogism was also presented in other forms. Historians have asserted that the logical structure of human thought and action is a consequence of changes in the course of historical evolution, provided that each of the races themselves legitimacy attributed to the use of their recognition logic. Finally, it was claimed that such a cause is not an explanation for the irrational factors determining human action (Dobrosielski, 1999). Mentioned doctrine goes far beyond the framework set out by the economy, not only question the economics and praxeology, the human knowledge and reasoning, it refers to the mathematics and physics, as well as economics. However, it seems to be a reasonable assertion that the ability to debunk mentioned conditions does not close in one area of knowledge but in epistemology and philosophy. Physicist gets upset when someone stigmatizes his theories describing them as “bourgeois”, Western or Jewish, the economist should ignore *detrakcję* or slander in the same way, according to Spinoza’s dictum “*Sane Sicut se lux et Tenebras Ipsam manifestat, sic veritas standard sui et falsi est*”. However, there is a reasonable search for identical analogy in the assumptions of economics, mathematics, and science—polylogism and irrationality are in conflict with the canons of praxeology and economics. Although similar in general respects to all fields of knowledge, a general theory of human action has in mind, emphasizing the illusory nature of the declaration that scientific research is possible to obtain results corresponding to their implementation in all ages, races, and social classes, and depreciating certain physical and biological theories as bourgeois or Western (Von Mises, 2010). But, if the solution of practical problems requires the implementation of these stigmatized doctrines, the above criticism is forgotten (Technologies used in Soviet Russia unscrupulous use all the achievements of bourgeois physics, chemistry, and biology, as if they were relevant to all social classes and the Nazi engineers and physicists did not slight theory, discoveries, and inventions “inferior” races and nations). The behavior of people of all races, nations, religions, language groups, and social classes in a simple way proves that they do not approve of the doctrines polylogism and irrational—forced, like logic, mathematics, and science.

### **Praxeology as a Legacy of the Austrian Economic School**

In the context of praxeology, the situation is completely different. The main motive for the development of doctrines of polylogism, historicism, and irrationality was to provide an excuse for disregard of economic thought in the implementation of economic policy—socialists, racists, nationalists, and statist, finally, were defeated in their efforts in refutation of economic theories and demonstrating the correctness of their own false doctrines. This frustration led them to the negation of logical and epistemological principles in the identification of cause—effect on human action, both in terms of practical and scientific research. However, it would be wrong to assign such motives as merely caused political aspirations and no researcher cannot be authorized to construct *ex ante* demands that the criticism faced by his theory is a derivative of unfavorable attitudes and mistakes made by the evaluator voiced disapproval of the theory. What is more, he is obliged to respond to any criticism without perceiving it in the context of hidden motives pejorative or the background. It is also not correct to conceal the facts that the usefulness and accuracy of economic theory occur only in specific areas and hypothetical assumptions, which in most cases, implementation of the realities of doing business is not possible. What is particularly important, although some schools of economic confirmed in the opinion, still officially direct your thinking according to accepted dogma, not worrying about the complete lack of usability of constructed models, in fact, assume this attitude is not tenable, since the main task of comprehensive scientific study is to describe and define all the terms and conditions under which the adopted

model is correct. It is a mistake therefore to establish physics as a model or regulation for economic research. Those who commit this fallacy, should take into account that none of the physicists never believed that the explanation of a number of assumptions or conditions of physical theory is an explanation outside of physics—a field of science. Therefore, the main problem to be solved for economic science is to identify the validation of economic theorems in the context of human activity and mental conditions, which are the subject of economics.

Mentioned assumptions make that economics as a science refers to a capitalist system and in a short period to liberalism in Western civilization, which is an aggravating factor for the science sector in other areas of learning. To take into account any objections and oppose them to often useless economic assumptions, particularly in the context of human activity, economic system should be constructed in such a way that the criticism in the section on irrationalism, historicism, behaviorism, and other varieties of polylogism. It seems not to be entitled to tolerate a state in which every day arguments are present that demonstrate the absurdity and futility of principles of economics and economists seem to ignore this fact, there is no justification for seeking solutions to the economic problems of using traditional foundations. What is more, clearly it highlights the need to construct a catallactic theory based on a permanent basis on the general theory of smooth operation—praxeology. This procedure not only protects against waves of particularistic critics but also explains a lot of problems, yet not even adequately perceived or resolved in a general way—that is, in particular, the fundamental problem of economic calculation.

It has become customary to blame the economists of backwardness. Today, it is quite correct to say that none of the economic theory cannot be considered to be perfect, since there is no knowledge of the human person, which could be described as a complete analogy also applies to every human achievement. Omniscience is therefore a denial of man, and the most elaborate theory of what seemingly is built to the highest possible level of competence (Janowski, 2006), may be reconstructed or negated thereafter. Science does not afford certainty, only to determine the theoretical optimum, the existing constraints and knowledge available in the area, which are just a point on the trajectory of development, and it is further distorted because inconsistency characterizes every human effort. This does not mean, however, that today's scientific activity in the field of economics is fragmentary, but it is also subject to evaluation, as a result of prior deficiencies and change. The allegation of an alleged backwardness of economics can be traced in two different approaches:

(1) There are naturalists and physicists who belittle the achievement of economy, because they believe that it is not a natural science, so there are no application methods and laboratory procedures. However, these manifestations of criticism can be derived from psychological education adversaries. Laboratory worker sees the study conducted by the researchers as only right and differential equations, a method of presenting the results to the signal. That investigator is unable to perceive the epistemological problems of human action, therefore, sees the economy as a derivative of mechanics;

(2) Other researchers emphasize the weakness of the social sciences because of the unsatisfactory social conditions. The life sciences over the last two years was obtained outstanding achievements and practical implementation *wzmiankowanych* results enabled the increase in standards of living to unprecedented levels, but completely failed social sciences in the area for a more satisfactory social conditions—because it cannot be excluded misery, poverty, economic crises, unemployment, war, and tyranny. These teachings are unproductive and do not contribute anything constructive to the promotion of human happiness and well-being.



Those malcontents do not notice the enormous progress that has been made in the technology of production, which contributed to the increase of wealth and prosperity, which was only possible thanks to liberal policies, based on the foundations constructed by the classical economists. On the other hand, none of the great modern inventions would not go to the consumer, if not economists, who pointed defectiveness pre-capitalistic thinking. The process is called the industrial revolution that was initiated ideological revolution, the doctrine of economists who challenged the hitherto used dogmas. It is not fair and equitable to outbid a competitor by producing better and cheaper goods which is ubiquitous deviation from traditional economics course, and the machines are perception as a source of unemployment (Balewski, 2014), while there is legitimacy for the government to “protect” effective entrepreneurs through the enrichment and protection units less effective by competition from the former. Also with social acceptance, meet the restrictions imposed by the government on businesses, which are compelled, or a violation of their freedom in the name of so-called “social welfare” (Hazlitt, 1993). Only British and French economic policy “physiocracy” enabled the development of the natural sciences, and the accumulation of achievements that have become useful for mass customers.

Unfortunately, there is widespread ignorance of the role that economic freedom played in the technological evolution in the last 200 years. Illusion introduced Marxist ideology resulted in the perception of modern industrialism, as a result of the mysterious “forces” that are not subject to any ideological factors. As a consequence, classical political economy, it is not a factor in the development of capitalism, but rather the product—the ideological superstructure, the doctrine sanctioning claims “of the capitalist exploiters”. Hence, the abolition of capitalism and its substitution by the socialist totalitarianism of a market economy and free enterprise could weaken further development of the technology. What is more, it would be possible to promote technological development due to the removal of obstacles posed by selfish capitalists.

A characteristic feature of this age of destructive wars and social disintegration is the revolt against economics. T. Carlyle (Ikeler, 1972) defined economics as “pathetic science”, and Karl Marx (Marx, 1922) stigmatized the economists as “the sycophants of the bourgeoisie”. Thus, there were favorable conditions for the development of the economy, as a science, when both the scientific community and the mass despised and ignored her achievements.

However, what is worth stressing that existence of modern civilization is based on assumptions, which are derivatives of the tips of economics to solve existing problems. Civilization will collapse, when nations will act in accordance with the doctrines that reject economic thinking.

### Conclusions

It is indisputable that economics is the theoretical science and as such does not allow the evaluation of values. What is more, it is the task of identifying, for what purpose human beings should follow, and deals with resources that should be deployed to achieve the goals, but certainly not the science of their selection. The final decision, determination, and selection purposes are outside the scope of each of the sciences. Science does not provide guidance to the human being, as a means to preserve, only shows how economic activity of humans should be made up in order to achieve a predetermined goal. The above analysis provokes a statement that all economic models, based on so-called “old schools” are not utilitarian for entrepreneurs, especially in the area of definition of the determinants of human activity. What is more, in many respects, predictions based on these models contain serious defects, if you try to make the implementation of theoretically derived parameters to the reality of business. As described phenomenon has already been identified before, an element of free enterprise

has been removed from the equation because it impaired the accuracy of the model equations. It seems to be a legitimate demand of the need to validate existing economic models for the management of human resources in the context of the principles of the Austrian school of economics.

### References

- Balewski, B. (2014). Local labor market identification, as a determinant of unemployment counteraction. In: W. Chomicz (Ed.), *Toward the economic school*. Konin, Poland: WSKM Publishing.
- Bocheński, J. (1993). *Outline of the history of philosophy*. Cracow: Dajwór Publishing House.
- Dobrosielski, M. (1999). *Rationalism and irrationalism*. Warsaw: Ellipse Publishing House.
- Espinas, A. (1897). The origins of technology. *Philosophical Review*, 30, 114-115.
- Hazlitt, H. (1993). *Economics one lesson* (p. 37). Cracow: Publisher Signum.
- Hume, D. (1965). *A treatise of human nature* (p. 469). Oxford: Clarendon Press.
- Ikeler, A. A. (1972). *Puritan temper and transcendental faith*. Columbus, O.H.: Carlyle's Literary Vision.
- Janowski, A. (2006). Powers of insurance agents as a determinant of the effectiveness of insurance companies in terms of changes. In B. Kożusznik (Ed.), *Managing people in a global environment—Between the old and the new* (pp. 333-340). Cracow: Publisher AGH.
- Janowski, A. (2007). Powers of agents and the efficiency of life insurance companies. Unpublished PhD thesis. Institute of Organization and Management in Industry, Warsaw.
- Jeavons, S. W. (1881). Richard Cantillon and the nationality of political economy. *Contemporary Review*, 39 (January 1881), 331-360. Reprinted in *The principles of economics*. London: Macmillan.
- Keynes, J. M. (2008). *The general theory of employment, interest and money*. New Delhi, India: Atlantic Publishers & Distributors.
- Lowe, A. (1954). The classical theory of economic growth. *Social Research*, 21(2), 127-158.
- Marx, K. (1922). *Das kapital* (Vol. 3, 10th ed.). Hamburg, Germany: O. Meissner.
- Menger, C. (1871). *Principles of economics*. Vienna: Vienna University Bookseller.
- Mill, J. (1869). *Analysis of the phenomena of the human mind* (Vol. 2, 2nd ed.). London: Longman, Green, Reader & Dyer.
- Mill, J. S. (1848). *Principles of political economy*. W. J. Ashley, (Ed.). London: Longmans, Green and Co.
- Smith, A. (1759). *The theory of moral sentiments*. London: A. Millar; Edinburgh: A. Kincaid & J. Bell.
- Smith, A. (2003). *Studies on the nature and causes of the wealth of nations*. Warsaw, Poland: De Agostini/Ediciones Altaya.
- Stigler, G. (1941). *Production and distribution theories: The formative period*. New York: Macmillan.
- Topolski, J. (1984). *Methodology of history* (p. 165). Warsaw: PWN.
- Von Mises, L. (1998). *Human action: A treatise on economics*. Alabama: Mises Institute.
- Von Mises, L. (2010). *Omnipotent government: The rise of the total state and total war*. Alabama: Mises Institute.

# The Impact of Exchange Rate on the Growth of Nigerian Economy From 1960 to 2010

I. M. Shuaib, Ogedengbe A. Frank, Ekeria O. Augustine  
Auchi Polytechnic, Auchi, Nigeria

This paper examined the impact of exchange rate on the growth of Nigerian economy using time series data from 1960 to 2010. The paper utilized secondary data and explored various econometrics and/or statistical analytical (E-view 7.0) method to examine the relationship between exchange rate and economic growth. The paper tested the stationarity—through unit root test (ADF), Vector Autoregressive Estimates (VARs), cointegration test, Granger-Causality test of Nigeria's time series data, and used an error correction model through over-parameterization and parsimonious model to determine the long-run relationship among the variables examined. It was discovered from the findings that the growth rate of national income was directly related to domestic investment and economic growth. The paper recommended based on the econometric results among others that the government should ensure that prevailing economic situation in Nigeria is tolerable in order to reap the full benefit/advantage of exchange rate policy, encourage domestic production of goods and services to enable the domestic economy to benefit from the exchange rate policy, ensure the stability of macroeconomics variables, and ensure the exchange rate policy which is to encourage exports and discourage imports in order to avoid cash drain (or flight) in the economy.

*Keywords:* exchange rate, trade, economic growth<sup>1</sup>

The theme of the exchange rate of this paper is one of the objectives of the macroeconomics. And exchange rate emanates from trade (or foreign trade). Trade is widely accepted as a major engine (or one of the variables of the model) of economic growth. Therefore, trade has a direct relationship with economic growth as revealed by several results from different researchers on this theme. While some of the researchers disagreed resulting from the fact that trade has an inverse relationship with economic growth. Their argument was based on the fact that trade most especially international trade is lauded with a lot of economic fisticuffs—such as inflation, unemployment, poverty and federal budget deficit, increase at aggregate price level, foreign exchange dwindling, and income inequality (Osagie, 2007; Omojimite & Akpokodje, 2010). So long as an international trade exists, there must be common unit of currency—with which the goods would be exchanged. The often

---

I. M. Shuaib, M.Sc, MBA, ACE, Department of Business Administration & Management, Auchi Polytechnic; research field: macroeconomic variables. E-mail: almuhalim@yahoo.com; mallamidris2@yahoo.com.

**Corresponding author:** Ogedengbe A. Frank, M.Sc, AMNIM, Department of Business Administration & Management, Auchi Polytechnic; research fields: operation research and management sciences. E-mail: franklaba@yahoo.com.

Ekeria O. Augustine, M.Sc, FCIB, Department of Business Administration & Management, Auchi Polytechnic; research field: management sciences.

<sup>1</sup> Smith (1776) and Ricardo (1817) as the ancient political economists laid emphasis on international trade (or globalization), which means the linking of the economies of the world. Linking of the world economies would boost the world's output or production.

used currencies are pounds and dollars. Before the dawn of crude oil boom of 1970s (i.e., 1960s), the composition (or structure of the Nigerian economy) of the Nigerian trade has changed over the decades. For instance, in the 1960s, agricultural exports (including cocoa, cotton, palm kernel, oil, groundnuts, and rubber) were the country's main sources of foreign exchange and revenue to the government. In other words, agricultural sector in 1960s accounted about 60% of the total share of the gross domestic product (GDP). But with the advent of the exploration and/or exportation of crude oil in the early 1970s, which accounted about 0.2% in the 1960s, the importance of agricultural exports<sup>2</sup> began to decline, and/or replaced by crude oil exports. Today, the reverse is the case that the crude oil sector now accounted about 60% of the total share of the GDP, while agricultural sector has about 5% share in the GDP (Onwuka, 1996; Todaro & Smith, 2006; Olayide, 1969; Shuaib, 2011). These sprang up the major crises faced in Nigerian economy till date, which has resulted in the fluctuation in GDP. However, the dependence of Nigeria on crude oil exports had important implications for the Nigerian economy since the oil market is a highly volatile one. For example, being dependent (mono-economy) on the export of crude oil, the Nigerian economy became subject to the vicissitudes and vagaries of the international oil market such that international oil price shocks were immediately felt in the domestic economy. Coupled with this, in 1982, under the stabilization policy, the Nigerian Government formulated and implemented a policy of a fixed exchange rate system (as instrument for solving economic problems) that engendered overvaluation of the domestic currency, serving as a disincentive for increased exports through non-competitiveness of the country's non-oil exports. On the other hand, the overvalued exchange rate enhanced imports thereby exacerbating the already precarious balance of payment position (Osagie, 2007; Omojimite & Akpokodje, 2010). Though several ad hoc measures were taken to stem the deteriorating tide of the Nigerian economy from the late 1970s to early 1980s, it was until 1986 during structural adjustment programme (SAP) that a comprehensive economic adjustment programme was put in place to restructure the economy. Exchange rate reform among others was a major component of this economic reform agenda that was further intensified under the Nigerian Economic Empowerment and Development Strategy (NEEDS 1 & 11)<sup>3</sup> in 2000s. The goal of exchange rate reform is to establish systematically an appropriate value for the Nigerian currency that would serve as a major incentive for exports but disincentive for increased imports. In this paper, from these findings we shall know whether the objective of exchange rate reforms in Nigeria was achieved.

### Review of Relevant Literature

Every economy be it—developed and/or emerging, has formulated policy(ies) on how to get its currency stable in order to achieve economic growth. Several researchers, analysts, and theorists have come up with different results in carrying out research(es) on the impact of exchange rate on economic growth and development. The theoretical impact of exchange rate reforms on trade is still highly controversial (Agbola, 2004). Three major approaches are proposed in the theoretical literature. These are the monetarist, elasticity, and absorption approaches. The nub of the monetarists is that devaluation changes the relative

<sup>2</sup> Iyoha (2000) asserted that though in 1960s, the mainstay of Nigerian economy was agricultural produces. But the recent development is that the most developed economies has developed synthesis that helps to preserve raw materials. This has an inverse relationship with the economies of the emerging or developing countries.

<sup>3</sup> Obadan (2010) opined that both NEEDS 1 and NEEDS 11 (2008 and 2011) have an overarching goal of poverty reduction, focusing on employment, wealth creation, and value reorientation, NEEDS 11 aimed to sustain and improve on the achievements of NEEDS 1.

price of traded and non-traded goods, thus improving both the trade balance and the balance of payments (Dornbusch, 1973; Frenkel & Rodriguez, 1975; Miles, 1979; Omojimate & Akpokodje, 2010). They propound that devaluation results in a fall in the real supply of money, resulting in an excess demand for money. The effect is hoarding and/or an increase in trade balance, Upadhaya and Dhakal (1997), Robinson (1947), and Krueger (1983) are the major proponents of the elasticity approach. At the heart of this approach is the point that transactions may dominate a short-term change in the trade balance thereby resulting in deterioration in the trade balance (Upadhaya & Dhakal, 1997). However, in the long run, export and import quantities adjust and this causes elasticity of exports and imports to increase and for quantities to adjust. This leads to a reduction in the foreign price of the devaluing country's exports but raises the price of imported goods and therefore lowers its demand. The result is that the trade balance improves. Quite obvious from this argument is that the effect of devaluation on trade balance depends on the elasticity of exports and imports. This reasoning has been extended by Williamson (1983) by noting that the higher import prices initiated by devaluation could stimulate increases in domestic prices of non-traded goods such that the inflation rate rises with the potential effect of reducing the benefits of devaluation as manifested in the increase in trade balance. The debate of the absorption approach is that devaluation may change the terms of trade, increase production, switch expenditure from foreign to domestic goods, or have some other effect on reducing domestic absorption relative to production, and thus improving the trade balance (Omojimate & Akpokodje, 2010).

Obadan (1994b) noted that its importance as the center piece of the investment environment derives from the argument that a sustained exchange rate misalignment in terms of overvaluation or undervaluation, is a major source of macroeconomic disequilibria which spells danger for investment. Consequently, an over-valued exchange rate will discourage export and negatively affect the foreign private investment environment.

There is no consensus in the empirical literature on the impact of exchange rate reforms on trade. For instance, in a study on the impact of 24 devaluation episodes in developing countries over the period 1959-1966, Cooper (1971) found that overall devaluation improved trade balance and balance of payments. In another study on devaluation and macroeconomic performance, Kamin (1988) discovered that the trade balance was improved by devaluation through its stimulation of exports. Similarly, Salant (1977), Gylfason and Risager (1984) established that devaluation improved the balance of payments though not trade balance. On the other hand, the study of Miles (1979) found that devaluation did not improve trade balance. Devaluation was also found to worsen the trade balance and the balance of payments. Solimano (1986), Roca and Priale (1987), Horton and McLaren (1989), Olayide (1969), Ajayi (1975), Komolafe (1995a), and Egwakhide (1999) fitted import demand functions using Nigerian data and found that import decisions are determined by the dynamics of foreign exchange availability. While Iyoha (2003) examined the determinants of exchange rate in Nigeria. None of these studies explored the effects of foreign exchange reforms on trade performance in Nigeria.

Foreign exchange operations in Nigeria have been influenced by a number of factors such as the changing pattern of international trade, institutional changes in the economy, and structural shifts in production. Before the establishment of the Central Bank of Nigeria (CBN) in 1958 and the enactment of the Exchange Control Act of 1962, foreign exchange was earned by the private sector and held in balances abroad by commercial banks which acted as agents for local exporters. The boom experienced in the 1970s made it

mandatory to manage foreign exchange resources in order to avoid a shortage. However, shortages in the late 1970s and early 1980s compelled the government to introduce some ad hoc measures to control excessive demand for foreign exchange. However, it was not until 1982 that comprehensive exchange controls were applied. The increasing demand for foreign exchange<sup>4</sup> at a time when the supply was shrinking encouraged the development of a flourishing parallel market for foreign exchange. Because the exchange control system was unable to evolve an appropriate mechanism for foreign exchange allocation in consonance with the goal of internal balance, it was discarded on September 26, 1986, while a new mechanism was evolved under the SAP introduced in 1986 (Osagie, 2007; Omojimite & Akpokodje, 2010). The main objectives of exchange rate policy under the SAP were to preserve the value of the domestic currency, maintain a favorable external reserves position, and ensure external balance without compromising the need for internal balance and the overall goal of macroeconomic stability. A transitory dual exchange rate system (the first and second tier—SFEM) was adopted in September 1986, but metamorphosed into the foreign exchange market (FEM) in 1987. *Bureau de Change* was introduced in 1989 with a view to enlarging the scope of the FEM. In 1994, there was a policy reversal, occasioned by the non-remitting pressure on the FEM. Further reforms such as the formal pegging of the naira exchange rate, the centralization of foreign exchange in the CBN, the restriction of *Bureau de Change* to buy foreign exchange as agents of the CBN, etc., were introduced in the FEM in 1994 as a result of volatility in exchange rates. There was another policy reversal in 1995 to that of “guided deregulation”. This necessitated the institution of the Autonomous Foreign Exchange Market (AFEM) which later metamorphosed into a daily, two-way quote Inter-Bank Foreign Exchange Market (IFEM) in 1999. The Dutch Auction System (DAS) was reintroduced in 2002 as a result of the intensification of the demand pressure in the FEM and the persistence in the depletion of the country’s external reserves. The DAS was conceived as a two-way auction system in which both the CBN and authorized dealers would participate in the FEM to buy and sell foreign exchange (Olayide, 1969).

The most important reason why continuous devaluation of the naira exchange rate has not revamped the Nigerian economy is the instability of the FEM. In technical terms, this is the occurrence of “inelasticities” of the relevant supply and demand curves, all resulting from wrong attitudes of citizens to consumption of imports and production of exports. In the specific Nigerian case, it has been established by empirical analysis and simulation as far back as 1985 that an initial devaluation of the naira exchange rate, far from the market toward equilibrium, rather moves it away from economy equilibrium. The Nigerian economy will continue to wallow in its current malaise until a realistic way is found for revaluing (raising the value of) the naira significantly and on a sustained basis until its value comes to values recorded in the mid-1980s. This is a hard fact for policy-makers to accept, as it is an open admission of error sustained for two decades (Omojimite & Akpokodje, 2010; Osagie, 2007; Olayide, 1969).

### Theoretical Framework

The model that captures the main objective of this study is Harrod-Domar model. Harrod-Domar model described the economic mechanism by which more investment leads to more growth. For a country to develop and grow, it must divert part of its resources from current consumption (or save) and invest them in capital

---

<sup>4</sup> Idehai (1996) asserted that with the introduction of structural adjustment programme (SAP) in 1986 and the introduction of foreign exchange market the commercial banks have been saddled with the additional responsibility of allocating foreign exchange through the process of the interaction of market forces.

formation. Diversion of resources from current consumption is called saving. While saving is not the only determinants of growth, the Harrod-Domar model suggests that it is an important ingredient for growth. Its argument is that every economy must save a certain proportion of its national income if only to replace worn-out of capital goods. The model shows mathematically that growth is directly related to saving and indirectly related capital output ratio. Supposing we define national income as  $Y$ , growth as  $G$ , capital output ratio as  $K$ , saving as  $S$ , and investment as  $I$ , average saving ratio as  $s$ , and incremental capital output ratio as  $k$ , then we can construct the following simple model of economic growth.

$$S = sY \quad (1)$$

i.e., saving ( $S$ ) is some proportion of ( $s$ ) of national income ( $Y$ ).

$$I = \Delta K \quad (2)$$

i.e., net investment ( $I$ ) is defined as the change in capital stock  $K$ .

$$G = \Delta Y \quad (3)$$

$\Delta Y$ , i.e., growth is defined as change in national income  $\Delta Y$  divided by the value of the national income.

But since the total stock,  $K$ , bears a direct relationship to total national income, or output  $Y$ , as expressed by the capital/output ratio  $k$ , then it follows that:

$$K = \frac{Y}{k} \quad (4)$$

or

$$K = \frac{\Delta K}{\Delta Y}$$

or, finally,

$$\Delta K = K \Delta Y$$

Finally, since total national saving ( $S$ ) must equal total investment ( $I$ ), we can write this equality as:

$$S = I \quad (5)$$

But from Equation (1) above, we know that  $S = sY$ , and from Equations (2) and (3) we know that:

$$I = \Delta K = k \Delta Y$$

It therefore follows that we can write the identity of saving equaling investment shown by Equation (6) as

$$S = sY = k \Delta Y = \Delta K = I \quad (6)$$

or simply as:

$$sY = k \Delta Y \quad (7)$$

$$\Delta Y = G = sY K \quad (8)$$

Now by dividing both sides of Equation (8) by  $Y$  and later by  $K$ , we derive the growth Model  $\Delta Y/Y$  which represents the rate of change of national income or rate of GDP (i.e., it is the percentage change in GDP).

Equation (8), which is a simplified version of the famous Harrod-Domar equation in the theory of economic growth, implies that the rate of growth of GDP ( $\Delta Y/Y$ ) is determined jointly by the national saving ratio ( $s$ ), and national capital/output ratio ( $k$ ). More specifically, it says that in the absence of government, the

growth rate of national income will be directly or positively related to saving ratio (i.e., the more an economy is able to save and invest out of given GDP, the greater will be the growth of that GDP) and inversely or negatively; relate to the economy's capital/output ratio (i.e., the higher the  $k$  is, the lower will be the rate of GDP growth).

The economy logic of Equation (8) is very simple. In order to grow, economies must save and invest a certain proportion of their GDP. The more an economy can save and invest, the faster they can grow, for any level of the rate of growth depends on how productive the investment is.

### The Specification of Model

The model of this paper is hinged on the model of Omojinite and Akpokodje (2010), which enables the determination of the impact of exchange rate on the growth of the Nigerian economy. The model is designed below:

$$RGDP = f(DINV, INFL, NEXCH, BTD) \quad (9)$$

Where: RGDP = real gross domestic product as a proxy for economic growth; DINV = domestic investment; INFL = inflation rate; NEXCH = nominal exchange rate; BTD = balance trade as a proxy for import and export trade.

The model was transformed into logarithm and we re-specify Equation (10) as thus:

$$\text{LogRGDP} = \alpha_0 + \alpha_1 \text{LogDINV} \pm \alpha_2 \text{LogINFL} \pm \alpha_3 \text{NEXCH} \pm \alpha_4 \text{LogBTD} + \square \quad (10)$$

Where:  $\square$  = White noise error.

The a priori expectations are as follows:

$$\alpha_1, \alpha_2, \alpha_3, \alpha_4, \square \geq 0$$

The contribution of this study to knowledge is in terms of the estimation techniques employed and the data used which are extended to 2010. Attempt will be made to empirically investigate the relationship between the impact of exchange rate and economic growth of Nigeria for the period 1960-2010 regression analysis. The equation was estimated using a variety of analytical tools, including unit root tests, co-integration tests, and Error Correction Model (ECM). The results are discussed below. The data used for the study cover the period 1960-2010. The study employed secondary data which are derived from various issues of Central Bank of Nigeria (2010; 2011).

### Model Summary

Table 1 shows the summary of the unit root test using ADF test with Schwarz Info Criterion (SIC) maxlags 10 and 9 of the variables used for the empirical study. The test shows that RGDP and DINV were stationary at the first differenced 1(1) at 10%, 5%, and 1% levels of significance respectively. NEXCH, INFL, and BTD were stationary at the level 1(0) at 5%, 1%, and 10% levels of significance respectively. The next step after finding out the order of integration is to run the regression for the variables at the first differenced 1(1), over-parameterization and parsimonious models and establish co-integration test. The variables NEXCH, INFL, and BTD that were stationary at level 1(0) have already co-integrated themselves. To establish this, Engle and Granger Cointegration test was used.



Table 1

*Results of Units Roots Tests Using Augmented Dickey Fuller (ADF): 1960-2010*

Variables	MaxLags (SIC)	ADF test statistics	95% ADF critical level*	90% ADF critical level**	99% ADF critical level***	Order of integration	Remark
Log(RGDP)	10	-6.777809	-2.923780	-2.599925	-3.574446	1(1)	Stationary
Log(DINV)	10	-6.658543	-2.922449	-2.599224	-3.571310	1(1)	Stationary
Log(NEXCH)	10	0.728966	-2.936942	-2.606857	-3.605593	1(0)	Stationary
Log(INFL)	9	-5.241616	-2.928142	-2.602225	-3.584743	1(0)	Stationary
Log(BTD)	10	0.458892	-2.921175	-2.598551	-3.568308	1(0)	Stationary

Notes: Variables are as defined in Equation (10); \*, \*\*, \*\*\* significant at 5, 10, and 1 level; Source: the author's computation.

### Empirical Results of the Dynamic ECM

Although long-run relationship may occur among variables in the regression model, short-run equilibrium may not occur. Error correction mechanism is therefore used to correct or eliminate the discrepancy that occurs in the short run. The coefficient of error-correction variable gives the percentage of the discrepancy between the variables that can be eliminated in the next time period. The coefficients of the explanatory variables in the error correction model measure the short-run relationship. When conducting error correction technique, an over-parameterized model is usually expressed to deal with the problem of misspecification in the model. This is followed by the parsimonious model, which is derived after some stepwise elimination of relatively insignificant parameters in the over-parameterized model. The results from the over-parameterized model are presented in Table 2. The parsimonious model is obtained from a stepwise elimination of insignificant dynamic variables until parsimony is obtained; the result of this process is given in Table 3. From Table 3, it is revealed that DINV has a direct and significant relationship with RGDP. And its coefficient is statistically different from zero at 5% level. It is obvious from the coefficient of multiple (or joint) determination ( $R^2$ ) that the model is satisfactory as the independent variables were found to jointly explain only 79% of the movement in the dependent variables while the R-Bar Square is 77%. The both are high. The fitness of the model is confirmed by the F-statistic which is significant at 5%. Both the error correction variables (ECM 1) and (ECM 2) which are -0.600047 and -0.588768, were highly significant validating the error correction model specification and significant at 5% level. This shows that a feedback of -0.60 (-60%) from the previous year's disequilibrium from the long-run elasticity of the identified variables can determine economic growth. The strong significance of the ECM connotes the existence of a long-run equilibrium relationship between RGDP and the factors affecting it. The ECM reveals a long-run relationship between explanatory and explained variables in the model. The DW (Durbin Watson) was 1.61 which means there was an absence of serial correlation or autocorrelation.

### Vector Autoregression Estimate (VAR)

Vector Autoregressive is used to ascertaining the shock effect of explanatory variables of the model. For this shock effect to be effectively estimated, it has to be estimated through impulse responses, Granger causality, and cointegration. See Table 4 below, the figure of current period of RGDP has a positive shock effect in the long run at 13% and not statistically significant at 5% level. While the figure of current period of DINV has a negative shock effect in the long run at -22% and not statistically significant at 5% level. Both the  $R^2$  and adj- $R^2$  are very high.

Table 2

*Modeling the Impact of Exchange Rate Policy on the Growth of the Nigerian Economy (A Dynamic ECM)—Over-Parameterized Model*

Dependent variable: D(LOG\_RGDP\_, 2)

Method: least squares

Date: July 7, 2013 Time: 17:52

Sample (adjusted): 1971 2010

Included observations: 40 after adjustments

Variable	Coefficient	Std. error	T-statistic	Prob.
C	-0.777620	0.303413	-2.562907	0.0196
D[LOG_RGDP_(-1)]	-1.247190	0.216034	-5.773105	0.0000
D[LOG_RGDP_(-1), 2]	0.042087	0.100570	0.418489	0.6805
D(LOG_DINV_)	0.879382	0.126940	6.927558	0.0000
D[LOG_DINV_(-1)]	1.114713	0.204773	5.443647	0.0000
LOG_INFL_	-0.069913	0.087382	-0.800089	0.4341
LOG_INFL_(-1)	-0.017325	0.078339	-0.221149	0.8275
LOG_BT_	0.057753	0.155005	0.372587	0.7138
LOG_BT_(-1)	0.109914	0.143811	0.764297	0.4546
LOG_NEXCH_	0.069883	0.047541	1.469955	0.1588
LOG_NEXCH_(-1)	-0.190483	0.102293	-1.862136	0.0790
D[LOG_NEXCH_(-1)]	0.137742	0.096594	1.425991	0.1710
D[LOG_NEXCH_(-2)]	0.050980	0.182866	0.278782	0.7836
D[LOG_NEXCH_(-3)]	0.235000	0.177344	1.325107	0.2017
D[LOG_NEXCH_(-4)]	0.041312	0.163780	0.252242	0.8037
D[LOG_NEXCH_(-5)]	-0.048682	0.156730	-0.310610	0.7597
D[LOG_NEXCH_(-6)]	0.065890	0.178166	0.369821	0.7158
D[LOG_NEXCH_(-7)]	0.052779	0.173570	0.304082	0.7646
D[LOG_NEXCH_(-8)]	0.050596	0.166392	0.304075	0.7646
D[LOG_NEXCH_(-9)]	0.077111	0.179776	0.428929	0.6731
D[LOG_NEXCH_(-10)]	-0.309530	0.265641	-1.165219	0.2591
ECM(-1)	-0.588768	0.232393	-2.533506	0.0208
R-squared	0.966929	Mean dependent var		-0.002093
Adjusted R-squared	0.928347	S.D. dependent var		0.396068
S.E. of regression	0.106020	Akaike info criterion		-1.348882
Sum squared resid	0.202325	Schwarz criterion		-0.419998
Log likelihood	48.97763	Hannan-Quinn criter		-1.013027
F-statistic	25.06128	Durbin-Watson stat		1.787051
Prob(F-statistic)	0.000000			

Table 3

*Modeling the Impact of Exchange Rate Policy on the Growth of the Nigerian Economy (A Dynamic ECM)—Parsimonious Model*

Dependent variable: D(LOG\_RGDP\_, 2)

Method: least squares

Date: July 7, 2013 Time: 17:56

Sample (adjusted): 1962 2010

Included observations: 49 after adjustments

Variable	Coefficient	Std. error	T-statistic	Prob.
C	0.002758	0.026157	0.105426	0.9165
D[LOG_RGDP_(-1)]	-1.176433	0.146965	-8.004847	0.0000
D[LOG_DINV_(-1)]	0.821321	0.218787	3.753972	0.0005
ECM(-1)	-0.600047	0.175504	-3.418988	0.0013
R-squared	0.787411	Mean dependent var		0.000628
Adjusted R-squared	0.773238	S.D. dependent var		0.357731
S.E. of regression	0.170350	Akaike info criterion		-0.623816
Sum squared resid	1.305860	Schwarz criterion		-0.469382
Log likelihood	19.28349	Hannan-Quinn criter		-0.565224
F-statistic	55.55859	Durbin-Watson stat		1.608268
Prob(F-statistic)	0.000000			

Table 4

*Vector Autoregressive Estimates (VAR)*

Vector Autoregression Estimates

Date: July 7, 2013 Time: 18:20

Sample (adjusted): 1961 2010

Included observations: 50 after adjustments

Standard errors in ( ) & t-statistics in [ ]

	LOG_RGDP_	LOG_DINV_
LOG_RGDP_(-1)	0.134222 (0.15964) [0.84078]	-0.221457 (0.12208) [-1.81399]
LOG_DINV_(-1)	0.628886 (0.13407) [4.69060]	1.122715 (0.10253) [10.9500]
C	1.414278 (0.29461) [4.80046]	0.565890 (0.22530) [2.51170]
@TREND	0.006103 (0.00492) [1.23925]	0.001732 (0.00377) [0.45997]
R-squared	0.956143	0.981044
Adj. R-squared	0.953282	0.979808
Sum sq. resids	1.779698	1.040810
S.E. equation	0.196695	0.150420

Table 4 to be continued

	LOG_RGDP_	LOG_DINV_
F-statistic	334.2855	793.5741
Log likelihood	12.44255	25.85366
Akaike AIC	-0.337702	-0.874146
Schwarz SC	-0.184740	-0.721185
Mean dependent	4.862646	4.269359
S.D. dependent	0.910027	1.058568
Determinant resid covariance (dof adj.)		0.000647
Determinant resid covariance		0.000547
Log likelihood		45.87345
Akaike information criterion		-1.514938
Schwarz criterion		-1.209014

### Cointegration Test Results

Co-integration test is carried out in order to determine the long-run relationship between the dependent and independent variables when one or all of the variables is/are non-stationary at level which means they have number stochastic trends in asymptotic distribution. Co-integration tests are conducted by using the reduced procedure developed by Engle and Granger (1987). They noted that a linear combination of two or more  $I(1)$  series may be stationary, or  $I(0)$ , on which case we say the series are cointegrated. Such linear combination defines a cointegrating equation with cointegrating vector of weights characterizing the long-run relationship between the variables. The Engle-Granger test results are divided into three distinct sections. The first portion displays the test specification and settings along with the test values and corresponding p-values. The middle section of the output displays intermediate results used in constructing the test statistic that may be of interest. The bottom section of the output depicts the results for the actual ADF test equation.

Engle and Granger procedure is used to determine the linear combination of two or more series and/or to identify a long-run relationship. The cointegration tests include RGDP and DINV, which include automatic lag specification (lag = 0 based on Schwarz Info Criterion, maxlag = 10).

The result is presented in Table 5. It revealed that the Engle and Granger tau-statistic (t-statistic) and normalized autocorrelation coefficient (which we term the z-statistics) both reject the null hypothesis of no cointegration (unit root in the residuals) at the 5% level. In addition, the tau-statistic rejects at a 1% significance level. On balance, the evidence clearly suggests that log (RGDP) and log (DINV) are cointegrated. The reason for this rejecting of the null hypothesis is that the p-value for achieving tau-statistic and z-statistic is 0.0012 and 0.0008, respectively. The probability of obtaining the ADF residual is zero, meaning it is less than 5%—which means that we need to reject the null hypothesis of no cointegration, in other words, there is cointegration among the variables. T-statistic is less than 2 and standard error is very low. The SIC, AIC, and HQC values are low, which confirms the satisfactory of the joint variables in the model. The DW is 2.12, which means there is absence of autocorrelation or serial correlation in ADF test. There is cointegration among the variables.

This carries out pairwise Granger causality tests and tests whether an endogenous variable can be treated as exogenous. For each equation in the VAR, the output displays  $X^2$  (Wald) statistics for the joint significance of each of the lagged endogenous variables in that equation. The statistics in the last row (All) is the  $X^2$  statistics for joint significance of all other lagged endogenous variables in the equation.

In Table 6, the result revealed that RGDP granger cause domestic investment and DINV do not granger cause RGDP. The probability of RGDP granger causes DINV lies between 0% and 5%, which significances that null hypothesis cannot be rejected even though alternative hypothesis has to be accepted.

Impulse response analysis is a device to display the dynamics of the variables tracing out the reaction of each variable to a particular shock at time (t). Figure 1 shows the results of the impulse response analyses derived from the estimated VAR models.

Table 5

*Results of Engle-Granger Cointegration Test*

Cointegration Test—Engle-Granger

Date: September 7, 2013 Time: 22:20

Equation: untitled

Specification: LOG\_RGDP\_LOG\_DINV\_C

Cointegrating equation deterministics: C

Null hypothesis: Series are not cointegrated

Automatic lag specification (lag = 0 based on Schwarz Info Criterion, maxlag = 10)

	Value	Prob.*
Engle-Granger tau-statistic	-4.873285	0.0012
Engle-Granger z-statistic	-32.38351	0.0008

Note. \* MacKinnon (1996) p-values.

Intermediate results:

Rho-1	-0.647670
Rho S.E.	0.132902
Residual variance	0.028455
Long-run residual variance	0.028455
Number of lags	0
Number of observations	50
Number of stochastic trends**	2

Note. \*\* Number of stochastic trends in asymptotic distribution.

Engle-Granger Test Equation:

Dependent variable: D(RESID)

Method: least squares

Date: September 7, 2013 Time: 22:20

Sample (adjusted): 1961 2010

Included observations: 50 after adjustments

Variable	Coefficient	Std. error	T-statistic	Prob.
RESID(-1)	-0.647670	0.132902	-4.873285	0.0000
R-squared	0.326444		Mean dependent var	-0.000633
Adjusted R-squared	0.326444		S.D. dependent var	0.205537
S.E. of regression	0.168685		Akaike info criterion	-0.701769
Sum squared resid	1.394278		Schwarz criterion	-0.663529
Log likelihood	18.54424		Hannan-Quinn criter	-0.687207
Durbin-Watson stat	2.117352			

Table 6

*Pairwise Granger Causality Tests*

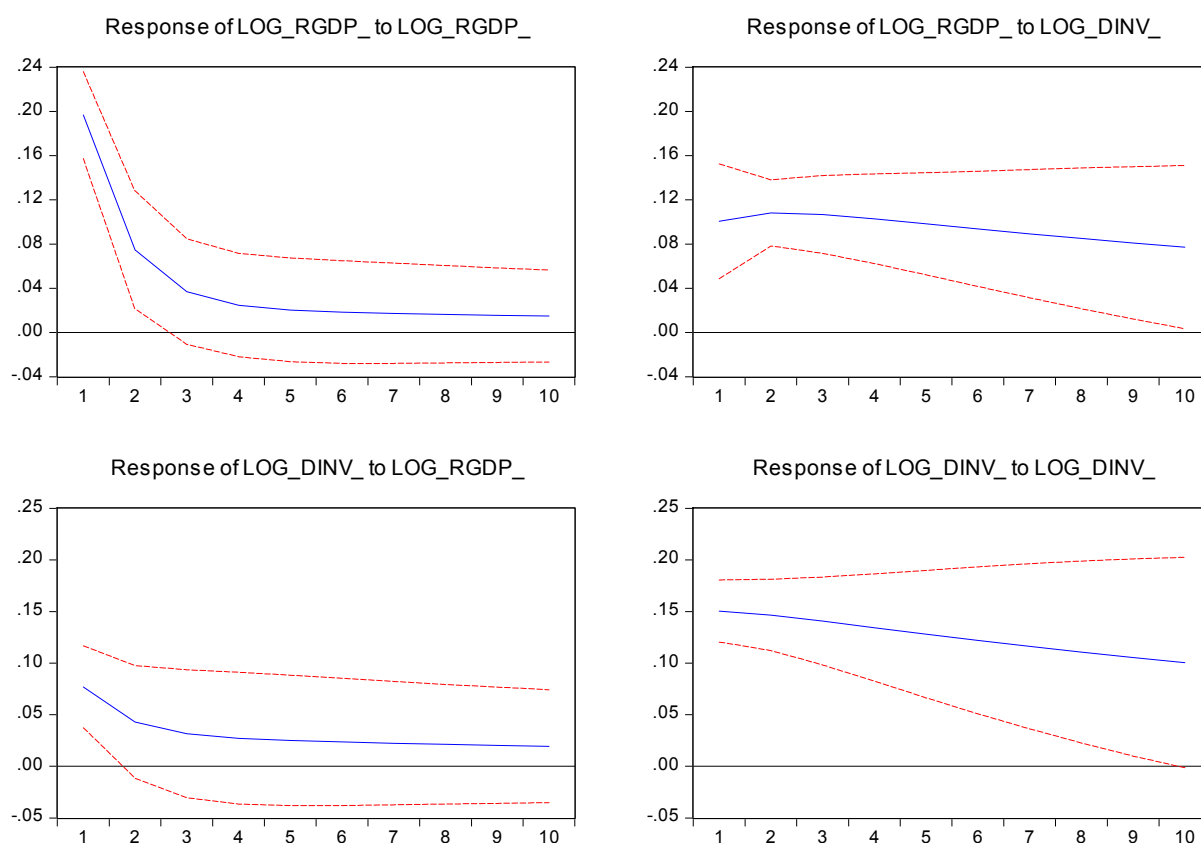
VAR Granger Causality/Block Exogeneity Wald Tests

Date: July 7, 2013 Time: 18:24

Sample: 1960 2010

Included observations: 50

Dependent variable: LOG_RGDP_			
Excluded	Chi-sq	df	Prob.
LOG_DINV_	22.00172	1	0.0000
All	22.00172	1	0.0000
Dependent variable: LOG_DINV_			
Excluded	Chi-sq	df	Prob.
LOG_RGDP_	3.290577	1	0.0697
All	3.290577	1	0.0697

Response to Generalized One S.D. Innovations  $\pm 2$  S.E.Figure 1. Impulse response to generalized one S.D. innovations  $\pm$  S.E.**Summary**

The econometric results of the stochastic characteristics of each time series by testing their stationarity using ADF test, Over-Pamaterization model, Parsimonious model, VAR, Engle and Granger cointegration tests, and Pairwise Granger-Causality Model employed to examine the impact of exchange rate on the growth of the

Nigerian economy for the period of 1960 to 2010. The Harrod-Domar growth is used for the study. The empirical results obtained from the paper make clear that there is a significant relationship between exchange rate and economic growth in Nigeria. With 79% of the changes in economic growth being explained by the model, it is only logical to summarize that other factors, for which a major share is qualitative factors, explain the minor 21% of the variability in economic growth in Nigeria. The study has therefore brought out in clear terms the reason for the economic growth in Nigeria. The empirical results of the paper conform with the existing studies in our literature that reveal that there is indeed a long-run relationship between the DINV and economic growth in Nigeria. All the variables have short and long run with each other as revealed by cointegration. The empirical result further proves that DINV leads to output growth in Nigeria. Nevertheless, the overall measure of domestic investment acts as a major determinant of output growth in Nigeria. This results supported the Harrod-Domar model which proved that the growth rate of national income will directly relate to investment and economic growth (i.e., the more an economy is able to save and invest out of given GNP, the greater will be the growth of that GDP). In other words, the Harrod-Domar model is applicable to Nigeria's situations. It is evident that there is a feedback mechanism between the domestic investment and economic growth in Nigeria. Also it was revealed from the results that NEXCH exerts an inverse impact on the economic growth in Nigeria. This happens because the macroeconomics atmosphere in Nigeria is porous.

### Recommendations

From the econometric study of the impact of exchange rate on the growth of the Nigerian economy, the following recommendations are stated below:

- (1) The government should ensure that prevailing economic situation in Nigeria is tolerable in order to reap the full benefit/advantage of exchange rate policy—flexible or rigid;
- (2) The government should encourage domestic production of goods and services to enable the domestic economy to benefit from the exchange rate reforms policy;
- (3) The government should create among others, the stability of macroeconomics variables such as inflation rate, balance of payment disequilibrium, foreign exchange rate, interest rate, and general price level;
- (4) The government should ensure that exchange rate policy is such that would create job opportunities, and/or source of generating wealth for the government. Hence, it increases in standards of living of the citizenries of the economy;
- (5) The government should ensure that the exchange rate policy is to encourage exports (or exports encouragement) and/or discourage import (or import substitution) in order to avoid cash drain (or flight) in the economy.

### References

- Agbola, F. W. (2004). Does devaluation improve trade balance of Ghana? Proceedings from *the International Conference on Ghana's Economy at the Half Century*. July 18-20, M-Plaza Hotel, Accra, Ghana.
- Ajayi, S. I. (1975). Economic analysis of import demand functions for Nigeria. *The Nigerian Journal of Economic and Social Studies*, 17, 169-182.
- Central Bank of Nigeria. (2010). *Statistical Bulletin*. CBN, Abuja.
- Central Bank of Nigeria. (2011). *Statistical Bulletin*. CBN, Abuja.
- Cooper, R. N. (1971). Currency devaluation in developing countries. *Essays in International Finance*, 86, 30-35.
- Domar, E. (1946). Capital expansion, rate of growth and employment. *Econometrica*, 14(1), 30-40.
- Dornbusch, R. (1973). Devaluation, money, and nontraded goods. *American Economic Review*, 5, 71-880.

- Egwakhide, F. O. (1999). Determinants of imports in Nigeria: A dynamic specification. African Economic Research Consortium, Research Paper No. 91. Nairobi.
- Engle, R. F., & Granger, C. W. J. (1987). Cointegration and error correction: Representation, estimation, testing. *Econometrica*, 55, 251-276.
- Frenkel, J. A., & Rodriguez, C. (1975). Portfolio equilibrium and the balance of payments: A monetary approach. *American Economic Review*, 65(4), 674-688.
- Gylfason T., & Risager, O. (1984). Does devaluation improve the current account? *European Economic Review*, 25, 37-64.
- Harrod, R. F. (1939). An essay in dynamic theory. *Economic Journal*, 49(10), 5-20.
- Horton, S., & McLaren, J. (1989). Supply constraints in the Tanzanian economy: Simulation results from a macroeconomic model. *Journal of Policy Modeling*, 11, 297-313.
- Iyoha, M. A. (2003). Determinants of exchange rates: Theoretical and policy perspectives. *The Nigerian Economic and Financial Review*, 8, 26-38.
- Kamin, S. B. (1988). Devaluation, external balance, and the macroeconomic performance: A look at the numbers. *Princeton Studies in International Finance*, 62, 50-60.
- Komolafe, O. S. (1995a). Modeling Nigeria's external sector: A co-integration approach. Interim report presented during the *Biennial Conference of African Economic Research Consortium in South Africa*. December 2-8, South Africa.
- Komolafe, O. S. (1995b). Modeling import demand under quantitative trade restrictions: An application to Nigerian data. *Journal of Economic Management*, 2, 55-77.
- Krueger, A. O. (1983). *Exchange-rate determination*. Cambridge: Cambridge University Press.
- Miles, M. A. (1979). The effects of devaluation on the trade balance and balance of payments: Some new results. *Journal of Political Economy*, 87, 600-620.
- Obadan, I. M. (1994a). *Real exchange rates in Nigeria* (pp. 53-70). National Centre for Economic Management and Administration (NCEMA), Ibadan, Nigeria.
- Obadan, I. M. (1994b). Nigeria at 50 and its national economic development paradigms: The benefit of hindsight. Lecture Delivered at New Auditorium, Auchi Polytechnic, Auchi.
- Olayide, S. O. (1969). Import demand model: An econometrics analysis of Nigeria's import trade. *The Nigerian Journal of Economics and Social Studies*, 10, 13-26.
- Omojimiti, B. U., & Akpokodje, G. (2010). The impact of exchange rate reforms on trade performance in Nigeria. *Kamla-Raj 2010 J Soc Sci*, 23(1), 53-62.
- Onwuka, E. C. (1996). Perspectives on the deregulation of Nigeria's agriculture. In E. C. Onwuka, S. O. Uniamikogbo, and S. A. Idehai (Eds.), *Economic development in a deregulated economy* (p. 108). Ibadan: Stirling Horden Publishers.
- Osagie, E. (2007). *The new Nigerian economy: From poverty to prosperity*. Benin City, Nigeria: AFBSN Publishers.
- Robinson, J. (1947). *Essays in the theory of employment*. Oxford: Basil Blackwell.
- Roca, S., & Priale, R. (1987). Devaluation, inflationary expectations and stabilization in Peru. *Journal of Economic Studies*, 14, 5-33.
- Salant, W. S. (1977). International transmission of inflation. In L. B. Krause and W. S. Salant (Eds.), *Worldwide inflation* (pp. 167-232). Washington, D.C.: Brookings Institution.
- Shuaib, I. M. (2011). Foreign direct investment and trade on the growth of the Nigerian economy. M.Sc thesis, Economics Department of Ambrose Alli University, Ekpoma.
- Solimano, A. (1986). Contractionary devaluation in the Southern Cone: The case of Chile. *Journal of Development Economics*, 23, 135-151.
- Todaro, M. P., & Smith, S. C. (2006). *Economic development in the world* (9th ed.). England: Pearson Education Limited.
- Upadhaya, K. P., & Dhakal, D. (1997). Devaluation and the trade balance: Estimating the long run effect. *Applied Economic Letters*, 4, 343-345.
- Williamson, J. (1983). *The open economy and the world economy*. New York: Basic Books Inc.
- World Bank. (1994). *Adjustment in Africa: Reforms, results and the road ahead*. Oxford: Oxford University Press.



# Operational Efficiency, Credit Risk, and Profitability in the Banking Intermediation

Herry Achmad Buchory

Ekuitas Economics College, Bandung, Indonesia

The aim of this study was to analyze the factors that affect the implementation of banking intermediation, including operational efficiency, credit risk, and profitability. The methods used are descriptive and verifictive, with secondary data from financial statements all over 26 Indonesian regional development banks (BPDs) as a research object's units. Data analysis technique is the multiple linear regression, hypothesis testing while using T-test to examine the effect of partial variables and F-test to examine the effect of variables simultaneously with a significance level of 5%. Based on the results, it is concluded that the partial operating expenses to operating income (OEIO) and the return on assets (ROA) have positive and significant effects on the loan to deposit ratio (LDR). While the non-performing loans (NPLs) have negative effect and no significant effect to the LDR. Simultaneously, the OEIO, NPL, and ROA significantly influence the level of the LDR with 51.4%, while the remaining 48.6% thought to be influenced by other variables not examined in this study.

*Keywords:* loan to deposit ratio (LDR), non-performing loans (NPLs), ratio of operating expenses to operating income (OEIO), return on assets (ROA)

Bank as the depository financial institution plays a very important role in the economy of a country. Bank facilitates the interests of savers and borrowers through products and financial services it offers. Apart from these activities, banks can also provide services that facilitate payments traffic. It cannot be denied that the role of banks which can be used as a tool in setting monetary policy is also the primary source of credit to the smallest businesses and individuals, which will ultimately affect the economic growth of a country (Koch, 2000; Buchory, 2006). The role that financial institutions have played in financial intermediation and growth, namely to mobilize savings and allocate them to the most productive and growth-promoting activities (Mahran, 2012). Banking plays such a major role in channeling funds to borrowers with productive investment opportunities. This financial activity is important in ensuring that the financial system and the economy run smoothly and efficiently (Mishkin & Eakins, 2006).

Intermediation function performed by banks through the purchase of surplus funds from economic units (business sector, government, and individual/household) to be distributed to deficit economic units (Hempel, Simonson, & Coleman, 1994). In other words, a financial intermediation is the diversion of funds activities from savers (ultimate lenders) to the borrower (the ultimate of borrowers). Implementation of financial

---

**Corresponding author:** Herry Achmad Buchory, Ph.D., SE, MM., lecturer, Ekuitas Economics College, Bandung, Indonesia; banking practitioner, the Director of Compliance and Risk Management, PT. Bank Jabar Banten; member of Indonesian Economists Association, Branch Coordinator, Bandung West Java, etc.; research fields: banking and finance. E-mail: achmad\_buchory@yahoo.com.

intermediation in banking can be seen through the bank's ability to transform the savings into credit or loans (Rose, 2002).

In the context of Indonesia's economy, the dominant role of banks remains compared with other financial institutions. This can be seen from the market share asset indicators of financial industry through the month of June 2013. Banks still dominate the market share, which is equal to 78.24%, followed by 6.13% for finance companies, 6.15% for insurance companies, 5.12% for social insurance companies, 2.70% for pension funds, 1.09% for corporate securities, and mortgage of 0.57% (Supriyanto, 2013). Especially with regard to banking assets in Indonesia, total assets to the position on July 2013, which have reached Rp 4,510.29 billion invested largely in the form of loans of Rp 3,045.51 trillion or 67.52% (Bank Indonesia, 2013). The ratio of credit to gross domestic product (GDP) of the Indonesian banking in 2011 only amounted to 29.6%, is still relatively low compared with 128.6% for Singapore, 117.3% for Malaysia, 81.2% for Thailand, and 31.4% for the Philippines. Indonesian banking though still relatively low but contribution of banking plays an important role in facilitating the growth of the Indonesian economy (Supriyanto, 2013).

Regional development bank (BPD) in Indonesia was established with the intent to provide funding for the implementation of local development efforts in the framework of national development (Law No. 13 of 1962). Later in the decree of Ministry of Internal Affairs No. 62 in 1999, it affirmed that the principal task of developing the economy and the BPD is motivating regional development, while the function is:

- (1) Promoting the creation of the level of economic growth and regional development in order to improve the standard of living of the people;
- (2) The holder or a regional treasury and financial management areas;
- (3) One source of revenue.

However, up to this time, in carrying out its duties and functions, the BPD still faces several problems, among which: (1) limited capital; (2) brand awareness community to BPD is still very low; (3) quality of service does not meet the expectations of society; (4) quality and human resources competencies have not been standardized; (5) innovation and product development are still limited; (6) networks office service is still limited; (7) not optimal strategic partnership; (8) structure of public funding is relatively low; and (9) composition of the productive loan portfolio is relatively low, and does not consolidate information technology (Budiwiyono, 2012).

As one of the commercial banks, BPD plays a very important role in the economy, especially the regional economy. The role is mainly seen how wide BPD can apply intermediary function. Intermediation function performed by BPD through the process of purchasing the surplus funds from economic units (business sector, government, and individual/household) to be distributed to deficit economic units. In other words, a financial intermediation is the diversion of funds activities from savers (ultimate lenders) to the borrower (the ultimate of borrowers). One commonly used indicator to measure the implementation of banking intermediation, is the ratio of loans to deposits or loans to deposits ratio (LDR) (Haruna, 2011; Buchory, 2006). The higher this ratio is, means the better that the bank could carry out intermediation function optimally.

The LDR achieved by BPD in December 2012 is 78.57%, lower than the national banks (83.58%) and other groups such as state banks (79.84%), private national banks (81.58%), non-foreign exchange banks (82.73%), joint banks (115.63%), and foreign exchange banks (111.21%) (Bank Indonesia, 2013). The achieved low LDR of BPD indicated that the implementation of banking intermediation by BPD has not been optimal. The not optimal implementation of banking intermediation by BPD is thought to include the effect of the capital adequacy ratio (CAR), non-performing loan (NPL), and return on assets (ROA).

Based on the phenomenon above, the problem in this research can be formulated into a research question: How the CAR, NPL, and ROA influence the implementation of banking intermediation? This study aims to analyse the factors that affect the implementation of the intermediation function of banks that allegedly include the effect of the CAR, NPL, and ROA.

## **Literature Review**

### **Definition, Role, Function, and Core Activity of Bank**

Bank is a financial institution whose main activity is receiving public deposits. The funds will be distributed in the form of loans to communities who need them. Besides taking deposits and giving loans, banks also provide other financial services.

According to the Law No. 7 of 1992 and amended by Law No. 10 of 1998 about banking, banks are business entities that raise funds from the public in the form of savings and channel them to the community in the form of credit or other forms in order to improve the living standard of the people.

The role of banks in the economy can be expressed as “Banking plays such a major role in channelling funds to borrowers with productive investment opportunities, this financial activity is important in ensuring that the financial system and the economy run smoothly and efficiently” (Mishkin & Eakins, 2006). The same is expressed as follows:

Commercial banks play an important role in facilitating economic growth. At a macroeconomic level, they represent the primary conduit of Federal Reserve monetary policy. Banks deposit represent the most liquid form of money, such that Federal Reserve efforts to control the nation’s money supply and level of aggregate economic activity do so by changing the availability of credit at banks. At a microeconomic level, commercial bank represents the primary source of credit to the smallest business and many individuals. (Koch, 2000)

While other opinions about the role of the bank are as follows:

A bank can be defined in the term of: (1) the economics function is serves; (2) the services is offered to its customer; or (3) the legal basis for its existence. Certainly, bank can be identified by the functions they perform in the economy, they are involved in transferring funds from savers to borrowers (financial intermediation) and in paying for goods and services. (Rose & Hudgins, 2008)

For the Indonesian banking, bank functions listed in the Law of the Republic of Indonesia No. 7 of 1992 and amended by Law No. 10 of 1998 on banking, banks are business entities that raise funds from the public in the form of savings and channel them to the public in the form of loans or other forms in order to improve the living standard of the people. In other parts of the act, bank also provides a variety of services and conveniences that in essence is to meet the needs of people of all financial transactions. The core activities of a bank as a financial institution that are always associated with the transactions or financial activity that occurred in the community are:

- (1) Intermediation (taking deposits and lending money);
- (2) Disintermediation (relinquishing the intermediary debtor/creditor position, while retaining a “broker” role);
- (3) Collection and payment system, money transmission;
- (4) Foreign exchange and foreign trade services;
- (5) Participation in the money and capital market (Cade, 1997).

**Definition and Factors of Affecting Banking Intermediation**

In simple terms, the role of banks in the economy is to fulfil the desire of ultimate borrowers and the ultimate lenders. However, the role of banks is actually quite complex because there are two interests besides other interests that must be met by a bank, and that are those of the owners and the government (regulator). Thus, a bank must be able to balance the various interests (ultimate borrowers, ultimate lenders, owners, and regulators) that are sometimes different (Hempel et al., 1994). Given that the banking sector is the intermediary between the parties that have the excess funds and those who need the funds, the reallocation of public funds has important implications for the movement of the economy as a whole. Therefore, the role of banks in the economy is especially from the extent to which the bank can apply its intermediary functions. Financial intermediation is the process of buying funds from surplus economic units (business sectors, government, and individual/household) to be distributed to deficit economic units (Hempel et al., 1994). The same is stated by Kidwell and Petterson (2000) which states that intermediation is the process of transformation or direct purchases of a claim with a series of characteristics (maturity, denomination) of Deficit Spending Units (DSUs) and turns it into a claim indirectly by a different set of characteristics to be sold to Surplus Spending Units (SSUs). Meanwhile, according to Gardner, Mills, and Cooperman (2000), intermediation is a process of transformation from secondary securities into primary securities. Primary securities are the claim of individuals, government, and non-financial companies, while the secondary securities are claims against financial institutions.

The implementation of financial intermediation in banking can be seen from the bank's ability to transform savings received primarily from household economic units into credit or loans for companies and others to invest in buildings, equipment, and other capital goods (Rose, 2002). The indicators commonly used to measure the extent of intermediation by the banking system have been implemented, namely by looking at the ratio of loans to deposits known as the LDR. An indicator to measure the workings of the banking intermediation function is to look at the LDR. According to Buchory (2006), the LDR ratio reflects the ability of banks to extend credit and collect public funds. The higher this ratio is means the better that the bank could carry out intermediation function optimally. *Vice versa*, the lower this ratio means that the bank in carrying out its intermediary function is not optimal. Some of the causes have not been optimal implementation of banking intermediation in the region, according to the research by Bank Indonesia which is caused by: the limited authority of the bank branches in deciding loans, the effect of the financial condition of the internal branch of the credit, the existence of alternative investment of funds, the business climate in the region, and the precautionary principle (Abdullah & Suseno, 2003). In this study, the authors estimate that the not optimal implementation of the intermediary function (LDR) by BPD is caused by the following factors: capital (CAR), credit risk (NPL), and profitability (ROA).

**LDR.** As noted above that the LDR is an indicator in the measurement of banking intermediation. According to the research result of Buchory (2006), implementation of financial intermediation function gives effect to banking performance. This means that banks will have good financial performance if the bank could apply its intermediary function optimally. For banks in Indonesia, according to Bank Indonesia Circular Letter No. 13/24/DPNP dated October 25, 2011 (subject: valuation of level commercial bank soundness), and the circular letter No. 15/41/DKMP Jakarta, October 1, 2013 (subject: calculation of minimum statutory reserved demand deposit and compulsory demand deposit by loan to deposit ratio in rupiah). The LDR is the ratio of loans to third parties in exchange rupiah and foreign currency, excluding loans to other banks, the deposits

which include demand deposits, savings and time deposits in rupiah and foreign currencies, excluding interbank funds. Therefore, a bank's LDR is determined by the bank's ability to collect and distribute funds to third parties in the form of credit. The higher the LDR shows greater use of bank deposits for lending, which means bank has been capable to run intermediary function properly. However, if the LDR is too high, it can also raise a liquidity risk for banks. The implementation of financial intermediation gives effect to banking performance. This means that banks will have good financial performance if the bank applies its intermediary function optimally.

**The effect of Operating Expenses to Operating Income (OEOI) of the LDR.** Profitability ratios are used to analyze or measure the level of business efficiency and profitability achieved by the bank itself. One of profitability ratios is the ratio of operating expenses to operating income (OEOI) in the same period. The OEOI ratio is also often used as an indicator to measure the level of efficiency of a bank. Bank Indonesia Circular Letter No. On 06/23/2005 Rating System for Commercial Banks set the ROA ratio ranged from 94% to 96% with the criteria quite well. If the ratio of a bank that the bank achieved the figure below the level of efficiency is good. And *vice versa*, the lower level of OEOI ratio means the better performance of the bank's management in using its resources or the lower the OEOI ratio achieved by the bank, the more efficient the bank. Asset-liability management of efficient banks will improve the profitability of the bank. And high profitability is one of the sources of bank capital to improve the intermediation function. The result of the research conducted by Utari and Haryanto (2011) found that the OEOI has a significant positive effect on the LDR with a significance level of  $0.001 < 0.050$ . Similarly, the results of research conducted by Oktaviantari and Wiagustini (2012), the OEOI has no significant negative effect on the LDR. Research results in line with previous research conducted by Amriani (2012) which found the results that the OEOI statistically has no significant effect on LDR. Similarly, research conducted by Granita (2011) found that the OEOI has negative but insignificant effect on LDR. Research results of Sitorus (2013) indicate that the OEOI influences the LDR.

**The effect of NPL of the LDR.** Credit is the greatest asset investment banks. Similarly, loan interest income is the largest source of revenue for banks. If the credit returns fail, then the ability of banks to provide new loans will be disrupted. In addition, the bank's revenue would also decrease in interest income due to non-receipt of credit. Besides, the bank also must establish reserves or provisions of problem loans that ultimately will reduce the bank's capital. Though, much capital is needed for credit expansion. The reduction of banks' ability provides credit interferes with the implementation of the bank intermediation. Credit quality of a bank is indicated by the NPL. Thus, the NPL can be used to measure the ability of banks to cover the risk of default of loan repayment by the debtor. Based on Bank Indonesia Circular Letter No. 13/24/DPNP on October 25, 2011, which concerning the commercial banks, problem loans are loans to a third party of non-bank consisting of the NPL (sub standard), doubtful and loss. The higher the level of the NPLs, the greater the credit risk borne by the bank. The NPL rate may affect the level of efficiency of banks. The research conducted by Karim, Chan, and Hassan (2010) states in Malaysia and Singapore, clearly indicates that the higher NPL reduces cost efficiency. Therefore, banks should be able to press a low NPL ratio so that the potential benefits to be gained will be even greater, because banks will save the allowance for credit losses or allowance for non-performing assets (ANPA). The low ANPA formed the greater profitability and ultimately improved the bank's capital. According to Sentausa (2009) cited by Pratama (2010), the amount of the NPLs is one of the causes of the difficulty banks in lending. Similarly, according to Harmanta and Ekananda (2005), the NPL is significantly and negatively related to bank credit. Therefore, according to Budiawan (2008), the NPL has negative and

significant effect on bank credit. Meanwhile, according to Soedarto (2004), the NPLs positively and significantly affect bank credit. While the study results of Nasirudin (2005) showed that the variable NPLs has a significant effect on the LDR. The research results of Utari and Haryanto (2011) showed that the NPL has a significant negative influence on the LDR with a significance level of  $0.000 < 0.050$ . The same thing was stated by Tamtomo, Setyo, and Hersugondo (2012) and Tangko (2012) that the NPL variable negatively and significantly affects the LDR. Meanwhile, according to Al-Abedallat and Al-Shubiri (2013), this research has empirically examined the determinants of credit risk held by Jordanian banks over 2006 to 2010 periods. The credit risk is one of the main risks that seriously affects banks' stability. Meanwhile, according to Sitorus (2013), the result of the research indicates that the CAR, ROA, NIM (Net Interest Margin), and OEOI totally influence the NPL.

**The effect of ROA of the LDR.** Bank is an organization that combines human effort and financial resources to carry out the functions of the bank in order to serve the needs of the community and make a profit for the owners of the bank (Hempel, Simonson, & Coleman, 1994). Banking profits obtained through bank intermediation process. Analysis of profitability needs to be done to measure the level of business efficiency and profit achieved by a bank. Ratio commonly used to measure and compare with the performance of profitability is the ROA. The ROA is the major ratio used in analyzing bank profitability. The ROA is used to assess the ability of bank management in managing all bank assets to create revenue in the form of profit which is calculated by comparing net income with average total assets. The higher of the ROA, the better of the bank's management to generate profits. The study results of Utari and Haryanto (2011) showed that the ROA has not significant negative influence on the LDR with a significance level of  $0.560 > 0.050$ . While according to Tamtomo et al. (2012), he found that the ROA has positive and significant effect on the LDR.

### Hypothesis

Based on the relationship between research objectives and theoretical framework to the formulation of the research problem, the hypotheses are as follows:

- H1: The OEOI negatively affects the LDR.
- H2: The NPL negatively affects the LDR.
- H3: The ROA positively affects the LDR.
- H4: The OEOI, NPL, and ROA affect the LDR.

### Research Method

The methods used in this research are descriptive method and verification method. Descriptive method is a method used to analyze data in a way to describe or depict the data that have been collected without intending to apply general conclusions or generalizations, while the verification method is a method of research that aims to determine the relationship between two or more variables. This verification method is used to test the truth of a hypothesis. Influencing or shaping the causal relationship between variables X and Y can be known as the research method of verification (Sugiyono, 2009).

### Type, Data Source, Population, Sample, and Data Collection Methods

Data used in this study are secondary data. All Indonesian BPDs which include the CAR, NPL, ROA, and LDR were obtained from the Indonesian Banking Statistics and Data Center Consultant EKOFIN Publications in 2012 (calculated quarterly). The research population was 26 BPDs served as the object of study, the object is observed on financial statements position on December 31, 2012. Data collection method used was studying the

documentation. Study of documentation is done with the data collection and classification category of written materials related to the research problem.

### Operational Variables

This study uses the independent variables, namely the CAR, NPL, and ROA, the dependent variable is the implementation of function banking intermediation as measured by the LDR.

### Data Analysis Techniques

The data analysis technique used in this study is a multiple linear regression. First, it is tested to determine whether the assumptions of classical linear regression model have problem of normality, multi-collinearity, heteroscedasticity, and autocorrelation. If all of them were fulfilled, it means that the model has a decent analysis used (Gujarati, 2003). To examine the hypothesis, T-test was used to determine statistical significance of the effect of independent variables on the dependent variable partially, F-test was used to determine the statistical significance of the coefficient of multiple significance or to determine significance of the independent variables on the dependent variable simultaneously. Data processing is done by using the software Statistical Package for Social Science (SPSS) version 20.0 for Windows. The regression equation used is as follows:

$$Y = a + \beta X_1 + \beta X_2 + \beta X_3 + e \quad (1)$$

Where,

$Y$  = LDR

$a$  = a constant which is the value of the variable  $Y$  when the variable  $X$  is 0 (zero)

$\beta$  = coefficient of the regression line

$X_1$  = OEOI

$X_2$  = NPL

$X_3$  = ROA

$e$  = residual

## Result and Discussions

### The Development of the LDR, OEOI, NPL, and ROA of BPD in Indonesia

Based on the data until December 2012, the development of the LDR, CAR, NPL, and ROA was achieved by 26 BPDs operating in Indonesia, it can be described as follows (see Table 1).

The average value of the LDR achieved amounted to 78.57% until December 31, 2012. BPDs throughout Indonesia have been able to apply the functions of bank intermediation through fund raising and lending of 78.57%, lower than the national banks (83.58%) and other groups such as state banks (79.84%), private national banks (81.58%), non-foreign exchange banks (82.73%), joint banks (115.63%), and foreign exchange banks (111.21%) (Bank Indonesia, 2013b). But it is still in the range of the LDR determined by Bank Indonesia, namely:

(1) The lower limit of the LDR targeted by 78%;

(2) The upper limit of the LDR target: of 100% up to the date of December 1, 2013; by 92% from the date of December 2, 2013.

The lowest value of the LDR at 55.77% is achieved by BPD South Kalimantan, while the highest value of the LDR at 113.21% is achieved by BPD South Sulawesi.

The average OEOI value achieved amounted to 73.16% by period of December 31, 2012. The highest value of 82.28% of the OEOI achieved by BPD South Sumatra and the lowest OEOI amounted to 59.56%

achieved by the BPD Southeast Sulawesi. By looking at the average value of the OEOI, it is still below the tolerance required by Bank Indonesia at 94%-96%. This means that BPD is able to control its operational efficiency so that the BPD still has the ability to improve the function of intermediation through lending.

The average NPLs value was 2.13% achieved by period of December 31, 2012. The highest NPL value of 7.45% was achieved by BPD Central Sulawesi and the lowest NPLs was 0.17% achieved by BPD West Kalimantan. By looking at the average value of the NPL, it shows that the credit risk was faced by BPD which is at moderate albeit under tolerance required by Bank Indonesia at 3%-6%. It means that BPD being able to control the credit risk. Because if the NPLs increase will disrupt the BPD's ability to improve the function of intermediation through lending.

The average ROA value was 2.13% achieved by period of December 31, 2012. The highest ROA value was 5.62% achieved by the West Nusa Tenggara and the lowest ROA was 1.27% achieved by the South Kalimantan. By looking at the average ROA value, it shows that all BPDs are able to get profit from all their assets. The average ROA value is above that required by Bank Indonesia at 1.25%. This means that the income earned from BPD still has the ability to improve the function of intermediation through lending.

Table 1

*The Development of the LDR, OEOI, NPL, and ROA of BPDs in Indonesia by December 31, 2012 (Percentage)*

No.	BPDs	LDR	OEOI	NPL	ROA
1	DKI-Jakarta	73.50	81.43	3.20	1.87
2	West Java	74.09	80.02	2.07	2.46
3	Central Java	82.62	76.35	0.80	2.73
4	DIY-Jogyakarta	71.89	74.85	0.84	2.56
5	East Java	83.55	68.89	2.95	3.34
6	DI-Aceh	89.89	71.51	3.30	3.66
7	North Sumatera	101.90	77.76	2.86	2.99
8	West Sumatera	100.35	77.62	2.69	2.65
9	South Sumatera	75.98	82.28	6.82	1.90
10	Riau	66.49	75.07	2.95	2.95
11	Jambi	82.29	63.32	0.33	3.58
12	Bengkulu	93.27	73.27	0.22	3.41
13	Lampung	91.73	75.05	0.74	2.80
14	Bali	80.60	62.82	0.57	4.28
15	East Nusa Tenggara	93.45	71.57	1.20	3.65
16	West Nusa Tenggara	108.41	64.32	1.98	5.62
17	Papua	71.65	74.15	0.84	2.81
18	Maluku	78.61	73.90	2.67	3.25
19	North Sulawesi	109.62	77.45	0.81	2.95
20	South Sulawesi	113.21	71.66	1.39	3.99
21	Central Sulawesi	107.27	80.60	4.49	1.59
22	Southeast Sulawesi	92.02	59.56	1.33	5.10
23	East Kalimantan	56.78	68.19	7.45	2.50
24	West Kalimantan	86.80	71.33	0.17	3.33
25	South Kalimantan	55.77	79.40	1.83	1.27
26	Central Kalimantan	71.88	69.83	0.84	3.41
	Minimum	55.77	63.32	0.17	1.27
	Maximum	113.21	82.28	4.49	5.62
	Average	78.57	73.16	2.13	3.10

Note. Source: Bank Indonesia (2013b).



### Multiple Linear Regression Analysis

Multiple linear regression analysis was used to determine basic dependence on dependent variable with one or more independent variables, with the aim of estimating or predicting the average of population data or average value of the dependent variable based on the value of the independent variable known (Gujarati, 2003). By using regression analysis, it can be seen whether there is an influence between independent variables and the dependent variable. The results of multiple linear regression analysis in this study can be seen in Table 2.

Based on Table 2, the regression equation is as follows:

$$LDR = -1.373 + 2.172X_1 - 1.165X_2 + 20.779X_3 \quad (2)$$

The equation above can be explained as follows:

(1) Constant value (a) is -1.373, which means a negative constant value. This shows if the OEOI ( $X_1$ ), NPL ( $X_2$ ), and ROA ( $X_3$ ) have a value of zero, then the LDR (Y) will be increased by 1.373;

(2) Regression coefficient for the variable OEOI ( $X_1$ ) is 2.172, indicating the positive relationship between the OEOI ( $X_1$ ) and LDR (Y), meaning that if the addition of OEOI ( $X_1$ ) for every unit, assuming other variables constant, the LDR (Y) will be increased by 2.172. And *vice versa*, if there is a reduction of the OEOI ( $X_1$ ) of the unit, it will decrease the LDR (Y) equal to 2.172;

(3) Regression coefficient for the variable NPL ( $X_2$ ) is -1.165, indicating a negative relationship between the NPL ( $X_2$ ) and the LDR (Y), meaning that if there is additional NPL ( $X_2$ ) per unit, assuming other variables remain the LDR (Y) was reduced by 1.165. And *vice versa*, if there is a reduction in the NPL ( $X_2$ ) of the unit, it will increase the LDR (Y) equal to 1.165;

(4) Regression coefficient for the variable ROA ( $X_3$ ) is 20.779 which means it has a positive value, it indicates the direction of the relationship between the ROA ( $X_3$ ) and LDR (Y), meaning that if there is additional ROA ( $X_3$ ) of one unit, assuming other variables remain the LDR (Y) which will add to 20.779. Otherwise any such reduction occurred ROA ( $X_3$ ) by 1%, then it will reduce the LDR (Y) equal to 20.779.

Table 2

*Test Results of Multiple Linear Regression Coefficients*

Model	Unstandardized coefficients		Standardized coefficients		T	Sig.
	B	Std. error	Beta			
(Constant)	-1.373	0.312			-4.401	0.000
1 OEOI	2.172	0.345	0.892		6.293	0.000
NPL	-1.165	0.679	-0.130		-1.716	0.089
ROA	20.779	2.189	1.297		9.494	0.000

Notes. Dependent variable: LDR; B—symbol of regression coefficients; T—T-test (symbol of partially significance test). Source: Output SPSS 20.0.

### Analysis of Correlation Coefficient and Coefficient of Determination

Correlation coefficient analysis was used to determine the direction and the strong relationship among the three independent variables. Those are the variables OEOI ( $X_1$ ), NPL( $X_2$ ), and ROA ( $X_3$ ), with the LDR as a dependent variable (Y) (see Table 3).

Based on Table 3, it can be concluded that the variables OEOI ( $X_1$ ), NPL ( $X_2$ ), and ROA ( $X_3$ ), with LDR dependent variable have a value of correlation (r) 0.717, meaning that the OEOI ( $X_1$ ), NPL ( $X_2$ ), and ROA ( $X_3$ ),

with the LDR dependent variable (Y) are in strong correlation (Sugiyono, 2009). While the coefficient of determination analysis was used to determine the contribution effect of the OEOI ( $X_1$ ), NPL ( $X_2$ ), and ROA ( $X_3$ ), with the LDR dependent variable (Y) as a dependent variable (Y) expressed as a percentage. Analysis of the coefficient of determination is squaring the correlation value ( $R^2$ ) and based on Table 3 that the  $R^2$  value was 0.514. So when multiplied by 100%, the contribution or effect of the variable OEOI ( $X_1$ ), NPL ( $X_2$ ), and ROA ( $X_3$ ) with the LDR dependent variable (Y) is 51.4% indicating that the OEOI ( $X_1$ ), NPL ( $X_2$ ), and ROA ( $X_3$ ) accounted for 51.4% of the LDR (Y), while the remaining 48.6% thought to be influenced by other variables not examined.

Table 3

*Test Results Correlation Coefficient and Coefficient of Determination Model Summary*

Model	R	R square	Adjusted R square	Std. error of the estimate
1	0.717	0.514	0.500	0.0906657

Notes. R—symbol of correlation coefficient. Source: Output SPSS 20.0.

**Partial Significance Test (T-Test)**

T-test is used to examine hypotheses on the significance of the partial model. It is intended to determine the effect of the independent variables (CAR, NPL, and ROA) partially to the dependent variable (LDR). Partially, the influence of the three independent variables to the LDR as independent variables, as shown in partial test results (t-test) in Table 4, it can be argued that:

**The effect of the OEOI of the LDR.** Partial test results between the OEOI and LDR show that the t-count value of 6.293 is greater than t-table (2.074) with a significant value of 0.000 which was below 0.05. This means that the OEOI has effect on the LDR. Thus, the hypothesis H1 which states the OEOI negatively affects the LDR which is acceptable. The test results are in line with previous research conducted by Sitorus (2013) which states that the OCOE influences the LDR. While the researches conducted by Granita (2011), Oktavianitari and Wiagustini (2012) found that the ratio of the OEOI negatively affects but no significance on the LDR. Yet, the results of this test are not in line with the results of the study conducted by Utari and Haryanto (2011), the OEOI results have a significant positive effect on the LDR with a significance level of  $0.001 < 0.050$ . While the results of research conducted by Amriani (2012) found that the OEOI results have not statistically significant effect on the LDR.

**The effect of the NPLs on the LDR.** Partial test results between NPLs and LDR show that the t-value of -1.716 is less than the t-table (1.983) with a significant value of 0.89 which is above 0.05. This means that the NPLs do not affect the LDR. Thus, the hypothesis H2 which states that the NPL negatively affects the LDR, is rejected. This means that the NPLs in BPD did not have a significant impact on the implementation of banking intermediation by BPD, because the average NPLs rate in BPD is relatively small. The NPL is relatively small indicating that the credit risk faced by small BPD as a result of good credit management. The test results are in line with the research results of Soedarto (2004) that states the NPLs have positive and significant effect on bank credit. However, in contrast to previous researches conducted by Pratama (2010), Harmanta and Ekananda (2005), Nasirudin (2005), Utari and Haryanto (2011), Tamtomo et al. (2012), and Tangko (2012) that partially, the NPLs variable has negative and significant effect on the LDR. Meanwhile, according to Budiawan (2008), who states that the NPL has no significant and negative effect on bank credit.

**The effect of the ROA on the LDR.** Partial test results between the ROA and the LDR show that t-test value of 9.494 is greater than t-table (1.983) with a significant value of 0.000 which is below 0.05. This means that the ROA has effect on the LDR. Thus, the hypothesis H3 which states that the ROA has a positive effect on LDR is acceptable. The test results are in line with previous research conducted by Tamtomo et al. (2012) which states that the ROA has positive and significant effect on the LDR. However, in contrast to Utari and Haryanto (2011), who state that the results showed that the ROA is not significant and has negative effect on the LDR with a significance level of  $0.560 > 0.050$ .

Table 4

*Partial Test Results (T-Test)*

Model	T-count	T-table	Sig.	Description
(Constant)	10.556		0.000	
1 CAR	-2.020	1.983	0.046	Significant
NPL	-0.001	1.983	0.999	Not significant
ROA	7.046	1.983	0.000	Significant

Notes. Dependent variable: LDR; Source: Output SPSS 20.0.

**Simultaneous Significant Test (F-Test)**

F-test was conducted to determine the effect of independent variables (OEOI, NPL, and ROA) together (simultaneously) with the dependent variable (LDR). Simultaneous influence of the three independent variables on the dependent variable LDR is shown in Table 5. Based on the results of the F-test calculations in Table 5, f-count was 35.323 larger than the f-table (2.1400) with a significance value (sig.) of 0.000 which is smaller than 0.05. This means that the independent variables (OEOI, NPL, and ROA) simultaneously have significant effect on the dependent variable (LDR). Thus, the hypothesis H4 which states that the OEOI, NPL, and ROA affect the LDR is acceptable. The test results are in line with previous research conducted by Prayudi (2011) that the variable OEOI, NPL, and ROA with the F-test, simultaneously affect the LDR. Furthermore, according to Siringoringo's (2012) research results simultaneously affect the capital structure of bank intermediation function. And Tangko's (2012) research results showed that the variables CAR and NPL have significant influence on the LDR, and the NPL variable has a significant negative effect on the LDR. Similarly, the results of research conducted by Sitorus (2013) which states that the CAR, ROA, NIM, and OEOI influence the LDR. Nasirudin (2005) states that the CAR and NPL have a significant effect on the LDR. While Tamtomo et al. (2012) found that during the research period partially, variables of the CAR and ROA ratio have positive and significant effect on the LDR of a company, the NPLs have significant negative effect on the LDR of a company, while the third party funds have no effect on the LDR of a company. The research results showed that the CAR variables significantly influence the LDR and NPL variable and have a significant negative effect on the LDR. But according to Utari and Haryanto (2011), the results showed that the five independent variables (CAR, NPL, ROA, OEOI, and minimum reserves) influenced by 24.4% against the level of liquidity proxy LDR, and the CAR does not have significant positive influence on the LDR with a significance level of  $0.192 > 0.050$ , the NPL has a significant negative influence on the LDR with a significance level of  $0.000 < 0.050$ . The ROA does not have significant negative influence on the LDR with a significance level of  $0.560 > 0.050$ , and the OEOI has a significant positive effect on the LDR with a significance level of  $0.001 < 0.050$ .

Table 5

*Simultaneous Test Results (F-Test)*

ANOVA						
Model		Sum of squares	df	Mean square	F	Sig.
1	Regression	0.591	3	0.197	17.854	0.000
	Residual	1.103	100	0.011		
	Total	1.693	103			

Notes. F—F-test (symbol of simultaneously significance test); dependent variable (LDR); predictors: (constant), ROA, CAR, NPL.

### Conclusions

Based on the background, the formulation of the problem, hypotheses, methods, and research results and discussion, some conclusions can be drawn as follows:

(1) In 2012, BPDs throughout Indonesia are able to carry out banking intermediation function as measured by the LDR of 78.57%, still lower than the national banks and other banks, but within the range of the LDR is determined by Bank Indonesia. The lowest LDR value was reached by the BPD South Kalimantan, while the highest LDR value was achieved by the BPD South Sulawesi;

(2) Based on the test results partially that variables of OEOI and ROA have positive and significant effects on the LDR. The NPL has positive effect but no significant effect on the LDR, while the NPL has negative effect and significant effect on the LDR. While based on the test results simultaneously that variables of the OEOI, NPL, and ROA have significantly influence on the LDR variable;

(3) The amount of the contribution or influence variable of the CAR, NPL, and ROA to the dependent variable of the LDR is 51.4%, while the remaining 48.6% thought to be influenced by other variables not examined in this study.

### References

- Abdullah, P., & Suseno. (2003). Regional banking intermediation function: Measurement and Identification. *Bulletin of Monetary Economics and Banking (Bank Indonesia)*, 5(4), 43-63.
- Al-Abedallat, A. Z., & Al-Shubiri, F. N. (2013). Analysis the determinants of credit risk in Jordanian banking: An empirical study. *Journal Management Research and Practice*, 5(3), 21-30.
- Amriani, R. F. (2012). Analysis of the effect of CAR, NPL, ROA, and NIM against LDR on state-owned bank in Indonesia period 2006-2010. Thesis. Management Department Faculty of Business and Economic, Hasanuddin University, Makassar.
- Astohar. (2012). The role of net interest margin (NIM) in strengthen effect on the loan to deposit ratio (LDR) of changes in earnings on a Devisa bank registered in Indonesian bank 2006-2009. *Economic Focus Journal*, 7(1), 30-42.
- Bank Indonesia. (2011). Circular letter (SE) No. 13/24/DPNP. October 25, subject: Valuation of level commercial bank soundness. Commercial Banks headquartered in Indonesia.
- Bank Indonesia. (2012). Bank Indonesia Regulation (PBI) No. 14/18/PBI/2012. November 28, on the minimum capital adequacy of commercial banks. Capital for Commercial Banks Headquartered in Indonesia.
- Bank Indonesia. (2013a). Bank Indonesia Circular letter (SE) No. 15/41/DKMP. October 1, subject: Calculation of minimum statutory reserved demand deposit and compulsory demand deposit by loan to deposit ratio in rupiah. Commercial Banks headquartered in Indonesia.
- Bank Indonesia. (2013b). *Indonesian Banking Statistics*, 11(7).
- Bank Indonesia. (2013c). *Publication of banking financial statement*. Retrieved from <http://www.bi.go.id>
- Buchory, H. A. (2006). The influence of financial intermediary function implementation, risk management application and bank capital structure on banking financial performance. Dissertation, Faculty of Economic, Padjadjaran University, Bandung.

- Buchory, H. A. (2014). Analysis of factors affecting implementation of banking intermediation function: Study on regional development bank all over Indonesia in 2012. Proceedings from *SIBR 2014 Conference on Interdisciplinary Business and Economics Research*. February 7-8, Kuala Lumpur, Malaysia.
- Budiawan. (2008). Analysis of factors affecting the distribution of credit in rural bank (BPR): Case study at Bank Indonesia Banjarmasin. Thesis. Magister Management Study Program of Diponegoro University Semarang.
- Budiwiyono, E. (2012). BPD (regional development bank) for strength in accelerating implementation of regional autonomy: Prospects and problems. Proceedings from *the National Seminar on Indonesian Economist Association*. October 2-4, Yogyakarta.
- Cade, E. (1997). *Managing banking risk*. Cambridge, London: Gresham Books.
- Culp, C. L. (2001). *The risk management process: Business strategy and tactics*. New York: John Wiley & Sons, Inc.
- Gardner, M. J., Mills, D. L., & Cooperman, E. S. (2000). *Managing financial institutions: An asset/liability approach*. New York: Dryden Press.
- Graddy, D. B., Spencer, A., & Brunsen, W. H. (1985). *Commercial banking and the financial services industry*. Virginia: Reston Publishing Company Inc., A Prentice-Hall Company.
- Granita, J. K. (2011). Influence analysis of deposits, CAR, ROA, NPL, NIM, BOPO, interest rates, inflation and exchange rate against LDR (studies in national private exchange bank 2002-2009 period). Thesis in Bachelor Program Economic Faculty Diponegoro University, Semarang.
- Gujarati, D. (2003). *Basic econometric* (4th ed.). New York: Mc. Graw-Hill Book Co.
- Harmanta, & Ekananda, M. (2005). Disintermediation function post-crisis banking in Indonesia 1997: Factor of demand or supply loans, a model approach to disequilibrium. *Bulletin of Monetary Economics and Banking*, 8(1), 51-78.
- Haruna, M. A. (2011). Determinant of cost of financial intermediation in Nigeria's pre-consolidated banking sector. Department of Accounting Ahmadu Bello University, Zaria, Nigeria.
- Hempel, G. H., Simonson, D. G., & Coleman, A. B. (1994). *Bank management: Text and cases* (4th ed.). New York: John Wiley & Sons, Inc.
- Karim, M. Z. A., Chan, S.-G., & Hassan, S. (2010). Bank efficiency and non-performing loans in Malaysia and Singapore. Proceeding from *Applied International Business Conference*. November 6-8, Grand Dorsett Hotel, Labuan.
- Karo, K. (2013). Ekofin konsulindo, banking & financial consultant. Indicators and directory of Indonesian banking in 2012. Jakarta.
- Kidwell, D. S., & Petterson, R. I. (2000). *Financial institution, market, and money*. New York: Dryden Press.
- Koch, T. W. (2000). *Bank management*. International edition. Orlando: The Dryden Press, Harcourt Brace College Publishers.
- Mahrn, H. A. (2012). Financial intermediation and economic growth in Saudi Arabia: An empirical analysis, 1968-2010. *Journal Modern Economy*, 3(5), 626-640.
- Mbizi, R. (2012). An analysis of the impact of minimum capital requirements on commercial bank performance in Zimbabwe. *International Journal of Independent Research and Studies*, 1(4), 124-134.
- Ministry of Internal Affair of the Republic Indonesia. (1999). Article number 62 of 1999. Guidelines for organization and work of regional development banks.
- Mishkin, F. S., & Eakins, S. G. (2006). *Financial market & institutions* (5th ed.). New York: Pearson, Addison Wesley.
- Nasirudin. (2005). Analysis of factors affecting the loan to deposit ratio (LDR) at rural bank in region job bank Indonesia Semarang. Thesis. Magister Management Study Program of Diponegoro University Semarang.
- Oktaviantari, L. P. E., & Wiagustini, N. L. P. (2012). Effect of banking risk to profitability on rural banks in Badung. Economic Faculty Udayana University, Bali, Indonesia.
- Pratama, B. A. (2010). Analysis of factors affecting bank lending policy (study on commercial banks in Indonesia period 2005-2009). Thesis. Master Program in Management, Diponegoro University, Semarang.
- Prayudi, A. (2011). *Pengaruh capital adequacy ratio (CAR), non performing loan (NPL), BOPO, return on asset (ROA) dan net interest margin (NIM) terhadap loan to deposit ratio (LDR)*. Retrieved from <http://www.papers.gunadarma.ac.id/index.php/mmanagement/article/.../14225>
- Rose, P. S. (2002). *Commercial bank management*. Chicago: Richard D. Irwin, Inc.
- Rose, P. S., & Hudgins, S. (2008). *Bank management & financial services* (6th ed.). Chicago: McGraw-Hill International Edition.
- Schroeck, G. (2002). *Risk management and value creation*. New Jersey: John Wiley & Son, Inc.
- Sentausa, S. A. (2009). *Banking ask Bank Indonesia easing rules*. Retrieved from <http://www.kompas.com/>

- Siringoringo, R. (2012). Characteristics and functions of banking intermediation in Indonesia. *Bulletin of Monetary Economics and Banking*, 15(1), 61-83.
- Sitorus, V. Y. (2013). *Analysis of factors influence non performing loan (NPL) at go public bank at Indonesia stock exchange period 2005-2011*. Retrieved from <http://www.sciencegate.ch/>
- Soedarto, M. (2004). Factor that affects distribution rural credit bank [BPR (rural bank) case study in work area bank Indonesia Semarang]. Thesis. Magister Management Study Program Diponegoro University, Semarang.
- Sugiyono. (2009). *Research methods*. Jakarta: Salemba Empat.
- Supriyanto, E. B. (2013). *Indonesian banking challenges in 2013*. Bureau of Research Infobank, Jakarta.
- Tamtomo, Setyo, H., & Hersugondo. (2012). Effect of CAR, NPL, ROA against LDR Indonesia banking company. *Students' Journal of Accounting and Banking*, 1(1), 1.
- Tangko, I. L. F. (2012). Analysis of effect of capital adequacy ratio (CAR) and non-performing loans (NPL) of the loan to deposit ratio (LDR) in the state-owned bank in Indonesia. Thesis. Management Department, Economic and Business Faculty, Hasanudin University, Makasar.
- The Republic Indonesia. (1962). Act of the Republic Indonesia number 13 of 1962 on main provisions of the regional development banks.
- The Republic Indonesia. (1992). Act of the Republic Indonesia number 7 of 1992 as amended in act number 10 of 1998 on banking.
- Utari, M. P., & Haryanto, A. M. (2011). Analysis of effect of CAR, NPL, ROA and BOPO on LDR (case studies in national private exchange bank in Indonesia period 2005-2008). Undergraduate thesis. Diponegoro University, Semarang.





**Journal of US-China Public Administration**  
Volume 11, Number 8, August 2014

David Publishing Company  
240 Nagle Avenue #15C, New York, NY 10034, USA  
Tel: 1-323-984-7526, 323-410-1082; Fax: 1-323-984-7374, 323-908-0457  
<http://www.davidpublishing.com>  
[managers@davidpublishing.com](mailto:managers@davidpublishing.com)

