



WYŻSZA SZKOŁA BIZNESU  
NATIONAL-LOUIS UNIVERSITY

**BUSINESS AND NON-PROFIT  
ORGANIZATIONS  
FACING INCREASED COMPETITION  
AND GROWING CUSTOMERS' DEMANDS**

Edited by

**Adam Nalepka  
Anna Ujwary-Gil**

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**Adam Nalepka, Anna Ujwary-Gil**

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## INTRODUCTION

On 20-21 June 2011, Zakopane hosted the 10<sup>th</sup> jubilee Seminar of Young Scientists, Ph.D. Students and Lecturers, with its regular topic: “**Business and Non-Profit Organizations Facing Increased Competition and Growing Customers’ Demands**”.

The form, thematic areas and principles of this year’s Seminar remained the same.

The papers presented at the Seminar focused on the description and analysis of new phenomena and processes concerning business and non-profit organizations. Scientists pointed at current conditions in which business and non-profit organizations function, and tried to explain how these conditions influence the situation of organizations. They also analyzed the strategies used by surveyed organizations in conditions of increased competition and growing consumer demands to achieve and maintain competitive advantage.

Our publication presents papers prepared for and presented at the 10th Seminar of Young Scientists, Ph.D. Students and Lecturers.

The major issues analyzed in the papers presented at the Seminar referred to:

- business and non-profit organizations as an object of scientific research,
- business and non-profit organizations in market economy,
- modern tools for business and non-profit organizations management



- business and non-profit organizations – global and regional aspects,
- financial aspects of managing business and non-profit organizations.

Such classification of issues was the basis of this publication. The papers published here have been amended, extended and improved following critical comments of their reviewers and the discussion initiated after their presentation..

We would like to thank the participants of the 10<sup>th</sup> Seminar of Young Scientists, Ph.D. Students and Lecturers for preparation and presentation of their articles and for responsible preparation for publication.

We would like to express our deep gratitude to our colleagues, professors: Barbara Błaszczuk, Józefa Famielec, Anna Fornalczyk, Mareki Lisiński, Kazimierz Perechuda, Halina Piekarcz and Kazimierz R. Śliwa for thorough and critical reviews of prepared papers and for active participation in the Seminar. Their contribution helped us create specific scientific discussion and improve the articles published here.

We would also like to thank our Ph.D. colleagues for their active and creative participation in the Seminar.

Finally, we would like to thank Mr. Krzysztof Pawłowski, Rector of WSB-NLU in Nowy Sącz, whose favorable response and support we have been experiencing since the first Seminar.

**Adam Nalepka, Anna Ujwary-Gil**

**I.**  
**BUSINESS AND NON-PROFIT**  
**ORGANIZATIONS AS THE OBJECT**  
**OF RESEARCH**



**Małgorzata Baran\***

## **MANUFACTURING COMPANY AS A CYBERNETIC AND COMMUNICATION SYSTEM**

### **Summary**

*The aim of this paper is to show production company as a purposeful system, characterized by goal-seeking behaviour, complexity, probabilistic, with sequential states, and the ability of self-regulation. These features cause that the company may be considered in the context of the cybernetic approach - as a cybernetic system. As the result the company is seen as communication system (network information), where information reduces the indeterminacy and uncertainty of the system.*

### **1. Introduction**

Continuous economic and political changes have influenced the way in which economic entities such as manufacturing companies operate in the market. Economic crisis, natural disasters, competition and tremendous dynamics of environment changes all influence the operational results of companies which are increasingly difficult to manage. Therefore new methods, tools and approaches supporting management are sought so as to meet the challenge posed by contemporary changes. One of such approaches, developing strongly in Poland in 1960s and 1970s and now experiencing a revival of interest is a cybernetic approach. It assumes that there are certain laws which govern the regulating and steering processes in natural systems (living organisms) and can be applied to regulating and steering artificial systems, such as enterprises. The condition here is the existence of common features for both types of systems.

This article aims at systematizing and presenting such features of a manufacturing company which would favor the opinion that we can treat this company as a cybernetic or communication system. The understanding of this approach allows us to model industrial systems as cybernetic systems. The designed cybernetic models of companies constitute a starting point in determining solutions optimizing the way these companies function [Gomółka 2000, p. 8].

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## 2. Basic features of a manufacturing company treated as a cybernetic system

The company is an economic subject economically, organizationally and legally separated from its surroundings [Encyklopedia PWN 1996, p. 361]. Kortan defines the company as an economic, social and technical unit singled out from the whole national economy, established in order to satisfy the needs of third parties in the market in a permanent and profitable way. The management of the company takes independent decisions at their own risk [Kortan 1997, p. 72].

A manufacturing company consists of the following subsystems [Flakiewicz, Oleński 1989, pp. 319-320]:

- a) production subsystem,
- b) management subsystem,
- c) information subsystem,
- d) economic subsystem,
- e) employment and social subsystem.

All the above systems, cooperating and interrelating with one another, constitute one comprehensive system which is called a company.

Gościński defines a cybernetic system as a coherent and purposeful complex system, which is probabilistic and self-regulating [1968, p. 34]. Beer provides a simpler definition of a system as a group of various elements joined together in one entity [1966, p. 13], which are interconnected by means of feedback or in series and create a network.

These connections carry certain amount of information<sup>[1]</sup> which flows between particular elements of the system and which is responsible for all dynamic changes taking place both within the whole system and in its particular parts. The type of connections and the kind of these changes are the main subject of research on systems. Analyzing the manufacturing company from the material and attributive point of view [Kožmiński, Piotrowski 2005, p. 29] we can treat it as a system consisting a certain number of connected subsystems<sup>[2]</sup>.

The typologies of cybernetic systems may vary a lot. Taking into account the criteria of system complexity we can single out simple, complex and extremely complex systems. Analyzing the behavior of the system, that is the way a particular system undergoes successive states<sup>[3]</sup>, we can differentiate

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1 Information is certain content being for example a description, request, order or prohibition passed by the sender to the receiver, see [Gościński 1968, p. 15] or any organizational (non-material) factor which may be used to make the activity more efficient or purposeful (by people, living organisms or machines), see [Müller 1974, p. 36].

2 It should be noticed that in cybernetics a system is defined analogically to the system in systemic thinking.

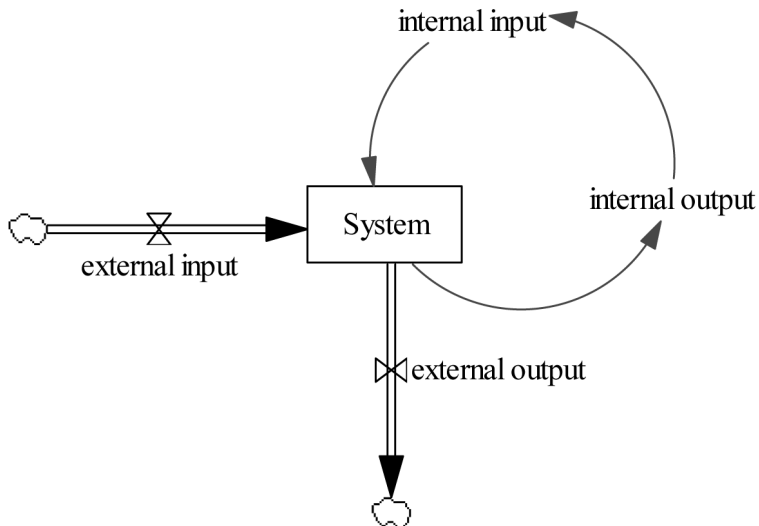
3 The state of the system should be understood as a value of the selected parameter or parameters.

deterministic and probabilistic systems. Deterministic systems are characterized by the behavior that can be predicted in advance (for example a computer), in case of probabilistic systems we are unable to determine the direction of changes to their behavior. A manufacturing company should be treated as a probabilistic, extremely complex system [Beer 1966, p. 21]. Beer emphasizes that while probabilistic complex systems may be examined by means of operational research, in case of probabilistic, extremely complex systems, they require a cybernetic approach.

Yet another typology of systems is presented by Gościński, who differentiates absolutely and relatively isolated systems, that is systems separated from the environment<sup>4</sup>. Absolutely separated systems are devoid of inputs and outputs beyond the system. Relatively isolated systems have at least one input from outside and at least one output outside as well as internal inputs and outputs (Figure 1).

Each external and internal input and output consists of two elements: supply and information. Supply is a material factor which may be the carrier of information, material to be transformed by the system or serving as a means to transform other supplies. A manufacturing company as well as any of its parts, may be treated as a relatively isolated system, in which supply can be: orders coming from customers, raw materials necessary for the production and machines, for example for metalworking.

**Figure 1.** The scheme of a relatively isolated system

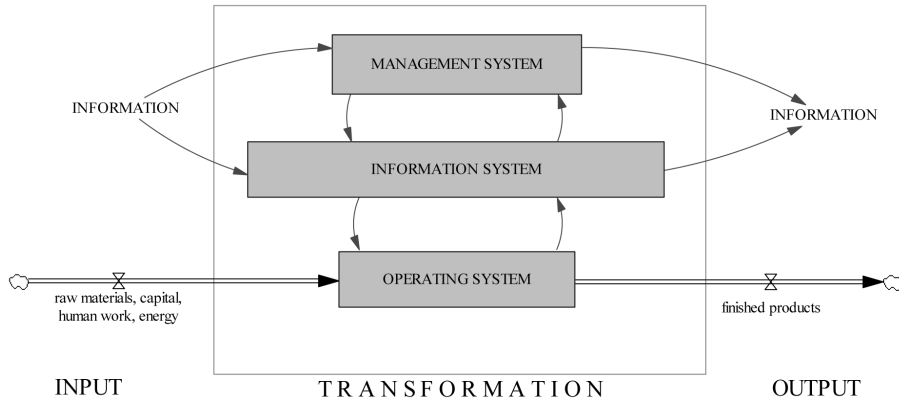


Source: own elaboration.

4 This type of systems was first defined by Greniewski, see [Greniewski 1955, p. 55].

Each supply and information may undergo the transformation process in systems. The word transformation comes from Latin ‘transformatio’ and means change, metamorphosis, change of form or substance [Flakiewicz, Oleński 1989, p. 47]. In a system such as a company, the output, for example in form of a finished product may be the result of transformation of such supplies as: raw materials, labor, etc. Transformation takes place due to coexisting, interrelated and cooperating systems of management, information and labor (Figure 2).

**Figure 2.** Transformation in a company



Source: own elaboration.

Transformation is connected with the process in which the cybernetic system strives at reaching the final state, in which all system parameters reach desired values. The system undergoes the so-called distinguished states or stage states until reaching the set goal. It is connected with the time factor and from the cybernetic point of view constitutes an orderly set of states distinguished in time. Stage transformation occurs to supplies and information, but, as Greniewski points out, the aim of the information stream is to direct supply streams [1967, pp. 14-15].

The features allowing us to consider a manufacturing company as a cybernetic system are also [Gościński 1968, pp. 27-34]:

- a) purposefulness,
- b) complexity,
- c) probabilistic type of distinguished states of the system,
- d) equifinality,
- e) self-regulation ability.

Purposefulness means that the system exists and is dedicated to realize a certain aim through particular actions. The company realizes internal aims serving the purpose of survival and development and external aims – imposed by

the environment. The most frequently mentioned main aims of manufacturing companies include [Skowronek, Sarjusz – Wolski 2008, p. 43]:

- a) maximization of financial result in the long period of time,
- b) consolidating its market position and obtaining competitive advantage,
- c) increasing economic potential,
- d) increasing the company value for shareholders.

The complexity of the system cannot be understood here as a number of all elements of the system, but as a number of distinguished states of this system [Ashby 1961, p. 96]. There are systems composed of numerous elements which may be presented by joining basic groups in simple entities differentiated by a couple of distinguished states.

Probabilistic type of distinguished states of a system is related to the existence of countless factors influencing processes realized in the company (for example production, storage, employment, sales, etc.) and causing random stochastic result of a reaction. In this case, knowing the initial state of the system and the program of transforming supplies and information, we can only with some probability determine the new state adopted by the system. Two identical companies with the same supplies and information provided in the input will not obtain the same number of finished products in the same time.

The above feature is also related to equifinality. It means that the aim can be achieved following different ways. For example, a company which has to produce a certain number of finished products may use a different combination of subjects, production means and labor. It is also connected with available technology and existing information flow channel.

The final, essential feature of cybernetic systems is self-regulation. It is connected with the notion of homeostat. Homeostat can be defined as a regulatory system, maintaining the value of any variable of this system within desired limits [Beer 1966, p. 26]. A company is a system of homeostat type, as through regulation it preserves desired states within determined limits (for example the state of raw materials necessary for production or the amount of necessary labor). It is, however, threatened with constant changes of economic, financial, social and political conditions as well as external environment. It adapts to them through self-regulation, whose main tool is feedback<sup>[5]</sup>.

To present and analyze the networks of analyzed systems cybernetics uses complete directed graphs<sup>[6]</sup>. Such a graph consists of knots (in our case knots are particular subsystems in a system represented by the company) and the lines connecting knots along which information flows (see Figure 3). A complete graph is one that has a complete (definite) number of knots and information

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5 See also [Gościński 1982, pp. 56-57; Kornai 1977, p. 255].

6 The basics of the graph theory can be found in [Wilson 2007].



lines. If all information lines appearing in the graph have the flow direction from one knot to the next one, then we have a directed graph.

### **3. The company as a communication system**

One of the processes analyzed by cybernetics is the already mentioned transformation of information. Each piece of information decreases the so-called indeterminacy of the system which results from diversity, that is a large number of elements of the set of possible distinguished states of the system [Czerniak 1978, p. 76]. Information introduces certain limitations to this set, decreasing the number of distinguished states which prevent the system from being undetermined and give it some order. Taking into account the significance of information transformation in a system created by each company, we can present this company as an information network or as a communication system in which information is stored, processed and sent inside the system as well as from the environment to the system and vice versa. This is illustrated by an example<sup>[7]</sup> presented in Figure 3 and discussed below.

The analyzed construction company was presented as a system consisting of eight subsystems presented below:

- a) P1 – leadership;
- b) P2 – subsystem responsible for managing production;
- c) P3 – production preparation;
- d) P4 – production supplies;
- e) P5 – planning and analysis;
- f) P6 – records and control;
- g) P7 – auxiliary production and services;
- h) P8 – construction production.

The above presentation of subsystems results from the functional division adopted by the company, using the service criteria rather than organizational division according to organizational units.

The company is centralized so the power of decisions lies in the hands of the company management. The system input is affected by external information (from the environment – the cloud picture in the scheme which comes from principals, suppliers, subcontractors, superior units and controlling bodies. They all constitute the so-called stimulus - information.

Information flows between subsystems mainly as a result of feedback and series connections.

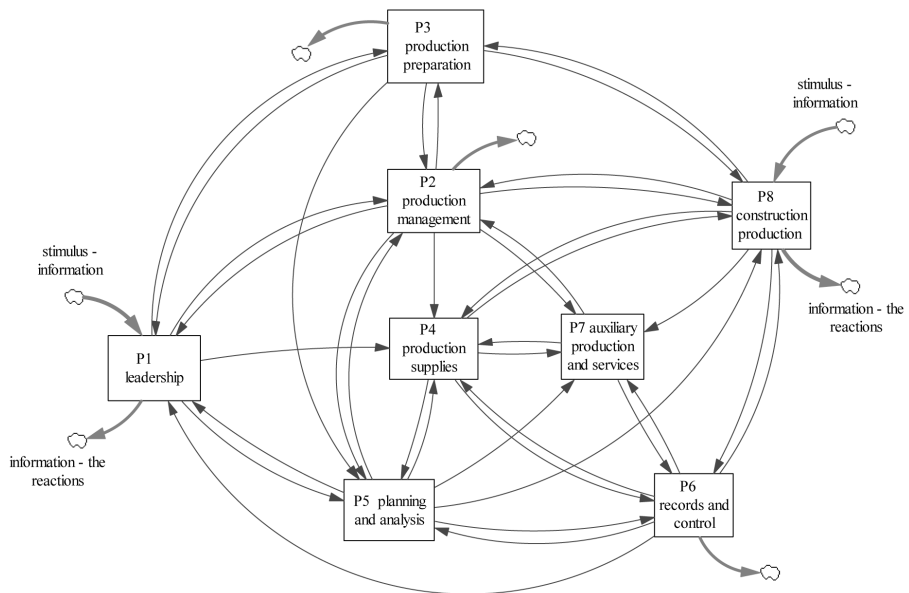
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<sup>7</sup> The example was taken from research conducted in a construction company. The presented scheme is simplified, omitting physical supply, see [Gościński 1968, pp. 126-131].

From P1 subsystem (leadership) the following information flows:

- to the environment – concerning production and technical arrangements, payment, raw materials orders and products, complaints directed at suppliers, etc.;
- to P3, as guidelines and orders related to production organization, valid or new technology, etc.;
- to P2, related to production, products, quality, flaws and health and safety regulations;
- to P4 – concerning material supplies, equipment and labor, etc.;
- to P5, concerning programs of company activity comprising technical and economic plans and operational plans.

**Figure 3.** A company as a communication system



Source: own elaboration.

P2 subsystem (production management) sends information to:

- the environment, concerning the realization of construction production and instructions to subcontractors in a construction project, etc.;
- to P7, instructions for auxiliary production and services units;
- to P8, instructions for construction production units;
- to P5, essential to draw up production plans, technical progress plans and period plans;

- e) to P4, instructions related to provision of production units with necessary production resources;
- f) to P1 – concerning realization of approved production plans and all problems that appeared during the realization;
- g) to P2, connected with the guidelines for production preparation.

P3 subsystem (production preparation) has information essential for:

- a) the environment, directed at the designers offices and customers, related to proposed design solutions, construction organization solutions, technical conditions, etc.;
- b) P8, in form of verified documentation for production units;
- c) P5, defining the technical conditions of contracts with customers;
- d) P2, generally referring to production preparation and updating original technical and organizational assumptions;
- e) P1, connected with all production arrangements – to be approved by management.

From P4 subsystem (production supplies) information flows to:

- a) P7, in form of instructions concerning shifting production resources between production units and renovation operations;
- b) P8, concerning management of production resources and power supply;
- c) P6, as data related to use of materials, employment and production equipment work;
- d) P5, in form of information essential for technical and economic planning and operational planning.

P5 subsystem (planning and analysis) sends information to:

- a) P4, constituting directive indicators and plan parameters;
- b) P2, connected with periodical plans of particular production subsystems;
- c) P7, concerning planned tasks of particular auxiliary production and services units;
- d) P8, as plan tasks for all construction production units;
- e) P6, as data on realization of approved plans and changes to long-term and operational plans;
- f) P1, in form of reports, analyses and progress reports from realization of planned tasks as well as contracts on performance of construction work together with attachments and necessary supplements resulting from changing contract conditions.

Information from P6 subsystem (records and controlling) goes directly to:

- a) The environment and concerns production results, its quantity, quality, etc.;
- b) P7 and is related to production, own costs of realized orders, expenditure, labor, remuneration fund management and other information connected with auxiliary and service operations of the company;

- c) P8, constituting a similar type of information as in P7, but related directly to construction production;
- d) P1, in form of financial reports and analyses, balance sheets and profit and loss accounts and information on the management of remuneration and operational funds;
- e) P5 and is connected with execution of production plan, costs, sales and general financial standing of the company;
- f) P4 and concerns production resources, labor and remuneration fund, etc.

P7 subsystem (auxiliary production and services) sends information to:

- a) P4 as data resulting from the volume of auxiliary production and necessary resources;
- b) P2 on auxiliary production state;
- c) P6 on use of resources and labor in order to verify and record it.

Finally P8 subsystem (construction production) shares information with:

- a) the environment, especially with production purchasers;
- b) P7, concerning breakdowns, stoppages and other disturbances which can be eliminated only with help of auxiliary personnel, transportation base, etc.;
- c) P3, connected with the project estimate documentation and with projects of construction work organization in production units;
- d) P6, as data on used production resources, labor and construction equipment;
- e) P4, in form of information on production means, disturbances in deliveries, unexpected changes in the production program which lead to changes in production means and workforce;
- f) P2, on core production, technologies and technical issues, health and safety of work at particular production posts.

In the above example we presented information connections between particular subsystems which connect the network into one entity. Subsystems are both receivers and senders of processed information. Information flows in the system through communication channels. The types of flowing information vary. There is information on information, information – operational orders, information on supplies connected with production and information coming from outside the system (stimulus – information) or going beyond the system (information – reactions). All these information items constitute tools limiting the diversity of the above system.

We should also draw our attention to the quality of received and sent information. It is desirable that the information coming into the company, flowing inside it and going outside is:

- a) true,
- b) valid,
- c) comprehensible,
- d) unambiguous,
- e) complete,
- f) comparable,
- g) available to interested parties at a particular time.

It is important as there might be various types of disturbances and information overload which result in information which is wrong, false or even misinforms. Wrong information results mainly from the use of wrong methods and measure or observation tools. Therefore it only gives us some approximation of reality. Usually it results from the features of the information system used in a given company. False information is untrue information intentionally sent in circulation in order to disturb the decision process. Misinformation happens when, apart from formal information connected with the main aim of the company, there is incomplete or wrong information which serves the purposes of particular units and often collide with the main and superior aim of the company.

#### **4. Conclusions**

The article presented a manufacturing company as a relatively isolated system, characterized by purposefulness, complexity, probabilistic character of distinguished states, equifinality and ability to self-regulate. The above-mentioned features allow us to analyze the company in the context of cybernetic approach – as a cybernetic system. The company was also presented as a communication system and the importance of information as a factor limiting indeterminacy of the system was emphasized.

To sum up, a manufacturing company in light of cybernetics is above all a “machine” to transform physical supply under the influence of information. We can clearly see the supremacy of information from physical supply which is derivative of information.

Looking at the company from the point of view of cybernetics also emphasizes the importance of the whole system which constitutes the company and the role of each part in this entity. Mutual connections between these parts (subsystems) account for the fact that a change in one part causes adaptive changes in other parts. The understanding of these processes may therefore lead to effective steering and regulation of the system constituting each manufacturing company.

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**Janusz Bak\***

## **THE CONCEPT OF CREATING AND OPERATING THE EARLY RECOGNITION SYSTEM**

### **Summary**

*Operating in a turbulent environment requires – both from academicians and practitioners - to seek, and perfect tools for an information support of the strategic management process. The information support is believed to limit uncertainty in decision making situations through better understanding their context. An answer to the needs of contemporary organizations, and at the same time an area of necessary scientific enquiry is information support of their strategic management, and the concept of early recognition.*

*In the following article, the concept of an early recognition system has been presented in its important three research aspects : functional, processual, and structural. Moreover, empirical study results have been offered verifying the relationships among selected elements which make up the theorized model of an early recognition system.*

### **1. Introduction**

Growing competition, intensification of global processes, shortened life cycles of products and technologies, intense innovation, interdependence and complicated relations between political, social and economic processes – they all account for the evolution of the contemporary organization surrounding towards the turbulent environment. The consequence of these processes is a growing uncertainty of decision situations and risk being an inherent part of managerial activity. The ability to cope with such a situation fundamentally depends on the ability to properly recognize and understand the company environment, not only concentrating on current affairs but also taking into account future events. The turbulent environment makes organizations and their managers subconsciously resist changes assuming they cannot identify weak signals or anticipate communicated changes. As a result, they operate in the space of strategic surprises.

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From the moment they realized the inevitability of functioning in turbulent environment conditions, theoreticians and practitioners of management have been looking for and perfecting the tools that support the strategic management process with information and allow the companies to limit the uncertainty of decision situations through better understanding of their context. An answer to the contemporary organizations needs and an area of necessary research work is the issue of strategic management information support and the concept of early recognition.

In answer to the expectations of management theory and practice outlined above, this article presents the concept of the early recognition system in three vital research aspects: functional, process and structural ones. Moreover, we present the results of the empirical research verifying relations between selected components of the early recognition system model.

## **2. The origins and essence of the early recognition system**

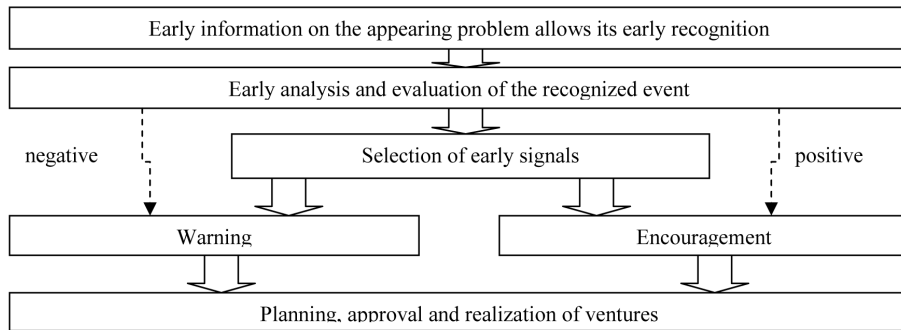
The concept of early recognition of environment changes has military roots, its present shape being influenced by the development of cybernetic approach and invention of a radar, which has become the metaphor for all systems aiming at recognition of weak signals. In a more definite form, this concept appeared in the 1970s simultaneously in a number of areas, such as geology (warning against earthquakes), technology (break-through changes transforming technologies), but it was the most visible in three areas: military (AWACS – warning in aviation), medicine (warning against illnesses) and economics (warning against financial crises). Successful application in non-business areas encouraged scientists to attempt at implementing the solutions developed there in business environment, which may be seen as search for the instruments enabling companies to manage the environment [Dworzecki 1985].

Historically, a concept developed prior to the early recognition system (ERS) was the concept of early warning system (EWS) orienting organization activities towards identification of threats in precisely defined areas of its environment. The “early recognition” concept was introduced into management literature in the 1980s by Kirsch [Kamasa 1992], who pointed out that, in accordance with strategic management rules, observation of the organization’s environment cannot focus only on seeking out threats and warning against them, but it should also recognize the opportunities as they pop up. Moreover, observation should not be restricted to defined areas, but should be complex and cover the whole environment of an organization. The introduction of the “early recognition system” meant not only extending the tasks of these systems to include information on opportunities, but also going beyond the quantitative mechanisms of their identification.



The early recognition systems in management have their origin in works of Ansoff [1975, 1980, 1985, 1990] and his weak signals theory and in the concept of strategic issue management. They spurred the development of similar systems, as they assumed that strategic surprises are signaled by weak signals which cannot be detected by the traditional planning and control process which is generally focused on building plans on the basis of forecasts relying on past data. Generally, the essence of early recognition of environment changes may be seen in Figure 1 below.

**Figure 1.** The essence of ERS oriented at the enterprise aims



Source: [Biliński 1990].

The concept of early recognition system can be metaphorically compared to the radar which vigilantly monitors its surroundings in order to identify approaching objects. It points at them even if it is not certain what type they are, and in this way it allows their monitoring in order to recognize them accurately and early and to enable action in due time. The time earned in this way gives us the comfort in form of possibilities of analysis, expanding our knowledge and taking proper decisions, since we can identify possible behavior and change directions together with their implications on the basis of gathered information.

In literature, the early recognition system is placed in the area of strategic controlling (strategic planning and controlling)<sup>[1]</sup> [Lorange et al. 1986; Kreikebaum 1997; Gharajedaghi 1999; Kotler, Caslione 2009] and in this aspect we see its usefulness for managerial activities, consisting in facilitating adaptation in turbulent environment. The system supports strategic planning with information through building information planning base and allowing its constant updating and verifying assumptions made. In this sense it should be treated as a subsystem of strategic management system, especially in the area of environment research, which is its vital element. The organization

1 Other identified areas are: decision-making [Choo 1998; Mukherji, Hurtado 2001; Murray 2001], risk management, [Mitroff, Shrivastava 1987], learning [Kozłowski 2004; Daft, Weick 1984].

being in constant interaction with its environment, which has turbulent nature, builds relationship with it through the strategy consisting in utilizing potential opportunities and threats. To make this happen it is necessary to constantly monitor the environment and anticipate future changes on the basis of current observations. The ERS, being an information system, obtains information, processes it and gathers, and its interpretation is left to decision-makers, who are only informed about potential opportunities and threats carried out by weak signals, anticipated long-term changes in the organization environment and their influence. By providing information about future characteristics of the environment, the ERS initiates and supports redefinition of the strategy, protecting long-term functioning and contributing to improved effectiveness of organizational management.

### **3. Systemic presentation of early recognition of changes to the organization environment**

Scientists have used different names and definitions of the ERS concept (for example, strategic issue management system [Ansoff 1980], strategic scanning [El Sawy 1985], system of early recognition of strategic problems [Fabiańska, Rokita 1986], weak signal research [Coffman 1997], strategic radar [Albrecht 2000], competitive early warning system [Gilad 2004], strategic early warning system [Cappallo, Wiegand 2004], peripheral vision [Day, Schoemaker 2006]. Therefore specialist literature provides a wide spectrum of ERS definitions provided by above-mentioned authors as well as others, also of Polish origin<sup>2</sup>.

Basing on the review of the subject literature and taking into account further characteristics of the system, the ERS will be understood as a special kind of information system whose aim is to anticipate changes in the organization environment and to reduce the uncertainties relating to them as well as to inform higher rank executives about them early enough to initiate actions aiming at avoiding strategic surprises. The specificity of the system lies in directing the processes of information processing (concerning organization environment and used in strategic management processes) towards perception and interpretation of weak signals being the symptoms of future changes, expressed by potential opportunities and threats. It is a tool that supports strategic management with information (it supplements the existing systems of strategic planning and control) through providing strategic information in form of future scenarios reducing the uncertainty of decision situations and allowing the organization to take strategic decisions which enable it to better adapt to the environment and guarantee long-term survival and success of the organization.

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<sup>2</sup> See [Dworzecki 1985], [Hunek, 1989], [Biliński 1990], [Kamasa 1992], [Wierzbiński 1998], [Cabała, Walas-Trębacz 2004].

According to the system methodology [Sienkiewicz 1988; Stabryła 2002] the ERS should be identified in vital aspects of its description. In accordance with the proposal of Gharajedaghi [1999], what needs separate description is; in the static area of the system, its structural aspect which points at its elements and relations between them, while in the dynamic area, the functional aspect defining the scope of system operations, and the process aspect which identifies activities and tools necessary in performing its function.

## **The functional aspect**

Systemic approach to early recognition should be started with the description of the functions which should be performed by the system in an organization. This is not possible without reference to the aim of the system, as this is superior to the functions, which, in fact, result from the assumed goals [Stabryła 2002, p. 47]. Bearing this in mind, below we will define the aims of the system, and then we will provide the functions and realized tasks resulting from them.

The superior aim of the system is to support the survival and development of an organization through information support offered to managers in making strategic choices, which is realized through strengthening the information basis of strategic decisions.

This protects the organization against strategic surprises being the consequence of not recognizing changes in the environment early enough. Performing the functions connected with information management (including informing/warning about potential opportunities and threats) the system is to signal problems early enough so that, while initiating decision processes, enough time is provided to take appropriate action. The basic tasks of the system are: early identification of strategic issues, diagnosis of their causes, their type and intensity, duration, influence (opportunities/threats) on realization of strategic aims and strategic instruments used as well as transmitting the identified issue to decision-makers. Synthetic presentation of aims, functions and tasks of the ERS can be found in Table 1 below.

**Table 1.** Aims, functions and tasks of the ERS

<b>Aims</b>		
<b>Main aim</b>	<b>Additional aim</b>	
Information support of strategic decision making process through providing higher rank executives with strategic information related to anticipated changes to the environment early enough	Internationalization of the culture promoting prospective, permanent vigilance, organizational learning and positive attitude to changes	
<b>Functions</b>		
<b>Information function</b>	<b>Recognition function</b>	<b>Anticipation function</b>
Realization of information process	Identification of change symptoms	Projection of changes and evaluation of influence
<b>Tasks</b>		
<b>Gathering and processing information about the environment</b>	<b>Scanning and monitoring the environment</b>	<b>Forecasting and evaluating changes to the environment</b>
<ul style="list-style-type: none"> <li>• Organizing and realizing information processes</li> <li>• Initiating and directing processes of gathering information concerning potential opportunities and threats</li> <li>• Initiating the observation system</li> <li>• Choosing the information gathering tools</li> <li>• Selecting information sources</li> <li>• Supervising information processing</li> <li>• Providing information about phenomena appearing temporarily</li> <li>• Passing a set of specific information in form of future scenarios to decision makers</li> <li>• Signaling all potential opportunities and threats early in time</li> <li>• Emitting alarm signals when environment conditions change in relation to planning assumptions</li> </ul>	<ul style="list-style-type: none"> <li>• Constant vigilance and observation of the environment</li> <li>• Defining observation areas</li> <li>• Searching for weak signals carrying information on potential opportunities and threats</li> <li>• Seeking out new phenomena and processes which may determine conditions of operating in the future</li> <li>• Early recognition of strategic issues and factors which may threaten or support strategy realization</li> <li>• Gathering information on potential changes in the environment in the area of currently realized strategy</li> <li>• Directed and not directed tracking of the environment</li> </ul>	<ul style="list-style-type: none"> <li>• Evaluation of factors directly shaping deviation from assumed aims</li> <li>• Description of events and trends and determining relationship between them</li> <li>• Attributing significance to obtained data and information</li> <li>• Diagnosis of the causes of problems, their type, intensity, duration</li> <li>• Evaluation of the influence of identified events on the situation of the organization and identification of main implications for the decision process and perfecting the strategy</li> <li>• Constructing the situation development variants in form of scenarios</li> <li>• Projection of the direction in which the environment changes and constructing forecasts</li> </ul>

Source: own elaboration with use of: [Dworzecki 1985], [Fabiańska, Rokita 1986, pp. 71-72], [Kamasa 1992], [Jędralska, Woźniak-Sobczak 1998, p. 35], [Kuc 2006, pp. 256-258].

## The process aspect

The description of the system in the process aspect boils down to identification of activities through which the above-mentioned functions are performed. Specialist literature points at two groups of activities in the early recognition process: the first one is connected with perception, the other one with interpretation of weak signals. The process of early recognition itself is coherent with the process of examining the environment [see Fahey, Narayanan 1986, pp. 37 - 42; King, Cleland 1987, pp. 156 – 161], as, in fact, it is only its special case, in which the “material” is not any information, but the one carried through weak signals and concentration on areas of changes signaled by them.

Analytically, the process of early recognition of environment changes may be divided into four groups of activities. These are scanning and monitoring in the perception phase and predicting and evaluating in the interpretation phase.

While scanning, we observe the environment in order to identify the symptoms of potential changes. These activities direct our attention towards possible events earlier, before they appear in a form easily recognizable by everyone. In the forward-looking sense it is all about concentrating our activity on identifying weak signals. This stage of the process *implicite* or *explicite* powers the monitoring process, providing information about the areas in need of more thorough and detailed observation. This should give us the time to analyze potential implications and to work out possible and desirable behavior when the signaled event takes place. Scanning is the least structured and the most ambiguous activity, as potentially important information is unlimited, therefore it is necessary to observe broadly and to be sensitive to information which may appear in an unexpected form and place, not only in the areas of present activity of an organization. The level of information overload is very high and the biggest challenge is to give meaning to ambiguous and unrelated data.

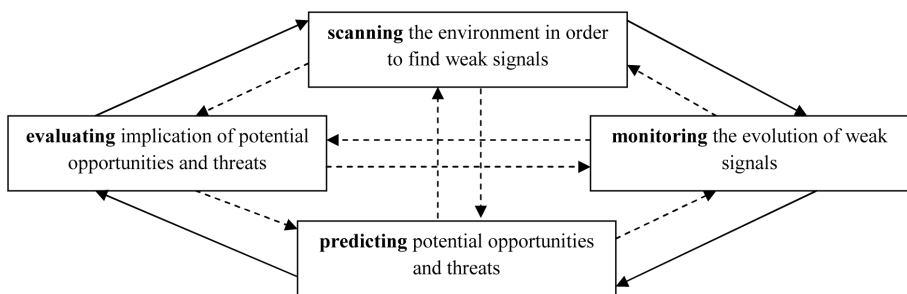
In the monitoring phase we witness the sharpening of the semantic field of weak signals thanks to tracing their evolution and “following the track” left by weak signals. This phase nearly always appears after the scanning phase and is supposed to make sure that premonitions and intuitive judgments concerning weak signals which appear during the scanning phase are monitored in order to confirm and describe them. The process of searching for information is more systematized in this stage and directed by identified signals. There is common premonition concerning the direction in which events evolve and efforts are concentrated on them. The interpretation and evaluations appearing together with the inflow of new data require adjustment and confrontation with the already possessed information.

The activities connected with predicting constitute the next stage in building future scenarios on the basis of the information gathered in previous stages, which provide the picture of what is happening in the environment. Strategic decisions, however, require particular insight into the future and orientation to future events and states of the environment. Predicting consists in developing reliable projections of directions, range, speed and intensity of changes in the environment. We can talk here about different variants of the future, which may appear not only on the basis of current trends but also on the basis of judgments concerning potential events. Predicting is usually better focused (more rigorous and deductive), as emphasis is placed on the changes considered important for the organization.

Evaluation, as the last group of activities, allows us to evaluate the information and knowledge generated by scanning, monitoring and predicting and acknowledged as relevant. It is necessary to evaluate their potential influence on organization and strategy, while the stress is transferred from understanding the environment to what it all means for the organization.

The division of early recognition acts into four phases serves only analytical purposes, as scanning, monitoring, predicting and evaluating are inseparably interrelated and the ERS cannot function effectively without any of these activities (Figure 2).

**Figure 2.** Relations between activities in the early recognition system



Source: own work with use of [Fahey, Narayanan 1986, p. 43].

The dynamic process of early recognition is characterized by recurrence (successive revision of interpretations and evaluations made), reproductiveness (inductive and deductive reasoning) and hierarchy (involvement of individuals on various levels of organization) [Dutton et al. 1983].

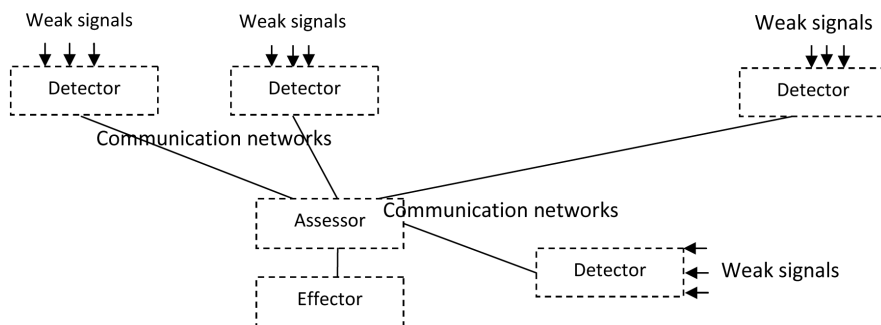
In the process aspect we should not forget the tools supporting early recognition both in analytical methods, such as scenario methods, Delphic, war games, etc., as well as tools of information technology, whose aim is to streamline the information flow and communication.

## The structural aspect

The structural aspect concerns elements of the system and the way in which they are related as well as possible organizational solutions within which activities will be performed. One can mention here two dimensions: universally understood elements realizing systemic functions as well as postulated and possible to apply formal structures.

Due to the purpose of the system and its functions, the key elements in process realization from the structural point of view are the elements which, while building the system, account for obtaining information (perception), processing information (interpretation) and communication. The basic elements of the ERS are people and technical appliances which gather, process and pass information [Hunek 1989].

**Figure 3.** Elements of the structure of the early recognition system



Source: own work.

We can differentiate here the following elements presented in Figure 3: (1) detector – seeking out and gathering weak signals about the environment, inside and outside the organization, performing preliminary processing and passing information which he considers relevant, (2) assessor – checking information obtained from detector, further processing it and organizing so that it could be used to inform about potential opportunities and threats, (3) effector – informing/warning about potential opportunities and threats and initiating actions necessary for implementation, (4) communication networks – information ties between elements, of key importance due to the effective functioning of the whole system, as they are responsible for transmitting data [Anthony et al. 2004, p. 3].

The need to institutionalize early recognition so as to allow management and improvement of a formally existing system should lead to proposals of possible structural solutions in this area. In this context the question posed

should not be whether to formalize the early recognition system, but rather what solution will be the best for the organization, as it depends on a number of factors. Within the ERS particular organizational units must be assigned clearly defined responsibilities, competencies and resources so that the functioning of the system and its effectiveness could really be monitored. Penc [1994] points at the following organizational solutions:

- „a team” responsible for early recognition, dealing with detecting changes the very moment they appear and passing them in form of appropriately prepared information and proposals to the top management,
- a group of specialists who constantly deal with early recognition of changes in the market, development of technologies, behavior of competitors, etc., and pass the information in form of reports to the top management,
- „radars”, that is appointed employees from each department (Research and Development, Finance, etc.), who, apart from their core activities, deal with additional observation and obtaining information in their professional field and pass it to their bosses.

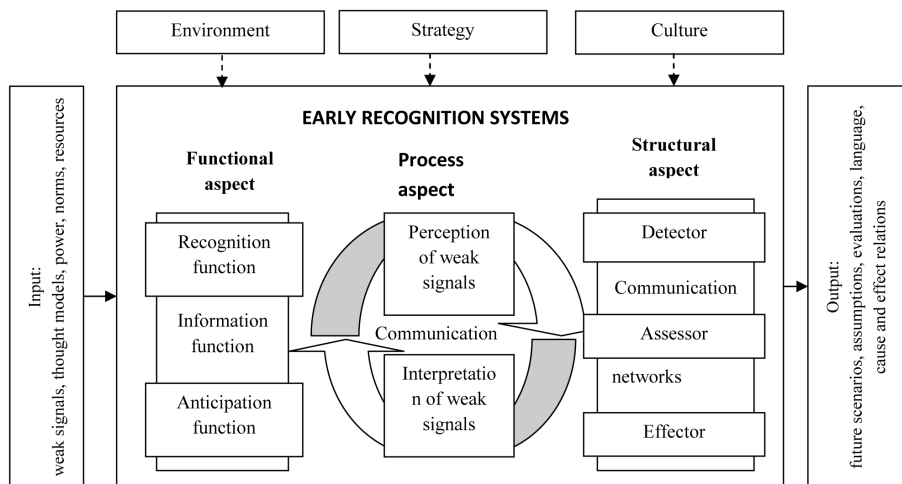
Apart from specific structural solutions, the best framework solution seems to be one in which detectors are all employees of an organization, assessors make up a formally appointed unit, team or task force analyzing information, while the effector is a person whose position in the hierarchy is high enough to allow the information passed to initiate real actions.

#### **4. The model of the system of early recognition of changes to the environment**

The characteristics of the system, presented in three vital aspects, leads us to the proposal of the model, which apart from the ERS reflects other elements interacting with the system. Such reflection is significant from the point of view of research possibilities and designing organizational solutions, however, it is either marginalized or omitted altogether. Seeking common features and building model solutions is vital if we assume that the basic research tool in systemic presentations is a model [Krupski 2005, p. 245]. The proposed ERS model is presented in Figure 4 below.



**Figure 4.** Model of the early recognition system



**Source: own elaboration.**

The strategy of an organization is a “fuse” of early recognition, as strategic management in fact defines information needs which determine actions. The ERS, being the subsystem of strategic management, must be integrated with strategic planning and control, which also emphasizes its importance.

The environment of an organization, as a source of uncertainty and a reservoir of information about changes is the subject of the ERS operations. The ERS functioning is determined by perceived strategic uncertainty [Daft et al. 1988], understood as interaction of perceived complexity, changeability and significance of the environment.

The information orientation defines the way in which we “work” with information and the degree to which shared patterns of behavior, norms and values are culturally internalized. In this area we can find for example proactiveness, information openness, sharing information [Marchandt et al. 2001].

Communication entails two loops. The first, internal one, concerns exchange of information between internal elements which reproduces the iterative process of transforming information needs into gathered information and produced knowledge. The second, external one, covers constant communication between decision makers and the ERS. The information generated in the internal communication loop is delivered to decision makers in the external loop and comes back in form of new information needs, thus generating feedback.

The ERS is realized in two stages of perception and interpretation of weak signals, which have respective functions and elements of the system assigned. In

the perception area, researchers [see Daft et al. 1988; Yasai-Ardekani, Nystrom 1996; Elenkov 1997] emphasize the following issues vital for effectiveness:

- frequency of observation – intensity of detecting information which is useful for recognition of potential opportunities and threats,
- sources of information – type of sources used, divided into internal/external and personal/non-personal categories,
- scope of observation – the area of the environment covered with observation,
- delegation of observation – the extent to which members of an organization are involved in observing the environment.

In the area of interpretation, the following issues vital for effectiveness are stressed [Kirschkamp 2007]:

- differentiation of thought models – involving various analysts in interpretation,
- use of tools – the extent to which various tools for interpreting data are used (such as scenario methods, Delphic method, war games, etc.),
- intensity of interpretation – frequency of taking up actions connected with interpretation,
- permanent time of interpretation – determining the terms of interpretation.

## **5. Results of the empirical research**

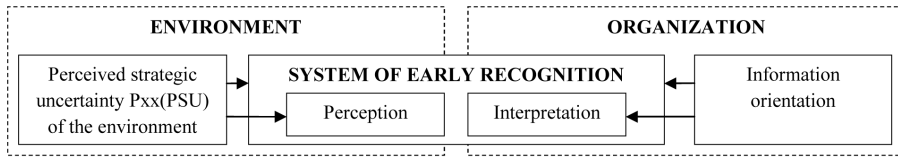
The review of the specialist literature dealing with construction and functioning of early recognition systems as well as the ERS model presented earlier imply the existence of a relation between the environment (perceived strategic uncertainty of the environment), culture (information orientation of an organization), and the early recognition system. This relation, expressed in correlation categories, may be interpreted as causal one. We made the following research hypotheses (Figure 5):

(H1) Perceived strategic uncertainty of the environment (PSU) and information orientation of an organization (IO) influence the early recognition system (ERS).

(H2) Perceived strategic uncertainty of the environment (PSU) influences perception of weak signals (PWS).

(H3) Information orientation of an organization (IO) influences interpretation of weak signals (IWS).

**Figure 5. Research model**



Source: own elaboration.

The hypotheses will be tested using the r-Pearson correlation, with the assumption that the numeric Likert scale of agreement will be treated as an interval scale. The hypotheses will be accepted when  $r \geq 0,2$  which proves the existence of at least a weak linear correlation between variables [Burns, Bush 2000, p. 591]. The testing procedure will consist in observing correlations between variables in the model (PSU, IO, PWS, IWS, ERS), and positive verification of hypotheses will be treated as an empirical proof for the existence of the relation.

The basis of empirical verification of hypotheses made are the results of the research conducted in the period of July-December 2010, aiming at, among others, identification of the ERS elements and relations between them. The data was gathered through phone interviews with use of structured questionnaires. The measure consisted in providing the respondents with a battery of statements referring to various aspects of the ERS model, which they evaluated using the Likert scale of agreement, anchored with statements (“I disagree completely”, “I agree completely”). The research population was made up of companies from the ranking<sup>[3]</sup> of the most innovative firms in Poland – Innovation Tuner 2008<sup>[4]</sup>. The population size was 374 units, and we managed to conduct interviews with 68 entities, which constitutes around 20%<sup>[5]</sup>. The interviews were made with top managers<sup>[6]</sup>. The questionnaire consisted of single and multi-positional scales examining various elements identified in the model of early recognition system, which were then changed into global scales<sup>[7]</sup>.

3 Source: [www.innowacyjnefirmy.pl](http://www.innowacyjnefirmy.pl).

4 The justification of such a choice was a conviction confirmed by specialist literature that innovative companies better cope with recognition of potential opportunities and market threats and are more aware of the early recognition.

5 Compared with research on enterprises, this seems to be quite a decent result.

6 Usually together with actively managing owners in case of smaller companies and members of the top management in case of bigger companies.

7 PSU variable is calculated as (changeability evaluation + complexity evaluation)\*significance evaluation; IO variable calculated as a sum of partial evaluations in the following areas: pro-activeness, openness, sharing information, control; PWS variable calculated as a sum of partial evaluations in the following areas: frequency of observation, sources of information, scope of observation and delegation of observation; IWS variable calculated as the sum of partial evaluations in the following areas: differentiation of thought models, use of tools, intensity of interpretation, permanent time of interpretation, ERS variable calculated as a sum of PWS and IWS variables.

**Table 2.** PSU and IO influence on PWS, IWS and ERS

	<b>PWS</b>	<b>IWS</b>	<b>ERS</b>
<b>PSU</b>	0.533**	0.142	0.472**
<b>IO</b>	0.295	0.458**	0.443**

\*\* . Correlation is significant on the 0.01 level (both ways).

Source: own elaboration with use of SPSS Statistics 18.0.

The results of correlation examination (Table 2) allow us to accept all our hypotheses.

(H1) Perceived strategic uncertainty of the environment (PSU) and information orientation of an organization (IO) **positively** influence the early recognition system (ERS) – there is statistically quite significant correlation.

(H2) Perceived strategic uncertainty of the environment (PSU) **positively** influences perception of weak signals (PWS) – quite strong, statistically significant correlation.

(H3) Information orientation of an organization (IO) **positively** influences interpretation of weak signals (IWS) – quite strong, statistically significant correlation.

We did not observe, however, any statistically significant relation between PSU and IWS or between IO and PWS. As we assumed, uncertainty of the environment intensifies activities in the area of perception of weak signals while information orientation determines the quality of interpretation processes.

## **5. Conclusions**

A tremendously vital and complex problem of early recognition of environment changes requires adequate reflection and analytic insight. This adequacy may be provided by a systemic approach and construction of a system model, with emphasis placed on the following vital aspects of the system: functional, process and structural ones. Considerations on the above subject became the content of this paper. In it we defined the early recognition system, characterized its aspects and integrated it with other essential elements within the model.

The empirical research results presented here prove the existence of a theoretically anticipated positive relation between particular elements of the model, but they should not be generalized to cover the whole population as the surveyed group was not representative.

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## **THE CONCEPT OF THE RESEARCH ON CHANGES IN HUMAN RESOURCE MANAGEMENT IN A PROCESS-ORIENTED ORGANIZATION**

### **Summary**

*The article presents the concept of research on changes taking place in human resource management in an organization adopting process orientation. The movement from the functional to the process organization calls for reformulation of organizational roles, including those connected with the personnel function. The research on changes covers three areas of human resource management: institutional, process and instrumental ones. To identify changes in the human resource management sphere the author used the the Process and Enterprise Maturity Model (PEMM) by M.Hammer. PEMM covers five key factors in process maturity and four factors developing organizational abilities for process management. The reengineering creator's long-time experience in analyzing processes has become the foundation and justification for identification of change areas in human resources management in a process-oriented organization*

### **1. Introduction**

The changes that are taking place in a contemporary enterprise mainly result from general economic trends, globalization, and ever growing fiercer and challenging competition as well as from concentration of resources and activities. The initiators of changes to management systems cannot fail to see the processes taking place in the macro-economic and political scale. Many scientists believe that the organization's driving forces in the 21<sup>st</sup> century are: the Internet, processes and cooperation. The Internet offers possibilities of limitless communication, learning, taking up economic cooperation without geographical constraints as well as realization of work processes which are

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better adjusted to meet the customers' expectations. Thanks to the Internet, the processes realized in organizations obtain external support, from various contractors and subcontractors. Development of internal market relations forces competition between internal organizational entities and external subjects, which undoubtedly improves the quality and effectiveness of realized processes. Cooperation not only inside an organization but also with external entities, creates new possibilities of initiating unique ventures with exceptional structure of resources, methods of operation and organizational competencies.

New ventures created on the basis of Internet communication, processes and cooperation, require creation of appropriate conducive organizational conditions. They call for appropriate design of basic business processes as well as all the auxiliary ones. Personnel processes belong to auxiliary processes. The place and role of these activities realized within the supporting function have been defined in the chain of values by M.E. Porter. Personnel processes creating the human resource management system in a process-oriented organization [Pocztowski 2003, p.39] should acquire new objectives and new measures of effectiveness. Therefore the research on the changes taking place in organizations adopting the process orientation may significantly influence the state of knowledge of new trends and challenges facing human resource management.

## **2. The reasons for analyzing the subject**

Human resource management is a concept which creates a proper approach to the personnel function in an enterprise. When in the 1980s the first models for human resource management were created (the Michigan and Harvard models), the reference point was a function-oriented organization. Work organization was related to the division of company into functional areas, which grouped individuals and organizational units on the basis of similarity of tasks performed by employees. Key personnel roles were assigned to line managers. The dominant path of vertical promotion in a hierarchic structure of the company additionally restricted line employees' access to knowledge, leaving the greatest privileges to executives. Such state of things accounted for the main barrier in competing in a dynamic and unpredictable market dominated by knowledge (Knowledge-Based Economy, KBE).

Companies soon realized that in order to compete effectively they should increase their flexibility in reacting to changes taking place in the environment. The fundamental requirement for such functioning, though, is unlimited access to knowledge and involvement of all employees in perfecting work organization which should be more oriented towards customer's (internal or external) expectations.

The beginning of the 1990s saw the origin of the movement for creating new concepts of company organization (Hammer, Champy, Davenport), which was called the revival of the process approach. The fundamental difference though, was the scope of defining the processes, covering all areas of the enterprise, not only its manufacturing systems.

The process forms of organization with all their conditions and consequences could develop in companies thanks to new information technology. Increasing the access of line employees to knowledge opened up possibilities of increasing decision power among process performers (empowerment). New challenges appeared for human resource management in such organizations. It is worth mentioning here the concept of D. Ulrich from the beginning of the 1990s concerning new roles for personnel managers. The author identified four key roles: strategic partner, administrative expert, employee champion and change agent [Ulrich 2001, p.51]. In the latest publications, two more roles appear: interest integrator and globalization expert. The above-mentioned roles clearly show that the personnel decisions have been taken out of personnel departments and transferred to executive positions, while personnel managers and specialists should provide support for all entities taking personnel decisions.

The type of activities in human resource management area can be recognized in three areas: process, instrumental and institutional. In the contemporary model presentation, the human resource management system consists of three elements: personnel strategy, which constitutes an integral part of organization's strategy, personnel processes integrated with basic business processes and tools used in solving particular personnel problems [Pocztowski 2003, p. 39].

One of the aims of personnel strategy is to provide an organization with competent personnel, able to achieve its new business objectives. In a process-oriented organization the demand for new competencies needed in managing and realizing processes will undoubtedly appear, for example designing the process, identifying process measures, creating and using IT infrastructure for the process management needs, identifying expectations of clients/process receivers, creating new organizational roles, etc. Therefore an organization will need employees who are independent and responsible, ready to self-organize in teams and to self-manage. Process-oriented organizations should possess a well-developed system of knowledge management, oriented at using and developing the intellectual potential of staff. Among the parameters of the knowledge management system we can distinguish: development of knowledge potential, involving employees' knowledge in company activities and continuous learning [Grajewski 2007, p. 172].

The development of knowledge potential should be through: 1) continuous identification of the influence of strategic goals of the organization on work

of individual workers and processes; 2) supporting activeness of workers in implementing new ideas, such as designing and improving processes; 3) growing significance of experimenting, also in risky conditions; 4) creating favorable conditions for informal learning through facilitating contacts between employees. The involvement of employees' knowledge in company activities should be possible due to: 1) consulting serious problems connected with development and changes with employees, 2) facilitating corporation activities – going beyond organizational framework; 3) taking care of openness in thinking and acting, so that procedures did not replace critical thinking. Continuous learning in the knowledge management system should be supported by 1) strengthening the position and independence in taking decisions by employees who learn on their own and support development of others; 2) rewarding those employees who learn on their own and support development of others; 3) new roles of executives as coaches; 4) effective system of recording knowledge potential in an organization; 5) strategic role of training programs [Grajewski 2007, p.172].

Personnel processes should be integrated with business ones. It is not only about internal coherence of the human resource management system, but a wider organizational perspective. It is one of the main reasons why changes in human resource management should originate in business processes. This point of view, though, is hard to find in contemporary work on human resource management. We could venture a thesis that strategic partnership for human resource management, if it happens in the company at all, is insufficiently tied to the company strategy and operationalization of business goals and with application of contemporary management methods.

Insufficient link between personnel function and economic activity of the company is also visible at the institutional level of human resource management. This problem becomes particularly acute when a company is introducing new orientation in work organization. Transition from function-oriented organization to process-oriented one requires redesigning all company areas. This is particularly difficult for managers responsible for particular functional areas of the company as they are afraid of losing their influence, power, and quite often – part of their financial income. The personnel function has been systematically strengthened in companies as a result of adapting the concept of human resource management popularized since the beginning of the 1980s [Fombrun, Tichy, Devanna, 1984, s.81]. However, if we look at the personnel issues included in publications on human resource management, it is not hard to notice how the researchers' attention is deeply focused on internal problems of the personnel function. The sources of personnel problems are often sought in the business area of the company, although we often observe competence problems in this area, which are not tied with business competencies.

Human resource management in a process-oriented organization requires development and application of appropriate tools. The tools created for function-oriented organizations will not always be appropriate for process-oriented ones. One of the basic tools is the job description as an effect of the work analysis. The aim of the job description was to precisely define the place of an employee in an organization and in an organizational unit, to determine the scope of their obligations, rights and necessary qualifications. However, the concept of a process-oriented organization assumes constant changeability of work processes, continuous improvement of processes by their performers. This means that precise job descriptions may constitute a barrier to the development of a process-oriented organization. This problem also concerns other tasks and tools applied in them, for example periodical assessment of employees or their remuneration. In function-oriented organizations, it is the task of the manager to evaluate employees, and even if other people appear in the evaluation process, the final decision is made by the manager. Managers decide how evaluation criteria will be used, though they are usually influenced by personnel specialists. These criteria are rarely directly related to process measures, as they are mostly indirectly related to achieving better effectiveness of an organization as a whole or with work specificity in a particular organizational unit. It rarely happens that workers participate in creating research tools, for example evaluation questionnaires, or at least in creating criteria or principles of evaluation. An equally problematic issue is rewarding staff. The rewarding foundations, if they are correlated with work effects, these are usually effects of an individual or the whole organization, rarely of the team. A process-oriented organization should operate basing on teams focused on process realization. The effects of the processes, corrected by the final effect of the organization, should be of vital importance in creating rewarding systems.

The above-presented problems of human resource management are only a short section of the issue of transforming an organization from the function-oriented to the process-oriented one and changes to the personnel function. The scope of this article refers to all the above-mentioned areas of human resource management: process, instrumental and organizational. This means that the research on changes in human resource management should cover all personnel processes in the company, all instruments and organizational solutions in realizing personnel processes and tasks.

### **3. Current state of knowledge**

The contemporary presentation of a process-oriented organization is quite a new area of scientific research. While the studies in this area have been conducted for two decades all over the world, in Poland they are still in their

infancy. This can be confirmed by the fact that the education content in the area of process management at the Management field of studies was introduced at the last program reform in higher education in 2007. Contemporary organizations face serious challenges concerning work organization facilitating flexibility of operations and, consequently, speed of taking decisions which are essential for clients.

The Polish research on human resource management in process-oriented organizations still lacks a publication which would cover an in-depth analysis of system solutions and which would aim at building a scientific model. An essential contribution to the development of this field of studies was made by the only book on this subject by Jarosław Marciniak (2006), "Standaryzacja procesów zarządzania personelem", which covers issues related to reorientation of the personnel department in a process-changing organization. Special emphasis is placed on the actions which are taken in relation with obtaining quality certificates. From the perspective of the latest concepts of process management, forcing process orientation for the purposes of obtaining quality certificates has many weaknesses. The change process is initiated from the top, managers still play a dominant role in an organization, whereas the contemporary process approach is based on root initiatives, involvement of employees in perfecting processes, empowerment, self-organization and self-management of teams.

The significance of the research problem can be seen in many articles or chapters appearing in the past few years, concerning changes in the realization of personnel function. Special attention should be drawn to the works of: P. Grajewski, W. Cieśliński, J. Kopeć and A. Kozina, R. Krupski, J. Czuchnowski, A. Pochtowski and Z. Wiśniewski, T. Oleksyn, A. Bitkowska, W. Kowalczewski.

Foreign sources definitely offer more knowledge of modeling the personnel function in an enterprise organized around processes. First of all, we should list the authors whose publications built a foundation for contemporary organizational transformations: M. Hammer, J. Champy, T. Davenport, J. Short, K.P. McCormack, W.C. Johnson, C.B. Adair, B.A. Murray, P. Drucker, J.R. Katzenbach, D.K. Smith, R.L. Manganelli, M.M. Klein, U.R. Muller, I. Nonaka, H. Takeuchi, G. Rummler, A. Brache, P. Senge, D. Ulrich, D.M. Fischer, P. Harmon, K. Lewin, M. Porter, M.J. Wheatley and others.

The current publications on managing a process-oriented organization prove clearly that companies are increasingly determined to improve the flexibility of their operations in the market. The most developed concept, meeting the needs of great dynamics of changes in the market is the process approach to management. The booming education and training market in this field satisfies the current growing interest in acquiring knowledge of business process management (BPM).

The development of the model of human resource management in process-oriented organizations may not only constitute a valuable contribution to the organizational management science but also support all entities responsible for shaping education programs and for practitioners searching for systematized knowledge and answers to some outstanding questions. An inspiring material referring to this issue could be an article by M. Hammer and S. Stanton, published in Harvard Business Review, entitled "How Process Enterprises Really Work". The authors quote examples of such companies as IBM, Texas Instruments, Owens Corning or Duke Power to prove that transformation of the structure focused on the main processes facilitates generating profits. The article, apart from organizational, systemic and relational concepts, also presents the challenges facing human resource management. The company managed by processes needs infrastructure which will support the work of teams responsible for realization of processes. The basic elements of this infrastructure listed by the authors are: 1) measure of work results, 2) rewarding, 3) work organization, 4) trainings and development and 5) career paths [Hammer, Stanton 2003, p. 88].

The measure of work results is still a daunting task that many managers cannot cope with. In a process organization, it is vital to be able to analyze processes using the criteria of achieving the main company goals. We must be able to determine the influence of particular processes on the achievement of company goals, therefore we have to identify appropriate measures of particular processes. Using these measures, managers may not only control the process flow, but by concentrating their employees attention on them, they build their awareness of how the process works. The same process measures should be used to determine the work results of particular process performers and effects of teamwork.

Rewarding employees should, at least partly, be related to process results. Process results are confronted with the objectives of the operational results. Team members may receive bonuses, depending on the degree in which these aims are realized, while process owners may grant additional bonuses to outstanding employees. The remuneration of process owners may depend on, for example, such factors as: process results, results according to business sector, company results.

Work organization in a process mature company gains transparent structure. However, the process maturity brings several conflict situations. Workers grouped in functional areas, subordinated to line managers, begin to participate in realization of processes for which their owners are responsible. This is a conflict-prone situation, especially at the level of measuring the effects of employees work, taking personnel decisions concerning rewarding or developing employees. Thus it is beneficial for each company starting

organizational reorientation towards processes to take consistent actions aiming at rejecting functional structures.

Employee training and development in a process organization are becoming even more important than in a function-based organization, in which employees have a narrow range of responsibilities and do not need extensive knowledge of how other departments work. In a process-oriented organization, employees must understand the whole process and the contribution of other units in its performance. Trainings for process performers are more important than trainings for managers. Self-management and self-organization based on employee empowerment require continuous perfection and development of competencies. Teamwork skills are especially important in a process-oriented organization, as it is the team performing the process which becomes a basic organizational unit.

Career paths in a process-oriented organization may change due to maximum shortening of the hierarchical ladder in a company. Employees are practically deprived of the possibility of vertical promotion, therefore new career models need to be developed. They are usually connected with acquiring the competencies for process management or obtaining more power and more serious tasks without changing the position in the company, or finally, with changing the position by moving to another process.

The elements of human resource management infrastructure in a process-oriented organization, outlined above by Hammer and Stanton, show the challenges and directions of change for personnel specialists in organizations. There is no doubt that the significance of some personnel processes is changing, the most important being employee development, measuring work effects and motivating staff to involve in performing and streamlining processes.

#### **4. Research assumptions and concepts**

Creation of the human resource management model in a process-oriented organization requires in-depth analysis of conditions created by the company for new solutions. Therefore, we should first refer to advanced work aiming at implementation of process work organization. We can use here the concept of examining process maturity and organizational capabilities included in the model of process audit proposed by M. Hammer - Process and Enterprise Maturity Model (PEMM). The factors of process maturity and organizational capabilities identified by the author of PEMM ([www.hbr.org](http://www.hbr.org) or [www.harvard.pl/hammer](http://www.harvard.pl/hammer)), constitute an essential and safe (the author has more than 20 years of experience) starting point in diagnosing process orientation of a company.

5 factors enabling process realization [Hammer 2007, p.116]:

- process design – is analyzed by formulating the purpose, the context of process performance and process documentation,
  - process performers – evaluated on the basis of their knowledge of the process, abilities needed in process performance, behavior connected with teamwork and responsibility for process effects,
  - process owner – analyzed through process identity, activities related to coordination of process work, authority over process performers, budget and IT systems
  - infrastructure – analyzed from the perspective of IT systems supporting process management and human resource management systems,
  - metrics – we evaluate how detailed they are and how they are defined
- 4 organizational capabilities [Hammer 2007, p.120]:
- leadership – identified by awareness of business processes, alignment to process changes, behavior of top managers towards process changes in management sphere, management style supporting process-oriented organization,
  - culture – analyzed by teamwork orientation, focus on customer, responsibility of managers and process performers and attitude to changes shown by all members of an organization,
  - competencies (expertise) – they refer to process mapping and modeling and methodology of implementing changes within processes,
  - supervision (governance) – analyzed on the basis of model solutions in process management developed and used by the company.

According to M. Hammer, the process reaches full process maturity when its design is documented and reflects adjustment to other processes and company IT systems in order to optimize the company and reflects adjustment to processes of clients and suppliers in order to optimize the effects of cooperation between companies. Such adjustment requires cooperation of process owners inside and outside the company, in relation to internal and external clients. Process documentation describes ties with other processes, and its electronic presentation should facilitate its management and improve effects as well as enable analysis of environment changes and process reconfiguration.

The requirements concerning performers' knowledge, capabilities and behaviors are vital in the maturity of processes. Performers should know and understand the process in which they participate, they should know how their work affects internal and external clients, they should be acquainted with the process effectiveness indicators and know the industry in which their enterprise operates as well as its ties with other companies. Performers should be able to solve problems related to process realization, be able to work in a team and self-manage. They should be able to make decisions and should possess appropriate skills of change management. The behavior of process performers should



guarantee conformity of process realization to company goals. Therefore it is vital to discern signals to start necessary changes to the process and to propose proper improvements.

Process maturity is also evaluated through the role played in it by the owner. It is assumed that this should be a senior level manager, responsible for designing, implementing and budgeting of the process. Their efforts should focus on improving the process taking into account company strategic aims.

Process infrastructure mostly covers IT systems and human resource management systems. The process is supported by the IT system with module structure, enabling communication with various internal and external subjects. The human resource management system, covering recruitment, professional development, rewarding and promoting, should serve the process needs and effects, cooperation inside the company and between firms, individual learning and readiness for changes.

Process metrics should mainly refer to costs and quality, and should be defined on the basis of customer's requirements, in accordance with enterprise's strategic goals and conditions of cooperation with other enterprises. These measures need regular reviewing and updating with reference to the realized strategy.

Progress in process management requires creation of appropriate favorable organizational conditions. Organization's capabilities are determined by appropriate leadership, organizational culture, competencies and proper supervision. Senior level managers treat process management not as a project but as a way of managing the enterprise, they treat their own work as a process, they base the development of new business opportunities on processes. A team of senior level managers hold the authority by presenting their vision and influencing others, not by ordering and controlling.

Organizational culture in process management is based on strong team orientation. Each employee is aware of their participation in the process and teamwork. Also teamwork with clients and suppliers is a common practice. Proper attitude to clients is a strong integrating element, focusing people on continuous perfection of processes. The most important organizational competencies are those related to process management, design and perfection. Supervision in an organization follows a developed model comprising properly defined organizational roles. All organizational forms are to improve processes.

The analysis of particular factors uses a four-degree scale, with each degree described. Reference to each degree calls for analysis of premises confirming the described state of the process. There are three possible states: when there are over 80% premises confirming the described state, 20-80% premises and up to 20% premises. The process maturity analysis should indicate areas of

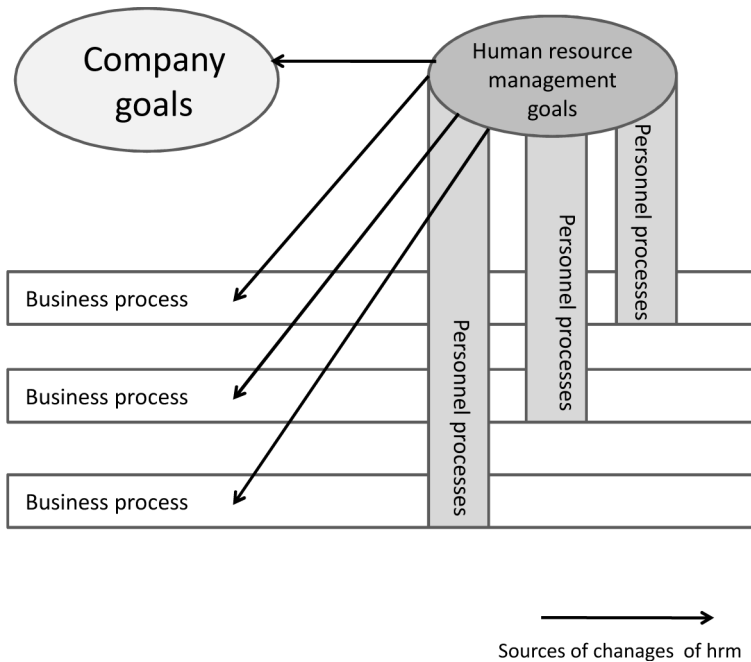
negligence in process performance. The author of the concept points out the necessity of harmonious development of the process within all factors in all levels of progress.

The evaluation of process maturity should constitute a reference point in interpretation of used practices related to human resources management. Identification of changes taking place in particular areas of human resource management should enable us to develop the model of human resource management for organizations adopting process orientation in management. The model of human resource management in a process-oriented organizations should incorporate the following elements:

1. New objectives of human resource management related to organization's process orientation
2. All subjects and their role in human resource management (with special emphasis on the role of a line executive)
3. Relations between the above subjects and communication principles
4. Operation principles of all employees (including functional staff)
5. System of managing human resources in the organization
  - 5.1. Key personnel processes and principles of their creation, performance and improvement
  - 5.2. Sources of designing and selection of methods of human resources management aiming at improving organization's flexibility (for example empowerment, forms of teamwork, measures of process effectiveness evaluation, self-management, self-organization)
6. Standardization of work processes
7. Cultural dimension of a process-oriented organization

Special attention should be paid to additional sources of changes in human resources management. In a process-oriented organization, these sources can be found not only in company objectives, but also in particular business processes. Designing all organizational processes should start with the survey of customers' expectations, then personnel processes will be an answer to the demands of employees involved in business process performance (Figure 1). This system of relations leads to the creation of new organizational structure, built on the basis of a client system. Experience obtained from research on functional cultures has shown that the role of an internal customer in reality boiled down to the postulate of managers, while a process-oriented company creates organizational conditions for the development of the client system. The role of an external or internal customer is incorporated in the process from the design to order processing and evaluation of effects. If clients of personnel processes are performers of all other processes in the organization, the sources of changes and improvement in human resource management should be sought mainly in changing expectations of employees.

**Figure1.** Business processes as new sources of organizational changes

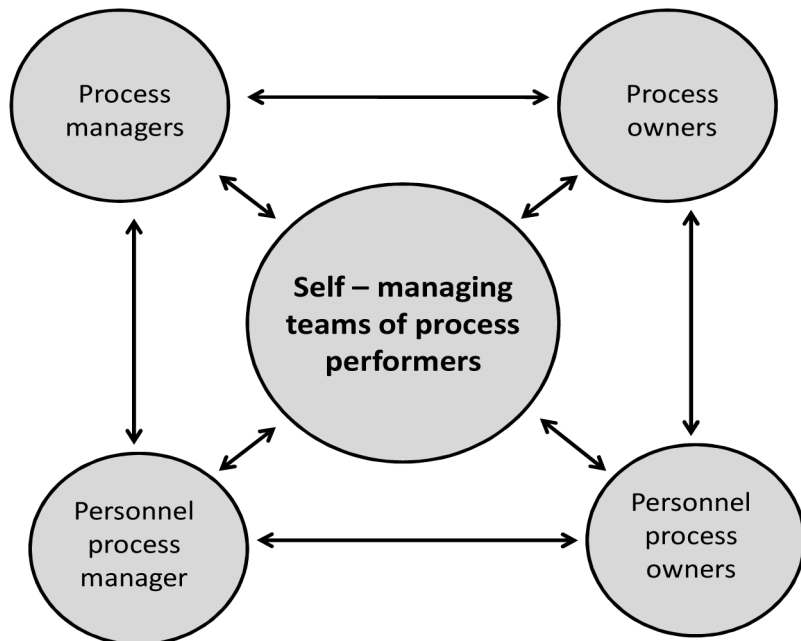


Source: own elaboration.

As a result of shaping new organizational roles, new subjects of human resource management appear. Process performers will become the main subject, and their importance will grow in line with the scope of empowerment inside the organization. It is postulated that in a mature shape of the process organization employees should work within self-managing and self-organizing teams. Through defining the areas of employee initiative, that is processes they can perfect, and through development of empowerment to make decisions, the significance of employees as process performers is growing. Therefore the influences and the scope for making personnel decisions by managers in functional structures and process owners in process organizations are shrinking. The role of a team executive is more concerned with coordinating work and creating conditions for task realization than in the classical system of management functions: planning work, organizing the team, motivating employees and supervising their work [Griffin 1997, p.40]. The organization of personnel processes in a process-oriented organization is also changing. The place of line managers is being taken over by process owners, the place of managers responsible for particular functional areas in the company is being taken over by managers responsible for groups of processes or mega-processes. Managers and process owners set in business processes or other supporting

processes, also participate in human resource management, to a smaller or larger extent realizing the objectives of personnel policy and strategy. Personnel specialists, personnel process managers and owners of particular processes in a process-oriented organization take on the roles of strategic partners, experts – advisors, administrators, leaders of change. In a process-oriented organization the concept of Ulrich’s four roles seems to have the best justification and real conditions for its application.

**Figure 2.** Subjects of human resource management in a process-oriented organization



Source: own elaboration.

Characteristic feature of process-oriented organizations is unrestricted communication in vertical, horizontal and even diagonal directions, possible thanks to IT tools and the basic principle of communicating as needs arise in processes. Such type of communication allowing initiating communication by all participants of an organization (Figure 2) naturally destroys the hierarchic system of information flow, information possession and information management.

## 5. Formulation and verification of research hypotheses

The direction of research on changes in human resource management in a process-oriented organization requires formulation of certain hypotheses. In Polish reality, the company operations are conditioned not only locally or regionally, but also internationally. Each company operating in Polish market, even if it is not a branch of a multinational corporation, must face international competition. Therefore it is justifiable to refer first of all to the international environment of an organization.

H1. Adopting process orientation in an organization is determined by international standards in enterprise management.

The research on changes in human resources management in a process-oriented organization should be correlated with process maturity. Not many companies decide to adopt radical solutions, for example through reengineering. Most companies enter the path of gradual organizational reorientation involving employees performing processes in this process. For employees to be able to participate in the process of designing and improving processes, they must possess appropriate tools and be empowered. In contemporary process management IT tools not only enable us to obtain, gather and process information, but also discipline the activities of employees responsible for processes. Therefore the second hypothesis refers to tools which help develop processes.

H2. Process maturity is determined mainly by use of IT tools in process management and by empowerment of employees and teams.

Strong position of the personnel team in an organization may constitute reinforcement of introduced changes or be a hindering force. Business competencies of personnel specialists seem to be crucial in understanding the environment of an organization and the needs related to competing, and in good communication with managers responsible for company strategy and its implementation. If personnel specialists understand business objectives and methods of achieving them, they should be able to incorporate themselves in the change process and to become change leaders using instruments of human resource management (for example motivating, improving efficiency or developing employees).

H3. Personnel specialists, if they are not leaders of process orientation, become the main source of barriers to implementation of changes.

Process maturity of an organization concerns all areas of the company, including human resource management. Changes related to process reorientation should cover all aspects of human resource management: process aspect – to adjust to the needs of teams performing processes in the company, instrumental aspect – to develop tools for intended objectives and tasks, institutional aspect –

to organize the process of making personnel decisions and to define the roles of subjects responsible for human resource management in the company.

H4. Development of organizational capabilities of process management is determined by human resource management spheres: process sphere (how personnel processes are performed), instrumental sphere (what instruments are used in process HRM) and organizational sphere (how institutionally organized HRM is).

The assumptions and research concepts listed in this section may constitute a starting point for conducting research on changes taking place in human resource management in a process-oriented organization or the one which is adopting process orientation. Research in this area should bring measurable benefits for the current state of knowledge in human resource management and for an organization which initiates research on process maturity and on human resource management support.

Verification of research hypotheses requires proper selection of research methods. The basic dilemma at this stage of research concerns which type of methods we should use, the qualitative or quantitative ones, or whether it is possible to combine them. Taking into account the fact that the concept of process management in Poland is at its early stages of implementation, it might turn out to be difficult in research practice to identify all subjects that implemented and began to introduce changes aiming at organizational reorientation. Obtaining information on research survey for companies located in Poland may prove impossible, therefore the choice of survey sample may also be doubtful. Obviously, if we take into account the current state of knowledge of management concept in Polish companies, qualitative research seems more purposeful and justifiable. Each case study related to a company implementing process management in Polish reality may prove invaluable source of information about changes taking place in human resource management as a result of process reorientation of a company. This could be an important step in discovering in Poland the same changes that we have been observing in multinational companies for the past several years.

## **6. Conclusions**

The aim of the article was to present the concept of research on changes taking place in human resource management in a process-oriented organization or the one which is adopting process orientation. Due to early stages of process orientation development in companies located in Poland, it was assumed that research on changes in personnel area should be combined with the level of process maturity of an organization. That is why Hammer's concept of PEMM was used to analyze process maturity and organization's ability

to manage processes. The presented concept of research should allow us to obtain knowledge which could become the foundation on which the model of human resource management in process organizations could be constructed. The presented assumptions concerning the model cover key components in process, instrumental and organizational or institutional aspects. The content of research: the object, subject or spatial one, covers the intended elements of the model and provides methodological coherence of the presented concept.

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**Katarzyna Kolud\***

## **ORGANIZATIONAL COMPETENCIES AND THE SCOPE OF CONTRACTING OUT IN OUTSOURCING IMPLEMENTATION ON THE EXAMPLE OF A BUDGET HOUSING MANAGEMENT ENTITY**

### **Summary**

*The purpose of this article is to analyze the problem of core competencies in determining the scope of elimination in outsourcing implementation in a budget housing entity. In this case, the protection of core competencies is not strategically important because of specificity of the housing resources and its social and intervention nature, intended to meet the housing needs of families with low or very low income. The budget housing entity does not need to maintain competitiveness in all its business areas and some of them may be transferred to external suppliers.*

### **1. Introduction**

The aim of the article is to analyze key and other organizational competencies in the context of the scope of contracting out in outsourcing implementation in a budget housing management entity, located in the Śląskie Province. As a public utility it serves satisfaction of social needs, and, according to article 4, section 2 of the Act of 21<sup>st</sup> June 2001 on Tenants Protection, Housing Resources of the Commune and Changes to the Civil Code (Journal of Law. 2001, No 71, position 733) it provides social and substitute lodgings and satisfies the housing needs of low income households. The financial situation of tenants influences their inability to search for competitive lodgings, and this accounts for lack of emphasis on achieving competitiveness of the entity on the housing market, directly affecting the effectiveness of its operations. The analyzed entity, however, assuming that not all organizational competencies – key and other ones – must be achieved by it, attempts to streamline its functioning through transferring a selected area of its activity outside.

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## 2. Key competencies in theory and practice

An economic entity may possess a large number of skills and competencies, but only some of them may be classified as key ones. Among them are those which differentiate the economic entity from its competitors (Power, Desouza, Bonifazi, 2006, p. 43), such as unique strategic resources allowing it to implement its strategic intentions (Bratnicki, 2000, p. 18): innovative knowledge, specialist skills, applied technologies, information flow and unique operational methods (Greaver, 1999, p. 87). Obłój claims that we should determine what makes particular resources strategically essential (Obłój, 1997, p. 80), while Greaver, Prahalad and Hamel point out that when particular skills or competencies do not create products or services considered unique by customers – they are probably not the key ones (Greaver, 1999, p. 87; Prahalad, Hamel, 1990, p. 82; Hamel, Prahalad, 1994). The conclusion drawn from it is that these entities compete for customers, profit and market share with products and services, trying to meet the expectations of buyers. As a result – as the theory of resources indicates – market survival depends on accumulation of rare and precious resources, impossible to be replaced with substitutes or to be copied (Grant, 1991, pp. 114-135; Barney, 2001, pp. 643-650). The above definitions confirm that key competencies:

- are to be sought in the main driving forces of an economic entity, especially in the spheres of core values, core and auxiliary activities, competitive edge factors,
- are identified in the processes and products (tangible aspect) and complex knowledge of the organization (intangible aspect),
- concentrate on the necessity of shaping or strongly influencing the value for clients,
- are not regarded as a single element, but as a set of features accounting for organization's competitive edge.

Specialist literature also emphasizes the difficulties in recognizing key competencies (Boguslauskas, Kvedaraviciene, 2009, pp. 75-81; Heikkilä, Cordon, 2002, pp. 183-193). It is particularly complicated when the definition of outstanding or market competencies is introduced, which are difficult to distinguish from key competencies (Hitt, Ireland, 1995, pp. 273-293), as the former are often associated with features distinguishing an economic entity, and the latter with possessed knowledge and market experience. Authors assume though, that competencies which do not position products or services of an economic entity in client's mind higher than those of competitors may not be the key ones.

The criteria qualifying competencies as the key ones on the basis of evaluation of the shaping force or the influence on value for customer are correct, as the determination of the scope of contracting out in outsourcing implementation concerns an economic entity functioning in a competitive environment. The scope would then actually cover the areas of activities which do not generate significant benefits for the end-user. In case when the activity of an entity is not directed at using the winning market strategy, the above-mentioned criteria may not be practically applicable, while pointing out key competencies will only be of distinctive and declarative type.

### **3. Outsourcing key competencies**

The movement from entrusting an external provider with realization of tactical scope of activities to strategic or transformational one, may be treated as a natural consequence of evolution in outsourcing. This turn is visible more in theory than in practice, as executives still believe that only the activities which are not the key ones may be contracted out in the outsourcing process. In theory, especially in Trocki's work, we can find opinions that the less the contracted out activities are connected with key competencies, the higher the proneness to contract them out (Trocki, 2001, p. 67). The fundamental problem here seems to be not the issue of contracting out areas connected with key competencies, but recognizing them. Mistakes made at this stage may block the optimal use of unique skills, deterring or even preventing successful implementation of outsourcing.

Scientists do not exclude though contracting out the scope covering key competencies both in main and side areas. As Obłój claims, with the increasing significance of knowledge, it is becoming harder to develop and control the most essential competencies (Obłój, 1997, p. 80). Power, Desouza and Bonifazi claim that outsourcing key competencies is possible, but requires the highest degree of trust in external provider, the highest precision in drawing an outsourcing contract, precisely defined standards as well as costs and operational conditions (Power, Desouza, Bonifazi, 2006, p. 71). On the other hand, Pierścionek suggests that an economic entity should first of all strive at recognizing what key competencies will be vital in the future shape of the sector and then start developing them (Pierścionek, 2006, p. 230), which seems to be an argument for and against outsourcing this type of competencies.

#### **4. The scope of contracting out in outsourcing implementation – theoretical approach**

One of the biggest challenges in taking outsourcing decisions is to determine the scope of contracted out area (Brown, Wilson, 2006, s. 55). According to Nalepka, this process should be started with the analysis of the scope of activities performed by an economic entity, which requires focusing on two areas: the content scope and the function scope, where the content scope is determined by a package of products or services offered by an entity in particular markets, while the function scope is determined by the type and number of realized preparatory, manufacturing and auxiliary and servicing processes (Nalepka, 1999, pp. 51-53). Power, Desouza and Bonifazi propose to characterize the scope of activity according to its process ties, and the result of the analysis will give us a list of functions which can be contracted out only separately or in a group in case of processes which cannot be separated. Authors try to convince us that if there is a possibility of separating the above-mentioned processes, this will facilitate the decision to contract them out, as the opposite situation would definitely complicate it (Power, Desouza, Bonifazi, 2006, p. 72). The key aspect in determining the scope of contracting out is the diagnosis of activities through the analysis of functions. Scientists distinguish core (operational), managerial (regulatory) and auxiliary functions (Trocki, 2001, p. 17). Core functions are those which directly concern the realization of the end target of an economic entity. Regulatory (managerial) functions consist in determining and maintaining the direction in which an entity functions, and are vital for the efficiency of its operations. The features that distinguish managerial functions from others are long-term predicting and conceptual type. Auxiliary functions, like all other functions, do not directly realize external objectives and do not contribute to the regulation of the whole entity. However, they considerably influence the possibility of realizing core functions (Zieleniewski, 1979, pp. 399-401, 480). It seems that special importance of managerial functions rules out the possibility of contracting them out. As Nalepka writes, the effect of the division of functions realized by an economic entity may indicate those functions which can be realized at lower costs by external units with no negative effect on the effectiveness and quality of activities; it may also point at insufficient use of the potential of organizational units which can be rationally utilized, or even indicate some gaps in using certain functions in realizing current core tasks of an entity (Nalepka, 1999, p. 50). It should be added that the determination of the scope of contracting out on the basis of functional division seems to be easier in case of economic entities with complex, but transparent organizational structure, with work posts, sections and organizational units and assigned job

responsibilities. The entity functioning in a freely constructed organizational structure could determine the scope of contracting out using the criteria of purpose, depth, speed of expected results and required control level. Such characteristics is presented in Table 1 below.

## 5. The scope of contracting out in outsourcing implementation – practical approach

The housing management entity has a transparent organizational structure. Both work posts, organizational sections and units have various functions and sub-functions assigned to them, which constitute organizational competencies – key ones and the others. As we have noticed earlier, the entity does not compete in the housing market, therefore the decision to transfer the scope containing the above competencies, especially the key ones, is not caused by the desire to protect them from competitors. The main reason is the unsolvable economic conflict between the entity and tenants.

**Table 1.** Determining the scope of contracting out in outsourcing implementation

Criteria determining the scope of contracting out	Area	Expected result after contracting out	Suggested scope of contracting out
Objective	Costs	Minimization. Optimization.	The widest scope, generating the highest fixed costs.
	Key competencies	Strengthening.	Experimentally, narrow scope.
	Outstanding competencies	Acquiring.	Experimentally, narrow scope.
	Market competencies	Access.	The scope served by poorly qualified and inexperienced staff.
	Technologies	Access.	Wide scope if the entity competes relying on innovative technologies.
	Working time	Effectiveness.	Time-ineffective scope, excess full-time employment.
	Production	Flexibility.	Scope does not require a long chain of deliveries. Scope requires shortening lengthy chain of deliveries.
	Changes	Time to market.	Wide scope. Decentralization of activities.

<b>Criteria determining the scope of contracting out</b>	<b>Area</b>	<b>Expected result after contracting out</b>	<b>Suggested scope of contracting out</b>
Depth	Auxiliary functions	Quantity minimization.	No complicated functions, not requiring high qualifications.
	Core functions	Quantity minimization.	Complex functions, but not too complicated, requiring specialist knowledge and qualifications. Complex functions with very complicated structure, requiring involvement and combining resources of the principal and the external provider.
Speed of results	Auxiliary functions	Minimization of processing time	Scope with short time to observe effects, for example noticeable change in quality level or speed of reaction to customer's needs.
	Core functions	Minimization of processing time.	Scope with long time of waiting for measurable effects, for example safety quality, number of critical events, use of emergency procedures.
Level of control	Auxiliary functions	Safety maximization	Scope covered by current, day-to-day control.
	Core functions	Safety maximization	Scope covered with periodical control due to its size and complexity.

Source: own elaboration.

The conflict of interests results from the expectations of tenants, who are interested in bearing the lowest possible maintenance costs of their premises, which in practice translates into pressure on lowering the rates of rent. The housing management entity, on the other hand, realizing its statutory obligations, must strive at exploiting housing resources in a proper way, in line with existing financial and social constraints. In practice, though, the scope of outsourcing could cover a greater number of organizational competencies, and yet it focuses mainly on functions and sub-functions using the competencies the realization of which will bring savings satisfying both parties. Table 2 presents the core functions and sub-functions realized in the analyzed housing management entity. For example, the analysis of the scope of outsourcing has shown that only in the Residential Buildings Maintenance and Administration Departments it is allowed to transfer the performance of tasks

to external providers (none is connected with key organizational competencies). In most cases the scope of tasks referred to modernization, exploitation and maintenance work, covering also repairs of roof on buildings constituting housing resources, repairs of flues, renovation of elevation on residential and service buildings, insulating external walls and painting the elevation of buildings, liquid waste disposal, as well as clearing the areas managed by the housing management entity of trees and bushes. In typically administrative departments tasks belonging to organizational competencies are realized by entity employees. The scope of outsourcing could easily cover most tasks, due to their small influence on the safety of using premises by tenants and on their level of satisfaction from rented flats. The verification of cost estimates for repair and modernization work performed at the expense of tenants was assumed to be connected with key organizational competencies, however with an option of outsourcing them. In the department dealing with administration of residential buildings most tasks were classified as using key organizational competencies, due to their significance in lowering maintenance costs (vital for tenants). The tasks transferred outside comprises only keeping cleanliness and order in the premises, conducting technical reviews and flat reviews, leak proof tests of gas installation, measurements of electrical and lightning systems and small maintenance work.

In light of the results obtained in the analysis, it would be advisable to consider the issue of creating value for the customer – tenant. The knowledge of key and other organizational competencies is vital to indicate those which can help create value for the customer. If an economic entity cannot create it itself, that is if it does not realize competencies in an effective way, it should contract this function out to a specialist entity. The analyzed housing management entity does not create such value. It does not either take up the fight for its market position, probably due to material situation of its tenants. Most tenants in the communal housing resource are poorer than other tenants who occupy other housing resources – cooperative housing or accommodation provided by their employers, and the rent in communal resources has not reached the level which would cover the maintenance costs and necessary expenditure for repairs. In practice, the housing management entity has limited financial, technical and technological base and it focuses its efforts mainly on maintaining proper standard of housing resources. Therefore, creating value for the customer – tenant, does not consist in offering him or her additional benefits from renting the premises, but translates into efforts to slow down the process of de-capitalization of resources and maintaining the quality of dwelling. The current scope of outsourcing implemented in the entity, covering key and other organizational competencies, brings satisfactory effects, especially as far as reduction of financial costs is concerned. Therefore it seems that encouraged

by positive economic results from outsourcing implementation, the housing management entity should not block the possibility of transferring outside other organizational competencies, especially if they were to create value for inhabitants.

## **6. Conclusions**

The state-owned entity managing the communal housing resources is a public utility, whose main goal is to satisfy the needs of the local community. The tasks which constitute management of housing resources are for example: administration of residential and utility buildings, technical care and management of premises – proper exploitation, development and supervision of commissioned maintenance, repairs and renovation system, as well as signing and terminating the rental contract for their premises.



**Table 2.** The scope of outsourcing in the analyzed housing management entity

Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	
Department of Residential Premises	Renting residential premises	Keeping records of tenants.		•		•
		Preparing contracts for residential premises rental.	•			
		Cooperating with tenants in rights and obligations resulting from the contract for residential premises rental.		•		•
		Collecting rental receivables and payments independent of the owner.		•		•
		Dealing with matters related to execution of court rulings.		•		
		Keeping records of free premises		•		•
		Keeping records of applicants for residential premises tenancy.			•	•
		Providing information on principles of renting free utility premises			•	•
		Announcing and organizing tenders for renting free utility premises.			•	
		Offering inspection of free utility premises by subjects interested in renting them				•
Department of Utility Premises and Debt Collection	Renting utility premises intended for economic activity	Issuing approvals for repair and renovation work in utility premises carried out by tenants,	•			

Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	Competencies that could be transferred outside
Department of Utility Premises and Debt Collection	Renting utility premises intended for economic activity	<p>Verifying cost estimates for repair and renovation work performed at the expense of tenants</p> <p>Collecting debts</p> <p>Signing and terminating contracts for utility premises rental and contracts for making communal property available for placing advertising and information content.</p>	•			•
				•		•
Department of Accounting	Finance and accounting	Supervising all matters related to records of property, cash management, settling financial obligations, settlements with insurers and records and depositing on bank accounts the amount being security for proper performance of construction work.	•			
		Preparing materials for the tender for insuring the Housing Management Entity property	•			
		Budget reporting.		•		•
		Preparing materials for financial plans and their verification.		•		
		Drawing up a tax return for real estate tax		•		•
Dealing with all matters related to accounting record of repairs and investments.			•		•	

Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	
Department of Accounting	Finance and accounting	<p>Settling sales and purchases for the VAT declaration. Drawing up VAT declaration</p> <p>Keeping synthetic and analytic records of fixed assets and intangible assets.</p> <p>Monthly calculation of amortization and depreciation.</p> <p>Keeping register of contracts made with subcontractors as regards exploitation and repair costs.</p> <p>Keeping synthetic and analytic records of other fixed assets.</p> <p>Day-to-day recording all bills and VAT invoices, keeping VAT register.</p> <p>Dealing with matters concerning recording and keeping on bank accounts the amounts being the security for proper performance of construction work and bid securities.</p> <p>Managing the payroll.</p> <p>Making settlements with National Insurance Agency and Tax Office.</p> <p>Employment policy (selection of staff, rational management of posts, work discipline, trainings).</p>		•	•	•
				•	•	•
				•	•	•
				•	•	•
				•	•	•
				•	•	•
Department of Personnel and Administration	Personnel, Payroll, Administration.		•			•

Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing		
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	Competencies that could be transferred outside		
Department of Personnel and Administration	Personnel, Payroll, Administration.	<p>Preparing and conducting periodical reviews of staff and employee evaluation.</p> <p>Cooperation with District Employment Agency in employing trainees, graduates, emergency workers</p> <p>Cooperation with Municipal Social Welfare Center in organizing socially-useful work.</p> <p>Cooperation with District Court, III Criminal Law Department in organizing socially useful work ruled instead of uncollectible fines.</p> <p>Dealing with social matters of employees.</p> <p>Running the Correspondence Register and correspondence dispatch.</p> <p>Keeping the records of office equipment and supplies.</p> <p>Procurement of office equipment and supplies and other materials – in line with the Act on Public Procurement.</p> <p>Supervising the Housing Management Entity archives.</p>	•			•		
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Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	
Department of Exploitation	Exploitation	<p>Keeping records of managed real property for statistical and tax purposes</p> <p>Dealing with matters concerning ownership of real estate.</p> <p>Dealing with matters concerning garage rental and land lease.</p> <p>Signing contracts for garage rental, land lease.</p> <p>Collection of rent receivables.</p> <p>Organizing and supervising maintenance of managed real estate as regards sanitation and cleanliness.</p> <p>Dealing with matters concerning the change in the way residential premises, utilities and other premises are used.</p> <p>Providing information on procedure of purchasing residential premises and expressing opinion concerning applications for purchase of premises.</p> <p>Making settlements with owners or co-owners of real estate.</p> <p>Dealing with matters connected with accepting and transferring real estate management.</p>	•		•	
			•		•	
			•		•	
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					•	

Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	Competencies that could be transferred outside
Department of Exploitation	Exploitation	<p>Signing contracts on services related to exploitation of managed buildings and areas.</p> <p>Signing contracts on servicing chimneys, boilers, hydrophores and hoists.</p> <p>Performing indoor and outdoor general construction repair and investment work.</p> <p>Day-to-day maintenance of objects and appliances constituting housing resources.</p> <p>Performing commissioned construction and painting work in buildings.</p> <p>Maintenance painting work in buildings and outside (gates, playground equipment, etc.)</p> <p>Maintenance painting work in buildings and outside (gates, playground equipment, etc.)</p> <p>Keeping organizational documentation of housing management entity and a register of internal normative acts.</p> <p>Collecting normative acts, such as Journal of Law, Polish monitor, other official journals, Resolutions of Town Council, Regulations of the Mayor, rulings of the Supreme Court, etc..</p>	•			
			•		•	
					•	
					•	
					•	
					•	
Organizational and Legal Department	Organizational and legal.			•		•
				•		•

Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	Competencies that could be transferred outside
Department of Exploitation	Organizational and legal.	<p>Preparing and storing correspondence issued by the Head to the authorities of Bielsko-Biała (City Council, Council Commission, President) and to other organs.</p> <p>Keeping register of questions asked by City Council members, motions of the Council Commission, statements made by members of parliament, as well as a register of complaints and interventions submitted to the housing management entity.</p> <p>Keeping contact with the press in matters related to statutory activity of the housing management entity.</p> <p>Coordinating matters related to personal data protection in the entity.</p> <p>Dealing with matters concerning health and safety at work.</p> <p>Legal servicing for the housing management entity.</p> <p>Running the secretary's office at the housing management entity.</p> <p>Dealing with matters related to monitoring the building in the premises of the entity.</p>	•	•		•
			•	•		•
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Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	Competencies that could be transferred outside
IT Department	IT services	Computer software and hardware servicing.	•		•	•
			•		•	
			•			•
			•			
			•			
			•			
			•			
			•			
			•			
			•			
Department of Residential Buildings Administration	Administration of residential buildings.	<p>Conducting technical reviews annually and every 5 years, inspections of flats, leak proof tests of gas installation, measurements of electric and lightning installations.</p> <p>Preparing schedules of maintenance and prevention repairs. Applying for general repairs and renovation of buildings.</p> <p>Organizing tenders, technical supervision of work and financial settlement of performed work</p> <p>Keeping the managed areas clean and in order.</p> <p>Issuing opinions concerning applications of inhabitants as regards changes to heating systems, changes to internal installations and reconstruction of the residential premises.</p> <p>Signing contracts for general and current repairs of residential premises at the cost of a future tenant.</p> <p>Cooperation with companies providing services of solid and liquid waste disposal.</p> <p>Maintaining buildings, small architecture objects and the surroundings in proper technical state.</p>	•			
			•			
			•			
			•			
			•			
			•			
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			•			
			•			
			•			
•						



Department	Core function	Sub-function of the core function	Real scope of outsourcing			Suggested scope of outsourcing
			Key organizational competencies	Other organizational competencies	Competencies transferred outside	
Department of Residential Buildings Administration	Administration of residential buildings.	Controlling expenses connected with electric energy supply for lighting common areas of the real estate and analyzing water consumption in particular buildings.	•			
		Classifying residential buildings for general and current renovation at the expense of a future tenant.	•			
		Signing contracts for leasing house gardens.	•			
		Providing maintenance services, small repairs, renovations and eliminating faults in construction and roof areas			•	
		Construction and reconstruction of stoves				•

Source: own elaboration on the basis of research conducted in a housing management entity.

The law-makers allowed state-owned entities to provide services connected with management of real estate belonging to Treasury, economic units and individual persons, on commission of their owners. They can also provide renovation and construction services as long as such activity does not result in constraints or quality deterioration and it positively influences economic effects of their activities. The realization of tasks is commissioned to external providers under the outsourcing implementation scheme, which is undoubtedly a positive consequence of institutional and legal changes introduced in communes, aiming at improving rationality of managing their own resources. In the analyzed case we can clearly see that the outsourced scope covers mostly other organizational competencies and accounts for a small share of all tasks realized in management of the communal housing resources, which can probably be attributed to an autarchic culture and organizational structure of commune budget entities. Further studies should include a profitability analysis of transferring outside suggested key and other organizational competencies.

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**Michał Piłat\***

## **THE INFLUENCE OF ORGANIZATIONAL CULTURE ON BUILDING A LEARNING ORGANIZATION**

### **Summary**

*The organizations of the 21<sup>st</sup> century more and more often see their human resources as the most valuable asset they hold. This is why they create wide range of opportunities to develop and self-improve for their employees. Such approach is aimed at increasing involvement, higher effectiveness, innovativeness and thus constant improvement of competitiveness. However this is not possible without employee constant learning and their self-actualization. In this way the learning process is stressed as essential element of every modern company. As a result of this thinking one of the key tasks for a company is to create proper environment which would generate and feasible knowledge. This is where organizational culture might prove very useful. The main objective of the article is to demonstrate the influence of organizational culture on molding learning organizations. The content has been drawn up based upon literature study as well as in-depth interview conducted with the computer programmer working for Google, Ireland. The study is a consequence of authors' interests in the fields of organizational culture as well as learning organization.*

### **1. Introduction**

The contemporary approach to enterprise management reflects the fact that an organization is affected by various factors originating in close and distant environment, which constitute a certain context in which it functions (Bukowska, 2005, p. 455). With each decade the competition is becoming fiercer and the companies which do not learn and do not introduce changes are doomed to failure (von Oetinger, 2004, p. 35). As Kotter points out (2007, p. 191) at the end of the 20th century a great number of organizations experienced growing difficulties with proper functioning, mostly due to fossilized structures, systems, applied practices and organizational culture. According to

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the author, these factors were more of a barrier to introducing changes than facilitated them. On the other hand, the experience of enterprises from East Asian countries point at ultra-positive dimension of organizational culture, including learning categories. Thanks to this we can talk of specific bipolarity of the organizational culture phenomenon in an enterprise. The aim of this article is to prove the positive influence of organizational culture on building and developing a learning organization.

## **2. The concept of a learning organization and its role in shaping competitive advantage**

As many scientists and entrepreneurs emphasize, the source of competitive advantage in organizations of the future will be their ability to adapt. From this point of view, modern organizations must resemble a chameleon. Both the shape and the outlook of such an organization should be subject to constant changes following modifications of the environment and its requirements towards the organization (Miller, 1998, pp.139-140).

Organizational ability to change is not a new concept. Also the organizations whose employees demonstrate willingness and ability to learn are nothing new. We should notice, though, that individual learning is not always a positive phenomenon for an organization, as employees may learn something undesirable for an organization (they may, for example, notice that it is enough to work effectively only two hours per day because their supervisor cannot effectively monitor the effects of their work), or they can learn to perfect their own work without any benefits for the team (Fazlagić, 2010). That is why it is essential that an organization should articulate the issues that are to form the basis of employees development and it should not emphasize only the motivation for constant and conscious learning.

A learning organization is any form of an organization which enables its members to learn and, as a result, it facilitates achievement of valuable results in shape of innovations (product, marketing, organizational, etc) which leads to better competitive position of an enterprise (Kożuch, 2007, p. 255). In such an organization the key values are (Yukl, 2006, p. 310):

- learning,
- innovativeness,
- initiative,
- flexibility.

In a learning organization all employees should be involved in solving problems, thanks to which they gain valuable experience. What is important, in learning organizations, each employee has wide access to knowledge. According to Senge – the creator of the learning organization concept, in this

type of structures people always look for new possibilities of obtaining desirable effects, create new models of unconventional thinking, develop in teamwork and learn constantly (Senge, 2008, p. 26). M. Bratnicki (1998, pp. 109-110) also points out that in a learning organization:

- all employees see themselves as people learning on behalf of the enterprise, take responsibility for their individual development, are aware of the risk related to constant changes,
- traditional supervisor-subordinate relationship is being replaced with self-management, employees are pro-active and take up initiative,
- there is spirit of self-development; employees take responsibility for the learning process; organization provides space for development; employees are treated as mature individuals,
- the way it functions resembles the consortium of small businesses; each treats work as their own business and shows typical vitality, energy and effort; the success of such an organization is in the interest of each employee,
- the organization as a whole creates, gathers, spreads and uses new knowledge and maintains and develops key competencies due to which it achieves competitive advantage in the market.

By definition, a learning organization creates possibilities of development for all its employees and is also able to learn itself and transform as a community.

### **3. The concept of organizational culture and the causes of growing interest in it**

According to Schein (1992, p. 36) organizational culture may be perceived as a model of basic assumptions – invented, discovered and developed by a group of people in the process of learning, dealing with problems of external adaptation and internal integration – functioning well enough to be considered just and proper to be passed on to new members of the community as an appropriate way of perceiving, feeling and reacting to these problems.

In such definition, organizational culture is a set of basic values, assumptions, interpretations and attitudes which characterize the organization (Cameron and Quinn 1988, pp.356-396) and “a kind of collective artifact (shared meanings, symbols, rituals, cognitive schemes), constantly formed and transformed as an organization is trying to balance the requirements of internal coherence with the needs to react discovered in the environment” (Bratnicki, Kryś and Stachowicz, 1988, p. 67).

Hofstede shows that organizational culture covers the way of thinking passed by the leaders to the group members and by the led ones to the leaders (Pocztowski, 2002, p.59). Practices in this area are the derivative of

organizational culture itself and cultural values of a particular country in which an enterprise functions. It should be emphasized that such relations function on a feedback principle (Konecki, 2007, p.16).

Just as in case of learning, the phenomenon of organizational culture is not new, but its significance is growing. This can be attributed to a number of reasons, such as (Kozłmiński and Piotrowski, 2006, p. 298) :

- economic success of Japan (over 10% economic growth in the whole decade of the 1960s and over 5% in the 1970s) and search for its origin. The comparative analysis of Japan and the USA clearly pointed at differences in organizational cultures and saw them as directly influencing the effectiveness of management (the 1981 publication by Pascale and Athos, entitled “The Art of Japanese Management” brought about hot debates on possibilities of implementing the Japanese model on the American grounds);
- revival of interest in qualitative methods in research on organizations and management. The interest in phenomena (including corporate culture) whose analysis hinders application of quantitative methods and forces the adoption of descriptive and explanatory style,
- growing competition and crisis of traditional management concepts, which forced companies to search for new factors guaranteeing success. Organizational culture which generated competitive advantage was thought to be “something possessed by Japanese companies” and “lacked” by others,
- interest in mythology and symbolism in the 1980s, especially rejection of the functional and acceptance of the individual, unique and expressive.

Organizational culture is an extremely complex phenomenon and its understanding requires to a large extent being “inside”. In other situations, the knowledge of the culture is restricted only to acquainting with its visible or partly visible elements. That is why leading Japanese companies like Toyota are not afraid to publish information on sources of their competitive advantage (Liker, 2004). They realize that they cannot be “just copied” and adapted to a different organization. If the aim of the enterprise is to create culture which will influence the growth of effectiveness, innovativeness, flexibility, etc., then the key process takes place as early as during the recruitment stage. The most essential thing is to recruit people whose values are consistent with the values respected and professed by the enterprise. Otherwise we have a strong dissonance which, in time, will cause the appearance of counter-culture destructively affecting the organization (J. Martin, C. Siehl, 1983, p.64). Therefore strong positive influence of organizational culture on the effectiveness of an organization can be perceived when it behaves in accordance with the values it declares.

#### **4. Organizational culture attributes which shape a learning organization**

Robbins (2001, pp. 428-430) points out that the essence of organizational culture can be boiled down to seven basic features which play a key role in managing an enterprise. The intensity of a particular feature in an organization directly influences the organizational effectiveness. These are:

- innovativeness and risk-taking, that is the extent to which employees are encouraged to innovativeness and risk-taking,
- paying attention to details, that is the extent to which employees are expected to be precise, use analytical approach and paying attention to details,
- focus on results, determining the degree in which management focuses their attention on results, not on methods used to achieve them,
- attitude to people, that is the extent to which management takes into account the influence of results on people in the process of decision-making,
- focus on teams, showing the degree in which work is organized around teams rather than around particular people,
- the degree in which people are aggressive and focused on competition, and the degree in which they are lenient,
- the degree in which organization's activities concentrate on development or on preserving status quo.

Taking the above into consideration, we should emphasize that these features are especially important for the influence of the phenomena on the development of a learning organization. They base on key values, typical for learning organizations.

Many East Asian organizations which build their competitive advantage on organizational culture (for example Toyota) are learning structures, that is such structures in which the method of operation contributes to the exchange and creation of new knowledge, essential both for the interest of the whole organization and for its particular parts (Bendyk, 2004, pp.223-224). This process is strengthened by such cultural background elements as socialization process, values, management systems, everyday practice, artifacts, etc (see Figure 1 and Table 1).



**Figure 1.** The influence of organizational culture on building a learning organization



Source: own elaboration on the basis of: C. B. Dobni: Measuring innovation culture in organizations. The development of a generalized innovation culture construct using exploratory factor analysis, 'European Journal of Innovation Management', Vol. 11, No. 4, 2008, p. 544.

Learning organizations may draw knowledge from various sources. However, as Jack Welch, one of the best world managers, points out, no employee will be able to innovate, self-develop or generate added value for the company, if they do not identify with it (Hoffmann & Pilat, 2010, p. 212). That is why the objective of organizational culture is to create the climate which would encourage learning. Table 1 presents examples of various culture-based practices which greatly facilitate creation and operations of learning organizations. The examples quoted were mostly based on Google company, which is an unquestionable leader among learning organizations.

**Table 1.** Organizational culture attributes which shape a learning organization

Culture-based attribute	Examples on the basis of Google company
Socialization process	<ul style="list-style-type: none"> <li>• team work,</li> <li>• international staff (Google branch in Dublin employs people from 38 countries all over the world),</li> <li>• arranging social space in enterprises (for example: library, canteen, playroom with table football, snooker tables, volleyball courts, various video games, pianos, table tennis and gyms in which yoga and dance classes are run),</li> <li>• creating free space as „open office”, allowing employees to work in one room (there are only a few separate offices),</li> <li>• weekly after work meetings on Fridays, in which both new staff and top management take part,</li> <li>• integration and training trips,</li> <li>• company support in developing off-work interests (for example mountain biking, wine-tasting, flying, Frisbee, etc.).</li> </ul>
Key values	<ul style="list-style-type: none"> <li>• learning,</li> <li>• innovativeness,</li> <li>• initiative,</li> <li>• flexibility,</li> <li>• self-development,</li> <li>• quality (perfectionism),</li> <li>• speed,</li> </ul>
Management system, policies, norms	<ul style="list-style-type: none"> <li>• avoiding red tape,</li> <li>• flat organizational structure,</li> <li>• employee empowerment,</li> <li>• down-top initiative of employees,</li> <li>• system of awards and bonuses (for example for the best innovative products),</li> </ul>
Artifacts, daily practices	<ul style="list-style-type: none"> <li>• informal dress,</li> <li>• local accents typical of a particular place, from mural paintings in Buenos Aires to cable cars in Zurich, which reflect the atmosphere and character of each office,</li> <li>• omnipresent laptops – standard equipment enabling programming, sending e-mails and taking notes at any place,</li> <li>• informal addressing other members of an organization,</li> <li>• common language, rich in terminology understood only by organization members,</li> <li>• mentors (for example Larry Page and Sergey Brin),</li> <li>• rituals,</li> </ul>

Source: own elaboration on the basis of an interview with Google programmer and information materials available at <http://www.google.com/corporate/culture.html>.

In Google, there is a strong belief that employee involvement in implementing innovations depends on how free they feel when presenting their ideas and opinions. It often happens at lunch time, when people can sit at any table they want and talk to members of other teams. What is more, Google's organizational culture strengthens the feeling that a single employee, irrespective of their length of service, education or position in a company, contributes to the company success. This accounts for considerable freedom of interpersonal relations, where everyone can approach Larry Page or Sergey Brin (company founders) and talk about their proposals concerning streamlining or totally new projects. Weekly meetings on Fridays mostly serve the purpose of integrating all employees and developing their feeling of belonging to the community. However, an accepted practice at these gatherings is discussion on new ideas of particular members and possibility of sharing knowledge. The examples above clearly demonstrate how important organizational culture is for employees' learning and self-development.

All the examples presented above are for the quoted enterprise tools which managers can use in managing the learning process. After using them, it is possible to shape the culture models in the company, and, in consequence, achieving intended objectives (Morgan 1997, p. 205). In case of a learning organization, these aims are mostly connected with developing the best practices concerning generating and distributing knowledge.

## **5. Conclusions**

Specialist literature more and more frequently observes that modern organizations are equipped with adaptive and cognitive abilities, just like living organisms. This analogy with living organisms is to emphasize that such organizations do not need external stimuli in order to develop constantly. Their development, however, must take place through generating, acquiring and processing knowledge, which boils down to developing mechanisms of individual and collective learning. This process should be built above all on such key values as self-development, innovativeness or initiative. It is vital, however, that these values were deeply rooted in the organizational culture, whose major task in this dimension is to create and strengthen behavior promoting generating and distributing knowledge. This is reflected in a number of organizational culture attributes, which can be associated with the socialization process, key values, various policies, norms and daily practices. Numerous examples from Google company, a leading learning organization, show that applied practices are mostly very simple solutions. That is why it should be quite easy to adapt them in other organizations.

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**Anna Ujwary-Gil\***

## **THE ANALYSIS OF BARRIERS TO KNOWLEDGE MANAGEMENT**

### **Summary**

*The subject of this article is to highlight the need for cooperation and exchange of knowledge among communities of the organization to develop and achieve competitive advantage in the market. On the other hand, research indicates that cooperation is not always the case, so it is worth considering why this is happening. An important part of this article is to present the latest results of research carried out under the EU project entitled Knowledge Management System Model for Enterprise. An analysis of barriers to knowledge management. A tool for analysis of barriers to knowledge management in the company (Model Personnel System Adaptation of Enterprises to the Economy of Structural Change, financed by the European Social Fund, Warsaw - Gdańsk 2008).*

### **1. Introduction**

The success of contemporary organizations, especially those operating in competitive markets, depends on their investment in knowledge capital, such as: staff trainings, development of IT infrastructure and software, brand creation, research (for example on new patents), copyrights, breakthrough products (process innovations) or global customer base. Each enterprise possesses some unique knowledge, skills, values and solutions, which can be transformed into market value. Knowledge capital helps them achieve competitive advantage, increased productivity and market value, and the ability to manage them is becoming a necessity. Social, economic and technological changes related to new information and communication technologies and growing use of computers in social and economic processes are often labeled “the third industrial revolution” or knowledge-based economy. The main resource of knowledge-based economy is endless, difficult to quantify, easy to accumulate knowledge and technologies which allow the company instant differentiation of its offer and matching it to people’s needs.

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Historians point out that contemporary discrepancies in productivity and economic growth between various countries are no longer connected with access to natural resources, but with the ability to improve the quality of human capital and new production factors, especially the ability to create new knowledge and ideas and to implement them in economic practice. Currently new knowledge is identified with innovation resulting from interactive learning. Innovations originate in teams, not in isolation, therefore it is vital to provide employees and companies with the possibility of cooperation, consisting in broad exchange of knowledge and experience. Taking the above into account, the purpose of this article is to draw readers' attention to the necessity of cooperation and exchange of knowledge within the community of a given organization to enable its development and achievement of competitive edge. On the other hand, research shows that such cooperation does not always take place, so it is worth considering why this is happening. An important element of this paper is presentation of the latest results of research conducted within the EU project called Model Knowledge-Management System in an Enterprise. Analysis of barriers to knowledge management. Tools for conducting the analysis of barriers to knowledge management in an enterprise (Warszawa – Gdańsk 2008)

## **2. Knowledge and its management in an enterprise**

An important role in defining knowledge is its context. It is determined by organizational culture, language, visual symbols, beliefs and behaviors. When knowledge is passed to another person – its transfer and assimilation are affected by the experience of the receiver, prior to this knowledge. If the receiver cannot interpret knowledge, it becomes worthless. Therefore, before being interpreted by a person, knowledge is only information which can potentially become knowledge. A list of situations in which a person thoughtlessly accepts information is presented below. It happens when<sup>[1]</sup>:

- information is obtained from an authority;
- the announcement is made in form of categorical formulations;
- the receiver considers information unessential;
- the receiver prematurely attaches some meaning to the information and does not want to change it.

These situations and thoughtless reception of information which does not create new knowledge, restrict human capabilities, conform human behavior and limit perception and consideration of contexts. Therefore, vital influence

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1 Z. Pietrasiński, Mądrość, czyli świetne wyposażenie umysłu, Scholar, Warszawa 2001, pp. 147-158.

on maintaining or dropping critical attitude to knowledge is exerted by the social dimension, forcing rigidity and conventionality of opinions.

Knowledge helps us understand the reality around us. It exists in specific cultural, organizational and individual “background”. If this is so, then knowledge will consist of various observations, intuition, created assumptions, opinions and even prejudices. T.H. Davenport and L. Prusak<sup>[2]</sup> similarly interpret knowledge as a stream of experiences, values, contextual information and expertise, which constitute foundation for the evaluation and implementation of new experiences. Knowledge originates in the heads of people (employees) and is contained in organizational procedures, processes, products and norms. This definition emphasizes dynamic nature of knowledge understood as a result of knowledge production and as a process of implementing new experience and information. However, authors do not explain how knowledge differs from information and how values and information are created in our mind. Moreover, they refer to the knowledge as value, experience and particular context on the basis of which knowledge is interpreted, without taking into account the relations between them. It is not clear, either, how knowledge should be located in an organization and in what form to make it possible for people to use it.

From the perspective of knowledge creation, it is vital to define types of knowledge and possibilities of assimilating it. It is impossible to describe all kinds of knowledge, however, the most exposed division of knowledge is that into explicit and tacit types. Table 1 lists knowledge “dichotomies” which could be found in specialist literature:

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2 T.H. Davenport, L. Prusak, Working Knowledge, Harvard University Press, Cambridge 1998, p. 5.

**Table 1.** Review of knowledge types

<b>Knowledge types and dichotomy</b>	
<b>Explicite</b> (clear, accessible)	<b>Tacit</b> (silent, quiet, closed, secret, inexplicable)
Codified	Un-codified
Objective	Subjective
Verbal	Non-verbal
General	Specialist (expert)
Useful	Useless
Esoteric (secret)	Exoteric (popular)
Current	Dated
Private	Public
Theoretical	Practical
Descriptive	Applied
Declarative	Procedural
Scientific	Casual
Creative (heuristic)	Repetitive
Individual	Collective
Internal	External
Abstract	Specific
Literal	Figurative

Source: own elaboration

Special attention should be paid to the division into explicite and tacit knowledge<sup>[3]</sup>. Explicite knowledge is independent of a person, thus more objective than tacit knowledge, whose subjective character results from the person's experiences. It contains a thought component which influences the way in which we perceive the surrounding world. Tacit knowledge cannot be formalized, documented or communicated to others in the same way as explicite knowledge, for example with information tools, such as Intranet, memos, company documentation or recorded procedures. Tacit knowledge cannot be codified, but in spite of that, it exerts greater influence on creating new knowledge and innovations. If we take into account associations, analogies, metaphors, creating thought models and ability to solve problems – they are constructed first in the person's mind and then, with varying degree of success, become the subject of communication (message).

It is worth taking a closer look at the definitions of “knowledge management”, leaving aside the possibility of managing something which is not material in its original form. According to D.J. Skyrme<sup>[4]</sup> knowledge management is determination and systematic management of the knowledge that is essential for an organization, and related processes of managing, collecting, organizing, diffusing, applying and exploiting performed in order to reach company objectives. Similar definition of knowledge management is provided by KPMG<sup>[5]</sup> - these are

3 M. Polanyi, *The Tacit Dimension*, Routledge&Kegan Paul, London 1966 and I. Nonaka, H. Takeuchi, *The Knowledge-Creating Company*, Oxford University Press, Oxford, 1995. Polish edition Poltex, Warszawa 2000.

4 D.J. Skyrme. *Knowledge Creation. Creating Collaborative Enterprise*, Oxford 1999, p. 39.

5 KPMG, Research Report 2000, p.6.



systematic and organized attempts at using knowledge in an organization in order to improve the results of its activities.

Undoubtedly, knowledge management is a process consisting of particular stages. Knowledge management is understood in this way also by G. Probst, S. Raub and K. Romhardt<sup>6)</sup>, who list: knowledge location, acquisition, development, sharing, popularization, use and storing. On the other hand, W.R. Bukowitz and R.L. Williams<sup>7)</sup> define knowledge management as a process through which an organization generates its wealth basing on its intellectual capital or knowledge-based assets. In the process presentation of knowledge management, they distinguished: obtaining knowledge from environment, using knowledge in an organization, assessing knowledge assets in an organization, maintaining and developing knowledge assets and selling knowledge in form of new products, services and technologies. Basing on this interpretation of knowledge management, one of the first pilot surveys was conducted<sup>8)</sup> by the research team of Management Studies Center at WSPiZ. The aim of the research was to identify initiatives related to knowledge management in enterprises operating in Poland (Table 2):

**Table 2.** Knowledge management initiatives

Level of relations between an organization and its surroundings	Level of relations inside an organization	Individual level
Regular cooperation with clients/suppliers Virtual e-room Website Strategic ties with other firms and research centers Discussions on new products and services Sending employees to other organizations Purchasing skills and expert opinions	Allocating budget for obtaining information and developing knowledge in an organization Collecting and analyzing employees ideas Team games and simulations Sharing knowledge by employees who participated in trainings Creating specialist teams Implementing procedures of documenting information Electronic and physical data bases Changes in physical arrangement of work posts Knowledge measure and evaluation in an organization	Developing methods supporting creative thinking of employees Access to information on strategy, products, services, clients and suppliers Team analysis of successes and failures Qualitative structures analyzing and transmitting various organizational structures Sending employees to conferences/seminars

Source: Own elaboration on the basis of: J. Dąbrowski, I. Koładkiewicz, *Inicjatywy zarządzania wiedzą w przedsiębiorstwach działających w Polsce*, „Organizacja i Kierowanie”, No 2(108)/2002, pp. 3-20.

6 G. Probst, S. Raub, K. Romhardt, *Zarządzanie wiedzą w organizacji*, Oficyna Ekonomiczna, Kraków 2002, p. 42

7 W.R. Bukowitz, R.L. Williams, *The Knowledge Management Fieldbook*, Financial Time&Prentice Hall, London 2000, p. 2.

8 Research conducted by the team led by professor Bogdan Wawrzyniak.

According to T.H. Davenport and L. Prusak<sup>[9]</sup> many projects of knowledge management refer to externalization of knowledge and to emphasizing its importance in an organization, for example through creating the so-called knowledge maps, which define the areas where knowledge from various fields is created and gathered. Moreover, organizational culture supports knowledge development by encouraging searching for knowledge and sharing it. The construction of knowledge infrastructure does not only cover technical systems and network communication, on the basis of which knowledge sharing is supported, but also physical (informal) interactions. It is worth noticing that knowledge management refers to identification and acquisition of collective knowledge<sup>[10]</sup>, which is much broader than the sum of knowledge possessed by individuals. Since there is collective knowledge, it might be worth considering the above assumption in the context of “collective mind”<sup>[11]</sup>, when the subject of thinking and creator of ideas and new knowledge are all members of the team. In a group it is hard to determine who is the real author of the solution. The premises for creation of a collective mind are emotional climate (sympathy, fascination, ludic attitude) created in a group; communication inside the group, using language understood by everybody (for example colloquial, metaphoric) and the aim organizing the group’s activeness.

### **3. To cooperate or not to cooperate – that is the question. Barriers to knowledge management**

We should keep in mind that one of the main factors restricting implementation of new knowledge, especially in small enterprises, is quite high labor turnover and little orientation towards investment in human capital. These enterprises do not pay much attention to creating knowledge and expanding employees competencies. Not all companies in Poland are ready for implementation of the knowledge management system. Managers must be explicit to new activities and changes and should provide wide access to information for their personnel. Although the management often realize the significance of knowledge management in contemporary world, they do not know how to do it or what to start with. Small enterprises reluctantly spend money on trainings and specialists’ visits. They want to invest in systems which are rather cheap, easy to install and use. Many Polish companies underestimate the role of knowledge in creating their competitiveness in the global market. The effects of such approach are soon to be visible. Only partial use of available

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9 T.H. Davenport, L. Prusak, *Working Knowledge*, op.cit

10 G. von Krogh, *Care in Knowledge Creation*, “California Management Review”, (40) 1998, pp. 133-153.

11 E. Nęcka, *Umysł zbiorowy, czyli grupowe myślenie twórcze*, „Przegląd Psychologiczny, Volume XXVIII, No 2, pp. 345-360.

resources, including human capital, is a common problem in enterprises. Each company loses financially when the available knowledge is not applied to activities determining success. From business perspective it is hard to accept the situation in which a firm possesses a precious resource sought after by clients, but cannot activate it. The knowledge management system allows companies to locate, catalogue, file, transfer and use again knowledge. Employees reach information faster, learn more quickly and become more efficient, which translates into visible improvement of effectiveness and better operational efficiency of the whole enterprise.

Knowledge management generally consists in creating, passing and storing tacit knowledge. Tacit knowledge may be at the level of an organization or at the individual level. At the organizational level, when decoding it, we deal with organizational theories, while at the individual level – with psychology. The process of sharing and spreading knowledge is endangered then, as its implementation weakens someone's position in the company, for example by losing exclusivity of information. It usually happens in organizations with clear division of power, in which knowledge becomes an attribute of the position held. In such conditions it is hard to talk of efficient knowledge sharing. A solution could be to create mutual trust among knowledge owners, which can be achieved through linking the process of knowledge sharing to the motivation and remuneration systems. Mechanism constructed in this way should aim at encouraging questions and developing demand for knowledge. Sharing knowledge should happen in the atmosphere of trust.

Creating such atmosphere is a long process – it consists in providing positive examples and absolute avoidance of bad behavior which may thwart all our efforts. Organizational culture of an enterprise is greatly affected by creating positions especially dedicated to knowledge management or expanding the tasks of existing posts to accommodate knowledge management elements. The main barriers to implementation of knowledge management concept resulting from inappropriate organizational culture are:

- reluctance to share knowledge,
- people's mentality, as our nature encourages us to build our competitive advantage on the basis of possessed knowledge,
- bad habits and customs, manifested in avoiding cooperation,
- unwillingness to delegate authority,
- lack of knowledge of foreign languages, inability to use some information tools

In order to manage knowledge effectively, we must convince people that they should work differently and change their values as no one can be successful alone these days. Cooperation with internal and external partners is gaining significance.

There are two fundamental barriers to knowledge sharing: lack of trust and lack of openness. The former is associated with uncertainty related both to the way the employee's knowledge will be used by the board or organization and to the future of such a person in the company after sharing knowledge. An employee may be moved to a worse-paid position. After spreading knowledge and developing new standards based on it, an employee may be made redundant and a person with lower financial expectations may be hired in their place. As a person who has shared knowledge – he has already lost his competitive advantage over other employees. However, without trust, no programs of identifying and sharing knowledge would work, it would not be possible to protect it, either. That is why it is so important to create a climate of trust inside the organization. The latter barrier is connected with rejecting solutions proposed by others. The ideas brainstormed by employees of other organizations are considered valueless. An important feature is openness and humbleness, and openness to surrounding stimuli which do not always bring ready-to-use solutions, but may be an inspiration for creating our own concepts. Cooperation is also essential – without it, knowledge sharing may not take place at all. That is why we need appropriate organizational structure, built on all organizational levels – from managers to laborers. We should appreciate and reward workers with appropriate attitude, acting in accordance with the values professed by the organization – clearly defined and critical for its culture.

The survey of knowledge management in Poland<sup>[12]</sup> has shown that in many surveyed enterprises their organizational culture does not support introduction of changes in favor of knowledge management. The main barriers – evaluated on the 0-5 scale (0 – no barrier, 5 – a very big barrier) were considered to be: poor communication (3.58), resistance to knowledge sharing (3.56), inappropriate management style (3.28), lack of financial resources (2.53), lack of measurable benefits of knowledge management implementation (2.43), specialist turnover (2.11) and finally – poor IT infrastructure (1.84). The first two barriers are connected with organizational culture of an enterprise and power. Access to information and possession of knowledge are its attributes. Sharing knowledge would lead to losing their position – and the third barrier is directly related to it – leading in a way that prevents employees from self-actualization and using their potential. That is how we can explain lack of involvement and labor turnover. Lack of financial expenditure on development and poor infrastructure also contribute to the emigration of intellectual capital.

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12 A. Błaszczuk, J.J. Brdulak, M. Guzik, A. Pawluczuk, Wyniki badań sondażowych nad zarządzaniem wiedzą w Polsce, Zarządzanie wiedzą w polskich przedsiębiorstwach, SGH, Warszawa 2002. Research was conducted in 33 enterprises in three provinces: Dolnośląskie, Mazowieckie and Podlaskie, at the turn of April/May 2002.

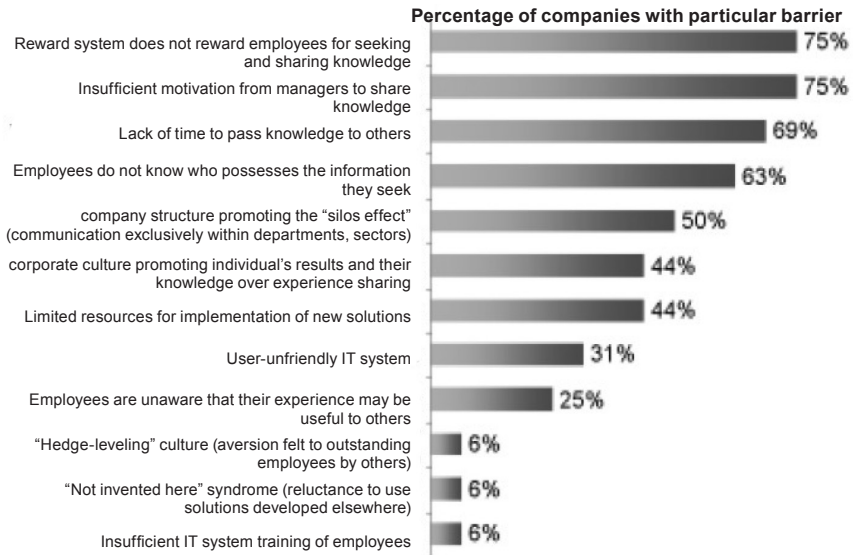
According to W.M. Grudzewski and I.K. Hejduk<sup>13</sup> company employees do not want to share their ideas because they are afraid to lose the job or the reputation they developed. Organization culture often makes it complicated to present one's proposals to the superiors. Employees doubt whether their ideas are good, and when they are convinced, they still feel that this is a one-way exchange. Managers may not support knowledge sharing or get involved in the process, discriminating lower level employees and protecting their own interests. There is a deficit of mutual trust and time to share knowledge. People are afraid of changes – related to implementation of new technologies and systems streamlining information flow. Finally, there are no systems motivating to share knowledge (there are no personal benefits attached).

As far as spreading knowledge in external environment is concerned, the basic barriers are: language, national differences, distance and fight for the customer. This fight accounts for the fact that most information is censored or omitted when sharing the whole concept with other partners. The company protects its own solutions, guaranteeing it appropriate market position. It is connected with taking risk – the company is afraid that it will lose jointly developed solutions and that they will be popularized by other cooperating enterprises, it hesitates whether it behaves properly. Little time is devoted to building trust and loyalty between companies. The fear that they may take over and use our solutions often leads to hiding ideas and slowing down creation of new solutions. There are cases when, in spite of huge market demand, the company is hiding the solution it developed – related to new technology or software, which leads to the situation when another company invents a similar technology and begins its sales. This causes that the original inventor has to bear additional costs to adjust its products to standards introduced by competitors, even if its original software was better and more useful. Also universities are beginning to protect their knowledge through the trend of new intellectual property management, which is less explicit to cooperation with companies. This slows down and limits usefulness of their results while the new solutions application speed results from competitive fight rather than from protecting and hiding knowledge.

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13 W. Grudzewski, I. Hajduk, *Zarządzanie wiedzą w przedsiębiorstwach*, Difin, Warszawa 2004, pp. 126-128.

**Figure 1. Barriers to knowledge management**



Source: P. Markowski, P. Tomczak, *Gdybyśmy tylko wiedzieli, co wiemy... .Efektywne zarządzanie wiedzą organizacji*, Bernard Brunhes Polska, Warszawa, 2004. Report on research.

One of the most important barriers to effective operation of the knowledge management system of an enterprise is lack of rewards for knowledge transfer efforts. Lack of elements motivating employees to share results in inferior treatment of this activity, as additional and unnecessary burden imposed by the employer. In extreme cases, the existing hedge-leveling culture discourages outstanding employees and hampers all initiatives exceeding employees scope of responsibilities. The syndrome of "constant lack of time" can be noticed in case of management systems favoring short-term objectives. Then sharing knowledge or new ideas is perceived by employees as a barrier to realization of objectives assigned to them. From the budget perspective, each new solution may then generate unplanned cost and therefore be "shelved". Another major barrier is the "silos" organizational structure of the company, which slows down communication between various sectors. A similar effect of deliberate retention of information appeared also in shift structures, in which particular teams competed with each other. The lowest intensity of this phenomenon was observed in enterprises in which work is performed in groups. Another frequent barrier is lack of belief and involvement of managers. Employees see that their superiors do not use knowledge exchange tools, for example they do not feed data to the IT system and they choose not to do it as well. They do not

share their ideas with others, assuming that the boss will treat it as unnecessary eagerness. Though they may sometimes be unaware that their experience could be useful to others, they usually realize that knowledge is a valuable resource. Nevertheless, company culture, promoting individual's effects over knowledge sharing, may transform this knowledge into some sort of competitive advantage in the internal labor market. Then some behaviors of deliberate blocking information and building employee's position of an expert with monopoly for knowledge appear. Frequently the contact with a person possessing particular knowledge is difficult. Knowing exactly their information needs, employees are forced to make an effort to find a competent person in a given field, the task not always successfully completed. Less frequent barriers are mechanism of selecting information which seems less important to an employee and aversion to solutions developed by other people, also known as the "not invented here" syndrome.

Summing up, Table 3 presents barriers existing in various levels: of the employee (individual), enterprise and economy (sector). An extensive list of barriers and difficulties definitely is not a complete list of obstacles appearing in the process of knowledge management, but these barriers are most common and may affect the effectiveness of knowledge management<sup>14</sup>.

It should be emphasized that not all these barriers must appear among employees and enterprises of a particular sector.

**Table 3.** Barriers existing in various levels

Level	Barrier type	Identified barriers
<b>EMPLOYEE LEVEL</b>	Psychological	<ul style="list-style-type: none"> <li>• natural fear of change</li> <li>• protection of one's interests and position and fear of one-way passing valuable experience</li> <li>• reluctance to do additional work</li> <li>• limited needs for professional development and self-actualization</li> <li>• lack of initiative</li> <li>• inability to gain and evaluate knowledge on one's own</li> <li>• no courage to share one's observations</li> <li>• fear of making a mistake and its consequences</li> <li>• inability to receive criticism and to criticize constructively</li> <li>• inability to ask for advice and help</li> </ul>
	Technical	<ul style="list-style-type: none"> <li>• inability to use new technologies</li> <li>• unclear codification of knowledge and freedom of interpretation</li> </ul>
	Financial	<ul style="list-style-type: none"> <li>• no possibility of bearing the costs of services related to access and acquisition of new skills</li> </ul>

14 Extensive report on research on barriers to knowledge management with detailed questionnaire consisting of 74 questions can be found [in:] BADANIE BARIER W ZARZĄDZANIU WIEDZĄ W PRZEDSIĘBIORSTWACH - RAPORT KOŃCOWY. Projekt EQUAL Nr F0576 MODELOWY SYSTEM WSPARCIA PRZEDSIĘBIORSTW I PRACOWNIKÓW W TWORZENIU SYSTEMÓW ZARZĄDZANIA WIEDZĄ, Warszawa-Gdańsk 2007.

Level	Barrier type	Identified barriers
<b>ENTERPRISE LEVEL</b>	Psychological	<ul style="list-style-type: none"> <li>• low awareness of benefits of knowledge management</li> <li>• low involvement of management in implementing and monitoring knowledge management</li> </ul>
	Social	<ul style="list-style-type: none"> <li>• lack of leader</li> <li>• fear of investing in an employee who may leave for another enterprise</li> <li>• national and cultural differences</li> <li>• inability to cooperate in a group</li> </ul>
	Organizational	<ul style="list-style-type: none"> <li>• no clearly defined strategy</li> <li>• no feedback with human resource management area</li> <li>• improper information flow</li> <li>• developed hierarchical structure</li> <li>• no inflow of people with new knowledge to enterprise</li> <li>• not integrated staff</li> <li>• unfavorable organizational culture</li> <li>• early retirement of experienced employees</li> <li>• fear of information leak from enterprise</li> </ul>
	Technical	<ul style="list-style-type: none"> <li>• architecture</li> <li>• distance</li> <li>• not integrated technical infrastructure or lack of it</li> <li>• no system of filing information</li> <li>• no possibility of substitution for period of training</li> </ul>
	Financial	<ul style="list-style-type: none"> <li>• limited possibility of expenditures on implementation and realization of knowledge management concept</li> <li>• inappropriate priorities leading to seeking economies in expenses on improving employee qualifications</li> </ul>
<b>SECTOR AND ECONOMY LEVEL</b>	Psychological	<ul style="list-style-type: none"> <li>• enterprise inability to cooperate and associate</li> </ul>
	Social	<ul style="list-style-type: none"> <li>• reluctance to share achievements and experiences</li> </ul>
	Technical and systemic	<ul style="list-style-type: none"> <li>• deficit of knowledge management specialists</li> <li>• no highly specialized and flexible trainings</li> <li>• no contact with the sphere of science and research</li> <li>• education system not adjusted to economy needs, inertia of education system</li> <li>• no uniform system of acknowledging qualifications obtained outside formal education system</li> </ul>
	Legal	<ul style="list-style-type: none"> <li>• bad legal protection of intellectual property</li> <li>• unstable law</li> </ul>
	Financial	<ul style="list-style-type: none"> <li>• poorly finance science and research programs</li> <li>• worse working conditions</li> </ul>

Source: Analiza barier i trudności w zarządzaniu wiedzą w obszarze zarządzania zasobami ludzkimi. Projekt EFS, EQUAL Modelowy system przystosowania kadr przedsiębiorstw do zmian strukturalnych w gospodarce, Gdańsk 2005.



The survey covered 406 employees from various levels within the EQUAL Project No F0576 „Modelowy System Wsparcia Przedsiębiorstw i Pracowników w tworzeniu Systemów Zarządzania Wiedzą” (Model System of Supporting Enterprises and Employees in Creating Knowledge Management Systems). Participants were employees of: 19 enterprises from chemical industry (159 people) and 38 enterprises representing light industry (247 people). The researchers obtained completed questionnaires from 369 people in the period from 9<sup>th</sup> March 2006 to 16<sup>th</sup> February 2007. In the whole period of the survey 91 groups of employees were analyzed, including 118 people representing chemical industry and 251 people from light industry.

Among psychological barriers at the employee level, the most important one was the feeling of loss accompanying the process of sharing knowledge with others. Presenting co-workers with the knowledge that one developed for years and which demanded a lot of effort, sacrifice and sometimes financial investment, arouses natural resistance in an employee. The thesis was confirmed by the survey results in which a significant part of employees (28%) share their knowledge with others only when forced to do so. Other major problems are: inability to self-learn (44%), inability to receive criticism and tendency to find malicious remarks in someone’s criticism (34%) and fear of improvements and new solutions developed in experimenting and questioning the existing operational methods. The survey results show that employees declare awareness of necessity of continuous professional development, are not afraid to ask others for help or explanation of complicated issues and try to communicate their dissatisfaction and comments in a balanced way, without unnecessary emotions. However, we should remember that the selected form of the tool has a number of restrictions and analyzed only declarative attitudes of employees. 15% of surveyed employees declared strong negative attitude towards any changes introduced in an enterprise and admitted to having problems with using information from various sources. Respondents declared significant lack of trust in their superiors (27%). It should be emphasized that as many as 44% of people do not consider their boss to be an authority at work for them. Problems in relations between subordinates and supervisors should be considered a serious barrier in implementing knowledge management in a company. Respondents show more trust in their subordinates and peers. Most of the surveyed employees expressed an opinion that their peers trust them. A serious problem damaging trust in employer is the fact that employees do not believe that if they perform their jobs properly and diligently and if their work constitutes real value for the company, they will probably keep their jobs.

All barriers classified as technical barriers at the employee level obtained more than 20% of answers. The most intense problem was lack of knowledge of foreign languages, preventing their use in improving qualifications (71%)

and inability to communicate effectively which leads to misunderstandings (56% and 60% of answers). Around 25% of respondents declared problems with using the computer and new technologies, being overburdened with job responsibilities and lack of interest in professional novelties.

As expected, a very serious problem are limited possibilities of financing one's professional development by employees. As many as 62% of respondents claimed that trainings, specialist literature, trade journals and other materials helpful in upgrading qualifications are beyond their financial reach. This conclusion is valuable in the context of supporting the professional development process at work and confirms that it is necessary to build the system of coaching and training inside the enterprise.

The intensification of identified problems in the group of social barriers at the enterprise level shows that it is one of critical areas. The basic problem is too little importance attached to the value of human capital in an enterprise. As many as 53% of respondents pointed out that investment in their companies is usually restricted to company property, while 42% claimed that investment in employees qualifications is shunned. Moreover, 64% of respondents indicated that employee development is pushed aside in their companies and it is not given proper attention. Other serious problems are: unfavorable work atmosphere (69%, 62% and 57%), not integrated staff (52%) and wrong people at executive positions. 29% of the surveyed gave answers which may signal unwillingness or inability to work in a team. It is an important signal for people responsible for development and evaluation of training programs, indicating that they should also include development of competencies necessary for working in groups and that in some cases professional development will bring better effects if it is individual.

Just like social barriers, organizational barriers at the enterprise level were very strong. Two major problems were: motivation systems not taking account of improving qualifications and lack of feedback on whether tasks are performed properly. As many as 73% of respondents stated that improving qualifications is not rewarded in any way by the company. The survey also demonstrated difficulties with information flow and its excessive protection. 39% of the surveyed people claimed that they do not obtain information necessary in their everyday work. Respondents were unable to answer many questions concerning the activities of their company (for example, whether the company belongs to some sector association or cooperates with research and development units) and they ticked the "I don't know/ Not applicable" answer (around 40% of answers). It is also worrying that 41% of respondents admitted to not knowing their company's goals and not knowing in which direction the company intends to develop, or regarded this information as not essential for their work post.

Among technical barriers at the enterprise level, the greatest challenge for enterprises will be organization of knowledge exchange between employees from different, distant branches and allowing workers to contact people they do not cooperate with every day in order to learn their mutual expectations concerning performed work. It should be emphasized that only 1% of respondents indicated that valuable information is not filed in a company.

Financial barriers at the enterprise level turned out to be lower than expected. The answers of overwhelming majority of employees imply that their companies could afford to allocate more money to development of employees competencies and implementation of knowledge management. The survey of social barriers at the sector and economy level proved that the level of cooperation between enterprises from the same sector is very low, which does not allow to use the experiences of other entities and to avoid mistakes made by them.

Among technical barriers, the biggest problem is inadequate preparation of graduates to work in their profession, lack of interest in innovations and in cooperation with research and development institutions, as well as limited access to specialist trainings in the existing market. The surveyed people also indicated that current system solutions do not create appropriate possibilities of confirming competencies employees gained: over 20% of the surveyed people stated that documents confirming possession of particular competencies do not reflect their actual level. A serious threat to the resource of employees knowledge is the possibility of early retirement taken by many experienced workers. More than a half of respondents, if presented with such possibility, would take advantage of it. Moreover, 74% respondents claim that Polish companies are unable to create, especially for talented employees, attractive working conditions, comparable with those offered abroad.

Due to the fact that the results obtained for light and chemical industry do not differ considerably, detailed description of each sector can be regarded as unnecessary, as most of the description would not differ greatly from the collective results presented here.

Knowledge management in Polish economic reality is still a new and unpopular concept. Practical application of knowledge management elements in a traditional enterprise is connected with the necessity to introduce changes in all functional areas of an economic entity, therefore implementation of knowledge management systems encounters barriers and difficulties at all levels: starting from the employee level, through the enterprise level, up to the sector and economy level. There is no doubt that the barriers to knowledge management at the level of an individual employee are the most difficult to break. Creation of a complete catalogue of such barriers is not possible due to individuality and complexity of human nature. However, we can talk of a group of barriers common for most people, which was reflected in current research

and observations. The last group of problems in knowledge management at the employee level are financial barriers. Employees who would be willing to devote their free time to improving their skills and gaining new knowledge are often unable to bear the costs of such activities. This is particularly true in sectors of economy where salaries are low and employees, after satisfying their basic needs, cannot afford to buy expensive books or journals, computer hardware and software, use IT services or pay for participation in a course or some training. Difficulties and barriers to knowledge management are not limited to the level of an individual employee, but also appear at the level of an enterprise and the whole sector (economy).

#### **4. Conclusions**

What can an organization do to make its employees want to share knowledge? It should create appropriate environment, in which employees will feel comfortable. Above all, the organization should prevent the situation in which employees feel burnt out and unnecessary. This could be achieved by various development trainings. Also a motivation system in which people sharing knowledge are promoted is desired. Of vital importance are also company message and values, especially if one of them is knowledge sharing. While naturally breaking barriers, we should use individual solutions tailored to a specific organization and profile as well as to expectations of its employees. The organization should try to learn them and respond to them.

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**II.**  
**BUSINESS AND NON-PROFIT**  
**ORGANIZATIONS**  
**IN A MARKET ECONOMY**



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## **A DRAFT OF A BUSINESS MODEL BASED ON CSR**

### **Summary**

CSR is a new trend in doing business. Therefore the main goal of this article was to prove that social entrepreneurship and activities in Corporate Social Responsibility provide a new way for creating innovative strategies inside and outside organization (close and open innovations). This is a new innovative CSR-driven business model going beyond traditional management and economic thinking.

### **1. Introduction**

Traditional view of managing the company practically consists of doing mundane and traditional things among four functions of management. The present environment forces a company to implement a new business model, which encourages stakeholders to participate in a company's life. Another advantage of the model is the ability to spread out an idea of CSR and use stakeholders willingness to create open innovations.

### **2. Corporate Social Responsibility (CSR)**

Analyzing statements of the business world can see that CSR is a big problem in a world where the only responsibility was previously responsible for the results to shareholders. According to M.E. Porter and M.R. Kramer many of executives see themselves in a no-win situation, caught between critics demanding ever higher levels of "corporate social responsibility" and investors applying relentless pressure to maximize short-term profits. On the other side rising donations result in more expectation of them. The dilemma has led many companies to seek more strategic philanthropy and models of corporate social responsibility [Porter M.E., Kramer M.R. 2006].

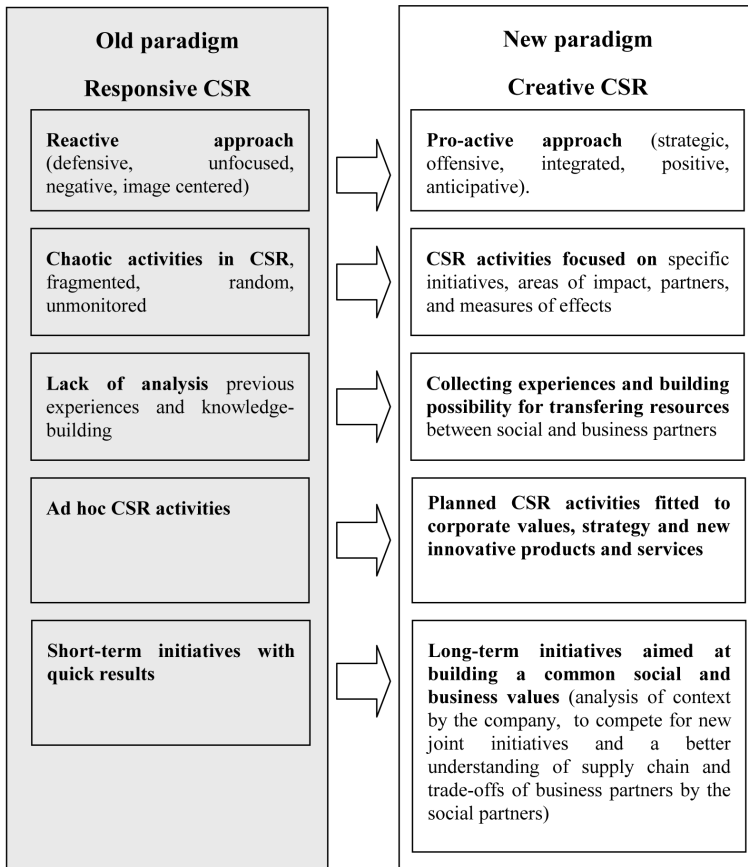
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**Figure 1. Corporate Social Responsibility: A Paradigm Shift**



Source: own elaboration.

Friedman asserts that the corporation is an instrument of the stockholders who own it. If corporation makes any contribution, it prevents the individual stockholder from deciding how he should dispose of his funds. Friedman argues that any contributions have to be made by individual stockholders or employees, but not by corporation. Friedman’s arguments have three implicit assumptions [Friedman M. 1970]:

- social and economic objectives are separate and distinct, so social spendings comes at the expense of its economic results
- corporations provide no greater benefit than is provided by individual donors
- engaging in CSR is symptomatic of an agency problem or a conflict between the interests of managers and shareholders, because managers

use CSR as a means to further their own social, political, or career agendas, at the expense of shareholders.

Friedman's assumptions hold true when organizations contributions and CSR activities are unfocused and diffused. M.E. Porter and M.R. Kramer [2006] argue that the more tightly CSR (and especially philanthropy) is aligned with a company's unique strategy the more company will benefit through enhancing the context (Figure 1).

McWilliams and Siegel stated that the definition of CSR is not always clear, because of so many conflicting goals and objectives. McWilliams stated that CSR could be perceived as actions that appear to further some social good, beyond the interests of the firm and that which is required by law. An example of CSR is going beyond legal requirements in adopting progressive human resource management programs, developing non-animal testing procedures, recycling, abating pollution, supporting local businesses, and embodying products with social attributes or characteristics [McWilliams A., Siegel D. 2001].

In the literature CSR (Corporate Social Responsibility) is known by many names. It is referred to as corporate citizenship, corporate ethics, corporate stewardship, and social responsiveness [Carroll A.G. 1974]. Laszlo use CSR and sustainable development interchangeably [Laszlo Ch. 2008, 34]. The term was used by the Brundtland Commission (EU) which coined the following definition: "meets the needs of the present without compromising the ability of future generations to meet their own needs."

Sustainability refers to the long-term maintenance of systems according to environmental, economic and social considerations. As indicated by Crane and Matten sustainability also represents a specific goal to be achieved which is called a TBL ('triple bottom line'). TBL represents the idea that business does not have just one single goal – namely adding economic value – but that it has an extended goal set which necessitates adding environmental and social value [Crane A., Matten D. 2007].

The most established and accepted model of CSR in the literature is the 'Four-Part Model of CSR' refined by Carroll and Buchholtz. Carroll and Buchholtz assert that CSR is a multi-layered concept, which can be differentiated into four inter-related aspects: economic, legal, ethical and philanthropic expectations, placed on organizations by society at a given point in time [Carroll A. B., Buchholtz A. K. 2003]. The economic aspect is concerned with the economic performance of the company, while legal, ethical and voluntary (philanthropic), address the societal aspects of CSR.

### 3. Understanding CSR

Maon, Lindgreen and Swaen stated that ‘CSR is a stakeholder-oriented concept that extends beyond the organization’s boundaries and is driven by an ethical understanding of the organization’s responsibility for the impact of its business activities, thus, seeking in return society’s acceptance of the legitimacy of the organization’.[Maon F., Lindgreen A., Swaen V. 2009, s. 71-89]

Garriga and Mele identified four groups of CSR theories that affect stakeholders from different perspectives (approaches): instrumental, political, integrative and ethical.[Garriga, E. M., Mele D. 2004 51-71] Garriga and Mele approaches have been described in Table 1 with explanation of theory outline by Okoye. [Okoye A. 2009, pp. 613-627]

**Table 1.** Groups of approaches used in understanding role of CSR into organization

CSR approaches	Main assumptions	Perceived role of CSR within corporation	Examples
Instrumental	Advancing economic objectives through social activities.	Instrument of wealth creation. Increase of long-term shareholder value.	Express corporate social activities in terms of: <ul style="list-style-type: none"> <li>• gaining a competitive advantage either within a competitive context.</li> <li>• generate new untapped markets such as in developing countries.</li> <li>• marketing and building of reputation and brand.</li> </ul>
Political	Advocating corporate power and its responsible use.	Notion of corporate power (the ability to influence the market) and relationship with responsibility within society (Corporate Citizenship).	Corporation as a citizen in society with rights and responsibilities: <ul style="list-style-type: none"> <li>• limited view - corporate citizenship with self-interested corporate social activity,</li> <li>• equivalent view – which equates corporate citizenship with CSR</li> <li>• extended view – describing the role of the corporation in administering citizenship rights form individuals.</li> </ul>

CSR approaches	Main assumptions	Perceived role of CSR within corporation	Examples
Integrative	Expressing the necessity for corporations to integrate social demands into its business operations.	Taking into consideration stakeholders or persons who affect or are affected by corporate policies and practices.	Corporate social performance involves an integrated theory that configures: <ul style="list-style-type: none"> <li>• the principles of social responsibility,</li> <li>• processes of social responsiveness</li> <li>• observable outcomes of corporate relationships.</li> </ul>
Ethical	Examining the morality and rightness of corporate social actions.	Doing what is right for a good society.	Ethical theories include: <ul style="list-style-type: none"> <li>• stakeholder theory,</li> <li>• universal rights based on human rights,</li> <li>• sustainable development and common good approach</li> </ul>

Source: own elaboration.

Presented definitions and approaches to CSR rely strongly on the stakeholder concept and call for the integration of CSR, into the organization's strategy.

#### **4. CSR, possibility of altruism or just a business**

CSR as a strategy aims particularly at social and environmental aspects of doing business. Assessing CSR from a strategic perspective may seem to imply that ethical responsibilities are subordinated to economic imperatives. It may seem as if CSR is not intrinsically valued, but only instrumentally. The suspicion arises that the motivation of firms behind CSR is not truly ethical, since it is in their self-interest.[Van de Ven B., Jeurissen R. 2005]

Tuzzolino and Armandi (1981) borrowing from Maslow's hierarchy of needs provides a more explicit conceptual framework for corporations that extent beyond profit-maximizing dogma.[Tuzzolino F., Armandi B. R. 1981, pp. 21-28]

**Table 2.** Hierarchy of organizational needs

Maslow's hierarchy of needs	Explanation towards organization
Physiological Needs	Profit maximization
Safety needs	Competitive position
Affiliation	Trade Associations (working with lobbyists, bargaining and co-optation)
Power, achievement and status	Market position (gaining position, product leadership, market shares, image building, price leadership)
Self actualization	Internal (employee relations - job enrichment, pension plans, goal alignment, financial ratios and margins) External (sense of CSR resides, meeting and exceeding the demands of society in areas of equal opportunity, affirmative action, pollution abatement, product reliability, corporate philanthropy and welfare-to-work programs.)(Philanthropy & Welfare-to-work)

Source: own elaboration.

According to Maslow theory, Tuzzolino and Armandi argue that organizations have hierarchy of needs that parallels Maslow's model for individuals (Table 2).

CSR research suggests that there is an inherent tension between a corporation's pursuit of profit and a corporation's pursuit of morality or CSR. Objections to CSR are sometimes economically motivated.[Cowe R. 2000].

It depends on the organizational strategy, culture, employees commitment (etc.) and perceived market conditions which way to go, but we must always take into account that to be socially responsible generally refers to business decision-making linked to ethical, social values, fulfillment with legal requirements and respect for people, communities and the environment.

## **5. The model of CSR-driven innovations**

M.E. Porter and M.R. Kramer argue that social considerations have to be integrated more effectively into core business operations and strategy. The result is helping companies identify, prioritize, and address the social issues that matter most or the ones on which it can make the biggest impact. They stated that successful organizations need a healthy society and education which is essential to a productive workforce. A healthy society needs successful organizations which that create new jobs, wealth, and innovations that improve standard of living and social conditions over time [Porter M.E., Kramer M.R. 2006].

M.E. Porter and M.R. Kramer presumes that a company must integrate a social perspective into the core frameworks by creating shared value during five steps [Porter M.E., Kramer M.R. 2006]:

- identifying the points of intersection (inside-out by mapping the social impact of the value chain, and outside-in linkages by analyzing competitive context as an opportunities for CSR initiatives);
- choosing which social issues to address (generic social issues – not significantly affected by a company’s operations nor affecting its long-term competitiveness; value chain social impacts - significantly affected by a company’s activities; social dimensions of competitive context - social issues in the external environment that significantly affect the underlying drivers of a company’s competitiveness in the locations where it operates);
- creating a corporate social agenda – categorizing and ranking social issues by creating an explicit and affirmative corporate social agenda (Responsive CSR – by evolving social concerns of stakeholders, and mitigating existing or anticipated adverse effects from business activities, mitigating the harm arising from a firm’s value chain activities; Strategic CSR - to mount a small number of initiatives whose social and business benefits are large and distinctive);
- integrating inside-out and outside-in practices (pioneering value chain innovations and addressing social constraints to competitiveness; value chain practices and investments in competitive context have to be fully integrated);
- creating a social dimension to the value proposition (a set of needs a company can meet for its chosen customers that others cannot).

According to R. Nidumolu, S.K. Prahalad and M.R. Rangaswami there’s no alternative to sustainable development and CSR. The research shows that sustainability is a mother lode of organizational and technological innovations that yield both bottom-line and top-line returns, for example becoming environment-friendly lowers costs because companies end up reducing the inputs they use [Nidumolu, R., Prahalad, S.K., Rangaswami, M.R. 2009].

R. Nidumolu, S.K. Prahalad and M.R. Rangaswami recognize that sustainability and CSR are starting to transform the competitive landscape, which will force companies to change the way they think about products, technologies, processes, and business models. The key to progress, particularly in times of economic crisis, is innovation [Nidumolu, R., Prahalad, S.K., Rangaswami, M.R. 2009]. To become innovative companies should go through the following five stages (Table 3).

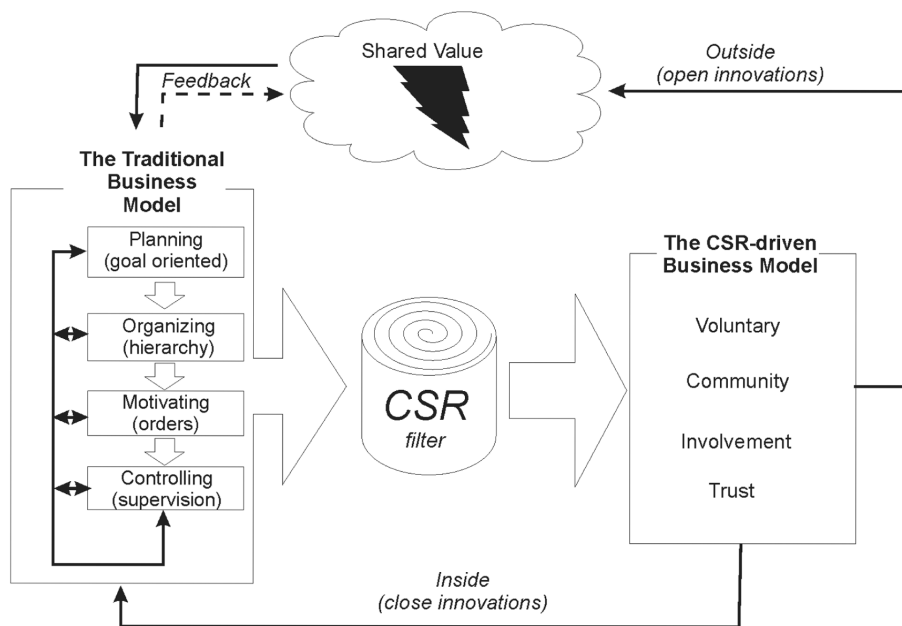
**Table 3.** Five stages to become innovative sustainable company

Stage	Activities and needed competencies	Innovation opportunity
<b>1. Viewing Compliance as Opportunity</b>	To ensure that compliance with norms becomes an opportunity for innovation by: <ul style="list-style-type: none"> <li>- anticipate and shape regulations,</li> <li>- work with other companies, including rivals, to implement creative solutions.</li> </ul>	Using compliance to induce the company and its partners to experiment with sustainable technologies, materials, and processes.
<b>2. Making Value Chains Sustainable</b>	To increase efficiencies throughout the value chain using techniques such as: <ul style="list-style-type: none"> <li>- carbon management and life-cycle assessment,</li> <li>- redesign operations to use less energy and water, produce fewer emissions, and generate less waste,</li> <li>- ensure that suppliers and retailers make their operations eco-friendly.</li> </ul>	Developing sustainable sources of raw materials and components. Increasing the use of clean energy sources such as wind and solar power. Finding innovative uses for returned products.
<b>3. Designing Sustainable Products and Services</b>	To develop sustainable offerings or redesign existing ones to become eco-friendly by: <ul style="list-style-type: none"> <li>- recognizing which products or services are most unfriendly to the environment,</li> <li>- generating real public support for sustainable offerings and not be considered as "greenwashing",</li> <li>- managing know-how to scale both supplies of green materials and the manufacture of products.</li> </ul>	Applying techniques such as biomimicry in product development. Developing compact and eco-friendly packaging.
<b>4. Developing New Business Models</b>	To find novel ways of delivering and capturing value, which will change the basis of competition by understanding: <ul style="list-style-type: none"> <li>- what consumers want and to figure out different ways to meet those demands,</li> <li>- how partners can enhance the value of offerings.</li> </ul>	Developing new delivery technologies that change value-chain relationships in significant ways. Creating monetization models that relate to services rather than products. Devising business models that combine digital and physical infrastructures.
<b>5. Creating Next-Practice Platforms</b>	To question through the sustainability lens the dominant logic behind business today by: <ul style="list-style-type: none"> <li>- asking how renewable and nonrenewable resources affect business ecosystems and industries,</li> <li>- synthesizing business models, technologies, and regulations in different industries.</li> </ul>	Building business platforms that will enable customers and suppliers to manage energy in radically different ways. Developing products that won't need water (such as cleaning products). Designing technologies that will allow industries to use the energy produced as a by-product.

Source: own elaboration.

The result of the above assumptions is a model of CSR-driven innovations which consists of two different platforms: the traditional management model (mitigating TBL issues) and the new CSR-driven business model (linking social, economical and ecological challenges and company resources). It is essential for the new innovative CSR business model to: empower employees and social partners to voluntary working in joint projects, building community and sharing ideas, involving employees to participate into strategic and operational decision making and problem solving, and relying on trust between company executives, employees and other stakeholders.

**Figure 2.** The business model driven by CSR



Source: own elaboration.

The output of the model there is Corporate Social Integration (CSI) through inside-out and outside-in activities or innovations and 'shared value' through new products and services, new markets and business models.



## **6. Reasons for the CSR filter**

### **6.1. Goal oriented or volunteers**

In the traditional approach planning is the first function of management. In most textbooks in management there are descriptions of a planning process, enumerated sorts of plans, conditions of successful planning. All these things are usually the content of first chapters. Planning is being seen sometimes only as a process [Burtonshaw-Gunn, S. A., 2008]. Other writers treat it as a pack of making preparing schedules and pointing goals [Bieniok, H. (red.) 1999, p. 159].

H. Bieniok defines planning as „pointing goals and describing efficient and adequate (...) means of obtaining goals” [Bieniok, H. (red.) 1999, p. 159]. Stoner and Wankel claim that at the beginning a manager must make a plan (or several plans), which are connected with goals and statements: what, when, how and who has to do that [Stoner, J.A.F., Wankel, C. 1994, 73].

In the literature there are some suggestions that planning should derive from a company’s mission and its strategic goals. This attitude makes planning more stable and not so flexible [Bittel L. R. 1998, s. 93]. However there is a rule of planning which implies that if we adapt a plan to circumstances, such a view must cause repeatable obstacles when looking for new ideas or solutions [Bieniok, H. (red.) 1999, p. 159].

During the last century we have had a very stable point of view on planning. However G. Hamel and B. Breen in their famous book “The Future Management – Becoming a Management Innovator” wonder why people in companies lose an ability of spontaneous, flexible and creative thinking [Hamel, G. Breen B., 2008, p. 24]. They reckon there are a few factors which can be blamed for it. There are criteria and methods of doing things based on punctuality, discipline, rationality and keeping order. A man who is under such pressure is changing his habits and thinking according to goals which are given. Goal oriented people are focusing more on coordination, a costs control, obeying particular rules rather than on their talents, imagination and initiative.

We think that in modern companies there is a phenomenon called “double thinking”. On one hand there is a necessity of planning the future and describing goals. This allows to decrease a risk of unsuccessful events or projects. On the other hand in companies there is some kind of fashion which forces employees to be flexible, creative and open to chances in environment.

G. Hamel and B. Breen claim that when we get older and more experienced we lose the ability to ask a simple question “why?”. There is a reason for losing a positive attitude to changes in companies and life in general. In other words: planning connected with controlling makes the managers stand by. There is

also an illusion that the environment is predictable and adjustable. There is little space for doing experiments and trials of any kind. The authors give the statement the planning makes an organization static and closed to development [Hamel, G., Breen B. 2008, p. 195].

Additional disadvantage of traditional planning is the lack of easiness, improvisations and “growing up” ideas. At the same time any mistakes are punished. G. Hamel and B. Breen say that in the opposite attitude the mistakes are „positive mutations” which may lead the organization in the future to new products and services [Hamel, G., Breen B. 2008, p. 201].

To summarize, planning is focused on projecting a way to achieve goals in the stable and predictable future. Companies which prefer planning to flexible activities lose the drive for innovations. As nearly everybody supposes, the most spectacular ideas occurred to inventors in their own garages, not in steel-and-window laboratories. The last 30 years give many examples of large companies – like IBM in the beginning of the 1980s – which had big troubles to keep up with smaller ones. Apple Corporation, Google, Pixar – these companies won the race leaving giants behind.

## **6.2. Hierarchy or community**

Every organization has its own structure. This trivial sentence is believed widely in the business world. Nevertheless a drilling doubt occurs to a nosy researcher’s mind: should every company have it? The answer is apparently clear. A structure is an embedded issue of any system [Skyttner, L. 2005].

In classical approach building a hierarchy is called “organizing” and it is defined as:

- a pattern and an order of system’s elements,
- a collection of elements and relations between them,
- only as a collection between elements [Krzyzanowski, L. 1985, pp. 212-222].

H. Bieniok and J. Rokita in the old, indispensable book say that an effect of organizing is an organizational structure. It contains “all relations between elements this organization and relations between the elements and the organization, which is needed to acting together in order to obtain the organizational goals.” [Bieniok H., Rokita J. 1984. s. 17]

One of the first inventors, who proposed the organizational division based on work specialization, was H. Fayol. He was the first to publish the typology of functions in companies. There were the following functions: technical, trading, financial, accounting, administrative and self-assurance [Kurnal, J. 1970, pp. 45-48]. Despite the fact that it was nearly one hundred years ago, such view of the company is still valid in most companies all over the world. We can find

the companies' functions as departments in the organizational structure. The structure is usually formal and stable. This approach is not focused on operating and informative relations [Bieniok H., Rokita J. 1984, p. 189].

The opposite attitude to organizing the company is an example of the W.L. Gore. It was set up in the 1950s by Bill Gore (previously an employee in DuPont), who hated hierarchy and formal procedures. He claimed that a group of people should do what they really want and what they have a flair for. He build a company which was "thin as a pancake". Its main features are: leaders chosen in democratic polls, sponsors of projects, spare time to do experiments, an ability to refuse orders, many small intra-companies (not larger than 200 employees), multidiscipline teams. [Hamel, G., Breen B. 2008, pp. 111-127]

G. Hamel and B. Breen claim that structures are good for resources management, but poor in allocating them from old to new technologies, challenges and projects. It seems that very few companies are able to create new values for the environment. Structures and hierarchy is the main reason for that. Additionally these companies usually have spectacular slogans in the missions and present as a creative motherhood for talented employees. The authors propone to come over the barriers of these traditional aspects. [Hamel, G., Breen B. 2008, pp. 87-88] Their proposal is contained by the Table 4.

**Table 4.** Hierarchy and Community

Factor	Hierarchy	Community
A type of exchange	A formal contract, a salary is paid when a the is done.	An unsolicited contract – a large scale of choice when doing job.
A role of a man	Workforce.	A partner.
Loyalty	Based on economic reasons.	Based on personal goals and needs.
A way of control	Based on rulet and regulations.	Based on values and norms of behaviours
Input of a man	Very little.	Large.
Satistaction	Economic.	Emotional.
Leadership	Given and based on power.	Chosen and based on democratic polls.

Source: [Hamel, G., Breen, B., 2008, pp. 87-88].

In the literature we can find an opinion that nowadays a main task for companies is to diminish a bureaucracy and to amplify a sense of community. It may cause many effects such as an increase of employees' self-esteem, a feeling of controlling their own lives, an ability to personal development. These features are parts of a base for a real commitment and looking for important chances in order to increase a competitive advantage.

### **6.3. Orders or goodwill**

In the management science we are used to a vocabulary which derives from an army. We are so much accustomed to this fact that we do not notice its consequences. L. R. Bittel even claimed that „managers must use written and spoken languages to form instructions, orders and hints for personnel”. [Bittel L. R., 1998, p. 171]

In the traditional management it is said that a manager should have a power which derives from Max Weber’s concept. There is also a statement that a manager should have a formal and real influence on companies so that they behaves the manager wants. [Gros U. 2003, p. 178]

In spite of the period of time from the Max Weber’s age up till now there is still a strong need to get the opportunity to have as much power as it is possible. The hierarchy is the main part of top managers attributes. A real signs of power is an ability to have a strong influence on any employee. [Lachiewicz, S. 2007, p. 80] In the hierarchy there are several obvious tools to put the power into practice, such as orders, prescriptions, regulations, etc. Apart from such a point of view, J.A.F. Stoner and C. Wankel claim that the influence should be adequate to a situation in order to improve the manager efficiency. [Stoner, J.A.F., Wankel, C. 1994, p. 261] However, such an attitude is not a revolutionary change and we can say that in a traditional approach, the manager is a still a general in an army leading the attack on enemy.

G. Hamel And B. Breen allege nowadays in companies there is too much power and too little liberty. Such domination of manager causes an effect called “a father knows better”. The hierarchy is an element of a common life in a company. Such companies declare openness and creativity, but when the time is passing by they are being stuck in procedures and regulations. When in management science a term “open innovations” appeared, it occurred to some people that formal leading in teams is not enough. A new approach and a necessity of launching more and more innovations are going to change some corporate aspects, such as influencing on subordinates, a number of orders, a range of control, a range of formal behaviors. [Hamel, G., Breen B. 2008, p. 85]

### **6.4. Control or trust**

Controlling is seen as the fourth function of management, because it is strongly connected to any other functions. This approach derives from a historical point of view. H. Le Chatelier, when describing an organizational cycle, pointed controlling as a the last phase in that. [Wren, D.A., Bedeian, A.G., 2009, p. 239] Nevertheless, H. Bieniok and J. Rokita define controlling

as a process which helps managers to coordinate activities so that effects are equal to parameters in set goals.[ Bieniok H., Rokita J. 1984, p. 257]

We assume his definition as a trouble itself. It is so because controlling badly shortens the limits of human activities. Men who are to obey the rules to obtain goals are becoming similar to machines. Every thing which we can make automatically should be made automatically. But the rest are human ingredients of business life.

There are many similar opinions which imply that controlling in management is indispensable. The reasons for this are: changes in the environment, an increase of organization complexity, employees' mistakes and their dishonest intentions.[Stoner, J.A.F., Wankel, C., 1994, pp. 459-460] We think that this point of view is so dominant that any other activities in management are influenced by controlling. The paradigm causes less commitment, an increase of formality and empty processes which are only performed to maintain some positions in organizations.

We can quote a statement made by W.L. Gore (it is worth saying that GoreTex was invented in the company): "When there is trust instead of fear, there is no need to control employees. The need only some hints and a little support in order to their job." Such a way of noticing a role of managers change every function of management putting into practice positive approach towards employees.[Hamel, G., Breen B. 2008, p. 237]

## **7. Understanding innovations**

In literature it is said that innovations are becoming the centre element of a company's strategy [Kelley T., Littman J. 2009]. Their influence on company's activity was indicated in the past as well. However, the authors of many books in the management science wrote about innovations in products and technology rather than in management processes. Nowadays there is a strong impact on innovations in the system of management which is to make the processes more innovative.

What is interesting, such an attitude towards innovations was very popular in the United States and Japan. The authors of real crucial concepts and methods were successful in putting them into practice in the 1950s and 1960s. We can name such scientists and innovators as Peter Drucker (Management by Objectives and subordinates' participation in management), Shigeo Shingo (Poka-Yoke, Just in Time), Masaaki Imai (Kaizen approach), founders of Boston Consulting Group (BCG method) [Bernais J., Ingram J., Krašnicka T. 2001]. In the 1980s and 1990s in the science we can find little interest in innovations, especially in management systems. This was the period of runaway innovations in products and technologies. As examples we can think of a personal computer

(Apple Computers and IBM), copy machines (Xerox), iPod (Apple) and last but not least – the Internet.

These examples may imply that scientific and systematic approach to innovations was caused by rapid development in electronics and IT, again in the USA and Japan. This accounts for a big launch of modern and sophisticated products. It was the second time when these two countries played a key role in innovations [Rheingold H. 2003].

The word „innovation“ derives from a latin word “innovatio“ which means „renewing“. In the management science the innovation is defined as a research and development process, which leads to implementing and using better solutions in techniques, technologies and processes inside the organization [Pomykalski A. 1997]. J. Penc, Polish scientist, claims that when we move the term into the management science, by innovations we should understand creating and modifying these processes, methods and techniques in companies which make the organizational resources more effective [Penc J. 1999].

The term in plural – “innovations“ – is used to understand a development process intended for large scale systems and concepts of management. However it seems that another understanding of the term matters equally. It is about small and slight steps in development of methods, techniques and tools used for managing. The small steps in an every-day managerial work are indispensable to increase the efficiency of assets [Perlaki I. 1983].

## **8. Open and closed innovations**

In many papers on innovations we can find a division of innovations into two groups. The first one is called “closed innovations” and the second one is named “open innovations”. The main point in the division is a different environment of the innovations and different attitude of managers towards them. The closed innovations mean that managers focus on internal environment of organization. Then only in the field we can find sources for new ideas, concepts, developing changes etc. On the other hand, looking for open innovations means that we search for them with company’s clients, business partners, suppliers etc. The focus is absolutely different.

There are four main reasons for focusing on innovations further then only inside the organization. Rothwell and Zegveld identify three important factors [Rothwell. R And Zegveld 1985]:

- technology explosion; an estimated 90 per cent of our present technical knowledge has been generated during the last 55 years,

- shortening of the technology cycle; the technology cycle includes scientific and technological developments prior to the traditional product life cycle; these cycles have been slowly shortening,
- forcing companies to focus their efforts on product development,
- globalization of technology; countries have demonstrated an ability to acquire and incorporate technology into new products.

P. Trott and D. Hartmann listed six principles which distinguish the closed and open innovations [Trott P., Hartmann D. 2009]. There are in the table 5.

**Table 5.** Six principles which distinguish the closed and open innovations

Attitude to...	Closed innovation statements	Open innovation statements
<b>people</b>	The smart people in our field work for us.	Not all of the smart people work for us so we must find and tap into the knowledge and expertise of bright individuals outside our company.
<b>R&amp;D</b>	To profit from R&D, we must discover, develop, produce and ship it ourselves.	External R&D can create significant value; internal R&D is needed to claim some portion of that value.
<b>discoveries</b>	If we discover it ourselves, we will get it to market first.	We don't have to originate the research in order to profit from it.
<b>time</b>	If we are the first to commercialize an innovation, we will win.	Building a better business model is better than getting to market first.
<b>where to find ideas</b>	If we create the most and best ideas in the industry, we will win.	If we make the best use of internal and external ideas, we will win.
<b>intellectual property</b>	We should control our intellectual property so that our competitors do not profit from our ideas.	We should profit from others' use of our IP, and we should buy others' IP whenever it advances our own business model.

Source: own elaboration.

Slowinski and Sagal suggest that there are about twelve core "good practices" for collaborative innovation. They also define the key inputs to open innovation system leading to high quality results. Slowinski and Sagal developed a four phases model that breaks the lifecycle of open innovation relationships. The phases have been called - Want, Find, Get and Manage.[Slowinski G. and Sagal M.W. 2010]

The first (WANT) phase show us what our resource needs are, and which should be develop internally or externally. The second phase (FIND) asks how we find and evaluate external sources of technology and capabilities that will

fulfill our wants. The third phase (GET) describes what processes we will use to plan structure, and negotiate an agreement to access external resources.

And the fourth phase (MANAGE) asks what tools and metrics we will use to implement and manage ongoing collaborative relationships.

**Table 7.** The four phases model that breaks the lifecycle of open innovation relationships

Phases	Good practices	Description
WANT	Incorporate external thinking into the strategic planning process	Includes the external world as a potential source of talent, technology, and other resources. A+E=C A – current asset base as well as assets the firm can create internally E – externally available resources C – the goal: a fulfilled customer need, leading to growth for the organization
	Convert planning outcomes into a set of prioritized Want Briefs	A well-crafted plan translates strategic intent into a set of assets that the firm wants. These assets are captured in a document, called a Want Brief, that clearly describes the needed asset in terms that enable a decision regarding sourcing (internal or external) and guide an efficient find effort.
	Utilize a structured process for the Make/Buy/ Partner decision	The Make/Buy/Partner decision-making protocol must take into account the full cost of internal development, the NPV effect of a potential early market entry or other benefits of collaboration, the effects of staff allocation to high-value projects, and the likely challenges of executing an OI relationship.
FIND	Look inside first	Looking inside first goes beyond mining internal tacit knowledge. Internal efforts should also include patent mapping to identify sources of likely intellectual assets, literature searches, and visits to academic institutions and other companies active in the areas of interest. These can reduce the costs of third-party agents by focusing their searches on gaps in the firm’s knowledge base.
	Treat the Find effort as a bilateral process	Even as the firm is trying to find the best partner for collaboration, potential partners are seeking the best match to meet their own needs. There can be fierce competition for high-quality partners, particularly in highly networked industries such as Pharmaceuticals and electronics. Consequently, the firm must demonstrate that it is itself a promising partner.
	Use information gathered in Find to refine the Want Brie	Design characteristics may be modified based on discussions with a source of complementary technology; the intellectual property of the source may prompt a reconsideration of the intellectual property strategy captured in the original Want Brief. The firm should establish a systematic process for feeding information generated during Find back into the Want Brief and communicating that information to stakeholders.



Phases	Good practices	Description
GET	Establish and maintain internal alignment	Within each firm involved in the alliance, functional groups (R&D, marketing, finance), individual business units, and senior leadership must be aligned on the objectives and terms of the alliance. Alignment means that all stakeholders have an opportunity to participate in the Want, Find, and Get phases; that their views are considered; that each stakeholder understands the details of the alliance as it takes shape during the Get process; and that all commit their organizations to making it work.
	Use a structured process for internal planning and negotiations	There is a clear correlation between the use of a disciplined, structured Get process and Get success, whether that success is defined as a mutually acceptable agreement or a quick realization . The process the firm decides to use, it must engage with internal shareholders at every stage. A designated team should identify the elements of the alliance relevant to particular stakeholders and prepare positions on those elements for internal review.
	Negotiate with a focus on "Win-Win-Lose-Lose-Lose."	The "Win-Win-Lose-Lose-Lose" principle is a simple guide to reaching an agreement that is fair to both parties. Acceptable compromises can be reached and a fair outcome achieved by a focus on how both parties can achieve their objectives, or win, while other marketplace participants lose in the heightened marketplace competition enabled by the alliance.
MANAGE	Hold a kick-off session to enable integration of management systems	At the beginning of implementation, managers from the partnering firms must learn how to integrate both firms' contributions into a functioning whole. Differences in processes and systems, including both formal structures and tacit culture elements, may create stumbling blocks in this process. Well-planned and executed kick-off meeting is an important vehicle to identify disconnects and start the process of resolution, avoiding the damage done by the gradual emergence process.
	Use the kick-off session to ensure that both firms have the same understanding of the operating principles established in the agreement	The kick-off session provides a mechanism for team members to get a clear and consistent explanation of the terms of the alliance and how the agreement terms should guide their actions.
	Train managers in both firms in the principles of conflict resolution	Some conflict is negative, expressing itself in unhealthy behaviors and a refusal to cooperate. Some conflict is positive, encouraging the group to explore multiple pathways to a common goal. Left unmanaged, conflict strains relationships, decreases productivity, erodes trust, and leads to an "us versus them" mindset characterized by decision-making paralysis.

Source: own elaboration.

## 7. Conclusions

The new perspective of doing business by creating sustainable and responsible innovations need to address a lot of paradoxes such as:

- using CSR as an organizational routine or using CSR as a breaking-through innovation, risky but profitable,
- creating innovations that bring CSR-benefits only without enhanced functionality, reduced prices and improved quality or as necessary by regulations,
- using CSR-driven innovations that certainly harm the interest of these companies (selling old products) and can't be turned into a profitable business under their present business models.

In this paper we have addressed the question of how specific conditions affect CSR and which activities are suitable for the corporation to create 'open' and 'close' innovations. Deciding which way to go executives need to mind the gap between certain regulations and future expectations of stakeholders to preserve more competitive and sustainable development.

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**Andrzej Lis\***

## **MILITARY OUTSOURCING IN POLAND: LESSONS LEARNED AND PROSPECTS FOR FURTHER DEVELOPMENT**

### **Summary**

*The aim of the paper is to discuss the key issues of military outsourcing in Poland. Outlining the theoretical background, the article discusses the nature and scope of military outsourcing. Then the development of military outsourcing market is analysed. In its empirical part, the paper identifies the outcomes and lessons learned from the implementation of contracting-out program in the Polish Armed Forces. Finally it attempts to forecast prospects for the further development of military outsourcing. The contents of the paper are based on the critical analysis of available sources (books, articles, legal acts, the Internet) and the opinions presented by interviewed experts (the PAF flag and senior officers, academic researchers and branch journalists).*

### **1. Introduction**

The transformation undertaken by the armed forces in democratic states in the 1990s and 2000s resulted in the increase of the military outsourcing market and taking over by civilian contractors the roles traditionally performed by military personnel. This tendency is particularly prominent in the United States and the United Kingdom. Although the value and the share of services outsourced by the Polish Armed Forces (PAF) is significantly lower in comparison with the aforementioned nations, the role of military outsourcing in Poland in recent years has been growing as well. This trend has been strengthened by the lessons Polish military decision makers learned from abroad operations (in particular Iraq, Afghanistan and peacekeeping missions in the Balkans), the PAF professionalization and the ongoing transformation of the military logistics system. In 2008, the Minister of National Defence officially approved the comprehensive program of services contracting-out in the PAF.

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Nowadays, three years later the time has come to analyse lessons learned, to assess the first outcomes of the program and to discuss its further perspectives. The prospects and determinants of the military outsourcing development in Poland were the topic of the paper presented by the author during the 8<sup>th</sup> WSB-NLU seminar in June 2009 (Lis 2009, p. 255-264). In the conclusion of the aforesaid article, the areas of further scientific exploration were outlined. The assumption was to study the problem from two different points of view: the customer's perspective and the supplier's perspective. The aim of this paper is to continue the research initiated two years ago and to explore the issues from the standpoint of the Polish Armed Forces. In order to achieve the above-stated aim the following operational objectives have been set:

- to outline the concept and scope of military outsourcing and the reasons for its development in order provide the theoretical background for the following empirical study,
- to analyse the issue of military market development in the countries known as leaders in military outsourcing implementation (the United States, the United Kingdom) and to review the literature presenting the lessons learned by those nations;
- to find out the outcomes and to assess (ex post) the effectiveness of projects implemented by the Polish Armed Forces in accordance with the MOD military contracting-out program dated as of 2008;
- to identify future opportunities and threats for the Polish Armed Forces resulting from outsourcing their in-home capabilities;
- to discuss the prospects for the further development of the Polish military outsourcing market;
- to identify the customer's (the PAF) expectations concerning military outsourcing projects and relations with suppliers and the experts' recommendations for military decision makers in order to improve military outsourcing management.

The contents of the paper are based on the critical analysis of available sources (books, articles, legal acts, the Internet) and the opinions of interviewed experts (the PAF flag and senior officers, academic researchers and branch journalists). The empirical study was conducted in May 2011 and included in total 11 experts. The respondents were divided into two groups. The first one consisted of six senior officers of the Inspectorate for Armed Forces Support (and subordinate units) responsible for the outsourcing program implementation in the Polish Armed Forces. They covered the following functional areas: maintenance, repairs and overhaul (MRO) of military equipment, car rental, movement and transportation, military infrastructure and facilities management, material supply (food, uniforms, petrol, oils and lubricants). They were asked about the lessons learned and the effects of the outsourcing program

implementation in the PAF. The second group numbering five experts (flag and senior officers, academic researchers and branch journalists) was expected to provide a more general picture of the process and assess the perspectives for its future development. Moreover, the outcomes of the author's previous empirical research on the determinants of Polish defence companies' strategies were found to be useful (Lis 2011) as well.

In order to define clearly the field of the research, some assumptions have been made. First of all, the paper focuses on military outsourcing in Poland. However, making efforts to build up the big picture, it refers to the research literature based on the American and West European perspectives. Nevertheless, in all cases the paper deals with the issues of military outsourcing in 'efficient', democratic states, omitting the challenges of security privatisation in weak states. The latter problem is discussed among other by Holmqvist (2005, p. 11-22). Secondly, the paper distinguishes a wide range of functional areas contracted out by ministries of defence, but in its empirical part it is limited to logistic support services outsourced by the Polish Armed Forces according to ministerial regulations in force. Thirdly, the aforementioned contracting-out program for the Polish Armed Forces gives particular attention to the in-place forces support, what affects the area of the paper's interest.

The article is organised around four issues. The first part has the theoretical character and it provides the background for the following empirical study. It attempts to define military outsourcing and to identify its scope. The second part presents the development of military outsourcing market and the reasons standing behind its growth. The purpose of the third part is to find out the outcomes and lessons learned from military outsourcing implementation in the PAF. The fourth part of the paper is devoted to the prospects for military outsourcing development in Poland.

Finally, one linguistic comment should be made. Generally British English standard has been used to write and edit the text. However, in some cases while referring to or quoting American sources the original features of American English standard have been purposely kept unchanged.

## **2. The nature and the scope of military outsourcing**

Outsourcing is commonly understood as the "process of subcontracting services and operations to other firms that can perform them more cheaply or better" (Griffin 2008, p. 599). As Perlo-Freeman and Sköns (2008, p. 3-4) observe "[o]utsourcing means the transfer of management, functions or services to an external service provider through a contractual arrangement, whether between private companies or from the public to the private sector". Outlining the background for military outsourcing, Skarzyński (2008, p. 168-

169) introduces two different classifications of outsourcing: the object typology covering different areas of outsourcing and the subject typology differentiating between beneficiaries of outsourcing. The object typology encompasses the outsourcing of: transportation, storage, shipping, technology, accounting, debt collection, training, IT and others. The subject typology may include among others: business outsourcing, public administration and military outsourcing.

Skarżyński (2008, p. 169) interprets military outsourcing as “the use of external resources and services by the institutions responsible for national defence [translation mine, AL]”. His understanding of military outsourcing is close to the definition proposed by Pan (2004) who describes military outsourcing as “[t]he process of contracting out to private companies tasks that used to be performed by the members of the uniformed military”. Perlo-Freeman and Sköns (2008, p. 4) point out that “[o]utsourcing of military functions to private industry is (...) a part of a broader trend of privatisation in military sector”. However, while analysing the nature of military services these researchers claim that “the key distinction is neither in the military or civilian identity of the customer, nor in the case of services, whether they were previously performed by uniformed personnel, but in the nature of the service – whether it is generic or military specific” (Perlo-Freeman and Sköns 2008, p. 5).

As Hartley (2004, p. 200) observes “[m]ilitary outsourcing has been the victim of various definitions. These include contracting-out, contractorisation, privatization, competitive tendering, market testing and the most recent initiatives in the form of the Private Finance Initiative (PFI) and Public Private Partnerships (PPP)”. This ambiguity in terminology may be observed even in the official NATO and EU publications. Neither the *NATO Glossary of Terms and Definitions AAP-6* (2010) nor the *NATO Allied Joint Logistic Doctrine AJP-4(A)* (2003) provides the definition of military outsourcing or even mentions it. Instead of outsourcing the AJP-4(A) (2003, point 0104) identifies the term ‘contracting’ and considers it as one of the functional areas of logistics<sup>1</sup>. The NATO doctrine highlights that “[c]ontracting has become increasingly important to the conduct of NATO operations, particularly in non-Article 5 CRO<sup>2</sup>. Contracting is a significant tool that may be employed to gain access to local resources, and other necessary materials and services”. (AJP-4(A) 2003, point 0323). Moreover, the AJP-4(A) (2003, point 0117c(9)) introduces the term Third Party Logistics Support Services (TPLSS) considered as “preplanned provision of selected logistic support services by a contractor” and states that “TPLSS can release scarce resources for higher

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1 The other functional areas of logistics according to the AJP-4(A) are: supply and services, maintenance and repair, movement and transportation, infrastructure, medical, funding.

2 CRO – Crisis Response Operations.



priority tasks elsewhere, overcome known logistic shortfalls and provide long-term endurance and sustainability”. Similarly, the EU directive on contracting in defence sector (Directive 2009/81/EC) uses the term ‘contracting’, not even mentioning the word ‘outsourcing’. However, on the other hand the European Defence Agency’s analyses on military expenditures commonly identify financial means ‘outsourced’ by the armed forces (cf *European – U.S. defence expenditures in 2009*, p. 14; *Defence Data of EDA participating Member States in 2009*, p. 29-30).

Beside the ambiguity in defining military outsourcing, another debatable issue is the scope of outsourced services. Analysing the employment of military outsourcing by the U.S. Armed Forces during the first phase of the Iraqi operation, Pan (2004) finds out that “[t]he assignments range[d] from mundane jobs like cooking or cleaning to specialized ones like maintaining and repairing sophisticated weapons systems, translating and transcribing, and interrogating Iraq prisoners”. Stockholm International Peace Research Institute (SIPRI) conducting the studies on military services extends their scope “from support services (e.g. logistics, communications, technical support) and consultancy services (e.g. operational support, training, intelligence) to the provision of frontline combat capacities”<sup>131</sup>. Perlo-Freeman and Sköns (2008, p. 6-7) identify the following types of military service provided by civilian contractors: research and development (R&D) of weapon systems, technical services (IT services, systems support, equipment maintenance, repair and overhaul – MRO), operational support (facilities management – FM, logistics, training, intelligence services, weapon destruction and disposal), armed forces services (armed security). Such an approach is close the classification of privatised military firms proposed by Singer (2003, quoted after Perlo-Freeman and Sköns 2008, p. 4) who divides them into:

- military provider firms engaging in military operations,
- military consultant firms providing training and consultancy closely linked to the military operations,
- military support firms providing logistics.

As Petersohn (n.d., p. 6-7) finds, such an approach to classify private military companies (PMCs) according to the type of services they provide is widespread in the literature. Referring to the works of Kümmel (2004, p. 14) and Singer (2003, p. 91-92), he identifies: private combat companies, private security companies, private consultant companies and private logistical support companies. Comparing Petersohn’s classification to the typology proposed by Singer one should notice that the former distinguishes between private combat companies and private security companies while the latter places both aforementioned categories

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3 [http://www.sipri.org/research/conflict/trends/research\\_projects/psc](http://www.sipri.org/research/conflict/trends/research_projects/psc) (05.06.2011).

under one header referring to them as ‘military provider firms’. In accordance with Petersohn’s classification, private combat companies are “involved in direct engagement of the enemy or else they command regular troops”, while private security companies “provide special personnel to guard facilities, convoys, and individuals” (Petersohn n.d., p. 6-7).

In order to provide a comprehensive picture of military outsourcing phenomenon, apart from defining it and identifying its scope, it is required to find the clear distinction between military outsourcing and outsourcing commonly used in a civilian environment. Depending on the differences in the way how military outsourcing is defined and classified, there are two approaches to establish the border line. The first one refers to the subject typology of outsourcing. According to this approach military outsourcing covers all the services contracted out by the armed forces on the civilian market, regardless of the fact whether the character of those services is military specific or civilian specific. Trying to justify the distinction between military outsourcing and services outsourced by other (civilian) customers, (Skarżyński 2008, p. 169) claims that military outsourcing is to be considered separately because:

- the national defence sector requires not only resources and services commonly used and easy to get on the market but also some very specific ones;
- service providers are to meet strictly defined requirements based on the military regulations;
- services for the military sector are often provided in a different environment than those for the civilian customers.

The second approach refers to the object typology differentiating between outsourcing of military specific services and other types of services (i.e. transportation, facilities management, catering services) which can be acquired by both armed forces and civilian organisations. Perlo-Freeman and Sköns (2008, p. 5) defining the nature of military services claim that “the key distinction is neither in the military or civilian identity of the customer, nor in the case of services, whether they were previously performed by uniformed personnel, but in the nature of the service – whether it is generic or military specific”. However as they stress “[i]n practice, the distinction between military and non-military goods and services is difficult to draw”. Referring to Lindley-French and Algieri (2004, p. 68), Petersohn observes that “[t]he military capabilities necessary to produce security depend on the mission, the characteristics of the theater, and other factors. (...) Providing security at home is apparently a different task from providing it when deployed abroad” (Petersohn n.d., p. 9). In order to classify those capabilities, he uses a traditional military typology encompassing: combat functions, combat support (CS) functions and combat service support (CSS) functions.

The U.S. field manual *Operational terms and graphics* defines ‘combat functions’ as the “[f]unctions that commanders integrate and coordinate to synchronize battle effects in time, space, and purpose. They are intelligence, maneuver, fire support, air defense, mobility and survivability, logistics and battle command” (FM 101-5-1 1997, p. 1-30). The U.S. *Dictionary of military and associated terms* introduces the term ‘operating forces’ denoting “[t]hose forces whose primary missions are to participate in combat and the integral supporting elements thereof” (JP 1-02, 2001, p. 390). Forces directly participating in combat are called ‘combat forces’ (JP 1-02, 2001, p. 98).

According to the NATO *glossary of terms and definitions* and the U.S. *Dictionary of military and associated terms* ‘combat support’ (CS) is defined as the “fire support and operational assistance provided to combat elements”<sup>4</sup> (AAP-6, 2010 p. 2-C-8; cf. JP 1-02 2001, p. 106). The term ‘combat service support’ (CSS) refers to “[t]he support provided to combat forces, primarily in the fields of administration and logistics” (AAP-6, 2010 p. 2-C-8). The combat service support covers “[t]he essential capabilities, functions, activities, and tasks necessary to sustain all elements of operating forces in theater at all levels of war. Within the national and theater logistic systems, it includes but it is not limited to that support rendered by service forces in ensuring the aspects of supply, maintenance, transportation, health services, and other services required by aviation and ground combat troops to permit those units to accomplish their missions in combat. Combat service support encompasses those activities at all levels of war that produce sustainment to all operating forces on the battlefield” (JP 1-02 2001, p. 106). Combat service support “also include those activities in stability and support operations that sustain all operating forces” (FM 101-5-1 1997, p. 1-32)<sup>5</sup>.

Taking into consideration the aforementioned classification of military capabilities and functions, one may observe that both combat and combat support capabilities should be considered as pure, military specific functions. The status of combat service support capabilities is much more complex. One may claim that a lot of services provided within the frame of CSS are the logistic services of civilian nature (i.e. transportation, storage or catering services). To a certain extent, such a statement is true in reference to some of logistic services acquired by in-place forces deployed in their home garrisons in peacetime. However, in any operational setting such a distinction between military specific functions and civilian specific functions used to sustain military troops is doubtful. There

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4 For example, in the U.S. Army and Marine Corps combat support includes the following branches and functions: “Chemical Corps, civil affairs, psychological operations, Military Intelligence, Military Police Corps, and the Signal Corps” (FM 101-5-1 1997, p. 1-32).

5 For example in the United States, “[t]he included branches and functions are: Adjutant General Corps, Acquisition Corps, Chaplain Corps, Finance Corps, Judge Advocate General Corps, Medical Corps, Ordnance Corps, Transportation Corps, and the Quartermaster Corps” (FM 101-5-1 1997, p. 1-32).

are, at least three reasons to differentiate between military logistic services and civilian logistic services<sup>6</sup>. Firstly, in operations all the troops, including CSS units providing logistic services, may come under fire. Secondly, on the battlefield logistics may be considered as an element of “combat functions’ (cf. FM 101-5-1 1997, p. 1-30), crucial for the final result of the operation. Thirdly, there are some important differences between military and civilian logistics. Those differences are discussed by Ficoń (2009, p. 175-177). The gist of this comparative analysis is presented in Table 1.

**Table 1.** Military and civilian logistics – a comparative analysis

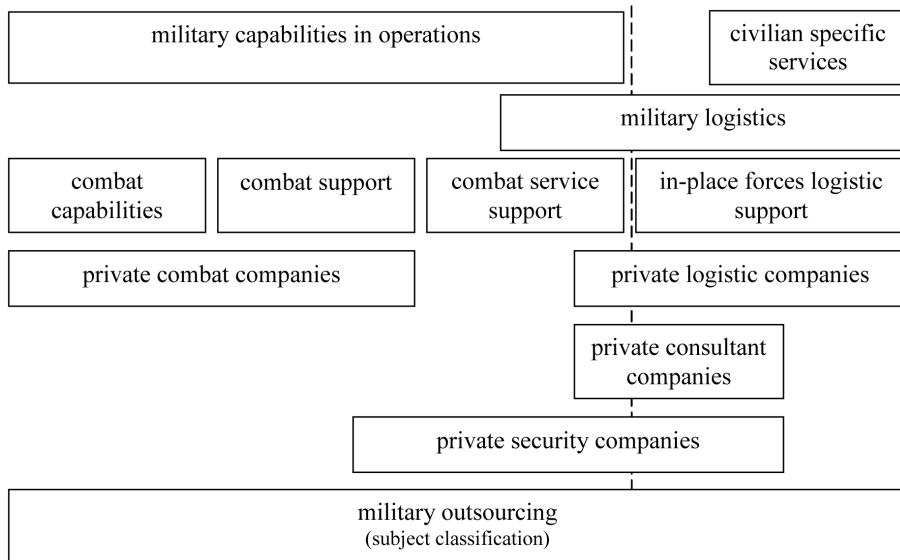
Characteristics	Military logistics	Civilian logistics
Mission of logistics	Operational and combat security	Market competitiveness
Criterion of operations	Security of supplies	Minimisation of costs
Time factor	Highest priority	According to the just-in-time principle
Level of stocks	Defined by military regulations	Minimal
Purchase of supplies	Operational requirements	Economic criteria
Distribution system	Adjusted to operational requirements	Wholesale/retail channels
Selection of suppliers	According to operational criteria	According to market criteria
Outsourcing	Limited scope	Full scale
Warehouses	Specialised	Universal
Packaging	Special	Market
Planning input	Operational plan	Market forecast
Logistic services	Very wide range	Narrow range
Material supplies	Very wide range	Range adjusted to the type of a company
Ecological requirements	Second-rate importance	First-rate importance
Just-in-time	Full scale	Full scale

Source: Ficoń K., *Dwie wojny dwie logistyki*, “Kwartalnik Bellona”, 2009, No. 1, p. 177. [translation mine, A.L.].

In order to summarise the discussion on the nature of military outsourcing, an attempt has been made to draw the distinction between military and civilian outsourcing. The graphical representation of this operation is presented in Figure 1.

<sup>6</sup> Operational logistic support includes the following functional areas: supply and services, maintenance and repair, movement and transportation, infrastructure, medical support, contracting, funding. AJP-4(A), point 0104.

**Figure 1.** The scope of military outsourcing



Source: Own study.

### 3. The development of the military outsourcing market

The military transformation undertaken by the armed forces in democratic states in the 1990s and 2000s resulted in the increase of the military outsourcing market. Referring to the works of Singer (2003) and Wulf (2005), Perlo-Freeman and Sköns (2008, p. 3) find that “[t]he current increase in the market for military services is the result of several trends during recent decades that affect both demand (the use of private companies for the provision of military services) and supply (the increase in private companies engaged in the sale of military services)”. They list the following factors standing behind the growth of the military services market (Perlo-Freeman and Sköns 2008, p. 3-4; cf. Holmqvist 2005, p. 2):

- the decrease in military expenditures and the number of military personnel,
- the increase in demand for private military services due to: the changing nature of armed conflicts, the growing role of expeditionary operations, ‘revolution in military affairs’ (military technology) and the loss of the expertise in some areas by the armed forces,
- the growing acceptance of privatisation and outsourcing of public activities.

The United States of America is the unquestionable world leader in contracting services out by the military sector. In Europe, the concept of military outsourcing is mostly widespread in the United Kingdom. Therefore, the two aforementioned nations are the cases of numerous analyses and publications, attracting the attention of both American and international researchers. For example, the outsourcing in the U.S. Army is widely discussed by Nigara (2004) in her dissertation for doctorate in management. The consequences and risks of using military outsourcing, and private military companies in particular, are a very debatable issue catching a lot of researchers' attention. The works by Markusen (2003), Holmqvist (2005), Schreier and Caparini (2005), Perlo-Freeman and Sköns (2008), Petersohn (n.d.) are only a few examples. The problem will be studied in detail in the further part of the paper. Apart from the economic point of view, military outsourcing is examined from military, political and legal perspectives. One can notice, that in the United States, the issues of military outsourcing are eagerly explored by American and foreign military service people doing their research projects in military academies (i.e. Naval Postgraduate School, Monterey, United States Army War College) and often published in military journals (i.e. a quarterly "Parameters" published by the United States Army War College). The role of civilian contractors in the support of the U.S. Armed Forces is the area of exploration for Polish academicians, too (cf. Jałowicz 2009, p. 179-183). Next, the UK policy on military outsourcing is presented by Hartley (2004, p. 202-205). Among Polish researchers, Jałowicz identifies British lessons learned from the process of military outsourcing implementation (2010, p. 62-65). A comprehensive analysis of the UK market for military outsourcing contracts is provided by MacDonald (2010, p. 115-132). Moreover, the latter makes the wide review of the literature on military outsourcing including theoretical approaches and empirical literature (MacDonald 2010, p. 25-59).

The significance of military outsourcing for the support of the armed forces in the United States and the United Kingdom can be expressed by the level of the 'outsourced' military expenditures. In the United States, outsourcing spending makes almost one fourth of total military expenditures. What is more, the value and the share of the outsourcing spending has been increasing in recent years. In 2007, the U.S. Armed Forces outsourced services for 76,2 bln<sup>[7]</sup> euro (17% of total military expenditures). In 2008, this value reached the level of 99,4 bln euro (21%) and in 2009 it peaked up to 112,5 bln euro (23% of total military expenditures). In the same period of time, the military outsourcing expenditures in the European Defence Agency<sup>[8]</sup> member states remained at the level of 6 to

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7 In this paper, the word 'billion' refers to the modern (short scale) English usage. One billion denotes one thousand million (10<sup>9</sup>).

8 The European Defence Agency numbers 26 participating member states (all the European Union member states with the exception of Denmark).

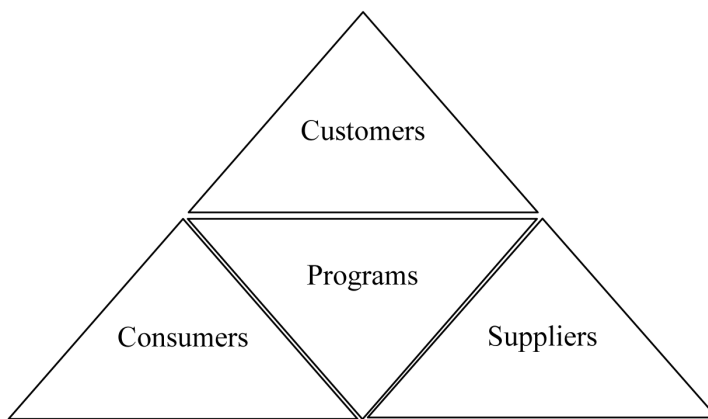
7% of total military expenditures (2007 – 14,4 bln euro, 2008 – 12 bln euro, 2009 – 14,1 bln euro). (*European – U.S. defence expenditures in 2009*, p. 14). The lion's share of this amount (around two thirds) is the military expenditure outsourced by the United Kingdom (9 bln euro as of 2009) (*Defence Data of EDA pMS in 2009*, p. 29).

Using the case of the United States as the base for their analyses, Apgar and Keane (2004, p. 46-55) propose a comprehensive model of military outsourcing market. The model includes four segments:

- customers: the military services, commands, agencies and other buyers;
- consumers: service members, their families, military retirees and civilians employed by the Department of Defence;
- suppliers: companies providing services to military customers and consumers;
- programs: mechanisms for outsourced activities management.

The graphical interpretation of the military outsourcing market model is presented in Figure 2.

**Figure 2.** The model of the military outsourcing market



Source: Apgar IV M., Keane J.M., *New business with the new military*, “Harvard Business Review” 2004, September, p. 46.

In order to sum up the foregoing theoretical introduction and provide the framework for the empirical studies some assumptions have been made. First of all, the definition of ‘military outsourcing’ proposed by Skarżyński (2008, p. 169) (“the use of external resources and services by the institutions responsible for national defence”) will be in force for the purpose of this paper. In the author’s subjective view, the aforementioned denotation reflects in the best way how contemporary military outsourcing is understood in the Polish

Armed Forces. Secondly, it should be emphasised that beside the differences in defining military outsourcing, there are numerous terms of similar or the same meaning, what makes the confusion about terminology. The most popular among them are: contracting, contracting-out, Private Finance Initiative, Public Private Partnership or Third Party Logistics Support Services. Thirdly, in the countries which are the most advanced in using military outsourcing it usually encompasses armed forces services including engagement in combat operations, training services and logistic support. In Poland, so far military outsourcing is limited to widely understood logistic sector. Fourthly, military outsourcing sector has been growing in the post Cold War reality (especially in the United States and the United Kingdom) and still has the potential for growth due to the trends affecting both demand and supply on the market of military services. Fifthly, the model of the military outsourcing market submitted by Apgar IV and Keane (2004, p. 46-55) will be applied for further discussion. The model consists of four elements: customers, consumers and suppliers and programs. The model, developed in the United States, seems to suit well to the Polish military outsourcing market, too.

#### **4. Military outsourcing in Poland – lessons learned**

Although the value and the scope of services outsourced by the Polish Armed Forces (PAF) is significantly lower in comparison with the United States or the United Kingdom, the role of military outsourcing in Poland has been growing since the beginning of the 1990s. The breakthrough in the Polish military outsourcing market came in 2008, when the Minister of National Defence officially approved the contracting-out program for the Polish Armed Forces. In his decision dated as of 3 July 2008, Bogdan Klich outlined the prospects for the further development of military outsourcing. According to this program, there are five potential fields for military outsourcing. They include: logistics, legal advisory services, administrative services, force protection and military infrastructure. Within logistics, the following areas are identified as the most promising for military outsourcing (Koncepcja 2008, p. 1031-1033, see also: Lis 2009, p. 260-261):

- maintenance, repairs and overhaul (MRO) of armaments and military equipment;
- rental of vehicles (passenger cars, trucks, medical vehicles) and other types of equipment;
- recycling of waste munitions, rocket propellants, chemicals, medical wastes and food wastes;
- transportation: air, railway, sea;



- storage of supplies: food, uniforms, petrol, oil and lubricants (POL), medicines;
- catering and laundry services.

The outsourcing of maintenance and repair services encompasses mainly the new types of equipment and the vehicles which are used both in the military and civilian environment. Among the examples MRO services which have been contracted-out the respondents participating in the survey mention: armoured personal carriers ROSOMAK, passenger cars or logistic vehicles.

Ciekot and Jałowicz (2010, p. 21-25) outline the main assumptions of the car rental outsourcing in the Polish Armed Forces. The program was launched by the Inspectorate for the Armed Forces Support (Inspektorat Wsparcia Sił Zbrojnych, IWsp SZ) in 2010 and it is planned to be implemented by 2018. The program consists of two stages. The first stage (2010-2013) is the experiment carried out in seven military units representing different armed services: Land Forces, Air Forces, Navy and military logistics. The experiment covers the outsourcing of heavy equipment transport systems (of loading capacity up to 30 tonnes) and general purpose vehicles (passenger cars, buses and mini buses, trucks). If the experiment brings positive effects the vehicles rental is going to be expanded in all military units by 2018.

Movement and transportation (M&T) is another field of military logistics, where outsourcing plays a significant role. Poland's accession to NATO resulted in the increase of the Polish Armed Forces' engagement in allied military operations abroad. This trend determined the growing demand for the access to the strategic air and sea transportation capabilities. Contemporary, the requirements of the Polish Armed Forces for the strategic air transportation are satisfied by three types of capabilities: Polish military transportation aircrafts (C-295 CASA and C-130 Hercules), the multinational military Heavy Airlift Wing (HAW) operating within the frame of the Strategic Airlift Capability (SAC) program<sup>9</sup> and the outsourcing of air transportation services. As far as strategic sealift is concerned military outsourcing is the only solution<sup>10</sup>. In order to ensure the flexible access to the means of strategic air and sea transportation, the Polish National Movement Coordination Centre (NMCC) uses three types of outsourcing tools: the SALIS program, the AMSCC program and framework agreements. Strategic Airlift Interim Solution (SALIS) is the consortium of sixteen NATO member countries, which "have pooled their resources to charter special aircraft that give the Alliance capability to transport heavy equipment across the globe by air. The multinational airlift

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<sup>9</sup> More: [http://www.nato.int/cps/en/natolive/topics\\_50105.htm](http://www.nato.int/cps/en/natolive/topics_50105.htm) (26.05.2011); <http://www.heavyairliftwing.org> (26.05.2011).

<sup>10</sup> This is a world trend. Few nations own their own military transportation ships. Among NATO members, only four countries have such a capability (the United States, the United Kingdom, Germany, Denmark).

consortium is chartering six Antonov An-124-100 transport aircraft, which are capable of handling 'outsize' (unusually large) cargo'<sup>111</sup>. The contractor is a Russian-Ukrainian consortium Ruslan-Salis consisting of two companies: Volga Dnepr and Antonov Design Bureau. While SALIS provides the access to the strategic air transportation, the Memorandum of Understanding (MOU) and Technical Arrangements (TA) signed between the Polish Armed Forces and the Athens Multinational Strategic Lift Coordination Center (AMSCC) facilitate the contracting of sealift services. The AMSCC provides a complex support during the contracting procedure conducted in accordance with the EU public procurement regulations<sup>112</sup>. The means of strategic transportation may be also acquired by the activation of framework agreements negotiated and signed in advance. Contemporary, there are two such framework agreements in-force which provide the PAF with the access to the ships and planes enabling the strategic transportation of equipment and personnel<sup>113</sup>. The interviewed experts list the contracting-out of strategic air and sea lift capabilities among the most successful examples of military outsourcing in the PAF. They highlight very positive economic and operational effects of the program.

According to the assumptions of the MOD outsourcing program, catering services were considered as the area of possible outsourcing expansion. In 2009, the experiment in catering outsourcing was launched in Wrocław. The key players of the experimental program were: the 2<sup>nd</sup> Military Support Unit (2. Wojskowy Oddział Gospodarczy, WOG) – the customer, military personnel of the Engineering and NBC Troops Training Centre (Centrum Szkolenia Wojsk Inżynieryjnych i Chemicznych) – consumers and the catering company PHU WIG – the supplier. There were plans to introduce outsourced catering in other military units. Although the first outcomes of the experiment were quite positive<sup>141</sup> (see more: Politowski 2009, p. 18-20), finally the program was given up. The main reason standing behind this decision was the radical decrease in needs for catering services resulting from the professionalization of the PAF. In 2009, the military compulsory service was suspended. Professional military personnel are authorised to be fed free of charge only in particular circumstances (i.e. operations abroad, training longer than eight hours, duty services). In effect, the number of military dining facilities' customers decreased from 70,000 in 2009 to 20,000 in 2011. Therefore, radical changes were introduced within the military catering system. The Armed Forces closed down around 150 out of 300 dining facilities, offering some of them (around

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11 [http://www.nato.int/cps/en/natolive/topics\\_50106.htm](http://www.nato.int/cps/en/natolive/topics_50106.htm) (26.05.2011).

12 <http://www.stirw.wp.mil.pl/Programy/AMSCC.pdf> (26.05.2011).

13 <http://www.stirw.wp.mil.pl/Programy/UMOWY%20RAMOWE.pdf> (01.06.2011).

14 Some experts participating in the study were much more skeptical about the effects of this experiment.

50) to be rented by civilian contractors. Simultaneously, the Armed Forces want to keep up in-home the remaining military catering potential and capabilities. In such circumstances, the further plans for the outsourcing of catering services are limited to several military units of low number of consumers. Due to the aforementioned changes any projects to outsource the storage of food supplies were abandoned, too.

The process of the armed forces professionalization reduced the military demand for laundry services as well. Professional troops receive financial bonus and take care of their laundry on their own. Military logistics is responsible for providing laundry services only for the personnel permanently accommodated in barracks: i.e. soldiers of the preparatory service basic training courses or cadets of military academies and schools. The gradual decline in demand accelerated by the professionalization processes, and the changes in the public finances legal regulations resulted in the close down of remaining seven military laundries at the end of the year 2010. Nowadays all laundry services are contracted by the military logistics on the local market.

The supply of petrol, oils and lubricants (POL) is another area of military outsourcing. Although the plans to outsource the storage capacities for POL products were postponed, the fleet fuelling program appeared to be unquestionable success. The program implemented initially in July 2009 in the logistic units subordinated to the Inspectorate for Armed Forces Support, one year later was extended to all military units of the Polish Armed Forces. The interviewed experts emphasise positive economic effects of the program and predict its further extension resulting, in some cases, in the close down of fuelling stations in the units devoid of heavy military equipment.

Beside logistics, the examples of military outsourcing application include such areas as: legal advisory services, administrative services, force protection and military infrastructure. The suspension of the compulsory military service and the professionalization of the PAF have strengthened the role of contracting-out in force protection and infrastructure. Nowadays, the force protection of military facilities is carried out by one of the following formations: military guards (military servicemen), civilian guards (civilian servants employed by military units) or outsourced force protection companies. The interviewed experts highlight very positive outcomes of force protection outsourcing. In their opinion, it enables military personnel to focus on core competencies such as training and operational tasks. Moreover, the respondents point out the economic effectiveness of force protection contracting-out. Nevertheless, they find as very positive the diversification of formations employed to protect military facilities. Such an approach allows to keep in-house force protection of the key military facilities and simultaneously to outsource the services for the rest of them. What is more, keeping some capabilities in-home enables their

extension in the case of crisis and increases the PAF bargaining power to the force protection outsourcing sector, preventing from the threat of unfounded rise of prices.

The contracting-out services by the military infrastructure has a long tradition. Since the 1989 breakthrough, the share of outsourced constructions works and military facilities maintenance services has been constantly growing. In 2010, the suspension of compulsory military service determined the extension of cleaning and outdoor areas maintenance outsourcing. Another factor stimulating the outsourcing of facilities management services is the reduction of employment in this area due to the organisational restructuring of the PAF aimed at the increasing the “tooth” (combat units) at the expense of the “tail” (support personnel). Beside facilities management, in recent years the lion’s share of construction works has been outsourced, too. Moreover, the changes in the public finances law determined the transformation of military (budgetary) construction enterprises (Wojskowe Zakłady Remontowo-Budowlane, WZRB) into subsidiary companies of the Military Housing Agency (Wojskowa Agencja Mieszkaniowa, WAM). In result, the Polish Armed Forces gave up any construction capabilities and nowadays relies totally on contracting-out.

The key motive behind the decision to outsource non-core capabilities is seeking the increase in effectiveness. The assumption is that external contractors will provide services of better quality and/or at a lower cost for the customer. What is more, Hartley claims that in ‘make or do’ decisions a simple analysis of technical efficiency (the lowest cost method of achieving a given output) is not sufficient. He recommends to employ a more complex allocative efficiency, which beside the technical efficiency takes into account margin social benefits and costs (Hartley 2004, p. 200). However, such an approach is much more challenging and demanding. Discussing the effectiveness of military outsourcing projects some researchers (i.e. Schreier and Caparini 2005, p. 98) raise the issues of transaction costs, which may in extreme cases outweigh financial savings achieved by the bidding procedure on the competitive market. These aforementioned transaction costs include the costs of negotiating and managing contracts.

Trying to assess the effectiveness of military outsourcing projects implemented in the PAF, the experts participating in the study highlight their positive economic effects (the decrease in costs). However, they pay special attention to the problems of the quality of services provided by some contractors. They find that precise description of the requirements for the outsourced services may be still a challenge for some less experienced contracting officers. The methodology of logistic services quality assessment, being currently worked out in the National Defence Academy, is mentioned as a potential tool to be employed in contracting procedures. Too short contract terms are another factor

harmfully affecting the cost effectiveness of outsourcing projects. Nowadays the most of them are one-year contracts (up to 90% of all outsourcing contracts according to the estimation of some experts participating in the study). The experts highlight that the lengthening of contract terms could result in lower costs and would make military bids more attractive for potential providers.

The attention of the second part of the paper has been focused on the outcomes and lessons learned from the implementation of the contracting-out program by the Polish Armed Forces. The key areas of the military outsourcing (logistics, military infrastructure and force protection) have been discussed. The special attention has been paid to outsourcing of logistic capabilities such as: maintenance, repairs and overhaul (MRO) of armaments and military equipment; vehicle rental, movement and transportation, catering and laundry services. Moreover, an attempt has been made to assess (ex post) the effects of military outsourcing projects.

## **5. Prospects for the development of military outsourcing in Poland**

The study on the prospects for the further development of military outsourcing in Poland has been focused on three key issues: the identification of opportunities and threats for the Polish Armed Forces resulting from outsourcing their in-home capabilities; the opportunities and barriers for the growth of the military outsourcing market in Poland and finally experts' recommendations for customers and suppliers aimed at the improvement of military outsourcing projects and their management.

According to the opinion of the interviewed experts, the key opportunities for the Polish Armed Forces resulting from the increase in the number and value of outsourced services are:

- focusing on core competencies (training, military operations);
- increasing the quality of non-core services provided by experienced external suppliers;
- increasing the number and strengthening the “tooth” (combat troops) at the expense of the “tail” (support personnel);
- rationalising costs of services and, in effect, decreasing the level of military expenditures or saving financial resources to be allocated in other areas.

Nevertheless, one should not forget to consider the risks connected with outsourcing capabilities by the armed forces. The respondents identify the following potential threats for the Polish Armed Forces:

- losing capabilities which are non-core businesses in the peace time, but might be critical and difficult to acquire from external sources during

crisis or war (drawing the line between ‘make or buy’ is a pending issue);

- loosing capabilities to monitor the quality of services provided by external suppliers,
- reducing the customer’s bargaining power towards contractors, in an extreme case making the PAF totally dependent on external contractors as an effect of complete outsourcing of a given capability;
- monopolisation and monopsonisation of the military outsourcing market including all their inefficiencies and negative consequences both for customers and suppliers,
- the increase in transaction costs (the costs of managing projects) levelling positive effects of economic gains from contracting services on the competitive market,
- the risk of corruption and unethical behaviours.

The analysis highlights the similarity between the aforementioned factors typical of the Polish Armed Forces and the opportunities and threats resulting from contracting-out services by the armed forces abroad identified in the secondary sources. It should be stated that contemporary studies provide a wide range of such researches. Some of them are the effects of benchmarking analyses in the civilian service outsourcing industry, the others are based on the empirical surveys among the world leaders of military outsourcing (the United States and the United Kingdom in particular). Referring to Tondorff (1998, p. 70-71) and Abt (2000, p. 193-194) Skarzyński translates the opportunities and threats of outsourcing projects identified on the civilian market into military environment (Skarzyński 2008, p. 169-170). Numerous positive effects of outsourcing military support functions in the United States and the United Kingdom are listed by Apgar IV and Keane (2004, p. 48-55). An interesting overview of problems, challenges and lessons learned from military outsourcing programs in the United Kingdom is presented by Hartley (2004, p. 200-205). His study, in comparison to the results of the experts interviews or Skarzyński’s findings, puts more emphasis on military outsourcing in combat missions. A long list of potential risks involved in military outsourcing is provided by Schreier and Caparini. They put the emphasis on the notions of transaction costs, monitoring outsourcing projects, the risk of monopolisation with its inefficiencies, political consequences and the lack of transparency (Schreier and Caparini 2005, p. 97-102). Referring to the US Government Accountability Office (GAO) reports <sup>[15]</sup>, Perlo-

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15 *DOD’s extensive use of logistics support contracts requires strengthened oversight*, GAO-04-854, US Government Accountability Office, Washington, DC, July 2004. <http://www.gao.gov/new.items/d04854.pdf>; *High-level DOD action needed to address long-standing problems with management and oversight of contractors supporting deployed forces*, GAO-07-145, US Government Accountability Office, Washington, DC, Dec 2006; <http://www.gao/new.items/d07145.pdf>.

Freeman and Sköns provide strong evidence to support the aforementioned concerns. They point out that GAO “has conducted a number of studies on the performance of logistics contracts in Iraq (...) and elsewhere and has found serious deficiencies in the planning, monitoring and oversight of the contract in Iraq”. (Perlo-Freeman and Sköns 2008, p. 15). In addition to purely economic and management challenges of military outsourcing which are typical of any kind of services outsourced by the armed forces, political, legal and operational consequences of armed security services provided by Private Military Companies (PMCs) on the battlefield are hot and debatable issues. Blackwater operations in Iraq are the best case to illustrate these concerns. Perlo-Freeman and Sköns (2008, p. 13-14) widely discuss the ramifications of the private military services growth: privatisation of the violence, problematic legal status of armed contractors, PMCs’ interest in the perpetuation of conflicts and the security of supply. Summing up the ongoing discussion on the positives and negatives of military outsourcing, one may find three conclusions. First of all, in spite of some negative examples, the vast majority of promising outsourcing cases are the logistic support projects. Secondly, as Perlo-Freeman and Sköns accurately observe (2008, p. 16) “the efficiency of outsourcing is likely to vary with the extent to which the key conditions – competition, clarity of requirement and effective monitoring – are present”. Thirdly, armed security contractors operating on the battlefield constitute the most controversial segment of the military outsourcing market arousing political, legal and operational concerns.

In February and March 2011, Lis (2011) conducted the empirical research on the future determinants of Polish defence companies’ strategies. Experts (representing defence companies management, the Ministry of National Defence, academic researchers and branch journalists) were interviewed to assess the probability and the impact of forecasted determinants (of economic, technological, social, legal and regulatory, and international origin) on the situation of Polish defence companies in the future. The list of potential determinants included, among other factors, the prospects for the development of the Polish military outsourcing market. According to the opinions of the respondents, the chance that the Polish military outsourcing market will grow is estimated at 42%. They forecast 40% probability of the trend stabilisation and only 18% probability of the market shrinking. The experts participating in the panel focused on military outsourcing point out the following areas as the potential candidates for the growth of contracting-out:

- a) in-place logistic support:
  - military facilities management (including cleaning services, the maintenance of outdoor areas, repairs and construction works);
  - force protection;

- maintenance, repairs and overhaul (MRO) of up-to-date military equipment and general purpose vehicles;
- medical services;
- b) military operations abroad:
  - military facilities management;
  - maintenance, repairs and overhaul (MRO) of up-to-date military equipment;
  - material supply (including food, petrol, oil and lubricants);
  - transportation: both strategic (mainly sea and air) and the movement on the theatre.

The data and opinions collected by interviewing experts enable to develop future scenarios for the Polish domestic military outsourcing market. The most likely scenario encompasses two parallel paths:

- centralised contracts for MRO of military equipment carried out by armament producers (included into bidding procedures for the product delivery and life cycle support) or former state owned military maintenance companies (WPRP) planned to be incorporated into Bumar capital group as a service division;
- and decentralised contracts for logistic support awarded locally in garrisons by military support units or regionally by one of four regional logistic bases. It is forecasted that this segment will be served by local, regional or national outsourcing companies operating mainly on the civilian market. Some contracts may be as well awarded to international suppliers.

Thereby, two other scenarios taken into consideration – the monopolisation of the market by any of world leading military outsourcing operators or the emergence of a powerful Polish company specialized in military outsourcing – seem not to be very likely. The experts highlight that, beside the support for the in-place forces, military outsourcing is very likely to be employed in military operation abroad. In such a case, in the most likely scenario the Polish military contingent will join the logistic support system organised by a leading nation and will outsource services to the contractor operating in the area of operation. In order to complete the picture emerging from the aforementioned study, the experts participating in the survey on the military outsourcing were asked to identify the potential opportunities in the environment of the Polish military outsourcing market and barriers for its development. The list of opportunities includes:

- the worldwide trend (both in civilian and military logistics) to replace non-core in-house capabilities by contracting them out;
- the increasing level of specialisation in service industry, what makes almost impossible for any efficient and effective organisation to keep all capabilities in-home,



- the professionalization process of the Polish Armed Forces and the tendency to increase the share of the ‘tooth’ (combat troops) at the expense of the ‘tail’ (support personnel) in order to augment operational capabilities;
- the increase in Poland’s military expenditures (MILEX) and expected changes in the MILEX structure (the decreasing share of personnel costs to the advantage of operation and maintenance (O&M) costs as well as investment expenditures);
- the ongoing transformation of the Polish military in-place logistic system aimed at the logistics’ consolidation in four regional military bases (Regionalna Baza Logistyczna, RBLog.) and the incorporation of military infrastructure to the logistic system (more: Szymański 2011; Klecha and Lis 2011).

The catalogue of aforementioned opportunities provides an optimistic view. However, on closer examination, it is corrupted by the long list of barriers in the development of the Polish military outsourcing market, which includes:

- a) external barriers:
  - very turbulent legal environment;
  - too short financial perspective of outsourcing programs (insufficient number of long-term contracts);
  - insufficient application of Public Private Partnership (PPP) programs;
  - bureaucratic regulations on the military personnel’s relations with contractors on one hand and the risk of corruption on the other hand;
  - ongoing organisational restructuring of the PAF resulting in frequent changes of military plans, structures and needs for outsourced services;
  - mentality of some operational commanders attached to relying on in-house capabilities and their resistance to change;
- b) internal barriers:
  - fragmentation of the Polish outsourcing sector, the lack of Polish companies ready to provide comprehensive outsourcing project encompassing different areas;
  - accidental unreliability and dishonesty of some contractors, what undermines customers’ trust to the outsourcing sector;
  - harvest strategies implemented by some service providers willing to exploit a single occasion instead of developing long term business relations, what strengthens military commanders’ prejudice against outsourcing.

Last but not least, the aim of the study was to identify the customer's (the PAF) and consumers' expectations concerning outsourcing suppliers and the experts' recommendations for military decision makers to increase the scope of the services contracted-out by the PAF and to improve the efficiency of outsourcing projects. The experts suggest that in order to meet the customer's and consumers' requirements and expectations the suppliers should:

- be highly specialised companies, preferable the leaders in their branches;
- know the specific requirements and determinants of military customers;
- be customer-oriented companies seeking the balance between the profit maximisation and the needs and interests of their military customers;
- be able to provide the PAF with the services of higher quality and cheaper (or at least reasonable) price in comparison with military in-home capabilities;
- develop partnership and long term relations with military customers and consumers,
- take care of their reliability and reputation.

Nevertheless, on the customer's side there is room for improvement, too. In order to make outsourcing projects more efficient and effective, the respondents recommend to:

- change the approach to the acquisition of military equipment (reorientation to product life cycle management including servicing and recycling not only purchasing of the product);
- increase the number of long-term projects (longer than one year);
- put more emphasis on preparing and monitoring contracts in order to ensure that services provided by external suppliers meet the needs of consumers and the requirements specified in bidding documentation;
- strengthen the structures and capabilities of military logistics with highly skilled personnel experienced in managing outsourcing projects and contracting procedures;
- develop the tools to assess the effectiveness of outsourcing projects including costs analysis, norms, standards and the project quality measurement;
- benchmark and learn from the civilian logistic industry's and other NATO countries' (especially the USA, the UK, Germany) experience in military outsourcing.

## 6. Conclusion

The paper has focused on four issues. First of all, military outsourcing has been defined and its scope has been identified. Secondly, the development of military outsourcing market and the causes for its growth in last two decades have been analysed. Then, the implementation of contracting-out program in the Polish Armed Forces, its outcomes and lessons learned have been outlined. Finally, the prospects for military outsourcing development in Poland have been discussed.

Summing up, some general conclusions should be mentioned. Military outsourcing is understood as the process of contracting out, by the armed forces, the services which earlier were their in-home capabilities. In recent twenty years, military outsourcing has been increasing its role in the support of the military sector. This trend is particularly prominent in the United States and the United Kingdom. In Poland, the development of military outsourcing market has been strengthened by three factors: the engagement of the Polish Armed Forces in military operations abroad, the professionalization process and the transformation of the military logistics system. In 2008, the MOD officially approved the program aimed the increasing the role of contracting-out in the support of the Polish Armed Forces. According to the program the potential areas for military outsourcing development include: logistics, legal advisory services, administrative services, force protection and military infrastructure. As opposed to the United States, in Poland military outsourcing is limited to the logistic support services, while armed security services and training linked to military operations remain military in-home capabilities. Looking forward, outsourcing-driven opportunities and threats for the Polish Armed Forces have been identified and the prospects for the domestic military outsourcing market have been discussed. Finally, some recommendations for suppliers and military decision makers have been articulated. The main conclusion is that the Polish military outsourcing market has expanded in recent years and there is still room for its further growth, especially in the area of military logistics.

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**Paweł Dowgier\***

## **THE REASONS FOR OUTSOURCING AND ITS SCOPE IN RESTRUCTURING AN ENTERPRISE**

### **Summary**

*Restructurization is an essential process, which allows the company to change and adopt to constantly developing business environment and to maintain its competitive advantage. In the first part of the article the factors and needs for restructuring are presented. Further the author describes the specificity of outsourcing as a tool in restructuring process. In the third part of this article advantages and drawbacks of outsourcing are shown. The author of this work tried to identify the sources for successful implementation of outsourcing in restructuring process.*

### **1. Introduction**

Growing competition in the global market is forcing contemporary enterprises to search for and to renew its competitive edge constantly. An effective way of achieving and maintaining competitive edge is effective management and getting rid of these elements of company resources which may hinder its development and absorb its potential. This means that contemporary enterprises have been forced to look for and to create ventures aiming at adapting to increasingly changeable environment but also to perform serious systemic reconstruction and modernization of their organizational structure, which all point to permanent restructuring.

Restructuring in the 21<sup>st</sup> century stems from the need and necessity to adapt to the turbulent environment. Changing market conditions of economic activity account for the fact that isolating some functions from the organizational structure of the enterprise and entrusting their performance in the hands of other economic entities [Trocki 2001, p. 13], in other words – outsourcing, often plays a decisive role in a chain creating value and shaping competitive edge.

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The aim of the article is to present the reasons for using outsourcing in the process of restructuring enterprises and to describe its types, advantages and drawbacks, which will allow us to determine the scope in which it can be used.

## **2. The essence and subject of company restructuring**

In western literature the common area in definitions of restructuring is the emphasis on the strategic nature of the process of changes taking place in an enterprise aiming at improving the way it functions (its effectiveness) [Hurry, 1993, pp. 69 – 84]. Another definition points at abrupt change in company assets, capital structure or organizational structure [Kowalczyk – Jakubowska, Malewicz 1992, p. 8]. Polish reflections of these definitions can be found in works of A. Nalepka, who treats restructuring as “a deliberate re-orientation of the company mission and aims (mostly on the strategic level) in accordance with past or future environment changes and adaptation of the organization, efficiency, human resources and technologies to it” [Nalepka 1999, p. 20]. A. Stabryła, taking into consideration the scope of restructuring, distinguishes the following types of restructuring [Stabryła 2000, p.251]:

- subject restructuring, concerning legal and economic transformations,
- object restructuring – concerning changes in technical and technological area as well as changes of the product assortment,
- repair restructuring, conducted in companies threatened with bankruptcy, aiming at improving unfavorable economic conditions and restoring company solvency,
- development restructuring, based on strategic decisions taken by the enterprise, concerns innovative and developmental activities, covers the period of 2-5 years.

Other classifications point at the following types of restructuring: marketing, product, company resources, technical and technological [Suszyński, p. 138]). It is worth emphasizing that all divisions are arbitrary, as restructuring plans in enterprises are a complex scope of tasks usually covering several elements from various areas. Moreover, the line between the areas is becoming blurred due to technological progress.

Economic practice and specialist literature indicate many reasons why companies restructure, attributed to joint appearance of tensions and weaknesses in the management and controlling system of an enterprise or in constant changes of the environment [Weston 1992, p. 1083]. Table 1 presents the factors causing the restructuring need, taking into account their division into those inside the company and the ones coming from its surroundings.



**Table 1.** Factors causing the restructuring need in contemporary enterprises

Internal factors of an enterprise	Factors coming from the environment
• depriving owners of direct control over enterprise activities,	• growing international competition,
• planning and controlling system faults which will not guarantee search for best solutions,	• changes in technology and intensified competition between different branches of the industry,
• excessive diversification of activity and problems in organizing business units,	• changes of manufacturing methods, replacing economies of scale with economies of scope of activities,
• incoherent internal systems of generating and spending cash, not fully compliant with the discipline requirements of capital markets	• changes of philosophy of human resources management from managerial to participative,
	• changes of currency exchange rates and changing consumer goods prices,
	• acceleration of unfavorable changes in basic industry branches, banks and other financial institutions,
	• government deficit causing uncertainty and fear of increase inflation and high interest rate

Source: own elaboration on the basis of: [Borowiecki 2003, pp. 77 – 79].

The above factors affecting the restructuring need confirm an obvious conclusion that contemporary enterprises, in order to survive and maintain their market position, must both predict and appropriately assess their situation in light of changes taking place in their environment. These changes constitute present indicators of expansion intentions formulated by enterprises in order to secure their efficient operations and long-term development. [Borowiecki 2003, p. 80].

For our further considerations we adopted a multi-dimensional approach to restructuring, treating it as a process of changes inside the company, whose aim is to adjust the company to its environment. In such an approach, real restructuring takes place when appropriate changes happen simultaneously in three areas of:

- strategy, covering the company's vision and policy, long-term planning, annual objectives and its budget,
- structure, covering static organization, process organization, information systems, operational rules,
- organizational culture, entailing attitudes, behaviors, norms, certain values, communicating style, forms of meetings.

### 3. Definition and use of outsourcing in the restructuring process

The term 'outsourcing' was first used in the second half of the 20th century. However, the specialist literature and economic practice point at numerous examples of forms of cooperation similar to outsourcing in their assumptions concerning the relationship between cooperators, such as subcontracting<sup>[1]</sup>. The etymology of the word shows that it is composed of three words: "outside-resource-using" [Laskowska, 1995, p. 17]. Outsourcing is defined as "the use of complex services being combination of various unit services sold and settled per single unit, offered by external contractors (service providers)" [Penc, 1997, p. 302]. Outsourcing analyses usually emphasize changes in the main company prior to the use of selected form of cooperation. P. Bendor-Samuel and M. F. Greaver Junior stress a characteristic feature of a relationship between the principal and the agent, consisting in the takeover of not only principal's resources but also decision competencies concerning their use by the agent in line with the provisions of a contract signed by both parties. M. Trocki, on the other hand, draws our attention to the fact that the functions passed to other economic entities are not key competencies of the main company [Trocki 1999, p. 16]. The concept of key competencies of an enterprise calls for explanation here. The most accurate definition was provided by C. Prahalad and G. Hamel: „key competencies are groups of resources, processes and skills determining the competitive advantage of an enterprise, providing access to important markets or market segments, making significant contribution to the benefits discerned by customers, allowing the company to lower costs, making it difficult for competitors to imitate the company or enabling the company to create strategic architecture” [Hamel., Prahalad 1999, p. 213]. Key competencies then refer only to specific, most essential functions of the company activities. In the outsourcing process the realization of other functions is passed to outside companies, which due to their specialization are able to replace the internal function effectively and efficiently. M. Trocki indicates a range of questions which allow us to propose the optimal range of outsourcing use. These are: [Trocki 1999, p. 181],

- Which functions are realized efficiently and effectively within the existing structure?
- Which company functions may be realized more effectively and efficiently outside the company structure?
- Which company functions realized outside the company structure could be realized more effectively within its structure?

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1 See more on this subject in: Lewis H. T., *Subcontracting: The Current Problem*, [in:] „Harvard Business Review”, vol. 19, No 4.

Outsourcing is a method of company restructuring consisting in shrinking or downsizing the company, which provides better flexibility in understanding the speed, effectiveness and efficiency of adapting to environment changes.

The superior aim of the restructuring should be to provide or restore the ability to compete effectively. In a turbulent environment ability to compete is mostly associated with companies characterized by such features as: flexibility and cooperativeness. Flexibility can be seen in enterprises which can quickly and precisely make investments and resign from them without incurring huge costs. Cooperativeness refers to cooperation with a wide range of interest-holders [Romanowska, Trocki 2002, p. 74]

In the current turbulent environment, enterprises, in order to be flexible, are looking for some kind of optimum of functions performed by them in the restructuring process. These functions are defined as a particular set of repetitive actions. There are a few main elements which locate these functions within or outside the company structure. The first of them is their significance, that is whether they are key competencies, the next one is their controllability [Trocki 1999, p.76].

In recent years the science of management has witnessed new trends and concepts of such restructuring ventures as: reengineering, lean management, flat organizations, network organizations or the outsourcing process [Garstka 2006, pp.23-28].

#### **4. The reasons for outsourcing and its scope**

The most important reason for using outsourcing in the restructuring process is the possibility of cutting costs understood as a difference in price at which an outsourcer may provide manufactures goods or services and the price at which the company would produce it. This difference is attributed to the specialization effect, economies of scale and scope [Kakabadse, Kakabadse 2000, p.7]. We should also point out that the presentation of cost benefits of outsourcing is the presentation of direct costs. There are also indirect costs, such as infrastructure and information systems.

There is no doubt that for the company undergoing the restructuring process improvement of its cost efficiency is the essential issue. Therefore we could conclude that it will be the most important reason for using outsourcing in the restructuring process. The next reason is the ability to achieve better control over costs and better information flow inside an organization, which is a vital factor in the change process.

Another, often emphasized in specialist literature, benefit of outsourcing is that it is a decision decreasing operational risk by transmitting part of it on the outsourcer. This argument gains importance if we assume the

changeability of the environment, when the operational risk is continuously increasing and there is more room for assessment-related mistakes. The main challenge then is to shorten the time the company needs to adjust to new conditions. This does not only consist in flexible approach to the production volume of a particular good or service, but also in making its kind and scope more flexible. This is of vital importance in organizations whose time of adjusting to constantly changing environment determines their competitive edge, such as in the IT branch.

Outsourcing also affects objectivity of economic results, introduction of economic acting and thinking as well entrepreneurship, fulfilling its motivation aims.

When deciding whether to use outsourcing as a restructuring tool, the company should consider the optimal scope, taking into account all costs, including process implementation costs.

The basis criterion is the choice between capital outsourcing and contract outsourcing.. The first option consists in creating a new economic entity (daughter company), in which a parent company will secure optimal ownership structure for itself [Trocki 2001, p. 134]. The new economic entity will perform the tasks within the isolated function on the basis of appropriate contract. Contract outsourcing, on the other hand, consists in resignation from independent realization of a particular function and passing its performance to an independent economic entity on the basis of a long-term contract. The prerequisite of outsourcing in this form is the existence of stabilized market offer of such services provided by independent economic entities. It is also essential that their offer is competitive in terms of quality and price in comparison to an analogical period of activity realized independently by an enterprise [Trocki 2001, p. 90].

Favorable ownership share of a parent company in the first option provides it with a possibility of eliminating one of the most serious drawbacks of outsourcing, namely limited possibilities of controlling the performance of tasks. Such a solution is possible, however, only if the parent company is technically and organizationally capable of such isolation. Another reason for using capital outsourcing is fulfillment of necessary conditions in the process of restructuring. We can divide all the arguments into those coming from the parent company and from the isolated unit, as in Table 2.

**Table 2.** Criteria of choice between capital and contract outsourcing

From the point of view of the parent company	From the point of view of the isolated unit
Provision of favorable ownership structure in a daughter company which takes over the isolated activity allows the parent company to maintain control over isolated activity through financial resources at its disposal.	Capital outsourcing is effective when isolated enterprise has the legal, technical and organizational abilities, which is connected with sufficient human resources both at the management level (executives) and production level (specialists). An essential element is also the existence of external market, that is outside the boundaries of a parent company. This factor makes competitiveness of an isolated unit more objective and may lead to its independence through obtaining revenue from other sources. This market should be the source of new external revenue increasing the independence of the isolated unit.

Source: own elaboration on the basis of: [Trocki M 1999, p. 207].

Choosing the scope of outsourcing we should take into account both general and specific conditions in the broadly understood environment of the enterprise [Trocki 1999, p. 207], such as: acceptance of the owners of isolated functions by showing them planned profits or predicted improvement of effectiveness in the strategic, market or economic area. It is also essential to obtain the acceptance of the staff employed in the function which is being isolated. Moreover, in case of external outsourcing, there must be a market offer of potential partners. This offer should include competition in Porter's understanding of this word: it covers price, quality and also scope. It is also important to determine the potential power of agents so that we could influence their decisions. The conclusion which is becoming more common in outsourcing literature, basing mainly on IT sector, assumes change of perspective on the central point in a relation between the provider of outsourcing services and their customer. Research conducted by [Kern & Willcocks 2002] points at the role played by properly formulated outsourcing contracts describing the scope and quality of provided services (service level agreements). The formal role of the contract offers a potential possibility of mutual trust and involvement in its development. [Goo 2009]

Basic limitations of the outsourcing use result from legal aspects of this process. Companies should decide whether the use of outsourcing in the restructuring process is legally regulated and feasible. An example here could be outsourcing in banking services concerning correspondence, which according to regulations cannot be commissioned outside the parent company.

Another frequently made mistake is too optimistic approach to possibilities of cost cuts, which may lead to the situation in which the outsourced process turns out to be more expensive than the process realized by the parent company.

This may be due to frequent omission of internal costs which the restructuring company has to incur, such as the costs connected with the contract, its monitoring and execution.

Another group are social costs, such as changes to employee motivation or even lower productivity in the company after outsourcing some of its processes. What is more, Lafferty and Roan indicate that through fully implemented outsourcing the company is losing the possibility of constant quality and task realization control, which creates additional risk of not performing it correctly [Lafferty, Roan 2000, pp. 76-85]. Much controversy has also arisen around the fact that the use of outsourcing may cost the company the loss of learning ability. In literature this ability is also known as intellectual capital of an organization [Oshri, Kotlarsky, Willcoc, p. 63] and consists of three elements: structural capital, defined as the behavior which could be used as a tool of inducing new people, human capital, seen as individual abilities to provide customers with best solutions, and client capital understood as the knowledge shared in the organization based on relations between people who interact with each other. The organization, therefore, runs the risk of losing such intellectual capital by taking advantage of the outsourcing process. [Oshri, Kotlarsky, Willcoc, pp. 62-68]

The above arguments induce some companies not only to avoid making outsourcing decisions in times of restructuring but also to initiate the opposite action, namely to restore the formerly outsourced processes to the structures of parent companies (in-sourcing).

## **5. Conclusions**

Analyzing the effects of restructuring by means of outsourcing we should remember that the measurable effects, such as improved financial indicators, better use of production factors, sales or isolation of part of the equity, improvement or deterioration of product quality, changes in production organization or changes in transport or technologies, are all complex changes, often correlated with each other. The effects of these changes should be analyzed in a company in a long, dynamic period of time, in which we should also assess the grounds for the introduction of outsourcing.

The aim of the article was to present outsourcing as a tool of company restructuring. We presented the possible scope of outsourcing use in restructuring the company and the reasons for its use. The article proves that outsourcing cannot be treated as the autonomous and exclusive factor of changes inside the company. It is a method of restructuring, that is a complex process referring to organizational structure, strategy and culture, therefore it requires adjustments in the whole organization of the company. We are entitled to pose

a thesis that there is a positive correlation between restructuring by means of outsourcing and the success of the restructuring process in the company, but this is not the sui genesis factor, but only a tool, an instrument which we can use appropriately to the current situation of the company and which must be analyzed in detail with reference to other environment changes. Such conclusion is compliant with the aim of the above article.

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**Izabela Markiewicz\***

## **CULTURAL COMPETENCIES IN MARKET ORIENTED INTERNATIONAL ORGANIZATIONS**

### **Summary**

*Market oriented companies are perceived as one of the most successful and sustainable business organizations. In recent years due to global economy changes increased interest in cross-cultural management issues has been noticed, though practitioners and academics are still working on the concept of cultural competency. The purpose of this paper is to present the possible impact of culture competence model on the market orientation of international organizations. The basic assumption is the greater culture competency, the greater market orientation of international organization.*

### **1. Introduction**

In order to achieve better consistence in understanding the concepts used in this paper, I provide their glossary at the end of the article.

Contemporary economy, undergoing the globalization era, has reached the stage of cultural regionalization. For marketers working in international markets it is imperative to think globally and act regionally. In order to achieve marketing objectives, we must learn the attitudes, values, ways of behavior and communication patterns of not only consumers but also other members of the organization, located in a culturally and geographically different region.

How do the international organizations declaring the market orientation strategy operate in culturally diversified markets? Their clients are people from different cultures, therefore they perceive the same product or service differently. Although they seem to buy the same thing, they are driven by diverse motives and needs. For example, for Germans, a car is a synonym of quality and engineering thought, while for Americans it defines their identity [Rapaille 2006]. If the product performs a different function, can we really assume that clients in the same way become the users and buyers of such a product?

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The concept of culturally determined consumer behavior is becoming commonly accepted in marketing, but does it influence the strategy of an organization? As the subject of my considerations, and the subject of my interest, I picked international organizations which declare market orientation, operating in culturally diverse markets, having culturally diverse clients and being internally culturally diversified. It seems logical to assume that such organizations are particularly interested in the cultural factor and are able to gain and distribute the knowledge of cultural profiles of their clients and their specific needs.

Gaining, analyzing and distributing the knowledge of the customer and their needs as a way of realizing the strategy of an organization requires, as regards human resources, specific knowledge, skills, attitude and behaviors defined as key competencies. In case of market oriented international companies, key competencies should be cultural competencies. While the concepts of cultural competencies and market orientation have been widely described and analyzed (more work has been devoted to market orientation), the relationship between cultural competencies and market orientation of international organizations still needs analyzing. The aim of this article is to attempt demonstrating the relationship between these two elements. I intentionally omit the description of the organizational success and competitive advantage. However, I assume that in case of market oriented international organizations, both market orientation and cultural competencies may be indispensable conditions for achieving competitive edge.

Thus the subject of this article covers two terms: market orientation in the context of international organizations and cultural competencies as a factor which theoretically strengthens market orientation of such organizations.

## **2. Market oriented organizations**

An organization may have a sales, product or market orientation. The chosen strategy defines business aims, determines activities, defines corporate culture and is a foundation on which models of competency are built. What characterizes the above-mentioned strategies?

A sales oriented organization is the one in which the sales function is the leading function for the whole organization. This strategy is possible when purchasing power exceeds supply and an organization focuses on production capacities, not on improving the product. The key competencies then are effective sales skills, sales and negotiation techniques. Sales orientation is typical of some group of products, for example cars or goods distributed via canvassing.

Product orientation focuses the attention and activities of the organization on the product itself. The basic assumption of the organization is the belief that a good product sells itself, regardless of the demographic or geographic profile of a customer. The main argument against this strategy is a common claim that it leads to “marketing myopia” – forgetting the actual needs of a customer. An organization is so intent on perfecting the product that it neglects its destination and simple elements of usefulness.

Market orientation, commonly known as marketing one, has the customers’ needs at its center. It satisfies them in a proper way, in proper place, time and at a proper price. Thus an organization knows a lot about its customers..

This has been aptly described by Theodore Levitt, who said that sales focuses on the needs of the seller, while marketing concentrates on the needs of the buyer.

A more detailed picture of assumptions behind market and sales orientations is given in the table below.

**Table 1.** Differences in activities of departments in market and sales orientations

Department	Sales orientation	Market orientation
Sales	Short-term activities Department is the most important thing Involvement of one department	Long-term profits Customer satisfaction is the most important thing Involvement of the whole organization
Purchasing	Narrow product line	Wide product line
Finance	Rigid budget Prices cover costs	Flexible budget Price dictated by the market
Production	Long-term orientation A few models Standardized orders	Short-term orientation Many models Orders of customers

Source: own elaboration on the basis of [The Chartered Institute of Marketing].

A market oriented organization is a customer oriented organization, flexible, searching, defining and satisfying customers’ needs with its products or services.

According to Kohli and Jaworski, market orientation is determined by three basic elements: customer orientation, coordinated marketing and profitability.

Therefore we should emphasize the importance of activities outside and inside a company, creating/strengthening the strategy of market orientation:

- outside – market orientation consists in market research and segmentation, learning customers’ needs and satisfying them with

products and services offered, but also obtaining and analyzing information concerning competition;

- inside – market orientation is a specific organizational culture, whose main assumption is orientation towards the customers and their needs; this requires the existence of cross-functional teams, acting best in a flat, horizontal structure [Narvey, Slater 1990], and the attitude of managers focused on market needs and distribution of market knowledge all over the organization.

Narvey and Slater also emphasize three essential elements of market orientation in an organization: customer orientation, monitoring competitors and cross-functional teams.

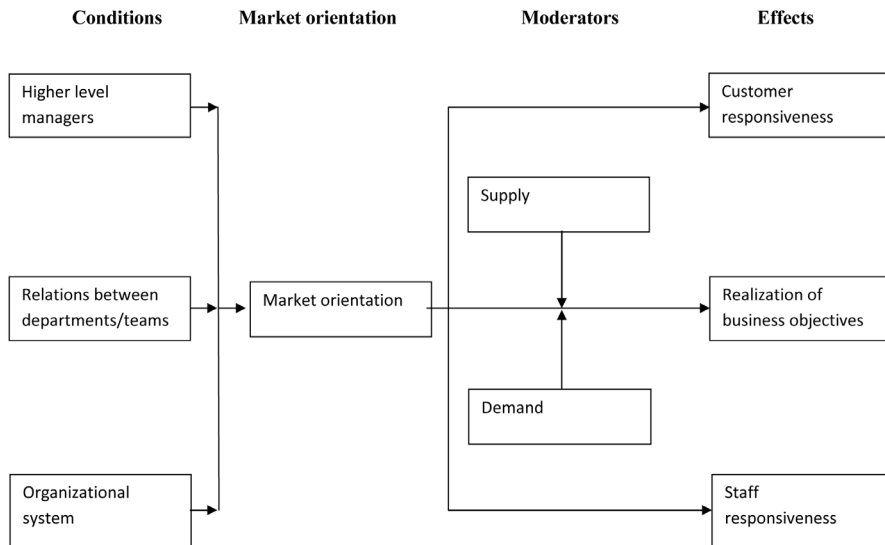
Customer orientation is at the heart of an organization's market orientation. This means that an organization continuously recognizes and satisfies the needs of its customers, creating added value (for example more flexible way of delivery, offering the product tailored to specific local needs). The research and contacts with customers are basic forms of activities in market oriented organizations. Employees of such organizations are encouraged to contact their clients, and, what is more, some internal programs of employee development are created, assuming the participation of customers.

Monitoring competition is also necessary in order to learn customers' needs and expectations. The analysis of strengths and weaknesses of competitors, and above all, defining who our customers perceive as competitors, is a key element in creating products and competitive advantage. An essential element is the attitude of staff involvement in gaining and distributing knowledge of competitors all over the organization.

Cross-functionality of teams stresses the importance of each employee of an organization in satisfying customers' needs. Regardless of the function performed by them, the superior objective is the client. This obviously requires appropriate corporate structure, whose physical manifestation are small project teams, comprising employees of various departments who work on a particular product. For example engineers participate in the stage of recognizing customers' needs. Small, cross-functional teams are much more effective and flexible than traditional functional divisions in large organizations.

The figure below presents determinants and effects of market orientation according to Kohli and Jaworski. They emphasize the internal element here: the attitude of the board, managers and the organizational system.

**Figure 1.** Causes and effects of market orientation



Source: A.K. Kohli, B.J. Jaworski: Market orientation: The construct, Research Propositions, and Managerial Implications; Journal of Marketing, vol. 54, April 1990.

The authors emphasize that market orientation consists in organizational generation of market knowledge concerning current and future customer needs and passing it to other departments, which leads to organizational responsiveness.

The most essential element is still a specific need of a customer.

In international context, can we assume that customers have the same needs regardless of the culture they live in? Can we also assume that the knowledge of them will be generated and spread in the same, uniform way in all international branches of an organization?

### 3. Culture and market-oriented international organization

Referring to the above questions, I will analyze some definitions and studies on culture.

The notion of culture is defined on various levels and from various points of view, one of the most complete definitions being provided by Geert Hofstede. According to him, culture [Hofstede 1980] is a collective mind programming which distinguishes members of one group or social community from another. Culture covers the way of thinking passed by parents onto their children, by teachers onto their students, by friends onto their friends, by leaders onto group members. Culture is expressed in the significance

attributed to various aspects of life, the outlook on the world and one's role in it, in values, in what we consider right and wrong, in common beliefs on what is true and what is false. Though not material, culture is reflected in form of social institutions and material artifacts of a particular community, strengthening the existing social codes.

Hofstede in his research defined the cultural dimensions which show the difference in perception of basic terms:

- attitude to group – collectivism versus individualism,
- attitude to power - hierarchy or egalitarianism,
- values – orientation towards competition or cooperation (masculinity vs. femininity),
- attitude to uncertainty – avoidance or acceptance.

Hofstede's analyses showed significant differences between national cultures.

Other interesting studies on culture have been presented by Fons Trompenaars and Charles Humpden-Turner, who define culture in the perspective of seven dimensions:

- attitude to ethics, principles: universalism vs. particularism (principles vs. relations),
- attitude to group: individualism vs. collectivism,
- way of defining status: achievement vs. ascription,
- way of perceiving the world: specific vs. diffuse,
- way of behaving: neutral vs. emotional,
- attitude to time: sequential vs. synchronic,
- attitude to environment, surroundings: do we control it or are we controlled by it?

Another important division is the one introduced by an American anthropologist, Edward T. Hall, who distinguished between high-context and low-context culture. Depending on our perception of the context, we communicate verbally or operate some hidden signs which are hard to define by people from another culture.

Analyzing the selected models of culture we should assume that international organizations operating in culturally diverse market and market-oriented, should continuously learn and develop their cross-cultural skills. Cultural differences they face exist both inside and outside the organization and concern customers and staff.

We have come to the second, internal element of organization's market orientation – distribution of knowledge and promoting orientation towards customer needs in an organization. In this case I will refer to the concept of culture, but this time it will be corporate culture.

Ed Schein describes corporate culture as a set of dominant values and norms of behavior typical of a particular organization, supported by the assumptions concerning the nature of reality and manifested through artifacts – external, artificial creations of a given culture. He distinguishes three levels of corporate culture:

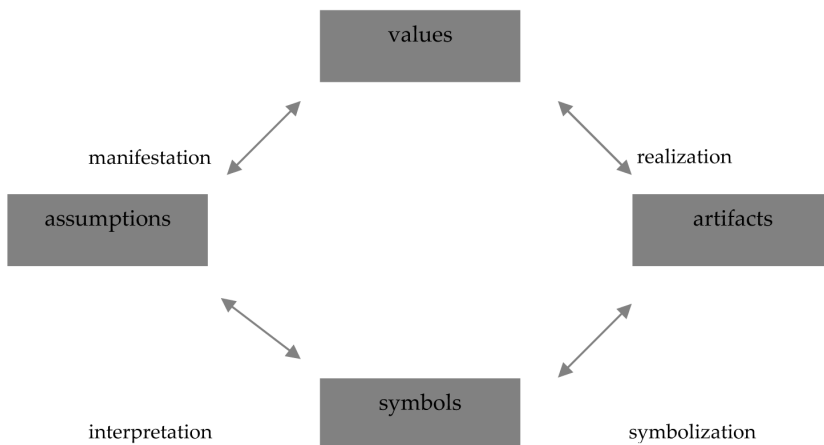
- basic cultural assumptions, for example that all people are equal,
- values and beliefs, for example company values,
- artifacts, physical manifests of culture, an example here could be the company architecture (an interesting example showing the relation assumption – value – artifacts, could be architecture of buildings in Nordic countries, where the way to the board room leads through the shop floor – which is the execution of the basic assumption concerning equality of people).

Taking into account cultural differences we must assume that the same organization operating in an international market will have a diverse corporate culture. This is even more true if we assume, as Mary Jo Hatch, that corporate culture is a dynamic model, subject to constant changes and reproduction.

Mary Jo Hatch, basing on Schein’s model, emphasizes the dynamism and possibility of changes to corporate culture, and shows it as a set of interacting processes [quoted from Kostera 2003 p. 36]:

- manifestation of cultural assumptions in form of values,
- realization of values in form of artifacts,
- symbolization of artifacts, that is giving some artifacts the status of symbols,
- interpretation of symbols, supporting assumptions.

**Figure 2.** Corporate culture dynamics



Source: Hatch, 1993.

In case of a market oriented international organization, with reference to the above model, we can assume the differences on the level of assumptions, values and also artifacts:

- employees from different cultures will use different systems of values [Hall 2006], for example, for some cultures the goal is essential, while for others the process itself, although the basic assumption will be the same – customer orientation,
- employees from different cultures will behave and communicate in a different way, for example they will serve customers, manage subordinates and suppliers differently, etc.,
- employees from different cultures will interpret the same artifacts and symbols differently.

The subject of national culture influence on corporate culture has been thoroughly analyzed in literature. One model is also presented by Fons Trompenaars and Charles Humpden-Turner, who base it on two variables:

- people-orientation vs. task-orientation,
- hierarchy vs. egalitarianism.

As a result, the authors obtained four basic organizational cultures:

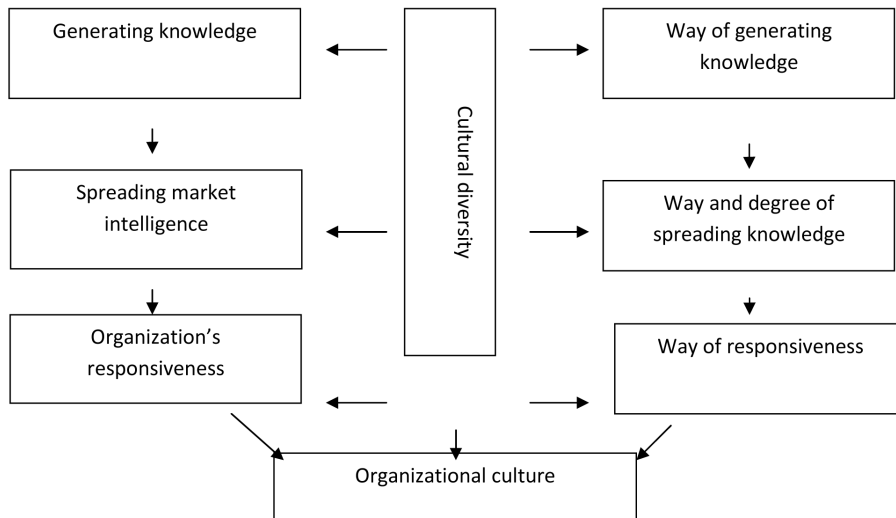
- incubator – egalitarian and people-oriented,
- guided missile – assuming quality but project-oriented,
- Eiffel tower – hierarchical and task-oriented,
- family – hierarchical, people oriented.

They also show the relation between national and corporate culture. The same organization, with clearly defined organizational culture will be strongly influenced by national cultures the moment it enters other markets. For example, with clear market orientation, the degree of cooperation between departments may be decreased by strong hierarchy and an assumption that not everybody in the organization is equal.

Going back to the definition provided by Kohli and Jaworski: market orientation is generating and distributing market knowledge which leads to proper responsiveness of the organization. How do these three processes run in an international organization, whose customers and employees come from diverse cultures?



**Figure 3.** The relation between cultural diversity and market orientation of an organization, the influence of various factors



Source: own elaboration.

I assume that market orientation of international organizations is subject to cultural influences which determine each of the three above-mentioned elements (generating knowledge, spreading market intelligence, responsiveness of the organization), and since business is perceived as a process of satisfying consumer needs, not as a process of manufacturing goods or providing services [Kotler 2003, p.93], consumers from different geographical, sociological and demographic markets, representing different cultures, should determine the way the organization operates.

Jaworski and Kohli [Kohli, Jaworski 1993] in their research point at the role of managers and their participation in transforming organizational culture into market-oriented one, treating it as a constant process and underlying the differences between organizations concerning the degree of such orientation. Their research shows the influence of managers on the level and direction of organization's responsiveness towards market changes, attitudes and needs of customers. In their hypotheses they show the significance of organization's internal processes for the degree of adjustment to the external environment. However, this research does not take into consideration an additional internal variable – cultural differences in an organization.

In case of international organizations, we should assume that the role of managers and the dynamics of internal processes are much more complex and also influenced by internal forces – culturally diverse employees. In this case, the realization of market orientation may require new competencies connected with managing in a culturally diverse environment.

## 4. Cultural competencies

National culture in which an organization functions influences organizational culture through values, beliefs, ways of behavior of particular community members. If we accept the concept of 'glocalization', clients search for local values, products and services [Robertson 1992]. McDonaldization and consumerism [Sztompka 2005] are beginning to give way to local, unique products. An organization acquires resources from the external environment, processes them into goods and services and manages them so as to gather additional resources [Rokeach 1979, p.74]. In cultural diversity, both resources acquired from outside and the way of using and processing them are determined by cultural factors. The organization faces the challenge of how to balance between standardization and adaptation, while internal processes influence the way and degree of market orientation even more than in domestic organizations.

What can then strengthen market orientation of international organizations?

Referring to the specialist literature and to intercultural projects I carried out, I can assume that the key element of success in international operations are cultural competencies.

Cultural competencies have various definitions. Let us start with a general definition of competence, provided by Ph.D. Małgorzata Sidor-Rządowska, who claims that competence is:

- knowledge
- skills
- attitude.

Starting with this model and adjusting it to the needs of international organizations, cultural competence may be defined as:

- knowledge of different cultures: their division, differences in perceiving basic phenomena, models of culture, how culture determines our behavior, knowledge of markets in which an organization operates;
- cross-cultural skills, especially ability of cross-cultural communication and combining and changing the people management style, dealing with stress;
- awareness of one's own culture, not only cultural identity, but also knowledge of one's own cultural profile, for example preferred management style, perception of time, tasks, authority;
- attitude which often determines the success of international projects, determines the way we perceive other cultures, our level of openness.

I perceive the above competencies as the key ones as regards international organizations. Each element should create separate clusters of competencies, developed especially for a particular organization.

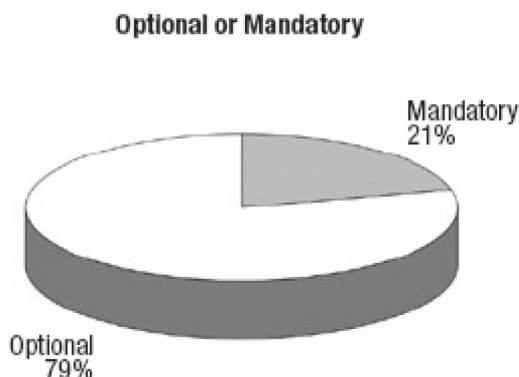
For example, Elisabeth Marx [Marx 2000], experienced manager working for international organizations, lists the following cultural competencies:

- sensitivity to other cultures, that is open attitude to other cultures and possessing cultural awareness;
- adaptability to new situations, that is ability to cope with open and ambiguous situations, flexible thinking, communication skills and ability to initiate contacts, knowledge of foreign languages and ability to learn them;
- people orientation, characterized by empathy, interpersonal sensitivity and ability to listen, assertiveness, ability to work in international teams;
- resistance to stress – self-confidence and ability to cope with difficult situations.

Although the issue of cultural competencies is becoming a popular subject of analysis, in practice they are not part of competence models of international organizations. In seven years in which intercultural projects were carried out for global organizations, only two out of fourteen organizations had the implemented and efficiently operating<sup>[1]</sup> model of staff development in cultural competencies, but they did not call it the cultural model of competencies <sup>[2]</sup>.

My observations are partly confirmed by research conducted by GMAC Global Relocation Services, which focuses only on expatriates, but on one graph it shows the significance and place of staff cultural development programs.

**Figure 4.** Mandatory vs. optional intercultural programs



Source: Global Relocation Trends, 2006 Survey Report.

Completing the list of requirements concerning expatriates, and often employees responsible for entering new national markets, I will quote

1 By „efficiently operating” I understand the model operating in all locations of the company and covering all international employees, regardless of their country of origin

2 Source: own analysis

some remarks made by Rothwell [quoted from Fuellgrabe 2010] and Black i Gregersena concerning cultural competencies which an international manager should possess:

1. *international knowledge* (Rothwell), which is general knowledge of global economy, specific knowledge of a hosting country as well as understanding strategies, processes and management styles prevailing in a particular place,

other features have been defined by Black and Gregersen:

2. *focus on communication*, regardless of the fear of being misunderstood, necessity of learning new communication styles and possibilities of making mistakes,
3. „*wide socialization*”, that is going beyond the circle of other expatriates and initiating local contacts (unfortunately quite a rare attitude),
4. *cultural flexibility*, and
5. *cosmopolitan orientation*, which is defined as open mind, willingness to experiment with new culture, attempts at understanding and practicing it,
6. *cooperative negotiating style*, learning negotiating techniques, connected with communication, is also unfortunately classified as soft competencies, while in real business world it turns out to be the basic “hard” skill in an intercultural environment.

Assuming that focusing on the customer is the foundation of market orientation, in case of international organizations the development of knowledge of new markets should be of key significance for the organization. The success of an organization in various markets and the ability to use intercultural knowledge in managing an organization are determined not only by the marketing department which is responsible for marketing strategies, but also by cultural competencies of the board and managers, dynamics of processes and communication between departments/teams and the organizational system [Kohli, Jaworski 1993].

Returning to the data from the report of GMAC GRT [Global Relocation Trends, 2008 Survey Report], only 23% of managers on international contracts are covered with mandatory programs of cultural competencies training and development (of which 80% believe that such programs are indispensable for the development of multicultural business). If we combine it with our own analyses, we can assume that companies realize the market orientation strategy in an incomplete way. They often focus on adapting products, but not on customers’ needs, as they frequently do not have complete data regarding local customers. The biggest challenge for international companies seems to be managing an internal customer. Following Kohli and Jaworski, assuming the significance of the flow of knowledge between departments/teams, it seems

even more desirable in international organizations, where both external and internal customers are culturally diverse.

In spite of declared market orientation, many international companies do not acquire specific information on local markets and do not prepare their managers to international tasks. This might be one of the causes of problems that large organizations experience as they are beginning to lose the battle with small organizations, oriented to a specific group of customers, not necessarily defined in the context of national culture.

## **5. Conclusions**

The analysis of the relation between market orientation of an international company and cultural competencies of an organization and its staff could lead to the conclusion that international organizations have higher cultural competencies. In case of market oriented international organizations, such competencies should be the essential condition in realization of the market orientation strategy.

However, many international companies declaring the market orientation strategy do not possess the competence models containing cultural competencies. Both the external and internal elements of orientation (diverse customers, diverse employees) require acquiring knowledge of the economy of new markets and cultural profile of customers as well as employees. Marketing knows numerous examples of unsuccessful attempts at entering new markets, but such cases are not analyzed from the point of view of cultural competencies of an organization. In practice they are not part of marketing strategies of entering new markets. The weakest point seems to be internal elements of market orientation: generating and distributing knowledge, organizational system and attitude of managers. If only 23% of international firms analyzed in this article have mandatory intercultural programs, how can the attitude of orientation towards a culturally diverse customer and employee be promoted?

The analysis of specialist literature and own analyses show a large discrepancy between declarations of organizations concerning market orientation and their practical actions. The development of the model of cultural competencies for market oriented organizations could be a perfect tool for strengthening market orientation and consequently – competitive advantage of an organization.

## **Glossary**

**Departments/teams** – I decided to use two terms together, as many organizations are switching from functional to project division.

**Cultural competencies** – a set of features, skills and knowledge related to cultural differences, as well as awareness of one's own cultural profile.

**Culture** – a system of assumptions, values, beliefs, attitudes and their reflections typical of a particular social group.

**International organization** – its market is global market, it acquires its supplies, takes loans, manufactures products or provides services in various places all over the world, it has branches located in different countries and employs staff with different cultural background.

**Market oriented organization** – one of marketing strategies of an organization, placing profitable satisfaction of customer needs as the most important goal and the method of operation; it assumes knowledge of customer needs, and also organizational system based on cross-functional activities between departments.

**Cultural diversity** – contact of two or more national or regional cultures.

**Competitive advantage** – success of an organization in international market manifested in above-the-average profits compared with other organizations from the sector, obtained in the period of at least three years.

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**Wioletta Kwak\***

## **MARKETING STRATEGIES OF NON-PROFIT ORGANIZATIONS IN LIGHT OF VALUE-BASED MARKETING\*\***

### **Summary**

*This paper presents the analysis of strategic decisions made by non-profit organizations in the context of value-based marketing. In the process of formulating and realizing the strategy non-profit organizations should always think in terms of value for their customers. The share and structure of the value for various groups of stakeholders are created by means of marketing instruments.*

### **1. Introduction**

Marketing strategy is defined as “a system of medium and long-term principles and guidelines which determine the framework for operational decisions and marketing activities<sup>1)</sup>” [Leksykon... 1998, p. 238]. Marketing, broadly analyzed, concerns not only business entities. “True marketing begins and ends with careful understanding of the needs that customers served by a particular organization have. The concept of marketing then refers to all types of organizations, irrespective of whether they are profit-oriented or not [Sargeant 2004, p. 26]. In the process of formulating and realizing the strategy non-profit organizations should always think in terms of value for their customers. The share and structure of the value for various groups of stakeholders are created by means of marketing instruments.

This paper presents the analysis of strategic decisions made by non-profit organizations in the context of value-based marketing.

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1 definition by R. Niestrój

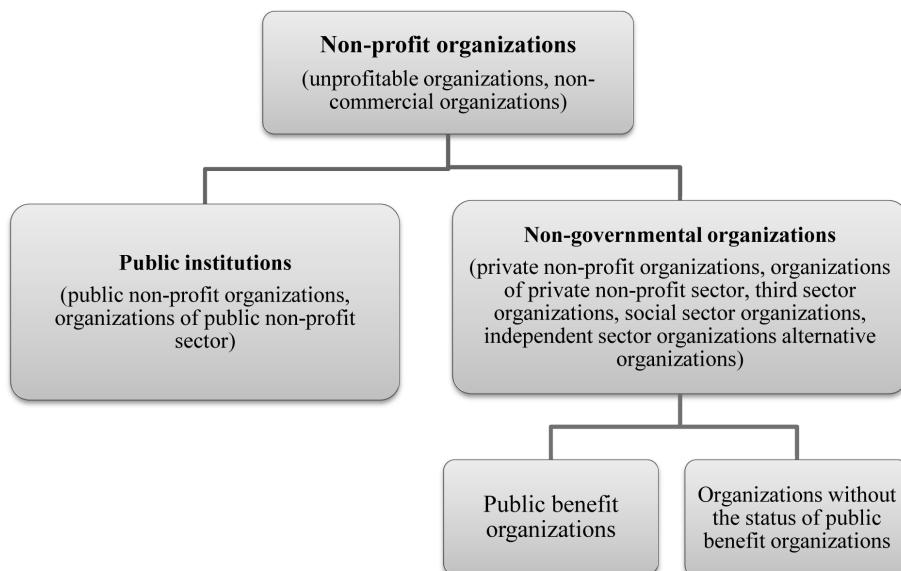


## 2. The essence of non-profit organizations

The term “non-profit organization (NPO) has various definitions in subject literature. The idea behind NPO operations, however, remains the same. Their driving force is to perform particular social missions. A. Sargeant emphasizes that these are organizations whose aim is to improve the living standards of the society. They conduct their activities collecting and redistributing resources and providing their services to those in need [Sargeant 2004, p. 17]. They do not function to generate profits for their members or shareholders. They can only take up profitable activities if the profits they generate are allocated to fulfill their missions and related objectives [Sargeant 2004, p. 17]. Non-profit organizations are expected to allocate their financial surplus to improve the services they offer or to reduce their prices [Wheelen, Hunger, 1998, p.307]. A characteristic feature of non-profit organizations is significant dependence on financing from external entities.

Specialist literature and everyday language bring us various terms which are often identified as equivalents and used interchangeably. We talk of non-profit, non-commercial, non-governmental, independent or social organizations, public (social) benefit institutions, third sector organizations, organizations of voluntary, independent or social sector, etc.,. It should be emphasized, however, that not all these terms are identical. Figure 1 brings an attempt at systematizing selected terms and classifying non-profit organizations.

**Figure 1.** Classification of non-profit organizations



Source: own elaboration.

Among non-profit organizations we can distinguish public institutions and non-governmental organizations. Non-governmental organizations create the so-called third sector<sup>[2]</sup> (independent or social sector).

Non-profit organizations, both private and public, play a vital part in the society, performing services in various areas. Depending on the type of conducted activities, we can distinguish the following areas in which non-profit organizations function<sup>[3]</sup> [Sargeant 2004, pp. 17-19]:

- culture and recreation,
- education and research,
- health care,
- welfare services,
- environment,
- residential housing and housing management,
- rights spokespeople and politics,
- philanthropy and promoting voluntary work,
- international activities,
- religion,
- business, trade associations and unions,
- others.

### **3. Value-based marketing as a sphere of creating value for interest-holders**

Analyzing the concept of value-based marketing as a sphere of formulating and realizing the strategy of a non-profit organization, we should first of all consider such terms as value and value-based marketing. M. Szymura-Tyc defines value for the customer as: “the surplus of benefits subjectively perceived by the customer over subjectively perceived costs connected with purchasing and using a given product” [Szymura-Tyc 2005, p. 74]. Marketing of non-profit organizations generates value for a wide range of interest-holders: clients, donors, certain social groups and even the whole society. The shape and structure of these values are created for various groups of stakeholders by means of marketing-mix instruments and largely depend on possessed resources.

The concept of value-based marketing may be understood as the management of “the process of creating and delivering value to clients” [Szymura-Tyc 2005, p. 90]. Marketing in this approach is a management and social process, thanks to which a mutually beneficial exchange between the client and the organization is possible. The process of managing value

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2 The other two sectors are: private sector and public (state) sector.

3 International Classification of Nonprofit Organizations (ICNPO).

for the customer consists of several consecutive stages: defining, shaping, communicating and offering value [Szymura-Tyc 2005, p. 90].

P. Doyle claims that “the aim of marketing is to support actions which maximize value for stakeholders”, and marketing activities of enterprises should be assessed with the criteria of creating value for investors. Maximization of shareholders’ benefits should be achieved through building customer satisfaction and taking advantage of opportunities appearing in the market [Doyle 2003, pp. XV, XVII, 29, 35]. Non-profit organizations also generate value for their stakeholders. Their aim, however, is not to increase owners’ profits but to act towards achievement of vital social objectives. The realization of these objectives is hindered by the fact that they are largely dependent on external finance. Building stable relations with stakeholders plays a significant part in the value creation process. J. Otto determines the long-term partnership with key clients as “strategic equity” [Otto 2004, p. 204].

The issue of “value-based marketing” has also been considered by Ph. Kotler, H. Kartajeya and I. Setiawan, who claim that people dealing with marketing “must identify fears and desires of customers in order to reach their minds, hearts and souls. In times of globalization paradox the fundamental desire customers have is to make their own community – and the whole world – a better or even ideal place to live. Therefore companies which want to become icons should share the same dream and try to change the world” [Kotler, Kartajaya, Setiawan 2010, p. 58].

Non-profit organizations cooperate with various groups of stakeholders, offering them differentiated values. Undoubtedly, the greatest beneficiaries are people to whom the organization’s offer is directed. However, the organization’s mission offers broader social benefits – for customers families, local communities or even for the whole society. Examples of values which non-profit organizations may offer selected groups of interest holders are presented in Table 1 below.

**Table 1.** Examples of values offered by non-profit organizations to selected groups of interest-holders

Groups of stakeholders	Values
Customers	<ul style="list-style-type: none"> <li>• obtaining basic help related to organization mission and objectives, for example psychologist’s support, obtaining meals</li> <li>• making contacts with people with similar interests/ problems</li> <li>• better self-esteem</li> <li>• expanding knowledge</li> <li>• changing attitude to particular problems</li> </ul>

Groups of stakeholders	Values
Individual sponsors	<ul style="list-style-type: none"> <li>• feeling of self-fulfillment</li> <li>• possibility of obtaining tax deductions</li> </ul>
Institutional sponsors	<ul style="list-style-type: none"> <li>• promoting sponsor's institution</li> <li>• building donor's credibility in eyes of potential customers</li> <li>• winning trust</li> <li>• improving image</li> <li>• obtaining tax deductions</li> </ul>
Volunteers	<ul style="list-style-type: none"> <li>• gaining experience</li> <li>• the feeling of being needed</li> <li>• establishing valuable contacts</li> <li>• possibility of demonstrating one's skills</li> <li>• possibility of expressing gratitude for received help</li> </ul>
Employees	<ul style="list-style-type: none"> <li>• possibility of working in an organizations with ambitious, pro-society objectives</li> <li>• possibility of participating in trainings</li> <li>• upgrading qualifications</li> <li>• expanding knowledge</li> <li>• remuneration</li> </ul>
Society, in general	<ul style="list-style-type: none"> <li>• drawing attention to serious social problems</li> <li>• awakening sensitivity</li> <li>• warning against threats</li> <li>• solving social problems</li> <li>• shaping proper social attitudes</li> </ul>

Source: own elaboration.

#### 4. The mission and objectives of the non-profit organization

“Mission is a clear and explicit self-determination of an organization. It determines the state to which an organization aspires, the values it wants to preserve while realizing its goals” [Rogoziński 2000, p. 227]. Ph. Kotler, H. Kartajaya and I. Setiawan define mission as the “reason why an organization exists” [Kotler, Kartajaya, Setiawan 2010, p. 59]. Mission is a specific role which a given organization performs or intends to perform [Stabryła 2000, p. 48]. In case of non-governmental organizations, formulating and believing in the mission is of particular importance, as such organizations act in the name of superior social values [see more in Iwankiewicz-Rak 1997].

J.-J. Lambin points out that the mission should cover [Lambin 2001, pp. 368-369]:

- reference to the history of an organization,
- definition of activity in terms of benefits provided for customers,
- objectives and constraints, and also

- fundamental strategic choices of the company.

„It would be ideal if the formula of the mission was narrow enough to provide practical direction, and wide enough to stimulate imagination...” [Lambin 2001, pp. 369-370].

All organizations operating in the market perform particular missions in their environment. Missions, objectives and methods of their realization differ considerably in case of business and non-business entities. Undoubtedly non-profit organizations should have a very strong sense of performing their mission. All operations and values which they can offer their interest-holders stem from the mission and are subordinated to it. „Peter Drucker claimed that formulating mission statement is the first lesson that enterprises can learn from observing non-profit organizations” [Kotler, Kartajaya, Setiawan 2010, p. 59].

The mission of an organization should constitute a foundation on which it formulates its goals. The operational goals are determined by development direction of an organization, its priorities and constraints [Lambin 2001, p. 369]. „The main problem in determining strategic goals in operations of non-governmental organizations is to compare benefits, costs and risk connected with realization of particular activities or projects” [Kafel 2006, p. 122].

M. Huczek claims that as early as in the stage of formulating strategic goals (and mission as well) work should be conducted in two directions [Huczek 2003, p. 80]:

- 1) to satisfy the customers’ needs,
- 2) to satisfy the needs of donors and the society in general.

The characteristics of objectives realized by non-profit organizations, especially charities, accounts for the influence on the whole society or its groups. Organizations deal with issues which affect the general situation of civil society, they draw our attention to major social problems, help develop educational, health and other types of services, etc [Sargeant 2004, pp. 20-21]. As a result of non-business organizations activities the values professed by the society change and social sensitivity to misfortunes grows. However, the mission and ambitious objectives are not sufficient to reach success. Effective performance of missions, resulting in superior values for various groups of interest-holders, also calls for professionally prepared management and marketing plans and effective cooperation with the environment.

## **5. Identification and selection of target market segments in the process of developing marketing strategies**

Just like enterprises, non-profit organizations cannot perceive their clients as one large market in which everybody has similar needs. In order to reach success quickly in the changing environment, it is necessary to learn this

market – to identify the so-called segments<sup>4</sup>, to choose the target group and design proper operational strategy [Kaniewska, Leszczyński 2002, pp. 42-43]. The market segmentation process is the process of dividing customers into relatively homogenous groups with analogical needs [Michalski 2007, p. 81]. These groups should have similar expectations not only towards the product but also to other marketing instruments [Jonas 2006, p. 65]. The aim of the segmentation is to single out homogenous groups of customers and, above all, groups reacting in a similar way to particular marketing programs [Jonas 2006, p. 65]. Segmentation allows better learning and understanding of the market structure and preparing an optimal offer for particular groups of customers [Kaniewska, Leszczyński 2002, p. 44]. The segmentation process in non-profit organizations should be considered and conducted with reference to two main groups of interest-holders – customers and donors. Donors, though in a different sense than customers, are also clients of non-business organizations. The division of donors into homogenous groups allows us to prepare and conduct a more effective strategy of obtaining resources for the organization. Moreover, skillful segmentation and choice of target markets (customers and donors) brings the following benefits [Krzyżanowska 2000, pp. 92, 94; Jonas 2006, p. 95]:

- better knowledge of conditions in which organizations function,
- focusing on the customer who need help most and greater probability of satisfying their needs,
- limiting the number of competitors,
- better use of resources,
- meeting donors' expectations more effectively.

The applied segmentation criteria may vary a lot. We can divide them into four main groups [Jonas 2006, pp. 67-68]:

- general and objective (demographic, social and economic, geographic),
- general and subjective (lifestyle, personality traits, professed values),
- specific and objective (frequency, time and place of using the offer, involvement in the service process),
- specific and subjective (desired benefits, reactions to marketing activities).

Non-profit organizations may segment their customers taking into account a single criterion or any set of criteria. The choice of segmentation criteria depends largely on the type of offered social services and possibilities of a particular organization. Properly conducted segmentation procedure allows us to assess reliably particular segments. Segments of customers and donors must be assessed using totally different criteria. Business organizations (enterprises)

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4 Relatively homogenous groups singled out as a result of segmentation [Krzyżanowska 2000, p. 92].

evaluate their potential and present customers taking into account potential profits. Non-business organizations will evaluate their potential and present donors analyzing what resources they may gain from them, while segments of potential customers will be considered bearing in mind how essential and urgent the need is and whether it can be satisfied with the resources the organization has. A. Pomykalski points out that when evaluating segments, we should pay special attention to their size and growth potential, structural attractiveness and resources of a given unit [Pomykalski 2001, p. 90].

As a result of segmentation we select the target group<sup>5</sup>. It should be carefully singled out, possibly internally homogenous and at the same time heterogeneous in comparison with other segments [Düssel 2009, pp. 45-46]. We should also monitor characteristics of the target group to see if it does not change in time [Düssel 2009, p. 45]. An organization may choose one or more segments to serve. Focusing only on one segment is known as concentrated marketing (market niche strategy) [*Marketing na rynku ...* 2003, p. 135]. Another used strategy is the so-called individualized marketing. This concept consists in formulating marketing programs for individual clients. Such strategy is recommended with reference to the most important donors. It allows us to strengthen the ties between partners and in consequence increases the probability of long-term cooperation. To complete the presented options we should also show the mass (undifferentiated) marketing strategy, which consists in preparing one marketing program for all potential clients. It is a simple but rather ineffective strategy (wasting resources) [*Marketing na rynku... 2003*, pp. 132-133].

## **6. Marketing strategy tools used by non-profit organizations**

Organizations realize their marketing strategy using appropriate tools. The choice of strategy realization tools is another stage, after segmentation and selection of target market, of formulating marketing strategy in a non-profit organization.

Marketing-mix is a set of marketing elements used by managers to realize their marketing strategies in a particular target market [Mullins, Walker Jr., Boyd Jr., Larreche 2005, p. 18]. M. Huczek emphasizes that marketing-mix is „an internally integrated structure” providing an opportunity to influence market phenomena [Huczek 2003, p. 83]. Over the years, various marketing mix formulas have been created, consisting of a various number of elements. The most popular formula is that of 4P's (product, price, place, promotion).

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5 „The target group consists of all real and potential individuals and groups to whom particular marketing activity is directed” [Düssel 2009, p. 45].

This classic formula of marketing-mix (4P) concentrates on the perspective of an organization. R. Lauterborn is the author of the 4C concept [Lauterborn 1990, p. 26], which looks at marketing tools from the point of view of a customer. The marketing mix in this case consists of [Lauterborn 1990, p. 26]:

- customer value – value for the customer (product),
- cost – costs incurred by the customer (price),
- convenience – convenience of purchase, conditions of making the offer accessible (distribution),
- communication – communication with the environment (promotion).

All marketing strategies are based on the above-mentioned elements. The customer perspective seems to be especially important in case of non-profit organizations, which act to fulfill some important social missions.

Non-profit organizations usually conduct service activities, therefore the role of the personnel is essential in creating value for interest-holders. However, it is not necessary to single out personnel as a separate instrument of marketing mix as its role is closely related to the process of providing services, that is the product (and also its distribution). Thus product in non-profit organizations will be treated as a combination of the offer (of provided services) and service quality (personnel). This approach is also accepted by B. Iwankiewicz-Rak, who, emphasizing the role of the personnel and the significance of quality and tangible aspects of the process of providing services, points out that these additional elements of marketing mix (people, process, equipment) are “a necessary element of each process of providing services; they also constitute elements of the service product or distribution. Therefore they are not new elements exceeding the scope of basic 4P’s, but they are the effect of its disaggregation” [Iwankiewicz-Rak 1997, p. 97, on the basis of: Altkorn 1994, Payne 1996].

The choice of marketing tools is affected by numerous factors. These are mainly objectives of the organization, resources it possesses and conditions of the environment. While constructing marketing strategies, organizations face a lot of dilemmas, such as whether they should [Kafel 2006, p. 123]:

- offer complex services to a small number of customers or provide many people with little support?
- fight the causes of problems or alleviate their effects?
- concentrate on providing services or campaign for changes?
- specialize in a narrow area or diversify services?

The answers to these questions have tremendous impact on the marketing instruments used. The basic decisions which must be taken concern [Niestrój 2004, p. 394]:

- function and brand of product and product range,
- forms and financial conditions of making the offer available,



- distribution channels, places of providing services,
- composition of promotion-mix.

Creating the marketing mix composition we should always take into account the wealth of interest-holders, the usefulness of the offer they desire and additional values they can expect.

## **7. Implementing and controlling the strategy realization**

While realizing their marketing strategies organizations may encounter many obstacles. The main barriers in the process of implementing the strategy are [Kalpan, Norton 2001, p. 175]:

- unfeasible vision and operational strategy,
- tactic, not strategic type of feedback,
- no relation between the strategy and objectives of particular units,
- mechanisms of allocating resources unrelated to the strategy.

While realizing planned marketing ventures we should most of all pay attention to the following aspects [Niestrój 2004, p. 396]:

- finding a proper person who is able to manage the implementation process professionally,
- determining objectives and requirements and communicating them to contractors,
- precisely formulating single tasks and appointing people responsible for their realization,
- delegating decision power to contractors and providing them with sufficient means to perform their tasks,
- properly motivating to involve in realization of plans,
- creating favorable climate for revealing problems and irregularities and finding ways to eliminate them,
- thoughtful decision-making.

The skills needed to effectively implement marketing programs can be divided into the following types [Kotler 2005, pp. 689-699]:

- *diagnostic* (answering the question whether lack of expected results stems from badly formulated strategy or the process of its implementation)
- *determining the level* (on which level – function, program or marketing policy – problems appear)
- *implementation* (allocation – how to allocate resources, organization – how to organize work, cooperation – how to motivate to work)
- *evaluation of activities*.

In the process of implementing marketing strategies in non-profit organizations, of vital importance are: selecting and motivating employees, involving donors and organizing work properly [Huczek 2003, p. 82].

The controlling process is an essential element of the operational strategy in non-profit organization. Controlling, as one of fundamental managerial functions, consists in such regulation of organization activities which causes that the assumed element of the organization's result remains within the acceptable limit [Griffin 2004, p. 654]. E. Michalski distinguishes three groups of criteria for the evaluation of marketing strategies: costs, efficiency and effectiveness [Michalski 2007, p. 464].

The major goals of controlling are [Griffin 2004, p. 655]:

- adjusting to changes,
- dealing with complexity of the organization,
- reducing the number of mistakes,
- minimizing incurred expenses.

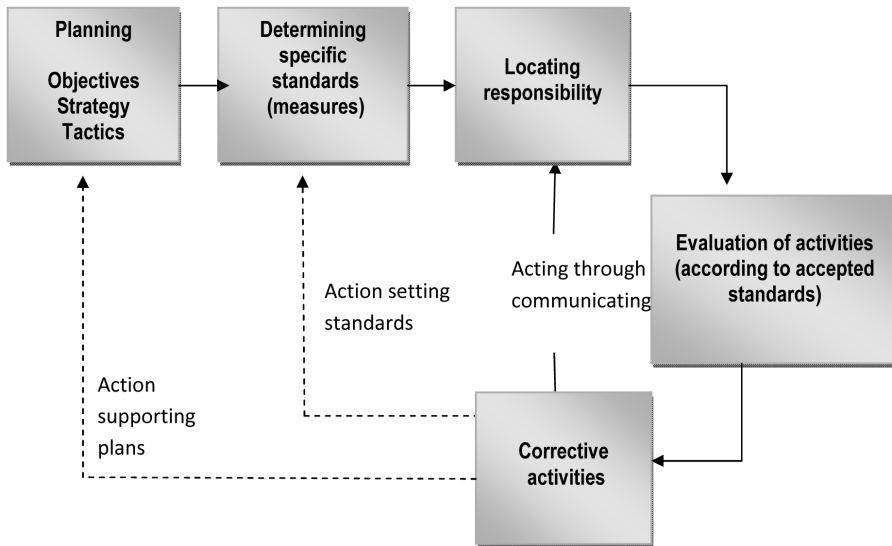
The controlling process should be properly organized. J. A. F. Stoner and Ch. Wankel determined the main elements of the controlling function. These include [Stoner, Wankel 1996, p. 34]:

- determining measures of effectiveness,
- measuring current effectiveness and comparing it with determined measures,
- taking up corrective activities if effectiveness does not match accepted measures.

Figure 2 shows the process of planning and controlling the management function, consisting of four elements [Pomykalski 2005, p. 166]:

- defining standards,
- locating responsibility,
- evaluation, and
- correction.

**Figure 2.** The process of planning and controlling



Source: [Pomykalski 2005, p. 166].

Measuring and determining the effectiveness of activities in a non-profit organization is not an easy task. There are difficulties with assessing the quality of offered services, which is due to problems with separating the market and no possibility of financial presentation of organization's operations [Foremniak 2001, pp. 103-109]. The controlling process may also be hindered by lack of quantitative definition of objectives [Huczek 2003, p. 82]. Observation and control are necessary, though, as they allow us to find out whether the strategy is realized properly and, if necessary, to verify it [Huczek 2003, p. 82].

## 8. Conclusions

Summing up, the idea of marketing is deeply rooted in the operations of non-profit organizations. The fundamental principles of marketing (marketing research, market segmentation process, designing marketing mix instruments, the need for creative, strategic thinking and innovations) are universal and can be applied regardless of the type of offered product [Brassingron, Pettitt, 2000, p. 939]. Differences can be discerned in detailed design and implementation of marketing tools [Brassingron, Pettitt 2000, p. 939].

Marketing of non-profit organizations generates value for a wide range of interest-holders. In the process of formulating and realizing marketing strategies, organizations should always keep in mind that they should provide their customers with value in the most effective way. This is not possible without

a strong sense of the social mission performed by the organization. The mission shows the sense of organization's activities and reflects the values it professes [Hudson 1997, p. 72]. The mission should constitute the basis for formulating objectives, singling out the target group and selecting tools to realize the strategy.

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**Mateusz Marszałek\***

## **ESTABLISHMENT OF BUSINESS PRESENCE ON THE INTERNET AND ONLINE SOCIAL MEDIA**

### **Summary**

*The paper Establishment of business presence on the internet and online social media presents the new reality in which customers are more important than ever. As 58% of consumers actively search for products and services on the internet, businesses must take active steps in order to capture the area of market that is still not fully understood. The report cites relevant studies, most of them published last year, on the topics of online marketing, e-commerce and social networks – with special focus on two most popular communities, Twitter and Facebook. The researched data is accompanied by comments from experts on new internet technologies and documented cases of successful and failed online social interactions from global brands like Levi's, BP and Starbucks.*

### **1. Introduction**

Technological progress irreversibly changes the way organizations – both businesses and non-profit ones – interact with their clients, other organizations and the environment around them. The Internet is one of the crucial parts of this progress. Widespread Internet access fundamentally transformed financial, managerial, administrative and marketing functions of organizations, both on global and local scale.

Nevertheless, online revolution has not ended yet. Recently, with the advent of online social media, the focus shifted from traditional, curated content, to user-generated content, which can be created, edited, published and shared by anyone with an Internet connection. Clients are no longer passive consumers of products and services. More than ever, they influence each other by communicating on virtual social platforms. Using appropriate strategies and

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techniques, organizations can improve their relationship with clients, as well as increase the value of the business.

The paper shows the importance of business presence on the Internet, together with examples of successful and failed attempts at being prevalent on social media, such as blogosphere, Facebook, Twitter and Google. It also tries to present the common patterns shared among users of these media and concludes how they can be used to organizations' advantage.

## **2. The importance of the Internet**

In the spring of 2010, Europe witnessed a series of eruptions of Icelandic volcano Eyjafjallajökull. In mid-April, during its most active period, the volcano released about 150,000 tons of CO<sub>2</sub> per day. The ash cloud emitted by the explosion, covered most of Eastern and Northern Europe, effectively disrupting air travel over the whole Europe. The airline shutdown was matched only by the events of 11 September, and vastly affected global travel, business and trade. According to the report commissioned by Airbus, disruptions during the first week of eruptions resulted in 4.7 billion dollars of lost global GDP (Oxford Economics, 2010). The International Air Transport Association has issued a warning, that nearly 150 European airlines would have gone bankrupt if the flight ban had gone for longer than a week (Spiegel Online, 2010).

However, more than ever, modern organizations rely heavily on another crucial piece of infrastructure – the Internet. Research carried out by Redshift Research indicates that only 1% of businesses could function adequately without Internet access, as nearly two-thirds of them state that their Internet usage is either continuous (27%) or high (34%) (Redshift Research, 2010, p. 4). Moreover, some 20% of companies admit that had they not had Internet access for a week, they would not have survived (Redshift Research, 2010, p. 6). Because organizations utilize Internet for communication (e-mail, Voice over IP), research, storage and marketing platform, any excessive downtime reduces productivity, damages the reputation and brings financial losses. It is estimated that four-hour downtime costs company £10,000 in lost productivity (Redshift Research, 2010, p. 8).

## **3. Internet presence**

There is an old Internet adage saying: “If it is not on the Internet, it doesn't exist at all”. Consumers seem to agree with this statement: in 2010 in the United States alone, 58% adults have at least occasionally researched on the Internet the products and services they buy, an increase from 49% in 2004. At 78%, this rate is even higher among Internet users (Jansen, 2010). Customers no longer depend



on the Yellow Pages or advertisements to discover new products. Instead, they use web search engines – in December 2009, people aged 15 or older conducted more than 131 billion searches: about 2.9 million per minute (comScore, 2010). Thus, in order to increase the number of potential customers, it is important for every business to create a website, which is accessible to Internet users.

With estimated 14 billion websites on the World Wide Web, as of 11 May 2011 (Kunder), the pressure from competing pages does not seem to ease. While overall computer and Internet usage increases (on average 58 and half hours per person in March 2011 in the United States), users spend 30% of this time browsing 10 most popular websites (The Nielsen Company, 2011), making attention for other sites limited.

Competition among websites is not restricted only to time, but also to space. Using eye-tracking technology, researchers discovered a strong correlation between a position in search-results page and a click pattern: the higher the link to the website is on the result page, the more likely a user will click it. More specifically, users' eye scan activity on the result page represents a distinctive triangle (figure 1), anchored on the number one organic (non-paid) result (Hotchkiss, Alston, & Edwards, 2005, pp. 7-8). Furthermore, almost 60% of all clicked organic links came from just the first three results, whereas fifty-one per cent of all clicked sponsored links came from the highest top result (Hotchkiss, Alston, & Edwards, 2005, p. 68).

That is why nowadays having a website is not enough – its owners need to promote it effectively, so the page can be visible on the top of the search results. This can be accomplished with the help of a strategy called search engine optimization, or SEO. The SEO refers to the set of improvements and tools that increase website's performance in search, both in content (such as its quality and quantity, links to other websites, usage of keywords) and technical aspects (like design, coding, scripting, error pages). The main purpose of these tweaks is to increase the position of organic links on the search results page in response to certain keywords. It is a difficult task, since the algorithms that calculate the positions using hundreds of variables are modified on a regular basis, to promote high-quality content and lower the significance of link farms or content-copyers (Singhal & Cutts, 2011).

One can argue that only large- and medium-sized organizations can capitalize online presence, and small, local businesses do not lose much by staying offline. Sometimes, the cost of maintaining the website outweighs the potential benefits, especially since they might not be monetized right away. However, there is a relatively new online trend, called “geosocial”, which can be applicable even to small businesses. Geosocial, or location-based services, use mobile devices with Internet access and geolocation capabilities (such as Global Positioning System – GPS or Wi-Fi connection locations) to assist users

with information about nearby businesses, services or other points of interest (Zickuhr & Smith, 2010, p. 2). For example, simply by looking at a mobile phone screen, customers can find specific restaurants that are within walking distance, together with detailed directions and comments or reviews written by others. Some geosocial services can also automatically send notifications to friends about visited places, while others reward active users with virtual badges. In exchange, businesses involved with geolocation receive real-time information about customers' habits. Although location-based services are not mainstream yet (1% of online adults use such services on a given day (Zickuhr & Smith, 2010, p. 3)), Foursquare – the most popular geosocial network, founded in 2009 – has 8 million registered users and has been named a Technology Pioneer for 2011 by The World Economic Forum.

Ultimately, no matter what the size of the organization is, it is advisable to include an online presence into the marketing strategy. The detailed plan however, depends on the type of the organization, its size, location and industry.

#### **4. Beyond e-mail**

If a company decides to go online, it cannot stop only at having a website – it is merely a means to an end.

E-mail is one of the ways that further enhance the customer's experience. It is an extremely versatile channel of communication. Its delivery is almost instant, yet the receiver can read it whenever he or she wants, its length can vary from one sentence to a dozen of paragraphs, it can display images, attachments can contain every possible file format, and the cost of sending one e-mail is virtually non-existent. All of it makes using the e-mail the most popular activity among adult Internet users. 94% of them admitted to sending or reading an e-mail (Pew Research Center, 2010), and 58% begin their day by checking their e-mail (ExactTarget, 2010). Considering such popularity, no wonder why businesses favor e-mailing over other forms of online communication, as they use the electronic mail to contact their customers, sending offers and invitations through newsletters and company mailing lists.

This is about to change. The usage of e-mail has begun to decline, especially among younger users, who switch to instant messaging, mobile texting and social media. 12 to 17 year olds spend 59% less time using e-mail than the year before, whereas among the 25 to 34 year olds the decrease is 18%. The overall decline in e-mail usage is at 8% in the past year (comScore, 2011). As if it is not enough, consumers more reluctantly accept commercial e-mail. In the United States, 77% of online consumers voiced concerns about giving companies their e-mail addresses. Nine in ten unsubscribed from a company e-mail lists they previously voluntarily opted-in-to. 18% admitted that they never even

open commercial e-mail (ExactTarget, 2010, p. 4). Among the most common reasons for unsubscribing, polled customers listed too frequent messages from one brand, repetitive or boring content and being too overwhelmed with e-mail altogether (ExactTarget, 2010, p. 9).

In addition, technical restrictions mean that the same e-mail, with the same content, is sent to every subscriber, without any regards to segmentation and targeting. This makes the interaction between the organization and customer less personal and more forced. No matter how eloquent and persuasive the content of the e-mail is, the message from the company is not perceived as trustworthy. Customers put a much higher value on the opinion of friends and word of mouth than companies' advertising. To turn this threat into an opportunity, organizations should engage in social aspects of online relationships.

## **5. Online content revolution**

Not so long ago the Internet was the medium just like TV, radio or the press – a platform dedicated to the distribution of information, with only a handful of people able to publish static content on privately owned websites. Still, the Internet combined the best features from each of them, as users were able to browse whichever content they wanted, including text, pictures, audio and video - all at low cost and delivered in a fraction of a second. As Internet access became more widespread, the need for social interactions appeared, along with new standard of Internet activity – Web 2.0

Web 2.0, an umbrella term coined in 1999 by information architecture consultant Darcy DiNucci and popularized since 2003 by Tim O'Reilly and his media company, represents an idea of using the Web as a platform, where users take control over generating and sharing of the content. (O'Reilly, 2005) The portions of information are no longer separated from each other, but can be combined and modified offering brand-new user experience. Users become treated like co-developers, who can unleash their collective intelligence, enriching the shared data. Examples of technologies based on user-generated content include blogs, wikis, social networking sites, file sharing networks, discussion boards, review sites and folksonomies (social categorizing).

It seems unlikely that the user-generated content might be worth any money at all. First, the user-generated content is usually shared free of any charges and fees – no upfront payment, such as a subscription, is required to view it. Moreover, the process of sharing this content is simple, as technology created with Web 2.0 in mind made distribution user-friendly. The legal aspects are becoming less troublesome. Even though the website owners retain some rights to the content published by users, some of them use models that are more open. Wikipedia and Flickr use Creative Common licenses – “a free, public, and

standardized infrastructure that creates a balance between the reality of the Internet and the reality of copyright laws” (Creative Commons).

Secondly, the quality of user-created content itself can be questionable. Anyone can create or edit content, even people lacking knowledge or expertise in the commented subject, which can lead to a situation where produced content is not true. There are cases of deliberate attempts to publish malicious information, intended to ridicule or harm the company or person’s reputation. The most famous incident involves the vandalism of John Seigenthaler Sr. biography on Wikipedia, where false information about his alleged involvement with the assassination of John Kennedy was available for 132 days since the prank edition (Seigenthaler, 2005). Although there are ways to enforce some credibility and authenticity, like the verified accounts on Twitter, many user-generated content websites allow anonymous posting, and some even encourage it – discussion imageboard 4chan does not have a user registration system. Lack of control can negatively affect quality of content in social media. Some news agencies took extreme measures to counter that risk. Agence France-Presse (AFP) has banned its reporters from using Wikipedia and Facebook as exclusive sources of news (Luft, 2008).

Despite these disadvantages, it is not only possible to make money using user-generated content, but it is a common practice. Out of thirty most popular Web 2.0 sites (Alexa), only one, Wikipedia, is non-commercial and relies solely on donations. The rest generate income by offering premium content or accounts (Flickr, Skype), displaying advertisements (Facebook, YouTube), selling related goods and services through affiliate programs (Etsy, Woot), or a combination thereof (Reddit, last.fm). Furthermore, because users often share their personal information and details, the marketers can present consumers with an accurate offer that might be more suitable for them. At minimal cost, advertisements and products can be targeted to a group of people who share the same demographics, location and interests, making them more useful to customers.

## **6. Twitter**

Renowned artist Andy Warhol once quipped: “in the future everybody will be world famous for fifteen minutes.” Right now fame can be achieved in 140 characters – the maximum length of messages on microblogging platform Twitter. It is not an accident that the restriction of one message – called “tweet” – closely matches the size of one text-message send by mobile phone (one message can contain up to 140 octets, or 160 characters (3<sup>rd</sup> Generation Partnership Project, 2011, p. 9)). As users are no longer bound to their home computers, they can write what is on their minds from everywhere in the world using mobile and wireless solutions.

In the words of Twitter's creator Jack Dorsey, Twitter means "a short burst of inconsequential information, and chirps from birds. And that's exactly what the product [is]." (Sano, 2009) It mimics the way people communicate with each other's face-to-face, with short, concise, and emotionally powerful sentences. One billion messages sent per week (Twitter, 2011) by 200-million-strong user base (Shiels, 2011) are organized through the system of simple punctuation marks attached to words: hashtags (#) represents topics, at symbols (@) – user names. There are no restrictions on who can write ("tweet") or read (usually by "following" or subscribing to other accounts) messages on Twitter, and straightforward and simple nature of the website lured some high-profile figures, who instead of getting help from the PR team, write their own tweets – like British actor Stephen Fry or NBA player Shaquille O'Neil. No other channel, offline or online, gives ordinary citizens such easy access to celebrities' lives.

Mainstream popularity of Twitter in modern culture prompted US Library of Congress to archive every single tweet in their digital database (Raymond, 2010). However, among the momentous entries, such as Barack Obama's victorious declaration "We just made history" on 5 November 2008, there are a considerable number of unimportant words and phrases. Pear Analytics study determined that over 80% of all tweets were either "pointless babble", "spam" or had "conversational" nature (Kelly, 2009). Yet, behind this seemingly trivial information hides the uncontrollable power of the masses. One tweet might not mean anything, but thousands of them do. Researchers at Hewlett-Packard correctly predicted how much money a movie would earn in the first weekend based only on the frequency of tweets about that particular movie (Asur & Huberman, 2010). Elsewhere, The United States Geological Survey has developed a system of earthquake detection based on the content of posted Twitter messages (Lubeck, 2009).

Direct and fast-paced nature of Twitter emphasizes real-time communication and fast responses, and unlike e-mails, users do not have to read all messages posted in there. Therefore, organizations present on Twitter need to adjust their interactions and prepare themselves to respond directly to clients' inquiries. Moreover, such messages are public, and people who are not followers or who do not even have a Twitter account can view them. It is estimated that Twitter's reach is double its user base. Also, Twitter followers are more active than the average consumer – they are three times more likely to blog, post ratings and write reviews at least once per month (ExactTarget, 2010).

## **7. Facebook**

With well over half a billion active users (Facebook, 2011), Facebook is the biggest and most recognizable social network service in the world. What

started as a simple website for comparing and rating photos of Harvard students (Tabak, 2004), soon evolved into the second most visited page on the Internet, right behind Google.

The concept is simple: users create profiles containing basic information about themselves: name, age, gender, where they live and work, what they like, and what kind of relationship they are in. They can attach photos, comment on other people's profiles, write random tidbits on "The Wall", or just attract others attention in the form of virtual "pokes". According to the official statistics, an average Facebook member creates 90 pieces of content each month (Facebook, 2011). It is addicting - with six and a half hours per person, US Internet users in March 2011 spend more time on Facebook than on Google, YouTube, Microsoft, Wikipedia and Apple websites combined (The Nielsen Company, 2011).

Facebook has a diverse user base, with slightly more males (51.2%) than females (48.8%). Although more than half of the users are aged 18 to 34, Facebook's audience represent 8% of people aged 45-54 and 4.6% of people aged 55 to 64. Three out of four people are from outside of the United States – the largest communities include Indonesia, the United Kingdom, Turkey and India (Inside Facebook, 2011).

In April 2010 Facebook launched the "Like" button, a feature that later reshaped the Internet landscape in an irreversible manner. With the Like button, users declare their emotional attachment to ideas, causes, associations and brands they support or agree with (in simpler words – become fans of). This allows users to define their self-expression beyond the rigid text fields in their profiles. The success of the Like button comes from the fact, that it can be placed outside of Facebook and integrated into any other website. In less than a month after the launch, 100,000 websites installed the Like button. As of April 2011, more than 10,000 sites add it every day (Parr, 2011).

It appears that the act of "liking" a brand, company or association is a clear signal that customers agree to receive commercial content. However, research shows that it is not that obvious, as people use the Like button for many different reasons. They do so to receive discounts, promotions and free samples, to show publicly their support for the company or idea, to access exclusive information and updates or simply for fun and entertainment (ExactTarget, 2010). 70% of consumers who "liked" a brand on Facebook did not feel they had given the particular company a permission to market to them, although 51% say that they are more likely to buy a product or service associated with the Like button (Chadwick Martin Bailey, 2010). It all stems from the fact that people join Facebook in a first place for its social and entertainment values, and they do not expect blatant advertising in there. It is still possible to communicate effective commercial messages to customers, but companies cannot focus only on placing advertisements. They have to unleash the full potential of social networking.

## 8. Marketing 2.0

The new marketing strategies need to exploit entirely both the social aspects of online communities and their technological features.

Consumers value highly the opinion of their families and acquaintances. Nielsen Global Online Consumer Survey confirms it – 90% of respondents “completely” or “somewhat” trusted recommendations from people they know in person. What is interesting, customer treasure the opinions posted online by others, even if they do not know them. Online word of mouth enjoys trust of 70% of people, as many as brand websites. On the opposite spectrum are other forms of online advertising – less than 45% of respondents trust sponsored search engine results, online video ads, banner ads and paid text messages on mobile phones (Nielsen, 2009).

Of course, businesses can let users share recommendations online using tools already available on social network sites. The better idea is to actively encourage and help customers with spreading the word. Levi's, for example, created a website called Friends Store. Integrated with Facebook, it allows consumers to share the jeans they like, and shows what kind of jeans others have liked. As people influence and trust each other, they are more likely to make an informed decision about the purchase (Solis, 2010). Another illustration of the creative recommendation system is Coca-Cola's Facebook application “Ahh Giver”, which allows fans to send a message to friends in the form of a video featuring a polar bear. Additionally, a discount coupon for one beverage is attached to the message. Both of these companies offered an interesting and unique way to engage consumers and their friends online.

Not every recommendation is equal, nonetheless. The quality of influencers varies, as according to the data collected by Meteor Solutions, “approximately 1% of a site's audience generates 20% of all its traffic through the sharing of the brand's content or site links with others”. It is then necessary to determine the key influencers, divide them into groups such as “experts” or “entertainers”, find out the social networks they frequent, and then, using proper methods, reach out to them (Straley, 2010).

Still, businesses try to reach the biggest audience they can, by encouraging users to become fans on Facebook and followers on Twitter. It is understandable and desired behavior - these consumers are more likely to buy (51% of Facebook fans and 67% Twitter followers) and recommend (60 and 79% of Facebook and Twitter users respectively) a particular brand (Chadwick Martin Bailey, 2010). That is why messages telling consumers to “Find Us On Facebook” and “Follow Us On Twitter” are ubiquitous these days, being present not only on the Internet, but also on television, outdoor billboards and products' packaging. Rarely, however, do marketers give a reason why customers should do that. In

a social experiment, Andrew Blakeley, a social strategist at DDB UK, for one week accepted every invitation to become a fan of brands he was exposed to. Out of 46 brands, only 10 gave him a reason why he should “like” them. Just one invitation out of 16 received by e-mail newsletters provided an incentive (a chance to win £100 worth of groceries) to switch from e-mail to Facebook (Blakeley, 2011). The author concludes: “consumers need a reason or an incentive to open themselves up to [brand] in another channel”. “Otherwise”, he argues, “all they [consumers] are doing is agreeing to be bombarded with more marketing, with no real reward for doing so” (Blakeley, 2011).

There are successful counterexamples of brands, which engage users with interactive and exclusive content upon “liking” or following. Nabisco, a subsidiary of Kraft Foods, encourages fans on Facebook to publish photos showing them with Oreo cookies, and then, each week they select a photo featured on the main page of the brand. In addition, in February 2011, they successfully attempted to set a Guinness World Record in the most “likes” given within 24-hours (Wasserman, 2011).

Starbucks, on the other hand, delegated a special employee, called a principal Tweeter, to write even up to 20 tweets a day delivered to over 1.4 million followers. The published content varies from press releases, new offers and latest events to apologies for bad service and personal stories from baristas. A haiku contest, where fans could have won Starbucks Gold Cards, attracted 200 entries within an hour (Israel, 2009). Outside of social networks, Seattle’s most popular coffee chain created a dedicated website where customers can openly share and vote on ideas about new products, experience and community involvement. The most popular ones are then presented on company’s Facebook, Twitter and YouTube channels, and eventually introduced to the franchise.

## **9. Damage control**

However, inappropriate usage, not to mention ignorance, of social media in promoting business can bring severe consequences. On 20 April 2010, Deepwater Horizon oil drilling rig owned by Transocean and leased by BP, exploded offshore, leaking nearly five million barrels of crude oil into the Gulf of Mexico. It was unprecedented event – because of not only the size and type of damage, but also due to its prevalence in social media. At the beginning, BP was reluctant to share up-to-date information with the public. The official BP America Twitter account was created on 30 April 2010, ten days after the explosion, and provided updates about the situation in the Gulf, current progress with plugging the leak and later with the cleanup. In May 2010, its feed was updated on average once every two days (BP), and gathered about 4,700 followers at that time (Heussner, 2010). Internet users, unhappy with BP’s



response, quickly took matters into their own hands. A mock Twitter account named BP Public Relations created on 19 May 2010, in just one week attracted about 20,000 followers, nearly four times more than the official feed. An example of one of its satirical tweet reads: “Thousands of people are attacked by sea creatures every year. We at BP are dedicated to bringing that number down. You’re welcome!” (BPGlobalPR, 2010) It was retweeted (shared) with others 1,203 times; making it more spread than any official message. The frequency of tweets on the spoof account has also been greater than on the official channel: about eight per day.

As if it was not enough, three months after the explosion, John Aravosis of the America Blog, discovered that the photography of the crisis response center published by BP in June 2010 had been altered with a photo editing software, and was actually taken in March 2001 (Aravosis, 2011). The story was then reported on the mainstream media, such as The Washington Post and Gizmodo. James Herring from London public relations firm Taylor Herring commented: “It’s astonishing in today’s media-savvy world that such a colossal and ongoing PR mess can be made.” (Walt, 2010)

A different outlook on managing an online crisis has been presented by Toyota. In early 2010, Japanese car manufacturer was forced to recall 8.1 million cars as a result of braking and accelerating malfunctions. After the initial slow response, Toyota took multiple measures to improve their public relations with the help of online channels. They created a website dedicated to aggregating top stories on Twitter about Toyota, combined with official press releases and videos (Rao, 2010), and successfully employed SEO techniques to lift corporate website into top three results for query “toyota recall” (Shier & Ress, 2010). Furthermore, Toyota’s US president of sales division Jim Lentz held an exclusive questions-and-answers session for social news site Digg (Cohen, 2010).

Greg Jarboe from Search Engine Watch concludes in his article on online reputation management that the ultimate lesson to be learned from the BP oil spill and Toyota recall is to “be prepared”, explaining “[...] you need to prepare your YouTube channel, Facebook page, Twitter feed, and Flickr photostream now, not after a crisis hits” (Jarboe, 2010).

## **10. Conclusions**

Organizations are entering a new era, where revolutionary communication tools are introduced not as a passing fad, but an effective way to acquiring customers. The key to success is no longer in buying people’s interest, but earning it. To be relevant, companies must reveal their presence on the Internet in such a manner, which allows building strong relationships with customers. However, online social media are only a part of organizational strategy, and one

should remember about other aspects of management and marketing as well, without losing the sight of the company's objectives.

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**III.**  
**MODERN TOOLS FOR BUSINESS**  
**AND NON-PROFIT ORGANIZATIONS**  
**MANAGEMENT**



**Magdalena Majowska\***

## **IN SEARCH OF HUMAN RESOURCES MANAGEMENT POLICIES AND PRACTICES IN NETWORK ORGANIZATIONS**

### **Summary**

*The purpose of this study is to determine configuration of policies and practices of HRM that are unique for specific types of network organizations. This paper is aimed at developing bases to support HRM complying with the requirements of interorganizational cooperation nature. In this respect, it was helpful to search for an answer to the question: What should be the guidelines orienting the HRM actions in network organizations? The discussion concerning guidelines in the area of HRM within network was held basing on the assumption that the choices made by an organization, including identified HRM contradictions, will depend on both the nature of relation and the method of arrangement. The result of the aforesaid discussion is a list of guidelines on developing the most favorable HRM policies and practices considering the two above-mentioned dimensions that constitute the essential characteristics of separate types of network organizations. The list comprised in this paper is by definition neither comprehensive nor exhaustive, it represents only a set of key strategic guidelines serving the purpose of developing specific solutions in the area of HRM within a determined type of network organization.*

### **1. Introduction**

In the era of global competition and knowledge-based economy, effective and efficient management of one of the most precious strategic resources organizations have, namely people, is becoming the crucial challenge for contemporary practitioners, scientists and theoreticians alike. The significance of people and human resources management (HRM) is a hot issue, considered vital from theoretical and practical point of view [18]. Therefore this article focuses on HRM issues in network organizations. The appearance of networks

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and inter-organizational cooperation in contemporary economy has become one of the fundamental tendencies of its development. It is often emphasized that inter-organizational relations play a key role in contemporary business [9].

Taking the above into consideration, the aim of this paper is to determine the configuration of HRM policies and practices typical of particular types of network organizations. The article aims at developing foundations on which we could base the HRM reflecting the requirements of the essence of inter-organizational cooperation. It would be helpful in this respect to define the outlines determining HRM activities in network organizations. Thanks to conducted studies and analysis of specialist literature, it was possible to achieve the aim set in this article.

## **2. Policies and practices in functional fields of HRM – dialectical presentation**

It is currently emphasized that competitive edge over other companies is achieved thanks to people [5]. According to the resource-based view (RBV), company resources, especially those rare, unique and impossible to imitate, mostly stimulate the effectiveness of an organization [3]. The quality of these resources makes them irreplaceable, which allows the organization owning them to develop a competitive advantage, especially in markets where obtaining them is extremely difficult if not impossible. These resources include resources based on human factor, vital for increasing the effectiveness of an organization.

In this perspective, HRM may be treated as a coherent approach to managing the most valuable assets of an organization – people who work for it. It is sometimes defined as a term especially related to activities contributing to attracting, developing, motivating and retaining highly productive staff, which results in the success of an organization [28]. “Attracting” is an English term which does not have its equivalent in Polish. It is usually identified with the processes of recruitment and selection, aiming at identifying and attracting candidates and choosing the best ones [1][27][25]. Motivating may be defined as an activity aiming at causing dynamic, internal state encouraging to acting or evoking changes [30]. Other activities identified with staff development are usually understood as creating overall conditions in which staff could develop their knowledge, skills, competencies and in which their behavior and attitude could be shaped [21]. Retaining may be defined as an activity encouraging staff to stay with the organization [29].

This paper assumes that HRM policies and practices will be perceived through dialectical presentation, that is in categories of strategic contradictions. This is important as in the last two decades a number of scientists have adopted a dialectical perception of the organization, strategy and management [26][22][4]

[6][7]. They isolated the dialectical approach from the traditional one [14]. The starting point for the analysis of dialectics were strategic tensions existing in the organization. From the perspective of strategic management, an organizational challenge is to find the best way to deal with these strategic tensions, identified as strategic contradictions [22][26]. In the science of management, contradiction usually refers to the processes taking place in reality and confirming the co-existence and clash of contradictory tendencies and forces in objects or processes. It covers relations between phenomena whose co-existence and mutual conditioning makes them counteract to each other. We similarly understand the set of contradictions constituting particular paradoxes of management – these are clashes of tendencies existing in strategies.

In this article we assume that HRM policies and practices (perceived through the prism of contradiction) provide some useful hints for managing people in an organization and formulate the basic assumptions determining thinking and acting while taking decisions in the area of effective functioning of an organization. The willingness to introduce some order in the HRM issue called for their initial conceptualization. It was useful to develop a list of opposites concerning the whole HRM, covering the following variables<sup>11</sup>: (1) centralization – decentralization, (2) quantity - quality, (3) top-bottom – bottom-top direction, (4) flexible – permanent solutions, (5) short – long time perspective, (6) unification - fragmentation, (7) internal – external context, (8) periodical – incidental nature, (9) effects - behaviors, (10) participation - arbitrariness, (11) routine – creative behavior. All the identified opposites are deeply rooted in theoretical work and empirical research, which confirmed their existence. Therefore it seems possible to use the above contradictions to create a more precise characteristics of HRM in network organizations.

### **3. The nature of relations and their ordering as parameters of network organizations**

Effective management of modern organizations consists in incorporating organizational skills and competencies into the process of creating and using opportunities existing in the environment. This process assumes interrelation between an organization and its environment. Such situation makes it necessary to analyze the way in which particular types of organization function in relation with their surroundings or environment or in relation to other business actors existing in their environment. Therefore, the foundation of our analysis of matching policies and practices in functional fields of HRM to particular types

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<sup>1</sup> These contradictions are the area of research of the Department of HRM. For example, the contradictions of the remuneration policy were identified on the basis of many articles and then empirically verified by Magdalena Majowska in her Ph.D. thesis paper

of network organizations is the assumption that the boundaries between the environment and the organization are blurred.

One of the key management challenges facing most organization in the 21<sup>st</sup> century is not only taking into account but also creating mutual inter-organizational relations in form of creating or shaping network structures [17]. Specialist literature calls these inter-organizational relations or interdependencies clusters, constellations, virtual corporations or networks [11]. All these terms are usually characterized by the co-existence of a particular combination or composition of complicated, various interdependencies and relations between organizations or institutions [19]. These interrelations (in case of networks) may be created and managed by a definite number of organizations or institutions (accounting for several elements of network), differing in type of ownership, size, branch, general strategy or business strategy, life cycle, growth dynamics or management structure. Usually these types of relations and interdependencies are created step by step, that is gradually and systematically, and to initiate them it is not necessary for the organization to be fully structurally shaped.

The notion of network is so wide that network organizations practically cover all structural forms and permeate all types of organizations. Simultaneously, taking into account characteristic features of network organizations, it is essential – from the perspective of their operations in changing and unpredictable markets and dramatically growing competition – that this type of organization is playing an increasingly dominant role. This is because network organizations on one hand allow technological mastering of a particular sector of activities and promoting modern technological standards, and on the other hand they contribute to achievement of better effects of economies of scale in production and experience. All these solutions promoted by them result in appearance of larger and more effective connections between various sectors, which have not been related nor have influenced each other before.

Taking the above into consideration, a network organization, as one of modern forms of organization, may be presented as a particular way of organizing mutual interactions and relations between particular subjects, organizations or elements of an organization. Taking into account its attributes as an organization, in which connections between particular elements may take up various forms, a network may constitute an attempt at questioning both the hierarchy and the power, as a way of regulating events, as task specialization, as a way of allocating responsibility between particular subjects. Therefore the issues of centralization and decentralization, treated as a foundation of designing an organization, may constitute a certain area of scientific interest.

The diversity prevailing in network organizations is reflected in various emphasis on normative interactions between participants of this network.

These interactions force a different approach to HRM practices. Some HRM researchers and theoreticians believe that it is possible to “capture” this multitude of actions and their multi-faceted nature. A vital role in this integration process is played by the corporate “center”, whose strategic attitude and way of thinking is identified with the management method by the company authorities. In this case this is the orientation towards emphasizing the role and significance of the “center” responsible for formulating and realization of tasks on the highest, central level. “The center also aims at implementing developed solutions in other, dependent (not only hierarchically) levels or areas. On the other hand, as some scientists point out [16], in case of multi-centered network organizations, the concept of the existence of a central core and its role in interactions between network participants may be verified.

As we can see from the above fragment, network organizations may be organized in a centric or pluralistic form. The term “centric” appears in a broad perspective (meaning – located near the center or directed towards the center), as well as in such terms as ethnocentric, polycentric, regiocentric or geocentric. With reference to the organization, the term “centric orientations” is also used in the area of strategic international HRM [24]. It covers then a dominant logic of top management, reflected in the strategy of the company, and visible in managing people in various branches and units of international corporations. The complementary term “pluralistic” appears with reference to a specific orientation of strategic global HRM in network organizations. In this perspective, pluralism reflects the issue of diversity of network elements, which are legitimized in a corporation. Both forms of organizational order seem essential in analyzing HRM practices in network organizations.

Centric networks differ from pluralistic ones. In centric networks whatever happens in subordinated units must gain acceptance of the center, which increases the significance of the processes of legitimization taking place in the network. In this perspective HRM policies and practices may for example be a decision area overtaken by the center. In pluralistic networks, on the other hand, subordinated units act at their own discretion and according to their will. In this case, the center also plays some important role, which is provision of authorization for introduced solutions. They are evaluated from the perspective of generated effects or results and from the perspective of a particular level and execution of duties imposed by the center. In this situation, the center does not control the spreading of knowledge between its subordinate units.

In pluralistic network one of the most essential issues is to what degree or extent the second line units (being in relation of subordination) realize the arrangements valid for the whole network/organization. The center in this situation should force a certain “mindset” on all network participants. Thanks to this it can influence the freedom to decide of other participants (line and local

managers in an organization). In this case, it is the center that guarantees the competitive edge, not on the basis of one-institution logic of the community, but on the basis of the knowledge possessed by local structures. The center develops and makes dynamic the competencies of subordinate units – it decentralizes the logic of competencies. The center is not omnipotent, but rather emerges as an effect of activities and mutual relations between subordinate units. It does not offer any “golden way of acting”, but is an undisputable supporter in achieving competitive edge and securing resources.

Apart from the way network organizations are ordered in a centric and pluralistic forms, the nature of relations between network participants is becoming important. Acquiring most global sectors and industries, networks show a high level of complexity and diversity as well as changeable architecture and structure. This changeability is visible in the strength and composition of ties between network participants [20]. The changing conditions of operations affect the process of creating and shaping networks, while the balance is not always disrupted and restored cyclically [13]. This instability is also reflected in particular characteristics of a network paying attention to the nature of connections between network participants, visible in their constant changes – the network “is becoming”, it never exists at any moment as a stable formula. In this perspective the essence of the network organizational structure based on primal role of relationships between its elements is creation of any voluntary and each time different configurations. In other words, a particular network structure is not the only optimal combination of its elements but the constitution of possibilities of instant changes in ways of organizing or making combinations of elements.

Analyzing the network organization, we must assume the dynamic nature of the analyzed phenomenon, which changes not only with the context in which it appears, but is also subject to time influence. This is so because the notion of creating or emerging refers to the appearance of novelties and coherent structures, formulas and features in the process of self-organization of the system. The appearing constructions are unpredictable and cannot be deduced from the components of lower levels of the system. Therefore we can say that a network organization emerges from the intellectual activity more than it is imposed through material or financial flows. The relations between network participants may be emerging or may be already fixed. Specific features of a particular set of network organizations are largely determined by the position of an external observer or an internal participant of the organization or the network. That is why some people claim that a network organization (or an organizational network) is identified with a relatively stable group of autonomous, independent units or organizations, which participate in a system of mutual interactions and cooperation, using the commonly accepted rules of the market [2].

If we want to match specific policies and practices in the functional areas of HRM to particular types of network organizations, we should pay attention to the typology presented here. It is based on two dimensions characterized above: (1) the nature of relations and (2) the way of arrangement. These dimensions correspond to the assumptions concerning the blurred boundaries between the environment and the organization. The intersection of these two dimensions forms a four-field matrix providing detailed information on essential elements for designing and implementing HRM practices in a particular type of a network organization (Figure 1). Each type of a network organization needs configuration of proper settings and provision of appropriate argumentation and justification for proposed configuration of HRM policies and practices. For this purpose we used a developed list of contradictions. The priority here is to “marry contradictions”, which will allow us to perceive new opportunities and to take advantage of unexpected events, and on the other hand, to use the available resources, increase productivity, lower costs and focus on creating value in a short period of time.

**Table 1.** Matrix of network organization types

		Arrangement	
		One center	Several central points
Nature of relations	Permanent/consolidated structures	<b>Centric - permanent</b>	<b>Pluralistic - permanent</b>
	Emerging structures	<b>Centric - changeable</b>	<b>Pluralistic - changeable</b>

Source: own elaboration.

Summing up, we have the following types of networks: (1) centric/permanent – these are network structures in which power belongs to one center for a longer period of time; (2) centric/changeable – these are network structures in which power shifts from one center to another in particular issues (for example tasks), (3) pluralistic/permanent – these are network structures in which relations are similar in a longer period of time, but no particular unit ever dominates, (4) pluralistic/changeable – these are chaotic networks, arranged for a short period of time, which do not have any specific centers (there is no dominance of one unit), but there are only particular concentrations of interests.

#### **4. Configuration of HRM policies and practices in network organizations**

Centric/permanent structures reflect hierarchical relations; power is held by one center in a longer period of time. These are rather networks of dominated partners, in which the relations of a dominant corporation prevail [8]. The existing center is responsible for all initiatives taken up in the network, aiming at attracting, developing, motivating and retaining the best or highly effective individuals. Of key importance here is the degree of centralization of taken decisions. It is necessary to determine to what extent the design solutions concerning: planning employment in the network, recruitment and selection – that is acquiring new partners in the network, motivating and rewarding network participants together with the evaluation of their development potential and work effectiveness, improvement and development of particular units functioning within the network, should be uniform or varied. In case of centric structures, the authority to shape particular activities in the area of HRM is closely regulated and controlled by the dominant center and it is attributed to centralization of decisions on one particular level. This is the orientation based on seniority and responsibility, in which the position of network participants depends on the scope of their responsibility according to the size of controlled resources. In this situation, shaping or designing particular HRM policies or practices is in the hands of the unit dominating the network structure. The unit is perceived as the “creator” of particular solutions, as most initiatives come from it. The actions and solutions imposed or initiated by it naturally stem from the aims and intentions of this dominant unit, confirming its power and authority within the network. It assumes a formalized shape then, its advantages being coherence, lack of ambiguity and better understanding by network participants. The designed solutions should meet the requirements of internal coherence and attractiveness and simultaneously be durable and stable. Shaping their own internal structure gives the network participants a feeling of being fairly treated and affects their motivation to work and to get involved. What matters for such network organizations is not willingness to participate in the network, but the effects and results generated in a particular structure. These decisions are connected with establishing measures of effectiveness (mostly quantitative ones) reflecting either aggregated or individual effects. This situation calls for cyclical verifications conducted in regular periods of time. Therefore the requirements towards network participants are clearly specified, tested solutions are valued as they guarantee achievement of expected results and they are quite conservative and certain.

In case of centric/changeable networks, power shifts from one center to another in particular issues. The center at a particular moment is a unit which possesses key or outstanding competencies, vital for the functioning of the network. It then plays the role of a coordinator and/or organizer of activities in a particular area of HRM. It is also responsible for the flow of human resources and tangible and intangible assets between network participants. The relationships reflect hierarchical interdependencies (which cause top-down direction), in which power is held by one center. This is not a permanent relation though, as if necessary, this function is passed on to another unit. Moreover, the analyzed decision center, being located in various places in the network, may take on different forms. It may be an organization or a specially designed network team, consisting of people delegated by particular partners. The composition of this team may also be subject to changes and modifications. As a result, in this type of inter-organizational networks, there is flexibility within a particular system, however, without any unnecessary organizational disturbances the system may be re-configured in a short period of time. The shift of power and authority from one center to another in particular issues to some extent encourages creativity, learning and experimenting, and also enables flexible use of possessed resources and competencies of various entities composing the network. The shaping of policies and practices in the area of HRM results from the activities of units which are higher in the organizational hierarchy. The policy is “suggested” to particular network participants through concrete actions taken at a particular time by the decision center. In this way it is implied which solutions are desirable from the point of view of the dominant center and which should not be considered in future actions. They become at particular time a set of guidelines for making further decisions. On the other hand, the pressure of the surroundings may also be seen as the source of creating particular solutions. In other words, HRM policies may be imposed from outside, by certain pressure groups. Usually, these areas are characterized by some degree of formalization of solutions. Particular network structures may emerge and shape freely, being more flexible and increasing the significance of relations and ties between particular units. Relations, together with behaviors, may become values for themselves, pushing aside such attributes of effective acting as generated effects or achieved results. They do not become less valuable, but they only remain less entangled in cause and effect dependencies with existing relations. Then, special attention is paid to the quality of these relations, reflected in particular behaviors of network participants.

Pluralistic/permanent structures are the ones in which the existing relations are similar in a long period of time, but no unit dominates over others. This situation is attributed to the fact that on one hand, network structures must achieve the state of coherence and harmony in basic areas, on the other hand, though, they



require a certain degree of decentralization and differentiation. Therefore we can talk here of networks of equal partners with similar bargaining power. There are more centers of responsibility which allocate tasks and actions. As a result, the partnership here is of long-term type. The choice of several centers does not limit the autonomy of any network participant, as each of them has equal possibilities to take up actions in particular areas. Due to this the responsibility for designing solutions in HRM is decentralized through delegating most responsibilities and power to the level of a particular unit. This situation may be caused by diversity of organizational and legal forms and mutual ownership systems of network participants. Of course, striving at elimination of hierarchical relations does not mean that there is no leadership in a particular network structure. Leadership exists though it takes on slightly different forms. Decisions concerning resources are made not only integrally by particular units, but also collectively, which accounts for specific participation in management [23]. The share of particular network participants in decision making is related to the possibility of exerting influence on the shape of HRM policy in the network. This assumption may intensify their involvement and translate into better functioning. However, due to diversity of units functioning within the network, the choice of HRM policies and practices is quite wide. They can be differentiated for various groups of partners, covering most network participants (then they are called universal) or only selected groups (then they are selective). The atomization of solutions tailored to different needs and expectations of particular units strengthens individualization of relations prevailing in the network. The starting point for designing actions concerning the analyzed area is determination of objectives that a particular unit wants to achieve and taking into account its needs and expectations. As these objectives are rarely changed or modified, it is very likely that designed solutions will not be subject to frequent changes. The foundation for designing specific HRM policies and practices could be current or periodical evaluations of effects, conducted in regular periods of time, concentrating on the evaluation of results (measurable results, usually in quantitative form). No matter how we create specific HRM policies and practices, they are not always clearly formulated within the network. In this case, HRM policies take the shape of permanent general management philosophy or a specific approach to making decisions within the network structures. They are not formalized then, but only implied.

On the other hand, pluralistic/changeable networks can be identified with chaotic networks, organized and orderly in a short period of time, in which there are no centers nor there is dominance of one unit, but there are only particular concentrations of interests. In this case we can talk of the networks of units with similar bargaining power and being equal partners. However, they often take the shape of “satellite” forms, subject to constant changes and functioning in

a given configuration for a short period of time. This excessive individualism may lead to partial decomposition of social ties resulting from belonging to the network, and cause atomization of the existing organizational solutions, including those concerning HRM. Questioning hierarchy as the foundation on which the network functions leads to replacement of hierarchic ordering and supervising dependencies with horizontal relations. Eliminating hierarchic relations brings greater flexibility of proposed solutions, greater willingness to take risks, better adaptability and more support for innovativeness, creativeness and entrepreneurial activities [12]. In other words, creating flat and not hierarchical structures may eliminate potential barriers to innovative activities. The reality of pluralistic-changeable network organizations is less structured and organized and more complex than the units functioning in a more traditional way. Therefore rigid procedures and inflexible organizational HRM policies and practices should limit it less. The introduction of various rules and regulations, excessive formalization and centralized decision-making may in this case lead to slowing down innovative activities, limiting creativity and flexibility and hamper pro-active decision-making necessary for realization of effective entrepreneurial ventures. Increasing flexibility of operating results from elimination or weakening existing hierarchic relations, bottom-top direction, complex information-communication relations and ties, greater participation and finally, increased level of innovativeness [23]. According to this reasoning, in pluralistic-changeable network organizations, HRM philosophy should be mostly based on creating value, and network participants should be assessed for the value they generate and the contribution they make to increasing the value of relations within the network. Therefore their behaviors are also verified, which calls for using subjective, qualitative measures. These few elements determine their position in the network structure. This situation forces organizations to conduct verification and to evaluate sporadically, possibly in irregular periods of time. It is beneficial, as many innovative, creative ventures or solutions need time to develop. As the risk is associated with failure, verification of the contribution made by particular units into the functioning of a given network structure, as well as concrete HRM policies and practices, should reflect tolerance for failure, while relations and network structure should assess the degree in which participants contribute to creating value of the organization. An effective source allowing creation of particular HRM policies and practices in case of pluralistic-changeable networks are specific circumstances or exceptional situations in which partners functioning within the network are. Great changeability in the network and outside it, as well as resulting lack of knowledge of participants of specific ways of behavior accounts for frequent “reference” to particular precedents. Taking decisions on the basis of developed guidelines leads to the creation of some kind of “common

law”, based on information concerning previous incidents. These precedents after some time become “a guide” for potential future activities. This situation may refer to the necessity of establishing a reference point, that is to constant monitoring and comparing with organizations functioning outside the network, taking into account external context.

## **5. Conclusion**

The discussion of HRM guidelines in the network was conducted basing on the assumption that the choices made by an organization, covering identified HRM contradictions, will depend on the nature of relations and the arrangement in the network. The result of the above considerations is a list of guidelines for designing HRM policies and practices, most beneficial from the perspective of these two dimensions which are essential discriminants of particular types of network organizations. The list is not complete as it represents only a set of key strategic guidelines helpful in designing particular HRM solutions in a given type of network organization.

In network organization the shaping and implementation of proper HRM policies and practices should be subordinated to specific rules, that is the dimensions of this policy must meet the requirements imposed by the nature of the relations (in which structures emerge or are quite permanent), as well as requirements of the type of ties (with one or a few centers). The above considerations based on the assumption that properly shaped and suitable for particular type of network organizations HRM policies and practices greatly help attract the best and most valuable network partners, retain them in existing structures, encourage them to constant improvement and motivate to achieve better effects of their work. In this way they facilitate the realization of the objectives network organizations have, strengthen the position of the network structure and support key success factors of network partners, leading to increased effectiveness.

What is more important, the selected HRM policies and practices should be internally coherent and consistent [15]. Unfortunately, not many empirical studies confirm or reject proposed assumptions. Going further this way we should notice that although there are certain premises for mutual match of decisions concerning HRM to particular types of network organizations, specialist literature does not offer empirical studies analyzing such dependence. On the basis of proposed configurations of contradictions specified for particular guidelines, one could prepare research on realization of HRM policies and practices, though the interpretation of obtained results will pose a serious challenge.

Summing up, HRM in network organizations largely depends on individual assumptions of the researcher or on the community of a given organization. The network is such a large and complex notion, that network organizations practically appear in all structural forms and in a sense permeate all types of organizations. We can assume the existence of some unchangeable, quite permanent “core” characteristic of network organizations (depending on the ontological and axiological approach of the researcher or decision-maker) or for the reflected paradigm or fundamental scientific assumptions concerning the nature of the organization.

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**Bernard Ziębicki\***

## **MANAGERIAL COMPETENCIES IN THE CONTEXT OF CONTEMPORARY MANAGEMENT CONCEPTS AND METHODS\*\***

### **Summary**

*The article presents the required management competences from the perspective of contemporary management concepts. As the main concepts we have presented: knowledge management and learning organization, Total Quality Management, processes management, Kaizen and elimination of waste, virtual and network management and time based management. The most important management competences connected with above concepts are: focus on outside and effectiveness, care about efficiency in work environment, introduction of changes and team working. The article describes the specificity of the managers' tasks and development of the research on management competences and skills in the management science.*

### **1. Introduction**

Management is usually associated with exercising power, influencing others, possessing special authorities. In reality managerial work is a hard and responsible task, requiring great, often interdisciplinary skills and huge involvement. Perception of managerial work as only the source of power, possibilities of subordinating others and deriving greater benefits is always harmful both for the subordinates and the whole organization. Such attitudes can only be maintained in organizations which do not operate in a competitive environment or which are tied to a strong lobby drawing particular benefits from maintaining the status quo. In market conditions, managers of all levels are expected to possess the highest level of competencies and effectiveness.

Executives' competencies and their roles change together with external and internal conditions in which an organization functions, as well as a result of general civilization progress constantly taking place.

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This paper states that contemporary management concepts and methods which are most commonly used in economic practice and which to a large extent determine contemporary approach to management, require that executives possess particular competencies and roles in an organization.

The purpose of the article is to present competence requirements related to executives, connected with most popular contemporary management concepts and methods.

## **2. Specificity of managerial work**

Managerial work is mostly associated with performance of basic management functions, namely planning, organizing, motivating and controlling. Many authors also emphasize the manager's role and skills in selection of proper employees, distinguishing "personnel recruitment" as an additional, essential function performed by executives [Bittel 1989, p. 18].

The above method of defining managerial functions is based on the concept developed by H. Fayol, one of the outstanding representatives of the so-called universalist, scientific management trend [Martyński 2002, p. 7].

According to H. Fayol, the functions constituting the essence of management (then defined as "administrative activities") are: anticipating, organizing, ordering, coordinating and controlling. *„Anticipating consists in analyzing the future and determining the appropriate action plan; organizing is establishing a double organism of an enterprise: material and social; ordering is causing the personnel to function; coordinating is combining, unifying and harmonizing all activities and efforts; controlling is checking that everything is going on in accordance with established regulations and given orders”* [Fayol 1947, p. 37].

A totally different definition of managerial functions was provided by Ch. Barnard, representative of the so-called humanistic approach to scientific management. In his opinion, the fundamental role played by an executive in an organization is „to serve as a communication channel as much as some messages must go through central positions” [Barnard 1997 p. 235]. The main function of management is provision of communication system which allows us to coordinate all aspects of an organization. Realization of this function consists of creation of particular organizational structure and executive positions which ensure realization of communication system at various levels of organizational hierarchy. Special importance within this function was attached by Ch. Barnard to informal management organization, connected with mutual adjustments of managers, related to such individual features as: education, age, sex, individuality, prestige, race, and to personal features such as: manners, way of speaking, or appearance. These factors according to the author play a more significant role in such organizations as: political, union, church and university

organizations than in industrial ones. They are responsible for situations in which people cannot be promoted or selected, although it has nothing to do with their formal competencies [Barnard 1997, p. 244].

Apart from ensuring communication, an executive, according to Ch. Barnard, performs two more functions: „*exacting basic services from individuals*” and „*formulating the main objectives and partial aims*”. Exacting services from individuals requires maintaining a system of incentives, providing sufficient disciplinary measures, supervising and controlling, inspecting, as well as educating and training. Defining objectives consists mainly in establishing a set of activities and their proper allocation as well as delegating authority [Barnard 1997, p. 247].

Managerial work is still the subject of research conducted by specialists in organization and management. The emergence of new management concepts as well as market changes necessitate work on identifying further determinants of effective management. This problem is not only important for management theories but also for supporting branches of science, such as organizational psychology or sociology.

### **3. The essence of managerial competencies**

The origins of the concept of employee competencies date back to the 1970s and 1980s [Filipowicz 2004, p. 14]. They are connected with research conducted by D. McClelland [McClelland 1973] and R. Boyatzis [Boyatzis, 1982].

The forerunners of research on employee competencies are claimed to be F. Galton and J. C. Flanagan. The latter is the author of the critical incident technique, consisting in analyzing human behavior and actions with reference to situations with known consequences. The technique was developed at the end of the 19<sup>th</sup> century as a result of continuation of research conducted by F. Galton and still remains one of the basic tools for assessing employee competencies [Dubois, Rothwell 2004, pp. 32-33].

The influence of managers' individual features on management effectiveness was the subject of research carried out not only by scientists specializing in competencies. This problem has accompanied research practically since the beginnings of management knowledge. The concept of competencies was not known then, instead, skills or features of employees (managers) were used. The essence of conducted research, however, was convergent with contemporary research on employee competencies.

The first management researcher who dealt with this issue was F.W. Taylor. On the basis of many years of observations and research, he indicated nine features which should differentiate a “model” master (“first line” manager):



intelligence, experience, technical knowledge, tactfulness, firmness, honesty, common sense, health. In his opinion “*it is hard to find a man who would possess five advantages listed here, not to mention someone with six or seven of them*” [Taylor 1947, p. 24].

Extensive research devoted to managerial abilities and their influence on management effectiveness was also carried out by H. Fayol. He determined the relationship between abilities of managers and the organizational function they perform and the size of an enterprise. Fayol distinguished the following categories of abilities: administrative (in management), technical, commercial, financial, securing, accounting. He was the first to point out that the higher the management level, the more desirable it is when managers possess general skills and abilities connected with broadly understood management. Managers of middle and lower level are above all expected to possess advanced abilities in narrow specialist fields which constitute management areas (Table 1).

**Table 1.** Relationship between managerial skills (competencies) and management level in a large industrial enterprise

Type of position	Percentage share of skills					
	Administration (in management)	Technical (production management)	Commercial	Financial	Securing (protecting people and property)	Accounting
Director of a large multi-branch enterprise	50	10	10	10	10	10
Director of a large single branch enterprise	40	15	15	10	10	10
Assistant Technical Director	35	30	10	5	10	10
Head of department	30	30	5	5	10	20
Head of section	25	45	5	-	10	15
Foreman	15	60	5	-	10	10
Worker	5	85	-	-	5	5

Source: [Fayol 1947, p. 44].

A relationship concerning required managerial skills similar to the one above exists as regards the size of an enterprise. The larger the size, the more managers are expected to possess general skills [Fayol 1947, p. 41].

The issue of managerial skills and their role in management was the subject of research conducted by other forerunners of organization and management theories, such as: H. Ford, T. Bata, Michelin brothers [Martyniak 2002].

The fundamental development of research on managerial skills and competencies took place in the 1990s and at the beginning of the 21<sup>st</sup> century.

Despite numerous scientific works on competencies, the term has not been precisely and unambiguously defined.

*„Competence, competencies, competence models or competence-based trainings are the words which may mean whatever the person uttering them wants them to mean. The source of this problem is not maliciousness, stupidity or marketing greed, but fundamental procedural and philosophical differences characterizing people who try to define these terms and develop their concepts”* [Dubois, Rothwell 2004, pp. 32-33].

Competencies are usually defined as *„predispositions in knowledge, skills and attitudes, which enable us to perform professional tasks at appropriate level”* [Filipowicz 2004, p. 17]. In this way employee competencies are also defined in British and American models of National Qualifications Standards [Rakowska, Sitko-Lutek 2000, p. 11.]. According to the British standard referring to education in business, competencies are: *„an ability to perform activities connected with one’s profession or function in line with expected standards”* [BTEC 1990, pp. 1-22]. According to this definition, competencies should be understood as individual features which allow effective performance of determined roles.

Some authors emphasize that competencies are not only factors limited to obtaining “standard” results by an employee. According to G. Klemp, the main property of competencies is *“possibility of achieving above-average results”* [Klemp 1980, s. 23].

There is no agreement as regards elements of competencies. According to D. Dubois, W. Rothwell, as far as the differences regarding elements of competencies are concerned, we can distinguish two trends. The first one states that competencies cover knowledge and skills, while the second one holds that competencies are all the features that allow a particular person to achieve determined results [Dubois, Rothwell 2004, p. 35].

According to O. Gupta and G. Roos, competencies consist of: skills, intellectual abilities and attitudes [Jabłoński 2009, p. 84] (Table 2).

**Table 2.** Attributes of employee competencies

Synthetic attributes	Elementary attributes
Skills	Skills appropriate for performed function in an organization Abilities improving status quo Entrepreneurial skills Selling skills
Intellectual abilities	Ability to innovate Ability to transform scientific discoveries and ideas into practical use Ability to think independently Versatility, keen mind
Attitudes	Ability to adapt to new organizational culture Ability to work in groups Willingness to share knowledge, experiences, observations Willingness to learn and self-develop Creativity Openness and willingness to use new ways in new applications

Source: [Gupta, Roos 2001, quoted after: Jabłoński 2009, p. 84].

According to the above proposal, skills are a component of competencies. This is confirmed by a great number of researchers [Boyatzis 1982; Yukl 1989; Cameron, Whetten 1983; Nogalski, Śniadecki 1998; Rakowska, Sitko-Lutek 2000]. There are also opposite views, stating that skills are a wider concept category than competencies [Priem 1981].

One could conclude then that together with the development of employee and managerial competencies concept, research on skills was aborted or incorporated into competence area. This was not the case. Skills, especially managerial skills are still the subject of various research and publications, also by Polish scientists. One could quote here the works of: G. Bartkowiak and H. Januszek [1997], B. Nogalski and J. Śniadecki [1998], J. Penc [2005].

What is then the difference between competencies and skills? B. Nogalski and J. Śniadecki explain it referring to the common understanding of these concepts: „*competencies are acquired in various ways, while skills must be learned*” [Nogalski, Śniadecki 1998, p. 98].

According to T. Oleksyn, managerial competencies should be analyzed separately. Their essence consists in ability to manage efficiently, effectively and ethically [Oleksyn 2006, p. 21]. Competencies of executives, both the expected and the actual ones, depend on many factors. They are different for top and line managers. They also depend on organizational culture, external conditions in which an organization functions, as well as on the type of conducted activity (business, public) or used methods and concepts of management.

The confirmation of the above opinions is the multitude of managerial competencies definitions presented in Table 3.

**Table 3.** Managerial competencies by various authors

R.E. Boyatzis	A. Rakowska, A. Sitko-Lutek	T. Oleksyn
Focus on effectiveness Seeking influence Pro-activeness Self-confidence Communication skills Conceptual skills Achieving objectives by influencing interpersonal relations Ability to apply models and methods Ability to work with a team	Technical skills Increasing own effectiveness Stress management Conceptual skills Communication skills Ability to motivate Winning power and influence Ability to solve conflicts Ability to work with a team Introducing changes	Effectiveness and efficiency Ability to select co-workers External orientation Responsibility Ethical conduct Credibility Kindness Reliability Generosity Ability to discern mutual interests Ability to understand others Ability to cooperate with people and to influence them effectively Ability to sense other people's needs Determination Participative leadership style Ability to combine the global vision with attention to detail Technical (specialist) knowledge

Source: own elaboration on the basis of: [Oleksyn 2006; Rakowska, Sitko-Lutek 1998; Boyatzis 1982].

Competencies and skills are associated with roles of executives in an organization. *“By the role we usually understand a set of tasks and behaviors determining what managers should or can do...”* [Nogalski, Śniadecki 1998, p. 81]. Particular roles are associated with using determined competencies, which often constitute an essential element of a given role.

#### **4. Evolution of roles and competencies of executives in management**

The issue of managerial roles and competencies evolution has been analyzed in many publications. Some of the most extensive research was conducted by R.E. Quinn and his colleagues from Harvard University.

The above researchers distinguished four main periods associated with the origin of new management models and essential change of executive roles and competencies.

The first model, defined as “rational goal” was connected with the development of management theory in 1900-1925. Managerial activities in this model boiled down to clear definition of goals, selection of appropriate methods of work and supervision guaranteeing their effective achievement. The basic effectiveness parameters in the analyzed model are: productivity and profit.

The second model, referring to the same period of time, is the “internal process model”. It was connected with seeking possibilities of ensuring management effectiveness through creation of hierarchic system, based on highly formalized relations within an organization. This model is often commonly called “organizational bureaucracy”. The basic parameters of effectiveness in this model are: stabilization and continuity.

The next model is related to research initiated by E. Mayo, concerning the influence of work satisfaction on achieved productivity. This is the model of “interpersonal relations”, developed in 1926-1950. This model contradicts the previous two models. Its main orientation is towards development of teamwork, participation, solving conflicts and reaching consensus. By providing better organizational climate, based on equality and individual approach to employees, it is expected to achieve high level of organizational effectiveness. Its main criteria are: involvement, integrity and morale.

The last model, related to development of management in 1951-1970 is the model of “open systems”. Its assumption was that organizations operate in highly competitive environment, but also deal with certain ambiguity. The main task of executives is to adjust actions to changing conditions, to develop innovation processes and to obtain external support. The basic criteria of assessing organizational effectiveness in this model are: flexibility and external support [Quinn, Faeman, Thompson, McGrath 2007, pp. 34-39] (Table 4.).

**Table 4.** Evolution of executive roles and competencies

Management model	Executive's role	Key competencies	Criteria of organizational effectiveness
Model of rational goal	Managing function	1. Formulating and passing on vision. 2. Setting goals. 3. Designing and organizing.	1. Productivity. 2. Profit.
	Performing function	1. Personal effectiveness. 2. Looking after efficient work environment. 3. Time management and dealing with stress.	

Management model	Executive's role	Key competencies	Criteria of organizational effectiveness
Model of internal process	Monitoring function	1. Managing information by means of critical thinking. 2. Dealing with information overload. 3. Managing basic processes.	1. Stabilization. 2. Continuity
	Coordinating function	1. Managing projects. 2. Designing work. 3. Inter-functional management.	
Model of interpersonal relations	Moderating function	1. Building teams. 2. Group decision making. 3. Managing conflict.	1. Involvement. 2. Integrity. 3. Morale.
	Mentoring function	1. Understanding oneself and others. 2. Effective communication. 3. Developing employees.	
Model of open systems	Innovating function	1. Accepting changes. 2. Creative thinking 3. Managing change.	1. Flexibility. 2. External support.
	Intermediary function	1. Building and holding power. 2. Negotiating agreements and obligations. 3. Presenting concepts: effective verbal presentations.	

Source: own elaboration on the basis of:[Quinn, Faeman, Thompson, McGrath 2007, pp. 43-44].

The analyzed models present different orientations in managerial functions. Contemporary management usually requires joint use of all four management models. The combination of the analyzed models is the concept of competing values, assuming their joint, situational use [Robbins 1990, p. 70]. In accordance with the essence of the competing values model, contemporary managers are expected to perform a number of roles simultaneously. They should: manage, perform, monitor, coordinate, mentor, moderate, innovate and serve as an intermediary. Each role is connected with different competencies requirements.

## 5. Contemporary management concepts vs. managerial competencies

Contemporary concepts and methods are subject of many publications. The best-known works on this issue were written by: K. Zimniewicz, Z. Martyniak, K. Perechuda and J. Brilman. Most management concepts and methods identified as contemporary ones by the above authors are similar. The differences mostly concern the degree of precision adopted by a particular system.

**Table 5.** Major contemporary management concepts presented by various authors

<b>K. Zimniewicz</b>	<b>Z. Martyniak</b>	<b>K. Perechuda</b>	<b>J. Brilman</b>
Benchmarking	Benchmarking	Fractal organization	Total Quality Management (TQM)
Outsourcing	Reengineering	Intelligent enterprise	Benchmarking and reengineering
Virtual organization	Shigeo Shingo system	Virtual organization	Horizontal (process) enterprise
Lean management	Hoshin method	Integrated management	Knowledge and competencies management
Internal competition	Lean management	Learning organization	Network and vast enterprise
Knowledge management	Workflow systems	Process management	
Management by Values	Self-organization	Network organization	
Time Management	Internal marketing	Benchmarking	
Reengineering		Outsourcing	
Process management			

Source: own elaboration on the basis of [Zimniewicz 2008, Martyniak 2002; Perechuda 2000; Brilman 2002].

We can assume that these concepts and methods can be assigned to six major areas:

1. Knowledge management and organizational learning.
2. Total Quality Management.
3. Process management.
4. Kaizen and elimination of waste.
5. Virtual and network management.
6. Time Based Management.

Knowledge management and organizational learning are management concepts consisting in building organizational potential by acquiring and implementing knowledge (both open and hidden) in operations of an organization. An organization which consciously uses the presented processes for improving its functions and development, is defined as a “learning organization” [Maier 2002, p. 48; Mikuła 2006, pp. 117-134]. The term “learning organization” was popularized in organization and management theory by P. Senge [Senge 1998, p. 26]. He claims that a “learning organization” is based on five pillars which he calls disciplines: systems thinking, personal mastery, mental models, building shared vision and team learning.

Systems thinking consists in moving away from simplified perception of an organization with simple cause and effect relations and replacing it with search for multi-faceted relations which jointly determine the success of an organization. Personal mastery regards each employee’s awareness and motivation related to their improvement and self-development. Building shared

vision is associated with identification of all employees with adopted direction of development and system of values in an organization. Team learning refers to processes of sharing knowledge in an organization and providing conditions for using knowledge to build its potential [Senge 1998]. Knowledge management and organizational learning are also connected with: benchmarking, coaching, mentoring, as well as competencies management.

Total Quality Management is often described as the leading (“mega”) concept of contemporary management [Brilman 2002, p. 225]. According to ISO 8402 norm from 1994, total quality management is *“a way of managing the whole organization, concentrated on quality, based on participation of all organization members and directed at achieving long-term success thanks to satisfaction of customers and benefits for all organization’s members and for the society”* [Leksykon zarządzania 2004, p. 672]. Operational dimension of TQM boils down to using improvement tools and initiating activities for continuous improvement. The main principles of this concept are: customer orientation, process approach, leadership, employee involvement, systemic approach to management and continuous improvement [Leksykon zarządzania 2004, p. 672].

Process management is the opposite of functional management deeply rooted in economic reality. It consists in grouping activities into systems of processes transforming particular supplies into products or services. Compared to functional approach, this solution is connected with lower running costs (leaner system), increased level of creating value for customers, and with higher innovativeness and operational efficiency. The approach is characterized by: flatter organizational structure, task orientation and high autonomy of executive workers [Grajewski 2003, p. 114].

Kaizen and elimination of waste are concepts taken from Japanese model of management. Waste is understood here in a specific way. According to T. Ohno, there are seven forms of waste existing in contemporary enterprises: overproduction, stocks, deficiencies, unnecessary movements, unnecessary processing, waiting, unnecessary transport. This list is sometimes supplemented with irregularity of production processes (lack of harmony, according to Adamiecki method) and excessive overload [Imai 2006, p. 115]. In companies which do not use Japanese management methods, the presented situations are often treated as normal phenomena, always accompanying business processes, not as sources of potential savings.

Waste prevention in the Japanese model of management is connected with continuous perfection by implementing a great number of small improvements proposed by production workers. This is the essence of the Kaizen approach [Imai 2006, p. 51]. Other major features distinguishing the Japanese approach to management which is gaining popularity all over the world are team work and



job rotation, process management and work standardization, update on results, customer orientation and added value priority, instant elimination of causes of mistakes, treating workers as the most important resource of a company.

Virtual and network management are connected with creation of organizational units spatially dispersed, realizing joint venture which is to bring them bigger benefits than if they operated traditionally [Klonowski 2000, p. 193]. The origin and development of this concept became possible mainly thanks to modern information and communication technology, significantly limiting barriers to international cooperation.

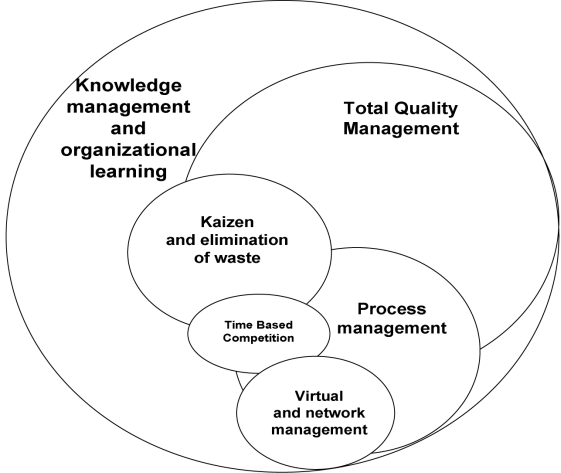
Time based management consists in building competitive advantage by shortening business processes completion time. Actions focus on the following aspects:

- time of launching a new product or launching a product into a new market,
- service time – period of time from placing an order to delivering a product to a customer,
- reaction time – the time that passes from change in demand to company reaction to it.

The effectiveness of management in this concept is related to completion of the above processes in a shorter time than our competitors. This requires constant comparisons with other organizations and immediate reaction in form of changes introduced to processes [Laskowska 2001].

The above concepts are interrelated. Usually some of them are elements of others. The broadest concept seems to be that of knowledge management and organizational learning, without which it is practically impossible to use any concept effectively (Figure 1).

**Figure 1.** Relations between contemporary management concepts



Source: own work.

The features of presented concepts translate into competence requirements from executives and employees. However, the effectiveness of implemented concepts depends mostly on executives, located in various levels of management. The main competencies that executives are expected to possess are presented in the table below (Table 6).

**Table 6.** Desirable competencies of executives related to the main contemporary management concepts

Concepts:	Features/principles:	Desirable competencies of executives:
Knowledge management and organizational learning	<ul style="list-style-type: none"> <li>• continuous personnel training, planned trainings, coaching; creating conditions for full use of employee competencies;</li> <li>• delegating authority, decentralization of management;</li> <li>• encouraging experimenting,</li> <li>• routine revision of operational procedures;</li> <li>• encouraging questioning work effectiveness,</li> <li>• making decision on empirical basis,</li> <li>• team work,</li> <li>• systems thinking,</li> <li>• personal mastery,</li> <li>• mental models,</li> <li>• building shared vision,</li> <li>• team learning,</li> </ul>	<ul style="list-style-type: none"> <li>• ability to cooperate with people and to influence them,</li> <li>• communication skills,</li> <li>• ability to work with a team,</li> <li>• introducing changes,</li> <li>• external orientation,</li> <li>• ability to recognize mutual interests,</li> <li>• participative leadership style,</li> <li>• ability to combine general vision with attention to detail,</li> </ul>
Total Quality Management	<ul style="list-style-type: none"> <li>• customer orientation,</li> <li>• leadership,</li> <li>• employee involvement,</li> <li>• process approach,</li> <li>• systemic approach to management,</li> <li>• continuous improvement,</li> <li>• decisions are made based on facts,</li> <li>• mutually beneficial relations with suppliers,</li> </ul>	<ul style="list-style-type: none"> <li>• external orientation,</li> <li>• ability to cooperate with people and to influence them effectively,</li> <li>• ability to work with a team,</li> <li>• ability to combine general vision with attention to detail,</li> <li>• introducing changes,</li> <li>• orientation towards effectiveness,</li> <li>• conceptual skills,</li> <li>• participative leadership style,</li> </ul>
Process management	<ul style="list-style-type: none"> <li>• customer orientation,</li> <li>• added value priority,</li> <li>• result orientation,</li> <li>• flatter structures,</li> <li>• monitoring processes</li> <li>• innovativeness,</li> <li>• clear allocation of responsibility</li> </ul>	<ul style="list-style-type: none"> <li>• orientation towards effectiveness,</li> <li>• ability to work with a team,</li> <li>• introducing changes,</li> <li>• external orientation,</li> <li>• caring for efficient working environment,</li> <li>• conceptual skills,</li> </ul>

Concepts:	Features/principles:	Desirable competencies of executives:
Kaizen and elimination of waste	<ul style="list-style-type: none"> <li>• team work and job rotation,</li> <li>• process management and work standardization,</li> <li>• current information about results,</li> <li>• customer orientation and added value priority,</li> <li>• continuous, gradual improvement,</li> <li>• instant elimination of sources of mistakes,</li> <li>• treating employees as the most important resource in the organization,</li> </ul>	<ul style="list-style-type: none"> <li>• orientation towards effectiveness,</li> <li>• ability to work with a team,</li> <li>• ability to work with people and to influence them,</li> <li>• technical knowledge,</li> <li>• introducing changes,</li> <li>• external orientation,</li> <li>• caring for efficient working environment,</li> <li>• conceptual skills,</li> </ul>
Virtual and network management	<ul style="list-style-type: none"> <li>• spatially dispersed,</li> <li>• business partnership,</li> <li>• system of network ties,</li> <li>• high level of information and communication technologies,</li> <li>• overcoming barriers of distance and competencies,</li> <li>• trust,</li> </ul>	<ul style="list-style-type: none"> <li>• external orientation,</li> <li>• ability to combine general vision with attention to detail,</li> <li>• technical knowledge,</li> <li>• ability to recognize mutual interests,</li> <li>• communication skills,</li> <li>• ability to work with a team</li> </ul>
Time Based Management	<ul style="list-style-type: none"> <li>• perfecting process flow,</li> <li>• elimination of expectations, repetitive work, “bottlenecks”;</li> <li>• production flexibility,</li> <li>• optimization of deliveries,</li> <li>• analyzing competitors’ processes.</li> </ul>	<ul style="list-style-type: none"> <li>• external orientation,</li> <li>• introducing changes,</li> <li>• caring for efficient working environment,</li> <li>• orientation towards effectiveness.</li> </ul>

Source: own elaboration.

The above table covers only managerial competencies pointed out by already mentioned researchers (R.E. Boyatzis; A. Rakowska and A. Sitko-Lutek, T. Oleksyn, R.E. Quinn) as those which characterize contemporary executives. Determining proper competencies for particular concepts, we limited them to the most essential ones. Competencies of lesser significance and base ones, such as ethical conduct, credibility, expertise, etc., have been omitted.

## 6. Significance of particular managerial competencies for contemporary management concepts

As we can see from the above analysis, contemporary management concepts are associated with the following twelve expected executive competencies:

- external orientation,
- participative leadership style,

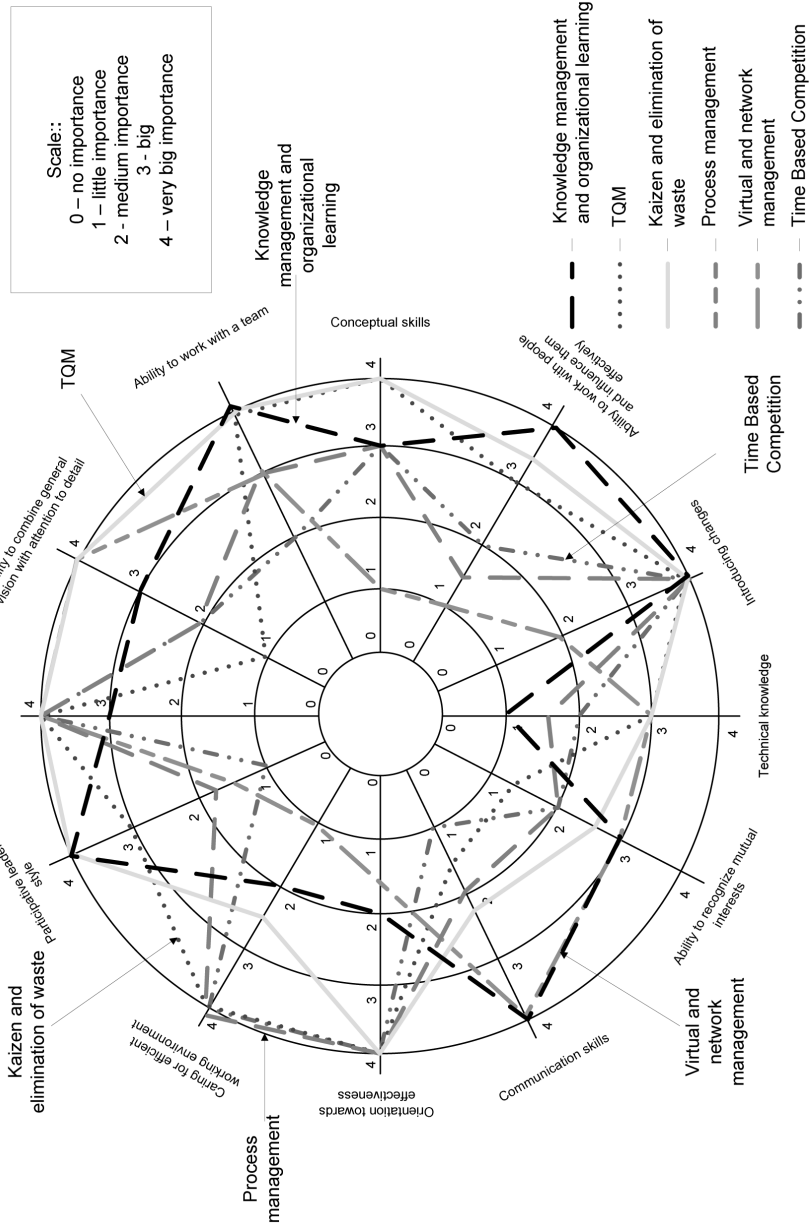
- caring for efficient working environment,
- orientation towards effectiveness,
- ability to combine general vision with attention to detail,
- ability to work with a team,
- conceptual skills,
- ability to work with people and to influence them effectively,
- introducing changes,
- communication skills,
- ability to recognize mutual interests,
- technical knowledge.

The significance of the above competencies in particular concepts varies. It was presented in the figure below (Figure 2).

In knowledge management and organizational learning, ability to work with people and influence them, participative leadership style, ability to work with a team, introducing changes and communication skills are the most important competencies. Total Quality Management requires executives to possess external orientation, using participative management style, orientation towards effectiveness, ability to combine general vision with attention to detail, introducing changes as well as conceptual skills and ability to work with a team. Kaizen and elimination of waste, on the other hand, is associated with orientation towards effectiveness and caring for efficient working environment, external orientation, conceptual skills, introducing changes and ability to work with a team. Process management is mostly about caring for efficient working environment, orientation towards effectiveness, introducing changes and ability to work with a team. In virtual and network organization the main expected managerial competencies are: external orientation, communication skills and ability to combine general vision with attention to detail. Time based management requires executives to be effectiveness-oriented, to care for efficient working environment, external orientation and to introduce changes.

From the above analysis we can conclude that the most frequently expected managerial competencies, connected with the majority of contemporary management concepts are: external orientation, orientation towards effectiveness, caring for efficient working environment, introducing changes and ability to work with a team.

**Figure 2.** Significance of various managerial competencies for contemporary management concepts



Source: own elaboration.

## 7. Conclusions

Managerial competencies are one of key success factors in management. Although this area has been intensively researched for over thirty years now, it is still treated as an open area, requiring further search. This is due to complexity of the competencies problem and their continuous evolution. There is no single, universal set of competencies. Their nature depends on many factors. One of them are requirements resulting from used management concepts and methods. Currently, the main management concepts are: Knowledge Management and Organizational Learning, Total Quality Management, Process Management, Kaizen and Elimination of Waste, Virtual and Network Management and Time Based Management). The main managerial competencies associated with these concepts are: external orientation, orientation towards effectiveness, caring for efficient working environment, introducing changes and ability to work with a team. These competencies may be considered core ones from the point of view of contemporary management concepts and methods.

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**Katarzyna Huk\***

## **CREATING A CORPORATE IMAGE IN THE CONTEXT OF TALENT MANAGEMENT**

### **Summary**

*The term "employer branding" is relatively new. It shows the trend in the labor market, to attract high-potential employees, with highly specialized knowledge – so called talents. Talent management is a relatively new concept that shows the company's management of its strategic capital which is human capital. An employer's brand which is positively perceived helps to attract talent into the ranks of employees, which is the main goal of the considerations contained in this paper. The paper is theoretical in nature and was based on the subject literature.*

### **1. Introduction**

Changes taking place in the market influence transformations in enterprises. Together with development of knowledge-based economy, the personnel function is beginning to be performed differently, which accounts for the evolution of management concepts. Time has brought change of attitude to employees. Currently they are perceived not as expense, but as capital capable of generating profits. Employers have noticed that people and their knowledge, abilities, competencies, skills and qualifications create the company's competitive edge. The only value which cannot be copied by competitors are employees. A current trend in the personnel function area is to pay attention to employees constituting a key resource for the company or standing out from the whole workforce. This accounts for the origin of talent management concept, which covers managing employees with high potential, broad competencies and impressive knowledge of some chosen specialization area. Currently most companies are struggling to attract and keep talents. Ideas, solutions, products and services can be copied, while human potential

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is unique and precious. Good financial terms are the basic but not the only factor influencing the employees decision to stay with the company. We can state that specialists and experts mostly decide where they want to work and change of workplace for them does not involve staying jobless for a long time. One of the elements attracting an employee with high competencies to a particular enterprise is its image. Many people, especially young ones, dream of taking up jobs in big, reputable corporations just after graduating from university. Most of such companies are considered “good employers”. This means that they enjoy positive opinion concerning good financial terms they offer, good atmosphere at work, favorable communication and cooperation, development prospects, stable employment, etc.

This paper deals with the essence of talent management and the impact of corporate image on attracting and maintaining talents in a company. The aim of the article is to describe the impact of creating a corporate image on the process of talent management, with special attention paid to attracting and retaining talented people in an enterprise. This paper is theoretical, based on studies in this area.

## **2. Creating corporate image**

The concept of corporate image originated in 1950s and quickly gained popularity. Significant contribution to the development of the image concept was made by P. Martineau. He noticed that the recipients of the corporate image are not only customers, but other groups of stakeholders as well: shareholders, employees, intermediaries, suppliers, potential clients or local communities [T. Dąbrowski p. 65]. Image is a broader category since we can talk of the image of the product, service, branch, person, etc. For the purpose of this paper our attention will be focused on corporate image.

Image is understood as our general opinion of an enterprise, shaped on the basis of our senses, impressions, opinions of other people and our perceptions. Each person shapes his or her image both in private and professional life. For example, the president of a large corporation at work may create his or her image of a meticulous, ambitious and analytical autocrat. This is the picture of an executive. However, in private life, he or she may be totally different: warm, caring, fun-loving and friendly. Our image is sometimes shaped by us quite unintentionally, but in this way we influence the opinions of other people. In enterprises image may also be shaped unintentionally, however, more often than not it is a mixture of carefully planned marketing activities. Creating corporate image is the responsibility of the public relations department. Strong influence on shaping opinions about a company is made by its employees, because it is the employee who is the true picture of a company. In service companies

a particular employee performs a given service for us. If we take a closer look at the banking sector, especially its corporate culture, its culture of appearance (in this culture strictly defined uniform clothes – a suit, a costume, a shirt and a tie – are obligatory) and behavior, we will perceive these employees as solid, reliable, diligent and professional people. This is the image of employees which builds the image of the whole sector of banking services.

Literature on this subject offers many definitions of the “corporate image” term. J. Szocki notices that “*image is a notional category, as it covers all described processes and phenomena related to the company*” [Szocki p. 13]. Therefore, as we mentioned earlier, we should not associate the corporate image only with its recipients – customers, and image-building activities with the public relations unit. Image activities should cover the whole company, together with its employees and tasks should be directed to a wider group of recipients, including both existing and potential employees. E.E. Gunther claims that “*image may be defined as something consisting of knowledge, feelings, ideas and beliefs concerning the company and being the effect of all its activities*”. [Dąbrowski p. 66] Our individual impressions and beliefs are the result of planned activities performed by the company but also the result of the opinion it has in the society as well as result from our experience.

Analyzing the concept of image, we should explain related concepts, sometimes considered equivalent, namely:

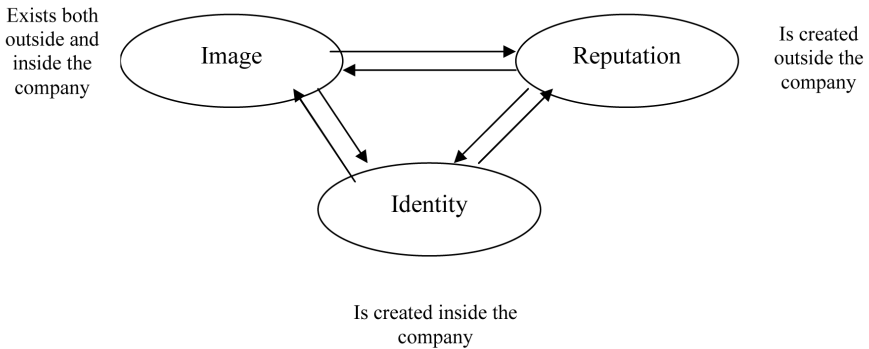
Image, reputation, brand, identity.

We can observe the following relations between these concepts:

- „Image may exist inside and outside the company. Inside it, it exists as a message constructed by the company or as a picture of the company in the employees’ minds. Outside it is an overall impression of the company, created by particular groups of people in its environment.” [Dąbrowski p. 67]
- „Identity is shaped inside the company and reflects its real personality, values, strategy, etc.” [Dąbrowski p. 67]
- Reputation is created outside the company. It is most often associated with corporate image. There are scientific disputes concerning these two concepts and so far we have not had a clear answer to the question whether these two are completely separate or connected.
- “Brand is the name, term, symbol, formula or their combination, created in order to identify goods or services of the seller, or their group and to differentiate them from competitors.” (definition provided by American Marketing Association) [Szocki p.19]

Relations between image, reputation and identity are presented in Figure 1 below.

**Figure 1.** Relations between reputation, image and identity



Source: T.J. Dąbrowski, *Reputacja przedsiębiorstwa*, Oficyna a Wolters Kluwer business, Kraków 2010, p.38.

In order to create a positive image in the society, companies build a strong brand, engage in social and charity appeals, organize pro-social campaigns, create the system of visual identification, organize integration meetings for their employees, develop their social policy, establish foundations operating at the companies, etc. Recently we have observed growing importance of corporate social responsibility, used by some companies to create their positive image. Therefore we can draw a conclusion that the corporate image may not reflect the reality but be artificially created by communication activities of the company.

Summing up, image may exist both outside and inside the company. In recent years the picture of the company as a good employer has gained importance. Managers pay attention to the employer image, try to attract specialists and to retain the already employed staff. The employer image also affects the purchases of the company products and services, as it is part of the overall company image creation. The image of a good employer is particularly important for attracting the best employees. If the company is considered a great employer, it will easily attract new candidates for work and also lower staff turnover thanks to the tools creating good jobs. In Poland we can observe more and more contests and awards being created, such as “Employer of the Year”, etc. These contests are very popular among companies participating in them. What really matters for people looking for a job is stable employment, good remuneration and opportunities of further development. These are attributes associated with a good employer. Many people looking for jobs, especially those with extensive knowledge and potential, before sending their applications, check the opinions and analyze the situation of the company they want to apply to. This situation forced employers to take care of their image if they want to attract the best workers.

The term „*employer branding*”, should be identified with the employer image. Employer branding is a narrow term and refers to the name of the company, while the image significantly influences the brand and its perception in the environment. If we hear the name of some company, we think about its brand, but this brand was shaped by the influence of the image. Therefore we will understand image as an overall process, while the brand will be the result of these activities. Creating positive employer image has two aims; the first one is connected with realization of personnel function, the second with marketing activities, that is with creating an overall good image of a company. In the never-ending fight for specialists and experts companies are trying to increase public awareness of their company and present it as an attractive place of work. The image of a good employer supports the process of attracting workers with high qualifications and competencies and helps the company win the so-called “war for talent”.

### **3. The essence of talent management**

Talent management appeared in 1990s in the USA together with popularization of the term “the war for talent”. Currently it is being widely analyzed in scientific and popular literature, although there is no clear definition of talent. Specialist literature defines talent management as:

- „*a set of activities related to exceptionally gifted people, aiming at developing them and achieving company objectives*” [Listwan, p.20];
- „*the use of individual abilities, passions and motivations the company has at its disposal in order to utilize them effectively to achieve the company objectives*” [Miś, p.40].

Literature does not offer a coherent and integrated definition of an employee as a talent. This causes a lot of confusion and misunderstanding connected with classifying employees as talents. Talent itself is interpreted as a feature and as a person who possesses it. Talent is:

- „*a person with an outstanding potential*” [Listwan p.20];
- „*accumulated gifts*” (J.W. Dawid) [Chełpa p.28].
- „*a gifted person*” [Robertson, Abeby p.12]

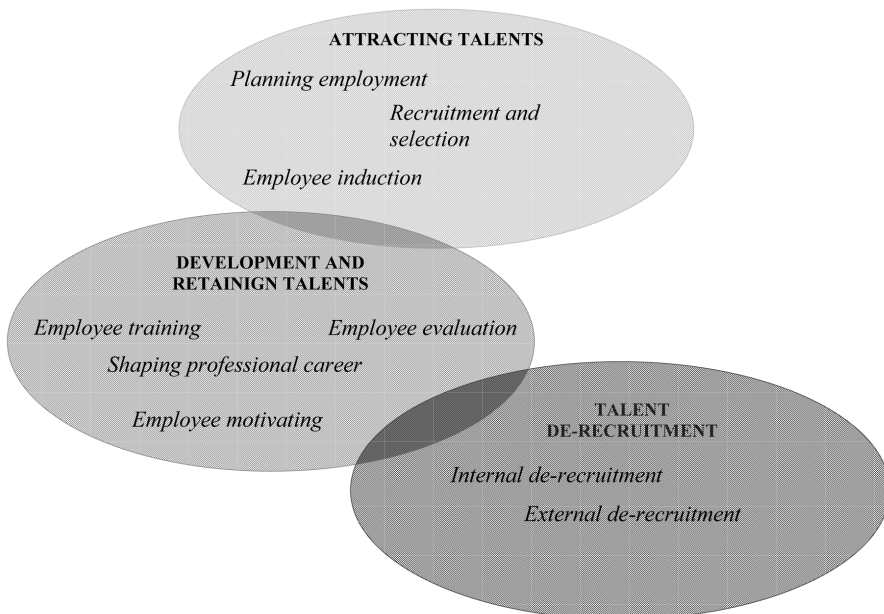
„Talent is also personified by particular employees with high competencies and potential. Talent is analyzed from the perspective of two assumptions: either talent is owned by the few who are clearly much better than the rest in particular features, or it is assumed that all employees possess some hidden talents and it is the role of the manager to discover these hibernated and invisible assets of each worker” [Morawski, Mikuła p.49]. Talents may be employees who excel in potential, creativity or other features or competencies or all employees because when employing them we were looking for particular competencies. A person considered a talent should have the following competencies [Kwiecień, p.163]:

- strategic thinking ability,
- leadership skills,
- emotional intelligence,
- ability to influence people,
- entrepreneurial skills
- results orientation,
- flexibility and adaptability to changes,
- team-working skills,
- technical skills in their field.

The literature on the subject does not provide a clear classification of talents nor does it determine “who is a talent?”. Classification of talent definitions may be based on such criteria as: exceptionality (scope) of abilities, their relation to the company aims (strategy) or type of abilities [Pocztowski p.39]. An important remark concerning talents is that the growing number of educated people did not translate into increased talent pool. Therefore education, although essential, without appropriate competencies and features, does not reflect the exceptionality of a person.

Relating to HRM, we can present the concept of talent management in three main stages: attracting, retaining and developing, de-recruitment (Figure 2).

**Figure 2.** Stages of talent management



Source: own elaboration.

The first stage is to attract talents. In line with its needs, the company will recruit people with appropriate features and competencies suitable for the model adopted in a given enterprise. The worker is then acquainted with his or her duties and responsibilities and induced in the strategy and aims of the company. It should be emphasized that the induction of the talent in a new work position costs less although later talents are expected to earn more. This is due to an employee's high communication skills and ability to adjust quickly to changes.

The second stage is to develop and retain talents. It is an essential element, as the loss of an employee with high potential in whose development the company invested, is a big loss for the company. It also costs a lot to replace this person with someone else. In order to prevent such situations companies shape young talents, showing them that through promotion they can replace their present supervisors. To retain an employee, companies use a number of advanced motivation and development tools, such as self-realization and delegating the whole projects and trainings tailored to the needs of a particular person. To take care of the talent, we must observe it and modify development tools and directions through assessment.

The third stage of talent management is to de-recruit talents. Parties may terminate employment contracts due to natural reasons (when an employee retires) or as a result of a decision of any party – an employee or an employer. Employers rarely decide to make a talent redundant, because by considering someone a talent the management has some development plans for this person and sees in him or her essential potential for the further development of the company. More often it is an employee who decides to leave the company, which is a severe blow for the employer. Investing in a talent, management does not want this person to leave so it tries to retain them.

#### **4. Fight for talents and good employer image**

The term “employer branding” is gaining significance, especially among executives managing the company. Entrepreneurs noticed the relation between having a good employer brand and attracting talented employees. The brand alone, though, is a result of various activities connected with creating internal and external image of a good employer. A lot of studies, conducted especially among students, show that the young graduates entering the labor market would like to find jobs with companies enjoying good reputation. The same opinion was expressed by professional who already possess their reputation of a good employer. On the basis of such research, a lot of contests and rankings were made, showing the best employers. The table below (Table 1) shows two selected contests: Employer of the Year and Ideal Employer 2010 as well as Top Employers Poland 2010 ranking. These ranking show the companies who have

good image and enjoy reputation of a good employer. The table also presents the methodology of conducted research and organizations performing it.

**Table 1.** Best employer rankings and contests

<b>Employer of the Year</b>	
<p>“Employer of the Year” contest is the biggest questionnaire survey organized by AIESEC Polska. It covers around 5000 students from all over Poland. The number of non-state universities taking place in it is increasing. Currently 47 universities and higher education schools participated in it. “Employer of the Year” contest is an independent survey, the time and results of which are kept secret.</p>	
<ol style="list-style-type: none"> <li>1. PwC</li> <li>2. Ernst &amp; Young</li> <li>3. Google</li> <li>4. MARS Polska</li> <li>5. Deloitte</li> </ol>	<ol style="list-style-type: none"> <li>6. ING Bank Śląski S.A.</li> <li>7. Nestle Polska</li> <li>8. KPMG</li> <li>9. Bank Millennium S.A.</li> <li>10. Unilever</li> </ol>
<p><i>Source: <a href="http://employer-branding.pl/2011/03/04/znamy-pracodawcow-roku-2010/">http://employer-branding.pl/2011/03/04/znamy-pracodawcow-roku-2010/</a></i></p>	
<b>Ideal Employer 2010</b>	
<p>The survey was organized by Universum Professional Survey, and conducted on-line by Universum Polska among professionals. Nearly 18 thousand young and more experienced people expressed their opinions. The survey was conducted in mid-November 2010. Employees of a particular company could not vote for it nor influence in any other way its position in ranking.</p>	
<ol style="list-style-type: none"> <li>1. TVN S.A.</li> <li>2. Google</li> <li>3. L'Oreal</li> <li>4. Skanska</li> <li>5. GlaxoSmithKline</li> </ol>	
<p><i>Source: Personel Plus No 3 (40)/2011</i></p>	
<b>Top Employers Poland 2011</b>	
<p>The survey covered 150 biggest Polish employers and 7 thousand respondents representing all age groups, students, employees and people searching for jobs. The Top Employer Polska certificate is granted by CRF Institute to the companies which meet the highest standards in management.</p>	
<ul style="list-style-type: none"> <li>• ArcelorMittal Poland S.A.</li> <li>• Bank Pekao S.A.</li> <li>• Citi Handlowy</li> <li>• Citybank International</li> <li>• Deloitte Polska</li> <li>• Elica Group Polska</li> <li>• Grupa ITI</li> <li>• Henkel Polska</li> <li>• Imperial Tobacco Polska S.A.</li> <li>• ING Bank Śląski S.A.</li> </ul>	<ul style="list-style-type: none"> <li>• JTI Polska Sp. z o.o.</li> <li>• The Lorenz Bahlsen Snack- Word Sp. z o.o.</li> <li>• McDonald's Polska Sp. z o.o.</li> <li>• Netia S.A.</li> <li>• Polkomtel S.A.</li> <li>• Polska Telefonia Cyfrowa Sp. z o.o.</li> <li>• RWE w Polsce</li> <li>• Samsung Electronics Polska Sp. z o.o.</li> <li>• Telekomunikacja Polska S.A.</li> <li>• Volvo Polska Sp. z o.o.</li> </ul>
<p><i>Source: Personel Plus No 4(41)/2011</i></p>	

Source: own elaboration on the basis of rankings.



The report of Randstad Award listed employers with the best image. The winner was TVN television, the second place was held by Toyota Motor Manufacturing Poland and the third - Vattenfall Poland. [Personel No 4(41)/2011] The first place was occupied by TVN television which also won the "Ideal Employer 2010" contest. Most brands of presented companies are well-known and belong to the companies which are popular with potential candidates.

Quality, effectiveness and durability of reputation depend on special abilities (competencies) of their creators, and this is currently defined in specialist literature as "intellectual capital" [Kwiecień p.32]. Thus, creation of a good employer image largely depends on company employees, their knowledge and abilities and their involvement in work. Volkswagen is an example of a company which implemented the concept of talent management and whose strategy for the next few years aims at becoming the best employer. The example of this company shows that there is mutual relation: employer's image facilitates attracting talents, and the image may be created by loyal and dedicated employees, including company talents.

A new tendency that can be observed is a decreasing number of people considered talents by management. The number of people with specialist education and desired competencies is falling. Another aspect is the demographic factor. Specialists forecast that due to observed population decline among students, universities will produce fewer specialists. Our knowledge-based economy is developing, which implies the necessity of educating young talents.

A method used by companies in their fight for young, talented employees and for experienced talents, is creation of a positive employer image. Such image allows companies to attract "diamonds" from the market and to lower the talent turnover and generally staff turnover.

The influence of employer image on particular stages of talent management may be presented in the following way:

### **Attracting talents**

Out of the elements of talent management listed above (see Figure 2), the most important one is recruitment and selection. In line with the existing needs, an organization plans the requirements to be met by potential employees and the number of existing and future vacancies. One of the assets talents possess is their flexible and quick adjustment to a new job, therefore we can conclude that induction is important, but this element is realized efficiently and at low costs. On the other hand, recruitment and selection will be greatly affected by positive image of an employer. The economic practice shows that companies with a good employer opinion are flooded with job applications. We can quote here the

example of Deloitte, which indisputably enjoys great reputation as an employer. This company organizes a contest consisting of several stages. Its winners are offered a well-paid work practice in the company, and most of them are later employed. Young people, often students of the final year at good renowned universities, are trying their luck in this contest. People who pass all the stages are given an opportunity to join the staff of Deloitte. Thanks to good brand and positive image the company has in the society, managers attract young talents and promote the company, thus maintaining its reputation. Another example is Timpson. In 2001, before publication of the list of 50 best employers, one of which was Timpson, the company had 20% vacancies. After the list was published, all vacancies were filled. Next year, the number of people applying for work in this company grew dramatically, and among the candidates, for the first time in history, there were women and university graduates. Mostly thanks to the image of one of the best employers, the company doubled its income [Leary- Joyce p.16]. An increasing number of candidates for a vacancy results in attracting employees with higher qualifications and precisely defined competencies, as managers have a wider choice. The image of a good employer also affects the quality of applications. The result of this is more effective selection of employees, as from the group of best candidates we can pick those we consider talents.

### **Developing and retaining employees**

In the above-quoted example of Timpson company, an additional benefit was lower staff turnover. The image of a good employer also affect employees and encourages them to stay in their present job. This is essential from the point of view of those regarded as talents, as the company invests in them, tailoring special development and motivation programs to their needs. Such features as good prospects of high remuneration and bonuses, professional development and trainings, creative and friendly work environment, independence and new challenges are incentives motivating an employee to work more effectively and account for the fact that employed people identify themselves with the company. The image of a good employer affects the retention of a worker in the company and makes his or her development more efficient and effective.

Keeping talents in the company allows it to plan succession. Possibilities of promotion created by the company are an additional motivator to work more efficiently. A person who sees his or her future place in the company, works better. Moreover, it is better for the company to prepare a specialist for promotion and taking up a higher post than to attract a person from outside who does not understand the company specificity. Some companies implement talent management programs to create employees succession plans. It is valuable contribution to the future survival of the company.

## **De-recruitment of talents**

Creating a good employer image assumes acting against redundancies. A company should be created by trustworthy and involved employees who will continue to work in it until they retire. Company reputation and its internal identity mostly influence employees to stay in the organization. Therefore, one of the core assumptions in creating a good employer image is to prevent employees (especially talents) from leaving the company. However, there are some exceptions. Talents realize that the present workplace does not satisfy their expectations or employees for some reasons do not meet the requirements of employers. However, a good employer image, attracting talents through management tools and methods, influences them to stay in the company.

The employer's image helps attract talents. Managers should provide appropriate conditions which will support its image of an employer and will attract specialists with a particular range of competencies. J. Lear- Joyce mentions the following elements which employers should fulfill to make sure the best people work for and create their organization [Leary-Joyce p.25]:

- provide such work environment in which their abilities will develop and shine,
- support and motivate them to use their biggest assets,
- make high demands and assess them strictly,
- build strong relations, reflecting talents, strengths and individual needs of particular people,
- acknowledge and celebrate successes – make work not only a task to do, but a source of pleasure,
- build and maintain high level of trust inside the whole company, as it is the only way to get what people have to offer,
- be an example to follow in one's work – put a lot of effort in it, observe company rules, work hard and derive pleasure from work, celebrate successes.

The research conducted by Universum Professional Survey shows that according to respondents, an employer should provide prospects for better remuneration in the future, competitive base pay, trainings and development. The most important aspects of professional life given by respondents were: stable employment, being an expert/specialist, achieve work/life balance.

Summing up, we can state that in order to attract the best employees, an employer must take care of its image both outside and inside the company. Developed personnel function and appropriate management models will create a place which is friendly for each employee, while investment in employees as the most valuable capital of the company will increase its profitability.

## 5. Conclusions

Management of companies that are considered good employers accept the new order and the changes taking place in the personnel function, understanding that these days people are moving from one place to another more often than in the past and employers must compete in order to attract the most talented people. The paradox consists in the fact that if a given place has the culture of a good employer, people do not leave it, their competencies and expertise remain in the organization and help it achieve high effectiveness [Leary-Joyce p.24]. Appreciating the influence of good image on attracting talented employees, specialists and experts, companies change their approach and pay more attention to their reputation and identity. Some companies even establish special units dealing with creating good corporate image. Image is a broad term and employer image is its element. Employees are the flagship of a company. Therefore we are witnessing the growing importance of human capital and the number of practically implemented concepts of personnel management.

The image of an employer and its perception in the society are reflected in contests and rankings for the best employer. Management of these companies noticed both material and non-material benefits they can draw from creating friendly places of work. A reliable employer is a company where employees may achieve their professional goals, develop themselves, and thanks to their passion and involvement contribute to added value of the company, including higher profits. We should not forget, however, that these rankings concern big national companies, which allocate quite big financial means to promote their brand and image through marketing activities. There are many enterprises in regional markets which enjoy great popularity and reputation, but due to their size, do not have such power of influence. Therefore fewer talents are interested in them.

Good reputation of the company and positive employer image also affect sales of goods and services. We have changed our attitude and believe we should not support companies which abuse their employees. Thus, a company caring for its employees creates good advertising for itself and performs marketing function. As a result of changes taking place in economy, tasks performed by particular functions are also changing. Today marketing is not only a good display of merchandise, but everything that shapes our opinion on a given product and its producer. Thanks to these transformations, corporate social responsibility has gained significance, but some companies use it for marketing purposes, not for pro-social causes.

Creating an image of a good employer brings many benefits on condition that the management takes up the challenge and covers related costs. Such ventures in time do bring benefits exceeding expenditure on them. Positive

image of the company attracts professionals, who become a “power engine” of the organization. All these elements realized simultaneously give us respect of our employees and allow us to preserve a strong position in the market.

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**Agnieszka Urbańczyk\***

## **IT GOVERNANCE FUNCTIONS AND AREAS OF APPLICATION IN AN ENTERPRISE**

### **Summary**

*IT Governance makes the IT solutions align with the business. It is currently one of the key objectives of the board. Taking the lead over IT by the board and chief executive officer prevents security breaches, project failure, the company's reputation damage. Fraud scandals at the beginning of 21<sup>st</sup> century did raise the bar for audit standards worldwide. The management is required to report on the quality of the internal control over financial reporting. The transparency of running the business increases the interest of potential investors. The information becomes the most important asset of the company and very often determines the market position and that is why the security of the organization's information is extremely important. Modern IT solutions not only make the operational side of the business easier but also help to make the strategic decisions faster based on the accurate data from the IT system. The most typical benefits of it are greater competitiveness and better shareholder returns.*

*The article attempts to present the idea of IT Governance. The main aim is to highlight the importance of the IT solutions and their impact on the business. The paper is composed of four parts. The first part presents the background of the IT Governance. It explores latest fraud scandals as results of failures in the corporate governance and IT systems. The second presents definitions of IT Governance and attempts to explain the idea of it. There are also presented the most typical and most obvious benefits of IT Governance implementation and its positive impact on the whole organization. The third part focuses on the description of the main areas of the organization where the IT Governance is present and the last part shows the main functions, some benefits and impacts on the business performance.*

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## **1 Introduction**

The Polish definition of *IT Governance* is translated analogically to *Corporate Governance*, however, Polish scientists have some problems with the word *governance*, as it has no clear equivalent in our language.

*IT Governance* became incredibly popular after a series of corruption scandals in the USA and Europe, which exposed the ineptitude and gaps in corporate governance, including information technology systems. The role of the IT department was perceived differently. It was assumed that it should cooperate and contribute to the achievement of the whole company's objectives, not only provide services or solve current IT problems of other departments or organizational units. Moreover, the issues of profitability of investments in IT and management and protection of information in order to minimize risk were emphasized.

The aim of this paper is to present what IT Governance is and how it has been defined by various authors. Due to the fact that it is an integral part of corporate governance, I will present the gaps concerning supervision which contributed to the introduction of changes in regulations and forced greater interest in IT solutions. Special attention will also be paid to people involved in the process of making decisions concerning implementation of IT Governance and the need for involvement of the board of directors will be postulated.

Then I will present particular areas covered with IT Governance and the function performed by it. I will show the main benefits resulting from IT Governance operating in an enterprise.

## **2 Corporate governance irregularities on the example of corruption scandals**

Corporate governance is not a new concept, it appeared together with separating ownership from management and was initially identified with owner supervision. The development of this area was affected by dispersed ownership forms and origin of joint stock companies, in which a vital element was supervision. In the 1980s, with numerous mergers and acquisitions in the USA and European privatization and economic transformations originating in the 1970s, corporate governance became the object of wider interest [Mesjasz 2011, pp.18-19].

*Corporate governance* has been translated into Polish in a number of ways [Mesjasz 2011, p.15]. However, there is no single definition stating exactly what corporate governance is. The Organization for Economic Cooperation and Development (OECD) in the preamble to "*Principles of Corporate*

*Governance*” defines „*corporate governance*” as a system of managing and controlling business organizations which assures division of rights and responsibilities between various groups of interests involved in the company activities, and also determines the rules of establishing its objectives, means of achieving them and monitoring effects of company activities. It also emphasizes the significance of relations between the executives and company organs, its shareholders and other groups interested in company operations. The structure of this system consists of a set of various mechanisms and institutions which allow shareholders and other stakeholders to supervise the company [Principles of corporate governance 2004, p.11].

The past decade has brought the revival of interest in corporate governance due to corruption scandals that took place in the USA and Europe at the beginning of the 21<sup>st</sup> century. They showed weaknesses of corporate governance and demonstrated numerous irregularities in its functioning. As there were instances of law violations and in order to prevent further abuse, governments of many countries implemented some amendments to the law governing public companies listed on stock exchange and other companies. The last financial crisis from 2008 may contribute to further changes in corporate governance [Mesjasz 2011, pp. 19-20].

Recent years have brought revelations concerning unethical behavior in management of corporations, based on misleading or even false information concerning accounting and incomplete or illegal audit procedures. Scandals involving such companies as Enron, Adelphi, Xerox, Arthur Anderson, ImClone, Tyco, WorldCom, Parmalat (Europe) drew the attention of public opinion on irregularities in corporate governance related to bad practices and improper behavior of employees at executive posts and to potential associated risk. Greed and misappropriations led to charging top managements with falsifying financial results, hiding information about the true financial situation of enterprises and embezzlements. The situation was further worsened by the fact that professional, external audit companies misled and cheated their clients or, in cahoots with their clients, cheated public opinion [Danter 2011, p. 13].

There are various regulations concerning corporate governance covering the area of the home country, Europe and the whole world.

„*OECD Principles of Corporate Governance*”, applicable all over the world are the widest-reaching and most universal. They constitute a model for domestic regulations in OECD member countries. Although they do not belong to this organization, some countries are inclined to follow these principles in order to increase investors trust in them [Jerzemska 2011, p. 174]. The document consists of two parts, the first presents five principles of corporate governance, the second comprises commentaries to the rules



presented in the first part. The main principles are: the rights of shareholders, the equitable treatment of shareholders, the role of stakeholders, disclosure and transparency and the responsibilities of the board [Jerzemowska 2011, pp. 176 – 177].

The history of contemporary regulations related to corporate governance in the USA dates back to 1978. Corruption scandals from the beginning of the 21<sup>st</sup> century resulted in passing the Sarbanes-Oxley Act (SOX, Sarbox) in 2002 by the US Congress. The act became federal law and was one of the strictest world standards of corporate governance [Jerzemowska 2011, pp. 189 – 190]. The act obliges CEOs and Directors of Finance to certify the correctness of financial statements and forced independent, external auditors to document operational effectiveness of their supervision and the structure of financial statement supervision. If any of these requirements is not observed, auditors may receive severe financial punishment [Danter 2011, p. 14].

Legal regulations in corporate governance account for the fact that corporations build discipline and the program of readiness for rigorous audits and assure their continuous, successful execution. Internal auditing organs responsible for this must choose the method of measure in order to be able to check and ensure balance and to create procedures ensuring integrity and honesty inside the company. This is not an optional solution, though. Currently it is the CEOs who are liable for correctness of financial statements [Danter 2011, p. 14].

The European Union also initiated work on corporate governance, issuing a number of directives, recommendations and statements [Jerzemowska 2011, p.184]. In 2004, the European Commission established the European Corporate Governance Forum, consisting of 15 members whose task is to monitor the codes of good corporate governance practices in EU countries. The result of their work are numerous announcements and recommendations which formulate guidelines and suggestions. Work on perfecting regulations related to corporate governance is still being conducted and new documents are bound to appear soon [Jerzemowska 2011, pp. 188 – 189].

### **3 Definitions of IT Governance**

In their everyday practice, companies manage various assets, such as people, money, fixed assets, as well as all kinds of relations with their customers and suppliers. However, it is information that is becoming the commodity whose value and significance are growing constantly. Business needs change all the time, while systems seem to be rigid. That is why various investments in IT are made, aiming at streamlining work and catching up with ever-growing market requirements. Increasing the effectiveness by

means of IT technologies accounts for the fact that managers lose control and voluntarily delegate some of their responsibilities to their subordinates.

Contemporary IT systems are adjusted to processes taking place in organizations and constitute their foundations. Responsibility for effective use of IT tools is not restricted only to IT department, but also concerns managers and leaders at all levels of management. Obtaining added value and return on investment related to IT increases competencies and professionalism of the whole organization [Weill, Ross 2004, pp. 1 - 2].

There are many definitions of IT Governance. One of the first definitions was proposed by Weill and Ross. In their opinion, IT Governance precisely determines the right to make decisions and indicates framework of responsibility in order to encourage desired behavior while using IT technology [Weill, Ross 2004, p. 2]. IT Governance Institute also emphasizes that it is the structure of various types of ties, interdependencies and processes allowing to control the enterprise as far as achievement and realization of its objectives are concerned. Return on investment in IT and processes greatly influences increasing value of an enterprise while limiting risk [<http://www.itgi.org>].

IT Governance formulates and explains the vision, responsibility and rights to make decisions concerning IT strategy, resources and actions related to controlling. It is a specific collection of many elements, covering:

- management,
- planning,
- company policy,
- business practices and processes, taking into account the rights to make decisions,
- controlling and measuring effects and return on investment in IT,
- data safety and protection.

It is to provide continuous activity of an organization and conformity to legal regulations and internal policies [Selig 2008, p. 9].

In 2009, Van Grembergen and De Haes, referring to the origin of IT Governance, defined it as an integral part of corporate governance. All implemented processes, structures and related mechanisms are to ensure that investment in IT supports company activities and meets its requirements, thus allowing it to achieve added value while reflecting the need to enforce responsibility [Van Grembergen, De Haes 2009, p. 3].

IT Governance focuses on the direction and supervision of IT. These activities cover strategies, plans and objectives concerning IT solutions which must be coherent with the objectives of the whole organization. Supervision also covers the resources possessed by IT department, both tangible and intangible ones. IT technologies should meet the needs and support

management processes, however, it is necessary to measure value provided by investment in this area. Currently, IT solutions should be flexible enough to quickly react to changing market needs and help in achieving results and offer the possibility of measuring them.

Following the growing significance of IT and an increasing number of organizations, the board of directors has become the organ which, apart from its current tasks, is responsible for the strategy concerning IT solutions, investment in this area and its supervision [Selig 2008, p. 5].

IT Governance itself is not for making IT decisions – this is the board's task. IT Governance is to indicate the people who systematically contribute to making such decisions. It is to facilitate observation of general principles of corporate governance. By focusing on managing and using IT tools, it allows us to achieve our corporate objectives. Implemented IT Governance enables the company to control business processes and limits the risk associated with conducting activities through limiting or depriving employees of the possibilities of improper behavior, inconsistent with company vision and values. Their activities which are against company policy are blocked by the IT system in which all processes and transactions take place [Weill, Ross 2004, pp. 2 - 3].

Managers do not have sufficient knowledge or motivation to make decisions which would be beneficial for the whole company. This is because in their daily work they deal with and focus on achieving the results of a particular department. They do not consider the effects their decisions may have on the enterprise. In order to solve their current problems, they insist on implementing IT solutions which may not be beneficial for the whole company. IT Governance is to prevent such behavior. It allows that the budget for IT expenses takes into account some small expenses on solving individual problems or satisfying specific needs, however, it stipulates that there is no rule granting each team some money for their IT needs [<http://radar.oreilly.com/2011/01/why-is-it-governance-so-diffic.html>].

The implementation of IT Governance cannot take place without participation of the board of directors. Their leadership and involvement requires regular and systematic approach, their active participation in various meetings concerning project progress. Employees, like representatives of middle management, do not have sufficiently deep and broad understanding of organizational objectives, nor do they have sufficient authority to determine and allocate priorities and make strategic decisions which will contribute to the support of organizational objectives [Kress 2010, p. 37].

## **4 Elements of IT Governance**

IT Governance is not only IT, but also business structure, processes and standards. It guarantees that while the company realizes its strategy and reaches its objectives, it meets requirements and acts in accordance with internal regulations and law [Calder 2007, p.12].

More and more activities in an enterprise depend on IT systems. That is why the significance of risk concerning digitization and observing management procedures is growing. Any faults or defects in this area may have grave consequences for the effects reached by the enterprise. Risk management in IT is a vital element, ensuring good functioning of a corporation [[http://www.openpages.com/solutions/it\\_risk/it\\_governance.asp](http://www.openpages.com/solutions/it_risk/it_governance.asp)].

### **4.1 Internal control**

SOX regulations forced stock exchange companies registered in the USA to introduce IT Governance to reporting financial results and in operational control. Institutional investors also exert pressure on private-owned companies to meet the SOX requirements, which accounts for the growing interest in IT Governance [<http://glossary.tenrox.com/it-governance.htm>].

In every organization there are reporting lines which can be transferred and implemented in operational systems to measure and compare results with targets. The development of operational structure of reporting allows us to control the results and activities of the enterprise more easily and quickly. Another area in which reports and various statements generated by the system can be applied, is internal audit, aiming at preventing and discovering all kinds of negligence or oversights. It is something more than internal control. The board of directors should establish an organ authorized to hold such controlling powers, equipped with knowledge of the areas which it controls. The effect of auditors' work should be reports on conducted audits with objections and guidelines concerning future actions. They should not only aim at discovering irregularities in current processes, but they should also focus on potential future threats [Calder 2005, pp. 123 - 124].

### **4.2 Data protection**

Information and information technology have become the most important element of contemporary economy and modern enterprises. We can observe a growing overdependence of enterprises on information systems. Legal regulations and public opinion are increasingly interested and concerned about proper use of information, this especially relates to personal data protection.

The fear of crime and cyber-terrorism in recent years has aggravated and this situation is bound to worsen. Many organizations perceive information as the area which should be protected by corporate governance, as a system of internal control [<http://www.itgovernanceusa.com>].

### **4.3 Risk management**

Meeting requirements concerning IT risk is becoming an increasingly challenging task due to growing complexity of the relation between risk, progress and results and growing complexity of various types of IT initiatives forced by other departments. Until quite recently organizations have had to rely on fragmentary and heterogeneous, sometimes even divergent approaches to managing risk related to new technologies. Reliance on risk management, which is closed in some kinds of silos of various departments is both expensive and ineffective. In this case it is impossible to understand the negative influence on the whole organizations which may be made by any failure or mistake in technological policy or processes [[http://www.openpages.com/solutions/it\\_risk/it\\_governance.asp](http://www.openpages.com/solutions/it_risk/it_governance.asp)].

It is worrying that auditing agency, while examining the method of conducting control and preparation for self-auditing of companies, will pay more attention to IT processes and will evaluate the way of their effective use in conducting the control. Proper financial statements and business processes are forced and depend on effective implementation of control using IT tools. Currently, more than ever before, all functions of an enterprise are very closely tied with the control system using IT tools. IT systems are the foundation of all business processes, many functions depend on or are powered by the data from automated systems. Integrity and honesty of data from these systems is reflected in various statements and reports, which are the basis for making important and sometimes critical decisions concerning the future of an organization. Controlling in this area is necessary to ensure that detailed data, at the appropriate time, is passed to and process in business processes. Negligence of IT control in management poses a serious threat to the existence and operations of the whole company [Danter 2011, pp. 14-15].

## **5 IT Governance functions**

In recent years information has gained significance and become the key resource of every enterprise. Paradoxically, growing expenditure on information protection is beneficial for companies which succeed and can develop competitive advantage thanks to it. Modern information technologies have become an indispensable element of competitive advantage. IT not

only supports standard processes, enables quick transmission of data and continuous information flow, but it also has become a foundation on which company's operational strategy is built. It is also a challenge for management which should enable and design changes in organizations rather than create obstacles in implementing them [Weill, Ross 2004, p. viii].

### **5.1 Controlling investment expenses on information technologies**

Research confirms that many IT projects fail and a large part of investment in this area brings loss. Some statistical surveys show that between 20% and 40% of the means spent on IT projects is wasted. This amounts to hundreds of billions of euro spent annually. The aim of IT Governance is to limit these losses and to make sure investment in new IT solutions brings true and measurable value for the whole enterprise [<http://www.bestpricecomputers.co.uk/glossary/information-technology-governance.htm>].

The basic tasks of IT Governance are generating value through investment in IT and minimizing risk associated with information technologies. It is achievable only when we implement an organizational structure with well-defined roles and responsibilities for information, business processes, application and the whole IT infrastructure. It is responsibility that remains at the core of IT Governance interest. Value created by right decisions concerning investment in new information solutions should result from good communication between business and IT, as well as from the conviction that they are jointly responsible for it [<http://www.infovidematrix.pl/inspiracje/?p=15#more-15>].

### **5.2 Synchronization of objectives and priorities**

The involvement of representatives of various company departments (for example departments of finance, marketing, sales, production) in IT projects guarantees that both priorities resulting from company objectives and those of IT department are synchronized and everybody is equally engaged in the success of IT projects [Kress 2010, p. 36].

The development and implementation of IT Governance in an enterprise creates bigger value than only the assurance that the board of directors in their work observe good practices and ever increasing domestic and international requirements concerning corporate governance. IT Governance equips the board and directors with certain weapon, both in commercial and legal actions, assuring them that they took proper steps in order to establish and develop the best practices of protecting and perfecting information and

intellectual resources of a corporation, risk management, controlling IT investment expenditure and meeting legal requirements concerning IT and digitization [Calder 2005, p. 23].

### **5.3 Development of intellectual resources**

Corporate governance is a system through which companies are managed and supervised. Initially it focused on shareholders rights, transparency of operations and responsibility of management, but now it concentrates on the structure of company board of directors, remuneration of executives and reporting. It is the board of directors which is considered responsible for developing the main management rules – such as defining strategic objectives, providing leadership, predicting and monitoring management progress and reporting results of one’s work to shareholders – and transforming them into intellectual capital of an organization, information and IT infrastructure. Currently intellectual resources are the greatest value of an organization [Calder 2005, pp. 11 - 12].

### **5.4 Increased credibility**

The challenge of our times and a necessity, especially in the USA, is for corporations to develop programs and provide infrastructure which will ensure readiness and guarantee correctness and precision of information. Managers cannot fully depend on results of external audits and their recommendations, they should create their own internal audit programs in order to regain credibility and trust of shareholders. Meeting this challenge is a critical factor for many enterprises if they want to survive and be successful [Danter 2011, p. 13].

Corporations must restore ethical and honest behavior and return to the basic effective corporate governance. It is also necessary to have solid, strong and well-conducted audit programs which will supply the board of directors with tools for restoring trust and self-confidence in action. Past experience shows that we should not over-depend on external audit companies, internal audit infrastructure should be the priority. The preparation for being audited emphasizes the need to establish ethical standards and expectations, education, change of behavior, preparation, open and honest communication and implementation of reasonable and solid managing and controlling practices [Danter 2011, p. 14].

It is currently expected that public companies should be managed in a transparent way. We can observe certain divergence here, connected with the necessity of maintaining confidentiality of data. Many managers do not

see that digitization allows us to perform both functions simultaneously. They treat IT only as an operational and functional element and do not understand its strategic significance. Organizations which promote development and are managed by people who grew up together with the development of IT, support and facilitate the development of this area. In the future IT Governance will definitely become more important than corporate governance is now. Information and IT are fundamental for the survival of the company. Organizations will make IT an element of their competitive edge [Calder 2005, pp. 11 – 12].

## **6. Conclusions**

IT Governance is not restricted only to IT specialists. Correlating organization's objectives with IT investment is a great challenge and requires involvement of many people from various areas of the company. Thanks to it we can prevent situations in which only one department benefits from IT, while the investment itself does not offer satisfactory return and does not match the real needs of the whole organization.

On one hand, IT solutions should facilitate conducting business operations and access to information, on the other hand, they should protect information against falling into the wrong hands. Information has the greatest value in contemporary world and it determines the competitiveness of many enterprises.

Requirements concerning companies listed in stock exchange oblige them to conduct effective internal controls as well as being audited by independent institutions. To perform this obligation efficient IT mechanisms in reporting are necessary. Many IT applications created in order to meet specific, sometimes unrelated, operational needs, do not offer this opportunity. IT Governance is to ensure decisions related to new investment not only solve current functional problems but also take into account other elements allowing more efficient and effective supervision of business processes.

Investors and other stakeholders expect the company to be managed in a transparent way. Numerous systems of collecting data do not support building trust. Moreover, they make it difficult to measure return on investment in IT. Individual decisions of particular departments are often more costly and less efficient than solutions covering most of the organization.

People holding power in the company play a key part in decisions concerning IT solutions. This is mainly due to their liability for passing information to the stock exchange and the obligations they have to ensure efficient mechanism of corporate governance. Taking into account Polish reality, we should consider whether members of the supervisory board (or



of directors) representing investor and capital owners, should participate in making such decisions. They are most interested in the future of the enterprise and want it to be managed in accordance with the law and to generate profits. Investment in IT is often very costly, while accepted solutions constitute strategic decisions determining competitive position of the company.

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**IV.**  
**BUSINESS AND NON-PROFIT**  
**ORGANIZATIONS – GLOBAL AND**  
**REGIONAL ASPECTS**



**Tomasz Kafel\***

## **NON-GOVERNMENTAL SECTOR IN POLAND – OPPORTUNITIES AND THREATS IN THE CONTEXT OF CREATING THE CIVIL SOCIETY**

### **Summary**

*The main purpose of the article is to present the current circumstances of non-government organizations development and the key opportunities and threats in the process of launching ngos into the process of Polish civic society building. In the first part of the paper the stages of non-governmental sector development in Poland are described. The traditions of the so-called Third Sector in Poland and two main causative factors forming its development in the transition time are shown next. The increasing role of non-government organizations in shaping the civic society in Poland as the result of SWOT analysis of civic society is considered in the further parts of the paper.*

### **1. Introduction**

Non-governmental sector, being an isolated part of the real and regulative market economy, has developed in the long process mainly due to insufficient realization of public and social tasks by the state as a remedy for negative consequences of spontaneously operating market mechanism, threatening, in various forms, the living conditions of large groups of people. The origin of non-governmental sector has been determined by human desire to help each other and by the civil society willingness to self-organize in order to provide basic goods and services to people in need and those underprivileged. Its origins and development may be explained by:

- historical determinants – people acted together in order to contribute to some work and to solve problems long before state institutions were established; it turned out that after establishment of state institutions citizens are willing to act within non-governmental structures;

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- low effectiveness of the state in realizing its social policy, caused by limited financial possibilities and shortcomings in satisfying individualized needs of smaller social groups;
- certain deficiencies of market economy – market mechanism which regulates most economic phenomena cannot balance demand and supply in consumption of such common goods as clean air, undestroyed forests, clean water, etc.; therefore there is social demand for organizations which create and protect common goods;
- pluralism and freedom – non-governmental sector is a place where all the attempts and views blocked by state structures manifest themselves;
- human solidarity – non-governmental sector is a place where particular social units may express their desire to help other people and to provide support for each other [Limański, Drabik 2007, pp. 31-32]. The aim of this article is to present current determinants in the functioning and development of non-governmental organizations and to characterize key opportunities and threats connected with including them into the process of creating Polish civil society.

## **2. The development of non-governmental sector in Poland**

The history of non-governmental sector in Poland shows that the animators of social activity (today we would call them social facilitators<sup>[1]</sup>), were both rulers and church structures [Juros 2006, p. 14]. In Europe in Middle Ages, institutionalized social activity was initially run by the Church, parishes and orders, and concentrated on educational and charitable work among the poorest, who often chose the state of poverty as way to perfection and salvation. In the 11<sup>th</sup> and 12<sup>th</sup> centuries, the attitude of Western societies towards poverty changed, which resulted in development of private and institutionalized charity. The development of private and institutionalized charity was the effect of a number of factors, among which the change in social structure of population was the major one. The material situation differed (there were more poor and more rich people), so social conflicts had to be toned down and social attitude to poverty changed [Leś 2011].

In Poland, non-governmental organizations, foundations and associations appeared more or less in the same time as in the West. Initially, they dealt with charitable work, then they also took up cultural, educational and scientific activities and promoted ideas of social development and social solidarity.

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<sup>1</sup> Social facilitation covers processes thanks to which presence of other people has intensified influence on behavior of an individual.

Some of them were religious, others totally lay<sup>[2]</sup>. Similarly to the West, also in Poland the origin of social organizations is closely related to Christian tradition. According to the Christian doctrine of mercy, valid in Middle Ages, supporting the poor was the basic attribute of a good Christian, while the poor were treated with respect and kindness [Leś 2011].

However, fundamental significance for the evolution of social activity is attributed to periods of economic upturns and downturns, as they determined the social situation. Such economic crisis took place in the middle of the 15<sup>th</sup> century and was closely related to the changes in ownership structure in the country and decline of traditional feudal society structures in the West, which led to social declassing and pauperization. Pauperization was further aggravated by famine disasters and epidemics and war aftermath. The second half of the 18<sup>th</sup> century starts the new and the longest stage in history of organized social activity in Europe and America, which lasted for 200 years, till the outbreak of the Second World War. This stage incorporates the period of Enlightenment, era of Industrial Revolution and the crisis of liberal democracy. The industrialization of the 18<sup>th</sup> and 19<sup>th</sup> centuries brought unprecedented mass pauperization – which revived the idea of lay philanthropy in Europe and America and also lay bare the need for organized protective activities performed by the state. In the 18<sup>th</sup> and 19<sup>th</sup> centuries, philanthropic organizations established by lay founders developed, but not at the cost of various traditional forms of charitable activities. There were also public care institutions created at that time. This period witnessed different relations between philanthropic institutions and public authorities in various countries, which, in the 19<sup>th</sup> and 20<sup>th</sup> centuries contributed to the creation of different models of social policy and differentiated relations between the state and social organizations [Leś 2011].

In the period from the second half of the 18<sup>th</sup> century to the outbreak of the Second World War, Poland witnessed three stages of non-governmental organizations development: the times of King Stanislaus, the time of Poland's partition (1795-1918) and the years of the Second Republic of Poland. The first period, though it lasted only a couple of decades, was essential for the formation of views on the function of religious and lay philanthropy and public care in a modern state. The loss of independence in 1795 coincided with the crisis of manor and serfdom economy and development of industry in Poland. This process was accompanied with pauperization of population and an increased number of abandoned, neglected and demoralized children as well as noticeable growth of juvenile crimes. These two factors were the main catalysts of various philanthropic, educational, social, cultural, socio-economic and army-political associations. The development of non-governmental organizations was also

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<sup>2</sup> Organizacje pozarządowe, [http://www.poland.gov.pl/Organizacje\\_pozarządowe,128.html](http://www.poland.gov.pl/Organizacje_pozarządowe,128.html), (accessed on 28th February 2011).

continued in the Second Republic of Poland. In this period there was organizational and institutional complementarity of associations, foundations, unions and cooperatives to the activities of government and self-government. In 1947–1989, defining, administering and financing collective needs was dominated in Poland by the monopolist concept of a social state. Its result was drastic reduction of the role of social subjects (non-governmental). Many hospitals, schools, kindergartens, spas and other institutions of social infrastructure belonging to non-governmental organizations were eliminated, property and equipment was nationalized, and in 1952, all foundations with registered offices in Poland were dissolved. Unfortunately, organizations were compulsorily joined, cooperatives were incorporated to social sector and the status of private cooperative ownership was eliminated for the benefit of collective cooperative ownership. The already mentioned traditions from before the war and scanty experiences after the war led in the 1970s and 1980s to strong pressure exerted on the political and state apparatus. This brought about the Act on Foundations in 1984, which was the first legal sanctioning for the non-governmental organizations in Central and Eastern Europe. Such organizations obtained the status of a legal person. Unfortunately, in line with the spirit of those years, the initiative possibilities were fully controlled. Organizations could only be set up adopting the foundation form. The act also stipulated the necessity of obtaining permission from the ministry. Proper minister was the one whose jurisdiction covered the planned activities of a foundation [Leś 2011].

The interest in the concept of social economy as a social policy instrument grew in Poland after 1989 as a result of structural pressure caused by changed relations between the main participants of economic and social processes: the state, the enterprise and the households. The changes mainly consisted in withdrawal of the state from its role of an employer, reduction of its instruments of social inclusion (normative narrowing of the scope of social rights and limiting access to social allowances and services) and liquidation of the enterprise's social function. The effects of these transformations were mass and high unemployment, dramatic growth of poverty and social gap in the sphere of social allowances and services [Leś 2010]. After 1989, non-governmental organizations have been experiencing their revival, thanks to regained freedom to associate and to establish associations. In a sense, this is the effect of one thousand years of Polish philanthropy. Some organizations with traditions dating back before the war were restored and took up their statutory activities (for example Caritas Polska – pastoral charitable institution of Polish Episcopate, or YMCA<sup>3</sup>, an apolitical and lay organization working to satisfy the needs of local societies in cooperation with organizations, state offices and self-governments).

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3 Young Men's Christian Association.

Many new foundations and associations have been established to meet the challenges and needs of modern society. We have also witnessed the appearance of many institutions (associations or foundations) which dealt with solving social problems: alcoholism, homelessness, drug-addictions, such as: Monar Association, Brother Albert Foundation. Non-governmental organizations expanded the scope of their activity, dealing not only with charitable work, but also promoting education among the youth, which is manifested by numerous scholarship funds and programs of supporting the most talented young people (for example Stefan Batory Foundation, Polish Foundation for Science Advancement). Universities have witnessed establishment of student organizations, international organizations supporting promotion of science set up their branches there. Apart from functioning in the philanthropic area, these organizations also dealt with cultural issues (for example Foundation of Culture, F. Chopin Foundation and numerous associations and foundations aiming at promotion and protection of historic buildings), human rights protection (for example the Helsinki Foundation for Human Rights, Polish section of Amnesty International), promoting natural environment protection (for example "Our Earth" Foundation, Foundation Supporting Ecological Initiatives).

The Polish non-governmental sector was shaped in the transformation period mostly by two decisive factors: mechanism of self-development and self-education, characteristic for many social and civic movements, and a broadly understood foreign aid. The first factor consisted in "work at the basics" performed by part of the society interested in community work, who, due to various reasons, continuing solidarity or intellectual elite ethos and realizing counter-culture ethos, but also driven by their own interest and necessity of self-defending their life situation, decided to shape the framework of social self-organization on their own. The second development factor – foreign aid – covers at least four dimensions: financial, educational (mostly know-how organizations), cultural (restoring the community activist ethos) and political. We could certainly say that although many institutions of Polish democracy were designed and imposed top-down, Polish civil society was actually built at grass-roots level, with help of foreign subjects, by a small part of our nation, often against its elites. Therefore it is mostly limited to some enclaves [Gliński 2006, p.31].

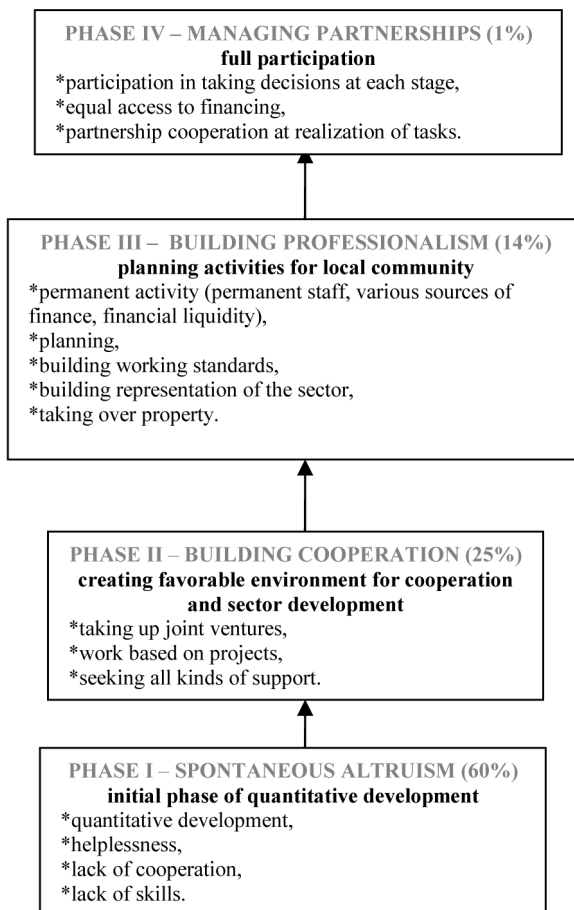
In Poland in recent years we have seen dynamic development of non-governmental organizations, which can be attributed to better public awareness of the population who understand that one should not limit their actions and behaviors only to those which serve the purpose of satisfying own needs and the needs of one's family [Kantyka...2005,p. 9]. In the past twenty years the number of non-governmental organizations has grown significantly, and the scope of their activities has widened, too. They are involved in almost every aspect of human aspirations all over the world.



The development of non-governmental sector in Poland since the beginning of economic transformation in 1989 has taken place, according to Jerzy Boczoń (Chairman of the SPLOT Network of Supporting Non-Governmental Organizations, Head of the Regional Information Center and Support for Non-Governmental Organization Foundation in Gdańsk), in the phases presented in Figure 1 below [Boczoń 2005].

Non-governmental organizations cannot be perceived only as performing some marginal activities of doubtful value. They play an important role in nearly every society, helping provide health care, develop education and social welfare [Sargeant 2004, p. 20].

**Figure 1.** Phases of non-governmental sector development in Poland



Source: A. Dawidowska, J. Boczoń, *Absorpcja funduszy europejskich przez organizacje pozarządowe w latach 2004–2006*, Trzeci Sektor No 7 – fall 2006, p. 29.

However, in spite of tremendous potential of ideas, organizational and intellectual efforts that have been made in the past 20 years in the activities of non-governmental organizations, they are not fully prepared to utilize this potential and to take advantage of the opportunities resulting, for example, from our membership in the EU [Boczoń 2005]. According to J. Boczoń, probably 60% of organizations are still in the first phase, 25% in the second phase, while only 14% in the third one, that is in the phase of being ready to become a professional organization with possibilities of cooperating with other sectors and building what we could call professional, full participation. This phase of full participation in social life has been entered by around 1% of non-governmental organizations.

### **3. Growing importance of non-governmental organizations in building the civil society in Poland**

Recent years have increased chances of full participation in social life for non-governmental organizations. We would like to draw the reader's attention to *The strategy of supporting development of the civil society in 2007-2013*, adopted by the Ministry of Labor and Social Policy in 2005. It indicates the key elements of the civil society, its mission, objectives, priorities and strategic operations which will be performed in order to develop the civic society in Poland. The principle of the civil society is one of axiological foundations on which the system of the Republic of Poland is based according to the Constitution of 1997. Its constitutional reference is an absolutely new idea in Poland. Of course, the term "civil society" has long been used in sociology, political science or philosophy of law. It is defined as "all institutions and organizations independent of the state, which do not oppose the state in its efforts to provide security and order, but they want to control the actions of the state authorities, influence them and defend their own interests" [Sześciło 2007, p. 74-75]. In definitions adopted in the Strategy, it was assumed that "civil society in general, covers two areas in Poland: civil group activity – manifested in activities of various communities, mostly in activities of non-governmental organizations of civil type, local and self-government communities, and informal groups and social movements (neighborhood communities, subcultures, etc.), as well as individual civil activities comprising attitudes and civil awareness of Poles" [Strategia... 2005, p. 7].

The SWOT analysis of civil society in Poland (Table 1) allowed to adopt the following strategic goals in the Strategy:

- Achieving the optimum level of citizens' participation in public life – as a necessary condition for creating stable foundations for subject activity

of citizens and their communities in shaping the social development, economic growth and political culture;

- Quantitative and qualitative development of civil society institutions – as an expression of objective necessity of strengthening non-governmental organizations, social integration and social economy subjects and forms and ways in which they function;
- Creating the foundations for proper functioning of the state – as the consequence of principles of subsidiarity, participation, partnership and civil dialogue between efficient public administration and citizens, which crowns the construction of the civil society.

**Table 1.** SWOT analysis of the civic society in Poland

Strengths	Weaknesses
<ul style="list-style-type: none"> <li>• sector performs two functions in the society: integrating (strengthens the feeling of social cohesion) and expressive (advocating)</li> <li>• performs niche task/services for the society</li> <li>• increasing number of organizations professionalize their activities basing on developing staff (employing people working for non-governmental organizations)</li> <li>• there is specialist infrastructure supporting non-governmental organizations and local civil activeness</li> </ul>	<p>Individual civil activeness:</p> <ul style="list-style-type: none"> <li>• low civil awareness characterized by lack of activeness and responsibility for the community</li> <li>• lack of broad civil education</li> <li>• civil passiveness</li> <li>• limited “openness” of state institutions for citizens as regards: participative legislation; functioning of state institutions in relation to citizens</li> <li>• low level of social capital measured by declared social trust in state institutions, mutual trust between public institutions and civil institutions</li> </ul> <p>Non-governmental civil activeness:</p> <ul style="list-style-type: none"> <li>• small number and often low quality of non-governmental organizations in relation to the potential of Poland</li> <li>• poor financial situation – small share of public means in budgets of organizations</li> <li>• poor internal differentiation of the sector</li> <li>• difficulties in creating a joint non-governmental representation</li> <li>• cases of violating self-regulatory and ethical standards by organizations</li> <li>• low corporate culture of the sector reflected in lack of strategic planning of the sector, lack of knowledge in issues affecting its operations, for example finance and taxes, cooperation with volunteers</li> <li>• problems with building modern membership base</li> <li>• lack of transparent and fair rules of access of civil groups to public money</li> <li>• lack of easy access to infrastructure services (advisory services, trainings, etc.).</li> </ul>

Opportunities	Threats
<ul style="list-style-type: none"> <li>• quite a high number of people interested in voluntary service</li> <li>• gradual growth of the number of non-governmental organizations</li> <li>• attempt at institutional change concerning the place and role of non-governmental sector in the state and society through introducing new institutions of social dialogue, development of legislature laying foundations for Polish “social economics” and passing the Act on Public Benefit and Volunteer Work</li> <li>• systemic change of the method of allocating public means as regards access to them by non-governmental organizations – Civil Initiatives Fund</li> <li>• the way the sector functions in the institutional environment of the EU</li> <li>• a chance of major contribution from European funds for the sector</li> <li>• participation of the sector in the National Development Plan for 2007-2013.</li> </ul>	<ul style="list-style-type: none"> <li>• attitude of many self-governments reflected in unwillingness to accept non-governmental organizations as equal partners in the process of managing local and regional communities</li> <li>• the status of a client the sector has in relations with public administration representatives</li> <li>• anti-participative characteristics of democratic institutions of the state</li> <li>• a phenomenon of sector ‘oligarchy’</li> <li>• poorly developed institutional and legislative structure for development of participative democracy, characterized by low participation of civil groups and communities in the process of preparing, taking and controlling political decisions, reflecting their rights and interests</li> <li>• weaker controlling function of social organizations towards public authority, resulting directly from lack of partnership balance and overdependence of non-governmental organizations from various levels of authorities.</li> </ul>

Source: Strategia wspierania rozwoju społeczeństwa obywatelskiego na lata 2007-2013, Ministerstwo Polityki Społecznej, Warszawa 2005, pp.17-18.

What attracts our attention (in Strategy...) is the fact that the *strong non-governmental organizations* priority was placed among priorities and activities serving the purpose of realizing the listed strategic objectives. Among other priorities we have:

- *active, conscious citizens, active local communities,*
- *social integration,*
- *social economy.*

Priority : *strong non-governmental organizations* is realized through the following activities:

1. Strengthening the potential of the non-governmental sector,
2. Providing equal opportunities for organizations – supporting development of third sector infrastructure,
3. Quality of management in modern public administration,
4. Promoting civil dialogue as a form of civil participation.

The realization of the first two activities is of particular importance for non-governmental organizations. Thus, strengthening the potential of the non-governmental sector is conducted through:

- supporting development of social base of non-governmental organizations, professional development of both the staff and membership and volunteer base,
- supporting self-regulatory initiatives of the third sector concerning transparency of their activities,
- strengthening financial and organizational stability of non-governmental organizations, especially as regards financing civil initiatives,
- supporting development of research and expert base of civil society organizations.

The activity: *providing equal opportunities for organizations – supporting development of third sector infrastructure* encourages the activities aiming at obtaining the following results:

- developing national systems of support for the third sector in areas of advice, consultation, services (including financial ones), trainings and technical assistance,
- strengthening the system of supporting organizations in regions with poorer access to infrastructure services which provide equal access to services on the regional level,
- strengthening the sector integration processes, including federalization of non-governmental organizations.

The implementation of the Social Economy priority offers great opportunities for non-governmental organizations. One of the activities within this priority is strengthening the role of the third sector as an employer. The social dimension of employment as the domain of non-governmental sector and other institutions and forms of social economy is supposed to improve significantly the situation in labor market, especially as regards particular groups of social risk. The perspective of changes concerning the role of non-governmental organizations as employers calls for such activities as:

- supporting education of social leaders who are real or potential employers,
- creating conditions for realizing programs of supporting employment in non-governmental organizations,
- developing social employment programs within the activities of the non-governmental sector.

The outline of the Strategy of Support of Civil Society Development is a document inaugurating the process of determining ideas and program supporting development of a good, that is efficient, transparent and fair, state. States with civil orientation are those in which universal and superior values, accepted by everybody and intended for everybody, should constitute criteria for social dreams of good life and ways of its realization. A good starting point in strategic thinking in this area was the government program – Civic

Initiatives Fund, which was created to stimulate and support development of civic initiatives with participation of the non-governmental organizations sector, and the Civil Society Operational Program which is being developed.

#### **4. Conclusions**

Non-governmental organizations which did not have any systemic support, in order to survive had to adjust to extremely unfavorable conditions. Constant search for new areas of intervention and innovative methods of working as well as taking up the most challenging tasks (often neglected by other subjects), coupled with lack of regular financing and constant threat to their functioning, forced them to use the project method and to adjust to the existing possibilities of financing. Compiling the budget from various sources, multitask jobs, replacing paid employees with professional volunteers and seeking supporters for the cause in various communities strengthened organization leaders and made their attitudes more flexible. However, we can discern a very troubling phenomenon which may be of great significance for the future development of civil society. We can observe some stratification in the non-governmental sector. Organizations which are fully prepared to use the EU funds will accumulate their resources entering next well-paid projects. Those who cannot deal with complicated procedures or managing their own structure themselves, without external support will never be able to reach the critical mass and become ready to apply for those resources and therefore will be doomed to regress. Another, more fundamental problem facing non-governmental organizations (unfortunately in Poland as well) has been brought to our attention by third sector experts. "We dreamt of civil society, and what we have is loads of non-governmental organizations", says Janos Kis, one of the key figures in democratic transformation in Hungary [Graff 2010, p. 18]. B. Einhorn, British sociologist, claims that after 1989, Eastern Europe fell into the "trap of civil society", and instead of building movements for systemic social changes, non-governmental organizations deal with filling the gaps left by the state retreating from many spheres of life. According to A.Graff, non-governmental organizations are no longer subjects of political transformations, but became a cog in the machine of neo-liberalism. Similar opinions on the development of civil society in Poland are expressed by many frustrated representatives of non-governmental organizations in our country. Such opinions are not voiced loud enough to be heard and often turned into a joke. We can also sometimes hear opinions of some politicians that civil society is foreign to Polish national culture, characterized by lack of trust (with the exception of one's family), passivity and proneness to conflicts. A.Graff rejects such assumptions and points at excessively institutionalized

operational methods of non-governmental organizations as the main reason why people who would like to realize their values and ideas are alienated. It takes a special skill to balance between “amateur” activity and extreme professionalism and to manage the organization without losing the values and ideas which lay at its foundation. It does not consist in adopting certain formulas of professional operation from commercial enterprises and increasing market orientation of some areas of activities of non-governmental organizations. It does not consist, either, in adopting operational standards of public institutions and creating a lot of posts or “governmentalizing” non-governmental organizations. As M. Rymśa, editor in chief of the “Trzeci Sektor” quarterly, points out, “professionalization of activities performed by such organizations should acquire its own, unique, ‘third sector’, civic profile, whose essence is orientation at public benefit and public wealth” [Rymśa 2010, p. 11-12]. We can state that dealing with the above threats should become a priority objective for the non-governmental sector. This battle will determine the shape of Polish civil society.

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**Bartosz Banduła\***

## **ORDERED EDUCATION PROGRAMS AS A NEW AREA OF EDUCATION DEVELOPMENT AT UNIVERSITIES**

### **Summary**

*In Poland, there has been a gradual increase in aspirations and mass higher education. Currently studies are started by more than 40% of young people, which is one of the highest percentages in the EU. At the same time universities report their financial requirements, which would modernize the infrastructure and introduce modern teaching methods. A chance to acquire these funds is ministerial program of ordering education. This article aims to show the importance of EU funding and funding trends in the development of innovative ordered higher education in Poland.*

### **1. Introduction**

Poland's accession to the European Union initiated the accelerated modernization processes in many sectors of Polish economy. The inflow of EU funds coming mainly from two sources: European Social Fund and European Regional Development Fund, positively influenced the growth of hard investment (infrastructure) as well as the improvement of the so-called human capital quality, considered a key factor in development of knowledge-based economy.

Apart from financial flows feeding the development of entrepreneurship and infrastructure, a considerable amount of European resources has been allocated to financing the development of higher education in Poland<sup>1</sup>. One of the key elements of the program of higher education modernization is the program of developing specialties of vital importance for the development of knowledge-based economy. These are mainly mathematical and technical specialties – this is due to the fact that currently both Polish and European economies show

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1 Intermediary Institutions for contests devoted specially to universities is the Ministry of Science and Higher Education. The value of projects realized only from resources managed by the Ministry of Science and Higher Education amounted nearly 14.6 billion zlotys on 15<sup>th</sup> April 2011 ([www.nauka.gov.pl](http://www.nauka.gov.pl) on 15th April 2011).

considerable demand for technical studies graduates. Simultaneously we can observe significant deficit of university graduates possessing such qualifications.

The aim of the article is to present the significance of European funds and financing ordered specialties in the development of innovative higher education in Poland.

## **2. Higher education as the responsibility of the state and the good of its citizens**

Providing access to higher education is the responsibility of the state. This task goes beyond the state boundaries. As far as Poland is concerned, it is particularly essential to integrate the organizational structure and education programs at universities with the idea of a European area of higher education; the issue is of vital importance to European integration process. Its element is harmonization of the rules governing higher education all over the European Union.

The operations and development of higher education however, require significant expenditure which depends on the general state of public finance, budget policy of a state and the income of its citizens. Taking into account the Central and Eastern European countries, including Poland, in comparison with the countries of the so-called “old EU”, expenditure on higher education per one student in our region is much lower than the average expenditure in old EU<sup>[2]</sup> [Kwiek 2010]. At the same time nearly all countries include expenses on higher education in their *public expenditure programs*, understood in public sector economics as public good. Even in countries with highly developed market economies – USA and Canada – university fees constitute a small percentage of expenses connected with higher level education. The state plays and should play a vital role in financing higher education – both public and non-public [Stiglitz 2004, p. 298; Schwarzenberger 2008, p. 25].

Organizational, formal and legal transformations in the higher education sector in Poland started in 1990 with passing the Act on Higher Education and the Act on Degrees and Scientific Titles [the Act]. At this stage higher education schools were granted considerable autonomy, visible in organizational and financial independence with reference to the university structure and forms of didactic activities. Another step towards adjusting Polish system of higher education to requirements posed by the accession to the European Union was the passing of the Act on Higher Vocational Schools. The standardization of the higher education system and the adjustment of the system to the EU standards

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2 In Poland the expenditure on higher education (expressed in absolute values with reference to purchasing power parity) amount to \$5200 while in such countries as France, Germany or Great Britain they range from \$11000 to \$15000.

was completed with passing the Act on Higher Education in 2005 [the Act], which was amended in 2011.

As a result of systemic changes higher education in Poland has been transformed significantly. Moreover, increased importance of this sector has been responsible for the growing number of university candidates since our accession to the EU. Following increased demand for the good which is higher education, the number of universities and higher schools in Poland has also grown<sup>3</sup>. Such a large number of public and non-public universities, coupled with weakened public finances of the state, have provoked a hot debate over the system of financing higher education. With Poland's accession to the European union structures, European funds became an element of this system and since 2004 they have been increasingly participating in financing development projects of universities – both public and non-public. Recently universities have actively been seeking European funds as a result of the Ministry program of ordering higher education (in form of the so-called ordered specialties). The program is a reaction of the state to increased demand for mathematical and technical specialties graduates expressed by various sectors of Polish economy.

Poland is witnessing gradual growth of aspirations and mass education on the higher level. Currently, over 40% of young people born in a particular year start their studies, which is one of the highest values in the EU. Simultaneously, we can observe lower interest in technical and engineering studies (only around 15% of students). According to the OBOP poll data, in the next three years we will have a deficit of over 76 thousand engineers in areas like IT, programming, designing and analysis of computer systems. According to the IDC report Poland already needs over 10 thousand IT specialists. The most wanted professions are programmers and telecommunications specialists.

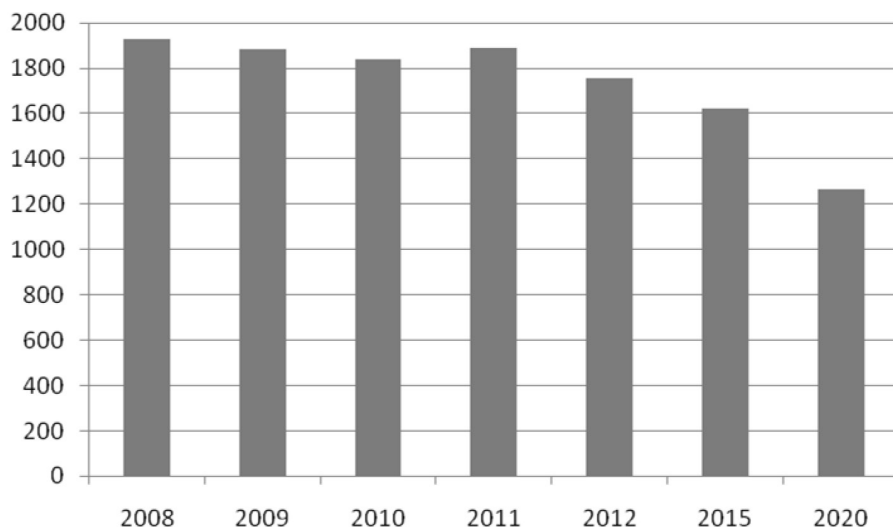
### **3. Financing higher education in Poland**

From the very beginning of the systemic changes financing higher education can be treated as a transformation dilemma. Analyzing data concerning the growing number of students in higher schools we can state that Poland looks impressive in comparison with the European Union. In spite of the population decline which is already beginning to affect Polish universities (both public and non-public), Ernst&Young consultancy predicts that until 2020 the number of people studying at Polish universities will remain on the level of 1.2 million people (see Figure 1).

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3 According to the data published on the website of the Ministry of Science and Higher Education (data for 2010) there were 457 higher schools in Poland, out of which 131 were public schools and 326 non-public ones.

**Figure 1.** The number of students in 2008-2011 and forecast for Poland until 2020



Source: own elaboration on the basis of [Strategia, p. 144].

A high number of students calls for increased financial expenditure on higher education. Poland is one of the countries which decided to maintain a dual type of expenditure on financing higher education. On one hand universities may take advantage of a subsidy for educating students, on the other hand – students' fees are a significant factor influencing financial flows in the education sector (especially non-public one). Despite the already mentioned constitutional responsibility to provide equal access to education (including higher education) in Poland, we can observe a clearly visible asymmetry concerning the number of students at free regular studies in public universities and those who pay for their education both at weekend studies at public and non-public universities<sup>[4]</sup> [Pomianek, Rozmus 2010, p. 56]. Such a situation accounts for the dominant position of revenues from didactic activity in Polish universities revenues. This is the effect of strong concentration of resources allocated towards research and development operations<sup>[5]</sup> [Pomianek, Rozmus 2010]. Analyzing the data concerning financing higher education in 2009 we can claim that

4 In the 2009/2010 academic year there were 659,400 students at non-public schools, which accounted for nearly 34.2% of all students; there were 198 thousand first-year students at non-public universities.

5 The resources for scientific research are strongly concentrated in Poland. 25 universities receive nearly 84% of all available resources for R&D in Poland.

the situation regarding distribution of resources according to titles is still being preserved. (see Table 1).

**Table 1.** Expenditure on higher education in 2009 (in zlotys)

No	Type	Mount In zlotys
1.	Subsidy for didactic activity	7.3 billion
2.	Subsidy for grants and scholarships	1.4 billion
3.	Subsidy for investment	0.3 billion
4.	Statutory activity	2.0 billion
5.	Total	11.0 billion

\*2009 was the first year in which all universities could take part in a competition concerning financing education ordered by the Minister.

Source: own elaboration on the basis of available data from the website of the Ministry of Science and Higher Education, [www.nauka.gov.pl](http://www.nauka.gov.pl).

It should be emphasized that a major part of resources allocated to financing higher education goes to public higher schools. This system does not take into account, however, the needs of the country concerning the number and structure of university graduates; this means that financing higher education by means of subsidies for didactic activity does not provide appropriate education structure for the labor market needs. Additionally, the system excludes (in spite of statutory obligation) non-public schools from financing, leaving them *de facto* only with subsidies for material support (grants and scholarships) – this situation can be attributed to lack of enforcement provisions to the Act on Higher Education Law. The only available form of fully financing didactic process at public and non-public universities are European funds, including the ordered education program, which constitutes an attempt of the Ministry of Science and Higher Education at addressing labor market demands. This program also takes into account the relations between expenditure on education, work demand and supply and costs connected with education process at particular specialties of studies.

#### **4. The essence and procedures of ordering specialties**

The economic and system transformations in Poland have revolutionized the way the labor market functions, which forced the institutions shaping this market to change their policies concerning university graduates as a vital factor shaping the competitiveness of our country and the effectiveness of its economy. Facing a visible deficit of technical professions graduates, in 2008, the Ministry of Science and Higher Education announced the program of “increasing

the number of graduates in specialties which are of key importance for the knowledge-based economy” – commonly known as the program of ordered specialties. From the very beginning the project has relied on financing ordered specialties from the European Union funds, that is European Social Fund which operates in Poland within the Human Capital Operation Program. Due to the specificity of the higher education sector, the realization of the program is supervised by the Ministry of Science and Higher Education<sup>6</sup>.

The first stage of ordered specialties program implementation was realized in 2008 and consisted in conducting the so-called pilot activity in which 47 Polish universities participated. Within this stage of ordered education implementation a list of areas of studies of key importance for the knowledge-based economy was selected. These are:

- Automation and Robotics,
- Biotechnology,
- Construction Industry,
- Chemistry,
- Power Industry,
- Physics (technical);
- Information Technologies,
- Materials Engineering,
- Environmental Engineering,
- Mathematics,
- Mechanics and Machine Construction,
- Environment Protection,
- Designing.

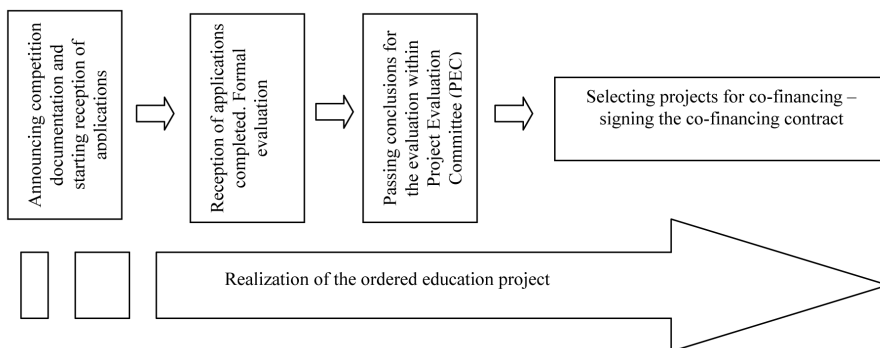
The second stage of the project implementation was the competition announced by the Ministry of Science and Higher Education within its plan of action for OP HC for a particular year<sup>7</sup>. This time the competition was for all higher schools realizing education in specialties covered by the ordering procedure. Excluding 2008 (pilot activity), in 2009-2011 the competition procedure was allocated 600 million zlotys (the project was covered by the financial engineering, that is 85% of the sum comes from EU resources, and 15% from the state budget). Figure 1 presents the procedure of realizing ordered education in higher schools.

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6 The ordered specialties program is realized within Priority IV of HC OP, Measure 4.1, Sub-measure 4.1.2. Ministry of Science and Higher Education plays the role of an Intermediate Body.

7 Ministry of Science and Higher Education announced a competition for ordered specialties in 2009, 2010 and 2011.

**Figure 1.** Procedure of ordering education at higher schools



Source: own elaboration.

The first stage in ordering education is the announcement of competition documentation. So far the Institution Organizing the Competition (IOC – Ministry of Science and Higher Education) has changed the provisions of the documentation each year in order to adjust them to current trends of education and labor markets. Competition documentation binds potential beneficiaries and sets project framework. This means that the documentation provisions are the basis on which an application for co-financing an ordered specialty is prepared. On this foundation MSHE defines minimum requirements that must be met by a potential beneficiary who wants to participate in the project (the so-called access criteria).

Documentation also defines strategic criteria (program assumptions essential for the ordering institution), namely the ones which, if met, are given additional bonus by the project evaluation teams.

The next step in the procedure of ordering specialties is formal evaluation of applications sent by potential beneficiaries.

Formal evaluation consists in checking whether the application for co-financing the project has been completed properly, especially if:

- the application was prepared on appropriate form and in an appropriate version of application generator;
- the documentation confirming financial situation of the beneficiary has been properly made (required especially from universities outside the public finance sector);
- the application has been signed by a person authorized to represent the beneficiary.

Proper formal verification of an application results in automatically passing it for the substantial (expert) evaluation. At this stage particular tasks proposed by the beneficiary are evaluated. Special verification is applied to eligibility aspects of budget expenses. The application is evaluated by two independent experts. On the basis of these evaluations the so-called ranking list is formed. Depending on the resources at the disposal of MSHE and the size of budgets of potential beneficiaries, a list of projects recommended for financing is produced.

## **5. Opportunities and barriers in the development of higher education through ordered specialties**

Currently ordered education on higher level covers 157 specialties at 75 universities<sup>8</sup>.

The ministerial program of ordering education is in many ways a very attractive and innovative form of financing higher education. This is due to the fact that the process of applying for financing activities from European funds requires universities to join the competition procedure and therefore to prepare an innovative and competitive didactic offer, which must be built in the frame of an application for financing within Human Capital Operational Program resources (HC OP). This, so to speak, constitutes a new area in university functioning, as so far universities (depending on their organizational form) have financed their activities from subsidies or student fees.

Ordered specialties undoubtedly provide opportunities for dynamic development of technical and mathematical studies. This is possible due to full refund of costs anticipated in the project budget. Thanks to the support from European fund resources (ESF), the program of ordered specialties provides full eligibility of expenses – this mainly concerns:

- conducting make up classes from secondary school subjects;
- running additional classes which make education in specific specialty more attractive and which are not included in the “standard” teaching program (language courses and trainings, professional certificates);
- creating a special grant program for the best students;
- paid work practice at potential employers;
- modernization of university infrastructure.

The prospect of modernizing university infrastructure (within HC OP) seems very interesting. It is possible thanks to the principle of flexible financing (*Crossfinancing*). This procedure allows participants to allocate 10% of their

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<sup>8</sup> Data obtained on 15<sup>th</sup> May 2011 from: [www.nauka.gov.pl](http://www.nauka.gov.pl).



budget for the purchase of fixed assets (research apparatus, IT equipment) or modernization of the building (for example adjusting it to the needs of disabled people). This offers an opportunity to improve university competitiveness and to obtain competitive edge in the education market.

The realization of such projects carries along certain threats, too, which are sometimes the consequence of incoherent government policy. The greatest worry of universities participating in the ministerial program of ordered education is the so-called principle of proportional expenditure. It refers to the procedure of settling the project budget adequately to the degree in which the main aim was realized – that is the number of educated engineers. The implementation of the principle (which aims at disciplining beneficiaries conducting courses and professional training) to quite long-lasting and complex projects<sup>9</sup> raises some fears in academic circles: this is because natural fluctuation of students of difficult and demanding technical specialties causes (in accordance with the principle) proportional limitation of the project budget (even if the payment application of the beneficiary has been settled properly and accepted).

So far MSHE has not developed a coherent concept of solving this problem even though this fact has been brought to its attention by professional media and beneficiaries have asked the Intermediate Body to give their statement on this issue.

## 6. Conclusions

Ordered specialties (despite the difficulties in realization of such projects) are an opportunity for modernization of higher education in two areas.

Firstly, the initiative of ordering education was one of the first attempts at introducing market principles of financing higher education. This is connected with abandoning subsidies for the objective competition which selects the best projects constituting an education offer of both public and non-public universities.

Secondly, European funds strengthen the position of universities which are project beneficiaries. They allow them to modernize their programs of studies, education in new specialties created in response to labor market needs. Universities, being beneficiaries of ordered specialties programs within the *Crossfinancing*, procedure may modernize their infrastructural base.

Priority IV of HC OP assumes eligibility of expenses until 2015 – that is until the moment in which the new budget for 2014-2020 has been defined and implemented. This period of time should also witness financing higher

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<sup>9</sup> Financing concerns engineering studies which usually last three years or supplementary, second degree studies.

schools with the procedure developed within ordered specialties proposed by the Ministry of Science and Higher Education in 2008.

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**Małgorzata Burkowicz\***

## **THE CRISIS OF THE FIRST DECADE OF THE 21ST CENTURY AND ITS INFLUENCE ON POLAND AND OTHER EUROPEAN COUNTRIES**

### **Summary**

*The financial crisis broke out in 2008 in the United States, spreading on other countries to become global. The main objective of the article is to present how the financial crisis in the United States has influenced other countries, mainly Poland and other European countries. The author also presents theoretical views on the international transmission of crises, transmission channels and selected models. The aim of the presented article is an attempt to identify reasons for the current economic crisis, pointing out that it has brought about significant changes in the attitude of the governments of the most powerful countries in the world towards state interventionism and it has led to transformations in the course of economic cycle.*

### **1. Introduction**

Recently we have experienced a dramatic growth of financial markets powered mainly by globalization and technological progress [Sławiński 2006, pp. 11-12]. This global financial system, however, was upset by the crisis which appeared in 2008 on the American mortgage loan market and led to serious disturbances and uncertainties in the whole global financial market.

The purpose of this paper is to determine how the financial crisis which started in the first decade of the 21<sup>st</sup> century has influenced Poland and other, mainly European, countries.

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## 2. The essence of an economic crisis

The term 'crisis' comes from Greek and means choice, decision-taking, coping with, fighting, in which one must act under considerable time pressure. Crisis can be associated with such features as: urgency, trauma and its subjective consequences in form of negative experiences. From the very beginning of history people have encountered crisis situations. They may be caused by chance, personal and life failures. Everyone's life is marked by constant changes being the result of critical events. We live in uncertain surroundings and environment, where positive and negative values coexist and cause internal imbalance.

We cannot fully predict or control the human behavior. Nor can we predict the forces of nature. However, we can limit situations causing crisis and minimize its effects. Hard as we might try, we cannot completely eliminate them. Crisis is a special phenomenon, appearing within a general and sometimes very long process of changes happening around us.

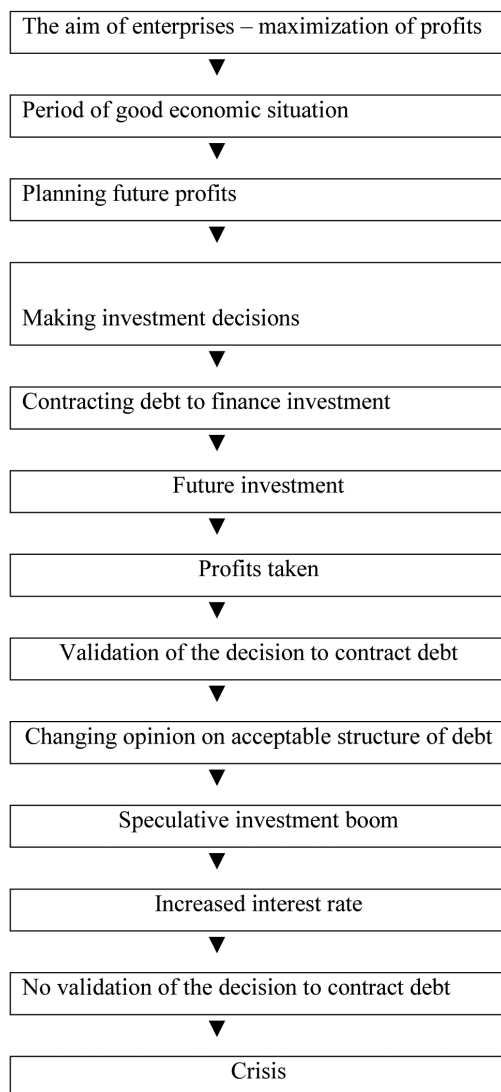
Economic crises, that is periodical slow down of economic activity, appear cyclically in the economy. In the past they were caused mainly by external factors, such as natural disasters, crop failure, epidemics or political phenomena, such as wars. Together with the development of market economy, natural phenomena have gradually become less important for the economic situation than economic factors [Morawski 2003, p. 9]. Economic crises are a frequent subject of articles and books, for example by M. Friedman, A. J. Schwarz, Ch. Kindleberger, H. Minsky, P. Krugman.

M. Friedman and A. J. Schwarz (1963) associated the financial crisis exclusively with the panic in banking sector. They attributed lower money supply to it, which led to serious weakening of economic activity. Such phenomena as serious decrease of asset prices or increased number of bankruptcies among enterprises were, according to them, not a serious financial crisis as long as they did not cause panic in the banking sector. Another definition of financial crisis was proposed by Ch. Kindleberger (1978) and H. Minsky (1972). In their opinion, financial crisis happens when we can witness one of the following phenomena: sudden and abrupt fall of asset prices, bankruptcy of many large financial and non-financial institutions, deflation, serious tension in the currency market. Many specialists assume in their works that the currency crisis is an element of the financial crisis (P. Krugman), while others believe that it may appear autonomously, without causing crises in other parts of the financial system, though currency crisis often precedes the financial one.

The financial crisis of the first decade of the 21<sup>st</sup> century accounts for more attention paid to the theory of financial instability created by H. Minsky. The economic mechanism used by Minsky to explain the process of endogenous generation of financial crises is shown in Figure 1 below. The most important

role in this mechanism is played by future investment. Decisions concerning investment are determined on the basis of predicted profits. In this element of his reasoning H. Minsky refers to the views of J.M. Keynes [Minsky 1984a, pp. 59-70].

**Figure 1.** Economic mechanism in financial instability theory



Source: own elaboration.

As Diagram 1 shows, the explanation of the financial crisis refers to several stages. At the beginning there is surplus of wealth, which leads to economic boom, and then inevitable breakdown. The latest crisis contained all these elements, namely there was a housing boom and breakdown leading to turbulences in financial markets.

### **3. The crisis in the USA**

Global imbalance in financial markets at the beginning of the 21<sup>st</sup> century was caused by maintained high deficit in current exchange in the USA financed by the capital flowing from Japan, China and countries exporting oil. American households started to spend more than they earned, so they had negative savings. In practice it boiled down to financing consumption with taken loans secured with the mortgage on this part of property which had not been mortgaged yet. This was possible as long as the property prices grew. After the Great Depression of 1930s, loan offices supporting construction industry were established. Gradual liberalization of their control led to the situation in which they started offering mortgage loans without sufficient collateral. The money was cheap and easy to obtain. The US government supported the development of the housing industry through programs aiming at enabling its citizens to own their flats. These activities encouraged the lower control of the risk associated with granting subprime loans.

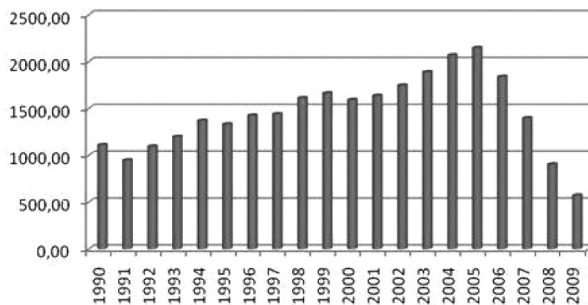
According to International Monetary Fund, subprime loan is a loan taken by the person who meets one or more of the requirements below [IMF, Global Stability Report, 2007] :

- bad credit history, resulting from payment delays or client's insolvency,
- weak credit scoring (point method of assessing credibility of a person applying for a bank loan) or high DTI ratio (debt-to-income ratio when financial obligations of a debtor exceed 50% of his gross income),
- no or partial credit history.

The constantly growing prices of real estate encouraged credit institutions to grant loans even to people without steady income, as it was assumed that the property itself is a sufficient security of the loan. These actions accelerated the demand for housing properties, increasing their prices to sky rocket levels, exceeding their real value.

Excess financial liquidity of the banking sector appeared in 2002-2004, and availability of cheap money translated into housing industry boom. As Figure 2 shows, the biggest number of properties were built in 2003-2005. In this period mortgage loans with variable interest rate which had the property as collateral were very popular, which caused subsequent periods of debt repayment with higher interest rate.

**Figure 2** Number of private houses built in the USA (in thousands)



Source: own elaboration on the basis of data from US Department of Housing and Urban Development, Office of Policy Development and Research.

When excess liquidity appeared, monetary policy was not tightened early enough, but on the contrary, it was loosened by lowering interest rates. Monetary authorities for some reasons abandoned the monetary policy based on Taylor's principle. At some point, an increased number of debtors stopped repaying their debts not only due to high interest rates but also because they lacked motivation to pay the installments. Bank debtors started realizing that the amount of credit significantly exceeded the value of their properties, so they lost the willingness to pay back the debts. At the same time, artificially increased prices of properties started decreasing at the end of 2006, which was the first symptom of the crisis. In the middle of 2007, subprime bonds turned out to be unsecured.

When the prices of houses in the USA started to fall, in July 2007 two investment funds of Bear Stearns Bank went bankrupt. Banks encountered gravely serious, billion-dollars-worth losses. These losses proved to be so huge that in March and April 2008 the capitals of big US banks (Merrill Lynch, Goldman Sachs, Morgan Stanley, Lehman Brothers, Citigroup) were increased to prevent their bankruptcy. It was feared that bankruptcy could cause the domino effect, a wave of bank and enterprise bankruptcies and increased unemployment. The rescue capital came from currency reserves of various countries: Saudi Arabia, Kuwait, South Korea, Japan, China, Singapore. In return for the issue of shares, each bank received from a few to several billion dollars. These actions brought only short-lasting effects. On 5<sup>th</sup> September 2008, the fourth largest investment bank, Lehman Brothers, after a fruitless plea for help from US Central Bank, was forced to file for bankruptcy.

These were not all the causes whose accumulation led to turbulence of financial markets. The problems were magnified by passing the risk connected

with granted subprime loans to indirect creditors in the process of securitizing debt into bonds secured with mortgages. Rating agencies did not assess properly the risk carried by these securities. Not many people knew which of these securities were highly risky. We still do not know which banks possess the so-called 'toxic' assets in their balance sheets.

The collapse of the market accounts for low trust people had in financial sector and low trust it had in itself. Financial institutions and banks limited the activity of mutual lending. This caused lower liquidity and increased threat of insolvency of the institutions possessing assets based on subprime loans. Decreasing numbers of paid back loans forced the banks to take over mortgages and their sale at a loss as the property prices were constantly decreasing. Governments decided to provide liquidity to the market in order to stop further bankruptcies of large financial corporations, without noticing that the main problem was in the increased risk.

The next reaction of US monetary authorities to the threat was to loosen the monetary policy by lowering interest rates. This was associated by the weakening of the dollar and increasing prices of oil. However, all these events did not bring positive effect, as they translated into lower sales in car industry. The breakdown was very painful. It not only stretched for a period of more than a year, but also caused serious loan crisis with severe side effects, which, coupled with expensive oil and housing market breakdown, affected the whole economy. Moreover, the most globalized market of finance allowed uncontrolled spread of toxic assets and financial breakdown.

The question should be asked whether the conclusions from this bad economic period should be limited only and exclusively to providing liquidity and blaming the banking system for causing the crisis. Of course not. The whole complicated course and improper actions of state authorities, international organizations, central bank boards and financial institutions were neither coherent nor well thought-out.

#### **4. Transmission of the American crisis into Poland and other European countries**

The events that initiated the property market crisis in the USA turned out a global problem. Together with the development of the situation in international financial markets, subsequent institutions started revealing financial losses connected with disturbances appearing in the markets. At the beginning the information was directly related to subprime loans, but it soon turned out that this is only part of the losses.

Crisis phenomena affected badly especially the countries with advanced economies, mainly those with important role of banking systems. The outbreak



of the global financial crisis and its unprecedented power of spreading into next segments of financial markets and real economy made it necessary to initiate coordinated, worth billions of dollars government interventions in many countries all over the world, both developed and developing ones. The value of public aid assigned to fight the consequences of the latest crisis turned out to be the biggest in history, as far as the nominal value and GDP percentage of particular countries are concerned.

As a consequence of the bankruptcy of the fourth largest investment bank, Lehman Brothers, and the real possibility of bankruptcy of other large US and European banks, the inter-banking market experienced the crisis of trust. Banks stopped lending money among themselves as they worried about insolvency.

When in September 2008 Lehmann Brothers announced its insolvency, the effects of this immediately reached Europe, especially Germany. It manifested itself in lower share quotations at Frankfurt Stock Exchange. The government and financial sector representatives drew up a new rescue plan for Hypo Real Estate bank which was threatened with bankruptcy (it specializes in mortgage loans and in financing public projects). The bank's troubles had their source in a banking subsidiary company Depfa, which was affected by the consequences of lower value of debt connected with mortgage loans. The implementation of a sound anti-crisis package did not help. Financial institutions tightened their criteria of granting loans, which influenced the situation of enterprises, in addition, unemployment rose.

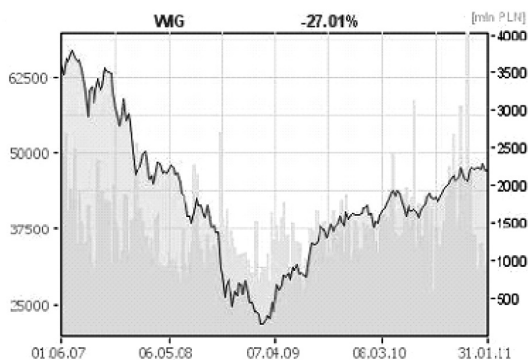
The governments of other European countries, in an attempt to avoid the development of the crisis, took immediate action. They tried to rescue financial institutions from bankruptcy. So, for example, the governments of the Benelux countries (Belgium, Holland, Luxemburg), some of the most urbanized and economically advanced countries in the world took control over the biggest Belgian bank – Fortis, also a banking and insurance institution – Dexia – was threatened with bankruptcy. Two most important financial entities – Fortis and Dexia faced aggravating problems which influenced the state of the whole banking sector. The government help did not prevent rapid plunge of bank shares, whose value decreased by 30% in September 2008. The crisis in the financial sector led to increased unemployment rate.

In 2008, the banking system of Iceland, the most developed branch of Iceland's economy, broke down. The consequence of this were the bankruptcies of four Icelandic banks (their liabilities proved too big for the GDP of such a small country) and a significant decrease of the Icelandic currency value. The government of Iceland asked IMF, USA, EU and Russia for help. From September 2007 to September 2008 the exchange rate of the Iceland's currency fell by over 70%. In order to defend the currency value the government used most of its financial reserves. According to the government the savings were

safe, but the foreign currency transactions were blocked. All these financial means were not sufficient to stabilize the endangered banking sector, the full control of which was taken over by the government. Prices in shops changed almost daily to catch up with ever-increasing inflation. As the situation did not improve, the country experienced some shortages in sales of fuel and imported goods.

On the other hand, in Russia and Ukraine, the payments from bank accounts were limited. There was some news about the troubles experienced by Hungary, Czech Republic and even Poland. All this was due to the significant number of loans taken in Swiss francs and in euro, which further weakened local currencies and threatened mortgage insolvency in the above countries and further expansion of the banking crisis. Poles experienced stock exchange decline associating the crisis (Figure 3).

**Figure 3.** WIG index quotation during the crisis. Value Turnover (in million zlotys)



Source: own elaboration on the basis of data from US Department of Housing and Urban Development, Office of Policy Development and Research.

As Figure 3 demonstrates, shares lost considerably in their value at the end of 2008 and at the beginning of 2009.

As Figures 2 and 3 show, lower demand and increased supply on the zloty market caused considerable fall of its value, mainly in 2008.

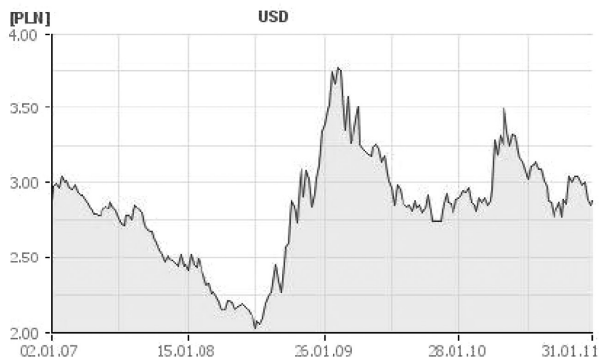
**Figure 4.** Changes of the zloty-euro exchange rate during the crisis



Source: EUR exchange rate, Money.pl, <http://www.money.pl/>.

Figure 4 shows that in July 2008, the euro exchange rate was close to 3.2 zlotys while in February 2009 it was only 0.08 zloty short of the level of 5 zlotys.

**Figure 5.** Changes of the zloty-dollar exchange rate during the crisis



Source: USD exchange rate, Money.pl, <http://www.money.pl/>.

In countries with liquid currency Exchange rates (Czech Republic, Hungary, Poland, Romania) the outflow of foreign capital caused the decrease of local currency value in relation to euro. Although it increased the competitiveness of export and attractiveness of these countries for foreign investors, it also brought about inflation-generating increase of imported goods prices and, more importantly, increased the debt level of enterprises, households and global debt expressed in foreign currency. Some countries (for example Czech Republic, Poland) decided that further loosening of monetary policy could lead to further devaluation of their currencies, therefore they reacted

to the crisis mainly through expansive budget policy. However, Romania and Hungary were much more severely affected by the crisis and had to ask for foreign support while introducing more restrictive budget policy. Slovakia and Slovenia, however, due to their membership in the euro zone (this was possible due to their internal and external balance) enjoyed a slightly better level of protection against uncertainty. However, these countries have to maintain their competitiveness in foreign trade now by real growth of productivity, not by depreciation of their currency.

Many other countries had established a fixed currency exchange rate to euro before within the ERM II mechanism (Bulgaria, Estonia, Latvia, Lithuania). They were all severely affected by the recession which ended the loan-based economic boom of recent years and caused export decline. The governments of these states decided to maintain fixed exchange rates of their currencies into euro (due to high national debt in foreign currencies) and are making efforts to keep low levels of public debt in order to enter the euro zone as soon as possible. This means that the correction is made through decrease of costs and remuneration and through increase in productivity. A restrictive budget policy was adopted, consisting in remuneration cuts in public sector, lowering retirement pension and social benefits and increasing taxes. In Poland the consequences of the crisis were mainly felt in restrictions in providing loans to entrepreneurs and households. In Czech Republic, Slovakia and Slovenia difficulties were mainly caused by lower demand for export goods and decreasing private investment, including direct foreign investment. Other countries (Bulgaria, Estonia, Latvia, Lithuania, Hungary and Romania) were more affected by the crisis, though. In the years preceding the crisis they all witness significant economic growth powered by access to EU markets and inflow of foreign capital, which led to the development of consumption-increasing investment, often based on loans taken in foreign currencies, in some countries leading to the loan-powered property boom. The financial crisis, however, encouraged capital to search for safer places for investment, which was reflected in frequent withdrawal of foreign capital from countries perceived as more risky and with limited financial liquidity being the consequence of restrictions imposed by foreign banks in provision of transnational loans.

In spite of considerable decrease of GDP in comparison to 2008 (5% to 1.7%), Poland was the only EU country enjoying economic growth in 2009.

**Table 1.** Real GDP growth (in percentage)

	2008	2009	2010	2011
U.S.	0.0	-2.6	2.7	2.2
EURO	0.3	-4.1	1.7	1.7
POLSKA	5.0	1.7	3.5	4.0

Source: OECD Economic Outlook, Volume 2010/2.

The GDP growth in Poland was positively influenced by increased net exports and total consumption, while negative influence was exerted by lower accumulation. The positive speed of GDP growth was also affected by the utilization of EU funds and investment related to our preparation to Euro 2012 championship.

Considering the prospects of economic boom in Poland we should pay attention to the fiscal policy, which, after a period of relaxation in 2008, in the next years became more restrictive. First of all, expenses, including remuneration in public sector, were limited. Adjusting the public finance imbalance is in the medium-term perspective vital for curbing the growth of public debt and meeting the obligations imposed on Poland within the excess deficit procedure.

It is interesting to note that while southern EU countries experienced problems with public finance, Turkey enjoyed a quick pace of economic growth.

Summing up, Central European countries, including Poland, fared better in times of crisis than other countries of Europe and Central Asia.

## 5. Conclusions

The global financial crisis spurred hot discussion on the role of fiscal policy in stabilizing the economic cycle. The experience of developed economies so far have not provided a uniform answer concerning the effectiveness of fiscal stimuli in moderating cyclical fluctuations. The state of public finance in a particular country is one of the most essential factors determining the effectiveness of fiscal impulse. High level of deficit and quickly growing public debt may considerably weaken the effectiveness of fiscal impulse. The influence of expansive fiscal policy on consumption will be then limited due to consumers' expectations concerning consolidation of public finance in future years – higher tax burden, resulting from the obligation to service and repay the contracted debt.

Moreover, the power of influence and acceptable scope of expansive fiscal policy are strongly determined by the possibilities of financing higher deficit by a particular economy, that is indirectly by the stage of development and the

situation on financial markets. The crisis accounts for the escape of investors to stable advanced economies, which considerably limited the possibility of using fiscal policy to stimulating final demand in most of new member states of the European Union.

The subject presented here is very wide and calls for further detailed studies.

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**Katarzyna Cięciak\***

## **GLOBAL PROBLEMS OF ENERGY MANAGEMENT**

### **Summary:**

*Global energy economy is in a period of huge transition. Economic development, technological progress accompanied by a large population growth lead to significant increase in energy demand. The availability of energy has a direct impact on the prosperity of the country, but on the other hand overusing it leads to major problems and risks.*

*This article aims to identify and analyze the fundamental problems of the energy sector of a global nature. Thesis of the article implies that the global challenges of energy management, such as issue of growth in energy demand caused by economic development and population growth in the world, growing dependence on energy imports from politically unstable regions, as well as increasing consumption of non-renewable energy are crucial for the economic and political stability of states, the smooth development of trade in international markets and the welfare of the people.*

### **1. Introduction**

The world problems and challenges of the energy sector should be considered globally in three dimensions: ecological, economic and socio-cultural. In this article we will mostly deal with economic and socio-cultural analysis of the problems since the impact of energy economy on environment focusing primarily on the growth of air pollution caused by emissions of gases and particulates produced by burning fossil fuels is the subject of a separate paper and requires detailed discussion. The purpose of the article is also to make an attempt to anticipate the energy sector developments in the upcoming years. This article has been prepared basing on literature of the economics of environmental protection and energy management as well as on the basis of legal acts, the source to develop national and Community institutions dealing with energy.

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## 2. Energy policy and management

Production and use of energy is the foundation of all living processes and human activity. Energy is a fundamental factor influencing the economic and social development of the world. It is, together with food and air, one of the core material needs humans have. The use of energy facilitated the development of our civilization and shaped the present state of the world economy. Energy and its acquisition is the basis of a distinct branch of economy, which is power industry. Energy management deals mainly with: acquisition, processing and delivery of fuels and energy, use of energy resources, exploitation of energy appliances and planning the development of energy infrastructure as well as managing and streamlining energy production and use. The term *energy management* is often used interchangeably with the term *energy sector or fuel and energy management*. These terms are used broadly, covering economic activity referring to all kinds of fuel and energy [Mikołajewicz 1983, p. 6].

The importance of energy for world economy manifested itself together with the oil crisis of 1973, commonly referred to as *the first energy crisis*. The crisis was caused by the embargo imposed by Arab states on deliveries of oil to Western states combined with rapid increase of its price which caused prices of other fuels to grow as well. At the turn of 1980/1981 there was the second energy crisis, when the world experienced another shock caused by skyrocketing prices of oil and its derivatives. Sudden increases of oil prices and limited delivery of this material by producers united in Organization of Petroleum Exporting Countries (OPEC), especially those from the Middle East, accounted for intensification of various negative phenomena in global economy. Difficulties experienced by many countries in satisfying their energy needs slowed down social and economic development of the world.

Careful management of fuels and energy became a necessity. Many countries initiated long-term actions called energy policies, whose main goal was to solve global problems of energy management.

The aim of sector policies drawn by states is to create conditions of desirable and rational management of resources which guarantees full satisfaction of the needs of economy and its constant development. Energy policy may be defined as a form of economic or administrative influence of public authority organs on energy sector, its structure and the way it functions. Energy policy is a sector policy. It may be understood as economic policy towards energy sector since the processes of management in fuel and energy sector constitute a separate area of activity. Energy policy is applied by public authorities to the sector – from the perspective of economic policy – commonly defined as a strategic sector (or in recent regulations defined as a crisis infrastructure sector). This causes a lot of problems, since any changes taking place in this sector happen simultaneously

in political and economic dimensions. This problem is further complicated as the political, economic and social spheres are closely interrelated. The subjects of energy policy are public authority institutions and organs as well as energy producers. The subject of energy policy in broad sense is energy management, composed of: production and distribution of energy, choice of fuel sources as well as consumption and technologies of energy production.

### **3. Fuel resources and reserves and energy production and consumption**

Presenting world resources and energy demand, we should rely mostly on data prepared by World Energy Council (WEC) and International Energy Agency (IEA), as well as statistics prepared by British Petroleum concern.

Analyzing the resources of energy raw materials and changes in energy production we should bear in mind different forms of energy and types of energy depending on the degree of transforming its carriers. The forms of energy include: current (used in engines, for lighting, in electric and electronic appliances), process heat (mostly high-temperature heat generated by industry), low-temperature heat (hot water, heating the buildings). The latest analyses single out data concerning only the energy subsector which is electro-energy sector, that is a division dealing with production of electric energy. As far as the degree of transforming its carriers is concerned, we have three energy types:

- primary – created from carriers which have not been technically processed: primary energy is obtained from existing energy resources which can be renewable or non-renewable (for example, coal, oil, natural gas, uranium, solar energy, wind energy),
- secondary – created from carriers which were subjected to one or more transformations in technical equipment (for example petrol, heating oil, current),
- final and useful – this is energy received by end-user to satisfy their needs, that is delivered to the user in the form their receivers can take (for example – heating oil in a container).

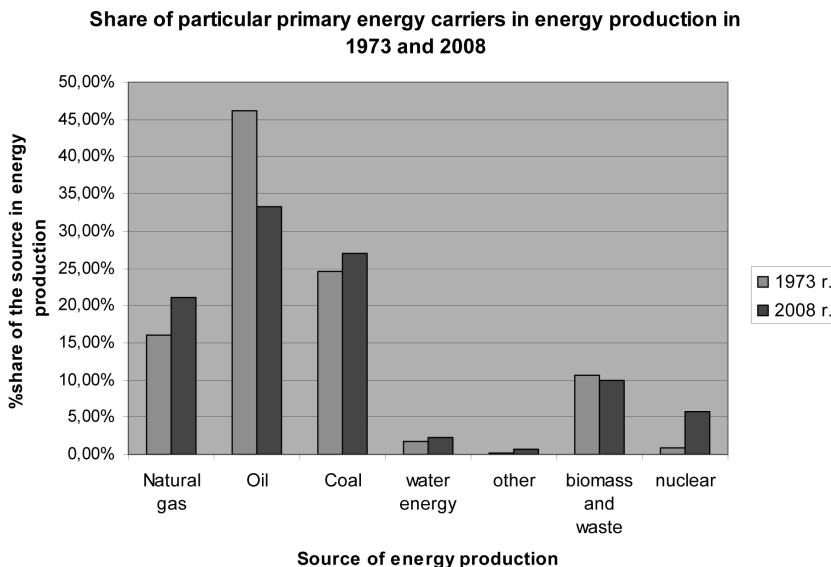
It should be noticed that the reserves that can be obtained have been analyzed in detail and are the foundation of currently developed forecasts of energy supply of the world and particular countries. However, we should remember that geological research of resources and reserves of fossil fuels is not complete, therefore further research, especially concerning resources located in inaccessible part of the globe, will allow us to discover additional, currently unknown, deposits of energy raw materials.

Due to their location, access to particular energy materials is very uneven all over the world. Thanks to its resources which exceed the resources of other

carbohydrate carriers, coal will still remain one of the basic energy carriers. Coal deposits on particular continents have different sizes and different degree of analysis. The main producers of coal are: China, USA, India, Australia, South Africa, Russia and Poland. The biggest producers of brown coal are Germany and Russia. The main oil producers are Russia and Middle East countries, while natural gas is mainly obtained in Russia, USA, Canada, Great Britain and Middle East countries.

Over the past 30 years we have observed changes in the share of particular primary energy carriers in production of energy. The changes in production of particular energy sources are presented in Figure 1.

**Figure 1.** Share of particular primary energy carriers in energy production in 1973 and 2008



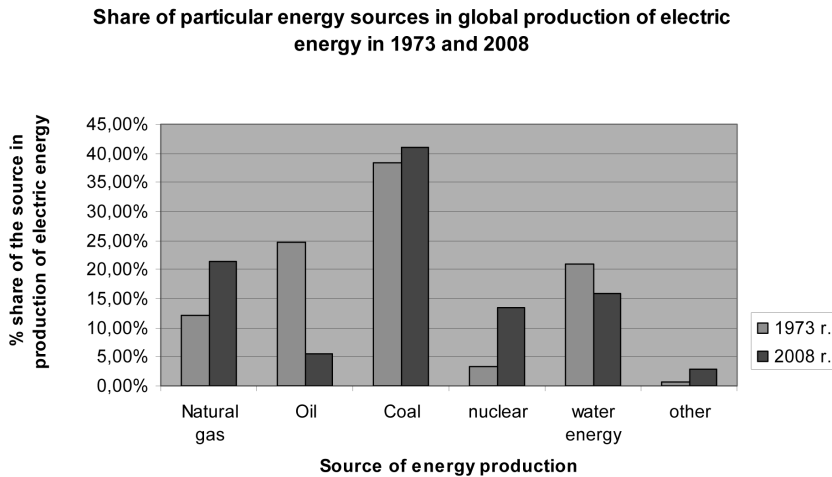
Source: Own elaboration on the basis of data from *Key Word Energy Statistics 2010 IEA*.

The nuclear energy production experienced the fastest growth, though its share in global energy production is still small and in 2008 amounted to 5.8%. Also natural gas production increased, while oil production fell significantly. Coal production enjoyed moderate growth. We can notice growing use of renewable energy sources, but they are not competitive to non-renewable energy sources yet [2010 Survey of Energy Resources. World Energy Council].

Since the beginning of the 1970s we have witness a three-fold increase of the global electric energy production - from 6116 TWh in 1973 to 20093 TWh in 2009 r, of which over a half is produced by OECD countries [BP Statistical

*Review of World Energy June 2010*]. The changes in the share of particular energy sources in electric energy production in the world in 1973-2009 are presented in Figure 2. The main fuel for the global production of electric energy has been coal, with its share remaining at around 40%. However, the share of other fuels has changed considerably. We can notice a significant decrease of oil share in electric energy production and noticeable increase of natural gas share.

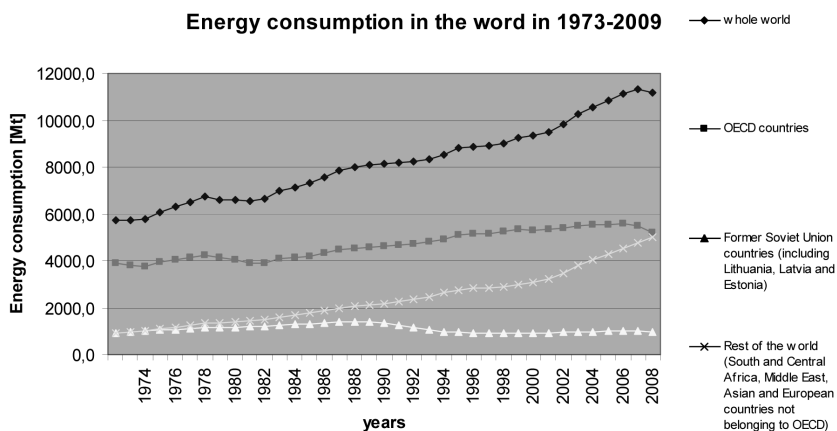
**Figure 2.** Share of particular energy sources in global production of electric energy in 1973 and 2008



Source: own elaboration on the basis of data from *Key Word Energy Statistics 2010 IEA*.

The share of renewable energy sources in the global production of energy has been systematically growing over the past decade, however, even with the dynamically developing nuclear energy production, it will not be able to cover most of the systematically growing world demand for energy in 30 years' time. According to International Energy Agency world energy consumption in 2030 will grow to 16790 Mtoe [*Key Word Energy Statistics 2010 IEA*]. Planned energy consumption in 2030 will grow by 50% compared to 2009 consumption.

**Figure 3.** Primary energy consumption in 1973-2009



Source: own elaboration on the basis of data from: BP *Statistical Review of World Energy June 2010*.

Figure 3 clearly shows that in the past 40 years we have witnessed a significant growth of primary energy consumption. Primary energy consumption has increased by nearly 40%, from 3813.1 Mtoe in 1965 to 11194.3 Mtoe in 2009. The biggest share of energy consumption belongs to OECD countries. Then we have China (17.4%), non-OECD Asian countries (11.5%) and former Soviet Union countries (8.5%). There are still huge differences between energy consumption per head in advanced economies and third worlds countries. In extreme cases the consumption is several times lower in the poorest countries than in advanced economies [*Key Word Energy Statistics 2010 IEA*].

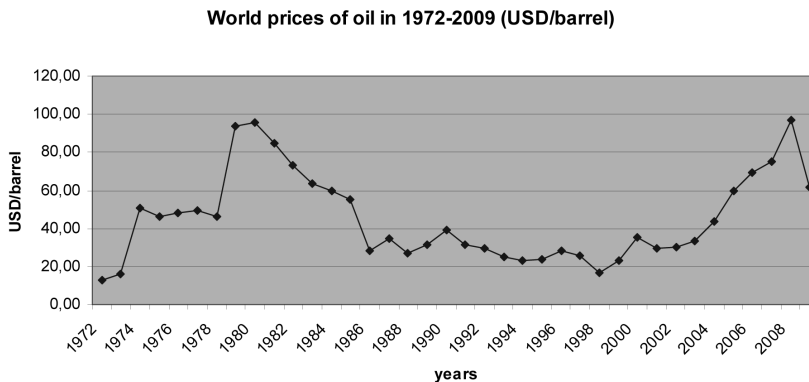
The problem of determining the world resources and reserves of energy materials is a serious global issue of mainly economic type. The new deposits are not always exploitable or the exploitation costs exceed the sales of particular materials. In 2003 oil reserves increased significantly because they also included oil sands in Canada. Contrary to traditional deposits of oil, which under influence of hydrostatic pressure flows onto the surface, the excavation of oil from oil sands takes place in strip mines. This is connected with much higher energy expenses needed to excavate it. Therefore the energy return on energy invested (EROEI) which is the relation of energy contained in the energy material to energy needed to obtain it is in case of oil sands 30 times lower than in case of liquid oil deposits. This accounts for significantly higher costs of the barrel of this material and makes its exploitation unprofitable [H. Manteuffel Szoeg, M. Bukowski 2010 p. 26]. Profitability issues also refer to the exploitation and distribution of unconventional gas and liquefied gas. Due to wider availability of liquefied natural gas (LNG), this material is approaching

a new era. Recently the costs of LNG production and transportation have decreased so much that it is starting to be competitive to natural gas as far as distribution costs are concerned. A very interesting phenomenon is quick growth of unconventional gas deliveries. In 2009 the USA beat Russia and became the biggest world producer of gas due to increasing production of shale gas and gas from coal deposits. The search for unconventional gas in China and Europe (also in Poland) is continuing, however the procedures of its excavation are still being analyzed. The main obstacle in search for oil and unconventional gas is still technology. This means, for example, the necessity of cooperation between independent international entities and state-owned enterprises. Each country is trying to realize this cooperation as well as it can.

#### **4. Oil prices as the main factor of energy prices**

Energy prices are largely determined by the market. Electricity, coal, gas and other energy materials have become tradable commodities. The factors influencing their prices are similar to those identified in other commercial markets, for example in stock exchange or commodity markets. The final price is established as a result of the game between supply and demand and market participants. Energy prices determined by the market are the best basis for encouraging investors to invest their capital in such areas as search and exploitation of energy sources or construction and maintenance of power stations. The market is the best basis for balanced energy management, but only when we can propose reasonable prices and attractive profits from invested capital and when investors are ready to supply the energy market with their financial resources (*Raport o światowym rynku energii*. 2005, p. 4). This concerns also competitively organized areas of energy management, such as energy production, trade and sale as well as regulated activity of energy transmission. This capital is vital for billion-dollars-worth investments so that individual and industrial clients could rely on smooth power supply in the future. The costs of production, distribution and use of energy are an important group of costs both for households and enterprises.

**Figure 4.** World prices of oil in 1972-2009



Source: own elaboration on the basis of data from BP *Statistical Review of World Energy June 2010*.

Global economic growth is connected with prices of materials, especially with prices of oil. Oil is one of the most important sources of energy used in world economy. Prices of other energy sources, including natural gas and coal, are connected with oil prices: if oil prices go up, other energy materials also become more expensive.

Since the 1970s oil prices have fluctuated considerably. As Figure 4 shows, during two oil crises (1973/74 and 1979/80) the price of one barrel of oil soared from around USD 20 to nearly USD 100. In the 1990s the prices plummeted back to around USD 20, while in the period of 1998-2008 it took off again to the level of USD 100. Such big fluctuations were caused by: speculation in global fuel markets, insufficient number of refineries, too quick demand growth in newly industrialized countries, lack of possibilities of obtaining more oil after reaching full production capacity of its sources. The forecast concerning oil prices in the nearest years predict their further growth. Such high prices of oil and natural gas account for considerable flow of financial resources from importing countries, which without remedy actions such as increasing the supply of exporting countries or limiting consumption, may lead to serious disturbances in the world economy (H. Rogal., 2010 p. 366).

Changing prices of basic carriers of primary energy, mainly of oil, not only influence the improvement of energy effectiveness but also, in times of great price fluctuations, in short term negatively affect economic growth indicators. According to the estimates prepared by OECD in 2004, there is an approximate rule enabling us to calculate the influence of oil price increases on the economy of a particular country. A year-long increase of oil prices in the global market by 10 dollars means GDP decrease of 0.3 to 0.5% for industrialized countries.

Taking into account very low growth rates in Europe in recent years, such loss seems to be serious. (*Raport o światowym rynku energii*. 2005, p. 14).

Oil prices are mainly influenced by the supply-demand relation. Oil prices grow when global demand for it increases or when producers – due to whatever reasons – decide to limit the supply. Moreover, a factor significantly influencing the situation in the oil market is political instability of the regions in which it is mined – mostly in the Middle East region. It is enough to fear that due to unrest in the region its supply may be limited to cause instant increase of oil prices. This happened in 1980-1981 (Iraq – Iran war) and in 1990 (the first Gulf War), or at present, due to unstable situation in Libya and other countries of Northern Africa.

## **5. Diversification of energy sources and increasing energy efficiency as the key to increasing energy security**

The efficiency of energy delivery significantly affects the efficiency of economy and determines the satisfaction of the needs of the society. Energy sector is one of key elements of economy, exerting enormous influence on adding value and employment. Availability of energy services and security of energy supply is the basic need of citizens and a vital element in the functioning of industrialized societies. Most advanced economies are implementing the policy of increasing energy efficiency for electrical appliances, which regulates minimum standards of efficient use of energy for an increasing number of appliances. Technologies of limiting fuel consumption and emission of carbon dioxide are key methods, enabling better energy efficiency and lower emission of carbon dioxide. The issue of efficiency is also connected with increasing demand for electricity, which exceeds the capacities of existing energy network. This fact, coupled with a growing number of decentralized energy-generating units, should force operators to perfect their measure taking and monitoring the network structure by implementing state-of-the-art technologies. These issues are closely related to the necessity of modernizing obsolete and badly affecting the environment energy installations.

Economic development depends on regular and constant access to energy materials. Security of energy fuel deliveries and their diversification is the basis of energy security in each country. One of the most effective methods is to diversify the import directions and to increase the number of suppliers. In this way we can minimize the risk of changes in material supplies. We also limit the possibility of exerting pressure on the importer by suppliers. In order to diversify supplies of energy materials to a particular country, it is necessary to create new possibilities of transmitting and transporting energy materials, including electricity.



The economic problem of assuring energy security and the necessity of increasing diversification of energy material supplies also lies in overdependence of a particular economy on supplies of materials from countries with unstable economic situation. Due to political and economic instability of the Middle East and Northern Africa countries, members of Organization of Petroleum Exporting Countries (OPEC) exporting energy materials, countries importing fuels should aim at the biggest possible diversification of the supplies of energy materials, which will result in greater security of supplies. A good example illustrating such actions is *energy solidarity mechanism* introduced by the European Union, reflected in the Regulation of the European Parliament and of the Council concerning the means providing security of natural gas supplies, which came into effect in 2010. The main assumptions concerning energy security are prevention and crisis plans in each EU member country, obligatory announcement of crisis state on the Union level if two countries announce crisis state, taking into account the criteria of geopolitical risk when assessing general risk of gas security of the EU. According to this document, in state of emergency member states are obliged to guarantee access to their storage installations and the European Commission facilitates the realization of such actions [Regulation of the European Parliament and of the Council concerning measures to safeguard security of gas supply and repealing Directive 2004/67/CE].

If we look at the main global energy management problems from the social and cultural point of view (which is a rare position), we should remember about the approval that citizens give to the used techniques of energy production, which plays a decisive role in democratic countries and influences the general level of satisfaction. Another essential issue is the durability and certainty of supplies. Used non-renewable energy materials cause some fears concerning major increases of energy prices among citizens. Analyzing the social and cultural dimension of producing and consuming energy one should take into account the already mentioned fact that significant part of global energy resource, especially oil and natural gas deposits, are in countries defined as *politically unstable states*. Therefore overreliance of industrialized countries on supplies from these regions rich in energy carriers may lead to military conflicts and threaten both energy and political security

## **6. Energy management of the future**

According to demographic forecasts the world population will grow by around which, combined with economic development and improvement of living standards, will further influence increased demand for energy. The biggest growth of energy consumption will take place in countries which now

use up to 0.2 toe/c (toe/c- consumption of energy per capita in one year). These are the poorest countries, with low level of economic development, the so-called *third world countries*. The possible development of these countries will happen at the expense of the environment, with use of obsolete, un-ecologic technologies. In countries with high consumption of energy at the level of over 3.2 toe/c the speed of total energy consumption growth is similar to the population growth rate [Manteuffel Szoegel, Bukowski, op.cit. p. 25]. Forecasts show that in the European Union alone energy consumption in member states will grow by 15% by 2030 compared to 2000. A great part of increased demand for energy will be satisfied with increased share of gas and renewable sources. Some European countries will be extinguishing their old nuclear reactors (for example Germany, Great Britain, Sweden), others are planning construction of new reactors. It is expected that by 2030 the electric energy production will have increased by approximately 50%. EU reliance on imports of gas, oil and solid fuels, already quite big, will further increase [*Key Word Energy Statistics 2010 IEA*].

According to international reports on world energy management, in the nearest decades this sector will develop in the shadow of China, which is tightening its cooperation with countries rich in natural resources. This cooperation will be one of the most important factors determining behavior of the global energy market.

Global revival of the nuclear sector, inspired mostly by China, India and Russia, is a noticeable trend in energy industry. Nuclear energy is considered one of the most cost-efficient technologies allowing us to satisfy the ever-increasing demand for electricity. Moreover, it contributes significantly to energy independence and security of the country. This type of energy production, however, has numerous drawbacks, such as high construction costs, problems of storing nuclear waste and negative attitude of public opinion. What is more, the size of the disaster that took place in Japan in 2011 accounts for an increasing number of voices against the development of nuclear energy. Nuclear energy, being one of the low-emission and most reliable sources of energy, is seen as an attractive alternative in emerging countries. We can talk of nuclear revival especially in Middle East and In China. Kuwait is planning to build 4 nuclear reactors by 2022, while China is planning to increase production capacity to 80GW by 2020 and to 400GW by 2050. In addition, European and North American countries will also be leaders of nuclear energy development [*Annual Energy Outlook 2011*, US Energy Information Administration]. Analyses and reports on the directions of energy sector development were prepared before the catastrophe in the nuclear power station in Japan, therefore global tendencies in development of nuclear energy may change considerably. Renewable sources of energy are to become priority for many countries. Complex strategies of their

development will have to take into account training needs of the employees of this sector. According to the report prepared by Deloitte Energy & Resources, in 2030 solar energy will be the most popular source of renewable energy. The factor explaining this tendency are rapidly decreasing production costs and easy adaptation of the technology in everyday life. According to the report Asia seems the beneficiary of the resources aiming at stimulating better efficiency of solar energy production.

## 7. Conclusions

Basic global problems of energy sector are mainly: increased demand for energy caused by economic development and population growth, increased pollution of the atmosphere caused by emission of gases and dust created in the process of burning fossil fuels (this issue is analyzed in a separate paper), growing reliance on imports of energy materials from frequently politically unstable regions and growing consumption of non-renewable energy carriers. These issues pose a serious challenge for the governments of countries striving at providing the best conditions for long-term, sustainable development. These issues should become priorities of home and foreign policy in the short and long term. To meet the challenges facing the world energy management, countries must join in creating common energy policies. Such an approach calls for open discussion and long-term plans. Decisions concerning the shape of energy policy in the future should be made independent of current political situation. With 30 or 40 years long investment cycles in energy management, any considerations in shorter periods are impossible or even harmful.

The development of global energy management should be based on rational international discussion, based on technical aspects and on provision of balance between safety of supply, economic efficiency, environment protection issues and planning investments in excavation installations, power stations and energy network. Only then will we be able to create favorable conditions which will ensure safe, competitive and ecological energy supply in the future.

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**Maria Gabryś \***

## **THE ROLE OF THE WORLD BANK IN SUSTAINABLE DEVELOPMENT**

### **Summary**

*The World Bank or, in other words, World Bank Group is an international finance institution whose primary goal is to decrease poverty and promote sustainable development in third world countries. Other goals include granting loans to governments for financing development projects, reform of economic policy and technical support. World Bank involvement in terms of environment protection is expressed by linking main tasks pertaining to financing of economic development and reduction of poverty, taking into account environmental issues.*

*The purpose of this article is to present the World Bank as a financial institution which actively supports and promotes various types of activities on behalf of sustainable development and environment protection. This article presents issues which pertain to the establishment and the idea of World Bank activity as well as characterizes functions of individual institutions which belong to the World Bank Group. Subsequently, this article also discusses the principles of financing of investments by the World Bank as well as presents financial instruments that are utilized in this process. In addition, this article depicts the conditions which must be fulfilled by the loaners.*

*The author also presents a detailed characteristics of World Bank activity in terms of environment protection worldwide as well as in Poland. The author also performed in-depth analysis of granted credits in the years 2005-2010, based on the types of activities and destined targets.*

### **1. Introduction**

Environmental protection issues are inseparably linked with countries' economic development. The essential role in solving environmental issues can be attributed to highly developed nations. It should be noted that these

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are predominantly European nations, which grant financial aid to developing countries. In recent years we have witnessed active involvement of international financial institutions, which are considered providers of necessary means allocated for environmental protection. International Bank for Reconstruction and Development belongs to a group of the aforementioned institutions. This particular bank allocates a significant amount of financial and context-related aid for environment protection as well as management of natural resources. In addition it takes into account the environmental consequences when accomplishing other tasks, like those that deal with infrastructure and economic branches.

The purpose of this article is to present the World Bank as a financial institution that actively supports and promotes various forms of activities on behalf of sustainable development and environment protection.

The primary thesis of this article assumes that the World Bank deals with coordination and control of global investment activity and at the same time guarantees best economic effects. Consequently the World Bank through the process of interaction largely contributes to investments that deal with sustainable development. The analysis of granted credits for environmental protection includes the period 2005-2010.

This article contains 3 separate sections. The first section presents issues that pertain to origins, principle assumptions and the essence of World Bank activity. In this section the author also discusses a number of functions, which are fulfilled by institutions affiliated with the World Bank. The second section provides a description of methods and principles of financing investments. The author provides a detailed discussion as to which financial instruments are utilized and determines the conditions that must be fulfilled by the debtor. In the third section the author characterizes the World Bank activity on behalf of environment protection. Special attention is given to Poland's collaboration with selected institutions.

## **2. World Bank as an international finance institution**

International Bank for Reconstruction and Development (IBRD), commonly referred to as the World Bank, is an international finance institution, which has been appointed during the proceedings of the UN Monetary and Financial Conference held in Bretton Woods (New Hampshire, USA) from July 1 to July 22, 1944. World Bank with its main headquarters in Washington, DC, commenced its activity on June 25, 1946. In the beginning World Bank members comprised of 44 founding nations, including Poland. It should be noted that Poland, due to extraordinary political and economical situation has withdrawn from the World Bank on June 14, 1950. Poland had not rejoined the World Bank until June 27, 1986 [Zabielski 2002, p. 330].

The principal conditions for becoming a member of the World Bank and its affiliated organizations is the membership of a given nation in the International Monetary Fund (IMF) and payment of member's share [Latoszek, Proczek 2001, p. 186]. Depending on the amount of state share, individual countries possess a respective number of votes.

Currently the World Bank unites 187 member countries [Annual Report 2010, p. 5]. The World Bank possesses a status of a joint stock company and its organizational structure is identical to the IMF and comprises the following components [Chrabonszczewska 2005, pp. 103-105]:

- The Board of Governors is the most important department which possesses paramount authority within the World Bank. It includes representatives of membership countries (1 representative from each country, usually minister of finance or president of the central bank). The term of office is 5 years. The board is summoned once a year and makes the most important decisions including: admission of new members, membership suspension, increase of capital stock, collaboration agreements with other organizations, division of the stock shares etc. Resolutions are passed according to the majority of votes.
- Executive Directors, which comprises of a chairman and 25 executive directors (Since Nov 25, 2010). It should be noted that 5 of them are appointed, whilst 20 are selected within the membership groups, which range between 1 and 21 nations. The chairman is selected among the executive directors but his candidacy is announced by the executive director from the United States. The chairman of the bank is simultaneously the president of affiliated organizations and is responsible for current affairs that pertain to bank management. This includes bank's organization, policy and personal issues. Since July 1, 2007 the function of the chairman was fulfilled by Robert B. Zoellick (USA). The chairman has 3 deputies. The first deputy is responsible for current operations, policy and strategy, the second serves as general advisor and the third is an economic director.
- regional and functional departments subordinated to 5 directors, which goal is to supervise management of two regional sections and three functional sections. These sections are involved with issues that deal with infrastructure, private sector development, financing, management, budget, and control. Additional tasks include affairs strictly associated with the World Bank, development of human resources, operational services, natural environment as well as particular issues and problems that pertain to third world and developing countries (Africa, Eastern and Central Europe, Asia and Latin America).

The main circumstance that led to the establishment of International Bank for Reconstruction and Development was the sheer will to provide aid to countries that have been devastated by WWII campaign as well as to the large number of developing countries. Consequently, the first loan was granted to countries in western Europe. However, in a short period of time the World Bank changed its basic aid policy and targeted its activity toward developing and poor countries in Asia, Africa and Latin America. Such a drastic change in World Bank's policy was the result of extensive aid that has been offered by the US to western European countries in the form of the so-called Marshall Plan [Baniecka 2009, p. 166].

World Bank initial capital possesses a joint stock character. The share of the capital comprises two basic components:

1. Paid-in capital (comprises 10% of the share of stocks), in which 1% is paid in redeemable currency or US dollars, and the remaining 9% is paid using the national currency of the particular member of the World Bank.
2. Subjected to call capital (90% of the share of stocks), which is also referred to as the guarantee fund. It is expressed in redeemable currency, which is a form of warranty of bank's obligations toward the emitted bonds and guarantees given by the bank.

Originally the World Bank initial capital was 10 billion USD and from that point on it increased proportionally to the increasing number of members, more extensive activity, and increasing initial capital.

World Bank ownership capital comes from the following sources (activities):

- raising mid-term and long-term bond loans (and Eurobonds) on the international capital markets within member countries, predominantly on industrialized markets,
- cash payments made by member countries,
- sale of bonds in a country that raised a loan with the bank,
- revenue obtained from various types of operations performed by the bank,
- repayment amounts of granted loans.

In addition, the capital can also come from the transfer of liability. In this particular case the bank withdraws the amount of loan that hasn't been paid and transfers it to other fiscal institutions. Consequently the bank obtains the capacity to raise new loans.

The mission of the World Bank is to decrease the level of poverty worldwide and to promote sustainable development in developing countries. In addition, the World Bank raises loans to these countries that will help to finance development projects as well as economic policy reforms and technical aid.

The statutory goal of the World Bank includes the following tasks [Czech 2006, p. 207]:



- supporting long-term and sustainable growth of international trade exchange and maintaining stability of balance of payments. Its role is to finance such investments which assure the development of productive resources of member countries as well as ensure the improvement of living standard and working conditions,
- providing aid for developing countries, which pertains to a lengthy task of reconstructing their national economies. This can be accomplished by directly establishing the real capital; that is by providing guarantees to raise loans,
- raising loans from different sources and subsequently using them to finance credit necessities of member countries. This is sometimes referred to as co-financing,
- facilitating foreign private investments and granting loans for production-type purposes (from own and borrowed means),
- granting loans or guaranteeing loans from other sources in order to finance the most needed investments,
- performing fiscal operations in order to improve the economic situation of member countries,
- Development of local enterprises by ensuring them foreign financial resources.

Currently the World Bank activity focuses on the following list of priorities [Kosztownik, Misztal, Pszczółka, Szelągowska 2009, p. 202]:

- Supporting the development of the private sector in developing countries,
- Elimination of extreme poverty in Africa,
- Development of human resources in developing countries through financing education, health care, and projects that deal with improvement of women situation.

The World Bank accomplishes its goals as a part of broad global strategy. In this context the World Bank fulfills the following functions [Kosztownik, Misztal, Pszczółka, Szelągowska 2009, p. 203]:

- Credit function, which provides member countries with indispensable means for financing the reconstruction process and development of economy in a given country,
- Coordinating function, which helps to standardize the credit aid that has been obtained from various local resources, including the bank itself and international organizations,
- Meditative function,
- Guarantee function, which inclines the parties to make international investments,
- Technical and advisory consultations offered by bank's experts.

Individual institutions that belong to the World Bank Group are responsible for specific needs brought forth by the member countries. The World Bank Group comprises the following organizations [Chrabonszczewska 2005, p. 101]:

- International Bank for Reconstruction and Development,
- International Development Association (IDA). The goal of this organization is to grant preference credits (loans) to very poor countries so they could start to develop and improve their economic situation. Candidate countries must have a GNP per capita lower than 925 USD and cannot possess credit liability. The credits are granted for a period of 35-40 years with a 10 year suspension period,
- International Finance Corporation (IFC). Is a type of business institution which activity focuses on direct financing (granting credits) of private sector projects as well as helping to mobilize capital for the private sector on the international finance markets. In addition IFC provides consulting services as well as technical assistance. The IFC obtains means for conducting its activity from the commercial banking market.
- Multilateral Investment Guarantee Agency (MIGA). Within the World Bank Group it functions as an insurance company. One of the basic tasks include support of capital and transfer of technology into developing countries. This is accomplished by ensuring investments from trade and non-trade risks that are involved as well as through promotion of foreign investments and provision of consultation services,
- International Center for Settlement of Investment Disputes (ICSID). This is a service type institution, which deals with establishment of amenities and rules of international arbitration in terms of settlement of investment disputes. This is a non-profit organization and its revenues come from the sales of publications and registration payments. Subsequently the revenue is transferred to IBRD in order to cover the costs of IBRD services on behalf of the ICSID.

The range of services provided within the World Bank Group changes accordingly with development of international financial markets. MIGA grants credits and loans for financing of development tasks, issues credit guarantees and purchases shares and stocks. However, in recent years the para-banking services readily available at a number of World Bank institutions play a more significant role.

### **3. Methods and principles pertaining to World Bank financing of secure activities**

The World Bank grants credits primarily to governments of member countries and institutions as well as banks which possess government warranty. This way the World Bank supports developing countries, which are characterized by very low credit liability and subsequently becomes their ultimate source of credit.

After WWII bank's activity focused mainly on financing the reconstruction projects for countries that have been devastated by the war. Subsequently this turned into the phase of development of these countries. In the beginning of the 1960s the World Bank financed numerous projects in developing countries, whilst during the 1980s participated in solving issues related to the debt crisis. In the 1990s the bank participated in aid activities which have been organized by the IMF on behalf of the countries, which were engulfed by subsequent financial crises. It should be mentioned that the bank also financed projects in socialist countries.

The World Bank's Policy is to grant only such credits which are utilized to finance investment projects. It utilizes credit instruments which can be subdivided into 2 groups [Chrabonszczewska 2005, p. 109]:

1. Investment credit instruments which include the following:
  - Specific investments credits for establishment and improvement of economic, social and institutional infrastructure,
  - Damage credits used for relief and reconstruction as a result of war or natural catastrophes,
  - Credits for financial mediators allocated to development of financial sector,
  - Credits for technical support, allocated to establish institutional possibilities of a given nation, which are associated with economic, social and public development,
  - Credits for preliminary innovative projects, which pertain to small projects up to 5 million USD. Such credits should be implemented up to three years.

Investment loans are aimed at financing tasks which create both material and social infrastructure. The aforementioned infrastructure is essential in controlling poverty and establishing permanent development.

2. Adjustable instrument credits among which we can distinguish:
  - adjustable structural credits which support policy of change and reforms,
  - special sector and structural adjustable credits, implemented in 1999. These type of credits are usually granted fairly quickly, which

is a direct result of sector crises that can be encountered and which have a significant impact on the structure of economy,

- programmable adjustable structural credits, implemented in 2000 in order to support a program of social and structural reforms,
- Loans for reducing debt (granted since 1997),
- recovery credits used for rapid improvement of infrastructure (granted since 1997).

The goals of adjustable loans (programs) are: to promote development of competitive trade structures, strengthen economic and trade policies, establish a proper control system with the financial sector and create a suitable environment for development of private sectors and related investments [Kosztownik, Misztal, Pszczółka, Szelałowska 2009, p. 204].

The World Bank also grants currency credits. At present the bank offers three types of currency credits:

- Currency Pool Loans (CPL),
- Variable Single Currency Loans (VSCL) based on the LIBOR interest rate,
- Fixed Spread Loans (FSL) with constant margin.

Besides various types of credits the World Bank also offers guarantees such as partial risk guarantee and partial credit guarantee which are based on the imposed project. The goal of the aforementioned guarantees is the promote private financing in member countries, by taking care of the risks that might be encountered by the private sector subjects.

The World Bank can issue 3 types of guarantees; in each case the state must provide warranty that the investment will be realized. The 3 types of guarantees are listed below:

- Partial risk coverage guarantee, which in the case of not fulfilling the obligations that result from the contract, cover specified types of risks,
- Partial credit coverage guarantee, which secures the creditor from any type of risk, which could result from the obligations on the grounds of debt services and prolongation of the credit payment deadline,
- Partial credit coverage guarantee, that has been incurred by the member nation in a private foreign bank in order to implement social-economic reforms.

In order to improve management of financial risks in terms of credit transactions, the bank has introduced a number of security products and implemented them in 1999. A list of these products is presented below [Kosztownik, Misztal, Pszczółka, Szelałowska 2009, p. 205]:

- currency swaps which are used in all types of loans after individual negotiations with bank authorities are held,

- commodity swaps, also used after and individual agreement from the bank authorities has been granted,
- interest rate swaps, which are aimed at limiting both upper and lower ranges of single currency loan interest rate changes, as well as loans which have a constant margin.

The World Bank also established a set of principles, which facilitate the limitation of credit risk. The aforementioned principles are outlined below [Czech 2006, p. 212]:

- non-exceedance principle which pertains to unpaid capital debts that have been transferred to the bank and subsequently increased by the amount paid in as well as by retained profits and surpluses,
- principle that pertains to division of risk between various geographical regions and which takes into account credit support of a large number of countries,
- principle that pertains to granting credits in the same currency that the bank incurs loans,
- principle that pertains to the share of member nation own assets in the financed project,
- credit repayment principle,
- principle that pertains to general profitability of projects that are subjected to financing,
- project reality principle

The World Bank employs the aforementioned principles when granting credits. It strives to maintain a situation in which the structure of foreign exchange credits is similar to the structure of foreign exchange loans. It should be mentioned that the World Bank incurs these loans, which results in the denomination of US dollar.

The World Bank utilizes various types of criteria for credit activity. Each project that is financed by the bank must be precisely determined and cannot compete with a financial mechanism that is operating in a given country. Financing of the World Bank possesses a supplemental character and functions parallel to the share of nation's own assets which uses bank's credits. Hence the means obtained by the nation which incurs a loan should be allocated exclusively for currency expenses. Meanwhile internal expenses should be conducted in the national currency of the loaner.

The World Bank does not grant tied credits, which means that the assets which are come from the credits granted by the bank may be spent by a given nation in each country and any currency.

In order to ensure risk warranty pertaining to investment financing the World Bank also utilizes the so-called project cycle, which includes 6 distinct phases [Chrabonszczewska 2005, p. 108]:

1. Identification phase, which is aimed at selecting a project from a group of projects that are scheduled for realization according to their priorities (so-called priorities test). Subsequently a proposition for financing of the project is presented.
2. Preparation phase, which features detailed technical, economical and social analyses of project's aspects. The aforementioned analyses are carried out by the investing nation.
3. Estimation phase, which is conducted in the following areas: technical, institutional, economical and financial. Estimation is performed by a panel of independent advisers and experts.
4. Negotiation phase (including approbation). The negotiations are held between the bank and the debtor and are based on the bank report that estimates the conditions for obtaining a loan.
5. Realization and supervision phase. The World Bank visits the investment sites in order to confirm the accordance of usage of means that have been allocated by the loan. In other words, the aims of the loan should be agreeable with the bank regulations. Recommendations and corrections pertaining to realized credit projects are published in The World Bank's report titled „Effective Implementation Key to Development Impact”.
6. Project Evaluation Phase. This evaluation is performed by an independent department (Operation Evaluation Department) which is directly subordinate to the board. In this evaluation a panel of experts compares the actual costs of the project and its benefits, abiding to the realization timetable as well as efficiency of the project in relation to primary assumptions. The annual project review is published in the report titled „Evaluation Results”.

Loaners, which apply for obtaining World Bank measures must fulfill a number of conditions. The most important conditions are outlined below [Zabielski 2002, pp. 331-332]:

- guarantee of loan repayment by state authorities, even if specific enterprise applies for such a loan,
- state-loaner must possess repayment credibility as well as provide additional payments that are used in the project,
- the need to accomplish the essential project after exhaustion of other available sources of financing,
- signing an agreement based on the contract and effective rules when using measures in accordance with bank's procedures.

Due to a diversified structure of activities performed by institutions that are a part of the World Bank Group, it is evident that credit instruments usually vary in terms of conditions of crediting, length of credit period, and possibilities of obtaining credits.

It should be stressed that the World Bank allows a possibility to make changes in preliminary loan conditions, however this feature is only available for varied interest rate loans and also when other extraordinary conditions are taken into account (i.e. realization of projects on a global scale). The aforementioned changes may create a number of difficulties in achieving a sustainable economic development. On the other hand this may be an attempt to adapt to ever changing economic and political conditions around the world.

#### **4. World Bank crediting policy in terms of environmental protection in the years 2005-2010**

The issues associated with environmental protection as part of World Bank activity have been introduced rather late, that is during the 1970s. At that time a special department has been appointed within the auspices of the World Bank organizational structure. This department was responsible for assessment of environmental aspects of investment projects in order to prevent possible losses during their realization [Budnikowski 1998, pp. 150-153].

World Bank's approach toward environment protection policy remained quite rigid and any changes have been introduced gradually. For example in 1987 a special department was established for the purpose of conducting routine environmental surveys of every investment project. Additionally, this department was responsible for carrying out consultations with non-governmental ecological organizations. Since that time environmental projects have become a permanent element of World Bank credit policy.

Subsequent phase which pertains to more broader inclusion of environmental issues in World Bank activity is associated with the recognition of sustainability. From that point on this was the official priority of bank's activity. This took place in the year 1992 in the eve of the Rio de Janeiro Summit. The World Bank also wanted to offer non-returnable aid to developing countries allocated for environment protection. In consequence the World Bank became a co-creator and an administrator of the Global Environmental Facility (GEF).

Changes that took place have been accompanied by an increase in financial resources utilized for accomplishment of environmental projects. The first agreement in terms of granting a loan in the amount of 15 million USD has been signed by the World Bank on May 18, 1971. These resources have been designated for controlling of water pollution [Brzozowska 2001, p. 19]. From that point on World Bank financial involvement in environment protection has rapidly increased. In 1986 it amounted to 1 billion USD, in 1991 45 million USD and in 1996 it achieved a staggering sum of 153 million USD [Budnikowski 1998, p. 152]. Meanwhile in the period 2001-2005 the total amount of World

Bank credits allocated for natural resources and the environment attained 9 billion USD [Czech 2006, p. 216].

During subsequent 5-year period (2005-2010) the World Bank granted numerous credits which amounted to approximately 201 billion USD. It should be mentioned that about 18 million USD has been designated solely for environment protection and management of natural resources. Table 1 displays the amounts of World Bank credits during the period 2005-2010 based on the type of activity.

**Table 1.** Size of World Bank credit share based on the types of activities in the years 2005-2010 (in millions of USD)

Sector	2005	2006	2007	2008	2009	2010
Agriculture, fishing and forestry	1933,6	1751,9	1717,4	1360,6	3400	2618,3
Education	1951,1	1990,6	2021,8	1926,6	3444,8	4944,5
Power industry and mining	1822,7	3030,3	1784	4180,3	6267,4	9925,2
Financing	1675,1	2319,7	1613,6	1540,7	4235,6	9136,6
Health care and social welfare	2216,4	2132,3	2752,5	1607,9	6305,5	6792
Trade and industry	1629,4	1542,2	1181,3	1543,5	2806,5	1251,3
Telecommunication and information technology	190,9	81,0	148,8	56,5	329,2	146,3
Law and public administration	5569,3	5857,6	5468,2	5296,4	9491,6	10828,2
Transport	3138,2	3214,6	4949	4829,9	6260,6	9001,9
Water and sewerage system and flood protection	2180,3	1721	3059,4	2359,9	4364,9	4102,8
<b>Total</b>	<b>22307</b>	<b>23641,2</b>	<b>24695,8</b>	<b>24702,3</b>	<b>46906</b>	<b>58747,1</b>

Source: author's own elaboration based on the The World Bank Annual Report 2011, p. 7.

During the analyzed period largest shares of credit amount in general pertain to credits associated with legal and public administration reforms (21%), followed by transport (15,6%), mining and power industry (13,4%). On the other hand the lowest shares are associated with credits allocated for investment projects such as information technology and telecommunications (0,5%).

When we examine the goal of individual credits in the period 2005-2010 we can see that the largest number of credits has been granted to development of private sector (48 million USD), which constitutes about 23,8%, followed



by development of human resources and the public sector. Reforms associated with human resources amounted to about 27 million USD (13,3%), whilst the development activity of public sector turned out to be about 26 million USD (12,9% - tab. 2). Credits designated for environment protection tasks amounted to nearly 18 million USD (9% of the total number of credits).

**Table 2.** Amount of credits granted by the World Bank in the years 2005-2010 based on the goal of crediting (millions USD)

Goal of crediting	2005	2006	2007	2008	2009	2010
Economic management	594,6	213,8	248,3	396,6	2304,7	3949,9
Environment protection and natural resource economy	2493,8	1387,3	2017,0	2661,8	5085,4	4337,2
Development of the private sector	3862,0	6137,8	4260,8	6156,2	9694,8	17726,0
Development of human resources	2951,0	2600,1	4089,4	2280,9	6378,6	8421,3
Public sector management	2636,4	3820,9	3389,7	4346,6	6108,4	5750,4
State activity, legal constitution	303,8	757,6	424,5	304,2	15,8	207,1
Development of rural areas	2802,2	2215,8	3175,7	2276,8	4298,6	5003,7
Social development, activity aimed at gender equality	1285,8	1094,1	1250,3	1002,9	813,2	952,3
Social protection and risk management	2437,6	1891,7	1647,6	881,9	5295,7	5006,3
Trade, integration	1079,9	1610,9	1569,9	1393,2	3444,1	1818,4
Development of Urban areas	1860,0	1911,2	2622,7	3001,2	3466,7	5574,5
Total	22307,0	23641,2	24695,8	24702,3	46906,0	58747,1

Source: The World Bank Annual Report 2010, p. 7.

Table 3 presents the percentage share of World Bank credits allocated for environment protection and management of natural resources subdivided into geographic regions.

**Table 3.** The share of World Bank credits designated for environment protection and management of natural resources according to geographical regions in the years 2005-2010 (values in %)

Regions	2005	2006	2007	2008	2009	2010
Africa	6	5	4	6	3	5
Eastern Asia and Pacific Islands	16	12	14	17	7	11
Europe and Central Asia	10	4	11	11	5	6
Latin America and the Caribbean	16	8	8	14	25	10
Middle East and Northern Africa	12	3	20	4	9	5
South Asia	9	2	5	9	5	7
Remainder	31	66	38	37	46	57
Total	100	100	100	100	100	100

Source: Author's own elaboration based on the Annual World Bank Reports 2005-2010.

When we examine the geographical subdivision we can see that the greatest share of World Bank credits is visible in Latin American countries. This share is near the 8% level (2006, 2007) and increases dramatically to 25% in 2009. A considerable amount of such credits is also visible in eastern Asian countries (7-17%) as well as in Europe and Central Asia (4-11%). It is clear that African countries did not take the opportunity to use credits; the share of credits ranges from 3-6%.

The World Bank provides access to financial resources for developing countries. At the same time it poses a significant impact on investment activities globally. World Bank role is not only limited to coordinating functions, but also to controlling the credited investments. By affecting global scale investments the World Bank also accomplishes rational economic benefits, and provides sustainable development. Linking activities that pertain to economic development and reduction of poverty with environmental aspects enable to determine a precise type of bank's input into the field of environment protection [Dziawgo 2010, p. 77].

The World Bank includes primarily environmental issues in credit activity. It is also involved in other types of initiatives on behalf of environmental protection and is persuasive in obtaining financial resources for such activity. The list below outlines World Bank activity in this matter [Dziawgo 2010, p. 78]:

- Climate Investment Funds, which were in 2008. They comprise of two types of funds: Clean Technology Fund and Strategic Climate Fund. The former fund deals with financing of advanced environmental technologies (i.e. renewable energy), whilst the latter deals with service

and financing of three separate investment programs: pilot program concerning flexible climate, forest investment program, and renewable energy enhancement program,

- Green Bonds, are a type of securities which were introduced on the market in 2008, and are issued by the World Bank. The revenue obtained from sales of these securities are designated to financing projects, which are aimed at reduction of greenhouse gases in developing countries.

The World Bank has also undertaken an initiative to elaborate a new environmental strategy for the World Bank Group (Environment Strategy 2010). The particular emphasis of this strategy concerns global regions which are most susceptible to climate change as well as environmental economics issues (i.e. indices, biodiversity, forestry, and coastal and marine management).

Poland benefits from World Bank preferential credits since 1990. In the beginning the bank's support pertained to financing of tasks in 6 different areas:

- macro-economical stabilization and strengthening of Poland's credit capacity, which was achieved by granting a structural adjustment loan to be allocated for structural reforms. In 1994 the World Bank granted a credit for handling foreign debt from commercial banks,
- development of the private sector, by granting in 1993 an agricultural structural adjustment loan,
- development of financial system by granting two separate loans (1991, 1994),
- protection of natural environment through the introduction of the following initiatives: forest diversity protection project, rationalization of fiscal economy of Principle State Forest Agency, promotion of energy-saving lightning,
- development of the power industry sector, through the introduction of projects which pertained to financing of energy industry, and geothermal energy,
- development of infrastructure, which has been facilitated by projects concerning the renovation and modernization of existing road network and construction of a highway system.

Since 1990 the World Bank granted to Poland a total of 72 loans with an aggregate sum amounting to 8.9 billion USD. It should be noted that Poland has not implemented 257 million USD worth of loans and over 4.2 billion USD hasn't been paid so far. The current credit portfolio includes 9 active projects:

- four investment projects with a total sum of 2 billion USD, allocated for financing renovations and modernization of roads, projects that deal with energy efficiency, projects that pertain to prevention of floods especially in major river basins, as well as social services in rural areas,

- three projects financed by the Prototype Carbon Fund, which pertain to reduction of greenhouse gas emissions,
- three loans (development policy loans) with a total amount equal to 3 billion USD. It should be mentioned that the latter loan was granted just recently (June 2010).

Presently the World Bank involvement is outlined by the Country Partnership Strategy (2009-2013) and is associated with the following areas: social and spatial integration (reforms of social sectors, regional development), reform of the public sector, public global goods (climate change, financial sector stability) as well as with development and competitiveness (infrastructure, improvement of the situation of the public sector development).

## **5. Conclusions**

The World Bank has played a considerable role in global economic development, particularly during the early stage of its operation. The World Bank provided easy access to crediting for member countries and subsequently enabled them to finance reconstruction of their nations as well as provided consulting and technical support. During almost six decades of operation the World Bank has undergone various transformations. These transformations resulted mainly from political, social and economical conditions. It should be stressed that bank's activity has always been focused on the most poor countries whilst currently the bank seeks to find possibilities that would enable significant improvement of financing.

World Bank's financial resources are primarily allocated for investment projects, that are targeted at accelerating economic growth in developing countries. For these countries the World Bank is not just the only source of long-term aid and direct investments, but plays a role of technical advisor, which includes technical support of various projects and implementation of investments. It should be noted that this becomes an essential component of the crediting process. The World Bank employs standardized set of banking procedures, that impose determined formulation, testing and execution of investment projects as well as offers preferential interest rate policy and calculation of commissions. The above-mentioned procedures ensure proper quality of investment projects, financial discipline and greater efficiency.

Poland has benefited from World Bank services since 1990. These services include a set of credits that have been granted on favorable terms. The aforementioned credits comprise 6 different areas: macro-economic stabilization and strengthening of credit capacity, support of private sector and financial sector development, environment protection and power industry, and infrastructure.

World Bank's ability to be flexible and adjust to the current global economic situation is very promising and leads us to believe that the bank will continue its activity targeted not only towards the poorest countries but also (at least partially) towards countries which have a sound economic situation. It is recommended that the bank targets its services toward all nations in terms of environment protection, women rights, labor standards and support of non-governmental organizations.

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**Henryk Pilecki\***

## **SELECTIVE GATHERING AND COLLECTION OF COMMUNAL WASTE AS THE TASK OF A COMMUNE**

### **Summary**

*Most duties connected with waste management are the responsibility of communes which are also responsible for ensuring appropriate conditions for selective collection and gathering of communal waste.*

*This obligation is fulfilled by most Polish communes, but the quantity of selectively collected waste does not exceed 6% of all collected community waste.*

*Selective collection is a very important form of waste management, because it allows to recycle and limit the weight of waste dedicated for storage – such effects are needed urgently.*

*The author suggests a way to increase the quantity of selectively collected waste: carefully segregate waste in places where it is created, selectively collect it and gather in such form. All activities resulting in mixing waste should be eliminated.*

### **1. Introduction**

The problem of solid waste generated by households and similar waste created outside them, that is communal waste<sup>[1]</sup>, has become an important issue in everyday life and an essential direction of social life organization, especially in urban environment. In the communal management, collection of waste is as important as provision of electricity, water, gas or sewage collection; taking into account their widespread generation, large amounts and necessity of collection. The scope and consequences of the waste phenomenon called for the legal regulation and organization of the whole waste management. Its numerous facets (logistics of gathering, removal and final elimination, possibility of recycling some materials, resources and energy, etc.), are dominated by the environment context.

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1 The term defined in Article 3, section 3, point 4 of the Act of 27<sup>th</sup> April 2001 on Waste (Journal of Law 2001, No 62, position 628, with subsequent changes).

The aim of the communal waste management is to reduce the amount of waste with biodegradable features in order to reduce the total amount of waste subject to landfill.

Before this challenging task, communes took up a number of actions aiming at reducing the total mass of waste subject to landfill<sup>[2]</sup>. They concerned isolation of nonbiodegradable elements of waste.

The aim of this article is to present the instrument of communal waste management, which is selective collection, which lowers the amount of waste for landfill.

The subject of our analysis are the techniques and ways of selecting from communal waste those elements which do not have to be deposited on the dumping ground in order to neutralize them.

The subject of our analysis are mostly producers of communal waste, together with real estate administrators and communal services dealing with waste management in the commune, as well as commune administration.

The evaluation of the phenomena presented in the article was based on: bibliography, own experience related to employment at institutions dealing with waste management or connected with evaluations of waste management.

## **2. The obligations of communes as regards waste management**

The generation of waste creates particular needs and consequently – in organized social life – obligations which must be fulfilled to meet those needs.

The chief principle related to waste generation is to dispose of it immediately in the place where it is created<sup>[3]</sup>. Other principles are:

- reasonable price of waste disposal,
- troublefree method of waste disposal;
- short period of time in which waste exists.

In this paper I limited the review of obligations only to obligations of communes, not of all participants of the waste management process<sup>[4]</sup>.

Commune obligations as regards waste management (defined in a direct way) are defined by the following legal acts:

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2 Statutory obligations of communes to reduce the mass of biodegradable communal waste intended for landfill (according to the Act of 27<sup>th</sup> April 2001 on Waste, Article 16a, point 4), include the requirement to reduce the quantity of this type of communal waste to not more than 35% of the total weight of communal biodegradable waste compared to the mass of this waste generated in 1995. The deadline for this obligation is 31<sup>st</sup> December 2020.

3 This is an incredible phenomenon: we all accept the fact that waste is generated, but we do not accept its existence.

4 The term waste management (and also participants of the process) is defined by the Act of 27<sup>th</sup> April 2001 on Waste in Article 3, section 3, point 1), which, according to J. Famiciec (*Kształtowanie cen na rynku usług gospodarki odpadami*, lecture, seminar materials Forum Dyrektorów Spółek Komunalnych, September 2008 r.): „(...) considerably restricts the proper understanding of this term”.

1. The Act of 8<sup>th</sup> March 1990 on Commune SelfGovernment (Journal of Law 1990, No 16, position 95 with amendments<sup>[5]</sup>),
2. The Act of 13<sup>th</sup> September 1996 on Maintaining Cleanliness and Order in Communes (Journal of Law, 1996, position 622 with amendments),
3. The Act of 27<sup>th</sup> April 2001 on Waste (Journal of Law 2001, No 62, position 628 with amendments).

The abovelisted legal acts are not the only source determining the commune's tasks. Several tasks also result from norms concerning selfgovernment finance, as the foundation of performing public tasks by territorial selfgovernment<sup>[6]</sup> is possession of property. The abovelisted legal acts determine direct obligations of communes, therefore they provide us with a clear and complete compendium related to waste management.

The Act on Commune SelfGovernment imposes the duty to satisfy collective needs of the community, among which maintaining cleanliness and order, as well as sanitary utilities, dumping grounds and neutralizing communal waste are mentioned (Article 7, section 1, point 3).

The Act on Maintaining Cleanliness and Order in Communes obliges the commune council to enact the regulation concerning maintenance of cleanliness and order in the area of the commune (article 4, section1). These regulations should precisely determine the principles of maintaining cleanliness and order in the area of commune, concerning (in case of communal waste):

- requirements related to maintaining cleanliness and order in the area of real estate, covering selective collection of communal waste, including generated by individual households dangerous waste, largesize waste, used electronic and electric appliances, used batteries and waste from renovation work (Article 4, section 2, point 1, subpoint a);
- type and minimal capacity of containers intended for collection of communal waste on the premises of real estate and on public roads, conditions of locating these containers and their proper sanitary, orderly and technical state (Article 4., section 2, point 2);
- frequency and method of disposing of communal waste and liquid waste from the real estate and areas of public use (Article 4, section. 2, point 3);
- maximum level of biodegradable communal waste allowed for landfill in dumping grounds (Article 4, section 2, point 4);

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5 The current name is in accordance with article 10 of the Act of 29th December 1998 on Changing some Acts in Relation to Implementation of State System Reform, Journal of Law No 116, position 1126, originally the Act on Territorial SelfGovernment.

6 Harańczyk A., Samorząd terytorialny. Organizacja i gospodarka, Wydawnictwo Uniwersytetu Ekonomicznego w Krakowie, Kraków 2010



- their requirements resulting from communal plan of waste management (Article 4, section 2, point 5).

The Act on Waste, on the other hand, defines the commune tasks concerning communal waste management, listing them all in one article as a catalogue. These tasks are (Article 16a):

- 1) covering all commune inhabitants with an organized system of collection of all kinds of communal waste,
- 2) providing conditions in which the system of selective collection and disposal of communal waste could operate so as to allow:
  - a) limiting landfill of biodegradable communal waste,
  - b) isolating dangerous waste from communal waste,
  - c) achieving recycling levels of packaging waste,
- 3) providing construction, maintenance and exploitation of own or managed jointly with other communes installations for recycling and neutralizing communal waste or providing conditions for construction, maintenance and exploitation of installations and appliances for recycling and neutralizing communal waste by entrepreneurs,
- 4) providing conditions for limiting the mass of biodegradable communal waste intended for landfill:
  - a) till 31<sup>st</sup> December 2010 – to not more than 75% of total weight of biodegradable communal waste,
  - b) till 31<sup>st</sup> December 2013 – to not more than 50% of total weight of biodegradable communal waste,
  - c) till 31<sup>st</sup> December 2020 – to not more than 35% of total weight of biodegradable communal waste in relation to the mass of this waste generated in 1995,
- 5) initiating and facilitating creation of collection points for used electric and electrical appliances, indicating locations in which such actions should be organized and taking up information and education activities in this area.

Moreover, the Act of 27<sup>th</sup> April 2001 on Waste obliges communes to develop plans of waste management (Article 14, sections 1 and 3), their updating at least once in four years (Article 14, section 14) and preparing reports on realization of the plan of waste management covering the period of two calendar years (ibid, section 12b).

The initiative for changes in legislature, expressed in the 2010 parliamentary project of the act on maintaining cleanliness and order in communes (paper No 1169) and the 2009 government project of the act on waste (paper No 2002) raises some worries about the future shape and clarity of division of obligations and about the polarity of motives expressed by participants of the waste management market. In developed discussion, generally the intention to

cover all property owners with a fee for waste disposal (as an effective means to stop the practice of dumping waste) is praised, while the intention to prevent demonopolization and to burden commune selfgovernment with the right to own communal waste is criticized.

In the current legal state, the major principles of waste management are defined by the Act of 27<sup>th</sup> April 2001 on Waste. According to Article 5 of this Act, these are:

1. preventing waste generation or limiting the amount of waste and its negative influence on the environment during and after their use;
2. providing recovery in accordance with principles of environment protection if generation of waste could not be prevented;
3. providing neutralization of waste in accordance with principles of environment protection if generation of waste could not be prevented or if it could not be recycled.

The above principles are some sort of ecological standards.

The realization of public objectives in waste management area is not possible without cooperation of all process participants who strive at achieving the same goals. To make this cooperation possible, it is necessary to create and implement some standards of conduct. When standards are developed, we have to implement them in the form and extent allowing satisfactory level of goal achievement.

### **3. Recycling of communal waste**

Recycling so far has been conducted in three basic forms:

- a) through selective gathering,
- b) through directing the flow of gathered mixed communal waste to segregation installations<sup>[7]</sup>,
- c) through using both abovementioned forms simultaneously.

Recycling through selective gathering consists in such arrangement of waste collection points so that they are composed of a set of containers for particular types of materials. These are usually separate containers for plastic, paper, glass and mixed material. Sometimes the set is extended to comprise the container for metals or for used batteries, sometimes for biodegradable waste. In suburbs or villages containers (usually with 110 dm<sup>3</sup> capacity are replaced with stands with bags with capacity of 50 – 80 dm<sup>3</sup>). In collection points located in housing districts, near blocks of flats, the container for mixed waste is much larger (capacity of 1,100 dm<sup>3</sup> or 3 m<sup>3</sup>). Mixed waste is sent to landfill while selectively gathered waste for recycling.

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7 J. Nędzusiak (*Segregacja zmieszanych odpadów komunalnych jako forma ich odzysku*, *Recykling*, 2006, No 11) identifies segregation of mixed waste with recycling, which should be considered the right opinion.

The second form, namely the recycling through directing the flow of gathered mixed communal waste to segregation installations, consists in gathering mixed waste and then segregating it using industrial methods. In a simplified version, such industrial sorting plant is an installation consisting of a set of sieves dividing waste into factions differing in sizes, foil catchers, electromagnet for catching steel elements, and then a set of conveyor belts with posts for manual segregation of waste. As a result of the segregation process, waste for recycling or landfill is picked.

The use of both mentioned forms consists in selective gathering of waste, including mixed waste. Mixed waste is subjected to industrial segregation through processing it in the segregation installation. Selectively gathered waste is also sorted out again in the segregation installation in order to isolate waste which may contain pollution (both in selective gathering or as a result of primary segregation).

Apart from the abovementioned forms of recycling, there are some others, such as: homogeneous collection of only one type of material (for example foil and plastic packages or glass packages), etc. This form usually does not apply to communal administrative areas but to individual properties, for example it is used near large department stores or has a form of public points of waste collection in the area of the commune. It also happens that waste is gathered selectively, but its collection is not selective<sup>[8]</sup>. This is a particularly reprehensible way of management. Particular forms of recycling are accompanied by different organizational elements, such as differentiation of prices for waste collection (mixed waste is more expensive, sorted out waste is cheaper or even collected free of charge).

There are also communes which are devoid of any form of segregation or recycling actions. There were 931 such communes in 2005 in Poland, though in 2009 there were only 147 of them, compared with 2331 communes with selective gathering of communal waste in 2009 (the total number of communes in Poland is 2478)<sup>[9]</sup>. The changes in the number of communes using selective system of waste gathering in Poland in the analyzed period are presented in Table 1.

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8 In selective gathering, there are many streams of waste (differentiated by types: plastics, paper, fabrics, glass, etc., and mixed waste), while during the collection the number of streams is restricted to two: selectively gathered waste (together as one stream) and mixed waste.

9 According to Różańska B., Sobczyk M., *Infrastruktura Komunalna w 2009 r.*, Główny Urząd Statystyczny, Warszawa 2010. [in:] <http://www.stat.gov.pl> – table 33: Selective gathering of communal waste in communes, line 1, column 2.

**Table 1.** Structure of communes in Poland in 2005-2009 which used selective gathering of waste

No.	Year	Number of communes with no segregation	Number of communes with selective segregation of waste	Percentage share of communes without selective gathering of waste
1.	2.	3.	4.	5.
1.	2005	931	1,547	38
2.	2006	558	1,920	23
3.	2007	312	2,166	13
4.	2008	188	2,290	8
5.	2009	147	2,331	6

Source: own elaboration on the basis of Infrastruktura Komunalna 2005 (and further years till 2009), Główny Urząd Statystyczny, Warszawa, 2006 – 2010.

The combination of pairs of quoted figures concerning particular years provides a pretty satisfactory picture. A clearly visible trend of equalizing the number of communes with selective waste gathering with the total number of communes in Poland is particularly positive.

A look at the achieved effects (that is the level of obtained recycling) ruins this satisfaction and may even cause some serious worries. Statistical data explaining this attitude can be found in Table 2.

**Table 2.** The amount of recycled waste in Poland in 2005-2009

No	Year	Communal waste					Amount of recycled waste from:			
		Total		Mixed		Selectively gathered	mixed waste		selectively gathered waste	
		Amount [t]	Amount [t]	Total share [%]	Amount [t]	Total share [%]	Amount [t]	Total share [%]	Amount [t]	Total share [%]
		3.	4.	5.	6.	7.	8.	9.	10.	11.
1.	2005	9 352 117.3	9 056 807.4	96.8	295 309.9	3.2	71 298.8	0.8	295 309.9	3.2
2.	2006	9 876 586.5	9 473 192.9	95.9	403 393.6	4.1	144 300.0	1.5	403 393.6	4.1
3.	2007	10 082 600.0	9 569 600.0	94.9	513 000.0	5.1	153 000.0	1.5	513 000.0	5.1
4.	2008	10 036 405.0	9 353 923.2	93.2	682 481.8	6.8	335 510.8	3.3	682 481.8	6.8
5.	2009	10 053 499.0	9 264 600.0	92.2	788 871.5	7.8	795 802.2	7.9	788 871.5	7.8
6.	average	9 880 241.6	9 343 624.7	94.6	536 611.4	5.4	299 982.4	3.0	536 611.4	5.4

Source: own elaboration on the basis of Infrastruktura Komunalna 2005 (and further years, until 2009), Główny Urząd Statystyczny, Warszawa, 2006 – 2010.

For around 10 million tons of communal waste collected in the period of 2005-2009, only from 295,309.9 tons to 788,871.5 tons were gathered selectively. This accounts for 3.2% to 7.8% (average rate was 5.4% in this period).

In the EU countries before 1999, in years 1994-1998, the figure was ten times higher and ranged from 53% (Austria) to 96% (Great Britain)<sup>[10]</sup>.

The future objectives related to selective collection of waste are determined in the Directive 2008/98/CE of the European Parliament and of the Council on Waste, which was given the status of a framework directive on waste<sup>[11]</sup>.

The basic norm established by Directive 2008/98/CE is obligation to selective collection of waste until 2015 at least as regards: paper, metal, plastic and glass, and obligation to recycle by 2020 at least 50% of the weight of household waste, such as: paper, metal, plastic, glass.

The comparison of these obligations (and their deadlines) with currently achieved effects of selective collection of communal waste defines the scope of necessary action in Poland.

#### 4. Selective gathering in place of generation and selective collection of waste as the basic ecological standard

The information in Table 1 shows that recovery from selectively gathered waste is much more effective than recovery from mixed waste. This statement is convincingly illustrated by the proportion of the recovery degree ( $pr$ ) from selectively gathered waste and mixed waste:

$$pr = \frac{so_s}{so_z} = \frac{100\%}{3\%} = 33,3 \quad (1)$$

where:

$so_s = 100\%$  degree of recovery from selectively gathered waste

$so_z = \text{average } 3\%$  degree of recovery from mixed waste.

This proportion, however, has this deficiency that the parameters used are not bound by the same (common for both parameters) reference value. Such reference value should be the amount of generated communal waste ( $W_{ok}$ ).

In case of mixed waste, the amount of gathered mixed waste ( $O_z$ ) is identical with the amount of generated waste ( $O_z = W_{ok}$ ), therefore the degree of recovery from mixed waste, referred to the average annual amount of generated waste (for data in Table 1) also equals 3%.

10 In selective gathering, there are many streams of waste (differentiated by types: plastics, paper, fabrics, glass, etc., and mixed waste), while during the collection the number of streams is restricted to two: selectively gathered waste (together as one stream) and mixed waste.

11 According to Różańska B., Sobczyk M., *Infrastruktura Komunalna w 2009 r.*, Główny Urząd Statystyczny, Warszawa 2010. [in:] <http://www.stat.gov.pl> – table 33: Selective gathering of communal waste in communes, line 1, column 2.

In case of selectively gathered waste, the amount of gathered segregated waste ( $O_s$ ) is not equal to the amount of generated waste ( $O_s < W_{ok}$ ), as selective gathering refers only to certain types of materials (for example glass, metals, plastics), and the remaining waste is gathered jointly, as mixed waste. The degree of recovery from selectively gathered waste referred to the amount of generated waste is therefore lower than 100%.

Scarcity of research on the structure of communal waste in Poland, coupled with lack of uniform methodology of conducted research<sup>[12]</sup>, account for difficulties in formulating a credible answer to the question concerning the value of achieved degree of recovery referred to the amount of generated communal waste<sup>[13]</sup>. Using the results of research on material structure of communal waste that can be found in specialist literature<sup>[14]</sup> we can accept an approximate figure of 37%, taking into account the fact that the average content of materials prone to selective gathering, such as wood, paper, cardboard, plastics, glass, fabrics, metals – equals 37.8%. If we assume that this group may also cover organic, biodegradable materials, the value increases to 78.3%.

Assuming also that the purity of segregation equals 80% (that is from the amount of selective gathering prone materials, only 80% are actually selected in the process of gathering<sup>[15]</sup>), we still obtain impressive results:

$$so_s' = 80\% * 78,3\% = 62,6\% \quad (2)$$

This means that it is practically possible to achieve 63% recovery of the mass of generated waste. Using the  $so_s'$  parameter instead of  $so_s$ , the proportion (1) assumes the value of 20.88. This proves that with selective gathering and collection of communal waste, potential profit is around 20 times higher than in case of recovery from mixed waste.

The first place in which we mix waste, bringing the most painful effects, is the place where it is generated. Therefore if we strive at limiting the amount of communal waste landfill through increasing recovery rate, selective gathering should be initiated at the very place of their generation. This is a widely accepted standard of conduct.

Selective gathering in the place of generation allows us to selectively gather in our houses or housing districts segregated waste with high level of

12 According to A. Jędrzak and R. Szpadt (*Określenie metodyki badań składu sitowego, morfologicznego i chemicznego odpadów komunalnych*, [in:] <http://www.mos.gov.pl>).

13 By the quantity of generated communal waste we should understand the quantity which was generated in the area in which selective gathering and mixed collection of waste is conducted.

14 For example: Jędrzak A, Szpadt R., *Określenie metodyki badań składu sitowego, morfologicznego i chemicznego odpadów komunalnych* or Clément F., *Gestion des déchets organiques municipaux*, Cré-ation & Réalisation Design Média, Paris, 2001.

15 As, for example, other quantities constitute sieve fractions with below 10 millimeter size.

homogeneity (purity) and high level of mixed waste limitation. Collection of waste from points of collection – where it is segregated – also allows selective collection with the same level of homogeneity and greatly limits the amount of mixed waste. The consequence of using these forms of gathering and collection is high effectiveness of recovery with considerable percentage of the mass of waste obtained in comparison with the mass of collected waste.

Thus selective gathering of waste in the place where it was generated allows us to achieve highly effective and limiting further expenses recovery. It realizes then one of the basic ecological standards: providing recovery in accordance with environment protection principles, if the waste generation could not be prevented..

## 5. Further directions of development in selective gathering and collection of waste

Our analysis so far has pointed out that selective gathering of waste in the place where it was generated ensures effective results. Therefore, the directions of further development should revolve around this place and this process. Further directions of the development of selective gathering and collection of communal waste should be connected with:

- a) as regards the place: the place of generation and the place of the first gathering
- b) as regards the process: gathering in a selective way (segregating before placing for temporary storing).

**Table 3.** Data for extrapolation calculation of amount of waste that could be gathered in selective gathering, if all communes in Poland conducted selective gathering of waste in Poland

No	Year	Communes in Poland						Communal waste					
		total		Conducting selective collection of waste		Not conducting selective collection of waste		Total		Actual amount of selectively gathered waste <sup>[16]</sup>		Theoretical amount of selectively gathered waste <sup>[17]</sup>	
		number	[%]	number	[%]	number	[%]	[thousand tones]	[%]	[thousand tones]	[%]	[thousand tones]	[%]
	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.
1.	2005	2478	100	1547	62.4	931	37.6	9 352.1	100	295.31	3.2	473.03	5.1
2.	2006	2478	100	1920	77.5	558	22.5	9 876.6	100	403.39	4.1	520.63	5.3
3.	2007	2478	100	2166	87.4	312	12.6	10.082.6	100	513.00	5.1	586.89	5.8

<sup>16</sup> In communes realizing the system of selective gathering and collection of waste.

<sup>17</sup> Assuming that all communes in Poland would conduct selective gathering of waste.

No	Year	Communes in Poland						Communal waste					
		total		Conducting selective collection of waste		Not conducting selective collection of waste		Total		Actual amount of selectively gathered waste <sup>[16]</sup>		Theoretical amount of selectively gathered waste <sup>[17]</sup>	
		number	[%]	number	[%]	number	[%]	[thousand tones]	[%]	[thousand tones]	[%]	[thousand tones]	[%]
	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.
4.	2008	2478	100	2290	92.4	188	7.6	10 036.4	100	682.48	6.8	738.51	7.4
5.	2009	2478	100	2331	94.1	147	5.9	10 053.5	100	788.87	7.8	838.62	8.3
6.	average	2478	100	2051	82.8	427	17.2	9 880.2	100	536.61	5.4	648.33	6.6

Source: own elaboration on the basis of Infrastruktura Komunalna 2005 (and further years until 2009), Główny Urząd Statystyczny, Warszawa 2006 – 2010.

Using the data from Table 3 we can obtain the information that even if all communes in Poland conducted selective collection of waste, in the analyzed period of five years the amount of selectively gathered waste would only range from 470.03 thousand tones to 832.62 thousand tones (on average 648.33 thousand tones), which would amount to between 5.1% and 8.3% (average – 6.6%) of the total amount of gathered communal waste.

Even if we continue a widespread management of selective gathering of waste, we are unable to exceed the level of 10% of the share of selectively gathered waste in the total mass of generated waste! This means that selective gathering and collection of communal waste is a pretended activity in our country.

This conclusion refers to the last five years from the years covered by statistical data publications by Central Statistical Office<sup>[18]</sup>. These are the years in which selective gathering of waste only started to become popular and widespread. As an example we can quote the fact that in 2005 selective gathering of waste was conducted in 2308 communes, but only in 1547 communes this referred to something more than just collection of paper and cardboard. In 2006, for the first time the research covered selective collection of biodegradable waste. Such waste was collected separately in 201 communes in 2006, in 252 communes in 2007, but in 2008 in as many as 834 communes.

<sup>18</sup> According to the publication plan of GUS, the data from 2010 showing waste management (Rocznik Statystyczny Rzeczypospolitej Polskiej 2011 and Infrastruktura komunalna w 2010 roku) are to come out in October-December 2011.



## 6. Conclusions

The activity related to selective gathering and collection of communal waste so far has brought meager effects (below 10% of total collected communal waste) compared to the level of 62.6% which is practically achievable.

The effectiveness of expenses on selective gathering and collection of waste is still far from the condition of economic effectiveness (so distant that it can be practically considered as wasting resources).

The activity related to selective gathering and collection of communal waste so far has not met the expectations concerning increasing the amounts of waste that is subject to recovery, nor has it fulfilled the requirements of gradual reduction of the amount of waste (especially biodegradable one) deposited on landfills.

These conclusions can be drawn from the analysis of the past. The conclusions concerning the future will allow us to determine the directions of further development.

The directions of further development in selective gathering and collection of waste should be connected with the issue of segregating waste in the place where it is generated and in the first nearest place of its storage.

The development of selective gathering and collection is conditioned not so much by further expenses on increasing material elements of the organized system, but by attempts at streamlining the system and better use of gathered means, therefore it will be more difficult to perform these activities and to achieve objectives.

There is an urgent need to increase the amount of waste subject to recovery, mainly due to the obligation of successive lowering of the amount of biodegradable waste deposited on landfills.

The identification of the factors which determine the development of selective gathering of waste requires a systemic approach as regards waste management and considerable extension of the process participants term.

The development of selective gathering of waste, in a simplified version, should be associated with increased reliability in performing obligations in each element of adopted procedure. Thus it all boils down to: responsibility, respect for law, awareness and growing role of culture in social life.

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**Anna Jurkowska\***

## **INVESTORS OF PROJECTS CO-FINANCED FROM EU FUNDS**

### **Summary**

*Poland has been granted financial support which amounts to nearly 67.3 bln for the period 2007-2013. That amount is designated for various tasks that deal with regional policies and coherence programs.*

*The purpose of this article is to verify a thesis which states that EU fund offer varies considerably depending on the investor criteria and that a major beneficiary of means allocated for regional operational programs are individual departments of territorial government.*

*The first chapter of the article includes a definition of the investor, which has been determined based on the particular features of the investment. Next chapter describes basic groups of investors which utilize EU funding (excluding financial investments). The third chapter provides a general overview of the EU fund offers that are available, as well as describes the principles of granting financial aid. The fourth chapter possesses an analytical character. According to current data pertaining to signing of contracts for financing of the Silesian Voivodship the share of individual groups of investors has been determined according the amount of subsidies that have been granted. Based on the performed research the author attempts to conduct an analysis and evaluation of the diversity of EU fund offers within the auspices of this particular program. It should be mentioned that both analysis and evaluation are performed according to the investor criterion.*

### **1. Introduction**

Poland has received 67.3 billion euro of financial support within the 2007-2013 perspective. The money from EU funds is used by various groups of investors to achieve such strategic goals as improving innovativeness and competitiveness, eliminating generally understood disproportions and supporting economic growth.

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The aim of this paper is to confirm the thesis that the EU funds offer is differentiated to suit the needs of groups of investors and territorial self-government units could be a major beneficiary of financial means from regional operational programs.

The first part contains a definition of an investor, developed on the basis of investment features. Then we distinguished basic groups of investors using financial means from EU funds in realization of their investment projects. This classification was based on the foundations of regional and cohesion policies as the subject of this analysis are European project investors, not the issues concerning financial investments. Next we present a general offer of EU funds and the rules of granting support. The fourth part is analytical; on the basis of current data concerning signed agreements on co-financing within the Regional Operational Program for Śląskie Voivodship we determine the share of particular groups of investors in the value of granted subsidies. On the basis of research the authors attempts to analyze and evaluate the varied offer of EU funds within this operational program using the investor criteria..

Due to spatial constraints of this paper, the issues presented in it require to be further analyzed and taken into account in research on other operational programs realized within the 2007-2013 financial perspective.

## **2. Definition and types of investors in regional policy and cohesion policy**

An investor is a subject making an investment. This is a very general statement, which focuses on a particular scope of activity performed by a given entity. On the basis of core features of investment<sup>[1]</sup> we can determine that an investor is a subject which, due to investment expenses (allocation of own and borrowed capital) and resignation from current consumption, wants to achieve future expected benefits. The time horizon between the period of capital commitment and obtaining particular effects is usually long. An additional factor affecting investors is risk, defined as accumulated effect of likelihood of some events which may positively or negatively influence the realization of investment [Pritchard 2002, p.7]. Risk, therefore, is a possibility of achieving other than planned values of expenses or benefits in time [Rogowski 2008, p.16].

Types of investment may affect the differentiation of investors realizing it. We can distinguish investment in assets in kind (tangible fixed assets and intangible fixed assets understood as proprietary rights, such as licenses, trademarks and patents), financial investment (capital) in financial and capital

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1 The review of definitions of the 'investment' term can be found in [W.Rogowski, Kraków 2008, pp.14-15]

market instruments and investment in intangible assets – intellectual capital. This capital is based on knowledge and constitutes a source of competitive edge in the market. It covers intangible elements which increase traditional financial value of the company presented in financial statements. These elements are: human capital (knowledge, experience, creativity of employees), relational capital (relations with clients, suppliers, co-operators) and structural capital covering intangible assets used in the company [Rogowski 2008, pp.17-20].

The further part concentrates on investors who invest in tangible and intangible assets within investment projects co-financed from EU funds. The analysis does not cover investments in financial instruments markets, where two basic types of investors exist: individual ones (households, enterprises) and institutional ones, with much greater scale of invested means and greater professionalism (banks, pension funds, insurance companies, open-ended or closed trust funds) [Jajuga, Warszawa 1999, p.23].

To finance their investment projects, investors may also use the means from EU funds, which serve the realization of EU regional policy. Regional policy is created deliberately and purposefully by central organs of public authority in order to provide harmonious and universal development of the whole European Union and to increase the level of economic and social cohesion and integrity of each member country [Uryga, Gdańsk 2007, p.8]. The fundamental aims<sup>[2]</sup> of this policy and instruments used serve the postulate that Europe must renew the foundations of its competitiveness, increase its growth potential and effectiveness, improve its social cohesion, concentrating mainly on knowledge, innovativeness, and optimal use of human capital. The European Union activates domestic and community resources in all three aspects of the strategy, namely in economic, social and environmental ones, to better utilize the synergy effect between them in the general context of sustained development [Komunikat, COM (2005) 0299, Bruksela 2005, p.4]. Regional policy is also called structural or cohesion policy, but it seems appropriate to differentiate these terms. Structural policy focuses on reconstruction of economic structure of a particular region, while cohesion policy emphasizes elimination of disproportions in the development of particular regions and achievement of comparable socio-economic indicators, such as unemployment level or GDP [Wąsowski, Warszawa 2006, p.11].

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2 The objectives of regional policy are determined by the Regulation of the European Council (EC) No 1083/2006 from 11th July 2006. These are: objective 1 – “Convergence” – which is supporting poor EU regions, for which 82% of the resources of European Regional Development Fund (ERDF), European Social Fund (ESF) and Coherence Fund (CF) were allocated, objective 2 “Regional competitiveness and employment” – covering activities supporting innovativeness in regions, providing stable and sustainable development and increasing competencies of employees; objective 3 “European territorial cooperation”.



The principles governing granting public support<sup>3</sup> within regional policy use the term of beneficiary. This is an individual, a legal person or an organizational unit which does not have the status of a legal person that uses public community means on the basis of a contract on co-financing the project or a decision made by an appropriate minister, if a particular beneficiary performs the function of a managing or intermediary institution, or by the province governor if the beneficiary performs the function of an intermediary institution [The Act on National Development Plan]. This term will be further used to describe an investor of an investment project co-financed with EU funds.

The EU regulations defining an entrepreneur and economic activity, which are binding for the purposes of public support, distinguish three types of subjects, potential beneficiaries of EU funds [Vademekum dla beneficjenta..., Warszawa 2009, p.22]:

- Entrepreneur according to Polish law, that is a subject conducting economic activity defined as profit-making production, distribution or service activity. The entrepreneur was defined in the Civil Code and in the Act on Freedom of Economic Activity. According to these regulations this is an individual, a legal person, or an organizational unit which does not have the status of a legal person whom a separate act grants the legal capacity, conducting economic activity on their own behalf. The first definition broadens the scope to incorporate professional activity, while the second one entails the partners of a private partnership. Entrepreneurs then are people conducting economic activity provided that they are mature, not incapacitated and can be registered in the Business Activity Register, family companies and companies of commercial law or consortia of these entities conducting regular economic activity. Entrepreneurs registered in the National Court Register are [Vademekum dla beneficjenta..., Warszawa 2009, p. 20]: personal partnership of commercial law, registered

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3 UE policy on state aid bases on article 87, section 1 of the Treaty Establishing European Community, which states that such help is generally incompatible with common market and should be controlled by Commission. Public aid is defined by four conditions which must all be met: 1) transfer of public means, that is granting aid from state budget, territorial self-government unit or government agencies, 2) creating economic benefit for its beneficiary, which disturbs or distorts the activities of competition in the market, 3) selectivity/ selective transfer, means directed to specific entities for production of specific goods, provision of particular services, 4) influence on trade between EU member states. Granting state resources may be done through state, regional or local authorities, public banks, foundations, etc., and also by public or private intermediary organs appointed by the state, for example when a commercial bank is entrusted with the management of a program of supporting SMEs financed by the state. The transfer of public resources may be in form of subsidies, lower interest rates, loan warranties, quicker depreciation write-offs, capital injections, tax exemptions, etc. Public aid allowed in the EU territory concerns the following aid: regional, investment and for employment in small and medium-sized enterprises (SMEs), for developing entrepreneurship among women, for environment protection, for advisory services for SMEs and for participation of SMEs in public tenders, aid in form of increased risk capital, for research, development, innovative activities and also for employees in particularly disadvantageous situation and disabled employees [Vademekum, Prawo..., pp. 3,7].

partnerships, limited partnerships, limited-joint-stock partnership, corporations: limited-liability companies, joint stock companies, cooperatives, state enterprises, research and development units, the so-called foreign companies, mutual insurance societies, branches of foreign entrepreneurs operating in Poland and the main branches of foreign insurance companies. According to the Act on Economic Freedom, the status of an entrepreneur gives a particular subject the right to profit-making activity. Taking the above into account a research and development center or an entity conducting non-profit activities are not entrepreneurs, while a housing community, share-holding company in process of formation, public health care center, clerical legal person (archdiocese, diocese, parish) are entrepreneurs if they conduct such activities<sup>[4]</sup>.

- Non-profit subject, performing work which is useful for the society or considered mission, allocating potential profit for the development of its core non-profit activity – commercial law companies with non-economic purpose, foundations, associations, spas, museums, sports and recreation centers, state budget units, health care centers (public and non-public), etc.,
- Organs of central and regional public authority and territorial self-government units (communes, districts, provinces).

It should be noted that the type and purpose of a particular transaction determines whether there is public aid in it, while the legal or organizational form of an investor is of no importance here. The aid for non-profit or charitable activities will not constitute public aid, while the beneficiary of aid is a subject conducting economic activity, regardless of their organizational and legal form or ways of financing, who received aid from public resources. The ownership issues, that is the fact whether the owner of a subject is the state, its unit or a private person, does not affect the aid.

A vital issue for public aid is the belonging of an enterprise<sup>[5]</sup> (the subject running economic activity) to the category of micro-, small or medium-sized

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4 Taking the above into consideration, we can quote a wide definition of an entrepreneur, included in the Act on Fighting Unfair Competition, according to which subjects should conduct at least side profit-making or professional activity or participate in economic activity. This definition covers the mentioned categories of subjects obliged or not obliged to enter any register, including those which, be it incidentally, conduct economic activity, although their statutory activity is not directed at profit-making. In the EU legislature, an enterprise is a subject regardless of its legal form, which conducts business activity defined as offering goods and services in a geographical and assortment-defined market, and the profit-making purpose of such activity emphasized in Polish law, is not taken into account here. This definition does not exclude for example foundations or associations, which in Polish law do not conduct economic activity.

5 The Civil Code (article 551), defines an enterprise as an organized set of tangible and intangible elements allocated for conducting economic activity. This definition emphasizes the fact that an enterprise is a special property whole established for the purpose of realizing production, trade or service activity. An entrepreneur may conduct his or her economic activity through several enterprises, whose number is not limited by anything but his needs.

entrepreneurs (SMEs), which is one of differentiating criteria while classifying beneficiaries [Vademekum dla beneficjenta., Warszawa 2009, p. 26]. The division is made measuring in at least one of the past two account years, the average annual employment and annual net turnover from sales of goods, products and services and financial operations or the sum of assets in its balance sheet made at the end of one of these years.

Taking into account the above criteria we can differentiate [Vademekum dla beneficjenta., Warszawa 2009, p. 26]:

- micro-entrepreneur, that is a small entrepreneur employing 10 people, whose annual turnover or assets at the end of the year did not exceed 2 million euro,
- small entrepreneur, who employed fewer than 50 workers, and whose annual turnover or assets at the end of the year did not exceed 10 million euro,
- medium-sized entrepreneur, who employed fewer than 250 workers, and whose annual turnover did not exceed 50 million euro, or whose assets at the end of the year did not exceed 43 million euro.

Enterprises may also be differentiated by the degree of independence, most SMEs are independent enterprises, which allow minority share (up to 25%) of other entrepreneurs. A lower degree of independence characterizes partner enterprises (up to 50% of shares) and related enterprises (more than 50% of shares) in which dominant subjects influence the conducted activity.

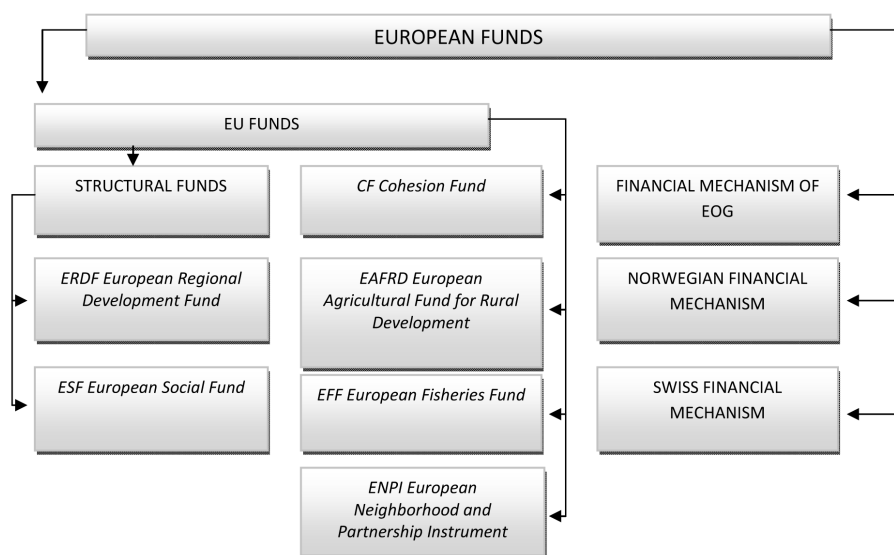
Beneficiaries are classified according to their legal form, but we can also distinguish the following types [www.funduszeuropejskie.gov.pl]: government administration, public finance sector unit, territorial self-government union or association, territorial self-government unit, a subject acting on territorial self government commission, public-private partnership, water law company, foundation, association or non-government organization, social or economic partner, housing cooperative or community, Social Housing Association, church or religious union or legal person of churches and religious unions, national or landscape park, State Forestry or its organizational unit, institution of culture, legal or individual person running schools and other posts, educational institution, higher education school, school or university of fine arts, scientific or research and development center, entrepreneur or enterprise, agencies and foundations of regional and local development, institutions of business environment, supervisor of transport infrastructure, operator of public transport, health care center operating in public health care system, institution appointed to implement the program, other, not mentioned on the list, company, scientific unit, state unit, churches and religious unions, social and non-government organizations, school/ higher education institution and health care center.

The classification of investors quoted above according to regulations and guidelines of regional and cohesion policies shows that standard divisions of investors according to legal and organizational form and ownership form cannot be applied in determining beneficiaries of public aid. They are classified simultaneously on the basis of their legal form and belonging to SMEs, for example separately a limited liability company, micro-enterprise; a limited liability, small enterprise; a limited liability, medium-sized enterprise; a limited liability large enterprise (other legal forms also follow this pattern). Additionally, classification according to types of beneficiaries is introduced.

### 3. EU funds offer for investment projects and principles of their use by investors

The already mentioned community policies of the European Union are conducted with use of financial support instruments defined as EU funds. The division and names of funds are presented in Figure 1 below. European funds are the broadest category of funds including EU funds.

**Figure 1.** Division of European funds



Source: Dylewski et al, Warszawa 2009, p. 23; Vademekum beneficjenta RPO WK-P, Toruń 2010, p.22.

For the cohesion policy in Poland in 2007-2013, structural funds entailing ERDF, ESF and Cohesion Fund are of vital importance (the value of support offered by them amounts to 85.6 billion euro, including 9.7 billion euro of

domestic means, 16.3 billion euro of private subject contribution and 59.5 billion euro of structural funds (52% from ERDF, 15% from ESF and 33% from CF).

The priorities and areas of use as well as the system of implementing EU funds under cohesion policy within the European Union budget for 2007-2013 are determined by the document called National Cohesion Strategy (NCS)<sup>6</sup>, formerly known as National Strategic Reference Framework (NSRF). According to its guidelines, structural funds together with separated domestic means, are channeled to sector (national) and regional operational programs. The means from European Regional Development Fund (ERDF) finance the “Innovative Economy” Operational Program, 16 regional operational programs (ROP), the Development of Eastern Poland Operational Program, some priorities of the “Infrastructure and Environment” Operational Program, European territorial Cooperation Program and “Technical Assistance” Operational Program. The “Human Capital” Operational Program is financed from European Social Fund (ESF).

Support from EU funds is subject to such principles as [Dylewski at al., Warszawa 2009, pp. 30-32]: additionality (EU funds supplement own contribution in a determined percentage share), complementarity (maintaining conformity of national programs and projects realized on their basis with basic principles of community policy), concentration (aid from EU funds for the regions which need it, the so-called maximum intensity of aid), evaluation, partnership in cooperation between the European Commission and appropriate state authorities, including cooperation of self-government and government with social partners, improvement of governing (quality of legislative and regulative instruments), programming, equal opportunities as regards fighting discrimination, creative civic society, subsidiarity, stable and sustainable development.

In order to realize one of the fundamental principles of public aid, that is avoiding double financing of the same project using the means from different funds, programs or actions, the so-called demarcation line was developed. It creates a table of common areas of EU funds interventions developed on the programming stage. One of the identification criteria is by the beneficiary of

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6 The strategic aim determined in NCS is to create favorable conditions for improving competitiveness of Polish knowledge-based economy and entrepreneurship, which will contribute to increased employment and increased level of social, economic and spatial cohesion inside the country as well as of Poland within the EU. This document also assumes realization of some detailed objectives, based on the Lisbon Strategy and on the Community Strategic Guidelines and on the conclusions drawn from the analysis of strengths and weaknesses of Polish economy and its threats and opportunities. Detailed objectives are: creating favorable conditions for maintaining stable and high pace of economic growth, development of human and social capital contributing to increased employment, improving competitiveness of Polish enterprises, especially from service sector, creation and modernization of technical infrastructure laying foundations for increasing competitiveness of Poland and its regions, broadly understood growth of competitiveness of Polish regions and preventing their social, economic and spatial deterioration, development of rural areas [Vademecum Beneficjenta RPO WK-P, Toruń 2010, pp. 9-10].

the project. Additionally, the value of the project is taken into account (the border amount, up to which the project is realized within the framework of regional operational programs, for example as regards roads, this is 20 million zloty, projects with higher value are realized within the Infrastructure and Environment operational program) and its location (national programs are destined for projects of national importance, just like regional ones for projects of regional importance, while projects in rural areas from the Rural Areas Development Operational Program).

Regional aid is restricted through defining limits of public aid intensity, which means the maximum allowable level of EU funds in relation to qualified expenses. The intensity of investment help is differentiated among particular regions, and the main factor influencing this are disproportions in development of particular regions, measured as their GDP per capita to the level of 75% of EU average. [Pomoc publiczna, Warszawa 2008, pp. 29-30]. The differentiation of this intensity in particular regions in Poland is shown on the so-called regional aid map.

**Table 1.** Regional aid map – size of allowable limits of regional aid

Location of the project	Maximum intensity of regional investment aid
Mazowieckie province	30% of qualified costs
Dolnośląskie, pomorskie, śląskie, wielkopolskie, zachodniopomorskie provinces	40% of qualified costs
Kujawsko-pomorskie, lubelskie, lubuskie, łódzkie, małopolskie, opolskie, podkarpackie, podlaskie, świętokrzyskie, warmińsko-mazurskie provinces	50% of qualified costs

Source: Dylewski, Warszawa 2009, p. 49; Regulation of the Council of Ministers 2006.

If the beneficiary belongs to the already presented category of micro, small or medium-sized companies, they may expect higher intensity of public aid than stipulated in Table 1, which shows preferential treatment of this sector. Investors from the SME sector may obtain higher level of co-financing of incurred qualified costs. The aid intensity may be 20% higher as regards micro and small enterprises and 10% higher as far as medium-sized enterprises are concerned.

The type of beneficiary, kind of project and region in which it is realized, determine the type of program. This is because each operational program has different objectives and priorities. This differentiation concerns predicted areas of aid, available budgets and singled out groups of beneficiaries (investors).

#### **4. The analysis and evaluation of the subject structure of investment projects with EU funds share on the example of the Regional Operational Program for Śląskie Voivodship for 2007-2013**

The Regional Operational Program for Śląskie Voivodship for 2007-2013 (ROP SV) is the most important instrument of regional policy in this province. It covers most of the tasks realized in this area by territorial self-government units and other public and private units within EU structural funds. The program incorporates such values as cohesion and social solidarity, as well as sustained development. It is of operational type, contains the justification of priorities determined in it and presents the allocation of resources on realization of particular priorities. The source of co-financing in the ROP are the resources from the ERDF in the amount of 1,713 million euro. Taking into account public national means, the program will be realized with 2,358 million euro, which makes it the second biggest operational program in Poland as regards financial allocation (second only to Mazowieckie voivodship ROP).

The main objective determined for the program was “the stimulation of the fast growth along with the strengthening of social, economic and spatial cohesion of the region”. The development is understood broadly in the economic, social, environmental and infra-technical areas. It covers for example economic growth and limiting unemployment, improving life quality, improving environment quality and activities for improving quality and functionality of technical infrastructure.

Specific priorities within the ROP SV are:

1. technological research and development (R&D), innovation and entrepreneurship in order to increase competitiveness of knowledge-based economy,
2. information society and creating favorable conditions for its development,
3. tourism, increased tourist attractiveness of the region,
4. culture – increased significance of culture as a driver of social and economic growth,
5. environment, environmental protection and improvement,
6. sustainable urban development,
7. transport – development of effective and integrated transport system,
8. educational infrastructure, creating conditions for the development of the society with high professional qualifications sought on the labor market,
9. health and recreation,
10. technical assistance aiming at effective absorption of funds within ROP SV.

Beneficiaries of aid resulting from priorities are selected groups (according to types of beneficiaries) presented in Table 2. We did not include technical assistance in which beneficiaries are the ROP Managing Authority (Board of the Śląskie Voivodship) and a 2<sup>nd</sup> grade intermediary (selected in the tender procedure). On the basis of presented data we can state that the offer of EU funds within the ROP SV is differentiated as far as its addressees, that is types of beneficiaries, are concerned. As territorial self-government units, their unions and associations and organizational units of territorial self-government are selected for financial aid in all priorities, we may assume that they constitute a major group of beneficiaries of EU funds.

**Table 2.** The main beneficiaries of projects realized under priorities of ROP SV

Beneficiary (investor)	Priorities								
	1	2	3	4	5	6	7	8	9
Territorial self-government units, their unions and associations	X	X	X	X	X	X	X	X	X
Territorial self-government organizational units with status of a legal person	X	X	X	X	X	X	X <sup>[7]</sup>	X	X <sup>[8]</sup>
Institutions of business environment	X								
Institutions of culture				X					
Higher education schools	X	X				X		X	
Non-government organizations	X			X	X	X		X	X
Social and economic partners	X		X	X	X	X		X <sup>[9]</sup>	X
SMEs	X		X		X				
Scientific units	X								
Other units of the public finance sector with status of a legal person	X	X	X	X	X	X		X	X
Churches and other religious associations			X	X		X		X	X
Water law companies, national and landscape parks					X				
State Forestry			X		X				
Housing cooperatives and communities						X			X

Source: own elaboration on the basis of [www.rpo.silesia-region.pl].

In order to make a more precise assessment of the significance of territorial self-government units in absorption of EU funds within the ROP SV, we determined the share of particular beneficiaries (investors) in the value of

7 The main beneficiaries under the „transport” priority are also subjects acting on commission of territorial self-government units, selected according to the Public Order Law, subjects in which majority of shares belong to territorial self-government unit, units of the public collective transport sector.

8 Beneficiaries under this priority are health care centers operating in public health care system.

9 Under “educational infrastructure” priority, beneficiaries are also individual or legal persons who are the agencies running schools and education centers.



granted co-financing from public aid. The subject of the study was data concerning signed agreements under the ROP SV, taking into account the value of granted co-financing and the total value of projects co-financed from EU funds. The proposed division of investors (due to the synthetic presentation of results) is not identical with types and groups of beneficiaries defined in the regional and cohesion policy.

**Table 3.** Share of beneficiaries (investors) in the value of granted co-financing within the ROP SV (in thousand PLN)

Beneficiary (investor)	Value of granted co-financing on 16.05.2011 according to signed agreement	Share (%)	Value of co-financed project	Share (%)
Territorial self-government (communes, districts, voivodship)	2,931,308.33	73.7	4,701,678.52	70.1
Hospitals and health care centers	117,965.56	2.9	188,198.14	2.8
Higher education schools	198,172.68	4.2	268,268.84	4.7
Enterprises	7,197.46	0.3	16,427.04	0.2
Communal enterprises	213,551.97	5.2	333,972.32	5.1
Financial institution (EBI) JESSICA Fund	249,618.00	3.9	249,618.00	6
Institutions of culture	249,557.14	5.7	363,429.76	6
Churches and religious associations	67,315.32	1.3	82,524.87	1.6
Other	146,058.41	2.8	176,512.06	3.5
<b>TOTAL</b>	<b>4,180,741.89</b>	<b>100</b>	<b>6,380,629.56</b>	<b>100</b>

Source: own elaboration on the basis of [www.rpo.silesia-region.pl].

Territorial self-government units are the main beneficiary of the EU funds within the ROP SV, and their share accounts for over 70% of the value of granted co-financing within the whole program. Major beneficiaries are also higher education schools, institutions of culture and communal enterprises.

## 5. Conclusions

The thesis of this paper stated that territorial self-government units may be a major beneficiary of EU funds within the regional operational programs. The analysis of signed agreements on co-financing under the ROP SV confirms this assumption. An additional argument can be found in data obtained from the analysis of the previous financial perspective for 2004-2006. In the structure of co-financing particular beneficiaries, the biggest share (42%) was that of territorial self-government units, of which 77% went to communes, 13% to districts and 9% to the voivodship. In the financial perspective 2004-2006 budget units were allocated 29% of co-financing, enterprises – 14%, while farmers – 4% [Bąk, Warszawa 2008, p.14].

As there is a demarcation line emphasizing difference between the scope of support for particular investment projects from regional and national programs, the conclusions from the research done in the analytical part of the article concern regional operational programs. In order to confirm the major share of territorial self-government in using EU funds under the community policies, we should conduct more detailed study covering all available resources from EU funds under all operational programs.

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**V.**  
**FINANCIAL ASPECTS**  
**OF ORGANIZATIONAL MANAGEMENT**



**Anna Berlińska\***

## **SHAPING CAPITAL STRUCTURE IN ENTERPRISES**

### **Summary**

*The aim of this article is to investigate the capital structure of small and medium sized enterprises (SMEs) in Poland. Different capital structures are reviewed in order to test their applicability to small business sector and to identify the most important determinants influencing financial policy of small and medium sized enterprises. The results may be used by small owners and policy makers to take advantage of better mixes of financial resources.*

### **1. Introduction**

Managing enterprise finances is inseparably connected with the necessity to take two kinds of decisions, namely financial and investment ones, whose significance should be evaluated from the perspective of the influence they have on achieving the main aim of an enterprise, which is maximization of its value. The strategic type of investment choices does not raise any objections while decision processes concerning seeking sources of financing have accumulated a lot of controversies which have become inspiration for theoretical and empirical research in this area. Their main objective is to determine the influence that financial decisions have on maintaining financial balance of an enterprise and realization of the set aims. Therefore the issue of conscious and optimal choice of financial policy instruments has become one of the most vital scientific dilemmas in the area of finance, the interpretation of which has exceeded the understanding of such actions only in the context of their supporting function to making investment choices. This practical issue of managing enterprise finances has become a separate and significant problem, the solution to which is hoped to improve the effectiveness of company operations.

This paper tries to answer the question to what extent the enterprise can use the output developed by theory and research in the area of shaping capital

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structure so far and in which areas we should expect further scientific work in order to find ways of better reflecting the enterprise functioning. The answer to the above questions will allow us to determine the scope of the issue which may constitute the foundation for further, multi-faceted research on capital structure. It will be possible to achieve the determined objectives when we conduct a theoretical analysis based on the review of literature and observation of real situations and decisions in the business world.

Due to the size and complexity of the analyzed issue, it will be inevitable to make a far-reaching synthesis of theoretical and empirical verdicts and to make some generalizations within formulated conclusions, therefore this paper is only a small contribution to the discussion over the essence and determinants of capital structure and the legitimacy of further interest of scientists and practitioners in Polish reality. In other words, the author is planning to present selected contemporary and future dilemmas connected with the subject of shaping capital structure and does not aim at analyzing the whole area of this essential and controversial and ambiguous issue.

## **2. Selected issues of shaping capital structure**

One of the dilemmas facing entrepreneurs is the choice of the method of financing their current and future needs, which is reflected in the capital structure. These decision problems of enterprise owners have become an area of interest for scientists, who try to determine the optimal (target) structure and then to choose particular sources of finance to achieve the determined limit. However, the conceptual involvement of researchers representing various fields of science in solving this problem has not brought any coherent and unambiguous solutions in this area yet. In spite of tremendous intellectual efforts made by researchers which has undoubtedly brought about identification of substantial regularities and formulation of important conclusions, capital structure still remains “eternal mystery in the science of finance” [Chittenden, Hall, Hutchinson 1996, p. 59].

The mysteriousness of this issue is connected with lack of coherent and unambiguous conclusions in many aspects. Their consideration should be started with stating the fact that so far scientists have not been able to formulate one definition of the capital structure term. This term is identified with all liabilities which reflects all sources of capital used to finance assets or with involved constant capital (owner’s equity and long-term liabilities), or finally, with all types of capital used in an enterprise which generates financial costs [Skowronek-Mielczarek 2007, pp. 37-38]. A natural consequence of the lack of uniform definition of the capital structure term is ambiguity concerning measuring and interpreting the existing indebtedness, as we are faced with

a variety of indicators which show its share [see Jerzemowska 1999, pp. 17-29]. Taking the above discrepancies into consideration, we should remember that the task of precise definition of the capital structure term must be completed each time by the scientist or practitioner, who should take into account the conditions in which the analyzed entities function and their specificity of using sources of finance.

Money undoubtedly determines the operations and development opportunities of any enterprise, therefore it is generally accepted that capital is “the blood circulation system of each economic organism” [Janasz 2008, p. 72]. The most essential and mutually interpenetrating are divisions of capital according to their origin and ownership right. In the first criterion we have internal financing, connected with utilizing resources generated in the enterprise and external financing, consisting in obtaining financial means from external sources, that is generated by another entity. The second division introduces the differentiation between owner’s equity connected with obtaining the ownership right to the enterprise by the person contributing it, and borrowed capital which does not give such rights, offering only the possibility of influencing the actions of an enterprise through monitoring the way in which it uses and repays the financial means lent to it. Borrowed capital is of external type, which distinguishes it from owner’s equity, which may be obtained from both sources. Other features of borrowed financing are its temporary character, payment for its use and the necessity of repayment and higher probability of its appearance, as in case of bankruptcy of a debtor, the claims of the capital provider are privileged in comparison with the claims raised by the owners. On the other hand, providers of owner’s equity usually do not expect their expenses to be reimbursed, but to participate in profits, which makes this type of financing more stable, positively influencing liquidity and financial credibility and creating a kind of guarantee for the creditors that they will recover the resources they invested. The most important feature of owner’s equity is its limitation, which makes it necessary to supplement it with means from external sources, the use of which may solve or let the enterprise prevent its current financial problems and provide an opportunity to carry out its investment plans requiring expenditure exceeding the resources owned and generated by the enterprise itself (see Table 1).



**Table 1.** Comparative analysis of owner's equity and borrowed capital

Owner's equity	Borrowed capital
<ul style="list-style-type: none"><li>• indefinite time, no interest rate charged</li><li>• safe source of financing</li><li>• guarantee function for creditors</li><li>• owners can control the board of directors</li><li>• cost of owner's equity higher than cost of borrowed capital</li></ul>	<ul style="list-style-type: none"><li>• definite time, interest rate applied</li><li>• flexible source of financing</li><li>• risk of bankruptcy and costs of financial difficulties</li><li>• tax benefits from interests</li><li>• effect of financial leverage</li></ul>

Source: [Duliniec 2007, p. 88].

We can conclude from the information contained in the table that each discussed type of capital has its advantages and drawbacks. Own funds are a safer source of financing as they offer practically limitless time and there are no regular and obligatory payments to creditors, which lowers the risk of the enterprise insolvency. On the other hand, though, own capital has its drawbacks, such as limitation and high risk run by capital providers, who do not have any certainty of achieving expected benefits, which makes this type of financing usually more expensive. Borrowed capital offers higher flexibility, providing owners with an opportunity of wide choice of financed instruments and their constant rotation when repaid liabilities are replaced with new ones, which allows the enterprise to shape its debt structure in various ways regarding costs, purpose and date of repayment, creating favorable conditions for adjusting contracted debt to current and investment needs of an enterprise. Moreover, the use of borrowed capital is connected with certain tax benefits, as its price is lowered due to the fact that its interest rate lowers the tax base, which is defined as the tax shield effect. Its disadvantages include: higher risk of bankruptcy (insolvency) of the enterprise which is connected with contracting a debt, resulting from the danger of failing to cope with the necessity to repay the contracted liabilities and the necessity to make periodical and fixed payments for debt interest rate.

The above presented pictures of both funds make the foundation for taking financial decisions and for theoretical analyses aiming at finding the aspects of maximizing enterprise value through manipulating its capital structure. Shaping capital structure consists in determining proportions of financing the enterprise activities from owner's equity and borrowed capital. For the past few decades, then, the issue of determinants and effects of capital structure policy has been a central point of theoretical considerations and empirical research conducted by scientists representing various fields of science.

The breakthrough moment for these considerations and search, commonly considered a specific accelerator for other theories and research, was the model of capital structure, developed by F. Modigliani and M. Miller (the so-

called MM theory), published in 1958. In their original version of the model, assuming the existence of ideally competitive markets, they formulated and mathematically proved the conclusion that capital structure does not influence the enterprise value. This controversial opinion, based on the assumptions of a perfect market, contrary to economic reality, gave a strong impulse for initiating scientific discourse concerning the possibility of increasing market value of an enterprise through intentional manipulation of its capital structure. This decades-long and still unfinished debate has led to significant development of finance theories in the area of financing enterprises, evolving towards more precise reflection of economic reality through gradual rejection of the assumptions of an ideal market (see Table 2). Currently, the most popular theories explaining financial decisions are: static trade-off theory, agency costs theory and pecking order theory [Ramalho, Vidigal da Silva 2009, pp. 623-633]. They all express a commonly held assumption that the policy of shaping capital structure affects the enterprise value, however this influence is either presented and proved by showing consequences of using particular sources of finance (static trade-off theory, agency costs theory) or by assuming a certain sequence of used instruments (pecking order theory). Each of them, however, points at the usefulness of introducing indebtedness into the structure due to the possibility of achieving some benefits resulting from financial leverage and tax shield and an opportunity of reducing the costs resulting from information asymmetry and representation problems. However, taking into account new types of costs, though allowing us to better reflect the real conditions in which enterprises operate, complicates the task of defining target limits of indebtedness due to difficulties of measuring them. Therefore a theoretical alternative to search for the target (optimal) capital structure is a pecking order theory, which assumes an order in which we use particular types of capital, abandoning any attempts at determining theoretically and practically risky levels of debt.

A great number of capital structure theories confirm the opinion that this issue is extremely complex and significant both for the economic theory and practice. The significance of the financial decisions issue is confirmed by the assumption being the foundation of all contemporary capital structure theories, according to which it is possible to affect the enterprise value by minimizing costs of obtaining sources, such as tax burden, contract costs and information costs. This possibility offers entrepreneurs another instrument that, in particular market conditions, can be used to increase the potential of their economic entities. The complexity of the analyzed issue can be confirmed if we look at particular theories from a historical perspective (see Table 2), which allows us to discern their evolution towards multi-faceted concepts taking into account costs and benefits of contracting additional debt, making it more difficult to determine uniform principles of shaping sources of finance.

**Table 2.** Presentation of selected theories of capital structure

Theory	Essence	
net profit	Ideal market	Fixed costs. Optimal capital structure when the entity is financed in 100% by borrowed capital.
net operating profit	Cost of borrowed capital	Enterprise value and average weighted cost of capital are independent of capital structure. There is no optimal capital structure, and the value of the enterprise and total cost of capital are independent of financial leverage used.
traditional	< Cost of owner's equity	Increasing share of cheaper borrowed financing is not balanced with increased financial risk. Optimal capital structure appears in the balance point, where the capital cost is the lowest and the market value the highest.
MM*	Model assumptions**	All differences in market value caused by capital structure changes are eliminated by arbitration. Finally capital structure is unimportant for the enterprise value, which depends only on expected financial flows.
MM*	Model assumptions***	Benefits of contracting debts amount to interest rate tax shield. Optimal capital structure appears when the enterprise is 100% financed by borrowed capital.
Miller model	Model assumptions****	The difference between tax rates for owner's equity and borrowed capital eliminates tax asymmetry, which accounts for the fact that indebtedness no longer affects the enterprise value. Return to the thesis concerning unimportance of capital structure.
static trade-off	Taking into account costs of financial difficulties	Fixed assets and total invested capital. Along with increasing debts, the enterprise is running growing risk of bankruptcy, which reduces tax benefits related to contracted debt. Optimal capital structure is a specific compromise between benefits and costs of contracting a debt of particular interest rate.
agency costs	Taking into account agency costs	Optimal capital structure minimizes agency costs resulting from conflicts of particular groups of interest in an enterprise (especially on the line of management – owners and creditors – owners).
signals	Taking into account costs of information asymmetry	Shaping capital structure is supposed to signal future financial results to external persons.
pecking order	Taking into account costs of information asymmetry	Assumption that the preference system exists. The sequence of using internal and external sources of finance (retained profits, issuing debt securities, issuing equities) aims at minimizing information and transaction costs.

\*Modigliani-Miller theories.

\*\*We can mention the following conditions: 1) uniform expectations of investors concerning future income and associated risk; 2) risk groups (enterprises with the same income and operational profit) are mutually homogenous 3) operational profit does not change in the whole period (zero growth of an enterprise); 4) ideal capital markets (complete information, particular investors do not influence the price, no transaction costs, no risk of insolvency, entrepreneurs and investors contract debt at the same interest rate free of risk); 5) there are no taxes [Modigliani, Miller 1958, pp. 262-267].

\*\*\*Introducing corporate income tax to the assumptions.

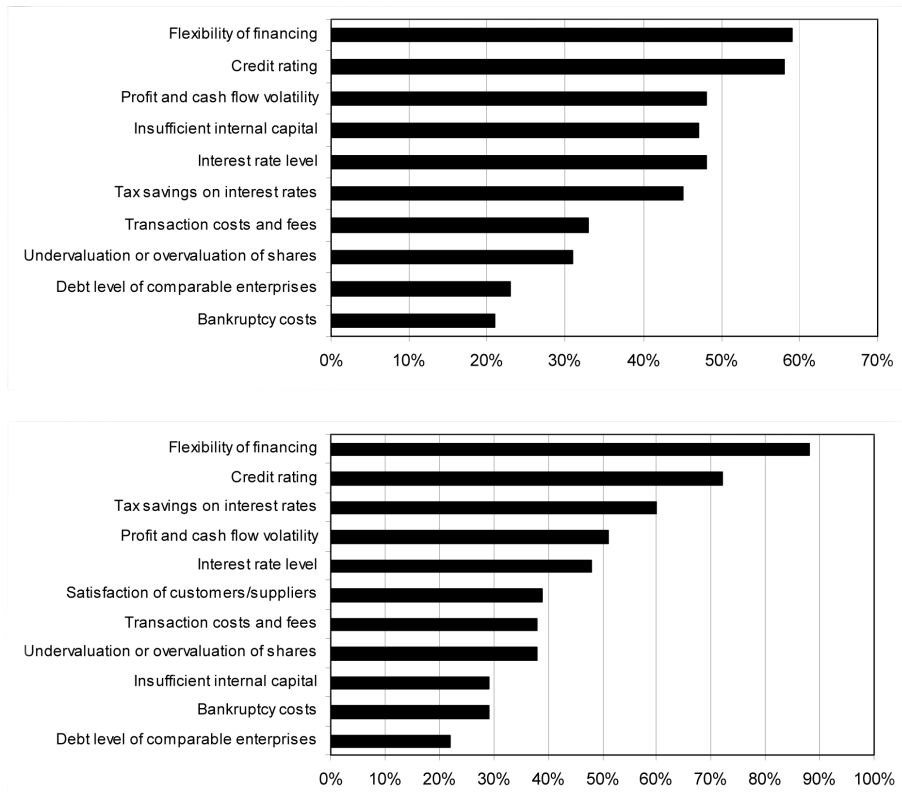
\*\*\*\* Introducing personal income tax to the assumptions.

Source: [own elaboration, on the basis of: Jerzemowska 1999, p. 61-132; Duliniec 2001, p. 105-141; Zawadzka 2009, p. 90-102; Modigliani, Miller 1958, pp. 261- 296; Modigliani, Miller 1963, p. 433-443; Myers 1984, p. 575-590, Stradomski 2004, p. 22-45].

The importance of capital structure issue is also confirmed by the fact that the theories presented above have witnessed numerous attempts at empirical verification, though as in case of theoretical considerations, the results of practical research have not provided conclusive evidence on which model is the most accurate and complete for the enterprises. They all point at the influence of various, often mutually limiting factors which determine capital structure. At the beginning it seems necessary to emphasize that the comparability of particular research is substantially limited due to purely methodological reasons., such as the scope of the sample, its size, criteria of selecting respondents and the time in which the research was conducted. In case of research conducted in different countries which will become the subject of our further analysis, the comparability mentioned above should be considered taking into account institutional differences between countries, such as economic development level, data availability, valid legal regulations, type and scope of control over the enterprise, role of banks and capital markets. Taking into account the above issues related to comparability of data, we will present the results of questionnaires checking the application of particular theories of capital structure in American and European enterprise practice, as the aim is not to make analogies between countries but to confront the analyzed theories with economic reality.

Figure 1 presents the result of the survey concerning the determinants of financial decisions, which show that the dominant choice given by entrepreneurs is the willingness to maintain flexibility of financing and credit rating, which, on the face of it, seems to prove that they operate exclusively in accordance with the pecking order theory. It should be noted, however, that American managers admitted to determining target debt levels (44%) and to considering the question of using external owner's equity (40%), which would indicate the static trade-off theory. In case of European entrepreneurs, we can observe a high percentage of tax benefits answers (60%). These results allow us to make assumptions that entrepreneurs do not only rely on economic rationality logic in their financial decisions, but also take into account the effect their decisions will have on the scope of legal and economic independence of their entities. The specialist literature often emphasizes the pragmatism of entrepreneurs, manifested in maintaining a lower debt level than it would be potentially possible and profitable, due to the willingness to keep some financial reserve needed in case of a worsening economic situation or if some opportunities of profitable investment of capital appear [Cwynar, Cwynar 2008, p. 61; Duliniec 2001 p. 93; Janasz 2007, p. 59].

**Figure 1. Determinants of the capital structure choice: the USA\* and Europe\*\***



\*In 1999 the survey covered 4440 enterprise (return rate of completed questionnaires was on the level of 9%).

\*\*in 2001-2002 the survey covered 710 enterprises (return rate – 8.5%) from 17 European countries (Austria, Belgium, Greece, Denmark, Finland, Ireland, Italy, France, Germany, Luxemburg, Holland, Norway, Protugal, Spain, Switzerland, Sweden and UK).

Source: [Graham, Harley 2002, p. 13-15; Bancel, Mittoo 2002, p. 23, 25, 31; quoted after: Cwynar, Cwynar 2008, p. 64].

The above content proves that in spite of many years passed, filled with numerous debates over the accuracy of particular theoretical assumptions and their empirical verifiability, scientists have failed to develop a uniform model of shaping capital structure in an enterprise [Wiśniewski 2009, p. 515; Janasz 2007, p. 50]. Therefore it seems justifiable to accept the thesis that particular theories do not exclude each other, while each facilitates, be it partly, the comprehension of some aspect of financial operations of an enterprise, directly or indirectly determining its influence on capital structure. These theories, therefore, may constitute some reference point for business practitioners in making their own

financial choices, in which they should compare the benefits of additional use of debt with the additional costs it generates, taking into account transaction costs and information effects beforehand. At the current development stage of theories of shaping capital structure, the concepts and models developed cannot be treated as “ready-to-use models” of conduct, but the knowledge of them facilitates identification of the role played by the factors related to the process of financial sources selection.

### **3. Determinants of capital structure**

Taking into account ambiguity of the theoretical aspects of shaping capital structure analyzed above, we can supplement the analysis of this issue with the presentation of financial decisions as the resultant of the influence of several factors, depending on the situation in internal and external environment of an enterprise and the changes that take place in it.

Among many potentially significant factors influencing the process of making financial decisions, A. Skowronek Mielczarek draws our attention to the importance of the following ones [Skowronek-Mielczarek 2007, pp. 176-177]:

- availability of particular sources – all kinds of restrictions in obtaining sources of finance (formal, legal, financial barriers, etc.);
- profitability achieved by an enterprise – source of security for the claims of capital providers and owners;
- structure of assets – determines the operational risk level of a particular enterprise (the issue of adjusting capital structure to the asset structure due to the time they are at our disposal and flexibility of sources of finance);
- cost of using particular sources of finance – costs of sources of finance differ, therefore there is an opportunity to optimize their level;
- tax system – differentiates the attractiveness of using particular sources of finance (the issue of the so-called tax shield);
- financial risk – taking into account such effects of using borrowed capital as loss of financial solvency, decision independence or finally bankruptcy;
- policy of the owners of a particular enterprise – the choices are influenced by the opinions of people making them (the problem of sharing generated profit, decision concerning increasing owner’s equity, etc.).

Literature often distinguishes a list of determinants of capital structure with their division into macro- and micro-economic conditions [Kowalik 2009, pp. 78-80; Jerzemowska 1999, pp. 51-60], where the most important ones are inflation, industry specificity, tax system, depreciation and government policy.

The list of specific factors is an extensive catalogue differently classified in literature. One of possible typologies covers [Jerzemowska 1999, pp. 52-53]:

- degree of operational risk of enterprise activities,
- company position on the market (in its sector),
- obtained profit margins and other measures of financial result,
- quality of enterprise management,
- conservatism of applied accounting principles,
- fixed charge coverage ratio,
- ratio relating borrowed capital to liquidation ratio of company assets,
- adequacy of financial flows to coverage of future debt and its service,
- financial flexibility of the enterprise in future.

The above lists of factors influencing shaping capital structure indicate above all their multitude and variety, which once again proves the complexity and difficulty of the analyzed issue. It is this richness of typologies, indicating variety and dynamics of financial decision determinants that accounts for the difficulties with identification of decisive factors in choosing a particular capital structure in an enterprise, making the financial decision process the domain of the management, realized on the basis of multi-faceted analysis and evaluation of a wide range of determinants. The undisputed benefit of this factor view of decision processes in an enterprise is its strong relation with economic reality, emphasizing the roles of relationships between the elements inside the enterprise and those from the close and distant environment. This allows us to achieve a wider perspective for the analysis of such a fundamental managerial issue which is shaping capital structure.

#### **4. Directions of further considerations and research on capital structure**

The analyzed literature allows us to draw a conclusion that the debate concerning shaping capital structure is not approaching its end, which may be justified by the complexity of this issue and dynamism of changes taking place in the close and distant environment of an enterprise, forcing it to constantly adjust the current solutions to new conditions and the search for new links in the chain leading to the explanation of the role financial decisions play in the process of enterprise operations and development. This rich theoretical and empirical outcome presents great cognitive and practical value, being a significant starting point for further scientific research as well as a useful tool for managers and owners of enterprises.

The existence of many important and yet unsolved issues in the area of shaping capital structure may encourage us to adopt an extremely relative approach consisting in formulating an opinion expressed by words “it depends”

as the main indicator in the process of explaining and interpreting phenomena. Such attitude, consistent with the principles of relativism, does not constitute a promising direction of research on scientific interpretation of a particular problem, which may happen when we ask the question: “What does it depend on?”. Regardless of the lack of a few elements in this puzzle of shaping capital structure, the fact that the process of identifying, interpreting and evaluating important variables of making financial decisions has been going on non-stop allows us to hold some hope that we will witness new and useful solutions both in economic theory and practice.

As there are many theoretical and empirical ambiguities concerning the issue of capital structure, we may expect further attempts at testing the accuracy and purposefulness of adopted assumptions, relations and conclusions, which will result in confirming their validity or rejecting insignificant and inaccurate judgments. One of possible directions of our considerations in this area could be an attempt at developing a model which, to a certain extent, will combine the simplicity, elegance and distinctiveness of predictions of static trade-off theory with realism of pecking order theory, as both concepts are not mutually exclusive, being more complementary in explaining and interpreting various aspects of financial operations of an enterprise.

We can also state that there are still many aspects of financial decision determinants that have not been theoretically determined and empirically tested at length. An example of such area is the issue of identification, explanation and evaluation of relationships between capital structure and the size of an enterprise. Bearing in mind the importance of small and medium-sized enterprises (SME) in market economy, we should try to find an answer to the question whether capital structure theories can be applied in case of smaller enterprises, and then identify the determinant whose influence on decision making practice of SME owners is the strongest. Empirical research proves that SMEs are not particularly interested in setting objectives in form of target capital structure, since due to lower profitability of the sector they cannot take as much advantage of tax allowances as larger entities [Graham, Harvey 2002, p. 15]. The dominant view states that there are possibilities of transferring the assumptions of pecking order theory to the reality of the sector of this size enterprises [Graham, Harvey 2002, p. 19; Ramalho, Vidigal da Silva 2009, pp. 631-634], though there are still some doubts as to what extent identified preferences in choice of financing sources reflect conscious policy of SMEs and to what extent they come from structural features of the sector. However, we should keep in mind that the analysis of finance sources of smaller enterprises is a daunting task due to great diversification of this group and various forms of accumulating data concerning their operations, therefore the knowledge of their financial policy still remains largely intuitive.



## 5. Conclusions

The synthetic analysis of the issue of shaping capital structure in an enterprise, demonstrating its theoretical and empirical richness, may confirm the importance and complexity of this problem for science and economic practice. It is this long-term topicality and significance of the issue that led us to take up the issue in an attempt at finding an answer to the question whether the existing scientific outcome may find some application in the economic practice of enterprises.

The capital structure of enterprises turned out to be determined by many various factor, which makes it difficult, if not impossible, to create a universal concept of its shaping, which could constitute an optimal solution for each enterprise. So far, theoretical and empirical efforts have taken us closer to the definition of main determinants, explaining what the enterprise capital structure depends on. Identification of factors influencing capital structure has practical significance, as when entrepreneurs are aware of their role, they will make decisions taking into account many elements which are not indifferent to the enterprise value growth. However, ambiguities and discrepancies in many issues concerning shaping capital structure still call for the need to continue systematic and extensive research in this area.

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**Marcin Jamrozý\***

## **MANAGING EXCHANGE RATE DIFFERENCES FOR TAX PURPOSES**

### **Summary**

*This paper aims to analyze the tax consequences of foreign exchange differences. The taxpayers can choose the method of determining exchange differences for tax purposes according to tax law or according to accounting law. The application of each method has its advantages as well as disadvantages, and the choice of a better method for the taxpayer should be based on a detailed analysis of his business activities and potential future economic events. In business practice certain economic events may result in recognition or irrelevance of such exchange differences for tax purposes, such as a waiver of or change of the currency of a liability. If foreign exchange gains are not recognized for tax purposes, for the taxpayer this would mean tax savings.*

### **1. Introduction**

Polish entrepreneurs may settle their accounts in foreign currencies not only with foreign contractors but since 24<sup>th</sup> January 2009 also with domestic contractors (residents) – without having to obtain individual foreign exchange permits. If the contract specifies the value of the service and its payment in foreign currency, the debtor is obliged to perform this service in foreign currency. If the value of the service was established in foreign currency but the contract does not specify payment currency, the debtor may pay in PLN. The principles of determining foreign exchange rates are defined in the resolution 51/2002 of the Management Board of the National Bank of Poland from 23<sup>rd</sup> September 2002 as regards the method of calculation and announcement of current exchange rates (Official Journal of the NBP from 26<sup>th</sup> September 2002 with subsequent changes). According to this resolution, average exchange rates are fixed at 11.00 and announced on the same day. If it is impossible to announce the exchange rate due to causes outside the NBP – the latest exchange rates are used.

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It is becoming more and more important for entrepreneurs to manage effectively the currency risk, which exists as economic, transaction or transfer risk. Currency risk depends on the fluctuations of foreign exchange rates and grows proportionally to the fluctuations of exchange rates [Misztal 2004, p. 37]. Transfer risk should be associated with reporting duties, including the fixing of exchange rate differences for tax purposes. The role of the tax risk management as regards changing values of assets and liabilities expressed in foreign currency is to optimize tax burden in such a way which does not expose an enterprise to increased or economically unjustified tax risk. Appropriate tax risk management as regards exchange rate differences leads to better after-tax results. In practice, apart from “usual” situations in which exchange rate differences appear (for example purchasing goods in foreign currency and cash payment, contracting a loan in foreign currency) there may be special economic events which will result in obligation to recognize exchange rate differences for tax purposes.

The aim of this article is to present and analyze the possibilities of making choices concerning settlement of exchange rate differences, to point out the so-called optimization potential through analysis of model economic events, for example currency change-over of liabilities. The analysis will be made from the point of view of a joint-stock company which is a taxpayer of CIT and is subject to unlimited tax liability in Poland (see article 3, point 1 of the Act of 15<sup>th</sup> February 1992 on Corporate Income Tax, consolidated act, Journal of Law from 2000, No 54, position 654 with subsequent changes – hereinafter referred to as ACIT).

## **2. Revenues and costs in foreign currency**

Polish regulations on income tax stipulate that revenues or costs expressed in foreign currency should be calculated using average exchange rate of the NBP from the last working day before the day of obtaining revenue or incurred costs (article 12, section 2 and article 15, section 1 of ACIT). Also accounting regulations generally state that economic operations in foreign currency are expressed in accounting books on the day of their performance using the average exchange rate announced for a particular currency by the National Bank of Poland on the day before the day of the operation if it is not justifiable to calculate them using the exchange rate from the actual day (in case of payment of dues or liabilities) – see article 30 of the Act of 29<sup>th</sup> September 1994 on Accounting (consolidated act, Journal of Law from 2009, No 152, position 1223 with subsequent changes). Exchange rate differences increase revenues as positive exchange rate differences (see Table 1) or tax deductible revenue as negative exchange rate differences in the moment of performing, for example receiving payment or paying dues (article 15, section 1 ACIT).

**Table 1** Situations when positive exchange rate differences occur

1.	Due revenue calculated with average exchange rate of NBP	<	Value of revenue obtained according to actual exchange rate on that day
2.	Incurred costs calculated with average exchange rate of NBP	>	Value of the cost on the payment day according to actual exchange rate on that day
3.	Value of received or acquired monetary means or values on the day of receiving them according to actual exchange rate on that day	<	Value of monetary means or values on the payment day or other form of outflow of these monetary means or values according to actual exchange rate on that day
4.	Value of credit (loan) in foreign currency on the day of granting it according to actual exchange rate on that day	<	Value of credit (loan) on the day of its repayment, calculated according to actual exchange rate on that day
5.	Value of credit (loan) on the day of receiving it calculated according to actual exchange rate on that day	>	Value of this credit (loan) on the day of its payment according to actual exchange rate on that day.

Source: own elaboration.

“Payment day” was defined as the day of settling dues in any form, also as a result of deducting liabilities (article 15, section 7, ACIT). When determining exchange rate differences to one’s monetary means or values in foreign currency, the taxpayer is obliged to determine the method of valuating these means using one of the methods applied in accounting, such as FIFO / LIFO or average price which cannot be changed during tax year [Felis, Jamroży, Szlezak-Matusiewicz 2010, p. 140]. It is vital to understand what “the actual used exchange rate” means in a situation when the taxpayer makes payments through foreign currency account and the transaction itself is not connected with exchanging financial means into PLN. In a precedential ruling from 3<sup>rd</sup> February 2011 (reference file number II FSK 1682/09), the Supreme Administrative Court stated that for the purpose of determining exchange rate differences resulting from inflows and outflows of monetary means in foreign currency collected on the foreign currency account, it is not possible to use “the actual used exchange rate”, as in this case there is no change over of monetary means in foreign currency into PLN, nor PLN into foreign currency. To calculate exchange rate differences one should therefore use average exchange rate announced by the NBP on the last day before the day of crediting/debiting the account. The Supreme Administrative Court denied the position adopted by tax authorities and presented in judicial decisions (see the WSA court ruling from 18.02.2010, reference file number I SA/Gd 914/09; WSA in Szczecin from 08.02.2010, reference file number I SA/Sz 72/10). In my opinion, we should accept the view that the actual used exchange rate on a particular day is the exchange rate at

which the taxpayer actually sold or purchased the currency on a particular day, not the buying or selling rate of the bank, which was not applied.

In order to determine revenues or costs resulting from exchange rate differences, it is essential to establish the day the revenue or tax cost originated. Revenues connected with economic activity obtained in a tax year include due revenues even if they have not been obtained yet. Revenue is created generally on the day of handing over a thing, selling property rights or performing a service (or partial performance of it), not later than on the day of:

- issuing an invoice, or
- making the payment (article 12, section 3a, ACIT).

Revenues from services settled in settlement periods (including revenues from supplying electric and heat energy and gas) are acknowledged on the last day of settlement period defined in the contract or on the issued invoice, at least once a year. In other cases the date of obtaining revenue is the day of receiving payment (article 12, sections 3c-3e, ACIT). Tax revenues do not cover, however, collected payments or receivables entered into books on account of deliveries of goods and services which will be performed in next reporting periods [Felis, Jamroży, Szlęzak-Matusiewicz, 2010, p. 130].

## **Example**

The contractor, due to default in delivery term is obliged to pay contractual penalty in the amount of 5000 euro. In December 2010, the limited liability company entered this receivable in the books (revenue on accrual basis) and received the amount on 15<sup>th</sup> January 2011. For tax purposes, in order to calculate this revenue into PLN, we should use the average exchange rate of the NBP from the last working day before the day of obtaining revenue (cash basis), that is from 14<sup>th</sup> January 2011.

On the other hand, the day of incurring cost is the day in which this cost was entered into accounting books on the basis of the invoice (the bill) received or the day on which the cost was entered on the basis of other proof in case of lack of invoice (bill), excluding the situation when this would refer to reserves or passive period settlements entered as costs (article 15, section 4c, ACIT). Costs directly related to revenues are deducted by the taxpayer who makes the financial report – in the tax year in which corresponding revenues were obtained, except when they were incurred after the day of making financial statement or after the date of submitting annual report (article 15, section 4, sections 4b-4c, ACIT). Costs other than directly related to revenues (indirect costs) are deducted on the date of incurring them, but if they refer to the period of time exceeding a tax year and it is not possible to determine what part refers

to a particular tax year, they are tax deductible expenses proportionally to the length of the period they refer to (article 15, section 4d, ACIT).

### **Example**

Interests from foreign currency bank loan taken for current needs may constitute tax deductible expenses on the moment of their payment. Therefore, calculation of interest costs into PLN should be made using the exchange rate from the day before the payment day (provided it is a working day) For tax purposes, there will not be exchange rate differences on account of interest payment, as the day of acknowledging them as tax deductible expenses is the day of payment (cash basis).

In my opinion, it is correct to say that economic operation cannot be identified with receiving an invoice. Entering an economic event into books is preceded by decrement on the voucher. The decrement of a document in a particular month is determined by the date of the event which took place in this reporting period, that is the performance of an economic operation. The invoice, irrespective of the day of receiving it, should be decreed on the day of performing an economic operation (see for example the ruling of WSA in Gliwice from 23<sup>rd</sup> March 2009, reference file number I SA/Gl 1026/08).

It should be pointed out that the Supreme Administrative Court on 18<sup>th</sup> May 2010 issued a controversial ruling (reference file number II FSK 1440/09), stating that for the calculation of incurred cost in foreign currency the date of receiving an invoice or a bill is essential rather than the date of issuing them, and costs incurred in foreign currencies should be calculated into PLN according to the average exchange rate of the NBP from the last working day before the day of entering the invoice or other document into books. According to the court, when making an interpretation of article 15, section 4e, ACIT, we should bear in mind that it contained a regulation on the basis of which cost is treated on the accrual basis, and the moment of incurring cost will be the day on which the cost was recorded in accounting books, that is the day on which it was entered into books on the basis of received invoice (bill) or other proof in absence of the invoice. In this way, costs incurred in foreign currencies should be calculated into PLN using the average exchange rate announced by the NBP on the last working day before the day of entering the invoice or other proof in the books. In my opinion, it is hard to accept the position expressed in the ruling of the Supreme Administrative Court. If costs are generally settled on the accrual basis, for the purpose of calculating the incurred cost in foreign currency we should use the day before the day of incurring the cost, not the technical moment of receiving an invoice [Jamroz 2010, *Przychody i koszty...*].

It should also be noted that for tax purposes we should only acknowledge exchange rate differences from net amounts of liabilities. Compare the Supreme Administrative Court ruling from 02.03.2011, reference file number II FSK 1840/09 in which it stated that although in foreign currency transactions there might be exchange rate differences in economic terms concerning the VAT tax included in gross price, they do not increase revenues or tax costs. In Principle, VAT tax cannot be due revenue or tax deductible expense (article 12, section 4, point 9, ACIT). We should critically comment that exchange rate differences appear actually in the whole amount of due liability, calculated, expressed and paid in foreign currency, thus also in the part corresponding to VAT tax included in the amount of liability after calculating it into foreign currency. Basing only on the linguistic interpretation of article 15a ACIT which contains a closed catalogue of situations in which exchange rate difference appear for tax purposes, distorts economic effects of a transaction.

### **3. Choice of the method of calculating exchange rate differences**

Taxpayers have the right to choose between calculating exchange rate differences on the cash basis (tax method) or on the accrual basis resulting from accounting regulations (article 9b, ACIT). The accounting method allows them to include into costs or taxable revenues both realized and not realized exchange rate differences, resulting especially from valuation of elements of assets and liabilities and off-balance items expressed in foreign currency. This valuation for tax purposes should be made on the last day of each month (quarter) and on the last day of tax year or only on the last day of tax year. Taxpayers can choose the date they will perform this valuation, but the chosen date must be used throughout the tax year.

#### **Example**

At the end of 2010 a limited liability company calculated its liability on account of a loan taken in euro to its foreign partner using the average NBP exchange rate on the balance sheet day of 3.9603 PLN/euro. Weakening position of PLN caused negative exchange rate differences from loan calculation in the amount of 5000 PLN. According to the tax method of calculating exchange rate differences, differences resulting from calculation (5000 PLN) will not constitute tax expenses, while in the accounting method they will be classified as costs acknowledged for tax purposes.



If on the balance sheet day (for example 31.12.2010) in the accounting books we had negative exchange rate differences from balance sheet calculations or off-balance items in foreign currency, switching to accounting method from next year (for example from 2011) is generally profitable, as we will obtain increased tax deductible expenses. We should remember that such differences are usually temporary. For example, in case of predicted weakening of Polish currency in relation to euro, taxpayers financing their operations with currency loans in euro will generate tax expenses due to exchange rate differences much faster. In order to choose the most profitable method of calculating exchange rate differences, a taxpayer should analyze the structure of its assets, their source of finance and long-term forecast concerning currency exchange rates. If taxpayers choose the accounting method, they will have to use it for at least three tax years, starting from the tax year in which the method was adopted [Jamróży, Sobieszek 2010, Optymalizacja w zakresie różnic...].

If we choose the method of calculating exchange rate differences described in section 1, point 2, taxpayers, on the first day of the tax year in which the method was adopted, count as revenues or tax deductible expenses the exchange rate differences calculated on the basis of accounting regulations for the last day of previous tax year (article 9b, section 5, ACIT). According to some courts, when switching to the accounting method of calculating exchange rate differences, for tax purposes, the taxpayer should count as expenses or tax revenues the exchange rate differences calculated on the last day of the previous tax year, which is supposed to be limited to exchange rate differences concerning the tax year preceding the year in which the method was changed, but it will not cover the unrealized exchange rate differences from previous years calculated in an accruing way on the last day of the previous tax year (see the ruling of WSA court in Warsaw from 24.01.2011, reference file number III SA/Wa 1169/10). It is hard to accept this view, which in fact means not settling exchange rate differences from previous years calculated in an accruing way for the last day of the previous tax year for tax purposes. Some part of revenues or expenses on account of exchange rate differences would not be taken into account in tax calculation.

From the point of view of tax optimization, such an approach would give taxpayers a possibility of legal “loss” of positive, unrealized exchange rate differences due to switching to the accounting method of calculating exchange rate differences. However, in case of negative, unrealized exchange rate differences, taxpayers would be deprived of the possibility of settling some of their tax deductible expenses. Ignoring the above controversies, the benefits of using the regulations of the Act on Accounting to calculate exchange rate differences for tax purposes would include lower expenditure of labor when

calculating tax result. Exchange rate differences recorded in accounting books cannot be corrected for tax purposes, which eliminates the influence of exchange rate differences on the amount of deferred tax. It should be noted, however, that taxpayers who are not subject to obligatory audit of financial statements and who choose this method, must have their financial statements checked by an independent auditor every year and in this way incur higher costs of general supervision.

#### **4. Currency change-over of liabilities**

Exchange rate differences appear for example in a situation when the value of obtained credit (loan) in foreign currency on the day of receiving it is lower or higher than the value of this credit (loan) on the day of its repayment, calculated according to actual used exchange rate of the currency from these days (article 15a, section 2, point 5, in connection with section 3, point 5, ACIT). It is generally accepted that for the appearance of exchange rate differences in corporate income tax in connection with repayment of the loan, the following conditions must be jointly fulfilled:

- the value of the loan must be expressed in foreign currency,
- loan repayment should be performed in foreign currency (see for example individual interpretation of the Head of Internal Revenue Service in Bydgoszcz from 11<sup>th</sup> June 2010, ITPB3/423-121/10/AW).

This means that for tax purposes, differences resulting from currency exchange rates are not treated as exchange rate differences if, for instance, liability is expressed in Polish currency and the payment for it is performed in foreign currency, or the other way round – the liability is expressed in foreign currency and the repayment is performed in PLN (see individual interpretation of the Head of Internal Revenue Service in Katowice from 20<sup>th</sup> May 2010, IBPBI/2/423-356/10/MO).

When using tax method, currency change-over is not treated as a form of payment (see for example the ruling of WSA court in Szczecin from 24<sup>th</sup> July 2008, reference file number I SA/Sz 74/08; individual interpretation of the Head of Internal Revenue Service in Warsaw from 5<sup>th</sup> August 2010, IPPB5/423-376/10-2/IŚ). In case of currency change-over of a liability on account of credit (loan), we only have the change of currency in which the loan was expressed, but it is not settled. Therefore currency change-over of the liability on account of credit (loan) cannot lead to exchange rate differences for tax purposes [Jamroży, Sobieszek, 2010, p. 169]. If the repayment of a liability expressed in foreign currency leads to realization of positive exchange rate differences which would increase taxable base for income tax, we could avoid taxing it through currency change-over. For the entrepreneurs who are borrowers such an activity

is profitable when Polish currency is becoming stronger. For entrepreneurs who are lenders currency change-over of liabilities is profitable when our currency is weakening. It should also be emphasized that especially in case of loans between related entities there is actual freedom of shaping terms of the contract. However, it should be noted that we can expect interference in case of shifting income (revenue) to the related entity due to performance of a service on terms diverting from market conditions. Income and due tax of the taxpayer showing lowered tax liability is determined then without taking into account conditions resulting from existing capital and organizational ties [Jamroży, Ceny transferowe... 2010, p. 325].

A necessary condition for appearance of exchange rate differences is payment of the liability in foreign currency. After currency change-over the liability will be expressed in PLN, therefore its repayment should not imply generation of exchange rate differences for tax purposes. Moreover, regulations state that received or repaid credits (loans) are not classified as revenues, with the exception of capitalized interests from these credits (loans), while tax expenses do not cover expenses on repayment of loans (credits) with the exception of capitalized interest from these loans (credits).

### **Example**

A limited liability company signed a contract for a loan with its shareholders with registered office in France. The amount of the loan was 100 thousand euro, which was the equivalent of 420 thousand PLN, calculated at the bank purchasing rate from the day the loan was credited on the account of the company. Repaying the loan, assuming that the value of PLN will strengthen (for example the exchange rate will drop from 4.20 PLN to 3.90 PLN/euro), the company would have to tax revenues from positive exchange rate differences (in the amount of 30 thousand PLN). Thanks to currency change-over of the liabilities from euro into PLN, the company may avoid the necessity of taxing its financial revenues.

The fact that the entrepreneur will not be obliged to acknowledge for tax purposes its revenues from exchange rate differences neither in relation to loan currency change-over nor due to its later repayment, has been confirmed by numerous interpretations of tax authorities (for example interpretation of the Head of Internal Revenue Service in Bydgoszcz from 26<sup>th</sup> January 2010, ITPB3/423-789/09/AM; interpretation of the Head of Internal Revenue Service in Warsaw from 12<sup>th</sup> March 2009, IPPB5/423-288/08-2/IŚ). It is assumed that currency change-over of the amount of credit taken by the company will not result in settling the liability, therefore the condition from article 15a, section 7, ACIT, determining the appearance of exchange rate

differences for tax purposes from settling the liability by the taxpayer, will not be fulfilled. Even though as a result of currency change-over from euro to PLN there might be differences between historic currency exchange rate from the day the credit was taken and the exchange rate used by the bank on the day of currency change-over, these differences do not matter in light of valid regulations of tax law which determine the issue of revenues and tax deductible expenses on account of exchange rate differences (see, for example, individual interpretation of the Head of Internal Revenue Service in Warsaw from 22<sup>nd</sup> October 2010, IPPB5/423-462/10-3/IS). Because currency change-over creates exchange rate difference as understood in the Act on Accounting, using the accounting method to determine exchange rate differences will not result in a difference between the calculated financial result in accordance with the Act on Accounting and the tax base for corporate income tax.

## **5. Liabilities redemption**

To decide whether in case of redemption of liabilities expressed in foreign currency, according to the acts on income tax we will have exchange rate differences in the “PLN” value of redeemed liabilities between the day it was created and the day of its redemption, the most important issue is whether redemption is one of the forms of liability repayment. Redemption of liabilities creates exchange rate differences as understood in the Act on Accounting, therefore they affect the tax base when we use the accounting method.

According to article 15a, section 7, ACIT, the payment day, essential for creation of exchange rate differences using the tax method, is the day of settling liabilities in any form, including liability redemption. Settlement of the liability is an event which leads to expiration of the liability due to performance of the service by the debtor for the creditor (see for example individual interpretation of the Head of Internal Revenue Service in Katowice from 29<sup>th</sup> April 2008, IBPB3/423-329/08/SD). As a result of taking over the debt, the claim of the company resulting from taken over contracts will not be satisfied, but from this moment it will be towards another entity. Due to taking over the debt the legal relation of the loan contract remains the same, but there is only the subject change on side of the debtor, therefore we cannot assume that as a result of taking over the debt, the loan liability was settled in any form (individual interpretation of the Head of Internal Revenue Service in Katowice from 6<sup>th</sup> March 2009, IBPBI/2/423-239/08/MO).

There is also another view, stating that in case of liabilities redemption tax revenue on the side of the entity (debtor), who due to this obtains property increment, should be recognized on the day the redemption was made at the

exchange rate from the last working day before the day of obtaining revenue, which, in this case, is the average NBP exchange rate from the day before the redemption (see the ruling of WSA court in Gliwice from 5<sup>th</sup> December 2006, reference file number I SA/GI 994/06; the ruling of NSA court from 20<sup>th</sup> May 2008, reference file number II FSK 528/07). In my opinion, such a way of determining the amount of revenue may be justified, as revenue on account of liabilities redemption should equal what the taxpayer would have to pay on the day of redemption. Recognition of exchange rate differences or using historic exchange rate (from the day of entering the liability in books) to calculate revenue on account of redemption would cause the situation in which tax result would not fully reflect the amount of property increment obtained by the taxpayer.

### **Example**

A limited liability company signed a loan contract with its shareholder with registered office in France. The amount of the loan was 100 thousand euro, which was the equivalent of 420 thousand PLN, calculated at the bank purchasing rate from the day the loan was credited on the bank account of the company. After a year the loan was fully redeemed by the shareholder. The currency exchange rate was then 3.90 PLN/euro. The use of current exchange rate causes that the company will recognize revenue of 390 thousand PLN. The amount of exchange rate difference of 30 thousand PLN will not constitute taxable revenue (using the tax method).

Liability redemption due to non-payment of it allows taxpayers not to take into account positive, unrealized exchange rate differences. Similarly, the value of redeemed interest is fiscally indifferent to the taxpayer. In case of interests we use the cash basis which states that interests become taxable revenue on the actual day of receiving them from the contractor.

## **6. Conclusions**

Taxpayers have the right to choose between calculating exchange rate differences on the basis of the Act on Income Tax or the Act on Accounting. The use of each method offers benefits and drawbacks, and the choice of the method should be based on detailed analysis of the subject's activities and potential future economic events.

In practice we can expect economic events which will not oblige us to recognize exchange rate differences, such as redemption or currency change-over of liabilities. If positive exchange rate differences are not acknowledged for tax purposes, the taxpayer will enjoy some tax savings. However, in

case of negative, unrealized exchange rate differences, taxpayers would be deprived of the possibility of settling part of their tax deductible expenses. It should also be emphasized that relying only on the linguistic interpretation of article 15 ACIT, containing a closed catalogue of situations which lead to origin of exchange rate differences for tax purposes, often distorts economic effects of transaction.

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**Małgorzata Ciepielowska-Sroka\***

## **FAIR VALUE OF A COMPANY**

### **Summary**

*The paper presents the particular assets and liabilities using the fair value concept, in connection with the implementation of the company value measurement. The above mentioned approach is based on the assumption of the true value approximation of the particular balance sheets elements. The key role in the analyzed approach is played by the company valuation in fair value, which improves the company estimation method in practice of company valuation.*

### **1. Introduction**

Diversity of valued enterprises due to their specific activities, financial situation, their market, location, as well as their size and social significance, accounts for popularity of various approaches to company valuation. Company valuation is one of key issues in the process of ownership transformation. Its importance should not be underestimated as social and economic consequences of the process are irreversible [Kamela-Sowińska 2006].

The aim of this paper is to present the methodology of company valuation using the method of fair value, which is used in practice to provide both managers and investors with the possibility of forecasting and comparing assets and liabilities of an enterprise.

### **2. Methodology of company valuation using the concept of fair value**

Valuation as the process of estimating company value is a tool supporting decision making on strategic level and is used as an advanced management tool applied in real life by managers [Dobija 2005].

On the other hand, company value is a measurable decision criterion, which is the basis and stimulator of actions taken in order to adjust the

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management system to the needs resulting from a strategic choice made [Kapa-Kejna 2002]. It is always necessary to determine the subject of valuation to define the concept of value. Specific methods of measuring value are connected with parallel existence of various concepts of value [Zarzecki 1999].

The essence of fair value is an attempt at creating maximally fair conditions for all potential parties to the transaction. It also means that these transactions do not have to be made only in the open market. The transaction between the buyer and the seller is realized on the basis of a legally binding agreement which excludes other potential buyers and sellers.

In order to present the discussed transaction properly, we must determine the value which the purchasing company will obtain for the paid or unpaid remuneration. Therefore the assets and liabilities of a company are valued using the fair value method, which may definitely differ from book value, that is the value that can be found in the books of the purchased company.

Fair value is treated as a sort of common denominator for various prices coming from the market and influencing the valuation of assets. This fact is taken into account in article 44b section 4 of the Act on Accounting, which precisely determines the basis of fair valuation of particular elements of assets and liabilities – concerning the case of taking over another company. This situation is illustrated in Table 1 below.

**Table 1.** Method of determining fair value

Element of assets and liabilities	Method of determining fair value
Listed securities	Current quotation minus costs of sale
Unlisted securities	Assessed value taking into account such factor as: price-earnings ratio and dividend rate of comparable securities issued by companies of similar type
Liabilities	Current (discounted) value of due payments subtracted by allowance for risky and bad debts, and possible recovery costs; however, determining current (discounted) values with reference to short-term liabilities is not necessary if the difference between value of liabilities according to due payments and their discounted value is not significant
Inventories: a) Finished products and goods b) work in progress c) materials	Net selling price reduced by profit margin discount resulting from costs of finding a purchaser for the inventories  Net selling price of finished products reduced by costs of ending production and profit margin discount resulting from costs of finding a purchaser for the inventories  Current purchasing price



Element of assets and liabilities	Method of determining fair value
Fixed assets	Market value or their value established in independent valuation. If it is impossible to obtain independent valuation of fixed assets – current purchasing price or production cost, taking into account current wear and tear degree
Intangibles	Assessed value established on the basis of market prices of the same or similar intangibles, and with reference to company value or negative company value in the balance sheet of the taken over company – null value; in case assessed value cannot be established on the basis of market prices, the value which will not cause or increase negative value of the company after the takeover is adopted
Liabilities	Current (discounted) value of due payments, established at appropriate interest rates; establishing current values
Deferred tax liability	Value that can be realized by merger companies after taking into account tax effects caused by evaluation of net assets of the taken over company using fair value method

Source: own elaboration on the basis of the Act of 29<sup>th</sup> September 1994 on Accounting, with subsequent changes.

Methods of assessing fair value of assets and liabilities of a taken over company, as well as fair value of objects with which payment is made, which are the basis of determining the takeover price, require subjective judgments and choices [Kamiński 2003]. This is visible in fixed assets valuation. Determining their fair value is difficult due to the fact that some objects do not exist independently, as they are integrally tied to the company or its department infrastructure. Another challenge is posed by lack of catalogue prices of taken over goods. It happens that the property elements which are subject of price calculation are traded extremely rarely or do not appear in a given area. Taking the above into consideration, the final assessment of fair value of these assets may differ depending on assumptions made.

The concept of fair value in company valuation is one of the most reliable methods of valuating companies. However, we should emphasize that even such a precise and detailed assessment of the value of complex set of elements constituting an enterprise will never fully reflect the price obtained in the unit purchase transaction. Economic conditions in which an entity functions can distort the final result and sometimes lead to wrong conclusions [Jędrzejczyk 2003]. It happens, for example, in times of high inflation which changes the value of all elements owned by the company. On the other hand, the accounting and finance theory has not come up with a better decision supporting tool in mergers, takeovers or generally understood acquisitions of enterprises.

We should mention here differences in definitions of company value and company price. The value, treated as the figure being the result of valuation, is not an identical term with price [Flazgić 2002].

The value of a unit depends on:

- value of expenditure on its creation – depending on the reference point of this expenditure,
- use value and resulting benefits for the owner,
- demand and supply, that is the resultant of exchange value and use value [Dobija 2005].

Therefore the value from valuation establishes the boundaries of the zone of price negotiations conducted by interested parties to the purchase transaction.

The subject of our analysis is the value of an economic entity expressed according to the concept of fair value, therefore we must meet all requirements resulting from the definition of fair value. Fair value is the amount for which a particular element of assets could be exchanged and liability settled on market transaction terms, between interested parties which are well-informed and not related to each other. Only such value may be the basis of the whole company valuation. The most important stage is to determine fair value, which will constitute the so-called “price range” for the economic entity which is sold.

Price range is determined by the sums of fair value of particular elements of assets and liabilities. According to the core balance sheet equation known from the accounting theory, total assets must equal total equity and liabilities. Of course, from the point of view of financial reporting, a different situation leads to the conclusion that the balance sheet contains an accounting mistake or some other mistake which may lead to under- or over-valuation of some analyzed category [Jędrzejczyk 2003].

An opposite situation can be observed in the process of estimating the value of sums of assets and liabilities. The difference between the value of property and capital is a natural thing, being the result of many factors, such as: choice of alternative valuation methods using the fair value concept, accepted by International Accounting Standards, varied simulation of market conditions and related different assessment of risk level and current discount rate, choice of different reference points when considering hypothetical purchasing transactions of similar elements of balance sheet, other factors influencing fair value of balance sheet elements. Therefore in reality we do not observe situations in which we have equal values after assessing the sum of property and capital of an enterprise [Jędrzejczyk 2003].

In line with the above, according to the assumed concept, fair value of an assessed company is an arithmetic average of balance sums. Therefore the most probable price being the result of the transaction will be:

$$E(FV_b) = \frac{FV_a + FV_c}{2} = \frac{\sum_{i=1}^n a_i + \sum_{i=1}^m c_i}{2} \quad (1)$$

where:

$E(FV_b)$  – estimated fair value of a business,

$FV_a$  – assets fair value

$a_i$  – fair value of the  $i$ -th asset

$n$  – number of all elements of a business property

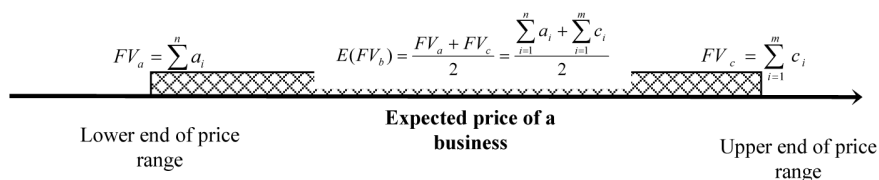
$FV_c$  – capital fair value,

$c_i$  – fair value of the  $i$ -th capital,

$m$  – number of all elements of a business equity and liabilities.

Taking account of the above considerations, we can present the expected value of the price of a business being sold (obtained in a hypothetical purchasing transaction) as the “zone of price negotiations” [Jędrzejczyk 2003].

**Diagram 1:** Expected price of a business being sold



Source: [Jędrzejczyk 2003]

The zone of price negotiations in case of stating lower value of total assets than the value of total equity and liabilities belongs to the closed range:

$$E(FV_b) \in \langle FV_a, FV_c \rangle \Leftrightarrow E(FV_b) \in \left\langle \sum_{i=1}^n a_i, \sum_{i=1}^m c_i \right\rangle \quad (2)$$

On the other hand, when the value of total assets is higher than the value of total equity and liabilities, the range depicting the span of the zone of price negotiations can be expressed as follows:

$$E(FV_b) \in \langle FV_c, FV_a \rangle \Leftrightarrow E(FV_b) \in \left\langle \sum_{i=1}^m c_i, \sum_{i=1}^n a_i \right\rangle \quad (3)$$

### 3. Assessment of fair value on the example of an enterprise

The value of an enterprise as an economic entity assessed in line with the concept of fair value must take into account valuation of all elements of assets and equity and liabilities of the assessed enterprise. Therefore it is vital to assess credibly the value of all balance sheet elements according to fair value guidelines.

Therefore the price of an enterprise may be treated as a result of a compromise between values proposed by both parties of the purchasing transaction. The company value in this case is the basis for determining its price. On the other hand, price in our considerations may be treated in two different ways:

- as a result of the process of valuation of an economic entity,
- as a parameter expressing expenditure and effects in order to compare them and to calculate net effects of the analyzed enterprise [Dobija 2005].

**Table 2.** Fixed assets value (in thousand zlotys)

ITEM	
FIXED ASSETS	102169.00
Intangible fixed assets	181.00
Development costs	
Goodwill	
Other intangibles	181.00
Payments on account of intangible fixed assets	
<b>Goodwill of subsidiary units</b>	
<b>Tangible fixed assets</b>	<b>101 847.00</b>
Fixed assets	53 169.00
land (including the right of hereditary tenure)	2 765.00
buildings, premises and structures of land and water engineering	28 359.00
machinery and technical equipment	19 333.00
transportation means	301.00
other fixed assets	2 411.00
Fixed assets under construction	48 425.00
Payments on account of fixed assets under construction	253.00
<b>Long-term receivables</b>	<b>0.00</b>
From related parties	
From other entities	

ITEM	
Long-term investments	141.00
Real estate	
Intangibles	
<b>Long-term financial assets</b>	<b>141.00</b>
in related parties	0.00
• shares and stocks	
• other securities	
• loans receivable	
• other long-term financial assets	
in other entities	141.00
• shares and stocks	141.00
• other securities	
• loans receivable	
• other long-term financial assets	
Other long-term investments	
<b>Long-term prepayments</b>	

Source: own calculations on the basis of [Jędrzejczyk 2003].

**Table 3.** Data from the period following the analyzed period (in thousand zlotys)

ITEM		Change in %
<b>FIXED ASSETS</b>	<b>144 828.00</b>	41.75%
<b>Intangible fixed assets</b>	<b>17.00</b>	-90.61%
Development costs		
Goodwill		
Other intangibles	17.00	<b>-90.61%</b>
Payments on account of intangible fixed assets		
<b>Goodwill of subsidiary units</b>		
<b>Tangible fixed assets</b>	<b>144 670.00</b>	<b>42.05%</b>
Fixed assets	<b>87 652.00</b>	64.85%
land (including the right of hereditary tenure)	2 765.00	0.00%
buildings, premises and structures of land and water engineering	31 234.00	10.14%
machinery and technical equipment	52 184.00	169.92%
transportation means	581.00	93.02%
other fixed assets	888.00	-63.17%
Fixed assets under construction	<b>57 016.00</b>	17.74%

ITEM		Change in %
Payments on account of fixed assets under construction	2.00	-99.21%
<b>Long-term receivables</b>	<b>0.00</b>	
From related parties		
From other entities		
<b>Long-term investments</b>	<b>141.00</b>	0.00%
Real estate		
Intangibles		
Long-term financial assets	141.00	0.00%
in related parties		
- shares and stocks		
- other securities		
- loans receivable		
- other long-term financial assets		
in other entities	141.00	0.00%
- shares and stocks	141.00	0.00%
- other securities		
- loans receivable		
- other long-term financial assets		
Other long-term investments		
Long-term prepayments		

Source: own calculations on the basis of [Jędrzejczyk 2003].

**Table 4.** Current assets value (in thousand zlotys)

ITEM	
<b>CURRENT ASSETS</b>	<b>47 515.00</b>
<b>Inventories</b>	<b>17 767.00</b>
Materials	117 76.00
Semi-finished products and work in progress	3 597.00
Finished products	1 130.00
Trade goods	164.00
Payments on account of deliveries	1 100.00
Short-term receivables	27 798.00
Related parties receivables	4 668.00
trade receivables, falling due:	4 668.00
• within 12 months	4 668.00

ITEM	
• after more than 12 months	
other receivables	
Receivables from other entities	23 130.00
trade receivables, falling due:	16 057.00
• within 12 months	16 057.00
• after more than 12 months	
receivables from the State budget	6 593.00
other receivables	
receivables in litigation	480.00
<b>Short-term investments</b>	<b>1 950.00</b>
Short-term financial assets	1 950.00
in related parties	0.00
• shares and stocks	
• other securities	
• loans	
• other short-term financial assets	
in other entities	0.00
• shares and stocks	
• other securities	
• loans	
• other short-term financial assets	
cash and other monetary assets	1 950.00
• cash in hand and at bank	1 950.00
• other cash assets	
• other monetary assets	
Other short-term investments	

Source: own calculations on the basis of [Jędrzejczyk 2003].

**Table 5.** Data from the period following the analyzed period (in thousand zlotys)

ITEM		Change in %
<b>CURRENT ASSETS</b>	<b>137 299.00</b>	188.96%
<b>Inventories</b>	<b>33 996.00</b>	91.34%
Materials	20 929.00	77.73%
Semi-finished products and work in progress	8 327.00	131.50%

ITEM		Change in %
Finished products	4 196.00	271.33%
Trade goods	85.00	-48.17%
Payments on account of deliveries	459.00	-58.27%
<b>Short-term receivables</b>	<b>10 3118.00</b>	<b>270.95%</b>
Related parties receivables	<b>81 108.00</b>	1637.53%
trade receivables, falling due:	81 108.00	1637.53%
• within 12 months	81 108.00	1637.53%
• after more than 12 months		
other receivables		
Receivables from other entities	<b>22 010.00</b>	-4.84%
trade receivables, falling due:	18 199.00	13.34%
• within 12 months	18 199.00	13.34%
• after more than 12 months		
receivables from the State budget	3 128.00	-52.56%
other receivables	683.00	
receivables in litigation		-100.00%
<b>Short-term investments</b>	<b>185.00</b>	<b>-90.51%</b>
Short-term financial assets	185.00	-90.51%
in related parties	<b>0.00</b>	
• shares and stocks		
• other securities		
• loans		
• other short-term financial assets		
in other entities	<b>0.00</b>	
• shares and stocks		
• other securities		
• loans		
• other short-term financial assets		
cash and other monetary assets	<b>185.00</b>	-90.51%
• cash in hand and at bank	185.00	-90.51%
• other cash assets		
• other monetary assets		
Other short-term investments		

Source: own calculations on the basis of [Jędrzejczyk 2003].



**Table 6.** Borrowed capital value (in thousand zlotys)

<b>ITEM</b>	
<b>LIABILITIES AND PROVISIONS FOR LIABILITIES</b>	<b>109 890.07</b>
Provisions for liabilities	<b>5 906.00</b>
Deferred tax liability	
Provision for pensions and similar obligations	5 860.00
• long-term	1 079.00
• short-term	4 781.00
Other provisions	46.00
• long-term	46.00
• short-term	
Long-term liabilities	<b>7 157.00</b>
Amounts owed to related parties	
Amounts owed to other entities	7 157.00
credits and loans	7 157.00
debt securities	
other financial liabilities	
other liabilities	
Short-term liabilities	<b>88 408.00</b>
Amounts owed to related parties	20 885.00
trade payables, falling due:	20 885.00
• within 12 months	20 885.00
• after more than 12 months	
other	
Amounts owed to other entities	66 591.00
credit and loans	23 393.00
debt securities	
other financial liabilities	
trade payables, falling due:	28 769.00
• within 12 months	28 769.00
• after more than 12 months	
payments received on account of deliveries	10 661.00
bills of exchange payable	
taxes, customs, social security liabilities	2 300.00
salary payables	1 215.00
other	253.00
Special funds	932.00

ITEM	
Accruals and deferred income	<b>8 426.00</b>
Negative goodwill	
Other accruals and deferrals	8 426.00
• long-term	7 810.00
• short-term	616.00

Source: own calculations on the basis of [Jędrzejczyk 2003].

**Table 7.** Data from the period following the analyzed period (in thousand zlotys)

ITEM		Change in %
LIABILITIES AND PROVISIONS FOR LIABILITIES	<b>19 4351.00</b>	<b>76.85%</b>
Provisions for liabilities	<b>2 597.00</b>	-56.03%
Deferred tax liability		
Provision for pensions and similar obligations	2 230.00	-61.95%
• long-term	1 566.00	45.13%
• short-term	664.00	-86.11%
Other provisions	367.00	697.83%
• long-term	367.00	697.83%
• short-term		
Long-term liabilities	3 500.00	-51.10%
Amounts owed to related parties		
Amounts owed to other entities	3 500.00	-51.10%
credit and loans	3 500.00	-51.10%
debt securities		
other financial liabilities		
Short-term liabilities	<b>172 417.00</b>	95.02%
Amounts owed to related parties	103 533.00	395.73%
trade payables, falling due:	103 533.00	395.73%
• within 12 months	103 533.00	395.73%
• after more than 12 months		
other		
Amounts owed to other entities	67 915.00	1.99%
credit and loans	29 205.00	24.85%
debt securities		
other financial liabilities		

ITEM		Change in %
trade payables, falling due:	33 086.00	15.01%
• within 12 months	33 086.00	15.01%
• after more than 12 months		
payments received on account of deliveries	87.00	-99.18%
bills of exchange payable		
taxes, customs, social security liabilities	3 793.00	64.91%
salary payables	1 442.00	18.68%
other	302.00	19.37%
Special funds	969.00	3.97%
Accruals and deferred income	<b>15 837.00</b>	87.95%
Negative goodwill		
Other accruals and deferrals	15 837.00	87.95%
• long-term	11 264.00	44.23%
• short-term	4 573.00	642.37%

Source: own calculations on the basis of [Jędrzejczyk 2003].

**Table 8.** Results (in thousand zlotys)

Category	Result 1	Result 2	Change in %
Fixed assets	102 169.00	144828.00	41.75%
Current assets	47 515.00	137299.00	188.96%
Equity capital	39807.00	45201.00	13.55%
Borrowed capital	109 897.00	19 4351.00	76.85%
Assessed total assets	149 684.00	282 127.00	88.48%
Assessed total equity and liabilities	149 704.00	239 552.00	60.02%

Source: own calculations on the basis of [Jędrzejczyk 2003].

**Table 9.** Results of company valuation

	Result 1	Result 2	Change in %
RESULTS OF COMPANY VALUATION	PLN 299 388.00	PLN 521 679.00	74.25%

Source: own calculations on the basis of [Jędrzejczyk 2003].

The above example aimed at presenting the practical application of fair value in company valuation.

As a result of conducted research we obtained the price of an economic entity in a hypothetical transaction of company acquisition, contained in the range of the so-called area of price negotiation 299 388.00 PLN - 521 679.00 PLN.

International Accounting Standards played an important role in creating a theory of valuation based on fair value. They were used to update the methods and to conform them to international regulations.

The key stage of conducted research on the role of fair value in estimating company value is such formulation of the algorithm leading to the most reliable result which will determine the future purchasing price of the entity. It should be emphasized though, that the issue of result objectivity is still open, especially in light of the elements which are not recorded or omitted in financial reports, such as the issue of intellectual capital and its reliable measuring [Jędrzejczyk 2011].

#### **4. Conclusions**

Many years of measuring company value have brought us various techniques and procedures of estimating the value of economic entities. One of alternative valuation models is the method based on fair value, which was introduced into Polish legislature by the amended Act of 23<sup>rd</sup> August 2001 on Accounting.

The validity of this approach is unquestionable due to the fact that the elements are valued with help of discounted procedure, which is one of the most precise and reliable methods of valuation taking into account problems of perception and frequent changes of the value of assessed objects in time.

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**Wojciech Haza\***

## **THE PREMISES AND EVALUATION OF NEW REGULATIONS AIMING AT LIMITING RISK IN THE BANKING SECTOR**

### **Summary**

*This paper will aim at proving that the introduction of the reforms known as Basel III considerably eliminates the deficits of the Basel regulations from 2004, but will result in lower availability of loans for bank clients and will slow down the economic development.*

*The article consists of three sections. The first part presents the role and challenges facing banks in times of crisis. In the second part special attention has been paid to the main assumptions of the changes proposed by the Basel Committee on Banking Supervision. The third chapter focuses on analyzing the predicted influence of Basel III on economy and banks operating in Poland and all over the world.*

### **1. Introduction**

Prudential standards, shaping for example the required capital level of the banks, should provide access to bank credit for their clients, but also should make banks more resistant to crises.

The aim of this paper is to present the reforms and intended shape of regulations aiming at changing the capital requirements and introducing liquidity norms as an element of the first pillar of capital contract. From various proposals of improving the effectiveness of regulations for the finance sector, special attention should be paid to the concept of solutions for the banking sector presented in 2010 by Basel Committee on Banking Supervision (the so-called Basel III).

The author expects that the proposed reforms of prudential standards in the banking sector, known as Basel III, require further changes, as they contain many unsolved issues necessary for proper operations of the banking sector.

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## 2. Challenges for banks in times of crisis in finance markets and economy

The banking sector play a special role in economy. Specialist literature distinguishes three main arguments for the existence of banks [Marcinkowska, Gdańsk 2009, p.15]:

- transaction costs – banks provide services of risk sharing and transformation, which borrowers would not afford alone due to transaction costs,
- asymmetry of information – while collecting market information concerning the needs of potential depositors and borrowers, banks have a better possibility of conducting monitoring services,
- depositors and borrowers liquidity preference – banks create liquidity, making transactions of illiquid assets into liquid liabilities.

In this way banks, by gathering deposits of business people and individual customers become public trust institutions. We could state that if the banks did not perform the above functions they would not exist. Apart from the role of the depository, banks lend money to households and entrepreneurs, increasing the money circulation. Another argument for the existence of banks is the fact that many entrepreneurs use credit facilities even though other, alternative (and often cheaper) sources of financing exist, because in this way they can inform other market participants about their credit rating<sup>[1]</sup>.

Specific type of transactions, such as trading financial instruments, is associated with huge risk, as financial instruments are based on the promise to perform a certain service in the future. As D. Korenik claims, the bank is held responsible for obtaining an advantage in risk management to its own benefit and to the benefit of its clients and the whole economy [Korenik, Warszawa 2009, p.171]. Bad management of the bank, not taking into account the risk run, may be one of the causes of financial crises, just as faulty macroeconomic policy or current development of the situation in the market. Turbulences in the operations of banks may also be provoked by improper prudential standards or banking supervision. Therefore it is essential to maintain banks' solvency understood as the ability to cover potential losses and risks with their own funds as well as maintaining required liquidity. In order to perform this task it is necessary to create and implement prudential standards.

Specialist literature provides numerous definitions of a financial crisis referring to the banking sector. One of them states that the crisis is a situation in which a considerable number of financial institutions have assets of lower market value than their liabilities. This leads to the run or movements in their portfolios,

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1 Explanation in the theory of signals.

bankruptcy of some of them and government interventions [Masiukiewicz, Warszawa 2011, p.22]. It is worth emphasizing the factors which, in the opinion of the European Social and Economic Committee, were the main causes of the global banking and financial crisis of the end of the first decade of the 21<sup>st</sup> century [Komunikat, COM (2009) 362, Bruksela 2010, p.1]. These were: loans offered by credit institutions to clients without credit rating; improper systems of remunerations and bonuses for employees of credit institutions serving individual clients; establishing credit securities without due care; purchasing the above securities by banks without due care; insufficient capital reserves, especially in portfolios of commercial banks, creating mechanisms of off-balance sheet financing which did not have sufficient capital coverage; existence of distorted incentives and improper remuneration systems which led to short-sighted decisions and excessive risk; pro-cyclical type of regulations; system deficiencies in risk management concerning the quality of owned securities, adequacy of capital reserves and influence of variables of remuneration systems on accumulation of institutional risk; lack of transparency in financial operations of the banks accounting for the fact that creditors, borrowers, contractors, investors and analysts were unable to meet the expectations of financial markets; insufficient scope of macro-prudential supervision and international coordination.

We should also supplement the above list with the role of rating agencies which, evaluating credit risk, had their share in irresponsible creation of toxic assets costing advanced economies hundreds of billions of dollars. Of great significance for the development of the banking system crisis were also the authorities and regulation bodies of particular countries, which accepted the level of capital reserves in their banks. Monetary authorities, especially in the USA, maintained their interest rates on a too low level for too long, which encouraged banks to risk behavior (granting mortgage loans to unreliable customers).

After 2007 once again specialists started worrying about the temptation of abuse created by silent guarantees of capitalizing banks [Ferguson, Kraków 2010, p.360]. It is estimated that the write-off for bad assets since the beginning of the crisis has exceeded 1.3 trillion euro. To cover the losses and improve indicators, banks all over the world gathered 1.1 trillion euro of new capital, vast majority of which came from taxpayers' money [Stypułkowski, Warszawa 2010, p. 93]. The situation of Polish banks looks quite good in comparison. Contrary to G20 advanced economies, where direct public help for financial institutions in 2008-2009 amounted to 3.7% of their 2008 GDP (in Poland this would amount to around 47 billion zlotys), Polish taxpayers did not spend a single zloty on supporting banks. Undoubtedly, the world needs a new bank deal: banking with more capital, less debt, more principles and much stronger supervision [Flejterski, Warszawa 2010, p.151].



Banks are institutions of public trust and in order to perform this role effectively, they must be understandable both to their clients and regulators. New regulations should discourage banks from speculative activities and motivate them to restrict their operations to the services they were established to perform. Greater understanding of the essence of risk by banks and their clients will limit the risk of crisis. The period of 2007-2010 encourages us to think about the direction of prudential standards – many people express an opinion that banks should return to the basics, such as conservative credit policy. The problem is still, however, how to combine the challenges of global economy with the elements that are traditional and limit the possibilities of obtaining additional revenues by the banks. The challenge facing current banking is to find the compromise between expectations of shareholders and bank managers concerning effectiveness with the security of financial means deposited in the banks, clear definition of their operating principles and paying special attention to the ethical dimension of banks' operations. The banking sector in Poland and all over the world will be subject to essential transformations in the nearest future. The direction of these changes will largely depend on trends in global economy, finance and on modifications of prudential standards defined as Basel III.

### **3. Evolution and principles of new prudential standards**

Crises of banks and banking systems are special moments in which changes in regulation areas take place. They show the weaknesses of the existing systems and prudential solutions and force state authorities to introduce new regulations protecting against new crises. New regulations should also minimize their economic effects felt by the society as well as restore public trust in the financial system.

Since 1930s authorities have gradually introduced guidelines regulating the range of banking activities and prudential norms determining the scope of these activities and the degree of risk exposure and risk management. Special attention in these regulations was paid to the issue of bank capital which is the source of financing their activities and the axis of prudential regulations for banks. Fortifying financial institutions with a large number of legal regulations (including prudential norms) results mainly from high bankruptcy costs for these institutions and the danger this poses to stability of global markets.

Economic theories offer two explanations for the activities aiming at regulation of financial institutions, including banks. The first ones are the so-called altruistic theories (public benefits) which define regulations as instruments used by the state to increase effectiveness and honesty of the society. The second one is the agency cost theory, which says that in multi-party relations conflicts and coordination problems grow, therefore introduction of regulations allows one

sector of the society (economy) to grow at the expense of other sectors. The basis of regulations then is imbalance between social and private revenue from assets (risk) which may encourage bank owners and managers to involve in excessive risk [Marcinkowska, Gdańsk 2009, p.72].

Subject literature usually gives two basic reasons for the introduction of prudential regulations in banks, namely: the necessity of protecting depositors and provision of security and solidity of the financial system. Regulation of financial entities concerns mostly [Marcinkowska, Gdańsk 2009, p.72]: licensing their activities, restricting free use of bank shares; limiting types of performed activities; limiting risk (dependent on the value of possessed own equity); creating and operating the system of guaranteed deposits; introducing special accounting principles and the obligation to disclose information on the activities and financial results of the banks; possibility of controlling banks by supervisory institutions and exerting pressure on them.

The implementation of regulations brings some direct costs – costs of regulations and costs that obliged entities must incur in order to observe these regulations. We could also mention here social costs connected with the limitations imposed by banks, such as changing interest rates (increase) and deposits (decrease).

We should also observe certain specificity of regulators – banks relations. Regulators take up activities aiming at introducing new restrictions to the financial system (controlling the risk, products, scope of activity), while banks, intent on achievement of their objectives (for example increased value for shareholders, increased profits) are busy looking for ways of avoiding restrictions. Economic entities act faster than public institutions, therefore they usually succeed in avoiding restrictive regulations, which leads to further attempts at tightening the policy by regulators. Therefore the regulation process is continuous.

Although financial markets are increasingly interconnected, the international system of financial regulation is based on the sector approach (for example banking, securities markets, insurance). There are many institutions which have great impact on the sphere of regulations and the shape of financial infrastructure influencing the real economic sphere. We could list here such institutions as: International Monetary Fund, Financial Stability Forum, European Banking Authority<sup>2</sup>, supervisory authorities of particular countries [Davies, Green, Warszawa 2010, p.149]. However, special role in the banking sector is played by the so-called concordats (or agreements) determining equity requirements published by the Basel Committee on Banking Supervision (Basel Committee).

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2 Since 2011 the powers of the Committee of European Banking Supervisors (CEBS) were taken over by the European Banking Authority (EBA). It will have greater influence on the shape of the market than CEBS. It was assumed that the new system will guarantee uniform use of the Union law and will become a place of coordination for supervisory actions, especially in crisis situations. The resolutions of the agency are to be binding for national supervisors in case of a dispute between them. EBA is also to identify risk for the benefit of stability of European banking sector.

It conducts work on standardization of supervisory regulations and determination of required level of bank's own funds. The Basel concepts – further proposals of the so-called agreements, arrangements or concordats – are discussed by a wide group of regulators, bankers and scientists [Marcinkowska, Gdańsk 2009, p.86].

In 1988 the Basel Committee on Banking Supervision developed a document called Capital Accord (Basel I). The document determined principles of establishing minimum levels of banks' own funds and assuring better conditions for competition between banks operating in the international market. The solutions adopted then concerned mainly credit risk, which had long been the basic type of risk threatening banks' security. Changing environment of the banking sector as well as great changeability of financial markets account for the necessity of taking into account market and operational risk in measuring capital adequacy. Due to a number of wide gaps, the Capital Accord soon became subject of criticism from banking, academic and private sectors.

The answer to this criticism was the document called "International Convergence of Capital Measurement and Capital Standards", known as the New Capital Accord (NCA or Basel II), which was based on more modern methods and tools of risk management. The essence of the New Capital Accord consists in three pillars constituting an integrated package which should be implemented in particular countries: pillar 1 – minimum capital requirements, pillar 2 – supervisory review, pillar 3 – market discipline.

Within the first pillar, banks were obliged to maintain capital adequacy on the level determined in the NCA. The measure of capital adequacy is associated with determining what capital or defined own funds a bank should possess to make its activities secure. NCA kept the requirements concerning the minimum level of banks' solvency ratio at 8%. At the same time it was decided that bank's own funds should be sufficient to cover credit and market risk and, additionally, operational risk.

In the European Union, the issues of banking activities and banking supervision are regulated by directives 2006/48/EC, 2006/49/EC and 2007/64/EC amended by directive 2009/111/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements and crisis management.

Currently the European Union is preparing to implement new banking regulations. In July 2011 the European Commission is to present the draft of a directive introducing recommendations made by the Basel Committee on Banking Supervision in the European Union. The Committee presented a wide range of new requirements for banks. Compared with the currently valid regulations, Basel III introduces a number of innovations and goes in two directions. One is change of capital requirements, the other – introduction

of liquidity norms as an element of the first pillar of capital accord. The above proposals cover:

- raising the quality, consistency and transparency of banks' capital base,
- taking into account a wider spectrum of risk the bank is exposed to (for example commercial portfolio, off-balance items),
- supplementing adequacy ratio with leverage ratio, which is to enable the limitation of the consequences of the process consisting in quick fall of bank assets prices, which is harmful to banks and the whole economy,
- reducing pro-cyclicality and promoting anti-cyclical capital surplus – the dependence of credit reliability of financial institutions and companies outside this sector on the economic cycle causes, due to introduction of methods of calculating capital requirements proposed by NCA, that in times of economic prosperity banks are less burdened with capital requirements, while in times of recession, requirements are higher. Banks are obliged then to maintain higher level of capital and, due to deteriorating client ratings, must slow down credit activity or sell assets. The growing cost of maintaining capital increases the cost of credit, reducing its availability and aggravating bad economic situation.

These changes will be gradually introduced until 2019. Also banks' assets will be subject to tighter control, which is to eliminate creation of investment transactions outside balance sheets. Before the crisis, banks kept some of their assets in various investment funds and in this way they could keep less capital. All these regulations aim at better protection of banks against losses incurred in times of crisis.

New capital requirements modify not only the quality but also the quantity of required capital. Basel III states that while preserving the old general level of obligatory own funds at 8% of risk-weighted assets, by 2015 banks will be obliged to increase the size of required equity (*Common Equity Tier 1 – CET 1*<sup>[3]</sup>) to the level of at least 4.5% of their assets, which is 2.5% more than the present level. In the same period banks should also increase required capital funds (*Tier 1 Capital*<sup>[4]</sup>) from 4% to 6% in 2015, the remaining 2% may be covered by additional own funds (*Tier 2 Capital*) so as to preserve the required 8% ratio all the time. Financial institutions will have to take into account capital requirements increasing because of deteriorating credit rating of a contracting party. These requirements will also be increased in case of the so-called bad direction of risk, when the probability of insolvency is positively correlated with the size of the investment [Sikorzewski, Warszawa 2011, p. 15].

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<sup>3</sup> Mostly own shares, undistributed profits and on some conditions, minority shares in the equity of related companies.

<sup>4</sup> Tier 1 capital will include some hybrid instruments.

Basel III introduces additional security mechanisms, such as: safety and anti-cyclical buffers. The safety buffer will be gradually introduced from the level of 0.625 of risk-weighted assets in 2016 to the level of 2.5% in 2019. Another important assumption is the fact that this buffer may only be covered by CET 1 funds. In case banks fail to meet this requirement, they will be subject to certain restrictions, such as lower bonuses for their boards. It should be emphasized that this buffer is not identical with own funds within Tier 2 Capital. Banks will have to maintain the capital security buffer in the amount of 2.5% of their assets and the capital ranging from 0 to 2.5% of their assets depending on the economic situation and the decision of a national supervisory authority. It will be built in economic boom periods and reduced in times of economic slow-down.

New regulations also stipulate the introduction of prudential measures concerning financial leverage and liquidity norms. The introduction of financial leverage ratio aims at avoiding excessive use of this leverage in times of economic boom, which could lead to considerable deleverage and breakdown of credit activity in crisis times. The Basel Committee is treating it as a minimum capital requirements ratio in comparison to measures based on risk-weighted assets. This ratio will compare own capital (*Tier 1*) with un-weighted value of all net exposures, including some off-balance elements [Sikorzewski, Warszawa 2011, p. 16]. Initially, to test it, it is planned to introduce this ratio at the level of 3% in 2013-2017, and then to make it obligatory.

Also new requirements concerning financial institutions short- and long-term liquidity are being proposed. The latest crisis has clearly demonstrated that the bank affected by liquidity crisis may become insolvent very quickly. If customers withdraw their money, it is forced to sell its assets. If these assets are not very liquid, it sells them at lower and lower prices. At some point the value of its assets is exceeded by the value of its liabilities. Such mechanism threatens mostly the institutions which borrow money for a short time to purchase assets with long-term maturity. The Basel Committee is proposing introduction of two requirements. The first one – liquidity cover ratio (LCR) states that every bank should keep sufficient amount of liquid assets<sup>5</sup>, to secure financing for the period of 30 days of a potential liquidity crisis. A thirty-day outflow of net monetary means reflects the situations of serious financial shock, mass outflow of deposits and lowering credit rating by three classes. In order to secure stable financing in a longer period of time it is also proposed to control the assets and liabilities liquidity features by net funding stability ratio (NFSR) NFSR forces banks to finance their long-term assets, such as mortgage loans, with liabilities due after one year. According to the accepted

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5 Instruments of low correlation with risky assets, traded in active and stable markets in presence of market animators and characterized by low concentration of buyers and sellers.

solution, available sources of stable financing<sup>[6]</sup> are supposed to cover at least the required means of stable financing<sup>[7]</sup>.

#### **4. The areas of applying new prudential regulations and assessment of potential financial implications for banks and their clients**

Currently work on improving prudential regulations is conducted all over the world, which is the consequence of gaps and mistakes diagnosed during the financial crisis. Also work on the new Basel III is approaching its end at the Basel Committee on Banking Supervision, which is the main institution dealing with banking regulations globally. It is vital that new regulations are implemented in a coordinated and coherent way, which will allow us to avoid disturbances in financial markets, competition or regulatory arbitration. The aim of the reform is to improve the ability of the banking sector to deal with the shocks resulting from financial and economic difficulties, irrespective of their source, and by doing this, to lower the risk of negative influence of the banking sector on real economy. [Basel III: A global regulatory framework for more resilient banks and banking systems, Basel 2011, p.9].

The agreements issued by the Basel Committee are not legally binding; their aim is to create common supervision standards promoting attempts at developing a common approach and facilitating harmonization of conditions of competition for banks conducting international operations. In the USA the latest reforms are included in the so-called Dodd-Frank Act. In case of the EU legislation, the implementation of the Committee guidelines will be transposed by the so-called CRD IV Directive, developed by the European Commission. It is a legal tool implementing new regulations in the European Union. The directive is mostly compliant with the Basel regulations, however it reflects the EU specificity [Didenkow, Warszawa 2011, p. 24]. Particular countries will be introducing different regulations (they have the freedom of choice and the freedom of implementation), moreover, financial systems in various regions of the world possess specific features which may matter in assessment of the effects of proposed changes. So far some research has been conducted, aiming at assessing the influence of Basel III on banks and economy.

As J. Zombirt claims, the impact of new regulations on banks may be considered in three areas [Zombirt, Warszawa 2011, p. 20]:

6 Own funds - Tier 1 and Tier 2, long-term liabilities and appropriately weighted liabilities to stable individual depositors and enterprises

7 Properly weighted maturity of loans provided for individual clients and enterprises, as well as bank investments in financial instruments.

- specific influence on the balance on the level of a banking enterprise, which cannot be attributed to any business lines, for example deductions for regulatory capital – in various ways they will concern balance sheets of particular banks, depending on possessed assets, but they will not particularly influence their activities,
- general influence on all banks and business lines – for example new capital requirements and leverage ratios will proportionally influence the whole activity of banks. The impact of these regulations will be mostly visible in business activity bringing relatively low income, but this will negatively influence the whole business activity (assuming that increased costs will not be transferred on customers),
- influence on specific types of activity – we could mention here new regulations concerning risk-weighted assets, liquidity and long-term financing – these are to affect reduction of problems revealed by the crisis.

A significant change is the introduction of higher risk weights for financial institutions.

**Table 1.** Value of planned shortfall of capital and short- and long-term liquidity of European and US banks as a result of introducing new prudential regulations (in trillion euro)

Type of shortfall	Europe	USA	Total
Shortfall of capital	1.1	0.6	1.7
Shortfall of short-term liquidity	1.3	0.6	1.9
Shortfall of long-term liquidity	2.3	2.2	4.5

Source: own elaboration on the basis of: J. Zombirt, Czy to wystarczy, „Bank” 2011, No 2 (calculations on the basis of balance sheet data of selected banks for the 2<sup>nd</sup> quarter of 2010).

Drawing conclusions from the latest crisis, the Basel Committee stated that the risk of such exposures correlations is much greater that it had been assumed. Table 1 presents the value of planned shortfall of capital and liquidity of European and US banks due to new prudential regulations. As J. Zombirt states (assessing the analyzed shortfalls on the basis of balance sheet data for the 2<sup>nd</sup> quarter of 2010), the total shortfall of capital will reach 1.7 trillion euro, shortfall of short-term liquidity – 1.9 trillion euro, and shortfall of long-term liquidity – nearly 4.5 trillion euro. According to calculations made by other institutions (for example Ernst & Young) obtaining additional capital by European banks will cause decrease of the ROE ratio in this sector in 2012 by 5% [Zombirt, Warszawa 2011, p. 20].

Analyzing the impact of the Basel III on capital requirements we should mention Quantitative Impact Studies (QIS) conducted by the Basel Committee on Banking Supervision. The aim of the research was to assess the influence of proposed solutions on capital requirements globally. The survey was conducted in 2010 in 263 banks from 23 countries.

**Table 2.** Solvency ratio at different counters reflecting target regulations of Basel III (banks surveyed by QIS in 2010)

Group of banks	Number of banks in a group	Counter of solvency ratio			
		Equity capital (CET 1)		Primary funds (Tier 1)	
		Level of solvency ratio at a given counter (in percentage)			
		Gross	Net	Basel II	Basel III
Group 1	74	11.1	5.7	10.5	6.3
Group2	133	10.7	7.8	9.8	8.1

Source: own elaboration on the basis of: M. Olszak, Kosztowna Bazylea III, „Bank” 2011, No 4.

Table 2 presents the levels of solvency ratio calculated according to the old method (Basel II) and the new one determined in guidelines accepted by the Basel Committee in 2010. CET 1 is a new ratio, which has not been determined by banks all over the world before (Common equity tier capital ratio: equity capital divided by risk-weighted assets). Gross CET 1 does not reflect deductions from equity capital determined in Basel III, while net CET 1 takes them into account. Tier 1 is an equivalent of the solvency ratios currently provided by banks (relation of primary funds to risk-weighted assets).

The most severe consequences of new prudential regulations will be felt by big international banks. They will witness clearly the biggest decreases of all ratios, contrary to smaller banks, whose ratios will experience lower falls. In case of CET 1 big banks will have net ratios nearly lowered by half in comparison to current ones (fall from 11.1% to 5.7%). CET 1 ratios of smaller banks will not decrease so dramatically, as they will fall from 10.7% to 7.8%. A similar trend can be observed in case of Tier 1 solvency ratios [Olszak, Warszawa 2011, p. 27]. Taking into account the 2009 structure and capitalization of banks and the target need to establish the CET 1 ratio at the level of 7%, in case of analyzed banks this would mean the shortfall of 577 billion euro for the group of big banks, which is 2.5 times the size of their 2009 profits. For smaller banks these figures are respectively 25 billion euro and 1.25 times their annual profits. The study confirms that banks must obtain additional capital by 2019.

It is worth analyzing the impact of new prudential regulations on retail and corporate banking globally. New capital requirements will be felt



particularly by retail banks, which in recent years, have had visibly lower capital ratios than corporate banks. Due to the fact that retail banks use mainly customers' deposits as a source of financing, the influence of new regulations on specific requirements concerning new products will be less visible. The Basel Committee accepted deposits as a source of long-term financing, even with reference to mortgage loans. On this example we can observe strong influence of bankers on regulators, because as late as in July 2010 mortgage loans had to be 100% financed from long-term sources of financing, while currently this coverage must be at least 65%. Corporate banking will suffer most from new requirements concerning new prudential norms. It is expected that long-term corporate loans and long-term financing of assets will be more expensive by 10 base points than now. The cost of credit lines for enterprises and financial institutions will also grow. The costs of other bank products with high risk weight (credit without security, structured financing) will grow significantly, by 60 base points. Planned increase of risk weights for financing commerce will reach 20-30% for financial institutions (for example increased risk weights for letters of credit opened in one bank ordered by another bank).

Researchers from the Basel Committee on Banking Supervision claim that financial and macroeconomic effects of new regulations will be quite limited. In their opinion, banks' financing costs resulting from higher capital requirements, will grow by merely 0.2%. Economic growth will be lower by only 0.03-0.05%. Quite similar calculations were presented by OECD experts. In their view, full implementation of Basel III regulations will increase the costs of credit by 0.15-0.5%, while subsequent economic growth will be lower by 0.15%. [Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements, Basel 2010]. Quite different calculations were presented by the Institute of International Finance (IIF) from Washington. Experts of this institution claim that the credit costs after full implementation of new regulations may increase by 1.3%, which is three times higher than the OECD calculation. The income loss may also be much greater and reach even 3.8% within four years, which is around 1% each year [www.iif.com].

The introduction of higher solvency ratio will force considerable increases in banks' own funds (especially CET1), which is much more expensive than Tier 1 or 2 own funds. This will cause significant growth of the costs of obtaining capital. This cost will probably be transferred to borrowers, which may worsen their financial situation or limit credit availability in economy. Such situation may negatively influence the GDP dynamic and create turbulences in the labor market. If banks do not obtain appropriate additional own funds, they will have to limit their risk-weighted assets. Experts expect the following behavior of banks caused by new prudential regulations:

- optimization of sources of finance and improvement in balance sheet management,
- verification of business strategies (verifying customer base, geographic scope, strategy of transforming risk and cost reduction, review of business portfolio, including reduction or abandoning some business areas, verification of possibilities of financing them).

As far as banks in Poland are concerned, the implementation of new Basel III regulations may cause difficulties in obtaining means to cover long-term liabilities. The capital market in Poland is quite narrow and there are no regulations concerning the issue of mortgage bonds, an instrument which is used by foreign banks together with capital market bonds. Commercial banks operating in Poland should not have any problems complying with new capital norms. Cooperative banks may face more serious problems, as their shareholders are less willing to capitalize them again. Another challenge will be to gather larger finance due after one year to finance long-term loans. This problem is vital in Poland, where citizens do not show much interest in long-term saving. Therefore it is often emphasized that the introduction of CRD IV Directive in Poland will have to take into account specific features of Polish financial market.

## **5. Conclusions**

New supervisory regulations are introduced in times of great instability of financial markets in the world. This situation makes it difficult to assess the real effects of reform implementation, but, as M. Marcinkowska claims, this situation constitutes a test of effectiveness of new solutions for banks, supervisors and financial markets [Marcinkowska, 2009, p. 524].

The results of the research presented in the article confirm that Basel III may limit credit availability due to increased requirements concerning capital adequacy and liquidity of banks. The consequence of such a solution will be slower economic growth in many countries all over the world. It should be pointed out that stability and safety of banks should be guaranteed not only by appropriate legal regulations but also by common sense, ethical conduct and responsibility of bank owners and managers.

In order to minimize costs, the process of verifying and shaping prudential norms and determining the consequences of their implementation remains the subject of debate among scientists, bankers and supervisory institutions all over the world.

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**Justyna Jankowska\***

## **MEASURES OF COMPANY INTERNATIONALIZATION**

### **Summary**

*Company (Enterprise) internationalization is a complex process. In addition, assessment of its proceedings and its degree is not an easy and unambiguous task. This article includes summary of indicators of internationalization process as well as grouping of indicators according to these particular components of the enterprise that can undergo internationalization process. This paper also contains criteria of assessment of the degree of internalization which shall make analysis of internationalization process in the companies easier for entrepreneurs.*

### **1. Introduction**

Company internationalization (regardless of adopted strategy of performing this process) requires obtaining capital, a competent manager, choosing appropriate product offer, then analyzing the target market (analysis of foreign markets), entering the foreign market (canvassing, sales, marketing) and developing operations (logistics, after-sales service, realization of payments, responsibility for sold products, intercultural communication in a team of employees) [Bielawska 2006, p. 20]. Each enterprise develops its own strategy of internationalization and in accordance with the adopted strategy it must provide a set of factors vital for the internationalization process and individually establish the level of these factors.

Internationalization usually does not cover all elements of an enterprise simultaneously and to the same extent. In order to measure the degree of internationalization it was necessary to construct detailed, analytical indicators and to determine ways of their interpretation in order to be able to measure equally all areas in which an enterprise may internationalize its activities.

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The aim of this article is to put together indicators assessing the scope, degree and intensity of internationalization in an enterprise and to develop their list and to determine the method of interpreting these indicators.

The first part of the article defines the term 'company internationalization' and the scope and degree of internationalization.

The second part presents the methodology of research on internationalization, while the third part regroups and lists indicators developed in the economic theories and measuring the degree of internationalization depending on the relation with a particular area of company activities.

The hereby article is the second part of the study which was published in post-conference materials in 2010<sup>[1]</sup>. The first part dealt with measures used in assessing internationalization of economy, while this article presents microeconomic analysis of internationalization and measures used in assessing company internationalization.

## **2. Defining the scope and degree of internationalization in selected areas**

Company internationalization is a process of gradual transformation of a domestic company into an international one, whose scope, degree and forms depend on its development strategy. The main forms of active internationalization of the company include: exports, international contacts and direct foreign investment [Gospodarka Polski po 15 latach transformacji 2005, p.289]

The scope of internationalization is a number of foreign markets served by this company and serving the company [Gospodarka Polski po 15 latach transformacji 2005, p.289], while degree of internationalization can be calculated using internationalization indicators.

The dictionary entry defines degree as a rung in classification. The degree of company internationalization assessed by means of indicators determines the position in the classification of internationalization level, which was developed as a model for assessment and analysis of results. Calculating the internationalization indicator and determining the degree of this internationalization by comparing it with the classification model allows us to conduct a comparative analysis with other enterprises. The term 'degree of internationalization' may be used interchangeably with the terms 'level of internationalization' and 'intensity of internationalization'[www.sjp.pwn.pl].

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1 J. Jankowska, Przegląd mierników internacjonalizacji gospodarki, [in:] Organizacje komercyjne i niekomercyjne wobec wzmożonej konkurencji oraz wzrastających wymagań konsumentów, edited by A. Nalepka, A. Ujwary –Gil, WSB, Nowy Sącz 2010, p. 191.

The classification of internationalization may have a numerical form in absolute values or be in form of ranges. These ranges are usually expressed in percentage and determine the internationalization level of an enterprise.

It is assumed that economic activity, which has a wide scope of internationalization, that is involved in many countries, has a higher degree of internationalization than an economic entity conducting business only in a few countries [Pietrasieński 2005, p. 20].

Internationalization is often a lengthy process and the company involvement in operations in foreign markets may develop gradually – both in terms of the scale of operations and qualitatively differentiated forms of foreign activity. In further stages of internationalization, the company is becoming more and more tied with foreign consumer markets [Duliniec 2007, p. 15].

Globalization is a wider term than internationalization. The term ‘globalization’ is used for identification of a new phase of strategic orientation of companies operating in international markets. In this phase the foundation of building competitive edge is global integration and coordination of company activities [Yip 1997, Pierścionek 1997 p. 317, Karcz 2004, p. 23].

Specialist literature sees internationalization as partial globalization or as an intermediary stage on the road to full globalization. Some authors identify internationalization exclusively with exports. Others believe that export, being clearly manifestation of internationalization, is the main indication of internationalization [Daszkiewicz 2004, p. 14]. In this article we assumed that export is the first step of internationalization, while globalization is the maximum level of internationalization a company can achieve.

### **3. Methodology of research on internationalization**

Internationalization may be analyzed and interpreted dynamically (as a process), statically (operations of companies are described by means of indicators and profiles presenting the degree of internationalization) and in a behavioral way (as a result of behavior of international companies’ management) [Nowakowski 2000, p. 19, Karcz 2004, p. 28].

An organized system of company internationalization assessment covers both objective and subjective criteria.

Among objective criteria we have those related to the structure, for example the number of foreign units of a company, capital ownership structure according to its origin, organizational structure of the company, etc., as well as criteria of productivity, for example value of foreign revenues, value of fixed capital located abroad, etc., [Podstawy nauki..., 2001, p. 395].

Subjective criteria cover such variables as company management orientation, for example to polycentrism, regiocentrism, or geocentrism and others.

Polycentrism consists in adjusting company activities in particular countries to specific conditions there. Regiocentrism is orientation of company activities at the specificity of vast international regions, such as South America countries. Geocentrism means standardization of products or services on a global scale) [Sznajder 1999, p. 99]. Geocentric or global orientation means that the company offers standardized products or offers worldwide, only slightly adjusting them to fit local markets. Company globalization also covers use of cooperative supplies from entities located in many countries [Nasierowski 1994, pp. 11-13].

Internationalization based only on exporting products is 'shallow' as it does not require involvement of resources necessary for their production abroad. 'Deep' internationalization is based on the second dimension, which is transition of production infrastructure from domestic market to other countries. Its 'depth' results from the size of financial, material and human resources engaged in the process of internationalization, which are necessary to launch production outside home country [Pietrasieński 2005, p. 16].

Internationalization of an enterprise concerns on one hand consumer markets and on the other hand ties with production factors markets. These are two integral sides of the company internationalization phenomenon. We can state that internationalization of consumer markets precedes the process of production factors internationalization.

The company's ties with foreign markets of factors of production may cover material and non-material supplies [Pierścionek 2003, p. 455, [www.ibngr.edu.pl](http://www.ibngr.edu.pl)]:

The highest degree of internationalization is achieved by companies in which internationalization of ties covers all types of factors of production. Moreover, intensity of internationalization of ties is high, therefore a large share of total consumption of raw materials, machinery, etc., belongs to those which come from foreign markets. What really matters for the level of internationalization of production factors is the number and type of countries – suppliers of production factors. The bigger the number of such countries, the greater their importance on the economic map of the world, the larger the share of foreign production factors (in total involvement), the higher the degree of internationalization of ties the company developed with supply markets [Pierścionek 2003, p. 456].

The degree of company internationalization may be assessed also on the basis of foreign capital saturation of the company. Using this method we can establish the company's ties with foreign capital markets and thus determine the level of foreign capital sources involvement in setting up foreign enterprises as well as determine foreign capital investments of the company of the foreign investment portfolio type [Pierścionek 2003, p. 455].

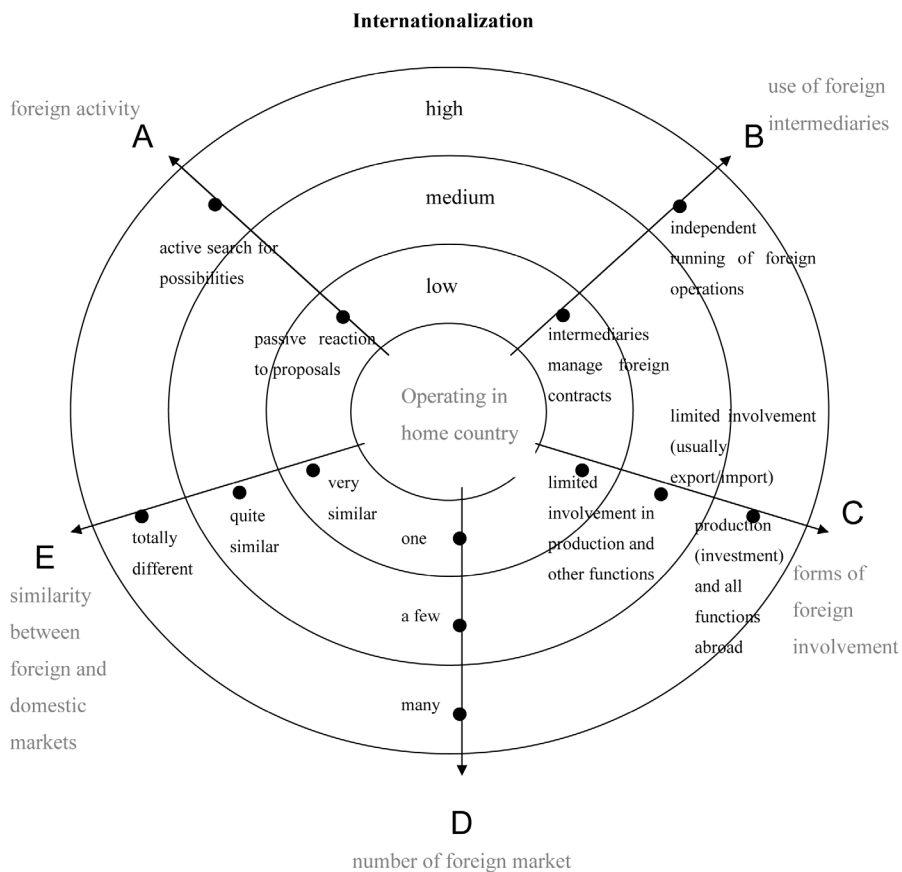
In case of economic units created with involvement of foreign capital, they can differ significantly in size of capital, and type of ties with shareholders [Międzynarodowe transakcje..., 2002, p. 356].

The realization of the strategy of company internationalization covers many areas of the company. In order to make synthetic assessment of the degree of internationalization, dimensions of the company internationalization have been determined (as shown in Figure 1). In this method we take into account various manifestations of internationalization in the company. These predominantly are [Marketing międzynarodowy 2007, p. 16]:

- company activity in performing operations in foreign markets (A axis in Figure 1): from clearly reactionary actions caused by appearing stimuli from abroad (as unsolicited inquiry or received offer of foreign cooperation) to strongly proactive search for possibilities (concerning exporting, launching production, etc.) in international market,
- the use of intermediaries in performing activities in foreign markets (B axis), namely the degree of independence in international involvement; usually initial stages of internationalization are accompanied by the use of intermediaries (trade agents, distributors) in performing activities concerning distribution, promotion, research, etc., sometimes even in domestic market, which may be attributed to lack of international experience, staff shortages, etc.; along with the progress of internationalization, the company is becoming more and more independent in managing its international operations, attracts appropriate personnel resources, creates branches abroad, etc.,
- scope of involvement (C axis): increasing internationalization means movement from less involving forms of presence in foreign markets (such as exports) to forms with much bigger involvement of company resources (as production and other activities connected with capital investments), and to forms in which a company offers in foreign markets not only its products but also licenses or management systems,
- number of markets in which a company is present (D axis): progress of internationalization results in performing operations in a growing number of countries,
- differentiation of foreign markets covered by company activities (E axis): Usually a company begins internationalization of its activities in neighboring and similar markets (for example with similar culture), then it gains international experience and enters more distant and different markets, which often means bigger difficulties in conducting its activities (for example marketing operations) and high risk of such activities.



**Figure 1. Dimensions of company internationalization**



Source: J.D. Daniels, L.H. Radebaugh, D.P. Sullivan, *International business environments and operations*, Pearson Education, Upper Saddle River 2004, p. 17.

In order to determine the level of company internationalization we should determine and mark on the axes of the diagram the levels of international involvement in each indicator of company internationalization. On the basis of the diagram we will be able to determine whether the company has low, medium or high level of internationalization, that is mark the field in which there will be the highest number of marked points.

The further from the center of the system (representing activities only in domestic market) the company is located, the higher its degree of internationalization [Marketing międzynarodowy, 2007, p. 17].

Apart from above-presented measures, the analysis of degree of internationalization may also cover other dimensions, such as the evolution stage of organizational structure or development of qualifications and scope of

experience possessed by company staff [Duliniec 2004, pp. 282-284, Marketing międzynarodowy..., 2007, p. 17], as well as the level of foreign ownership and use of foreign borrowed capital.

#### 4. Measures of company internationalization and their interpretation

The economic theory has developed a number of indicators which can also be used to measure company internationalization. Table 1 groups indicators measuring internationalization according to areas of company activity (components) and listed evaluation indicators: internationalization of production and sales, internationalization of factors of production and the degree of connections with foreign capital markets

**Table 1.** Measures of company internationalization

Component	Feature of internationalization	Indicator of internationalization
Production and sales	Exports of products	Share of revenue from export sales in total (global) volume of revenues,
		Share of profit from exports in total (global) volume of profits,
		Share of foreign clients in total number of company clients.
	International contacts	Share of sales revenues from sales through foreign partners in total (global) volume of revenues,
		Share of profit from sales through foreign partners in total (global) volume of profits,
		Share of foreign clients attracted through foreign partners in total number of company clients
	Foreign direct investment	Number of production process links located in other countries in relation to total number of links in the company value chain,
		Value of assets (fixed capital and current assets) constituting foreign direct investment in the total value of company assets (fixed capital and current assets),
		Number of branches located abroad in relation to the total number of company branches,
		Share of revenue from sales of products manufactured in factories being foreign direct investment in total (global) volume of revenues,
		Share of profit earned on sales of products manufactured in factories being foreign direct investment in total (global) volume of profits

Component	Feature of internationalization	Indicator of internationalization
		Share of foreign direct investment value in total value of company investment,
Factors of production	Employment	Number of people employed abroad in relation to total number of employed people,
		Number of employees with foreign citizenship in relation to total number of employees.
	Deliveries of materials, fixed assets and services	Share of deliveries of raw materials, parts and components by foreign suppliers in total amount and value of deliveries,
		Share of machines and equipment bought from foreign companies in total value of machine and equipment purchases,
		Value of purchased services of foreign subcontractors in relation to total value of purchased services,
	Technological knowledge	Share of new products documentation, technologies and solutions in organization and management, that is licenses and know-how acquired abroad in total value of documentation, technologies, organizational solutions and know-how acquired by the company,
		Share of foreign consultation, expert opinions and trainings in total value of services purchased by the company concerning consultation, expert opinions and trainings,
		Share of used research and specialist literature created by foreign institutions in total amount of research and specialist literature used by the company.
	Capital markets	Companies with ownership share of foreign capital
Share of foreign start-up capital in total value of capital ((balance sheet total) .		
Foreign sources of financing operational activity		Share of foreign capital (loan, leasing, subsidy) used to finance operational activity in total sum of company capital (balance sheet total),
Foreign portfolio investment		Share of investment in foreign securities in total value of financial investment of the company.

Source: own elaboration on the basis of [Duliniec 2004, Gospodarka Polski... 2005, Międzynarodowe transakcje 2002, Pierścionek 2003, Rymarzyk 1996, Sudol 2006, Yip 1996].

All internationalization indicators listed in the table are used in assessment of company internationalization, but they evaluate only one element of company activities. Using all three components listed in table 1 we can create composite indicators which will provide us with the most complete assessment of company

internationalization. The trans-nationalization indicator is a weighted average of foreign shares in three dimensions: sales, assets and employment. In companies with the highest international cooperation this indicator exceeds 90% [Sudoł 2006, p. 134].

The second composite indicator is the Company Internationalization Indicator (CII) [Rymarczyk 1996, p. 19]. This indicator is arithmetic average of foreign sales, foreign employment and fixed assets in their total value in the company.

$$CII = \frac{\frac{FA_2}{FA} + \frac{T_2}{T} + \frac{E_2}{E}}{3}$$

where: FA2 – fixed assets abroad; FA – total fixed assets; T2 – turnover abroad; T – total turnover; E2 – employment abroad; E – total employment.

High percentage share of internationalization of all elements points at a totally internationalized company. Very high internationalization level of one element with low internationalization of other elements confirms high level of company internationalization.

The results of company internationalization indicator belong to the 0-1 range, where 0 means total lack of internationalization, and 1 – 100% of foreign employment in a company located abroad (100% of fixed assets are located abroad) and all company revenues come from foreign sources.

The most universal measure used to determine the scope of internationalization is the number of countries the company cooperates with in each area of its activity.

With indicators based on the level of product exports, it is assumed that the company is [Pietrasieński 2005, p. 21]:

- poorly dependent on foreign markets, if its foreign sales are lower than 13% of total company sales,
- averagely dependent, if its foreign sales are between 13% and 30% of total sales,
- strongly dependent if it sells over 30% of its production abroad.

In specialist literature it is assumed that companies which achieve at least 25% of their production from investments located in other countries can be called “international companies” [Chwistecka-Dudek 1993, pp. 74-75].

Companies which start internationalization of their operations from the very beginning of their history or shortly after their establishment, are called “born globals”. Such enterprises –in the period of up to three years after

registering their economic activity – achieve at least 75% of total revenues in foreign markets [Pietrasieński 2005, p. 27].

Companies which sell their products in the whole global market and which are present in strategic world markets, such as US, Chinese, Japanese and EU markets, achieve the highest possible level of internationalization, which is globalization [Yip 1996, p. 91].

Evaluating internationalization through involvement of foreign capital in a company, we should pay attention to the size and structure of this capital. The companies may show [Międzynarodowe transakcje..., 2002, p. 356]:

- full subordination to foreign capital (100% of ownership), uniform or dispersed ownership,
- dominant share of foreign capital: uniform or dispersed,
- majority share of foreign capital: uniform, dispersed, without limited rights, with limited rights (golden share),
- minority share of foreign capital, uniform, dispersed, with majority or minority of votes.

## 5. Conclusions

Due to universality of internationalization processes and their significance for company development, it has become vital to develop measures which would allow quantitatively determine the size of company internationalization and to enable us to compare this phenomenon in various companies. The ways of measuring internationalization presented in this article, including composite indicators, allow us to make such comparisons.

This paper is of methodological nature but all methods of assessing internationalization presented here could be used in empirical studies and in evaluation of the degree of company internationalization.

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**Beata Pater\***

## **NATIONAL PARKS – THEIR OPERATIONS AND FINANCING**

### **Summary**

*National parks, as guardians of nature protection, perform their tasks of preserving the wealth of fauna and flora and geological features for future generations. They also offer tourist attractions in shape of many kilometers of routes in the most beautiful nature spots of our country. These tasks, however, should be properly financed. Till the end of 2010, the state budget covered the financial requirements to a small extent – only 10-12%. The remaining amount was financed from non-budget means and revenues of auxiliary enterprises. The reform of public finance deprived national parks of revenues generated by their auxiliary enterprises, decreasing their budgets below the minimum level. New regulations do not guarantee maintaining the current level of financing parks. We should remember that the tasks assigned to parks have not changed. Maybe another system of financing could help parks overcome these difficulties. In September 2010, the government developed a project of amending the Act on Nature Protection, introducing the regulation stipulating that a national park will become a so-called state legal person, which will result in ability to retain revenues and to allocate them for statutory purposes. Any disturbances in realization of tasks assigned to national parks may negatively influence various spheres of economic and social life.*

### **1. Introduction**

In the second half of the 19<sup>th</sup> century, on 1<sup>st</sup> March 1872, President Ulysses Simpson Grant established the first world national park in the USA – Yellowstone National Park. More than 30 years later, in 1909, the first national park in Europe, Sareks National Park was established in Sweden. At present, there are over 2500 national parks in the world and the new ones are still being created [16].

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In Poland, the first national park was created on 17<sup>th</sup> August 1932 as the Białowieża National Park, restored in its present form on the strength of the resolution of the Council of ministers from 21<sup>st</sup> November 1947 [15].

A national park is a state budget unit according to regulations on public finance. The Minister of Environment, in his resolution, grants the national park the statute determining its organizational structure. In light of the definition included in the Act on Nature Protection, this is an area possessing special natural, social, cultural and educational values, not smaller than 1000 hectares, on which all nature and landscape values are protected.

It is created to preserve biological diversity, resources, creations and elements of geological features as well as landscape values. The purpose is to restore the proper state of natural resources and elements and to reconstruct natural habitats of plants, animals or fungi.

According to article 12, section 1 of the Act on Nature Protection, the area of the national park is accessible for tourist purposes inasmuch as it does not influence nature negatively. The available places and the maximum number of visitors who can stay at one place at the same time are determined in the preservation plan of the national park or, until such plan is established, in protective tasks. Simultaneously, detailed norms of accessibility for recreation purposes are defined by the head of the national park in their regulation on principles of park accessibility [3].

Currently, there are 23 national parks in Poland, covering 1% of the total area of the country, that is 316,748.4 hectares, including 195,443.1 hectares of forests. On their area there are 3326 kilometers of tourist routes, 124 educational paths 607 kilometers long, 29 hostels, 275 rain shelters, 45 campfire sites. Each year around 11 million people visit national parks. 18 parks have museums of nature and field museum exhibitions, there are 34 education centers. 8 national parks (Babiogórski, Białowieski, Bieszczadzki, Kampinoski, Karkonoski, Poleski, Tatrzański) were granted the status of biosphere reserves. Białowieski National Park has been enrolled on a list of UNESCO world cultural heritage [Ministry of the Environment, pp. 2, 14 -15].

The aim of this paper is to review the tasks delegated to national parks, the way they function and are financed, the differences in financing national parks before and after closing down auxiliary enterprises, and to attempt at answering the question whether there are methods and it is possible to value natural goods, which is the task imposed on management of parks.

## **2. The tasks of a national park**

Initially, the main tasks of national parks were their protection and scientific function.



Currently, apart from these functions, parks have been allocated a number of new ones. They perform many functions which bring about particular social and economic effects. At present, the main functions of parks are:

- preserving natural environment and protecting valuable natural elements,
- performing educational, scientific research and economic functions,
- satisfying tourist needs and other social and cultural needs.

We can look at the tasks of national parks from two different perspectives – from the point of tasks realized by 1 out of 23 entities or by a group of entities, that is the whole network of national parks. They have some joint tasks, defined by general objectives of nature preservation and individual objectives resulting from natural phenomena characteristic of a particular entity. There are 6 typical features of each national park.

**The protective function** consists in preserving and documenting natural diversity of a country. The key issue here is to protect as many species of fauna and flora as possible, containing the biggest pool of genes of animated nature and to preserve the remains of primal and natural biocenosis as well as all existing semi-natural communities. Protection also covers various structures of nature and their spatial systems, not only the natural ones but also those developed through hundreds of years of economic activity, which have historical value and which document the natural history of the nation.

**The educational function** covers running libraries, museums of nature, scientific and general interest publications and outlining education paths. Therefore, if the park is to perform this function properly, it must be prepared to it in terms of organization, premises and staff, so the scientific center must cooperate with the education center and the museum of science.

**The scientific function** is fulfilled through conducting scientific research activities. It preserves and saves from destruction animated nature and geological features, which are or will become subject of research. The use of protected objects is increasing and they are becoming an indispensable workshop of scientific work, allowing to conduct research without the disturbance caused by intense economy.

**The economic function.** The use and significance of objects created for preventive protection of nature has various economic functions, such as supplying timber obtained from protective treatment. Parks are gene banks from which we can obtain genetic material for reproduction of valuable species of plants and animals or their local breeds and variations.

The tourism and recreation function is realized through making accessible particular places and tourist routes for sightseeing and recreation purposes such as walking, cycling, water activities or skiing. These are, due to their natural and landscape values, areas valuable for tourism [Michałowski, Zabierowski 1978, pp. 452-455].

A dangerous issue is too heavy tourist burden resulting from the same reasons for which parks were established. Parks must take care not to let the recreation function overshadow the ultimate goal which is protection. They cannot allow the situation in which nature is protected from the tourist, not for the tourist.

The cultural and historical function is manifested in supporting local style of architecture, clothes, taking care of the national memorials and historic places [Lubczyński 1999, p. 54].

National parks, with their own management, are, by operation of law, the highest located formations in the hierarchy of the nature protection system. They cover quite vast areas with natural, only slightly changed eco-systems and landscape. These institutions have to cope with high expectations. They should cover the largest possible part of the areas which preserved the primal or only slightly changed eco-systems and landscape with high natural and esthetic value, as well as protect and preserve the diversity of nature through protecting the eco-systems and landscape typical of large geographic regions together with related environment. They are also expected to preserve unique eco-systems, landscape, fauna and flora in a given geographic region [Olaczek 1991, p. 3].

National parks, just like monuments of culture, are perceived as common national good. This can be attributed to the scarcity of virgin nature. In the protection of unique features of nature, the scientific function is of major importance, as these are the last natural areas, unaffected by human beings and excluded, by operation of law, from their economic activities. National parks must preserve the richness of genetic resources of fauna and flora. That is why the network of parks in Poland, thanks to proper protective management, allows us to preserve the diversity of eco-systems and to maintain their balance [Szczyński 1991, p. 2].

Entering the Yellowstone National Park, visitors pass a stone gate with the inscription from the times of President Teddy Roosevelt: "For the benefit and enjoyment of the people". This sentence perfectly expresses the responsibility imposed on management of national parks all over the world.

### **3. A national park and its surroundings**

The neighborhood of a national park positively influences economic development of a region. After establishing a national park, the area experiences economic boom, which improves the economic situation of local community. This is attributed to increased tourist movement, followed by development of infrastructure in the close and distant surroundings of the park.

In the protected area, instead of exploiting nature's resources, which leads to environment degradation, material benefits are obtained from making them

accessible for sightseeing, education or recreation. Profiting from natural values of the region poses lower (if any) threat to the resources [Michalik 2000, p. 15].

Adjusting the structure and intensity of economic activities is the key element in the policy of managing the national park area. The borderline is natural capacity of eco-systems, observation of ecological ties and elimination of situations of ecological conflict. Economic functions usually collide with natural environment, therefore the risk of their appearance should be reduced to absolute minimum. In the protected area, it is the natural environment that plays a dominant role and forces subordination of all entities involved in economic activity.

We can draw not only ecological, but also economic and social benefits from the areas of protected nature. Spreading the knowledge of environment-friendly ways of managing and using natural values, without disturbing their ecological functions is vital. Such attitude helps preserve nature's values and contributes to improvement of economic conditions of local community.

Defining the scope and type of protective activities is a difficult, thankless and responsible task, as each decision brings about particular effects concerning the managing method. It happens that all economic activities are forbidden, which eliminates the possibility of obtaining potential material benefits. As a result, the acceptance level for the protected area is very low among local inhabitants [Zielińska 2002, p. 123-126].

The most harmful influence on national parks is exerted by changes affecting water system, such as drainage, swelling water flows, obtaining water, activity causing micro-and macro-climatic changes, air pollution, erecting buildings and penetrating the area off the outlined routes.

The conflicts between national parks and their surroundings are caused by local authorities and population ignorance of the park objectives, ignorance of benefits offered by its neighborhood, lack of distinction between protective regulations resulting from valid law and those connected with park creation [Baranowska-Janota, Ptaszycka -Jackowska 2000, p. 7].

#### **4. Financing the activity of national parks**

A national park, according to article 8, section 3 of the Act of 16<sup>th</sup> April 2004 on Nature Protection (Journal of Law 2009, No 151, position 1220 with subsequent changes), and the Act on Public Finance, is a state budget unit. The principles concerning the financing of state budget units are determined in the Act of 27<sup>th</sup> August 2009 on Public Finance (Journal of Law 2009, No 157, position 1240 with subsequent changes).

State budget units are the units of public sector, covering their expenses directly from the state budget and transferring their revenues to the account of

state budget revenues, with the exception of revenues collected on their own income account.

The Minister of Environment establishes, transforms into a different organizational and legal form, or dissolves the national park. Creating the park, the Minister defines the property transferred for the management of a state budget unit, that is the national park [Babczuk, Krawiec, 2009, pp. 14-15]. All real estate belonging to the Treasury, located within the borders of the national park and serving realization of its goals, are transferred for the permanent management of the national park according to the Act on Real Estate Management [12].

The Minister of Environment supervises national parks. The supervision covers:

- 1) approving financial plans and preparing collective reports from the activity of national parks;
- 2) approving annual material tasks resulting from protection plan or protection tasks;
- 3) coordinating scientific and educational activities;
- 4) controlling the functioning of national parks;
- 5) functioning of National Park Service [11, article 9, sections 1 and 2].

The head of the national park is entitled to represent the Treasury in civil law relations concerning the management of national park property.

In order to achieve the objectives stipulated in the act and the tasks imposed on them, national parks also use non-budget sources of financing. The main non-budget source of finance is the National Fund for Environmental Protection and Water Management, which finances over 20% of tasks performed in national parks. Also the share of national park activities financed with EU funds is increasing, which confirms active search for these means by national parks.

The basic source of financing the statutory objectives and tasks of national parks till the end of 2010 were the revenues from auxiliary enterprises. After changes introduced in the Act on Public Finance and liquidation of these enterprises, national parks should receive additional financing from state budget in the amount equivalent to that earned by auxiliary enterprises. Otherwise, they are unable to realize their statutory tasks.

#### **4.1. Auxiliary enterprises**

According to article 26 section 1 of the Act of 27<sup>th</sup> August 2009 on Public Finance (Journal of Law 2009, No 157, position 1240 with subsequent changes), an auxiliary enterprise of a state budget unit is an organizationally and financially separated part of the core activity of a unit or its side activity. The enterprise covered the costs of its activity from obtained own revenues. The aim of the auxiliary enterprises in national parks was to perform tasks

concerning environment protection, financed from the means obtained from this activity.

The revenue sources of auxiliary enterprises in national parks were:

- Sales of wood and non-wood products,
- Fees for the entrance to the park or some of its parts,
- Fees for making the national park or its part available,
- Fees for entrance to some park objects,
- Sales of services, for example transportation, repairs, construction ones.

The share of auxiliary enterprises in realization of national parks tasks reached up to 90%. The figure depended on the type of performed tasks, the size of auxiliary enterprises revenues, subsidies from non-budget sources and share of budget finance.

The fees for entrance tickets in the amount of 15% of quarterly revenue, in line with the Act on Nature Protection, were allocated to financing activities of specialist rescue organizations – Mountain Volunteer Rescue Service and Tatra Volunteer Rescue Service, which perform their operations in the area of national parks [Raźny 2007, p. 104].

Until recently this money was passed through national parks. Since the Ministry of Finance took over the money management, specialist rescue organizations do not have any information when and on what principles, their accounts will be credited with statutory due funds [Kraczyńska 2011]. In consequence of lack of clear regulations, rescue services have to apply for them first to their superior, that is the Ministry of the Interior and Administration, and then the ministry asks the Ministry of Finance to allocate these funds for the services.

Until 31<sup>st</sup> December 2010, national parks diversified their sources of income. Employees' salaries, uniforms and trips were financed from the state budget. The expenses related to nature protection or maintaining tourist infrastructure were covered from the incomes of auxiliary enterprises which performed economic activities in parks. So, if the auxiliary enterprise at TPN earned around 12 million PLN annually, half of that sum, according to valid regulations was transferred to the state budget while 6 million PLN remained on the account of TPN and could be used to finance the park activities.

The Act of 27<sup>th</sup> August 2009 on Public Finance does not allow the possibility of performing the tasks of state budget units – national parks by auxiliary enterprises functioning in their area, nor does it allow them to gather financial means on their own income account. This regulation came into force on 1<sup>st</sup> January 2011. [Ministerstwo Środowiska 2010, pp.16-18].

Therefore, since 1<sup>st</sup> January 2011 parks have been transferring all their revenues. The Ministry of Finance obliged itself to activate the money from

purpose reserve for the tasks which were realized by auxiliary enterprises. In the first quarter of 2011, the Ministry of Finance kept its obligation and parks received the first part on time. At the beginning of April 2011, however, they expected to receive the second part of financial means, but they did not receive it on time. In this situation, they functioned by limiting all costs to absolute minimum, only settling their liabilities for utilities. All tenders and repair works have been stopped.

The Ministry of Finance explained the delays in transferring money with lack of income generated by parks. However, although the Tatrzanski National Park transferred high amounts of money to the Ministry as the tourist season lasts there almost all year round, it did not receive money on time, either, as all the money goes to one Ministry fund.

The system of financing national parks before 2011 was not perfect, either. It did not provide the means for the basic needs of national parks. Poland's accession to the European Union opened up new possibilities of applying for the means supporting activities of national parks from EU funds, but parks were not prepared for direct acquisition of EU financial means. The participation of national parks in projects financed from EU sources until 2009 was based on partnership base, in cooperation with non-governmental organizations, as for example Polish Society for the Prevention of Birds in the project of protecting the aquatic warbler in Biebrzanski National Park, or scientific institutions such as participation of mammal Research Institute of the Polish Academy of Sciences in protecting the European bison in the area of the Bialowieza Primeval Forest.

The Infrastructure and Environment Operational Program is an important source of financing national parks operations. In the V priority axis it allows financing national parks in developing projects of protection plans, protection of species and habitats, natural education and other programs, such as LIFE + or Norwegian Financial Mechanism.

## **4.2. State legal person**

Following the liquidation of auxiliary enterprises in national parks, it was necessary to prepare legislature regulating the change of organizational and legal form of national parks. The aim of introducing amendments to the Act of 16<sup>th</sup> April 2004 on Nature Protection was the necessity of giving national parks a new organizational and legal form. The essence of the project of the act is to ensure proper functioning and financing the activity of national parks.

In the law-makers mind, potential transformation of state budget units – national parks into state legal persons will allow them to retain the obtained revenues and to allocate them for nature protection as well as it will allow them

to preserve the jobs from liquidated auxiliary enterprises. It should be noted that in spite of organizational and legal changes, there will be no modification of tasks that national parks are to perform.

The choice of a state legal person as a new organizational and legal form is to assure more efficient functioning and performing statutory tasks imposed onto national parks. We should remember, however, that the choice of a state budget institution as an organizational and legal form is connected with the necessity of commissioning national parks to perform tasks, as according to article 23 of the Act on Public Finance, such unit is created to perform public tasks and performs selected tasks for payment. Therefore, a special unit should be created, which would deal with commissioning and supervising such tasks, which would definitely increase the costs of implementing such a regulation [Ministerstwo Środowiska 2010, p. 18].

Effective execution of national park tasks influences the economic development of regions and often determines the tourist attractiveness of particular geographical areas. The annual cost of national parks operations according to data for 2011 is around 200 million PLN, out of which 137 million PLN is allocated from the state budget. The above means are the means allocated to national parks within the limit for 2011 for state budget units, amounting to nearly 84 million PLN, and the means for which the ministry applies within the budget reserve, amounting to 53 million PLN, created on the basis of article 94 of the Act of 27<sup>th</sup> August 2009 – Regulations introducing the Act on Public Finance (Journal of Law, No 157, position 1241 with subsequent changes).

The amount granted within the limit for state budget units allows only to finance remunerations of national parks employees, but excluding the employees of auxiliary enterprises liquidated in 2011. The activities related to nature protection, including the tasks connected with making national parks accessible and remunerating employees from acquired auxiliary enterprises are financed from the means within the purpose reserve, amounting to 53 million zlotys, as well as from other sources, such as National Fund of Environmental Protection and Water Management, province funds of environmental protection and water management in the amount of 35 million PLN. In 2011 it is expected that the foreign means will amount to 28 million PLN.

It seems justifiable then that national parks, apart from budget subsidies, could retain the revenues obtained as a result of their own activities resulting from protective actions and allocate them to cover costs related to realizing tasks stipulated by the Act on Nature Protection. [14]

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