



Univerza v Mariboru

Ekonomsko-poslovna fakulteta



Letnik: 66 | Številka: 2 | 2020 |  
Volume: 66 | Number: 2 | 2020 |

**NG  
OE**

**NAŠE GOSPODARSTVO**  
Revija za aktualna ekonomska in poslovna vprašanja

**OUR ECONOMY**  
Journal of Contemporary Issues in Economics and Business

# NAŠE GOSPODARSTVO

Revija za aktualna ekonomska in poslovna vprašanja

Letnik 66, št. 2, 2020

## Izdajatelj:

Ekonomsko-poslovna fakulteta Maribor (EPF)

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## Glavna in odgovorna urednica:

Darja Boršič

## Pomočnica glavne in odgovorne urednice:

Romana Korez Vide

## Naslov uredništva:

Maribor, Razlagova 14, Slovenija,  
telefon: +386 2 22 90 112

## Elektronska pošta:

nase.gospodarstvo@um.si

## Spletna stran:

<http://www.ng-epf.si>

Revija je uvrščena v bibliografske baze podatkov EconLit, European Reference Index for the Humanities and the Social Sciences (ERIH PLUS), Directory of Open Access Journals (DOAJ), ProQuest, EBSCO, Ulrich's Periodicals Directory in številne druge.



**Lektorji:** Alkemist d.o.o. in ServiceScape Incorporated

**Dtp:** NEBIA, d. o. o.

Letno izidejo 4 (štiri) številke. Letna naročnina: za pravne in fizične osebe 46 €, za tujino 57,5 €.

**ISSN 0547-3101**

Revijo sofinancira Javna agencija za raziskovalno dejavnost Republike Slovenije.

# OUR ECONOMY

Journal of Contemporary Issues in Economics and Business

Vol. 66, No. 2, 2020

## Published by:

Faculty of Economics and Business, Maribor (FEB)

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## Editor-in-Chief:

Darja Boršič

## Co-editor:

Romana Korez Vide

## Editorial and administrative office address:

Maribor, Razlagova 14, Slovenia,  
phone: +386 2 22 90 112

## E-mail:

[our.economy@um.si](mailto:our.economy@um.si)

## WWW homepage:

<http://www.ng-epf.si>

The journal is indexed/abstracted in EconLit, European Reference Index for the Humanities and the Social Sciences (ERIH PLUS), Directory of Open Access Journals (DOAJ), ProQuest, EBSCO, Ulrich's Periodicals Directory and in a number of other bibliographic databases.

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# CSR and Financial Performance – Linked by Innovative Activities

## Majda Bastič

Retired by University of Maribor, Faculty of Economics and Business, Slovenia  
majda.bastic@gmail.com

## Matjaž Mulej

Retired by University of Maribor, Faculty of Economics and Business, Slovenia  
matjaz.mulej@um.si

## Mira Zore

ZOMI, d.o.o., Stari trg 25, SI-8210 Trebnje, Slovenia  
mira.zore@zomi.si

## Abstract

The purpose of the present study was to investigate the relationships between different dimensions of corporate social responsibility (CSR), as well as the mediating role of innovation between CSR dimensions and financial performance. Data was collected with questionnaires from 321 managers of Slovene companies to test a conceptual model with structural equation modeling (SEM). The field-research results were that CSR is the most relevant dimension for employees. It positively influences CSR to the natural environment, to customers, and to the local community. The mediating role of innovation between CSR and financial performance was confirmed. The results also showed that CSR to the natural environment and CSR to customers positively affect innovation, while CSR to the local community had a negative impact. In addition, the positive impact of innovation initiated by CSR on financial performance was confirmed. The principal limitation of this study was its focus on Slovenian firms and the fact that data was obtained from only one manager in each firm. Slovene companies should consider the global initiatives supportive of CSR as the way to create opportunities for innovation and differentiation from other companies and increase their financial performance. The conceptual model developed and tested on the data obtained by Slovene managers gives new perspective on the impacts of social responsibility, innovation and financial performance. It highlights the areas in which the theory of social responsibility needs more research.

**Keywords:** corporate social responsibility (CSR), Slovene companies, innovation, financial performance, structural equation modeling (SEM)

## Introduction

The concept of corporate social responsibility (CSR) is not new and the interest in CSR is still spreading (Bontis & Serenko, 2009; Wagner et al., 2009). However, the European Commission (EC, 2011) found very few enterprises embracing CSR, as an organization's responsibility for its impacts on society as defined in ISO 26000 (ISO, 2010). Executive managers remain doubtful about engaging in

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ORIGINAL SCIENTIFIC PAPER

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RECEIVED: DECEMBER 2019

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REVISED: APRIL 2020

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ACCEPTED: MAY 2020

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DOI: 10.2478/ngoe-2020-0007

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UDK: 005.35:001.895(497.4)

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JEL: M14, O3, M20

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**Citation:** Bastič, M., Mulej, M., & Zore, M. (2020). CSR and Financial Performance – Linked by Innovative Activities. *Naše gospodarstvo/Our Economy*, 66(2), 1–14. DOI: 10.2478/ngoe-2020-0007

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OE**

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NAŠE GOSPODARSTVO  
OUR ECONOMY

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Vol. 66 | No. 2 | 2020

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pp. 1–14

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CSR (Sachdev, 2006). Many of them have reduced CSR to an issue of charity and costs, instead of innovative cost reduction and market creation by ISO 26000 notions. These focus on one's responsibility for one's influences on society, i.e. humans and other aspect of nature, interdependence and holism. Its principles include: accountability, transparency, ethical behaviour (reliability, honesty, and integrity), respect for stakeholders' interests, the rule of law, international norms, and human rights (ISO, 2010).

A literature review suggests that there is still a lack of understanding about the ways in which CSR initiatives can both rely on innovation processes and improve performance, (Perrine, 2013; Lockett et al., 2006). CSR and innovation diminish one-sided, abusing, short-term and narrow-minded practices, but require more systemic values, culture, ethics and norms from decisive persons and bodies (Zore, Mulej & Bastič, 2016).

The resource-based theory sees innovation as an important determinant in creating value and sustaining competitive advantage of companies (Baregheh et al., 2009). Theoretical works (Friedman, 1970; Porter & Kramer, 2006; Asongu, 2007) emphasize the importance of innovation when creating CSR, as the increasing CSR also grows company innovation. CSR initiatives can thus lead to the implementation of innovation processes that respond to social, environmental, and economic needs by creating new work methods, products, services, processes, and markets in a context that could lead numerous firms to redefine their strategy (Little, 2006). The incorporation of CSR criteria as a value-creating element requires a change of philosophy within organization, as CSR involves important modifications in company management (Mathieu, 2005). Less one-way commanding and more creative cooperation results from the managerial social responsibility toward co-workers and leads to more innovation.

The use of innovation to enhance CSR includes complex challenges with multidimensional characteristics. An overview of the empirical research available in the literature shows that several scholars have focused on the quality of CSR in companies and on the relation between CSR and financial performance.

However, we detected no empirical research examining the concept of innovation and its mediating role between CSR dimensions and financial performance. In empirical research, CSR is considered as a single numerical or dummy variable. However, different CSR dimensions may have varying effects on innovations and financial performance. We also did not find consensus regarding the impact of CSR on financial performance (Orlitzky et al., 2003; Vogel, 2005; Hull & Rothenberg, 2008).

Good CSR to employees may make co-workers enthusiastic and effective; CSR to the environment may reduce costs and provide new opportunities to differentiate. We found no empirical studies about the relationship between CSR to either the local community or innovation. If at least one CSR dimension does not positively influence innovation, that may explain the varying findings in theoretical and empirical research about the CSR-innovation relationship.

To extend the previous literature, the aim of this paper is to investigate four CSR dimensions (CSR to employees, CSR to natural environment, CSR to customers, and CSR to the local community) to find out how managers prioritize and balance aspects of CSR. Therefore, we investigated the relationships between CSR to employees and other three stakeholder groups (natural environment, customers, and local community) as well as their impacts on innovation. The effects of innovation initiated by CSR on financial performance were also included in the study.

After briefly reviewing the relevant literature and presenting hypotheses, we present the applied methodology and the results obtained. Finally, we discuss our findings. The empirical research covers Slovenia as a relatively new member of the European Union, experiencing a market economy, with all its currently usual good and bad attributes, for only 30 years (except its older exporting businesses).

## Literature Review and Hypotheses Development

### CSR and relationships among CSR dimensions

CSR is a process of improvement which companies integrate into their management considerations of social, environmental and economic order in a voluntary, systematic and coherent way, in consultation with their stakeholders (CIDD in Perrine, 2013). In ISO 26000, CSR signifies one's responsibility for one's influence on the society (ISO, 2010). ISO 26000 also states that CSR reinforces honesty, reliability, broad-mindedness and long-term orientation, which enhances reputation and brings other advantages: by following CSR principles, the companies can prevent many opportunity costs, which are often hidden in accounting reports. Hence, a firm engaging in CSR should endeavor to make a profit, abide by the law, participate in ethical practices, and be a good business citizen (Carroll, 2016). CSR is a multidimensional construct accommodating not only economic concerns, but also non-economic matters, such as community or employee relations (Saeidi et al., 2015).

The literature on CSR shows that the stakeholders' interests matter. Freeman (1984) defines stakeholders as groups or individuals who can affect, or be affected by the achievement of the organization's objectives or who are directly or indirectly interested in the company (Turker, 2009). Verdeyen et al. (2004) classify stakeholders as either internal or external. The dimensions of CSR emerge in line with internal and external stakeholders with whom the business is in a relationship (Gürlek et al., 2017). In terms of stakeholders, the CSR dimensions can be evaluated as responsibility to employees, to customers, to local community, and to the environment. Specifically, managers should recognize that a thorough consideration of stakeholders is important, as the utilization of stakeholders in strategic decisions dramatically improved the CSR policy and the effect of self-transcendence (Reisdorf Tolmie et al., 2019). Companies, especially small ones, are constrained with limited resources; thus conflicts of interest among stakeholder groups may arise (Editors of Academy of Management Journal, 2016).

### **CSR to employees**

It covers the way an organization interacts with employees. Responsibility to employees includes activities such as protecting employee rights, guaranteeing occupational health and safety, improving workers' skills and ensuring labor quality (Longo et al., 2005). Employees who perceive strong encouraging signals from their supervisors, are more likely to develop and implement creative ideas that positively affect their natural environment (Ramus & Steger, 2000). John et al. (2019) showed that when employees perceive organizational CSR positively, it generates a sense of pride in affiliating with the organization and eventually strengthens organizational identification.

While customers have been traditionally considered the key drivers of companies' social initiatives, employees have become at least as important as customers, if not even more so, in driving company sustainability initiatives (Editors of Academy of Management Journal, 2016). CSR for employees, out of the three aspects of CSR under consideration, has a particularly important effect on organizational attractiveness; thus, firms should pay more attention to the CSR for employees to attract more qualified employees (Zhang, 2020) who, in turn, help organizations to increase efficiency, innovation and growth (Asongu, 2007).

### **CSR to the national environment**

Responsibility to the environment includes minimizing environmental pollution and protecting natural resources, as well as water and energy saving (Benavides-Velasco et al.,

2014). Companies that match CSR's environmental standards are more competitive, at least in the middle and long term. They are better able to invest in more efficient, cleaner, and environmentally friendly technologies (EC, 2007). Environmental issues are closely linked to human rights, community involvement and development, and other issues of socially responsible behavior (ISO, 2010).

### **CSR to the local community**

Responsibility to the local community increases the welfare level of society, supporting educational and artistic activities and increasing living standards of the society (Abaeian et al., 2014). The community provides employees for the organization, makes the environment that either attracts or drives away competent personnel, stipulates taxes, ensures basic support, and can enforce restrictions on the institution's or industry's activity (Theaker & Yaxley, 2012). Socially responsible companies should also employ people from their local communities (Salb, Friedman, & Friedman, 2011).

### **CSR to customers**

Relationships with customers are critical in the CSR-to-outcomes relationships, especially customer satisfaction, consumer–organization fit, and consumer trust (Levy et al., 2010). Responsibility to customers refers to consumer rights protection, providing exact information about products and providing high quality products (Longo et al., 2005) which also includes health and environmental dimensions of quality. Socially responsible customers know the social consequences of their shopping; they choose socially responsible suppliers. To enhance customer satisfaction, firms should exert more efforts in CSR activities to offer better products or services, as CSR for customers has the highest impact on customer satisfaction (Zhang, 2020).

Consistent with the theory and findings discussed above and especially with CSR as an important factor in ensuring employee perceptions of CSR initiatives (Lee et al., 2013), we hypothesised that CSR to employees had a positive effect on the other three dimensions of CSR:

*Hypothesis 1a: CSR to employees positively affects the CSR to customers.*

*Hypothesis 1b: CSR to employees positively affects the CSR to environment.*

*Hypothesis 1c: CSR to employees positively affects the CSR to local community.*

## Its Relationship with CSR and Financial Performance

The Organization for Economic Co-operation and Development (OECD) defines innovation as the “implementation of a product (goods or service) or of a new or notably improved procedure, of a new method of commercialization, or of a new organizational method in a company’s practices, in the organization of the workplace, or in external relations” (OECD, 2005). New opportunities can arise from different sources, and CSR is a fertile field in which to identify changes in customers’ needs and environmental challenges or to solve social issues through innovation (Porter & Kramer, 2006).

Devinney (2009) considers the link between CSR and innovation as an additional area within the relationship between CSR and corporate performance. Bellow (2012) suggests a model presenting a value chain for sustainable, responsible, ethical corporate governance emphasizing innovation and creativity. Mulej and Dyck (2014) regard innovation and CSR as intertwined factors that bring added value to the company and increase its competitive advantage, but without abusing the influence, although abuse is a frequent characteristic of the influential firms.

CSR-innovation offers companies additional opportunities to differentiate. Lekkerkerk (2008) defines several combinations of CSR and innovation: new ways of implementing CSR in corporate behaviour; a CSR-innovation brings only CSR-benefits; introduction of additional CSR criteria in evaluations of innovations for customers; CSR is based on the idea of “open” innovation.

Although previous literature has argued about the positive relationship between CSR practices and innovation, there is a little explicit research that links innovation and CSR (Bellow, 2012). We found only one empirical study (Hull and Rothenberg, 2008) investigating the impacts of corporate social performance (CSP) and innovations on financial performance. They found a negative correlation between CSP and innovation, and non-significant impact of CSP on financial performance, but positive impacts of innovation and differentiation on financial performance.

Having followed the theoretical findings, which suggest a positive impact of CSR on innovation and the empirical results, but have not confirmed positive impact, we hypothesized:

*Hypothesis 2: Among the three CSR dimensions (CSR to natural environment, to customers and to local community) at least one has a positive, and at least one has a negative impact on innovation.*

Innovation is needed for companies to survive and maintain their profitability (Hamel, 2000). Strategic CSR can bring both short and long-term financial benefits to socially responsible companies (Asongu, 2007). There is no conclusive evidence of a short-term correlation between CSR and economic/financial performance; many studies highlight the strategic role of CSR in creating value in the long term, because it enables innovation (Husted & Allen, 2007).

Innovation is generally conceived as being positively related to performance (O’Reilly & Tushman, 2004; McWilliams & Siegel, 2000). Some authors reported that innovation positively affects firm performance, when environmental factors are considered (Werther & Chandler, 2005). Organizational innovation positively and significantly affects performance, covering many innovations, the proactive or reactive character of those innovations, and the resources the firm invests in innovation (Jiménez-Jiménez & Sanz-Valle, 2011).

Due to a consensus in the literature about relationships between innovation and financial performance one may predict positive impacts of innovation on financial performance.

*Hypothesis 3: Innovation positively affects financial performance.*

Considering the hypotheses H1a, H1b and H1c, H2 and H3, the following conceptual model was created (Figure 1).

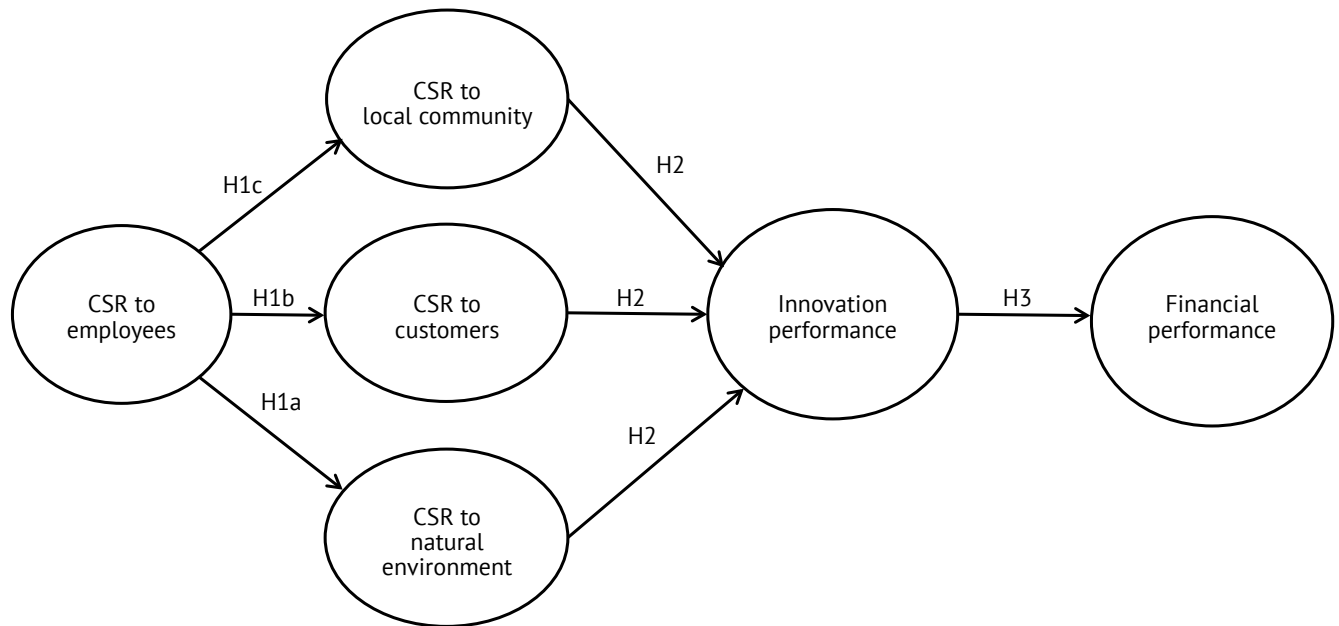
## Data and Methodology

### Sample selection and data collection procedure

The study was based on a survey of Slovene industrial companies. The respondents were business professionals (managers and owners) knowing CSR, innovation and financial performance in their companies. Considering the small response rate in Slovenia, especially when respondents were managers, we decided to select 4,500 Slovene companies from a wide range of industries, using the Slovene business register (PIRS). A self-administered questionnaire was applied to collect data on CSR, innovation, and financial performance within a one-month period, from June 2013 to July 2013. The questionnaire was sent by e-mail, including a cover letter explaining the study purpose and the link for access to the questionnaire.

In all, 321 questionnaires were fully completed and returned. The response rate was about 7.1%, which is normal response rate for Slovenia when the respondents are managers.



**Figure 1.** Conceptual (Research) Model

Almost half (49%) of the sample included small companies (10-49 employees), a quarter of the sample were micro companies (fewer than 10 employees) and 20% of the sample had 50 or more employees. In order to guarantee anonymity, no personal identifying information was requested from the respondents.

### Construct measures

The questionnaire consisted of three sections. The items in the first section measured the respondents' perceptions of the CSR practices in their company. The second section was allocated to capture data on the respondents' perception on company's innovation. The third section was included to measure the company's financial performance. The respondents expressed their statements on the five-point Likert scale, where 1 means "strongly disagree" and 5 "strongly agree". Some demographic questions were included in the last section.

#### CSR scale

We developed the scales to measure four CSR dimensions: environment, customers, local community, and employees; these are described in Zore et al. (2016). High values on these scales mean high firm social responsibility.

The CSR to environment scale included three items. High values on these items mean that companies take care of future generations' lives; they encourage their employees to take part in voluntary activities to protect and improve the

environment quality; and they also manage and control risks within the company to prevent environmental accidents.

The CSR to customers scale consisted of three items measuring the company's respect for the customers' rights, its concern about the satisfaction of its customers and its attitude toward unfair competition.

The CSR to local community scale was measured by three items. They referred to the intensity of activities with which companies create employment possibilities, support non-government organizations and promote the well-being of the local community.

The CSR to employees scale included seven items. They measured working environment, employees' possibilities for constructive criticism and debate, and discrimination against employees.

The innovation performance scale consisted of six items. Two of them were taken from Griffin and Page's (1996) scale; two were taken from Cooper and Kleinschmidt (1995), and two were proposed by the interviewed experts. Two items measured the innovation output, with the other four innovation advantages referring to an increase of sale in new markets, reduction of energy, material, or purchasing costs per product unit or an increase in package recycling. The responses were expressed on the five-point Likert scale, where 1 means "strongly disagree" and 5 "strongly agree".

The financial performance scale included four items. Three of them belonged to Samiee and Roth's (1992) scale and

one item was proposed by the financial experts. The items measured the company's returns on equity, assets, investments, and profit per employee. The responses were expressed on the five-point Likert scale, where 1 means "strongly disagree" and 5 "strongly agree".

## Research methods

We used exploratory factor analysis (EFA) for innovation and financial performance and then confirmatory factor analysis (CFA) to assess construct reliability and validity of measurement instruments for all six constructs (Anderson & Gerbing, 1988). The results of EFA for the other four constructs are described in Zore et al. (2016). The scale reliability was assessed by both the individual reliability of each indicator and by the composite reliability of each factor. Individual reliability coefficient  $R^2$  should be higher than 0.5, and composite reliability coefficients should be higher than 0.7 (Hair et al., 1995). In addition, we analysed Cronbach's alpha, which should be higher than 0.7 (Nunnally, 1978).

Convergent validity was accepted when factorial loadings were higher than 0.4, and  $t$  values were significant, i.e. higher than 1.96. Discriminant validity was confirmed when the average variance extracted (AVE) was higher than the squared correlations between constructs (Fornell & Larcker, 1981).

The overall fit of the hypothesized conceptual model (Figure 1) was tested using the Chi-square statistic and other fit indices, such as ratio of Chi-square to degrees of

freedom, goodness-of-fit index (GFI), adjusted goodness-of-fit index (AGFI), comparative fit index (CFI), root mean square residual (RMSR), and the root mean square error of approximation (RMSEA). We considered 0.9 as the suggested minimum value for GFI, AGFI and CFI, and 0.05 as the maximum value for RMSR and RMSEA (Lu et al., 2007)

## Results

Table 1 covers the results of EFA for two constructs — innovation, and financial performance — while the CSR scale description is provided in Zore et al. (2016). The construct innovation performance was hypothesized as a one-dimensional factor measured by six items. All factor loadings were relatively high, ranging from 0.695 to 0.832. The value of Cronbach's alpha, which was 0.895, confirmed its internal consistency. Four items measured the construct financial performance. The related factor loadings were high, ranged from 0.810 to 0.865 and the value of Cronbach's alpha of 0.946 additionally confirmed the reliability of this factor.

The hypothesized conceptual model consists of six constructs: CSR to employees, CSR to natural environment, CSR to local community, CSR to customers, innovation performance, and financial performance. Each of them was measured with several items. Therefore, construct validity (convergent and discriminant validity), construct reliability and goodness of fit were evaluated.

Factor convergent validity was assessed by examining the factor loadings and their statistical significance (Dunn et al.,

**Table 1.** Exploratory factor analysis for factors innovation and financial performance

Factor Item	Factor loadings
Innovation performance (Cronbach's alpha = 0.895)	
We successfully placed on the market more radical innovation as our most important competitor.	0.730
We successfully placed on the market more smaller innovations (improvements) as our most important competitor.	0.695
With the introduction of innovation in business processes, we won new markets.	0.764
With the introduction of innovation, we reduced production time, and consumption of energy and material.	0.832
With the introduction of innovation, we increased the use of recycled and environment-friendly packaging.	0.719
With the introduction of innovation, we reduced the annual cost of the purchasing process.	0.800
Financial performance (Cronbach's alpha = 0.946)	
Relative to our most important competitor, during last year we achieved	
Substantially better return on equity (ROE)	0.856
Substantially better return in assets (ROA)	0.865
Substantially better return on investment (ROI)	0.836
Substantially better profit per employee.	0.810

1994). Factor loadings were very high and significant at the 0.01 level (Table 2). It was evidence that there were posited relationships among observed items and a respective factor.

In order to achieve reliability of factor innovation performance, three items (we successfully placed on the market more smaller innovations/improvements as our most important

**Table 2.** Standardized factor loadings, critical ratios and R<sup>2</sup>

Factor Item	Stand. Factor loading	C.R. <sup>a</sup>	R <sup>2b</sup>
<b>CSR to employees</b>			
Our company policies provide a safe and healthy working environment avoiding abuse of the labour force, harsh and inhumane treatment of employees.	0.658	- <sup>c</sup>	0.432
Our company policies encourage employees' commitment.	0.799	12.418	0.638
In our company, managers are not reluctant to constructive criticism; they display interest in learning from employees and encourage debate on the ideas.	0.834	12.782	0.696
Our company practices moral integrity as behaviour that inspires employee trust and promotes transparency throughout the organization, freely admitting mistakes, and valuing integrity over profit or material gain – refusing to use manipulation or deceit to achieve personal goals.	0.868	13.203	0.753
Our company stimulates ethical consumption.	0.810	12.553	0.656
In our company, the employees receive a reasonable salary to maintain an acceptable quality of life.	0.712	11.278	0.507
Our company avoids linguistic, religious, sex, age and ethnic discrimination.	0.670	10.689	0.448
<b>CSR to natural environment</b>			
Our company invests to create a better life for future generations.	0.761	- <sup>c</sup>	0.580
Our company encourages its employees to participate in voluntary activities associated with protection of natural environment.	0.777	13.322	0.604
Our company manages and controls risks within the organization to prevent environmental accidents.	0.733	12.588	0.538
<b>CSR to local community</b>			
Our company emphasizes the importance of its social responsibility to the society/community.	0.816	- <sup>c</sup>	0.666
Our company tries to contribute to sustainable economic development.	0.873	14.946	0.761
Our company creates employment possibility for local community residents.	0.708	11.742	0.501
<b>CSR to customers</b>			
Our company respects customers' rights beyond the legal requirements.	0.626	- <sup>c</sup>	0.392
Satisfaction of our customers is very important for our company.	0.638	8.880	0.407
Our company always avoids unfair competition.	0.643	9.931	0.413
<b>Innovation performance</b>			
We successfully placed on the market more smaller innovations (improvements) as our most important competitor.	0.715	- <sup>c</sup>	0.511
With the introduction of innovation in business processes, we won new markets.	0.831	11.877	0.690
With the introduction of innovation, we reduced the production time, and consumption of energy and material.	0.678	10.582	0.460
<b>Financial performance</b>			
Relative to our most important competitor, during last year we achieved			
Substantially better return on equity (ROE).	0.951	- <sup>c</sup>	0.905
Substantially better return on assets (ROA).	0.966	39.102	0.933
Substantially better return on investment (ROI).	0.870	26.661	0.757
Substantially better profit per employee.	0.830	23.368	0.689

**Legend:**

<sup>a</sup> – C.R. is critical ratio obtained by dividing the estimate of the covariance by its standard error. Its value is the same as *t*-values.

<sup>b</sup> – R<sup>2</sup> is squared correlation coefficient expressing item reliability.

<sup>c</sup> – Indicates a parameter fixed at 1.0 in the model.

competitor; with the introduction of innovation, we increased the use of recycled and environment-friendly packaging; with the introduction of innovation, we reduced the annual cost of the purchasing process) were omitted as their  $R^2$  did not meet the 0.4 criterion (Table 2).

In the next step, we tested an overall model fit applying absolute, incremental, and parsimonious indices. The  $\chi^2$  (344.422 with 218 degrees of freedom) was statistically significant ( $p < 0.05$ ). The value of normed  $\chi^2$  ( $\chi^2/df = 1.580$ ) fell within the recommended interval values between one and two. The GFI had a value of 0.917, which was above the threshold value of 0.9, while the AGFI was 0.895, which is very close to value of 0.9. RMR had the value of 0.043, which was below the threshold value of 0.05.

Among comparative fit indices, the Comparative Fit Index (CFI) and the Tucker-Lewis Index (TLI) were chosen. Their values were 0.973 and 0.969, respectively, indicating support for the proposed measurement model. We also assessed the parsimony model fit by the Parsimony Goodness-of-fit Index (PGFI) and the Root Mean Square Error of Approximation (RMSEA). Their values were 0.724 and 0.043, respectively. The values of these indices indicated a good model fit.

Assuming the adequate model fit, a discriminant validity of the constructs was assessed by comparing average

variance extracted (AVE) with the squared correlation between the constructs. As can be seen in Table 3, all values of AVE exceeded the corresponding squared correlations coefficients. These results demonstrated the evidence of discriminant validity of the constructs in the proposed model.

Then the construct reliability was tested by assessing both composite reliability and AVE (see Table 4). All values of the composite reliability exceeded the threshold value of 0.7. The values of AVE were higher than 0.5, except the value of construct CSR to customers, which was close to 0.5. It means that only 46% of the variance in the specified items was explained by this construct.

To summarize, the overall results of the goodness-of-fit of the model and the assessment of the measurement model indicated that the proposed model exhibited a reasonable fit with the collected data.

The significance tests of the estimated standardized regression coefficients provide the basis for accepting or rejecting the proposed relationships between latent variables. The results for the hypothesized model are given in Figure 2. All regression coefficients relating to the proposed relationships in the hypothesized conceptual model were significant at  $p < 0.05$ .

**Table 3.** AVE and squared correlations

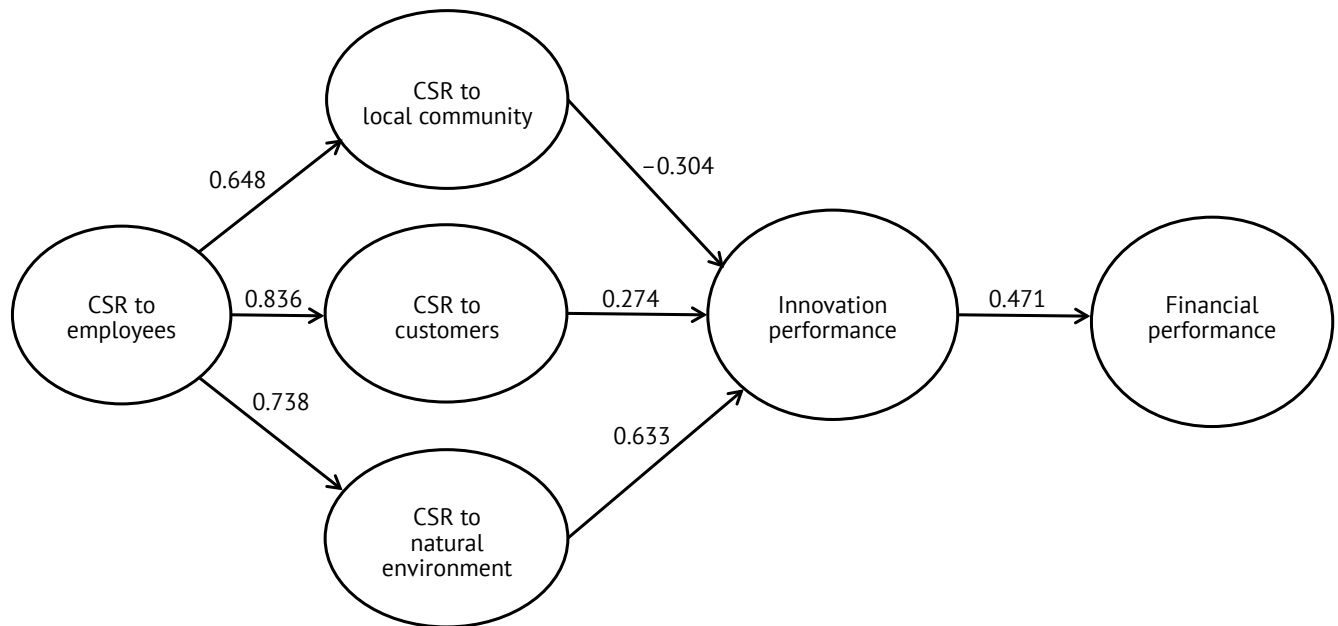
Factor	AVE	Squared correlations					
		CSR to employees	CSR to local community	CSR to customers	CSR to environment	Innovation	Financial performance
CSR to employees	0.59	1.000	0.347	0.436	0.433	0.150	0.099
CSR to local community	0.90	0.347	1.000	0.236	0.430	0.102	0.048
CSR to customers	0.46	0.436	0.236	1.000	0.211	0.098	0.080
CSR to environment	0.57	0.433	0.430	0.211	1.000	0.205	0.092
Innovation	0.53	0.150	0.102	0.098	0.205	1.000	0.209
Financial performance	0.82	0.099	0.048	0.080	0.092	0.209	1.000

Note: CSR – Corporate Social Responsibility

**Table 4.** Construct reliability and AVE

Construct	Composite reliability	Average variance extracted
CSR to employees	0.91	0.59
CSR to local community	0.96	0.90
CSR to customers	0.77	0.46
CSR to environment	0.80	0.57
Innovation performance	0.82	0.53
Financial performance	0.95	0.82

Note: CSR – Corporate Social Responsibility

**Figure 2.** Results of structural modeling analysis

We have assumed that CSR to employees positively effects CSR to customers (H1a), to the natural environment (H1b), and local community (H1c). The path coefficients measuring the impacts of CSR to employees on CSR to environment, local community, and natural environment were significantly positive and ranged from 0.648 to 0.836, which confirms Hypothesis 1a, 1b and 1c. Social responsibility to employees positively affects employees' responsibility to customers, environment, and local community.

In Hypothesis 2, we assumed that among the three CSR dimensions (CSR to natural environment, to customers and to local community) at least one has a positive, and at least one has a negative impact on innovation. The regression coefficient measuring the impact of CSR to local community on innovation was significant and negative (-0.304). It means that higher CSR to community reduces the firm's innovation performance. On the other hand, the regression coefficients measuring the impacts of the CSR to environment and to customers on the firm's innovation performance are both positive and significant, at 0.633 and 0.274, respectively. CSR to environment generates more opportunities to innovate, which finally reflects in better company's innovation performance. Positive, but somewhat smaller is the impact of CSR to customers on innovation performance. All these results support Hypothesis H2.

In Hypothesis 3, we hypothesized the positive effect of the innovation performance on financial performance. The regression coefficient measuring this effect is positive and significant (0.471), which confirms Hypothesis 3.

## Discussion

The purpose of this study was to investigate the relationships between CSR dimensions and the mediating role of innovation between CSR dimensions and financial performance, in order to clarify the ambiguity in empirical research about the impact of CSR on innovation. Our conclusions are based on the results relating to the hypothesized conceptual model and data on Slovenian companies.

Four stakeholders that are beyond economic and legal interests of companies were included in the conceptual model. We investigated the relationships between CSR to employees, customers, the natural environment, and the local community. According to theoretical findings, we hypothesized that CSR to employees positively effects CSR to customers, natural environment, and local community. The obtained results confirmed this hypothesis. This finding matches the extensive research on employees' justice perception, which posits that employees' perceptions of their firms' CSR activities shape their attitudes and behaviours toward their firm. Employees' perceptions of a firm's social policies affect their willingness to participate in, contribute to, and initiate social change (Aguilera et al., 2007). Employees may view a socially engaged organization as one that cares for all people, both internal and external to the organization. Such organizations generally show concern for fairness (respect and care for the environment, for working conditions); employees may deduce that chances and conditions are fair for them, thus satisfying their need for control. Therefore, employees seek and promote CSR

in order to maximize their own outcomes/benefits. If the company is socially responsible to employees, their ability to invent can be formed and a culture of honesty and accountability to employees is created. This positive culture is also reflected in the other three forms of CSR.

Only a few empirical studies have investigated the impact of CSR, generally considered as a single factor, on innovation and they reported different results about this relationship. To clear up this ambiguity we hypothesized that at least one CSR dimension has negative impact on innovation. Our results also confirmed this hypothesis. We found that CSR to customers and to natural environment create opportunities for innovations, and the higher these responsibilities in companies, the more innovations companies produce. On the other hand, CSR to local community had a negative impact on innovations.

Slovene companies are aware of the importance of their responsibility to well-being of local community. They try to contribute to sustainable development of society and create employment possibilities for local people. On the other hand, the results also showed that CSR to local community significantly, but negatively, influences innovation. This means that Slovene companies have not found opportunities for innovation in their responsibility to local community. This finding can also be understood to show that companies see no need to be innovative to improve their social responsibility to the local community and that the target improvement can be achieved in other well-known ways. Small and medium-sized companies especially (dominating in Slovenia and in the sample) usually lack sufficient staff for innovation development. Probably, they cannot afford to assign their employees with innovation capabilities to activities that improve CSR to local community.

Both CSR to environment and to customers positively affect innovation; however, the responsibility to environment has a higher impact on innovation than responsibility to customers. For example, less waste is an easier goal to attain than increasing customers' satisfaction by replacement of established work habits.

CSR, as soon it is not considered only as charity, leads to innovation but, of course, is not its only factor. CSR and innovation are related in companies. The relationship is not easily understood, because CSR and innovation are two complex and multi-dimensional phenomena. The causal interaction and relation between the two can be understood this way: socially responsible businesses and management motivate and inspire employees for the invention-innovation-diffusion processes (IIDP), the technological and especially the non-technological IIDP. Internally, CSR

supports inspiration and guidance for IIDP. Outwardly, CSR can support IIDP concerning business relations; it also supports the company's public image, products and trademarks in communication.

If a company reaches a sufficiently larger/more complete integration of CSR and innovation, it can bring some new benefits. Synergy and the impacts of both factors contribute to the improvement of the situation, when organizing management, human rights, environment, labour relations practice, business honesty, customer problems and involvement in the community and its development. CSR enables this more easily because interdependence and a holistic approach are integrated in it as connecting principles. Thus, for businesses, their implementation of all CSR dimensions means creating sources of innovation – technological and, especially, non-technological – in all business processes.

We also assumed that innovation positively affects financial performance. This hypothesis was confirmed, as well. It is already well-known that innovation is a precondition for financial performance. Our study also confirms that companies succeed if they can enable their employees to exercise innovation and entrepreneurship, allowing diversity and recognizing and rewarding performance. Increasing productivity and profits depend on the success of IIDP (as designated by J. Schumpeter decades ago). Its success depends on the integrity of the approach, which can be much more easily reached, if it is designed with a long-term perspective, objectively and within creative collaboration between employees and managers.

The results and findings of this study contribute to the theory of social responsibility in the context of the relationships between CSR dimensions and their impacts on innovation. The important finding also refers to the mediating role of innovation between CSR to different stakeholders and financial performance. The contribution derives from the empirical examination of the structural model of social responsibility, innovation and financial performance. The purpose of the conceptual model was to set assertions in the context of examining the relationship between social responsibility, innovation and financial performance. In accordance with these assertions, social responsibility should influence innovation and financial performance. The results offer to the business practitioners of CSR information on both the positive and the negative impacts on their introduction of CSR in their enterprises.

The research findings show that social responsibility pays off. It is a source of opportunity for innovation and financial performance. With the successful integration of the social responsibility concept, companies can establish

good relations between stakeholders; they can promote innovation, achieve differentiation and enhance the company's reputation.

Companies should review their culture and ways of thinking and develop new working methods to integrate their vision of CSR. For companies that wish to develop and introduce major innovations, it is advisable to invest in increasing the level of social responsibility, especially toward the environment, customers, and employees. In their activities, they ought to consider and recognize the fundamental principles of social responsibility, i.e. accountability, transparency, ethics, respect for human rights, respect for all stakeholders and norms, in order to implement all content, fair treatment of employees, customers, integration into the community in which the organization operates, and the preservation of the natural environment. A higher level of social responsibility is achieved by exposing the integrity of the approach, supported by interdependence, when it comes to essential activities and relationships of people. Everyone involved in the process of company operations must participate: owners, their managers and co-workers (employees and business partners). The basic principles must be present at all levels of company functioning; these principles are the key initiatives to ensure that the companies survive in the demanding marketplace.

### **Limitations, Further Research and Conclusions**

The results of the research, despite their substantial contribution, represent only a fraction of the whole picture of studying the relationship between social responsibility, innovation and financial performance. There are still many open topics. The main limitation of this study is its focus on Slovenian firms. We collected data from only one person in each company, which can affect the bias of data. Such focus limits the scope of generalisation on the entire industrial sector.

The conceptual model that we have developed and tested in the study gives new insight into social responsibility. More important, it highlights areas in which the theory of social responsibility, innovation and financial performance

is substantively and methodologically under-researched. Mostly we used the already established measurement scales to measure latent variables in the model of social responsibility, innovation and financial performance; we added our own insights, and the approximations proved satisfactory in their present form. The scale for measuring CSR to customers could be expanded by new items to improve its reliability.

All assertions are based on data obtained from respondents as individuals having their opinions and practices and expressing their opinions on a scale of agreement. Since the topic of social responsibility is lately socially popular, they may tend to exaggerate in evaluation. We recommend inclusion of several respondents from the same organization in the survey, because this increases transparency of responses and reduces the possibility of favouritism. For example, managers often assess companies more favourably, regardless of the true opinions and feelings about the problem, so their answers are often overestimating. Involvement of multiple respondents from one organization is a better approach. However, for the researcher and the respondent this causes additional coordination and consequently lower responsiveness of respondents. Finally, we suggest repetition of the study in other economies. Thereby it will be possible to compare results and generate new findings about influence of social responsibility on innovation and business excellence.

Our model addressed an important gap in the existing organizational literature by proposing a multilevel theoretical framework of CSR, which follows the advice of CSR researchers (Margolis & Walsh, 2001; Waddock et al., 2002) and turns our attention to new research questions. We examined the relationships between CSR to different stakeholders and the mediating role of innovation between CSR and financial performance at the organizational level. We provided a unique conceptual model to address organizations and discuss the key variables that will shape CSR in Slovenian businesses and professionals. In sum, while research to date has been fruitful in pushing human knowledge of CSR forward, we hope to show that the conceptual model developed here will shed light on how CSR might be triggering progress. We pointed to important contributions for researchers, managers, and policy makers.

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# Družbena odgovornost podjetij in finančna uspešnost – povezujejo ju inovativne dejavnosti

## Izvleček

Namen študije, o kateri se poroča, je bil preučiti razmerje med različnimi dimenzijami družbene odgovornosti podjetij in posredniško vlogo inovacij med dimenzijami družbene odgovornosti podjetij in finančno uspešnostjo. Podatki so bili zbrani z vprašalnikom za preskušanje konceptualnega modela z modeliranjem strukturnih enačb (SEM), ki ga je izpolnilo 321 direktorjev slovenskih podjetij. Rezultati raziskav na terenu kažejo, da je odgovornost podjetij do zaposlenih najpomembnejša dimenzija družbene odgovornosti podjetij. Pozitivno vpliva na družbeno odgovornost podjetij do naravnega okolja, strank in lokalne skupnosti. Potrjena je bila tudi posredniška vloga inovacij med družbeno odgovornostjo podjetij in finančno uspešnostjo. Rezultati so pokazali tudi, da družbena odgovornost podjetij do naravnega okolja in strank pozitivno vpliva na inovacije, medtem ko ima družbena odgovornost podjetij do lokalne skupnosti negativen vpliv. Poleg tega je bil potrjen pozitiven vpliv inovacij, ki jih je sprožila družbena odgovornost podjetij, na finančno uspešnost. Študija je omejena v tem, da je osredotočena na slovenska podjetja, podatki pa so bili pridobljeni samo od enega direktorja iz vsakega podjetja. Slovenska podjetja bi morala svetovne pobude, ki podpirajo družbeno odgovornost podjetij, videti kot način, da ustvarijo svoje priložnosti za inovacije, se razlikujejo od drugih podjetij ter povečajo svojo finančno uspešnost. Konceptualni model, ki je bil razvit in preizkušen s podatki, pridobljenimi od slovenskih direktorjev, ponuja nov pogled na vplive družbene odgovornosti, inovacije in finančno uspešnost. Izpostavlja področja, na katerih je teorija družbene odgovornosti premalo raziskana.

**Ključne besede:** družbena odgovornost podjetij, slovenska podjetja, inovacije, finančna uspešnost, SEM

# Quality of Family Life and Workplace Deviant Behaviour with Perceived Competence as a Mediator among University Staff

**Dare A. Fagbenro**

Obafemi Awolowo University, Department of Psychology, Osun State, Nigeria  
dareinui2008@yahoo.com

**Mathew O. Olasupo**

Obafemi Awolowo University, Department of Psychology, Osun State, Nigeria  
gbenga.olasupo@oauife.edu.ng

## Abstract

Several studies have found a variety of factors as antecedents of deviant behaviour but the role of family life on workplace deviant behaviour, as well as the mediating role of perceived competence in the quality of family life-deviant behaviour relationship, have received little study. This study examines the mediating effect of perceived competence on the relationship between the quality of family life and work-deviant behaviour. The study adopted the wellness model and self-determination theory as theoretical standpoints. Three hundred and eight-four (384) university staff in Nigeria participated in the study. Results revealed that there was a significant negative relationship between the quality of family life and workplace deviant behaviour. The result of the hierarchical multiple regression also revealed that perceived competence mediates the link between the quality of family life and workplace deviant behaviour. These findings suggest that psychologists should design training programmes aimed at improving the sense of competence and quality of family life, which invariably will reduce workplace deviant behaviour.

**Keywords:** quality of family life, perceived competence, workplace deviant behaviour, university employees

## Introduction

Workplace deviant behaviour has continued to be a source of concern among psychologists and relevant stakeholders all over the world. This is because of the negative outcome this illicit behavior has both on organisational growth and employee well-being (Saad, Yahya, & Yean, 2016; Shamsudin, Subramaniam, & Ibrahim, 2011). Robinson and Bennett (1995, p. 556) “defined deviant behaviour as voluntary behaviour of violation of organisational norms, and therefore disrupting workplace strategies, and values, by an individual or group of people which invariably jeopardize organisation wellness or its employees”. According to Shamsudin, Subramaniam and Ibrahim (2011), deviant behaviour is an act perpetrated by the organisation’s members which causes damage to co-workers, management and the organizational facilities/equipment. In the literature, these negative-oriented

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ORIGINAL SCIENTIFIC PAPER

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RECEIVED: APRIL 2020

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REVISED: MAY 2020

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ACCEPTED: MAY 2020

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DOI: 10.2478/ngoe-2020-0008

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UDK: 316.36:316.624:378

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JEL: F13, D2, O11

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**Citation:** Fagbenro, D.A., & Olasupo, O. M. (2020). Quality of Family Life and Workplace Deviant Behaviour with Perceived Competence as a Mediator among University Staff. *Naše gospodarstvo/Our Economy*, 66(2), 15–27. DOI: 10.2478/ngoe-2020-0008

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OUR ECONOMY**

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Vol. 66 | No. 2 | 2020

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pp. 15–27

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behaviours have been labelled by a variety of terms such as organisational misbehaviour, counterproductive work behaviour, dysfunctional behaviour, antisocial organisational behaviour, organisational deviance, and employee withdrawal (Everton, Jolton, & Mastrangelo, 2007). This deviant behaviour could occur either at an interpersonal and/or organisational level (Robinson & Bennett, 1995). "Interpersonal deviance includes deviance showed to colleagues, co-workers and subordinate in the workplace (Fagbohunge, Akinbode, & Ayodeji 2012, p. 209) which may include acts that range from verbal abuse, physical assault (Robinson & Bennett 1995, p. 565-566) as well as gossiping" (Robinson & Bennett 1995, p. 562). Organisational deviance, on the other hand, includes deviant acts directed to the organisation, which are not limited to sabotage, theft, (Fagbohunge, Akinbode, & Ayodeji, 2012; Robinson & Bennett, 1995), absenteeism (Robinson and Bennett, 1995), and tardiness (Fagbohunge, Akinbode, & Ayodeji, 2012). These two types of deviant behaviour—organisational and interpersonal—can also occur simultaneously, singly, or sequentially (Fagbohunge, Akinbode, & Ayodeji, 2012).

Roy-Bastounis and Minibas-Poussard (2012, p.1342) "asserted that work deviant behaviour harmed the organisation because this illicit behaviour directly affected organisational property and/or reduced employee effectiveness". Workplace deviant behaviour remains a serious issue, both in the developed world and in developing nations. In the United States, for example, Hollinger (2011) reported that nearly 45% of retailers attributed their inventory shortage to employee theft. In particular, employees' poor attitude toward work as a form of workplace deviance has been reported in public and private sector organisations (Suleiman, 2013). Further, some empirical studies have found that university employees engage in deviant or unethical work behaviours in Nigeria (Caroline, 2015; Moti, 2010), and Zimbabwe (Chirasha & Mahapa, 2012). "The forms of deviant behaviours perpetuated by this set of employees included extortion of money, irregularity in examining students, abuse of office, sexual harassment, gross insubordination or disregard for constituted authority, employment racketeering, admission fraud and impersonation, distortion of staff records and manipulation of students' grades for financial gain" (Igbe, Okpa, & Aniah 2017, p.74). This unacceptable behaviour contributes negatively to the growth and standard of the university system in the world, as well as in Nigeria. Due to these consequences, factors that could be responsible for deviant behaviour need to be investigated among university staff. To this end, some available studies have found factors such as job boredom (Chiamaka, Tochukwu, & Kizito, 2015), job stress (Omar et al., 2011), and low job satisfaction (Balogun, Esan, Ezeugwu, & Orifa, 2016; Omar et al., 2011), as predictors of deviant behaviour among employees in different types of organisations, but with little study of such factors as

the quality of family life. For example, Chernyak-Hai, Kim, and Tziner (2019) studied marital status, but not exactly the quality of family life, as related to varieties of deviant behaviour performed in the workplace.

Zuna, Summers, Turnbull, and Hu (2012) define the quality of family life as a unique sense of subjective well-being within one's family, which is often informed by the degree to which family members and family-level desires are met. Quality of family life is also defined as the level of satisfaction or happiness with one's family well-being. The family is a vital and integral part of an individual's well-being. To achieve this well-being, an individual needs to pay adequate attention to family basic needs, as well as to put in constant effort to ensure harmony in family life by having a satisfactory personal life. It is also important to find ways of delivering excellent results with the limited resources at hand while maintaining a peaceful family life. Sometimes, having a satisfying family life seems challenging to employees with different personalities.

Krischer (2010) asserted that when employees have challenges in providing basic amenities or solving family issues, employees may resort to deviant behaviours by which they hope to gain some level of control over those situations. For instance, the inability of a university employee to manage challenges within the family can cause problems that often further contribute to poor satisfaction with one's family. In a bid to cope with these challenges, university employees sometimes engage in some form of deviant behaviour against the university out of a desire either to make their family happy or to escape from the challenges being faced in the family. Deviant behaviour like absenteeism, coming late to work or leaving work early, theft, and so on are behaviours that university employees may utilize to gain more time to focus on their quality of family life or to escape from the challenges that affect their family well-being. There have been some studies in the literature suggesting that conflict which is embedded in the quality of family life can contribute to negative work attitudes and behaviours (Shakir & Siddiqui, 2014; Kinnunen, Geurts, & Mauno, 2004; Ajala, 2017). While these outcomes are very pertinent for organisational effectiveness, there remains a need to examine the role of quality of life on workplace deviant behaviour.

Little is still known about the mechanism by which quality of family life influences work deviant behaviour. Studies have revealed that employees who have a high sense of competence manifest organisationally relevant work outcomes such as effective performance, acceptable behaviour and contributions to organisational goals (Dutcher & Adams, 1994; Laschinger, Wong, McMahon, & Kaufmann, 1999). It can be inferred that employees who are not satisfied with their family life may see themselves as not contributing to family

well-being, which invariably makes such employees engage in work-deviant behaviour. However, the few studies (Shakir & Siddiqui, 2014; Rubab 2017; Dewanga & Verghese, 2018) that have investigated work-family conflict as an important component of family life paid little attention to the role of perceived competence as a mediator in the relationship.

This present study seeks to address the limitations of the extant literature by first, investigating the impact of the quality of family life on deviant behaviour and second, examine the mediating role of perceived competence on quality of life-workplace deviant behaviour, especially among a less-explored population (i.e., university employees) in a developing country, such as Nigeria. Studies on quality of life-workplace deviance link in an environment such as Nigeria are relatively scarce in the literature and thus this study significantly contributes to existing knowledge on the subject. The study investigates the indirect role of perceived competence in the relationship between the quality of family life and workplace deviant behaviour. The outcome of this study will contribute significantly to both theory and practice. Theoretically, the outcome of the study will lend support to, and also highlight the importance of, using a wellness model (Adams, Bezner & Steinhardt, 1997) and self-determination theory through incorporating quality of family life and perceived competence as an important personal resource that can explain workplace deviant behaviour among employees in any economy of the world. In practice, the study will also broaden managerial knowledge about possible intervention programmes that would reduce or prevent workplace deviant behaviour among university employees. The study is divided into five sections: introduction, literature review, methodology, results and discussion.

## Literature Review

### Quality of family life and workplace deviant behaviour

Dewanga and Verghese (2018) examined the predictors of deviant workplace behaviour. The study established that family-to-work conflict predicts workplace deviant behaviour. Malisetty and Kumari (2016) examined work-family conflict, stress, organisational justice and deviant behaviour among a sample of 500 operational staff. The study found a significant positive connection between organisational justice, perceptions of work-family conflict, stress and deviant behaviour. Rubab (2017) examined the role of work-family conflict on burnout and workplace deviant behaviour of 250 employees. The finding revealed a positive relationship between work-family conflict and burnout and

workplace deviant behaviour. Shakir and Siddiqui (2014) explored the association between work-life balance and deviant workplace behaviour. The study used 282 employees from several organisations in Karachi, Pakistan. The results showed that all dimensions of work-life balance except personal commitment have a significant influence on deviant workplace behaviour. The study found that family functioning has a significant influence on counterproductive work behaviour.

Radzali, Ahmad and Omar (2013) examined family-to-work conflict, workload, job stress and deviant workplace behaviour among 234 nurses in Malaysia hospitals. The result revealed a joint influence of family-to-work conflict, workload and job stress on deviance behaviour. Furthermore, the study also showed that family-to-work conflict independently predict workplace behaviour. Also, Bennett and Amyx (2013) investigated the influence of work-family conflict on job deviance among 234 respondents. The result revealed that increased work and family role divergence negatively influenced job deviance and contributed significantly to high deviant workplace behaviour. Ferguson, Carlson and Whitten (2012) examined the role played by work-family conflict and gender on production deviance. The result showed that work-to-family conflict positively influences production deviance. Ferguson (2012) examined the influence of family conflict on deviant behaviour among 344 participants. The result revealed that family conflict has an influence on work deviant behaviour.

Another study by Darrat (2010) empirically investigated the influence of family conflict on deviant behaviour among employees. The result showed a significant influence of family conflict on work deviant behaviour. The association between quality of life and workplace deviance was also supported by the Wellness Model (Adams, Bezner & Steinhardt, 1997). This is because when employees is satisfied with their family wellness, such employees engage in behaviour that is not detrimental to the organisation; but in a situation where the wellness of a family is jeopardised, such employees would engage in deviant acts in an attempt to manage these challenges.

No research has yet investigated the influence of quality of family life on workplace deviant behaviour using data from university employees, especially in Nigeria, where workplace deviance seems to be highly prevalent (Fagbohunge, Akinbode, & Ayodeji, 2012; Olabimtan & Alausa, 2014). This study hopes to overcome the constraints of earlier studies. Hence, we expect that:

Hypothesis 1: Quality of family life significantly and negatively relates to workplace deviant behaviour among university employees.

### The mediating role of perceived competence in the quality of the family life-deviance relationship

Competence has been conceptualised broadly by different scholars. According to Ratnasari and Adam (2019), competence is defined as the abilities required in the workplace; this refers to the expertise needed by each individual that will allow them to carry out their duties and responsibilities effectively and improve their professional quality standards at work. Balogun, Ojedokun and Tijani (2012) defined competence as a person's ability to successfully meet complex demands in a particular context through the use of both cognitive and non-cognitive aspects of problem-solving.

Boyatzis (2008) defined competence as a hidden attribute of an individual that is often linked to actual performance. Masterpasqua (2010) asserted that competence refers to versatile, psychological, passionate, behavioural and social characteristics which complement an individual's absolute or unrestricted beliefs and expectations about his/her ability to perform those attributes. Thus, it can be said that having a sense of competence means the confidence of an individual that he or she has the abilities to master the work environment and the work itself.

White (2001) concluded that perceived self-competence refers to the belief that an individual has the necessary skills and ability to communicate and also manipulate the environment. Some individuals have the belief that they are competent in a variety of tasks, while some individuals do not believe that they are competent to handle tasks assigned.

A sense of competence at work may serve as an important buffer to predict how the employee will tackle issues and relate with other co-workers in the workplace. The employee who believes that they are not competent in the workplace tends not to have the personal resources to cope with this challenges of family commitment or is unable to meet family expectation or satisfaction which invariably could make the employee engage in deviant behaviour. According to Harter (1990), one way in which a person can perceive their competence level at work is through measures of their self-esteem.

The few available studies on perceived competence and workplace deviant behaviour have shown that employees with high competence engage in less destructive behaviour, such as workplace deviance. For instance, Abas, Omar, Halim and Hafidz (2015) examined the mediating role of organisational-based self-esteem in the relationship between perceived organisational support and counterproductive work behaviour among public service officers. Their study found that organisational-based self-esteem

mediates the relationship between perceived organisational support and counterproductive work behaviour.

Ferris Brown, Lian, and Keeping (2009) also found that organisational-based self-esteem mediates the relationship between perceived organisational support and counterproductive work behaviour. Thau, Aquino, and Wittek (2007) found that workers who were uncertain about their competency level were more likely to be involved in antisocial work behaviour.

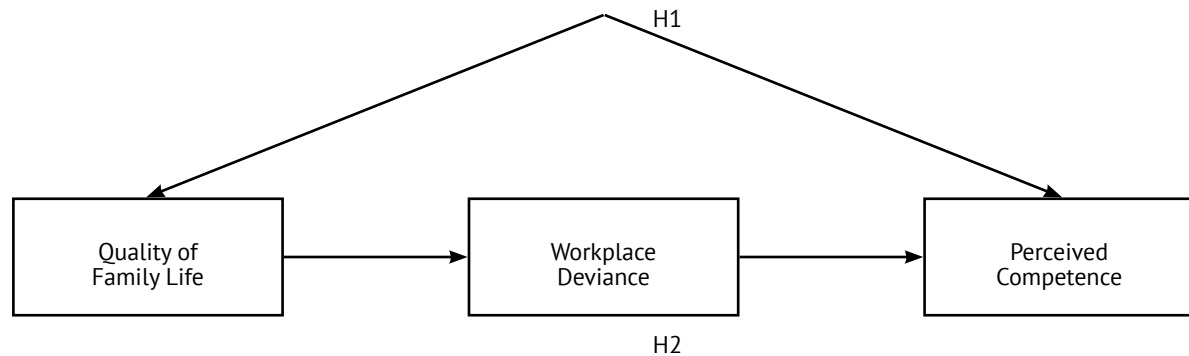
There is a scarcity of literature linking perceived competence to workplace deviant behaviour, but there are related studies on perceived competence and other constructs, such as job outcome. For instance, Manani and Ngui (2019) found that there is a significant positive effect of competence on employee job performance. Also, Li (2015) examined perceived competence and autonomy on subjective happiness. The results showed that employees' subjective happiness is influenced by both competence and autonomy factors.

From the tenets of self-determination theory (Deci & Ryan, 1985), the employee who lacks self-determination might not have the prerequisite skill and knowledge to perform a certain task, which may influence such individuals to engage in negative behaviour. Research has also shown that a high sense of competence results in organisationally relevant work outcomes such as optimal individual and organisational performance (Dutcher & Adams, 1994; Laschinger, Wong, McMahon, & Kaufmann, 1999). Studies have also shown that employees who perceived that they have the skill and knowledge to engage in a task could enhance their sense of taking responsibility for their family well-being, which invariably makes them engage in positive work behaviour. However, when employees perceive low competence, this may lead to neglect of family well-being; this may, in turn, result in unacceptable behaviour, such as workplace deviant behaviour. Based on the pattern of relationships reported among quality of family life, perceived competence and workplace attitudes in the literature (Ulrich 1998; Wu 2010; Fadli, 2012), we expect that:

Hypothesis 2: Perceived competence significantly mediates the association between the quality of family life and workplace deviant behaviour among university employees.

This model proposes that when university staff manage their quality of family life well, they might not engage in workplace deviant behaviour. It is also expected that workplace deviant behaviour may be reduced when employees have high perceived competence, despite the low quality of family life.

**Figure 1.** Conceptual model and hypotheses



## Methodology

### Design and participants

The study utilised a cross-sectional survey design. The predictor variable was quality of life while the criterion variable was workplace deviant behaviour. The mediating variable in this study was perceived competence. The 384 respondents who participated in the study were between 21 to 63 years old, with a median age of 48 years and a standard deviation of 9.26. Descriptive analysis of participants' gender revealed that 229 (59.6%) were males and 155 (40.4%) were females. In terms of religious affiliation, 234 (60.9%) were Christians, 149 (33.9%) were Muslims, while 1 (.3%) was adherent of traditional religion. Respondents' educational background revealed that 19 (4.9%) had completed only primary/secondary education; 37 (9.6%) claimed they were NCE (Nigeria Certificate of Education)/OND (Ordinary National Diploma) holders, 123 (32.0%) reported that they were B.Sc/HND holders, (Bachelor of Science /Higher National Diploma) holders, 59 (15.4%) reported that they were M.Sc holders, while 146 (38.0%) respondents claimed qualification at PhD level. The spread of participants in terms of marital status showed that 33 (8.6%) were single, 279 (72.7%) were married, 45 (11.7%) were widowed while only 27 (7.0%) were separated. Staff category revealed that 165 (43.0%) were non-teaching staff while a majority, 219 (57.0%) were teaching staff. Furthermore, the distribution of respondents by university category revealed that a majority of the participants 251(65.4%) were from public universities while 133 (34.6%) were from private universities. Lastly, the distribution of participants by length of service showed that 219 (57.0%) had spent 1-10years in service, a majority 230 (59.9%) of respondents had spent 11-20 years, while 37 (9.6%) had spent 1-5 years as university employees.

## Population

The population of the study was comprised of university employees working in Obafemi Awolowo University, University of Ibadan, Lead City University and Oduduwa University—all in SouthWest Nigeria.

## Measures

**Work Deviant Behaviour Scale:** Workplace deviant behaviour was assessed with the 19- item Workplace Deviance scale developed by Bennett and Robinson (2000) named the "Interpersonal and Organisational Deviance Scale" by its authors. A sample item on this scale reads "Put little effort into your work" (Bennett & Robinson, (2000), p.360). The participants' answers were scored on a 5-point scale ranging from 1 – never to 5 – daily. "The original authors of the scale required answers on a 7-point scale and they reported reliability of .81 for the Organisational deviance sub-scale and .78 for the Interpersonal deviance sub-scale" (Bennett & Robinson, 2000, p. 354). In Nigeria, the scale has also been used by Olabimitan and Alausa (2014) where they reported reliability coefficients of .75 for the interpersonal deviance sub-scale and .77 for organisational workplace deviance among nurses in Lagos State University. In this study, the scale was validated using confirmatory factor analysis (CFA) and virtually all the items loaded significantly on their constructs ( $p < .001$ ), with weights ranging from 0.45 to 0.87. A Kaiser-Meyer-Olkin (KMO) of .90 indicated the sampling adequacy of the scale. The present study had a Cronbach coefficient of .97 for all 19 items. The high total score on all 19 items of the scale was intended to measure high workplace deviant behaviour while a low score meant low workplace deviant behaviour.

**Quality of Family Life Scale:** Quality of family life was captured using a 25-item Beach Center Family Scale

(FQOL) described by Hu, Summers, Turnbull and Zuna (2011). A sample item of the scale reads "My family enjoys spending time together". The 5-point scale ranged from 1 for "very dissatisfied" to 5 for "very satisfied." In this study, the scale was validated with confirmatory factor analysis (CFA) and the items ranged from 0.50 to 0.84. A Kaiser-Meyer-Olkin (KMO) score of .89 indicated the sampling adequacy of the scale. Hu, Summers, Turnbull and Zuna (2011) reported a coefficient of .88 for the total scale. The coefficient Cronbach's alpha for this scale was .96. A high score means high quality of family life while a low score on the scale means a low quality of family life.

**Perceived competence Scale:** Perceived competence was captured using a 13-item perceived competence scale adapted and applied in Nigeria (Bajo, 2005; Balogun, Ojedokun, & Tijani, 2012; Olasupo & Fagbenro, 2018), but this scale was originally developed as a 23-item scale by Wagner and Morse (1975) and re-modified by Snyder and Morris (1978) to consist of 15 items only. Two sample items read "No one knows this job better than I do" (Wagner & Morse, 1975, p.454) and "I honestly believe I have all the skills necessary to perform this task well" (Snyder & Morris, 1978, p. 423; Wagner & Morse, (1975), p. 454). A 5-point Likert format ranging from 1 = strongly Disagree to 5 = strongly agree was used to score the scale in the present study, as well as in the studies conducted by Balogun, Ojedokun and Tijani (2012), and by Olasupo and Fagbenro (2018), differing from the procedure suggested by Wagner and Morse (1975) to answer the items from -4 (very strong disagreement) to +4 (very strong agreement). Some items were reversed-scored on the scale. In Nigeria, Cronbach's alpha coefficient of .65 was reported, and the Split-half reliability coefficient of was .57 for the scale (Bajo, 2005; Balogun, Ojedokun, & Tijani, (2012); Olasupo & Fagbenro, (2018)). Balogun, Ojedokun and Tijani (2012) also reported a Cronbach's alpha coefficient of 0.72 among employees in a university teaching hospital in Nigeria. The present study validated this scale using a confirmatory factor analysis (CFA) with weights ranging from 0.47 to 0.88 for the items. A Kaiser-Meyer-Olkin (KMO) score of .70 indicated the sampling adequacy of the scale. Cronbach's alpha coefficient was .56 in this present study. Scores that are high above the mean reflect a high level of perceived competence, while a score below the mean represents low perceived competence.

## Procedure

A questionnaire was used to collect data after the required permits were obtained from the management of the four universities. Thereafter, the researchers explained the purpose

as well as the rationale for the study to the respondents. The researchers also assured the respondents that their responses would only be used for research purpose and any respondent could decide to withdraw from the study. The researchers adhered strictly to the ethical rules of research. Furthermore, respondents were approached in their various offices during the close of work, to avoid distracting these workers. The questionnaire distribution was carried out by the researchers, assisted by two research assistants who were trained on the techniques of proper data collection. The researchers sought the consent of the respondents by asking them to sign the informed consent form attached to the questionnaire. The questionnaires were distributed by the researchers to each participating university employee in their offices in their respective universities at different times. Most of the employees in the four universities used were so busy that only a few employees filled out their questionnaire on the spot while the majority of the respondents returned it at a later date. Twelve weeks were used for the data collection in the study. Using a purposive sampling technique, 100 copies of the questionnaire were distributed across the four universities, totalling about 400 questionnaires, while 10 of the questionnaires were not returned and 6 had incomplete responses, making only 384 questionnaires usable for data analysis, yielding a response rate of 96%.

## Results

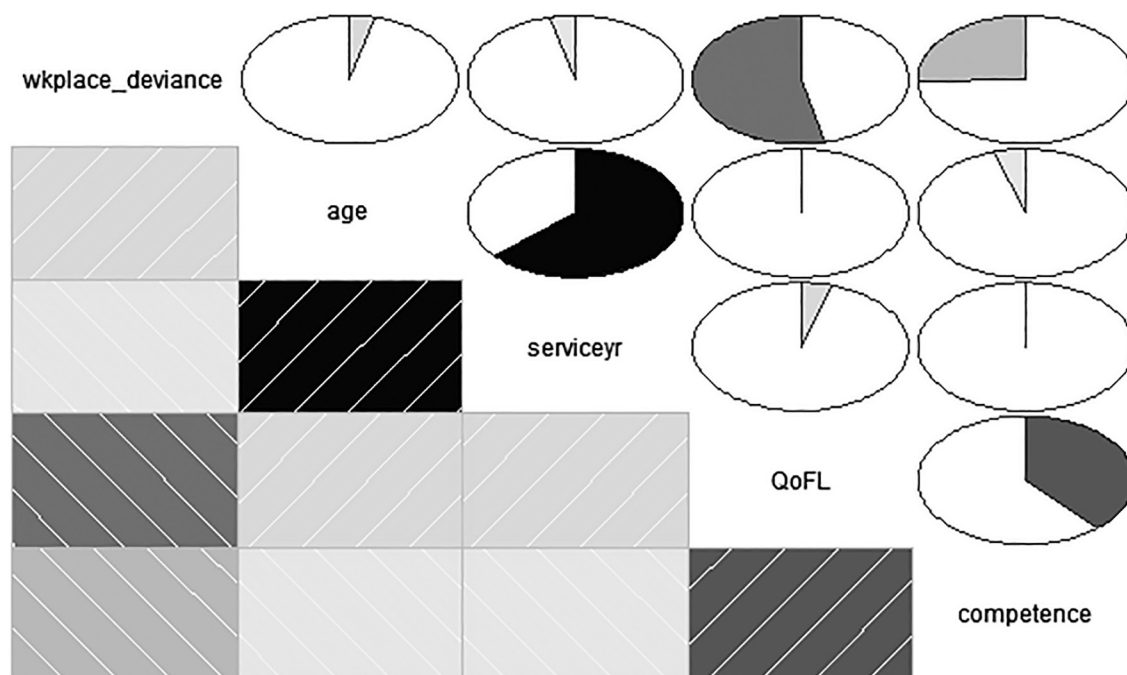
### Hypothesis one

The study used Pearson Correlation to test all the variables in this study and the analysis is presented in both Figure 2 and Table 1.

Figure 2 shows the direction and magnitude of correlations among the study variables. The blue colour indicates positive relationships while the red colour indicates negative relationships. The intensity of the colour shows the magnitude of relationships among the variables. The result, as shown in Table 1 revealed that there was a significant inverse relationship between the quality of family life and workplace deviant behaviour [ $r(382) = -.53, p < .01$ ]. The result implies that as the quality of family life of university employee increases, the tendency to engage in workplace deviant behaviour decreases. There was a significant negative relationship between perceived competence and workplace deviance [ $r(382) = -.25, p < .01$ ]. This implies that as university staff's sense of competence increases, their tendency to engage in workplace deviance decreases.



Figure 2. Correlogram of study variables



Note: wk\_deviance = Workplace deviant behaviour, serviceyr = years in service, QoFL = quality of family life, competence = Perceived competence

Table 1. Pearson correlation matrix showing the mean, SD and variables relationship

Variables	M	S.D	1	2	3	4	5
1. Age	46.88	9.36	1	.63**	0.00	-0.04	0.03
2. Years in service	10.75	6.82		1	0.04	-0.00	-0.04
3. Quality of Family life	83.54	22.25			1	.38**	-.53**
4. Perceived competence	30.08	4.87				1	-.25**
5. Deviant behaviour	44.81	21.43					1

Notes: \* $p < .05$ , \*\* $p < .01$ ,  $N = 384$ .

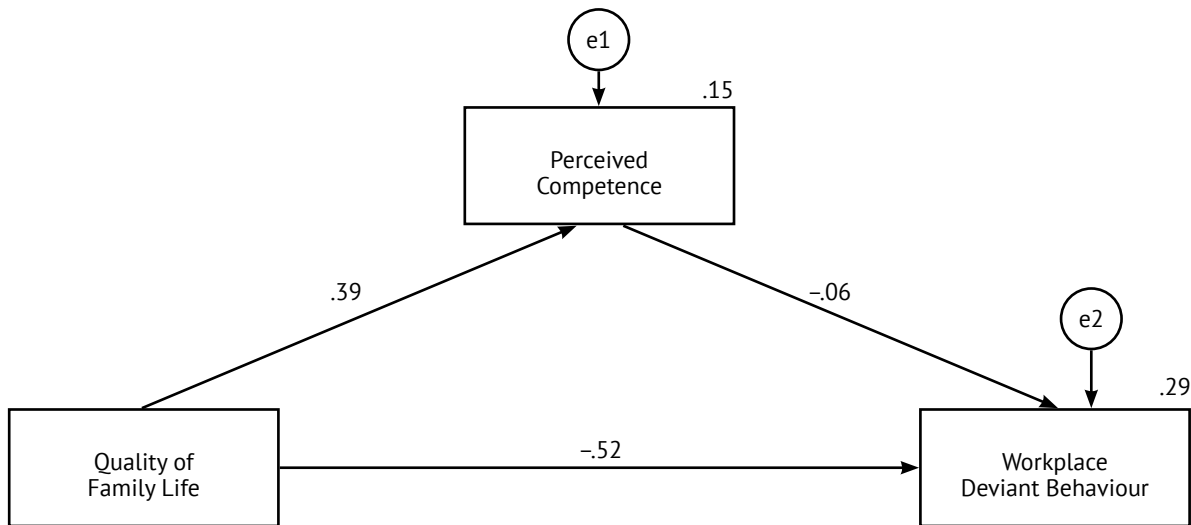
### Hypothesis two

Baron and Kenny (1986) recommended the use of a four-step multiple regression approach in a mediation study in which several regression analyses were conducted and the significance of the coefficients were examined at each step. In the first model, workplace deviance was regressed on quality of family life. In the second model, perceived competence was regressed on the quality of family life. At the third level, workplace deviance was regressed on perceived competence. Lastly, in the fourth model, the predictor (quality of family life) and mediating variables (perceived competence) were entered simultaneously into the equation to determine whether the introduction of the

mediating variable (perceived competence) would influence the initial link between the quality of family life and workplace deviance.

Figure 3 shows a simple mediation model of workplace deviance behaviour by university employees. In Model 1 of Table 2, workplace deviance was regressed on the quality of family life. The result revealed that the quality of family life explained a significant 29% variance in the prediction of work deviant behaviour ( $R^2 = 0.29$ ,  $F(1, 382) = 154.10$ ,  $p < 0.01$ ). The quality of family life has significant independent predictors on workplace deviant behaviour ( $\beta = -0.52$ ,  $t = -12.45$ ,  $p < 0.01$ ). This indicates that when employees' quality of family life goes up by 1 standard

**Figure 3.** Simple mediation model of workplace deviant behaviour



**Table 2.** Hierarchical multiple regression of mediating effect of perceived competence on quality of family life and workplace deviant behaviour

	R	R <sup>2</sup>	F	B	SE	β	t	p
Quality of family life → Workplace deviant behaviour	0.54	0.29	154.10					
				-0.54	0.04	-0.52	-12.45	<0.001
Quality of family life → Perceived competence	0.39	0.15	66.50					
				0.08	0.01	0.39	8.16	<0.001
Perceived competence → Workplace deviant behaviour	0.26	0.07	26.79					
				-1.13	0.22	-0.26	-5.18	<0.001
<b>Quality of family life &amp; Perceived competence → Work deviant behaviour</b>	0.54	0.29	78.37					
Quality of family life				-0.50	0.05	-0.51	-11.02	<0.001
Perceived competence				-0.25	0.21	-0.06	-5.23	<0.001
	Test Statistic	p						
Sobel Test	3.23798285	<0.05						

deviation, workplace deviant behaviour reduces by 0.52 standard deviations (as the quality of family life improves, workplace deviant behaviour reduces).

The result in the second model revealed that the quality of family life explained a significant 15% variance in relationship with perceived competence ( $R^2 = 0.15$ ,  $F(1, 382) = 66.50$ ,  $p < 0.01$ ). More important, the quality of family life significantly influences perceived competence ( $\beta = 0.39$ ,  $t = 8.16$ ,  $p < 0.01$ ). This indicates that when employees' quality of family life goes up by 1 standard deviation, perceived competence of the employee improves by 0.39 standard

deviations, meaning that improvement in the quality of family life of the employees leads to an enhanced sense of competence in the employees.

The third model revealed that perceived competence, which is the mediating variable, significantly predicted workplace deviant behaviour ( $R^2 = 0.07$ ,  $F(1, 382) = 26.76$ ,  $p < 0.01$ ). It was further revealed that perceived competence ( $\beta = -0.26$ ,  $t = -5.18$ ,  $p < 0.01$ ) has a significant direct influence on workplace deviant behaviour. This implies that an increase in perceived competence leads to a decrease in workplace deviant behaviour.

In the final model, the predictor (quality of family life) and mediator (perceived competence) were simultaneously entered into the equation. The mediator (perceived competence) significantly mediates the relationship between the quality of family life and workplace deviance ( $\beta = -0.06$ ;  $p < 0.01$ ). The inclusion of perceived competence in the fourth model reduces the beta ( $\beta$ ) value of the link between the quality of family life and workplace deviance from -0.54 to -0.06.

Furthermore, a Sobel test was conducted to determine the mediating effect of perceived competence on quality of family life-workplace deviant behaviour, since Baron and Kenny's (1986) analytical approach did not provide enough information on the mediating role of perceived competence in quality of family life-workplace deviant behaviour, but only indicated that mediation of perceived competence is possible.

The Sobel test revealed that perceived competence mediates the relationship between the quality of family life and workplace deviance behaviour ( $z = 3.23$ ;  $p = <0.05$ ). The second hypothesis was also accepted.

## Discussion

The current study examined the mediating role of perceived competence in the relationship between the quality of family life and workplace deviant behaviour among university staff in Nigeria. The first hypothesis revealed that there was a significant negative relationship between quality of life and workplace deviant behaviour, suggesting that university staff who perceived high quality of life showed a low tendency to engage in workplace deviant behaviour. The finding was also in line with Ferguson (2012), who investigated the influence of family conflict on deviant behaviour. The result showed a negative association between family conflict and deviance. The study finding was also in line with Shakir and Siddiqui (2014), who found that work-life balance, except personal commitment, has a significant influence on deviant workplace behaviour. The reason for this finding may be connected to the attention that employees give to their family life. Culturally, in Nigeria as well as conventional wisdom, the family are always vital and an integral part of individual well-being. Employees are always happy when their families are happy because oftentimes, the family is what employees fall back to when challenges or problems arise. This reality even makes the quality of family life important. Employees who are happy with the present state of their family often engage in positive behaviour at work, because they tend to be happy, fulfilled and ready to work for the goal of the organisation and not engaging in

behaviours that deviate from the university standard. Theoretically, the wellness model (Adams, Bezner & Steinhardt, 1997) also supports the finding of this present study, as it postulates that employees who are satisfied with their family wellness would not engage in deviant behaviour.

The second result supports the hypothesized mediation of the relationship between the quality of family life and workplace deviant behaviour, indicating that perceived competence partially mediates the relationship between the quality of family life and workplace deviant behaviour. This implies that university staff who have the confidence that they can handle most situations will make their family happy and satisfied at any point in time without necessarily resorting to any form of deviant behaviour. The finding agreed with that of Abas, Omar, Halim and Hafidz (2015), who found that organisational-based self-esteem mediates the relationship between perceived organisational support and counterproductive work behaviour. The study finding was also similar to that of Ferris Brown, Lian, and Keeping (2009), who found that organisational-based self-esteem mediates the relationship between perceived organisational support and counterproductive work behaviour. The reason for this finding could be because employees in Nigeria are often employed by bias or through favouritism, without considering if they are competent for the job. Any minor challenges, such as family challenges, may make such employees engage in deviant behaviour as a result of their incompetence. One possible explanation for the finding was offered by self-determination theory (Deci & Ryan, 1985), which proposed that individuals who believe in their ability are often determined to engage in any roles. Therefore, university employees who believe in their ability often handle their family well-being in a way that satisfies them without triggering any negative behaviour at work.

## Theoretical and practical implications

Based on the findings of the present study, we concluded that quality of life not only has a negative relationship with workplace deviant behaviour but also an indirect relationship with workplace deviant behaviour through perceived competence. Though the mediation hypothesis is partially supported, it is suggested that when university staff have the belief and confidence to handle their family well-being, they tend to be happy and satisfied, which, in turn, decreases their tendency to engage in any form of deviant behaviour. Our study findings revealed important implications for theory and practice. Theoretically, the findings lend support to and also highlight the importance of using the wellness model (Adams, Bezner & Steinhardt, 1997) and self-determination theory (Deci & Ryan, 1985) to explain the dynamic relationship between perceived competence, quality of life and

work deviant behaviour among university staff. In terms of practical implications, the finding can provide university management with greater insight on the role of quality of family life on deviant behaviour among university staff. It, therefore, means that university management should implement an appropriate family programme and policies for its staff. The result also has a practical implication for managers to formulate intervention aimed at improving competence among university staff such that it will enable them to have the skill to maintain their family life, which, in turn, will decrease their likelihood of engaging in the deviant act.

Given these practical implications, we, therefore, recommend that university management should implement policies meant to improve the quality of family life. Policies such as flexible work scheduling, implementation of family leave, and family support programmes could serve as a buffer for employees to improve their family life which, will reduce their engagement in deviant behaviour. Also, psychologists should develop a psychological test at the recruitment level aimed at identifying the potential employee who is highly competent on the job, while for staff who are already on the job, frequent training and competence skill programmes can be put in place to improve and enhance their sense of competence, so that this category of individuals will have the capacity and skill to manage their family well-being, which will decrease their likelihood of engaging in deviant behaviour.

### Limitations and suggestions for future studies

Despite the rich contribution of this study to literature, it is still faced with some limitations. First, the data were obtained from four universities' employees. Therefore, its findings may not be generalisable to other universities employees in Nigeria. Another limitation of the study is the inability to get quality of life studies; instead, the researchers relied on work-life conflict studies. Future studies can also increase the sample size for more valid generalization. More empirical studies should be conducted on the quality of family life on work deviant behaviour using a different set of employees in different settings. Finally, a more improved method of data collection such as focus group discussion and interview can also be incorporated by future researchers.

### Acknowledgement

The authors of this study will like to acknowledge the university staff members who took their precious time to participate in this important study.

### Declaration of interest statement

The authors in this study declare no conflict of interest.

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# Kakovost družinskega življenja in odklonsko vedenje na delovnem mestu z zaznano kompetentnostjo kot posrednikom med osebjem na univerzi

## Izvelek

Več študij je ugotovilo različne dejavnike kot predhodnike odklonskega vedenja, vendar je o vlogi kakovosti družinskega življenja v smislu odklonskega vedenja na delovnem mestu in o vlogi zaznane kompetentnosti kot posrednika med kakovostjo družinskega življenja in odklonskim vedenjem v literaturi še vedno malo napisanega. Študija preučuje posredniški učinek zaznane kompetentnosti na odnos med kakovostjo družinskega življenja in odklonskim vedenjem na delu. Študija je kot teoretski izhodišči uporabila model dobrega počutja in teorijo samoodločanja. V študiji je sodelovalo 384 oseb, zaposlenih na univerzi v Nigeriji. Rezultati so pokazali, da obstaja pomembno negativno razmerje med kakovostjo družinskega življenja in odklonskim vedenjem na delovnem mestu. Rezultati hierarhične multiple regresije so prav tako pokazali, da zaznana kompetentnost deluje kot posrednik med kakovostjo družinskega življenja in odklonskim vedenjem na delovnem mestu. Te ugotovitve nakazujejo, da bi morali psihologi oblikovati programe usposabljanja, ki so usmerjeni v izboljšanje občutka kompetentnosti in kakovosti družinskega življenja, kar bo neizogibno zmanjšalo odklonsko vedenje na delovnem mestu.

**Ključne besede:** kakovost družinskega življenja, zaznana kompetentnost, odklonsko vedenje na delovnem mestu, zaposleni na univerzi

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ORIGINAL SCIENTIFIC PAPER

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RECEIVED: FEBRUARY 2020

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REVISED: MAY 2020

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ACCEPTED: MAY 2020

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DOI: 10.2478/ngoe-2020-0009

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UDK: 338.48-44(1-22)(497.5)

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JEL: M20, M21, Q56

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**Citation:** Baković, N. (2020). Regional Development of Rural Tourism: The Case of the Gorska Hrvatska Region. *Naše gospodarstvo/Our Economy*, 66(2), 28–41. DOI: 10.2478/ngoe-2020-0009

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NAŠE GOSPODARSTVO  
OUR ECONOMY

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Vol. 66 | No. 2 | 2020

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pp. 28–41

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# Regional Development of Rural Tourism: The Case of the Gorska Hrvatska Region

**Nina Baković**

Sveučilište u Zagrebu, Agronomski fakultet Zagreb, Croatia  
nbakovic@agr.hr

## Abstract

An approach to sustainable tourism through clusters is considered an appropriate strategy in less-developed rural areas of tourist-oriented countries, such as Croatia. This paper clarifies the key challenges of the development of tourism clusters in the region of Gorska Hrvatska and provides new data for an approach to sustainable rural tourism development. Using available secondary data from governmental bodies, non-governmental organizations, protected areas of Gorska Hrvatska, and primary data of the Lika Destination Cluster, the paper explores the key challenges of developing a cluster of tourism and selective forms of tourism. Most tourism clusters in Croatia have remained in the first phase of development for years, even though this approach has failed to achieve significant results. The key benefits of networking and branding in rural areas are identified and defined, but these potentials are still largely underutilized. The objective of this study is to provide practical recommendations to the Croatian tourism industry on how to learn from the suggested best practices and how to implement them effectively. For that purpose, the case of sustainable tourism located in the Gorska Hrvatska region, called the Lika Destination Cluster is analyzed.

**Keywords:** rural tourism, Gorska Hrvatska, clusters, protected areas, competitiveness, Lika Destination Cluster

## Introduction

Tourism is a set of relationships and phenomena, which, unlike other economic activities, is very closely related to nature conservation and protected areas. Croatia has significant potential for the further development of rural tourism, especially if we take into account the fact that most of the overnight stays are spent at its coastal region and tourism is still based on offering visitors “sun, sea and sand” activities. More sustainable and balanced regional rural development through the development of rural tourism can be a significant source of employment due, to its labor-intensive character (Sharpley, 2002). Rural areas, according to data from the *Rural Development Program of the Republic of Croatia from 2014 through 2020*, cover almost 80% of the country's land area. Those living in rural areas constitute 56.7% of the total population. These data support the need to design development models that will primarily reconcile environmental and economic interests and benefit local rural communities.



Researchers in developed countries such as the United States (e.g., Látková and Vogt, 2012) are dedicated to exploring the attitudes of residents towards the existing and future development of rural tourism. On another hand, the evolution of tourism in developing countries like Croatia, where tourism is one of the main sources of income, has not yet been sufficiently investigated. In recent years, the growth and development of tourism have been increased in Croatia, both in the coastal area and inland, where Croatia has more and more to offer both to European and non-European tourists.

The cornerstone of a rural tourist destination should lie in a complementary tourism product (Demonja et al., 2011), which consists of accommodations, transportation, food, and natural attractions. All companies within one tourist region are interconnected in some way, so it is a logical sequence of their development and survival to networking through clusters. One of the main activities of the cluster is tourism promotion — branding of the destination, in both the domestic and foreign markets through natural, cultural, gastronomic, and historical features. The tourism clustering model has been accepted worldwide as an appropriate strategy for the sustainable development of a destination, primarily because it enables a particular region to be as competitive as possible through numerous activities in the “tourism value chain” (Đurašević, 2009).

Gorska Hrvatska stretches through three counties: Primorje-Gorski Kotar, Karlovac and Lika-Senj County, and geographically through Gorski Kotar, Lika, and Ogulin-Plaški valley. It is the least populated part of Croatia, with approximately seven inhabitants per km<sup>2</sup>, and it is known for its exceptional natural beauty. There are three national parks in this area: Risnjak, Northern Velebit, and Plitvice Lakes. Most tourist activity occurs just inside or around the parks, especially in the Plitvice Lakes National Park, which is the most visited national park in Croatia. According to the Ministry of Tourism, the average tourist stay is 1.3 days. Apart from national parks, most of this area is under protected status; under the protection of Natura 2000 (almost 70% of the surface is included), there are also special nature reserves, significant landscapes, strict nature reserves and nature monuments. An effective marketing policy in a protected area is extremely important, not only for the local population and its impact on regional tourism, but also for the overall presentation of the natural phenomenon and the specific features of the protected area. In the context of great global competition, major changes in tourists' lifestyles and increased demand for vacations in naturally attractive non-urban areas, rural areas will experience new challenges and obstacles to their sustainable development.

To create a competitive advantage for a tourist region in the global market (especially if we observe the market in developing economies with low rates of economic development) the clustering of micro, small and medium enterprises can only contribute to development. Developing business relationships and achieving family business goals (Andersson, Carlsen, & Getz, 2002) by combining relevant sectors such as agriculture and trade with tourism can create an environment of longer job retention and circulation of money in the region. Within the cluster, the focus is placed on the links between companies and businesses by supporting connections between customers and suppliers, joint education, marketing, and lobbying (Nordin, 2003). The term *networking* refers to a widespread type of behavior and the cooperation between businesses or organizations that would potentially, in other circumstances, be competitors (Hall et al., 2003).

The main purpose of the paper is to show the possibilities of developing sustainable rural tourism, in synergy with economic activities, and which represents additional income to local communities, that is, the additional channel for distribution of local products. The existing literature on rural tourism of developing country clusters is very limited, and this paper aims to provide new data and a broader understanding of tourism clusters in underdeveloped regions to test the assumption that *by adopting the recommended tourism-cluster approach, Gorska Hrvatska can become a unique and recognizable destination for rural tourism in the European tourism market*. This paper aims to clarify the challenges in the development of rural tourism in Croatia through secondary research done by the Ministry of Tourism, the State Bureau of Statistics, the Institute of Tourism, and other relevant sources on the Internet. In order to fulfil the paper's aim, the following research questions have been posed: RQ1: What are the opportunities for developing regional tourism and the local economy in the protected natural region? RQ2: What are the advantages and disadvantages of the tourism cluster for Croatia? RQ3: What are the ways to finance tourism cluster employees? RQ4: What are the benefits of networking and branding in a protected natural area? RQ5: What are the economic interests of the local population that are served through tourism development?

The structure of this paper consists of six interconnected sections. After the introduction, now completed, the second section discusses tourism clusters and selective forms of tourism in the literature review. The third section describes the methodology, which is followed by the fourth section, a case study of the Lika Destination Cluster. Section Five presents research results and discussion for the development of tourism clusters in Croatia, and section Six presents the conclusions and future implications of the research.

## Literature Review

### Selective forms of tourism

Modern rural areas development within the European Union is oriented towards sustainable rural development concepts, seeking to encourage specific actors in a particular area to create development visions based on their comparative advantages (Bušljeta-Tonković, 2018). This is precisely how the development strategies of each region are shaped, and this is ultimately the common strategy for rural development at the European level (Galdeano-Gómez et al., 2011) i.e., to support rural development projects launched locally to revitalize rural areas and create jobs. Rural tourism is considered to be a series of different activities and forms of tourism that occur outside the cities and those areas where mass tourism has developed and is conditioned by the tourist attractions located in rural areas. "The importance of rural tourism is reflected in the interaction of agricultural production, production of traditional products, presentation of tradition, traditional gastronomy and tourist services, and use of existing resources" (Demonja and Ružić 2011, p. 12).

Attractions and activities that are considered as the basis of tourism clusters have a positive foothold, based on the experience from all over the world through theme paths, routes, or simply branding of an entire geographic region, such as Tuscany in Italy, Silicon Valley in the US or Provence in France. There is extensive literature on the thematic trails of countries in Europe that have been used to develop rural tourism, whether in Montenegro (Morić, 2013), Macedonia (Petrevska et al., 2013), Serbia (Pavlović & Čavlin, 2014), Sweden (Nordin, 2003), or Italy (Babalola et al., 2011).

All rural areas are different, in terms of needs, amenities opportunities for development. There are also various specific products and services in each area, as well as their connection with agriculture or another economic branch. Production and consumption occur with the help of tourism in parallel, but at the same place (Bušljeta Tonković, 2018). Selective rural tourism is linked to farms, as well as small and medium-sized enterprises, and yet it is in close collaboration with the natural world and cultural heritage, along with traditional practices construction. The basic elements of any selective form of tourism, regardless of its content, must include physical infrastructure, high-quality human resources and financial institutions, along with successful marketing and advertising.

### Tourism clusters

There are many possible definitions of a cluster and, accordingly, a wide experience of cluster economy development

is present in many countries. It is common for clusters to support the development of relationships among different participants, providing opportunities to create critical mass, reduce costs, and to improve productivity, information, knowledge, and technical expertise. The atmosphere of a cluster is cooperative, and the competition and cooperation can exist side-by-side because they occur in different dimensions and among different actors (Potter, 1998). The concept of the cluster is well-positioned to stimulate small and medium-sized enterprises at different levels and can, therefore, help to revitalize underdeveloped areas and regions.

According to several authors, the key benefits of a tourism co-operation and advantages of a cluster in the protected natural region are the following:

The cluster could be an element of strategic orientation towards sustainable development, maximizing positive effects while minimizing negative ones (Hall, 2005); the tourism cluster could overcome key shortcomings in rural tourism, increasing competitiveness and merging small and micro enterprises; a tourism cluster can be used as a framework for SMEs to compete globally by collaborating locally (Partalidou et al., 2012); a tourism cluster could help to alleviate poverty and retain locals who would devote themselves to supporting tourists (Moric, 2013). Economic downturns and depopulation are continually occurring in the regions of tourism-dependent countries, especially in transition countries (Braun, 2005). Multi-level tourism clusters can create greater economic benefits for the local economy by fostering image and brand creation, thus integrating more actors and attractions into a competitive product (Hall, 2005).

However, the research also suggests several, possible disadvantages of tourism clusters: the duration period of the cluster due to government funding and public sector policy (Hall, 2005), lack of skills of regional managers and human resources (Morić, 2013), poor quality of transport, information and communication infrastructure (Braun, 2005), availability and expertise of capital financing in the region (Đurašević, 2009), the existence of significant separate, distant space between cluster participants within the region (Morić, 2013) and administrative separation - the existence of multiple public administrative agencies and units in the region (Williams & Hall, 2002).

The attractiveness of selective forms of nature-related tourism can bring operators together in specific regions via clusters. The cluster development based on the European examples of rural development programs has been used for various thematic rural product projects and thus increased the attractiveness of rural tourism (Partadidon et al., 2012). A cross-sectoral collaboration between stakeholders such

as caterers and small renters (e.g., restaurants and lodging), cultures (e.g., museums and cultural centers), shops (e.g., souvenirs and other shops) and the food and agriculture sectors (e.g., farmers, mills, dairies, farms) increases the level of viable income and thus affects the most important problem, which is the unfavorable demographics of rural parts of the countries that have developed tourist coasts (Morić, 2013; Galdeano-Gómez et al., 2011; Đurašević, 2009). Selective forms of tourism have the potential to increase the number of tourist visits and the number of nights (Kesar, 2007); the result would be that the trade sector increases and makes a diversified supply of indigenous and authentic products and goods, which in turn would have an impact on the agricultural sector, as it would be directly marketed (Morić, 2013).

Within the document *Strategy for the Development of Croatian Tourism until 2020* (Ministry of Tourism, 2013), selective forms of tourism that are considered promising for the entire territory of the state of Croatia are listed: health tourism, cyclo tourism, gastronomy and enology, rural tourism, cultural tourism, adventure, and sports tourism, hunting and fishing tourism, team-building tourism, ecotourism.

The biggest advantage of the tourism cluster is the linking of selective forms of tourism with the public sector, technology, manufacturers, suppliers of products and services, and sales channels (i.e., linking the economy of small and medium-sized enterprises). In this way, tourist destinations are positioned globally, especially if everything is rounded off with a quality brand (Đurašević, 2011). According to Nordin (2003), tourism clustering can be viewed most easily from a geographical point of view (protected reserves, geographical natural regions) or the aspect of basic activity of clusters, such as adventure tourism, rural tourism, eco-tourism, agri-tourism, sports tourism, etc.

Clusters are gaining importance, both in theory and in practical terms, in the development of contemporary tourism. Many authors give recommendations for tourism cluster models that are specific to their countries and regions. In Serbia, for example, tourism clusters include sub-areas or micro-destinations within a region that have similar tourist value (Pavlović & Čavlin, 2014). Their Master Plan for the Sustainable Development of Rural Tourism was adopted in 2011 and covered the development of 12 rural tourism clusters, grouped into four rural tourism groups that are divided by regions in Serbia. Capone (2016) shared his findings on the analysis of tourism clusters in Western Europe, in which he talks about thirteen groups of tourism clusters, involving more than a thousand businesses and located in popular tourist destinations, such as Paris, Madrid, London and Barcelona.

Staszewska (2009) highlighted three important sectors in her research on cluster models in Poland as the driving force behind the tourism cluster: the private sector, the public, and the R&D sector.

Ferreira and Estevão (2009) presented a tourism cluster model in which the effectiveness of a tourist destination depends on the level of managerial handling of the destinations, information services, promotional activities, hospitality and staffing. Mirčetić et al. (2019) discuss the Danish model of the tourism cluster in terms of local government mediation, regional development agencies, chambers of commerce, and the private sector. Tourism clusters in Poland (Staszewska, 2009) are coordinated by tourism organizations that provide advisory activities, audits, and promotion.

Novelli et al. (2006) investigated the development of tourism clusters in the United Kingdom and they have promoted economic innovation and the measurable success of SMEs as a key factor. According to them, clusters are important for creating conditions that stimulate the development and advancement of business in the economy. In Slovakia (Szekely, 2010), the current model of the tourism cluster in the Zilina region is coordinated as part of regional innovation, and in cooperation with the private sector; a local university is located in the cluster.

Italy is one of the leading countries in tourism clusters (Babalola et al., 2011), especially in its rural areas. As one of the key recommendations for improving the business of tourism clusters, the authors cite improvements to the unique quality standard, focused branding, improving coordination between the private and public sectors, and improving integrated tourism strategy and marketing. At the same time, they state that current world trends should be exploited so that artistic and cultural tourism, health and wellness tourism, and oenological and gastronomic tourism are improved and promoted.

Weiermair and Steinhauser (2003) explore opportunities for improvements to tourism sports and wellness clusters in the Alps, taking into account lifestyle changes. Tourists coming to the Alps, above all, expect a healthy and active way to spend their holidays. This is precisely why the service providers in Alpine tourism have to guarantee even better quality and greater orientation and flexibility to tourists than they ever have before.

Rural tourism is an extremely important economic activity that can play a decisive role in a given space, especially if there is no alternative, and can even boost the natural and historical-cultural potential of underdeveloped regions (Ferreira & Estevão, 2009).

Tourism clusters imply an interaction between a variety of participants, namely competitive enterprises providing accommodation, transport, travel agencies and tour operators, tourist attractions, non-profit organizations (banks, insurance companies, etc.) educational and government institutions. The basic type of interaction refers to the links between tourism companies, suppliers, and tourists, and is called the vertical linking model.

The second model of relationships is called horizontal and represents links between and within tourism businesses, such as joining forces in their claims to the government to obtain certain benefits (e.g., tax relief), or to avoid some levies. Uniquely looking at integration, we can observe horizontally (the agricultural sector) and vertically (the agricultural and tourism sector). Cross-sectoral clusters are considered as diagonal clusters (Morić, 2013), because each member creates a value chain with some contribution, and such clusters are considered by some authors to be the most efficient (Partalidou et al., 2012).

Vertical and cross-sectoral clusters are recognized in their first form through the creation of certain activities and attractions (Hall et al., 2003) such as wine trails, honey trails, or cheese roads. Another form of clustering involves joint branding via marketing through brochures, workshops, exhibitions at fairs, and websites. This type of networking improves the structure, character, and quality of rural tourism products (Morić, 2013).

Certain clusters in Italy have a tradition of networking through personal contacts and long-term business relationships, thus building a strong social trust capital (Gomezelj Omerzel et al., 2016). Giving export incentives, reducing value-added taxes, creating conditions around the cluster, attracting financial capital and exporting promotional activities are just some of the common interests that can achieve better results.

In the last few years, there has been a lot of talk about rural tourism development in Croatia, and many public meetings and conferences have been held on this topic (Demonja & Ruzić, 2011). Much of the rural area of the country is empty and has experienced an exodus, and the results of the economic crisis have not yet been eliminated. Given the specificities of tourist countries and the diversity of clusters, much more analysis and systematization are needed to come up with a unique model at the national and regional levels. Tourism clusters should be unique in their form for each country and region. Such clustering has led to successful results in many EU member states, such as Ireland, Finland, and Sweden (Tijanović, 2009. Nordin, 2003), as the clusters produce numerous positive effects for rural regions (Rosenfeld, 2002). This shows the need for clusters to be included

in regional policy because, in addition to overall economic development, clusters also contribute to innovation (Tijanović, 2009) The policy of encouraging cluster formation in tourism and other sectors should become a project of national, regional and local interest.

The role of protected natural areas is increasingly important in rural tourism in Croatia, as confirmed in the research by the Institute for Tourism Zagreb (2017). The demand for nature-based tourism accounts for 7% of total global tourism demand, with an annual growth rate of 10% - 30%. The demand for eco-tourism is 7% and 10% of world tourism demand with annual growth rates of 2% and 4%. The demand for adventure tourism is growing at an annual rate of 8%.

Tourism clusters may look similar, but each cluster has the specificities that make it unique (Fundeanu, 2015). In the European Union, positions on the importance of clusters in economic development are very clear (Tijanović, 2009). Thanks to their development, many European regions have developed their comparative advantages, even though they may not have had certain natural predispositions for them, such as flower production in the Netherlands.

## Methodology

The research was conducted following Tong, Sainsbury and Craig's (2007) framework criteria in the basic form for reporting qualitative research (COREQ), focusing on the following issues: (i) research team, (ii) design and (iii) data gathering and analysis.

### Research team

Research was focused on the Lika Destination Cluster. The primary data was collected from rural tourism operators and managers in tourism offices in Lika, with the aim of investigating the key challenges and factors associated with (in)efficiency of the cluster. The team consisted of the main researcher and other associates. The interviews with cluster managers were conducted by the main researcher. Other associates, who work in the tourism offices in Lika, checked the results of the interviews in order to find possible inconsistencies in relation to the situation on the field.

### Design

A qualitative study using a content analysis approach was employed for data collection and analysis. Qualitative approaches enable researchers to explore complex phenomena

encountered by policy makers (Tong et al., 2007). Content analysis is a systematic approach to coding and categorizing, which can be used to explore textual information in order to ascertain the trends.

Participants were selected by a purposive approach. Only one tourism cluster is successful in the Lika region, and all the three interviewees were employed there. They were all exclusively engaged in branding for the Lika region. They interact regularly with 59 cluster members, which are mostly manufacturers. In addition, they find new members each year. The possible source of the bias is the fact that managers live in the Lika region, but possible inconsistencies and bias were checked by the supportive team members, as described in previous text.

### Data gathering and analysis

In addition to using the available secondary data from the Ministry of Tourism, the Institute for Tourism, and relevant sources from the Internet, the primary data surveys were conducted through personal in-depth interviews with Lika Tourism Cluster managers. In-depth interviews were conducted over the telephone and were additionally requested in writing. The results of the interviews are presented in the rest of the paper, the purpose of which was to explore the character, structure, and key development challenges associated with the effectiveness of the tourist cluster and to provide ideas and guidance for future development through this approach.

The managers have provided written answers to the following research questions: (i) What are the advantages and disadvantages of the tourism cluster? (ii) what business results have been observed with local manufacturers and service providers since they were in the cluster? (iii); how is the quality of services and products within the cluster maintained/controlled? (iv) how is the Tourism Cluster Branding implemented? (v) how are branding cluster managers funded?; and (vi) how much does the public sector help them in branding the tourism cluster? The participant quotations are presented to illustrate the theme findings. Each quotation is identified, and there is a consistency between the data presented from the managers and the findings in secondary data. Each interview lasted on average between 20 and 40 minutes. Participants were encouraged to openly convey their viewpoints.

### Case Study: Lika Destination Cluster

In the area of Gorska Hrvatska, a five-year project of LAG Lika (a local action group) is underway, which implements

the tourist clustering of Lika and Ogulin-Plaški valley by branding the integrated quality label brand Lika Quality. The project is oriented towards the development of a wide range of economic activities, but its primary objective is to establish self-sustaining economies in a specific rural area. The space is thus branded as a protected natural area and gastro-destination, and the activities of the Lika Destination Cluster take place under the slogan "smart sustainable destination".

The branding is carried out through a series of smaller cooperation projects, and perhaps the most significant is "Stay 3 days in Lika", or "7 days in Lika", whose main goal is to keep tourists in Lika longer than one day, focusing mostly on visitors to Plitvice Lakes National Park. According to the Ministries of Tourism and Institute of Tourism (2017), Plitvice Lakes National Park has been visited annually by 10% of tourists who visit Croatia, and allowing small producers to sell at such a location is a big step in their development.

These projects also offer visits to other natural phenomena, cultural heritage, and recreational amenities found in this region. The cluster employees are dedicated to constantly informing cluster participants, from suppliers to tourists. Since 2017, they have been implementing the regional food, beverage, and souvenir quality system called Lika Quality, which aims to brand the destination as a gastronomic destination, and they are involved in connecting small local producers with catering facilities. In cooperation with the Agricultural Cooperative Lika Coop, in 2018 they opened a joint outlet of all the Lika Quality products at the entrance to the Plitvice Lakes National Park. Currently, there are 169 products from 59 manufacturers in the Lika Quality system, divided into 11 categories (honey, meat and meat products, milk and dairy products, bakery products, drinks and beverages, vegetables, wild herbs, cosmetics, souvenirs, fruits, and fruit products). For each category, there are certain parameters that a manufacturer must satisfy for his product to receive the Lika Quality mark. When asked about the certification method, the managers of Lika Tourism Cluster answer was "that most manufacturers are familiar with the required documentation and application method before launching a public invitation so that they have no major problems with certification. Each certificate is awarded every two years and quality control is carried out at the very award of the certificate, during product recertification and the period of certification through periodic inspections".

In addition to expanding the market to small local Lika producers, for the first time, they had the opportunity to sell their products at one of the most visited tourist destinations in Croatia. In this way, local producers can present themselves and their products, and tourists visiting the park

have the opportunity to buy local traditional Lika products. When asked about satisfactory quantities, the managers of Lika Tourism Cluster answer was that *“there are several businesses in the Lika Quality system that work with large quantities for several years, but most of them are small local manufacturers whose sales were mostly limited to door-steps and fairs and there were deficiencies in quantities of seasonal fruits and vegetables”*.

With the opening of such a large market as Plitvice Lakes National Park, the need for production has increased. Due to good business results, in the next year, the Lika Quality brand products will be represented in other institutions managing protected areas in Lika (Paklenica National Park, North Velebit National Park, Velebit Nature Park, Cave Park Grabovača and the Caves of Barać).

This project brings together entities that are already an existing part of the tourist offer, namely manufacturers, associations, travel agencies, catering establishments, hotels, small renters, tourist boards, and all forms of attractions. The standard set for collecting the Lika Quality brand is authentic—that is, they must be from this destination and somehow inspired by nature and the environment. The cluster includes three national parks (Plitvice Lakes, North Velebit, and Paklenica), Cave Park Grabovača (the only cave park in the world), Shelter for Young Bears on Velebit, Cerovačke Caves, natural landmarks of the rivers Lika, Gacka and Una, Rizvan City Adventure, Linden Tree Retreat & Ranch, Nikola Tesla Memorial Center.

Attractions and activities related to the purchase of indigenous products of rural households have been increasing since 2016, and their number is increasing year by year (Adventure parks, Canoeing Gacka, House Velebit, Lika Falcon, Linden Tree Retreat and Ranch, Memorial Nikola Tesla Museum and the Museum of Gacka Lika, Plitvice Art farm, Plitvice Bike and Bed, Mountaineering Association, Rizvan city, Plitvice Resort, Bio Bašča and other family-run farms, hotels, and camps with private rentals). The cluster operates in the area of 15 local self-government units (Karlobag, Lovinac, and Brinje municipalities and the towns of Senj, Otočac, and Gospić) of which the tourist board has 9 of them. When asked how they carry out destination branding, the managers of Lika Tourism Cluster answer is as follows: *“They implement destination branding through promotion in all media, enabling them to make financial constructions. This is the first time Lika has been mentioned as a tourist destination, operating under the motto: Smart sustainable destination. Training that serves to attract new participants to the cluster is conducted as part of informing the population and therefore they organize workshops throughout the year”*. They have already implemented several projects, one of which is interesting: a collective ticket is for all protected areas. Also, to make the destination

branding more successful, all projects involve children and young people, civil society organizations, public institutions, numerous external associates, all holders of tourist offers in the destination, and all interested members of the public who want to get involved.

Of the mentioned tourism participants, the public, private and civil sectors are merged in this way. Although this tourist cluster does not significantly change the tourist map of Croatia, it does change the tourist map of the region by using the natural environment as a basic resource.

Cluster integration, together with appropriate strategic management and marketing, enables the region to compete on the international scene (Geić et al., 2014). Proper branding at the global level strengthens the tradition of the highest natural, historical, and ecologically preserved whole, and with a distinctive offer, it can undoubtedly compete in the demanding international market.

There is no single definition of the concept of a cluster, even though a great deal of literature has been devoted to this concept. Perhaps most commonly used is the one first defined by Porter (1998, p. 78) as: *“Clusters are geographic concentrations of interconnected enterprises and institutions in a particular area, connected by commonality and complementarity.”*

His theories applied in the beginnings to the manufacturing industries and eventually were applied to tourism. The implementation of tourism clusters is in developed European countries ia different from developing countries, primarily due to differences in economic development and social capital. Several authors have viewed tourism clusters through Porter's diamond of competitive forces (Aznar-Sánchez et al., 2011; Đurašević, 2009; Morić, 2013; Hall et al., 2003). In this model, the competitive advantages of a destination determine its competitive positioning. To be successful, a destination must offer a higher market value than competing destinations. According to the Porter diamond (Porter (1990, 2013)), clusters represent groups of all businesses and other elements that make a destination competitive, such as attractions, infrastructure, equipment, service providers, other ancillary sectors, educational and training opportunities, and all other contributing activities that experienced consumers expect from the destination they have chosen to visit.

The entrepreneurial clusters of different economic entities that are classified into one or more comparative activities are developing rapidly with focused marketing activities, and under directed strategic management they will make the most of their environment. The result is that the region gains a competitive edge over others. Cluster-based economic development is a model for the successful development

of small and medium-sized enterprises because they are the main drivers of development. Undoubtedly, clustering offers a greater degree of sustainable competitive advantage for all small business activities, which, in turn, underpin the survival and revitalization of demographically disadvantaged regions.

The entire tourism product of the region can be viewed as a package (Lončarić et al., 2014) with five segments: attractions in the tourist region, tourism infrastructure, traffic access to the destination, brands and perception and price to the customer. The Lika tourist destination currently has a complete package. Perhaps one of the most competitive segments of the cluster is the successful tourist experience. A variety of attractive resources, whether the natural environment or historical cultural sights, form the core brand within tourism marketing (Geić et al., 2014). Tourist attractions, thematic trails, monuments, archaeological sites, cultural and gastronomic traditional manifestations, along with naturally attractive resources, are the basis of the region's competitiveness and the cornerstone of development. The selective forms of tourism are one of the great potentials of this area, primarily because of the trend of a return to its roots and nature. The increasing number of outdoor adrenaline parks and cyclo tourism trails in this region confirms this. With visits to natural beauty, there is an increasing need for direct living in nature that can be experienced in rural households.

The support of national and regional institutions and EU funds is of utmost importance for the economic revitalization of the region and rural area of Croatia, as the EU, through its programs has greatly influenced the depopulation in the rural areas of Austria, France, Italy and Switzerland (Geić et al., 2014). Following the LEADER + program, LAGs have a wide range of options for rural development projects. In Greece, for the development of rural tourism in the period 2000-2006, 40 tourism clusters were organized within the LEADER initiative (Partalidou et al., 2012).

The main tourist drivers of rural tourism are attractions and activities, as they bring tourists to their destinations (Morić, 2013). Attractions support all forms of selective tourism because they cover all the needs of tourists while traveling, including food, lodging, experiences, all retail and transportation, travel agencies, and even construction companies, as they build hotels and retail establishments (Morić, 2013).

A successful combination of rural tourism with other forms of selective tourism (e.g., wine and bicycle, honey and bicycle, cheese and mountaineering) could increase revenues and improve business opportunities for all cluster stakeholders (Morić, 2013), and such combinations would be a good selection for weekend breaks and day trips.

According to Ružić (2009), in Croatia, it is possible to carry out these tourist activities in the rural areas (with examples carried out in the Lika Destination Cluster): a) all forms of hiking, such as hiking on marked trails (Mountaineering Association Gromovača), motorized hiking tours with off-road vehicles and motorcycles, horseback riding (Lindeen Tree Retreat and Ranch, Eguus Igni Ranch, Velki Mlin Ranch), b) all kinds of water activities, such as swimming, staying on rivers in houses by the water (Plitvice Holiday Resort), boats, barges, canoes (Kanu Gacka), fishing (Velebit activities), c) all kinds of air activities, such as flying gliders and small aircraft, flying kites and hot air balloons (Lika Falcon), d) all kinds of sports activities, such as rock climbing, skiing, tennis and golf (Rizvan City Adventure Park Likos, Park Ogi, Zipline Bear), e) all activities of discovering local attractions, such as local traditional production, agricultural family businesses (family run farms), f) all kinds of cultural theme activities, such as handicraft workshops, art workshops, folklore groups, archaeology groups, gastronomic resources, and g) all health activities (health benefits, fitness, wellness).

Tourist farms are generally considered to be a pattern of rural tourism, but all other accommodation facilities are very important for the development of rural tourism.

Both the problem and advantage of Gorska Hrvatska is that all the concentration of tourists is happening around the Plitvice Lakes National Park. Within the park itself, there is some concern for environmental protection; however, for the rest of the region, any form of selective tourism development would bring economic revitalization.

Collaboration and networking are highlighted as a key moment in shaping, implementing, and realizing sustainable development ideas. For this reason, this could be called a pilot project, relevant in the sense of a kind of innovation that has been tried elsewhere in Croatia, adapted to the context of Gorska Hrvatska, and it becomes a platform for designing development strategies in the future.

## Research Results and Discussion

### Successful cooperation between the public and private sectors

The basic model of cluster business in a tourist destination is primarily designed to connect the public sector, technology, suppliers of products and services and sales channels, travel agencies, and other private tourism entities. Interconnecting and using all forms of communication through technology

can enhance business and position the cluster on the international scene. Small and medium-sized enterprises in Croatia do not have the economic strength to achieve greater business results if they are not led by the public sector. By creating a unique brand, the reputation of a tourist destination grows in the world, making it easier to sell a 'tourism product'. Businesses within this branded tourism cluster will develop faster, thereby maximizing their market environment.

There is currently a very low level of communication and coordination between national, regional, and local levels, and thus inadequate microeconomic policy, as evidenced by the everyday situation in Croatia. Certain parts of the public sector do not cooperate on the same issues, which creates confusion for the private sector with increasing administrative and tax burdens. SMEs in tourism are much more sensitive to competition than to the benefits of working together, and trust is the key to the success of a partnership. Without trust in institutions among cluster members, it is difficult for a cluster to succeed. Clusters should be fostered by more intensive public policies and measures as they achieve the objectives of SMEs, by establishing professional management and long-term budgeting. The most important function of clustering is precisely the greater involvement and proactiveness of small businesses, both urban rural.

### **Adequate cluster leader, i.e. the leader of the tourism cluster**

In different countries there are various institutional forms of cluster leaders; however, they all share approximately the same goals and objectives of the action. The World Tourism Organization stands for DMO (Destination Management Organization), that is, tourism destination management organizations, which in Croatia is the Ministry of Tourism, i.e. tourist boards and offices. Their role in promoting tourism in Croatia is indisputable; however, they are not able to organize and maintain tourism clusters by themselves. Tourist boards and offices in Croatia are non-profit organizations, financed by statutory income such as residence taxes and membership fees, income from the performance of economic activities, the budget of local self-government units and the state (regional) self-government and the state budget.

In the case of Gorska Hrvatska from the LAG Lika initiative, as a leader of the Lika Destination Cluster, a tourist cluster was created with the cooperation and encouragement of Plitvice Lakes National Park, which is the leader of the entire development of this region. LAGs (Local Action Groups) can be set up as destination management organizations if they are guided by a targeted policy of self-financing from EU projects. However, if they are not driven by quality

management and the public sector, their existence and implementation of the set goals is questionable.

Multisectoral tourism clusters in rural areas were addressed as a topic at the congresses on rural tourism in 2007 and 2011, which discussed clusters, their development, advantages in entrepreneurship, services, and everything else related to the organization of rural tourism in Croatia (Demonja, 2012). Much has been said about the importance of tourism clusters and the necessity of marketing and branding, but concrete results have not yet been achieved.

The National Center for Clustering has been operating in Croatia since 2004 as a part of the Croatian Employers Association. However, the organization and management of this economic form of association is still largely unknown in tourism, since the first major tourist cluster, Lika Quality, was not launched until 2017.

Given the impact of globalization, changes in tourism trends indicate that it will be very difficult for small entrepreneurs to succeed in tourism unless new solutions are found. A professional cluster management approach requires quality management that can balance between small manufacturers and service providers and government institutions.

### **Physical infrastructure**

Shortcomings in the physical infrastructure are a major problem in underdeveloped regions of Croatia. The places where people live and their places of work are very poorly connected by public transport. According to the public sector, transportation is becoming more expensive and more difficult to organize. Connections within underdeveloped regions, and even larger cities, are poorly organized. Inadequate access to public transport and mobility of the local population is becoming an increasing problem.

### **Continuous competitiveness and environmental sustainability**

The answer to the question of how to achieve success in realizing the development of a tourist destination is to create its competitiveness without incurring too much social and environmental cost. According to Porter's diamond, success in the destination's rural tourism is reflected in a unique market offering that cannot be found elsewhere. Croatian tourism is still heavily oriented toward mass tourism. It is in the region of Gorska Hrvatska that there is a natural wealth of the Plitvice Lakes National Park around which intense discussions about pollution have been going on for years. There has been uncontrolled construction of apartments in



the vicinity of the National Park, which has disturbed the ecological balance and caused pollution of underground waters. The biggest issues are the high number of new apartments and construction permits in areas with no access roads or sewage, which is critical in the case of such a sensitive ecological system. Because of the region's great popularity, attention has been paid to this issue; however, other protected areas and nature reserves have the same problems, but they are not so exposed to tourists, so the true consequences of pollution are not yet known.

### Information literacy

Particular emphasis should be placed on the information literacy of the local population to better promote and implement marketing activities. Specifically, if the diversity of the cluster's offer and its promotion is to be increased, there is a wide scope for the use of information technology to make further improvements. Opportunities for more rational adoption of marketing concepts include Customer Relationship Management (CRM), segmentation, differentiation, brand building, images, and other systems. In the field of marketing research, data mining tools have been identified, which is a new technology that can help crafts and businesses to predict future trends and behavior (Pejić-Bach, 2003). Undoubtedly, information technology is an advantage for all rural tourism stakeholders in creating a marketing strategy through direct and interactive communication (Morić, 2013).

### Long-term financing of tourism clusters

One of the key problems for cluster survival is long-term financing. Given the opportunities provided through EU projects, all clustering funding depends solely on the persistence of individuals. The resulting projects provide short-term financing. The role of the state should be to stimulate precisely such individuals and to disseminate information on the opportunities created by the cluster and support for public-private cooperation. Creating a favorable business environment is not possible without the financial support and legitimacy provided by the public sector. Unfortunately, the practice of all implemented clusters is that they are successful while there is financial support, and then they stagnate and lose their attractiveness among all stakeholders, from travel agencies to manufacturers and tourists.

Available indicators indicate that there are two main sources of financing for tourism clusters, those funded by the government (national and regional), and others financed by the local tourism industry. In developing countries such as Croatia, financial institutions are comparatively weaker and investments are mainly high risk, (Đurašević, 2009), and the

function of financial brokers in such countries is carried out by a country that usually lacks funds. Unless the role of the state in the development of the regions and small business is clearly defined and the laws adopted are controlled, the issue of financial survival becomes equal to the issue of demographic and environmental sustainability.

### The lack of human capital and quality retention

Rural areas in Croatia face a depopulation, or rather, an exodus of space. There is a very low level of human capital, primarily because the young population has left the rural areas, leaving behind a largely older population. Consequently, there is a general lack of SMEs and an overall interest in development. There is a serious shortage of experts who can innovate in development, or just follow established models from abroad. The increasingly competitive environment in tourism raises several questions regarding new models of tourism development and cooperation between local actors in the form of social relations and shared values. Human resources and skilled labor are crucial for the success of the tourism business, and this is a problem for the global tourism future.

Much of the tourism infrastructure is collapsing because it has not received investment for years, reducing the overall quality of both accommodation and services.

The quality standards should define the membership of the cluster and should be very clearly set for both accommodation providers and food producers. Often the problem in clusters is the definition of quality standards and a significant mismatch concerning the services provided.

The Lika Destination Cluster is not the first cluster to be established in Croatia. Other clusters were launched, such as the Eco-Ethno Cluster and the Slavonia Cluster, among others, but they did not have much success in their promotion or development. According to secondary data, there is a great deal of information about the states, needs, desires and necessities, but, in general, clustering is still a "foreign" term in the rural tourism of Croatia.

## Conclusions

Rural tourism in Croatia is still underdeveloped; perhaps the biggest fault lies in the inefficient and stagnant state system, especially those state institutions that should specifically address rural and regional tourism development. However, there has been a continual decrease of the quality workforce in tourism, and local government policies have not had any

noticeable results for years. The activities of the Ministry of Tourism are quite intense, but they have been unsuccessful in preventing such a large negative trend of emigration from rural parts of the country. Finding the right position and recognition in the fast-growing market is one of the great challenges of developing the tourism industry in Croatia. The Lika Quality Cluster should be involved in the solution of numerous ecological programs, not only in Lika and the Ogulin-Plaški valley, but also in Gorski Kotar and other protected areas in Croatia. According to this concept of clustering, all regions in Croatia could and should harmonize spatial plans and develop rural tourism.

Clustering as a way of networking should become a key driving force for the development of not only Gorska Hrvatska, but also other parts of the country. The planning, budgetary, and strategic clustering approach should be a guideline for all future rural regional tourism clusters in Croatia. The targeted development of selective forms of tourism, such as cyclo tourism, eno-gastro tourism, with thematic trails featuring bicycle and wine, bicycle and honey, as well as bicycle and cheese features, will surely have increased benefits and will attract targeted, eco-conscious tourists. It is precisely such environmentally-conscious tourists that we should strive for, with targeted branding of the tourist cluster regions. Directed marketing and branding of protected area clusters should primarily be undertaken for the sake of the local people, who are sometimes unaware of their wealth of natural and cultural heritage. Local peoples' role in preserving their natural environment and their shared role as promoters of development should be the topic of future research and new literature dedicated to this particular issue.

The research revealed the following answers to the research questions.

The aim of the research was to highlight the facts regarding the development of tourism clusters as potential drivers of rural regional tourism, and in response to the first research question (RQ1), a good example of a tourism cluster in a protected natural area in Croatia was analyzed. Our research revealed that there are opportunities for the development of regional tourism, as well as opportunities for the development of the local economy, especially if there is support from the public sector or the state.

In the following analysis, the tourism cluster of sustainable tourism development in the part of Gorska Hrvatska called Lika Destination Cluster shows us all the benefits of a tourism cluster in a protected natural area (RQ2). The disadvantages of the cluster are not noticeable for the time being among the cluster participants and managers, and it is expected that in the near future they will be able to respond

to the challenges they are facing. Due to the possible challenges, successful development of any other tourism cluster in Croatia has not occurred, and they should be taken into account in further strategic plans aiming to revitalize the country's rural regional space.

The answer to the third research question (RQ3) confirms that, for the time being, employee financing is only made possible through public tenders and awarded EU projects, but this should change in the near future. The public sector should serve as the support in financing, especially when projects are coming to an end.

The benefits of branding and networking in a protected area are perceived by the increasing number of cluster participants each year, which means that there is the aspiration on the part of the local population to stay in rural areas and earn money from their land through agriculture and tourism (RA4). Protected natural areas for the local community are rich in opportunities for sustainable development, and the tourism cluster offers the opportunity for all family members and all generations to stay. The branding is also affecting the habitation of new inhabitants who would like to live within a protected area, away from cities. Collaboration and networking is highlighted as a key moment in shaping, implementing and realizing sustainable development ideas.

Related to the fifth research question (RQ5), economic interest of the local population is recognized through the development of tourism. With the increase of tourism in the coastal part of the country every year, there is an increase in the development of rural areas. In the observed area, it was found that the tourists take this route on the way to the coast, and manage to stay for more than a day. Tourism clusters form a positive movement in the local interest groups.

### **Theoretical implications**

This model of a tourism cluster is a relatively new phenomenon in Croatia. The challenges of developing tourism clusters in Croatia are outlined and should chart a direction for future planning and organization of tourism cluster models that could contribute to the conservation of this country's protected natural areas. The tourism cluster could overcome obstacles and achieve the necessary competitiveness in the world market. The factors influencing the development of tourism clusters and selective forms of tourism are the successful cooperation of the public and private sectors, the existence of a tourism leader in the region, the availability of all necessary infrastructures, and qualified staff.

This research contributes to new insights regarding tourism clusters of underdeveloped regions and protected natural

areas. It contributes to the tourism literature by providing recommendations to the Croatian tourism industry. Accordingly, our research proposition that the cluster approach could generate a competitive advantage for the rural tourism sector in Croatia is confirmed.

In Croatia, the National Center for Clustering has been formed, functioning as part of the Croatian Employers Association since 2004. However, the organization and management through this economic form of association is still the big unknown in tourism, because the first serious tourist cluster, Lika Quality, was launched only in 2017. Given the impact of globalization, changes in tourism trends are sure to make it very difficult for small entrepreneurs to succeed in tourism of the future, unless new solutions are found for "survival" and competition.

More intensive tourism development on the coast, as well as in national parks in Croatia, has connected consequences, and ecological sustainability will be seen only after longer exploitation. Then the question remains whether it will be able to stop the destruction of natural and cultural heritage, i.e., whether nature will be able to recover.

The Lika Quality Cluster is one of the few positive examples and a valuable source of information and experience to be used and applied for future research, primarily because promotions and projects are being conducted through it.

### Practical implications

Research results indicated are that there are some changes in the development of tourism in Gorska Hrvatska, which is the most underdeveloped region in Croatia. Consequently, we come to new issues related to the local population. Can the locals fight for survival alone, or do they need a significant intervention? It is precisely the locals who, with the help of the public sector, are at the forefront of this tourism cluster, and until the public sector fully embraces this form of "innovation" in terms of development, it will hardly be possible to revitalize other protected rural areas of Croatia.

Much of the rural area in Hrvatska is not inhabited and has experienced a population exodus, public national funds are decreasing and the results of the economic crisis have not yet been eliminated.

However, new opportunities have been brought through the EU funds, which are confirmed with the project like this. There is still relatively healthy and organic agricultural production in Croatia, and such insights may lead to a different understanding of the current situation and the future of rural tourism.

### Limitations of the research

The main limitation of the research stems from the fact that the participants in the survey are local residents, as a result of which, unsurprisingly, the primary survey did not indicate disadvantages in the tourism cluster. Participants mostly see only the benefits of the tourism cluster within the Gorska Hrvatska region through the implemented branding of the protected natural area. This limitation was offset at least partially with the participation of a supporting research team, who checked the interview results for potential inconsistencies.

### Future research directions

This paper provides a descriptive analysis of a tourism cluster in Croatia, in the region of Gorska Hrvatska, and its structure, along with key advantages and challenges. Although the key benefits of the cluster approach have been identified and clearly defined, in the case of Croatian rural tourism, this potential mode of development and revitalization is still largely unused. Further research should focus on the role of government in creating tourism clusters, that is, the role of the entire public sector, which will improve the entrepreneurial environment in the rural tourism sector and contribute to the conservation of protected areas. These measures could be in the form of tax incentives, financial support, legal frameworks, etc. Future research should empirically explore the impact of the cluster approach on the entire Croatian rural tourism.

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## Regionalni razvoj podeželskega turizma: primer regije Gorska Hrvatska

### Izveček

Pristop k trajnostnemu turizmu, ki temelji na združevanju v grozde, je primerna strategija za manj razvita podeželska območja turistično usmerjenih držav, kot je Hrvaška. Ta prispevek skuša pojasniti ključne izzive razvoja turističnih grozdov v regiji Gorska Hrvatska in predložiti nove podatke za pristop, ki temelji na trajnostnem razvoju podeželskega turizma. Na podlagi razpoložljivih sekundarnih podatkov, pridobljenih od vladnih organov, nevladnih organizacij, zaščitenih območij Gorske Hrvatske, ter primarnih podatkov grozda destinacije Lika skuša prispevek raziskati ključne izzive razvoja turističnega grozda in izbranih oblik turizma. Večina turističnih grozdov na Hrvaškem je ostala v prvi fazi razvoja, čeprav s takšnim pristopom že leta skušajo doseči rezultate. Glavne prednosti mrežnega povezovanja in znamčenja so prepoznane in opredeljene, vendar so ti potenciali še vedno v veliki meri premalo izkoriščeni. Cilj te študije je predložiti praktična priporočila hrvaški turistični industriji o tem, kako se učiti iz predlaganih najboljših praks in kako jih učinkovito izvajati. V ta namen smo analizirali primer grozda trajnostnega turizma, imenovan grozd destinacije Lika, ki se nahaja v regiji Gorska Hrvatska.

**Ključne besede:** podeželski turizem, Gorska Hrvatska, grozdi, zaščiteni območja, konkurenčnost, grozd destinacije Lika

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ORIGINAL SCIENTIFIC PAPER

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RECEIVED: FEBRUARY 2020

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REVISED: MAY 2020

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ACCEPTED: MAY 2020

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DOI: 10.2478/ngoe-2020-0010

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UDK: 332.02:352(497.5)

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JEL: H71, H72, R51

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**Citation:** Hodžić, S., & Paleka, H. (2020). Fiscal Capacities of Large Cities in Croatia – Financial Support for Smart Cities. *Naše gospodarstvo/Our Economy*, 66(2), 42–49. DOI: 10.2478/ngoe-2020-0010

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**NAŠE GOSPODARSTVO  
OUR ECONOMY**

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Vol. 66 | No. 2 | 2020

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pp. 42–49

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# Fiscal Capacities of Large Cities in Croatia – Financial Support for Smart Cities

**Sabina Hodžić**

University of Rijeka, Faculty of Tourism and Hospitality Management,  
Opatija, Croatia  
sabinah@fthm.hr

**Hana Paleka**

University of Rijeka, Faculty of Tourism and Hospitality Management,  
Opatija, Croatia  
hanap@fthm.hr

## Abstract

In a dynamic market, the city has become a main source of competitiveness, along with financial and economic benefits. Due to the processes of digitalization, a new concept has been developed, namely smart cities. This concept delivers economic and financial potential, not only to cities, but also to urban and local economic development. Therefore, to ensure the establishment of this concept, local government units, i.e., cities, need to have enough financial resources. In addition, the fiscal capacity of their local budgets should be sufficient. The objective of this paper is to evaluate the fiscal capacity of large cities in Croatia over the 2016-2018 period, as well as to present the financial support through funding schemes for the establishment of smart cities. After calculating the level of fiscal capacity of large cities, the analysis revealed interesting results. Only four large cities (Split, Rijeka, Zadar and Pula) achieved positive fiscal capacity in the observed period. This provides evidence of fiscal performance and fiscal capacity for the establishment of smart cities. This concept will enhance the quality of life, stimulate economic growth, sustain local government budgets and create new value for both investors and the local population.

**Keywords:** local government, smart cities, fiscal capacity, local economic development

## Introduction

Cities around the world nowadays face many challenges in such areas as urban sustainable development, education, energy, environment, safety and public service among others. These challenges have a strong impact on issues of urban quality, including economic, financial, cultural, social and environmental conditions. As a result, the concept of smart cities has grown over the last 20 years. This concept has become an important determinant in urban development planning as a strategic means for solving cities' problems. To improve the quality of life in cities, to reduce the operating costs within budgets and to achieve the goals of sustainable development, all largely depend on the fiscal capacity of cities, in addition to advanced technologies. Therefore, local government is a very

important determinant in creating public policy that is in line with citizens' interests. The government of the Republic of Croatia has three levels of government: the central state government, regional government (consisting of counties and municipalities) and local government. For the establishment of a smart city concept, cities are vital as units of local government. This paper contributes to the existing literature on the smart city concept and the importance of local governments' fiscal capacities by examining the implementation of the smart city concept in Croatia.

The objective of this paper is to evaluate the fiscal capacity of large cities in Croatia over the 2016-2018 period as well as to present the funding schemes for smart cities. The paper is structured as follows: After a brief introduction, the literature review regarding the smart city concept is presented. In the third section, the analysis of funding schemes of smart cities is described. Section four presents the data and methodology for measurement of fiscal capacity, while section five presents the results. The last section includes conclusions and limitations, as well as providing recommendations for future research.

## Literature Review

In recent years, the smart city concept has attracted significant interest in scholarly literature. Therefore, the literature offers a broad scope of authors who have discussed the concept of smart cities (Mahizhnan, 1999; Giffinger et al., 2007; Caragliu, Del Bo & Nijkamp, 2011; Allwinkle & Cruickshank, 2011; Cretu, 2012; Angelidou, 2014; Söderström, Paasche & Klauser, 2014; Ferrara, 2015; Albino, Berardi & Dangelico, 2015; Marek, Campbell & Bui, 2017; Stanković et al., 2017; Sikora-Fernandez, 2018; Borsekova et al., 2018; Siegfried Ruhlandt, 2018; Maček, Ovin & Starc-Peceny, 2019).

In Table 1 the set of various definitions of the concept of a smart city are presented.

According to the definitions above, we can conclude that the concept of a smart city has a multidimensional approach, covering areas such as people, infrastructure, information and communications technology, government, mobility and others. A very important determinant is the innovation

**Table 1.** Definitions of the concept of a smart city

Definitions	References
A smart city that actively embraces new technologies to be a more open society where technology makes it easier for people to have their say, gain access to services and stay in touch with what is happening around them, in a simple and inexpensive manner.	Partridge (2004)
A smart city is a city that performs well in a forward-thinking way in six characteristics, built on 'smart' combination of endowments and activities of self-decisive, independent and aware citizens.	Griffinger et al. (2007)
A smart city is when investments in human and social capital and traditional and modern communication infrastructure fuel sustainable economic growth and a high quality of life, with a wise management of natural resources, through participatory governance.	Caragliu, Del Bo & Nijkamp (2011)
A smart city is an ICT-enabled public sector innovation undertaken in urban settings. It supports long-standing practices for improving operational and managerial efficiency and quality of life by building on advances in ICTs and infrastructures.	Nam & Pardo (2011)
Smart cities should do everything related to governance and economy by using novel paradigms and networks of sensors, smart devices, real-time data and ICT integration in every aspect of human life.	Cretu (2012)
A smart city is a city that gives inspiration, shares culture, knowledge and life, a city that motivates its inhabitants to create and flourish in their own lives.	Rios (2012)
Smart cities are supposed to be supported by appropriate and trustworthy governance structures and by open-minded, creative people who through a joint effort are able to increase local productivity.	Kourtit & Nijkamp (2012)
Smart cities represent a conceptual urban development model based on the utilization of human, collective and technological capital for the enhancement of the development and prosperity in urban agglomerations.	Angelidou (2014)
Smart cities are, on the one hand, increasingly composed of and monitored by pervasive and ubiquitous computing and, on the other, their economy and governance is driven by innovation, creativity and entrepreneurship, enacted by smart people.	Kitchin (2014)
A smart city is a city that efficiently mobilizes and uses available resources (social, cultural, capital, financial capital, natural resources, information and technology) for efficiently improving the quality of life of its inhabitants, commuting workers and students and other people.	Bosch et al. (2017)

capacity in the local public sector, especially in cities. The barriers are inherent and external. According to OECD (2019, p. 23) inherent barriers include "political leaders who do not publicly promote innovation; lack of workplace incentives for employees to think creatively and take risks; fiscal austerity and limited budgets for experimental programmes and policies; fragmented approaches to complex challenges due to overly specialised workplace silos; red tape, inertia and a risk-averse culture in the public sector; inability to synthesise and process data holistically across administrative departments; limited institutional resources for citizens' engagement throughout the policy cycle; a culture that prioritises the expertise of professionals to the exclusion of other sources of insight, including research and residents themselves; challenges with procuring innovative solutions; fear of experimentation in the local public sector due to political and social scrutiny, and failure and lack of mechanisms and structures for facilitating learning and good practice exchange across the local public administration".

On the other hand, external barriers involve "lack of trust in the public sector and its leadership and apprehension to use public money to experiment; underfunding of core capacities within local government, including innovation capacities like data analysis, citizen engagement and project management; shortages in knowledge and skills in the wider workforce market; information asymmetries between private sector suppliers of new technology and municipalities; public resistance to change, in particular to the ways and types of public services that are delivered; lack of technological solutions for problems at hand; and national and regional government restrictions and mandates" (OECD, 2019, p. 24).

Therefore, a smart city investment is able to increase innovation and to make a city more attractive to people and businesses. Despite the growing number of scholars dealing with the smart city concept, the literature lacks a detailed analysis of financing funding schemes for smart cities as well as for the sustainability of local development.

### Analysis of Financing Funding Schemes of Smart Cities

The task of every regional and local economic development is to transform a city into a smart city due to dynamic trends. This requires a major effort from its political representatives, administrators, inhabitants, entrepreneurs and communities. According to Kumar and Dahiya (2016), there is a strong indication that the population size of a city matters, especially in terms of its urban economy and smart city development. Therefore, there are smart city dimensions and indicators (Table 2).

**Table 2.** Smart city dimensions and indicators

Smart economy	Innovative spirit Entrepreneurship Economic image and trademarks/city image Productivity Flexibility of labor market International integration
Smart people	Level of qualification/education Lifelong learning Ethnic diversity Open-mindedness
Smart governance	Participation in public life/political awareness Public and social services Transparent governance/ Efficient and transparent administration
Smart mobility	Local accessibility/local transport system International accessibility Availability of ICT infrastructure Sustainability of transport system
Smart environment	Environmental conditions Air quality (low pollution) Ecological awareness Sustainable resource management
Smart living	Cultural facilities Health conditions Individual security Housing quality Education facilities Tourism attractiveness Economic welfare/social cohesion

Source: Giffinger et al. 2007, p. 12.

In line with traditional regional and neoclassical theories of urban growth, these six main dimensions and indicators have served as background for many research studies. Using Croatia as a sample, this was the basis for research conducted by Jurlina Alibegović, Kordej-De Villa and Šagovac (2018). In their research, they identify the most important indicators for measuring the economic competitiveness of 25 large Croatian cities.

Besides the difficulties involved in implementing the concept of a smart city, the local government units also have the problem of funding. Therefore, overcoming the lack of public financial capacity requires efficient business models. Moreover, the financial system operates through two alternative financing channels, i.e., direct financing and indirect or intermediated financing. The first channel refers directly to savers by selling them securities for cash, and the second one refers to raising capital through financial intermediaries, such as commercial banks, insurance companies' pension funds and venture capital funds.

The smart city concept imposes a dynamic organizational model where five major types of stakeholders are essential (European Commission, 2013, p. 17):

- 1) "Promoter bodies – national authorities, administrative bodies, government agencies, large private investors, etc.



- 2) Achieving bodies – in charge of physically building infrastructures and smart services where entities can be businesses, construction companies, etc.
- 3) Financial institutions – task is to aggregate flows of investment by private capital, through public-private partnership mechanisms. These entities can be banks, foundations, capital management bodies, large private investors, etc.
- 4) Certification authorities – evaluate the effectiveness of smart initiatives and protect sensitive data and investors' information. These entities can be scientific institutes, consortium companies, financial certification companies, etc. and
- 5) Guarantor bodies – provide coverage of private investments made through public-private partnership mechanisms. These entities can be insurance agencies, national banks, international banks, capital management bodies, foundations, managers of programs and European investment funds, etc."

Due to the ongoing challenges related to the nature of financing, there is a need to diversify the financial sources and create innovative business models to find various resources for long-term financial incentives to facilitate their growth and prosperity. According to the European Commission (2013, p. 18), new funding mechanisms include:

- 1) "Models for early demonstration and deployment of innovative solutions using a grant, guarantee and loan blending mechanism
- 2) Project financing
- 3) Spread shareholding
- 4) Smart bonds
- 5) Crowd finance and
- 6) Energy performance contracting for energy efficiency"

For the smart city concept, the most interesting model of financing is smart bonds, where many small private investors are involved in contributing to the creation of infrastructure. Moreover, they produce an economic return for all the stakeholders, including the investors themselves. Therefore, for the establishment of a smart city concept to be viable, an efficient financial system is key. Bakici, Almirall and Wareham (2013) found that in Barcelona, financial development to attract new firms and start-ups was inadequate. To satisfy infrastructure needs and to make cities more conducive to innovation and growth, the smart city concept should incorporate both a capacity function and efficiency function. The efficiency function is present in urban development strategy reacting to challenges faced by cities. According to the EIB (2018, p. 9), in Central, Eastern and Southeastern European cities, "urban productivity can be boosted by increasing the quality of human capital, business environment quality, entrepreneurship, quality of institutions, market access and access to capital as well as research and innovation".

## Data and Methodology

In order to investigate the fiscal capacity of large cities in Croatia over the 2016-2018 period as a budget basis for the establishment of smart cities, all the data were collected from publicly available local budgets. The data from the local budgets are in line with the European system of National and Regional Accounts 2010. For the purpose of this analysis, we used data for each large city and for each year from local government unit budgets. In Croatia there are a total of 127 cities, of which 25 have the status of a large city; 17 cities (including the City of Zagreb) have more than 35,000 inhabitants; and eight cities are county capitals with fewer than 35,000 inhabitants. The average population of the 25 large cities is 84,000.

Since the measurement of fiscal capacity of local government units is a broad topic, there is no consensus in the scientific literature regarding such measurement. This is an important factor in determining the allocation of intergovernmental grants to equalize the amount of resources available to each of the local government units. Hence, the fiscal capacity of a local government units cannot be easily quantified. It is influenced by economic structure and by availability of taxable resources, or tax bases. Therefore, it presents the cost of delivering a standardized basket of goods and services within a specific local government unit. To calculate the fiscal capacity, we followed the methodological approach of Akin (1973), Chitiga-Mabugu and Monkam (2013) and Bajo et al. (2015). Following the proposed methodological approach, the Representative Revenue System (RRS) and the Representative Expenditure System (RES) have been applied in assessing the overall level of fiscal capacity of specific local government units, i.e. cities.

The first approach (RRS) estimates the revenue capacity, which measures the relative ability of a sub-national government to raise revenue. Therefore, it is necessary to define the revenue sources of local government units.

$$RRS = R_{bo} + R_{nmp} \quad (1)$$

Where:

$R_{bo}$  (total revenues from business operations) consists of tax revenues, grants from other general government units (capital and current grants), income from property, as well as revenues from fees, penalties, sales of goods and services and donations.

$R_{nmp}$  refers to revenues from non-material property.

On the other side, RES measures the expenditure side of the total local government budget. It estimates the amount of expenditures that must be spent by local governments in the

provision of a standard level of service for each representative bundle of local spending.

$$RES = E_{bo} + E_{nmp} \quad (2)$$

Where:

$E_{bo}$  (total expenditures from business operations) consists of employee, material and financial expenditures, along with subsidies, grants to foreign governments, grants to households, and other expenditures.

$E_{nmp}$  measures total expenditures for supply of non-material property.

In order to calculate fiscal capacity (FC), which gives a sense of local governments' ability to fund its expenditure needs through its own revenues, the following equation is applied:

$$FC = RRS - RES \quad (3)$$

Following this methodological approach, fiscal capacity is the difference between total revenues and expenditures of economic activity in certain local government units, i.e. cities. In addition, fiscal capacity represents the ability of governmental units to raise tax revenues for financing public services, given the tax sources available. A local government unit with low fiscal capacity has a relatively small revenue capacity, a relatively high need for expenditures, or a combination of both.

### Results of Measuring the Fiscal Capacity of Large Croatian Cities

As aforementioned, the fiscal capacity presents the cost of delivering a standardized basket of goods and services within specific local government units, i.e. cities.

In Table 3, the results of measuring the fiscal capacity of large cities are presented.

**Table 3.** Fiscal capacity of large cities over the 2016-2018 period

	2016		2017		2018	
	Fiscal position	%	Fiscal position	%	Fiscal position	%
Zagreb	-253202223.00	103.9	-377936168.00	105.8	-288677832.00	104.0
Split	41047577.00	94.5	128918784.00	83.7	34087867.00	95.9
Rijeka	41858364.00	93.8	16226916.00	97.6	21916874.00	97.0
Osijek	30904898.00	91.3	20492752.00	94.7	-5430028.00	101.3
Zadar	11067874.00	97.0	58181298.00	83.9	43002101.00	88.4
Velika Gorica	14834161.00	94.0	-21774877.00	106.7	-31585158.00	111.9
Slavonski Brod	-364993.00	100.3	1050401.00	99.3	26857655.00	85.2
Pula	21827220.00	92.9	16561788.00	95.3	2704031.00	99.1
Karlovac	9605358.00	95.9	-3275825.00	101.6	3546247.00	98.3
Sisak	-20708836.00	112.1	-31401386.00	117.7	6367384.00	96.6
Varaždin	22562124.00	90.1	24475794.00	88.9	-8650701.00	103.6
Šibenik	-542314.00	100.3	-186444.00	100.1	15167805.00	92.1
Dubrovnik	-12866177.00	103.3	33582161.00	91.6	-1027975.00	100.2
Bjelovar	3557465.00	96.9	378313.00	99.7	-1631955.00	101.3
Kaštela	18505281.00	84.7	-7930357.00	107.6	18941401.00	86.1
Samobor	-20597208.00	110.1	-511111.00	100.3	5981058.00	96.9
Vinkovci	3883402.00	96.7	1663373.00	98.1	-7042091.00	106.4
Koprivnica	2473472.00	97.9	-8612928.00	107.4	83691.00	99.9
Vukovar	6880921.00	95.5	23591748.00	84.7	-6790414.00	104.0
Čakovec	-14887146.00	114.0	9078980.00	92.0	3265406.00	97.1
Požega	-18539498.00	128.4	-14139229.00	121.2	-2491944.00	102.7
Virovitica	3837157.00	94.5	-5936848.00	109.3	-15144900.00	111.4
Gospić	-5085780.00	109.3	-291064.00	100.5	1364667.00	97.8
Krapina	2599470.00	92.8	-2992706.00	108.9	1583004.00	95.8
Pazin	1297463.00	97.4	-273661.00	100.5	1457844.00	97.4

Source: Authors' calculation.

Based on the results, we can conclude that the fiscal capacity of large Croatian cities varies over the years analyzed. The cities that had a negative fiscal capacity over the 2016-2018 period were Zagreb and Požega, while cities with positive values over the years analyzed were Split, Rijeka, Zadar and Pula. This means that, in those years, the cities had enough revenues to cover all their expenditures and to finance their own capital and current expenditures in order to stimulate the local economic development of the cities. It is worth noting that these cities are based in the coastal area of Croatia, which can be explained by higher investments in the tourism sector. The responsibilities covered by cities, according to the Act on Local and Regional Self-Government Units, include the organization of settlements and housing, spatial and urban planning, utility services, child care, social welfare, primary health protection, primary education, culture, consumer protection, traffic in the local area, and maintenance of public roads, as well as other tasks in accordance with special laws. Although the cities have responsibilities in public functions, they are trying to collect more revenues in order to establish local economic development and to implement the smart city concept. Moreover, this will lead to the effective and efficient local development of public functions within the local public sector. Jurlina Alibegović, Kordej-De Villa and Šagovac (2018) identified the most important indicators for measuring the economic competitiveness of 25 large Croatian cities by means of six dimensions of the smart city concept and then ranked the cities according to the smart urban development index. The results revealed that only eleven large Croatian cities can be considered smart cities for 2018: Pazin, Dubrovnik, Varaždin, Pula, Rijeka, Zadar, Čakovec, Split, Koprivnica, Samobor and Karlovac. Therefore, our research contributed to the previous research by identifying that large cities like Split, Rijeka, Zadar and Pula also have a fiscal capacity for local economic development.

## Conclusion

Nowadays, good quality local and regional government policies are a precondition for providing efficient and effective public functions and services to citizens. The bearers of responsibility for local development activities are cities. In addition, the population and economies of cities have been growing much faster than in less urban areas. Due to their attractiveness and economic structure, cities are faced with difficult challenges. These are social exclusion, fiscal and financial capacity, limited budget funds, migration and environmental quality, among others. One of the possible solutions to these challenges is innovation capacity. Moreover, due to the processes of globalization and digitalization, a new concept has been developed within cities, namely smart cities. This concept offers significant economic and financial potential for all local government units. To ensure sustainability in the future, the main obstacle to be overcome requires finding appropriate financial resources. Therefore, in our paper, we evaluated the fiscal capacity of large Croatian cities over the 2016-2018 period. The results of the measurement revealed that only four large cities (Split, Rijeka, Zadar and Pula) achieved positive fiscal capacity over the observed period. This provides evidence for the necessity of fiscal performance and fiscal capacity within local budgets as a precondition for the establishment of smart cities.

## Acknowledgement

This paper has been financially supported by the University of Rijeka, for the project ZP UNIRI 7/18 and “Pametni gradovi u funkciji razvoja nacionalnog gospodarstva” (uniri-drustv-18-255-1424) projects.

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## Fiskalne zmogljivosti velikih mest na Hrvaškem – finančna podpora za pametna mesta

### Izvelek

Na dinamičnem trgu je mesto postalo glavni vir konkurenčnosti, finančnih in gospodarskih koristi. Zaradi procesa digitalizacije mesta prinašajo nov koncept, imenovan pametna mesta. Ta koncept zagotavlja gospodarski in finančni potencial ne le za mesta sama, ampak tudi za urbani in lokalni gospodarski razvoj. Da bi lahko zagotovile vzpostavitev tega koncepta, morajo imeti lokalne upravne enote, tj. mesta, dovolj finančnih sredstev. Poleg tega mora biti fiskalna zmogljivost njihovih proračunov pozitivna. Cilj tega prispevka je oceniti fiskalno zmogljivost velikih mest na Hrvaškem za obdobje 2016–2018 ter predstaviti finančno podporo za ustanovitev pametnih mest prek shem financiranja. Po izračunu fiskalne zmogljivosti velikih mest je analiza pokazala zanimive rezultate. Samo štiri mesta (Split, Reka, Zadar in Pulj) so v opazovanem obdobju dosegla pozitivno fiskalno zmogljivost. To je dokaz fiskalne uspešnosti in fiskalne zmogljivosti, ki sta potrebni za ustanovitev pametnih mest. Ta koncept bo povečal kakovost življenja, spodbudil gospodarsko rast, vzdrževal proračune lokalnih uprav in ustvarjal novo vrednost tako za vlagatelje kot za lokalno prebivalstvo.

**Ključne besede:** lokalna uprava, pametna mesta, fiskalna zmogljivost, lokalni gospodarski razvoj

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ORIGINAL SCIENTIFIC PAPER

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RECEIVED: SEPTEMBER 2019

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REVISED: DECEMBER 2019

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ACCEPTED: FEBRUARY 2020

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DOI: 10.2478/ngoe-2020-0011

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UDK: 339.56(436)(83)

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JEL: M16, F14

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**Citation:** Rotter, S., Bobek, V., & Horvat, T. (2020). Prospects and Challenges of Market Entry for Austrian Companies in an Emerging Market – the Case of Chile. *Naše gospodarstvo/Our Economy*, 66(2), 50–61. DOI: 10.2478/ngoe-2020-0011

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NAŠE GOSPODARSTVO  
OUR ECONOMY

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Vol. 66 | No. 2 | 2020

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pp. 50–61

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# Prospects and Challenges of Market Entry for Austrian Companies in an Emerging Market – the Case of Chile

**Stefan Rotter**

University of Applied Sciences FH Joanneum, Graz, Austria  
stefan.rotter@edu.fh-joaanneum.at

**Vito Bobek**

University of Maribor, Faculty of Economics and Business, Slovenia  
vito.bobek@um.si

**Tatjana Horvat**

University of Primorska, Faculty of Management, Koper, Slovenia  
tatjana.horvat@fm-kp.si

## Abstract

Chile is, compared to several other South American countries, geographically and demographically rather limited, but despite that it is the second most important trading and investment partner for Austria in this region. The aim of this paper is to gain firsthand insights into the motivations and perceptions of the entry of Austrian firms into the Chilean market by using an exploratory research approach. Interviews with thirteen qualified and experienced persons were conducted and analyzed, using Mayring's qualitative content analysis. The Chilean market is an attractive opportunity for Austrian firms, as it performs quite well in international business environment rankings. The study results indicate a variety of motivations for entering the market, as well as diverse entry mode decisions based on numerous factors, together with a prevailing positive perception of the Chilean business environment. Several results probably cannot be generalized for the entire country, as the capital city is the center of business, and research in other regions of Chile might have different results. Challenges have been identified in the matters of language, distance, time, culture, recruitment, complexity, local partners and the indigenous population. Chile is a highly developed emerging market where doing business faces few obstacles. Therefore, the country represents a very attractive location in South America with great potential for Austrian companies.

**Keywords:** market entry, internationalization, entry mode, business environment in Chile, emerging markets

## Introduction

### Theoretical considerations

Many companies assume that having a good product or service is enough to operate successfully in foreign markets, even though practice and scientific

research reflect a different story (Fuchs & Apfelthaler, 2009, pp. 267-268). Pacek and Thorniley (2007, p. 30ff) claimed that firms repeatedly enter new markets without understanding the specific requirements. Well-planned preparation is the key to success. Business plans should be based on sound assumptions, especially for operations in emerging markets. Therefore, an external audit, including the political and economic environment as well as the business environment of the target market, should be executed. Despite the fact that detailed and continuous understanding of the external environment is crucial, the internal capabilities, necessary to match the market requirements, must also be assessed.

Kouznetsov (2009, p. 375) demonstrated that understanding the differences in conditions between markets is vital for a successful international market entry. Numerous entry mode researchers acknowledge that the actual decision of firms do not always match best theoretical choice of companies regarding the appropriate market entry mode. (Wulff, 2016, p. 961). Hence, the key factor of success is to be flexible and adaptable regarding the entry decisions. The same approach cannot work for every situation. Rather, the operating model for a country needs to evolve. The initial chosen strategy may be appropriate for the first time but requires adjustment over time (Manktelow, 2014, p. 86).

### **Chile as a business partner**

Nevertheless, even though as a market Chile is geographically and demographically rather limited, it is one of Austria's most popular trading and investment partners in the South American continent. In 2018, Austrian exports to Chile reached a record level of almost 200 million €. This means that Austria has almost tripled its exports to Chile in the last decade. After Brazil, Chile remains Austria's second most important trading partner in South America (Chamber of Commerce Austria, 2019).

In Latin America, Chile has served as a role-model for a successful open and liberal economy. The country enjoys political stability and has the highest living standard in the entire continent. Consequently, the middle class is relatively wealthy. Legal certainty, low levels of corruption and a strong respect for property rights are other positive factors contributing to the market dynamics of the country (Manktelow, 2014, p. 205).

International business literature shows that doing business in international markets offers numerous opportunities for firms. Chile seems to be a lucrative market for internationally operating companies worldwide. Although considerable literature and market studies on entry strategies exist, none is focused on specific conditions for Austrian companies in Chile.

Therefore, motivations and perceptions regarding market entry of Austrian firms into Chilean market will be analysed.

### **Purpose and approach**

The aim of this paper is to contribute to the pool of knowledge by answering the following four research questions:

- (1) What are the main motivational aspects leading an Austrian company to enter the Chilean market?
- (2) Which factors have the principal influence in choosing the market entry mode for Austrian companies in Chile?
- (3) How do the Austrian firms perceive the Chilean business environment?
- (4) What are the biggest problems or challenges for Austrian companies when doing business in Chile?

In addition to providing a critical reflection of important influences for Austrian companies, this research enables a better understanding of internationalization process of Austrian companies into this South American country. Based on the experience of Austrian companies, the paper should provide recommendations for other possible market entries. Additionally, this study considers imminent problems and challenges that firms might encounter when doing business in Chile, and offers practical advice on how to manage them. This paper begins with the literature review in order to deliver a precise observation of the Chilean business environment.

The empirical research consists of a two-fold qualitative approach. One aspect is provided by a preliminary expert interview with the Austrian trade commissioner and delegate of the Austrian chamber of Commerce in Chile; the other discusses semi-structured interviews with experienced persons from Austrian firms operating in the Chilean market.

The qualitative research approach has been selected due to its ability to provide a deep insight into the area of research. Moreover, this type of investigation involves verbalizing data for observing and interpreting them individually. This makes the process flexible and open for interpretation. Instead of a quantitative presentation of numbers, qualitative studies seek to articulate data by observing and interpreting it individually (Ebster & Stalzer, 2008, pp. 139-140). To analyze the conducted expert interviews, Mayring's (2015) qualitative content analysis of Mayring (2015) has been identified as the appropriate tool.

### **Contribution of the paper**

In addition to a critical reflection of important influences on Austrian companies, this research gives an overview of

different motivations and approaches of companies entering the Chilean market, together with insight into the Chilean business environment. Therefore, the paper enables a better understanding of the internationalization process of Austrian companies into this South American country. Based on the experiences of Austrian companies, it should provide recommendations for other possible market entries. Additionally, the study discusses imminent problems and challenges that firms might encounter when doing business in Chile and offers practical advice on how to manage them.

### Literature Review: The Chilean Business Environment

This section introduces the business environment of Chile. First, it provides a look at general data and Chilean demography. Then, it presents some factors relevant to the business environment and investment climate in Chile, which are presented more in detail. Next is a discussion of international rankings and indices regarding the Chilean economy to assess the country's global competitiveness. The section closes with an evaluation of opportunities and risks of the Chilean business environment.

#### General indicators

Chile is a South American country with slightly more than 18 million inhabitants, covering 756,000 km<sup>2</sup> (24 persons per km<sup>2</sup>) (Central Intelligence Agency, 2018, p. 185ff). Almost half of all Chileans live in the capital region of Santiago de Chile, where most of the national and international trade and business is done (Central Intelligence Agency, 2018, p. 185ff; Banco Santander, S.A., 2019). For the year 2018, Chile indicated a GDP of almost 300 billion USD (The World Bank Group 2019a). In 2017, Chile was considered the 45<sup>th</sup> biggest import and the 42<sup>nd</sup> biggest export economy in the world, with total exports of 70.1 billion USD and imports of 62.7 billion USD (Observatory of Economic Complexity, 2019a). Chile's most important trading partner, in both exports and imports China, followed by the US (Observatory of Economic Complexity, 2019a).

Besides the prosperity in copper, Chile holds more than the half of the global proven lithium deposits. Since this commodity is used in making rechargeable batteries and electronic equipment, as well as for generating nuclear power, a huge demand in the future is certain.

Economic growth improved, from 1.3% in 2016 to 1.5% in 2017. There was a sharp increase to about 4% in 2018, which was caused by sharp rises in copper prices and the

election of president Sebastián Piñera, who induced an economic rebound with his political values stimulating business confidence.

Traditionally, the country is considered a model in South America regarding both political and financial transparency (Banco Santander, S.A., 2019a). Furthermore, Chile's has been one of the fastest-growing economies in Latin America in recent decades. A solid macroeconomic framework enabled the country to reduce the poverty level from 30 % in 2000 to 6.4 % in 2017 (The World Bank Group, 2019b).

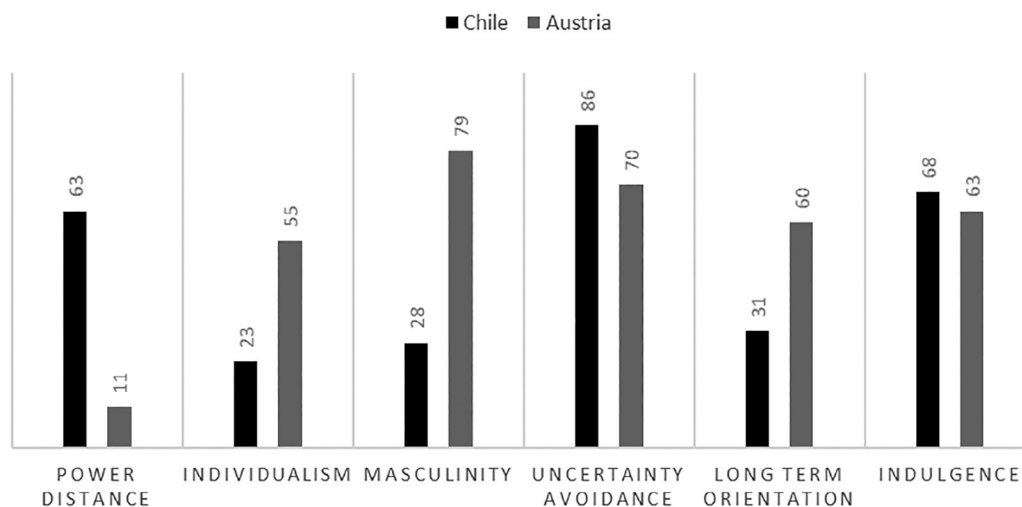
Some strong points for FDI in Chile include macroeconomic stability, a growth perspective with a rather low level of risk, the high purchasing power compared to other Latin American countries, and the fact that labor laws tend to be favorable towards business. Chile's foreign investment policy is based on simplicity, non-discrimination and transparency. Still, the weak points for FDI in Chile involve a lack of innovation, vulnerability to fluctuations in commodity prices and a lack of qualified workforce (Banco Santander, S.A., 2019c).

#### Cultural differences

Chile scores higher in power distance than most European countries, so one needs to understand that they do not like top-down communication and hierarchies deriving from historical authoritarian regimes and brutal history. Hence, Chile is an individualistic country, since Chileans prefer autonomy and variety in their position, which may also be a result from its history. Still, there is a difference between the capital, Santiago de Chile, and the rural areas, which are in favor of a more collectivistic society. A low score in masculinity versus femininity derives from a feeling of belonging. Chileans value equality, solidarity and quality in their working lives. Negotiations and talking are more favored ways to solve conflicts than punishment or other negative consequences. The high score in uncertainty avoidance may result from the nation's former connection to Spain and indicates that Chileans appreciate codes and beliefs, which should be considered in negotiations and communication. Lastly, Chile is a rather indulgent country, with an easy-going life philosophy, meaning that Chileans enjoy life and have fun. All those facts need to be considered in order to fully understand the culture and the way of communication in Chile. If businesspeople consider these differences, cross-cultural illiteracy may be avoided (Griffin & Pustay, 2015, pp. 135-136). Gesteland (2012, p. 26) contends that, similar to central Europe, Chile is a country with a moderately deal-focused culture. In contrast, the other Latin American states can be classified as having relationship-focused cultures.



Figure 1. Hofstede's cultural dimensions – Chile versus Austria



Source: Own illustration after Hofstede Insights (2019).

## Infrastructure

According to GCI (World Economic Forum 2018), the Chilean infrastructure is ranked 41<sup>st</sup> of 140 countries, with a score of 75.2. However, Chile is also ranked highly in other economic indicators, including road connectivity (14), electric power transmission and distribution losses (20) and the quality of roads (24). In contrast, several economic aspects of the country are ranked rather low, such as the efficiency of train services (79), the railroad density (56) or the airport connectivity (51) (World Economic Forum, 2018, p. 156). The Ministry of Infrastructure plans to award new contracts totaling almost USD 15 billion by 2023. The main share of the funds will be used for the expansion of the road network (motorways, expressways and tunnels through the Andes to connect to Argentina), the construction and expansion of hospitals along with the expansion of airports and the railway network (Chamber of Commerce Austria, 2019).

## Institutions

In the 2018 edition of the GCI index, Chilean institutions are well-positioned, with a total of 64 points and ranked 32<sup>nd</sup> out of 140 observed countries worldwide. Detailed examination of this index shows that Chile is performing especially well in strength of auditing and reporting standards (20), conflict of interest regulation (23) and reliability of police services (24). However, the high indicators for terrorism incidence (89), shareholder governance (81) and homicide rate (80) are some of the negative components within this ranking (World Economic Forum, 2018, pp. 155-156).

In the Human Capital Report (World Economic Forum, 2017, p. 79) Chile ranks 53<sup>rd</sup> out of 130 countries, with a score of 64.22. Compared to other countries in the Latin American and Caribbean region, Chile and Argentina are the two top performers. Peru (66<sup>th</sup>), Colombia (68<sup>th</sup>), Mexico (69<sup>th</sup>) and Brazil (77<sup>th</sup>) are below them in this index. Chile and Argentina share similar strengths and weaknesses across the deployment and know-how sub-indexes, but differ in human capital capacity. In this dimension, Chile is ahead, with higher rates of educational attainment across several age groups. By improving the quality of the education system and reducing youth unemployment and underemployment, Chile could lift its human capital score even higher (World Economic Forum, 2017, p. 13).

In the Corruption Perception Index 2018 (Transparency International 2019), which ranks 180 countries and territories, Chile is ranked 27<sup>th</sup>, with a score of 67/100. In comparison, Austria is ranked 14<sup>th</sup> with a score of 76/100. The country is still one of the least corrupt in the region. In South America, only Uruguay scores higher (Transparency International, 2019).

Chile considers itself a Latin American Hub, having signed more Free Trade Agreements than any other country in the world. Chile has signed FTAs with 64 countries worldwide, joined international agreements and treaties to avoid double taxation with 32 economies and reached special trade tariffs with 86.3% of global GDP. Moreover, in 2010, Chile became the first South American member of the Organisation for Economic Cooperation and Development, being also a member of the World Trade Organization (International Trade Administration, 2018). Chile and the European

Union concluded an Association Agreement in 2002, which includes a comprehensive Free Trade Agreement. This FTA entered into force in February, 2003. Although these agreements have worked well so far, the EU and Chile have already started to work on a modernization of the trade component of the EU-Chile Association Agreement.

### Austrian firms doing business in Chile

In 2015, Austrian companies provided active direct investment in Chile of 130 million € (OeNB, 2019a). The stocks tend to upsurge, but the precise data cannot be analyzed yet. Furthermore, in 2016, more than 3,200 workplaces were created in Chile by Austrian businesses (OeNB, 2019b). Due to stable political and economic conditions, its emerging economy and the existing EU-Chile Association Agreement, Chile is one of the most attractive locations in Latin America for Austrian export-oriented companies. In 2019, there were more than 50 branches of Austrian companies situated in Chile (Chamber of Commerce Austria, 2019, p. 8).

As in previous years, Austria achieved a trade surplus with Chile in 2018 (Chamber of Commerce Austria, 2019, p. 8). Austrian exports to Chile increased by 8.8% in 2018 and reached a record value of 199.2 million €. The export figures to Chile almost tripled between 2008 and 2018. Due to strong export growth in energy drinks (€ 23.1 million; +12.5%), electrical machinery, such as alternators and switchgear (€ 20.6 million; +67.2%), vehicles (€ 19.7 million; +7.5%), blood serums and medicines (€ 18.9 million; +43%) and plastics (€ 11.4 million; +38 %), 2018 was a record year for Austrian exporters in Chile. However, strong declines were recorded in the export figures for machinery (€ 40.5 million; -17.4%). This export product group includes truck crane superstructures, injection molding machines, water filter systems and baking machines (Chamber of Commerce Austria, 2019, p. 7).

According to the Observatory of Economic Complexity (2019b), in 2017 Austria exported a volume of goods worth \$297 million to Chile in the following sectors:

- 29% machines (e.g.: lifting machinery, rubber-working machinery and excavation machinery)
- 22% foodstuffs (e.g.: flavored water)
- 12% chemical products (e.g.: packaged medicaments and human or animal blood)
- 8.5% transportation (specialized vehicles, delivery trucks and motorcycles)
- 7.6% metals
- 4.6% wood products
- 4.4% plastic and rubbers
- 3.4% paper goods
- 3.2% instruments
- 6.3 % others

From 2016 to 2017, export-oriented chemical and paper industries increased the most. In a 5-year period, from 2012-2017, the export figures of sector foodstuffs, transport and textiles have seen the greatest increase (Observatory of Economic Complexity, 2019b).

The field of transport infrastructure offers good business opportunities for Austrian companies. Particularly in the civil engineering sector, Chilean companies have little experience and thus benefit from the expertise of foreign partners. Good business opportunities are also available in the passenger transport sector (e.g., cable car transport) and smart cities. The realization of such long-term projects requires close cooperation. For this reason, a permanent local presence, either in the form of a branch or a trade representative is recommended, minimizing start-up difficulties or acceptance problems that might arise from insufficient information about the local market. Compared to the rest of the world, the costs for a branch in Chile are relatively low (Chamber of Commerce Austria, 2019).

The renewable energy market offers great opportunities in Chile. Numerous business ventures are available for Austrian companies in the field of conversion and construction of power plants, as well as in wind, solar, hydropower and biomass projects (Chamber of Commerce Austria, 2019, p. 8). The use of renewable energy, energy efficiency and green buildings were identified as future fields of knowledge transfer and export of goods from Austrian companies. Business opportunities exist in both the industrial sector ( in the mining and food industry, transport, waste to energy, etc.) and the private sector (residential and house construction, insulating building materials, efficient heating systems, etc.). For Austrian companies, the numerous power plant and electricity transport projects offer many supply opportunities along the entire value chain. In addition to the machinery and plant sector, there are also good opportunities for services exports. Winter tourism is booming in Chile and the potential for development of infrastructure in winter sports areas is therefore very high. However, the quality standard of the lifts and the electronic access systems do not yet meet the European standard (Chamber of Commerce Austria, 2019).

Austria is still a country where it is easier to do business than in Chile. However in Chile, according to the Ease of Doing Business Index, there are few barriers to starting a business, acquiring electricity and trading across the borders and the country is therefore a good base for growing business environment.

## Empirical Analysis

### Methodology

Due to the exploratory objective of this research, interviews seemed to be the best approach. For the empirical research in this paper, the authors decided to apply semi-structured interviews based on an interview guideline, as this allows the interviewer a flexible approach in guiding the interviewee. According to Flick (2018, pp. 236-237), a specific form of applying semi-structured interviews is the expert interview. Here, the capacities and experience of experts in a certain field of activity are of high interest. For expert interviews, staff members of an organization with a specific function, knowledge and experience are typically the focus. For this study, interviews were conducted with experts from various Austrian firms who have knowledge and experience regarding the market entry process to Chile.

Most of the interviews were conducted via telephone or Skype-audio-call. Only one face-to-face interview was conducted. The interviews took place with two experts from the same firm simultaneously. This facilitated the collection of contradictory perspectives of the same event or issue. An interview guideline was developed in which mainly open-ended questions were asked, to ensure that the experts could contribute with their own opinions and experiences. Open interviews give the experts complete freedom about content and the phrasing of the answer. This guarantees that

**Table 1.** Summary of research design

Method	Qualitative, Semi-structured interviews
Structure	Interview guideline (see appendix)
Data acquisition	Telephone, Skype and Personal interviews
Population	Managers of Austrian firms who are doing business in Chile and experienced with their market entry process
Sample size	13 Interview partners + 1 Preliminary interview
Time Frame	14/06/2019 – 16/08/2019
Method for data analysis	Qualitative content analysis by Mayring

Source: Own illustration

the interviewee can reveal everything that is known and relevant about the topic. The guideline was divided into three topic areas (market entry, business environment and other comments) and ten main questions as well as some sub-questions were designed to answer the research questions. In addition, occasionally a few follow-up questions were asked if the situation allowed or required guidance of the interviewer.

According to the Austrian chamber of Commerce ([advantageaustria.org](http://advantageaustria.org), 2019), around 450 Austrian companies are present in the Chilean market. This number cannot be considered completely valid, as the interviewer received responses

**Table 2.** List of interview partners

#	Position	Date	Duration (min)	Year of entry	Entry Mode
Pre.	Delegate of Austrian chamber of commerce in Chile	20/03/2019	46:42	X	X
1	Commercial Director	14/06/2019	23:57	2001	FDI/JV
2	CEO + R&D Mechatronics	10/07/2019	30:33	2012	Export
3	Managing Director	17/07/2019	27:08	2013	FDI
4	CEO/CFO	24/07/2019	33:33	1994	Export/ Sales Rep
5	Sales Administrator	29/07/2019	27:34	1999	Export/ Sales Rep
6	Regional Sales Manager	29/07/2019	41:40	2005	Export/ Distributor
7	CEO	30/07/2019 02/08/2019	26:14	2005	X
8	Senior Technical Sales Manager	31/07/2019	22:32	2015	Export/ Sales Rep
9	Segment Manager	05/08/2019	11:12	~ 1991	Export/ Strategic Partner
10	Partner/ Advisory Board	06/08/2019	29:26	2010	FDI/ Subsidiary
11	CEO	07/08/2019	18:00	2019	Export - Subsidiary
12	General Manager LATAM	07/08/2019	34:07	2010	JV – Export/ Sales Rep
13	Area Sales Manager	16/08/2019	25:07	X	Export

Source: Own illustration

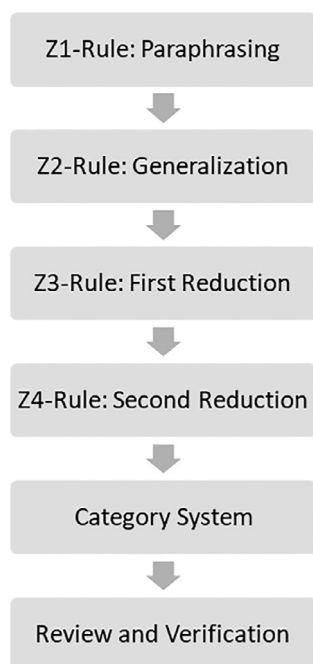
from some Austrian firms on this list who said that they had no activity within the Chilean market. Therefore, no precise number regarding the target population can be given.

However, 57 companies were contacted during this research, and 13 of them were willing to participate. A special emphasis was put on the level of experience of the interviewees. The respondents were usually sales managers or members of the management board, as is illustrated in Table 2. Therefore, they could exhibit a high level of involvement and experience regarding the market entry. The interviewed firms operated in different industries and sectors, ranging from machinery, manufacturing and automotive suppliers to commodity goods. As shown in Table 2, the companies entered the Chilean market between the early 1990s and 2019.

Companies of all sizes are represented in this study. The firm with the smallest number of employees has 30 people. On the other end of the scale, one corporation stands out with 1,600 employees. However, most of the interviewees worked for a typical Austrian small or medium-sized company.

The data sources in this study are the transcripts of the conducted interviews. However, as all experts agreed to record the interviews, the transcription process was eased tremendously. The transcriptions were evaluated using the qualitative content analysis developed by Mayring (2015). Figure 2 illustrates Mayring’s process model of the summarizing content analysis.

Figure 2. Qualitative content analysis after Mayring



Source: Own illustration after Mayring (2015, p. 70)

Table 3. Overview of categories

Categories	Variables
C1*Company features	Size and industry
C2*Motivational factors	Image, level of knowledge, perception before entry
C3*Market entry strategy	Mode, change, factors
C4*Market perception	Business environment, political and legal situation
C5*Challenges	Problems, Disadvantages
C6*Other comments	Other relevant comments

Source: Own illustration

For the purpose of this paper, the categories were derived from both existing literature and the research interest, inductive and deductive (Malhotra, Nunan, & Birks, 2017, p. 161-162; Flick, 2018, p. 483). Considering the literature, the target of research and the interview guideline, six central categories were used to capture the central statements. These categories are presented in Table 3.

After an initial category design, the analysis was revised and adapted after the first interviews, as suggested by Mayring (2015, p. 71). To certify that each paraphrase could be assigned to only one category, the first category design was rejected and reduced to the described six categories. Within these categories, the statements of the interview partners were assorted, due to their content.

## Discussion

### Motivational aspects for entering the Chilean market

The underlying motivational aspects for Austrian companies to enter Chilean market are manifold. While some firms entered the market without prior market research, relying on identification of potentials, other companies chose Chile because of cultural aspects. If markets in South America are perceived as probable locations for the future, the most suitable market for the initial entry is Chile.

Even though the interviewed firms represented several industries, a significant motivational aspect for all of them was the very high demand in the industries and specific product segments. This holds true even if a particular market was seen as rather limited in size. However, the market demand was perceived as high enough, especially because of the quest for higher technology and high-quality products and services. The stability of a market that is

perceived to be easily served, combined with great potential, are other motivational factors in selecting the Chilean market for entry. For those firms establishing a subsidiary in Chile, the local conditions in this South American country favored investment decisions. Furthermore, both countries, Chile and Austria (or the European Union, arranged some attractive trade agreements because of cost saving. The Chilean business environment provides a stable currency, good morale among both customers and suppliers, legal certainty, good human capital and adequate infrastructure. Furthermore, the Chileans are willing to pay for the offered high quality and service.

An additional motivational aspect derives from the fact that German emigrants have often preserved German business culture and therefore minimized the culture shock for Austrian firms. The open market provides various similarities to Europe. Nevertheless, some negative aspects that must be considered before the market entry decision was made include the relatively small market, the high competition in some industries, the high dependence on copper and the rather disadvantageous geographical location.

### **Market entry strategies**

The most common entry mode for Austrian companies to Chile is exporting. Sales representatives or distributors are local partners who take over sales and after-market service. As this mode is characterized by minimal risk and requires only limited resource commitment, it is preferred over other entry modes, because of an internal company-specific situation in terms of low monetary and personnel resources. The Chilean partner plays a very significant role in this mode, as he supports business success by market knowledge. Local presence in the distant market and proximity to the customers is necessary in Chile. With low resource commitment, this is only sustainable with a well-qualified and trustworthy partner who can provide prompt after-market service. Problems stemming from large distance and specific legal requirements are therefore minimized by the partner. This mode is primarily preferred, as direct entry into distant markets can be complicated.

Firms choose to enter the market via Joint Venture (JV), because of risk sharing and the already existent market knowledge of a partner. In contrast to exporting, this mode indicates a higher growth potential. As exporting is simply not doable in various industries, an investment and therefore local presence is greatly preferred. However, establishment of a joint venture also includes challenges. In one instance, the collaboration in the form of a JV with a partner had to be cancelled after some successful years for internal reasons. Latin America can be principally divided

in two different trade blocks. Chile is therefore included in the Pacific Alliance, and may be used as a hub for a great part of Latin America. The Mercosur countries constitute another homogeneous unit.

A strategic partner is mainly chosen because social and cultural issues, such as language barriers are minimized by a partner providing market knowledge. Even this mode is less profitable than a wholly-owned subsidiary, but a strategic partner may serve as a link to the country and end users. Relevant factors for choosing this strategy are the market size and cultural differences of the country.

The main influencing factors for the establishment of a wholly-owned subsidiary are: a distant market requires local production, transport would be too costly, personnel transfer is not sufficient, proximity to the market is necessary, security of prior investments and tax incentives. With a local subsidiary, communication is faster and more efficient. Due to investment favoring factors, such as a low level of corruption, high ranking in international statistics and a functioning legal and contractual system, a subsidiary in Chile can also serve as a hub for neighboring countries.

### **Market perception**

As all respondents said that the Chilean business environment is perceived as positive. the following comments should be mentioned. Aspects leading to the positive perception are low inflation, stable economy, low barriers, stable currency, positive economic development, little competition and the fact that a good product is easy to sell and the global price can be reached. Austrian products are very popular in Chile. The label “Made-in-Austria” is a huge benefit and is used by Austrian firms. Lastly, also the environment of interest rates, financing and tax issues is very reasonable.

Some negative aspects were also mentioned. Government administration is rather slow, competition is fierce, pricing is hard to enforce, the openness of the market demands competitiveness and the size of the country/ market is rather small. The dependency on copper is also perceived as negative.

The market demand is perceived as generally high. This proves is true especially for environmentally-friendly produced energy or specific niche products. There is great demand for high-quality products and high-tech solutions. However, the demand is stagnating in some industries, and in others it is at least extremely volatile. The local production costs are high, mainly because of the inefficiency of the Chilean workforce.

The cultural differences between Austria and Chile should be considered, but are not perceived as insuperable. The interviewees stated that the differences have moderate effects on the operative business as they might be interpreted by the partner. Another tactic to minimize the effect is an intern native speaker who can create a link to Chilean culture. Cultural characteristics are generally relaxed, but in business involves high expectations and long detours before decision-making. Because of the European background of many Chileans due to German emigrants and the influence of the United States of America, the differences are not dramatic.

Chile seems to provide all necessary institutions for a functioning market. Institutional voids are acknowledged as not evident, as services like consultants are available. One interviewee, however, stated that Chile provides a rather small start-up market. Nevertheless, all probable upcoming voids could be overcome by the partner.

Regarding the infrastructure, the respondents agree that especially around the capital, Santiago de Chile, very good conditions prevail. However, challenging differences exist between urban and rural areas. Some respondents even benefited from current infrastructure projects. Important factors are the expensive transport within the country and slow communication. Travelling any distance in Chile is generally done by plane, as the country is extremely long.

Human capital is predominantly good. The labor force is well-educated but somewhat expensive. It is very hard, and expensive to recruit people with English language skills. A recommendation is to recruit personnel from other Latin American countries. A problem is the so-called gold digger mentality, where workers only stay in the company for a short-term engagement and leave it as soon as another, more lucrative, job offer occurs.

The reasons why the political and legal situation are considered stable are the low level of corruption and bribery, an emphasis on environmental requirements and legal strictness. The Free Trade Agreement and Double Tax Agreement are beneficial for the globally-operating firms. The negative aspects in this respect are that a drastic change after a political election might affect business adversely. Lastly, legal permits sometimes take very long and occasionally a certain arbitrariness characterizes the Chilean legal environment.

### Challenges in Chile

Language barriers obviously occur, because the official language in Chile is Spanish. This barrier often leads to

misunderstandings, but could also be partly ameliorated by the partner.

The distance, of course, is an issue as Chile is located around 12,000 kilometers from Austria. Detailed planning is needed, logistics are complex, transportation is costly and time-intensive, personnel costs for transfer are high and a return shipment of goods is expensive. The market demands local presence, which can pose a problem. Time represents a challenge, as things in Chile usually take longer. On the one hand, the decision-making in a firm is slow, but on the other hand, consumers demand very fast service.

The recruitment of personnel for other industries, apart from mining, is hard and costly. Apart from this, a worker typically stays for a shorter period if a more lucrative offer arises.

Another notable challenge is the high complexity deriving from internationalization. When entering Chile, support by consultants and law firms is important and helpful. The prosecution of rights can be costly, there is less legal certainty than in Austria, the contract design must be known, and the right balance of price and quality represent other challenges. Identification of a good local partner can be difficult, but the offer of service is crucial, as problems in technical sales are frequent. Good will to solve the problem with a customer is central.

The solution to reduce the described challenges is executed market research beforehand, assistance by a partner and a simple dialogue.

### Implications

Most companies stated that the decision to enter Chile was the right one, even though the market is smaller than others in South America. The market became the most important and best functioning market in Latin America. Various business opportunities are existent, even in some industries where the best locational spots are already covered. The market holds great potential. The flight connection between Austria and Chile is very good. Firms consider opening a subsidiary in Chile, but also state that a certain volume of sales should be reached before making this step. Prior to the market entry, it is advisable to conduct market analysis in order to comprehend the unique characteristics of the country. Furthermore, quality and service are central, competent representatives must be found, personal and friendly business contact is a key to success, and Chileans should be placed in upper management. One company mentioned that they are leaving the market currently as its specific industry had become less attractive.

## Conclusion

According to the literature review, the Chilean market seems to be an attractive opportunity for Austrian firms, as it performs quite well in international business environment rankings. Nevertheless, the persistence of institutional voids and cross-cultural differences must be considered carefully. Chile is the most competitive country in Latin America. The macroeconomic stability, numerous trade agreements and the growth perspective are the main benefits of the business location. Furthermore, the country's foreign investment policy and the favorable business climate ensure a positive business environment for foreign investors. The institutional conditions for interaction between buyers and sellers are very good in Chile.

Even though the infrastructure in Chile is already one of the best in South America, the roads and highways must be improved in order to cope with the constantly growing traffic volume of the transport of goods. Austrian companies can benefit with knowledge transfer and export products, – for example, in the field of civil engineering and passenger transport systems. Renewable energy, energy efficiency and green buildings were identified as a future market with strong business opportunities for Austrian companies.

Regarding the cultural differences between Austria and Chile, a comparison based on Hofstede's cultural dimensions shows that Chile mainly differs in the dimensions of power distance and masculinity. In this context, one needs to understand that Chileans do not like top-down communication but rather value equality, solidarity and quality in their working lives. In general, among all other Latin American countries, Chile's cultural aspects are the most similar to Austria.

Austrian firms entered the Chilean market for a variety of reasons. Besides the direct approach of an international company to enter the market jointly with a partner, no active approach, such as a planned opportunity or following competitors led to entry. Likewise, the unattractive development in the home market was motivating to conduct a market entry into Chile. While some firms entered the market without prior market research, but just by identification of potential, other companies chose Chile because its cultural aspects are relatively comparable to Austria. Additionally, several positive locational factors, like the stability of the market and the attractive trade agreements, played a significant role in the market choice. Because of the professional business environment, the country is also utilized as a hub for neighboring countries.

The Austrian companies, mainly SME's with a critical size and limited monetary and personnel resources, prefer to enter Chilean market by exporting through a local sales representative. Others chose a joint venture as the entry mode, due to shared risk, higher growth, market knowledge by the partner, and positive locational factors. If a wholly-owned subsidiary was established in Chile, it was mainly because a distant market requires local production and transport would be too costly, personnel transfer is not enough, proximity to the market is necessary, security of prior investments must be maintained, the chance to build a hub for other countries is possible, and tax incentives are plentiful. Locational factors like the low level of corruption, good ranking in international statistics and a functioning legal and contractual system also favor the investment decision.

Generally, Austrian companies perceive the Chilean business environment as positive. The stable economy with little inflation, low barriers to business, stable currency, positive economic development, low corruption and a political and legal system which does not affect business exert a positive influence on the perception of Austrian firms. Furthermore, market demand is high, infrastructure is good, institutional voids are not problematic and human capital is good, but costly. The cultural differences between the two countries are not insuperable, but have to be considered. Specific problems in Chile deal with matters of language, distance, time, culture, recruitment, complexity, the local partner and the indigenous population.

In conclusion, if markets in South America are perceived as probable locations for the future, according to the Austrian companies, the most suitable market for the initial entry is Chile. Although the market is smaller than others in South America, the decision to enter Chile was the right one, as the market became the most important and best-functioning market in Latin America for many Austrian firms. Despite some minor challenges, an increase of turnover and even investment is expected as the development is very positive. Indeed, the Chilean market offers great opportunities, as the appreciation for Austrian products is very high. Chile can be regarded as a well-developed emerging market and therefore represents a very attractive business location in South America.

## Limitations

Only a fraction of the target population was considered in the analysis. It should be mentioned that other companies, and therefore other interview partners, might have different ideas and experiences regarding their market entry process to Chile and perception of its business environment. A reduction of the sample based on the size of companies could have been beneficial, as the structure and decision-making processes of firms differ very much. Probably MNEs vary

greatly from SMEs in their market entry process, as well as in their perceptions of the business environment.

Moreover, qualitative research is often subjective. In the content analysis, the paraphrases of the interviews were selected instinctively and then the generalization and reduction steps were likewise applied to some extent subjectively. Furthermore, the interviews were conducted in a rather short time frame and can only represent a snapshot of the opinions. Thus, the results could change, when conducting the same research at another time.

## Future outlook

For future research, this paper could be used as a basis for quantitative research, analyzing a bigger sample, whereas a focus could be put on a specific industry. Furthermore, the approach could be extended to other Latin American countries. It would be interesting to find out the similarities or differences in results when conducting similar research with the Brazilian or Colombian market for example. Likewise, further research may also focus on a specific market entry strategy, such as exporting or FDI.

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## Obeti in izzivi vstopa na trg za avstrijska podjetja na nastajajočem trgu – primer Čila

### Izvleček

V primerjavi z več drugimi južnoameriškimi državami je Čile geografsko in demografsko precej omejen, vendar je kljub temu drugi najpomembnejši trgovinski in naložbeni partner Avstrije v tej regiji. Namen tega prispevka je iz prve roke pridobiti vpogled v razloge in zaznave o vstopu avstrijskih podjetij na čilski trg. Uporabljen je bil raziskovalni pristop. Opravljenih je bilo trinajst razgovorov z usposobljenimi in izkušenimi osebami, vsebina razgovorov pa je bila kvalitativno analizirana po Mayringu. Čilski trg se zdi privlačna priložnost za avstrijska podjetja, saj se precej dobro uvršča na lestvicah mednarodnega poslovnega okolja. Rezultati prikazujejo številne vidike, ki spodbujajo k vstopu na trg, pa tudi različne odločitve o načinu vstopa, ki temeljijo na mnogih dejavnikih, skupaj s prevladujočim pozitivnim zaznavanjem čilskega poslovnega okolja. Pridobljeni podatki odražajo trenutno poslovno okolje. Več rezultatov verjetno tudi ni mogoče posplošiti za celotno državo, saj je glavno mesto poslovno središče, druge regije Čila pa bi lahko dale različne rezultate. Izzivi so bili opredeljeni z vidika jezika, oddaljenosti, časa, kulture, kadrovanja, kompleksnosti, lokalnih partnerjev in avtohtonega prebivalstva. Čile bi morali dojemati kot zelo razvit trg v nastajanju, kjer je poslovanje dokaj enostavno. Zato država predstavlja zelo privlačno lokacijo v Južni Ameriki z velikim potencialom za avstrijska podjetja.

**Ključne besede:** vstop na trg, internacionalizacija, način vstopa, poslovno okolje v Čilu, nastajajoči trgi

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REVIEW PAPER

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RECEIVED: OCTOBER 2019

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REVISED: FEBRUARY 2020

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ACCEPTED: FEBRUARY 2020

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DOI: 10.2478/ngoe-2020-0012

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UDK: 37.014.54:657.471:005.336.1

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JEL: H750, I210, I220

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**Citation:** Štrangfeldová, J., & Štefanišinová, N. (2020). Value for Money in Organizations Providing Public Education Services and How to Measure It. *Naše gospodarstvo/Our Economy*, 66(2), 62–70. DOI: 10.2478/ngoe-2020-0012

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NAŠE GOSPODARSTVO  
OUR ECONOMY

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Vol. 66 | No. 2 | 2020

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pp. 62–70

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# Value for Money in Organizations Providing Public Education Services and How to Measure It

**Jana Štrangfeldová**

Matej Bel University in Banská Bystrica, Faculty of Economics, Slovakia  
jana.strangfeldova@umb.sk

**Nikola Štefanišinová**

Matej Bel University in Banská Bystrica, Faculty of Economics, Slovakia  
nikola.stefanisinova@umb.sk

## Abstract

The public has put increased pressure on organizations providing public services to demonstrate the most productive use of resources, with due regard for value received. Education is no exception. This study focus on the presentation and evaluation of public organizations (public grammar schools in our case) in education on the basis of their economy, efficiency and effectiveness as one of the indicators of performance assessment. The methodology of Value For Money presented in this study can provide useful information about the situation of education for public forces and for public grammar schools themselves. Also, this methodology may help to gain a deeper insight into strengths of individual schools, as well as in which they can improve. A limitation of the concept of VFM is that performance evaluation is possible only between homogeneous services. The originality and value of the study are reflected in its focus on such topics as monitoring and measuring of performance for public service organizations (i.e., education services ). It also provides a tool for districts and individual schools to gain information using indicators employed here for identifying and solving the performance problems that occur in education system of Slovakia.

**Keywords:** performance, value for money, economy, efficiency, effectiveness, organizations providing public services, education

## Introduction

Efficiency and performance are central at all levels of corporations (Šebo & Vaceková, 2011). Performance management is the process through which an organization guides its performance according to defined organizational and functional strategies and goals. The goal is to create an integrated management system in which these strategies are involved in all processes in the organization, its activities and tasks. The ultimate goal of the process is to increase the performance of the organization. Feedback is obtained through a performance-measurement system that can provide the information needed for management decision-making (Bititci, Carrie & McDevitt, 1997). Performance management takes advantage of the synergistic effect of system components in the organizations that fulfill their partial functions and goals aligned to one common goal (Kaplan

& Norton, 2001). Based on the research of several scholars (e. g., Armstrong & Baron, 2004; Dransfield, 2000; Gillen, 2007; Neely & Austin, 2002; Varma, Budhwar-Pawan & Denisi, 2008; West & Blackmann, 2015), we can say that strategic performance, integrity and systematicity are important features of performance management. Performance management is not just a philosophy but has a clear goal and tools to achieve it. Therefore it is necessary to examine performance management from a comprehensive perspective.

Performance and quality are also frequently-discussed topics in the public sector, not only because of public budget deficits, but also because of increased interest in the quality of services provided by public sector organizations. Applying the business sector principles of performance management to measure the performance of public expenditures at the micro level has been addressed by scientists and researchers, as well as those organizations providing public services (e. g., Boyne, 2002; Brignal & Modell, 2000; Cavalluzzo & Ittner, 2004; Coombes & Verheijen, 1997; Emery, Wyser, Martin, & Sanchez, 2008; Gray & Jenkins, 1995; Hood, 1991; Osborne & Gaebler, 1992; Pollitt, 2006; Propper & Wilson, 2003; Radnor & McGuire, 2004; Smith, 1993; West & Blackmann, 2015). Constant pressure from the public forces these organizations to monitor and improve the provision of public services in order to achieve long-term existential security. These facts consequently require a comprehensive measurement of their performance.

However, it is necessary to have the relevant amount of information. Disposing of qualified information is, in addition to knowing what needs to be measured, and what kind of data is important in making decisions can be difficult, even with measuring methods.

The study focus on the presentation of methodology of Value For Money for measurement and evaluation of public grammar schools on the basis of their economy, efficiency and effectiveness. The research tasks are focused on answering 2 research questions:

- (1) How can the Value For Money concept be used to measure performance for organizations providing public education services?
- (2) What performance indicators can be used to measure performance for organizations providing public education services?

We will answer the first research question by suggestion our own methodology, based on the underlying concept of VFM. The second research question will be answered by compiling suitable indicators based on the underlying concept of VFM in cooperation with the education department of the Banská Bystrica self-governing region.

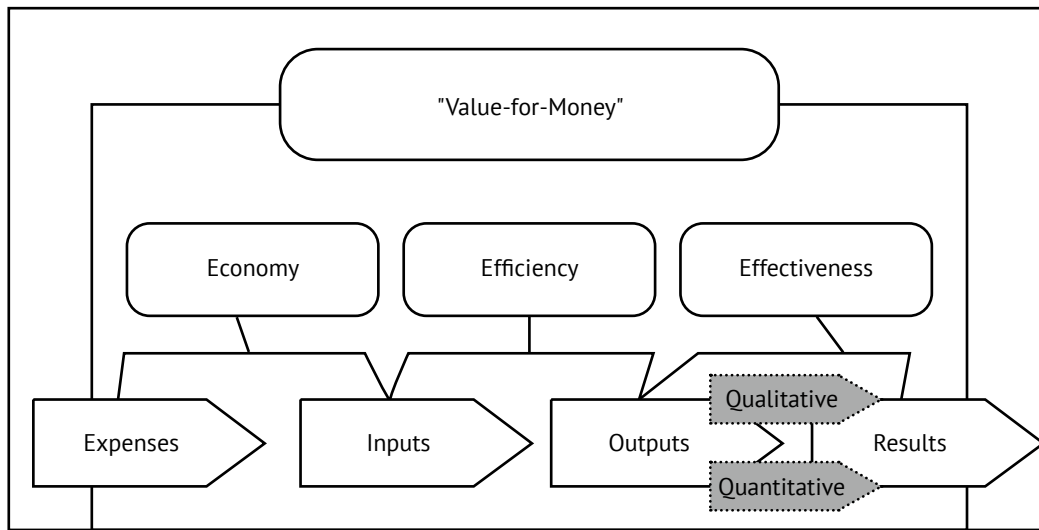
## **The Concept of Value For Money and Performance Parameters of Public Services**

Performance measurement is the implementation of procedures used to demonstrate the economy, efficiency and effectiveness of an organization in its pursuit of objectives. The principles of the concept of Value For Money (VFM) (Smith, 2009) have been implemented through the efforts of different countries. Based on the work of Barnett, Barr, Christie, Duff & Hext (2010), using the concept of VFM can ensure greater transparency and accountability when spending public funds. The very term of VFM is generally used to describe the explicit commitment to ensure the best possible results obtained from spending (Department for International development [DFID], 2011).

Achieving VFM has become synonymous with the optimal combination of organization costs and quality assurance to meet the needs of clients. VFM is used to assess whether the organization receives the maximum benefit from the services provided. This is not just about cost; a combination of quality, cost, resource use, the suitability of the equipment, as well as their topicality, must be taken into account. Studies about VFM show that this approach can be used in various public services, including education (e. g., Amaratunga & Baldry, 2000; Bradley & Durbin, 2013; Coates, 2009; Dolton, Marcenaro Gutiérrez & Still, 2014; Garnett, Roos & Pike, 2008; Mante & O'Brien, 2002), healthcare (e. g., Ariste & Di Matteo, 2017; Hollander, Kadlec, Hamdi & Tessaro, 2009; Leigh-Hunt et al., 2018; Lorenzoni et al., 2018; Mawani, 2011; McGrail, Zierler & Ip, 2009; Severens, 2003; Smith, 2009; Tuffaha et al., 2019; Young, Chatwood & Marchildon, 2016) and many others.

The central element of VFM in public sector organizations is the principle of the best use of public funds. Public sector managers are required to demonstrate the most productive use of resources, i.e., money, goods and people, to achieve the desired results, with due regard of value for money (Kalubanga & Kakwezi, 2013). Different authors interpret the terms performance, economy, efficiency and effectiveness in various ways. This conceptual mismatch was subsequently transferred to the use of methodology and evaluation methods. Those authors centered on performance management (e. g., Armstrong & Baron, 2004; Armstrong, 2015; Bacal, 1999; Ingram & McDonnell, 1996; Ittner & Larcker, 2003; Johnston & Pongatichat, 2008; Kaplan & Norton, 1996; Kaplan & Norton, 2000; Kuwaiti, 2004; Neely & Austin, 2002; Stevers & Joyce, 2000; Wouters & Sportel, 2005), are focused on creating relevant, integrated, balanced and strategic performance management systems. Over the last three decades, a variety of systems has been developed to ensure balanced growth of an organization, but there is still no uniform way to clearly measure performance.

Figure 1. The concept of value for money



Source: Mikušová Meričková, Šebo & Štrangfeldová, 2011.

However, several authors suggest that it is necessary in identifying goals and measuring whether they are achieved, that organizations reduce ambiguity and confusion about objectives and gain coherence and focus in pursuit of their mission (Verbeeten, 2008).

The concept of VFM is a broadly conceived methodology able to express wholly the value of not only the organization but also the programme, project or the widest public expenditure programme.

Similarly, we can say that while an activity, projector program can be very cheap and work efficiently, if it does not reach the expected results it does not represent value for money (Jackson, 2012). Figure 1 illustrates the relationship between economy, efficiency and effectiveness. Economy is related to procurement, efficiency with efficient delivery of outputs and effectiveness with achievement of intended results. This definition contains both a quantitative and a qualitative aspect.

The underlying concept of VFM used in our study is originated in the USA and is based on an analysis of three key performance indicators, the so-called "3E" (Nemec & Wright, 1997): economy – achieving the stated objectives at minimum cost, efficiency – the pursuit of the best possible relationship between inputs and outputs and effectiveness – the degree of success in achieving the objectives set, the merits of the objectives set, such as using funds for their intended purpose. The approach used for overall assessment of VFM is benchmarking (peer comparison) of the individual areas (economy, efficiency, effectiveness) of the

providers of public services. Mathematical representation of the overall economy, efficiency and effectiveness features has the following formula (Šebo & Vaceková, 2011):

$$H_{ij} = \prod_{z=1}^n h_{ij}^z \tag{1}$$

$$E_{ij} = \prod_{z=1}^n e_{ij}^z$$

$$U_{ij} = \prod_{z=1}^n u_{ij}^z$$

where:

- $H_{ij}$  - overall economy indicator for organization  $i$  in year  $j$ ,
- $h_{ij}^z$  - partial economy indicator for organization  $i$  in year  $j$ ,
- $E_{ij}$  - overall efficiency indicator for organization  $i$  in year  $j$ ,
- $e_{ij}^z$  - partial efficiency indicator for organization  $i$  in year  $j$ ,
- $U_{ij}$  - overall effectiveness indicator for organization  $i$  in year  $j$ ,
- $u_{ij}^z$  - partial effectiveness indicator for organization  $i$  in year  $j$ .

When testing performance in the area of economy, efficiency and effectiveness, standardized values of partial indicators are used. Accepting the multiplier effect of three areas can be expressed as an overall indicator of VFM. The subsequent overall value of the indicator VFM has the formula (Šebo & Vaceková, 2011):

$$VFM_{ij} = \frac{1}{\log \left( \frac{1}{H_{ij}E_{ij}U_{ij}} \right)} \tag{2}$$

A disadvantage of the concept of VFM is that performance evaluation is possible only between homogeneous services.

## Research Methodology

The study used secondary information from scientific papers as well as literature related to performance management for the suggestion of methodology of Value For Money for organizations providing public education services. Also, the study used the underlying concept of VFM, which is based on an analysis of three key performance indicators, "3E" – economy, efficiency and effectiveness. This approach used for overall assessment of VFM is benchmarking (peer comparison) of the individual areas (economy, efficiency, effectiveness) of the providers of public services.

However, the use of VFM is possible only between homogeneous services. For this reason, we have chosen particular public grammar schools from all schools in our study and adapted the possible performance indicators to the nature of these institutions.

The primary information used in the suggestion of performance indicators for organizations providing public education services was based on cooperation with the education department of the Banská Bystrica self-governing region.

Through this information, we suggest the methodology of Value For Money, which is potentially suitable for organizations providing public education services. Also, we suggest the possible performance indicators, which will be suitable for organizations providing public education services.

## Discussion

### The suggestion of methodology of value for money in organizations providing public education services

Due to the need for the assessment of several criteria, the heterogeneous nature values of the indicators examined and the necessity for expression of the integral indicator, we decided to use the standardized variable method. Its advantage is that it respects the relative variability of individual indicators, and the results obtained through the application of this method are less sensitive to extreme values of the parameters in the sample.

The essence of the standard variable method is a transformation of various parametric values for comparable shape, i.e., a standard variable which is a dimensionless number. Application of this method consists of the initial arithmetical average ( $\bar{x}_j$ ) and standard deviations ( $s_{xj}$ ) for individual indicators and the subsequent transformation of the original values of variables ( $x_{ij}$ ) on a standardized form

( $z_{ij}$ ), while in the event that the indicator has a maximizable character we use the illustrated relationship (Stankovičová & Vojtková, 2007):

$$z_{ij} = \frac{x_{ij} - \bar{x}_j}{s_{xj}} \quad (3)$$

If the indicator has a minimizable character, we use the illustrated correlation:

$$z_{ij} = \frac{\bar{x}_j - x_{ij}}{s_{xj}} \quad (4)$$

A significant problem that can develop during implementation of VFM assessment is incomplete and partially unavailable data. The problem can be solved by filling in the gaps of data with the worst value, i. e., if the variable is missing, make up the worst value from a given set of data transmitted for the indicator in a given year. The assigned value was either the minimum or maximum value, depending on the nature of the indicator. In order to allow construction of a model evaluating the quality of public grammar schools, the aforementioned data adjustment to so-called normalized data was necessary, even though it could possibly lead to disparagement of the schools that did not supply the necessary data. The relevant element can be removed only by supplementing the required data. However, the relevant element should at the same time act as an incentive for individual public grammar schools. In accordance with the principle of the method of standard variables, those relationships for the maximisation and minimisation of the character of indicators were applied to the so-called standardized data (i.e., the modified data using the worst value).

To eliminate subjective determination of weighting, multi-criteria evaluation in the study was supplemented by the analysis of the interrelationships between indicators. For individual partial indicators of economy, efficiency and effectiveness there is defined weighting, using correlation relations between individual partial indicators in all three monitored areas: economy, efficiency and effectiveness. Weighting defined by analysing the structure of the correlation matrix was determined according to the equation (Stankovičová & Vojtková, 2007):

$$v_j = \frac{|\sum_{i=1}^k r_{ij}|}{\sum_{j=1}^k |\sum_{i=1}^k r_{ij}|} \quad (5)$$

for  $j = 1, 2, \dots, k$ ,

where  $r_{ij}$  = pair (Pearson) correlation coefficient for each individual indicator.

The subsequent characteristic, i.e., integral indicator ( $d_{ii}$ ) we calculated as the weighted arithmetical average standard value according to the equation (Stankovičová & Vojtková, 2007):

$$d_{ii} = \frac{1}{k} \sum_{j=1}^k z_{ij} * v_j \quad (6)$$

where  $i = 1, 2, \dots, n$ ;  $v_j$  = weighting  $j$ -th indicator.

Achieving a good placement of the evaluated object depends on good results in all the researched variables; it is not sufficient to achieve an excellent result in only one or a small number of variables (the higher the value, the better the evaluation) (Stankovičová & Vojtková, 2007).

The evaluation of the performance of the public grammar schools was realized by evaluation of three areas, namely economy, efficiency and effectiveness. Each of the three mentioned areas was represented by selected partial indicators, while accepting the character of the relevant area. Indicators for these three areas of the concept of VFM in the school system were divided into groups according to those fields of activity of the organizations concerned. For all three areas, we cannot neglect the defined objectives of the organization achieved, meeting the needs of consumers of public services (quality of service) and compliance with financial policies and relevant laws.

### The suggestion of performance indicators for organizations providing public education services

As we mentioned, if we want to establish performance indicators of organizations providing public education services, we must comprehensively inspect the process from the perspective of an organization that has its personnel, material-technical, economic and pedagogical content. For this reason, we cooperated with the education department of the Banská Bystrica self-governing region and proposed the following indicators.

For the personnel area of an organization, we can establish indicators such as the length of teaching experience, length of professional experience, length of the head teacher's experience, the average age of the teaching staff, the average number of pupils per teacher, the average number of pupils per class, the number of courses for teachers, and so on.

Indicators for the material-technical area of an organization may be presented as availability of textbooks, teaching aids, information and communication technologies, the number of classical classrooms, the number of specialized classrooms, the share of the school's own funds, the share of external funds, the number of equity investments in tangible and intangible assets of the school, and so on.

For the economic area of the organization, we can determine the type of indicators of total staff costs, total cost per pupil, total cost per class, total cost of maintenance of buildings belonging to the school complex, and so on.

In the pedagogical field, indicators such as attendance, number of observed lessons, the average number of pupils in hobby groups, the ratio of pupil intake to those enrolled in secondary schools, entrance exam success to universities, number of complaints per teacher, number of provided consultations per teacher, number of specialized classes for gifted children, average results per pupil in school leaving examinations, average grade of the school report in the third year of study, number of awards per student, graduate unemployment, and so on, can be defined.

Based on this, we divided the indicators from the personnel area, the material-technical area, the economic area and the pedagogical area into three areas – economy, efficiency and effectiveness (Table 1). The assignment of indicators from the personnel, material-technical, economic and pedagogical

**Table 1.** Performance indicators in education

<b>Economy</b>
– share of the school's own funds
– share of external funds
– number of equity investments in tangible and intangible – assets of the school
– total staff costs
– total cost per pupil
– total cost per class
– total cost of maintenance of buildings belonging to the – school complex
<b>Efficiency</b>
– length of teaching experience
– length of professional experience
– length of the head teacher's experience
– average age of the teaching staff
– average number of pupils per teacher
– average number of pupils per class
– number of courses for teachers
– availability of textbooks
– teaching aids
– information and communication technologies
<b>Effectiveness</b>
– the average number of pupils in hobby groups
– ratio of pupil intake to those enrolled in secondary schools
– entrance exam success to universities
– number of complaints per teacher
– number of provided consultations per teacher
– number of specialized classes for gifted children
– average results per pupil in school leaving examinations
– attendance
– number of observed lessons
– average grade of the school report in the third year of study
– number of awards per student
– graduate unemployment

Source: Author's work

areas into three areas (economy, efficiency and effectiveness) was realized based on the character of the given indicator and logical link to the area of economy, efficiency and effectiveness.

In terms of economy, the organization seeks to achieve the set objectives at minimum cost (cost, time, effort). In terms of efficiency, the organization follows the relationship between inputs and outputs, i.e., the efforts of the organization to achieve the best possible relationship between inputs and outputs. Effectiveness for the organization is monitoring the degree of success in achieving its objectives (University of Cambridge, 2010). Whereas the fields of economy, efficiency and effectiveness are interrelated, linking all three of the defined areas, the organization should seek to achieve a kind of optimum whereby the overall performance evaluation achieves the best possible success.

Of course, even for the concept of VFM, there are differences in measurement methodology and value for money, varying in different dimensions, such as ability to measure results, impacts, ability to measure value for money across sectors, projects, countries and organizations, the ability to include beneficiaries and other stakeholders in the measurement process and, of course, the cost of implementing each technique.

## Conclusion

The study focused on the presentation and the possible suggestion of methodology of Value For Money for measurement and evaluation of public organizations (public grammar schools in our case) in education on the basis of their economy, efficiency and effectiveness as one of the indicators of performance assessment. The essence of the research and methodology was based on performance management. The presented study answered two research questions:

- (1) How can the Value For Money concept be used to measure performance for organizations providing public education services?
- (2) What performance indicators can be used to measure performance for organizations providing public education services?

We answered the first research question by suggestion our own methodology for measuring the performance of organizations providing public education services, based on the underlying concept of VFM. The selection of VFM to measure the performance in education shows possibilities to measure, evaluate, monitor and obtain relevant information about the situation of education and subsequent

decision-making, not only for public forces. Also, it can be a suitable tool for public grammar schools themselves. Individual schools can monitor their situation and gain a deeper insight into their strengths as well as areas where they can improve. The advantage of this methodology is the ability to supplement and modify indicators according to the nature of the particular type of school (primary schools, grammar schools, etc.) or other public service organizations. The limitation of the concept of VFM is that evaluation is possible only between homogeneous services.

The second research question we answered by compiling suitable indicators in cooperation with the education department of the Banská Bystrica self-governing region. For establishing performance indicators, we had to comprehensively inspect the process from the perspective of an organization that has its personnel, material-technical, economic and pedagogical content. Based on this, we suggested the indicators for the personnel area, the material-technical area, the economic area and the pedagogical area. Then we divided the indicators from the personnel area, the material-technical area, the economic area and the pedagogical area into three areas – economy, efficiency and effectiveness in accordance with the concept of VFM. The assignment of indicators from the personnel, material-technical, economic and pedagogical areas into three areas (economy, efficiency and effectiveness) was realized based on the character of the given indicator and logical link to the area of economy, efficiency and effectiveness.

Practically, this research contributes to the body of knowledge by suggesting a framework to monitor and measure of performance for organizations providing public services (education services in our case) and by providing a tool for the self-governing regions and individual schools to gain adequate information for identifying and solving the performance problems that occur in Slovakia's education system.

The presentation of the suggestion of methodology of VFM in this study is the part of research which is realized by Faculty of Economics at Matej Bel University in Banská Bystrica (since 2014) and also the subject of the pilot project aiming at the creation of the measurement and evaluation system of performance in regional education with cooperation of self-governing regions of Slovakia. We are strongly aware that the research needs substantial development and adaptation to the needs of practice. For this reason, the authors are constantly working on this research and are currently verifying the relevance of the proposed indicators in a study with education professionals and school leaders from other self-governing regions. Further development of the present study could lead to software processing and the use of neural networks, in case of refilling other adequate indicators from education

professionals and school leaders. Potential use of neural networks in the future may provide further relevant information on the future development of public grammar schools. Within public policies it could be helpful in the rationalization process of the number of schools needed at the regional level.

### Acknowledgement

This study was supported by project VEGA No. 1/0334/19, "Evaluating the performance of regional education by the value-for-money method, using the example of grammar schools".

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## Stroškovna učinkovitost v organizacijah, ki zagotavljajo storitve javnega izobraževanja – kako jo meriti?

### Izvleček

Organizacije, ki zagotavljajo javne storitve, so pod večjim pritiskom, da prikažejo najbolj produktivno uporabo virov za doseganje zelenih rezultatov – ob ustreznem upoštevanju stroškovne učinkovitosti –, pri čemer pa tega pritiska nanje ne vršijo samo javni organi, temveč tudi državljani. Izobraževanje ni izjema. Študija se osredotoča na predstavitev in možni predlog metodologije stroškovne učinkovitosti kot enega od kazalnikov ocene uspešnosti za merjenje in vrednotenje javnih organizacij v izobraževanju (v naših primerih javnih gimnazij) na podlagi njihove ekonomičnosti, učinkovitosti in uspešnosti. Predlog metodologije stroškovne učinkovitosti, predstavljen v tej študiji, lahko zagotovi ustrezne informacije o stanju izobraževanja za javne akterje in javne gimnazije same. Ta metodologija je lahko primerno orodje tudi za globlji vpogled v prednosti posameznih šol in področja, ki bi jih lahko šole izboljšale. Vendar je koncept stroškovne učinkovitosti, ker je ocenjevanje uspešnosti mogoče le med homogenimi storitvami. Izvirnost in vrednost študije se odražata v obravnavi tematik, kot sta spremljanje in merjenje uspešnosti organizacij, ki zagotavljajo javne storitve (v našem primeru izobraževalne storitve), in zagotavljanju orodja za samoupravne regije in posamezne šole, da pridobijo ustrezne informacije po vrstah izbranih kazalnikov za prepoznavanje in reševanje težav glede uspešnosti, ki se pojavljajo v izobraževalnem sistemu Slovaške.

**Ključne besede:** uspešnost, stroškovna učinkovitost, gospodarnost, učinkovitost, organizacije, ki zagotavljajo javne storitve, izobraževanje

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