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THEMATIC KEY



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Humanities

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PREFACE

The Centre for Research and Interdisciplinary Studies (CRIS) was founded with the idea of developing interdisciplinary research crossing several fields and subject areas underlying the academic curricula at Prague College, and its main purposes are:

- To promote a medium of participation and discussions by means of regular interdisciplinary workshops and seminars.
- To promote and to encourage the collaboration among different schools and programmes in the design and creation of multidisciplinary courses in the college.
- To provide a means of publishing research work for both students and staff as part of a quarterly academic bulletin and e-journal.
- To cooperate with other education institutions and organisations in the development of common projects of interest.

The Centre was developed from projects initiated by Stefano Cavagnetto in the context of his role as Head of the School of Business and the School of Computing, by Bruce Gahir, Principal Lecturer in the School of Business and Computing, and by Pascal Silondi, Director of Libat and Principal Lecturer in Interactive Media. Beginning in 2009, research in the following areas had been initiated:

1. Game theory and its application to economics, business, philosophy, and international relations.
2. The history of programming languages and history of computers.
3. Experimental media (Prague College and the CRIS, formerly PCRC, is an associate partner for Underground City XXI an international interdisciplinary EU project).
4. The history of cryptology and the science of enciphering.
5. Art and mathematics: a profitable relationship in history - from classical geometry to fractals and topology.

By combining academic study with practical training, the CRIS aims to create an environment where personal achievement goes hand-in-hand with social responsibility. Strategically, this offers students the chance to actively collaborate in several research areas with the support of faculty members and lecturers of the college.

Since 2010 a quarterly Bulletin has been published detailing progress in relevant research activities of lecturers and students. This bulletin forms an integral part of the CRIS and provides a medium whereby the research activities of the centre can be documented. Faculty members, lecturers and students belonging to every school of the college are welcome to submit their work for publication.

You can find the published Bulletins of CRIS on Ebrary (electronic library), in the college library, in six Prague libraries (Narodni knihovna, Knihovna Narodniho muzea v Praze, Ministerstvo kultury CR, Parlamentni knihovna, Mestske knihovne v Praze, Knihovna a tiskarna pro nevidome K.E. Macana), Moravska zemská knihovna in Brno, Stredoceska vedecka knihovna in Kladno, Jihoceska vedecka knihovna in Ceske Budejovice, Studijni a vedecka knihovna Plzenskeho kraje in Plzen, Severoceska vedecka knihovna in Usti nad Labem, Krajska vedecka knihovna in Liberec, Studijni a vedecka knihovna in Hradec Kralove, Moravskoslezska vedecka knihovna in Ostrava, Vedecka knihovna in Olomouc, Krajska knihovna in Pardubice, Havlickuv Brod, Zlin, and Karlovy Vary.

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A NEW INTERFACE

SEAN CLARK

The means by which humanity communicates has seen great change over the last two millennia shaping the many ways we share knowledge today. Before the written word, oral traditions allowed for communication locally. If compelling enough these vocalised thoughts would move across time through retelling and fresh interpretation. Trained storytellers and singers enabled this early aural interface.

As the Roman Catholic Church grew across Europe, knowledge began to centralise. Monks labored to transcribe the Bible and other religious works while defining the page structure and layout of the written word. They created beautiful works of art through their illumination and helped to bring the written word and a new mode of knowledge sharing into the lives of those who could afford it. Unfortunately, the heavy labour of transcription meant that only a small quantity of books could be made each year. Then, in the middle of the 15th century, Johannes Gutenberg's invention of the printing press formed the defining moment in Europe's search for a better mass communication interface. An invention still important today, it made quick copying and mass dissemination of information possible. It also helped to standardise page structure and typography making it possible for more people to read and comprehend the text. The printed word remains the most trusted source in today's Information Age. The connected digital environment has again broadened access and added a new element, interactivity, into the formerly static page. However, digital media has yet to see its full potential as it remains tied to the traditions and axioms of print design that came before it. A new interface, free of the strictures of print design, could have an impact not unlike Gutenberg's invention of the printing press.

The term interface may have had its origins in the sciences, but today it is generally accepted as a term used to describe how a person interacts with a computer. Merriam-Webster defines it as "a system that is used for operating a computer: a system that controls the way information is shown to a computer user and the way the user is able to work with the computer" and "the means by which interaction or communication is achieved at an interface". Further, it has come to simply mean the direct interaction between people or between a person and a device when transferring information. Through this lens we can look back across history and view the printed page, the illuminated manuscript, and the conversation of the early illiterate masses as interfaces. Technology has played a large role in humanities progression through these modes of communication. Even the printed page required advances in the production of vellum, parchment, and finally paper to be fully effective. A more concise definition might look something like this: a mode of expressing or displaying thought in an organized manner through aural, visual, or interactive means in order to share knowledge.

COMMUNICATION INTERFACES

Oral tradition or the expression of thought by a storyteller or singer to localised communities of listeners is in itself both a form of technology and interface. Albert Bates Lord defined this tradition, "for any individual singer the tradition consists of all the performances of all the songs of all the singers he has ever heard. All the singers encompasses the worst, the best, and all in between. ... A tradition is dynamic and ongoing" (Lord, 1995, p. 3). This trained individual was called a *Filí* in traditional Irish culture (Nagy, 1986). Before the spread of the Latin alphabet and literate populations, he had linguistic methodologies and memory devices he could use within his speech to help listeners understand and memorise his stories; not so much as changing them, but simply making them more relevant to the current listeners. A modern day example can be heard in the performance of traditional jazz. These jazz musicians learn not solely by reading, but by listening to other musicians. They improvise within their own performance to the benefit of the audience listening at that moment while maintaining the themes and ideas from previous renditions of the same piece. A recording of this piece of music would only capture the musicians' performance at that moment, creating a static snapshot, though variations on the same piece exist across time.

When oral "genres first appeared in writing, their metric base, their poetic and compositional devices, were already fully developed and none of them could have been invented by any person at any one time" (Lord, 1995, p. 1). Lord argues that early scribes used the structure and devices of the storytellers and singers that came before them. He also theorised that the discrepancies between written versions of early stories was due not to errors in the scribes' transcriptions, but to them hearing different versions. In committing these stories to the permanence of the page, the scribes stripped them of their dynamism and lent permanence to the singular versions that they had heard. The spread of the Latin alphabet along with Christianity across Europe brought a major new communication tool into the lives of the storytellers. Nowhere was this more evident than in Ireland where oral tradition and the written word lived, seemingly equally, side by side. In a talk given by Joseph Nagy (1988), he spoke of evidence pointing to close connections being formed between the old oral traditions of the *Filí* and the new monastic class who were well-learned in Latin and the literature of late classical Christianity as Ireland moved out of the 5th century.

In transcribing the Bible and other religious texts, scribes, generally monks at this time, worked with and as artists. They left room on the page for initial caps, rubrics, and later for miniatures that grew ever more elegant and complex. They created margins around the text and sometimes commented within them. Their art progressed into illumination which required the use of gold and silver to literally light up the page. This interface progressed from the oral tradition before it by using the visual sense to pull the reader in and hold their gaze (Bradley, 2006, p. 32). Interest in the ownership of these illuminated books spread from ecclesiastic to the secular. The wealth and royalty of Europe began requesting books on a variety of subjects to fill their private libraries (Jones, 2000).

As a new industry of non-religious publishers provided greater access to information, literacy began to spread among the common peoples of Europe. The control of published information moved from a closed system to one that was more broadly open. It also reawakened the ability of non-religious oral traditions to spread through written word. As an example, William Shakespeare wrote his plays to be seen and heard, but the printed versions have had a large impact on the literary world that followed. Gutenberg's greatest achievement was to bring information access to the masses. The printing press created a greater economical means for spreading knowledge versus the scribes and illuminators it ultimately replaced. Through the relative openness of the media and the permanence of this new interface, the printed page became the most trusted, if easiest, to access sources for knowledge.

New forms of print were created such as newspapers, magazines, and pamphlets. The mechanically printed page retained the layouts formulated by the monks and secular scribes by continuing to use margins, initial caps, white space for hand drawn illustrations, and carrying on the practice of using red ink for initial paragraphs. Gutenberg's printing press ultimately served to broaden and speed up the average person's access to information while maintaining rules of structure and layout that were recognisable across all forms of print.

Today's printed page, especially in book form, is still the most trusted source of information. However, digital media and the Internet as humanities latest innovations in transmitting knowledge are slowly replacing the printed page through convenience and perceived cost reductions as the primary source for knowledge. Born with tremendous potential, the Internet promised to share more information than any medium before it through an interface that can support all forms of media and in an interactive way not previously possible. The Internet and its related technologies connect people across the globe in instantaneous communication, sharing information as we never could before. A young student in the United States and another in Estonia can quickly and effortlessly share local experiences across differing cultures, geographies, and even languages. Digital media and the Internet are now in a state of transition between the confines of print norms and the promise of an all inclusive and sharing medium that can truly revolutionise the way we find and share knowledge.

TOWARDS A NEW INTERFACE

Today's digital interface has several barriers that must be overcome for it to achieve its full potential. The vast majority of websites and apps are formatted to look, or simulate, their printed counterparts. They often make use of only a fraction of the screen which has an aspect ratio ranging from 4:3 to 16:10. This has become more apparent over the last few years as technological advances have migrated the screen to wider aspect ratios, whether in standalone monitors, laptops, tablets, or smartphones. The latter wreaks havoc on typical web design because of their small size and the user's ability to change the orientation between portrait and landscape at will. On the other hand, the tactile and on-screen interfaces of smart phones may help to push digital media beyond the confines of print if designed for properly. Along with these, a clutter of information often distracts from the main content or most important element of a page.

Another challenge for digital media in this transitional period is tied to its place within the computing world. Over the last couple years the design community has argued over the use of skeuomorphs in website and app design. These metaphorical and representative uses of imagery help a user connect a digital concept to a real world object; take the image of a file folder used to represent a place where digital files are stored on a computer as an example. The larger argument centres around the use of real world textures, three-dimensional fakery, and the representation of everyday objects within the flat display space of the screen based interface, highlighted in the much cheered changes in the look of Apple's iOS7 interface. However misrepresented, this argument is over aesthetics and design choice. The old iOS interface may have been kitschy, but it was also very popular and making big changes, as Apple did, can confuse users.

Metaphors will always find a place in digital media design. Their appearance, whether flat, three-dimensional, or somewhere in between, is up to the designer while likely being influenced by current trends. Most importantly these visual displays must always make content the first priority and make sure that the user has easy access.



Figure 1: Boutique Networks.

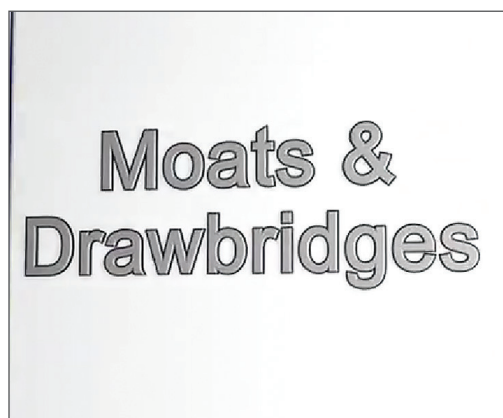


Figure 2: Moats and Drawbridges.

From the turnable pages of books, to economics and social media, access may be the biggest road block to the evolution of the connected digital media interface. The Internet Society, a non-profit organisation formed in 1992 to promote standards and open access on the Internet, has some concerns about the future of connected devices. Through a scenario called the "Boutique Network Scenario" in Figure 1, they show the possibility of the Internet becoming segmented in a future where everyone connects to a localised intranet and have no access to content outside of it. In another example called "Moats and Drawbridges", Figure 2, they show a future in which governments and corporations work together to wall off data and charge large fees to move through these walls while also removing creative control from the content developers (InternetSocietyVideo, 2010). These sorts of controls and centralised powers would be more akin to the publishing industry that rose with the invention of the printing press constricting control of content. Under these scenarios a few big players will control everything and digital media will not be able to reach its full potential. The individual who has leveraged the openness of the Internet to self publish will no longer exist. Less competition will also reduce access through higher costs to the user. The possibilities here are all the more real given current global events and concerns about security. Governments may push to lock the virtual gates of their networks and only allow traffic within their own borders, thus destroying the global community and sharing of knowledge that the Internet has fostered since its beginnings.

In efforts to better monetise digital media, search engines such as Google and social networks including Facebook have worked to personalise content displayed to each individual user. In 2011, Eli Pariser coined the term "filter bubble", Figure 3, to explain how this works to narrow the information displayed to a user by showing only what they are most likely to want to view (Pariser, 2011). The user no longer receives information counter to or outside of what they have unwittingly told the provider they prefer to see. While these large Internet based companies may mean well they are working counter to societies views of what the internet should be. Narrowing visible content removes an advantage of connected digital media in allowing a user to quickly find information across an entire field of possibilities from any location and in the long term may affect their own world view. Three computer scientists now say they can reverse this trend with an algorithm that uses the similarities between users in one subject area to show them counterintuitive information in another subject. Their research has shown that users actually prefer to have access to information counter to their own views and that users are more likely to stick around when the content served to them is more fully rounded (MIT Technology Review, 2013). For digital firms concerned about their bottom line and maintaining users, this should be good news and impetus to maintain fully rounded content for each individual user instead of placing them within a more restrictive filter bubble.



Figure 3: Eli Pariser, Beware Online "Filter Bubbles".

Designers must consider content as top priority and place it highest in their visual hierarchy. Whether designing for typographic or other forms of content, the user's intent should come first. The page structure and layout created by the early writers of manuscripts lived on through Gutenberg's printing press and moveable type. However, typography is struggling in the digitally connected domain where the form factor of the displaying device varies greatly and too much is being placed on the screen to grab the user's attention. As standards progress and designers move towards responsive designs, typography on the Internet is coming of age. Digital typography also has an advantage over the printed page in its interactive ability. Many websites and digital devices now allow for the scaling of text and changing of foreground and background colours by the user to better suite their environment and needs. This helps the content remain at the top of the hierarchy and engages the user in continued use. Responsive design as a whole can keep content up front no matter the size or orientation of the display. This flexibility is where digital has its advantages over print.

Connected digital media has several advantages than can elevate the screen above the printed page. Both content and user can be anywhere in the world separated by geography, culture, and political boundaries. The user can access the information almost instantaneously at any time from the moment it appears on the internet. That content is also fluid and flexible. The device used to display it can vary in shape, size and functionality. It can be displayed on the latest highest end smartphone or on a low cost "dumb" phone that is connected and at the very least displays simple html pages. The interface served up to the two phones may differ, but the content can remain the same removing barriers to those with fewer and lower tech choices in device. It can be updated at any time to reflect current knowledge and can link to and from other pertinent information. The greatest advantage that digital media has over print is in its mode as an interactive medium. A well designed and connected digital interface can engage users like no other medium can in sharing knowledge. It can guide users through content while also allowing them to navigate freely to discover the wealth of information at their fingertips.

It is in the Internet's ability to store and share all forms of media that this can be best accomplished. When the interface combines audio with imagery and animation, or the occasional video, it can become more engaging to a broader audience than print. That audience might even learn more through the multi-pronged presentation of information. The Internet as a malleable medium can look very different on one screen versus another while still conveying the same information. Today we think in terms of a rectangular screen, but soon it could be something very different. Smartphones can create new environments and add to the ones we know through a concept known as augmented reality. When a user points his smartphone at the

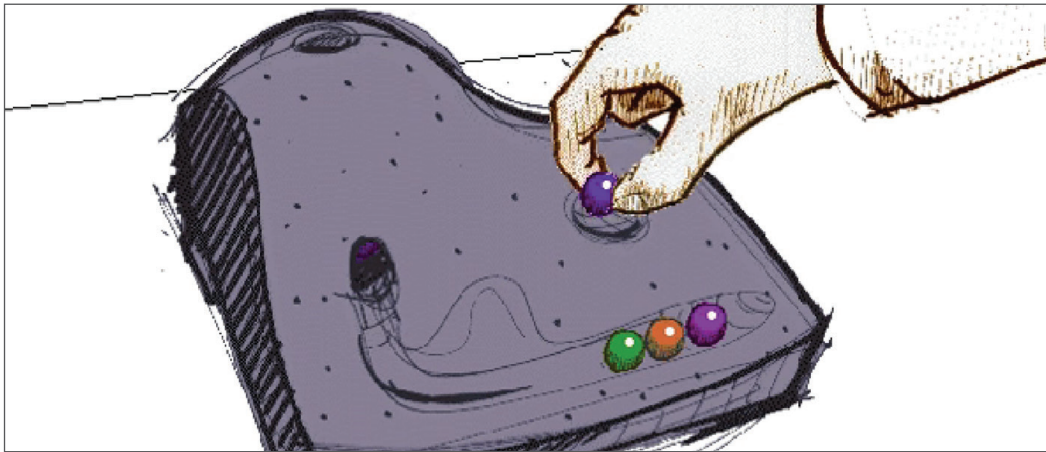


Figure 4: Durrell Bishop, "Marble Answer Machine".

real world, it can use its various sensors to place virtual objects within it for the user, even while moving around, creating a whole new experience. The rectangular screen then appears more as a window on the world to look through rather than directly at. The next step might be something like Google Glass, non-corrective eye wear which will allow the users to look directly at the world around them while simultaneously seeing location relevant information right at eye level. However, there is a counter argument for interfaces that are more physical in their interactions with digital media. An example is given in Durrell Bishop's 1992 prototype of an answer machine, Figure 4, uses different coloured marbles to represent messages left by people calling when he is away. These marbles can be placed back into the machine to play or erase the message or directly on the phone to initiate a call. They can also be placed elsewhere as a reminder for later use (Do, 2011).

THE LOOK OF A NEW INTERFACE

New ways are needed in looking at how information is stored, searched for, gathered, and displayed on the Internet and digital devices. Ethan Marcotte, in his "The Map Is Not the Territory" talk (2013), Figure 5, argues that we are still using a vocabulary meant for print when discussing knowledge shared over digital media. He believes that we need a new definition of beauty in web design and that it should include ease of access as a high priority. As we move through this transitional period, Bret Victor argues that we are too focused on the screen as an interface, that there is nothing natural about it. He argues for a new user interface that truly allows us to use our hands (2011). The smooth glass screen is perhaps not the only answer to connecting users to the dynamic information that lives on the Internet.

The trusted sources of knowledge is moving from the large publishers and media corporations that have controlled information since Gutenberg's time and back to the common person. Through this shift the Internet has taken on a aural sense. Through blogs and social media site such as Twitter the everyday person posts their thoughts, often with little editing, and while the Internet lends more permanence to these digital bits, they are often treated just as aural populations of our past treated the non written word. We are returning to information sharing as a social medium rather than a professional medium controlled by a few big players. Communication in an aural sense, store as digital bits, has expanded beyond the local community. The difference today is that we as individuals can share on a global scale. While the interface that will bring connected digital media into its own does not yet exist much has been said about what it may look, sound, and feel like.



Figure 5: Ethan Marcotte, "The Map is Not the Territory".

In a talk given by Vinton Cerf, Figure 6, he mentions a comment made by one of his colleagues, "one hundred years from now people are going to say, 'did you know that one-hundred years ago we didn't have books that talked to each other?'" (2009). This is an interesting idea that someday soon books will be able to communicate and update dynamically on their own. But as Cerf mentions in his talk, this creates problems. How does the user know where that bit of information they found earlier has moved to or has it changed totally? This interfacing of information between different sources will create a new challenge in the interface to users. If we look at digital media in the print or typographic form only, what is really needed is simplicity.

Returning to Ethan Marcotte's talk, designers should also consider the global user. Many people do not have a flashy, latest off the production line smartphone. In many markets people are still using simple text based phones. If the design goal is to make content beautiful by making it accessible to the simplest of devices, we can reach more people. In doing so, more users would benefit from the spread of knowledge (2013). If we take this a step further perhaps the interface can also be improved by where information is pulled. If all information is placed in the cloud, a massive network of databases, or multiple and interoperable cloud systems it will make for better information sharing if data about a single subject can be pulled from multiple sources. To illustrate, a Bible scholar doing a single search on a passage would be able to see various versions and translations of that single passage. He would not have to look at multiple web pages or search libraries and collections for multiple books. Instead, he would see within a single unified interface all of these versions. The interface pulling these bits of information from various sources into a single interface that allows the scholar to quickly go back and forth between them and pull them all together for a better understanding of the passage and how it may have changed over time and through translation.

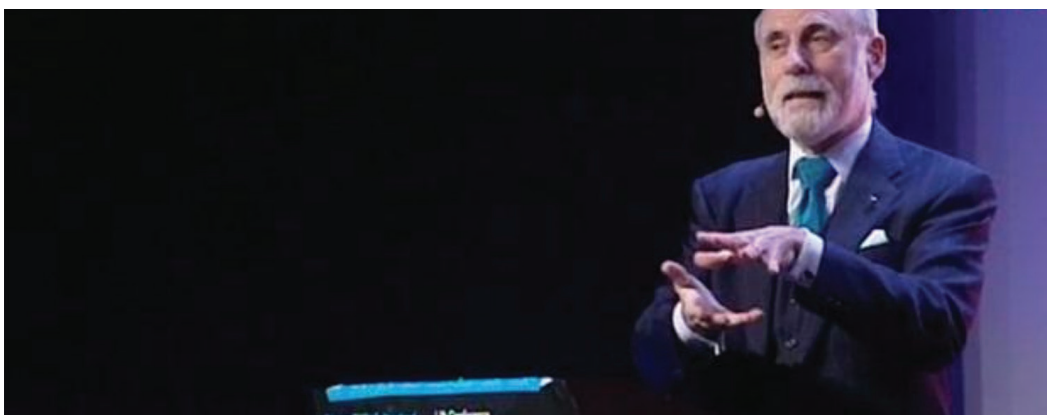


Figure 6: Vinton Cerf, "From the Jurassic Era".



Figure 7: Cenk Uygur of The Young Turks.



Figure 8: The Guardian, "Three Little Pigs" Ad.

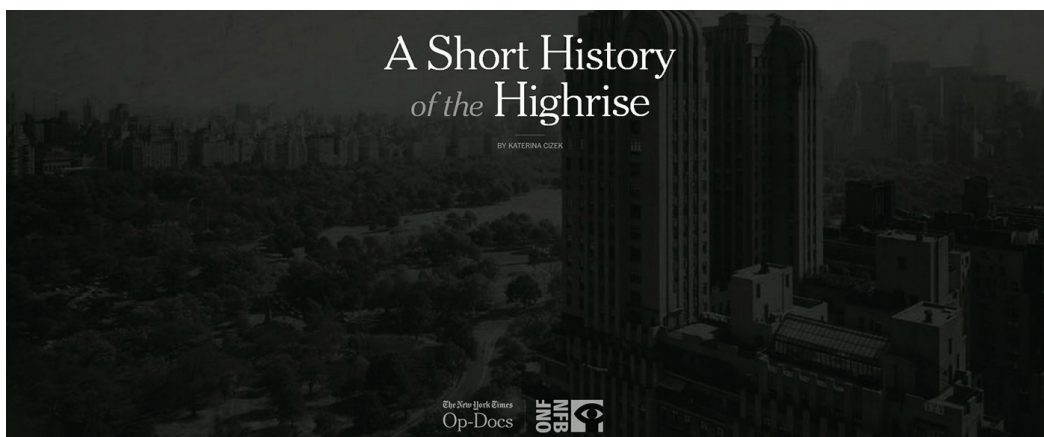


Figure 9: The New York Times, "A Short History of the Highrise".

Social media has reintroduced society to the aural mode of communication that existed before the written word. Except this time it is happening on a global scale and with more permanence than the purely vocal word. This is happening through short phrases on sites like Twitter and videos on sites like Youtube and Vimeo. In the process these posts from everyday people and independent groups are displacing the traditional news media. Figure 7 shows a still of Cenk Uygur of The Young Turks, an independent news organisation that broadcasts on their own Youtube channel and claims to be the most watched news on the Internet. Figure 8 is a still from The Guardian's ad for their open journalism project. The ad depicts how social media would react and how The Guardian would report the story if the three little pigs existed today and were blamed for the apparent murder of the big bad wolf. In their new initiative The Guardian is harnessing the views and perspective of the everyday reader to help them report the news. The New York Times has begun to move their print media towards a more interactive and digital media friendly format. In examples like "A Short History of the Highrise", Figure 9, they combine text, images, audio, video, and animation all into a near seamless interface in which the user can push and pull at the elements and move forward and backward through the story at will. The user can decide whether to watch, listen, and interact with only some portions of the story or enjoy it in its entirety. In doing so they are moving traditional media towards a model that supports and utilises the digital interface that connects people to knowledge and information while acknowledging the renewed aural sense that instant and global connectedness has given society.

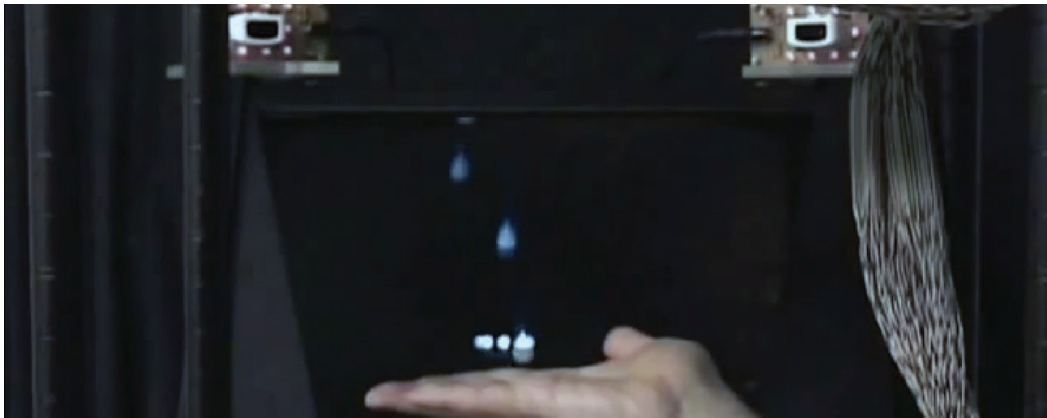


Figure 10: Shinoa Lab, "Touchable Holography".

In an essay by Frank Chimero he writes that "web and interaction design are just as much children of film-making as they are of graphic design" and that screens do not care what content is being displayed they just want it to move; he calls this movement "flux" and defines it as covering everything from animation and user customisation to the responsiveness of the site itself (2013). If we take Shakespeare's plays as an example, the best way to experience them is to see them performed. However, to understand and truly appreciate them requires study. An interface that takes advantage of flux and can operate in an open environment to pull video from different performances, text from different folios, and scholarly knowledge together will enable greater understanding and appreciation. Through intertwining the written word with audio and video and showing them in context, the user will achieve this goal. However the interface must go beyond this, it must adapt to the device in hand. If the design is successful, it will not only respond to screen size but scale to show only the content the device is capable of while maintaining a clean and user friendly appearance. The interface should be able to construct a full multimedia experience, but at the same time leave no device behind or cause the content to appear broken due to lack of capability.

Haptic feedback, a feature missing from stock iOS devices, but available on most Android devices, enables a short subtle vibration every time the user tabs a key on the virtual keyboard of their smartphone. This vibration acts as feedback that immediately alerts the user through touch that they pressed a key. It is similar to the audible beep of older phones with physical buttons but provides more direct feedback that is only noticed by the user. Feedback is essential to human understanding especially where the sense of touch is concerned. The vibration on a key press is only a small example; feedback is largely missing from the interfaces of our digital world.

Returning to Bret Victor's essay on the future of interaction design, he calls the touchable glass interface of current devices "Pictures Under Glass" and writes that they "sacrifice all the tactile richness of working with our hands, offering instead a hokey visual facade" (2011). The future of digital design may be less digital. Engaging the user more deeply may require more feedback, more physical interaction than can be had with smooth glass surfaces. At SIGGRAPH 2009 a group of researchers from Shinoda Lab showcased a video, Figure 10, in which they demonstrated that users can interact with holograms through the use of motion tracking cameras and focused ultrasound waves that create force and allow for tactile feedback. The user in the video can feel the virtual raindrops hitting their hand. This of course is a very rough technology that is barely into its infancy. However, in the future it may be a more practical means for interacting with digital media than the example given in the last section of the marble answer machine.

As an example, imagine sitting in your future living room and you are about to assemble a piece of furniture. Many people today find printed assembly instructions hard to follow. What if in that future living room you could go to a hologram display in which you opened up a virtual manual. The tactile hologram would allow you to manipulate the various pieces and maybe even practice assembling them before you sit back down to assemble the real furniture. The digital interface of the future may be more familiar, more tactile and more inviting than the shiny glass screens we interact with today.

IMPACT OF A NEW INTERFACE AND CONCLUSION

It is unlikely that a single interface will elevate digital media above the printed form. A mix of different interfaces providing access to our digital world is advantageous. The seven billion people now living in varying cultures, topographies, and means do not all learn alike, they do not use the exact same digital devices, and indeed they each have preferences of their own if not simply differences in options based on geographic location. New designs that harness all that digital media has to offer from textual, visual, audio, and mixed sources will allow users to customise their experience to their own needs and learning style. The return to an aural sense of communication spurred by social media will force large media and news corporations to adapt or disappear. The Guardian's open journalism project is an example of this shift and The New York Times has begun to show that old media is willing to invest in redefining how they share the news instead of simply pasting what they print into digital media that mimics the paper medium. A new economic model may still be forced upon the media giants of old while empowering and enriching the global community that participates in the networked sharing of information. The invention of writing and later the printing press did not stop the modes of communication that came before them. Digital media is unlikely to fully replace print any time soon, but only to enhance upon what came before.

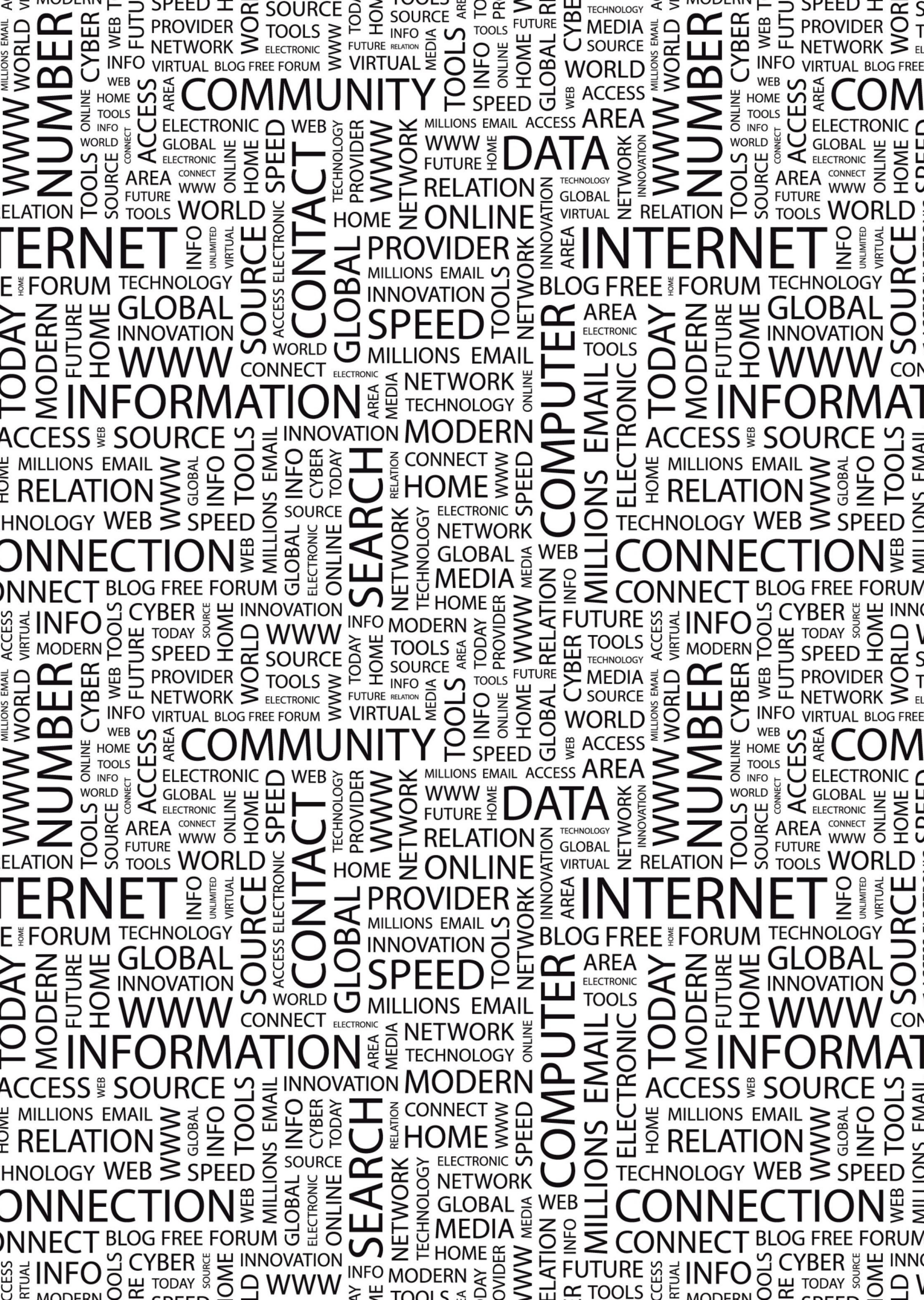
We are moving through a transitional period from print media to a new more open and global community-oriented digital medium. However, digital media is still in its infancy and we do not know yet what era defining interface will propel the digital medium beyond the dominate interface of the last 500 years. There are still barriers to be overcome, from threats to global openness to economic forces that may reduce access locally. It will take continued action from a global community committed to furthering all of humanities access to knowledge. It will also require the continued innovation of designers, researchers, and inventors to realise a truly groundbreaking interface that builds upon but exists free of the strictures and limitations of those that came before. Through these efforts, connected digital media could have an impact not unlike Gutenberg's invention of the printing press. ■

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IMAGE LIST

- FIGURE 1:** InternetSocietyVideo (2010) *Future of the Internet: Boutique Networks*. Available at: <http://www.youtube.com/watch?v=YUd8dVVXmRQ> (Accessed: 11 February 2014).
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EMERGING BUSINESS AND HUMAN RIGHTS STANDARDS: INTERNET SERVICE PROVIDERS AND CENSORSHIP DEMANDS

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Over the past several decades, the world has seen a dramatic growth in the activities of global businesses and multinational corporations. While this expansion has led to an increase in the availability of goods and services around the world, with it has also come more occurrences of human rights violations often at the hands or behest of corporations. Yet the role of businesses in human rights also often involves corporate complicity when countries violate human rights. Many of these violations have been clearly brought to the public's attention, such as the use of sweatshops in developing countries. There is no question that as corporations play a greater role in our society, the possibility they have for both advancement and human rights abuse have the potential to increase hand-in-hand. However, there has been great debate over the accountability that corporations should have if and when they violate human rights.

While human rights have traditionally been a domain for state governments, there has been a growing discussion on the role businesses play in ensuring human rights (Office of the High Commissioner for Human Rights). Businesses often involved in human rights protection or responsible for human rights infringements include, but are not limited to, those in manufacturing, information and communication technology, mining, oil and energy extraction, agribusiness, banking, and finance. Over the past several years, the world has seen increased pressure on corporations to close down sweat shops or adopt less environmentally harmful practices, thereby protecting local populations. However, the extent that a business can be held legally responsible for human rights violations and, consequently, obligated to provide remedies for such violations, has been the subject of much debate.

With the increasingly significant role of corporations in the world, it should come as no surprise that the area of Business and Human Rights has been developing rapidly in recent years, both in the private sector and the international legal arena. The United Nations has endorsed a set of Guiding Principles, which outline globally accepted standards on the responsibilities of both businesses and governments to prevent and address human rights issues arising from business activities (Guiding Principles, 2011). In 2013, the United Nations hosted the Second Annual Forum on Business and Human Rights, the largest global discussion on the subject to date. On the other end of the spectrum, many businesses and industries have taken it upon themselves to generate human rights standards and ethical practices, often through the notion of corporate social responsibility. While there has been some case law regarding the responsibility of businesses when human rights are in question, much of the adherence to standards is voluntary and a decision left to the individual industries or companies (Ku, 2011).

This article will focus on the legal regulations of businesses in a position to protect or violate human rights. The case in point concerning Internet Service Providers (ISPs) operating in countries that require censorship, thereby raising questions of the freedoms of expression and information which are enshrined in international human rights law, will seek to create an understanding of the ways in which businesses are obliged to consider human rights law. Certainly, there are examples of very grave human rights violations, but the example of ISPs and censorship is much more widespread and likely an issue that may continue to have an impact on people across the globe (Global Network Initiative Inaugural Report, 2010). In order to create a more focused picture of the situation, this article will use the example of Google's choice to operate in China by balancing censorship requirements with the drive to do business in a huge market. As such, the obligations of an ISP to protect human rights in the context of censorship will be the example throughout this discussion.

INTERNATIONAL HUMAN RIGHTS LAW

INTERNATIONAL BILL OF RIGHTS

Before going into further detail about the responsibility of corporations, it is important to understand specifically what is meant by *human rights* and to illustrate the potential difficulty in applying human rights obligations to corporations. There is no one definition of what are considered to be human rights. Certainly, the Universal Declaration of Human Rights is the best source for identifying human rights and it includes the right to life, freedom from discrimination of all kinds, freedom from torture, freedom of expression and many others (Universal Declaration of Human Rights, 1948). However, as the law generally goes, human rights law is always evolving to include new rights or modify old ones to meet the needs of the current global society. This is often done through new treaties, such as the International Covenants on Civil and Political Rights and Economic, Social and Cultural Rights, as well as treaties covering race, women, children and more (International Convention on the Race Discrimination, 1969; Convention on Discrimination Against Women, 1981; Declaration on the Rights of the Child, 1959).

When it comes to human rights law and thus the types of rights that might be violated by businesses, there are a few key international legal documents that generally govern human rights: the International Covenant on Civil and Political Rights (ICCPR, 1966), the International Covenant on Economic, Social and Cultural Rights (ICESCR, 1966), and the Universal Declaration of Human Rights (UDHR, 1948). These are collectively known as the "International Bill of Rights." However, these documents apply to States and do not provide for direct liability of private individuals or corporations. The United Nations Office of the High Commissioner for Human Rights further explains that:

Human rights entail both rights and obligations. States assume obligations and duties under international law to respect, to protect and to fulfil human rights. The obligation to respect means that States must refrain from interfering with or curtailing the enjoyment of human rights. The obligation to protect requires States to protect individuals and groups against human rights abuses. The obligation to fulfil means that States must take positive action to facilitate the enjoyment of basic human rights. At the individual level, while we are entitled our human rights, we should also respect the human rights of others.

Thus, provisions in the International Bill of Rights are instrumental in demonstrating the human rights that States must ensure and protect, even if the violations are being committed by corporations, as well as what rights corporations should be mindful of.

GOOGLE IN CHINA: CENSORSHIP ISSUES IN THE INTERNET SERVICE INDUSTRY

While Internet Service Providers are designed to provide information and related services to users, if they want to operate in certain countries they must often balance these activities with laws in those countries that require censorship or restricted information access, even when such censorship may be in violation of the countries' international obligations, as explained in detail below. Google's experience in China first began in 2000 when it developed a Chinese-language interface for its main website, Google.com (Schrage, 2006). However, over the next five years, Google's services in China were unavailable as much as ten percent of the time, and often slow and generally unreliable for users in mainland China (Schrage, 2006). Even the reachable services were almost always slower than Google's local Chinese competitors (Schrage, 2006). This was said to be largely because Chinese laws required extensive filtering even by smaller ISPs, which Google had to go through since it did not actually operate servers in China at the time (Schrage, 2006). The variation of filtering mechanisms maintained by each ISP led to a wide range of inconsistent outcomes that differed depending on time of day and location (Schrage, 2006). This diminished service was creating serious consequences for Google's market share. In fact, Google found that not operating with a local presence was "a major – perhaps the major – factor behind steadily declining market share" (Schrage, 2006).

For over a year, Google's management studied the positive and negative aspects of entering China (Schrage, 2006). Then on January 27, 2006 Google officially launched a search page based in China: Google.cn, opting to accept certain censorship requirements. According to local laws, Google would have to censor its search results, which it considered to be a "trade-off to 'make meaningful and positive contributions' to development in China" (Lee, 2010). For three years Google engaged in the Chinese market from Chinese soil without too much controversy or complications. However, in March 2009, China blocked all access to YouTube (BBC NEWS Business, 2010) and then in June, it began to mandate filtering software on all new PCs sold in China (Lee, 2010). Google's Gmail, Google.com site and other services became inaccessible in China the day before a Chinese official accused Google of spreading obscene material through its Internet services (Lee, 2010).

In January 2010, Google announced that it would no longer accept China's censorship demands and threatened to pull out of China altogether (Lee, 2010). China retaliated by calling this a Western stance and attacked Google for having close ties with the White House (BBC NEWS Business, 2010). By March 22, 2010, Google began automatically redirecting all customers from mainland China to its Hong Kong site, Google.hk, which was completely uncensored due to Hong Kong's independent legal system (BBC NEWS Business, 2010). China claimed that it would not renew Google's Internet Service Provider license under these circumstances. In June, China's preliminary list of license renewals did not include Google (Lee, 2010). Immediately following this, Google said that it would stop automatically rerouting Chinese customers to Hong Kong. Rather, users would have to actively choose to be redirected out of Google.cn and to Google's Hong Kong site (BBC NEWS Business, 2010). On July 9, 2010, China renewed Google's ISP license (Lee, 2010). Though the exact terms of the agreement are unknown, it was declared a victory for both sides because Google was able to continue operating from within China and Chinese users have the option of using Hong Kong's uncensored search engine.

However, now in 2014, as a result of Google's refusal to continue to censor its Internet content at the demand of the Chinese government, which would contrast with international human rights law standards, the Chinese government has recently been blocking Google's services in China again, particularly in the days leading up to the 25th anniversary of the Tiananmen Square incident (Roberts, 2014). In order to fully understand this situation and others like it, this article will discuss the ethical and legal implications of corporations taking steps to protect human rights. Overall, the aim of this article is to create a candid analysis of the accountability businesses should or should not have in human rights protection, based on both corporations' legal responsibilities to their shareholders and the rights of people to have basic human rights.

INTERNET SERVICE PROVIDERS AND HUMAN RIGHTS

Without a doubt, Internet Service Providers play an instrumental role in advancing the freedoms of expression, speech and information, which are essential in advancing many human rights issues. Furthermore, the freedom of expression is considered to be vital to human rights, as the Inter-American Court of Human Rights explained:

Freedom of expression is a cornerstone upon which the very existence of a democratic society rests. It is indispensable for the formation of public opinion. It is also a *conditio sine qua non* for the development of political parties, trade union, scientific and cultural societies and, in general, those who wish to influence the public. It represents, in short, the means that enable the community, when exercising its opinions, to be sufficiently informed. Consequently, it can be said that a society that is not well informed is not a society that is truly free (IACHR Advisory Opinion, 1985).

Thus, when Google had to make the decision regarding whether to abide by China's censorship demands or forego operating in that country and sacrificing potentially large profits, it also had to face the question of whether or not it should be concerned with violations of freedom of speech and information at the expense of profits.

A country that violates the right to freedom of information may be in violation of its international law obligations. There are two main provisions in international law that are directly on point when content censorship is at issue: Articles 19 of both the ICCPR and the UDHR. Both apply to States in most situations. Article 19 of the ICCPR, which was signed by China in 1998 and is now considered customary international law and thus must be respected by all countries, states that:

1. Everyone shall have the right to hold opinions without interference.
2. Everyone shall have the right to freedom of expression; this right shall include *freedom to seek, receive and impart information and ideas of all kinds*, regardless of frontiers, either orally, in writing or in print, in the form of art, or *through any other media of his choice*.
3. The exercise of the rights provided for in paragraph 2 of this article carries with it special duties and responsibilities. It may therefore be subject to certain restrictions, but these shall only be such as are provided by law and are necessary:
 - a. For respect of the rights or reputations of others;
 - b. For the protection of national security or of public order (*ordre public*), or of public health or morals (ICCPR 1966).

Furthermore, Article 19 of the Universal Declaration of Human Rights (UDHR), which is a UN General Assembly resolution and not a treaty, but is also strong evidence of customary international law and thus binding all States under international law, asserts that "Everyone has the right to freedom of opinion and expression; this right includes the freedom to hold opinions without interference and to *seek, receive and impart information and ideas through any media and regardless of frontiers*" (UDHR 1948, emphasis added).

While exemplary, both of these documents apply only to States. Under international law to date, these obligations do not legally apply to corporations. Therefore, the question of whether a corporation could be liable for violating human rights if it complies with government censorship requirements remains unanswered. There have been, however, public concerns that Google may be or have been complicit in China's suppression of its citizens' human rights by agreeing to censorship demands. Such concerns are raised when a company "contributes to, or is seen as contributing to, adverse human rights impacts caused by other parties"

(Guiding Principles, 2011). Before going further, it is important to understand what complicity means, to the extent that there is a limited understanding of what it takes for a corporation to be complicit in human rights violations. John Ruggie, the author of the UN Guiding Principles on Business and Human Rights, which will be described in detail below, explains that complicity has two different meanings, both non-legal and legal:

As a non-legal matter, business enterprises may be perceived as being 'complicit' in the acts of another party where, for example, they are seen to benefit from an abuse committed by that party. As a legal matter, most national jurisdictions prohibit complicity in the commission of a crime, and a number allow for criminal liability of business enterprises in such cases. Typically, civil actions can also be based on an enterprise's alleged contribution to a harm, although these may not be framed in human rights terms (Guiding Principles, 2011).

With regard to the non-legal interpretation, it is possible that Google could be seen as benefiting from maintaining business in China by agreeing to China's demands to censor some material. However, that would be the case for all foreign Internet Service Providers, including Microsoft and Yahoo!, as well as any other company that does business in China and pays taxes to the Chinese government and complies with national Chinese laws. Therefore, while an argument could be made that Google has been or is being complicit in this sense, it does not seem to be a particularly strong argument considering how broadly sweeping it would be, at least in the legal sense.

On the other side of the spectrum, even if one wanted to argue that a corporation, such as Google, does have human rights obligations, which in this case would involve the right to freedom of information or expression, then an ISP entirely refusing to operate within a country could itself, in fact, appear to be a violation of this obligation. For example, in a CASS Internet Survey which found that in China "the political impact of the Internet is more significant than it is in other countries. The impact can be seen not only in the relationship between government and citizens but also among people who share similar political interests. Thus, we can predict that as Internet becomes more popular in China, the impact on politics will be stronger" (Schrage, 2006). This ties in with the Inter-American Court of Human Rights' discussion on the importance of freedom of expression to human rights (IACHR Advisory Opinion, 1985, para. 70). As such, this was an important factor in Google's decision to enter China in the first place. As Elliot Schrage explained, by bringing its information and communication technology to China, including services such as "email, instant messaging, web logs, bulletin boards, podcasts, peer-to-peer applications, streaming audio and video, mobile telephones, SMS text messages, MMS photo-sharing," Google has provided opportunities for Chinese citizens "to read, discuss, publish and communicate about a wider range of topics, events, and issues than ever before" (Schrage, 2006). As Schrage further explained, if Google were to withdraw completely from China in protest to censorship demands, it would severely reduce "the opportunity for individuals to find relevant information. Consequently, individuals [would] have less information to make important decisions regarding economic transactions, and form independent opinions on political, social, or human rights issues" (Schrage, 2006). As such, when an ISP decides to acquiesce to some censorship demands in order to bolster the freedoms of information and expression in a country, it can perhaps be deemed not to be complicit in the country's censorship, but to be respecting the human rights of the people to receive and impart information.

This of course is also an argument that is a bit far-reaching. However, since the state of human rights and businesses is still very uncertain and emerging, far-reaching arguments seem to drive the debate. As this debate has raged on, one man has been able to create a set of principles that have reached some consensus: John Ruggie and his Guiding Principles on Business and Human Rights. Thus, it is relevant to drive the discussion forward and engage with Mr. Ruggie's Principles.

INTERNATIONAL STANDARDS ON BUSINESS AND HUMAN RIGHTS

JOHN RUGGIE AND THE GUIDING PRINCIPLES ON BUSINESS AND HUMAN RIGHTS

The Guiding Principles provide practical and concrete recommendations to governments and companies on the policies and processes they may put in place to manage [human rights] risks (Ruggie, 2011, emphasis added).

This budding area of international law and human rights standards is embodied in the Reports by the United Nations Secretary-General's Special Representative for Business and Human Rights, John Ruggie. Most recently, Ruggie released the Guiding Principles for Business and Human Rights, which he explains, "seek to provide for the first time an authoritative global standard for preventing and addressing the risk of adverse human rights impacts linked to business activity" (Ruggie 2011). The UN Human Rights Council formally endorsed the text at its June 2011 session. The Principles build upon the United Nations' "Protect, Respect and Remedy" Framework, which is explained as follows:

The **first** is the State duty to protect against human rights abuses by third parties, including business enterprises, through appropriate policies, regulation, and adjudication.

The **second** is the corporate responsibility to respect human rights, which means that business enterprises *should* act with due diligence to avoid infringing on the rights of others and to address adverse impacts with which they are involved.

The **third** is the need for greater access by victims to effective remedy, both judicial and non-judicial (Guiding Principles, 2011).

However, as the name implies, these are not law, but rather principles meant to guide states and corporations with respect to human rights. Ruggie explains this in his Commentary to Article 12's discussion on businesses respecting the human rights outlined in the 'International Bill of Human Rights:' "The responsibility of business enterprises to respect human rights is distinct from issues of legal liability and enforcement, which remain defined largely by national law provisions in relevant jurisdictions" (Guiding Principles, 2011, Commentary to 12). In other words, at this point businesses should feel the moral pull towards respecting human rights, but will not face international legal liability, and will only face domestic legal liability if they violate national laws. As such, looking at the following emphasised language in the first three "foundational principles" on the corporate responsibility to respect human rights furthers this point:

11. Business enterprises *should* respect human rights. This means that they *should* avoid infringing on the human rights of others and *should* address adverse human rights impacts with which they are involved.
12. The responsibility of business enterprises to respect human rights refers to internationally recognized human rights – understood, at a minimum, as those expressed in the International Bill of Human Rights. . .
13. The responsibility to respect human rights *requires* that business enterprises:
 - (a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur;
 - (b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts (Guiding Principles 2011).

The Commentary to Paragraph 13 further explains that "The responsibility to respect human rights is a global standard of expected conduct for all business enterprises wherever they operate. [...] And it exists over and above compliance with national laws and regulations protecting human rights." When a violation or "adverse human rights impact" does occur, this Commentary holds that "Addressing adverse human rights impacts requires taking adequate measures for their prevention, mitigation and, where appropriate, remediation" (Guiding Principles, 2011). Even as Paragraphs 12 and 13 describe the responsibility, and in fact Paragraph 13 uses the word *require*, it must be pointed out that this is only describing what respect must mean according to Ruggie. It is still only in the terms of Paragraph 11 which claim that corporations *should* respect human rights. Therefore, even though Ruggie was able to incorporate words like *require* into the Principles, it was only in defining respect, not in stating corporations' legal responsibilities.

As mentioned above, while the Human Rights Council has formally adopted these principles, they are a reference for how corporations should act, and not legally binding. As Ruggie explained, the Guidelines are an "authoritative global standard for preventing and addressing the risk of adverse human rights impacts linked to business activity" (Ruggie, 2011). Furthermore, the Principles "*provide a blueprint for companies to know and show that they respect human rights, and reduce the risk of causing or contributing to human rights harm*" (Ruggie, 2011). However, the Guiding Principles are essential in outlining the ways in which corporations should respect human rights, such as undertaking human rights due diligence analyses and remedying any violations.

DUE DILIGENCE: A KEY TO RESPECTING HUMAN RIGHTS

According to Ruggie, all corporations should undertake a due diligence analysis in order to ensure that they are respecting human rights, thereby being certain they are not infringing on rights and if they are, then taking steps to address any adverse impacts (Ruggie, 2011). The Guiding Principles explain that a corporation's human rights due diligence "should cover adverse human rights impacts that the business enterprise may cause or contribute to through its own activities, or which may be directly linked to its operations, products or services by its business relationships" (Guiding Principles, 2011). Ruggie's Commentary included in the Guiding Principles explains that "human rights due diligence should be initiated as early as possible in the development of a new activity or relationship," and then must be revisited as "human rights risks may change over time as the business enterprise's operations and operating context evolve" (Guiding Principles, 2011, Commentary to 17). To return to our previous example, Google's corporate culture and decision-making process undertakes due diligence in an exemplary way. This can be seen in its debates and extensive calculations made while deciding whether to enter China in the first place (Schrage, 2006). Google continually monitors its human rights impacts and tries not to be complicit in any violations, which is evidenced by its broad analysis of the situation in 2010 and its lengthy decision-making process with regards to whether to continue doing business in China (Schrage, 2006). This on-going analysis is part of the Guiding Principles' due diligence requirement which is key to a corporation's duty to respect human rights (Guiding Principles, 2011). Additionally, companies have domestic legal obligations, such as duties to shareholders, which they must contend with, regardless of how dedicated they are to promoting human rights.

LIABILITY TO SHAREHOLDERS AND DUE DILIGENCE

Corporations may have a drive to respect human rights, but in many domestic legal arenas their actions must not conflict with their duty to shareholders, which is primarily to bring a profit. In the past, Google has been able to balance its legal obligations to its shareholders with its ethical drive to respect human rights. This is evidenced first in its lengthy decision-making process to go into China originally, as well as its reevaluations of the situation in China. Furthermore, by making such calculations, a company has achieved a two-fold victory: it has hopefully ensured its desire to respect human rights while also having taken an extra step to insulate itself from national liability or from shareholder dissatisfaction. As John Ruggie explained, "[c]onducting appropriate human rights due diligence should help business enterprises address the risk of legal claims against them by showing that they took every reasonable step to avoid involvement

with an alleged human rights abuse" (Ruggie, 2011). However, as a corporation, Google has a legal duty to its shareholders and that is not to play the role of a human rights activist. In reality, despite the interests of the media and other players to insist that ISPs should be good "corporate citizens," companies such as Google were not created to promote human rights. Rather Google's dual purpose is (1) to make profits by (2) furthering technological innovations (Lynch, 2010). Legally, as a publicly-traded company in the US, "Google can only apply its 'Don't Be Evil' motto to the extent that it doesn't conflict with the interests of Google's shareholders. A publicly-traded corporation's duty to shareholders is normally fulfilled by maximizing profits through increased share price" (Lynch, 2010).

There is possibility, of course, that if Google was found to be complicit or engaging in human rights violations by censoring its content in China, the so-called "court of public opinion" could weigh in. If the public believes a corporation is violating human rights or is complicit in such violations, the public may choose not to use the services or products of that company and shareholders may elect to sell shares. This is also known as the "Wall Street Rule" or "Wall Street Walk" (Wall Street Walk, 2009). While any company's Board of Directors should contemplate the impact its decisions will have on the public opinion and the opinions of its shareholders, these are business calculations, not legal ones.

While Ruggie's Guiding Principles provide a very good external reference for how businesses should respect human rights, they are still suggestive and not legally authoritative (OECD Guidelines). Certainly, international law may move in that direction, but it simply is not there yet. Therefore, companies such as Google need not worry about whether their actions could have international legal consequences at this point in time with respect to Ruggie's Framework and Principles. Yet there is no doubt that Ruggie's "work has provided a structure for the debate and action on business and human rights to be built on" (Davis, 2011) and has led to or assisted many industries in maintaining standards and organisations designed to promote human rights.

INDUSTRY STANDARDS

Another point to consider regarding businesses' human rights standards is the voluntary initiatives that corporations may undertake with respect to human rights. The most universal of these is the United Nations' Global Compact, which is a collaboration of businesses and industry leaders that strives to promote corporate social responsibility and the respect of human rights by businesses (UN Global Compact). The Global Compact encourages "companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas of human rights, labour standards, the environment and anti-corruption" (UN Global Compact). Yet, participation in the Compact, while admirable, is entirely voluntary and there is no solid enforcement mechanism for participation.

There are also many industry-specific organisations, as well. Of particular relevance to our example, Google is part of the Global Network Initiative, which was organised by several Internet Service Providers, including Google, Microsoft, and Yahoo! Inc., as well as nongovernmental organisations, such as Human Rights Watch, Human Rights in China and the Center for Democracy and Technology, among many others. The Principles and Implementation Guidelines of GNI "establish a framework to provide direction and guidance to the Internet and Communications Technology industry" (Global Network Initiative). The GNI Principles, in conjunction with the Ruggie Guidelines, hold that "Internet and Communications Technology companies have the responsibility to respect and protect the freedom of expression and privacy rights of their users, as well as avoid complicity in violations" (Global Network Initiative). Such complicity in violations would likely be agreeing to a country's censorship demands. However, this is not a legally binding organisation and in fact maintains nothing more than aspirational values and a forum to share ideas.

Furthermore, even in the wake of the controversy between Google and China, GNI still considered Google to be a very important member company that upholds the values of GNI. In its 2010 Annual Report, during the midst of Google's decision concerning whether to stay in China or leave, GNI cited Google as good an example of what member companies are doing to promote human rights. The Report explains that "Google's implementation of GNI's Principles relies on corporate infrastructure to ensure that human rights concerns are mainstreamed into Google's business operations. To this end, Google has established protocols for ensuring consideration of free expression and privacy rights" (GNI Inaugural Report, 2010). Furthermore, it explained that Google implements the GNI Principles "through support of and engagement with individuals, organizations and entities that further the cause of user freedom of expression and privacy." For example, Google was commended for providing support to NGOs, engaging with governments on Internet freedom policy developments, contributing to Internet freedom initiatives, sponsoring awards for Global Internet activities, and sponsoring Internet freedom conferences (GNI Inaugural Report, 2010). While admirable, these are prime examples of the voluntary nature of human rights in corporate culture, which are far from stemming from a sense of legal obligation.

CONCLUSION: A BALANCING ACT

In conclusion, the complexities of ISPs' effort to balance activities in censoring countries, such as China, and efforts to respect international human rights standards with regard to censorship demands and obligations to shareholders demonstrate how challenging the area of Business and Human Rights can be. In many ways, Google seems to have abided by Ruggie's Principles and stayed true to its purpose. Though it may have been cooperating to some extent with China, in recent years many of its services have been inexplicably inaccessible in China as it has refused to comply (Jacobs, Buckley, and Wingfield, 2014), but it has still managed to promote the freedoms of expression and information by providing invaluable avenues for the Chinese people to collect and disseminate information. While Google has suffered disruptions in China in recent months due to its refusal to fully censor its content, by working within China and not taking stands that markedly drop its shares in one of the fastest growing Internet and Communications Technology market in the world (Jacobs, Buckley and Wingfield, 2014), Google is being true to its legal obligations to its shareholders as well as to the international human rights norms. Furthermore, Google seems to have exercised due diligence with regard to its human rights impact in China, even though it is not *legally* obligated to do so. Internet Service Providers have an important role to play in allowing the people of China to reform their government from within. This alone, may be a strong indicator of respecting human rights.

While John Ruggie has made a commendable effort to create a uniform set of guidelines for businesses regarding what their human rights obligations are, if any, and has in fact succeeded at getting many businesses, industries, governments, and the United Nations on board with supporting these principles, they are still only principles and have no legally binding effect. There may be emerging international standards regarding businesses and human rights, but they are not legally solidified. Thus, whether the law will rise to meet the needs of a changing world and create a system in which corporations can be held legally responsible for human rights violations they commit, or are complicit to, remains to be seen. For the time being, we must hold on to such a hope while satisfying ourselves with encouraging businesses to respect human rights and balance their drive for profits and advancements with the lives of people across the globe. ■

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REGULATION OF CAPITAL ADEQUACY IN WESTERN EUROPEAN BANKING THROUGH THE INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS (ICAAP) & THE SUPERVISORY REVIEW & EVALUATION PROCESS (SREP)

THOMAS DRAPER

The regulation of capital adequacy within Europe is complex and has only recently started to become coordinated. This paper will first define the European legislation which controls such national regulation and then specifically analyse the functioning of the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) in the largest Western European economies. The specific enforcement regime of the SREP is usually left up to national regulators, and thus the 'main focus' of the SREP in each country will be elucidated with the methodology used in each country explained in "Methodological Focus Areas". The countries examined are: Austria, Belgium, France, Germany, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Spain, Switzerland, and the United Kingdom. Conclusions will then be drawn as to the differences in the approaches, and the efficacy of the regulation and the implications for an integrated international enforcement system will be discussed.

INTERNATIONAL STANDARDS ON BUSINESS AND HUMAN RIGHTS

At its core, the form and role of regulation in Europe is governed by the Basel agreements (Basel.int, 2014). There is, however, a wide variation of enforcement programmes and detailed methodologies. The overall agreement is based on membership of the Financial Stability Board (FSB) and adoption of the Basel Accords. The European Union has also adopted legislation, a Capital Requirements Directive (the current update is known as CRD 4) from Directive 2013/36/EU, and a set of Capital Requirements Regulations (CRR) from Regulation 575/2013 (Europa.eu, 2014). Precise methodologies of the measurement of risk-based assets vary, and these are examined for each country. Specifics can sometimes be closely guarded; Italy, for example, uses an algorithm to measure aspects of capital adequacy, the precise nature of which remains obscure.

THE FUNCTIONING OF ICAAP AND SREP IN INDIVIDUAL COUNTRIES



AUSTRIA

The banking market in Austria is broken down into three sectors: savings, private, and cooperative banking. Erste Bank, UniCredit Bank Austria, and Raiffeisen Zentralbank are the three largest banks in the country. UniCredit Bank Austria is a subsidiary of Italy's UniCredit Group. Austrian banks must conduct an Internal Capital Adequacy Assessment Process (ICAAP) as required by the Austrian Banking Act (BWG) under articles 39 and 39a in cooperation with the Österreichische Nationalbank (OeNB). FMA (Österreichische Finanzmarktaufsicht), Austria's financial supervisory authority, also published guidelines. While these guidelines ('Guidelines for Bank-Wide Risk Management', 2006) are not formal requirements, they do factor in FMA's assessment of a bank's ICAAP (Woschnagg, 2008).

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT AUSTRIAN BANKS

The FMA has defined several different ICAAP approaches that banks may use: the 'going concern' approach, the 'gone concern' approach, and a capital planning stage. Banks should apply at least two of these approaches in parallel (Basel.Int., 2014).

The goal of a 'going concern' approach is to make sure there is enough regulatory capital on hand so that business can continue even during a global recession. The primary goal of a 'gone concern' approach, on the other hand, is to protect creditors and a bank's ability to repay debts and deposits regardless of the economic environment. The 'going concern' will thus come to the fore when conducting what under the Basel III agreement are known as 'stress tests'. Such tests are the ability of a bank to repay a specified number of creditors and meet other obligations over a specified period of defined financial adversity. Most large banks will generally turn to economic capital models when calculating their required capital. Under a gone concern approach, many banks will typically use a value-at-risk method at a 99.9 percent confidence level over a one-year time frame. It is up to banks to define available cash resources in a gone concern approach, and definitions vary widely. Many large banks will typically compare their capital to the current value of their equity and subordinated liabilities. Meanwhile, the confidence level used with a going concern approach is lower, generally between 95 and 99 percent over a one-year time frame. Available cash resources may include a bank's excess capital reserves and projected earnings. Results derived at higher confidence levels, between 70 and 90 percent, for example, with a three-year planning horizon, can sometimes be complemented by a third capital planning stage. This can be seen as an early warning sign.

None of the approaches discussed above generally recognise diversification benefits, not even at larger banks. Semi-annual stress tests are conducted by OeNB. As part of the ICAAP framework, Austrian banks are required to update their stress tests and conduct internal stress scenarios, for example, macro-economic stress scenarios.



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THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

The existing OeNB and FMA supervision processes lay the foundation of the Austrian banking sector's ICAAP assessment procedure. OeNB monitors banks and conducts on-site and off-site reviews, while FMA executes supervisory action if needed. Several factors are taken into consideration when reviewing a bank's ICAAP implementation. The bank must submit a detailed ICAAP questionnaire, as well as qualitative and quantitative data to the regulator. This information includes internal and external audit reports. Senior managers, especially those overseeing risk management, will also be interviewed. OeNB has the right to request additional information (Oenbat, 2014).

SREP: MAIN FOCUS

Austria's supervisory review of its banking sector used to focus primarily on overall risk management and control frameworks, including liquidity management. As a result, other aspects of ICAAP were not sufficiently reviewed and monitored. FMA is now dedicated to making sure each bank's ICAAP framework is more comprehensive, encouraging banks to incorporate these steps into their daily management and controlling processes. Qualitative ICAAP aspects, such as the relationships between internal risk control systems and information provided to the board, now carry equal weight in a bank's ICAAP assessment (str-act! Agentur für interaktives Marketing, 2014).

FMA also has a system in place for quantitative assessment. A risk tolerance analysis is performed on a quarterly basis, the results of which are used to help verify a bank's ICAAP data. The analysis looks at key risk drivers under Pillar 1 and their impact on a bank (Google Books, 2014a).

SREP: METHODOLOGICAL FOCUS AREAS

The FMA and OeNB guidelines provide a comprehensive list of what qualitative aspects a bank's ICAAP assessment should cover. However, they do not include detailed quantitative recommendations. The guidelines, for instance, point out the risk measurements and capital resource differences in the gone and going concern approaches. Capital requirement calculations in a gone concern approach should be based on a confidence level of at least 99.9 percent. These calculations need to be weighed against the bank's available financial resources. While the guidelines do not point out which parts of capital resources may be available, they do thoroughly analyse potential options, such as core capital and sustainable unrealised reserves (F.m.a.gv.at.2014, pp. 14-40). Potential risk in a 'going concern' approach, measured at least a 95 percent confidence level, is weighted against the available capital resources. These resources should be identified quickly.

Banks are required by FMA to use at least two approaches. An early warning system should be installed if daily management decisions are based around a going concern approach. An example of this might be measuring risk at a confidence level of 80 percent (Sommer and Spielberg, 2014).



BELGIUM

Belgium's two largest financial conglomerates, KBC and Dexia, offer banking and insurance services. The local subsidiary of ING Group, with more than 100 billion Euros, is also a dominant player in the Belgian financial market. The country's supervisory authority, CBFA (Commissie voor het Bank-, Financie- en Assurantiewezen), outlined the ICAAP implementation process in Title VII of a decree issued in October 2006, which was published in the *Belgisch Staatsblad/Moniteur Belge*. Additional information regarding banks' ICAAP framework can be found in *Circulaire PPB-2007-15-CPB-CPA*. The focus areas of CBFA's 2008-2009 ICAAP review of the banking sector are detailed in its annual report for that time period. The supervisory architecture for the financial sector in Belgium was changed by the law of 2 July 2010. The legislature opted to move towards a bipartite supervisory model known as 'Twin Peaks' which was implemented from 1 April 2011. It is organised as follows:

- The National Bank of Belgium, in addition to its mandate of guaranteeing the macroeconomic stability of the financial system, became responsible for the individual prudential supervision of the majority of financial institutions (micro-prudential supervision).
- The Financial Services and Markets Authority (FSMA), the successor to the CBFA, gained a more robust role in the supervision of the rules of conduct applicable to financial institutions, in order to ensure that all clients are treated honestly, fairly and professionally (Cbfa.be, 2014).

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT BELGIAN BANKS

ICAAP approaches in the Belgian banking sector are wide ranging. The approach depends on a bank's size, relevance and services (Kpmg.at, 2014a). Banks usually focus on regulatory capital when considering available financial resources. Larger banks, however, may also look at regulatory capital adjustments, especially if some components under stressed conditions are no longer available. These could include a decrease in goodwill, deferred tax assets, and unrealised losses. The banks could choose to implement a couple of these adjustments under Pillar 1 of Basel III.

Pillar 2 risks are covered by regulatory own funds. Large banks may use an economic capital model to measure these risks. To calculate how much capital they need, many of the country's larger banks will estimate their unexpected losses at a fair value, generally above a 99.9 percent confidence level. This is usually connected to their target rating. In addition to standard risk categories, including credit, operational, concentration and interest rate risks, there are two other economic capital models that also include other risk categories, such as credit spread and funding cost risks. This is a benefit for banks, as it is recommended they measure all material risks. Many banks will also usually examine the impacts of diversification effects when calculating economic capital. Banks, however, do not appear to be evaluating risks facing their economic capital, including strategy and liquidity risks. Instead, they are putting together contingency plans and management frameworks to help combat these risks (Google books, 2014b).

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

Banks operating on the Belgian market are expected to submit an information file to FSMA detailing their ICAAP approach. The file, which is not predefined by the supervisory authority, lays the foundation for the FSMA review. The file should include an overview of the bank's basic risks and an explanation as to why it selects these risks to hold capital against. The file should also include internal audit reports on the ICAAP assessment and Pillar 2 validation reports (Belgium Detailed Assessment of Compliance with the Basel Core Principles for Effective Banking Supervision, 2014a). FSMA auditors conduct on-site visits as part of their review of a bank's ICAAP submission. FSMA also schedules regular meetings with the bank's top managers to discuss its ICAAP (Belgium Detailed Assessment of Compliance with the Basel Core Principles for Effective Banking Supervision, 2014b).

FSMA discusses its ICAAP review with the bank's top managers. It also puts its findings, including observations of the bank's risk management and issues related to the ICAAP methodology, in a written report (Belgium Detailed Assessment of Compliance with the Basel Core Principles of Effective Banking Supervision, 2014c).

SREP: MAIN FOCUS

The scope of FSMA's supervisory review, according to the proportionality principle, is based on the size and relevance of each bank. A Belgian bank's ICAAP framework must be holistic and consistent. It should be based on a stressed capital plan that is forward-thinking. The plan should define the bank's risk appetite and risk policies as well as outline its management measures and contingency plans. A bank must prove that its risk management methodologies are useful and accurately reflect the bank's risk profile (Kpmg.at, 2014b).

A bank's internal Pillar 2 models and ICAAP framework are factored into its ICAAP score card by the FSMA. The supervisory review scores the quality of a bank's ICAAP approach and control functions as well as its internal management, risk management, shareholder support and relevance. The bank does not see its final score. Instead, the bank is told how much own funds it is required to have, which is then compared with the bank's internal calculations.

The FSMA assessment provides recommendations on ways a bank can improve its ICAAP methodologies. However, SREP does not just end with a list of recommendations. It is a continuous process. Banks respond to FSMA's report with additional information related to its ICAAP methodologies. Action plans addressing the critical points of a FSMA report may be put into place. Banks may also send in regular progress reports (Kpmg.at, 2014c). Banks may be forced to comply with Pillar 2 adjustments if they fail to have the required level of own funds. (This is based on Article 136 of the CRD.) However, such capital add-ons are seen as a last resort and should only be considered if all other measures have failed.

SREP: METHODOLOGICAL FOCUS AREAS

FSMA's primary focus when conducting an ICAAP assessment is the methodologies used in a bank's ICAAP framework. The methodologies should be sufficient, and the framework should be consistent. Banks identify available financial resources based on an economic concept where only stressed capital can be considered. During its ICAAP review, FSMA makes sure to address necessary regulatory own funds adjustments. These can include unrealised losses, deferred tax assets, and a decrease of goodwill.

FSMA requires banks to identify, measure and manage all their material risks. These may include funding cost risks, pension risks and migration and spread risks. Banks are responsible for defining their material risks. A bank must prove its ICAAP framework is sound and functional. The framework must include a management risk assessment, an internal audit of ICAAP methodologies and comprehensive stress testing procedures.

The stress tests must cover a range of scenarios. Banks should routinely analyse their capital needs and resources to ensure they can meet their capital requirements should a macro-economic shift lead to a crippling recession.

If a bank plans on taking management action to decrease its capital needs, then its stress tests should consider the potential challenges of this action. If a bank's ICAAP analysis takes diversification effects into account, then they, too, should be subjected to a stress test. These could involve, for example, inter-risk correlations or diversification between subsidiaries.



FRANCE

There are four dominant banking groups in France: Société Générale, BNP Paribas, Crédit Agricole, Banque Populaire and Caisse d'Épargne (BPCE). The Autorité de Contrôle Prudentiel (ACP), the country's financial supervisory authority, outlined its ICAAP requirements in 'Implementation of the Supervisory Review and Evaluation Process (Pillar 2) – Criteria and Methodology Used by the Commission Bancaire' (December, 2006). *Annual Report Commission Bancaire* (2007) also provides more information about the ICAAP process (Acpr.banque-france.fr, 2014a). The ACP guidelines are similar to the rules followed by the Committee of European Banking Supervisors (CEBS).

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT FRENCH BANKS

French banks use a wide variety of ICAAP methods. Most will start with the regulatory capital requirements addressed in Pillar 1 before moving on to the requirements outlined in Pillar 2. A bank may consider additional add-ons for risks not covered in Pillar 1. These may include concentration and interest rate risks. Large banks will apply various models before deciding on the add-ons. This could include an economic capital model at a confidence level of at least 99.9 percent. A bank will usually also assess its capital requirements using macro-economic stress scenarios and add a buffer to the capital demand in Pillar 2. Buffers could also be identified for risks that are difficult to quantify, including strategic, reputation, and liquidity risks (www.Kpmg.at, 2014d). The effectiveness with which a bank integrates ICAAP methods into its management systems is taken into consideration by ACP during the supervisory review and evaluation process.

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

ACP will generally review a bank's ICAAP structure on an annual basis. The process involves qualitative and quantitative information, some of which must be provided by the bank. This information includes accounting data, annual financial reports, internal documents, outside audit reviews, and data collected during senior management meetings. A bank is assigned a risk classification based on its overall SREP score, which incorporate its ICAAP results. While each bank's SREP review follows a similar framework, the methods used may differ depending on a bank's size, relevance, and complexity.

SREP: MAIN FOCUS

ACP evaluates quantitative and qualitative data when assessing a French bank's ICAAP framework. It considers potential risks the bank may face as well as its internal monitoring and control systems. Aspects of the bank's ICAAP framework are usually compared with other French lenders' ICAAP approaches. CEBS best-practice recommendations also factor into the review process.

Best-practice models for risk management, based on a bank's business model, are formed during the review and evaluation process. SREP feedback will differ depending on a bank's overall results. ACP will evaluate the quality of the bank's risk management systems and provide detailed recommendations on how to improve. The regulator's feedback might also include guidance related to Tier 1 capital targets. The French regulator does not disclose either its SREP scoring system or Tier 1 capital targets. However, market analysts speculate that Tier 1 capital ratios for large financial groups operating in France would range between upper and lower single-digit percentages (Acpr.banque-france.fr, 2014b).

If ACP observes serious problems with a bank's internal control, compliance or risk management systems during its review, the regulator may choose to publicly report its findings.

If the regulator feels corrective measures would not be effective, it may impose a supplementary capital requirement (Acpr.banque-france.fr, 2014c).

SREP: METHODOLOGICAL FOCUS AREAS

A bank's management team is responsible for the ICAAP framework and implementation. Internal capital management should be a central factor of the bank's risk assessment strategies. The main focus of the regulatory off-site review is to make sure the bank is in compliance with liquidity, solvency, and management ratios. ACP will also analyse additional quantitative information during its off-site review. This analysis will take several qualitative factors into consideration, including the bank's day-to-day income and profits, regulatory capital, corporate governance strategies, and internal control systems, particularly in regards to risk monitoring, money laundering, and terrorist financing. ACP stresses the importance of monitoring available capital resources, specifically minority interests and hybrid capital tools. To that end, the regulator intends to regulate capital resources. A bank should pair its ICAAP assessment with a forward-thinking capital plan that reflects its long-term business strategies. The bank can apply, for example, a stress test to measure what kind of impact changes to the financial environment could potentially have on business (Acpr.banque-france.fr, 2014d).

**GERMANY**

The German financial market is broken down into private, savings and cooperative banking. Deutsche Bank is the leading lender, followed by closely by Commerzbank. There are also numerous other banks operating on the market, including Landesbanken (savings) and DZ Bank and WGZ Bank (cooperative). BaFin, the federal financial supervisory authority, outlines ICAAP regulations using a principles-based approach under its risk management (MaRisk) guidelines (Circular, 11/2010). Banks operating on the German market must abide by the country's bank act, Kreditwesengesetz (KWG), which introduced Pillar 2 of Basel II into law (Bafin.de, 2014a).

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT GERMAN BANKS

Most banks will either use a 'going concern' or 'gone concern' approach when implementing their ICAAP. Larger banks seem to favour a 'gone concern' approach; however, they will also apply a 'going concern' approach as an auxiliary measure to better assess their capital reserves. The goal of a 'going concern' approach is to make sure there is enough regulatory capital on hand so that business can continue even during a global recession. The primary goal of a 'gone concern' approach, on the other hand, is to protect creditors and a bank's ability to repay debts and deposits regardless of the economic environment. A bank's available capital resources and required capital would differ depending on which approach is used.

'GONE CONCERN' ICAAP APPROACH

A 'gone concern' approach is usually centred on an economic capital model. A bank will typically use a value-at-risk method at a 99.9 percent confidence level over a one-year time frame to calculate its economic capital. It is up to banks to define available cash resources in a 'gone concern' approach, and definitions vary widely. Many banks will typically compare their capital to the current value of their equity, hybrid capital, and subordinated liabilities. Adjustments may be made to simulate the capital situation a bank may face following an economic meltdown. Such adjustments may include a decrease of minority shares, deferred tax assets, or goodwill. Banks may also choose to adjust unrealised gains or losses, such as loans and customer deposits. It is not uncommon for banks to use stress tests during their ICAAP assessment to simulate a serious financial downturn. Many banks use the results from these tests to better assess their capital adequacy levels.

'GOING CONCERN' ICAAP APPROACH

Aspects of a 'going concern' approach are similar to a gone concern approach. The confidence level used to calculate economic capital in a 'going concern' approach; however, it is lower, generally between 95 and 99 percent. This helps banks pinpoint potential future losses. A bank's objective is to ensure it has sufficient capital resources available for business to continue in the event of a serious economic meltdown. Banks will generally factor in regulatory own funds. Adjustments may be applied to take future profits into consideration. Stress tests are normally used in a 'going concern' approach.

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

BaFin conducts the supervisory review and evaluation process in partnership with the German central bank (Deutsche Bundesbank). While the financial regulator oversees the assessment process, the central bank is in charge of monitoring the lenders on a regular basis. The Deutsche Bundesbank will report its findings to BaFin, which will impose any necessary corrective measures (agm.db.com, 2014). In order to effectively monitor the country's financial sector, the Deutsche Bundesbank requires banks to disclose their annual financial and external audit reports, as well as any pertinent quantitative information. The Deutsche Bundesbank will also meet regularly with a bank's senior managers. BaFin may require the central bank to conduct further on-site reviews in accordance with section 44 of the country's bank act. These additional reviews will depend on a bank's size and complexity, but typically take place every few years. BaFin may also request an additional on-site review to clarify any observations or questions raised during the review process.

SREP: MAIN FOCUS

The main focus of the supervisory review and evaluation process is to assess how a bank could impact the German financial sector if its risk management and profile are not up to standards. The review process, specifically in regards to a bank's ICAAP assessment, has become more rigorous since 2010. Most large banks are subjected to at least one on-site ICAAP review a year. A bank will be rated based on the assessment results, which will determine how much supervision that bank will need in the future. The results will also include observations about the bank's risk management process. Regulators will scrutinise the bank's ICAAP approach and methodologies. BaFin will either accept the bank's ICAAP or require certain adjustments be applied to the approach. BaFin will only hand down specific capital guidance in atypical situations.

SREP: METHODOLOGICAL FOCUS AREAS

BaFin and the Deutsche Bundesbank outlined methodological focus areas of the ICAAP assessment in November 2010. The focus areas are consistent with descriptions large banks have given about the regulatory process. When applying a gone concern approach, banks need to evaluate all their economic risks. These generally will include Pillar 2 risks, such as interest rate, concentration, business, pension, and credit spread risks. The methodological focus areas for the gone concern approach should also address banks' available financial resources. Banks need to consider how a sudden serious loss might impact their capital resources and plan accordingly. A loss can impact, for example, potential future profits, minority shares, net deferred tax assets, unrealised losses, and goodwill. In addition to these focus areas, German financial regulators will also evaluate the management and integration quality of a bank's overall ICAAP framework (Bafin.de, 2014b).



ICELAND

This small nation has recently become involved more closely with the European Union after its bankruptcy and bailout.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT ICELANDIC BANKS

Since the IMF involvement in the Icelandic economy, provisions for ICAAP and SREP have been made. The CRD IV rules are followed. The ICAAP is a matter for individual banks with the SREP undertaken by the Financial Supervisory Authority (FME).

SREP: MAIN FOCUS

The main focus is to ensure that each bank is adequately capitalised and has a loan to capital ratio that accords to Basel 3 principles. There is still uncertainty in the face of Supreme Court rulings on foreign exchange-indexed loans and what risk weighting should be applied to these and other sets of assets. Maintaining a strong, independent, and adequately resourced Financial Supervisory Authority (FME) is considered essential for effective financial sector oversight (Sedlabanki.is, 2014).

SREP: METHODOLOGICAL FOCUS AREAS

Iceland has adopted, or is in the process of adopting, ICAAP and SREP according to CRDIV and CRR. The focus is on detailed analysis of the Pillar 2 areas of Basel 3. Counterparty risks of other banks are also fully explored. The main banks are in the process of being recapitalised which sometimes makes the Capital Adequacy Ratio complex to compute.

**IRELAND**

There are a surprisingly large number of World and European banks registered in Ireland due to its low partial rate of taxation.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT IRISH BANKS

Ireland observes the current CRD IV rules and requires an ICAAP of all institutions currently trading as banks in The Republic. The ICAAP must clearly state all relevant ratios according to the directive and is enforced through the Capital Requirement Regulations. These are expected to be clearly stated in the same template as all other European countries (Google Books, 2014c).

SREP: MAIN FOCUS

The main focus of the supervisory review and evaluation process is to assess how a bank could impact the Irish financial sector if its risk management and profile are not up to standards. The review process, specifically in regards to a bank's ICAAP assessment, has become more rigorous since 2010-2011. Most large banks are subjected to at least one on-site ICAAP review a year. The bank of Ireland may at any time use its executive powers to increase any capital ratio on any bank to a level it regards as reasonable. Furthermore, any bank will be rated based on the assessment results, which will determine how much supervision that bank will need in the future, based on previous ICAAP results. The results will also include observations about the bank's risk management process, and fully coordinate with European and international regulators (Google Books, 2014c).

SREP: METHODOLOGICAL FOCUS AREAS

An ICAAP Review is conducted annually for all credit institutions. For high impact firms and all other firms subject to a full risk assessment in any given year an in-depth review is carried out. This is a full review of the ICAAP as updated and submitted by the firm. The review of the ICAAP will be influential in preparing the supervisory engagement plan for the year and the review in conjunction with other engagement tasks ensures that the supervisors can determine the adequacy of the outcome of the ICAAP (capital number) in addition to also assessing the following: 1) the extent to which the subject institution's board and senior management have taken responsibility for the ICAAP, 2) the extent to which the design of the ICAAP has been fully specified and documented the extent to which the ICAAP is used to inform decision-making (the use test), 3) the extent to which the ICAAP is risk-based, 4) the extent to which the ICAAP is reviewed, 5) the comprehensiveness of the coverage of the ICAAP, and 6) the adequacy of measurement and assessment processes. For banks that are not high impact and are not subject to a full risk assessment in any given year a less granular assessment of the ICAAP is taken, with less individual areas assessed (bankofireland.ie, 2014).

**ITALY**

UniCredit Group and Intesa Sanpaolo dominate the Italian banking market, followed by Banca Monte dei Paschi, Banco Popolare and UBI Banca. At the end of 2009, these banks' balance sheets topped 100 billion Euros. The Bank of Italy (Banca d'Italia, also known as Bankitalia) outlined the country's new implementation process for SREP and Pillar 2 of Basel II in 'New Regulations for the Prudential Supervision of Banks' (Circular 263, December, 2010). More information about the ICAPP can be found in the 'Guide to Supervisory Activities' (Circular 269, May, 2008).

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT ITALIAN BANKS

ICAAP approaches vary depending on the complexity of the bank. Larger Italian banks, for instance, favor economic capital models, which they use to measure their risk profile. This covers Pillar 1 risks, including credit, operational and market risks as well as interest rate risk, real estate risk, participation risk and business risk. Diverse approaches are used to identify available financial resources. The typical starting point is regulatory own funds. However, each bank's adjustments will vary. These adjustments could include future or unrealised profits, goodwill, and losses (Bafin.de, 2014b). Banks will apply stress tests to their capital adequacy evaluations. They might also use other capital buffers to study the impact of different stress scenarios. Buffers can be defined for each risk category, for example, model risk.

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

An algorithm based on prudential returns is used to assess a bank's profit, risk exposure, and capital adequacy. The algorithm is able to generate an automatic score. If necessary, the regulator will outline a corrective action plan a bank must implement if its ICAAP score is not up to par. A bank's ICAAP approaches are reviewed during the Supervisory Review and Evaluation Process. Risk areas, such as profitability, capital adequacy, governance and control systems, are assessed by the Bank of Italy annually. A bank must submit a report detailing its ICAAP framework. This should include methodologies and risk appetite as well as an internal ICAAP review, pinpointing any weaknesses and necessary corrective measures. Information provided in a bank's ICAAP report will depend on the business services it provides to clients. Additional information related to a bank's ICAAP framework can be collected during off-site document reviews. Such documents may include internal supervisory and audit reports and financial statements.

The Bank of Italy now conducts on-site reviews and meets regularly with banks' top managers about issues related to the ICAAP. While banks must assess and disclose their capital adequacy levels to the Bank of Italy on an annual basis, it is strongly recommended that they perform internal ICAAP assessments regularly throughout the year. It is up to each bank to decide how often they conduct this assessment based on the methodologies they apply and the risks involved (Imf.org, 2014a).

SREP: MAIN FOCUS

Large Italian banks are expected to apply advanced methodologies during their ICAAP assessments. There are currently no other specific target areas of the SREP process. While the Italian SREP currently does not have any other specific requirements, it is likely that the Bank of Italy will at some point in the future increase on-site ICAAP reviews (Imf.org, 2014b).



LUXEMBOURG

There are more than 100 banks registered in Luxembourg however only a few are local banks; the rest are affiliates of foreign financial groups which adhere to the capital requirements of their respective parent companies. The country's financial regulator, the Commission de Surveillance du Secteur Financier (CSSF), has published its own ICAAP implementation requirements (Circular 301/2007). The requirements were updated in Circular 338/2008 in regards to stress tests for interest rate risks and again in Circular 403/2009 in regards to liquidity risk. A detailed study was carried out into the impacts of the liquidity ratios in 2011 (Cssf.lu, 2014a).

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT LUXEMBOURG BANKS

ICAAP approaches used in the Luxembourg banking sector are wide ranging. Most banks, though, keep their approaches simple, mainly sticking to Pillar 1 capital requirements. Pillar 2 risks, meanwhile, apply capital buffers. The size of the buffer is calculated by qualitative formulas. To that end, a bank's risk capacity would be based on its regulatory own funds (Kpmg.at, 2014d). A few banks will use more advanced ICAAP approaches, for instance economic capital models, which can show the effects of diversification in

various risk categories. A few banks will choose to incorporate additional measures into their risk-taking strategy, such as future profits and losses. ICAAP results are submitted to top managers and must be approved by the bank's executive board. In accordance with regulatory requirements, banks will generally conduct an internal audit of their ICAAP assessment.

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

CSSF will review a bank's ICAAP at least once a year. The frequency depends on the bank's size and standing or if the bank has recently reported any strategic or economic changes. Banks must send an ICAAP report to CSSF. The report should include an outline of the bank's ICAAP structure and its current and future risk profile. It should also discuss the effect its capital planning may have on its financial resources (PwC.lu, 2014). An outside auditor will review a bank's ICAAP. The long form audit will include a review of the bank's risk management. The auditor will also evaluate whether the bank is complying with regulatory requirements. A copy of the audit report will be submitted to CSSF. A bank's internal and external audits will have a strong impact on the final review conducted by CSSF. The regulator may also take into account additional data provided by the bank, meetings it conducts with bank managers and on-site audits. Discussions held between CSSF personnel and bank managers play an important role in the supervisory review process. The findings reported in an external or internal audit or in a CSSF report are thoroughly examined by a bank's top managers. Banks are required to implement any corrective measures outlined in the reports. CSSF will follow up and make sure the banks are in compliance. CSSF is allowed to impose stricter regulatory measure on banks at its discretion. For example, a bank may be required to increase its capital levels above the regulatory minimum. Its services or operations may be curtailed or its risk profile lowered (Cssf.lu, 2014b).

SREP: MAIN FOCUS

The CSSF applies a diverse approach to its review and evaluation of the country's banking sector. It assesses all data available, including quantitative and qualitative data. ICAAP is considered an internal process; therefore, banks are allowed to use different implementation approaches. The final report, which should include qualitative data, must show that the bank has enough capital in its reserves. Given Luxembourg's diverse regulatory makeup, market analysts believe regulators, including CSSF, will put increasing pressure on banks to improve their ICAAP approaches. The emphasis will be on economic capital models, inside of buffers.

SREP: METHODOLOGICAL FOCUS AREAS

As there is a high number of fund managers operating within the country, Luxembourg regulators pay particular attention to risks associated with wealth management. These include legal, reputational, and operational risks. Private banking is paramount in Luxembourg. Wealth management aside, the primary focus of CSSF audits is interest rate and concentration risks.

In order to measure total risk during the assessment process, CSSF will examine the effects that intra- and inter-risk categories have on each other. It will also look at the effects of mitigation, which is normally not permitted when calculating adequate own funds. Since there is a lack of available market data, correlation assumptions are, for the most part, based on estimates (Putnis, 2014, pp. 514-533).



THE NETHERLANDS

The Dutch banking sector is dominated by Rabobank, ING and ABN Amro. SNS REAAL, which has a balance sheet of more than 100 billion Euros, is also active in the Netherlands. *Policy Rule on Principles for the Implementation of Pillar 2 of the Basel II Capital Accord*, published in 2007, outlines the country's ICAAP requirements. In this publication, De Nederlandsche Bank (DNB) lists the ICAAP guidelines banks must use as well as the primary criteria evaluated during the review process. The publication also addresses confidence levels, diversification effects, and the ICAAP time frame. In addition, it lists the data banks need to provide to the regulator.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT DUTCH BANKS

A bank's ICAAP approach will depend on its size and complexity. Large banks tend to use Advanced-IRB for the Pillar 1 assessment. They will use the AMA approach for operational and credit risks, while for market risks, they generally use internal model approaches. When conducting the Pillar 2 assessment, large banks prefer to use economic capital approaches (Kpmg.at, 2014f, pp. 26-27). A bank will usually take diversification effects into consideration when calculating the contributions of various risk types. With the exception of Pillar 1 and interest rate risks, banks are allowed to apply add-ons or buffers to other types of risks. These can include pension, business model, funding, and concentration risks. In an effort to be more forward-thinking about capital resources, banks will apply business planning assumptions to their ICAPP assessments. Banks will incorporate results of their top-down stress tests, which should include internal as well as macro-economic tests, into their ICAPP approach to help calculate capital adequacy levels. Banks must use macro-stress scenarios that have been approved by DNB.

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

Banks must file regular reports with DNB, which are taken into account during the supervisory review process. The report must include qualitative and quantitative data. Qualitative data would detail, for example, the ICAAP setup and how the process would be implemented into the bank's management systems. Quantitative data, meanwhile, would cover stress testing and risk measurement and identification. Banks must also outline the difference between Pillar 1 and Pillar 2 capital (Db.nl, 2014a).

DNB will audit a bank's ICAAP approach and capital during its yearly review and evaluation. The regulator will then review the bank's capital adequacy. This second step also takes into account the bank's 'SREP capital'. In order to compare the capital requirements defined under Pillar 1 and Pillar 2, DNB will apply a 99.9 percent confidence level to a one-year time frame. It will also review the capital requirements at other banks. This process helps DNB set a target capital level, which is reviewed by bank management. DNB submits a report to the bank that outlines its ICAAP findings and may include corrective measures the bank is expected to implement within a certain time frame. Corrective measures could surround capital calculations related to various risks and capital management. The DNB report might also find fault with a bank's assessment of Pillar 2 risks or other risks factors considered important under Pillar 2. Capital add-ons could be used to boost Pillar 1 capital if DNB determines its capital target level is greater than a bank's own calculation. These add-ons, considered corrective measures, may be temporary or permanent.

SREP: MAIN FOCUS

A bank's ICAAP approach must be in line with CEBS guidelines related to stress tests, interest rate risks, ICAAP, and concentration risks. DNB supports these guidelines. A bank's size and complexity should be taken into consideration before ICAAP methods are applied. DNB suggests large banks calculate how much ICAAP capital they will need using an economic capital model (Dub.nl, 2014b).

Banks should take several things into consideration when coming up with their ICAAP framework, which must cover material risks lenders face on the Dutch market. Banks must thoroughly analyse Pillar 1 and Pillar 2 risks to determine how they might impact business. Pillar 1 risks include operational, market and credit risks, while Pillar 2 risks cover interest rate, pension, reputational, and concentration risks. Future capital adequacy must also be analysed and stress tests should be applied to assess capital adequacy in different scenarios. A contingency plan should be prepared. Finally, a bank's ICAAP framework must adhere to its business strategy. Therefore, changes in services that could impact capital resources must be addressed (Dub.nl, 2014c). Most large Dutch banks rely on state support, which is why DNB stresses the importance of maintaining adequate capital levels and adding more qualitative measures to the ICAAP framework. These can include the stability of a bank's business model and quality risk management procedures.



SPAIN

Santander Group and Banco Bilbao Vizcaya Argentaria (BBVA) are two of Spain's biggest commercial banks, while Caja Madrid and La Caixa are the sector's biggest savings banks. Mortgage loans are also big market drivers. Banco de España (Bank of Spain) is the country's financial regulator. It has published guidelines related to ICAAP requirements. The Basel III common equity theory was introduced into the guidelines in January 2011 (*Guía del Proceso de Autoevaluación del Capital de las Entidades de Crédito – PAC*, 2011). The Bank of Spain's regulatory review process is outlined in *Guía del proceso de Revisión del Capital*, 2010. Additional capital requirements are also addressed by the Spanish Ministry of Economy in the law '*Real Decreto-ley 2/2011, para el reforzamiento del sistema financiero*'. The law outlines solvency and minimum capital requirements.

THE 'SPANISH BASEL 2.5'

Basel 2.5, as the new capital directive is referred to in Spain, requires that banks maintain their minimum common equity at 8 percent. This is a significant increase of Basel II capital levels. Banks that meet certain criteria are required to maintain their minimum common equity at 10 percent. This includes banks that have more than 20 percent of wholesale funding or if less than 20 percent of its capital is not privately owned. The 10 percent requirement generally applies to savings banks (Esr.b.europa.eu, 2014).

Under Basel 2.5, the Spanish regulator is permitted to impose high minimum capital levels based on stress test results. The Ministry of Economy looks to Basel III to define common equity. The definition considers several factors, including minority interest, share premiums, disclosed revenues, common shares and retained earnings. It also takes into account AfS adjustments, as well as tools from the Fondo de Reestructuración Ordenada Bancaria. FROB was created by the state to help improve the banking sector's capital levels (Kpmg.at, 2014, p. 29).

The regulator released an extensive report in March 2011 about how well the new capital requirements were being maintained on the market. Banks found to have inadequate capital levels had to submit a plan detailing how they would maintain their capital levels at 8 or 10 percent. Their plans had to be filed with the Bank of Spain by 30 September 2011. Banks whose strategy included a possible stock market listing were given three extra months to turn in their plans (Roldan, 2007).

THE INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT SPANISH BANKS

Banks are under increased pressure to maintain adequate capital levels, which is why capital planning is an integral part of the ICAAP assessment. Banks have had to update their strategies to fit new capital regulations, especially those outlined under Pillar 2. To the end, economic capital models will likely become less relevant in the future (Esr.b.europa.eu, 2014). Banks use two different approaches to measure risk. Most will use the Bank of Spain's standard approach for measuring Pillar 2 risks, while others, typically larger banks, favour a more advanced economic approach. The more advanced approach examines the benefits of diversification effects.

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

Spain's supervisory process has four key focus areas. The Bank of Spain will review a bank's accounting process and make sure it is in compliance with financial regulations. The regulator will also conduct an economic analysis and review the bank's risks and solvency. The review process for most banks includes off-site monitoring and inspection visits. The market's two largest banking groups are also subjected to on-site monitoring. The Spanish regulator will base its review of a bank's ICAAP framework on a wide range of relevant data, including information related to own funds, as well as the internal adequacy assessment report (ICAAR). The regulator will also meet with bank officials in accordance with the on-site inspection plan specified by the ICAAR (Bde.es, 2014).

SREP: MAIN FOCUS

Each bank is responsible for designing and implementing an ICAAP framework that best suits its needs. However, the regulator stresses the importance of risk assessment, as well as a capital plan that accurately reflects a bank's core business and risk strategies. Banks are advised to implement their ICAAP into all their control and risk management structures. A bank should also incorporate a capital plan that covers a two- to three-year time frame into its ICCAP. This plan should uphold the Pillar 1 capital requirements as well as the bank's business strategies. The bank must demonstrate in its plan that it has sufficient capital to survive a serious economic meltdown.

A key goal of the supervisory review process is to make sure banks maintain and regularly update their risk profiles, which helps the regulator assess a bank's solvency and predict any future liquidity or profitability issues. Supervisory measures will be determined based on a bank's risk profile. High risk could lead to more supervision if the Bank of Spain deems it necessary (Kpmg.at, 2014, p. 30).

SREP: METHODOLOGICAL FOCUS AREAS

The Spanish regulator specifically lists what types of capital a bank can use to meet its own funds goal. The Bank of Spain bases its list on Pillar 1 capital resources. The bank should outline its capital plan and own funds goal in its internal adequacy assessment report. The bank needs to show that it has enough capital to meet the regulator's minimum requirements regardless of the economic environment.

When setting its capital goal, the bank needs to take several things into consideration, including the current economic environment, the quality of available capital and possible methods for securing more capital if necessary. Top managers should also review the bank's strategic business plan and risk management and control policies before setting a capital target. The capital plan should be in sync with the bank's strategic business plan. Capital needs identified by stress scenarios should be calculated, and banks should outline possible funding sources for these needs in their ICAAP framework. Funding that is capable of absorbing losses in a stressed economic environment must derive from a going concern approach. Stress scenarios must be adequately severe in order to be useful during the ICAAP process. The regulator may request a bank perform particular stress tests, concerning, for example, GDP reductions, real estate fluctuations and unemployment rates. The regulator can also outline particular scenarios banks should account for during reverse-stress testing (App.bde.es, 2014).

**SWITZERLAND**

There are more than 300 banks in Switzerland, a third of which are affiliates of foreign financial entities. The country's leading lenders, however, are UBS and Credit Suisse.

A division of what is now the Swiss Financial Market Supervisory Authority (FINMA) has been overseeing the country's larger banks since 1998. The publication 'Supervision of Large Banks' (Circular 2008/9) outlines special measures related to this task. It addresses a variety of issues, including audits, requirements for reporting and discussion protocol between bank management and the supervisory authority. Basel II requirements were introduced into law in September 2006. The federal ordinance is called 'Capital Adequacy and Risk Diversification for Banks and Securities Dealers'.

THE 'SWISS FINISH'

In an effort to meet the requirements defined in Pillar 1 of Basel II, FINMA has imposed a buffer that requires banks to increase their net regulatory capital, otherwise known as the 'Swiss finish'. Pillar 1 of Basel II enforces a firm bottom limit in regards to a bank's capital resources. However, this limit can be breached for a short amount of time if related to FINMA's capital buffer. The bank must submit a plan that details how it will maintain an adequate capital level. The plan must be approved by FINMA (Kpmg.at, 2014, p. 32).

With the exception of the country's two largest lenders, the buffer is equal to 20 percent of a Swiss bank's regulatory capital, according to Pillar 1. The buffer was increased for UBS and Credit Suisse to 100 percent in 2008. The banks needed to maintain this buffer until 2013. The buffer, however, could be lowered to 50 percent during an economic meltdown, but it would need to be brought back up to 100 percent once the crisis passed (Kpmg.at, 2014, p. 32).

A risk-independent leverage ratio was introduced when these new capital requirements hit the Swiss banking sector. The ratio compares a bank's total assets against its core capital. A 3-percent limit was applied to a consolidated level, while a 4-percent limit was applied to an individual level (Kpmg.at, 2014, p. 32). Swiss banks may face other Basel-related adjustments when operating in other countries within Europe. These could include increased asset class weights and capital demands.

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT SWISS BANKS

While FINMA stresses that Pillar 2 is a key factor in a lender's controlling processes and risk management, Swiss banks are ultimately responsible for implementing their own ICAAP structure. In an effort to meet the requirements outlined in Pillar 2, large banks tend to use detailed economic capital models at high confidence levels to simulate unexpected losses. Inter-risk and intra-risk correlation assumptions reflect diversification benefits (Kpmg.at, 2014, p. 32). Banks will, for the most part, base their available financial resources off of their regulatory own funds, which are made up of Tier 1 and bits of Tier 2 capital. A bank will distribute its available financial resources to individual businesses to make sure the ICAAP is properly integrated into its management systems. It will also perform rigorous stress tests to its capital planning (Kpmg.at, 2014, p. 32).

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

FINMA will meet periodically with a bank's board of directors and top managers. The supervisory process also includes internal audits and quarterly meetings with outside audit companies. The regulator will conduct yearly on-site reviews. Its findings are outlined in a report and submitted to the management board of the bank. FINMA or an outside auditor will follow up and make sure any corrective measures highlighted in the report have been properly implemented. Outside auditors will also perform more in-depth reviews if requested by FINMA.

SREP: MAIN FOCUS

Swiss banks are responsible for implementing their own ICAAP framework. However, FINMA stresses the importance of sufficient risk assessment. A bank's capital plan must also be in line with its business and risk strategies. UBS and Credit Suisse are required to maintain acceptable capital planning structures, which must include detailed studies of their capital requirements and outline how they plan to distribute their capital resources.

The banks must show they will be able to sustain their regulatory capital levels throughout the planning stage. To do this, they must evaluate capital demand under normal and stress scenarios, inspired by macro-economic studies by the Swiss National Bank and FINMA.

The regulator may require further studies to determine, for example, whether certain portfolios or business opportunities may be susceptible to losses (Kpmg.at, 2014, p. 32). The main goal of the SREP process is to establish that UBS and Credit Suisse, in particular, have enough capital to meet the 100-percent requirement under the Pillar 2 add-on. On a wider scale, the process is also used to examine the banks' risk management systems and ensure they can adequately maintain the lenders' risk profiles (Kpmg.at, 2014, p. 33).



THE UNITED KINGDOM

The Royal Bank of Scotland, Barclays, Lloyds Banking Group, HSBC, and the Spanish-owned Santander Group control the UK retail and commercial banking markets. There are however a very large number of foreign banks which operate within the United Kingdom, the regulation of which is unclear.

Recently, the UK's chief financial watchdog has sharply tightened its grip on overseas banks that want to take deposits in Britain, pressuring them to open locally regulated subsidiaries with their own access to cash and capital. This is so they could be properly regulated if they operated in the UK.

The FSA's push started in 2008 when the UK government had to step in to protect British depositors in branches of Icelandic banks that collapsed. Its drive has accelerated recently. In September, the FSA announced plans to force non-European Union banks to use subsidiaries if they are from countries such as the US and Australia that give preference to home depositors in the case of a bankruptcy.

Andrew Bailey, who heads the Prudential Regulation Agency, told a Parliamentary committee last month that he would also like to seek an exception to EU rules that in theory allow any bank from the 27-nation bloc to open a London branch. "I do not think that a bank should be able to branch in and the host authority have to accept it come what may," he opined (FT.com, 2014).

There appears to be considerable expense involved in the necessary ICAAP and SREP sections. For a branch with assets of less than £2bn the PRA estimates there will be an one-off cost of £525,000 and annual costs of £150,000 to convert to a subsidiary. There are also other indirect costs the PRA cannot quantify, such as having to hold more capital in a UK subsidiary, which is a separate legal entity from the parent bank, unlike a branch (BBC News, 2014). The result is, however, expected to be a more stable banking system with more foreign banks investigated and regulated.

The Prudential Regulatory Authority (PRA), which is the UK supervisory authority, requires banks to maintain stable capital management in order to combat serious risks and support their regulatory capital levels on a long-term basis. To that end, banks need to integrate the ICAAP process into every aspect of their risk management and business strategies, with a particular emphasis on stress tests and risk appetite. FSA outlines its regulatory requirements and ICAAP guidelines in the Prudential Sourcebook (Fca.org.uk, 2014).

THE INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AT UK BANKS

FSA wants to make sure banks conduct detailed assessments of their risk profiles and calculate their internal capital resources. Banks must also be able to demonstrate how regulatory capital requirements will be maintained under stressed conditions for a five-year period. A bank's ICAAP framework must be reviewed and if necessary amended at least once a year. The bank board must approve the findings (Kpmg.at, 2014, p. 34).

Most banks operating in the UK will use the 'Pillar 1 plus' approach when implementing their ICAAP. Under this approach, a bank will measure its capital needs by first defining its Pillar 1 financial requirements as well as Pillar 2 risks, which include interest rate and concentration risks (Bankofengland.co.uk, 2014).

Larger banks, on the other hand, will often use an economic capital model to help define and measure risk. Some will outline in their ICAAP the difference between required regulatory capital and required risk-taking capacity for one year. Both approaches are different. Economic capital models, for instance, accept diversification benefits. However, this is not permitted under regulatory guidelines. If a bank bases its ICAAP on an economic capital model, it must also chart regulatory capital outcomes. By doing so, the bank's regulatory requirements can be based on a 'Pillar 1 plus' approach. The bank needs to prove to FSA that economic capital models are an important part of its business and operational strategies (Kpmg.at, 2014, p. 34).

THE OVERALL ORGANISATION OF THE SUPERVISORY REVIEW & EVALUATION PROCESS

A bank must have its ICAAP approved by its board before submitting it to FSA. The submission must detail the bank's ICAAP framework and include a financial summary, along with any relevant background information and business and risk strategies. FSA published submission guidelines in 2007, but the process has drastically changed since then (Bankofengland.co.uk, 2014). FSA will test the efficiency of a bank's ICAAP through a series of on-site and off-site examinations. The regulator will conduct numerous interviews before an on-site visit. The number of interviews will depend on the scope of the bank's business. They can be conducted discretely or incorporated into FSA's risk assessment review (ARROW). FSA will sometimes request an outside examination of a bank's capital calculations and management structure, in accordance with the Financial Services and Markets Act (Kpmg.at, 2014, p. 34).

SREP: MAIN FOCUS

The supervisory review and evaluation will assess how effectively a bank integrates its ICAAP framework into its risk management strategies and overall governance. These include capital allocation, stress testing, risk assessment, forward capital, and liquidity planning (Bankofengland.co.uk, 2014). After completing its review and evaluation, FSA will issue Individual Capital Guidance (ICG) to the bank. ICG outlines the quality and quantity of capital the bank should have in order to meet Pillar 1 and Pillar 2 capital requirements. If the bank's assessment does not adequately address its risks, FSA may require that the bank apply additional financial requirements. ICG combines the bank's capital regulatory requirements and specific risk add-ons under Pillar 2 (Kpmg.at, 2014, p. 34). FSA rigorously reviews the qualitative and quantitative aspects of the bank's ICAAP framework before calculating its ICG. The regulator will analyse Pillar 1 and 2 risks to determine whether the bank has assembled an adequate five-year capital plan that will be able to withstand a serious economic meltdown.

FSA does not publicly release a lot of information about ICG calculations and methods. However, any Pillar 2 add-on will usually exceed the Pillar 1 minimum by a double-digit percentage, sometimes more depending on the situation. FSA also looks at overall governance and potential weaknesses in the bank's risk management framework. In an effort to help the bank maintain its ICG during periods of stress, the UK regulator will set up a capital planning buffer.

SREP: METHODOLOGICAL FOCUS AREAS

Risk measurement requirements are outlined in Pillar 1. However, banks must decide whether they will need to maintain more capital under Pillar 2 for situations where Pillar 1 methods do not cover certain risks. Banks are required to identify those risks and calculate how much extra capital they will need to hold (Kpmg.at, 2014, p. 34).

Most banks, in general, will focus on concentration, pension and Interest Rate Risk in the Banking Book (IRRBB) risks and will ensure they have enough available capital to cover those risks. Pension risks take into account life expectancy increases and the vulnerability of asset prices as well as funding risks. Banks are not required to set aside capital for non-quantifiable risks. However, they must show that they have considered these types of risks in their capital plans (Kpmg.at, 2014, p. 34).

Liquidity risks are subjected to a separate assessment process called ILAA (Individual Liquidity Adequacy Assessment), which considers the risks involved if a bank is unable to pay its debts. It also studies high-funding cost risks, which could lead to additional capital costs. Banks need to prepare for situations that might bite into capital reserves. A bank's ILAA report should address both qualitative and quantitative aspects of liquidity risks (Bankofengland.co.uk, 2014).

Considered valuable management tools, banks are expected to integrate stress and scenario tests into their ICAAP structure. These tests should reflect the scope and complexity of potential risks as well as the business interests of the banks. Banks need to assess how their future earnings, capital resources and CRR would be affected during an economic downturn. They should also examine how a downturn might impact their credit and potential consequences of management action (Kpmg.at, 2014, p. 34).

FSA's so-called 'anchor scenarios' give banks guidance about suitable stress and scenario tests as well as the regulator's expectations. Anchor scenarios could, for example, involve the current condition of the UK's GDP, unemployment and real estate prices. Banks can use anchor scenarios to help evaluate their own scenarios.

The general facets of ICAAP and SREP enforcement are shown in the table below:

Countries	Use Going and Gone Concern	Enhanced Capital Adequacy Rules for Larger Banks	Enhanced Leverage ratio Rules for Larger Banks	Covered by European Banking Directive CRD4 2013/36/EU	Use Algorithm	In EU Single Resolution Mechanism
Austria	✓	✓	✓	✓	⊗	✓
Belgium	✓	✓	✓	✓	⊗	✓
France	✓	✓	✓	✓	⊗	✓
Germany	✓	✓	✓	✓	⊗	✓
Iceland	✓	✓	✓	✓	⊗	✓
Ireland	✓	✓	✓	✓	⊗	✓
Italy	✓	✓	✓	✓	✓	✓
Luxembourg	✓	✓	✓	✓	⊗	✓
Netherlands	✓	✓	✓	✓	⊗	✓
Spain	✓	✓	✓	✓	⊗	✓
Switzerland	✓	✓	✓	⊗	⊗	⊗
United Kingdom	✓	✓	✓	✓	⊗	⊗

Table 1: Facets of Investigation and Enforcement

CONCLUSIONS

The European Council meeting of 28-29 June 2012 marked the starting point of an ambitious project to create a European banking union as part of a collective European effort to resolve the current crisis and build a more resilient policy infrastructure for Europe's financial system (European Council, 2012a). The first step will be the creation of the Single Supervisory Mechanism (SSM), now being finalised following an agreement at the Economic and Financial Affairs Council meeting of 13 December 2012 (ECOFIN, 2012). In its subsequent meeting on 14 December 2012, the European Council outlined a tentative vision for the next steps towards the aim of creating a banking union, which will involve significant legislative work alongside other policy initiatives.

On 17 December 2012, ECB President Draghi stated before the ECON Committee, "the second priority for 2013 from the ECB's perspective is the completion of financial union with the establishment of a single resolution mechanism. The aim of resolution is to deal with non-viable banks through measures that include their orderly winding down and closure while preserving financial stability. Such a mechanism will make it possible for banks to fail in an orderly manner."

The first step, which the European Council conclusions imply should be completed by March 2013, is centered on the Single Supervisory Mechanism (SSM). In addition to the adoption of the Council regulation establishing the SSM (SSM Regulation; Council, 2012), this includes the adoption of the regulation reforming the European Banking Authority (EBA Regulation 2) to adapt it to the new situation created by the advent of the SSM, as well as the adoption of the Capital Requirements Regulation (CRR3) and its complement the fourth Capital Requirements Directive (CRD4), so that the SSM can implement a harmonised supervisory 'rulebook' based on the Basel III Accord, instead of the currently applicable (and often divergent) national regulations. The operational build-up of the SSM would follow. Its initial phase has already started at the ECB with the cooperation of national supervisors.

One important parameter in this build-up phase is the question of which non-euro area Member States will enter "close cooperation arrangements" that would make them participating members of the SSM. While Sweden and the United Kingdom have indicated they did not consider entering such arrangements in the foreseeable future, other non-Euro area member states still have to make a decision. Another significant operational question is the pace of expansion of the ECB's supervisory staff and the specific arrangements it will establish with national supervisors.

Although the situation in Europe is much more highly integrated than that between Europe and the rest of the world, as this paper has shown the current regulation of the Western European banking system, particularly in terms of the regularity of enforcement and penalty, remains highly fragmented. Regrettably this situation provides plenty of scope for regulatory arbitrage which reduces the effectiveness of fractional reserve policy as enshrined in Basel III. It is imperative that enforcement and penalties are standardised to create a more consistent system. The European Banking directive will to some extent reduce the differences between regulation, although it does little to coalesce enforcement policy and penalty values. In addition the Basel Committee on Banking Supervision (BCBS) is in the process of performing an extensive assessment to determine whether all member jurisdictions have uniformly adopted and implemented the capital requirements under the Basel regulatory framework comprising Basel II, 2.5, and III. The BCBS intends to expand its efforts to cover the monitoring and assessment of the Basel standards relating to liquidity, leverage ratios and systemically important banks (SIBs). To this end it is the Regulatory Consistency Assessment Programme (RCAP) which is designed to monitor the harmonisation of the supervisory systems across member jurisdictions worldwide and identify potential gaps in the Basel regulatory framework (Bafin.de, 2014c). ■

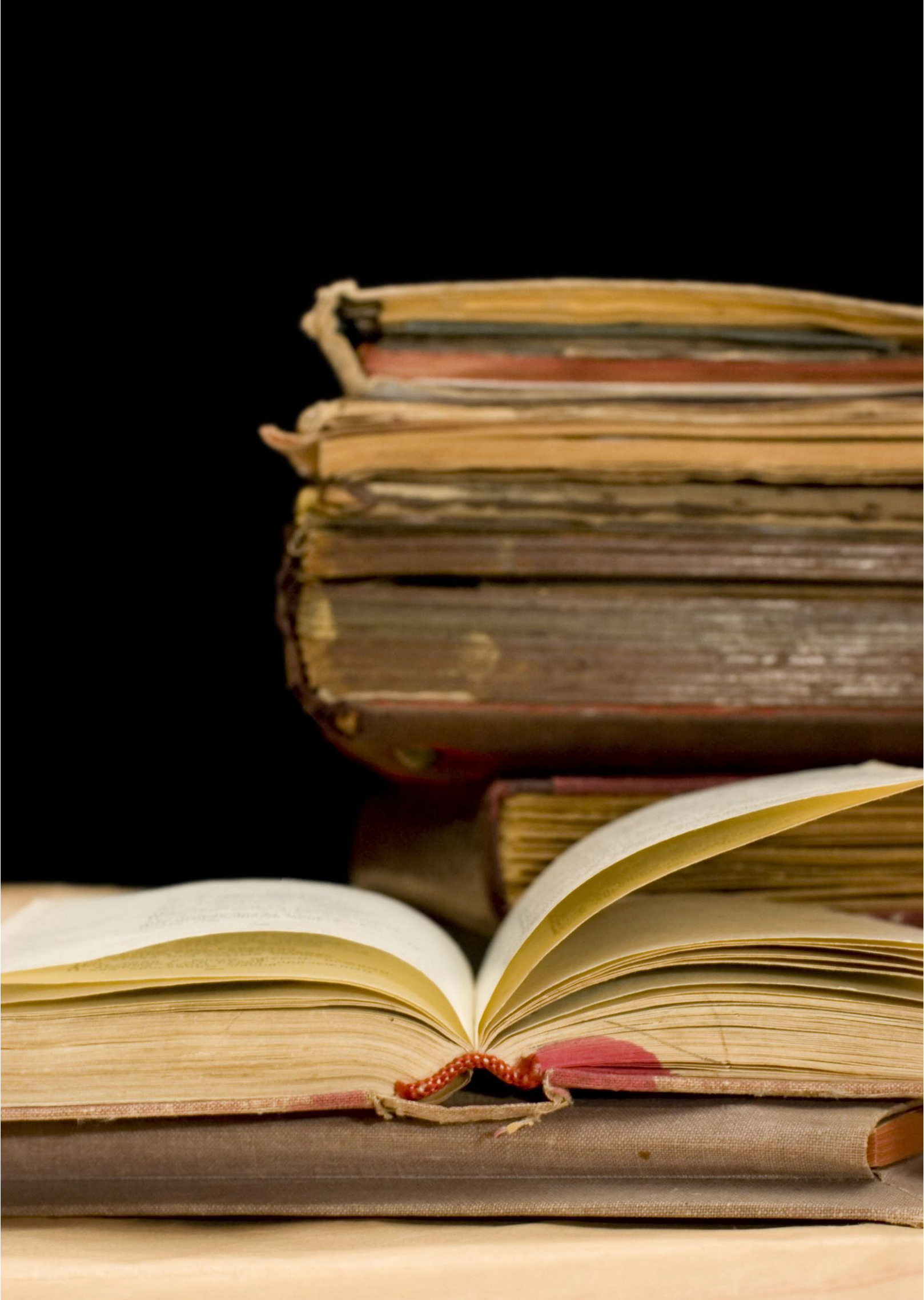
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TABLES

TABLE 1: Draper, T. (2014) *Facets of Investigation Enforcement*.





POETRY AND THE WORLD OF BUSINESS – AN EXPLORATION

GILLIAN PRITCHETT, MA. CPFA.

Despite a lengthy career in the international department of Lloyds Bank of London, the closest T. S. Eliot ever came to writing about the business world was in these lines from *The Waste Land*:

At the violent hour, when the eyes and back
Turn upward from the desk, when the human engine waits
Like a taxi throbbing waiting... ¹

And although Dana Goia believed that poetry could help creative thinking he admitted that "American poetry has defined business mainly by excluding it. Business does not exist in the world of poetry, and therefore by implication it has become everything that poetry is not—a world without imagination, enlightenment, or perception. It is the universe from which poetry is trying to escape" (Goia, 1992). But let us not pause to reflect on the extent to which poets write about business – the purpose of this article is to explore the various ways in which poetry can add value in the world of business.

Whilst most people can accept a potential connection between poetry and advertising, they tend to be sceptical that reading poems and experiencing the process of getting to grips with their possible meaning can be of help in business. The idea that poetry can help with strategic thinking, in decision-making, in communications, in the way we look at situations, the way we think, the way we interact with others, the way we express our opinions, with creativity and innovation leaves many people struggling. And yet - reputable companies, world-class CEOs, institutions, and scholars propound the value of poetry for business.

Concerned that business and management strategy were too often reduced to a narrow, toolbox approach, the Strategy Institute of the Boston Consulting Group commissioned Clare Morgan to work with them on a project exploring the relationship between poetry and strategic thinking. The investigation of the role poetry might play in business by Morgan and her colleagues is recorded in the book, *What Poetry brings to business*² published in 2010. Ted Buswick, who initiated the project, said, "What our theories offer isn't an 'alternative' approach. It's a tough, skills-based initiative aimed at adding to the repertoire of analysis-based thinking spaces."

The BCG Strategy Institute was not alone in recognising the value of poetry in business. Its value has been recognised by many a CEO. In 2007 Sidney Harman, founder of Harman Industries said, "I used to tell my senior staff to get me poets as managers, [...] Poets are our original systems thinkers. They look at our most complex environments and they reduce the complexity to something they begin to understand" (Rubin, 2007). When asked about his success in turning Jell-O from a business with a seven million dollar loss to a twenty million dollar success Dana Goia, a poet and author of *Can Poetry Matter?* replied, "I looked at things differently. I made associative connections. I thought around and beyond and through the data that confronted me" (Morgan, 2010, p. 43). He ascribed this to the fact that he was also a poet.

Business schools use poetry to teach business studies for example Babson College requires its MBA candidates to take a five-week creativity workshop early on in the programme. Students are randomly assigned to one of seven art seminars which include poetry. Professor Mary Pinard says "There is a lot of ambiguity in the creative process, and that's hard for people who want answers. [...] Yet successful entrepreneurs are people who can stay open to possibilities, take risks, and find new solutions to problems [...] The nature of what entrepreneurs do is very close to what poets do." Tom Chandler, poet laureate of Rhode Island and a full-time professor at Bryant College in Smithfield teaching literature classes and a poetry workshop for undergraduates says,

¹ Published in 1922 in the UK in the October issue of *The Criterion* and in the US in the November issue of *The Dial*. It was published in book form in the US by Boni and Liveright in December 1922 and in the UK by Hogarth Press in September 1923.

"Business school promotes a very conformist culture [...] but I want students to take that coat off while they are in my class. Individuality is contagious just as conformity is contagious. I see these two at war." For Chandler the value of poetry is not limited to just making students more creative thinkers, it also makes them more well-rounded people. It could be argued that this is important in increasingly global and often uncertain economy.

Lieutenant General James Lennox, Superintendent of the United States Military Academy at West Point from 2001 to 2006, believed that poetry was of value in achieving good communications: "Those who can't communicate can't lead. Poetry, because it describes reality with force and concision, provides an essential tool for effective communication. [...] In studying poetry, cadets gain a unique appreciation for the power of language" (Lennox, 2006). To this day, poetry is part of the curriculum. Indeed, the 2016 curriculum not only includes poetry in courses on British Literature, American Literature, and World Literature, but a 36-hour course just on poetry: "Embracing a wide variety of authors, works, periods, traditions, and forms, this course considers the literary genre through which human beings have expressed their most intensely imaginative visions of themselves and the world, and connections between the two. Some consideration of poetics and prosody will complement the cadets' reading of verse that ranges from Japanese haiku through the Shakespearean sonnet to the free-verse creations of modern and contemporary poets." As well as developing communication skills, Lennox (2006) also considered that "poetry confronts cadets with new ideas that challenge their worldview. [...] In teaching cadets poetry, we teach them not what to think, but how to think. [...] We may not produce a poet laureate at the United States Military Academy. If, however, we develop graduates who can communicate clearly, think critically, and appreciate the world through different perspectives, we will provide the Army and the nation with better leaders."

Clare Morgan (2010, p. 14) suggests that poetry can help business in the following ways:

- A poem is multidimensional which develops our ability to detect different modes of meaning and to deal with ambiguity and uncertainty.
- A poem doesn't offer closure – this teaches us to handle non-resolution
- A poem isn't based in a logical deductive mode and so we learn to make associative connections
- Poems can show the ordinary as extraordinary which encourages us to question givens and makes us more aware of complexity
- A poem is almost infinitely interpretable and can help us to consider the views of others, to recognise that 'meaning' is unstable and to examine and revise our current insights and perceptions
- A poem operates at different levels of accessibility which could enable us to detect weak as well as strong signals and to seek less obvious linkages
- A poem is full of coexistent complements and contradictions which could develop our ability to time judgements carefully and be aware that binary thinking is not enough
- By drawing attention to human needs and motivations poetry could help us to make decisions in a more comprehensive context and address ethical issues
- By exploring emotional complexity poems could help us develop the ability to offer wholeness of response

Let us take a top level look at the potential value that poetry can bring to some specific business contexts.

POETRY AND MARKETING

Poetry and advertising are no strangers. Klepper and Piller (2004) contend that "socially, advertising has long taken over the community-building function of the bard, gluing together individuals with the semiotics of shared symbols and narratives". Referring to the advertising slogans, "Have a Break, Have a Kitkat" and "Wonderbra for the way you are", Clare Morgan (2010, p. 31) suggests, "the power of poetry has been added to the words of the advertisements to reach beyond those words and elicit a response that does not depend on logic or fact. The poetry aspect has reached into the customer's decision-making process to assess nonlogical but highly decisive responses that affect the purchasing patterns of whole sectors of society."

Poems have often been used to market products and this was especially evident at the start of the new millennium. In March 2000, *The New York Times* ran an article on the use of poetry by marketing departments reporting that "American Airlines is the latest company to jump on the poetry bandwagon. In April, National Poetry Month, flight attendants on selected international flights will hand out 100,000 copies of a poetry anthology along with the peanuts" (Meredith, 2000). Volkswagen put 40,000 copies of poetry books in the glove boxes of its new cars. Lancome paid for 15,000 copies of an anthology called "Great Love Poems" given out on Valentine's Day (Meredith, 2000). In 2000, Monster.com announced record-breaking traffic spikes following the launch of its new advertising campaign during the broadcast of Super Bowl XXXIV. In the commercial, a young woman standing at an urban crossroads is 'advised' by a cast of characters as they walk past her. The advice is recited in the form of lines from Robert Frost's poem, *The Road Not Taken*. The final lines, delivered by an elementary school teacher and some of her students, suggest that the choices you take will make all the difference in your career.

Two roads diverged in a wood, and I,
I took the one less traveled by,
And that has made all the difference.

In the abstract to his article, *What Business can learn from the Poetry of Thomas Kinsella*, John Fanning (2007, p. 46) wrote, "A growing number of voices, [...], call for a greater embrace of literature and the arts in seeking to understand and master the world of marketing and business. The contention is that creative writers, such as novelists and poets, can articulate usefully the consumer condition. In this spirit, a close reading of the poetry of Thomas Kinsella, [...], can shed insight into a number of aspects of marketing and management practice. These aspects include the role of creative and innovative processes in business; the frequent misuse of scientific approaches; a tendency to settle for the second rate – 'the ease of the spurious'; the need for thoroughness in new product development – 'reading the ground'; and the consequences of corporate, and brand, amnesia."

Since marketing is only as good as the research that underpins it, could poetry have a role to play in consumer research? John F. Sherry, Jr. and John W. Schouten considered that poetry could be included in the various methods for data collection since it might serve to tap into consumers inner worlds, cogently arguing the case in *A Role for Poetry in Consumer Research* (Sherry and Shouten, 2002). They contend, "if, [...] we accept that the task of science is to accommodate disparate voices and attend to the polyphony of science (Jackson 1998), then poetry is a viable vessel for the conveyance of research experiences." They go on to argue, "perhaps former poet laureate Rita Dove's belief that poetry makes 'the interior life of one individual available to others' (Dove, 1994, p. 25) can serve as a rationale for the rapprochement of art and science in consumer research." They considered that poetry could be included in the various methods for data collection since it might serve to tap into consumers inner worlds. Either the consumer

would express their views and feelings in poetry or they could share their feelings with a researcher who would express them in poetic form. They conclude that "we have discussed two ways that poetry can inform studies of consumer behavior: as reflexivity within research and a revelation of researcher point of view and as stand-alone qualitative research in its own right. Yet these are not the only means by which poetry may contribute to the discourse on consumer behavior. We have written this article simply to launch the tide of exploration" (Sherry and Shouten, 2002, p. 230).

POETRY AND BUSINESS STRATEGY

Clare Morgan (2005) used the poem "*Traveling through the dark*" by William Stafford at a workshop she conducted with a high tech company in the UK. The CEO wanted to spend time at a strategy retreat developing the thinking of his management team as well as addressing the concrete issues that faced the company; "being a poetry reader himself—he was eager to see how exposure to some poetry would affect the way his team approached certain key issues."

When asked what approach she took in presenting such an unusual subject, Clare Morgan (2010) explained that she chose a poem that "showed how complex making decisions is: complex, that is, in terms of how so many different elements can affect how we see 'the facts.'"⁴ For Morgan, *Traveling through the Dark* was appropriate because "the content of the poem opened up a wide-ranging discussion of real issues like: when is the right time to kill off a project? What influences we may not be aware of are affecting how we prioritize value and make fine judgements? The poem also opened up how we may be judged, for making tough choices that affect the lives of others. [...] The CEO liked the way the discussion highlighted that in many cases there is not a clear cut right or wrong to the decision we're faced with. Sometimes the information we have is incomplete, or the different strands of need cannot be definitively prioritized."⁵

By learning - or re-discovering - how to think laterally and how to recognise and accept ambiguity business leaders and managers might be better equipped to take oftentimes complex decisions.

POETRY AND DECISION-MAKING

Can reading poetry make you think differently? Intuitively, one would answer yes, but is there empirical evidence to support this intuition? And will the process of understanding poems open spaces in your mind that will facilitate strategic planning, creativity, communications? Wolfgang Iser in his essay, *The Reading Process: A Phenomenological Approach*, proposes that reading literary texts fosters an ability to ask questions and make connections. In the world of business "we look forward, we look back, we decide, we change our decisions, we form expectations, we are shocked by their non-fulfilment, we question, we use, we accept, we reject" (Iser, 1974). This is exactly what we do when we read a poem and try to grasp its meaning. Because of this, Iser believes that literature gives us the chance to formulate the unformulated. Morgan (2010, p. 12) considers that "reading poetry requires – demands – a very particular way of thinking. And that way of thinking is vitally important in addressing the complexities of the economic, social, and political world we live in." Ted Buswick (2005) suggests "reading poetry opens up new thinking spaces, and accessing those spaces requires you to develop a new set of thinking skills."

³ "Poetry in the Boardroom: Thinking Beyond the Facts: A Roundtable Discussion among Clare Morgan, Kirsten Lange, Ted Buswick, and Nancy Healy," *Journal of Business Strategy* 26 (January-February 2005), pp. 34-40.

^{4,5} Ibid.

Clare Morgan (2010) argues that a poem is:

a distillation of thought, experience, emotion into a tightly controlled form which utilizes words, images, sound and rhythm patterns to create a complex set of meanings that constantly form and re-form themselves. Its components take it beyond argument into a realm where expectations of single, analysable meaning are deliberately questioned and subverted. All art does this, but poems do it in a particularly condensed and therefore intensive way. A poem is a puzzle with multiple, inexhaustible, co-existent – and interchangeable - 'solutions', each more or less dependent on the others for validity. This means that the desire for closure, which drives most business considerations, the desire for pursuing the shortest route between A and B, another dominant mode in business thinking – won't get you anywhere at all when you're faced with a poem.

For Morgan, a poem is not an act of logical deduction; "if you try to cut to the chase the poem will elude you" (Morgan, 2010, p. 23). In other words, a poem needs to be read carefully and thought about rather than being read rapidly and then a hurried decision made about its meaning. This is in stark contrast with the business world where typically facts are gathered, analysed and a decision made, usually with tight deadlines that preclude a careful thinking through of the issues, the possible decisions and the potential outcomes of those decisions.

In *What Poetry Brings to Business*, Morgan discusses the notion of sharpeners and levellers. The Leveller likes to categorise, levels differences and emphasises similarities and finds the unique, unclassified sensation difficult. In contrast the Sharpener tolerates anomalies; is ready to think and perform symbolically, may seek out ambiguity and variability of classification; plans ideationally and is ready to assume an attitude toward 'the merely possible' (Morgan, 2010, pp. 36-37).

Morgan argues that engaging with poetry fosters a different mindset from that which typical analytical business training promotes. In today's complex world, the sharpener mindset is essential for strategic thinking and for being creative and innovative. Leaders need to be sharpeners.

Reuven Tsur⁶ undertook experiments to see whether how a person is trained to think makes a difference as to whether they use sharpener or leveller strategies and whether having been trained to work with poems enables someone to use different thinking strategies than if they were not. Tsur worked with groups of literary professionals and students as well as control groups of people who were not literary trained. Participants had to evaluate different versions of a poetry text considering criteria such as static-dynamic, open-closed, emotional-unemotional. The differences perceived by the literary trained group were markedly greater. Tsur's results indicated that the non-literary trained participants tended to level out the differences and lacked the skills associated with those who had benefited from literary training.

⁶ Reuven Tsur is professor emeritus of Hebrew literature and literary theory at Tel Aviv University. He is known for his theory of Cognitive Poetics.

⁷ From *The Hawk in the Rain* (1957).

POETRY AND CREATIVITY

Companies need to be innovative in order to differentiate. Can poetry help with creativity and innovation? This question was raised in 1999 by Jules Mann of the Poetry Society: "regarding the world of business and poetry, I spoke recently with Elizabeth Wild of ARCO [...] she referred to a book by business guru Charles Handy titled 'The New Alchemists', which indicates that leading business are thinking more about motivation, and ways of encouraging creativity and not stifling it. Handy notes a trend towards many more workshops and courses on how to stimulate creativity... perhaps poetry could be worked in there somehow" (Mann, 1999)?

One of the most ambitious attempts to define the nature of creativity was Arthur Koestler's *The Act of Creation*: "The creative act is not an act of creation in the sense of the Old Testament. It does not create something out of nothing; it uncovers, selects, reshuffles, combines, synthesises already existing facts, ideas, faculties, skills." This led Koestler to his creative theory of 'bisociation' in order to distinguish between routine thinking on a single plane and creative thinking that always occurs on more than one plane. "The bisociative act connects previously unconnected matrices of experience – the essence of discovery is that unlikely marriage of cabbages and kings, of previously unrelated frames of reference or universes of discourse whose union will solve previously unsolvable problems" (Fanning, 2007, p. 48).

During the past decade businesses have been harangued from all sides on the need to become more innovative and creative if they are to have any hope of surviving in an increasingly competitive world. From Michael Porter: 'innovation is the central issue in economic prosperity', to Gary Hamel: 'radical non-linear innovation is the only way to escape the ruthless hypercompetition that has been hammering down margins in industry after industry', all of the 'big beasts' of the business academic world have been singing the same tune. In the past business has never been shy of ransacking other disciplines for any insights they may have to offer, so it should come as no surprise that the humanities have now become a particular target (Fanning, 2007, p. 46).

It should follow therefore that when trying to arrive at creative solutions the more we know about the background to the problem under review the more likely we are to make the necessary connections and, as the poet Kinsella advises, we need to keep stirring the pot (Fanning, 2007, p. 48):

We have to dig down
sieve, scour and roughen
make it all fertile and vigorous
get the fresh rain down.

The genesis for Fanning's article was a request from Diageo's head of advertising to address a conference of their marketing staff and agency teams on the subject of creativity in November 2006. Thomas Kinsella's connections with Guinness – he was brought up in the area, has written extensively about it and both his father and grandfather worked for the brewery.

A useful poem to study in the context of creativity is *The Thought Fox*⁷ by Ted Hughes which describes how the moment of creative insight creeps up on the poet.

I imagine this midnight moment's forest:
Something else is alive
Beside the clock's loneliness
And this blank page where my fingers move.

The opening line, "I imagine this midnight moment's forest", warns us that this is not a poem about a forest or a fox. The poet is sitting alone at the midnight hour, faced with a blank page. The process of creativity is like a fox creeping through the forest making footprints in the snow. The snow represents the white page. The footprints are the words that slowly appear:

Cold, delicately as the dark snow
A fox's nose touches twig, leaf;
Two eyes serve a movement, that now
And again now, and now, and now
Sets neat prints into the snow
Between trees, and warily a lame
Shadow lags by stump and in hollow
Of a body that is bold to come

At the end of the poem the page is printed. A poem has been produced.

Till, with a sudden sharp hot stink of fox,
It enters the dark hole of the head.
The window is starless still; the clock ticks,
The page is printed.

This is reminiscent of the recommendation Ted Hughes gives in *Poetry in the Making*: "Imagine what you are writing about. See it and live it. Do not think it up laboriously, as if you were working out mental arithmetic. Just look at it, touch it, smell it, listen to it, turn yourself into it. When you do this, the words look after themselves, like magic" (Hughes, 1967, pp. 17-19).

Luc de Brabandere⁸, a BCG fellow and author of The Forgotten Half of Change, argues that creativity is central to change in an organisation but suggests that central to creativity is the ability to shift perceptions since such changes can make way for imaginative leaps that generate new ideas that fuel organisational changes.

He uses poetry to exemplify some of the challenges of creativity. One of his clients was a global hotel chain who put their request for proposals in the form of a poem in order to find consultants who would bring breadth and freshness to the project. de Brabandere (2005) says "a strategic vision is a representation – an ambitious image of a future state that is radically preferable to the current state." Studying relevant poems could assist in this process. He talks of the need to have an attitude of *non finito* whereby even though we do not know and cannot know what is going to happen we have the will to act, to "be actively participating in a world that is becoming, without knowing what it's going to be become" (de Brabandere, 2005). In many ways this ties in with how it is when we read and study a poem. There is no absolute certainty as to what the poet meant us to understand. There are no right answers.

⁸ Luc de Brabandere is a senior advisor to BCG. He specialises in creativity, scenario building, and strategic vision techniques applied to business.



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POETRY AND ORIGINAL LEARNING

Monika Kostera examined the contribution of poetry to research into the relationship between feelings and organising. She argues that poetry, as an approach, is well suited to expressing the ambivalence and volatility of the managerial experience. "Its strength is that it does not 'flatten out' the domains of organizing or 'translate them into rationality'" (Kostera, 1997, p. 343). As a result she proposes that poetry can be used to understand more about organizational realities. Her aim in using poetry was to learn about the subversive and subjective experience of talking about management topics. She argues that poetry is particularly powerful in that it does not avoid passion and it is disruptive because it is inconclusive.

Grisoni and Kirk in their paper, *Voice, Verse and Va va voom: Illuminating Management processes through Poetry* (Grisoni and Kirk 2006), explored the power of using poetry as a process of critical reflection and organisational analysis in the management process. In this qualitative study poems were created from the experiences of two members of the organisation in dialogue in relation to their roles and focus on specific decision-making critical incidents within the life of the organisation. Writing in the form of poetry enabled them to find a voice, increased personal learning, and new insights in relation to roles, management processes of decision-making, and interpersonal dynamics in the organisation. Grisoni and Kirk (2006, p. 344) found that "the power of poetry lies in its ability to focus not only on events but also on behavioral and

affective elements embedded in the episode. Poetry has been used to reveal hidden aspects of organizational life where the essence of an event or episode opens up an opportunity for greater understanding as well as the potential for change in individuals and organizations".

Louise Grisoni (2007, p. 341) argues that poetry "can be used to create a fusion between tangible, rational and explicit knowledge and tacit or implicit knowledge, providing opportunities to access new organizational knowledge and understandings and learning." Her paper is a case study of 60 middle and senior UK-based public services managers from one local authority who worked together to explore how research into their experiences might help address some problematic issues facing public services as well as developing ideas about best practice. Poetry in the form of haiku was used as a creative research method to access tacit knowledge, which, when combined with explicit knowledge and understanding, led to new insights and organisational learning. The structure for a haiku was chosen in that it channelled anxiety into the need to count syllables and ensure that the haiku that were created conformed to the 17 syllable pattern arranged in a 5, 7, 5 pattern.

In small groups of three, participants in the workshop were invited to tell each other stories about significant events from their recent organisational experiences. Listeners noted key words from these stories and together the small group developed short poems using the haiku form of poetry. Participants were encouraged to play with words rather than worry about whether the poems they created were good examples of poetry. The poems were then read back to the whole group and participants invited to capture the thoughts and feelings that emerged in hearing and understanding the new knowledge presented to them. Through this process of reflection a revised sense of the issues and priorities held in the organisation were discovered and action plans identified. It was noticed by the group that the use of poetry enabled a surfacing and discussion of emotions and emotional engagement with the organisation in a new and different – more accessible way.

AND WHERE DO WE GO FROM HERE?

In his *Philosophical Investigations*, Wittgenstein asserted that anyone who could not understand poetry was 'meaning blind'. He also believed that language can hide things from us; that words don't have simple and singular meanings. False perceptions of meaning can lead us to ingrained ways of thinking. He believed that one of the ways that we can be set free of this is by reading poetry. "Do not forget that a poem although it is composed in the language of information, is not used in the language game of giving information."⁹

Certainly more efforts are being made to bring poetry to the masses which in turn could make it more acceptable as a training device in companies and organisations. The scheme, *Poems on the Underground*, was launched in 1986 by London Underground to showcase a diverse range of poetry - classical, contemporary, international as well as work by new poets – with the aim of bringing poetry to the masses. Poems are displayed in 3,000 advertising spaces in train carriages across London, and are usually changed three times a year. This scheme has been highly successful resulting in the publication of several volumes of poems. In 1998 the Poetry Society in the UK launched Poetry Places – a scheme that between 1998 and 2000 placed many of the UK's leading poets in settings that would show how poetry can be part of everyday life. Writing in *The Guardian* when the scheme came to an end, Maev Kennedy (2000) described it as having "brought poems to the public in the most unlikely places: poems on greaseproof wrappers in Wigan chip shops, poems printed on refuse sacks in Norfolk, poems on spikes among the plants in a botanical garden, and poems on walls, bus shelters and beaches." The project generated unprecedented publicity for British poetry - when Peter Sansom became Marks and Spencer's poet-in-residence, the news went global. *The Star* newspaper quipped poetically:

⁹ Wittgenstein, Ludwig. Zettel. ISBN: 9780520252448

I wandered lonely through the crowd
 At my local M&S
 When all at once I saw a bard
 Among the pants and vests.

Poems bridge the gap between knowing and perceiving because they use the highly differentiated, logic-driven structures of language to point to the undifferentiated arena where emotion holds sway. Poems put down their roots in the no-man's land between thinking and feeling, the borderland where logic shades into the non-logical, where a world defined and delineated by language gives way to the more diffuse territory of what psychologists sometimes call the "feeling state" (Morgan, 2010, p. 55). This is the same strange land, in which twenty-first-century business executives routinely find themselves. A world in which facts and data are never enough and there is rarely a right or a wrong answer. Regularly reading, discussing, and thinking about poetry, Morgan claims, can help business professionals become more comfortable with ambiguity, and, as a result, prepare them to be creative, ethical leaders. She goes on to say that thinking contains rational and nonrational elements and making effective decisions depends on both. "Poetry brings together these rational and nonrational elements more clearly and intensely than other modes of expression" (Morgan, 2010, p. 55). She argues that reading poetry can encourage the "play between the rational and nonrational processes. This improved confluence enhances your decision-making abilities and therefore enables you to operate more fully and effectively in a complex, decision-led world" (Morgan, 2010, p. 56).

Just as "the poet isn't trying to tell you something. The poet isn't trying to tell you anything. The poet is taking you on a journey of exploration, and where you arrive in the end, and the nature of the journey, will be different for each person" (Morgan, 2010, p. 13); so this paper was a journey – an exploration – seeking to open your mind to the possibilities; to encourage you to see poetry in a different light. "If you're going to be able to think innovatively or creatively, you have to abandon the quest for swiftness of conclusion. You have to see thinking as an exploration, not just a means to an end" (Morgan, Lange and Buswick, 2005). It has explored just a few of the potential benefits that studying poetry might bring to the world of business - a world where companies need to constantly find a blue ocean to operate in by differentiating themselves from other players; developing new markets and innovative products. Has the time now come to take poetry down from the shelf, dust it off, and take a serious look at what it can do for the business world and then move on to harness that power? ■

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MANAGEMENT OF CULTURE SHOCK

MAREK KOCAK

The rise of globalisation has led to many changes in the nature of how businesses operate including an increasing number of long-term international assignments, which remains for many organisations a challenging problem to the present day. The aim of this paper is, therefore, to provide readers with the general overview of the existing research and findings regarding the topic of cross-cultural adjustment of the expatriates leaving for a foreign assignment and their suitable management procedure in regards to the most effective ways of how different aspects of cross-cultural adjustment could be increased, and thus success of the expatriates in the foreign assignment maximised.

THE IMPACT OF CULTURE

The nature of today's business environment is becoming more globalised and interconnected on the international level than ever before (Giddens, 1999; Friedman, 2005; Inkpen and Ramaswamy, 2006). On one hand, this globalised business environment provides organisations with unparalleled opportunities, whereas on the other hand, it also offers tremendous challenges due to a higher level of complexity, which results from conditions of multiplicity, ambiguity, and interdependence (Lane, Maznevski, and Mendenhall, 2004). Within many organisations, there can be seen increased multiculturalism and thus increased interaction between employees of different cultures. The culture in the context of this discussion could be defined as follows:

Culture is an integrated system of learned behaviour patterns that are characteristic of the members of any given society. Culture refers to the total way of life of particular groups of people. It includes everything that a group of people thinks, says, does, and makes - its systems of attitudes and feelings. Culture is learned and transmitted from generation to generation (Kohls, 1996, p. 23).

To put it briefly, culture could be understood as a shared meaning system (Fisher, 2009). It implies that the environment, which is more prone towards increased interaction between employees of different cultures, is more open to, and in some cases, directly requires an increasing number of short-term business trips to foreign countries or even long-term foreign assignments. These international assignments are, however, very beneficial both for expatriates as well as for the organisations. According to the research done by Oddou and Mendenhall (1991), foreign assignments increase expatriates global perspectives, increase the ability to communicate more effectively with people from culturally diverse backgrounds, or better comprehend business trends.

Benefits for the organisation that are arising from international assignments may include intersubsidiary communication and coordination (Boyacigiller, 1991; and Rosenzweig, 1994) due to the corporate philosophies and vision, which are likely to be transferred together with the expatriate. Similarly, Boyacigiller (1991) argues that the use of expatriates can help the organisation to form links with host-country governments, local businesses, or other interest groups. This form of connection is likely to provide the organisation with a competitive advantage over competition, especially when the organisation is the first one among competitors to make this form of connection, and thus likely to gain the 'first mover advantage'. For these reasons, it could be argued that the success of an expatriate in a foreign assignment increases an organisation's overall efficiency as well as profitability.

The success of international assignments is, nevertheless, to a large extent affected both by the native culture of an expatriate and the culture to which an expatriate is assigned.

However, due to the effect of globalisation, which increases the interconnectedness and interaction of different cultures, and thus seems to converge behaviour among countries, one might mistakenly come to the conclusion that the effect of the difference of cultures is insignificant for an expatriate and thus negligible. This kind of reasoning is, however, flawed and Schneider and Barsoux (2002) argue that cultural differences are not disappearing in the process of globalisation, instead the problem may be in the inability to recognise the presence and the force of the culture. Similarly, the survey of 12,000 world managers done by Harvard Business Review indicates that "the idea of a corporate global village where a common culture of management unifies the practice of business around the world is more dream than reality" (Kanter, 1991).

Thus, not only are there different national cultures in different countries that need to be taken into consideration as they play a role in the success of an expatriate, but also different styles of management need to be taken into account and applied to fit the specific organisational culture which is always to some extent influenced by employees' national cultures. Similarly, the factors of the individual expatriates that are likely to have an effect on the success of an assignment needs to be thoroughly evaluated. For these reasons, there exists cross-cultural management, which could be understood as follows:

Cross-cultural management is the study of the behavior of people in organizations located in cultures and nations around the world. It focuses on the description of organizational behavior within countries and cultures, on the comparison of organizational behavior across countries and cultures, and, perhaps most importantly, on the interaction of peoples from different countries working within the same organization or within the same environment (Adler, 1983, p. 226).

However, the existing research indicates relatively large differences between the existing practices (or lack of practices) of cross-cultural management by organisations and what is generally agreed to be the most successful set of practices that maximise the success of an expatriate in a foreign assignment. The cost of largely ignoring and not implementing such practices is certainly not negligible. Various studies have found that between sixteen and forty percent of all expatriate managers who are given foreign assignments end these assignments early due to their poor performance or their inability to adjust to the foreign environment (Black, 1988; Dunbar and Ehrlich, 1986) and as much as fifty percent of those who do not return early function at a low level of effectiveness (Copeland and Griggs, 1985). Black and Gregersen (1991, pp. 462-463) further argue that "the cost of ineffective expatriates may well be higher than the costs of 'failed' expatriates". Failure, therefore, could be also considered to include factors such as stresses, strains, and underperformance of the expatriate, negative outcomes of repatriation, negative effects on the expatriate's family, the career prospects of expatriate's partner, or negative view about the prospect of overseas postings in the future (Harzing, 1995).

Therefore, once the appropriate practices are implemented, the failure rate as well as the ineffectiveness of the expatriates who are having difficulties with adjustment could be lowered and thus related costs of such failure or low efficiency reduced. The following overview is thus a summary of the most important theory necessary for understanding cross-cultural adjustment, and the practices the existing research found effective in the maximisation of the success and effectiveness of foreign assignments.

CULTURE SHOCK

When an expatriate is entering a new environment, there is always a certain degree of uncertainty about what behavior is acceptable. According to Oberg (1960), such uncertainty is due to the loss of all familiar signs and symbols of social intercourse (both in the work and non-work environment), most of which are not carried out on the level of conscious awareness. The reason for not consciously carrying these cultural signs and symbols, and thus not realising the loss of these culturally inherited habits, stems from the fact that culture has a major role to play in the way an individual's psychology is shaped due to human ethnocentric nature (Berry, et al., 1997). In other words, it is not only cultural differences as such that contribute to the culture shock, but also each individual's psychology which is by default predetermined by our own culture to unwittingly see and judge the outside world through the lenses of our own culture. Because particular beliefs, perceptions, thoughts, and feelings (broadly called basic underlying assumptions) operate at an unconscious level (Thomas, 2008); some degree of culture shock is, therefore, always inevitable. To get a better notion of this complex idea, the core of the problem could be pointedly illustrated in a quote by Eagleton (2000), "one's own way of life is simply human; it is other people who are ethnic, idiosyncratic, culturally peculiar."

This implies that even though an expatriate takes proactive measures both in the form of studying the new environment in advance as well as in trying to perceive new environment non-judgmentally, the individual will always face stress, uncertainty, and the differences of behavioural expectations, both due to imperfect knowledge of the novel culture as well as an unawareness of their unconscious cultural programming, resulting in some degree of culture shock.

The physical, psychological, and behavioural reactions caused by culture shock occurs when expatriate's "cultural clues, the signs and symbols which guide social interaction, are stripped away" (Piet-Pelon and Hornby, 1992, p. 2), and thus "the expatriate is not (fully) able to understand any type of feedback from the novel environment due to the lack of (complete) knowledge of a novel culture" (Louis, 1980). The symptoms of culture shock can include homesickness, increased irritability, the feeling of helplessness, exaggerated concern over drinking water, food, and bedding, or excessive criticism of local customs or ways of doing things (Oberg, 1960). The cross-cultural adjustment could be then understood and measured as the degree of psychological comfort with different aspects of a new country (Black, 1988; Nicholson, 1984).

Oberg (1960) postulated that a degree of psychological comfort with a host country could be divided on four phases: honeymoon, crisis (sometimes called also shock), recovery, and adjustment. Based on these four phases the degree of adjustment could be assessed. The first phase may last from a few days up to six months depending on the circumstances. But generally researchers agree that the honeymoon phase is relatively short (Gullahorn and Gullahorn, 1963; Harris 1979; Moran, 1989; and Torbiorn, 1982). During this stage an individual is fascinated by the new environment (Adler, 1986). The second phase - crisis - starts when an expatriate starts to cope with the real conditions of the foreign environment. Due to the difficulty of an individual adjusting to the foreign environment, one reacts as being hostile or even aggressive towards the foreign environment. This negative attitude is then further exacerbated by the indifference of host nationals towards the difficulties of the expatriate due to the lack of understanding of the expatriate's problem(s). It is usually at this stage when the success of an expatriate is decided. Oberg (1960) argues that when an expatriate is able to overcome this stage, he/she is able to stay in the new environment. Conversely, however, when an expatriate is unable to overcome this stage, he/she leaves the country before he/she reaches the nervous breakdown. This "breaking point" is on the cross-cultural adjustment timeline more clearly specified by Black (1988) who argues that the culture shock as such appears specifically between the second and the third stage "when the person has received the maximum amount of negative feedback but as yet has very little idea as to what the appropriate behaviors are". In the third phase an expatriate begins to be open to the new cultural environment although he/she can still experience some difficulties. Lastly, in the fourth stage an expatriate completely accepts the foreign country and its customs as another way of living and begins to enjoy them.

CURVES OF ADJUSTMENT

Various adaptation development models have attempted to describe degrees of the different stages of cross-cultural adjustment. The most prominent from them are the "U-curve" by Lysgaard (1955) and "W-curve" by Gullahorn and Gullahorn (1963). U-curve describes the four phases of cross-cultural adjustment as postulated by Oberg, whereas W-curve diverges from U-curve after the stage of culture shock, which is followed only by initial adjustment from which the degree of adjustment is again decreased due to mental isolation, which then definitely succeeds in a high level of adjustment due to the expatriate's acceptance and integration into the new environment. For a better picture of the variances between the two curves, the graphical depiction of the two curves could be seen on p. 67.

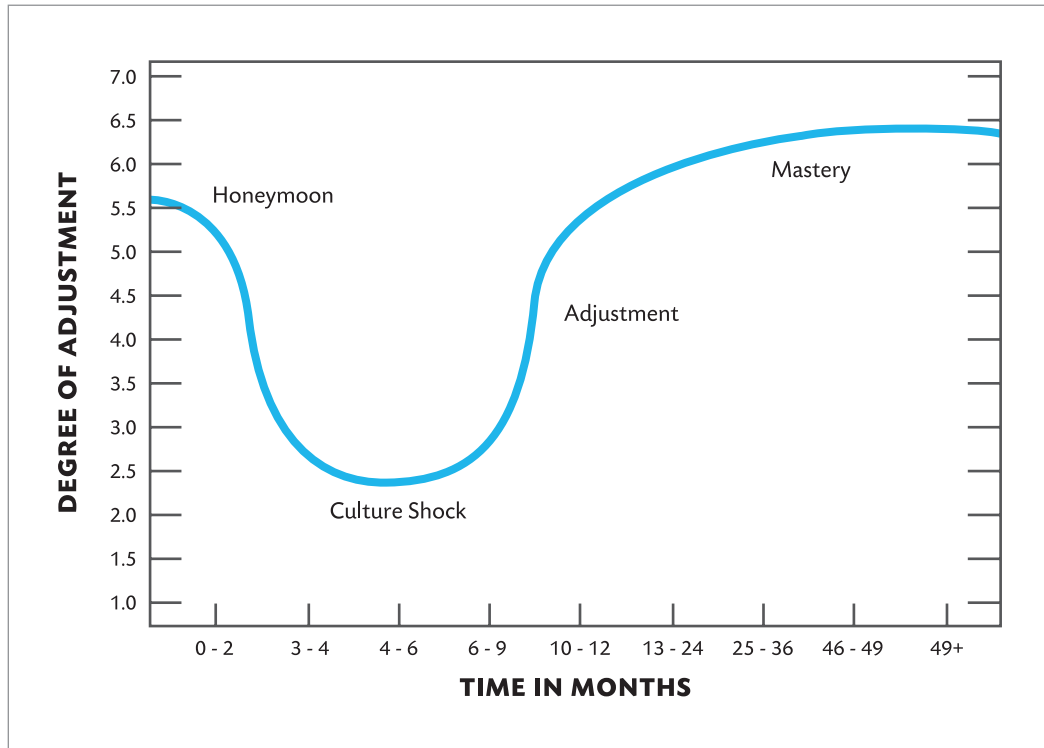


Figure 1: U-curve model by Lysgaard

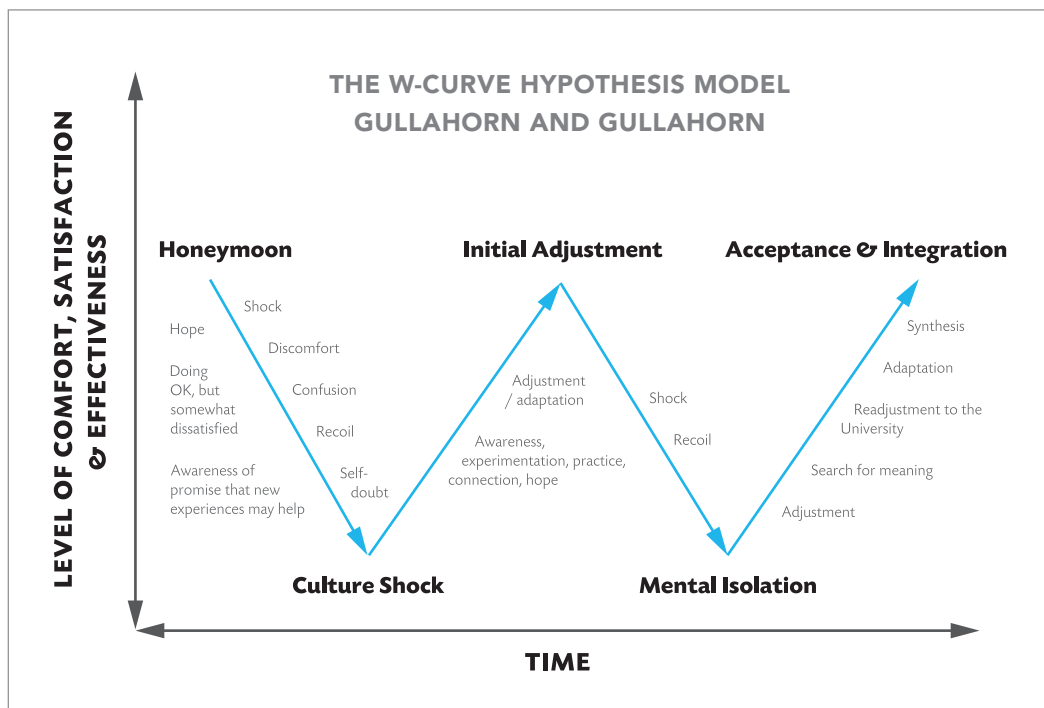


Figure 2: W-curve model by Gullahorn and Gullahorn

However, although according to Dutton (2011) the existing research indicates that different stages of cross-cultural adjustment are the real phenomenon, broadly empirically accurate, Churn (1982) argues that the research support for the U-curve model is inconclusive. In addition, Ward et al. (2001) and Ward et al. (1998, p. 290) went as far as rejecting the U-curve model of sojourner adjustment completely. Similarly, Bernardo (2006) and La Brack (2013) recommended, based on an exhaustive review on the validity of the 'curves', to stop using the models, as they have not withstood critical empirical testing and research. The rejection of adjustment curves could be based on the grounds of findings such as of Churn (1982) and Stening (1979), which indicate that the level of anxiety and the length of experienced anxiety are likely to differ for individual expatriates. In addition, different patterns of adjustment have been also found between work and non-work environment of expatriates, as well as between expatriates and their spouses (Briody and Chrisman, 1991; Nicholson and Imaizumi, 1993).

These different patterns of adjustment between expatriates as well as their spouses could be explained by the differences between various factors such as the ability to speak language, individual factors, foreign work experience(s), expectations and requirements, demographic factors, the differences between job and organisational factors (e.g. job level, cross-cultural training or lack thereof), and due to the differences between environmental factors (e.g. cultural novelty, social support).

Importantly, although it might seem intuitively appealing, it should not be deduced from the curves that the lower the amplitude of the curve the better the performance of an expatriate. The research done by Thomas and Lazarova (2006) actually indicates the contrary. Specifically that the highest-performing expatriates usually experience the most severe culture shock and thus have the most difficult adjustment process. Likewise, steep amplitude of the curve (or in other words the severe shock) should not be understood as an indicator of high-performance in an expatriate as the steep curve is not a reason itself for high performance, but merely a consequence of desirable attributes that enable expatriates to be effective in a new environment (such as perceptual skills or others' orientation) which have a simultaneously negative effect on the culture shock. Therefore, it could be argued that organisations should proactively help to decrease an expatriate's culture shock, but not infer an expatriate's unsuitability for the foreign position from the high aptitude of the cross-cultural curve.

Thus because the curve would differ in each individual, it implies that for ensuring the possibly the smoothest cultural transition of an expatriate the different aspects and stages of cross-cultural adjustment should ideally be closely analysed as there might occur specific problems that would diverge from the specific curve of adjustment. By doing so, identified problems can be proactively tackled in advance. Thus the psychological discomfort of an expatriate could be further reduced and their chances in succeeding in the foreign assignment would be maximised. Failing to recognise these nuances or more significant differences in behaviour between each expatriate would mean for an organisation to diverge from an optimal cross-cultural management strategy and thus decrease in its efficiency.

DIFFERENT ASPECTS OF CROSS-CULTURAL ADJUSTMENT

As already mentioned, the reduction of culture shock can be seen as the process of cross-cultural adjustment (Black, 1988; Black and Gregersen, 1991; and Churn, 1982) where the cross-cultural adjustment could be understood as the degree of psychological comfort with different aspects of a host country (Black, 1988; Black et al., 1991; Oberg, 1960; and Nicholson, 1984). Aspects to which the degree of psychological comfort could be related, however, among many researchers differ. Although it was thought in the past that cross-cultural adjustment is one-dimensional phenomenon (Gullahorn and Gullahorn, 1962; Oberg, 1960; and Torbiorn, 1982) where the degree of adjustment could be measured

by job satisfaction (Abe and Wiseman, 1983; Hammer, Gudykunst and Wiseman, 1978; and Torbiorn, 1982), life satisfaction (Cui and Van den Berg, 1991), ratings of depression (Armes and Ward, 1989), or organisational commitment (Wanous and Lawler, 1972; and Reichers, 1985). More recent research indicates that cross-cultural adjustment could be also understood as a multidimensional phenomenon (Black, 1988; Black and Stephens, 1989).

According to this research, cross-cultural adjustment could be divided on three main dimensions or sometimes referred as facets. The first facet is connected to work adjustment. This facet includes adaptation to job roles and task as well as to novel work environment. The psychological uncertainty resulting from this facet of adjustment can be effectively reduced by similarities in various types of policies, task requirements, and procedures between the parent company and host subsidiary to which the expatriate was assigned (Black et al., 1999). The second facet is called interaction adjustment and relates to the level of comfort arising from the interaction with host nationals including both work and non-work environments. The third facet is then called general adjustment and according to Black (1988), refers to general adaptation to living in the particular novel culture. According to Black and Stephens (1989), this facet includes various factors level of health care, cost of living, or housing conditions.

Generally it could be said that a degree of psychological comfort could be enhanced by learning about appropriate, less appropriate, and inappropriate types of behaviour. Factors that generally facilitate cross-cultural adjustment could be seen as those that reduce the degree of an expatriate's psychological discomfort, whereas factors that increase the degree of an expatriate's psychological discomfort reduce the ability to adjust (Black, 1988; Brett, 1980; and Church, 1982).

However, from the point of view of cross-cultural adjustment as being a multifaceted phenomenon, it could be argued that it is important to take into account different facets of an expatriate's adjustment and enhance an expatriate's appropriate types of behaviour in each specific facet of adjustment in order to maximise the overall reduction of an expatriate's level of psychological discomfort. This argument is supported by the findings of Black (1988) who found that specific facets are very strongly related to the general adjustment of an expatriate.

In line with this logic, it could be argued that because the curves of adjustment unite different facets of adjustment into one unifying curve; such a curve would be of very little help when trying to facilitate an expatriate's adjustment by identifying root cause(s) of expatriate difficulties in each facet of adjustment as such information would not be obtainable from the curve. In other words, whereas the aptitude of the curve would provide information about the expatriate's time and severity of the difficulty with adjustment, the curve would fall short in providing information about the extent to which these difficulties can be attributed to each facet of adjustment. Arguably then, more an effective alternative could be to use specific curve for the description of each facet of adjustment. By doing so, the problem(s) in each particular facet would be more transparent, and thus proactive measures to reduce or completely eliminate such problems could be more accurately and effectively applied.

The reduction of expatriate's difficulties with adjusting relating to each specific facet of adjustment could be done while being in the country and going through culture shock and different stages of cross-cultural adjustment, which could be generally called in-country adjustment, and prior to entering the country called anticipatory adjustment. The theory seems to agree that organisations can proactively accelerate the process of cross-cultural adjustment of expatriates by implementing suitable selection mechanisms and criteria (Black, 1988; Thomas, 1998), applying appropriate cross-cultural training (Worchel and Mitchell, 1972), and using suitable organisational (Stroh et al., 1994; Torbiorn, 1982) and job factors (Nicholson, 1984; Thomas, 1998; Tung, 1981).

SELECTION MECHANISM AND CRITERIA

The failure rate of expatriates is extraordinarily high even despite the fact that it is generally the more successful domestic employees who are sent abroad (Tung, 1981). This rate of failure is primarily due to the fact that often the same selection mechanisms and criteria are used for selecting both expatriates as well as domestic employees with the identical or similar title. The primary decision criterion used by firms in selecting employees for foreign assignments used to be technical competence (Bormann, 1986; Hays, 1971; Howard, 1974; Ivancevich, 1969; Miller, 1975; Tung, 1981). Surprisingly, however, more recent research indicates that very little has changed as technical competence and managerial performance in the domestic setting still lead the list of selection criteria and other criteria that could play a significant role in the expatriate's performance and overall success in the foreign assignment, are still generally neglected (Anderson, 2005; Graf, 2004; Tye and Chen, 2005). However, the idea of not distinguishing between selection practices of domestic employees and expatriates, by relying mainly on technical expertise and managerial competence for both cases, is arguably not very well-founded as requirements for the performance for expatriates and domestic employees are likely to differ (Lee, 2005) as well as factors affecting their success.

Firstly, domestic employees and foreign expatriate have different expectations and requirements about the job position that organisations should during the selection process take into consideration. According to Stahl, Miller, and Tung (2002) unlike with domestic employees, a significant factor in the expatriate's decision to accept an overseas assignment is the enhancement of an international career, especially then, when it comes to an expatriate's first posting. Similarly, Tharenou (2003) agrees that individuals with high outcome expectancies, but interestingly also with few family concerns such as the employment of the spouse or children's schooling, would be more receptive to a foreign assignment. Not recognising these expectations and requirements can lead to decreased satisfaction of an expatriate and thus increased probability of failure.

Secondly, when selecting potential candidates for a foreign assignments, an organisation needs to be aware of the effect of novel environment on an expatriate. The main difference in the work environment is that it will generally consist of more host nationals rather than compatriot expatriates. Therefore, the organisational culture of the expatriate will more reflect a host culture than the expatriate's domestic culture (Louis, 1980) and an expatriate will have to adapt to such behaviours, norms, and values. It is important to note, however, that not all the expatriates will experience the same level and length of anxiety during the cross-cultural adjustment (Churn, 1982; Stening, 1979). Some expatriates may return home early, some may not achieve the mastery stage in the new environment, whereas others may complete the foreign assignment without really adjusting (Thomas, 2008). Therefore, organisations during the selection process should ideally also concentrate on selecting candidates with specific abilities and skills that will decrease and shorten the experienced level of anxiety with the new culture and thus maximise the probability of the success in the foreign assignment.

These individual factors can be according to Mendenhall and Oddou (1985) divided on self-efficacy, relational skills, and perceptual skills. The first set of skills called self-efficacy or in other words self-oriented skills are according to Mendenhall and Oddou (1985) and Bandura (1977) important as an expatriate possessing this skill has an ability to believe in oneself and one's ability to succeed in novel environment, despite this new environment being for an expatriate very uncertain (Black et al., 1991). Therefore, possession of this skill leads to learning new behaviors that better correspond to the expectations of the expatriate. This in turn will decrease the level of uncertainty of the expatriate and thus facilitate a degree of adjustment. The second set of skills called relational skills are important for the expatriate in order to provide information about what is expected from him in the novel environment. According to Mendenhall and Oddou (1985), the greater level of relational skills an expatriate possesses, the easier it is for him/her to communicate with host nationals. Logically, the more an expatriate communicates with host nationals, the more

information about types of appropriate behaviours in the novel environment he/she receives (Black et al., 1991), and thus can adapt accordingly. This is because information received from this communication reduces the uncertainty associated with the new environment. In fact, there could be found a positive relationship between time spent with host nationals and the degree of general cross-cultural adjustment (Black et al., 1991). The third set of skills that falls into category of individual factors are perceptual skills. These skills help the expatriate to better understand and separate appropriate behaviours in the host country from less appropriate or inappropriate ones (Black et al., 1991). It implies that by having a high degree of perceptual skills, an expatriate can decrease the uncertainty connected to a novel environment.

To summarise individual factors, it could be said that candidates with a higher ability to manage psychological stress, communicate effectively, and a higher ability to establish personal relationships were more likely to succeed in the foreign assignment. In addition to the consideration of expatriates' expectations and requirements and individual factors, there are also other relevant factors that need to be taken into consideration during the selection process in order to maximise the success of an expatriate, such as previous foreign work experience, ability to speak a foreign language, and demographic factors.

Previous foreign work experience was also found to be an important uncertainty reduction mechanism (Dawis and Lofquist, 1984; Nicholson, 1984; Torbiorn, 1982). Interestingly, however, according to Black (1988), an expatriate's previous foreign work experience is only positively related to work adjustment for expatriates, but not to general adjustment. This finding could be, however, considered to be in a disagreement with the findings of Dunbar (1992) which found that expatriates with previous work experience are more likely to use appropriate intercultural behaviours (which are arguably also helpful in facilitating general adjustment). Torbiorn (1982) also found that the length of previous foreign work experience seems to have no effect on current foreign adjustment, whereas other studies indicated that the amount of previous foreign experience is positively related to adjustment as well as to job satisfaction (Naumann, 1993; Parker and McEvoy, 1993; Taukechi and Hannon, 1996). The research of Black and Gregersen (1990) even argues that previous foreign experience can be negatively related to particular attitudes of expatriates, such as the amount of discretion that expatriates feel they have in performing their jobs.

Therefore, the existing research suggests that the intuitively appealing notion that previous foreign experience is straightforwardly positively related to all facets of adjustment as well as to the success of all expatriates equally is perhaps an oversimplification. Based on the findings, it could be argued that similarly as there are differences between expatriates in experienced degrees and lengths of adjustment to the new environment, there could be also found differences between expatriates in benefits that previous foreign work experience(s) has given to them, either due to different abilities of expatriates to learn and benefit from the experience or due to the differences in the characters and lengths of foreign work experience between each individual candidate.

Another relevant factor for expatriate success is considered by many researchers to be the ability to speak a foreign language. There has been found a positive relationship between foreign language fluency and the degree of interaction with host nationals, and to a smaller extent with adjustment, satisfaction, and commitment (Church, 1982; Thomas and Fitzimmons, 2008). It could be also argued that the ability to speak a foreign language slightly increases an expatriate's performance as there was found a moderate relationship between foreign language fluency and expatriate performance (Mol et al., 2005). The positive effects of the knowledge of a foreign language are often (at least partly) attributed to benefits of so-called social currency (the ability of expatriates to make conversation about everyday things such as weather, local restaurants, or ways of commuting), which can, according to Brein and David (1971), facilitate expatriates' interaction with host nationals.

However, another explanation could be that the ability to speak is not the primary reason for the expatriate success, but that it could rather be the willingness to communicate that leads to a higher degree of interaction, and the knowledge of the language then merely enables such communication. In such a case, foreign language fluency would be by itself an insufficient factor predicting success unless it was combined with the expatriate's willingness to communicate. This explanation could be supported by several empirical studies that found the ability to speak a foreign language by itself as an ineffective predictor of the success of an expatriate (Benson, 1978). Therefore, it could be concluded that organisations should during selection process not only concentrate on the foreign language fluency, but also on the expatriate's willingness to communicate in a novel environment and the importance of these factors could be assessed in regards to the character of the assignment such as required intercultural interaction.

In order for a selection mechanism to be successful, organisations should also consider demographic characteristics of expatriates such as age, educational level, length of time an expatriate has worked for an employer, or the existence of spouse, or eventually family, as these factors have been found to play both positive and negative roles in the success of a foreign assignment. The following is the summary of the research findings done by Thomas (1998). It was found that age has both positive and negative effects on particular aspects of foreign assignment. On one hand, there was a positive correlation between the age and organisational commitment, job satisfaction, and work adjustment. On the other hand, however, there was found a negative correlation between the age and general satisfaction, willingness to relocate, and intent to leave. Similarly, the length of time a potential expatriate has worked for their employer was found to be positively correlated to job satisfaction, but negatively correlated to intent to leave. The findings also indicate that educational level positively correlates with general adjustment and interaction adjustment, but negatively correlates with job satisfaction, work adjustment, and commitment to the organisation.

Eventually, the selection process should also take into account factors such as the existence of a spouse or eventually family of a potential expatriate that would be leaving with an expatriate as their inability to adjust is the number one reason for the expatriate's inability to succeed in the transition (Hays, 1971; Torbion, 1982; Tung, 1981). The extensive study of expatriates of various nationalities by Arthur and Bennet (1995) indicates that expatriates themselves are also well aware of this issue as they identified family situation as the most important characteristic relating to success in the overseas assignment. On the other hand, however, if an adjustment of a spouse is successful it can increase an expatriate's work performance and job satisfaction (Thomas, 1998).

It could be argued that in order to reduce the spouse's inability to adjust, and thus simultaneously minimise the most likely reason for the expatriate failure, organisations should include in the selection process also factors influencing the spouse's or family's ability to adjust. Therefore, the above described selection criteria should not only apply to an expatriate, but also to their spouse and other members of the family who are entering the new environment with an expatriate. Obviously then the above described criteria should not be applied uniformly to all the members of the family, but rather relevant criteria should be tailored to fit each specific member of the family, such as expectations and requirements about job position would be largely irrelevant for a spouse unless he/she will work in the novel environment, whereas individual factors such as self-efficacy might be even more important to him/her than for an expatriate as he/she will be more likely isolated in the novel environment and thus his/her ability to believe in succeeding in the new, uncertain environment may play a more crucial role in the adjustment than in the adjustment of an expatriate. Once the relevant criteria relating to a spouse or family is thoroughly applied the chosen family members will arguably have better ability to adjust to a new environment than family members of a candidate who are lacking skills that selection criteria found relevant. As a result the spouse's or family's high ability to adjust would be then negatively correlated with the expatriate's intent to leave (Thomas, 1998); therefore, the success of an expatriate will be further increased.

To summarise selection mechanism and criteria, the existing research indicates that organisations still generally use the same selection mechanisms and criteria (consisting of technical competence and managerial performance) for selecting both expatriates and domestic employees. This goes contrary to the plethora of existing research pointing out other factors that have a significant beneficial effects on the expatriate's performance and overall success in the foreign assignment and which should thus be included in the selection criteria as well. These factors include an expatriate's expectations and requirements, individual factors, previous foreign work experience(s), foreign language fluency, and demographic factors. Furthermore, because the spouse's inability to adjust is the number one reason for the expatriate's failure in the assignment, it is argued that described selection criteria should not be limited only to an expatriate, but should also include spouse and family. In such a case, however, relevant criteria need to be tailored to each specific member of a family, rather than applied uniformly. It is essential that all the above-described factors are not underestimated and are properly considered during the selection process, as they are the first important precondition for the subsequent success of an expatriate. Also, it is necessary to consider these factors at this stage, as they cannot be (e.g. previous foreign work experience), or can hardly be (e.g. foreign language fluency) positively influenced to a significant extent by subsequent cross-cultural training. Although selection mechanism and criteria are limited in its nature, they should be considered as an important acquirement of control of factors that lie beyond the control of cross-cultural training (which is further described below) but, nevertheless, play a significant role in the success of an expatriate.

CROSS-CULTURAL TRAINING

Similarly, as in the case of selection mechanism and criteria, although the positive effects of cross-cultural training are well known and agreed by different studies (e.g. Beffus, 1988; Black and Mendenhall, 1990; Brislin, MacNab and Nayani, 2008), organisations often fail to provide training whether it be due to insufficient time prior to expatriate departure, or simply due to a lack of belief in the effectiveness of such training (Enderwick and Hodson, 1993; Tung, 1981). Nevertheless, the theory seems to agree that the organisation should not only apply appropriate selection mechanisms and criteria to decrease expatriate failures and inefficiencies, but also proactively accelerate the process of cross-cultural adjustment by understanding and implementing appropriate cross-cultural training as the research supports the conclusion that there is a positive relationship between cross-cultural training and cross-cultural adjustment (Befus, 1988; Early, 1987; Gudykunst et al., 1977; Mitchel et al., 1972; O'Brien, Fiedler and Hewett, 1970; Steinkalk and Taft, 1979; Worchel and Mitchell, 1972). Similarly, there could be found a positive relationship between cross-cultural training and cross-cultural skill development (Black and Mendenhall, 1990) and cross-cultural training and performance (Earley, 1987; Katz, 1977; Lefley 1985, 1986; McDaniel, McDaniel and McDaniel, 1988; Nayar et al., 1968; O'Brien, et al., 1970; Randolph, Landis and Tzeng, 1977; Salisbury, 1971; Worchel and Mitchell, 1972). However, cross-cultural training has an impact on an expatriate's performance only to the extent that that performance has a culturally related component, which nevertheless studies found in most cases (Black and Mendenhall, 1990) as there are mostly expatriates working with other employees of different cultures and within a novel environment. Finally, there is also a positive relationship between cross-cultural training and subsequent success in foreign assignments (Brein and David, 1971; Church, 1982; Mendenhall and Oddou, 1985).

Based on these findings and on meta analysis of Deshpande and Viswesvaran (1992) and of Morris and Robie (2001), it could be concluded that the empirical evidence supports the idea that cross-cultural training has a positive impact on cross-cultural effectiveness. In other words, cross-cultural training limits some risks of an expatriate's failure. This failure, Harzing (1995) argues, could be also considered to include factors such as stresses, strains, and underperformance of the expatriate, or a negative view about the prospect of overseas postings in the future.

As there is no research indicating otherwise, it could be argued that the research uniformly indicates that cross-cultural training reduces the degree of psychological comfort with different aspects of a host country, or in other words, cross-cultural training positively influences expatriates' cross-cultural adjustment. But although cross-cultural training seems to be in general effective, different aspects of such training need to be understood and taken into consideration, because as it was described more in detail above, cross-cultural adjustment is considered by some to be a multifaceted construct (Black, 1988; Black and Stephens, 1989) with expatriates adjusting to work, to interaction with host nationals, and to general environment (Black and Stephens, 1989). All of these factors determine the extent of success of the expatriate's cross-cultural adjustment and thus his or her success in a foreign assignment.

Surprisingly, however, despite the agreed positive effects of cross-cultural training on the effectiveness on expatriates, there is relatively little known about the effects of different training types (Thomas, 2008). Black and Mendenhall (1989) argue that by drawing on social learning theory for guidance by Bandura (1997), specific training methods should be applied to each specific expatriate based on the difficulty of his or her particular situation (such as degree of cultural novelty, required intercultural interaction, or job novelty). Training methods could be then divided based on the degree of required participation on factual (e.g. books, lectures), analytical (e.g. culture assimilators, classroom language training) and experiential (e.g. field trips, role playing, and interactive language training) from which analytical is the least participative and experimental the most. According to this theory then, the more demanding the situation is for an expatriate, the more participative cross-cultural training should be applied. Applying an experiential method in the most demanding situations seems reasonable, especially in the light of the findings of Brislin et al. (2008) who found experiential training to have the best results.

Similarly, as in the case of the type of training, there is also some uncertainty regarding the appropriate timing of training (Thomas, 2008). Grove and Torsion (1985) argue that in-country training is likely to be more effective after the arrival to the novel environment, when expatriates have a corresponding frame of reference as well as the highest motivations to learn. The existing limited research generally supports the idea of in-country training as being more effective than pre-departure training (Eschbach et al., 2001; Feldman and Bolino, 1999; Selmer, 2001).

However, the existing research indicates that pre-departure training should not be completely disregarded. This is due to the findings indicating that pre-departure training provides an expatriate with accurate information which lead to realistic expectations (Caligiuri et al., 2001; Meglino and DeNisi, 1963), which were consequently found to be positively related to positive outcomes such as to all facets of expatriate adjustment (Black, 1990) and job satisfaction (Feldman and Thompson, 1993; Stroh et al., 1994). Thus pre-departure training is important in a way that it leads to pre-departure knowledge about the host country so an expatriate can reduce the uncertainty of the new environment by anticipating environmental differences (Gullahorn and Bullhorn, 1963).

Although cross-cultural training of the expatriate seems to be effective, such training should not apply only to an individual expatriate, as they often are not isolated individuals without spouses or families (Harvey, 1985). Furthermore, despite the important effect of expatriate's cross-cultural training on cross-cultural adjustment, the failure of an expatriate to living and working in an overseas environment is not the most common reason for the expatriate's inability to succeed in the transition (Tung, 1981). As it was already mentioned above, it is, perhaps paradoxically, the expatriate's family, or spouse's inability to adjust which is the number one reason for the expatriate's inability to succeed in the transition when the expatriate is leaving with the family or spouse (Hays, 1971; Torbion, 1982; Tung, 1981). This is due to the findings of previous research which indicates that "the adjustment of the spouse is highly correlated to the adjustment of the expatriate and the adjustment of the spouse and the expatriate are



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positively related to the expatriate's intention to stay in the overseas assignment" (Black, 1989). As there is problem with a spouse's or family's inability to adjust and also there exists evidence suggesting that cross-cultural training facilitates cross-cultural adjustment (Black and Mendenhall, 1990), it could be argued that when an expatriate is leaving for an assignment with a spouse or family, cross cultural training should also include them, as an expatriate's spouse or family's ability to adjust to the changes of new environment has significant impact on the expatriate's transition at work (Black, 1988).

However, if the family's or spouse's adjustment is indeed related to an expatriate's adjustment, it is crucial to understand specific factors accelerating their adjustment and thus adapt cross-cultural training accordingly. Black and Stephens (1989) argue that whereas expatriates adjust to work environment, general environment, and interaction environment, spouses adjust only to interacting with host nationals and to the general foreign environment. Therefore, an expatriate's training should focus on all facets of adjustment, whereas a spouse's or family's cross-cultural training should concentrate only to interaction adjustment and general adjustment.

FACTORS INFL. THE EXPATRIATE AFTER ARRIVAL TO THE NOVEL ENVIRONMENT

The review so far has only described those ways of how an organisation can reduce an expatriate's psychological discomfort with a host culture that could be implemented prior to entering to a novel environment although they have an effect on an expatriate's in-country adjustment. Firstly, it was discussed that an organisation needs to implement specific selection procedures that will choose from the candidates those expatriates that have specific characteristics that will make them most likely to succeed in the foreign assignment. Secondly, it was explained that these chosen expatriates, with the highest preconditions to succeed, need to undergo cross-cultural training possibly with their families or spouses (though cross-cultural training will differ between the expatriate and spouse, or family to concentrate on specific needs).

However, although the selection process combined with appropriate pre-departure training is important in order to minimise psychological stress arising from a novel environment, Xia (2009) argues that by doing so culture shock will not be completely avoided and moreover the period after entering the novel environment is more crucial for the expatriate when it comes to cross-cultural adjustment as the expatriate needs to transform gained knowledge from cross-cultural training into practice (Cushner, 1994). Therefore, it is reasonable to argue that in-country adjustment should be also carefully considered and planned by organisations when sending its employees on foreign assignments.

Once an expatriate has arrived to the novel country and works in the new environment, there could be various factors that can speed up, slow down, or even completely prevent the expatriate from adjusting to the novel environment, despite previous successful selection process and cross-cultural training which is usually more general in nature and thus have mostly positive effects on non-work factors. Therefore, several other factors (or some aspects of these factors) are important to consider by an organisation once the expatriate arrived to the novel environment as these factors can either further facilitate or inhibit adjustment of an expatriate. Factors with such a potential could be considered to fall in the category of job factors and organisational factors. From the point of view of job factors, there could be found particular job factors that have the potential to facilitate work adjustment. Role clarity is, for example, important for an expatriate as the existing research indicates that it reduces the amount of uncertainty connected to the work situation (Black, 1998; Nicholson, 1984; Pinder and Schroeder, 1987); therefore, it facilitates adjustment at work (Nicholson, 1984). Karasek (1979) and Kahn et al. (1964) argue that role flexibility, another job factor, makes the transition easier as it enables expatriates to make the role more controllable, predictable, and familiar.

Some job related factors were also found to inhibit an expatriate's adjustment. These include role novelty (Burr 1972; George 1980; Minkler and Biller 1979; Pinder and Schroeder, 1987) which could be defined as the difference between previous role and new role, role ambiguity (Harvey 1982; Pinder and Schroeder, 1987), role conflict (Kahn et al., 1964), the amount of ambiguity (Thomas, 1998) and role overload (Kahn et al., 1964; Karasek, 1979; Tung, 1981). Interestingly, although the influence of job factors mainly affect the expatriate work adjustment in the foreign assignment, there were also found some spillover effects of job factors on other facets of adjustment (Thomas, 1998). Thus, the proactive measures taken by an organisation to enhance positive job factors (i.e. factors that have the potential to facilitate adjustment) and reduce negative job factors (i.e. factors that are considered to inhibit adjustment) will decrease the expatriate's failure mainly due to enhancing his or her work adjustment (Black, 1990), but partly also due to the positive effect of work adjustment on other facets of adjustment.

When it comes to organisational factors, organisational culture novelty is expected to increase the uncertainty connected to the work environment (Churn, 1982; Mendenhall and Oddou, 1985). Logically then, the greater the difference between the expatriate's original organisational culture compared to the organisational culture to which an expatriate has been assigned, the more difficult the international adjustment for an expatriate would be (Black et al., 1991). The uncertainty arising from the organisational culture novelty could be reduced by social support from co-workers and possibly superiors from the novel environment that would provide an expatriate with information relating to the description of acceptable, less acceptable, or unacceptable behaviours in the new organisational setting (Pinder and Schroeder, 1987). In a similar vein, a parent company can facilitate the adjustment of an expatriate by remaining in contact with an expatriate by various ways, such as by visits to headquarters, or by some form of distant communication, as the amount of contact with a parent company was found to be positively related to some of facets of expatriate adjustment (Black, 1990).

Another factor falling into organisational factors that organisations should consider is providing an expatriate and possibly also his family or spouse with logistical support such as housing, grocery stores, schools, etc. This recommendation is based on the findings indicating that logistical support has a potential to reduce uncertainty relating to such issues (Copeland and Griggs, 1985; Tung, 1988) and thus have a positive effect on interaction and general adjustment (Torbiorn, 1982). Certain types of logistical support would be then especially determinant of spouse adjustment as inadequate living conditions would likely create uncertainty, especially when the spouse would tend to spend a significant amount of their time engaged in such activities (Harvey, 1985). Such company assistance was found to be positively correlated to an expatriate job satisfaction (Stroh et al., 1994), and limited research also indicates such support to be a notable predictor of a psychological adjustment of a spouse (DeCieari et al., 1991). Obviously then the research indicates that because there are likely to be differences in expatriates' family situations, gender of an expatriate (Caligiuri and Lazarova, 2002), or work situation of a spouse (Harvey, 1997), the organisational support needs to be tailored to fit specific support requirements of each expatriate and family rather than to be applied universally.

CONCLUSION

This research overview presents numerous benefits international assignments bring to both expatriates as well as organisations. However, it also indicates cross-cultural adjustment of expatriates to be a complex long-term process accompanied by different physical, psychological, and behavioural reactions. Such reactions were found to be a result of increased uncertainty about the accepted behaviour in a novel environment and its effects on an expatriate's psychology. These effects were found to be in the initial stage generally positive; however, the psychological uncertainty was found to gradually lead to the stage of so-called culture shock, which an expatriate can overcome and get to the stage called adjustment and subsequently to the stage of mastery. Although these stages were attempted to be described by various adaptation development models, they have not withstood critical empirical testing and thus are argued to be either inconclusive or suggested to be completely rejected. In order to minimise costs connected with an expatriate's failure to adjust to novel environment, or his low level of effectiveness due to a complete inability to adjust, different methods facilitating expatriates cross-cultural adjustment were proposed. Firstly, these methods concentrated on the selection process consisting of criteria such as expectations and requirements, individual factors, previous foreign work experience, ability to speak foreign language demographic characteristics, and the existence of a spouse or family. Subsequently, various effects of cross-cultural training and its appropriate use on an expatriate and family were discussed. Lastly, factors influencing the expatriate and the spouse after arrival to the novel environment were analysed concentrating specifically on job factors and organisational factors.

The above-described procedures can, however, only serve as a rough outline to cross-cultural management despite being empirically supported by the research done in different countries. It is crucial to understand that this is due to the fact that each country is in some ways different from any other country, and thus unique. Therefore, this uniqueness of an expatriate's home country and novel country which an expatriate is entering would always to some extent affect the expatriate. Based on inductive reasoning it is because of this uniqueness of every country that the theories describing more generally cross-cultural adjustment and its management cannot be taken for certain (unless the theory is specifically derived from and supported by the empirical evidence of the expatriate's home country and the novel country that an expatriate is entering). but can only be considered as probable on the two specific cultures. Similarly, described procedures should be tailored in a way to reflect specific requirements and characteristics of each individual assignment. ■

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