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## Editorial

Information Management and Business Review (IMBR) provides a unique platform to scholars around the world to share their knowledge and publish research work in the fields of information management, business, management and related disciplines. The work submitted for publication consideration in IMBR should address empirical and theoretical developments in the subjects related to scope of the journal in particular and allied theories and practices in general. Scope of IMBR includes: subjects of finance, accounting, auditing, cost & management accounting, financial psychology, financial literacy, marketing, information management, human resource management, knowledge management, innovation, change management, enterprise management, e-commerce and information system. Author(s) should declare that work submitted to the journal is original, not under consideration for publication by another journal, and that all listed authors approve its submission to IMBR. It is IMBR policy to welcome submissions for consideration, which are original, and not under consideration for publication by another journal at the same time. Author (s) can submit: Research Paper, Conceptual Paper, Case Studies and Book Review. The current issue of IMBR comprises of papers of scholars from Indonesia, India, Thailand and Malaysia. Recapitalization effectiveness & performance of banks, determinants of sales force performance in banking sector, paradigm of islamic education in the future, comparing & scoring selected train ticketing mobile phone applications, effect of bank merger on the shareholders wealth & post-merger situation, factors influencing service innovation capabilities & performance and financial accounting information system & the quality of local government financial reports are some of the major practices and concepts examined in these studies. Journal received research submission related to all aspects of major themes and tracks. All the submitted papers were first assessed by the editorial team for relevance and originality of the work and blindly peer reviewed by the external reviewers depending on the subject matter of the paper. After the rigorous peer-review process, the submitted papers were selected based on originality, significance, and clarity of the purpose. Current issue will therefore be a unique offer, where scholars will be able to appreciate the latest results in their field of expertise, and to acquire additional knowledge in other relevant fields.

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**Table of Contents**

<b>Description</b>	<b>Pages</b>
Title	1
Editorial	2
Editorial Board	3
Table of Contents	4
Papers	5
Recapitalization Effectiveness and Performance of Banks in Malaysia <a href="#">Etri Ernovianti, Nor Hayati Binti Ahmad, Ahmad Rizal Mazlan</a>	6
Determinants of Sales Force Performance in Banking Sector: A Case of Malaysia <a href="#">Zunarni Kosim, Nor Hayati Ahmad, Tan Sek Choo</a>	13
Paradigm of Islamic Education in the Future: The Integration of Islamic Boarding School and Favorite School <a href="#">St. Wardah Hanafie Das, Abdul Halik, Amaluddin</a>	24
Comparing and Scoring Selected Four Train Ticketing Mobile Phone Applications <a href="#">Vaishnavi Venugopalan, Chaitanya Vyas</a>	33
Effect of Bank Merger on the Shareholders Wealth and Post-Merger Situation of Nepalese Banking Industry <a href="#">Manoj Kumar Bhatta</a>	41
Assessing the Factors Influencing Service Innovation Capabilities and Performance <a href="#">Nor Asiah Omar, MuhamadAzrin Nazri, Syed Shah Alam, Azhar Ahmad</a>	52
Region's Financial Accounting Information System and the Quality of Local Government Financial Reports <a href="#">Abdul Rahman, Zulkifli Fachri</a>	64

## **PAPERS**

## Recapitalization Effectiveness and Performance of Banks in Malaysia

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**Abstract:** Recapitalization through capital injection is one of the strategies for banks to strengthen their banking system from the possibility of bank failures. Banks cannot deny that capital is one of the most important components to run their business. In spite of that, few studies have been conducted to assess the effectiveness of such strategy on Asian banks. This paper investigates the effectiveness of capital injection in the Malaysian banking sector which was adversely hit by the financial crisis. Panel data from 1997 to 2014 was used. The financial data is obtained from annual reports published in Bank Scope and The World Bank database. The data were processed using Panel Least Square and Random effect model. The empirical analysis reveals that, GDP, CAR, previous year capital injection and loan write-off (LWO) explain 89.6 percent of the variance in capital injection effectiveness. CAR and LWO/TA are significant at 5 percent confidence level. The evidence from the results shows that recapitalization is vital for long term survival of the banking sector. The study recommends that in order to improve the profitability of banking sector, the banks should write off bad loans and ensure they have adequate capital either through capital injection, or growth to withstand financial risks.

**Keywords:** *Capital Injection, CAR, Loan write-off, economic growth, bank*

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### 1. Introduction

Banking system plays an important role in mobilization and allocation of financial resources or capital in the economy. Banks as financial intermediaries allocate capital from units which have surplus funds to those units who needs or lack funds. According to Elliot (2010), capital is intended to protect the bank or any parties including bank customers, bank counterparties and also depositors from losses. During financial crises, Mehran and Thakor (2009) and Diamond and Rajan (2000) mentioned that capital injection enables banks to reduce the probability of insolvency and closure of the banks. However, capital injection or recapitalization can be a very expensive strategy to the banks affected by financial risks because banks have to provide higher dividends to a larger number of shareholders from the enlarged capital. Therefore, banks have to consider the cost and benefit of capital injection versus profit improvement. Did capital injection bring improvement to the banks? There is no clear evidence on the success of this strategy since study on the effectiveness of capital injection is limited especially on Malaysian banks after the 1997 Asian Financial Crisis (AFC).

Several countries have faced financial difficulties and challenges to undertake recapitalization due to the banking crises. Malaysia was no exception. The 1997 Asian Financial Crisis (AFC) adversely affected Malaysian banks stability. Many banks recorded huge losses due to credit risk and high NPL. This posed serious problem to Malaysian banks survivability, resulting in Malaysian government to take actions to recapitalize the banks which experience acute capital erosion. Rebuilding and restructuring banks from the 1997 crises and 2008 financial crises has been done by many regulators to save the banks from insolvency. Recapitalization is one of the strategies used to survive from the inadequate capital. Giannetti and Simonov's (2013) study on equity injection on Japanese banks from 1998 to 2005 find that recapitalization will help banks to increase their lending to more creditworthy borrowers if the injected capitals are large enough. Although this strategy was widely implemented, only a few empirical studies were done to assess the effectiveness of such strategy. Hence, the objective of this paper is to evaluate the effectiveness of capital injection for Malaysian banks over the 1997 - 2014 periods. This paper is organized as follows: Section 2 briefly outlines the history of Malaysian banking crisis; Section 3 provides critical review of the related literature, Section 4 describes the methodology used, Section 5 presents the result of the study, and Section 6 concludes the paper.

**Malaysian banking sector crisis period:** In 1997-98, Malaysia was hit by the pressure of AFC with depreciation of Ringgit from RM2.50 per US Dollar to RM4.88 in 1998. At the same time, the average capital adequacy ratio (CAR) of Malaysian banks was 10 percent, the highest in Southeast Asian countries. However, the asset quality of Malaysian banks deteriorated seriously when borrowers faced difficulties to meet their obligation, resulting in a very huge non-performing loan (NPL). In 1998, the economic growth declined to -7.4 percent, while NPLs of the banking system worsened from 4.1% in 1997 to 13.6% in 1998. In 1999, it improved slightly to 11.0% but still in the double digit level. Many banks suffered severe financial losses causing them to be merged in order to survive. This situation demanded serious attention from the government to strategize effective recovery plan. The Central Bank, however, instructed bank mergers across the banking sectors together with capital restructuring and consolidations exercise over the 1999 – 2000 period. Since then, Malaysian banks experienced several capital injections, to which no empirical research has been conducted to assess the effectiveness of the exercise.

Berger and Bouwman (2009) argue that the importance of capital to banking organization and also to other financial institutions is elevated during banking crises. This is because during the crises, banks need to have fresh or additional capital being injected, in order to absorb their losses and continue their lending operation. However, capital injections may not take place during the banking crises only, but also in normal situation where banks need capital injections to expand their lending investment and asset acquisition activities. Their argument is further supported by Mehran and Anjan (2009) and Diamond and Rajan (2000). The 1997 situation unveiled the weaknesses in the Malaysian banking system as one with weak risk management, banks undercapitalized, and heavy lending concentration in high risk sector such as broad property sector. The rescue plan started with a capital injection by the Central Bank to Bank Bumiputera, followed by several capital injections and acquisitions of weaker banks by stronger banks. This massive recapitalization exercise resulted in the downsizing of banks from 58 to 10 domestic anchor banking groups. The banks are Affin Bank Berhad Group, Alliance Bank Berhad Group, Arab-Malaysian Bank Berhad Group, Bumiputra-Commerce Bank Berhad Group, Eon Bank berhad Group, Hong Leong Bank Berhad Group, Malayan Banking Berhad Group, Public Bank Berhad group, RHB Bank Berhad Group, and Southern Bank Berhad.

Subsequently, the 10 anchor banks were reduced to 8 through merger and acquisitions with the acquisition of Southern Banks by CIMB Bank and EON Bank by Hong Leong Banking Group. To date, the assets of the Malaysian banking system is RM 440,568 million in 2015 from RM 427,617 million in 2014 and RM 181.4 billion in 1997. Several factors influenced capital injections in the Malaysian banks, such as capital regulation and loan write offs by individual banks. In other instances, strong recovery efforts and good risk management practices were in place. Nonetheless, there are conflicting opinions as to which factors are more effective to bring about performance improvement. This motivates us to search for empirical evidences and underpinning theories from reviews of the literatures and empirical analysis.

## 2. Literature Review

**Related Theories:** Theories which have been identified to be relevant in this study are theory of financial intermediation, theory of survival and theory of bank capital. The theory of the financial intermediation was developed by Diamond (1984) based on resolving incentive problems between borrowers and lenders. This theory explained about financial institutions' role in the flow of fund system; from fund provider, investor or depositors to borrowers or customers. In this discussion, the bank acts as a third party by receiving money from depositors or an investor and invest the money or giving loans to customers. The developments of financial intermediaries tend to lead the development of financial markets. This development has provided a distinct long term increase in market capitalization relative to GDP. Although greater bank capital reduces the probability of financial distress, it also reduces liquidity creation. Diamond and Rajan (2000) find that optimal bank capital structure trades off effects on liquidity creation, costs of bank distress and the ability to force borrowers' repayment. In contrast, Theory of Survival suggests that capital helps the banks to enhance the probabilities of survival and increase in the market share of small banks at all time (Berger and Bouwman, 2013).

## Definition of Variables

**Loan Write Off:** Previous studies demonstrate that banks which are inadequate to capitalize are more likely to keep non-performing loans on their books than the healthy banks. However, for banks which can source new capital, the effectiveness of the capital injections encourage banks to write off their non-performing loans. The main objective of the capital injection program was to mitigate the tendency of bad loan (Peek and Rosengren, 2005). Regulators also encouraged the banks to write off their non-performing loans that have been left their books for years. However, according to Montgomery and Satoshi (2009), few banks which suffered from bad loans would write off their bad loans and having to write-off more bad loans is negative shock to bank capital. Bank will reveal their bad loans if their numbers are larger than a certain threshold. The research gap is the less attention in the previous studies to undertake research on loan write offs. According to Peek and Rosengren (2005), when the depressed banks are not recapitalizing, it will lead banks to give less lending which might result in depressed growth for banks.

**Capital Injection:** There are evidences to support the usage of capital in banks to protect for losses, for example in the case of Indonesian Islamic banking system (Abusharba, Triwuyono, Ismail & Rahman, 2013). They found that non-performing loan is significantly but negatively related to the capital adequacy. This proves that capital would be used by banks to meet their obligations and cover their non-performing loan to protect the owners of the capital from further losses. This is supported by Berger and Bouwman (2013), which argue that capital can helps banks profitability to become stronger in terms of survival and market shares; whether it is during the crises or normal times. According to Philippon and Schnabl (2013), efficient recapitalization programs inject equity capital against preferred stock plus warrants and conditions implementation on sufficient bank participation from existing and new shareholder (bank debt holders). Efficient recapitalization is profitable if the benefits of lower aggregate credit risk exceed the cost of implicit transfers to bank debt holders.

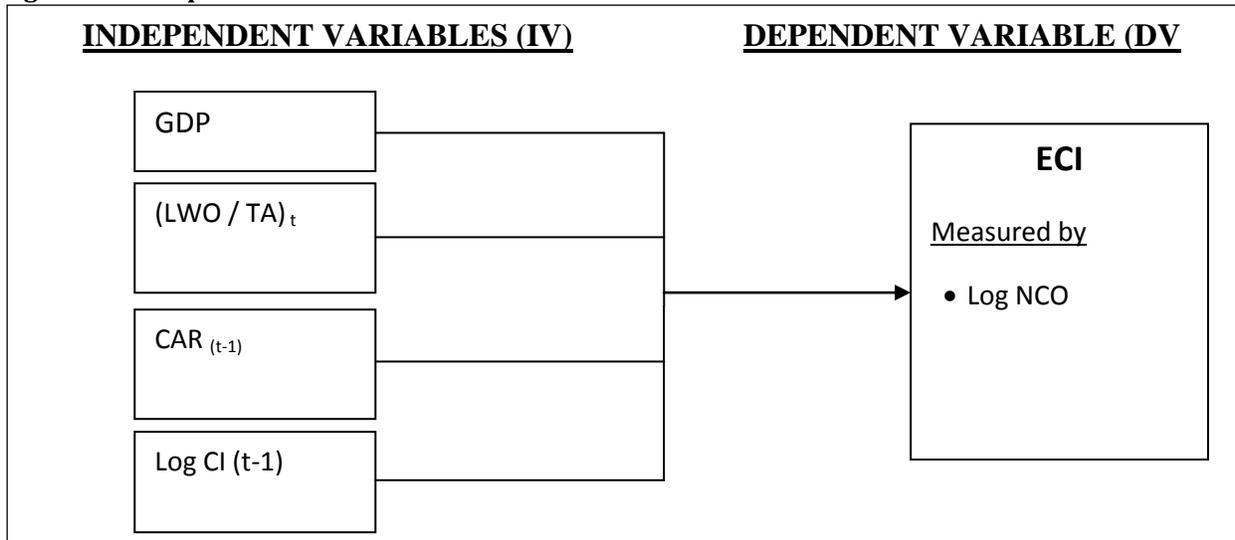
**GDP:** The downturn in the economic environment can cause losses for banks which decrease a bank's capital; which consequently require the banks to increase regulatory capital ratios in order to provide adequate coverage for higher risk assets in their balance sheet. This situation requires the banks to inject new capital or to curtail lending. However, there is still an ambiguous impact of the effectiveness of capital injection on the banking performance related to the macroeconomic factors namely GDP and Inflation. From the previous studies (Berger and Bouwman, 2013; Takashi and Montgomery, 2011; Adegbaaju & Olokoyo, 2008), GDP has not been discussed in terms of its influence on the effectiveness of capital injection.

**Capital Ratio:** Strengthening capital ratios is a key priority in the outcome of the global financial crisis. Increasing the quantity, quality, and transparency of capital is of paramount importance to restore the banking sector to health. When the banks have higher capital ratio, it is found that the banks tend to have stronger loan growth over the years (Carlson, Shan & Warusawitharana, 2013). However, such effects need further investigation to ascertain whether Malaysian banks curtail their lending or inject new capital to restore the banking healthy. This presents another research gap for this study as no recent empirical research was carried out on the effect of capital ratios on loan growth of Malaysian banks. According to Onji, Vera and Corbett (2012), which study on 81 banking group of regional banks with a panel dataset, shuffling of personnel to subsidiaries was a common response among banks that receive large capital injections. The personnel needs to assume new jobs and this require re-training in new areas, new job system as the enlarged banks (from the capital injection) venture into new activities for higher profitability. This finding was supported by Mariathan and Merrouche (2012), which study on the characteristics of public recapitalizations of banks and their relationship with bank lending. The analysis covers 15 OECD countries whose banking sectors were most severely hit by the crisis and the countries d the largest public bailouts of the banks relative to their national gross domestic product (GDP). Larger and higher loss-absorbing capital injections were found targeted at weaker banks and at those banks of 'systemically relevant' size, allowed by the state of public finances. The recapitalization had resulted in significant increase in bank lending for the OECD countries.

### 3. Methodology

The data from this study was collected from Bank Scope database and the Central Banks, while the economic data was extracted from the World Bank website. The analysis period is from year 1997 until 2014. This unbalanced data requires Panel Least Square, Breusch-Pagan test or Panel data test to be conducted to decide whether fixed effect or random effect is the appropriate method of analysis. The population of this study consists of 8 conventional banks in Malaysia. The conceptual framework in which the relationships were tested is as in Figure 1.

**Figure 1: Conceptual Framework**



**Empirical Specification:** To conduct the investigation of the effectiveness of capital injection, the model for this study is expressed in the following terms.

$$Y = \beta_0 + \beta_{x1} + \beta_{x2} + \beta_{x3} + \pi \dots \dots \dots (1)$$

Where: Y= Effectiveness of capital injection  
X= Independent variables  
β= Coefficient of capital injection  
π= Error term

Hence, the actual model investigating the independent variables is formulated as below:

$$ECI = \beta_0 + \beta_1 (LWO/TA)_{t-1} + \beta_2 (CAR)_{t-1} + \beta_3 \text{Log CI}_{(t-1)} - \beta_8 \text{GDP} + e_{it} \dots (2)$$

Where:  
ECI= Effectiveness of Capital Injection  
CI= Capital Injection  
LWO/TA= Loan Write Offs to Total Asset  
CAR= Capital Ratio  
GDP= Gross Domestic Product

The operational definition and measurement of variables is per Table 1.

The period of analysis was chosen from 1997 to 2014. The reason for the choice of this length period (17 years) is because these periods witnessed major capital injection and recapitalization of the banks in Malaysia. Hence, we used 5 years (1997 – 2001) as pre capital injection period and 12 years (2002 – 2014) as post period in order to assess the effectiveness of capital injection exercise.

**Table 1: Operational Definition**

<b>Variables</b>	<b>Variables name</b>	<b>Measurement</b>
ECI	Effectiveness of capital injection	Net charge offs
LOGCI <sub>(t-1)</sub>	Capital Injection	Capital injection in previous year
LWO/TA	Loan write offs/ total asset	Loan write offs/ total asset
CAR	Capital ratio	Tier 1/ RWA
GDP	Gross Domestic Product	Percentage growth in Domestic Product

#### 4. Results

Table 2 present the pre and post 2002 capital injection performance of Malaysian banks. Table 3 presents the descriptive result of the variables for Malaysia banks used in this study. Meanwhile, Table 4 presents the Random effect statistics.

**Table 2: Pre and Post bank performance**

<b>Name</b>	<b>Pre-recapitalization</b>				<b>Post-recapitalization</b>				
	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2001</b>	<b>2002</b>	<b>2004</b>	<b>2008</b>	<b>2014</b>	
Net Interest Margin (NIM- %)	3.94	3.82	2.91	3.72	3.38	3.07	3.28	2.60	
Return on Asset (ROA- %)	1.18	0.26	0.38	0.29	0.89	0.93	1.13	1.42	
Return on Equity (ROE - %)	17.3	3.31	2.41	2.22	11.29	11.87	16.06	17.02	

**Table 3: Descriptive Statistics of Variables for Banks in Malaysia**

<b>Variables</b>	<b>Mean</b>	<b>Std. Deviation</b>
LogNCO	2.524	0.410
GDP	4.528	3.861
CAR	3.35	0.441
LWoTA	56.161	98.062
Logcit1	3.309	0.393

Table 3 shows the descriptive statistics of the variables for the banks in the study. It is observed from Table 3 that LWO/TA has the highest mean that is 56.161, while the mean for LogLWO is 32.524, GDP is 4.528 percent, and CAR is 3.35 times while Logcit1 is 3.309. The highest mean shows that banks in Malaysia have higher loan write off to total asset. The mean value for GDP is 4.528 percent but standard deviation (SD) is at 3.861 percent. The large SD is due to fluctuation in GDP growth where the lowest GDP was -7.14 in 1998. There has been no evidence of multicollinearity problem exists in the model for Malaysia since all variables have VIF value less than 10. Variance Inflation Factor (VIF) is used to examine the existence of multicollinearity issue among the variables of the study. According to Hair et al. (2010) when VIF values are above 10 or tolerance values are less than 0.10, it shows that multicollinearity problem exist. Further, Pallant (2010) suggested that the correlation matrix should be checked in order to identify the existence multicollinearity in the model.

**Table 4: Result of Random Effect model**

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Dependent Variable: LOGNCO  
Method: Panel EGLS (Cross-section random effects)  
Sample: 1 132  
Periods included: 13  
Cross-sections included: 8  
Total panel (unbalanced) observations: 71  
Swamy and Arora estimator of component variances

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.428508	0.389778	-1.099364	0.2758
GDP	-0.001553	0.005391	-0.287977	0.7743
CAR	-0.070901	0.027754	-2.554656	0.0131
LOGCIT1	-0.119792	0.089827	-1.333578	0.1871
LWOTA	0.004446	0.000329	13.53323	0.0000
R-squared	0.895821	Mean dependent var		2.507606
Adjusted R-squared	0.884245	S.D. dependent var		0.418898
S.E. of regression	0.142521	Sum squared resid		1.279665
F-statistic	77.38954	Durbin-Watson stat		1.464327
Prob(F-statistic)	0.000000			

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The result shows that out of four variables tested, two variables namely capital ratio and LwoTA were significant in reducing the loan write offs for banks resulting in stronger performance. The F-statistic that explains the overall significance of the model is found to be significant at 0.000 levels with adjusted R-squared of 0.8958. It shows that the regression model consisting of GDP, CAR, LOGCit1, LWo/TA could explain 89.58 percent changes in the effectiveness of recapitalization measured by logNCO.

## 5. Conclusion

This study evaluates the effectiveness of capital injection in Malaysian banks as a result of recapitalization policy made by the Malaysian central bank to strengthen the country's banking sector. Using a panel data of individual bank, we empirically estimate the effectiveness of bank recapitalization or injections. Overall, the result shows that the capital injections have had an effective and significant impact on the Malaysian banks. Out of four variables tested, two variables namely, Capital Ratio and Previous Capital Injection were significant in reducing the loan write offs for banks resulting in stronger bank performance. The result implies that the Malaysian banks benefited significantly from the capital injection policy. Notwithstanding that, future research should extend this framework to include new financial variables such as operating profit to total asset, bigger sample comprising local and international banks from selected countries for comparative evaluation and use a new methodological approach.

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## Determinants of Sales Force Performance in Banking Sector: A Case of Malaysia

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**Abstract:** Globalisation, deregulation, technology, competition and new customers' needs influence the banks to adopt marketing approach in promoting their product and services to generate income. In this aspect, personal selling which focuses on selling skills of banking employees becomes a very important banking function. This study intends to investigate the relationship between the determinants namely teamwork, learning, leadership, communication and, high performance culture and Key Performance Indicators (KPI). In spite of the importance of KPI in measuring performance of salesforce, there is a lack of published empirical findings to explain the influence of these predictors on KPI achievement in banking sector. This study reported that the model explains 0.21 percent of the variance in KPI achievement. In which teamwork and high performance culture are found to be positive and significantly related. This new finding appears to imply that bank should cultivate and promote teamwork and high performance culture to ensure KPI highly achievable and enhance banks profitability.

**Keywords:** *Salesforce, banking, KPI, high performance culture, teamwork*

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### 1. Introduction

Globalisation, deregulation, technology, competition and new customers' needs influence the banks to adopt marketing approach in promoting their product and services to generate income. In this aspect, personal selling which focuses on selling skills of banking employees becomes a very important banking function. With the advancement of technology, rapid development in innovative products in financial services industry banks become more competitive in terms of achieving and sustaining high profit performance. As a strategy banks employ staff to be involved in sales of banking products and services. Sales in banking cover two types of financial products and services; i) interest-based ii) fee-based products. Interest-based products comprise of mortgage loan, Bumiputra Unit Trust loan (ASB) and personal loan while fee-based products covers investment products, bancassurance (health insurance, education insurance etc) and credit card. In term of customer-type, the sales force has to target two major types of market segments namely corporate customers and retail customers. In term of scope, sales involve direct sales and cross selling. Direct sales are those sales involving pre-determined products such as mortgage loans, ASB loan while in cross selling, the sale force has to sell products which are complimentary to the pre-determined products and other products determined by the bank's management. For example in selling mortgage loan, the sales force will also sell MRTA (Mortgage Reducing Term Assurance) and other products; internet banking services.

Nowadays, banking industry is highly affected by intense competition. However, the existing performance measurement is traditional in nature and become less competitive in the new banking environment. Presently, many banks are using the modern approach of performance measurement called as Key Performance Indicator (KPI). KPI has gained increasing popularity and attention among the industry players but not among the researchers. Hence, this paper provide the empirical evidents on performance measurement in banking sectors using KPI. The merits of KPI is that it measures both financial and non-financial results and it is also robust in nature because it consists of four performance elements namely financial, customer, process and learning growth. The performance observation under financial are on achievement of sales target, acquiring new and retaining customers, while for customers; improvement in turnaround time and service index. The performance observation under process is the ability of sales force to maintain or improve from previous years' audit rating. Learning growth elements on the other hand is measured by the numbers of times the salesforce attending courses and training for period under review. Therefore, the existing performance measurement in banking sector needs a new performance measurement such as KPI in order to achieve both operational and financial goals.

KPI originated from the balance score card (BSC) used by organization as performance measurement system to measure both organizational and staff performance (Karr, 2005; Kuvaas, 2007). Based on the balance score card Wua, Tzeng & Chen (2009) improved the system to produce KPI as a new system of performance measurement in bank. Callahan (2003) discovered several benefits of the new performance measurement. First, KPI links employees' current performance with his/her previous performance or against his/her banks' target. This analysis will reveal the degree of changes between actual achievement and target as well as the improvement required in the future. Second, KPI is target set by bank with a date for accomplishment. The accumulation of individual sales target forms the overall banks' (Callahan, 2003). Third, it is very vigorous as it measures both financial and non-financial results achieved by the sales force. Forth, KPI also builds flexibility into the performance measurement system and reaps an acceptance by all levels of management (Crandall, 2002). Since some banks are still using balance score card (BSC), while others employ the new method using KPI; the performance measurement in banking industry becomes more complex and challenging. Todate, hardly any empirical academic research has been published involving salesforce performance measurement using KPI. The only published finding is by Zakaria et al. (2011) but this study involved KPI achievement government servants in Malaysia. Due to lack of empirical research it is the objective of this paper to investigate and to present the findings on the determinants of salesforce performance based on KPI application.

**Problem statement:** One of the main problem faced by Malaysian banks is the difficulties to identify factors that enhance salesforce's performance. This is important because salesforce's performance contributes significantly banking group performance. Nowwithstanding that little reserach has been undertaken specifically to identify the factors which could enhance salesforce's performance. The gap in this area has resulted in no systematic identification of factors both at individual and organizational levels. A survey report by CSO in 2011 revealed that, only 53.3% of the sales force achieved or exceeded their targets. The finding suggest that banks need to identify the types of characteristics of the performing salesforce. Therefore, further investigation need to be undertaken to address the problem of handling the 46.7% of the sales force that have not met or exceeded their targets. Many practices today use psychometric test to screen potential sales perfomers. With many factors existing in psychometric test, bank management often to get confused as to which factors should be given priority while selecting candidates for sales force position. There is no matrix containing salient factors would could help bank management in their selection decision. The unavailability of such matrix constraints wider application of psychometric test in the banking industry.

## 2. Literature Review

Verbeke, Dietz & Verwaal (2011) conducted a study entitled: Drivers of Sales performance: A contemporary meta analysis: Have salespeople becomes knowledge workers. The study produces evidenced that the following factors are among the drivers of salesforce performance: communication, learning, leadership, culture and teamwork. The following are related literature review on variables.

**Communication:** Scudder & Guinan (1987) conceptualized communication competence by using three dimensions which are encoding, decoding and maintaining user relation. Encoding and decoding is referring to the ability of individual to understand another person and to communicate the idea to other persons effectively selling (Govaerts et al., 2011). Both dimensions are the traditional way to measure communication competency. While, maintaining user relation means that the ability of individual to communicate in relation to the specific task. Communication competence is essential in personal selling as it permits an interaction between sales force and customer which in turn leads to success in selling ( Govaerts et al., 2010). Along with this line of thought, Mantrala, Sridhar, & Dong (2012) found there are no significant differences in term of communication skills requirements for three types of sales jobs namely balanced firm, customer acquisition and customer retention. Good communication skills like persuasion, written, oral and nonverbal skills are expected from sales recruiters in all positions. It has been proven as communication skills recorded a very high importance ratings by the vast majority of respondents in past surveys of salesperson success factors which has been done in the developed world.

Downing (2011) found changes in pitch and volume, used language that customer can understand, used short and affirmative word, and listen to customers are elements classified as communication competence among the call centre agents in Western United States. Goebel, Deeter-Schmelz, & Kennedy (2013) also found listening skill was important to sales job and it was reported significant with salesperson self-efficacy. The researchers also reported self-efficacy is positively influenced customer relationship development, representative job performance, and satisfaction with the manager. This finding strengthens Fohlke (2006) who found communication competence (presentation skill) is positively correlated with sales performance. It is also supported Johlke & Duhan (2001) who found communication quality is strongly associated with salesperson communication satisfaction. In turn, communication satisfaction is positively associated with job satisfaction and organizational commitment.

**Learning:** Bell, Mengüç, & Widing (2010) defined learning as the sales force's ability to create knowledge through the transformation of experiences and through testing the concepts. While, Kohli et al. (1998) define learning as a sales force's self-improvement in term of skills, knowledge and abilities that lead to a better performance. Hence, sales force with learning orientation has a strong desire to improve and master their selling skills and abilities continually. Bell et al. (2010) reported that learning ability was significant with store performance among the retail salesforce. This finding supports Kohli et al. (1998). The researchers posit that learning is very important as it is a source of a company's competitive advantage.

**Leadership:** According to MacKenzi & Podsakoff (2001), transformational and transactional leadership behaviour have been widely research. Transformational leadership behaviour is a leadership style which emphasises on articulate the vision, provide appropriate role model, foster the acceptance of goal, provide individualized support and intellectual stimulation and express high performance expectation. While, transactional leadership behaviour is more related to leadership style that emphasises on reward and punishment or feedback. Recently many literatures discuss on servant leadership which is a new paradigm of leadership behaviour. According to Jaramillo, Grisaffe, Chonko, & Roberts, (2009), the leader who posses servant leadership will consider the needs of the followers as his priority. Chen & Silverthorne (2005) argued that leadership behaviour help employees to increase their job performance and job satisfaction. On the other hand, it can reduce job stress and turnover intention among the employees. This finding is consistent with Yukl (2012) who contended leadership style in an organization is able to influence and facilitate individual employees and collective efforts to accomplish shared goals or improve performance.

Shannahan, Bush, & Shannahan (2013) found that sales performance will be higher under influenced of transformational leadership among the salesforce in food an beverages companies in United States. This finding supported Verbeke et al., (2011) empirically reported that supervisory leadership particularly the transformational leadership has positive, significant impact on self report performance. Panagopoulos & Dimitriadis (2009) on the other hand provided an evidence for the mediating effect of transformational leadership on behaviour based control and sales person key outcomes. The researchers also found transformational leadership has positive relation with affective commitment and satisfaction with supervisory. For this study, leadership style that focus on articulate visionary will predict sales performance and the retention among salesforce. Articulate visionary leadership style has been defined as leader's/manager's behaviour that is aimed at the identification and expression of a clear vision in future (MacKenzi & Podsakoff, 2001).

**High performance culture:** Organizational culture has been defined as pattern of values, beliefs and expectation shared by members of organization which produce norms to shape and controls the behaviour members (Williams & Attaway, 1996). High performance culture on the other hand has been defined as a demonstration of both high levels of engagement (passion, commitment and drive for results) among the employees and a strong alignment of people practices with organization strategy and brand (Nesbit, 2005). While, Robson (2005) found that employees who embraced high performance culture will do their daily operational activities and also to continually assist in improving the organization performance. Doç, Akdem, & Erdem (2010) on the other hand reported that high performance culture provides employees with the accountability and responsibility necessary to meet customers' needs in a timely manner in order to ensure business success. Mualla (2011) described the employees of high performance culture as "engaged" with organization.

Hence, the difference between ordinary organizational culture and high performance culture is the level of employees “engagement”. Harrim (2010) put forward that engaged employees will work significantly as compared to others. As a result they more likely to stay with the company and better at generating customer loyalty (Mualla, 2011).

**Teamwork:** Griffin, Patterson, Malcolm, & West (2001) assert that teamwork requires employees to work cooperatively to achieve a group’s goals. El-Ansary, Zabriskie, & Browning (1993) defined teamwork as the deliberate actions taken by management to ensure that the support needed by sales force will come from both the internal company units and the managers. Spencer & Spencer (1993), teamwork implies a genuine intention to work cooperatively among the employees in organizations and it eliminates the elements of competition. In addition, Harrim (2010) affirmed that teamwork reflects organization’s vital quality. Therefore the implementation of teamwork can accomplish the sales objective and assure customers’ satisfaction in sales organization(El-Ansary, Zabriskie, & Browning, 1993), foster commitment and team spirit with others for achieving goals (Rodriguez, Patel, Bright, Gregory, & Gowing ,2002) and motivate to work and increase job satisfaction. Piercy, W.Cravens, Nikala, & Vorhies (2006) reported team building has direct impact on salespersons’ outcome performance. This finding is consistent with El-Ansary et al. (1993). The in-role performance is found partially mediated the relationship between teamwork and salesperson outcome performance in Piercy, W.Cravens, Nikala, & Vorhies (2006). Teamwork however has a mixed result with job satisfaction. It was found significant but with inverse relationship with job satisfaction (Griffin et al., 2001) and not significant at all with job satisfaction (Loveland, Lounsbury, Park, & Jackson, 2015). Albrecht (2013) showed team climate was positively associated with engagement and job resources in multi-national company.

**Table 1: Key Performance Indicators for Banking**

<b>Key Result Areas (KRAs)</b>	<b>Key Performance Indicators (Titko &amp; Lace, 2010)</b>	<b>Key Performance Indicators (Wu et .al, 2009)</b>
Financial	ROA, ROE Cost/Income Ratio Revenue For New Products Revenue per Salesperson Market Share for Asset Market Share for Deposit	Operating Revenue (Sales revenue) Debt Ratio Return on Asset (ROA) Earnings Per Share (EPS) Profit Margin Return on Investment (ROI)
Customer	Customer satisfaction and loyalty index Revenue and cost for customers Customer Retention Rate New Customer Acquisition Rate New Customers per Employees Number of customers complaint	Customer Satisfaction Profit per Online Customer Market Share Customer Retention Customer Increasing Rate Profit per Customer
Internal process	Request Fulfilment Time Transaction per Employees Number of Errors according to Audit Result Customers Complaint	Number of New Service Items Transaction Efficiency Customer Complaints Rationalization Forms and Process Sales Performance Management Performance
Learning and Growth	New Revenue for Salesperson Sales Contact per Salesperson Number of Sold Product by Salesperson Number of Errors per Employees Qualification Test Results	Response of Customers Service Professional Training Employees Stability Employees Satisfaction Organization Competence

Source: Titko & Lace (2010) and Wu (2012) adopted from Wu et al. (2009)

**Key Performance Indicator (KPIs):** The traditional salesforce performance measurement tool has been criticized in literature. Crandall (2002) pointed out that conventional performance measure which is stressing more on financial performance but less on quality and customer service as incompatible. He suggested the existing performance measurement needs an improvement particularly in achieving both operational and financial goals. Grasing (2003) highlighted that the performance measurement in banking industry is more challenging. This is because banking industry is exposed to rapid changes in technology, delivery channels, and sales strategy, segmentation and management practices. Hence, banks continually need to respond to the changes either by changing objectives, shifting resources or varying its operational tools. Karr (2005) found that many organizations use key performance indicators (KPIs) to measure both organizational and staff performance. Harim, (2010) provides evidence on the utilisation of KPIs at organizational level in pharmaceutical industry. This study was extended to banking industry by Wu (2012) and he found the most essential KPIs elements for banking performance are customer satisfaction, sales performance and customer retention rate. As far as Malaysian banking industry, Maybank Annual Report (2015, pp.38) has disclosed an evidence on the utilisation of KPI in Maybank. Other successful financial service companies which are adopters of KPIs are Unibanco (Brazil), DnB Nord Bank (Scandinavian and Baltic region), Nordea Bank (North Europe and Baltic region), Chemical Bank (USA), KeyCorp (USA), Bank of TokyoMitsubishi (Japan), Wells Fargo Bank (USA), Lloyds TSB Bank (UK) and others (Titko & Lace, 2010). Table 1 presents Wu (2012) on selected KPI for retail banking.

### 3. Methodology

**Sample:** In this study eight commercial banks were selected and the data required comprising branches distribution by states as at December 2013 and the number of sales forces per branch were taken as at December 2013. This study used survey method where respondents were personally approached by researcher or researcher representative by giving them a copy of the questionnaire. The sample was selected from three regions of Malaysia (Northern, Central and Southern. The sampling procedure used for this study was stratified random sampling (SRS). First, stratification was done on the banks where banks' branches were proportionately determined. Next, stratification on branches was done by region. Based on this stratification the number of respondents (sales force) was total 4242 (1414 branches x 3 sales force.). This estimation method is based Jantan & Honeycutt (2013). To ensure the minimal response number obtained and taking into account that survey method has high probability of poor response rate, the researcher summed that 600 questionnaires must be distributed to the identified sales force (Nik Kamariah, 1995). Banking sales forces who participate were given three weeks to complete the survey. The survey package consists of a cover letter and one printed copy of questionnaire in English. Two weeks after the questionnaires have been distributed, the researcher reminded the respondents to complete the survey. On the third week, the researcher collected the completed survey from the participating sales forces for analysis.

**Survey Measurement:** The researcher used two types of scale in the questionnaire. In the first part of the questionnaires, the researcher used the 5-Likert scale. While, the second part of questionnaire consisted of 13 respondents' demographic related items and organizational information. Learning competency was measured using adapted instrument used by Kohli et al. (1998). It involves six items on a five -point Likert-type scale ranging from "1=strongly disagree" to "5=strongly agree". The reliability measured in their study was 0.79. The instrument for communication chosen for this study was adapted from the Scudder and Guinan (1987). These three dimensions inclusive of seventeen items scale used to measure the effective communication competency. This study employs five-point likert type-scale ranging from 5 = very important, 4 = important, 3 = not sure, 2 = less important and, 1 = not important. Salesforce perception on an articulate visionary leadership was measured using five items measurement adapted from Schwepker and Good (2010). This study employs five-point likert type-scale ranging from 5 = strongly agree, 4 = agree, 3 = not sure, 2 = disagree and, 1 = strongly disagree.

The sales force perception on high performance culture in bank was assessed using an eleven-item scale. Six items were adapted from Nesbit (2005), while the other five items were adapted from Harrim (2010). Respondents viewed high job quality in banking on a five point-likert scale-type, ranging from 5= always, 4 = often, 3 = not sure, 2 = seldom, and 1 = never. Salesforce perception toward sales teamwork has been developed based on work done by Mualla (2011) and Spencer and Spencer (1993). The questions regarding this sales teamwork were measure using five items scale. However, for the purpose of presence study, the wording of four item scales drawn from Mualla (2011) was modified slightly to match the domain of local bank sales force. This study employs a five point-likert scale-type, ranging from 5= strongly agree, 4 = agree, 3 = not sure, 2 = disagree, and 1 = strongly disagree. A self-report measurement was used to measure KPI achievement. The performance measured used in this study was summated scale comprised of seven KPIs items as reported by sales force and their sales manager through focus group exercise. This approach is similar to Dwyer et al. (2000) who also used the items which reported by insurance agent. A five-points Likert -type scale was used to assess sales force relative performance within the banks (with 1= indicating for far below target, 2 = below target, 3 = meet target, 4 = exceed target and, 5 indicating far exceed target). Dwyer *et al.* (2000) had used this summated scale to measure respondent-generated performance among insurance agent. In the present study, salesforce KPIs achievement was generated by respondent or self-reported performance. Respondent-generated performance measures was commonly used in sales research (Johnson & Sohi, 2014; and Shannahan et al., 2013).

#### 4. Results and Discussion

**Measurement and validation:** The model has been assessed using SPSS Version 19. Firstly we employed factor analysis to purify measurement items for each construct. Two separate factor analyses have been conducted on independent and dependent variables respectively. The items with poor factor loading which is below 0.45 and /or with cross loading (load more than 0.35 on more than two factors) have been deleted. All items have significant loading between 0.49 to 0.79. The result of principal component analysis on the independent variables revealed eight factors with eigenvalues greater than 1.0, which explained 66.08 percent of total variance. The first factor explained 37.11 percent of total variance. However, due to cross loading, only six factors were retained. After re-run the factor analysis the result of principal components analysis on dependent variable revealed that the total variance is 58.46 percent in one component. The result from factor analysis, showed that KPI achievement (DV) secured 58.4 percent of total variance from principal component analysis. This is a unidimensional construct. Table 2 shows the result regarding reliability statistics for variables used in this study. The cut of point for reliability values is set at greater than 0.7.

**Table 2: Cronbach Alpha Value for Variables**

Variables	Cronbach $\alpha$ values
Learning	0.826
Interpersonal Skill	0.724
Presentation Skill	0.852
Articulate Visionary Leader	0.901
High Performance Culture	0.906
Teamwork	0.878
KPI Achievement	0.849

Based on the result of factors analysis, this study has six hypotheses to be tested.

H1a: There is a positive and significant relationship between sales force learning and KPI achievement.

H1b: There is a positive and significant relationship between sales force interpersonal skill and KPI achievement.

H1c: There is a positive and significant relationship between sales force communication and KPI achievement.

H1d: There is a positive and significant relationship between articulate visionary leader and KPI achievement.

H1e: There is a positive and significant relationship between high performance culture and KPI achievement.

H1f: There is a positive and significant relationship between teamwork and KPI achievement.

**Demographic Profile:** This section reports the demographic profile from the respondents. Out of 201 questionnaires collected from the respondents, 197 were useful for analysis, hence the response rate was 32.83 (197/600). The breakdown of the respondents is as follows. 55 respondents from Maybank (27.9%), 50 responses from CIMB (25.4%), 14 from Public Bank (7.1%), 25 from RHB Bank (12.7%), 13 from Hong Leong Bank (6.6%), 11 from Affin Bank (5.6%), 28 responses from AmBank (14.2%) and only 1 from Alliance Bank (0.5%). 158 respondents are (80.2%); permanent while 39 (19.8%) are contract staff. Respondents were requested to answer several demographic questions such as their gender, age, academic qualification, race and religion. The result shows that gender distribution is slightly higher for females (60.4%) compared to males (39.6%). While for age distribution, majority of the respondents are in aged range between 25 and 44 (92.9%), and out of this percentage, 52.8% of respondent are in age range between 25 and 29. Thus, it can be concluded that the sales force in Malaysian banks are relatively young. This was expected as the banks do have problem in retaining senior sales force and in addition senior employees are reluctant to fill up the sales position.

Most of respondents (184) or 93.4% of sales force had diploma to master qualification. While, the remaining of respondents (13) have professional qualification and others. In terms of ethnicity and religion, the majority of the respondents are Malays (71.6%) and Muslim (71.6%), followed by Chinese (20.3%) and Buddha (21.3%), Indians (7.1%) and Hindu (6.1%), and others (2%). Respondents were asked to provide information on job related such as their job tenors in same banks and sales position, performance, branch location and region. 107 respondents (54.3%) had 1 to 5 years works experience in the same banks, whilst 38 respondents (19.3%) already worked in the same banks between 5 to 10 years, followed by 32 respondents (16.2%) who have more than 15 years experienced in the same banks. Only 6 respondents (3%), who work less than 1 year in the same banks. In term of job tenors in sales position, majority of the respondents 53.3% (105 respondents) had worked in the hotel industry for more than 1 year to 5 years. 31.5% of the respondents indicated that they had worked in the sales line between 5 years to 10 years, 5.6% had been worked between 10 years to 15 years, 7.6% had worked more than 15 years and only 2% had experienced less than 1 year. 157 sales forces respondents (79.7%) are working in urban area and only 40 of them (20.3%) are working in non-urban areas. In term of regional distribution, 98 sales forces (49.7%) came from Northern, 68 sales forces (34.5%) were from Central and the remaining 31 sales forces (15.7%) from Southern region.

**Test for Hypotheses:** The hypotheses were tested using multiple regression analysis and the result is shown in Table 3. The six variables collectively explains 21 percent of the variance in KPI achievement ( $R$  square = 0.21). Two of the six variables were significant namely HPC and teamwok and the remaining four were insignificant.

**Table 3: Determinants of saleforce performance (KPI Achievement)**

Variables	Regression Coefficient	Beta Coefficient	t Value	p Value
Learning	-.121	-.125	-1.349	.179
Interpersonal Skill	.079	.073	.784	.434
Communication Skill	.185	.160	1.658	.099
Leader	-.036	-.042	-.471	.638
Hpc	.201	.210	2.068	.040*
Teamwork	.218	.251	2.695	.008**

Note: \* $p < 0.05$ , \*\* $p < 0.01$

### Analysis of Results

**Learning and KPI Achievement:** The present study finds a negative and insignificant relationship between learning and KPI achievement. This means that the ability of sales force's to learn did not strongly influence KPI achievement which is supported by Kohli et al. (1998). They found that the ability of sales force to learn in two Fortune 500 companies which operate in industrial market did not give the impact to their sales performance. It is possible that the impact from ability to learn does not influence performance in short term however; it may influences sales force performance in long term.

Hence this result does not support  $H_{1a}$ .

**Interpersonal Skill and KPI Achievement:** The coefficient estimation of interpersonal is 0.07 with t-value of 0.784 ( $p > 0.05$ ). This result indicates that a 0.07 point increase in interpersonal skill resulted of 1 point increase in sales force KPI achievement in Malaysian retail banks. The absence of significant relationship between interpersonal skill and KPI achievement may be explained by lesser time provided by sales force for interaction successfully with others particularly with customers. However, the positive sign of the estimate indicates that the more time the sales force spends to build the relationship with their customers the higher will be the KPI achievement. Therefore, hypothesis  $H_{1b}$  is rejected.

**Communication and KPI Achievement:** The result shows that there is a positive and not significant relationship between communication ability and KPI achievement, which indicates that higher communication could increase KPI achievement. The result is consistent with a study conducted by Verbeke, Dietz, & Verwaal (2011). They found communication is not significant with sales performance. The possible reason could be that the salesforce tends to communicate with their customers relating to the banking products that they wish to sell but the products that the customers' want. Once sales have been made, the salesforce in most cases, do not follow up with their customers on the after-sales services. Hence, it effects their KPI achievement in long term. This is also due to the fact that salesforce involves more on transactional rather than relationship selling.

$H_{1c}$  has not accepted.

**Articulate Visionary Leader (Visionary Leader) and KPI Achievement:** The coefficient estimation of visionary leader is -0.04 with t-value of -0.471 ( $p > 0.05$ ). This result indicates that an increase of 1 point in KPI achievement resulted of 0.04 point decrease in articulate visionary leadership in Malaysian retail banking. The result shows that there is a negative and not significant relationship between articulate visionary leadership and KPI achievement, which appears to suggest that articulate visionary leadership reduce encouragement among the salesforce to achieve KPIs. This finding inconsistent with Panagopoulos & Dimitriadis (2009) in USA. The result suggest that the salesforce may be dissatisfied with the articulate visionary leader in the banks. The articulate visionary leader is fundamentally changed the values, goals, and aspirations of followers. In this case, the followers are the salesforces. They might not follow the visionary leader if the values of the leader are not consistent with the work culture (Panagopoulos & Dimitriadis, 2009). However, according to Schepker and Good (1999) when performance KPI target is a dominant objective, the salesforce is willing to follow the visonary leader to make unethical decisions to make sure his/her KPI target will be achieved. It is more worsen when failing to achieve those KPI target will give the negative consequences to salesforce such as termination and reprimand (Schepker and Good 1999). This opinion is in contrast with the later finding of Schepker & Good (2010) who opined that the leader who articulates ethical principles would implement additional behaviors to avoid the potential adverse effects by the salesforce to the organization (Schepker & Good, 2010). Therefore,  $H_{1d}$  rejected

**High Performance Culture (HPC) and KPI Achievement:** The coefficient estimation of HPC is 0.210 with t-value of 2.068 ( $p < 0.05$ ). This result indicates that a 0.210 point increase in HPC, result in an increase of 1 point in KPI achievement among the sales force in Malaysian retail banks. The result shows that there is a positive and significant relationship between HPC and KPI achievement, which suggests that banks that embedded with HPC will support higher KPI achievement. This finding is consistent with Harrim (2010). One probable explanation could be that the banks with high performance culture promote high levels of engagement among their salesforce and a strong alignment of their people practices to achieve KPI targets (Nesbit, 2005). In other words, High performance culture motivates employees to improve performance by awarding them extrinsic rewards. In Malaysian banking sector, the salesforce will be rewarded generously if he/she achieve the KPI target. This practice is consistent with high performance culture organization which advocates a 'Pay for Performance Reward', where high performers are duly rewarded. Hence,  $H_{1e}$  accepted.

**Teamwork:** The result shows positive and significant relationship between teamwork and KPI achievement, which reveals that the banks which are fostering teamwork among their employees would most likely motivate their sales forces to achieve higher KPI. The result rejects null hypothesis and accept alternative hypothesis. The result in this study provides empirical evidence that of highly significant impact of teamwork

on KPI achievement ( $\beta = 0.251$ , t-Value = 2.695). This result is consistent with El-Ansary *et al.* (1993) and Rabey (2003) who found the performance could be enhanced by the synergy of teamwork. The possible reason could be regular interactions between the employees and superior will encourage, intensify the bonds, and create an auspicious of organizational environment. In turn, it would increase commitment to the work unit's efforts. Therefore,  $H_{1f}$  accepted.

## 5. Conclusion

The present research has set out to investigate the relationship between the determinants namely teamwork, learning, leadership, interpersonal skills, communication and high performance culture and Key Performance Indicators (KPI). The respondents of the study are sales force in eight Malaysian commercial banking groups. Out of the six hypotheses being examined, two were supported whereby demonstrated that the significant relationship between high performance culture and teamwork, and KPI achievement. The results from this study suggest that the bank should cultivate high performance culture in the organization and nurture teamwork spirit among the employees, hence can significantly boost KPI achievement. Recognizing the importance of high performance culture, banks should give emphasis and efforts to 'engage' more employees toward this culture. The results imply that the banks should revise and improve more teamwork related activities. These include initiative for more team building and training to all employees.

**Recommendation:** The banks are recommended to revise sales force performance incentives individual - based incentives to team-based. Formulate teamwork recognition policies also can foster the teamwork in the banks. Banks should now treat high performance culture and teamwork as critical component in sale activities of the banks. For further studies, researchers are recommended to examine the impact of micro economic variables on KPI achievement and sales performance in banking sector.

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## Paradigm of Islamic Education in the Future: The Integration of Islamic Boarding School and Favorite School

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**Abstract:** Islamic education goes into future options, and became a reference in developing the potential of learners and the embryo of world civilization; the progress of Islamic civilization was born of Islamic education quality. Therefore, islamic religious education should be managed professionally, based saintek and quality. Islamic educational system urgently reformulated in accordance with the dynamics of the times, the needs of the market, and based on local wisdom, thus bringing forth a superficial scientists clerics and scholars scientist. Methodology used in this research is qualitative research, this research works in Parepare city, with sample of excellent school and *Pesantren Al- Badar*. The result of study is the integration of the educational system, good educational system and system seed boarding school education, relevant done as an attempt to find the ideal model of islamic education and real in the era of globalization.

**Keywords:** *Excellent school, Integrity, Model of Islamic education*

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### 1. Introduction

Contemporary educational system is dichotomized by the importance of profane and transcendence. Therefore, education out-put gets various problems to survive in the wrestling era. On the other hand, there is a modern out-put and traditional out-put. Consequently, the convergence discourse of Islamic educational system dichotomized is urgent to be reformulated (Baharuddin & Sri, 2011). Historically, Islamic education in Indonesia which is still exist and consistent with cultural local is Islamic boarding school, yet in general, the weakness of it is lack of seeing the global knowledge in the future, Islamic boarding school is more strengthening or often called beyond education (Wakhuddin, 1998:207). Even though the appreciation of it is not necessarily corrected, yet this statement is able to be a "reflection" that Islamic boarding school is urgent to revival in answering the demand of the era. The discourse above is relevant and urgent to do introspection, reflection, prospection, and projection in formulating the Islamic educational system. The existence of Islamic education in the future is determined by integrating the ability culturally with the international system indicated with rational relation, dynamic and competitive (Mastuhu, 1999: 276). Islamic boarding school is faced by the acceleration of science and technology. Those are appropriately able to adapt and contribute the modern development. Besides, it has to maintain its own characterization as the basis of spiritual moral and its function in constructing the religious society. Islamic boarding school in the future is urgent to reformulate the system being the best choice in facing the globalization era. Accelerative change by the development of SAINTEK demands its adapting and contributing system. This change is appearing the combinations of Islamic morals, traditions, and developed cultures, so that the education will be integrative (Muchsin and Wahid, 2009: 70). Thus, the demand of collaboration of Islamic boarding school with favorite school is a choice on synergizing the advantage and reducing the weakness (Muhaimin, 2009: 105). Islamic boarding school is assessed as the basis of the religiosities and moral, then favorite school as the basis of science result and managerial. Synergistic of both educational systems is able to be an alternative of Islamic educational system connected with dynamic and the demand of the era.

### 2. Literature Review

**Islamic Educational system in Islamic boarding school:** Islamic boarding school is educational institution which is based on the Islamic principle. It is being a unique characteristic of Islamic education in Indonesia which it is based on the grass root societies. The Islamic institution has factually existed in over century. It is an indigenous education, then it got a modification of its educational system/mosque, curriculum, technique, teaching method, etc (Azra, 1998:91). Islamic boarding school got transformation and adaptation with the cultural local wisdom of archipelago and Islamic morals. The advantage of it is based on both integration and synergy of morals power. In this case, Islamic boarding school, as the community and the biggest educational

institution, has given an asset in creating the religious human (Tafsir, 2000:191). The institution has produced a lot of leaders in the past, present, and the future. Most of the graduated students of Islamic boarding school took participation in developing nation. We can see the mission of 'Islamic boarding school' as a big asset on producing religious generation and developing nation. It is because of the central orientation of Islamic boarding school is learning creed (Tafsir, 2000: 230).

Zuhri (2002: 51) defines Islamic boarding school is a system of *tafaqquh fi ad-din* which is usually backing up by some components either software nor hardware supporting the existence of Islamic boarding school as a system such as *kiyai*, *santri*, tradition of reciting the holy *qur'an*, guardian's home, mosque, and the classroom placed for staying in Islamic boarding school. As the institution of *tafaqquh fi ad-din*, this function to keep, develop, report, and conserve the Islamic religion, and of course it wants to produce Islamic religious teachers. It is the same as what Prasojo said (1982:2) that Islamic boarding school is an educational institutions and teaching of the Islamic religion generally using non classical method which *Ulama* teaches Islamic knowledge to *santri* based on the verse written by using Arabic language or *Ulama* in the middle century, and *santri* are usually staying in the Islamic cottage. The uniqueness of Islamic boarding school as the Islamic institution is still exist in giving Islamic values to the societies with model, strategy, and individual approach. Buchori (1994: 3) reminds that Islamic boarding school is a part of internal structure of Islamic education in Indonesia conducted traditionally, Islam as the way of living. The life style in Islamic boarding school seems different with the environment such as simplicity life, leadership charisma, *santri*'s obedient, diligence of understanding the classical verse, togetherness, sincerity, etc. Islamic boarding school ratify the values of Islam through the local wisdom, and being a media synergizing both of norms which is culturally assessed very near and identical.

On the other than, Abdullah (1995: 3) describes that in every varieties, Islamic boarding school is a seedbed, experience, and also spreading the Islamic knowledge. This looks at the prototype of Islamic boarding school as educational and proselytizing institution. Next, Dhofier wrote that; cottage, mosque, *santri*, reciting the classical verse, and *kiyai* are five basic components of Islamic boarding school tradition, then she continued her theory that a reciting institution that has developed until it has those five elements, its status will change as the Islamic boarding school (Dhofier, 1990: 44). In scientific context, the existence of Islamic boarding school is realization of *egalitarisme* of Islam in scientific and human field. Because of it, every single Muslim having the knowledge, religious knowledge in certain aspect, is seen having the sacred aura (Azra, 1998: 88). This thing is clarification of three main functions, those are; transmission of Islamic tradition, maintenance of Islamic tradition, and candidates of *ulama*. Those three main functions above show the consistency at the Islamic pattern of Islamic boarding school.

Imam Bawani described the characteristic in the system and his philosophy. Those characteristics are:

- a. Philosophy of Islamic boarding school is traditionally characterizing *ahlu sunnah wal jamaah*;
- b. Islamic boarding school curriculum is only about Islamic knowledge;
- c. Using a classical teaching method;
- d. Simplistic and classical facilities;
- e. The environment of Islamic boarding school is mostly in the village;
- f. The relation between *kiyai* and *santri* forming intellectual geology and kinship (Bawani, 1993:108).

The identity of Islamic boarding school is the place and ideology fort of Islam from the intervention and contamination of imperialism. It is not only used to represent the tradition of Islamic education but also being a symbol of the Islamic local tradition. The identity of it is as the collaboration of Islamic substance and the local wisdom being a unique treasure in education. It is a symbol of the education unit integrating Islam and the local wisdom which are factually intellectual, emotional, spiritual, and social development. The purpose and orientation of it is being a modal to survive and exist in the globalization era. Islamic boarding school built in the educational system combined by history of archipelago. It has produced some good souls to ascertain the standardization of morals. These souls will be the characters which never be built by others educational system as a whole. Islamic boarding school's soul implicates in five souls:

- a. Sincerity
- b. Simplicity but prominent

- c. *Ukhuwah Islamiyah* which is Democratic
- d. Independent
- e. Free to choose alternative way of life and decide the ambition seriously and optimistically to face problems of life based on Islamic morals (Siradj, 1999: 216).

Soul or Spirit of character which is built by Islamic boarding school implicating with the learning attitude and diversifying. The attitude of studying can construct the *santri* because of concern and togetherness constructed in their community. It is also happening in the attitude of diversity which is being powerful and stable because they are remaining each other and using this tradition in their daily life collectively and collegially. Sincerity, obedience, patience, and giving thanks to Allah are being a requirement of life and studying in Islamic boarding school. Those things are being a factor of *santri* to be excited in doing worship, studying Islam, and living in the simplicity. Living in the Islamic boarding school gives advantages such as interaction between teacher and students intensively, controlling the student easier, giving simulation or stimulus of studying, and giving a good chance at the habitual. Learning system in the Islamic boarding school is generally traditional and nontraditional. Traditional method is offering with *balahan*, *weton*, *sorogan*, and nontraditional is the new method introduced to the institution based on the scientific research (Arifin, 2000: 209). There is an awkward thing inside of Islamic boarding school in maintaining its traditional method has been happening in the hereditary. Besides, methods are seldom to get sympathy. Furthermore, it is sometimes doubted by members of Islamic boarding school, whether it is influenced by *introvert* and *extrovert* leader in order to show, use, and produce the new methods needed to do the wise approaches for teachers in the Islamic boarding school (Rizkiani, 2012: 12).

In consequence, it is impossible to combine the curriculum among Islamic Boarding Schools when there are still big differences inside of educational system used in. This appears in the Islamic boarding school. Generally, it is not formulating the goal of education specifically elaborated in the complete and consistent system of education (Nata, 2001:167). Yet in general, the goal written in *Ta'lim al-mua' allims'* book created by Zarnuji (1963). Several moral guidance of Islamic boarding school is improving knowledge because of obligation honestly. On the other hand, religion studied is a basic moral bringing the education goal, creating a good human of having an Islamic awareness that Islam is comprehensive *weltanschauung* (Madjid, 1997: 18). In order to conduct the goal, it is needed to celebrate reciting the holy Qur'an which has a basic moral of Islam. Amount of book decided to be studied in Islamic boarding school is seen as its curriculum. Understanding the curriculum is same with the perspective of Nata, "Amount of subjects obligated to be passed in getting a particular educational certificate (Nata, 1997: 123), while Islamic boarding school curriculum is containing eight subjects, namely humaniora knowledge (Kuntowijoyo, 1994: 20).

Islamic boarding school's subjects contain Arabic language (tool science), *fiqh-ushul*, *tafsir*, *hadist*, *adab* (Arabic literature), attitude, *tasawuf* and *tarikh* (Dhofier, 1990: 20). Series of those subjects exist in every single book level which is containing two visions of education, those are; first is moral vision, it is teaching the attitude and *akhlakul karimah*, second is intellectual vision, it is improving the ability of thinking (Nata, 1997: 168). In several Islamic boarding schools, the implementation of educational system and teaching got the transformation because of the influence from science, technology, education in Indonesia, and the demand of the societies in the Islamic boarding school itself. Then, some of Islamic boarding schools are still maintaining their own old system. In this case, Ghazaly (2000: 32) defined teaching method in Islamic boarding school consists of two systems, those are:

- a. Traditional system:
  - 1) *Sorongan*, is the educational system which every *santri* is reciting Qur'an in front of *Ustadz* and *Kiyai*.
  - 2) *Wetonan*, is educational system which *Kyai* reciting Qur'an to the *santri*, then it is followed and seen by *santri*.
  - 3) *Bandongan*, is the combination of two methods above.
- b. Modern system:
  - 1) Classical system
  - 2) Course system
  - 3) Training system

The classification of Islamic boarding school is a reflection on responding the dynamic of era and dialectic of science and technology acceleration. Accommodative and rejection toward the dynamic is *ijtihad* of the

leader of Islamic boarding school regarding the ways that should be passed in order to develop the educational institution. One unique thing that it is still maintaining is expanding the characters through Islamic education culture in the Islamic boarding school's environment. In fact, the implementation of educational system and teaching at the Islamic boarding school is now classified in three forms:

- a. It is an educational institution and Islamic teaching generally given classically which the *kiyai* teaches *santri-santri* based on Arabic verse or familiar *ulama* since in the middle era, while every *santri* is usually staying in the cottage or dormitory of Islamic boarding school.
- b. It is the educational system and Islamic teaching basically similar with the Islamic boarding school above, yet every *santri* has no provide a cottage, but they lives in resident around it.
- c. Nowadays, it is the group institution between Cottage and Islamic School giving education and Islamic teaching by using *bandongan*, *sorongan*, and *wetonan* system. Every *santri* is provided a cottage or even *santri kalongan* which in modern education term fulfilled the criteria of the informal education, and also celebrate the formal education like *madrasah* until favorite school in every grade and various department based on their interest (Department Agama RI, 1985: 10).

Thus, the system of Islamic boarding school can be seen into three forms. First, there is Islamic boarding school which is complete with cottage and educational system for 24 hours, second is Islamic boarding school which has no cottage and educational system is only for particular times, and last is Modern Islamic boarding school which *santri* lives in the cottage and it has general subjects. The discourse of Islamic boarding school in applying good ideas, that educational system sees the Islamic educational system combining the deductive normative approach of Islamic values: *Al-Qur'an*, *As-Sunnah*, and law of *Allah* in the universe with descriptive-inductive approach that can preserve human aspiration and develop the culture based on the goal of independence by using a formulation of education program based on the output oriented (Faisal, 1995: 116). Global character in education of Islamic boarding school is very famous with *vis a vis* between power and weakness of Islamic education which comes from society and sometimes being orthodoxy, so that the management of Islamic education should dominate the four domain priorities, those are:

- a. Quality development.
- b. Innovation and creativity development.
- c. Networking the corporation.
- d. The realization of regional autonomy (Tilaar, 2000: 153).

In realization process of education, it is very influenced by the system of constructing the education. So in Islamic educational system, it can be seen with manifestation of Islamic morals and its learning is filled by Islamic education. The tendency of the contemporary Islam is massive effort at the scientific Islam in order to implement the influence of secularization and reduce the dichotomy of educational system. That awareness gives wish to the Islamic education development so that it can be survival in the wrestling civilization. This shows the indicator that Islamic education is an alternative way of the education development in the future. In the education management, Islamic boarding school is oriented to the talent, competence and skill, logic, critical, rational analysis and spiritual development by looking for abstract meanings in order to illuminate the living. In traditional Islamic boarding school, its education management is still filled by charisma and authority factor of *kyai*. Consequently, policy is still *top down*. It is an instructional policy of *kyai*. Besides, the modern Islamic boarding school has been shifting its management pattern. Simply, it has implemented the participative management. Participative management is one of the fundament indicators based on the school (MBS). MBS is a school management model which is very relevant with the educational autonomy, based on the circumstance of democratic societies (Suryosubroto, 2004; 31). The development of the society is stimulated by the acceleration of science and technology producing many demands and very complex needs. This has brought influence to the existence of Islamic boarding school in doing education process. It seems there are various models and educational system in responding the dynamic era, yet in general, it can be classified into two patterns, those are: Traditional pattern which is still consistent on the system and learning program by taking a few of general lesson, and the modern pattern combining the characteristic of Islamic boarding school (system and its learning program) and the characteristic of Public school containing science and technology. The collaboration of both approaches is being one of the forms of contemporary Islamic boarding school showing its own uniqueness and attractiveness.

**Educational system in Favorite School:** Indonesia is one of the countries which are in the low rating of quality of education in the world. Based on the yearly report of UNESCO *Education for All Global Monitoring Report 2012*, quality of education in Indonesia is on 64 of 120 countries in all around the world. This reality makes Indonesian worried which the quality of education is still anxious. It is far from the rating of Singapore and Malaysia. On the other hand, another realities portrays the quality of education especially of the Indonesian's students is getting achievement and award at the International event whether at the Physics, Mathematics, and Robot Olympiad. Those portray that the quality of education in Indonesia can compete in the international level, but it has not been equal in Indonesia as a whole. The implementation of *Undang-undang No.20 Year 2003* about National educational system is putting school as a part of subsystem of national education. School as the instrument to develop the innovation and discovery whether it is institutionally or even from its quality of out-put (Muhaimin, 2009: 35). The quality of school output has been determined in UUD 1945 *pasal 31 ayat 3* which is saying that the government effort and accomplish a national educational system improving creed, virtue, and ethics. This context emphasizes that education in the school level is guided to be a part of excellence to produce the intelligence, emotional, spiritual, and good vocational. The integration of the intelligence is relevant and urgent to be developed through education in the school as the form of penetration and up to date innovation in order to facilitate the appearance of good output.

The societies put their hope to the favorite school to educate the innovative and competitive generations. The favorite school got the trust from societies to entrust their children without thinking how much the payment will be spent. This reality makes the favorite school being a good business out of the particular mission of school built by the private. Favorite school implements the modern management giving a guarantee of the quality and leaning process of education. Therefore, the society is able to control and evaluate activities in the school. The societies' mindset is more trust at the vision, mission, goal, and reliable programs and getting the warranty of quality. Ontologically, the perspective of ministry of education at the favorite school is school developed to achieve the favorite output. In achieving the superiority, it needs input, learning process, teacher, educators, management, educational service, and facility to support the goal (Muhaimin, 2009: 39). This perspective describes the favorite school which has output indicators, process, supra structure, and infrastructure.

The indicators of favorite school portraying in the effective prototype of school. The criteria of effective school, based on Danim (2006: 62), can be seen as follows:

- a. Improving the standardization of working and clear about the goal of students to know and work for something.
- b. Stimulate the activity, multi cultural understanding, gender equality, and improving the learning process based on the potency standard had by the students.
- c. Expectancy of students to take the responsibility in studying and behavior.
- d. Having an instrument of evaluation and assessment of students' achievement regarding students' capability, deciding the meaningful feedback for students, family, staff, and educational environment.
- e. Using the learning method based on educational research and voice of professional practice.
- f. Organizing school and class to create the environment supporting the learning process.
- g. Making the democratic decision and accountability for students' success and satisfaction of user.
- h. Creating the comfortable, respect, and accommodate the environment effectively.
- i. Having the high wishes to all staffs to improve their capability in terms of professionalism and capability of practice.
- j. Putting the family in helping students to achieve their success actively.
- k. Cooperating with societies and other people to support students and their family.

Those criteria above portray the circumstance of the favorite school. Favorite school is created because it is managed by professional human resource, so that education process is running well and similar with the demands of era. Various things appearing in the favorite school is the excellent of academic service, based on the technology, educative environment, democratic management, participative management, partnership relation with societies, etc. The circumstance inside of school will give a good achievement compared with others school. The effective of School manager implicates on the process and result of the good education. The system of favorite school shows the programs and activities effectively, especially in education activities of

learning process. The more effective school's program, the more applicable the organization of favorite school will be. The characterizations of effective school are:

- a. Climate and School's culture;
- b. The higher wishes to get achievement;
- c. The observation toward the improvement of students;
- d. The leadership of headmaster;
- e. The involvement of parents in school's activities;
- f. Freedom, responsibility, and involvement of students in the school.
- g. The reward and incentive, and
- h. The implementation of curriculum (Arismunandar, 2005: 65).

The model of favorite school wished in the future is the good leadership of headmaster, partnership with the stakeholder, the invention of academic culture and scientific, future orientation, democratic circumstances in the school. The model of favorite school is an ideal thing and it is needed commitment and togetherness to achieve the target. Jarome S. Arcaro explains that model of favorite school should be supported by five pillars, those are (1) focusing on the users; (2) the involvement of all members as a whole; (3) doing measurement, (4) commitment on the change; and (5) completing it continuously (Danim, 2006: 13). School orientating with five pillars above will stimulate the process of dialectic to be good achievement. Knowing the target that will be achieved, empowering teachers professionally, utilizing facilities maximally, doing evaluation continuously, and being consistent on the change and always organize the system, will increase the change dramatically based on the dramatic era. Then, the characteristics of favorite school are:

- a. Focusing on costumer, whether to the internal or even external stakeholder;
- b. The total involvement, every people should participate in participation of mute;
- c. Measurement, measuring the affectivity of effort in fulfilling the standard;
- d. Commitment, every supervisor and school board must have commitment on the mute;
- e. The continue revision, repairing process continuously and make the necessary revision (Arcaro, 2007: 4).

In management perspective of mute at the education unit, school categorized as the favorite school should enclose these three aspects; those are suggestion to school which new students are being a target of school. Domain of intelligence quotient, emotional, and spiritual of candidate students ought to be on the selection test. Consequently, the selection test of new students should measure those three aspects of intelligence or even measure multi intelligence. The goal of test is to know the level of students' intelligence. This data of the students' intelligence can be used as a standard to determine their guiding process or even determine the target or education direction in the future (Trimantara, 2007; 7). In designing the favorite school, it should be described by input, process, output, outcome, and benefit impact way. The school's conceptions (The formal institution of education) are to care for the reproduction, awareness, and mediation simultaneously. Those school's functions are collected by education and learning process as a core business. School's main stream can be favorite if it has good systems whether its superstructure and satisfying infrastructure. Like in education components, favorite school, even from its learning program, curriculum, students, teachers, facilities, funding, the good relationship among societies. Thus, favorite school can be seen from infrastructure, funding, and the satisfying of its human resources. So that, in implementing the education and teaching process, those are necessary to create the good process which at the end it produces good outputs.

### 3. Methodology

The method of this research is qualitative research, this research work in Parepare city, with sample excellent school SMAN 5 Parepare and Madrasah Aliyah Pondok Pesantren Al- Badar. The characteristic of this research is comparative study, the second unit education with take overbalance system education and learning. Overbalance the second unit education with integration and formula of construction educational system is relevant with social dynamic and acceleration science. Energy source is headmaster, document of teacher, triangulation and focus group discussion for getting expert judgment education field.

#### 4. Results and Discussion

**The Reformulation of Islamic Educational system in the Future:** Graduated students in the future are facing several of awful obstacle, those are global acceleration implicating on the competitive, individualism, secularism, materialism, etc. In facing those obstacles, school, as the place to develop potency of students, is demanded to prepare graduated students who can perform and survive in the globalization era. Those descriptions are expected to create good human. The indicator of good human is the person who realize about science, technology, creativity and morals are having the best role in facing the globalization era (Nizar and Syaifuddin, 2010: 89). Human's visions in the future are always orienting on utilizing and empowering science and technology followed by creativity, innovation, strong characters and human solidarity. Based on the phenomena and the demand of globalization era, therefore it is needed the development of quality of good education. Umar Juoro assesses that it is urgent to anticipate the change of competition decided by the quality of human resource and the ability of technology (Juoro, 1996: 168). The quality of education can be seen by its indicator which it can produce graduated students having the competitive human resource and be able to use technology.

The role of education is preparing individual and society; therefore, they have ability and motivation and participate actively on articulation and institutionalization of civilized society. Education has to be able to produce good human intellectually, morally, master on science and technology, and having a high commitment in every social pattern. At the micro level, the democratic education is needed decentralization and pluralism orientation. All these are reflecting on equity and accessibility of education chance (Nizar & Syaifuddin, 2010: 92). The paradigms of Islamic educational system are developing the Islamic education by using multidisciplinary and interdisciplinary approach. Multidisciplinary approach is a form of the development of scientific knowledge in every single aspect, and interdisciplinary approach is intensifying the scientific knowledge in one cluster. The deepness and wideness of scientific knowledge can be realized to face the era, market, and the demand of scientific dynamics. The paradigms of Islamic education have to be established with strong foundation, scientific and based on the local wisdom.

Islamic boarding school as the educational institution is still *istiqamah* and consistent in doing its role as the central of intensifying the Islamic knowledge (*tafaqquh fiddin*), Islamic proselytizing institution, and participating to educate Indonesian which has been trusted by the society (Nizar & Muhammad, 2010: 191). Islamic boarding school is on the domain of Islamic science development as the basis of characters affirming of students in giving contribution to develop the country. Then, public school is very important to develop the intelligent quotient, science and technology as the modals of competitive era. Therefore, the paradigm of developing the education unit in the future is synergist and collaboration of educational system of Islamic boarding school and public school, which those are more popular with *boarding school*. Boarding school is model of educational system integrating Islamic boarding school and public school's system. The combination of those education models is being an ancestor of the appearance of the new Islamic education which is representing Islamic, scientific and technologic tradition. The graduated students are wished getting the good provisions and global knowledge.

The steps of straightening above have to consider at least six things:

- a. The goal of education in the future is need to fulfill the willingness, wish, and needs in the future.
- b. The goal of global education is need to be guided on improving the technology and information.
- c. The goal of global education has to be guided on economic problem understanding, language politic and global culture.
- d. The goal of global knowledge is appropriate to be guided in the tight competition in every aspect among nations.
- e. The goal of global education has to be guided on mastering language, so that it can be active in the international life.
- f. The goal of global education especially on economic sector, business, and monetary need to be guided to achieve the affectivity and efficiency of production tools and service globally and competitively in the era of free market (Bastian, 2002: 62).

The education of global orientation is ideal vision. It is because of being adaptive and accommodative toward the social condition and able to answer the phenomena by using the proportional ideas. Through this education, there are therefore eight preparations to face the future, those are:

- a. Potential reading toward life they faced in.
- b. Potential answer toward problems that appear.
- c. Individual integration (abolishing the split of personality).
- d. The ability of spreading the Islamic mission.
- e. Perceptual integration (abolishing the dichotomy of perception).
- f. Cosmopolitan integration.
- g. The ability of keeping the nature.
- h. Science input, technology and methodology (Getteng, 1997: 6)

Therefore, favorite school in perspective of Islamic education as a shoulder strap of glorious morals is:

- a. Islamic education as one of cultural power is history, religious, and moral value.
- b. Balancer and secular education is containing futuristic values and observer of glorious values.
- c. Islamic education is containing the alternative education by proposing the democratic and independence value (Tilaar, 2002: 80).

Islamic education is assessed as the solution for human development as a whole, because its graduate students are directed to the faithful personal establishing and able to care for *khalifah* in the profound dogmatically. It should be established from collaboration of two characteristics of education model, namely Islamic boarding school and Favorite school. Islamic boarding school as a place to create religious values and students' morality as the basis of spiritual and emotional quotient (SEQ), and favorite school as a place to develop science and technology as the basis of intellectual and vocational quotient (IVQ). Students should be collected at the complex of education unit so that they can study for 24 hours (*boarding school*), the habitual of *akhlakul karimah* (character) are being more effective, improving the mindset and better vision in the future. Model of Islamic education unit is accommodating the ability of leadership, managerial, and administrative system in the favorite school to complete the attitude and leadership character which are charismatic and respected in the Islamic boarding school. The curriculum being united (Islam, Science, and Technology) will give solution of the superior generation establishment and having civility. Cultural research in the favorite school gives a positive value of scientific tradition in Islamic boarding school, so that it will be more adaptive and functional of Islamic science with the social life dynamic and technology. The description of future school of Islam is being an ancestor of the appearance of Islamic civilization in the globalization era.

## 5. Conclusion

Islam as a universal religion and related in every single aspect which is familiar with dogma Islam *rahmatan lil alamin*. As the religious civilization, Islam has to survive through the relevant system of education with progression era. The history in Indonesia, education unit as an icon of Islam is Islamic boarding school is assessed as the representation of Islamic science, while it has to interact with sciences acceleration and technology as the effort of the implementation *rahmatan lil alamin*. Consequently, favorite school as the science and technology representation are along with modern education are urgent to integrate with the system of traditional Islamic boarding school in order to give a better solution of achieving the goal of Islam. The solution is Islamic boarding school system is still maintained at the academic cultural aspect which propose creativity. Community aspect at the area of *ushuliyah* religion and *akhlakul karimah*, and then creativity aspect is at the rationalization area and research. The collaboration peculiarities of educational system is being model of Islamic education which has prospect and able to answer the demand of era.

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## Comparing and Scoring Selected Four Train Ticketing Mobile Phone Applications

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**Abstract:** To find the best train ticket booking mobile application on the bases of application features. Four widely used mobile phone applications (Ixigo, MakeMyTrip, ClearTrip, and IRCTC) for railway ticket booking are selected and application features related to ease of download and use, rating, number of installs, etc. are compared. A practical attempt is made to book a train ticket using all these applications one by one and comparing features such as coach locator, platform locator, route map, fare break-up, showing seat availability, save and pre-fill passenger details, sort search list by train name/number, sort search list by journey duration, sort search list by class, train running status, etc. 1 point is allotted to the applications if a particular feature is available in the applications and 0 is allotted if the feature is not available. Sum of all the points is calculated separately for each application and then ranks are given from 1 to 4 considering the final score. Ixigo mobile application scores the highest among other three train ticketing mobile applications – MakeMyTrip, ClearTrip, and IRCTC. Features such as downloading applications via a miss call or SMS; downloading application from websites of Ixigo, MakeMyTrip, ClearTrip, and IRCTC; and sorting train search list by class on applications are not found in any of these four applications. Furthermore, features are grouped into groups such as – the features only available in top ranking Ixigo and the features not available in top ranking Ixigo but available in any or all other three applications. This research will be of a good value for mobile railway ticket booking application providers as competition is becoming acute and the booking pattern is shifting from using desktop or laptop to mobile phones and tablets.

**Keywords:** *Train ticketing, applications, Ixigo, MakeMyTrip, ClearTrip, IRCTC*

### 1. Introduction

In the concluding chapter of the book titled *Mobile Design and Development: Practical concepts and techniques for creating mobile sites and web apps*, author Brian Fling writes “I like to think about what’s next and what tomorrow’s innovations will be. A question I get asked a lot is ‘What will the future of mobile be?’ The best answer I can think of that comes close to capturing the potential those mobile offers is simply ‘Everything’.” This note from the book on mobile sites and applications tells much about how cell phone applications are changing customers’ experiences and expectations of satisfying their needs of buying range of goods and services, from groceries, healthcare products, electronic goods, clothes to travelling. Not only travel or leisure related but mobile applications related to emergency and health services are also becoming popular and a matter of everyday use. There are more than 40,000 mobile applications related to health and roughly 247 million users downloaded one or the other application (West, 2012). Not only to the patients or health cautious users, these applications also increase efficiency of medical practitioners too. Some systems in the field of cardiology have significant research and apps are available (Martínez-Pérez et al., 2014). There were 710 apps related to cardiology and heart disease available by May 2013. The potential worth of the mobile application industry was once estimated to reach as \$ 100 billion by the year 2015 (Rakestraw et al., 2013). Witnessing extraordinary growth and proliferation of smart phones, mobile application business is growing leaps and bounds. Ease of downloading applications, storage power of cell phones, data transfer speed, connectivity and other favorable factors motivate users to download, use, and spread a word about usefulness of mobile applications. Shekhar (2014) referring to mobile industry forecast, notes that application download was projected to grow at a rate of 92% per annum i.e. from 7 billion downloads in 2009 to nearly 50 billion downloads in 2012. A research company named ABI Research forecast that revenue generated from mobile applications will reach to \$ 46 billion in the year 2016. India is not an exception in the acceptance of mobile applications. Train ticket booking in India has witnessed a sea change in last one decade. Though India saw this transformation not so early unlike other countries, passengers have always been remained in the focus while developing infrastructure or customer convenience. Indian Railways, which is a public sector enterprise managed by Ministry of Railways, Government of India, was running 11,824 trains in 2010-11 and today runs 19,000 trains ([www.indianrailways.gov.in](http://www.indianrailways.gov.in)).

Indian Railways ranks fourth when length of railways measured in kilometers; being the United States, China, and Russia first, second, and third respectively. The transformation has been passed through vending railway tickets at railway station windows manually to making reservation computerized, online booking through [www.irctc.co.in](http://www.irctc.co.in), and now via IRCTC (Indian Railway Catering and Tourism Corporation) mobile application. From personally visiting railway stations to buy tickets, passengers' preference is shifting to use train ticketing websites or mobile applications on their cell phones or tablets. IRCTC carried 7,651 passengers in the year 2010-11 and today 23 million passengers buy railway ticket daily ([www.indianrailways.gov.in](http://www.indianrailways.gov.in)). This figure was 1,284 passengers in 1950-51. It made 294 computerized reservation offices functional during 2010-11. In 2013-14 it had seat/berth capacity of 5,171,547. Year 2015 Whitepaper of Indian Railways noted "...ease of booking tickets are issues that need urgent attention." There are many train ticket booking applications available on application platform such as Android, iOS, and Windows. Among many, popular ticketing applications are Ixigo, MakeMyTrip, ClearTrip, and IRCTC (Choudhary & Sachan, 2013). Though Ixigo redirects to IRCTC for making payment and booking tickets, feature-wise it is the best application. It searches and compares the most useful information required for train ticketing. Mr. Alope Bajpai and Mr. Rajnish Kumar launched Ixigo in 2007. NASSCOM enlisted Ixigo in the *Top 10 Emerging Company in India* in 2010 and in 2012, it featured in BBC World's Fast Track list of *globally most innovative products*. Ixigo goes beyond just ticket booking by providing trip related information like accommodation, food, sight-seeing, travel tips to help users plan and enhance their travel experience. Companies such as SAIF Partners, MakeMyTrip Ltd., and Micromax Informatics Ltd. have invested in Ixigo. Founded in the year 2000 by Deep Kalra, MakeMyTrip Limited provides access to airlines operating in India, airlines connected to India, more than 83,000 hotels in and outside India, Indian Railways, and to bus operators in India. After in U.S., MakeMyTrip began operations in India in the year 2005. Besides through its website and application, MakeMyTrip operates also through retail franchise and affiliates. It has offices in 20 Indian cities. Founded by its CEO Stuart Crighton, ClearTrip has developed award winning applications and website. Its products include flights, hotels, and train booking. ClearTrip has three offices in India.

## 2. Literature Review

Nysveen, Pedersen, & Skard (2015) reviewed research conducted on mobile services. Finding research gaps, authors suggested future research on mobile applications. In their research work, authors found that studies on mobile services were largely described in a generic way about m-commerce, mobile marketing, data services etc. Literature, largely quantitative studies, focused mainly on definitions, opportunities, and challenges of mobile services, success criteria, implications, system design, and on modeling processes. The research gaps identified was that there were fewer studies on mobile application-based services, on effects of mobile service usage, and on services in context. Authors anticipated increase in number of mobile services in future and observed lack of research with experimental design used. The study quantitatively and qualitatively examined the rise of mobile phones and mobile internet services (mobile commerce and mobile marketing) globally. Based on a conceptual review of 212 articles, the study outlined factors critical to the success of mobile marketing services, in terms of adoption of these services by the market. The factors were related to resolutions of challenges such as personalization, multiple devices, security, message, and sound. The study found influences of subjective norms, perceived usefulness, ease of use, and enjoyment on attitude to use while behavioral control and usefulness were significant antecedents of intention to use mobile apps. Usefulness, gender, income, and intention to use were revealed as antecedents of actual usage of mobile apps. The study noted a work on direct or indirect influences of monetary value, network factors, interface convenience, context controllability, usefulness, ease of use, continued intention to use, influences of enjoyment, network externalities, usefulness, communication effectiveness, and service costs. Mobile phone applications have become a selling point for devices. Rakestraw et al. (2013) developed a case study on mobile application industry, which was predicted to be \$100 billion worth and still growing. The study elaborated on boost given to mobile applications by smart phones; the changed way of accessing internet, games, and social networking, and on how Android and iOS have created differentiation through application development, availability of distinctive applications, and through selling platforms. Amidst the presence of niche players and predicted positive future, there are obstacles present such as privacy and security issues among other issues. Apart from entertainment purposes, applications are also playing life saving role. Martínez-Pérez et al. (2014) compared research magnitude in various geographic areas according to income and mobile applications developed for fatal health conditions.

Banerjee & Lennon (2012) studied M-commerce evolution in India. The authors examined CLIP (Communication, Location, Information, and Payment) framework and found that integral aspect was present of communication with ABN AMRO India's and Aviva's customer management, of location with order fulfillment of HP, of information with ICI Paint's sales reporting, and of payment with gaming and music services. There has been a phenomenon growth observed among number of internet users and mobile phone users, and online buyers in India. Ghosh (2014) analyzed the reasons for e-commerce in India being not able to achieve targeted level. The study also included trend of consumers' online buying behavior in India. Positively and negatively influencing variables with reference to socio-cultural in India, encouraging or discouraging buyers, are identified. Variety of factors affecting online buying behavior are researched, age being one of them. A study noted that use of smart phones, related with use of mobile applications in India, has been extensive among Gen Y users (Bhave, Jain & Roy, 2013). Applying Focus Group Discussion and in-depth interview methods, these authors attempted to understand Gen Y users' attitude towards applications and advertisement. Determinants behind forming the attitude were identified. Widely accepted by young customers, increase in sales of smart phones is discouraging sales of some products while encouraging sales of other products. Natarajan and Kumar (2013) observed significant growth of mobile payment and mobile banking and linked it with penetration of smart phones in India. Authors observed that m-commerce in India included travel and ticketing, utility bill payments, merchant and retail transactions, and money transfers. Evolution of M-commerce in India is due to assembling of MSP (Mobile Service Providers), banks, and of payment service providers. Web traffic coming up from mobile phones was predicted to be 50% by the year 2013. Penetration of cell phones in India was estimated to be 60% and was expected to touch 90% by the year 2015. Approximately 80% of size and growth of e-commerce in India, calculated as 500 billion INR in 2011, was related to air ticketing, rail ticketing, hotel bookings, recharge, etc. Internet and reference group as sources of information are vital for travelers.

Verma, Stock, & McCarthy (2012) observed preference of search on internet and devices used by travelers. This research with a sample of 2,830 respondents revealed that business travelers relied on their employer's recommendations about hotel stays besides their collection of information about hotels and online travel agents via internet search engines. On the other hand, leisure travelers gave importance to the advices by their colleagues and friends. Travel websites, search engines, and online travel agents were next important sources. Company websites, online travel agents, and websites such as TripAdvisor are preferred in post information collection stage. Originally a calling and texting device, mobile phones are now handy platform for making payments for different services availed. Balaji & Babu (2013) explored the concept of m-wallet as a mobile phone based e-ticketing. The paper focused on the creation of a mobile wallet (m-wallet) for mobile transactions, and saw it as a necessity in an era of 3G and wireless internet services. Moreover, e-ticketing showed a broad and promising future, as it offers a safer, convenient, and low-cost alternative to the conventional form of ticketing. The authors aimed to provide an integrated platform for both ticket-reservations and non ticket-reservations, using an MWALLET. mWallet would be a universal mobile ticketing platform, supported by external environments. mWallet aims to overcome the weaknesses of existing ticketing systems, and e-ticketing systems including the greater, pressing problems of convenience of security. The world today is becoming increasingly app-savvy. The research paper by Inukollu et al. (2014) recognized the role of good mobile applications in consumers' daily life, and analyzed the mobile application business from the point of view of the end-user as well as from the developers'. Through surveys and observations, the authors identified the causes for an app being called "bad/low quality", and how best to avoid this tag. The authors also acknowledged that with the presence of thousands of mobile applications today, app developers must keep an open mind and embrace continual innovations in the life-cycle of the app. This is the only way to stay abreast of the app-game and compete with the numerous apps entering the market every day. Enhancing consumer satisfaction has to be kept at the crux of it. Moreover, continual innovation, and new entrants promise a dynamic, eventful and interesting future for mobile applications. With increasing tourism around the globe, increasing use of mobile applications, mobile services in day-to-day activities, all activities and events becoming exceedingly experiential; a paper by Lim (2012) provided an exceedingly contextual view of mobile tourism activities. The paper proposed a theoretical approach for designing mobile tourism applications using situation awareness i.e. it tried to develop contextual awareness of mobile applications that will improve a traveler's situation awareness before, during, and post-travel. Three hypothetical scenarios were presented, discussed, and measured to create situational awareness.

### 3. Methodology

Descriptive research design is used in this research. Data on features of the mobile applications are collected by actually downloading and using these applications on phones. Scoring pattern follows allotting 0 or 1 to the mobile application according to availability of the features. The features are related to downloading and using the applications (Table 1) and facilities provided by the applications (Table 2). For each available feature the application is given point 1, and 0 is given for each missing feature. Column-wise sum of score is taken for the application and the same is repeated for all the mobile application. The application with the highest score is ranked 1, followed by ranks 2, and 3. Application with lowest score is ranked 4<sup>th</sup>. The features listed in Table 1 are explained below:

- Download app via miss-call or text message: Receiving a link for downloading application via text/SMS or via giving a missed call to a given number.
- Download app from website: Downloading application from download link given on company's website.
- App Ratings: Ratings given to mobile applications by their users, as seen on Google Play store.
- No. of installs: Number of application installs, as seen on Google Play store.
- Size of App: The size the application occupies in phone memory. The smaller the application size, higher the rank allotted.
- OS Compatibility: Cross-platform compatibility of mobile applications on phones based on Android, iOS or Windows operating systems.
- Send feedback: Provision in applications for users to be able to provide feedback to developers and organization.

The features listed in Table 2 are explained below:

- Coach locator: Virtual map of where the coach will be located on platform when the train arrives.
- Platform locator: Predicts which platform the selected train will arrive on.
- Route Map: Shows a map of the route the train will take during its journey.
- Fare Break-up: Shows what portion of the fare the passenger pays is charged for. For example, base fare, tax, services charges etc.
- Showing seat availability: Shows number of seats available on a certain train.
- Save and pre-fill passenger details: This provides the provision of saving passenger details such as name, age, contact number etc. and fills these details automatically at every new ticket booking is made by a regular user.
- Search by train name/number: Look for trains by providing input of train name or number, rather than searching for all trains between the desired stations.
- Sort search list by train name/number: Sorts the list of trains in ascending or descending order according to the train names and according to train numbers.
- Sort search list by journey duration: Sorts the search list in ascending or descending order, by the time taken in the journey.
- Sort search list by class: Orders search list according to the class of tickets available.
- Train running status: Shows the real time information about status of trains.
- Train reviews: Shows passenger reviews about trains by different parameters.
- Train ratings: Shows star ratings of trains, given by passengers.
- Sort search list by arrival/departure time: Order search list by time of arrival of train, or time of departure.
- Sort search list by number of stops: Order search list by the number of stops each train makes between the origin and destination stations.
- Show days of train running without selecting journey date: Shows train weekly schedule without required to enter travel dates.
- Search trains by station: Provides a list of all trains arriving at a particular station even within selecting a time.
- Station alarm: Alerts certain distance before reaching specified station.
- Seat map: Shows a virtual map of the train and helps locate the seat.
- Local and metro train searcher: Provides search facilities for local trains and metros as well.

- Save favorite trains: Allows users to save certain trains as favorite and minimizes time and efforts to search for the train at the time of subsequent trips.
- Find hotels around stations: Allows users to locate hotels close to railway stations.
- Shows rescheduled/cancelled trains: Shows all trains that have been rescheduled or cancelled within a certain time frame.
- Train tips: Provides tips for rail travel.
- Current availability: Shows whether number of trains running currently from a certain station have available seats.
- Booking via app: Offers not only train or availability searching on application but also booking and payment facility on application.
- Book ticket for round trip: Tickets can be booked for the return trip as well.
- Berth preference: Asks for berth preference such as lower, middle, upper, side lower, side upper berth etc.
- Shows number of trains: Shows total number of trains running between selected stations.
- Payment modes: Shows available options of payment while booking.
- Details of bank transaction charges: Shows the details of how much banks charge for the transactions.
- Reservation preferences: Provides the option of booking tickets only if a particular berth preference is available.

#### 4. Results and Discussion

As shown in Table 1, MakeMyTrip mobile application scores the highest (9 points) in terms of ease of downloading and using this application. Though MakeMyTrip application has certain missing features, as shown in Table 2. It does not scores high for application rating received on Google Play Store and scores the least for occupying small size on users' phones or tablets. Remaining applications Ixigo, ClearTrip, and IRCTC score 8, 6, and 7 points respectively.

**Table 1: Downloading and using applications**

S/N	Application Features	Mobile Applications			
		Ixigo	MakeMyTrip	ClearTrip	IRCTC
1	Download app via miss-call or SMS	0	0	0	0
2	Download app from website	0	0	0	0
3	App Ratings (Play Store Data)	1	3	2	4
4	No. of installs	2	1	1	1
5	Size of App	3	4	2	1
6	OS Compatibility	1	0	0	0
7	Send feedback	1	1	1	1
A	Score	8	9	6	7

Table 2 shows comparison and allotment of points to four mobile applications on the bases of features provided by respective applications once the applications are downloaded on to mobile phones or tablets. Ixigo scores highest (25 points), followed by MakeMyTrip scoring second with 11 points. ClearTrip and IRCTC mobile applications stand with equal 11 points.

**Table 2: Application features**

S/N	Application Features	Mobile Applications			
		Ixigo	MakeMyTrip	ClearTrip	IRCTC
1	Coach locator	1	0	0	0
2	Platform locator	1	0	0	0
3	Route Map	1	0	0	0
4	Fare Break-up	1	1	1	1
5	Showing seat availability	1	1	1	1
6	Save and pre-fill passenger details	1	0	0	1
7	Search by train name/no.	1	1	0	0
8	Sort search list by train name/no.	1	0	0	1
9	Sort search list by journey duration	1	1	1	0
10	Sort search list by class	0	0	0	0
11	Train running status	1	0	1	0
12	Train reviews	1	0	0	0
13	Train ratings	1	0	0	0
14	Sort search list by arrival/departure time	1	1	1	1
15	Sort search list by no. of stops	1	0	0	0
16	Show days of train running without selecting journey date	1	0	0	0
17	Search trains by station	1	0	0	0
18	Station Alarm	1	0	0	0
19	Seat map	1	0	0	0
20	Local and metro train searcher	1	0	0	0
21	Save favorite trains	1	0	0	0
22	Find hotels around stations	1	0	0	0
23	Shows rescheduled/cancelled trains	1	0	0	0
24	Train tips	1	0	0	0
25	Current availability	1	0	0	0
26	Booking via app	0	1	1	1
27	Book ticket for round trip	0	1	0	0
28	Berth preference	0	1	1	1
29	Shows number of trains	0	1	0	0
30	Payment modes	1	2	3	1
31	Details of bank transaction charges	0	0	0	1
32	Reservation preferences	0	0	0	1
B	Score	25	11	10	10

Adding scores of Table 1 and Table 2, the final ranking to mobile applications are given, as shown in Table 3. Ixigo ranks number 1, followed by MakeMyTrip ranking 2<sup>nd</sup>, and IRCTC and ClearTrip ranking 3<sup>rd</sup> and 4<sup>th</sup> respectively.

**Table 3: Total score**

Ranking	Ixigo	MakeMyTrip	ClearTrip	IRCTC
Score on downloading and using applications (Table 1)	8	9	6	7
Score on application features (Table 2)	25	11	10	10
Total Features Score	33	20	16	17
App ranks according to score	1	2	4	3

Ixigo offers highest number of the features and IRCTC offers the least. Further, two examinations are made such as list of features not present in any of the four mobile applications compared here, and the features absent in top ranked application Ixigo. The following three features are not available with any of the four mobile applications:

- Download app via miss-call or SMS
- Download app from website
- Sort search list by class

Table 4 enlists the features missing in the top ranked mobile application here i.e. Ixigo while Table 5 shows the list of features provided by Ixigo application only among four applications.

**Table 4: Features not present in top ranked app Ixigo**

S/N	Features
1	Download app via miss-call or SMS
2	Download app from website
3	Sort search list by class
4	Booking via app
5	Book ticket for round trip
6	Berth Preference
7	Shows number of trains
8	Details of Bank Transaction Charges
9	Reservation Preferences

**Table 5: Features available only in Ixigo application**

S/N	Features
1	Coach locator
2	Platform locator
3	Route Map
4	Train reviews
5	Train ratings
6	Sort search list by no. of Stops
7	Show days of train running without selecting journey date
8	Search Trains by station
9	Station Alarm
10	Seat Map
11	Local and Metro Train Searcher
12	Save Favorite Trains
13	Find hotels around station
14	Shows rescheduled/cancelled trains
15	Train Tips
16	Current Availability

## 5. Conclusion

Using mobile phone applications for train ticket booking is not totally a new phenomenon in India. Train ticket booking experience in India has traverses from personally buying tickets by visiting railway station to booking using World Wide Web and now to using ubiquitous cell phones and tablets. Passengers expect mobile ticket booking platforms with as many features as can provide effortless and quick ticket booking. Mobile ticket booking applications such as Ixigo, MakeMyTrip, ClearTrip, and IRCTC are popular applications among all. Features such as users' convenience to download application via sending a text (SMS) or giving a miscall to a phone number, downloading from websites, size of application, and compatibility with users' cell phone operating systems play important role in addition to the rating received by applications on App Store, Play Store, or Windows Store; or number of installs or number of stars received by the applications. Number of features offered by one application gives competitiveness over others. It was found that Ixigo scores highest among remaining three train ticketing mobile applications namely MakeMyTrip, ClearTrip, and IRCTC in terms of number of features offered. While there are nine features which are not present even in top ranked Ixigo, there are sixteen features which are present only in Ixigo, which makes it top ranked application. Ixigo does not provide selecting berth preference which is present in remaining three competing

applications, besides its limitation to not booking the tickets directly but redirecting to IRCTC. The best train ticketing mobile application can be the one which has all the features that Ixigo application has plus three features such as downloading application via a miss-call or sending text/SMS, downloading application from booking website, and a feature of sorting train search list by train classes.

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## Effect of Bank Merger on the Shareholders Wealth and Post-Merger Situation of Nepalese Banking Industry

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**Abstract:** This research studies the effect of independent variables such as cost efficiency, ROA, ROE and Capital on dependent variable EPS of the merged bank in Nepal. Various statistical tools such as mean standard deviation, correlation, regression were employed to measure the effect of bank merger on the shareholders wealth. Based on the result of study, except ROA, no other independent variable under study showed any impact on earnings per share. The superior bank shareholders are not getting what they deserve and inferior bank shareholders get more than they deserve after the post-merger. It is also finding out that external factors such as earthquake, border blockade and political instability highly affects the shareholders earnings.

**Keywords:** *Shareholders wealth, Cost Efficiency, ROA, ROE, Capital base*

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### 1. Introduction

**Background of the Study:** In 1937 AD, Nepal Bank Limited was established as the first commercial bank in the history of Nepalese banking industry. It was the jointly owned bank of the government and general public. In these more than seven decades, there were many ups and downs in the Nepalese financial system. It has faced various experiments to advance the system and changes in policies and regulations. After 1990s financial sector was liberalized and resulted into entry of many new banks in the Nepalese market. By the end of 2015, altogether 241 banks and non- bank financial institutions licensed by NRB were in operation. Out of them, 29 are "A" class commercial banks, 76 "B" class development banks, 48 "C" class finance companies, 38 "D" class micro-credit development banks, 15 saving and credit co-operatives and 27 NGOs. Also, the total banks branches reached to 3,838 (NRB Report, 2015). Nepal's financial market opened up for international investment in January 2010 and merger by-laws came in place in May 2011 (Adhikari, 2014). This scholar has closely observed that the merger transactions are increasing in Nepal over the past few years – almost only since year 2011- with an aim to create wealth for shareholders, developing efficient and reliable banking that can compete with new entrants from foreign. In recent Nepalese scenario mergers & acquisitions is playing an important role in shaping competent and advance banking in Nepal.

Roberts, Wallace and Moles (2010) have defined merger as a combination of two companies to form a new company. Onikoyi and Awolusi (2009) have concluded that going by market value of the merged banks, shareholders wealth creation has been decreased, in some cases completely destroyed. According to these scholars, the noticeable problems that challenge the shareholders return of the merged banks involved decrease of market prices of their shares on the stock market, reduction of shareholders money due to of losses incurred from merger and lack of dividend pay out to the owners. Capital accumulation has important role in accelerating the economic growth, which in terms is basically determined, among others, by saving and investment propensities. The dimension of commercial banks transactions mirror the economic movement in the country. The financial system in Nepal has from a narrow, repressed regime till the eighties to a dynamic expanding sector in the nineties. Indicators of the last decade shown that the sector has growth both quantitatively and qualitatively and there will be 15 to 20 commercial banks with combined paid-up capital of around NRs 120 billion by 2017/18. Going through the Nepal Rastra Bank (NRB) monetary policy of the fiscal year 2015/16, NRB has raised the minimum capital requirement for banks to NRs 8 billion from current NRs 2 billion. In this context the commercial banks are forced to go for merging and acquisition. At the same time, it becomes immense important to see whether the performance of these merged banks and financial institutions is creating wealth to their shareholder and impact of merger on return to shareholder of the merged banks is the pinning point for the present researcher in this paper.

**Problem Statements:** Economic liberalization and privatization policy adopted by the government has open up the opportunity and threat to the banking sectors. As a result, we see a rapid growth in the numbers of commercial banks in the country and of course, the rapid increment in numbers of commercial banks in small country like Nepal has created tough competition among bankers. While operating after merger there may be different kind of changes in the position of organization. Change may take place as regard net worth, deposit collection, investment, income generation, expenditure etc. In this research work it would be relevant to analyze the direction as well as magnitude of such change that has taken place during the study period. This research work attempts to know whether the change pattern or direction of changes as regards various trends of the concerned banks is beneficial to the shareholders and to the economy or not. This study will try to seek the answers relating to the merger of banks and the consequences to the shareholders return and to the economy as a whole. Do merger really enhance the shareholders' value?

**Research Questions:** Taking into consideration the background of the study, missing link, objectives and significance, the present researcher has composed a set of four research questions (RQs) with an aim to access the overall impact of merger on shareholders wealth in the Nepalese Banking industry.

RQ 1: To what extent are the shareholders of the bank following merger getting the worth they deserve?

RQ 2: what are the best practices in the global context and what could be the best option in Nepalese context?

RQ 3: Is it really true that shareholders wealth is increasing as a result of merger of the banks?

RQ 4: Is there any alternative for the merger?

**Research Objectives:** The general objective of the study is to assess the effect of merger in shareholders' wealth creation. To attain the main objective, the present researcher will further explore following aspects as part of specific objectives of the enquiry:

- Know the association of capital base increment and shareholders' wealth maximization.
- Explore the best practices of merger in the global context.
- Investigate the relationship between merged banks' ROA & ROE and its impact on shareholders' wealth.
- Uncover the alternatives to the merger.
- Know the relationship of banks' cost savings and shareholders' wealth.

**Research Significance:** Analyzing the above situation, the present researcher could discover the impact of merger in the context of Nepal. The researcher could find the situation of merger in Nepal that no study has yet been done regarding this. The impact and significance of merger on shareholders' wealth creation will be addressed in this study. Moreover, such a study would serve instrumental in exploring global best practices in merger of financial institutions and also uncover alternatives to merger. In the context of Nepal, this is a relatively new topic. This study will try to find out the effects of merger in terms of capital base, revenue and cost saving on shareholders wealth creation. As the present researcher has been determined to develop professional career in this sector, such an exposure would serve instrumental to understand the reality. So, this study is expected to be useful to various concerned persons or groups such as management, shareholders, depositors, creditors, investors, stock brokers, policy makers, researchers and so on.

## 2. Literature Review

**Merger and its Concept:** Mergers and acquisitions are capital investment projects in which a business expands externally by acquiring or amalgamating with another related or non-related firm. Motivations for mergers are different. Some go for merger for superior management skills, for the technical capabilities, new market entrant, and to achieve operating economies. Scholars have found out that managerial motives are important determining factor for the outcome of the merger.

**Motives of Companies Merger:** Based on the literature review, it can be concluded that merger has been driven by many factors and rationales. The major motives that drive for merger in Nepalese context are as follows:

**For Synergy:** When two or more firms are combined to form one superior and combined value is more than individual than synergy is achieved Jensen and Ruback (1983). It can be shown as  $2+2=5$ . Synergy can be achieved from operational efficiency or by the financial efficiency. Economies of scale are can help in reducing cost and creates synergy. Wang and Xie, (2009) concluded that corporate governance influences merger synergies which are earlier divided among the firms.

**Efficiency gains:** Efficiency is using resources in such a way as to maximize the production of goods and services. Merger brings greater efficiency to the domestic banking with greater economies of scale that help in building strong and more competitive banking industry in the country.

**For Growth:** Growth is one of the major motives for merger. After 1990s trend of merger, where size matter to compete play important role for merging. Growth is seems in terms of size, capital and resources. Banks can grow either by acquiring another bank for more opportunity to grow and expand. Merger for growth helps in reducing threat in the market and future potential competitors.

**Merger History:** History of merger can be traced back from nineteenth century in the United States and after that it occurred in waves. After that each movement of merger was observed based on the nature of merger and particular industries. In 1900s when first wave of merger started it was characterized as horizontal merger done for creating monopoly According to Lipton, in 1920s second phase of merger was seen mainly in the US with vertical merger where giant automobile manufacturing companies. Third wave of merger was seen in 1960s where conglomerates merged to diversify their business and to enter into different sector of business and research. In 1980s fourth wave of merger was seen which was called disciplinary merger where most of the affected financial institutions merge to overcome weaknesses. After 1990s, next wave was observed where firms merger for size. To compete in the market, size does matter concept emerged.

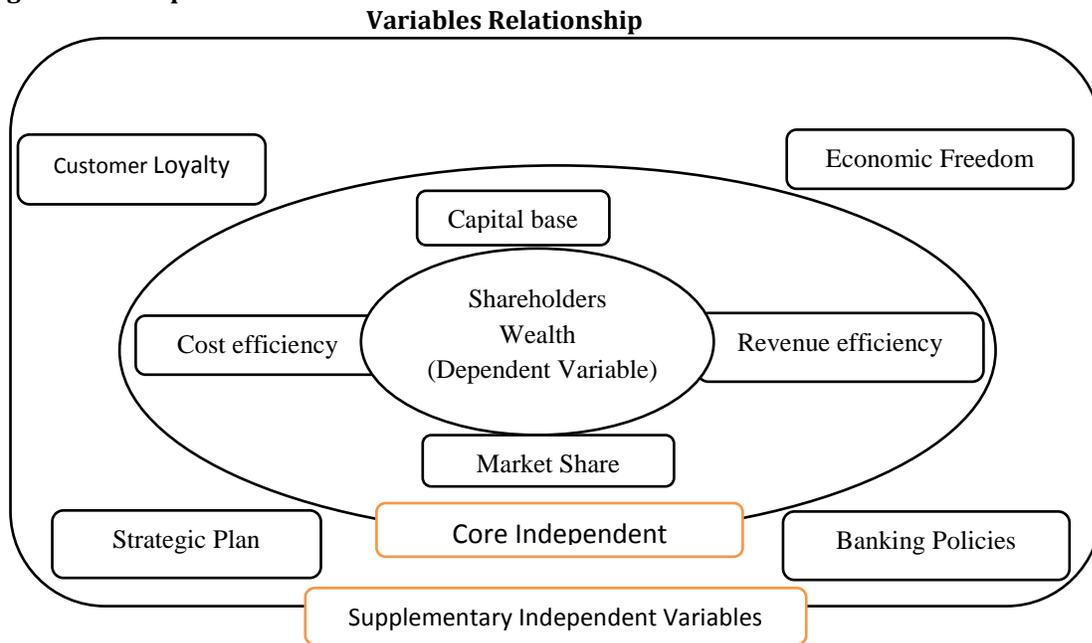
**Merger in Nepal:** Article 68 of Banking and Financial Institutions Act (2063) opened the door for the merger in Nepal by clearly mentioning that one company can go for merger with another if procedures are fulfilled, though it do not describe acquisition. It is a common phenomenon that one of the basic goals of a firm is to increase the value of the firm or shareholders wealth. Nepal Economic Forum, 2010 also highlighted merging as one of the daunting tasks for the financial institutions in many respects, especially to maintain the sentiment of shareholders, management committee, employees, and the governing institutions. Nepal Rastra Bank (NRB) unified directives 2072 based on revised framework of international convergence for capital measurements and capital standards states that minimum capital requirement is necessary to increase to mitigate the operational risk and banking failure.

The past studies on efficiency of merger have seen elaborative and consistent. Many of the research scholars supports the conclusion that merger create value and are economically efficient. Most of the results strongly support the conclusion that mergers are profitable and are socially needed for economy growth (Caves, 2003). Doytch & Cakan (2011) studied the merger growth effect both in the domestic market and cross boarder in terms of sectors and on the overall economy. The scholar concludes that there is no support to the hypothesis. Merger activity does not any support the economic growth, except service industry. They found out that merger of both financial and non-financial services has positive effect on growth and negative effect on manufacturing and other industry growth rates. When analyzing impact of merger in aggregate economy growth seems negative ( Doytch & Cakan , 2011). Scholars have also found out that stock performance of the bank is not the deciding factor for bank growth. Many times the stock value is the result of speculation, wrong expectations or a game of luck. The banks with better profitability ratios in comparison to the industry average shows banks are profitable as well as more competitive within the industry ( Maditinos, Theriou, & Demetriades, 2009). Few of the scholars had conducted a systematic empirical analysis of merger activity in UK for the period of thirty years data. They analyze the effects of related and unrelated mergers and hostile versus friendly mergers. It was concluded that merger activities were followed by substantial and statistically significant employment and increase in efficiency after the post-merger phase (Conyon, Girma, Thompson , & Wright, 2000).

Omah, Okolie and Durowoju (2013) have come up with the finding that operating expenses, profit margin, return on capital employed and expenses ratio are the most influencing factors on shareholders wealth creation. While analyzing the inter company and intra company results, it shows that there is marginal positive effect on shareholders wealth creation. Omah, Okolie and Durowoju (2013) concludes that motive of merger is to enhance the synergy. In this study, an attempt has been done to analyze the merger impact on shareholders wealth of the companies which have gone for merger during the period of 2001 to 2010. A scholar has stated that after the economic liberalization in 1984, banking sector got a lot of opportunities to expand, grow and introduce modern technologies in banking service. A study by Juma, Wawire, Byaruhanga, Okaka, and Odera (2012) has revealed that merger significantly influences shareholders value, creating more value than those that have not gone for merger. Merged banks were supposed to have better results than the overall sector.

**Bank Overview:** Global IME Bank Ltd. Emerged as a successful merger of Global Bank Ltd. An A class commercial bank with IME Financial Institutions and Lord Buddha Finance Ltd. C class finance companies in the year 2012. In 2013, Social Development Bank and Gulmi Bikas Bank merged with Global IME Bank. In year 2014, A class commercial bank i.e. Commerz & Trust Bank merge with Global IME Bank (Annual Report 2014). NIC ASIA Bank was established in the year 1998. The bank was retitled as NIC ASIA bank after the merger of NIC Bank Ltd. and Bank of Asia Nepal on 30<sup>th</sup> June 2013. This was one of the successful mergers in the history of Nepalese commercial banks merger history. After the post-merger phase, bank was able to manage the transition very smoothly receiving praises from its stakeholders.

**Figure 1: Conceptual Framework**



**Shareholders Wealth Maximization:** Wealth creation or maximization refers to the changes in the wealth of the shareholders on annual basis. Shareholders wealth changes mostly from changes in stock prices, dividend paid, and equity raised during the period (Institute of management accountants, 1997). Oladipupo and Okafor in 2011 point out that the fundamental and traditional objective of business organizations is to maximize the shareholders wealth.

**Capital Base:** Capital bases the back bone of the banking operation which supports business. The importance of the adequate capital in banks cannot be overemphasized. It is an essential element that enhances banks confidentiality and permits banks in banking business. Having more capital means banks can bear more losses and it can sustain without going bankrupt.

**Revenue Efficiency measured in terms of ROA and ROE:** ROA and ROE are the measuring tool for the revenue efficiency. It indicates how well a bank perform in terms of profit with other banks in the same period. ROA and ROE of the bank help in determining the revenue efficiency of the bank.

**Cost Efficiency:** Bank cost efficiency is also the major factor influencing the shareholders wealth. Banks that shows higher cost efficiency might be able to generate greater profits than inefficient banks. Cost is also a major factor in determining operation efficiency and increasing profit.

### 3. Methodology

In this study banks that have gone for merger in the period of 2011 to 2015 are taken into consideration. In Nepalese Banking only 2 'A' class commercial banks completed the merger and operations. The empirical analysis of the merged banks has been done with through analysis of pre-merger and post-merger to give clear view on their success and failure. There are about 3 commercial banks that completed merger during the period. Out of them 2 were selected for the study. In total 9 banks and financial institutions are merged to form these 2 commercial banks. Research is based on the secondary data analyses. The annual report of 'A' class merged banks are analyzed. The gain and loss of shareholders in terms of earnings per share has been evaluated. The major analyses is whether the shareholders of superior banks getting what they deserve or not. Data Analysis: Using quantitative methods, data from the financial statements of the concerned banks were used to calculate the various financial ratios that are proxies for shareholder wealth measurement. Ratios such as: Earnings per share, ROA, ROE, Capital base, and Cost efficiency. Correlation and Regression coefficient is calculated for the analysis of the data. Assets and ROA, Equity and ROE is analyzed and its increasing and decreasing order has been calculated. Merged banks that exist are taken as superior banks and after merger that do not exist are considered as inferior bank.

**Dependent and Independent Variables:** In this study shareholders wealth (SHW) is taken as a dependent variable. This is the earnings per share value of banks as result of merger after 2013.

**Calculation of dependent variable:** SHW (EPS) = Net profit after tax/No. of shareholders

Independent Variable

There are four independent variables used for the analysis of the merger effect on shareholders wealth. For the purpose of this study, Capital Base (CB), ROA, ROE and Cost Efficiency (CE) are used as independent variables.

Calculations of Independent Variables

Capital base (CB) = Equity /Total Assets

ROE= Net Profit after tax/Total Equity

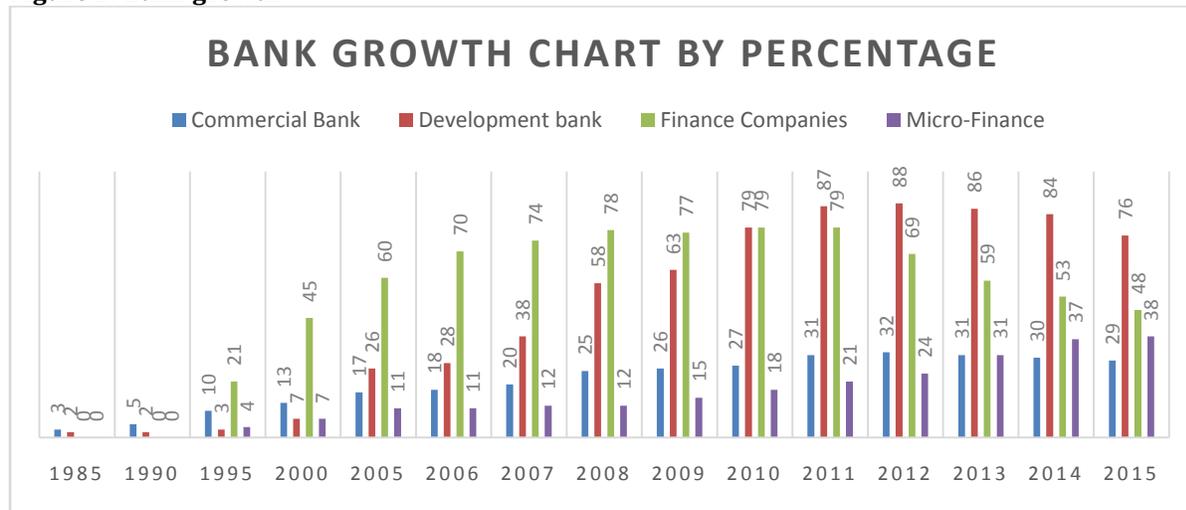
ROA= Net Profit after tax/Total Assets

Cost Efficiency (CE) =Operating expenses/Operating revenue

### 4. Data Collection and Analysis

In this research, major secondary sources of data was collected from the NIC ASIA Bank and Global IME Bank and other merged commercial banks as these are only the banks that have an operating history of at least two years before and after merger. Personal interview with the managers and CEOs was taken as the primary sources. Quantitative techniques such as mean value, standard deviation, coefficient of correlation and regression were calculated. Different measures of central tendencies were the outcomes of descriptive research design which was normally executed through surveys, interviews, and annual reports analysis. The annual report of all the merged companies before the merger and after the merger were thoroughly analyzed.

Figure 2: Bank growth



(Source: NRB Bank Supervision Report, 2015)

The chart above shows the increasing trend of bank and financial institutions growth in Nepal before and after the year 2011 when Nepal open the door for the international community in banking industry. Nepal Rastra Bank (NRB) also motivate banks to go for the merger to increase the capital base and strengthen national banking sector. With the end of 2015, 6 commercial banks merge and form 3 commercial banks. Along with this 12 development banks and 31 finance companies has been merged with commercial banks, development banks and with oneself. The target of NRB to meet Rs. 8 billion for commercial banks, Rs. 2 billion for development banks and Rs. 1 billion for finance companies by year 2016/17, are unable to accomplish and it shows that still many of the banks are in the merger process. Year 2011 was the year of highest banks and financial institutions in the country.

### Bank Performance Indices

**Superior Bank:** Financial year 2013-14 exhibited a year with change towards growth for Global IME Bank. This year shows various accomplishments, a thriving performance post-merger with Social Development Bank Limited and Gulmi Bikas Bank Limited, acquisition majority shares of Elite Capital Limited and change of its name to Global IME Capital, a successful merger with Commerz and Trust Bank Nepal Limited. (Annual Report 2014). Financial Year 2014-15 shows the slowdown in the performance level of the bank. Earnings per share decreases with decrease in ROA and ROE. Year 2014 show the highest earning per share.

Table 1: highest earning per share

Global IME Bank					
YEAR	EPS	CE Ratio	Capital	ROA	ROE
2015	15.58	43.54%	0.106	1.39	13.06
2014	19.57	42.65	0.102	1.62	16
2013	16.15	42.10	0.0823	1.15	14
2012	11.79	50.55	0.0827	0.87	10
2011	14.06	45.75	0.097	1.28	13
2010	4.95	46.41	0.088	0.42	5
2009	2.63	59.88	0.083	0.26	3

The year 2014/15 was yet another challenging year, with persistent high liquidity, moderate credit growth, and political uncertainty, with the entire last quarter of the year lost due to the devastating earthquake that struck on April 25, 2015, and its subsequent aftershocks. NIC ASIA Bank report analyses and calculation of various efficiency ratios show year 2013 was better than year 2014 and even better than 2015. In year 2015 bank performance slow down highly.

**Table 2: bank performance**

<b>NIC Asia Bank</b>					
<b>YEAR</b>	<b>EPS</b>	<b>CE Ratio</b>	<b>Capital base</b>	<b>ROA</b>	<b>ROE</b>
2015	25.59	41.58	0.092	1.21	13.05
2014	35.98	34.13	0.095	1.71	15.93
2013	47.41	30.45	0.094	1.78	14.63
2012	29.87	37.04	0.081	1.64	19
2011	37.80	29.19	0.090	2.34	28.09
2010	34.30	26.72	0.087	2.30	27.09
2009	27.83	27.08	0.088	1.88	24.23

**Inferior Bank:** Here those banks which are amalgamated into another bank and whose name do not exist in today banking are referred to as inferior banks. Low performance level and not able to maintain the NRB target on self are inferior. These banks fully accept and amalgamated into the better performing banks which are here known as superior banks. Commerz and Trust Bank came into operation on the year 2009. It was merged with Global IME Bank in the year 2014. The process of merger was initiated in the year 2013 and completed in 2014. Due to the announcement of merger with Global IME Bank in the year 2013 Commerz and Trust bank has experienced tremendous growth except ROE. Its shareholders achieve more after the post-merger than the pre-merger period.

**Table 3: post-merger and pre-merger period**

<b>Commerz and Trust Bank</b>				
<b>YEAR</b>	<b>EPS</b>	<b>CE Ratio</b>	<b>ROA</b>	<b>ROE</b>
2015	15.58	43.54%	1.39	1.39
2014	19.57	42.65	1.62	1.62
2013	16.15	42.10	1.15	1.15
2012	8.63	36.63	0.3	1.75
2011	10.49	75.25	0.19	1.05
2010	13.86	57.61	0.55	1.6
2009	6.15			

Earnings per share seems highest in the year 2014 with Rs. 19.57 per share though it was decreased in the year 2015. Cost efficiency ratio has been maintained and ROA is also in increasing trend except in year 2015. Bank of Asia came into operation from October 2007. Bank performance index shows that there is huge difference and gain to the shareholders after the merger. Low performing bank shareholders turns out to be the high earning shareholders.

**Table 4: Shareholder Earning**

<b>Bank of Asia</b>				
<b>YEAR</b>	<b>EPS</b>	<b>CE Ratio</b>	<b>ROA</b>	<b>ROE</b>
2015	25.59	41.58	1.21	13.05
2014	35.98	34.13	1.71	15.93
2013	47.41	30.45	1.78	14.63
2012	8.63	45.62	0.97	7.93
2011	10.49	39.66	1.26	9.74
2010	13.86	40.56	1.53	13.11
2009	6.15	49.46	0.77	6.05

Bank of Asia merged with NIC Bank in the year 2013. Earnings per share increased with 445 percent. Likewise ROA, ROE and cost efficiency has been improved quite a lot. Bank of Asia shareholders earn very high return after the bank was merged with NIC Bank. Researcher has used SPSS data processing to obtain data such as mean and standard deviation. The following is a table of the descriptive statistics result:

**Table 5: Descriptive Statistics**

	<b>N</b>	<b>Mean</b>	<b>Std. Deviation</b>
AVG ROA	7	1.4179	.25227
AVG ROE	7	15.4343	2.51232
AVG CE Ratio	7	39.7907	3.35229
AVG CB Ratio	7	.0904	.00642
AVG EPS	7	23.1079	5.63763
Valid N (list wise)	7		

**Table 6: Correlation**

		<b>AVG ROA</b>	<b>AVG ROE</b>	<b>AVG Ratio</b>	<b>CEAVG Ratio</b>	<b>CAAVGEPS</b>
AVGROA	Pearson Correlation	1				
	Sig. (2-tailed)					
AVGROE	Pearson Correlation	.819*	1			
	Sig. (2-tailed)	.024				
AVG CE Ratio	Pearson Correlation	-.689	-.548	1		
	Sig. (2-tailed)	.087	.203			
AVG CA Ratio	Pearson Correlation	.516	.150	-.207	1	
	Sig. (2-tailed)	.236	.748	.655		
AVGGEPS	Pearson Correlation	.736	.324	-.684	.314	1
	Sig. (2-tailed)	.059	.478	.090	.493	

\*. Correlation is significant at the 0.05 level (2-tailed).

(Source: Data processed SPSS version 20)

Above correlation table reveals the relationship among core variables. There is a positive relationship between the return on assets (ROA) and the organizations' earnings per share (EPS) ( $r= 0.736^*$ ,  $p=0.059$ ). This relationship implies that ROA influences shareholders' wealth positively. It shows that EPS and ROA are moderately higher positive correlation. Also, there is a positive relationship between EPS and ROE ( $r=0.324^*$ ,  $p=0.478$ ). This signifies that in order to maximize shareholders' wealth, an organization should seek to maximize ROE (Heffernan, 2005). Consequently, a negative relationship exist between the EPS and cost efficiency ratio (CER) ( $r= -0.684^*$ ,  $p= 0.098$ ). This implies that shareholders earnings and CFR are related although negatively and that an organization seeking to maximize shareholder value should struggle to reduce the CER.

**Table 7: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the estimate
1	.978a	.957	.872	2.02005

a. Predictors: (Constant), AVG CA Ratio, AVG ROE, AVG CE Ratio, AVG ROA

**Table 8: Coefficients a**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	57.446	20.774		2.765	.110
AVGROA	43.658	9.474	1.954	4.608	.044
AVGROE	-2.861	.701	-1.275	-4.079	.055
AVG CE Ratio	-.246	.358	-.146	-.687	.563
AVG CB Ratio	-467.771	189.416	-.533	-2.470	.132

a. Dependent Variable: AVG EPS

The regression coefficient of ROA (b1) is 43.658 which implies that an increase of one rupee in ROA increase EPS by rupees 43.658 on average if the other factors remain constant. The regression coefficient of ROE (b2) is -2.861 which also implies that increase in one rupee of ROE decrease EPS by 2.861 on average if the other variables remain constant. Similarly the regression coefficient of CER (b3) is -0.246 which implies that an increase of one rupee in CER decrease EPS by 0.246 rupees. But the estimates of b1, b2 and b3 may vary by 9.474, 0.701, 0.358 and 189.416 respectively as indicated by standard error. The significant t-values and significant F-values are greater than 5% level for ROE, CER and CB, and less than 5% for ROA. So coefficients mentioned above are not statistically significant for ROE, CER and CA and significant for ROA. However, there is positive relationship with ROA indicated by the coefficient B=43.65 and  $\beta = 1.954$ . This implies that the ROA influences the shareholder value positively representing that in order to improve or grow shareholder value; banks should seek to improve ROA and reduce CER.

### Interpretation and Discussion of Findings

**Pearson Correlation Coefficient (R):** The Pearson correlation coefficient (R) of .978 shows a positive correlation. The strength of the relationship between shareholders wealth and capital base, ROA, ROE and cost savings is strong. But this prediction may vary by 2.02 as shown by the figure in the column of standard error of estimate (SEE).

**Coefficient of Determination (R<sup>2</sup>):** The results presented above indicates that R<sup>2</sup> value of 0.957 indicates that about 95.7% of the total systematic variations in the shareholders wealth were due to of the variations in capital base, ROA, ROE, and cost efficiency. This means that only about 4.3 % of the systematic variations in the shareholders wealth are left unexplained hence captured by the external factors.

**Major Findings:** Capital base increase can enhance earnings by reducing the expected cost including bankruptcy as cited by (Asikhia & Adeyinka, 2013)but in this though EPS and Capital base are positively related but impact of capital base very low. With the increase in capital base EPS is increasing by 0.21.ROA has positive impact on earnings per share and ROE has negative impact. Increase in ROA has helped to increase the EPS of the shareholders whereas ROE has no contribution on the EPS of the banks. Global IME bank has increased its capital base to Rs.7323 lakhs. It still need Rs.677 lakhs to meet the target of NRB by next year. Every year capital has been increased continuously. Earnings per share is fluctuating every year but in increasing trend. In year 2015 EPS downfall to Rs. 15.58 per share. Cost efficiency is good but not satisfactory. Though CE Ratio is decreasing from the last few years but in year 2015 it again shows increment.

Return on Assets (ROA) has been increased since merger but in year 2015 it also decreased. Return on Equity (ROE) also decreased in year 2015 but it has been increased after merger in year 2013.

The Bank's earnings per share stood at Rs. 25.59 which is around 28.89 percent decrease than year 2014 and 46 percent less than year 2013. Return on equity at 13.05% against the industry average of Rs. 27.04 and 17.91%, respectively. In year 2015 bank capital base increased to Rs. 5576 lakhs but far from meeting the target of NRB by 2016. ROA has also been decreased in year 2015 but year 2014 shows the highest growth after merger. ROE was decreased after merger. Pre-merger ROE was better than post-merger ROE. EPS ratio has been increased which is good sign for the bank. Cost efficiency ratio has been increased which is not the good sign for the bank. Pre-merger CE ratio was better than post-merger. Study showed that shareholders of the superior banks are not getting what they deserve. It is shown from the earnings per share of the superior and inferior bank EPS of the consecutive years. Inferior banks shareholders are earning more than the shareholders of the superior banks. It is shown that superior banks are not getting what they deserve after merger.

## 5. Conclusion and Future Implications

The major implication of the findings is that new capital brought in by shareholders of the merged banks increase the banks operation in post-merger era. Size has been increased. Revenue was also on increasing trend while cost of operations reduced slightly for the superior banks and mostly by the inferior banks due to elimination of redundancy. Mergers led to changes in banks share ownership. Bank efficiency increases with more competent and merged ideas. Excess capital made able to compete favorably with foreign banks that are willing to enter into the Nepalese market very soon. Financial performance of the banks and the result of the findings are affected by the external factor in the year 2015.

- Due to the devastating earthquake many banks has to suffer huge loss. It is the one of the main reason despite the merger in year 2015 banks incur loss and slowdown in the major performance index.
- Border blockade by the India for more than six months also seriously affect the performance of the bank.
- Another is the political instability and various ups and downs. Especially in the Terai region local political parties forced the industries to shut down for long time and it affected the banking operations.

The outcome of this study suggested that ROA is the influencing factor in shareholders wealth creation. Besides this, there are various external factors affecting the banks performance and ultimately affects the shareholders wealth. Cost reduction should be in the priority. Other supplementary variables should be analyzed to know their effect on shareholders wealth.

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## Assessing the Factors Influencing Service Innovation Capabilities and Performance

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**Abstract:** Innovation has been recognized as a central source of business growth and a key determinant of competitive advantage for many organizations. This paper seeks to address two main objectives. The first objective is to examine the direct effect of organizational structure (i.e. centralization and formalization), transformational leadership, organizational learning and customer orientation on innovation capabilities. The second objective is to examine the effect of innovation capability and organizational performance. Findings show that customer orientation, organizational learning, and transformation leadership had significant positive effects on innovation capability. The results further show that innovation capability had a significant impact on organizational performance.

**Keywords:** *Innovation, performance, organizational learning, transformational leadership, organizational structure, customer-oriented*

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### 1. Introduction

Studies on the current business landscape indicate that services are becoming a major focus. Most developing countries, which historically have concentrated on manufacturing, are now experiencing fast service growth (Boswijk et al., 2007). Similar trends are developing in other countries as well; for instance, in Malaysia the service sector plays a primary role in economic growth. This sector is estimated to expand at 6.3% per annum, contributing 53% to GDP. During the Tenth Malaysia Plan (RMKe-10), the service sector growth was supported largely by the wholesale and retail trade, finance and insurance, and communications sectors. Investment in the service sector increased by 9.5% annually to RM125.3 billion in 2013, as a result of expansion in domestic investment (Economic Planning Unit, 2015). In the Malaysia-OECD Roundtable Discussion on Technology, Innovation and Industry 2013, innovation was acknowledged as an important driver of value creation, economic growth, and social welfare (Hutschenreiter, 2013). The service sector has played an important role in economic growth in Asia in recent years and has been identified as the engine to trigger an economic rebound (Wilson, 2014).

A growing body of literature suggests that a competitive advantage can be enhanced through services (Pralhad & Ramaswamy, 2004). Indeed, several researchers have introduced the term “experience economy,” which emphasizes services that must “orchestrate memorable events for their customers, which in turn will create value to firm” (Pine & Gilmore, 1999). As service economy is growing and customers are demanding better value and improved service, the innovation process is becoming essential in order to provide a timely response to the market with new or improved service solutions (Hidalgo & D’Alvano, 2014). Recently, researchers have shown an increased interest in service management, particularly service innovation (Storey et al., 2016; Witell et al., 2016). The issue of innovation has received considerable attention due to the complexity and intangible nature of services (Lusch & Nambisan, 2015). However, in Malaysia innovation in the service sector has not received vast attention despite its significant contribution to the economic growth and employment of the country (Narayanan and Hosseini, 2014). According to compared with studies on the manufacturing sector in Malaysia, there is a dearth of researchers on innovation in services. Moreover most of the studies on innovation are likely to focus on large firms as innovation is seen as the least vital for SMEs. Recent report by Malaysia Economic Planning Unit (EPU) (2015) indicated, several important issues relate to the service sector which includes insufficient skilled human capital, low capabilities, and low technology adoption.

From the strategic point of view, service organizations are required to innovate in order to experience sustained growth, raise the quality and productivity levels of services, respond to changing customer needs and expectations, or stand up to superior competitive service offerings (Magnusson et al., 2003). Although the

role of innovation is vital for organizations as a key strategy for growth and sustainability in the service sectors, several researchers have emphasized the intangible aspects, resulting from the interactive nature of service, that create the peculiar way in which service innovates (Miles, 2000). Innovation in service delivery has forced retail operators to rethink their strategies in treating customers and meeting their expectations. A study in Malaysia's SME retail business found that, among other problems faced by these retail outlets, to introduce new innovation in service delivery they encounter inadequate knowledge and skill in retailing, difficulty in getting competent employees for stores, and lack of skills in managing marketing activities (Hamid, Baharun & Hashim, 2006).

According to Gallouj (2002), service innovation requires greater consideration of the organizational aspects, beyond the traditional product and process innovation method through the diffusion of knowledge and skills rather than through the purchase of machinery or technology. The innovative capability varies by firms and it is determined by a vast and complex number of aspects, both internal and external to the firm (Silva, 2007). Scholars such as Shih et al. (2014) focus on study innovation from service-oriented setting, while Ngo and O'cass (2012) call for research in non-technical context to investigate how service-based retailers implement innovations in service delivery and processes (Ponnam & Balaji, 2015). Although several studies on innovation were conducted in service context, researchers have noted that studies involving innovation in service industries are still lacking about the conditions for and consequences of innovation which need further attention (Hristov & Reynolds, 2015; Djellal et al., 2013; Kimberly & Evanisko, 1981; Tidd, 2001). Several researchers have identified contextual, structural and organizational factors that differentiate innovative from non-innovative firms (Bayo-Moriones & Lera-Lopez, 2007; Slappendel, 1996) while others focused on the organizational supports for developing absorptive capacity and technology innovation (Ahmed Aljanabi et al., 2014).

Hence, the insufficient researchers that have established the relationships that may exist between the variables of current study create the theoretical gaps within the current context of the study. Referring to the above-mentioned gaps, based on the contingency theory (Drejer, 2002; Tidd, 2001) and the resource-based view (RBV) (Barney, 1991) this study aims to examine the influence of organization structure (centralization and formalization), organization learning, transformational leadership and customer centered on service innovation capabilities. This work aims to close the literature gap on the determinants of service innovation capabilities and its impact on organizational performance. Consequently, the aim of this study is to investigate the organizational factors in explaining innovation capabilities and business performance of the service sector in Malaysia. It is expected that the study will assist the academicians, administrators, and government policy makers to gain a better understanding of the pivotal factors affecting innovation capabilities and performance of firm's particularly involving service sector. Innovation capabilities involving service sector is new; therefore, it is expected that this research will stimulate further research to add to the extant body of knowledge in the sustainability of service sector.

## 2. Literature Review

**Organizational structure:** Businesses require a well-designed organizational structure to grow and be profitable (Tran & Tian, 2013). Several researchers noted that organizational structure decrease ambiguity helps explain and predict behavior (Sablinski, 2010) and manage resources (Brown, 1995). Organization structure can be defined as the architecture of business competence, leadership, talent, functional relationships and arrangement (Russell & Russell, 1992). Kartz and Kahn (1978) describe organizational structure as the relatively enduring allocation of work roles and administrative mechanisms that create a pattern of interrelated work activities and allow the organization to conduct, coordinate and control its activities. Among the most important components of the organizational structure are formalization and centralization (Zheng, Yang & Mclean, 2010). Formalization has been defined as "the degree to which rules define roles, authority relations, communications, norms, sanctions, and procedures" (Jaworski & Kohli, 1993, p.54). While centralization refers to the "inverse of the amount of delegation of decision-making authority throughout an organization and the extent of participation by organizational members in decision-making" (Jaworski & Kohli, 1993). Centralization can be beneficial in predictable, less turbulent environments where market demand is stable and simple (Ruekert et al., 1985). Previous researchers have suggested that, one of the most important factors facilitating and reinforcing the innovation ability in an organization is a

convenient structure and a suitable formation designed to fulfill the ultimate goal (Carmona-Lavado, 2010). Wan et al. (2005) indicated a positive and significant relationship between innovation level and structural decentralization, and the tendency to take risks and to change ideas. Accordingly, this study hypothesis:

**H1a: There is a relationship between centralization and service innovation capabilities.**

**H1b: There is a relationship between formalization and service innovation capabilities.**

**Organization learning:** Learning capability is considered as one of the essential elements for the organization that can be conducive to the growth and innovation. Organizational learning can be regarded as a dynamic process including the knowledge creation, acquisition, and collection with the aim to the development of resources, and capacity that leads to the better performance of the organization (Perez et al., 2005). Therefore, the spread of learning culture among an organization's member's leads to the production and innovation of knowledge systems and new creative ideas in the organization that finally generates the innovation (Samadsaki et al., 2013). Several researchers have identified that the market-oriented learning (OL) and self-learning are among the important factors that influence organizational innovation (Hung, et al., 2010; Jiménez & Valle, 2011). An organization that invests in learning is likely to possess the state-of-the-art technology to create greater products and processes innovation (Calantone et al., 2002; Damanpour, 1989). Moreover, innovation capability is positively related to firm performance (Calantone et al., 2002; Slater & Narver, 1994). Thus, it is proposed:

**H2: There is a relationship between organizational learning and service innovation capabilities.**

**Transformational leadership:** Leadership is an influencing factor on how innovation occurs in organizations both in terms of ideas and motivation to overcome obstacles. Among the traditional leadership styles, transformational leadership has been suggested as the most promising way of leading innovation effectively (Rosing et al., 2011). Several researchers have found the significant and positive relationship between leadership style and innovation (Garcia-Morales, 2012; Norouzy et al., 2013). Transformational leaders facilitate innovative activities at organizational levels using the employee's mental encouragement and their motivation stimulation (Vaccaro et al., 2012). In view of this, the following hypothesis is suggested:

**H3: There is a relationship between transformational learning and service innovation capabilities.**

**Customer orientation:** Customer orientation can be defined as the degree to which the business unit obtains and uses information from customers, develops a strategy which will meet customer needs, and implements that strategy by being responsive to customers' needs and wants (Ruekert, 1992). According to Korunka et al. (2007), customer orientation is part of corporate culture and characterizes not only the company's opinions but also its employees' behavior in dealing with customers. The desire to continually adapt to customer needs and wants more than the competitors often produce an organization that have strong customer-focused and need to innovate (Dukic et al., 2015; Santos-Vijande & Gonzales, 2007). Several past studies asserted that customer orientation has a positive effect on innovation at product, process and organizational level (Jiménez-Zarco et al., 2011). In view of the preceding discussion, the following hypothesis is proposed:

**H4: There is a relationship between customer orientation and service innovation capabilities.**

**Innovation capability and performance:** Several researchers suggested that innovation capability as the skills/knowledge and abilities that enable the application of resources, to effectively and continuously transform knowledge and ideas into new product/service to benefit the firm and its stakeholders (Kindström et al., 2013). According to Tamer Cavusgil, Calantone & Zhao (2003) a firm with high innovation capability employs a learning-by-doing effect, which helps firms to sustain their competitive advantage and prevent competitors from imitating the know-how tacit knowledge. The literature on innovation suggested that innovation is positively related to organization's performance (Calantone et al., 2002; Gunday et al., 2011). Organizational performance is an indicator that measures how effective an organization accomplishes its objectives (Valmohammadi, 2012). Past study suggested the performance of organizations entails performance in finance such as profit and sales growth (Kuei et al., 2001) and non-financial measures such as satisfaction (Venkatraman & Ramanujan, 1986). Discussion in past studies showed no consensus on the appropriate measures of firm performance (Ambad, 2014). Some researchers used a balance approached of adopting both financial and nonfinancial measures to assess organizational performance (Sneyd & Rowley, 2004; Wang et al., 2012). Another aspect of measuring performance in previous studies used the two approaches methods: objective (actual information) and perceptual (subjective) (Andersen, 2010). Many

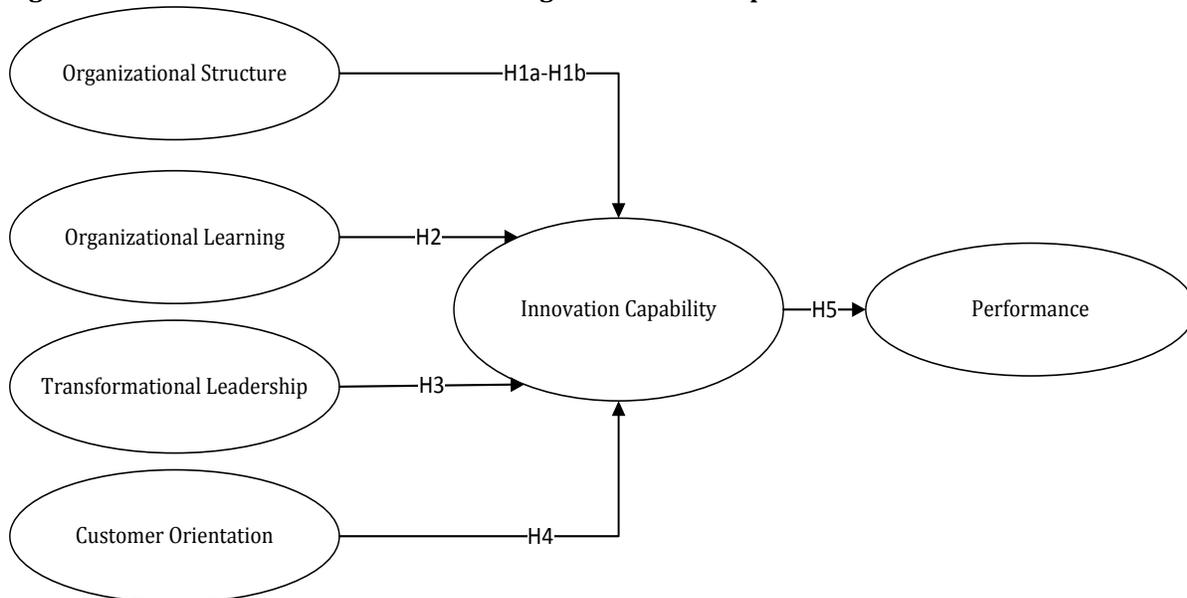
studies in the area of entrepreneurship are based on the perceptual performance data (Andersen, 2010; Wiklund & Shepherd, 2005). Hence, perceptual (subjective) measures of performance would be employed in this study. With regards to the relationship between innovation and performance, many scholars have found that innovation influence organization performance (Calantone, Cavusgil, & Zhao, 2002; Saunila et al., 2014). Damanpour et al. (1989) attempted to investigate the relationship between administrative and technical innovations and organizational performance. They posited that organizations that have a high rate of adoption of both administrative and technical innovations would have higher performance level than those that have a low rate of adoption of both administrative and technical innovations. In this paper based on the above discussions, we propose the last hypothesis:

**H5: There is a relationship between service innovation capabilities and organization performance.**

**Research Model:** A comprehensive literature review shows a lack of empirical studies that examine the impact of organizational culture, structure, leadership styles, learning, and customer-centered on innovation capability and the effect of innovation capability on performance in the context of service. Hence, a conceptual model was proposed as shown in Figure 1. In this model, the organizational structure was operationalized with two dimensions: formalization and centralization. All the four factors (organization structure, learning, transformational leadership and customer orientation) are related to service innovation capabilities (H1a-H4) which then impact organization performance (H5).

### 3. Methodology

**Figure 1: Research model on factors affecting innovation and performance**



**Sample and data collection:** In order to understand the nature of innovation service, the data of this study was collected in September to November 2015 by sending a questionnaire to the managers of 20 firms in five service sectors: food, travel agency, communication, insurance, and education services located in Klang Valley, Malaysia. Klang Valley is where the capital of Malaysia is situated. It was reported that most of the modern establishments in Malaysia are located in the Klang Valley (Euromonitor, 2001). Managers are chosen as respondents because they are involved in the management of organizational affairs and processes. To uphold confidentiality, the name of this organization is kept anonymous. This study used purposive sampling and the data were collected by using self-administered questionnaires distributed via the drop and collect technique. Drop and collect technique involves researchers and/or trained field assistants deliver the questionnaire directly to the target respondents or through gatekeepers and collect back the completed questionnaire (Ibeh et al., 2004). To ensure that the respondents were staff that holds a position as a manager or above with more than five years working experience and well versed in the nature of service work practice

in their organizations, the questionnaires were handed over to the representatives who were also employees of the company for data collection. The questionnaires were delivered and collected by the researcher. The survey questionnaires method was used to further comprehend the staff characteristics, and the nature of work, as well as the working environment in the service organizations. The gathered information is then used for the actual research. Of the 250 questionnaires that were distributed, 209 participants completed the questionnaires, representing a response rate of 84 percent. The survey questionnaires were answered by participants by their consent and a voluntary basis.

Multiples item scales were used to measure each construct in this study. The questions in the questionnaire are designed based on a review of the literature. All the five factors namely organizational structure, transformational leadership, customer orientation and learning capabilities were adopted from Hoonsopon and Ruenrom (2012); Sivadas and Dwyer (2000); Olson et al. (2005); Podsakoff et al. (1996); Nasution et al. (2011) and Jerez-Gómez et al. (2005). While innovation capabilities and organizational performance were measured using a multi-item scale developed by Hogan et al. (2011); and Luca and Atuahene-Gima (2007) respectively. All items in this study were measured on a 5-point Likert scales ranging from “strongly disagree” (1) to “strongly agree” (5). Of the 209 valid responses, 46% came from insurance sectors, 20% and 18% from food and communication sectors respectively. Majority of respondents were female respondents (53 per cent). In terms of income, 36 per cent of the respondents had an income of between MYR6,000 to MYR7,999. The highest age group distribution of the respondents falls in the 36 to 45 years old age group (40 per cent), followed by 33 per cent in the 26-35 years old age group. Regarding ethnicity, 44 per cent of the respondents are Malay, 24 per cent are Chinese and 18 per cent are Indian. The majorities (65 per cent) of the respondents are married with children while 25 per cent are single. A total of 81 respondents (39 per cent) are degree holders, 39 respondents (19 per cent) are postgraduate holders, and 41 respondents (20 per cent) are diploma holders. In terms of the size of the company, 54 per cent of the respondents were from an organization with more than 300 employees; 16 per cent from 201-200 employees; and 13 per cent from 61-100 employees.

#### 4. Findings

The internal reliability of the items was verified by performing the Cronbach’s alpha analysis. According to Sekaran and Bougie (2016) an alpha value of less than 0.6 is seen as a weak reliability while an alpha value of more than 0.7 is regarded as strongly reliable. The Cronbach’s alpha for organizational learning was 0.89, transformational leadership was 0.90, centralization was 0.86, formalization was 0.85, customer-centered was 0.92, innovation capabilities was 0.95 and organizational performance was 0.95. Reliability statistics for all the factors passed the cut-off value of 0.70 (Nunnally, 1978). The impact of multicollinearity is a concern for interpreting the regression variance (Hair et al., 2009). Highly collinear variables can distort the results substantially and thus not generalizable. The variance inflation factor VIF output for each construct was lower than the common cut-off threshold of 5. Hence, collinearity among the predictor constructs was not an issue.

**Table 1: Multiple regression analysis**

Factors/determinants	Standardized Beta Coefficients	t	Sig.
(Constant)		2.025	.044
Centralization	.045	0.838	.403
Formalization	.052	0.863	.389
Organizational Learning	.212	2.691	.008
Transformational Leadership	.206	2.455	.015
Customer Orientation	.437	6.062	.000
F(5,200)=55.26, R <sup>2</sup> = 0.656, Adj. R <sup>2</sup> =0.644			
Dependent Variable: Service Innovation Capabilities			

Table 1 presents results of a multiple regression analysis used to evaluate the strength of the proposed relationship. Seven hypotheses were formulated and all the variables were retained after performing the reliability and validity testing. Multiple regression prediction models follow the guidelines by Hair et al. (2009) to test the impact of formalization, centralization, transformational leadership, customer orientation and learning capabilities with service innovation capabilities as the dependent variable. The generic model, without controlling for organizational and individual factors, is significant at 1% level (F value = 55.26). Table 1 shows the multiple regression results obtained revealed that out of six hypotheses (H1a-H5), four hypotheses were found to be significant. According to the regression results, organizational learning, transformational leadership, customer orientation, and organizational structure (centralization, and formalization) jointly explained 64% of the total variance in innovation. Four factors had significant positive relationship with innovation: organizational learning ( $\beta = .212$ ;  $p < 0.01$ ), transformational leadership ( $\beta = .206$ ;  $p < 0.01$ ), and customer orientation ( $\beta = .437$ ;  $p < 0.01$ ). These results provide support for H2 (a significant positive relationship between organizational learning and innovation), H3 (a significant relationship between transformational leadership and innovation), and H4 (a significant positive relationship between customer orientation and innovation) but not for H1a (relationship between centralization and innovation), and H1b (relationship between formalization and innovation). Customer orientation displays the largest coefficient on innovation compared to other factors. With regards to the effect of innovation on performance, the multiple regression results in Table 2 showed that service innovation capabilities was found to be significantly and positively related to organizational performance ( $\beta = .804$ ;  $p < 0.01$ ), thus H5 was supported.

**Table 2: Multiple regression analysis**

Factors/determinants	Standardized Coefficients	Beta	t	Sig.
(Constant)			5.013	.000
Service innovation capabilities	.804		19.45	.000
F(1,207)=378.40, R <sup>2</sup> = 0.646 Adj. R <sup>2</sup> =0.645				
Dependent Variable: Organizational Performance				

**Discussion and Implication:** The objectives of this study were to investigate the influence of organizational learning, transformational leadership, customer orientation, and organizational structure on innovation capabilities. Additionally, this study proposed the relationship between innovation and organization performance. Six hypotheses were tested, four of which were supported. The findings show customer orientation was the most significant antecedents to innovation capabilities followed by organizational learning and transformational leadership. The significant relationship between customer orientation and innovation was in line with past literature (Jiménez-Zarco et al., 2011) indicating a possible association. Therefore, businesses that understand and anticipate customers' latent and future needs allow firms to be more innovative and pursue market opportunities that are not evident to competitors (Tellis et al., 2009). It is further found that most innovative companies, instead of competing on accepted performance dimensions, differentiated themselves by adapting to environmental changes and exploiting emerging or unarticulated customer needs (Berman & Hagan, 2008; Day, 2011).

Further, there was significant a relationship between organizational learning, and innovation, which are consistent with the findings of previous studies such as Atuahene-Gima, 2005; Westwood & Low, 2003; Weerawardena, 2006). This implies that one of the key aspects of an innovative firm is the strength of its organizational culture towards learning orientation. According to Sinkula et al. (1997, p.309), a learning orientation influences "the propensity of the firm to create and use knowledge". Hence, service organizations need to spread the shared principles, ideas and belief on innovation through learning culture among an organization's member's as it shapes the patterns dealing with novelty, individual initiatives and collective actions in regard to risks as well as opportunities (Kaasa & Vadi, 2008; Samadsaki et al., 2013). According to the results for effects of transformational leadership on innovation is likely to show a positive and significant relationship. In this regard, this study confirmed the results of Gumusluoğlu and Ilsev (2009), which exhibits that transformational leaders not only promote innovative activities within the organization but also ensure their market success. Several past studies have suggested the important task of the leader to set an appropriate tone and driver for innovation (Yadav, Prabhu & Chandy, 2007) which transformational

leadership seems to be more appropriate for stimulation creativity and innovation (Jamaludin et al., 2011; Rosing et al., 2011).

In addition, the results provide no support for the effect of organizational structure (formalization, and centralization) on the relationship of innovation. The results are inconsistent with Carmona-Lavado et al. (2010) and John and Doty (1996), which highlighted the importance of convenient structure and a suitable formation designed to achieve innovation. However, the results are in line with a study conducted by Lai et al. (2014). As mentioned by Fredrickson (1986) and Chandler (1962) organization structure follows strategy and strategy follow environment in a high degree division between the roles and function the dynamic capability to change accordingly will be more complex to the environment. Another possible reason is innovations are typically complex procedures, consisting of a variety of different activities depending on the stages or phases, like the ideation and implementation stage (Amabile et al., 1996; Anderson et al., 2004) or the distinction between conceptualization, development, and commercialization (Stemberg, Kaufman & Pretz, 2004). These distinctions are relevant because there are strong indications that different phases of innovation activities require different demands of strategies to boost innovation (Anderson et al., 2004; Gilley et al., 2008). Finally, innovation capabilities have a strong positive relationship with firm performance, as organization enhances its capacity to adjust to market demands through innovation, this allows the firm to sustain their advantages through improvement in organization performance. The finding is in accordance with various empirical studies supporting this relationship (Cho & Pucik, 2005; Javier Llorens Montes et al., 2005).

The results have important implications for service managers. This is particularly vital to Malaysia service sector because according to the recent report (Economic Planning Unit 2015), the service sector in Malaysia continue to be the primary propeller to the economic growth for the country. This sector is estimated to expand at 6.3% per annum, contributing 53% to GDP. Moreover, the investment in the services sector increased by 9.5% annually to RM125.3 billion in 2013, as a result of expansion in domestic investment (Economic Planning Unit 2015). Innovation in service delivery has forced many operators to rethink their strategies in treating customers and meeting their expectations.

This study finding are also useful for managers of service firms as well as policy-makers regarding the dependence of performance on innovation capability and the effective implementation of organization structure, leadership, organization learning and customer orientation. In this respect, the study results allow managers to understand the important factors that contribute towards a successful innovative firm. First, the findings of this study provide evidence that customer orientation significantly influences innovation capabilities, managers need to focus on enhancing customer value through customer focus to increase the level of innovation. Secondly, the current study results will also be helpful in promoting culture that assists organizational learning to enable a firm to achieve success in innovation. Both learning and innovation are important factors that allow response to changes in the environment and basis for long-term survival, competitiveness and achieving greater performance. Therefore, it is important to point out that managers should encourage employees to use company time to acquire knowledge that may lie outside the immediate scope of their work. Lastly, the findings of the study can be used to prioritize the practice of innovation to be utilized by managers to boost the organization performance. The results can help to design strategies to pursue creativity and innovation, which can lead to higher performance.

**Limitations and Future Research:** There are some limitations that suggest caution in assessing the findings. First, the factors used in this study are confined to several organizational factors (organizational structure, organizational learning, transformational leadership and customer orientation) which do not cover all the factors that can contribute toward innovation capability in service firms. The method used for this research can be a limitation as well because purposive sampling technique was used in collecting the data. Thus the results of the study cannot be generalized to represent the whole population. Moreover, this study focuses on Malaysian service firms located at Klang Valley thus; the result may not sufficiently represent all service firms in Malaysia. In order to enhance the generalisability of the results, future study should cover other countries, type, and size of firms and organizational age. Finally, future research should as well consider other moderating and mediating variables in the context innovation and performance.

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## Region's Financial Accounting Information System and the Quality of Local Government Financial Reports

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**Abstract:** This study aimed to analyze the use of region's financial accounting information system to the quality of local government financial reports. The quality of the financial statements includes the relevance, reliable, comparable, and understandable. The dependent variable in this study is the quality of local government financial reports, while the independent variable in this study is the region's financial accounting information system. This research method is qualitative research with this type of approach theoretical studies that the methods used to collect data or resources related to the topics in a study. Data obtained from journals, thesis, books, and various other literatures related to the study. The results showed that the use of local financial information systems positive effect on the quality of local government financial reports.

**Keywords:** *Accounting Information System, Regional Financial, Quality of Financial Reporting*

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### 1. Introduction

**Background:** Poor financial reporting from local governments in Indonesia is rampant phenomenon discussed. It is marked by the government's financial statements are still many areas that do not provide information in accordance with applicable regulations and there are many irregularities in the financial statements found by the Audit Board of the Republic of Indonesia (BPK - RI) in the audit . Based on data from the Overview Examination Semester II that of 524 LKPD government audited by BPK 157 LKPD or 30 % that received unqualified opinion, 309 LKPD or 59 % who obtain the qualified opinion, and the rest get a bad opinion (BPK RI, 2014). These financial statements are a tool of accountability for financial performance management of a government to the public entrusted to him (Prasetyo & Juliaty, 2005). The financial report is a reflection to be able to know a government has been running well, so the government is required to be able to produce quality financial reports. According to the Regulation government Number 71 Year 2010 described the qualitative characteristics of financial statements of the government that is normative preconditions necessary for the financial statements of the government can meet the desired quality that is relevant, reliable, comparable and understandable.

One contributing factor in producing high quality financial statements is an accounting information system, in which the financial statements resulting from a process that is based on good input, process and output are both good. These three aspects must be integrated and sustainable as the foundation of good financial reporting systems (Slamet, 2011). The development of information technology so rapidly makes the technology as part of a support various activities, especially for government entities who expect good governance, economic, effective and efficient. In line with the expectations of the government, especially the local government to realize good governance, local governments is trying to make it happen by building information technology in the field of finance or accounting in relation to financial management. We have had many local governments use information technology in the form of software accounting or financial management applications developed both by the government such as Financial Management Information System (SIPKD) and Regional Management Information System (SIMDA) and applications developed by the private sector.

**Problem Statement:** Based on the background of the problem, the formulation of the problem in this research is: The use of Regional Financial Accounting Information System for Quality Government Finance Report.

**Research Purpose:** The purpose of this research is to know how to use Regional Financial Accounting Information System for Quality Government Finance Report.

**Research Method:** This research method is qualitative research with this type of approach theoretical studies that the methods used to collect data or resources related to the topics raised in a study. Data obtained from journals, thesis, books, and various other literatures related to the study. Data collection is by direct or by direct observation is the way to collect data by using the eye without the help of another standard tool for this purpose. Data obtained and analyzed by descriptive analysis method is to describe the influence of financial accounting information system of the area with the qualitative characteristics of financial statements. The qualitative characteristics of financial statements in question are relevant, reliable, comparable and understandable.

## 2. Literature Review and Discussion

**Regions Financial Accounting Information System:** Accounting information systems (AIS) is a framework for coordinating the resources (data, materials, equipment, suppliers, personnel, and funds) to convert the input in the form of economic data into the output of financial information that is used to carry out the activities of an entity and to provide accounting information for party concerned (Wilkinson, 2000). The purpose of accounting information system is to provide the information required in decision making activities carried out by the so-called information processing. Most of the output required by the information processing is provided by the transaction processing system, such as the financial statements of a transaction processing system. In general, Management Information System (MIS) is a system that can assist management in data collection, processing and analysis of data evaluation and present to the limits of valuable information and finally came to the decision where this information is useful to support the functions of management operations (Machmud, 2013)

The area of financial accounting information system is a system of grouping, recording, and processing of financial activities of local governments into a financial statement as information that can be used by certain parties in decision-making. With advances in information technology are evolving so rapidly and the potential for widespread utilization, the management of, and access to financial information areas can be carried out more quickly and accurately. In the government accounting system, there are some important characteristics or the necessary requirements, including that the government accounting system must be designed in accordance with the constitution and the laws in force in a country. Government accounting system must be able to provide information that can be accounted for and audited. Government accounting system must be able to provide the financial information necessary for preparation of plans / programs and the evaluation of physical and financial execution (Gunadi et al., 2002). In the preparation and financial management, we need a system that regulates the process of classification, measurement, and disclosure of all financial transactions, called the accounting system. To produce financial information that is useful for the users, the financial statements should be prepared by personnel who have competence in the field of financial management and accounting system (Tuasikal, 2007). It is also that by applying Accounting Information Systems effectively, it can provide the information received to assist management decisions in question. Accounting Information Systems Effectiveness can be evaluated as value-added benefits. Effectiveness of Accounting Information Systems is a measure of success to meet the goals set. The successful implementation of SIA can be interpreted profitable application, a major concern of the organization, to give satisfaction to many users and improve the quality of their performance (Moscoveet et al., 2009).

Financial management starting from planning, budgeting income and expenditure (APBD), financial administration to accounting and reporting. Financial administration system applications good area should include all phases of financial management so that there is continuity of processes and data. The continuity of the process and the data input process will eliminate repeated data from one stage to the next so as to reduce the volume of work and improve the consistency and quality of data because there will be no errors in the process of rein putting the data (Kusrini and AndriKoniyo, 2007). In the explanation of the Government Regulation No. 56 of 2005 that has been updated to Government Regulation No. 65 Year 2010 on Regional Financial Information System mentioned that in order to follow up the implementation of the development process in line with the principles of good governance ( good governance ), local governments are obliged to develop and exploit advances in information technology to improve financial management, and deliver financial information to public service as a form of accountability for the activities carried out by the Government.

**Qualitative Characteristics of Financial Statements:** The qualitative characteristics of financial statements in accordance with Government Regulation No. 71 of 2010 concerning Government Accounting Standards (SAP) are normative measures that need to be realized in the accounting information so that it can fulfill its purpose. The following four characteristics is a prerequisite normative necessary in order to meet the government's financial statements desired quality:

**Relevant:** Financial statements can be said to be relevant if the information contained therein may affect decisions by helping them evaluate the events of the past or the present, and predict the future, and confirm or correct the results of their evaluations in the past. Accordingly, the financial statements of the relevant information can be linked to the intended use. Information can be said to be relevant if it fulfills the conditions which have the benefit of feedback, have the benefits of predictive, timely and complete. So that relevant information can be presented, the information presented in the financial statements of the government should be based on the information needs of users of financial statements of the government.

**Reliably:** The information in the financial statements is free from errors and misleading understanding of material, presenting any facts in an honest and verifiable. Information may be relevant, but if the nature or presentation of unreliable then use that information could potentially misleading and detrimental to the financial statements. The information reliably meets the characteristics of that presentation honest, verifiable, and neutrality. So that the information produced reliable (reliably), the presentation of information in the financial statements of the government should be based on the legislation in force, and presented thoroughly.

**Can Be Compared:** Users should be able to compare the financial statements of entities between periods to identify trends in financial position and performance and to compare the financial statements to evaluate an entity's financial position, performance and changes in relative terms. Therefore, measurement and presentation of financial effects of transactions and other similar events done consistently. Information contained in the financial statements would be more useful if it can be compared to the prior year financial statements or other reporting entity's financial statements in general. Comparison can be done internally and externally. Internal comparisons can be made when an entity apply the same accounting policy from year to year

**Can Be Understood:** The information presented in the financial statements can be understood if the government said users understand the information presented and is able to interpret it. It can be seen from the benefits of the information presented to decision making. To that end, the presentations of information in financial statements the government should use the format/form and terms that are tailored to the understanding of the users. Users must be assumed to have sufficient knowledge of the activities and the reporting entity's operating environment and a willingness to study the information presented in the financial statements of the government.

### 3. Empirical Review

Several studies on the application of accounting information systems at the local government is Indriasari (2008), Harifan (2009) and Yosefrinaldi (2013), found no evidence that suggests that a significant difference between the use of information technology to the quality of financial reports of local government and its relationship positive. Research Fikri (2011) states that the area of financial supervision SIKD and positive significant effect on the quality of financial statements. Delanno (2013) showed that a significant difference between the use of information technology to the value of the local government financial reporting information and positive relationship. The influence of the use of information technology to the value of the local government financial reporting information is the greater use of information technology, the value of financial reporting information generated will be the better government. Ratifah (2012) showed that the area of financial accounting systems have a significant impact on the quality of financial statements. Winidyaningrum study (2010) showed that in addition to human resource capacity, the quality of local government financial statements are also affected by the use of information technology.

In line with Government Regulation No. 56 Year 2005 concerning Regional Financial Information System that is in line with research conducted by Nurlaela and Rahmawati (2010) with the title of the Organization Keprilakuan Effect Uses Regional Financial Information System . The result is that with the application of financial accounting system is a good area then it will have an impact on the quality of financial reports good area anyway. Halens (2014) in his research entitled Analysis System Implementation Management Information Region (SIMDA) terhadap Quality Financial Statements on education shows that the use of SIMDA has been mandated by the legislation in force, but the level of user participation SIMDA still low which will affect the quality of the financial statements. Correspondingly, Diana (2005), finding the obstacles facing local government in order to implement financial accounting system area of the cash-based to cash a modified accrual, including: the weakness of human resources who understand the accounting in the financial section, require long duration of time (transition) whenever there is a change in the system from the old system to the new system, the slow pace of preparation of regional regulations with respect to changes in the system, the selection of an alternative model of the accounting system of the Indonesian Institute of Accountants based International Public Sector Accounting Standards (IPSAS) that use accrual basis accounting system of governments using a modified cash basis.

#### 4. Conclusion

Based on the study of theory and to analyze the results of previous studies, the researchers in this case can be concluded that the use of Financial Accounting Information Systems area affects the quality of local government financial reports. If use of Financial Accounting Information Systems daerah operated properly it will create a better quality of financial reporting as well and vice versa. One of the success factors so that an accounting information system can be a positive influence on the quality of financial statements that human resources be user in the application of the system. Level of competence, participation will be strongly supported in order to realize the effectiveness of the use of the Financial Accounting Information System.

**Recommendation:** Based on the above conclusions, some suggestions can be given that:

- To each government, in order to obtain good quality financial statements, the accounting information system already owned in order to be implemented effectively, especially pay attention to the quality of human resources that support the effectiveness of the implementation of the system.
- Limitations researchers here are only limited to the study of theory without taking into account the primary data field such as direct observation and interviews with the object of study; it is suggested further research to conduct field research.

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