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A2 BUSINESS AND MANAGEMENT

BUSINESS AND MANAGEMENT

STUDY TEXT

A2

Foundation level

THE NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS TANZANIA (NBAA)

A2
BUSINESS AND MANAGEMENT

STUDY TEXT

NBAA

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FOREWORD.

The National Board of Accountants and Auditors is a professional body in Tanzania, established under the Auditors and Accountancy Registration Act No 33 of 1972 (CAP 286 R.E.2002). The Board has been charged with among other things, the responsibility to promote, develop and regulate the accountancy profession in the country.

In fulfilling its statutory obligations, NBAA prepares National Accountancy Examination Scheme for students aspiring to sit for Accounting Technician and Professional Examinations. Further, for effective implementation of the examination scheme and improve examination results, the Board provides Study Guides for all subjects to assist both examination candidates and trainers in the course of learning and teaching.

The Study Guides have been prepared in the form of text books with examples and questions to enable the user to have comprehensive understanding of the topics. The Study Guides cover a wide range of topics in the NBAA syllabi and adequately cover the most comprehensive and complete knowledge base that is required by a leaner to pass the respective examination levels.

Furthermore, the Study Guides have been prepared to match with the Competency Based Syllabi to enable the learners to be exposed to practical understanding of issues rather than memorisation of concepts. In this case, the Study Guides are characterized by the following features:-

1. Focus on outcomes – The outcomes shown in every topic provides clear understanding on what to be learnt.

2. Greater workplace relevance – the guides emphasize on the importance of applying knowledge and skills necessary for effectively performance in a work place. This is different from the traditional training where much concern has been expressed in theoretical perspectives.

3. Assessments as judgments of competence – The assessment questions embedded in the Study Guides are adequate measures of understanding of the subject matter.

Study Guides are also useful to trainers specifically those who are teaching in the review classes preparing learners to sit for the professional examinations. They will make use of these Study Guides together with their additional learning materials from other sources in ensuring that the learners are getting sufficient knowledge and skills not only to enable them pass examinations but also make them competent enough to perform effectively in their respectively workplace.

NBAA believes that these standard Study Guides are about assisting candidates to acquire necessary skills and knowledge that will enable them to perform as professionals. The outcomes to be achieved are clearly stated so that learners may know exactly the skills and knowledge they are supposed to acquire in a particular topic.

NBAA wishes all the best to NBAA Examination candidates, trainers in their review classes, lecturers in the higher learning institutions and all other beneficiaries of these learning materials in making good use of the Study Guides towards promoting the accountancy profession in Tanzania.

CPA. Pius A. Maneno
EXECUTIVE DIRECTOR
JUNE, 2019

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Total Page Count: **140**

Features of the book

‘The book covers the entire syllabus split into various chapters (referred to as Study Guides in the book). Each chapter discusses the various Learning Outcomes as mentioned in the syllabus.

Contents of each Study Guide

‘Get Through Intro’: explains **why** the particular Study Guide is important through real life examples.

‘Learning Outcomes’: on completion of a Study Guide, students will be able to understand all the learning outcomes which are listed under this icon in the Study Guide.

The Learning Outcomes include:

‘Definition’: explains the meaning of important terminologies discussed in the learning Outcome.

‘Example’: makes easy complex concepts.

‘Tip’: helps to understand how to deal with complicated portions.

‘Important’: highlights important concepts, formats, Acts, sections, standards, etc.

‘Summary’: highlights the key points of the Learning Outcomes.

‘Diagram’: facilitates memory retention.

‘Test Yourself’: contains questions on the Learning Outcome. It enables students to check whether they have assimilated a particular Learning Outcome.

Self-Examination Questions’: exam standard questions relating to the learning outcomes given at the end of each Study Guide.

EXAMINATION STRUCTURE

The syllabus is assessed by a three hour paper based examination.

The examination will consist of two sections.

Section A	One conventional question of 20 marks	20 Marks
Section B	Forty multiple choice questions of 2 marks each	80 Marks

BUSINESS ORGANIZATION AND ENVIRONMENT

1

STUDY GUIDE 1: BUSINESS ORGANISATION AND ENVIRONMENT

Get Through Intro

An accountant's main function has always been to provide owners / managers of an organisation with accurate and timely financial information. This information serves as the foundation from which tactical and strategic decisions are often made. However, much more is expected of accountants today. The view of accountants being pure "number crunchers" or gatherers of information is fading.

Today accountants are becoming increasingly involved in the operational and strategy formulation side of business. They now advise and consult with owners and managers on productivity, profitability and other business issues. In short, an accountant is now expected to become an integral part of the organisation. To do this he will need to understand the nature of organisations, their structure and their operations.

The contents of this Study Guide will provide you with an appreciation of the rationale behind organisations, their objectives, the stakeholders involved, how business organisations may differ and the different types of business organisations.

Learning Outcomes

a) Understand and explain nature of business management.
b) Explain types of organization
c) Understand organizational objectives
d) Explain stakeholder
e) Explain the external Environment
f) Discuss growth and evolution

1. Understand and explain nature of business management.
[Learning Outcome a]

1.1 Organisation

Definition

An organisation is an arrangement where a collection of people with a set of shared objectives create a formalised group.

A business organisation refers to a commercial or industrial enterprise and the members who are a part of it. Such organisations are formed to provide goods or services (or both) to consumers.

1.2 Purpose of business organisations

An organisation brings together a number of people, who work collectively towards the common objectives. Following are the reasons behind formation of organisations:

1. **Time savings:** with the help of collective efforts and economies of scale, considerable time can be saved.

2. **Division of labour:** individuals working in an organisation are required to concentrate on the tasks that they are best at. This creates specialisation among the workforce which eventually leads to division of labour.

3. **Synergistic effect:** in successful organisations, the output quantity or quality is higher than the inputs put together i.e. 2 + 2 = 5. Thus they are able to create this synergy effect.

4. **Knowledge sharing:** since an organisation is a collection of employees with diverse skill sets, employees can learn from each other about various tasks, and thus enhance their knowledge base on an on-going basis.

5. **Satisfying social needs:** organisations provide a platform where people can come together and interact and share their feelings, ideas and opinions.

Business organisations are formed to satisfy the above and additionally, enable the members to achieve the following objectives relating to carrying on business activities.

Economic objectives: the economic objectives spell out the objectives relating to the money earning capacity of a business and include profit making, creating and maintaining customers and innovation and development.

Social objectives:

These objectives relate to the responsibilities of a business entity towards the society and include providing:

Employment to the society
Quality goods / services at affordable prices
Fair returns to investors
Society development

1.3 Features of business organisations

The following are the common features of business organisations:

1. **Name:** every organisation has a unique name, which is non-personal in nature and serves as its identity. Names of organisations may include words and phrases reflecting their function, like, Citibank, Virgin Trains, Royal Mail, National Health Service, etc. Certain organisations may be required to include words like “Private Limited” or “limited” in their names under statute.

2. **Common goal:** business organisations are social arrangements of people who come together to perform certain activities in order to achieve a common set of goals.

3. **Vision and mission:** a vision statement defines an organisation’s purpose in terms of its values. It is long term in nature and outlines the desired or intended future state of the organisation.

An organisation's purpose and primary objectives are contained in a concise, internally focussed statement known as the mission statement. Mission also outlines how an organisation plans to compete and deliver value to its customers and thus, attain its vision

Example

Examples of vision statements of few organisations:

XEROX: The document company

SIEMENS: Where technology touches lives

HYUNDAI: Building a better world through innovative technology

NOKIA: Connecting people

---

4. **Strategies:** strategies define the long term direction and scope of organisations to meet stakeholder expectations. They describe how organisations intend to succeed in their chosen market place against their competitors.

5. **Organisation structure:** organisation structure refers to a framework depicting the way work is organised and control is exercised in an organisation. It outlines the ways in which work roles are allocated, responsibilities are delegated and efforts are coordinated in a formal setting.

6. **Rules and regulations**: every organisation has its set of rules and regulations, framed for the general business conduct. Rules are aimed at either emphasising on business structures or controlling behaviour of members.

   Organisation rules can be based on explicit or tactic information. Rules based on explicit knowledge are more specific and formal in nature (for example, rules regarding customer credit checks, payrolls, ordering of inventory are explicit). Rules based on tactic information are difficult to express as they are highly personal and subjective in nature.

   Rules are implemented with the help of documented systems and procedures.

7. **Organisational culture:** organisational culture refers to the personality of an organisation. It describes how an organisation organises itself, its rules, procedures, beliefs, stated and unstated values, customs and rituals, metaphors and symbols, etc. Culture provides a framework that enables employees to work together in achieving their own departmental goals, as well as the goals of the company.

8. **Division of work and specialisation:** the entire task of an organisation may be broken down into sub tasks or activities and these different activities are performed by different people, in accordance with their specialisation.

Test Yourself 1

Which of the following primarily relates to controlling member behaviour in organisations?

A Strategies
B Rules
C Mission
D Common goal

---

1. Describe advantages and disadvantages of different forms of legal structure: sole trader, partnership and companies.

[Learning Outcome a]

'Entities' is the generic term used internationally and includes the following:

1.1 Sole traders: a 'one-man-band', usually manages and owns the business - for example: a hairdresser, a plumber, an accountant, a lawyer, a trainer. The identity of sole trader is not separate from his business.

Example

The nearest retail shop selling your favourite brand of candies may be owned by a single person. He can hire employees to help him with the work but the assets and liabilities of the business will belong to the owner of the retail store.

Advantages of a sole trading form of organisation

- **No sharing of profits**: the business is owned by a proprietor who enjoys the whole profits.
- **No chances of disputes**: all business decisions are taken by the proprietor hence there is no scope for disputes.
- **Few legal formalities**: generally there are only a few legal formalities required to be fulfilled to start a business as a sole proprietor.
- **Simple accounting procedures**: a 'sole trader' form of organisation is not bound by a specific set of accounting rules.

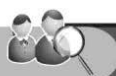
Disadvantages of a sole trading form of organisation

- **All business risks are borne by one person.**
- No scope for sharing of **authority and responsibility**
- **Low growth rate**: the resources employed in a sole trader business are limited and hence the growth rate is low when compared to any other form of business.
- **Unlimited liability**: in the case of bankruptcy, owner's personal assets are used to repay loans or other debts of the business e.g. for making payments to trade payables, the sole trader might have to sell his house, car, personal jewellery etc.

1.2 Partnerships: two or more persons coming together and sharing the profits – for example: professional firms: lawyers, doctors, accountants etc.

As per the Law of Contract Act, "Partnership" is the relationship which subsists between persons carrying on business in common as defined with a view of profit.

Persons who have entered into partnership with one another are called collectively a 'firm', and the name under which their business is carried on is called the 'firm name'.



Example

Blake and Henry are both bakers. Blake came up with the idea of starting a business venture with Henry.

By forming a partnership they can pool their resources and share expenses as well as business risks. Forming a partnership will benefit them in the following ways:

- Instead of paying rent for two different bakery premises they will rent a single bakery premises.
- Henry can concentrate on making cakes and Blake can concentrate on making different types of bread so that they can generate more revenue.
- They can share staff and machinery needed to make cakes and bread.
- Their marketing capability will also increase.

This arrangement between them is called a **partnership,** and Blake and Henry are called **partners**.

Partners are entitled to share all the profits of the partnership in a ratio agreed between them from the beginning. They also jointly bear all the risks i.e. if there are debts due to others which cannot be paid from business funds; they share the amount to be paid to others. In the absence of any agreement to the contrary, the profit sharing ratio is assumed to be equal among the partners.

Another form of partnership is an LLP. In an LLP (limited liability partnership), the partners have limited liability. However, depending on the jurisdiction under which the partnership firm is incorporated, one or more partners must have unlimited liability.

Advantages

- **Sharing of business risk**: unlike a sole trader, who bears all the business risks, in a partnership the business risks are shared between the partners.
- **Skills and experience**: apart from contributing capital to the business, a partnership also provides a better opportunity for a group of individuals to pool their knowledge, skills and experience.
- **Improvement in business**: all the business responsibilities can be distributed amongst the partners who have a larger skill base than a sole trader.
- **Higher investment**: the amount of capital invested in the business is generally higher for a partnership, compared to a sole trader. This gives more scope for expansion.
- **Fewer legal formalities**: a partnership firm is not required to comply with stringent legal formalities as compared to a limited liability company.

Disadvantages

- **Sharing of profits**: the profits earned by the business are distributed among the partners. Determining a fair split-up of profits may be difficult as some partners may work harder than others.
- **Chances of disputes**: while managing the affairs of a business, all the partners need to reach a consensus. However, sometimes this does not happen and disputes occur.
- **Unlimited liability of the partners**: in the case of bankruptcy, the partner's personal assets are taken away to repay loans or other debts of the business.

1.3 Companies: a company is a business entity registered under the Companies Act or any other relevant local law specific to companies. The owners buy shares in the entity and this money is used by the entity to carry out its activities. The owners are known as shareholders. A peculiar feature of an entity incorporated as a company is that unlike partnership or sole trader form of organisations, the liability of the investor is limited to the amount that has been invested in the business.

An entity may be incorporated as:

(a) an LLC (limited liability company: that incorporates both the characteristics of a company and a partnership firm) or

(b) a Plc (public limited company : listed on a Stock Exchange – these companies can have thousands of shareholders and they are generally medium to large entities).

Example

Blake and Harry are both bakers. They decide to open a company together to sell bakery products. They create a company legally, called 'Baker-eeze Limited' and each buys shares in the company. Each of them pays equally to buy 1,000 shares in the company. Now that there is balance in the bank account, the company can buy the items it needs to start making and selling the bakery products e.g. rent, equipment, flour and staff.

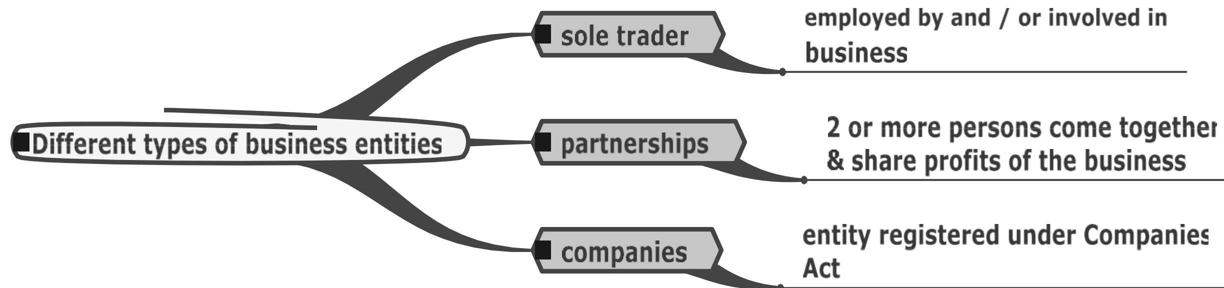
Advantages

- **Large amount of capital**: as there is no limit on the number of owners, large amounts of capital can be amassed. This will allow the business to expand.
- **Better management**: as ownership and management are different, usually professional managers are appointed to manage the running of the company e.g. finance function may be handled by a professional in finance such as a Certified Accountant.
- **Limited liability**: the liability of each member of the company is always limited to the nominal value of the shares purchased by him. The nominal value is the amount printed on the shares. If the company goes bankrupt, the members are not required to use their personal assets for repaying the debts of the company.
- **Transfer of shares**: shares can be easily transferred from one individual to another. This gives liquidity to the investors.

Disadvantages

More legal restrictions: since a company enjoys the benefit of limited liability, many restrictions are imposed by law e.g. a company dealing in computers cannot sell any other item if it is not stated in the memorandum of the company.
Double taxation: profits earned by a company are taxed. However, in some countries, tax is imposed yet again when the above taxed profits are distributed to the shareholders in the form of dividends.
Fraud: the day to day management of affairs does not rest with the owners and hence there is greater scope for committing fraud without the owners' knowledge.

SUMMARY



Test Yourself 1

How many owners does a sole trader business form have?

A Two
B One
C Any number up to a maximum of 20
D Unlimited

Test Yourself 2

Who are the owners of a limited liability company?

A Directors
B Partners
C Shareholders
D Managers

1.2 Legal differences between a sole trader, partnership and a limited liability company

The three types of legal entities will be compared on the basis of following points of view

1. Raising capital

Sole traders and partnerships are principally financed by the owners and generally have limited capacity for raising capital from other sources (obtaining loans or other finance for expanding the business). Partnerships have greater access to sources of finance compared to sole traders since the partners can pool their resources.

Companies tend to have greater access to sources of finance because they have numerous shareholders. In addition, companies can also apply for loans and other sources of finance, similar to partnerships and sole traders. However, unlike partnership firms and sole traders, companies can also raise finance from the market through debt and equity issues.

2. Authority

Sole traders and partnerships are generally owned and run by the same individuals. Although the owners can employ other staff, ultimately they retain complete control, responsibility and ownership of the business.

If they employ other people, they pay them a salary (resulting in an expense in the income statement). However, the reward of the sole trader / partner is called **withdrawals / drawings** and is a statement of financial position item. This is distinguishable from the salary or interest that a sole trader / proprietor would additionally receive.

Tip

Although the reward of the sole trader / partner is salary paid to the sole trader / partner, it is treated as drawings / interest / profits. You will understand these terms better as you read through this Study Text.

Within companies, the owners (shareholders) do not usually run the business but appoint a board of directors who, in turn, appoint managers.

One has to subscribe or buy shares in the company to become a shareholder / owner. A company has a corporate or separate legal status i.e. if an owner / shareholder dies or sells his shares, the company still continues to exist. Managers are appointed by the board of directors who run the company on behalf of the shareholders. The owners check whether their wealth has increased and their resources are properly safeguarded and utilised by management by analysing the financial statements.

The **reward** of the shareholders is in the form of **dividends** – each shareholder receives an amount of money, paid out of the profits made by the company. The shareholders may also make profits when they sell shares.

3. Liability

Sole traders and partnerships have an unlimited liability i.e. if the company is liquidated (closed down) or if the entity becomes bankrupt they are liable to repay the liabilities of the business with their own personal assets and belongings. From a legal point of view, sole traders and partnership firms are regarded as an entity inseparable from their owners. For example, if the sole trader dies, the business comes to an end. In the case of LLPs, one or more partners have unlimited liability – the liability of the rest of the partners is limited to the extent of their investment in the partnership.

Shareholders of a limited liability company have limited liability i.e. if the business goes into liquidation, they stand to lose only the amount of capital they had introduced into the business (the amount they had paid for their shares in the company) and are not liable to pay for business liabilities with their own personal assets. Only if a part of the nominal value of shares is unpaid, that amount may be called for from the shareholders.

Tip

Unlimited liability is the main difference between unincorporated entities (i.e. sole traders and partnerships) and incorporated businesses (companies). Remember, companies have limited liability.

4. Succession

The sole trade and partnership businesses have no perpetual succession. The business comes to an end on death or retirement or resignation or dismissal of the partner unless specifically provided for in the partnership deed.

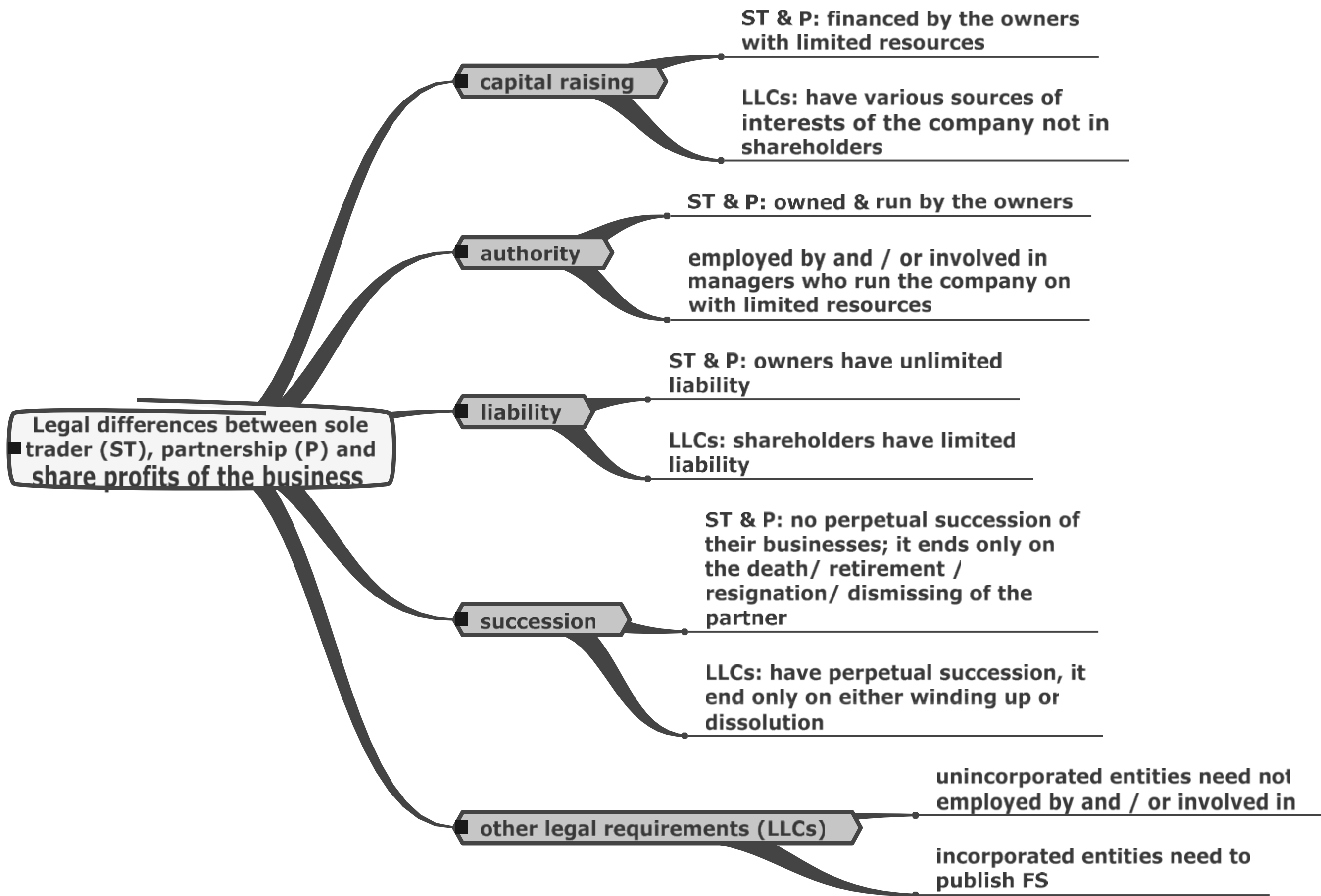
A company exists as a formal and legal entity in its own right. It is separate from its shareholders. The company has perpetual succession i.e. the company continues to exist even on the death or resignation of all the shareholders. The company comes to an end only by winding up or dissolution.

5. Other legal requirements

Unincorporated entities are generally not required to publish their financial statements. They are also generally not required to have their financial statements audited.

However, legal organisation form of business entities as well as other related legal requirements (such as the obligation to audit financial statements) may differ from country to country. For example partnerships in certain countries may be required to have an audit for their financial statements if their profit or turnover is above a certain limit.

SUMMARY



Test Yourself 3

If a sole trader entity becomes bankrupt, can the personal property of the owner be used for paying debts?

A No
B Yes
C The liability is limited to the face value of shares
D The liability is limited to profits of the business

Test Yourself 4

If a partnership business becomes bankrupt, can the personal property of the owners be used for paying debts?

A No
B Yes
C The liability is limited to the face value of shares
D The liability is limited to profits of the business

Test Yourself 5

Which of the following entities generally have a legal obligation to publish their financial statements?

A Limited liability companies
B Sole traders
C Partnerships
D None of the above

Test Yourself 6

If a company becomes bankrupt, can the personal property of the shareholders be used for paying debts?

A No, never
B Yes
C Yes, to the extent of the amount unpaid on nominal value of shares
D No, the liability is limited to profits of the business

Test Yourself 7

When a shareholder dies:

A The company will have to take permission of the legal heirs of the deceased shareholder to continue the business
B The company will have to take permission of the remaining shareholders to continue the business
C The company will continue its activity and the heirs may retain the shares or sell them to whomsoever they wish
D None of the above

---

2. Describe the difference between the private sector and the public sector in terms of ownership and objectives.

[Learning Outcome b]

2.1 Ownership

Private sector entities are owned, managed and controlled by individuals.
Example: Companies like Apple Computers, Samsung Electronics are private entities. These are owned by shareholders and the management is with the Board of Directors.

Public sector entities are broadly classified into two categories:
(i) enterprises that are owned, managed and controlled by the government
(ii) enterprises where tasks are performed by management with the intention of providing services to the society

Examples of public sector entities include entities that develop public roads, public transport, primary education, healthcare for the poor, electricity etc.

2.2 Objectives

The primary aim of private sector entities is to maximise return on earnings. Some part of the profits is ploughed back into the business, and the remainder is distributed among the owners of the entity.

Public sector entities provide the best possible service to society. Any profits go back into the operations.

In today's global and socially responsible economy, the **distinctions between the aims** of profit-oriented entities and those of public sector entities **are blurred**. The aims of the different types of entities cannot remain in watertight compartments any more.

All types of entity are concerned with **using resources in the best possible manner in order to maximise returns**. They all aim to make optimal use of their resources through adequate planning, decision-making and control.

A **private sector entity** uses its resources efficiently in order to maximise return on investment. At the same time, it also puts back into the business a part of its profits for expansion purposes and functions in a socially responsible manner.

A **public sector entity** uses its resources efficiently and tries to maximise profits in order to be able to put back a sizeable amount into the enterprise. This helps it serve the society in a better manner.

Public sector entities receive the funds required to carry out their activities smoothly through voluntary contributions from members, the government or from outside agencies. These entities measure their performance by evaluating whether they provide value for money to the recipients of their services. The term 'value for money' refers to how well the public sector entities make use of the available resources by utilising the three Es: **Economy, Efficiency** and **Effectiveness**. The meanings of these terms are explained below:

Economy: buying goods and services at the best possible price so as to reduce costs.
Efficiency: utilising the inputs in the most resourceful manner so as to obtain the maximum output.
Effectiveness: meeting the right goals at the right time.

Public sector entities are not supposed to show a profit or spend less than their budget. If they do spend less than their budget, the allocation for the next year would be considerably reduced. As a result, instead of financial performance measures, the performance of public sector entities is measured by what they have achieved. They will have key performance measures illustrating the level of service achieved by spending public money.

The key objectives of public sector entities include the following:

1. To provide the general public with services.

2. To break even (in order to stay in business) rather than generate a surplus

3. To provide value for money which can be broken down into providing the following three Es:
   Economy
   Efficiency
   Effectiveness

4. To provide the services and fulfil the objectives that they were created to fulfil

Test Yourself 8

Public sector entities measure their performance by _____________.

A Measuring the profits that they have generated
B Evaluating whether they provide value for money to the recipients of their services
C Evaluating the returns that they have earned for their shareholders
D Measuring the increase in their sales

---

3. Describe other forms of business entities: strategic alliances, franchises, cooperatives, non-governmental entities and subcontracting.

[Learning Outcome c]

3.1 Strategic Alliances

Definition

Johnson, Scholes and Whittington state that a strategic alliance occurs when "two or more organisations share resources and activities to pursue a strategy".

It typically occurs when two or more organisations want to enter a particular industry or market with a particular type of good / service but do not individually have all the needed resources and / or competences.

One of the main types of a **strategic alliance** is a **joint venture**. Here the participating organisations remain independent of each other and instead form a jointly owned special purpose firm. The resources and work each participating organisation is then expected to contribute is explicitly spelled out and formally agreed upon.

Life1 is an American organisation that manufacturers soaps, deodorants and other personal care products. The organisation wants to be able to service the Chinese market but does not have the necessary local presence or knowledge to do so. Therefore it enters into a joint venture with a local company calling the new organisation LifeChina. Life1 will provide LifeChina with all the necessary products which will then be marketed and sold by the sales force and distributors of their local partner.

Another type of a strategic alliance is a **network**. A network occurs when two or more organisations agree to work upon a particular activity in collaboration. Co-branding is a common example of a network and occurs when a single product or service is associated with more than one organisation.

The Senseo coffeemaker carries both the Philips (appliances) and Douwe Egberts (coffee) brands.

Motives or benefits for organisations to form strategic alliances include:

- the costs and risks of **producing a new good / service** can be shared
- the opportunity for each participating organisation to **concentrate on its core competencies**
- the opportunity for each organisation to **learn from the other participating organisations**
- the opportunity to gain entry into markets / industries that would other otherwise be inaccessible

3.2 Franchise

Franchise is a type of strategic alliance. In a franchise arrangement, the franchisor is responsible for corporate activities such as marketing and brand building and the franchisee (owner / operator of outlet) is responsible for all operations involved in running the individual outlet. The franchisee acts as a local representative of the franchisor in the particular area where the franchisee has been appointed and markets / sells the franchisor's product in that area.

A franchise model is a good way of expanding business for the franchisor in unchartered territories by tying up with individuals who know that area well. The franchisor also benefits from low investment as the investment for the outlet and other related infrastructure is done by the franchise.

McDonalds is an example of an organisation that works on the franchise business model. All corporate activities such as marketing and brand building are handled by McDonalds. The franchisee is responsible for all operations and running the individual outlets.

Some other well-known organisations that use the franchise model of business include Subway, Pizza Hut, Starbucks, KFC etc.

3.3 Cooperatives

Cooperatives are defined as being autonomous associations of persons united voluntarily to meet a common economic, social and/or cultural objective, through a jointly owned and controlled enterprise.
(Source: International Co-operative Alliance statement on the Co-operative identity)

In short, it is an organisation that is **owned and managed jointly by those who use its facilities and services.** A cooperative's purpose is to provide services on a non-profit basis to the shareholders or members who control it.

An example of a cooperative (in certain countries) is apartment buildings. A cooperative would own the building and the land it is on. Individual apartment owners would be granted shares in the cooperative based upon the size / value of their individual apartments. The cooperative would also be responsible for the maintenance of the building with financing from members' monthly dues.

3.4 Non-governmental organisations

Non-governmental organisations (NGOs) are any organisations that work towards a social, cultural, economic or educational cause.

They are usually started and run to provide a good or service that the government is not providing or to better the interests of citizens. NGOs cover a wide spectrum of aims ranging from education to the environment.

Examples include Amnesty International, Greenpeace and the Red Cross. Amnesty International campaigns for human rights across the globe. Greenpeace activities are all geared towards protecting and preserving the natural environment. The Red Cross' mission is to provide relief to victims of wars and internal conflicts.

3.5 Subcontracting

With subcontracting, an organisation typically contracts out part of its work / activities to another organisation. Subcontracting is a fairly common practice in the construction industry (e.g. construction of a building is done by one firm which then subcontracts out installing all the necessary wiring and electrical points to another organisation).

Which of the following organisations works towards a social, cultural, economic or educational cause?

A Franchise
B NGO
C Cooperative
D None of the above

Answer to Test Yourself

Answer to TY 1

The correct option is **B**.

A sole trader has a single owner, a partnership has two or more owners and a limited liability company has an unlimited number of owners.

Answer to TY 2

The correct option is **C**.

Directors and managers are employees of the company but not the owners. Shareholders are the owners of the company.

Answer to TY 3

The correct option is **B**.

A sole trader does not have limited liability and if the business goes bankrupt, the sole trader's personal assets are utilised to settle business debts if the business' net assets are insufficient to cover these debts.

Answer to TY 4

The correct option is **B**.

A partnership does not have limited liability. If the business goes bankrupt, the partners' personal assets are taken away to settle business debts. However there are some partnerships which can be formed as limited liability depending on the legislation in each country.

Answer to TY 5

The correct option is **A**.

A limited liability company has to comply with the legal provisions of the Companies Act, and is required to publish its financial statements.

Answer to TY 6

The correct option is **C**.

Shareholders of a company have limited liability. Shareholders are liable to pay the company the amount of face value of shares bought by them. The personal assets are never taken away to settle business debts.

Answer to TY 7

The correct option is **C**.

A limited liability company has separate legal status. When a shareholder dies, the legal heir of the deceased shareholder by default becomes the owner of the shares and the company continues to exist.

Answer to TY 8

The correct option is **B**.

Public sector entities measure their performance by evaluating whether they provide value for money to the recipients of their services.

Answer to TY 9

The correct option is **B.**

Non-governmental organisations (NGOs) are any organisations that work towards a social, cultural, economic or educational cause.

Self-Examination Questions

Question 1

Which of the following is not an advantage of a sole trader form of business?

A Single taxation
B Limited liability
C No sharing of profit
D No need to publish financial statements

Question 2

Which of the following are differences between sole trader entities and limited liability companies?

(i) A sole trader entity is generally not required to publish its financial statements.
(ii) A sole trader has unlimited liability, and a shareholder's liability is limited.
(iii) Only a limited company will have share capital.

A (i) and (ii) only
B (ii) and (iii) only
C (i) and (iii) only
D (i), (ii) and (iii)

Question 3

Which of the following statement(s) is / are correct about a partnership?

(i) Personal assets of partners can be called for in the case of debt repayment.
(ii) Profits are shared equally between the partners.
(iii) Must involve two or more partners.

A (i) and (ii) only
B (ii) and (iii) only
C (i) and (iii) only
D (i), (ii) and (iii)

Question 4

The profits of a company are:

A Shared by employees and the shareholders
B Exclusive right of the sole trader
C Shared by the partners
D Distributed to the shareholders in the form of dividends

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **B**.

A sole trader has unlimited liability. Limited liability is enjoyed by the limited liability companies.

Answer to SEQ 2

The correct option is **D**.

A sole trader business does not have to publish its financial statements. The liability of a sole trader is also unlimited. A company has to publish its financial statements and has limited liability. The capital contributed by the shareholders is called 'share capital'.

Answer to SEQ 3

The correct option is **C**.

A partnership has unlimited liability and needs two or more persons to create it. Partners can decide any profit sharing ratio and may not necessarily be equal.

Answer to SEQ 4

The correct option is **D**.

The management of the company declared dividends to the shareholders, which are distributed out of the profits of the company.

2. Describe needs of different stakeholders in a business: employees, management, shareholders, suppliers, creditors, customers and government.
[Learning Outcome b]

2.1 Stakeholders and their types

The purpose behind any organisation is to produce a good or service. Here is where the concept of added value comes into effect. This is because the good or service produced is typically sold at a premium to customers (the price charged is higher than all the input costs incurred). This premium in turn creates value for an organisation. This value is then distributed to the firm's different stakeholders in different ways:

To employees through salaries and wages;
To lenders of capital through interest;
To the owners of the organisation through profits / dividends and
To customers through goods and / or services.

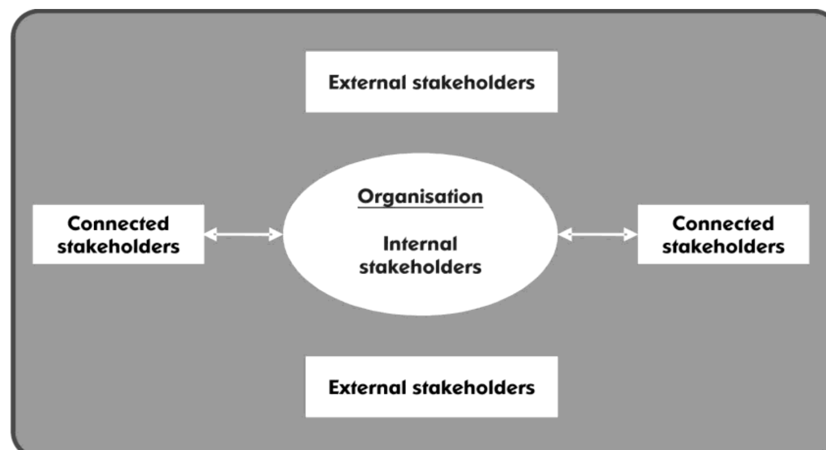
Johnson, Scholes and Whittington in their book Exploring Corporate Strategy provide the following definition of stakeholders:

Example

"Individuals or groups who depend on the organisation to fulfil their own goals and on whom in turn the organisation depends"

Stakeholders are people who have an interest and stake in the operations of the company. A corporate **stakeholder** is a party who affects, or can be affected by, the company's actions. Businesses are affected by the "environment" in which they operate. Businesses come into regular contact with customers, suppliers, government agencies, families of employees and special interest groups. Decisions made by a business are likely to affect one or more of these "stakeholder groups".

Diagram 1: Types of stakeholders



2.2 Agency relationship in business

The work of Berle and Means highlighted the concept of separation of ownership and control. The emergence of joint stock companies, increasingly led to this separation where the shareholders were the principals and the directors, agents. **Agency theory is an extension of the concept put forward by Berle and Means of the division of authority and responsibility and of the agent's accountability towards his principal.** In the context of corporate governance, **the theory deals with the relationship between management and shareholders, and with other stakeholders** and the continuous efforts they take and disputes they face in the process of aligning their interests.

Definition

Jensen and Meckling (1976) define the agency relationship as a contract under which one party (the principal) engages another party (the agent) to perform some service on their behalf. As part of this, the principal will delegate some decision making authority to the agent.

Agency theory aims to address the relationship between the agent and the principal and the problems that can arise when the agent does not act in the best interests of the principal. For example, companies' directors may pursue their own interests, such as power and personal return rather than pursuing the success of the company for its shareholders. This can happen even when their remuneration is related to profits and they hold shares in the corporation. '

Example

Theodore Plc manufactures and sells PVC pipes in Germany. Diane, one of the major shareholders of the company, has identified a good potential market for their products in Austria. She accordingly approaches the directors and suggests that the company opens a distribution centre in Austria.

CEO Helga does not want to take the risk of investing in the distribution centre because she is unsure that she personally has the capability to develop contacts in Austria comparable to those she has developed in Germany, her native country.

This is a case where the agent (director) is acting in her own interests and not necessarily in the long-term interests of the company.

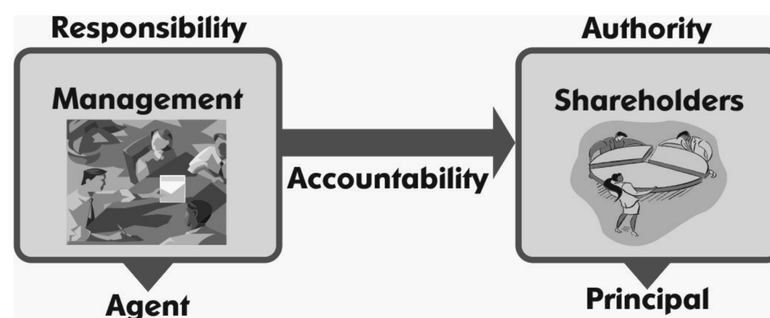
Agency theory suggests that the interest of the business should come before self-interest. This may imply maximisation of profit, growth and shareholder return.

Some writers such as Herbert Simon have argued that directors are more likely to act as 'satisfiers' than maximises since corporations as organisations don't act to achieve the best possible results but merely to achieve satisfactory results across several objectives.

Simple agency theory aims to explore the corporate governance issues involved in the shareholder and director relationship as principal and agent. Whereas shareholders represent the owners of the business, the executive directors / directors look after the running of the business for them. The board of directors is responsible to the shareholders as a body. Shareholders as a body equates to the company as a whole.

It can be argued that directors should manage the business in such a way that ensures that the business will remain in business and make long-term profits. If shareholders require accountability then they will require a process for monitoring the performance of directors. The cost of monitoring is known as an "agency cost".

Diagram 2: Agency theory



SUMMARY

Test Yourself 2

The main objective of the agency theory is to:

A Address the nature of relationship and problems between the principal and the agent
B Control agency related costs
C Ensure profit maximisation of organisations
D Ensure social objectives are met

2.3 Internal stakeholder

Definition

To be classified as an internal stakeholder, an individual or group must meet the definition of a stakeholder and in addition must also be employed by and / or be involved in the running of the organisation.

Internal stakeholders are closely connected to an organisation. Their objectives have a strong influence on how an organisation runs.

Employees, investors and management are the different categorises of internal stakeholders for an organisation.

1. Employees: employees and their representative groups are interested in the **stability and profitability of their employers**. They are also interested in information which enables them to assess the ability of the enterprise to provide remuneration, retirement benefits and employment opportunities.

2. Investors: are concerned with the **risk inherent in, and return provided by, their investments**. They need information to help them determine whether they should buy, hold or sell.

3. Management and those who appointed them: managers and directors are interested in the economic condition of an organisation. Financial statements help them to take **economic decisions**, for example, whether to hold or sell their investment or whether to reappoint or replace the management.

SUMMARY

Test Yourself 3

Which of the following statements is incorrect?

(i) Internal stakeholders are involved in the running of an organisation.
(ii) Internal stakeholders' objectives have a strong influence on how an organisation runs.
(iii) Internal stakeholders are closely connected with external stakeholders.

A (ii) and (iii)
B (i)
C (iii)
D All of the above

Test Yourself 4

Which of the following is not an example of an internal stakeholder?

A A partner in a law firm
B An executive of a publicly traded company
C A customer
D A consultant working part-time

Connected stakeholders

Definition

To be classified as a connected stakeholder, an individual or group must meet the definition of a stakeholder and in addition **must also have a financial link with the organisation**.

Main examples of connected stakeholders include:

(a) Shareholders

Shareholders are people who have invested money in the organisation and have received partial ownership or a **share in the company,** in return. Their only involvement with the running of the organisation is electing its board of directors. However given their ownership status, they have the **ultimate authority** over an organisation.

Example

Individuals or organisations who purchase shares of a publicly traded company become its connected stakeholders.

Shareholders are interested in high profits, high returns on their investments (dividends) and long-term growth of an organisation.

(b) Board of directors (management)

A board of directors is not involved in the day to day operations of the organisation. Their responsibility is to set the **long-term objectives and strategy** of the organisation. However, given that a board of directors also appoints the executives of an organisation (who in turn appoint the management, who in turn appoint the employees); they have considerable influence over the organisation.

Example

On August 29, 2006 Apple announced the latest addition to their board of directors, Dr. Eric Schmidt. Schmidt was the chief executive officer of Google. Steve Jobs, Apple's CEO said one of the main reasons for this appointment was because "Like Apple, Google is focused on innovation and we think Eric's insights and experience will be very valuable in helping to guide Apple in the years ahead.

(c) Suppliers

Suppliers are individuals or companies that sell an organisation the **inputs** (e.g. raw materials) it needs to produce its outputs (final goods or services).

Example

James is an owner of Super Group, textile mill. He used to purchase cotton from a retailer, John. Here, John is a supplier of Super Corp. and therefore, a connected stakeholder.

Without the support of its suppliers, no organisation would be able to bring its goods or services to market. Suppliers look for a long-term relationship with the firm, frequent and regular orders from the organisation followed by prompt payment at a fair price. The growth of the organisation leads suppliers to accept more orders. In case suppliers are unsatisfied they may limit or withdraw credit, and charge higher rates of interest to the organisation.

(d) Creditors / suppliers of finance

Creditors are an organisation's **supplier of finance**. They include banks, venture capitalists as well as other financial institutions. They typically provide an organisation with the capital it needs to start up, run operations and / or expand. Although creditors do not normally involve themselves with the running of an organisation, they will intervene if they feel their investment is under risk.

Example

In the early 1990s when Donald Trump's business empire was in serious decline, creditors intervened in the running of the company. Some of the changes or constraints they imposed were that Trump appoint a chief financial officer, live on a budget, and standardise operations.

Creditors also look for prompt payment including interest on outstanding debt and its repayment at the agreed date.

Creditors are interested in knowing whether an organisation has sufficient positive cash flow to meet its obligations.

(e) Customers

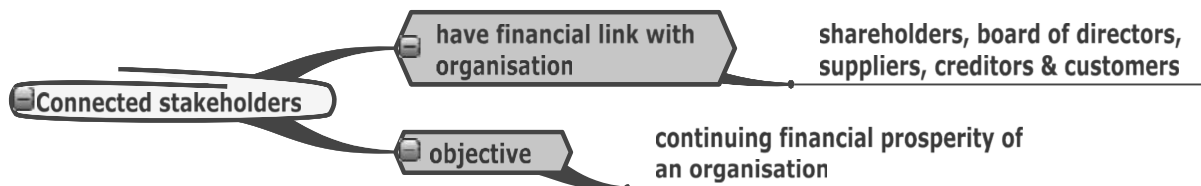
Customers are the individuals or companies that **purchase** the organisation's goods / services. They arguably represent the **most important stakeholder group**, as the organisation cannot make any money without customers. Therefore they have the greatest influence or impact over an organisation.

Example

In 1985, without adequate customer research, Coca Cola executives decided to change the formula of their existing coke drink. However, the new Coke was strongly rejected by consumers (the company received 400,000 protest calls and letters within three months). The new Coke was then quickly replaced by Coke Classic (which kept the original recipe).

The above example shows that customers have high expectations of the goods and services they buy, which includes low cost, value for money, quality and service support. If customers are unhappy with the organisation, they will take their business elsewhere.

SUMMARY



Test Yourself 5

Connected stakeholders must have an operational link with the organisation.

A True
B False

2.4 External stakeholders

External stakeholders are individuals or groups that have no direct link with the organisation. They do not have any monetary link nor are they involved with the running of the organisation in anyway. However, they are affected by the actions of an organisation and can in turn affect the actions of the organisation.

The main types of external stakeholders are:

1. Government

Governments will not normally interfere with the daily affairs of an organisation (unless the organisation is breaking the law). They will however set the **regulatory framework and economic environment** that organisations operate in.

Increased Government regulation of an industry normally creates threats for firms, as it limits their actions. De-regulation of an industry on the other hand normally creates opportunities for firms. For instance, in the early 1990s, the UK telecommunications market was de-regulated and a number of new national public telecommunications operators were granted licenses. This ended the duopoly that had been enjoyed by BT and Mercury.

Normally, governments look for compliance to laws and regulations. They are interested in knowing the contribution of the organisation to the national economy (by providing employment and paying taxes).

2. Trade Unions

Trade unions represent a **collective bargaining unit** for the employees of an organisation. They will interact with the management / executives of an organisation to negotiate working conditions / remuneration terms. They expect to take an active part in the decision making process.

The US airline industry contains several different operating trade unions. These groups include the Air Line Pilots Association, the International Association of Machinists as well the Professional Flight Attendants Association. Each trade union negotiates with airlines to better the interests of its own particular group of members. If any department is to be shut down, the trade union will want to be consulted, and there should be a scheme in place to help the employees of that department in finding alternative employment.

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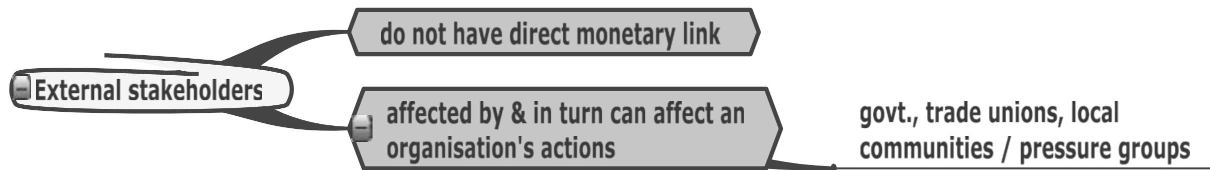
3. Local communities / pressure groups

These stakeholders do not typically deal directly with the organisation. However they have large expectations on the type of behaviour they expect from the organisation, and often influence its actions. For example, environmental pressure groups expect that the organisation does not harm the external environment.

In 2005 Ford launched the Escape Hybrid, an environmentally friendly car (it contains a hybrid electric engine). Many believe Ford launched this car mainly because of the criticisms and negative press it received from environmental groups.

SUMMARY



Test Yourself 6

_______________ stakeholders will have diverse objectives and will have the ability to ensure that the organisation meets its objectives.

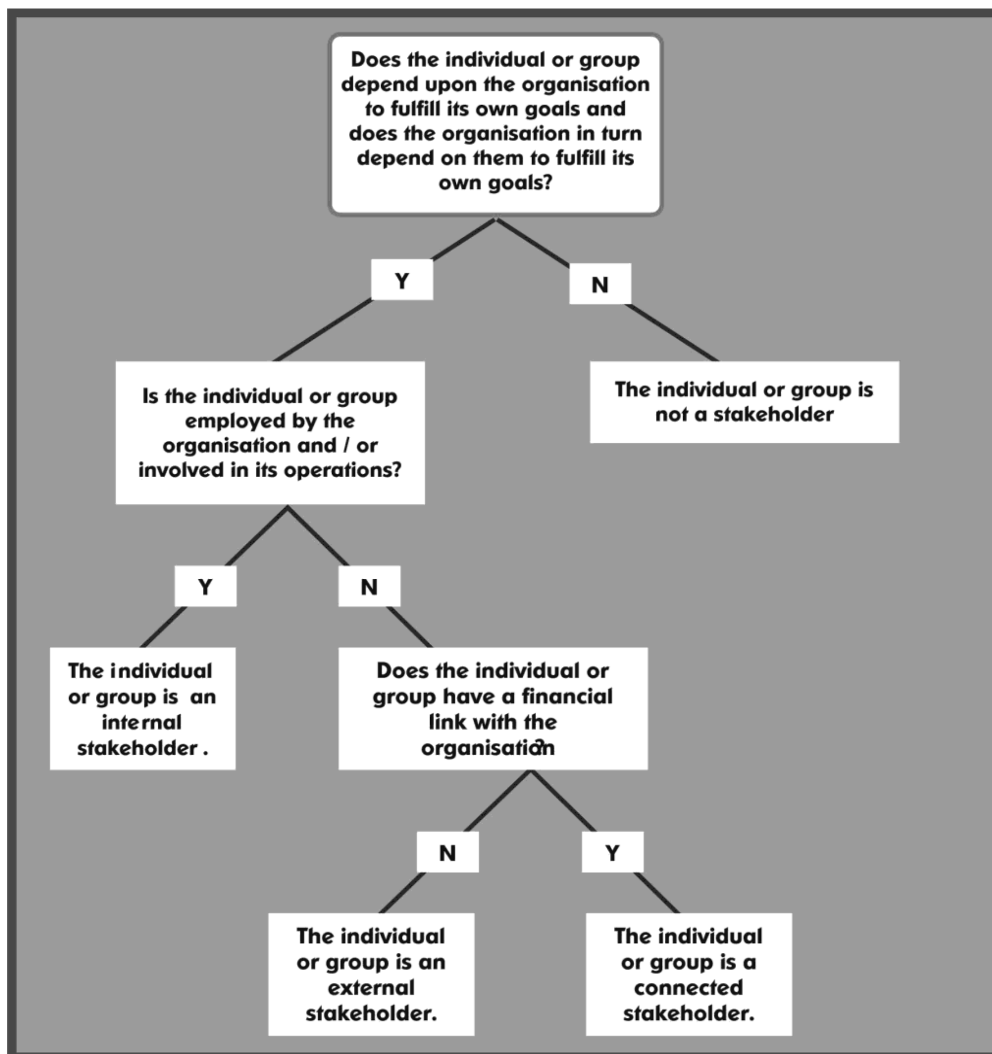
A External
B Connected
C Internal
D All of the above

2.5 Mendelow framework

The following diagram helps to identify the groups of stakeholders:

internal
connected
external

Diagram 3: Identifying different stakeholder groups



Another way to describe stakeholders is to define them as individuals or groups who are affected by an organisation's actions, and who in turn are in a position to affect the way an organisation operates through their actions.

As mentioned before, all organisations will have internal, connected and external stakeholders. Their objectives (and correspondingly the majority of their actions) will broadly comprise of:

(a) Internal stakeholders

Their main objective is to help the organisation **achieve its goals.** The work environment and long-term prosperity of the organisation are also a priority for this group of stakeholders.

Recognising the importance of employees as key internal stakeholders, many organisations have begun rewarding staff with ESOP (Employee Stock Option Plan) programs, where employees are given shares in the organisation. This also acts as a motivation for employees to work harder, as the better the organisation performs the more valuable their shares become.

(b) Connected stakeholders

As mentioned before, connected stakeholders have a financial link with the organisation. This group will buy from, sell to or have money invested in an organisation. Their main interest will be in seeing the **continuing financial prosperity** of the organisation and the quality of its goods / services.

Banks will actively follow the financial performance of any organisation they have lent funds to. If the financial condition of the organisation worsens over time, banks may directly involve themselves in the firm's operations (e.g. restrict the level of bonuses to executives).

(c) External stakeholders

Although there is no direct link between these stakeholders and an organisation, external stakeholders are those individuals or groups who are affected by the actions of an organisation. They will have a set of varied expectations on the type **of behaviour** they expect from the organisation.

Environmental activist groups will demand that an organisation does not pollute the environment.

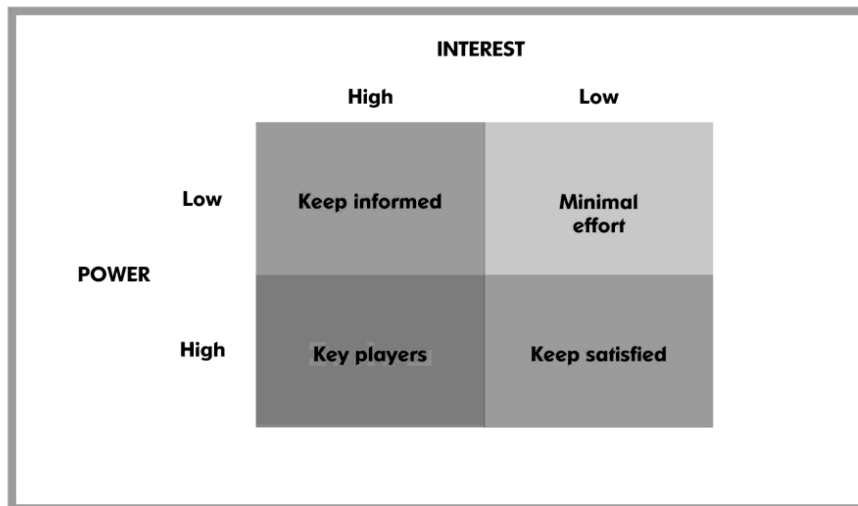
It can now be seen that every organisation will have its share of internal, connected and external stakeholders. However, the combination of these stakeholder groups will vary from organisation to organisation. In addition, the influence each group has over the particular organisation will also vary.

Organisations therefore need to:

- Identify all their stakeholders and
- Rank them in order of importance to the organisation.

Mendelow provides a tool that organisations can use to classify their various stakeholders. Each stakeholder should be evaluated in terms of **their interest** in the organisation and **their power** over the organisation. Power refers to the ability the stakeholder has over the decisions that the organisation will make.

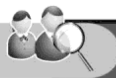
Diagram 4: Mendelow's stakeholder mapping matrix



Type of stakeholders	Examples
High interest and high power	Institutional Investors, Local Planning Authority
Low interest and high power	Major Customers, Central Govt, Media,
High interest and low power	Employees, Environmental Groups, Local Community Average investors
Low interest and low power	Small customers, Small Shareholders, employees

(a) High interest-high power

The **most important** stakeholder group is that which has high interest in the organisation and a high level of power over the organisation. They are the key players of an organisation.


Example

For General Motors, Kirk Kerkorian would fit into this category. Kerkorian is a billionaire investor who bought millions of the company's shares. His holdings amount to close to 10 percent of General Motors' stock. Kerkorian closely follows the operations of the company and actively pushes for reforms. General Motors in turn listens and acts on what he says.

(b) Low interest-high power

Stakeholders with low interest but a high level of power would be of **medium importance** to an organisation. They should be kept satisfied by the organisation as they are powerful, but their intensity of interest in the organisational strategies is low. Generally, these stakeholders are spontaneous; they may appear suddenly to become a key player regarding a particular issue.

Example

Governments are typically not interested in the operations of an organisation. However they will intervene if laws are being broken or the organisation is detrimentally affecting society as a whole. For instance, many Governments took Microsoft to court when they believed it was following monopolistic practices. Microsoft therefore needs to keep the Government satisfied.

(c) High interest-low power

Stakeholders with a high interest but low power are of **medium importance** to an organisation. This is because; the stakeholders in this group should be kept informed. They can be important to influence the more powerful stakeholders.

Example

A common example of such a stakeholder is the average individual investor for a large publicly traded corporation. This type of stakeholder is very interested in the operations and performance of the organisation, as the value of his investment depends upon it. However given the fact that his holdings are typically only a few hundred shares or a tiny percentage of the firm, he can exert very little influence over the organisation. However, the company needs to keep him informed, or he may lose interest and sell his shares.

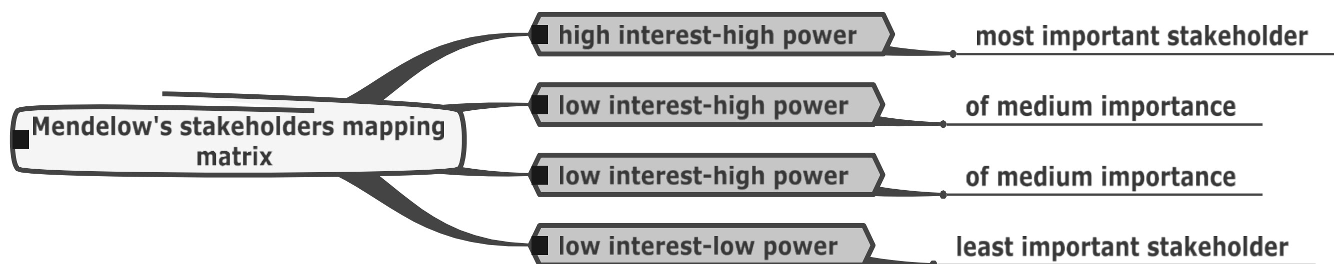
(d) Low interest-low power

Stakeholders with low interest and power are of **low importance** to the organisation. The stakeholders in this group require only minimal effort and monitoring.

Example

An office cleaner would be an example of such a stakeholder. Though he meets the definition of an internal stakeholder, his work is of minimal consequence to the success of the organisation. In turn, such stakeholders typically have very little interest in the activities or success of the organisation.

SUMMARY



Test Yourself 7

If an organisation is having difficulty deciding who the principal stakeholder is, it can be identified by using ____________ power-interest matrix.

A Edgar Schein's
B Mendelow's
C Geert Hofstede's
D Handy's

2.6 Conflicting interests of stakeholders

As described in the previous sections, an organisation's stakeholders will come from a **variety of backgrounds**. This diversity will result in different stakeholders having not only very **different** but often **contradictory objectives**.

The different stakeholder groups have different objectives, some are similar with other stakeholders and some are in conflict.

Examples of similar interests

Shareholders and employees have a common interest in the success of the organisation. They would like:
- High profits which not only lead to high dividends but also job security.
- Suppliers and shareholders have an interest in the growth and prosperity of the firm.

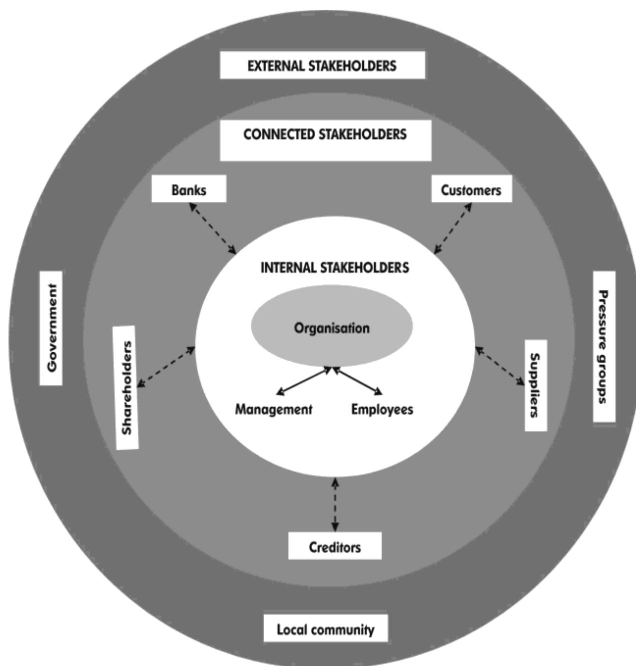
Many of the stakeholder objectives conflict with other stakeholder objectives

Examples of conflicting interests of stakeholders:
The shareholders cannot maximise their profits/dividends if the employees maximise their salaries and the material manufacturers maximise the price for their material.
Managers have an interest in organisational growth, but this might be at the expense of short term profits.
Growth of the organisation might be at the expense of the local community and the environment.
An organisation's customers would like it to charge the lowest possible price for its goods and services. Shareholders would like it to charge the highest possible price, as they will make more money.
Management and unions are two of an organisation's stakeholders that are frequently at loggerheads. Management's priorities are maximising profits / shareholder value whilst the focus for unions is protecting their employee members (better wages, work hours, job security etc.).

One of the most important challenges for an organisation is to ensure that it **balances the interests** of these conflicting groups, as these groups will all simultaneously pull the organisation in different directions.

In most cases, their different agendas are settled by talks and compromise. However, in extreme cases when communication breaks down, the result is walk outs and strikes.

Diagram 5: Stakeholders of an organisation



Which of the below two stakeholder groups are most likely to have conflicting objectives?

A Customers and employees
B Trade unions and management
C Suppliers and creditors
D None of the above

Which of the below two stakeholder groups are most likely to have similar objectives?

A Creditors and shareholders
B Customers and employees
C Suppliers and environment activists
D None of the above

3. Identify objectives of organizations: survival, profitability, market penetration, market share, sales maximization, revenue maximization, technical excellence, level of service.
[Learning Outcome c]

The following are the common objectives of most business organisations:

1. Survival

Survival is important for any organisation, especially in three scenarios:

First, when the organisation is new, it needs to face existing competition in the market, survive and establish itself. At this stage, profitability would not be an important objective of the organisation.
Second, after the organisation enters a new market, it needs to survive competition from existing players in that new market. At this stage meeting with its economic and social objectives would be the priority objective of the organisation.
Third, during times of crisis, an organisation would give less emphasis on some of its other objectives like profitability, growth etc. and just look to survive and ride out the crisis.

Additional aspects which affect the survival of business are as follows:

Recession

Example

The recession which began in the late 1990s, led by US slowdown, impacted most economies. During this period, organisations were struggling for survival. Under the reduced business volumes, cost cutting was their top priority. Many major organisations therefore opted for business process re-en

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Technological advancements

Example

New developments such as computer reservation systems, flight booking on the internet, internet auctions and electronic ticketing have radically transformed the travel business. Travel agencies are forced to find survival strategies because airlines have started to sell tickets directly via the internet or call centres. They have to change their business from just selling tickets to modularised systems that meets the needs of the individual customers.

Online ticketing has now replaced the traditional systems for booking tickets. Travel agents have to change over quickly to the new systems or be forced out of business.

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2. Profitability

Profitability is also important for any organisation to continue as a going concern. If the organisation is not profitable, then it will not be able to sustain itself for too long. Owners / shareholders would look at profitability after the initial years, to earn returns on their investment. A profit making organisation gives a sense of security to employees, vendors and other stakeholders. The organisation can invest its profits in its future growth by introducing new products, entering new markets etc.

3. Market penetration

Market penetration is the name given to a growth strategy where the business focuses on selling existing products in existing markets. Market penetration seeks to achieve four main objectives:

To maintain or increase the market share of current products: this can be achieved by a combination of competitive pricing strategies, advertising, sales promotion and perhaps more resources dedicated to personal selling.

To secure dominance of growth markets. When the overall market is growing, or can be induced to grow, it is easier for organisations with a small market share or even new entrants to gain share. This can happen because the absolute level of sales of the established organisations may still be growing, and in some instances those companies may be unable or unwilling to meet the new demand. In contrast, market penetration in static markets may be much more difficult to achieve.

To restructure a mature market by driving out competitors: this would require a much more aggressive promotional campaign, supported by a pricing strategy designed to make the market unattractive for competitors.

To increase usage by existing customers by introducing loyalty schemes and also through advertising and other promotional measures.

A market penetration / consolidation strategy is the least risky way for a company to grow. According to this strategy, a business focuses on markets and products it knows well. It is likely to have good information on competitors and on customer needs. It is unlikely, therefore, that this strategy will require much investment in new market research.

it is important for any organisation to work towards developing the market and increasing its market share. The deeper the market penetration, the wider is the reach of the organisation's products / services.

4. Market share

It refers to the portion of the market controlled by a particular product or service of an organisation. Any organisation would like its products / services to have the maximum market share. Organisations look to increase market share by increasing market penetration and / or entering new markets. Some organisations may resort to price wars to gain market share from competitors. Big firms may do this to force smaller competitors out of business and then increase prices once they gain market share and drive out competition.

5. Sales / revenue (profit) maximisation

Some large organisations focus more on maximising sales. At times, this may come at a lower profit margin. Organisations can meet the economic objective of profit maximisation only from economies of scale by selling products / services at lower prices as compared to competitors and gain market share.

Example

Downstream oil marketing companies that are in the business of retailing petroleum products like petrol, diesel, gas etc. concentrate on maximising sales as much as possible. They operate on low profit margins.

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6. Technical excellence

Having technical excellence helps an organisation to come out with new innovative products on a regular basis and stay ahead of competition. With its iPods, iPhones and iPads, Apple has demonstrated how coming up with innovative products from time to time can help maintain market leadership.

7. Level of service

Maintaining good quality service is essential for any organisation to retain its customers. Quality refers to meeting the characteristics of the product / service that are expected by the customer. Quality can be measured with the help of its characteristics / dimensions.

Service quality can be assessed based on the following parameters:

- reliability (ability to perform promised service)
- appearance of physical facility (personnel, equipment, communication materials)
- responsiveness (willingness to help customers promptly)
- assurance (knowledge, courtesy of employees)
- empathy (of employees)

A customer will rate the service of the hotel by assessing the above mentioned dimensions of the service e.g. He will say that the quality is excellent if the hotel is clean, well equipped and secured, rooms are luxurious, the staff is helpful and responsive, etc.

In such a case it can be said that the customer is satisfied with the hotel service.

Repeat customers are the foundation for the success of any business. This is because they reorder products / services from the organisation and help to attract new customers to the organisation by word of mouth.

It is always said that obtaining a new customer is easier than retaining him. R**epeat customers are built on a foundation of consistently high quality products or services**. This is because a new customer can be obtained by, say, aggressive advertising; however, the customer will come again only if he is satisfied with the quality.

Also, good quality service can lead to positive word-of-mouth publicity and help the organisation win new customers. At the same time, poor service can lead to bad word-of-mouth publicity and loss of market share.

Test Yourself 10

Survival is important for an organisation at which of the below stages?

A When the organisation is new
B When the organisation enters a new market
C When the organisation is in a crisis situation
D All of the above

---

4. Distinguish between for-profit and not-for-profit business in terms of ownership and objectives.

[Learning Outcome d]

4.1 Differences between business organisations

Business organisations can differ from each other in the following ways:

1. **Ownership and control:** organisations differ on the basis of their ownership and control.

Sole trading firms are owned and controlled by the proprietor.
Public limited companies are owned by shareholders (whose number may run into millions) and controlled by elected board of directors.

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2. **Legal status:** organisations can be classified depending upon the statute under which they are formed.

Organisations may be classified as public limited companies (if registered with the Company House), partnership firms (formed under Partnership Act of 1890), etc.

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3. **Activity undertaken:** Different organisations engage in different types of activities. Activities undertaken can be broadly classified as manufacturing and service.

A bank (like Natwest) undertakes provision of financial services.
An automobile manufacturing firm (like General Motors) manufactures automobiles.

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4. **For profit/not for profit:** the primary aim of some organisations is profit maximisation, whereas some organisations may exist for providing a service to the society (and not earning profits).

Example

Retailers like Marks and Spencers can be classified as profit oriented organisations.
The National Health Service can be classified as a not for profit organisation.

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5. **Sources of finance:** Different organisations pool up finance from different sources, like, issuing shares and debentures, borrowing from banks and other financial institutions, etc.

Example

Sony raises a part of its capital by issuing shares to the general public.
NHS gets most of its funding from the government of UK (in other words, from taxpayers' contributions).

---

6. **Operating capacity:** organisations also differ based on their size of operations.

Example

The size of operations of a retail giant like Walmart is considerably more as compared to that of a local grocery store.

---

7. **Level of technology involved:** the type and level of technology used by firms can be used as a base to differentiate between them.

Example

Aircraft manufacturing firms like Boeing & Westervelt use sophisticated technology as compared to retailers like Waitrose.

Test Yourself 11

Business organisations may differ based on:

A Ownership and control
B Activity undertaken
C Operating capacity
D All of the above

4.2 For-profit and not-for-profit organisations

Normally, on the basis of the ownership and objectives, organisations can be divided into two parts:

For-profit organisations and
Not-for-profit organisations.

Commercial organisations, such as sole trader, partnership firms, and limited companies fall under the category of profit oriented organisations. More details about these organisations are covered in Study Guide 2.

Not-for profit organisations, public sectors, non-governmental organisations (NGOs) and cooperatives fall under the category of non-profit oriented organisations.

For-profit organisations

It is an entity that has been created **for the purpose of generating profits.**

Ownership and objective

This type of entity is mostly owned and controlled by individuals whose aim is to indulge in commercial activity rather than social work. This is the only criterion that needs to be satisfied for an organisation to be deemed a commercial organisation.

For-profit organisations are commonly referred to as commercial organisations. The primary objective of commercial organisations is to maximise profits.

The type of activity or work that the organisation does is of no relevance. The same rule applies with regard to the size of the organisation.

A small one man consulting firm and a multinational conglomerate like Accenture are both examples of for-profit organisations.

These days, most for-profit organisations do some amount of social work as part of their corporate social responsibility (CSR).

Not-for-profit organisations

In direct contrast to commercial organisations, not-for-profit organisations are started and run for the purpose of **providing benefits.** These benefits may be provided on an individual level or to society as a whole.

Ownership and objective

This type of entity is mostly owned and controlled by the government, public sector entities, non-governmental organisations (NGOs), cooperatives etc. Lot of private enterprises also have a separate division that is engaged into not-for-profit activities. For example some pharmaceutical companies run charitable hospitals.

The objective of these organisations is to indulge in social work rather than commercial activity. These organisations work towards a social, cultural, economic or educational cause.

These organisations generally do not earn a profit but aim to provide or deliver a service. Not-for-profit organisations derive their revenue from three sources:

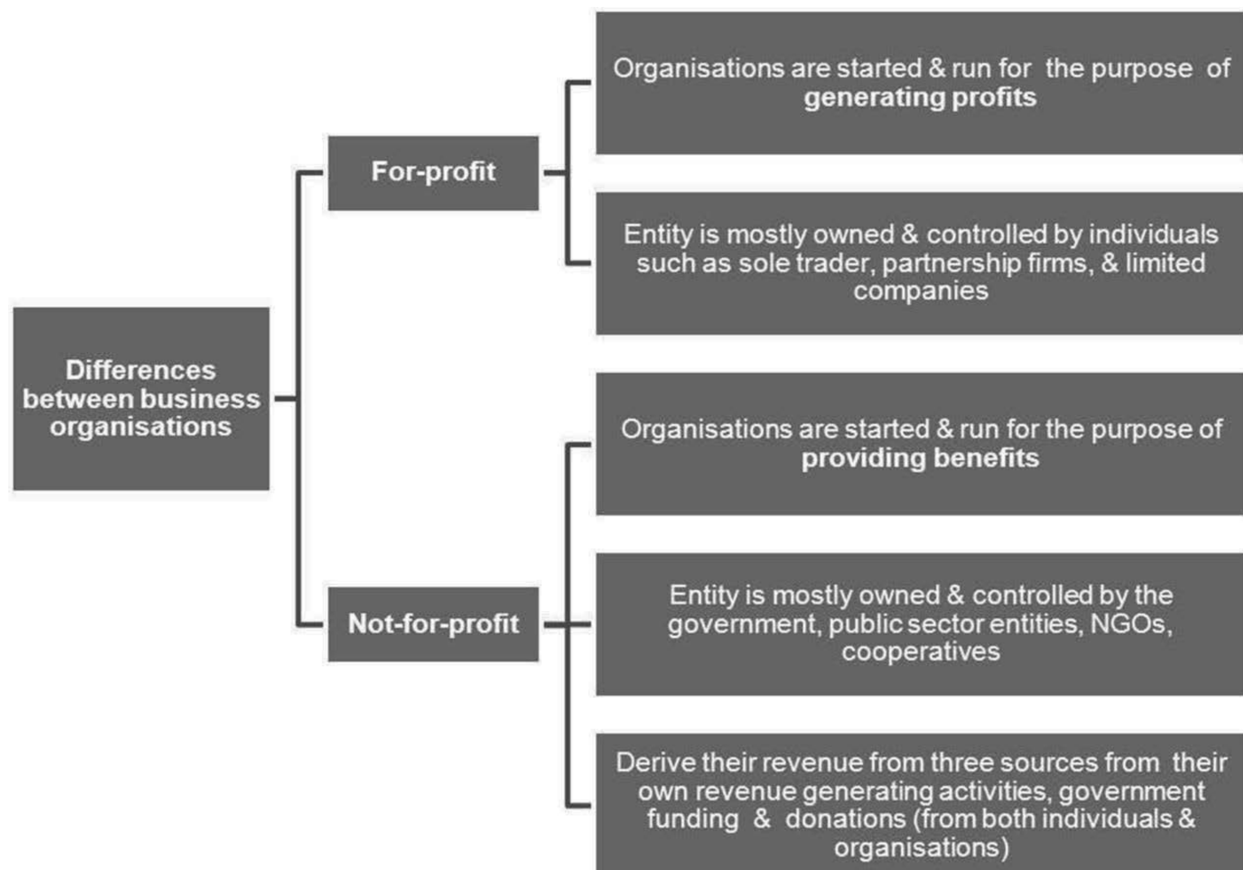
- Their own revenue generating activities;
- Government funding and
- Donations (from both individuals and organisations).

Such companies are prohibited from distributing the profits generated by them through operation.

Not-for-profit organisations vary greatly in terms of both size and type.

Examples include trade unions, public hospitals and universities. All of these organisations have been created and are run for providing a beneficial service. Trade unions exist to bargain for better working conditions for employees, hospitals to treat the sick and universities to provide learning and education.

Diagram 6: Differences between business organisations



Test Yourself 12

The aim of a not-for-profit organisation is:

A To provide or deliver a service
B To generate losses
C To generate large profits
D To enhance shareholder wealth

Answer to Test Yourself

Answer to TY 1

The correct option is **B.**

Rules are aimed at either emphasising on business structures or controlling behaviour of members.

Answer to TY 2

The correct option is **A.**

Agency theory aims to address the relationship between the agent and the principal and the problems that can arise when the agent does not act in the best interests of the principal.

Answer to TY 3

The correct option is **C.**

Internal stakeholders are closely connected to an organisation.

Answer to TY 4

The correct option is **C.**

Customers depend on the organisation to fulfill their own goals, and in turn the organisation depends upon the customers to fulfill its goals. However (unlike the other choices) they are not employed by and / or are not involved in the running of the organisation.

Answer to TY 5

The correct option is **B.**

Connected stakeholders are individuals or groups who depend on the organisation to fulfill their own goals and on whom in turn the organisation depends. They must also have a financial link with the organisation.

Answer to TY 6

The correct option is **A.**

External stakeholders will have diverse objectives and will have the ability to ensure that the organisation meets its objectives.

Answer to TY 7

The correct option is **B.**

If an organisation has difficulty deciding who the principal stakeholder is, it can be identified by using Mendelow's power-interest matrix.

Answer to TY 8

The correct option is **B.**

Trade unions and management have not only different but often contradictory objectives. Management's priorities are maximising profits / shareholder value, whilst the focus for unions is protecting their employee members (better wages, work hours, job security etc.).

Answer to TY 9

The correct option is **A.**

Creditors and shareholders have similar objectives; both the financial position and performance of the company should be as strong as possible. This is because it is their money that is financing the operations of the organisation.

Answer to TY 10

The correct option is **D.**

Survival is important for any organisation in three scenarios. First, when the organisation is new, it needs to face existing competition in the market, survive and establish itself. Second, when an organisation enters a new market, it needs to survive competition from existing players in that new market. Third, during times of crisis, any organisation would put less emphasis on some of its other objectives like profitability, growth etc. and just look to survive and ride out the crisis.

Answer to TY 11

The correct option is **D.**

Business organisations may differ based on ownership and control, activity undertaken and operating capacity.

Answer to TY 12

The correct option is **A.**

Not-for-profit organisations are started and run for the purpose of providing benefits on an individual level or to society as a whole.

Self-Examination Questions

Question 1

Specialisation in a business organisation implies:

A All tasks being performed by a specialised individual
B Individuals performing only those tasks that they are specialised in
C All individuals performing a special task
D None of the above

Question 2

The objective of internal stakeholders is:

A To continue the financial prosperity of the organisation.
B To help the organisation achieve its goals.
C Both A and B
D none of the above

Question 3

An internal stakeholder is one who:

A Depends on the organisation to fulfill his own goals, and on whom the organisation depends.
B Is employed by and/or involved in the running of the organisation.
C both of the above
D none of the above

Question 4

A connected stakeholder is one who:

A Depends on the organisation to fulfill his own goals, and on whom the organisation depends.
B Has a financial link with the organisation.
C both of the above
D none of the above

Question 5

The objectives of an organisation's different stakeholder groups are often the same.

A True
B False

Question 6

All the different types of stakeholders are interlinked, and hence have a direct link to an organisation.

A True
B False

Example

Answers to Self-Examination Questions

Answer to SEQ 1

The correct option is **B.**

Specialisation refers to an individual performing only those tasks in which he / she may be qualified in, or has experience thereof.

Answer to SEQ 2

The correct option is **C.**

Both the given points are the objectives of internal stakeholders.

Answer to SEQ 3

The correct option is **C.**

Internal stakeholders are individuals or groups who depend on the organisation to fulfill their own goals and who, in turn, the organisation depends on. In addition they must be employed by and / or be involved in the running of the organisation.

Answer to SEQ 4

The correct option is **C.**

Connected stakeholders are individuals or groups who depend on the organisation to fulfill their own goals and who, in turn, the organisation depends on. In addition they must also have a financial link with the organisation.

Answer to SEQ 5

The correct option is **B.**

An organisation's stakeholders will come from a variety of backgrounds. This diversity will result in different stakeholders having not only very different but often contradictory objectives.

Answer to SEQ 6

The correct option is **B.**

Internal stakeholders are stakeholders who are employed by and / or are involved in the running of the organisation.
External stakeholders are stakeholders that **have no direct link with the organisation**. They do not have any monetary link nor are they involved with the running of the organisation in any way.
Connected stakeholders are stakeholders who have a financial link with the organisation.

1. Identify and explain different types of environmental factors affecting a business. [Learning Outcome a]

Definition

Physical environment (also known as natural environment) of a country / region / market refers to its geographical location, topographical conditions, land forms, natural endowments, climatic conditions, soil, lakes, rivers, oceans, coast lines, forest, mountains, flora and fauna, etc.

Organisations share a symbiotic, inseparable relationship with the physical environment. On one hand, they depend upon biodiversity and ecosystems for the resources they use to carry out their activities, and on the other hand, their direct or indirect activities may have an impact on the biodiversity and ecosystems.

1.1 Impact of physical environment on business activities

Business and commercial organisations are dependent on the physical environment due to the following:

(a) Biodiversity: biodiversity refers to a diverse variety of ecosystems and living things: plants, animals with their habitats and their genes. Biodiversity is the bedrock of life and all commercial establishments are dependent on it. For example, genetic resources are extensively used in agriculture and pharmaceutical industries.

(b) Renewable and non-renewable resources: renewable resources refer to those natural resources that are replaced by natural processes even as they are being used (for example, soil, water, air, wood, etc.). Non-renewable resources (like, coal, crude oil and natural gas) are those resources which cannot be grown or generated once they have been used up. The type and quantity of these natural resources available in an area would determine the type of business activities that can be carried out. For example, diamond mining in Botswana and petroleum refineries in the OPEC countries.

(c) Geographical and climatic factors: location and climatic aspects and would help in deciding the type of commercial activities that can be carried out in an area. For example, France is famous for its wine industry as the climate there is friendly for grape cultivation.

(d) Natural hazards: natural disasters - earthquakes, floods, volcanic eruptions, storms, droughts, etc. can have a huge impact on business organisations. For example, in April 2010, due to a volcanic eruption in Iceland, around 20 countries had to close their airspace, causing huge losses to the aviation industry.

1.2 Environmental risks faced by an organisation:

The major risk faced by an organisation from any environmental issue is business failure. For some companies, failure to address such issues can have a major impact on the company's success for the following reasons:

1. Bad public image

The managers of the biggest companies are aware of the fact that, as a business gets larger; the public in it is more because it has a greater impact on the community. The attention of these managers is tuned to public opinion and they react to it. They seek to maintain a "correct" image of their company in the public mind.

Quality Ltd was a major player in the steel industry. As it grew, it failed to adopt environmentally-friendly policies and therefore caused damage to the environment. The media continuously reported Quality's failures on this front. In the long run, this caused Quality to lose its brand image and along with it its customers too.

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2. Loss of goodwill

A company faces the danger of losing customers as customers may opt for other products, which will eventually hinder the growth of the business. If a business addresses its environmental responsibilities, it will improve its public reputation.

Example

Hard News House prints eco-friendly books using paper made from bagasse; not from trees. Bagasse is a by product of the sugar industry. When sugarcane is crushed to make sugar, the leftover pulp is turned into paper. Thanks to its eco-friendly policy, the company has been able to win more customers as it has helped to make the planet greener by saving trees.

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3. Fines and penalties for non-compliance

Businesses recognise that if they do not introduce environmental protection programmes, the government will. Businesses which ignore this need for the parallel development of environmental investments will suffer in the long run. A company may face penalties and fines or may even be blacklisted if it doesn't comply with the legislation.

Example

Future Co tried to earn profit by avoiding or ignoring environmental management expenses in the short term. However, this strategy proved futile in the long run when the process cost and product cost went up due to wastage and it incurred other related penal and compliance costs towards restoring the environment.

1.3 Impact of business activities on environment

1. **Loss of biodiversity:** business activities may disturb biodiversity. For example, excessive use of land or generation of wastes can lead to habitat loss of certain species of flora and fauna.

2. **Depletion of natural resources:** overconsumption of natural resources (minerals, coals, etc.) by industries may lead to the exhaustion of the same.

3. **Deforestation:** rapid industrial growth may be at the cost of felling of trees and clearing of forest land. Deforestation leads to an imbalance of the ecosystem.

4. **Pollution:** business activities can lead to the following:

   Air pollution: industrial activities may release harmful gases like carbon monoxide, sulphur dioxide, hydrocarbons and some particulates, into the atmosphere, thus, polluting it and making the air unfit for breathing. For example, heating or air conditioning units in offices may release greenhouse gases into the atmosphere.
   Water pollution: industrial and commercial wastes may be discharged into lakes and rivers, thus polluting the water bodies and making the water unfit for human consumption or survival of aqua life.
   Soil pollution: soil pollution occurs due to soil erosion, long term dumping of industrial wastes, injudicious use of pesticides, water logging etc. For example, if toxic waste is dumped without being treated, it would not break down easily and may release harmful chemicals into the soil.
   Noise pollution: noise pollution contributed by commercial activities (through running of machinery, aircrafts taking off and landing, off shore activities, transporting raw materials, etc.) can have devastating effects on life.

5. **Global warming and depletion of ozone layer:** greatest danger threatening the earth is that of global warming caused mainly by the industrial world burning fossil fuels which leads to imbalance of gases in the earth's atmosphere and depletion of the ozone layer.

All the above mentioned points can lead to serious (and sometimes permanent) health hazards among the population.

1.4 How can businesses operate more efficiently and effectively to limit damage to the environment?

Actions on the part of businesses which lead to over use of natural resources and cause an imbalance in the eco system are not only undesirable, but also unethical.

For businesses, positive and friendly environmental attitude can represent profitable market opportunities and competitive advantage, as various business stakeholders are committed to supporting the cause of a clean planet. The modern era businesses have realised the importance of saving the natural environment while conducting business and earning profits.

Example

Following are some of the ways in which businesses can operate effectively to protect the physical environment.

1. **Recycling:** refers to the collection and processing of used materials (which would otherwise be dumped into soil or in water bodies causing pollution) like glass, paper, plastics, textiles, etc. into new products, thus enhancing their usability. By recycling materials, businesses are able to protect the environment by effectively reducing consumption of resources and energy (as they can use the recycled and treated materials as their inputs). Recycling also provides business opportunities to many entrepreneurs.

Example

Mobile phone manufacturer Nokia encourages its customers to drop in their old mobile phone handsets and other old phone accessories in recycle bins installed at selected Nokia centres. These recycled materials can aid in the production of numerous products. Nokia also plants a tree for every old handset recycled.

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2. **Treating industrial and commercial wastes:** industrial and commercial wastes can contain harmful elements (solid, liquid and gaseous elements) which can cause havoc to human life. By installing waste treatment plants, industries can remove the hazardous chemicals and gasses from their wastes, before disposing the same.

3. **Eliminating noise pollution:** organisations must take steps to control any kind of noise emitted by them as a result of their production process. Efforts should be made to eliminate the noise at source, increase the wavelength of the noise and protect the recipients of such noise.

4. **Going "paperless":** by eliminating or reducing use of papers in offices, felling of trees and deforestation can be avoided. Electronically maintaining and transferring of data can reduce consumption of paper and enable organisations to reduce costs.

Example

Customers of banks can get their account summary via electronic mail, thus enabling the banks to reduce paper consumption and reduce their costs.

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5. **Eco - labelling:** by obtaining eco – labels, businesses can convince customers that their products have been produced in an environmentally friendly manner and the same can be used without harming the environment.

Example

Green Stickers are mandatory for appliances and automobiles in North America.
The EU Ecolabel enables customers to identify "green", environment friendly products.

---

6. **Training of staff members:** organisations should train their employees to work towards making the workplace sustainable and energy efficient. They should be encouraged to efficiently use all resources and identify sustainable opportunities not only in their place of work, but also in the entire supply chain. Further, employees should also be told the benefits of using public transport, cycling or "car pooling" while commuting to and fro their workplace.

7. **Research and development:** businesses by taking up environment oriented research and development, can initiate environmentally friendly methods of procurement of inputs, production and distribution of goods and services.

8. **Management policies:** with increasing awareness among stakeholders, regulators and the society at large about the environmental problems caused by economic activities, businesses can no longer remain indifferent to green issues. They can separate the environment from their business strategies only at their own peril. Today, the only way in which businesses can sustain long-term growth is by pursuing environmentally responsible practices and economic interests at the same time.

   The management of a company must set some **targets for environmental performance**. It must formulate policies to ensure effective control on the achievement of its targets.

The organisations in UK should **adhere to ISO 14000 (19W6) and obtain the British Standards Institute's ISO 14001 (19W9), relating to Environmental Management Systems**. ISO 14000 and ISO 14001 are the two series that have been issued stating the industrial norms to be followed by industrial units.

The **ISO 14000** environmental standards exist to help organisations minimise the negative effects of their operations on the environment (adverse effects on air, water or land). ISO 14000 relates to the process (how a product is produced) rather than to the product itself. The overall idea is to establish an organised approach to reducing the negative effects on the environment which an organisation can control.

ISO 14001 is the international specification for an environmental management system (EMS).

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9. **Environmental Management System:** an Environment Management System (EMS) is a tool for managing the impacts of an entity's activities on the environment. It is a set of processes and practices that enables an entity

   to reduce its environmental impacts

   increase its operating efficiency

   to monitor its environmental performance just as a financial management system enables regular checks of a company's financial performance.

   to integrate environmental management into a company's daily operations, long-term planning and other quality management systems.

An EMS can be a powerful tool for entities to improve both their environmental performance and business efficiency. This approach encourages creative and relevant solutions from the entity itself. Although the implementation of an EMS is essentially a voluntary initiative, it can also become an effective tool for governments to protect the environment as it can aid regulations. Governments can encourage entities to use EMS to meet standards, by providing incentives for strong environmental performance.

10. **Conducting environmental audits:** an environmental audit is a systematic, independent internal review to check whether the results of environmental work meet the targets. It also focuses on whether the methods used to achieve goals are effective. In other words, the work of an environmental audit is a study of documents and reports to see whether there are any deviations from targets. An environmental audit will confirm whether or not the environmental targets have been attained.

The purpose of an environmental audit is to:

   see how objectives and decisions are being followed
   give the management an overview of and information for the environmental work
   make environmental questions more real and give a feeling of continuity and coordination
   give the staff increased awareness of environmental issues and greater skills to deal with these issues

Freehand Ltd was a multinational company that dealt in oil, gas and chemicals. Environmental issues were essential to the company for the following reasons:

The company dealt in the earth's natural resources.

   It employed a large number of people some of whom worked in a dangerous environment.
   Its business was heavily environmentally legislated.

In response to the issues raised above, the company decided to set targets of environmental performance which needed to be evaluated and reported on to shareholders on an annual basis.

1.5 Role of National Environment Management Council (NEMC)

NEMC is the regulator for environmental issues in Tanzania. NEMC was established with a broad mandate to oversee environmental management issues. The Environmental Management Act No. 20 was enacted in 2004 and re-established NEMC.

EMA 2004 provides for a legal and institutional framework for sustainable management of the environment, prevention and control pollution, waste management, environmental quality standards, public participation, environmental compliance and enforcement.

Furthermore, EMA 2004 gives NEMC mandates to undertake enforcement, compliance, review and monitoring of environmental impacts assessments, research, facilitate public participation in environmental decision-making, raise environmental awareness and collect and disseminate environmental information.

Vision and Mission of NEMC

NEMC vision is “to be a world-class environmental management authority that ensures a clean, safe, and healthy environment for people in Tanzania”.

NEMC mission is “to promote environmental management in Tanzania through coordination, facilitation, awareness raising, enforcement, assessment, monitoring and research”.

Test Yourself 1

Eco labels enable customers to identify environmental friendly products.

A True
B False

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2. Explain how firms can use PEST (political, economic, social and technological influences) analysis as part of a business strategy.
Describe the effect on businesses of changes in external factors: interest rates, exchange rates, inflation, unemployment, government legislation and technology.
[Learning Outcomes b and c]

An organisation operates within the boundaries of an economic environment. The nature and condition of this external environment is influenced and shaped by a number of different factors. These factors will impact upon organisations and need to be considered as part of the strategic planning process.

Before discussing the different factors influencing the macro-environment in depth, let us first look at the meaning of macro-environment.

2.1 Macro-environment

The macro-environment comprises all **external environmental forces** which affect the operation of an organisation but which are beyond its control. These forces include – political, economic, social / socio-cultural, technological.

2.2 PEST Analysis

It is essential for an organisation to effectively and constantly analyse its external environment because, as the environment changes, the strategies of the organisation change. One of the best methods of **analysing the external environment** is to use the **PEST analysis**.

Analysing the external environment is not an easy task for the managers of an organisation. There are innumerable variables in existence that could potentially affect the future of an organisation. PEST analysis method classifies those variables within the following framework:

Political
Economic
Social
Technological

PEST analysis helps to simplify matters by forcing managers to **categorise factors into appropriate slots** (e.g. political, economic, social, technological etc.). The factors in each slot can then be **further classified in terms of the probable impact** they will have on an organisation. For instance, would they cause a change in demand for the goods / services produced or require the organisation to change the way it operates.

For exam purposes it is best to use PEST analysis as a framework to gauge the positive and negative impacts that these factors might impart upon the organisation.

Use of PEST analysis as part of business strategy

Strategic planners use PEST analysis to assess whether the environmental climate is attractive or attractive for the organisation or a part of the organisation and to estimate changes in the environmental climate that might impact upon the organisation.

1. Political factors

Political factors are caused by the **role that the government plays in shaping the environment** within which the organisation operates. They represent the nature and type of external environment within which the organisation must operate.

Example

On the domestic front, examples include regulations such as the introduction of new taxes. On the international front, an example could be integration of the nation into the EU (for European countries) or the introduction of NAFTA (for US and Canadian companies). New taxes make the product or service an organisation offers more expensive. The increased price could result in a decrease in demand for the particular product or service. The main purpose of bodies such as the EU and NAFTA is to increase trade between their member countries by removing tariffs, duties etc. that exist and thereby allowing a free flow of goods and services between countries.

This would result in organisations facing greater competition from their foreign competitors (as their goods or services would become more accessible).

A country's political system and government policy will **set the rules and regulations of the external environment** within which all organisations must operate. In turn, the combination of these rules and regulations will create the **economic, social and political conditions** that organisations must work under. Naturally, these conditions will **affect the business and strategic choices** that an organisation can and does make. They will influence decisions the organisation makes such as:

- what goods or services to produce and market
- how to produce and market these goods and services
- what prices to charge
- where to market these goods and services

Furthermore these conditions will change over the course of time, either making life simpler or more difficult for an organisation.

Example

An import duty or tax is imposed on a particular product. For instance in India, a 115% import duty is levied on any new, imported car. The existence of this tax is beneficial for local car manufacturers that produce the same product because their foreign competitors' goods become more expensive. This has also led to some of the premium car manufacturers taking the strategic decision to start manufacturing in India, in order to avoid the import duty – Mercedes Benz and General Motors, for example, have recently opened new manufacturing plants in India to service the domestic market.

(a) Political factors affecting an organisation

(i) Government policies: each organisation needs to comply with the government policies applicable to it. While assessing the environment, an organisation has to forecast possible changes in the environment as these changes could affect the strategic actions and strategic position of the company.

(ii) Stability and tenure of government: each government has its own beliefs and strategies. For example, one government might be for outsourcing and another might be against it. Therefore, if the government of a country is stable, this makes it easier for organisations to form their strategies.

(iii) Pressure groups: these groups may put pressure on companies to change their strategies**.** For example, the Envirocare works towards implementing development programs that are aimed at improving environmental conservation and ensuring equal sharing of the natural resources that most Tanzanians depend on for their livelihoods. In this way Envirocare (a pressure group) puts pressure on companies to become more environmentally-friendly

(iv) Government's planned strategy: planned reforms, implications of regional government's plans and actions on the nation's strategy and subsidies awarded by the government are factors which change the organisation's external environment**.**

(b) Questions for assessment (questions that an organisation needs to ask itself):

(i) How does a change in the political situation affect an organisation?

(ii) Who will win the next election?

(iii) What are the political views of that party?

2. Economic factors

Economic factors refer to the **macroeconomic factors** that will shape the broader economic environment within which the firm operates. They represent **the financial condition** of the external environment within which the organisation must operate.

Example

An economic example of how the political system and government policy affects an organisation is when interest rates are increased. Rising interest rates make it more expensive for an organisation to borrow capital. This could potentially result in an organisation having to reconsider any planned acquisitions or large item purchases. In addition, if this increase also results in an extra cost for an organisation's suppliers, it could also increase the cost of raw materials for an organisation. Rising interest rates will also normally mean that consumer spending will reduce leading to a contraction of demand.

(a) Economic factors affecting an organisation

(i) GDP

Gross Domestic Product is the market value of all the goods and services produced within the country. A country's GDP is an indicator of its market size. Low GDP means that the country is still developing. An organisation has to keep such economic factors it in mind while forming its marketing strategies.

(ii) Taxes

A change in the government's taxation policy will affect the organisation's plans. A change in tax leads to a change in cash flow. However this is a micro-environmental change. If the government declares any area to be a tax-free region, then the organisation can take strategic decisions accordingly. Organisations might enter into the production or sale of tax-free goods.

(iii) Exchange rates

Organisations which conduct cross-border business such as the import or export of goods are affected by fluctuations in exchange rates. Fluctuations in exchange rates are considered to be micro-environmental changes except when such differences affect strategic decisions such as where to set up a factory for manufacturing goods.

(iv) Unemployment

Unemployment is directly linked to the purchasing power of consumers. It is also one of the indicators of a recession. Since demand for organisations' goods and services is dependent on the market conditions, organisations have to predict changes in the economy and plan accordingly.

(v) Trade factors and tariffs

Each country has its own rules on import and export. Some countries enter into free trade agreements (e.g. the US and Canada). These trade factors and tariffs control the supply of foreign goods in the nation and consequently their sale. Favourable rules increase the demand for the organisation's goods internationally. Therefore these factors change the macro-environment of an organisation by changing its market share.

(vi) Monopolistic practices

If an organisation has a monopoly on a particular product, the organisation has control over the market. If the monopoly is accompanied by cost effectiveness through mass production, it does not result in the exploitation of consumers. On the other hand, if the monopoly does result in the exploitation of consumers, the government will interfere.

(b) Questions for assessment (questions that an organisation needs to ask itself):

(i) Is the economy towards a recession or a boom?

(ii) How are the current economic conditions affecting the organisation?

(iii) Are there any changes expected in the economic conditions and will they have an impact on the organisation?

3. Social factors

Social factors refer to factors such as changing demographic patterns, changing consumer tastes and preferences and overall societal trends. They represent the **tastes and demands** of the external environment within which the organisation must operate.

Example

An article published by BBC news online magazine described changes which have taken place in the ageing population in the UK. The article recognised two types of pensioners: those who are in poor health or have a low income and those who are in good health or have a high income. Organisations are learning slowly that the aged population is a group of customers which is increasing day by day and which could even determine the future of the UK.

The UK company Saga has benefited tremendously from this demographic change: Saga arranges trips for elderly people who have a love of travelling and exploring new places and who were unable to visit those places in their youth. The organisation aims to provide facilities to these elderly customers which make them feel at home and more comfortable.

(a) Social factors affecting an organisation

(i) Population growth: population growth has an impact on the market share and the purchasing power of consumers. An increase in population is directly linked to an increase in demand for essential goods and services. If this growth is accompanied by a reduction in per capita income, then it leads to reduced demand for luxury goods and services.

(ii) Population profile and education levels: the population profile relates to the education levels of the population. Organisations demanding highly-skilled workers are interested in environments in which such people are available. The unavailability of such an environment could affect an organisation's strategic decisions such as whether or not to outsource a particular function.

(iii) Age and health of the population: the ratio of the working population to the dependants, such as the elderly and the young population, affects the organisation's strategy as it affects the demand for essential goods and luxury goods. If there is a large population of elderly people, then is there is a high demand for the goods required by these people, such as medicines. All these factors help the organisation in planning its strategic actions.

(iv) Disposable income levels: high disposable income which is the result of low deductions from salaries means high purchasing power. High purchasing power results in an increase in the market volume. The disposable income levels of consumers affect an organisation's strategic decisions such as what to produce and the selling prices of its products.

(v) Social trends: social trends in fashions, lifestyle and religion have a huge impact on an organisation's environment. These factors are directly related to strategic decisions such as what to produce and what prices to charge.

(b) Questions for assessment (questions that an organisation needs to ask itself):

(i) What socio-cultural factors are affecting the organisation?

(ii) Will change in these factors have an impact on the organisation?

4. Technological factors

Technological factors take into account the **effect that technology has** on the way an organisation makes and delivers its goods and services. In addition to looking at present technology, organisations also need to look at upcoming technology and how it will affect the current way of business.

Example

Amazon.com Inc was one of the first companies which sold its products over the internet. This organisation became popular during the dot com bubble of the late 1990s. The organisation launched the model using advanced technology immediately after the bubble burst, but it earned its first profit only in the year 2003.

The organisation initially sold books online. Later on, with the development of technology, it expanded its scope of business. It started selling electronics, MP3s, DVD's, CDs, computer software etc. online.

Every organisation needs to continually assess these influences to see if they are changing the external environment within which it operates. If these forces are **significant in changing the external environment**, then the organisation may have to **significantly change the way** it does business.

(a) Effect of technological changes on an organisation

(i) Rate of change and new developments in technology: the rate at which technology is changing is really amazing. Every year, manufacturers of electronic goods and automobiles introduce new models with added features using new technology or even completely new products. Organisations have to keep up with the new market trends and form their strategies keeping in mind that their existing products might become obsolete. Toyota's invention of the hybrid car in response to strategic risk is an example of an organisation changing its strategy because of its external environment.

(ii) Patents granted: an organisation which introduces new technology to the market, takes out a patent on the technology. This means that if another organisation wants to use the same technology then it has to either invent the technology itself or pay a large amount to the patent holder as copyright fees.

(iii) Diffusion of technology: as technology spreads throughout the market, organisations are forced to update their products in order to prevent them from becoming obsolete. Organisations survive due to the profit on the sale of their products and if an organisation's products become obsolete this could signal the end of the organisation. Therefore organisations have to modify their strategies according to the market conditions.

(b) Questions for assessment (questions that an organisation needs to ask itself):

(i) How is technology changing?

(ii) Has the technology we are using become obsolete?

(iii) How have changes in technology affected market conditions and marketplaces?

2.3 Effect on businesses of changes in external factors

(a) Interest rates

Current interest rates in the economy play a very important role in crucial decisions for an organisation. Higher interest rates increase financing costs for an organisation. If the organisation decides to pass on this increased cost to the consumer, the cost of final goods and services will go up. This can lead to reduction in demand for goods and services. Higher interest rates can also make new projects unviable for organisations and they may decide to postpone them or shelve them altogether.

On the other hand, lower interest rates encourage organisations to come forward and borrow and invest in business. This leads to increase in employment and increase in disposable income in the hands of consumers thereby pushing up demand for goods and services.

(b) Exchange rates

The impact of exchange rates on an organisation is covered under Learning Outcome 2: Point 2.2 (PEST Analysis): sub point 2 (economic factors) of this Study Guide

(c) Inflation

Definition

Inflation relates to how prices for goods and services continuously and considerably rise over time. The inflation rate refers to the percentage increase that has occurred for the rise in the price for goods and services.

Inflation is measured by taking the total price for a determined bundle of goods and services. The total price for the same bundle of goods and services is again taken at a later date (usually one year later).

The **amount** that the total price has increased corresponds to the amount of **inflation**.
The **percentag**e by which the total price has increased corresponds to the **inflation rate**.

Example

The total price for a bundle of goods and services in year 1 is Tshs100 and the total price for the same bundle of goods and services in year 2 is Tshs108.

The inflation rate here is 8%. (Tshs108 – Tshs100)/100

The main effect of inflation is that it makes goods and services **more expensive to purchase** as time progresses. Therefore, if inflation is expected, a consumer is always better off buying a good or service now then at some point in the future.

Inflation is an everyday fact of life for most economies. The impact it has on organisations is as follows:

Organisations: Inflation corresponds to an **increase in the cost of raw materials** needed to produce their goods or services. If they are not able to pass this cost on to their customers, then their profitability will decrease.

Example

Screw1 is an organisation that manufacturers screwdrivers. Their main raw material is aluminium. It costs Screw1 approximately Tshs1000 to make a screwdriver, which it then sells for Tshs2000. However an increase in the price of aluminium has meant that it now costs Tshs1500 for Screw1 to make a screwdriver.

But given the vast number of cheap screwdrivers that are imported from China, Screw1 is unable to increase the price and pass the additional cost on to its customers. Therefore, Screw1's profitability declines by 50%.

(d) Unemployment

Unemployment is said to exist when the **supply of labour exceeds the demand for labour**. It occurs when there are individuals who are willing and able to work but cannot find full time employment. The unemployment rate refers to the percentage of the workforce that falls into this category.

As mentioned previously full employment (or a zero percent unemployment rate) is one of the four main macroeconomic objectives for a government. However, full employment can never be achieved. This is because at least one of the four types or factors of unemployment listed below will always exist:

Demand-deficient unemployment: occurs when the supply of labour (number of people who want to work) is greater than the demand for labour (number of jobs available)

Seasonal unemployment: occurs because of a certain season or time of year.

Example

Ski resort communities have a high unemployment rate during the summer season as the main business occurs in the winter months.

Frictional unemployment: refers to the period during which able and willing individuals have left one job and are searching for another.

Structural unemployment: the nature of goods and services that an industry produces will change over the course of time, which in turn changes the structure of the industry. If the skill set of an individual working in that industry does not change in accordance with this, then he / she will soon be unemployed in that industry.

Example

In the 1970s several regions in the UK were dominated by labour intensive manufacturing industries such as steel, textiles and coal mining. In the 1980s when these regions began to be dominated by service industries, the unemployment rate in areas such as Sheffield, Manchester and Glasgow rose to 20%, as many workers found that their particular skill set were no longer in demand.

When the unemployment rate rises, the total number of people who do not have a job also rises. This is because the number of workers who are willing to work at a prevailing rate but are unable to find a suitably paying job also increases.

The impact that this has on organisations is as follows:

Organisations: having an economy with a high unemployment rate has advantages and disadvantages. The advantage is that there is a **larger pool of applicants to choose from** if there is a need to hire additional labour. However the disadvantage is that the **purchasing power of a society decreases** (which may mean that fewer people purchase the goods and services).

(e) Government legislation

A country’s Government legislation and political system will set the **rules and regulations** of the external environment that all organisations must operate in. In turn, the combination of these rules and regulations will create the **economic, social and political conditions** that organisations must work under.

From time to time the government will change these rules and frameworks, forcing businesses to change the way they operate. The organisation is thus intensely affected by government legislation.

Naturally, these will affect the choices that an organisation can and does make. They will influence decisions the organisation makes on factors such as:

What goods or services to provide;
How to provide these goods and services and
Where to provide these goods and services.

Furthermore these conditions will change over the course of time either making life simpler or more difficult for an organisation.

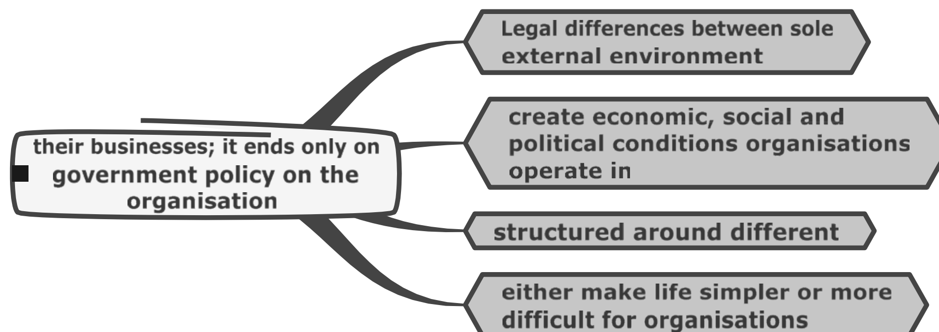
Example

An **economic example** of how government legislation and political system affects an organisation is when interest rates are increased. Rising interest rates make it more expensive for an organisation to borrow capital. This could potentially result in an organisation having to reconsider any planned acquisitions or large item purchases. In addition, if this increase also results in an extra cost for an organisation's suppliers, it could also increase the cost of raw materials for an organisation.

A **political example** is when an import duty or tax is imposed on a particular commodity. For instance in Country A, a 115% import duty may be levied on any new imported car. The existence of this type of tax benefits local organisations that produce the same goods as their foreign competitors. The commodities of the foreign competitors then become more expensive.

A **social example** is when organisations are offered tax breaks or incentives to donate to charities or sponsor welfare activities.

SUMMARY



(f) Technology: The impact of exchange rates on an organisation is covered under 'technological factors' section in this Study Guide

Test Yourself 2

Unemployment is said to exist when:

A The demand for labour exceeds the supply for labour
B The supply of labour exceeds the demand for labour
C The supply of labour equals the demand for labour
D None of the above

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3. Identify and describe other influences on organisational activity: cultural, moral, ethical and environmental.

[Learning Outcome d]

3.1 What is culture?

Culture refers to the customs, traditions and the way of life of a particular community.

Definition

The Oxford English Dictionary defines culture as "the arts, customs, ideas etc. of a nation, people or group".

This definition also applies to the culture of an organisation.
In practice, culture is an **intangible resource** for the company. It provides a **framework** that enables employees to work together in achieving their own departmental goals as well as the goals of the company.

The foundation of this framework is the **basic assumptions and values that all employees share**. These common standards are developed over time through a system of **collective learning**. The culture of an organisation will represent and reflect how it operates and functions.

Example

Organisations with an informal culture have a very relaxed working atmosphere. Managers will typically keep their office doors open, be easily accessible and on a first name basis with their subordinates.

In contrast, organisations with a formal culture have a much more rigid working atmosphere. Subordinates typically have to schedule an appointment to see their seniors and would refer to them by their last names.

Culture is explained pictorially as consisting of four separate layers rather like the texture of an onion.

(a) Values

Values are often formally documented by top management in the form of aims, objectives, vision or mission statements. These statements are typically very broad-ranging and cover the **long-term objectives** of the organisation. The values of an organisation are often unclear but indicate what the firm stands for and rates as being right and justifiable.

Example

Wal-Mart defines its values or core beliefs as being “respect for the individual; service to the customer; equal benefits to all and strive for excellence”.

(b) Beliefs

Beliefs are the **views and feelings** held by the employees of the organisation. These are more precise. These are the opinions on a particular matter which can be easily discussed. These often flow from the values of the organisation.

Example

Staff at Virgin Atlantic Airways is known for the effort they put into making flights a pleasurable experience for their passengers. This behaviour communicates their employees’ belief that they are working for a focused but fun organisation.

(c) Behaviour

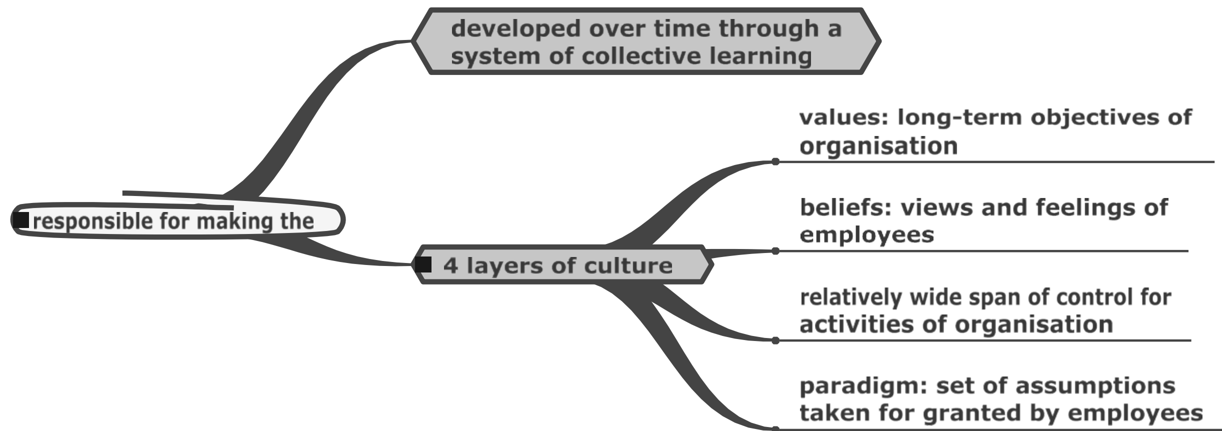
Behaviour represents the visible **day-to-day operations** of the organisation. These include items such as work routines, the way employees interact and even dress.

(d) Paradigm (taken for granted assumptions)

Paradigm refers to the **set of assumptions that are held in common and taken for granted** by the employees of an organisation.

It is important to note here that the paradigm is far more representative of an organisation’s culture than its values. The paradigm is the **core of a company’s culture** and is what enables employees to pull together and work towards a common goal.

SUMMARY



The Handy model of cultural types is based on a four quadrant model which names Apollo, Athena, Dionysus and Zeus for the four cultures of role, task, people and power respectively.

Role culture - The responsibilities are assigned on the basis of the official position in the organisation. The style of communication is formalised.

Task culture - The task culture is friendly and co-operative because it is not hierarchical. The style of communication is open and relaxed. The organisation is structured according to tasks and processes.

People culture - The people culture focuses on the needs of the individual first and makes the organisation the source for individual skills and talents. The style of communication is personal.

Power culture - Power culture is focused on the leader. This type of culture performs effectively when the organisation is relatively smaller in size and the leader is efficient enough to lead the team as a group. The style of communication is formal and generally based on the procedures and systems applied.

3.2 Factors that shape organisational culture

The main factor that shapes the culture of an organisation is the **system of collective learning** amongst employees. This collective learning occurs as employees work together to solve problems and overcome difficulties. Successful methods and practices go on to become the generally held assumptions and values of the organisation.

ANB Inc is a relatively small bank that specialises in offering finance to small owner-operated organisations. The bank also offers personal banking products such as mortgages and car loans. The commercial department of the bank has always been very successful, the personal division much less so.

However, over time, ANB's personal division has found that it has the highest success rates in its marketing efforts when representatives from both the commercial and personal divisions make a joint sales call. Over time, this has grown to become standard operating practice for the bank and now reflects the teamwork culture present in the organisation.

Culture is reflected both internally and externally by the organisation:

internally, in terms of employee attitudes, morale and motivation
externally, by the way staff deal with customers, suppliers and other stakeholders

Other factors that determine the culture of an organisation include:

(a) the industry the organisation belongs to

(b) the type of environment it operates in

Example

Advertising companies typically have cultures that develop and support a creative environment. An open door policy is followed across the organisation to promote cross-lateral thinking and the flow of ideas as well as information across all divisions. Inter-departmental cooperation and teamwork is the normal behaviour.

This is in direct contrast to the culture found in most governmental agencies. Here, employees are regimented into following strictly laid out policies and procedures. Deviation from these procedures and teamwork or even cooperation among divisions is minimal.

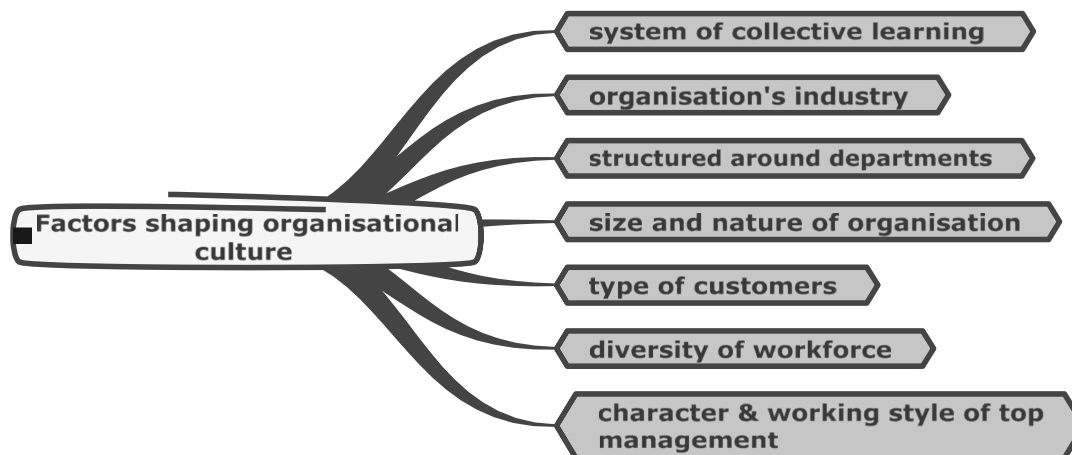
(c) **the size and nature of the organisation** (e.g. large publicly traded organisations typically have a formal work culture involving factors such as strict dress codes, timings, routines etc. whereas smaller privately held organisations tend to have a much more informal work culture)

(d) **the type of customers it has** (e.g. organisations such as Accenture that have only corporate clients have a very task-focused, goal-focused and competitive culture whereas a small owner-operated grocery store would have a more people-oriented and relaxed culture)

(e) **the diversity of its workforce** (the more minorities, ethnic groups and nationalities present in an organisation's workforce, the more diverse its culture is likely to be)

(f) **the character and working style of top management** (the policies, procedures and work practices set by top management will form the foundation on which the culture of the organisation is formed)

SUMMARY



3.3 Organisational strategy and culture

Culture is one of the determinants of the individual's behaviour. The impact of culture on organisational purpose and strategy are as follows:

1. In the case of organisational strategic management, the managers have to **integrate the culture** of the organisation with the strategy so that the strategy can be **successfully implemented**.

2. For **excellent performance** and **achievement of goals**, culture cannot be ignored because if **behavioural values** are not considered then strategies cannot be effectively implemented.

3. Culture influences the **formulation of strategies** in the organisation.

There are some researchers who are of the different view that culture has a negligible impact on strategy formulation or implementation.

3.4 Significance of organisational culture

It is important for performance, growth and success of the organisation.

It promotes product innovation.

It is reflected in the mission

It facilitates team work.

It is the centre of all aspects of organisation.

It supports strategy innovation.

Through collective learning, employees obtain more knowledge.

Employees share knowledge which leads to creativity.

Case Study

General Electric

In 1981, General Electric (“GE”) named Jack Welch as their new CEO. At the time the company had a market capitalisation of approximately $12 billion. When Welch stepped down as CEO in 2000, GE’s market value was close to $500 billion.

One of the main reasons for the company’s success is because of the cultural change Welch implemented and drove throughout the organisation. Before Welch’s tenure, GE was a very bureaucratic organisation. Managers had to fill numerous forms and seek various approvals before taking decisions.

Welch changed all this by empowering managers to build up their units in an entrepreneurial fashion. Managers in turn were also expected to empower their subordinates and involve them in the running of the business unit. As Welch put it “the best way to manage people is just to get out of their way”.

This “boundary-less culture” still remains at GE today where employees from all levels involve themselves in innovation and problem solving”.

3.5 Ethical and moral influences on an organisation

The term “ethics” comes from the Greek word “ethikos”. Ethikos literally translated means **theory of living**. This definition has evolved over time and now refers to abiding by a set of written and unwritten rules based on both **legality and morality.**

Definition

Ethics can be defined as abiding by a set of written and unwritten rules based on both legality and morality.

Legality, because ethics involves obeying the laws of a country. Morality, because ethics involves doing what a society believes is just and correct.

Example

Although cheating while playing sports or cards with a friend is not illegal, it is considered unethical. This is because it is widely believed that people should be honest in all their activities.

Ethics also involves having a **permanent commitment** to abiding by these rules. A person cannot claim to be ethical by following ethics in some situations, but not in others.

Example

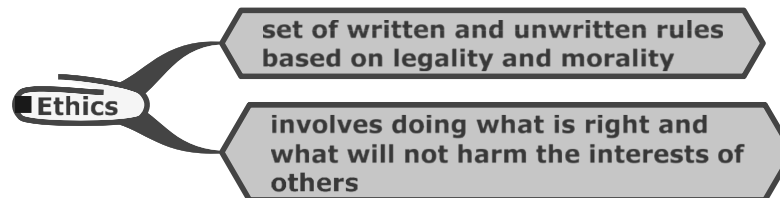
Sam is an honest employee and a law-abiding citizen. However, if Sam lies about the condition of a car he is selling he becomes unethical, despite his ethical behaviour in other situations.

Very broadly speaking, ethics involves doing **what is right and what will not harm the interests of others.** Having a system of ethics is very important to people on both an individual and a collective level. Individuals have a basic level of trust with one another because they expect others to have a basic set of ethics. This trust level sets the foundation on which people interact with each other on social and business levels. It is also what allows society to function as a whole. Having a system of ethics is as important as having a legal system.

Example

Most people do not commit murder, not just because it is illegal but also because they feel it is immoral.

SUMMARY



3.6 Role of ethics in commerce

Ethics also has a very **important place in commerce**. Remember that the business world comprises and is run by people. Even the world's largest organisations are all ultimately controlled by one individual. How ethical an organisation is, will depend upon how ethical its employees are.

Definition

Business ethics can be defined as the branch of ethics that examines rules and principles within a commercial context.

The original view of organisations was that their only ethical responsibility was to maximise profits for their owners or shareholders so long as they behaved lawfully (Friedman). The belief was that profitability should be the only criterion used to evaluate decisions.

This view later changed to the belief that organisations also have an ethical **responsibility towards their various stakeholders** (e.g. their employees, suppliers, customers etc.).

Friedman famously stated that the only responsibility a business had was to its shareholders (so long as it acted within the law).

Friedman supports the 'shareholder value' view. The Friedman doctrine states that the social responsibility of any business is to increase its profits so long as it acts lawfully. Freeman supports the stakeholder theory of the firm which recognises the groups of stakeholders within an organisation. R. Edward Freeman, in his book, Strategic Management, defined stakeholders as "those groups who can effect, or are affected by, the achievement of an organisation's purpose."

The theory also details the methods by which the top management of the organisation can give due importance to these respective groups.

Any decision now needs to be considered in terms of both profitability and also whether it will detrimentally affect the interests of any of the organisation's stakeholder groups. Decisions that would hurt the interests of any stakeholder group would be **unethical** despite the level of profits they would bring to the organisation.

Example

It would be unethical for an organisation to exaggerate or lie about the features of one of its products, regardless of how heavily this tactic would increase sales.

Today, organisations are expected to have an ethical responsibility to their **shareholders and stakeholders, as well as to society at large**. Organisations are expected not to take decisions or engage in activities that will hurt the interests of any of these groups. In addition, organisations are expected to also "**give something back**" to society through donations or by sponsoring welfare activities.

Example

IBM, through its Used Technology Donation Program has provided over 5,000 used personal computer systems to over 1,000 non-profit organisations. These organisations provide education, training, and computer literacy skills to adults and children with disabilities.

It should be noted that there is also a **strong economic justification** for organisations to behave ethically. Experience has shown that being ethical makes good business sense for the organisation in the long run. For example, suppliers are more willing to deal with organisations that have an established reputation for behaving ethically; staffs are more motivated if they are treated well and the local community feel valued if there are community-corporate links.

Research has also shown that people are more willing to work for or buy products from an ethical organisation. Behaving ethically across all levels will promote the overall efficiency of both the organisation and society as a whole.

Example

The purchase managers of the organisation Trust1 have a well-earned reputation for not accepting bribes. Therefore, the organisation's suppliers offer this bribe amount as a legitimate discount to the organisation instead.

Trust1 also follows a very strict policy of not discriminating against candidates on any level when recruiting. This has led to the organisation having great success in hiring the most suitable candidates for its job openings over the years.

Trust1 has also itself followed a policy of not giving bribes to win government contracts. By following this policy, it has earned credibility with both the government and the public, which has led to the organisation being awarded several large construction projects.

Lastly and most importantly **in today's world, organisations have to be ethical.** Society and governments will no longer tolerate unethical behaviour from organisations. Stakeholders are increasingly showing their frustrations via activism including: industrial action in the case of employees; boycotts in the case of consumers and blacklisting in the case of suppliers. Just as individuals are expected to abide by a code of ethics, so too are organisations.

Although an organisation may "get away" with unethical practices in the short run, in the long run it will see its sales, profitability and share price decline because of this type of behaviour.

Case Study

Nike

Nike Inc is the largest producer and seller of footwear, clothing, equipment and accessory products in the sports and athletic market. The organisation produces these products both in its home country (the USA) and internationally through a network of 700 contract factories.

The employment conditions in these contract factories have been a never-ending controversy for Nike. Its main critics, which include labour groups such as Oxfam's Nike Watch and the Clean Clothes Campaign, state that Nike:

- does not pay fair wages;
- does not have adequate working conditions for its factory workers; and
- employs child labour.

Continued on the next page

Nike's response has been to implement a global code of conduct for all its suppliers (which strictly prohibit child labour) and work with the NGO Global Alliance to review 21 of their factories. Nike also states that its auditing of factories will continue.

However, this has not been enough for its critics who want independent inspections. Nike has refused, explaining that it will be better able to monitor the conditions in these factories by using independent third parties on a confidential basis.

So, despite these efforts along with continual reporting on its website, criticisms of Nike continue.

SUMMARY

3.7 Business ethics

Business ethics emerge on three **levels:**

1. macro level
2. corporate level
3. individual level

1. Macro level

At this level, the responsibility of the organisation is put in a wider context. The organisation has to exercise ethical considerations in the international business environment.

2. Corporate social responsibility (Corporate level)

With regards to an organisation, the expectations of different stakeholders conflict because every stakeholder has its own expectations which an organisation needs to satisfy. So, an organisation is under an obligation to manage the expectations of all the stakeholders.

This is explained in more details in the next section.

3. Individual level

An organisation is responsible for the individual behaviour of its employees in the workplace. Employee behaviour in the workplace is an example of ethics at an individual level.

Every organisation has certain goals to achieve, which are referred to as the mission of the organisation. While operating for the attainment of a goal, organisations are under an obligation to follow the **norms and standards** which are in existence. The managers of the organisation have to frame the decisions according to the ethical considerations prevailing in the society. They have no right to make any policy which is unethical and against the interests of the stakeholders at large.

Examples of **unethical acts** include corruption, bribery, coercion, undue influence, dishonesty etc. Some people commit unethical acts for the following reasons:

- A person is aware of the right thing to do but it needs **courage and willpower** to do the right thing.
- A person has to carry out **many tasks** at a time in a short span of time.
- A person may even commit unethical acts by **mistake**.
- When there are many people engaged in a particular task, they **all agree** together to perform the work unethically.
- Sometimes, in an organisation, it is essential to **complete the task** but the managers are unable to achieve the target unless they apply unethical means.

SUMMARY

Moral standard in business

A moral standard in business is a **set of values, norms or ethical principles which are accepted as a benchmark, reference point or criterion for use by those who work within the company and which as a consequence will guide and influence behaviour**. By this, it is meant not just that certain kinds of behavior are deemed acceptable or unacceptable, but something stronger: namely that these kinds of behaviour are also categorised as good or bad, right or wrong.

The question of what should be included in a company moral standard and the way in which it is expressed will vary from company to company. However, in examining the statements of a variety of companies, there are recurring themes: the need for integrity, transparency, honesty and telling the truth; a respect for the individual person because of his or her innate dignity as a fellow human being; a sense of fairness in the way people are treated; the ideal of service, especially in relation to customers but also in the style of leadership shown by executives; the value of teamwork; the responsibility of the corporation to respect the environment; and a commitment to support those communities in which the corporation has facilities. In fact, these themes appear so frequently in different sectors, different countries, different continents and different cultures, that they become less a collection of disparate values chosen by individual companies and more and more a set of universals. A moral standard makes strenuous demands, taking the corporation beyond the boundary of legal requirements. It may require a corporation to refuse a piece of business, to invest heavily in developing its personnel, or to sort out problems without resort to lawyers, all of which will adversely affect short-term profitability but which, at the same time, demonstrate its commitment to the standard.

3.8 Environmental influences on organisational activity

Consumers are becoming increasingly concerned with the protection of the environment in which they live. This is, in part as a result of the tremendous surge in media attention directed to such issues as: climate change, carbon emission, waste disposal and recycling, they desire that their environment should be prevented from all harmful effects so that it does not deteriorate over time. In the present era, along with the consumers, the government is also becoming much more concerned about the environment. This has resulted in the introduction of large amounts of legislation designed to protect the environment and encourage its conservation.

Example

Railways are one of the most environmentally-friendly modes of transport because the rate at which harmful gases are emitted is comparatively less than other modes of transport. In addition, the resources used by railways are generally renewable in nature.

Network Rail is involved in protecting the largest number of sites of Special Scientific Interest (SSSIs) near railway tracks in the UK.

Protection of the environment is essential because it is a source of resources needed for the production of goods. Harmony between man and the environment is the essence of healthy life and growth. To the organisation it's also a source of competitive advantage, e.g., the environmentally friendly organisation may find it easier to win and retain customers, to recruit staff and to encourage investment (ethical investors).

(a) Environmental factors affecting an organisation

(i) Trends: what are the environmental standards in the area? How is waste disposed of? All these trends are important. If there are no specific laws governing environmental issues such as waste disposal, an organisation should follow the practices prevalent in the industry**.**

(ii) Penalties for abuse: there are huge penalties for non-adherence to environmental laws.

(iii) Competitive advantage: companies which adopt environmentally-friendly practices such as planting trees or adopting special measures to reduce pollution, have a competitive advantage.

(b) Questions for assessment (questions that an organisation needs to ask itself)

(i) What are the current rules and regulations affecting the organisation?

(ii) What are the environmental standards published by the government?

(iii) Is the organisation complying with these rules?

(iv) Are there any alternatives for carrying out the organisation's activities?

Test Yourself 3

Business ethics emerge at

A Macro level
B Corporate level
C Individual level
D All three levels

Answers to Test Yourself

Answer to TY 1

The correct option is **A.**

Eco labels convince customers that the products that they are buying have been produced in an environmentally friendly manner and the same can be used without harming the environment.

Answer to TY 2

The correct option is **B.**

Unemployment is said to exist when the supply of labour exceeds the demand for labour

Answer to TY 3

The correct option is **D.**

Business ethics emerge at three levels: macro, corporate and individual level.

Self Examination Questions

Question 1

Which of the following is **not** an example of a non-renewable resource?

A Natural gas
B Coal
C Crude oil
D Air

Question 2

Political systems and Government policy affect the choices that an organisation can and does make.

A True
B False

Question 3

Under PEST analysis, where will demographic patterns be classified?

A Political factors
B Economic factors
C Social factors
D Technological factors

Question 4

Inflation refers to ___________ in the prices of goods and services.

A Decrease
B Increase
C Decrease by 10%
D Increase by 10%

Question 5

__________ refers to the period during which able and willing individuals have left one job and are searching for another.

A Demand-deficient unemployment
B Seasonal unemployment
C Frictional unemployment
D Structural unemployment

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **D.**

Air can be classified as a renewable resource.

Answer to SEQ 2

The correct option is **A.**

Political systems and Government policy affect the choices that an organisation can and does make.

Answer to SEQ 3

The correct option is **C.**

Under PEST analysis, demographic patterns be classified under social factors.

Answer to SEQ 4

The correct option is **B.**

Inflation refers to increase in the prices of goods and services.

Answer to SEQ 5

The correct option is **C**.

Frictional unemployment refers to the period during which able and willing individuals have left one job and are searching for another.

STUDY GUIDE 2: BUSINESS PLANNING

Get Through Intro

Imagine you have had enough of working for other people and you want to start up your own business. You have always wanted to set up your own radio station and you have heard that the local government is tendering licences.

You need to decide how you are going to convince the government to give you the licence, instead of other people with more experience. In order to do this, you need to show the government your strategy – who your station will be for, how you will finance it and how long it will take to become profitable.

In fact, any business you join will always be looking at where they currently are, and where they want to be in the future. An important role for you will be to help shape that strategy. The more you understand how a strategy is built, the more important and useful you will be to the organisation.

This Study Guide will teach you the building blocks of how to build a good strategy, maintain it and expand it to stay ahead of your competitors. Furthermore you will also learn the elements of a business plan and what is meant by vision, mission, values and objectives and how organisations apply these to themselves. You will also learn about the steps in strategic plan development and the elements of a business plan.

Learning Outcomes

a) Identify and describe the meaning and relationships of strategic vision, mission, values and objectives.
b) Describe the relationship between strategic, business and operational plans.
c) Describe the steps in strategic plan development.
d) Examine the elements of a business plan.
e) Formulate vision and mission statements in a given business scenario.

1. Identify and describe the meaning and relationships of strategic vision, mission, values and objectives.

[Learning Outcome a]

1.1 What are missions, vision statements and core values?

1. Mission statements

Mission statements are written to explain the **purpose behind the particular organisation** and where the organisation is going at present. They should include a description of what the organisation does as well as why it does it. A mission statement explains 'why' the organisation is in existence or its raison d'etre. An organisation's purpose and primary objectives are contained in a concise, internally focussed statement known as the mission statement. Mission also outlines how an organisation plans to compete and deliver value to its customers and thus, attain its vision

Example

For instance, the Federal Express mission statement declares "FedEx is committed to our People-Service-Profit Philosophy. We will produce outstanding financial returns by providing totally reliable, competitively superior, global, air-ground transportation of high-priority goods and documents that require rapid, time-certain delivery."

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2. Vision statements

Some organisations even use vision statements in place of mission statements. A vision statement defines an organisation's purpose in terms of its values. A vision statement is written to define and describe what the organisation is aspiring to be in the future. It typically reflects an ambitious and optimistic view of what management believes the organisation can and should achieve.

Example

For instance the vision statement for Toastmasters International is "To empower people to achieve their full potential and realize their dreams. Through our member clubs, people throughout the world can improve their communication and leadership skills, and find the courage to change".

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3. Core values

Definition

Johnson and Scholes define core values as:

Core values are the principles that guide an organisation's actions.

(Source: JSW)

Core value statements explain how an organisation will value its suppliers, customers and employees. The values of all the members of the organisation are essential to form the corporate culture.

Example

Good Health hospital is a provider of medical services in the UK. It is listed on the London Stock Exchange.
Its core values include:

Safety: of all employees, customers and the environment
Integrity: transparency, honesty and governance
Continuous improvement: provision of upgraded services and adoption of ethical practices

---

4. Strategic vision

A strategic vision is the roadmap for the future of the organisation. It focuses on the customer, products and geographical markets to be pursued. The mission statement deals with the core purpose of existence of an organisation

1.2 Objectives

Objectives of an organisation refer to what an organisation is aiming to achieve. Every organisation has broad objectives that apply to the entire organisation as a whole. An organisation may have a separate set of objectives department wise, and finally every department may specify the objectives for every member based on which he / she will be judged.

Peter Drucker, in his management by objectives (MBO) system, mentioned that an organisation's objectives should be SMART:

Specific: the objective should be clearly stated

Measurable: a measurable objective helps in judging whether the expected end result has been achieved or not.

Achievable: objectives should neither be too easy to achieve nor impossible to achieve. Objectives should be teasingly out of reach.

Realistic: the objectives should be within the realms of possibility.

Time-related: the objective should be time-bound so that it can be ascertained whether it has been achieved in the required time.

Example

An example of a SMART objective for a marketing department would be to increase annual sales from Tshs150 million to Tshs195 million by the end of the financial year.

Specific: increase sales
Measurable: increase sales by Tshs45 million
Achievable: represents a 30 percent increase in sales, which should be achieved by the end of the year.
Realistic: represents a 30 percent increase in sales, (not an unrealistic goal e.g. 130 per cent increase).
Time bound: objective has to be achieved by the end of the financial year.

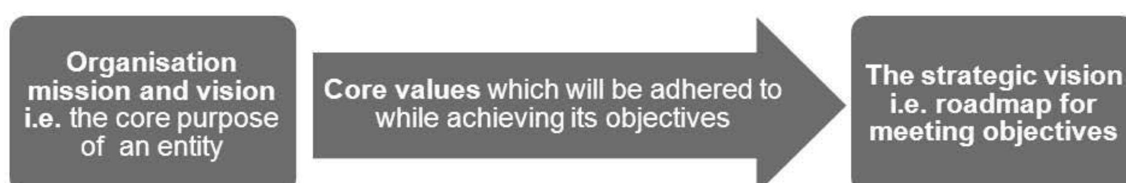
1.3 Relationships of strategic vision, mission, values and objectives.

Organisation mission and vision deal with the core purpose of existence of an organization.

The strategic vision is the roadmap for the future of the organisation. i.e. the objectives to be achieved.

Core values are the principles that guide an organisation's action i.e. the values which will be adhered to in the process of meeting its objectives

Diagram 1: Relationships of strategic vision, mission, values and objectives



Test Yourself 1

Which of the below are written to explain the purpose behind a particular organisation?

A Mission statements
B Vision statements
C Strategy
D Values

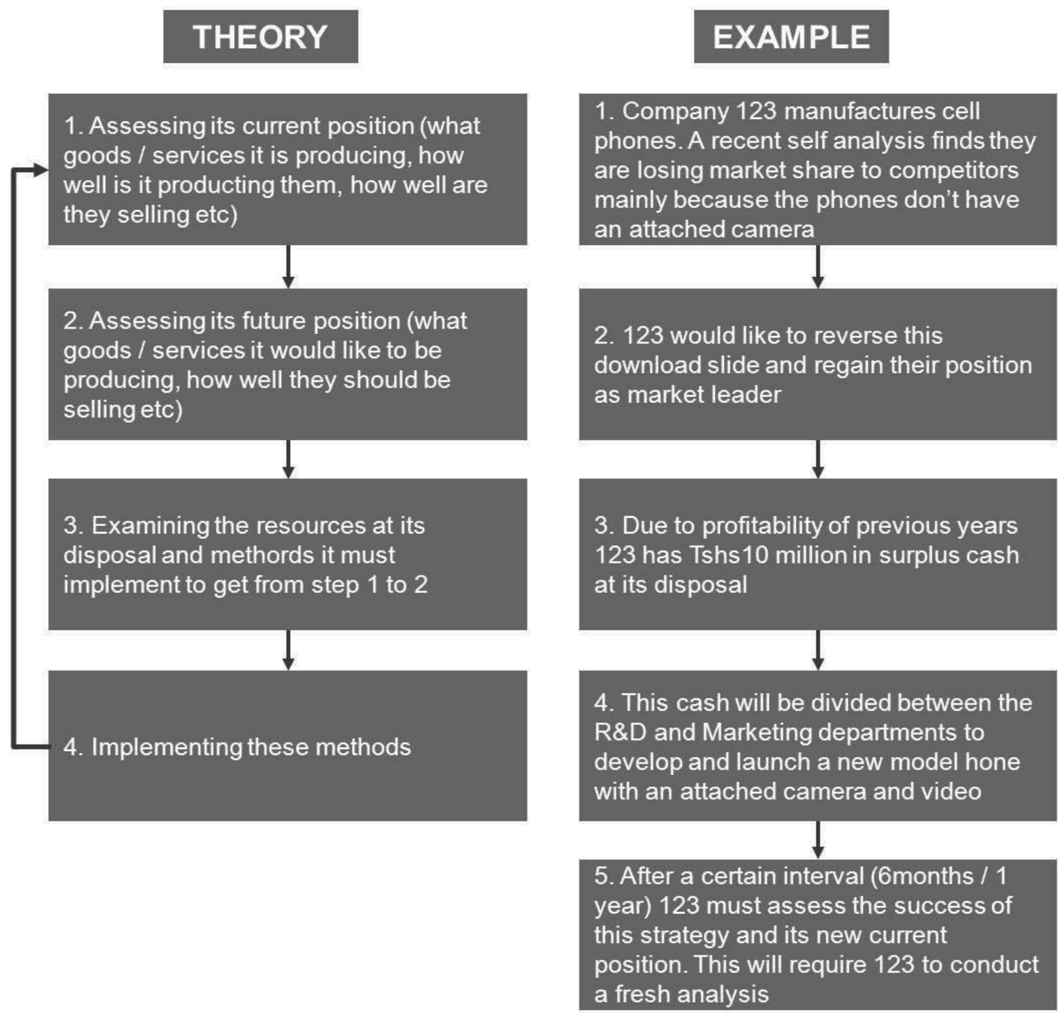
---

2. Describe the relationship between strategic, business and operational plans.
[Learning Outcome b]

2.1 Strategic plan

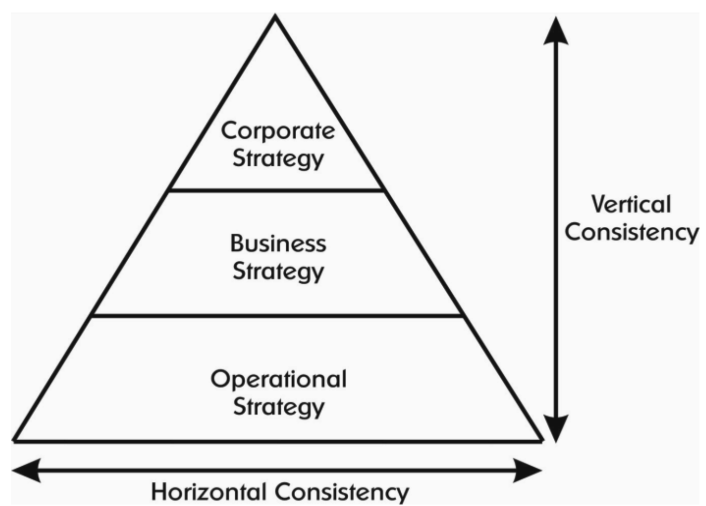
A general strategic plan involves an organisation following the steps illustrated below:

Diagram 2: General strategy formulation and management



As the arrows suggest, strategic management is a fluid on-going process rather than a static detailed one-off plan. It should be thought of as a general set of directions rather than a specific map. Strategic Management can be broadly broken down into the three components diagrammed below.

Diagram 3: Components of Strategy and Strategic Management



In simplified terms the differences between the three strategies are:

Corporate Strategy: Corporate strategy looks at the overall suite of businesses / products of an organisation. It involves an organisation asking itself what kind of business should I be in? For instance should I be an orange or an apple seller?

Business Strategy: Business strategy is usually at the Strategic Business Unit (SBU) level and involves an organisation asking itself how it can achieve its corporate strategy? For instance how can I be a better orange or apple seller?

Operational Strategy: Involves an organisation asking itself how it can implement its business strategy? For instance how do I now go about selling oranges or apples?

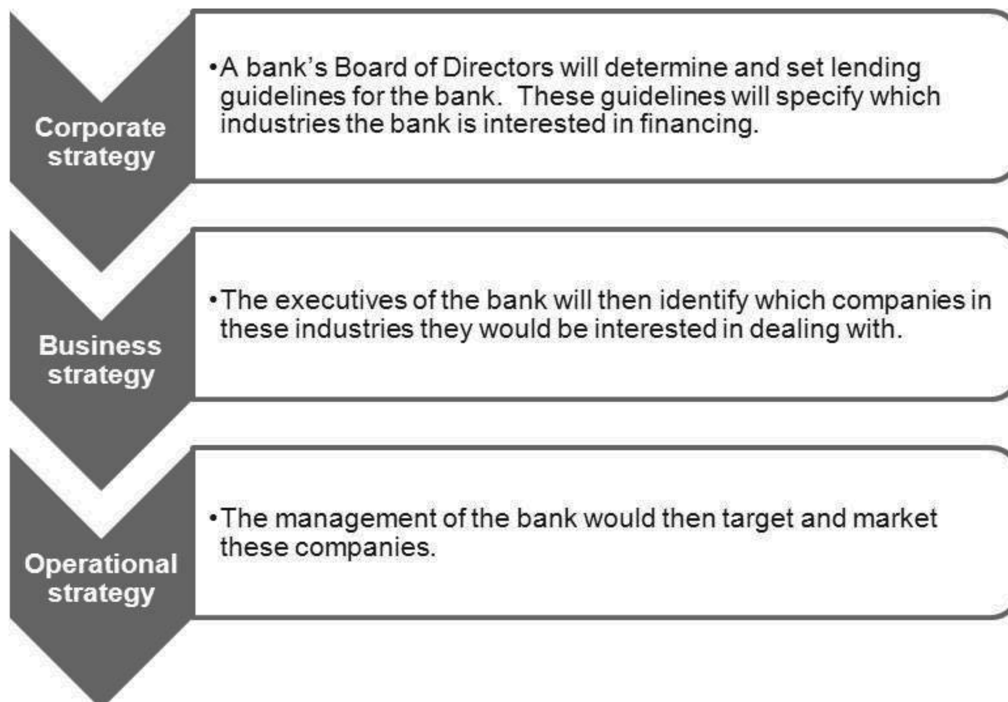
As the above indicates there is a hierarchy of strategy for most organisations. At the top of the hierarchy is corporate strategy. Corporate strategy is in essence the "macro" and overreaching strategy of the organisation. More specifically, corporate strategy involves an organisation deciding upon what industries and markets it should be in and is typically set by the top executives or board of directors.

The next level strategy is business strategy which is the more focused or "micro" strategy for the organisation. It involves an organisation assessing how it should compete in the markets and industries identified at the corporate strategy level. Business strategies are normally formulated by management as they set about implementing the organisation's corporate strategy.

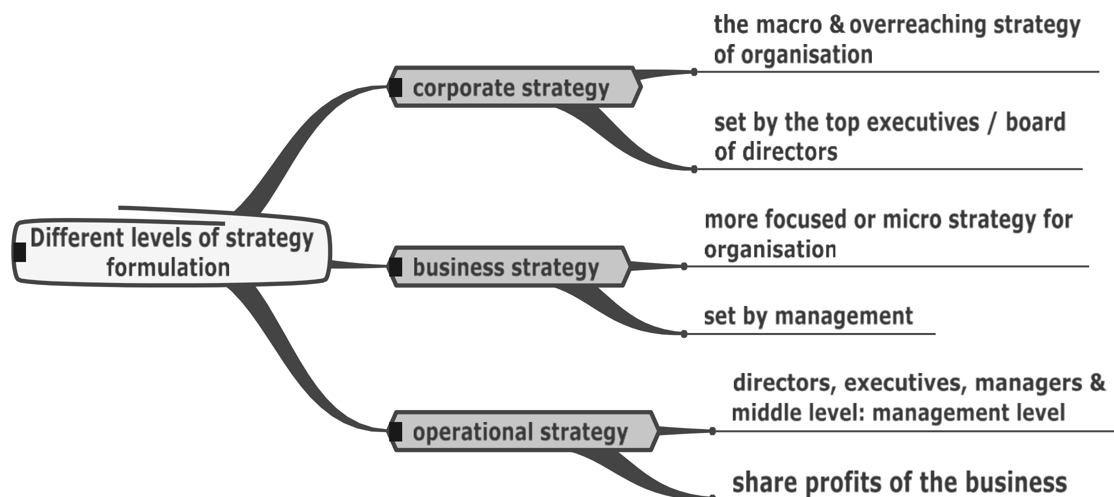
The lowest level of the strategy hierarchy is operational strategy. Operational strategy has a very narrow focus and is concerned with the day to day operating activities of the organisation. It represents how an organisation implements the strategies set at the preceding business level. This type of strategy is formulated by the employees / management of an organisation.

Example

Different levels of strategy formulation



SUMMARY



Example

Tasty Burgers is an established chain of fast food outlets in London which began operation in 20X4. Initially it had only a few outlets. The company grew rapidly and now has 15 outlets in the UK.

The company has recently appointed Mack Dellas as the CEO who is also responsible for the company's global operations.

Dellas has started working towards the long-term objectives of the company. He has prepared a list of challenges to be met in order to achieve the company's goals. The key elements of Dellas' strategy are as follows:

- Opening a further 500 outlets over the next 5 years, both within the UK and abroad
- identifying a suitable market position and promoting the brand name through extensive advertising
- offering high value to customers by providing efficient and quality services
- increasing the existing range of meals by offering new menu items including special low price meals to increase market penetration

In addition, instead of managing each outlet individually, Mr. Dellas has decided that entering into franchising agreements would be a cost effective strategy. Franchising is an arrangement whereby Tasty Burgers would grant its dealers (or franchisees), the right to sell the fast food products in exchange for some consideration. However, if any of the franchisees performs poorly, this could adversely affect the reputation of the entire group.

From the above scenario, explain the strategy which has been adopted by Dellas. Also explain the level / type of the strategy adopted, stating the reasons for its adoption.

Answer

Strategy, in a broader sense, can be considered the key in setting the long-term direction for an organisation. It requires an organisation not only to examine and assess its present position but also its desired future position. The strategy is the bridge that will help an organisation to progress from "where we are now" to "where we want to be in the future". In the case in question, the management has a strategic plan to expand globally with the vision of providing high quality products under its brand name.

Tasty Burgers' strategy is a **corporate strategy** which often involves the organisation questioning the kind of business the organisation should be in.

Corporate strategies represent the long-term direction of the organisation. They could include diversification plans, acquisition, divestment, strategic alliances and the formulation of new business ventures. The organisation's long-term expansion plan is part of its corporate strategy.

Corporate strategies deal with plans for the entire organisation and change in accordance with industry and market conditions. Penetrating the global market is a part the organisation's corporate strategy.

Continued on the next page

Since the company has decided its long-term objectives, it needs to focus on how to achieve these objectives. The key points of Dellas's strategy indicate the organisation's corporate strategy as they give an insight regarding the following:

The business mission, i.e. to expand globally, has already been stated by the directors (top management). This is the long-term strategic plan which would need to be implemented.

The CEO's long-term performance target is to expand the operations globally and devise a strategic plan which forms a part of the organisation's corporate strategy.

It should be noted that top management has the primary decision making responsibility in developing corporate strategies and the managers are directly responsible to shareholders.

2.2 Relationship between strategic, business and operational plans

Strategic plans are the strategies chosen to achieve the business and operational plans

Business plans are for any period of time / scale of operation

Operational plan is a plan for next twelve months
The key members of an organisation get their heads together at the planning stage and formulate a business plan. The components of a business plan will include: the direction in which the organisation is headed, the strategy for it, decision making and the possible outcomes of it.

The environment in which an organisation operates may keep changing from time to time and hence the business plan should be flexible enough to accommodate these changes.

An organisation may have a long term business plan for the next ten years or so. The implementation may be broken down into two phases of five years each or three phases of three years each etc. Within these phases also, an organisation may have an annual operational plan in place.

Test Yourself 2

In a strategic management pyramid, which of the below will be at the top of the pyramid?

A Operational strategy
B Business strategy
C Corporate strategy
D Corporate social responsibility (CSR) strategy

---

3. Describe the steps in strategic plan development.

[Learning Outcome c]

3.1 Intended and emergent strategies

Intended strategies, as the name suggests, are strategies that are **planned and deliberate**. This is a set of planned acts that have the intention of achieving a prospective goal. The goal that needs to be achieved is pre-determined and set in advance, before the strategy is implemented. An intended strategy is also referred to as a **deliberate strategy**.

There is often a question about whether intended strategies are realised strategies.
The answer to this question is 'yes' and 'no'; there is no single answer.

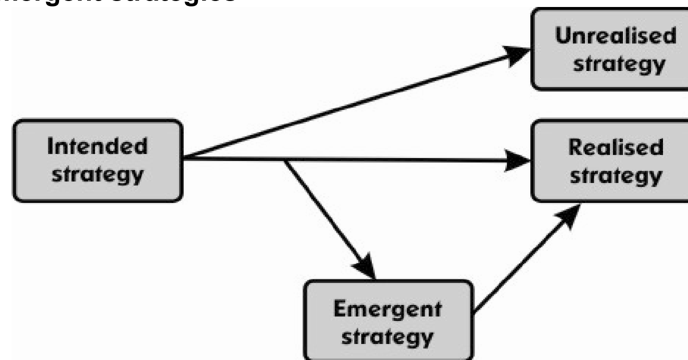
When deliberate and intended plans are **realised completely**, intended strategies result in **realised strategies**. It may be that the resultant strategy is **completely different** from the strategies that were intended and planned – these are **unrealised strategies**. There may be a third situation where the resultant strategy was **not perfectly executed (according to its intentions), but also did not completely deviate** from the intended actions, called as **emergent strategy**. Emergent strategy is a set of actions or behaviour which becomes a realised pattern and is **not expressly intended** at the time of planning the strategy.

Example

Excellence University decides to appoint students from a new high school. This appointment becomes the intended strategy of the university.

When the actual appointment process is implemented, it is realised that the students who responded effectively to recruitment were students from community colleges. Therefore, the recruitment process was modified to attract more college students. This became Excellence University's emergent strategy.

Diagram 4: Intended and emergent strategies



From the above diagram, we can see that the intended strategy can be realised or unrealised, but the emergent strategy is only ever a realised strategy. Emergent strategy results when intentions do not followed through completely but, in the process of accomplishing the goal, some unintentional strategies emerge; these are called emergent strategies. According to the Mintzberg, this is like a potter making a pot. Emergent strategy is a result of the day-to-day activities and processes of organisations.

Example

Healthy Drinks Co is a producer of prepackaged juices made from a combination of vegetables, fruits and herbs. The company is based in country A. One of the main goals of Healthy Drinks is to satisfy health-conscious consumers. The company has had enormous success in country A because of the health benefits offered by its juices. As a part of its growth strategy, Healthy Drinks decided to enter a significant untapped market for prepackaged juices. The company formed a committee to analyse the possibilities of market expansion. Based on the recommendations of the committee, a market survey was conducted in country B and the company decided to implement its strategy of entering the new market. However, the company was not able to sell as well in country B as in country A because of the different tastes and preferences of consumers in country B. Eventually, Healthy Drinks starts producing and selling only fruit juices in country B in order to satisfy all kinds of consumers, including health-conscious consumers.

Explain whether the strategy followed by Healthy Drinks is intended / emergent / realised / unrealised.

Answer

Healthy Drinks' strategy in country A is an intended strategy as it is planned and deliberate. Its act of producing juices made from the combinations of vegetables, fruits and herbs is intended to achieve the predetermined goal of satisfying health-conscious consumers. This shows Healthy Drinks' sense of focused direction. At the same time, it is evident from the success of Healthy Drinks in country A that its strategy is a realised strategy. The company's deliberate and intended plans are realised completely in country A.

Healthy Drinks' strategy in country B is an emergent strategy as it is unplanned and not deliberate. Its goal to satisfy all types of consumers in country B is accidental and incidental, as the company's juices that were made from vegetable, fruits and herbs failed in country B. The resultant strategy of Healthy Drinks to sell only fruit juices in country B is not perfect according to its intentions but does not completely deviate from intended actions. The emergent strategy of Healthy Drinks implies that the company began to understand that what works in country A may not work in country B. This is a realised strategy, as emergent strategy is always realised strategy.

3.2 Development of intended strategy

An organisation forms an intended strategy when it wants to achieve some **specific goals** in future. Every organisation has its own intended strategy. The formulation of intended strategy relates to its **strategic planning systems**.

A strategic planning system is a **process of strategic implementation**. It explains how strategies are formulated. The stages in the strategic planning cycle are:

1. **Planning guidelines**: this is the first step in the process of planning a cycle. The organisation forms the guidelines for what the plan should be for the benefit of the organisation. It assesses the conditions prevailing in the external environment and studies the factors that are going to affect it adversely. The organisation forms guidelines for how it will tackle problems. The organisation plans its priorities to attain future objectives.

2. **Prepare a rough business plan:** when the guidelines are set, the next step is preparing the business plan. The divisions and business groups within the organisation set their business plans. The business plan contains the goals that need to be achieved by different business processes.

3. **Consultation with the senior level managers:** the business plans formulated by divisions and businesses are discussed with the corporate managers. Generally, this discussion occurs in face-to-face meetings because it is beneficial for managers to resolve issues by communicating and clarifying doubts in person.

4. **Review the business plan:** if, after discussion, the corporate managers form the opinion that the business plan needs to be revised, then the plan is revised accordingly.
5. **Prepare estimate budgets:** the next step is the preparation of the annual budgets. The managers prepare the budget relating to the funds required for capital expenditure and operating expenditure. This provides an overview of the organisation's fund requirement.

6. **Prepare a final corporate plan:** business plans, when taken together, form a corporate plan. A corporate plan is prepared for the accomplishment of corporate goals.

7. **Take approval from the board of directors:** when the corporate plan is prepared, it needs to be approved by the corporate board of directors.

8. **Annual performance targets and review:** the corporate managers plan performance targets for the organisation on an annual basis.

9. **Performance appraisal:** once the targets are set, corporate managers compare the actual goals achieved with the targets set. The organisation is inclined to scrutinise the performance of the strategic-level managers using the balanced scorecard.

Example

Gotcha Ltd, a manufacturing company, has its branch offices in many countries. Each country is represented by the managing director of the company located in that region. These managing directors receive their revenue targets from Gotcha's head office in London. These managing directors have the freedom to develop their own strategies to achieve their respective targets. Gotcha, while conducting performance appraisals, compares the managing director's performance against the given targets.

Diagram 5: Stages in strategic planning cycle

3.3 Benefits of a strategic planning system

1. It helps to **prioritise future objectives** according to their importance. It suggests which objective should be fulfilled first and provides ways to achieve them.

2. It promotes the **optimum utilisation of resources,** be it financial resources or human resources.

3. It provides a **performance measurement** because the actual goal achieved can be compared with the planned goal.

4. When the objectives are specified clearly, it helps to form an **effective analysis** and to think of ways to achieve them.

5. It helps to create a **sense of co-operation** and togetherness in the organisation because, when business plans are compiled together, they form an overall corporate strategic plan.

6. When plans and objectives are fixed, it encourages managers to operate and **perform effectively** to achieve their goals.

7. Once the planning is done, the senior managers can exercise **effective control** over lower level managers and staff in case they deviate from the set objectives.

3.4 Problems in strategic planning systems

1. There is a possibility that the **right strategy may not be planned for** in the planning process.

2. When the planning process results in the formulation of a strategy, there is a chance that the mangers may not think beyond the planned activity. Therefore, the planning process may **hinder managers' innovative and analytical thinking**.

3. Sometimes the planning process and budgetary control processes are considered the same. This is incorrect because budgetary control deals with financial aspects and strategic planning is a wide concept which considers all the aspects in an organisation.

4. When the planning system is **complicated**, it is **difficult for staff** to understand and implement it.

5. Sometimes the implementation of the strategic planning system becomes difficult because operational managers are so busy in their day-to-day activities that they cannot find time to implement strategic plans effectively.

6. In the case of extensive planning systems, the information collected may be voluminous, which may lead to an overburdening of information and wastage of managerial time. This may result in the neglect of important strategic issues. In addition, if the planning takes too long, the firm may not be able to devote sufficient time to market operations,

Test Yourself 3

Which of the below is the first step in the strategic planning cycle?

A Preparing a rough business plan
B Planning guidelines
C Consultation with senior level managers
D Preparation of estimate budgets

---

4. Examine the elements of a business plan.

[Learning Outcome d]

4.1 Business plan

The business plan provides a rationale for investment and as such should support robust analysis and rational decision-making. The development of project benefits criteria revolves primarily around the business plan.

The purpose of the business plan is to establish why the project should go ahead. As in the case of a project, the business plan also follows a development cycle as the project evolves from idea to formal proposal.

Traditionally, the reason for developing a business plan for a project was to obtain funding for a large financial investment. However, when considered in a broad sense, the business plan is intended to realise benefits by implementing a project. In addition, a business plan is also necessary:

to enable priorities to be set among different investments for funds and resources;

to identify how the benefits identified will be delivered – a benefit realisation plan;

to ensure commitment from the business managers to achieve the intended investment benefits; and importantly

to create a basis for review of the realisation of the proposed business benefits when the investment is complete.

4.2 Elements of a business plan

A typical business plan document consists of the following elements:

executive summary
introduction
project scope and organisation
benefit and cost
timing
certain other items

The executive summary, project benefits and costs are the sections that are usually read first and so it is essential that these sections:

capture the attention of the reader;
convince them of the suitability of the project; and
request for the resources (money, manpower, machinery, materials, etc.)

The remainder of the business plan document should discuss how the project will be delivered, the alternatives, risk factors etc.

1. Executive summary

This section provides an opportunity to capture the attention of the reader. It comprises the main purpose and benefits of the project. The executive summary should be precise, written in two or three paragraphs and ideally fit in half a page.

2. Introduction

This section provides the problem statement, the background to the project, reasons for its selection, impact on business and so on. It should be established that a suitable option has been selected after identifying a number of options that arose from consideration of the needs of the business.

3. Project scope and organisation

The scope of the project should be defined in such a way that it is easy to understand. The major deliverables and activities should be briefly discussed rather than detailing too much since the objective is to present a ‘feel’ of the overall project.

Project organisation should consider the nature of resources required (internal and external) to deliver the project.

4. Project delivery strategy

The strategy for delivering a project is mainly concerned with how the project will be delivered as opposed to why it should be delivered. The overall approach to delivering the project should be considered within the business plan. A formal Project Delivery Plan (PDP) should be in place.

It should include:

a project roadmap (key stages and gateways)
project controls (cost, scope, time, risk, change)
benefits management
engagement of the business

The discussion here should be limited to the extent of establishing how the project will be delivered when it is approved. Too many details should not be discussed here.

5. Benefit and cost

The project approvers would, in the first instance, be interested in knowing whether the benefit is greater than the cost (within some defined business criteria). The benefit / cost statement should be mentioned in the beginning of this section.

In addition to the above statement, there should be a summary of the benefit and cost data. It should contain a summary table of both the key cost and benefit areas. It should also explain how the estimates have been made (with reference to quotations for cost and data assembled for benefits). Figures should be used to illustrate the cost-benefit analysis.

The costs and benefits analysis should also consider sensitivity within the calculations. Sensitivities are different from risk factors. Sensitivities refer to variables that are outside the control of the project manager that will impact the returns from the project investment. Risk factors may be controllable, are internal to the project (even if they arise due to external factors) and impact the ability of the project to deliver.

6. Timing

This section should contain a top level plan of the project indicating the key milestones and deliverables.

Others

The key issues that should be considered are:

The alternatives that could be considered if no project is undertaken (if nothing is to be done, this should be highlighted in the business case).
The risks such as potential impact on production and failure to meet specific deadlines should be considered.

4.3 Preparing a business proposal / business plan

Writing a business plan serves the two-fold purpose of:

guiding the organisation on the direction in which the business is headed and
serving as a ready reckoner to the financial institution that is planning to fund / invest in the business

Step-by-step writing a business plan

1. **Executive summary:** The contents of the business plan must be concise and yet it should give the required details about the business. While reading the business plan, the financial institution/s should be able to get answers to questions like who, where, why, what, when, how, how much etc. about the business. The plan should have a short synopsis at the beginning and the key point summary at the end.

2. **Mission and vision:** This section should state the mission and vision of the organisation. This section should also have a brief of goals / objectives for the next three years / five years / ten years etc. and how does the organisation plan to go about achieving them.

3. **Business details:** The plan should have a brief background about the industry and the organisation's business. The key elements of the business along with the details should be included

   For example the details would include:

   the organisation's products / services, the target market, competition,
   a SWOT analysis and how the organisation has a competitive edge over others in the industry.
   the key risks that the industry and the organisation in particular face.
   the details of how the business will be taken to the next level.

4. **Organisation structure:** It should contain a framework depicting the way work is organized and control is exercised in the organisation. It should outline the ways in which work roles are allocated, responsibilities are delegated and efforts are coordinated in a formal setting. The business plan should include the profiles of the organisation's top management like CEO, Board of Directors, etc.

5. **Funding requirement:** The plan should mention the existing equity capital, working capital, funds the organisation is looking at raising and the end use of these funds. If the organisation is looking to raise debt funding, then the plan should mention the time duration and the repayment plan.

6. **Legal and financial documents:** The business plan should be supported with all the essential legal and financial documents. Some of these include:

   the registration certificate for commencing business
   various approvals / no objection certificates (NOC) from various bodies / authorities like pollution control board
   financial statements like Balance Sheet, Income Statement, Cash Flow Statement for the last one year / three years / five years.
   a break-even analysis and projected cash flows
   List of assets and liabilities of the organisation and the various financial ratios.
   credit rating reports, reference letters etc.

Before starting to write the business plan, an organisation should gather all the business details, funding requirement, legal and financial documents etc. and then put them together in the business plan.

Test Yourself 4

In a business plan, the main purpose and benefits of the project are included in which section?

A Executive summary
B Introduction
C Project scope and organisation
D Project delivery strategy

---

5. Formulate vision and mission statements in a given business scenario.
[Learning Outcome e]

Let us look at an example to learn how to formulate a vision and a mission statement.

Example

ABC Bank is a mid-sized bank engaged in all segments of banking: retail, corporate, investment etc. The bank management wants ABC Bank to become a large sized bank and be ranked among the top three banks in the country by the end of the decade.

They plan to do this by expanding their product portfolio and branch network, hiring people and expanding their balance sheet.

In the above scenario, let us look at the vision and mission statement of ABC Bank.

A vision statement is written to define and describe what the organisation is aspiring to be in the future. It typically reflects an ambitious and optimistic view of what management believes the organisation can and should achieve.

Vision statement of ABC Bank

Vision 2020: To become one of the top three banks in the country by 2020 and to become the most preferred bank for customers by choice

The mission statement focuses on how ABC Bank plans to accomplish its vision.

Mission statement of ABC Bank
To increase market share by offering new innovative products, and stay ahead of the competition and strive to achieve excellence in customer service.

To expand the existing branch network tenfold, i.e. from the existing 150 branches to 1500 branches along with doubling the employee headcount and trebling the balance sheet size by the end of the decade

Answer to Test Yourself

Answer to TY 1

The correct option is **A.**

Mission statements are written to explain the purpose behind a particular organisation.

Answer to TY 2

The correct option is **C.**

In a strategic management pyramid, corporate strategy will be at the top of the pyramid.

Answer to TY 3

The correct option is **B.**

The first step in the strategic planning cycle is planning guidelines.

Answer to TY 4

The correct option is **A.**

In a business plan, the main purpose and benefits of the project are included in the executive summary.

Self Examination Question

Question 1

Which of the below statement is written to define and describe what the organisation is aspiring to be in the future?

A. Mission statement
B. Vision statement
C. Strategy
D. Values

Question 2

An intended strategy is also referred to as deliberate strategy.

A. True
B. False

Question 3

_____________in his management by objectives (MBO) system, mentioned that an organisation's objectives should be SMART.

A. Johnson
B. Peter Drucker
C. Scholes
D. Micheal Porter

Question 4

__________ strategy looks at the overall suite of businesses / products of an organisation and involves an organisation asking itself what kind of business should I be in.

A. Operational
B. Business
C. Corporate
D. All of the above

Question 5

Which of the below plan is for the next twelve months?

A. Corporate Social Responsibility
B. Business **C.**
Corporate **D.**
Operational

Answer to Self Examination Question

Answer to SEQ 1

The correct option is **B.**

Vision statement is written to define and describe what the organisation is aspiring to be in the future.

Answer to SEQ 2

The correct option is **A.**

An intended strategy is also referred to as deliberate strategy.

Answer to SEQ 3

The correct option is **B.**

Peter Drucker in his management by objectives (MBO) system, mentioned that an organisation's objectives should be SMART

Answer to SEQ 4

The correct option is **C.**

Corporate strategy looks at the overall suite of businesses / products of an organisation. It involves an organisation asking itself what kind of business should I be in?

Answer to SEQ 5

The correct option is **D.**

Operational plan is for the next twelve months.

BUSINESS FUNCTIONS, ACTIVITIES AND PROCESSES

3

STUDY GUIDE 3: THE BUSINESS FUNCTIONS, ACTIVITIES AND PROCESSES

Get Through Intro

Organisations whose departments share an amicable working relationship are much more likely to achieve quality and efficiency as well as be effective and profitable, which in turn will enable the organization to meet with its business objectives.

Although the individual departments of an organisation all have very specific and very different functions to perform, they are all ultimately working toward achieving the overall objectives of the business. Therefore it is important that they coordinate their efforts and “partner” with each other.

As an accountant one of your main functions is to be the financial watchdog of the organisation. However there is a growing tendency across most organisations to integrate their accountants more fully into the business by having them work closely with other departments. Therefore it is important that you understand the roles and responsibilities of other departments so as to help them achieve their objectives.

This Study Guide will help you understand the various departments in an organisation and the functions / activities / processes carried out by these departments. You will learn about how these departments are related to each other and how they work towards achieving business objectives.

Learning Outcomes

a) Describe and distinguish relationships between business functions, activities and processes and their support for achieving business objectives.
b) Explain the relationship between entity and functional strategies.

1. Describe and distinguish relationships between business functions, activities and processes and their support for achieving business objectives.
Explain the relationship between entity and functional strategies.
[Learning Outcomes a and b]

Business processes are sets of logically related tasks that use an organisation's resources to provide the goods / services its customers want and will enable the organisation to achieve its objectives. Business processes, business activities and business functions are synonyms.

Almost all organisations engaged in manufacturing activities have some, if not all, of the following departments in their organisation structure: **research and development; purchasing; production; direct service provision; marketing, administration and finance**. Each of these business departments performs a specific function / activity / process that contribute to meeting the business objectives of the entity.

1.1 Business functions

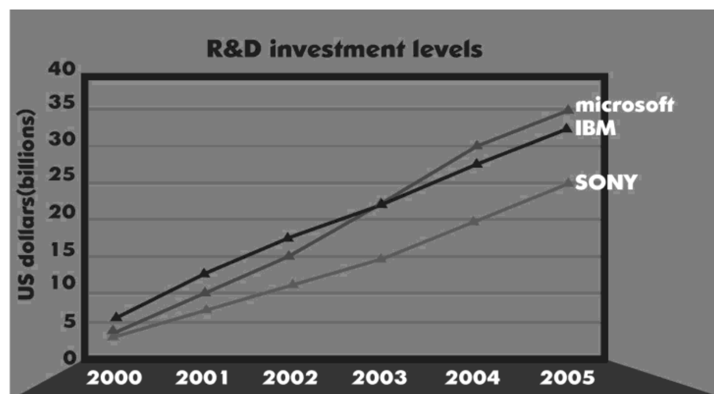
Let us now understand how the functions help in achieving business objectives.

1. Research and development

Many believe that the long term prosperity of an organisation depends entirely on how well it can bring innovative new products / services to the market. This responsibility falls mainly on the research and development department. The department's purpose is **to bring about significant improvement in the existing products, develop new and better products, processes or services and** create effective processes.

Example

During their analyst day on 27 July 2006 Microsoft released statistics showing how it had outspent its competitors on research and development.



Microsoft typically spends around USD 5 billion a year on research and development.

The organisation has research centres or departments in the USA (Redmond, San Francisco and Silicon Valley), the U.K. (Cambridge) and China (Beijing).

This heavy expenditure and focus arises out of Bill Gates' commitment to research and development or as he puts it "because of our optimism (over) what software can do in the decade ahead".

Normally, the research and development department performs the following functions

- Research and development of new products
- Product maintenance and improvement
- Quality and regulatory observance

2. Purchasing

The purchasing department is responsible for procuring all the goods or services that an organisation needs to conduct its operations. The rationale behind having a dedicated department to perform this function (as opposed to each department handling its own respective purchasing) is the efficiency and cost savings to the organisation as a whole that can be gained.

Therefore the main responsibility given to a purchasing department is **to procure all the goods or services that the organisation will require in the quickest time and at the lowest price, without compromising on quality.**

Example

Unilever Inc has set up a purchase department for effective purchases. Ken, purchase manager, has received a requisition note of 100 kg material from the stores department. On receiving requisition, Ken has checked the actual requirement. According to him, only 80 kg materials are required.

He calls for the quotations from different suppliers. From the quotations received, Ken had placed an order with the supplier who was ready to send the materials at cheapest price and in the quickest time. On receiving materials from the supplier, he has checked the quality and quantity of the procured materials.

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3. Production

This department produces the goods an organisation sells to its customers. It is the functional area that is responsible for turning inputs (raw materials) into outputs (finished products).

The role of the production department is **to manage the production process** in order to ensure that the products are made **on time** and meet a certain minimum **standard of quality**. This department is also given the responsibility to continually improve the efficiency of the production process.

In recent times, the task of implementing quality control programs such as ISO 9000, Total Quality Management or Six Sigma has also been assigned to this department.

Example

One of the main reasons why Toyota has become one of the 10 largest companies in the world is its strength in production. The Toyota Production System (“TPS”) is both a framework and philosophy used by the company throughout its manufacturing facilities.

TPS is based on two fundamental premises

‘**jidoka**’ (automation with a human touch), a system that allows any employee to halt production when a problem or defect is noticed and

‘just in time’ where inventory is produced in exact quantities and at the exact time when it is needed thereby eliminating waste and storage costs.

These philosophies and systems have enabled Toyota to consistently produce quality vehicles at relatively economic prices.

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4. Direct service provision

The direct service provision department is also commonly referred to as the client servicing department. Its function is to serve as a **single point contact** for an organisation’s clients.

This department becomes particularly beneficial for organisations whose clients have to deal with several of their departments. The direct service provision acts as an **intermediary between the client and the rest of the organisation.**

An advertising company's client would need to interact with the following departments

Creative department	to decide upon artwork / graphics for any upcoming advertisements
Copywriting department	to decide upon the text for any upcoming advertisements
Media department	to decide upon what publications the advertisements should appear in

To simplify life for their clients, most advertising companies have a client servicing department that will coordinate with these other departments on their behalf.

5. Marketing

The marketing department serves as a **link between an organisation and its customers**. The main responsibilities for this department are twofold

to ascertain the current needs and demands of customers and

to communicate to the market what the organisation's products and services are.

Ronson Ltd is a mobile manufacturing company. Marketing department of Ronson Ltd has identified that customers are interested in handy and light weighted mobiles rather than heavy and large-framed mobiles.

Most organisations also give their marketing department the ability to work closely with the production and the research and development departments, to help ensure that the finished products are in line in with the current market tastes.

6. Administration

The administration department serves a purely **support function.** Its main purpose is to ensure that the overall **day to day functioning** of the organisation goes smoothly. It does this by ensuring that

All departments have the necessary infrastructure and resources they need;

All buildings and equipment are well maintained and in good order;

All employees are updated on organisational changes and new policies;

Official company policies are observed (e.g. employees arriving on time) and

All supporting paperwork of the organisation is up to date (e.g. requisition forms, time cards etc.).

7. Finance

The finance department is involved with **controlling and managing an organisation's money supply.** This department has two main functions: **treasury and control.**

With treasury, the finance department is required to determine how the on-going operations, projects and/or acquisitions of the organisation are to be funded as well as how the surplus funds, if any, are to be invested. Control requires the department to implement and monitor a system of procedures to ensure that there is no misuse or embezzlement of company funds.

Finance manager, Monty, is responsible to estimate financial requirements of business. For the purchase of fixed assets, he has decided to raise finance internally by issuing debentures.

1.2 Relationship between entity and functional strategies

A business entity makes a broad strategy at the organisational level. This is made keeping in mind a long term horizon of 10-15 years.

Thereafter, the various departments / functions make their strategy based on the organisation's strategy. The respective department's strategy will be planned for the next one year, based on the annual budget and the resources allocated to it.

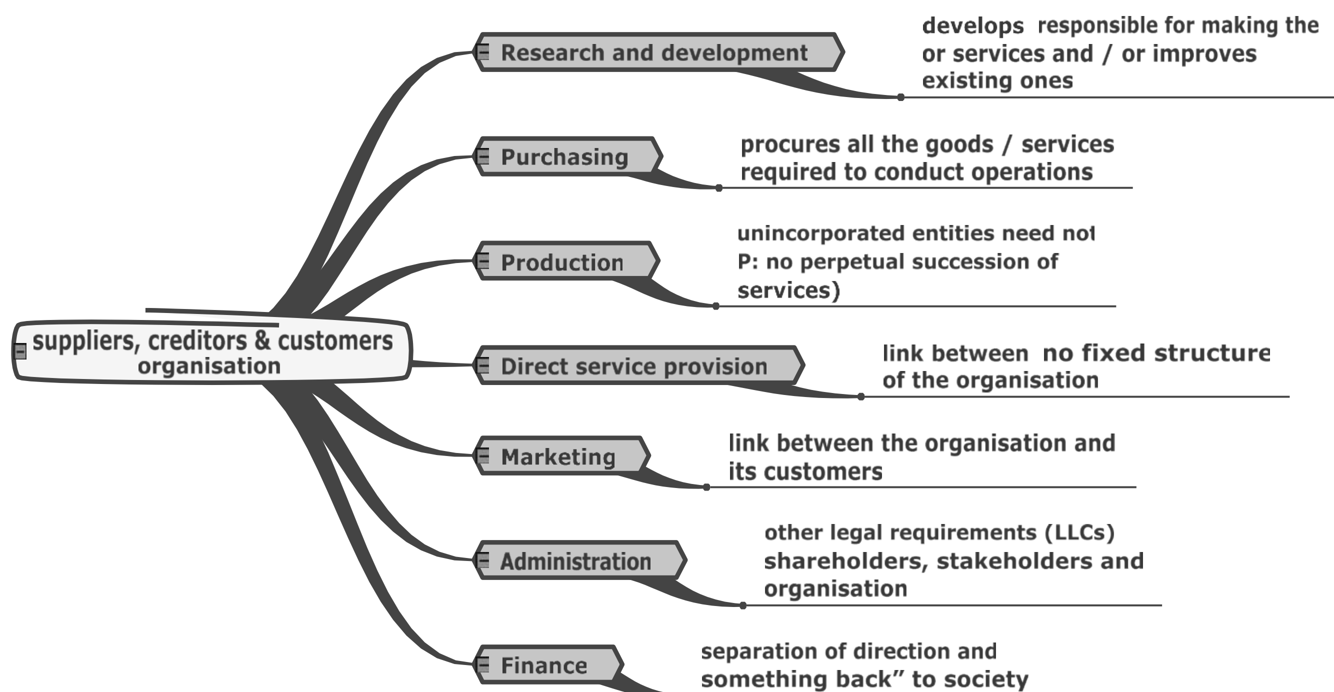
Example

The research and development department's strategy should be closely linked to that of the business entity. The business entity may have a long term goal of introducing new products from time-to-time to keep pace with the changing needs of customers and to diversify its product line. Accordingly, the research and development department can survey the market for customer preferences and come out with new products from time-to-time in line with the entity's long term goals.

Apple Computers has introduced new products like iPods, iPhones, iPads etc. on a regular basis and captured market share. It has demonstrated how a business entity can meet its long term goals with an active research and development department.

Similarly, the other departments will frame their own strategies, which will be in line with the organisation's broad strategy.

SUMMARY



Test Yourself 1

The direct service provision department

A Provides support to all the other departments in an organisation
B Acts as an intermediary between the client and the rest of the organisation
C Controls the finances of the organisation
D Procures the goods or services required by the rest of the organisation

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The responsibility of controlling and managing an organisation’s money supply rests with the:

A Administration department
B Marketing department
C Purchasing department
D Finance department

Answers to Test Yourself

Answer to TY 1

The correct option is **B.**

The direct service provision department serves as a single point contact for an organisation’s clients. It is particularly beneficial for organisations whose clients have to deal with several of their departments.

Answer to TY 2

The correct option is **D.**

The finance department controls and manages an organisation’s money supply.

Self-Examination Question

Question 1

The main function(s) of the accounting department in relationship to the purchasing department is (are) to

A Make payments for any goods or services purchased
B Make and maintain records and reports of the purchases
C Ensure that all the purchases remain within budget
D All of the above

Question 2

The financial consideration(s) in the production function include(s) maintenance of appropriate accounting records related to

A The production process
B All finished goods and work in progress
C Both A and B
D None of the above

Question 3

Determining the credit terms that can be granted to customers is a financial issue associated with

A Production
B Marketing and sales
C Production planning
D Purchases

Question 4

The service provision department is very advantageous for an organisation whose clients have to deal with several departments of the organisation

A True
B False

Question 5

The financial costs involved with effective service provision include

A Salaries of the staff in the department
B Direct and indirect expenses of the client services department
C Both A and B
D None of the above

Answers to self-examination questions

Answer to SEQ 1

The correct option is **D.**

The accounting department needs to ensure that correct payments are made to suppliers, all purchases made are properly authorised and accounted for and that they remain within budget.

Answer to SEQ 2

The correct option is **C.**

In the case of the production function, appropriate accounting records need to be maintained relating to both the production process (recording of all the costs associated to production) and all finished goods and work in progress (reflecting the quantity and value of all finished goods and all work in progress).

Answer to SEQ 3

The correct option is **B.**

The marketing and sales department has to attend to all the activities associated with the sales function. Hence determining the credit terms that can be granted to customers is a financial issue associated with marketing.

Answer to SEQ 4

The correct option is **A.**

The service provision department is very advantageous for an organisation whose clients have to deal with several departments of the organisation as this department can serve as a single point of contact.

Answer to SEQ 5

The correct option is **C.**

The financial costs involved with effective service include salaries of the staff in the department and other direct and indirect expenses e.g. rent of equipment.

HUMAN RESOURCE MANAGEMENT

4

STUDY GUIDE 1: HUMAN RESOURCE MANAGEMENT

Get Through Intro

Human resource management (HRM) is concerned with all aspects of how people are employed and managed in organizations. HRM has a strong conceptual basis drawn from the behavioural sciences and from strategic management, human capital and industrial relations theories. This foundation has been built with the help of a multitude of research projects. The aim of this chapter is to provide a general introduction to the practice and underpinning concepts of HRM. It covers the definitions and functions of human resource management, organisational structure, leadership and management, motivation, organizational (corporate) culture, and industrial/employee relations.

Learning Outcomes

- Explain functions and evolution of human resource management
- Describe Organizational structure
- Explain leadership and management
- Explain Motivation
- Discuss organizational (corporate) culture
- Explain Industrial/employee relations

1. To explain the functions and evolution of Human resource management.
[Learning Outcomes a]

4.1 Definitions and Functions of Human Resource Management (HRM/HR)

Human resource management (HRM) is a strategic, integrated and coherent approach to the employment, development and well-being of the people working in organizations (Armstrong 2009).

Human Resource (HR) management therefore is the design of formal systems in an organization to ensure the effective and efficient use of human talent to accomplish organizational goals.

Human Resource Management is a function within an organization which focuses mainly on the recruitment of, management of, and providing guidelines to the manpower in a company. It is a function of the company or organization which deals with concerns that are related to the staff of the company in terms of hiring, compensation, performance, safety, wellness, benefits, motivation and training.

4.2 Functions of Human Resource Management

Human Resource Planning (HRP)
Human resource planning, or HRP, is the ongoing, continuous process of systematic planning to achieve optimum use of an organization's most valuable asset — its human resource. The objective of human resource planning is to ensure the best fit between employees and jobs while avoiding manpower shortages or surpluses.

The main purpose of HRP is to set the goals and objectives of the company. In other words, it is to have the precise number of employees, with their skills matching the requirements of the organization, so that the organization can move towards its goals

The four key steps of the human resources planning process are analyzing present labor supply, forecasting labor demand, balancing projected labor demand with supply and supporting organizational goals.

Analyzing Present Conditions
The first step of human resource planning is to identify the company's strengths and weaknesses in the current labor pool. This is when a company performs a comprehensive audit of the skills, demographics qualifications, experience and compensation of every worker. HR then has to determine if these statistics fit in line with the company's goals. Does the firm need to hire more staff to compete in a future marketplace, or are more automated tools necessary to capture more market share from competitors? Is the status quo acceptable, or should the company reorganize its staff so that it can make more money?
Forecasting Demand
HR forecasts demand based on the strategic goals of the company. HR managers may examine market trends, industry analyses and technological improvements to try to come up with ways to meet the company's goals. Forecasting possible retirements is also one major facet that needs to be considered when businesses assess future staffing levels. Do retired employees need to be replaced, or can new technology do the job? Does a company need more full-time workers, part-time help or outsourced labor?
Striking a Balance
The next step involves striking a balance between supply and demand. At this point, HR creates a gap analysis that lays out specific needs to narrow the supply of the company's labor versus future demand. Should employees learn new skills in the future? Does the company need more managers? Do all employees play to their strengths in their current roles?
Integrating the Plan
The answers to these questions let HR determine how to proceed, which is the final phase of the human resources planning process. HR must now take practical steps to integrate its plan with the rest of the company. The department needs a budget, the ability to implement the plan and a collaborative effort with all departments to make the plan happen.
The overall goal of HR planning is to have the optimal amount of staff to make the most money for the company. Because the goals and strategies of the company change over time, human resource planning is a regular occurrence.

Employee Recruitment
Recruitment is the process of identifying an organizational gap and attracting, evaluating, and hiring employees to fill that role.

Recruitment is the process of attracting, screening, and selecting employees for an organization. The different stages of recruitment are: job analysis, sourcing, screening and selection, and onboarding.

The Four Stages of Employee Recruitment
Job analysis involves determining the different aspects of a job through, for example, job description and job specification. The former describes the tasks that are required for the job, while the latter describes the requirements that a person needs to do that job.
Sourcing involves using several strategies to attract or identify candidates. Sourcing can be done by internal or external advertisement. Advertisement can be done via local or national newspapers, specialist recruitment media, professional publications, window advertisements, job centers, or the Internet.
Screening and selection is the process of assessing the employees who apply for the job. The assessment is conducted to understand the relevant skills, knowledge, aptitude, qualifications, and educational or job-related experience of potential employees. Methods of screening include evaluating resumes and job applications, interviewing, and job-related or behavioral testing.
After screening and selection, the best candidate is selected. Onboarding is the process of helping new employees become productive members of an organization. A well-planned introduction helps new employees quickly become fully operational.

Recruitment Approaches
There are many recruitment approaches as well. *Approaches*, in this context, refers to strategies or methods of executing the recruitment process. As recruitment is a complex and data-heavy process, the supply of applications and interest can be quite overwhelming. These strategies assist in simplifying the process for HR professionals:
In-house personnel may manage the recruitment process. At larger companies, human resources professionals may be in charge of the task. In the smallest organizations, recruitment may be left to line managers.
Outsourcing of recruitment to an external provider may be the solution for some businesses. Employment agencies are also used to recruit talent. They maintain a pool of potential employees and place them based on the requirements of the employer.
Executive search firms are used for executive and professional positions. These firms use advertising and networking as a method to find the best fit.
Internet job boards and job search engines are commonly used to communicate job postings. Social media is also playing a vital role in recruitment in this century.
Social networking, whereby websites such as LinkedIn enable employers and prospective employees to interact and share information, is perhaps the most recent trend in recruitment.

Employee Selection
Selection is the process—based on filtering techniques that ensure added value—of choosing a qualified candidate for a position.
Selection is the process of choosing a qualified person for specific role who can successfully deliver valuable contributions to the organization. The term *selection* can be applied to many aspects of the process, such as recruitment, hiring, and acculturation. However, it most commonly refers to the selection of workers. A selection system should depend on job analysis. This ensures that the selection criteria are job related and propose value additions for the organization.

Selection Requirements
The requirements for a selection system are knowledge, skills, abilities, and other characteristics, collectively known as KSAOs. Personnel-selection systems employ evidence-based practices to determine the most qualified candidates, which can include both new candidates and individuals within the organization.
Common selection tools include ability tests, knowledge tests, personality tests, structured interviews, the systematic collection of biographical data, and work samples. Development and implementation of such screening methods is sometimes done by human resources departments. Some organizations may hire consultants or firms that specialize in developing personnel-selection systems rather than developing them internally.

Employee Orientation
Orientation tactics exist to provide new employees enough information to adjust, resulting in satisfaction and effectiveness in their role.

Employee orientation, also commonly referred to as onboarding or organizational socialization, is the process by which an employee acquires the necessary skills, knowledge, behaviors, and contacts to effectively transition into a new organization (or role within the organization).
Orientation is a reasonably broad process, generally carried out by the human resources department, that may incorporate lectures, videos, meetings, computer-based programs, team-building exercises, and mentoring. The underlying goal of incorporating these varying onboarding tactics is to provide the employee enough information to adjust, ultimately resulting in satisfaction and effectiveness as a new employee (or an existing employee in a new role).

Employee Development

A core function of human resource management is development—training efforts to improve personal, group, or organizational effectiveness.
Employee development helps organizations succeed through helping employees grow. Human resource development consists of training, organization, and career-development efforts to improve individual, group, and organizational effectiveness.

Development Stakeholders

There are several categories of stakeholders that are helpful in understanding employee development: sponsors, managers and supervisors, participants, and facilitators. The sponsors of employee development are senior managers. Senior management invests in employees in a top-down manner, hoping to develop talent internally to reduce turnover, increase efficiency, and acquire human resource value. Line managers or direct supervisors are responsible for coaching employees and for employee performance and are therefore much more directly involved in the actual process. The participants are the people who actually go through the employee development, and also benefit significantly from effective development. The facilitators are human resource management staff, who usually hire specialists in a given field to provide hands-on instruction.
Each of these stakeholder groups has its own agendas and motivations, which can cause conflict with the agendas and motivations of other stakeholder groups. Human resource professionals should focus on aligning the interests of every stakeholder in the development process to capture mutual value.

Talent Development

Talent development refers to an organization's ability to align strategic training and career opportunities for employees. Talent development, part of human resource development, is the process of changing an organization, its employees, and its stakeholders, using planned and unplanned learning, in order to achieve and maintain a competitive advantage for the organization.
What this essentially means is that human resources departments, in addition to their other responsibilities of job design, hiring, training, and employee interaction, are also tasked with helping others improve their career opportunities. This process requires investment in growing talent. It is often more economical in the long run to improve on existing employee skill sets, as opposed to investing in new employees. Therefore, talent development is a trade-off by which human resources departments can effectively save money through avoiding the opportunity costs of new employees.

Employee Career-Path Management

Career-path management requires human resource management to actively manage employee skills in pursuit of successful professional careers.

Career-path management refers to the structured planning and active management of an employee's professional career. The results of successful career planning are personal fulfillment, a work and life balance, goal achievement, and financial security. A career encompasses the changes or modifications in employment through advancement during the foreseeable future. There are many definitions by management scholars of the stages in the managerial process. The following classification system (with minor variations) is widely used:

- Development of overall goals and objectives
- Development of a strategy
- Development of the specific means (policies, rules, procedures, and activities) to implement the strategy
- Systematic evaluation of the progress toward achievement of the selected goals and objectives to modify the strategy, if necessary

Human Resource Development

Human resource development (HRD) is the central framework for the way in which a company leverages an effective human resources department to empower employees with the skills for current and future success. The responsibility of the human resources department in regard to employee development primarily pertains to varying forms of training, educational initiatives, performance evaluation, and management development. Through employing these practices, human resource managers can significantly improve the potential of each employee, opening new career-path venues by expanding upon an employee's skill set. This is achieved through two specific human resource objectives: training and development (TD) and organizational development (OD). Training and development, as stated above, is primarily individualistic in nature and focused on ensuring that employees develop throughout their careers to capture more opportunity.

Organizational development must be balanced during this process, ensuring that the company itself is leveraging these evolving human resources to maximum efficiency. Depending too heavily upon TD may result in an organization incapable of capitalizing on employee skills, while focusing too much on OD will generate a company culture adverse to professional development. Therefore, human resources departments are central to empowering employees to take successful career paths while maintaining an organizational balance.

Compensation and Benefits
The HR department has also responsibility to perform the function of compensation and employee benefits. Compensation is defined as all the rewards that are obtained by the employee as a result of his employment. These rewards may take any of the following forms.

Pay
The money received by an employee for performing his job.

Benefits
Benefits are those extra financial rewards that are received other than pay. Benefits include sick leaves, paid leaves, holiday& medical insurance.

Non-financial Rewards
There are also some non financial rewards that are availed by the employees & which are non-monetary in nature like pleasant working environment & delightedness of work performed etc.

Employee Relations and Legal Responsibilities

The HRM handles employee relations matters within an organization. Employee relations involves employee participation in different aspects of organizational activities. The department maintains the relationship between employees and management by promoting communication and fairness within the company. The HRM also handles disputes between employees and management, as well as disputes between the company and labor unions or employee rights organizations.

The HRM is responsible for interpreting and enforcing employment and labor laws such as equal employment opportunity, fair labor standards, benefits and wages, and work hour requirements. The department also investigates harassment and discrimination complaints and ensures company officials remain compliant with Labor laws and regulations.

Self-Test Questions
1. Outline factors that will influence an organisation's workforce needs for the next year.
2. Why is it difficult for an HR department to predict workforce needs for the future?
3. State **three** reasons why the skills requirements of the workforce of a manufacturing firm are likely to change over time.
4. Explain why the recruitment of appropriate staff is important to a business.
5. Distinguish between a job description and a person specification.

2 To describe organisational structure.
[Learning Outcomes b]

4.3 Organizational structure

Organisational Structure is the pattern of relationships among positions in the organisation and among members of the organisation. The purpose of structure is the division of work among members of the organisation, and the coordination of their activities so they are directed towards achieving the goals and objectives of the organisation.

Structural design can deeply influence the sources of an organisation's advantage, particularly with regard to knowledge manage- ment; failure to adjust structures appropriately can fatally undermine strategy implementation. But good structure alone is not enough for success.

The various structures, processes and relationships will be considered in the light of three key challenges for organisations in the twenty-first century:

- *The speed of change* and the increased levels of *uncertainty* in the business environment. As a result, organisations need to have flexible designs and be skilled at reorganising.
- The importance of *knowledge creation* and *knowledge sharing* as a fundamental ingredient of strategic success. Organisational designs should both foster concentrations of expertise and encourage people to share their knowledge.
- The rise of *internationalization.* Organising for an international context has many challenges: communicating across wider geography, coordinating more diversity and building relationships across diverse cultures are some examples. Internationalisation also brings greater recognition of different kinds of organising around the world.

This implies that the first step in organisational design is deciding what the key challenges facing the organisation actually are. Whatever structure is chosen should also be aligned with matching processes and relationships.

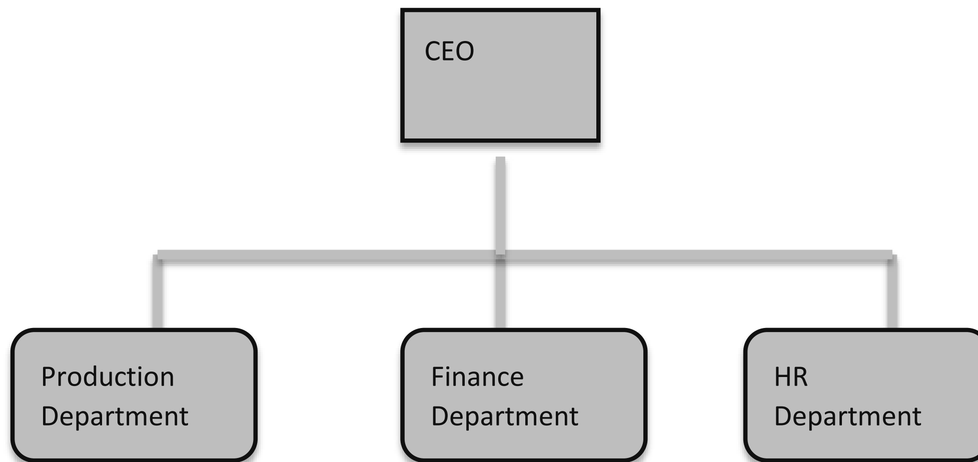
- **Types of Organizational Structures**

The functional structure

A **functional structure** is based on the primary activities that have to be undertaken by an organisation such as production, finance and accounting, marketing, human resources and research and development.

Once an organisation grows beyond a very basic level of size and complexity, it has to start dividing up responsibilities. One fundamental kind of structure is the **functional structure,** which divides responsibilities according to the organisation's primary roles such as production, research and sales. This structure is usually found in smaller companies, or those with narrow, rather than diverse, product ranges. Also, within a multidivisional structure, the divisions themselves may be split up into functional departments.

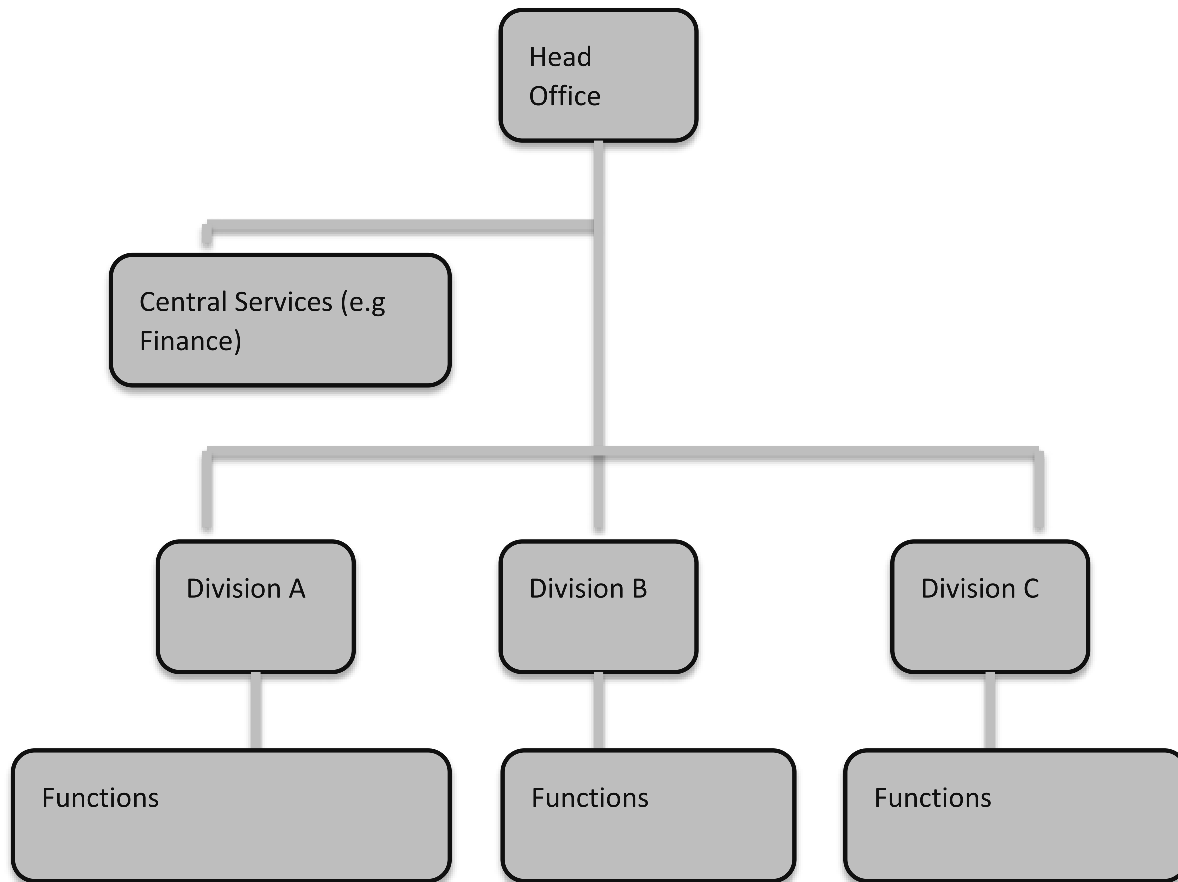
A functional structure



The functional structure provides a clear definition of roles and tasks, increasing accountability. Functional departments also provide concentrations of expertise, thus fostering knowledge development in areas of functional specialism.

The multidivisional structure
A **multidivisional structure** is built up of separate divisions on the basis of products, services or geographical areas.
A **multidivisional structure** is built up of separate divisions on the basis of products, services or geographical areas. Divisionalisation often comes about as an attempt to overcome the problems that functional structures have in dealing with diversity. Each division can respond to the specific requirements of its product/market strategy, using its own set of functional departments. A similar situation exists in many public services, where the organisation is structured around *service departments* such as recreation, social services and education.

A multidivisional structure



The matrix structure

A **matrix structure** is a combination of structures which could take the form of product and geographical divisions or functional and divisional structures operating in tandem.

A **matrix structure** combines different structural dimensions simultaneously, for example product divisions and geographical territories or product divisions and functional specialisms.

A Matrix Structure

	Head Teacher **Subject Leadership**				
Pupil Groups	Head of Lower School	Head of Languages	Head of Science	Head of Social Studies	etc.
	Head of Upper School				
	Head of Sixth Form				

The transnational structure

Transnational structure combines the local responsiveness of the international subsidiary with the coordination advantages found in global product companies.

The transnational structure is a means of managing internationally which is particularly effective in exploiting knowledge across borders. The transnational structure seeks to obtain the best from the two extreme international strategies, the multidomestic strategy and the global strategy.
A global strategy would typically be supported by global product divisions (for example, a worldwide cars division and a worldwide lorries division); a multidomestic strategy would be supported by local subsidiaries with a great deal of design, manufacturing and marketing autonomy for all products (for example, the local subsidiary responsible for both cars and lorries).

The transnational has the following detailed characteristics:

- Each national unit operates independently, but is a *source of ideas and capabilities* for the whole corporation. For example, in Unilever, the centre for innovation in hair-care products worldwide is in France.
- National units achieve greater scale economies through *specialisation* on behalf of the whole corporation, or at least large regions. Unilever in Europe has replaced its web of small national food manufacturing units with a few specialised larger factories that export its products to other European countries.

The corporate centre manages this global network by first establishing the role of each business unit, then sustaining the systems, relationships and culture to make the network of business units operate effectively. Unilever has established a system of 'forums' bringing managers together internationally to help them swap experience and coordinate their needs.

Project-based structures
A project-based structure is one where teams are created, undertake the work and are then dissolved. Many organisations rely heavily on project teams with a finite life span. A project-based structure is one where teams are created, undertake the work (for example, internal or external contracts) and are then dissolved. This can be particularly appropriate for organisations that deliver large and expensive goods or services (civil engineering, information systems, films) or those delivering time-limited events (conferences, sporting events or consulting engagements). The organisation structure is a constantly changing collection of project teams created, steered and glued together loosely by a small corporate group.

The project-based structure can be highly flexible, with projects being set up and dissolved as required. Because project teams should have clear tasks to achieve within a defined life, accountability and control are good. As project team members will typically be drawn from different departments within the firm, projects can be effective at knowledge exchange. Projects can also draw members internationally and, because project life spans are typically short, project teams may be more willing to work temporarily around the world.

Self-Test Questions

1. Why do organisations need a formal structure?
2. Explain how the organisational structure of a business might change as it expands.
3. State factors that could influence how a business organises its HR function.

3. To explain Leadership and management
[Learning Outcomes c]

4.4 Leadership and management

1. Leadership

Leadership is a process by which a person influences others to accomplish an objective and directs the organization in a way that makes it more cohesive and coherent.

Leaders carry out this process by applying their leadership knowledge and skills.

However, we know that we have traits that can influence our actions. While leadership is learned, the skills and

knowledge processed by the leader can be influenced by his or hers attributes or traits; such as beliefs, values, ethics, and character. Knowledge and skills contribute directly to the process of leadership, while the other attributes give the leader certain characteristics that make him or her unique.

Leadership Styles

Leadership style is the manner and approach of providing direction, implementing plans, and motivating people. The three major styles of leadership are:
Authoritarian or autocratic
Participative or democratic
Delegative or Free Reign

Although good leaders use all three styles, with one of them normally dominant, bad leaders tend to stick with one style.

Authoritarian or autocratic
This style is used when leaders tell their employees what they want done and how they want it accomplished, without getting the advice of their followers. Some of the appropriate conditions to use it are when one has all the information to solve the problem, one is short on time, and ones employees are well motivated. The authoritarian style should normally only be used on rare occasions.

Participative or democratic
This style involves the leader including one or more employees in the decision making process, that is, determining what to do and how to do it. However, the leader maintains the final decision making authority. Using this style is not a sign of weakness; rather it is a sign of strength that your employees will respect.
This is normally used when one has part of the information, and ones employees have other parts. Note that a leader is not expected to know everything. This is why one employs knowledgeable and skillful employees. Using this style is of mutual benefit. It allows them to become part of the team and allows one to make better decisions.

Laissez-faire (abdicratic) Style.
The laissez-fair approach to leadership is the idea that the participants should be able to work problems out and make their way through an expedition without too much extra guidance. These kinds of leaders would provide very little guidance when dealing with group issues on the expedition and would allow group members to come up with decisions on their own. The abdicratic leader would take an extremely “hands-off” approach to leading in order to encourage group problem-solving and critical thinking, without allowing participants to depend on the leader for the final word.

Effectiveness of leadership styles
There is not one leadership style which is best in all circumstances and for all businesses. The style used will depend on many factors including:

- the training and experience of the workforce and the degree of responsibility that they are prepared to take on .
- the amount of time available for consultation and participation
- the management culture and business background of the managers, e.g. whether they have always worked in an autocratically run organization.
- personality of managers – do they have the confidence and strength of character to lead by persuading and motivating people to follow them or must they hide behind the authority of their role to ‘dictate’ what needs to be done? the importance of the issue – different styles may be used in the same business in different situations. If there is great risk to the business when a poor or slow decision is taken, then it is more likely that management will make the choice in an autocratic way.

Leadership Skills
The leadership skills approach by Mumford, Zaccaro, Harding, et al. (2000) has five elements: individual attributes, competencies, leadership outcomes, career experiences, and environmental influences.

Competencies are the most important element in this model. Competencies lead to leadership outcomes but themselves are affected by a leader’s individual attributes. In addition, the impact of leaders’ attributes on leaders’ competencies and leaders’ competencies on outcomes is dependent on career experiences and environmental influences.
Mumford, Zaccaro, Harding, et al. (2000) identified three competencies that result in effective leadership: problem solving, social judgment, and knowledge. These three work together and separately to affect outcomes.

Problem-Solving Skills. These are creative abilities that leaders bring to unique, vague, “hard to get a handle on” organizational problems. These skills include the following:

- defining problems and issues that are important,

- accumulating information related to the problem/issue,
- developing new ways to comprehend each problem/issue, and developing unique, first-of-its-kind alternatives for solving the problems/issues.

Problem-solving skills operate in the context of an organization and its environment and require that leaders be aware of their own capacities and challenges relative to the problem/issue and the organizational context

Social Judgment Skills. These are skills that enable leaders to comprehend people and the social systems within which they work, play, and have a social life (e.g., friends and family) Social judgment skills facilitate working with others to lead change, solve problems, and make sense of issues. Mumford and colleagues outlined four elements important to social judgment skills: perspective taking, social perceptiveness, behavioral flexibility, and social performance.

Perspective taking is sensitivity to others' objectives and perspective; it is an empathic perspective to solving problems, and it means that leaders actively seek out knowledge regarding people, their organization's social fabric, and how these two very important areas of knowledge intersect with each other.
Whereas perspective taking is associated with others' attitudes, *social perceptiveness* is about leaders knowing what people will do when confronted with proposed changes.

Behavioral flexibility means being able to change what one does when confronted with others' attitudes and intended actions based on knowledge gained through perspective taking and social perceptiveness, respectively. Leaders with behavioral flexibility under- stand that there are many different paths to achieving change and the goals and objectives associated with change.

Social performance means being skilled in several leadership competencies. Some of these are abilities in persuading and communicating in order to convey one's own vision to others in the organization, abilities in mediation that enable the leader to mediate interpersonal conflict related to change and to lessen resistance to change, and abilities in coaching and mentoring by giving subordinates support and direction as they work to achieve organizational objectives and goals.

Knowledge. Knowledge is the gathering of information and the development of mental structures to organize that information in a meaningful way. These mental structures are called schema, which means a diagrammatic representation or depiction. Knowledgeable leaders have more highly developed and complex schemata that they use to collect and organize data. Knowledge is linked to a leader's problem-solving skills. More knowledgeable leaders are able to consider complex organizational issues and to develop alternative and appropriate strategies for change. Knowledge allows leaders to use prior incidents to constructively plan for and change the future.

Individual Attributes
Mumford and his colleagues identified four attributes that affect the three leader competencies (problem-solving skills, social judgment skills, and knowledge) and, through these competencies, leader performance.

General Cognitive Ability. Perceptual processing, information processing, general reasoning skills, creative and divergent thinking capacities, and memory skills. This is a brief description of general cognitive ability. This type of intelligence grows as we age to early adulthood but declines as we grow older. General cognitive ability positively affects a leader's ability to acquire knowledge and complex problem-solving skills.

Crystallized Cognitive Ability. Intelligence that develops because of experience. As we age and gain more experience, we acquire intelligence—this is crystallized cognitive ability. This type of intelligence remains relatively consistent and generally does not diminish as we age. As our crystallized cognitive ability increases, it positively affects our leadership potential by increasing our social judgment skills, conceptual ability, and problem-solving skills.

Motivation. Motivation affects leadership competencies in several ways. We discuss three ways in which motivation helps in the development of leadership competencies.
First, a person must want to lead—there must be a willingness to engage in solving complex organizational issues and problems.
Second, leaders must be willing to exert influence— to be willing to be dominant within a group of people.
Finally, the leader must be willing to advance the "social good" of the organization.

Personality. This is the fourth attribute positively linked to leadership competencies. Northouse (2010) gives three examples of personality that affect how motivated leaders are able to resolve organizational issues and problems. They are tolerance for ambiguity, openness, and curiosity. Leaders with confidence and adaptability may be helpful in situations of conflict. The skills model suggests that personality traits that aid in developing leader competencies lead to better leader performance

- **Management**

Management is the coordination of all resources through the process of planning, organising, directing and controlling in order to attain stated objectives.

Management is therefore guiding human and physical resources into dynamic organisational units which attain their objectives to the satisfaction of those served and with a high degree of morale and sense of attainment on the part of those rendering service.

Nature and Characteristics of Management

The salient features which highlight the nature of management are as follows:

Management is goal-oriented: Management is not an end in itself. It is a means to achieve certain goals. Management has no justification to exist without goals. Management goals are called group goals or organisational goals. The basic goal of management is to ensure efficiency and economy in the utilisation of human, physical and financial resources. The success of management is measured by the extent to which the established goals one achieved. Thus, management is purposeful.

Management is universal: Management is an essential element of every organised activity irrespective of the size or type of activity. Wherever two or more persons are engaged in working for a common goal, management is necessary. All types of organisations, e.g., family, club, university, government, army, cricket team or business, require management. Thus, management is a pervasive activity. The fundamental principles of management are applicable in all areas of organised effort. Managers at all levels perform the same basic functions.

Management is an Integrative Force: The essence of management lies in the coordination of individual efforts in to a team. Management reconciles the individual goals with organisational goals. As unifying force, management creates a whole that is more than the sum of individual parts. It integrates human and other resources.
Management is a Social Process: Management is done by people, through people and for people. It is a social process because it is concerned with interpersonal relations. Human factor is the most important element in management. According to Appley, “Management is the development of people not the direction of things. A good manager is a leader not a boss. It is the pervasiveness of human element which gives management its special character as a social process”.

Management is multidisciplinary: Management has to deal with human behaviour under dynamic conditions. Therefore, it depends upon wide knowledge derived from several disciplines like engineering, sociology, psychology, economics, anthropology, etc. The vast body of knowledge in management draws heavily upon other fields of study.

Management is a continuous Process: Management is a dynamic and an on-going process. The cycle of management continues to operate so long as there is organised action for the achievement of group goals.

Management is Intangible: Management is an unseen or invisible force. It cannot be seen but its presence can be felt everywhere in the form of results. However, the managers who perform the functions of management are very much tangible and visible.

Management is an Art as well as Science: It contains a systematic body of theoretical knowledge and it also involves the practical application of such knowledge. Management is also a discipline involving specialised training and an ethical code arising out of its social obligations.

Role and importance of management
Management is indispensable for the successful functioning of every organisation. It is all the more important in business enterprises. No business runs in itself, even on momentum. Every business needs repeated stimulus which can only be provided by management. The importance of management has been highlighted clearly in the following points:

Achievement of group goals: A human group consists of several persons, each specialising in doing a part of the total task. Each person may be working efficiently, but the group as a whole cannot realise its objectives unless there is mutual cooperation and coordination among the members of the group. Management creates team-work and coordination in the group. He reconciles the objectives of the group with those of its members so that each one of them is motivated to make his best contribution towards the accomplishment of group goals. Managers provide inspiring leadership to keep the members of the group working hard.

Optimum utilisation of resources: Managers forecast the need for materials, machinery, money and manpower. They ensure that the organisation has adequate resources and at the same time does not have idle resources. They create and maintain an environment conducive to highest productivity. Managers make sure that workers know their jobs well and use the most efficient methods of work. They provide training and guidance to employeers so that they can make the best use of the available resources.

Minimisation of cost: In the modern era of cutthroat competition no business can succeed unless it is able to supply the required goods and services at the lowest possible cost per unit. Management directs day-to-day operations in such a manner that all wastage and extravagance are avoided. By reducing costs and improving efficiency, managers enable an enterprise to be competent to face competitors and earn profits.

Survival and growth: Modern business operates in a rapidly changing environment. An enterprise has to adapt itself to the changing demands of the market and society. Management keeps in touch with the existing business environment and draws its predictions about the trends in future. It takes steps in advance to meet the challenges of changing environment. Changes in business environment create risks as well as opportunities. Managers enable the enterprise to minimise the risks and maximise the benefits of opportunities. In this way, managers facilitate the continuity and prosperity of business.

Generation of employment: By setting up and expanding business enterprises, managers create jobs for the people. People earn their livelihood by working in these organisations. Managers also create such an environment that people working in enterprise can get job satisfaction and happiness. In this way managers help to satisfy the economic and social needs of the employees.

Development of the nation: Efficient management is equally important at the national level. Management is the most crucial factor in economic and social development. The development of a country largely depends on the quality of the management of its resources. Capital investment and import of technical know- how cannot lead to economic growth unless wealth-producing resources are managed efficiently. By producing wealth, management increases the national income and the living standards of people. That is why management is regarded as a key to the economic growth of a country.

DISTINCTION BETWEEN MANAGEMENT AND LEADERSHIP

The table summarises some of the key differences between leadership and management.

LEADERSHIP	MANAGEMENT
Motivating and inspiring others	Directing and monitoring others
Innovators who encourage others to accept change	Problem-solvers
Stems from personal qualities or traits	Official position of responsibility in the organisation
Natural abilities and instincts	Skilled and qualified to perform role
Believes in doing the right thing	Believes in doing things right
Respected and trusted by followers – they want to follow because of leader's personality	Listened to by others because of status – not necessarily because of personality
Creates and develops a culture of change	Accepts and conforms to the 'norms' of the organisation

QUESTIONS

1. Explain what you consider to be **the** functions of managers.
2. Explain the autocratic (authoritarian) style of management. Under what circumstances might this style of management be necessary?
3. Give examples to explain why one manager may need to adopt different styles of management in different circumstances.
4. "Management is an art as well as science" Explain.
5. Discuss the nature and scope of management.
6. Explain the objectives and importance of management.

4. To explain Motivation, to describe and discuss organizational (corporate) culture, explain Industrial/employee relations.

[Learning Outcome d, e and f]

4 Motivation
Many studies have been undertaken to try to explain what motivates workers. There seems to be some agreement that pay and benefits are important in encouraging staff to work well, but these are not necessarily the most important factors. Work enjoyment, work challenges and recognition for work well done – these are the factors most frequently quoted by employees when asked what keeps them with their current employer. Compared to job satisfaction and pay, benefits (financial and non-financial) have a smaller role in terms of recruitment, retention and motivation.

Well-motivated workers will help an organisation achieve its objectives as cost effectively as possible. Motivated workers will also be trying to reach their own personal goals by satisfying their own needs. Employers need to be aware of extrinsic needs, such as pay, which can provide motivation even if the job itself does not. Intrinsic motivation stems from the nature of the job itself but this does not mean that employers can pay workers doing interesting work nothing at all! Some rewards will be needed even for workers driven by the fulfilment of intrinsic needs.

Unmotivated or demotivated staff will not perform effectively, offering only the minimum of what is expected. Motivation levels have a direct impact on productivity levels and the competitiveness of the business – highly motivated workers have high productivity and this reduces unit costs. Motivated staff will be keen to stay with the firm, reducing the costs of labour turn- over. They will be more likely to offer useful suggestions and to contribute in ways other than their contractual obligations. They will often actively seek promotion and responsibility.

Theories of motivation
Psychologists have studied human motivation extensively and have derived a variety of theories about what motivates people. This section briefly highlights the motivational theories that are regularly discussed in management textbooks. These include theories that focus on motivation being a function of 1) employee needs of various types, 2) extrinsic factors, and 3) intrinsic factors.

Needs-Based Theories of Motivation

Maslow's Hierarchy of Needs

Maslow postulated a hierarchy of needs that progresses from the lowest, subsistence-level needs to the highest level of self-awareness and actualization. Once each level has been met, the theory is that an individual will be motivated by and strive to progress to satisfy the next higher level of need.

The five levels in Maslow's hierarchy are:

- Physiological needs—including food, water, sexual drive, and other subsistence-related needs;
- Safety needs—including shelter, a safe home environment, employment, a healthy and safe work environment, access to health care, money, and other basic necessities;
- Belonging needs—including the desire for social contact and interaction, friendship, affection, and various types of support;
- Esteem needs—including status, recognition, and positive regard; and,
- Self-actualization needs—including the desire for achievement, personal growth and development, and autonomy.

The movement from one level to the next was termed satisfaction progression by Maslow, and it was assumed that over time individuals were motivated to continually progress upward through these levels. While useful from a theoretical perspective, most individuals do not view their needs in this way, making this approach to motivation a bit unrealistic.

Alderfer's ERG Theory
The three components identified by Alderfer drew upon Maslow's theory, but also suggested that individuals were motivated to move forward and backward through the levels in terms of motivators. He reduced Maslow's levels from five to the following three:
Existence —which related to Maslow's first two needs, thus combining the physiological and safety needs into one level;
Relatedness —which addressed the belonging needs; and,
Growth —which pertains to the last two needs, thereby combining esteem and self-actualization.

Alderfer also added his frustration-regression principle, which postulated that individuals would move in and out of the various levels, depending upon the extent to which their needs were being met. This approach is deemed by students of management to be more logical and similar to many individuals' world views.

Herzberg's Two-Factor Theory

Herzberg modified Maslow's needs theory and consolidated down to two areas of needs that motivated employees. These were termed Hygienes —These were characterized as lower level motivators and included, for example, "company policy and administration, supervision, interpersonal relationships, working conditions, salary, status, and security.

Motivators —These emphasized higher level factors and focused on aspects of work, such as "achievement, recognition for achievement, the work itself, responsibility and growth or advancement.
Herzberg's is an easily understood approach that suggests that individuals have desires beyond the hygienes and that motivators are very important to them.

McClelland's Acquired Needs Theory

The idea here is that needs are acquired throughout life. That is, needs are not innate, but are learned or developed as a result of one's life experiences. This theory focuses on three types of needs:

1. Need for achievement —which emphasizes the desires for success, for mastering tasks, and for attaining goals;
2. Need for affiliation —which focuses on the desire for relationships and associations with others; and,
3. Need for power—which relates to the desires for responsibility for, control of, and authority over others.

All four of these theories approach needs from a somewhat different perspective and are helpful in understanding employee motivation on the basis of needs. However, other theories of motivation also have been posited and require consideration.

Extrinsic Factor Theories of Motivation

Another approach to understanding motivation focuses on external factors and their role in understanding employee motivation. The best known of these is:
Reinforcement Theory studied human behavior and proposed that individuals are motivated when their behaviors are reinforced. His theory is comprised of four types of reinforcement. The first two are associated with achieving desirable behaviors, while the last two address undesirable behaviors:

Positive reinforcement —relates to taking action that rewards positive behaviors;
Avoidance learning —occurs when actions are taken to reward behaviors that avoid undesirable or negative behaviors. This is sometimes referred to as negative reinforcement;

Punishment —includes actions designed to reduce undesirable behaviors by creating negative consequences for the individual; and,

Extinction —represents the removal of positive rewards for undesirable behaviors.
The primary criticism of the reinforcement approach is that it fails to account for employees' abilities to think critically and reason, both of which are important aspects of human motivation. While reinforcement theory may be applicable in animals, it doesn't account for the higher level of cognition that occurs in humans.

Intrinsic Factor Theories of Motivation

Theories that are based on intrinsic or endogenous factors focus on internal thought processes and perceptions about motivation. Several of these are highlighted below:
Adam's Equity Theory —which proposes that individuals are motivated when they perceive that they are treated equitably in comparison to others within the organization (Adams, 1963);
Vroom's Expectancy Theory —which addresses the expectations of individuals and hypothesizes that they are motivated by performance and the expected outcomes of their own behaviors and,
Locke's Goal Setting Theory —which hypothesizes that by establishing goals individuals are motivated to take action to achieve those goals.

While each of these theories deals with a particular aspect of motivation, it seems unrealistic to address them in isolation, since these factors often do come into play in and are important to employee motivation at one time or another.

Importance of Motivation
A motivated and qualified workforce is essential for any company that wants to increase productivity and customer satisfaction. In this context, motivation means the willingness of an individual to do efforts and take action towards organizational goals. The challenge for any manager is to find the means to create and sustain employee motivation. On one hand, managers should focus on reducing job dissatisfaction (working conditions, salary, supervision, relationship with colleagues), while on the other hand should use motivating factors such as achievement, recognition, responsibility and the work itself.

Employee participation and empowerment do not only enhance efficiency, growth and innovation but they also increase employee motivation and trust in the organization. If employees feel appreciated for their work and are involved in decision-making, their enhanced enthusiasm and motivation will lead to better productivity and loyalty.

Self-Test Question

1. Why is a ‘motivated workforce’ important for a manufacturing business?
2. Explain why studying intrinsic and extrinsic needs is an important part of motivation theory.
3. Consider two different levels of Maslow’s hierarchy.
   Explain how these needs could be satisfied at work.
   Differentiate, using examples, between Herzberg’s motivators and hygiene factors.
4. Outline the **three** key features of job enrichment.
5. Why did McClelland believe that achievement was so important to motivation?

5. Organizational (corporate) culture

Organisational culture is the basic *assumptions and beliefs* that are shared by members of an organisation, that operate unconsciously and define in a basic taken-for- granted fashion an organisation’s view of itself and its environment.

Related to this are taken-for-granted ways of doing things, the routines, that accumulate over time. In other words, culture is about that which is taken for granted but nonetheless contributes to how groups of people respond and behave in relation to issues they face. It therefore has important influences on the development and change of organisational strategy.

The culture of an organisation is often conceived as consisting of four layers:

Values may be easy to identify in an organisation, and are often written down as statements about an organisation’s mission, objectives or strategies

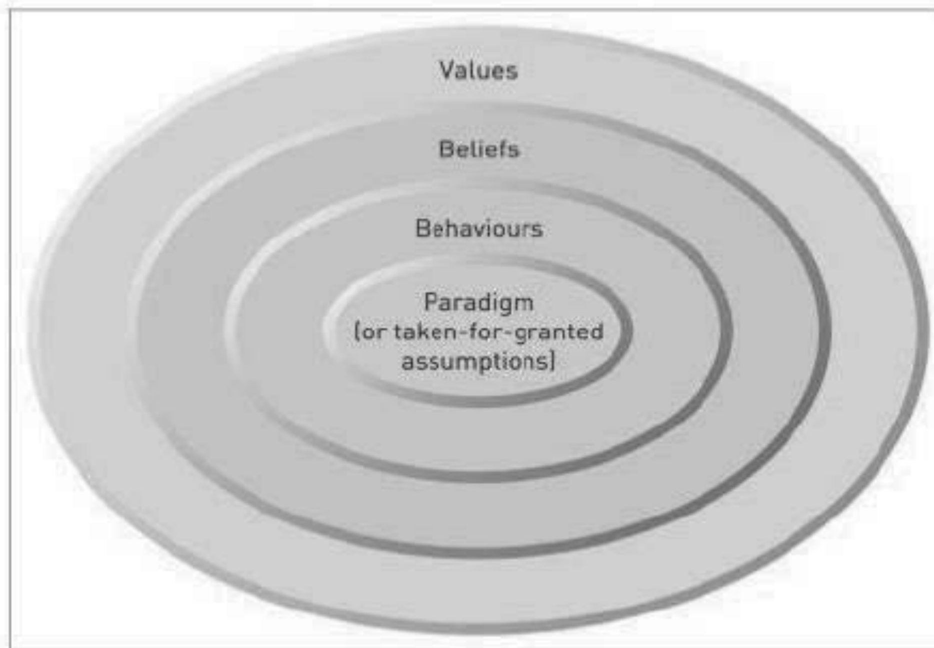
Beliefs are more specific, but again they can typically be discerned in how people talk about issues the organisation faces; for example, a belief that the company should not trade with particular countries, or that professional staff should not have their professional actions appraised by managers. With regard to both values and beliefs it is important to remember that in relation to culture, the concern is with the collective rather than individuals’ values and beliefs. Indeed it may be that individuals in organisations have values and beliefs that at times run counter to their organisation’s, which can give rise to the sort of ethical tensions and problems.

Behaviours are the day-to-day way in which an organisation operates and can be seen by people both inside and outside the organisation. This includes the work routines, how the organisation is structured and controlled and ‘softer’ issues around symbolic behaviours.

Taken-for-granted assumptions are the core of an organisation’s culture. They are the aspects of organisational life which people find difficult to identify and explain. Here they are referred to as the organisational paradigm. The **paradigm** is the set of assumptions held in common and taken for granted in an organisation. For an organisation to operate effectively there is bound to be such a generally accepted set of assumptions.

As mentioned above, these assumptions represent *collective experience* without which people would have to ‘reinvent their world’ for different circumstances that they face. The paradigm can underpin successful strategies by providing a basis of common understanding in an organisation, but can also be a major problem, for example when major strategic change is needed , or when organisations try to merge and find they are incompatible.

Culture in four layers

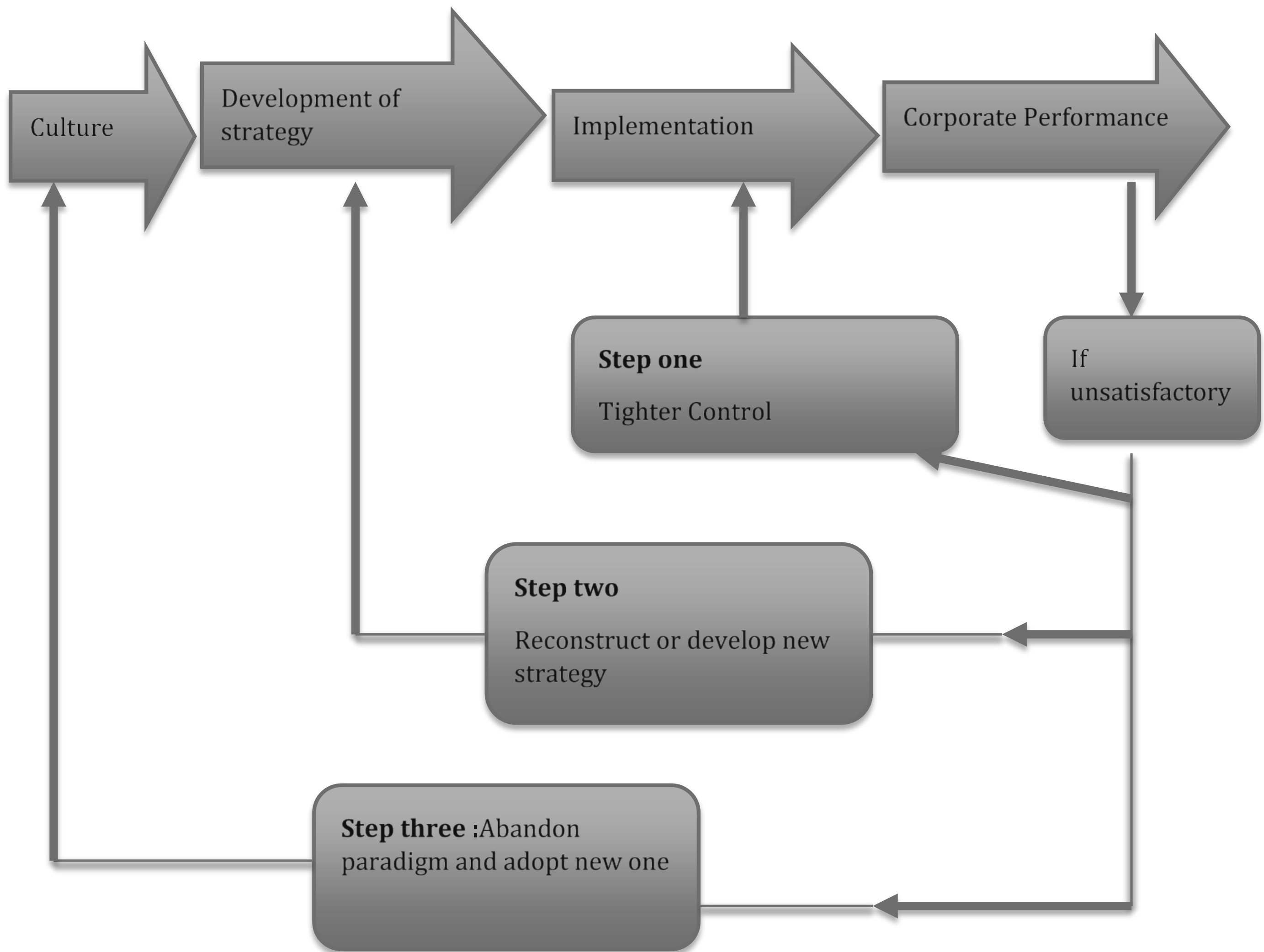


Culture's influence on strategy
Example
The taken-for-granted nature of culture is what makes it centrally important in relation to strategy and the management of strategy. There are two primary reasons for this:

Managing culture. Because it is difficult to observe, identify and control that which is taken for granted, it is difficult to manage. This is why having a way to analyse culture so as to make it more evident is important.

Culture as a driver of strategy. Organisations can be 'captured' by their culture and find it very difficult to change their strategy outside the bounds of that culture. Managers, faced with a changing business environment, are more likely to attempt to deal with the situation by searching for what they can understand and cope with in terms of the existing culture. The result is likely to be incremental strategic change with the risk of eventual strategic drift. Culture is, in effect, an unintended driver of strategy.

Faced with a stimulus for action, such as declining performance, managers first try to improve the implementation of existing strategy. This might be through trying to lower cost, improve efficiency, tighten controls or improve accepted ways of doing things. If this is not effective, a change of strategy may occur, but a change in line with the existing culture. For example, managers may seek to extend the market for their business, but assume that it will be similar to their existing market, and there- fore set about managing the new venture in much the same way as they have been used to.



Culture’s influence on strategy development

Self-Test Questions:

1. If you were appointed to a management position in a well-known business, what evidence would you need to identify the culture of the organisation?
2. Explain the possible problems of changing the culture of a business with a small but loyal staff and customer base.
3. How might a business attempt to establish a people culture?
4. Explain **two** reasons why workers may resist attempts to change the culture of the organisation they work for.
5. Examine the differences between role culture and entrepreneurial culture. Include examples of different circumstances of when each culture might be appropriate.

6 Industrial/employee relations

6.1 Introduction

Conflict resulting from differing objectives may be inevitable between labour and management within business. How can these conflicts be resolved or at least reduced so that the disagreement is not so great that it prevents all forms of co-ordination and working together? How can positive co-operation be achieved between these two groups for the benefit of the business and all stakeholders?
The methods used by employees and employers to achieve their objectives will depend on the relative ‘strength’ of each side. Much also depends on the culture and legal structure of the country in which the organisation operates, as well as the culture of the business itself. In some countries, trade unions are still illegal or their operations are strictly controlled.

6.2 Collective bargaining

Collective bargaining refers to the negotiations between employees’ representatives (trade unions) and employers and their representatives on issues of common interest such as pay and conditions of work. The opposite of collective bargaining is individual bargaining, where each worker discusses separately with his/her employer issues such as pay and conditions. This process becomes unwieldy in large organisations. Instead, many employees belong to trade unions or professional associations and these bodies bargain or negotiate on their behalf. In some countries, employers also belong to employers’ associations that negotiate with unions and any agreements made will cover all firms that belong to the association.

6.3 Trade unions and their role

Trade union is an organisation of working people with the objective of improving the pay and working conditions of its members and providing them with support and legal services. Industrial action refers to measures taken by the workforce or trade union to put pressure on management to settle an industrial dispute in favour of employees.

Importance of trade unions
Power through solidarity has been the basis of union influence and this is best illustrated by their ability to engage in ‘collective bargaining. This is when trade unions negotiate on behalf of all of their members in a business. This puts workers in a stronger position than if they negotiated individually to gain higher pay deals and better working conditions.

Individual industrial action – one worker going on strike, for example, is not likely to be very effective. Collective industrial action could result in much more influence over employers during industrial disputes. Unions provide legal support to employees who claim unfair dismissal or poor conditions of work.
Unions pressurise employers to ensure that all legal requirements are met, e.g. health and safety rules regarding the use of machinery.

Union recognition
Trade union recognition when an employer formally agrees to conduct negotiations on pay and working conditions with a trade union rather than bargaining individually with each worker.

In Tanzania trade unions are legally recognised and employers required to negotiate with union officials on matters concerning employees. Such a law is likely to boost union membership and influence. It could also have benefits for the employers:

Employers would be able to negotiate with one officer from the union rather than with individual workers. The union system could provide an additional, useful channel of communication with the workers – two-way communication in the sense that workers' problems could be raised with management by the union and the plans of the employers could be discussed via the union organisation.

Unions can impose discipline on members who plan to take hasty industrial action that could disrupt a business – this makes such action less likely.
The growth of responsible, partnership unionism has given employers an invaluable forum for discussing issues of common interest and making new workplace agreements. Very often, these will lead to increased productivity, which should help to secure jobs and raise profits.

6.4 Action taken by employees and employers

Unions
Trade union objectives include higher pay, improved conditions and security of employment. Union leaders can use a number of measures to 'encourage' employers to accept their demands for improvements in pay and conditions:
Negotiations − and, possibly, agreeing to arbitration.

Go slow – a form of industrial action in which workers keep working but at the minimum pace as demanded by their contract of employment. Bonus payments may be lost by workers, but at busy times of the year this action can be very disruptive and costly for employers.

Work to rule – a form of industrial action in which employees refuse to do any work outside the precise terms of the employment contract. Overtime will not be worked and all non-contractual co-operation will be withdrawn.

Overtime bans – industrial action in which workers refuse to work more than the contracted number of hours each week. During busy times of the year, this could lead to much lost output for the employer.

Strike action – the most extreme form of industrial action in which employees totally withdraw their labour for a period of time. This may lead to production stopping completely. Strike action leads to the business shutting down during the industrial action.

Employers
Settling disputes with unions can increase the long-term profits of the business. Settlement may be reached in a variety of ways:

Negotiations – these aim to reach a compromise solution. If face-to-face negotiations with union leaders fail to reach an agreement, then the dispute may require arbitration.

Public relations – using the media to try to gain public support for the employer's position in the dispute. This may put pressure on the union to settle for a compromise solution.

Threats of redundancies – these threats would, again, put pressure on unions to agree to a settlement of the dispute, but they might inflame opinions on the employees side and could be looked upon as 'bullying' and lead to poor publicity for the employer.

Changes of contract – if employees are taking advantage of their employment contracts to work to rule or ban overtime, then new contracts could, when the old ones are due for renewal, be issued that insist on higher work rates or overtime working.

Closure – closure of the business or the factory/ office where the industrial dispute takes place would certainly solve the dispute! It would lead to redundancy for all of the workers and no output and profit for the business owners. This is a very extreme measure and would only be threatened or used if the demands of the union would, if agreed to, lead to a serious loss being made by the business or factory anyway.

Lock-outs – short-term closure of the business or factory to prevent employees from working and being paid. Some workers who are not keen on losing pay for long periods may put pressure on their union leaders to agree to a reasonable settlement of the dispute.

The power and influence of employers and unions in an industrial dispute will depend on a number of factors

Union/employee power will be strong when:
- Most workers belong to one union
- All workers agree to take the industrial action decided on
- The business is very busy, operating close to full capacity, does not want to disappoint customers and

profits are high

- Industrial action rapidly costs the employer large amounts of lost output/revenue/profits
- There is public support for the union case, e.g. for very low-paid workers
- Inflation is high so a high wage increase would seem ‘reasonable’ to maintain living standards
- Labour costs are a low proportion of total costs.

Employer power will be strong when:

a) Unemployment is high – there are few alternative jobs for workers to take
b) The employer takes action, e.g. lock-out has a very quick impact on workers’ wages
c) There is public support for the employer, e.g. when unions are asking for rises much higher than other workers receive profits are low and threats of closure are taken seriously
d) Threats of relocation to low-cost countries are taken seriously, e.g. the business has already closed other plants and relocated them.

6.5 Strategies to reduce conflict

No-strike agreements
At first glance, these seem rather unusual agreements for a union to sign with an employer. Why give up the most effective form of industrial action? There are two main reasons:

1. It improves the image of the union as being a responsible representative body and this could encourage employees to become members.
2. These deals are often agreed to in exchange for greater union involvement in both decision-making and in representing employees in important negotiations. This has led to union−employer agreements to change working methods and increase labour flexibility that lead to higher productivity, higher profits *and* higher pay and worker participation. This is sometimes referred to as a win−win settlement as both employer and employee will gain from this new partnership approach to industrial relations.

Conciliation and arbitration
Conciliation refers to the use of a third party in industrial disputes to encourage both employer and union to discuss an acceptable compromise solution

Arbitration refers to resolving an industrial dispute by using an independent third party to judge and recommend an appropriate solution

In the Tanzania labour disputes handling machinery starts with the Commission for Mediation and Arbitration (CMA). Its primary function is to reduce conflict in Tanzania industry by improving employment relations between employers and employees. It gives advice to employers and employees and their representatives on issues likely to cause disputes between them. Most countries have a similar organisation. As a conciliator in industrial disputes, CMA would listen to both sides of the argument – perhaps over pay or working conditions – and attempt to find common ground. This might then be used as a basis for an eventual compromise agreement.

Arbitration is different. A CMA official will again listen to both sides of a dispute, but will now make a decision for resolving the disagreement. This might be a compromise between the opposing views of employer’s and union’s officials. If both parties agreed to accept this, then this becomes binding arbitration. The risk of the arbitrator setting the compromise closer to ‘one side’ than the other can lead to both groups establishing extreme negotiating positions. For example, in wage negotiations, a union might ask for a rise of 10% rather than a more realistic figure of, say, 5%. This is in the hope that the final decision of the arbitrator may be influenced by the high pay claim and will set a ‘compromise’ of 7.5% – which is what the union was hoping to achieve anyway.

6.6 Employee participation and industrial democracy
These are attempts to reduce industrial conflict by achieving a closer working relationship between employees and employers. This then might lead to commonly agreed objectives. Participation at work by employees can take different forms:
Industrial democracy, in its purest form, implies workers’ control over industry, perhaps linked to workers’ ownership of the business, e.g. producer co-operatives.
Employee or trade union directors on the company’s board of directors represent the workers’ approach to major company issues at the highest decision-making level.
Works councils, e.g. European Works Councils, discuss issues such as the employment situation, major investment projects planned by the business, major organisational changes and health and safety.
Autonomous work groups and quality circles lead to employee participation in decision-making and help to avoid the ‘them and us’ environment. By involving workers in everyday decisions that impact on their working lives, such as work schedules, improvements in work practices and how to plan team working, the threat of industrial disputes is reduced.

Self-Test Questions

1. Explain reasons why good labour–management relations are important to a business.
2. Define collective bargaining. State two benefits to a business of collective bargaining with representatives of the workforce.
3. There is an industrial dispute between the managers and the employees' trade union of a large hotel in your town/city. Discuss the factors that will influence whether the final agreement to settle the dispute is a better deal for the employer or employees.
4. Why would a union sign a no-strike deal with employers? What would it expect in return?
5. Would you advise an employer to agree to pendulum arbitration when attempting to settle a pay dispute with a trade union? Explain your answer.

MARKETING

5

STUDY GUIDE 5: MARKETING

Get Through Intro

Marketing is a value-enhancing function that identifies opportunities, develops markets, and builds brands. Consequently, good marketing enables companies to charge price premiums, sustain competitive advantage and maintain long-run profitability.

Learning Outcomes

a) Understand and explain the role of marketing
b) Describe marketing planning
c) Describe the four Ps (product, price, promotion, place) and it extensions (seven Ps).
d) Understand the importance of conducting market research.
e) Understand and explain e-business and e-commerce.

1. Understand and explain role of Marketing.

[Learning Outcome a]

1. Marketing

Marketing is not just about advertising and selling of products. According to Chartered Institute of Marketing: Marketing is the management process responsible for identifying, anticipating and satisfying consumers' requirements profitably.

So, marketing is a very important business activity. Marketing activities are all those associated with identifying the particular wants and needs of target-market customers and then trying to satisfy those customers needs better than your competitors do. This means that market research is needed to identify and analyze customer needs. With this knowledge, strategic decisions must then be taken about product design, pricing, promotion and distribution.

1.1 Market: size, growth and share

KEY TERMS

- **Marketing** the management task that links the business to the customer by identifying and meeting the needs of customers profitably – it does this by getting the right product at the right price to the right place at the right time
- **Market size** the total level of sales of all producers within a market
- **Market growth** the percentage change in the total size of a market (volume or value) over a period of time
- **Market share** the percentage of sales in the total market sold by one business

Market size

This can be measured in two ways: volume of sales (units sold) or value of goods sold (revenue). The size of a market is important for three reasons:

- A marketing manager can assess whether a market is worth entering or not.
- Firms can calculate their own market share.
- Growth or decline of the market can be identified.

Market growth

Some markets are obviously growing faster than others; some, such as non-HD TVs, are declining rapidly. The pace of growth will depend on several factors including economic growth, changes in consumer incomes, development of new markets, changes in consumer tastes and technological change, which can boost market sales through innovative products. The rate of growth will also depend on whether the market is 'saturated' or not.

Market share

This is calculated by the following formula:

$$Market\ share\ \% = \frac{Firm's\ sales\ in\ time\ period}{Total\ market\ sales\ in\ time\ period} \times 100$$

'Firm's sales' and 'total market sales' can be measured in either units (volume) or sales value in this market. Market share, and increases in it, is often the most effective way to measure the relative success of one business's marketing strategy against that of its competitors. If a firm's market share is increasing, then the marketing of its products has been relatively more successful than most of its competitors. The product with the highest market share is called the 'brand leader'. Why might it be important for a brand or a manufacturer to have market leadership in this way?

1.2 Consumer markets and industrial markets

1. **Consumer markets** - markets for goods and services bought by the final user of them
2. **Industrial markets** - markets for goods and services bought by businesses to be used in the production process of other products

1.3 Marketing approaches

1. **Market orientation** an outward-looking approach basing product decisions on consumer demand, as established by market research
2. **Product orientation** an inward-looking approach that focuses on making products that can be made – or have been made for a long time – and then trying to sell them
3. **Asset-led marketing** an approach to marketing that bases strategy on the firm's existing strengths and assets instead of purely on what the customer wants
4. **Social (societal) marketing** this approach considers not only the demands of consumers but also the effects on all members of the public ('society') involved in some way when firms meet these demands

1.4 Market segmentation and consumer profile

1. **Market segment** a sub-group of a whole market in which consumers have similar characteristics
2. **Market segmentation** identifying different segments within a market and targeting different products or services to them
3. **Consumer profile** a quantified picture of consumers of a firm's products, showing proportions of age groups, income levels, location, gender and social class
4. **Target market** the market segment that a particular product is aimed at

Markets may be segmented in a number of different ways. The three commonly used bases for segmentation are:

i. Geographical differences
ii. Demographic differences
iii. Psychographic factors

1.5 Corporate image

Corporate image is a consumer perception of the company behind a brand. In a competitive business climate many businesses actively work to create and communicate a positive image to their customers and other stakeholders. This helps to build a good reputation, has a positive impact on sales and makes the successful launch of new products easier to achieve.

1.6 Unique Selling Point/Proposition (USP)

Unique selling point/proposition (USP) is a differentiating factor that makes a company's product unique, designed to motivate customers to buy. Unless a business can pinpoint what makes its product unique in a world of homogeneous competitors, its sales efforts will not be targeted effectively. Customers are often attracted towards goods or services that offer a distinctive image, service, feature or performance. Establishing a USP is about differentiating a company from its competitors. USPs can be based on any aspect of the marketing mix

2. Describing Marketing planning

[Learning Outcome b]

2.0 Marketing planning

Marketing planning is the process of formulating appropriate strategies and preparing marketing activities to meet marketing objectives

A market plan is often a formal written document which outlines in detail how the business unit intends to achieve the marketing objectives derived from the corporate objectives. Effective market planning is nearly always based on clear awareness of market trends, competitors' actions and consumer wants so market research is vital. The plan will then contain detailed action programmes, budgets, sales forecasts and strategies.

The key components of a marketing plan include:

- SMART marketing objectives, e.g. to increase sales by 10% in each of the next three years
- Strategic plans – an overview of the steps to be taken to achieve these objectives, e.g. selling existing products in new markets and how this will be attempted
- Specific marketing actions, e.g. which new markets? By when? Which methods of promotion to be used?
- A marketing budget – the finance that will be needed to pay for the overall cost of the marketing strategy and actions.

3. Describe the four Ps (product, price, promotion, place) and it extensions (seven Ps).

[Learning Outcome c]

3.1 Marketing mix

The marketing mix is made up of seven interrelated decisions − the 7Ps. The four key ones are product, price, promotion (including advertising and packaging) and place (where and how a product will be sold to consumers). The other 3Ps largely relate to marketing services – people, process and physical evidence.

- Consumers require the right product. This might be an existing product, an adaptation of an existing product or a newly developed one.
- The right price is important too. If set too low, then consumers may lose confidence in the product's quality; if too high, then many will be unable to afford it.
- Promotion must be effective – telling consumers about the product's availability and convincing them that 'your brand' is the one to choose. Packaging is often used to reinforce this image.
- Place refers to how the product is distributed to the consumer. If it is not available at the right time in the right place, then even the best product in the world will not be bought in the quantities expected.
- Selling services successfully requires people who can interact positively with customers and create the correct impression to encourage them to return. This particularly relevant in the hotel and restaurant industry.
- The processes that a business has in place to satisfy customers' wants reliably and consistently form an important part of marketing services. For example, banks replacing an out-of-date debit card without the customer having to ask for one.
- Physical evidence means allowing customers to see for themselves the quality of the service being provided. This will reduce the element of risk in buying a service as opposed to a tangible product. For example, a clean and well-presented reception area in a hotel would raise appropriate expectations in the mind of the customer.

3.1.1 Product

1. **Product** the end result of the production process sold on the market to satisfy a customer need
2. **Consumer durables** manufactured products that can be re-used and are expected to have a reasonably long life, such as cars and washing machines
3. **Product line** a set of related products sold by a business
4. **Product mix** the variety of product lines that a business produces or a retailer stocks
5. **Product range** all of the types of products made by a business

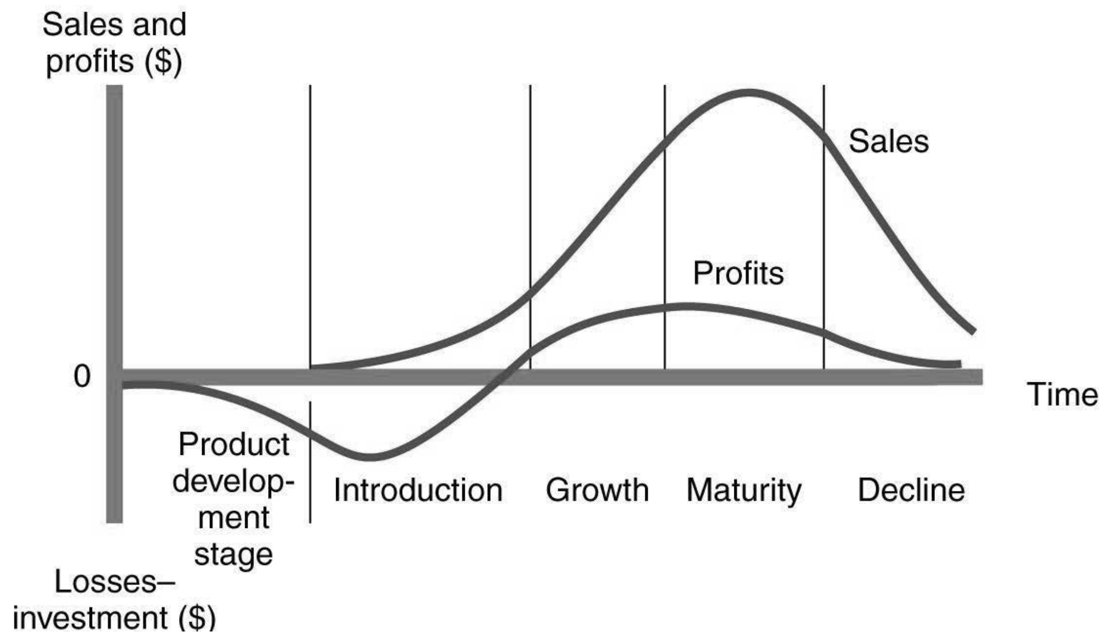
3.1.1.1 New product design and development

New product development (NPD) is crucial to the success of some businesses operating in markets with constant technological changes, such as computer games consoles.
There are seven stages in the NPD process:

- Generating new ideas, e.g. market research, brainstorming, adapting existing products.
- Idea screening – eliminate those ideas that have the least chance of being commercially successful.
- Concept testing – establishing most likely consumers, possible cost of production, specific features that the product will have.
- Business analysis – analyzing likely impact of the new product on revenue, costs and profits.
- Product testing – developing prototypes to assess performance and to obtain feedback.
- Test marketing – launching the developed product in a small but representative section of the market to assess likely sales following a national launch.
- Commercialization – full-scale launch of the product with appropriate promotion and distribution.

3.1.1.2 Product life cycle

Product life cycle the pattern of sales recorded by a product from launch to withdrawal from the market. There are several stages in this life cycle and these are shown



Points to note on the first three stages:

- Introduction. This is when the product has just been launched after development and testing. Sales are often quite low to begin with and may increase only quite slowly – but there are exceptions.
- Growth. If the product is effectively promoted and well received by the market, then sales should grow significantly. This stage cannot last forever, although all firms wish that it would. Eventually, and this may take days, weeks or even years, sales growth will begin to slow and might stop altogether, which leads the product into the next stage. The reasons for declining growth include increasing competition, technological changes making the product less appealing, changes in consumer tastes and saturation of the market.
- Maturity or saturation. At this stage, sales fail to grow, but they do not decline significantly either. This stage can last for years

Uses of the product life cycle

The life-cycle concept has two main uses.

1. **Assisting with the planning of marketing mix decisions.** The following table explains how marketing mix decisions can be influenced by knowledge of the product life cycle.

Table 1: The marketing mix and phases of the product life cycle

Product life cycle phase	Price	Promotion	Place (distribution outlets)	Product
Introduction	May be high compared to competitors (skimming) or low (penetration).	High levels of informative advertising to make consumers aware of the product's arrival on the market	Restricted outlets - possibly high-class outlets if a skimming strategy is adopted.	Basic model.
Growth	If successful, an initial penetration pricing strategy could now lead to rising prices.	Consumers need to be convinced to make repeat purchases – brand identification will help to establish consumer loyalty.	Growing numbers of outlets in areas indicated by strength of consumer demand.	Planning of product improvements and developments to maintain consumer appeal.
Maturity	Competitors likely to be entering market – there will be a need to keep prices at competitive levels	Brand imaging continues – growing need to stress the positive differences with competitors' products.	Highest geographical range of outlets as possible – developing new types of outlets where possible.	New models, colors, accessories, etc. as part of extension strategies.
Decline	Lower prices to sell off stock – or if the product has a small 'cult' following, prices could even rise.	Advertising likely to be very limited – may just be used to inform of lower prices.	Eliminate unprofitable outlets for the product.	Prepare to replace with other products – slowly withdraw from certain markets.

2. **Identifying how cash flow might depend on the product life cycle.** Cash flow is vital to business survival and ignoring the link between cash flow and product life cycles could be very serious.

1. Cash flow is negative during the development of the product as costs are high, but nothing has yet been produced or sold.

2. At introduction, the development costs might have ended but heavy promotional expenses are likely to be incurred – and these could continue into the growth phase. In addition, there is likely to be much unused factory capacity at this stage which will place a further strain on costs. As sales increase, then cash flow

should improve – precisely when will depend on the length of consumer credit being offered.

3. The maturity phase is likely to see the most positive cash flows, because sales are high, promotional costs might be limited and spare factory capacity should be low.
4. As the product passes into decline, so price reductions and falling sales are likely to combine to reduce cash flows. Clearly, if a business had too many of its products either at the decline or the introduction phase then the consequences for cash flow could be serious.

3.1.1.3 Branding

Mobile phones are an example of a product, but iPhone and Samsung is an example of a brand. What is the difference? Product is the general term used to describe the nature of what is being sold. The brand is the distinguishing name or symbol that is used to differentiate one manufacturer's products from another.

- **Brand** an identifying symbol, name, image or trademark that distinguishes a product from its competitors
- **Brand awareness** extent to which a brand is recognized by potential customers and is correctly associated with a particular product – can be expressed as a percentage of the target market
- **Brand development** measures the infiltration of a product's sales, usually per thousand population. If 100 people in 1000 buy a product, it has a brand development of 10
- **Brand loyalty** the faithfulness of consumers to a particular brand as shown by their repeat purchases irrespective of the marketing pressure from competing brands

Types of branding

- **Family branding** a marketing strategy that involves selling several related products under one brand name (also known as umbrella branding)
- **Product branding** each individual product in a portfolio is given its own unique identity and brand image (also known as individual branding)
- **Company or corporate branding** the company name is applied to products and this becomes the brand name
- **Own-label branding** retailers create their own brand name and identity for a range of products
- **Manufacturers' brands** producers establish the brand image of a product or a family of products, often under the company's name

3.1.2 Price

Price is the amount paid by consumers for a product. Price is a vital component of the marketing mix as it impacts on the consumer demand for the product. The pricing level will also: determine

i. The degree of value added by the business to bought-in components
ii. Influence the revenue and profit made by a business due to the impact on demand
iii. Reflect the marketing objectives of the business and help establish the psychological image and identity of a product.

Factors determining the price decision

There are a number of factors that will determine the pricing decision for a product:

- Costs of production
- Competitive conditions in the market
- Competitors' prices
- Marketing objectives
- Price elasticity of demand
- Whether it is a new or an existing product.

Pricing strategies

Cost-based pricing

The central idea is that fi rms will assess their costs of producing or supplying each unit, and then add an amount on top of the calculated cost. There are a number of different methods of cost-based pricing that may be adopted.

- **Cost-plus pricing** adding a fixed mark-up for profit to the unit price of a product
- **Marginal-cost price** basing the price on the extra cost of making one additional unit of output
- **Contribution-cost pricing** setting prices based on the variable costs of making a product in order to make a contribution towards fixed costs and profit
- **Full-cost/absorption-cost pricing** setting a price by calculating a unit cost for the product (allocated fixed and variable costs) and then adding a fixed profit mark-up
- **Competition-based pricing** a firm will base its price upon the price set by its competitors
- **Predatory pricing** deliberately undercutting competitors' prices in order to try to force them out of the market
- **Going-rate pricing** the price charged is based upon a study of the conditions that prevail in a certain market and the prices charged by major competitors

Market-based pricing strategies

These are normally split into two different approaches depending on the marketing objectives of the business or price discrimination.

- **Penetration pricing** setting a relatively low price often supported by strong promotion in order to achieve a

high volume of sales
- **Market skimming** setting a high price for a new product when a firm has a unique or highly differentiated product with low price elasticity of demand
- **Loss leader** product sold at a very low price to encourage consumers to buy other products
- **Psychological pricing** setting prices that take account of customers' perception of value of the product
- **Promotional pricing** special low prices to gain market share or sell off excess stock – includes 'buy one get one free'

3.1.3 Promotion

Promotion the use of advertising, sales promotion, personal selling, direct mail, trade fairs, sponsorship and public relations to inform consumers and persuade consumers to buy

Promotional objectives
Promotional objectives should aim to:
- Increase sales by raising consumer awareness of a new product remind consumers of an existing product and its distinctive qualities
- Encourage increased purchases by existing consumers or attract new consumers
- Demonstrate the superior specification or qualities of a product compared to those of competitors – often used when the product has been updated or adapted in some way
- Create or reinforce the brand image or 'personality' of the product
- Correct misleading reports about the product or the business and reassure consumers after a 'scare' or an accident involving the product
- Develop or adapt the public image of the business – rather than the product
- Encourage retailers to stock and actively promote products to the final consumer.

Place

Place refers to the mode of distributing a firm's products (including channels of distribution, location of retail outlets, warehousing and other logistics, etc.) to the targeted customers.

The placing strategy or the distribution strategy relates to decisions regarding how a firm's products and services would reach the ultimate customers at the right time and right place. The role played by the distribution function is supportive, but very crucial.

It is essential to identify the most relevant distribution methods to befit the products / services on offer. Just like the plans relating to product decisions, pricing, etc., the distribution strategy would also be drawn from the marketing strategy of a company. The distribution strategy needs to be tailored to suit the specific requirements of a product, the targeted market segments and the performance criteria and standards required.

1. Choice of distribution channels

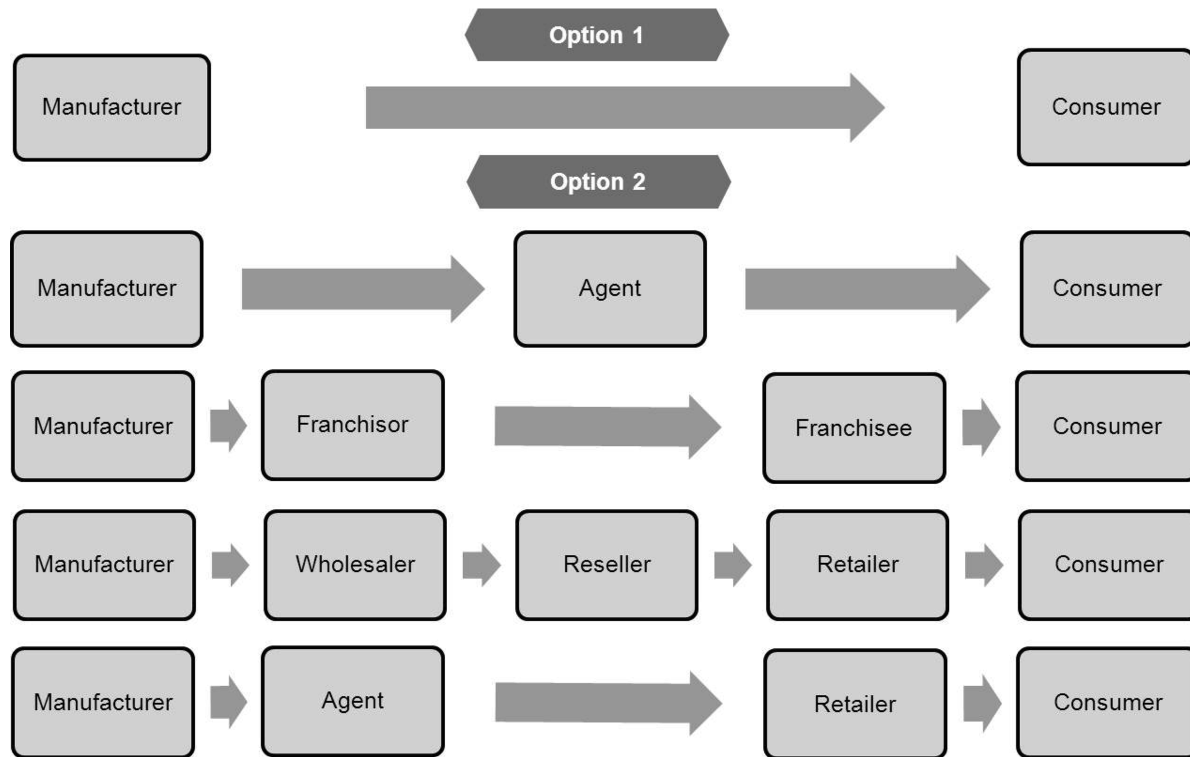
The following are the two prime categories of distribution channels:

(a) Direct channel: this involves the manufacturer distributing its product directly to the end customer. No specific intermediary is used here in the distribution process. The advantage of this channel is that the manufacturer retains control over the entire course of distribution. For example, Dell Computers selling its machines directly to its targeted customers. This type of channel has a *flatter* structure as compared to the indirect channel of distribution.

(b) Indirect or multiple channels: this involves making use of an intermediary in the process of distribution of goods. Intermediaries can include any one or all of wholesalers, agents and retailers. This type of channel has a taller structure as compared to the direct channel of distribution.

The following diagram illustrates the distribution channels listed above.

Diagram 12: Distribution channels



2. Factors to be considered while developing distribution channels:

(a) the most convenient means for the targeted customers to acquire the product / service and the level of service they expect from the channel
(b) the ability of the chosen distributor in reaching the target market
(c) degree of exclusivity offered and cost effectiveness of the channel
(d) the extent of support functions (promotion, after sales services and other customer service) offered by the channel
(e) the channel strategy used by the firm's competitors
(f) other considerations of the 'place' strategy

3. Based on the nature of the product / service to be distributed, a firm has the following options to choose from:

(a) Intensive distribution: in this form of distribution, a manufacturer stocks his products with many retail outlets, for distribution to the targeted customers. This type of channel strategy is followed for products of daily use like milk, bread, confectionaries, cigarettes, items of stationery, etc. Here, the main consideration of customers is the convenience of location and thus, the manufacturer ensures that the daily required products are made available at convenient locations to the customers.

(b) Selective distribution: in this form of distribution, the manufacturer, in order to achieve optimal market coverage, selects a few outlets to distribute their products. Products like apparels, home appliances, home furnishings, etc. are distributed using this form of distribution.

(c) Exclusive distribution: in this form of distribution, the product in question is distributed through one or two major outlets in a geographical area. Products like high-end designer apparels, automobiles, major domestic appliances, etc. are distributed using exclusive stores. In the case of such products, the consumers usually do not mind overcoming the inconvenience of location.

4. To describe the importance of conducting market research.
[Learning Outcome d]

4.1 Market research

Market research is a process of collecting, recording and analyzing data about customers, competitors and the market. Market research is a broad and far-reaching process. It is concerned not just with finding out, as accurately as possible, whether consumers will buy a particular product or not, but also with trying to analyze their reaction to:

i. Different price levels
ii. Alternative forms of promotion
iii. New types of packaging
iv. Different methods of distribution.
v.

The results of market research can have a great impact on decisions made in all areas of the marketing process:

i. To reduce the risks associated with new product launches
ii. To predict future demand changes
iii. To explain patterns in sales of existing products and market trends
iv. To assess the most favored designs, flavors, styles, promotions and packages for a product

The extended 7 Ps:

In the late 70's it was widely acknowledged by Marketers that the Marketing Mix should be updated. This led to the creation of the Extended Marketing Mix in 1981 by Booms & Bitner which added 3 new elements to the 4 Ps Principle. This now allowed the extended Marketing Mix to include products that are services and not just physical things.

People

People are a defining factor in a service delivery process, since a service is inseparable from the person providing it. Thus, a restaurant is known as much for its food as for the service provided by its staff. The same is true of banks and department stores. Consequently, customer service training for staff has become a top priority for many organizations today.

Process

The process of service delivery is crucial since it ensures that the same standard of service is repeatedly delivered to the customers. Therefore, most companies have a service blue print which provides the details of the service delivery process, often going down to even defining the service script and the greeting phrases to be used by the service staff.

Physical Evidence

Since services are intangible in nature most service providers strive to incorporate certain tangible elements into their offering to enhance customer experience. Thus, there are hair salons that have well designed waiting areas often with magazines and plush sofas for patrons to read and relax while they await their turn. Similarly, restaurants invest heavily in their interior design and decorations to offer a tangible and unique experience to their guests.

5. Explaining the importance of e-business and e-commerce .
[Learning Outcome e]

4.1 E-business and e-commerce

In the emerging global economy, e-commerce and e-business have become an essential component of business strategy for organisations. The relationships within organisations and between organisations and individuals have been revolutionised by integrating the information and communication technologies (ICT) in business.

Besides reducing costs, the use of ICT in business has enabled:

- higher client participation
- enhanced productivity
- mass customisation: i.e. delivering customised content to a group of users through web pages or e-mail

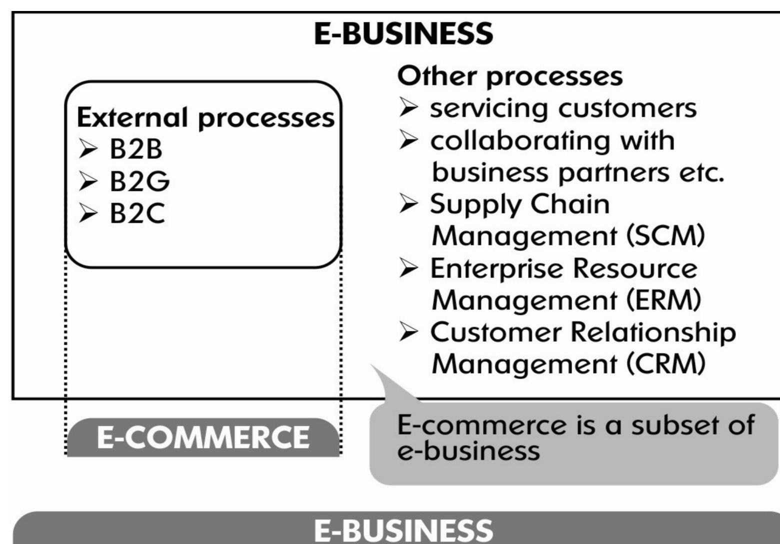
With recent developments in Internet and web-based technologies, the differences between traditional markets and the global electronic marketplace have lessened gradually. Apart from providing a level playing field, e-commerce, coupled with the appropriate strategy and policy approach, enables smaller organisations to compete with their large-scale counterparts.

E- business

IBM has defined e-business as the transformation of key business processes by an organisation through the use of Internet technologies. **E-business refers to the application of ICT to business processes in order to reduce costs, improve customer value and to find new markets for products and services.**

The terms e-commerce and e-business are often used interchangeably. However, e-commerce involves buying and selling transactions which are conducted online, whereas e-business is a broader concept because it encompasses the integration of ICT into the business processes of companies. Moreover, e-business involves varied business dealings which can be done over the Internet, whereas e-commerce is more specialised and encompasses things such as ordering, invoicing, payments and receipts for goods or services.

Diagram 1: E-business (using ICT)



E-commerce

Definition

E-commerce refers to any activity involving an organisation's interactions and business dealings either with clients within the organisation or between various organisations through electronic means.

In simpler terms, e-commerce refers to any kind of business transaction in which the parties interact electronically rather than through direct contact.

Features of e-commerce

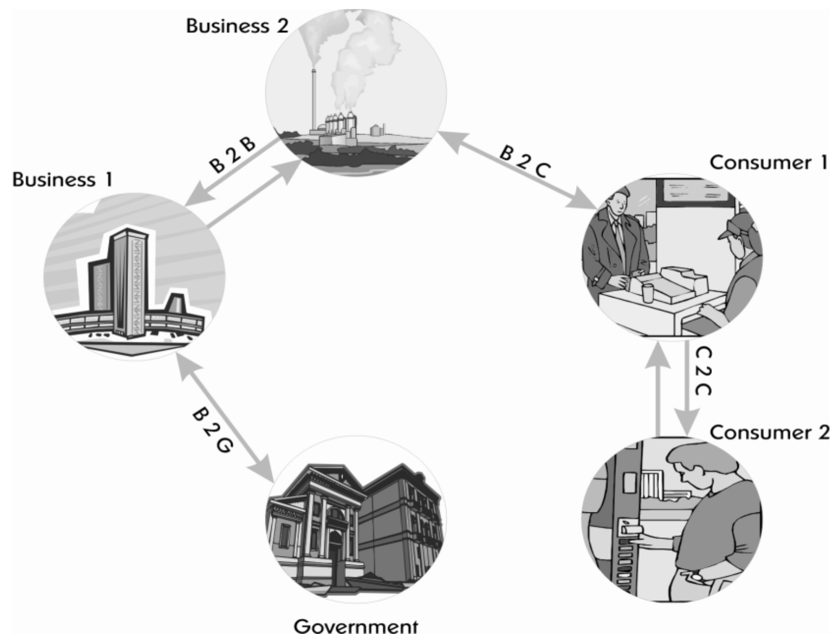
- E-commerce is usually associated with buying and selling over the Internet, or conducting any transaction involving the transfer of ownership or rights for using goods or services through a computer-mediated network.

- E-commerce encompasses electronic ordering of goods and services which are delivered using traditional channels such as couriers, online ordering, electronic share trading and electronic fund transfers.

- E-commerce is sometimes classified as buy-side e-commerce and sell-side e-commerce. Buy-side e-commerce refers to transactions relating to the procurement of resources by an organisation from its suppliers, whereas sell-side e-commerce refers to transactions relating to the selling of products by an organisation to its customers.

Types of e-commerce

Diagram 2: Types of e-commerce



The e-commerce activity can be activated either by organisations or their customers. The main types of e-commerce are:

(a) Business-to-business (B2B)

B2B e-commerce is the e-commerce that exists between companies. It deals with relationships between and amongst businesses. It forms the majority of the transactions conducted through e-commerce when compared to the B2G and the B2C segments.

Example

A commonly used example of B2B e-commerce is Dell Inc, which deals in computer hardware and software. It offers a range of products including laptops, desktops and printers and has a diversified client base which includes many multinational companies and retail clients. It receives a large majority of its orders over the Internet. The dealings between Dell and the companies represent B2B e-commerce.

Most B2B applications are in the areas of:

supplier management (e.g. purchase order processing)

inventory management (e.g. managing order-ship-bill cycles)

distribution management (e.g. transmission of shipping documents)

channel management (e.g. information dissemination on changes in operational conditions)

payment management (e.g. electronic payment systems or EPS)

(b) Business-to-consumer (B2C)

Business-to-consumer e-commerce is the commerce that exists between companies and consumers. The more common B2C business models are the online retailing companies such as Amazon.com and E-Trade for information regarding goods.

Common applications for this type of e-commerce deal with the purchasing of products and information.

(c) Business-to-government (B2G)

Business-to-government e-commerce or B2G is generally defined as the commerce between companies and the public sector. It refers to the use of the Internet for public procurement, licensing procedures, and other government-related operations.

This kind of e-commerce has two features:

- the public sector assumes a leading role in establishing e-commerce.
- it is assumed that the public sector has the greatest need for making its procurement system more effective.

(d) Consumer-to-consumer (C2C)

Consumer-to-consumer e-commerce or C2C is simply commerce between private individuals or consumers. This type of e-commerce is characterised by the growth of electronic marketplaces and online auctions.

Example

Many people trade on www.eBay.com and use the website as a source of secondary income. Trade occurs mainly by way of an auction. Since the trade takes place through a website, only a computer and access to the Internet is required. After the deal is finalised over the Internet, the physical exchange of the product takes place through courier or postal services. Therefore, the need for having a showroom is eliminated.

(e) Mobile commerce (M-commerce)

M-commerce is the buying and selling of goods and services through wireless technology i.e., handheld devices such as cellular telephones and personal digital assistants (PDAs). Financial services and telecommunications are examples of industries using M-commerce.

(f) Government-to-Government (G2G)

G2G e-commerce is the online non-commercial interaction between government organisations, departments, and authorities within a country or between the governments of different countries.

(g) Government-to-business (G2B)

G2B e-commerce is the online non-commercial interaction between the government and the commercial business sector (excluding private individuals).

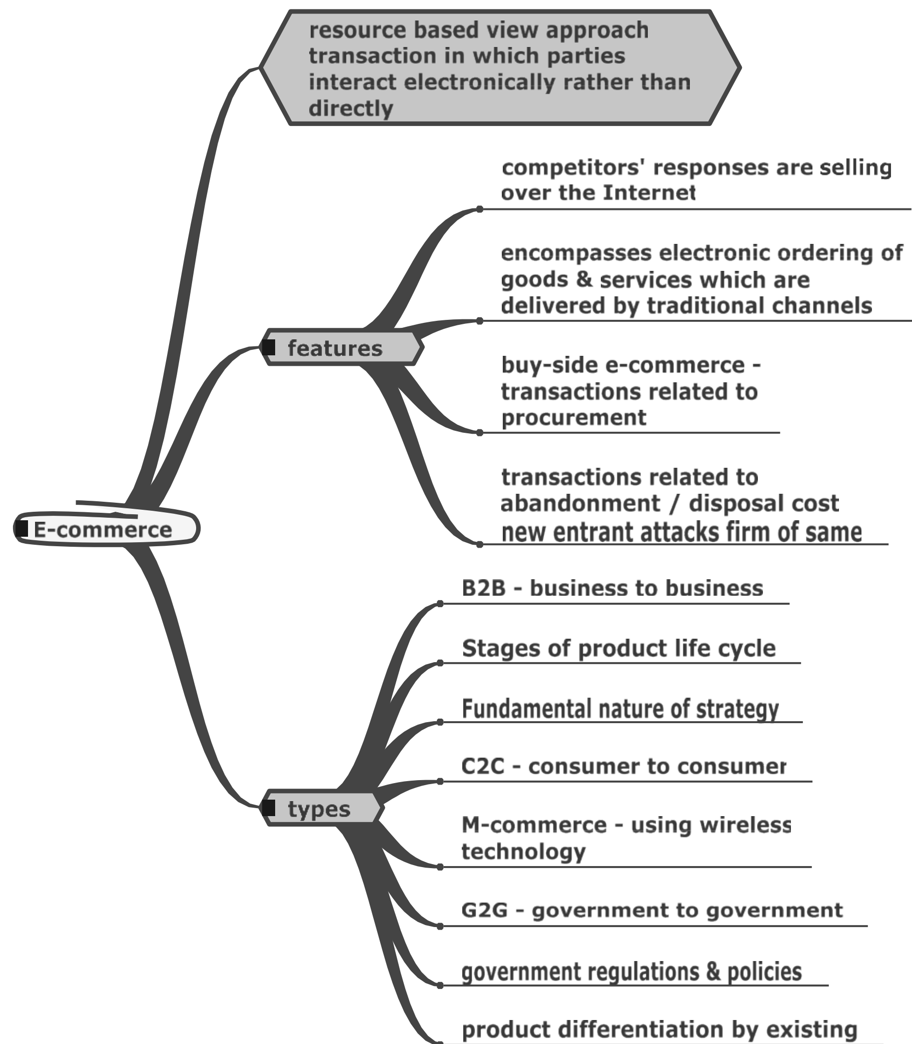
(h) Not-for-profit to consumer (NFP2C)

This refers to the e-commerce between not-for-profit organisations and the customer. Examples include donations by individuals to the Cancer Research Institute, UK.

4.3. Convergence technology

Convergence technology refers to the use of technology that is created by combining two or more technologies. Examples include the use of audio, video and Internet technologies in mobile phones which has enabled the use of mobiles for financial services and telecommunications. Virgin and Orange have introduced convergence technologies into the enterprise world.

SUMMARY



4. Scope of e-business

The following are some of the activities covered by e-business:

(a) **Supply Chain Management (SCM):** includes logistics, warehouse management and distribution.

(b) **Enterprise Resource Management (ERM):** includes human resource management, finance and administration.

(c) **Customer Relationship Management (CRM):** includes channel sales management and marketing.

5. Variants of e-business

There is no single standard or best way of doing e-business. It can be done through different modes using the Internet. The following are some of the variants of e-business:

(a) Business models: e-business models cover the exchange of goods and services between the supplier and the customer. The customers contribute their feedback or participate in the solutions development processes. An example of this model is the Just-In-Time (JIT) delivery model in which the customer provides feedback. E-commerce business models could also be classified on the basis of revenue models, market opportunity or value proposition. The scope for the use of revenue models is higher because there are several options for different performance units, such as pay by time.

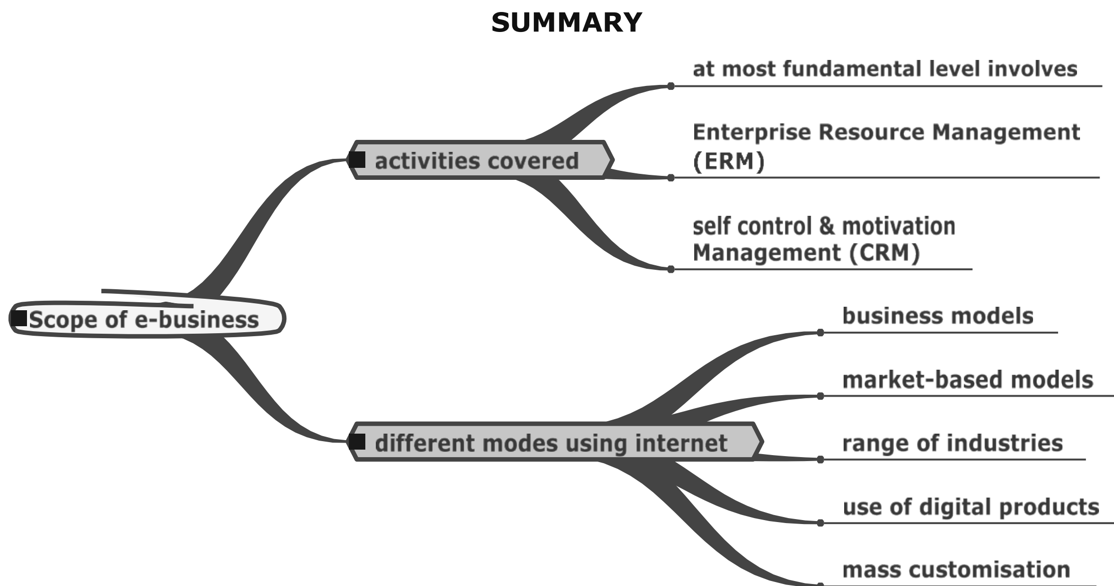
(b) Market-based models: these models are also known as marketplace channel structures. These structures describe the way in which the seller distributes its products to its customers. Channel structures are mainly in the form of disintermediation, re-intermediation and counter-mediation which will be discussed later in this Study Guide.

(c) Range of industries: e-business is particularly useful in media and communication industries since these industries don't offer a physical product, thereby avoiding logistics problems. However, for the manufacturing industries, e-business is not highly relevant because these involve only a few processes, such as contracting and billing.

(d) Use of digital products: with the use of digital products, almost all business processes can be run through the Internet. This means that contracting, communication, billing, etc. can all be done using the click of a computer mouse. The other variants of e-business have a lower digitisation capability. This is due to modelling problems or specification issues relating to the goods or services in question. Examples include consulting and construction businesses.

(e) Customisation: e-business models can enable mass customisation of content which could be in the form of e-mail alerts or web pages.

SUMMARY



6. Reasons for adoption of e-business

The adoption of e-commerce and e-business is driven by their benefits to different parts of the organisation. Managers are concerned about how the benefits of e-business will impact their earnings. Two general benefits arising out of e-business, which can affect earnings are:

(a) Higher customer reach: potential for higher sales is achieved by expanding the reach to a large number of customers and opening up new customer segments (e.g. online retail customers). It also encourages loyalty and repeat orders from existing customers.

(b) Cost reduction: e-business helps in reducing marketing costs, administrative costs and supply chain costs. Reduction in costs can be achieved through electronic delivery of goods or services.

Marketing cost reductions arise from online sales and reduced printing and distribution costs. Administrative cost reductions arise from more efficient routine processes such as billing and supply chain cost reductions arise from reduced inventory requirements.

In addition to these reasons, **other reasons for the possible adoption of e-business are:**

(a) Operational efficiencies: e-business enables an organisation to reap the benefits arising from replacing manual processes with automated systems. This results in a range of efficiencies like getting paid more quickly.

(b) Improved marketing and promotion: e-business is a promotional tool that complements other forms of sales promotion. A properly designed and maintained website can be an excellent promotional tool.

(c) Convenience in conducting business: an organisation with a well planned and designed e-business model can conduct business operations with its customers, suppliers and other associates with relative ease. In addition, customer websites have the effect of creating a retail outlet which is available 24 hours a day, 7 days a week.

(d) Meeting customer expectations: a well planned and designed website and e-mail enable a firm to meet the expectations of its customers via on-line customer care programmes, etc

(e) Brand enhancement: a well planned e-business strategy plays a big role in enhancing the brand value of an organisation by influencing customer perceptions about the perceived quality of the products.

(f) Improvement of security position: e-business improves the security of the organisation's business information, records and contracts by reducing the vulnerability of paper-based records.

(g) Improvement of legal position: an organisation can improve its legal position in case any disputes or obligations arise. This can be done by data encryption standards.

(h) Competitive advantage: the use of e-business is essential for organisations in terms of the long-term competitive point of view, as it enables organisations to expand their business into new territories. It also helps develop cost leadership strategies by lowering the cost base and also differentiation strategies by offering increased efficiency and better service such as 24/7 operations.

7. E-business strategy

An e-business strategy has wide implications for the business of an organisation, as it affects more than one department within the organisation. Therefore, it should be considered by the highest level of management in the organisation. E-business is not simply developing a website but rather involves changing a company's business model to adapt to the new economy.

(a) Traditional strategy and e-business strategy

Before e-business became popular, many strategy models had been developed for the corporate strategy, supply chain management strategy, marketing strategy, etc. Many of these models can be applied to the e-business strategy. However, there are certain differences between traditional business strategy and an e-business strategy. These are:

(i) Traditional business strategy requires a single development effort as opposed to an e-business strategy, which requires an iterative development effort because technological changes happen rapidly.
(ii) Traditional business strategy assumes that it is possible to forecast the future and then to develop long-term plans. However, an e-business strategy has limited predictability and focuses on adaptability and responsiveness.
(iii) Traditional business strategy focuses on production and factory goods whereas e-business strategy is customer-oriented.

(b) Strategy model of continuous planning and feedback

Kalakota and Robinson have suggested a dynamic and emergent strategy process specific to e-business. They have emphasised that continuous planning with feedback is essential in any e-business strategy. The method of continuous planning with feedback is structured around the following steps:

(i) Knowledge building and evaluation of capabilities: this involves understanding the customer's needs comprehensively and developing a clear understanding of the capabilities needed to address those needs.
(ii) Development of the e-business design: this involves developing competence for addressing customer needs.
(iii) E-business blueprint: this is the vital link between the e-business design, organisational goals and technology. The e-business design should be linked to the overall corporate objectives of an organisation.
(iv) Application development and deployment: this involves the translation of key objectives and projects into integrated applications.

(c) Development of e-business strategy

Before developing any type of strategy, the management should agree the process they intend to follow for developing and implementing that strategy. While developing an e-business strategy, an organisation should take a combined view of its existing approaches to business, marketing, supply chain management and the development of an IT strategy.

An organisation's e-business strategy should meet the following criteria:

- It should be based on the organisation's current performance in the marketplace, its strengths and weaknesses, products and distribution channels, competition, opportunities, etc
- It should define how the organisation would meet its objectives. This involves mapping a path to implement the strategy which would put an emphasis on quality service to the organisation's customers, channel partners and others. The strategy should focus on a more personalised approach than is used in traditional technical support.

- It should allocate the resources required to meet objectives.
- It should provide a long-term plan for the development of the organisation.
- The strategy should be flexible and have a scalable architecture which allows the system to adapt to the changing needs of the future.

Lastly, the e-business strategy should conform to the standard criteria of acceptability, suitability and feasibility:

(i) Acceptability: the e-business strategy should be acceptable to the shareholders and the business groups which deal with the company.

(ii) Suitability: e-business supplements the other business strategies of an organisation and should be part of the overall corporate strategy of an organisation.

(iii) Feasibility: resources such as skilled manpower and funds are essential for setting up an effective e-business strategy. These resources should be obtained feasibly by the management.

Ideally, an e-business strategy should be incorporated into the information systems (IS) strategy. However many organisations, such as GE and Dell Inc, consider e-business strategy to be part of their corporate strategy.

Example

Many stock brokerage firms have adopted IT in a support role. Earlier, dealing with brokers involved tremendous paperwork, such as maintaining several paper forms, contract notes for trades executed and daily ledgers. In order to save costs and provide a better service to their customers, many brokerage firms have started issuing digital contract notes through e-mails, electronic forms and scanning those forms to the back-office, as well as maintaining electronic records, margin account summaries through e-mails, online trading platforms, etc. The adoption of IT has resulted in the reduction of a lot of paperwork and ease in conducting transactions.

2.5 Role of IT in supporting supply chain, value chain and value networks

1. Supply chain

Definition

A supply chain is a network of facilities and distribution options that deals with:

- Procurement of materials
- Transformation of these materials into finished products
- Distribution of the finished products to the consumers

Supply Chain Management

Definition

Supply Chain Management (SCM) can be defined as the process of influencing the behaviour of the supply chain in order to get the desired results.

However, SCM is different from the traditional concept of logistics. Traditional logistics is associated with activities such as procurement, distribution and inventory management. SCM encompasses these activities and, in addition, also includes activities such as the development of a new product, marketing and finance.

The supply chain is primarily divided into an upstream supply chain and a downstream supply chain. The upstream supply chain includes the processes involved in transforming the inputs into outputs whereas the downstream supply chain includes the processes involved in delivering the products to the final customer. E-commerce and the Internet are changing the way SCM functions and redefining the manner in which customers choose, purchase and use various products and services.

This has resulted in the emergence of new B2B supply chains that are more consumer-focused than product-focused and that provide customised products and services.

(a) Push model of supply chain

The push model of the supply chain refers to the push of materials through the supply chain to the end consumer and is associated with forecasting demand by an organisation. An interconnected network of manufacturers and distributors is connected to the consumer through a sales channel. Suppliers and vendors push their products or services through the supply chain to the end customer. Costs are accumulated throughout the supply chain and the end customer incurs most of the cost.

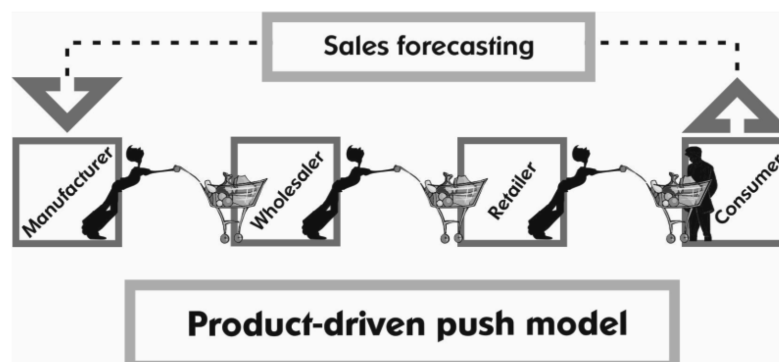
Example

Highly automated service platforms that are supported by standardised processes and which deliver resources to the right places at fixed time schedules. In the case of information technology, large enterprise applications state the activities to be performed and the resources to be deployed for meeting the expected demand.

The core assumptions of push models are:

- that organisations can anticipate demand, and
- mobilising scarce resources is the most efficient and reliable way to meet that demand.

Diagram 3: Push model of SCM

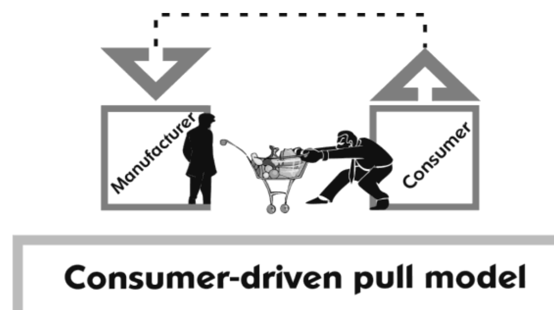


Push models are highly centralised and restrictive in nature, which prevents organisations from experimenting, improvising, and learning as quickly as possible.

(b) Pull model of supply chain

The pull model of the supply chain refers to the end customer's pull of finished goods and is associated with responding to the actual consumer demand rather than forecasting demand by organisations. Many companies are moving from the traditional push models to a consumer-driven pull model. The pull models are driven by the capabilities of e-commerce for empowering clients and are less product-driven and more consumer-focused.

Diagram 4: Pull model of SCM



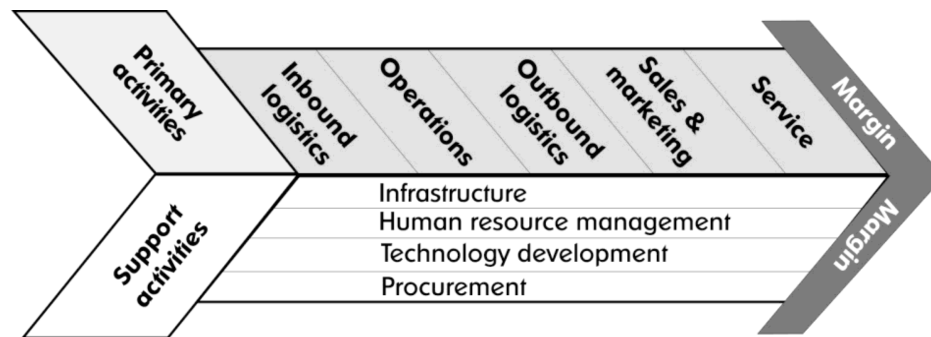
2. The value chain

The concept of a value chain was first described and popularised by Michael Porter in 1985. The value chain framework is considered a strong analysis tool for strategic planning. Products pass through all activities of the chain in order and gain some value at each activity. This chain of activities gives the products more added value than the sum of the added values of all activities.

In the case of the diamond-cutting business, the cutting activity could be made less costly, but the activity adds to the value of the end product, since a rough diamond is much cheaper than a cut diamond.

In order to analyse the specific activities which enable organisations to create a competitive advantage, it is useful to model the firm as a chain of value-creating activities. Michael Porter identified certain interrelated generic activities common to a wide range of firms. The resulting model is known as the value chain and is depicted below.

Diagram 4: Primary and support activities of value chain



(a) Primary value chain activities

The generic value-adding activities of an organisation could be categorised using the value chain. These activities are mainly classified as primary activities and support activities.

The goal of the primary activities is to create value that exceeds the cost of providing the product or service, therefore generating a profit margin.

(i) **Inbound logistics** primarily include the receiving, warehousing, and inventory control of input materials.

(ii) **Operations** are the value-creating activities that transform inputs into the final product. Examples include manufacturing and assembly.

(iii) **Outbound logistics** are the activities required to get the finished product to the customer, including warehousing, order fulfilment, etc.

(iv) **Marketing & sales** involve those activities associated with getting buyers to purchase the product, including channel selection, advertising, pricing, etc.

(v) **Service activities** are those that maintain and enhance the product's value, including customer support, repair services, etc.

The primary activity or activities can be essential in developing a competitive advantage for an organisation.

Logistics activities are critical for a provider of distribution services, and service activities may be the key focus for a firm offering on-site maintenance contracts for office equipment.

The primary activities mentioned above are generic in nature and each generic activity includes specific activities that vary by industry.

(b) Support Activities

The primary value chain activities described above are facilitated by support activities. Porter identifies four generic categories of support activities, and they are as follows:

(i) Procurement: the function of purchasing the raw materials and other inputs used in value-creating activities.

(ii) Technological development: includes research and development, process automation, and other technological developments used to support the value-chain activities. It includes the activities related to Information Systems.

(iii) Human resource management: the activities associated with the recruiting, development, and compensation of employees.

(iv) Firm infrastructure: includes activities such as finance, legal and quality management as well as the general administrative activities of the firm.

Support activities are often considered overhead activities, but some firms have successfully used them to develop a competitive advantage. An example of this would include developing a cost advantage through the innovative management of information systems.

An organisation's value chain links to the value chains of its upstream suppliers and downstream buyers. This results in a larger stream of activities known as the "**value system**". The development of a competitive advantage depends not only on the value chain of an organisation, but also on the value system which the organisation is a part of. The value chain concept is also discussed in Learning Outcome C of Study Guide A4.

3. Value networks

The value network includes the organisations, groups, and individuals that are involved in the development, marketing, and use of a particular type of technology. The value network is derived from the value chain concept. Value networks can be thought of as a set of relatively autonomous units that can be managed independently but operate in a framework of common principles.
A value network can also be considered a web of relationships that generates economic or social value by exchanging tangible and intangible benefits in an organisation. Value networks consist of complementary nodes and links. A service delivered over the value network requires the use of two or more network components. By understanding an organisation's relationships with other network members, the following can be ascertained:

(a) Where does value lie in the network?
(b) How do the activities of the organisation affect the network?
(c) How are the other members of the network likely to respond?

4. Strategic role played by IT

(a) Supply chain restructuring

Supply chain restructuring is a broader concept than changes in the supply chain function. It includes vendor managed inventories or employing electronic reverse auctions. Supply chain restructuring results in fundamental alterations in the supply chain activities of an organisation and affects all functions and activities**.** Restructuring of the supply chain needs to be viewed as a process of fundamental rejuvenation throughout the organisation and requires an understanding of:

(i) the reasons and constraints for change
(ii) the paradigm shift required (this includes changing product lines, implementing e-business, increasing the operating hours to 24/7)
(iii) the process of implementation
(iv) the problems that require solutions

(b) The Internet

Using the Internet in supply chain management improves communication and collaboration between businesses along the supply chain. Using the Internet has a number of benefits, which include:

(i) cost reduction by eliminating paper transactions, purchases orders, invoices, consignment notes, and speeding up response times

(ii) **reduction of errors** in the information passed along the supply chain by avoiding hand-written or faxed documents

(iii) **improving the satisfaction** of customers or suppliers by 'real time' delivery of information (i.e. the point at which a product is moved)

(iv) **achieving real cost savings** by the integration of dispatch and distribution data with product development data at each node of the supply chain

(c) Technology and the value chain

Since technology is used to some degree in every value-creating activity, changes in technology can increase competitive advantage by making marginal changes to the activities themselves or by constructing possible new configurations of the value chain.

The following technologies are used in both primary value activities and support activities:

(i) Inbound logistics technologies:

material handling transportation communications material storage testing information systems

(ii) Operations technologies:

machine tools material handling process packaging materials maintenance testing building design & operation information systems

(iii) Outbound logistics technologies:

transportation packaging communications material handling information systems

(iv) Marketing & sales technologies:

media communications audio/video information systems

(v) Service technologies:

communications Internet and broadband mobile technologies convergence systems
testing Information Systems

It is important to note that many of these technologies are used across the value chain. For example, information systems are present in every activity. Similar technologies are also used in support activities. In addition, technologies related to training, computer-aided design, and software development are also employed in support activities. Technologies enable an organisation to gain a competitive advantage to the extent that they make an impact on cost drivers.

(d) Impact of e-commerce on supply chain management

E-commerce impacts supply chain management in a variety of ways. These include:

(i) Cost efficiency

E-commerce enables shippers, freight forwarders, etc., to streamline document handling without the costly and time-consuming formalities required by traditional document delivery systems. By using e-commerce, companies can: reduce costs improve data accuracy streamline business processes accelerate business cycles enhance customer service

(ii) Changes in the distribution system

E-commerce provides organisations greater flexibility in managing the highly complex movement of products and information between businesses, their suppliers and customers. It eliminates the link between consumers and distribution centres.

Customer orientation: using the Internet for e-commerce allows customers to: access price information place delivery orders track shipment pay freight bills

E-commerce makes it easier for customers to do business with organisations. Organisations can make their websites a place where customers can not only get detailed information about the services the company offers, but also where they can actually conduct business with the company, thereby providing a universal self-service system for customers.

(iii) Shipment tracking

E-commerce allows users to obtain real-time information about cargo shipments. They may also:

create and submit bills of lading
place a cargo order
submit a freight claim
carry out several other functions

(iv) Shipping documentation and online shipping enquiry

The need for manual intervention is reduced, as standard bills of lading and shipping labels can be used.

Online shipping enquiry gives instant shipping information access to anyone in the company, from any location

6 OPERATIONS MANAGEMENT

Get Through Intro

Operations Management (OM) is concerned with the management of resources and activities that produce and deliver goods and services for customers. Efficient and effective operations can provide an organization with major competitive advantages since the ability to respond to customer and market requirements quickly, at a low cost, and with high quality, is vital to attaining profitability and growth through increased market share. As competition becomes fiercer in an increasingly open and global marketplace, a company's survival and growth become greatly contingent on its ability to run its operations efficiently and to exploit its resources productively.

Learning Outcomes

a) Describe and compare the features and applications of production methods (job, batch, line, flow and mass production)
b) Analyse the implications for functional departments that arise from changing the production methods
c) Analyse the most appropriate method of production for a given situation.
d) Explain the concept of quality.
e) Understand the difference between quality control and quality assurance – total quality management.

1. Describe and compare the features and applications of production methods (job, batch, line, flow and mass production)
[Learning Outcome a]

Production methods

Job production

This is normally used for the production of single, one-off products. These products may be small or large and are often unique. Good examples of job production would be a specially designed wedding ring. In order to be called job production, each individual product has to be completed before the next product is started. At any one time, there is only one product being made. New, small firms often use labor-intensive job production, before they get the chance to expand and purchase advanced equipment. Job production enables specialized products to be produced and tends to be motivating for workers, because they produce the whole product and can take pride in it.

Batch production

Batch production makes products in separate groups and the products in each batch go through the whole production process together. The production process involves a number of distinct stages and the defining feature of batch production is that every unit in the batch must go through an individual production stage before the batch as a whole moves on to the next stage. A good example of this form of production is a baker making batches of rolls. First, the dough is mixed and kneaded. Then, after being left for a time, the dough is separated into individual amounts, the right size for rolls. After this, the rolls are baked together and then they are left to cool. When they have cooled, they are put on display in the shop and another batch can be prepared. Each roll has gone through the process with the other rolls in the batch and all the rolls have undergone each stage of the batch before going on to the next stage. Batch production allows firms to use division of labor in their production process and it enables economies of scale if the batch is large enough.

Flow production

This method is used when individual products move from stage to stage of the production process as soon as they are ready, without having to wait for any other products.
Flow production systems are capable of producing large quantities of output in a relatively short time and so it suits industries where the demand for the product in question is high and consistent. It also suits the production of large numbers of a standardized item that only requires minimal alterations. This is why it is often referred to as mass production. Flow production usually takes place on a production line – hence the use of the term line production.

Mass Customization

The search for production methods that combine the advantages of job production flexibility and worker satisfaction – with the gains from flow/mass production – low unit costs – has led to the development of mass customisation. This method is only possible because of tremendous advances in technology such as computer-aided design (CAD) and computer-aided manufacturing (CAM). These have allowed much quicker developments of new products, designs that feature many common components and robotic machinery that can be switched to making different parts. Developments in the organization of the production fl ow lines have also reduced the alienating effects of typical mass production. The emphasis on repetitive, boring tasks has been a major factor in poor worker motivation. The mass customisation process combines the latest technology with multi-skilled labour forces to use production lines to make a range of varied products.

2. Analyse the implications for functional departments that arise from changing the production methods

[Learning Outcome b]

A change in production methods will impact on the different functional departments of a business.

From job to batch

- Finance:
  - Cost of equipment needed to handle large numbers in each batch
  - Additional working capital needed to finance high levels of stocks and work in progress.
- Human resources: staff demotivation – less emphasis placed on an individual's craft skills.
- Marketing:
  - Can no longer promote the product as being 'customized to each consumer'
  - May have to promote the benefits of lower prices and consistent quality.

From job or batch to flow

- Finance:
  - Cost of capital equipment needed for flow production
  - Any production delays during the change-over period may impact on cash flow.
- Human resources: risk of low motivation and boredom if traditional line production techniques are used.
- Marketing:
  - Mass production requires mass marketing so market research will be vital to identify largest market segments
  - Accurate estimates of future demand to ensure that output matches demand
  - Promotion and pricing decisions will have to be geared towards a mass marketing approach – not niche marketing, so the orientation of the business might have to change.

From batch or flow to cell production

- Finance: expensive CAM methods may be needed to allow cells to switch from one product to another.
- Human resources:
  - Recruitment of flexible, adaptable staff keen to work in teams
  - Staff training will be needed to achieve multi-skilling.
- Marketing: productivity and quality improvements should allow competitive pricing and promotion of the improved quality products.

3. Analyse the most appropriate method of production for a given situation

[Learning Outcome c]

The following factors will influence whether a business adopts one of the four methods of production considered above – that is job, batch, flow or flow production with the development to mass customization.

Size of the market

If the market is very small, such as for designer clothes, then job production is likely to be used. Flow production is most efficiently adopted when the market for similar or identical products is very large and consistent throughout the year. If mass production is used in this way, then mass-marketing methods will also have to be adopted to sell the high output levels that can be manufactured. Even in a market for mass produced items, such as cars, there may be market niches that will allow smaller manufacturers to survive by making one-off products or batches of identical goods before changing the design or style for another model. If the market demands a large number of units, but at different times of the year, for example textbooks at the start of the academic year, then batch production might be most appropriate.

The amount of capital available

A purpose-built flow production line is difficult and expensive to construct. Small firms are unlikely to be able to afford this type of investment and are more likely to use job or batch production.

Availability of other resources

Large-scale flow production often requires a supply of relatively unskilled workers and a large, flat land area. Job production needs skilled crafts people. If any of these resources are unavailable, or very limited in supply, then the production method may have to be adapted to suit available resources, given the market constraint referred to above.

4. Explain the concept of quality

[Learning Outcome d]

The Concept of Quality

A quality product does not necessarily have to be the 'best possible'.

Consumer expectations are very different for goods and services sold at different prices. A quality product does not have to be made with the highest-quality materials to the most exacting standards – but it must meet consumer requirements for it.

A quality product does not have to be expensive. If low cost light bulbs and clothes pegs last for several years in normal use, then they have still met consumer expectations and have been of the required quality. So, a highly priced good may still be of low quality if it fails to come up to consumer requirements. A cheap good can be considered of good quality if it performs as expected. It should be understood that quality is a relative concept and not an absolute one – it depends on the product's price and the expectations of consumers.

Quality standards is the expectations of customers expressed in terms of the minimum acceptable production or service standards

The advantages of producing quality products and services are:

- Easier to create customer loyalty
- Saves on the costs associated with customer complaints, e.g. compensation, replacing
- Defective products and loss of consumer goodwill

- Longer life cycles
- Less advertising may be necessary as the brand will establish a quality image through the performance of the products
- A higher price – a price premium – could be charged for such goods and services. Quality can, therefore, be profitable.

5. Understand the difference between quality control and quality assurance –total quality management

[Learning Outcome d]

Quality control this is based on inspection of the product or a sample of products

Quality assurance this is a system of agreeing and meeting quality standards at each stage of production to ensure consumer satisfaction

These two terms are used to classify two very different approaches to managing and achieving quality in any business.

Quality control is the traditional approach to achieving quality based on inspection or checking, usually of the completed product or of the service as it is being provided to a consumer.

For example:

- an MP3 player being tested at the end of the production line for battery-charging capability
- a telephone-banking adviser having a call to a customer listened to and recorded.

Quality-control techniques

There are three stages to effective quality control:

- Prevention – this is the most effective way of improving quality. If the design of the product follows the requirements of the customer and allows for accurate production, then the other two stages will be less significant. Quality should be ‘designed into’ a product.
- Inspection – traditionally this has been the most important stage – but it has high costs and these could be reduced by ‘zero-defect’ manufacturing that is the aim of total quality management (TQM).
- Correction and improvement – this is not just about correcting faulty products but is also concerned with correcting the process that caused the fault in the first place. This will improve quality in the future.

Quality assurance

Quality assurance is based on setting agreed quality standards at all stages in the production of a good or service in order to ensure that customers’ satisfaction is achieved. It does not just focus on the finished product. This approach often involves self-checking by workers of their own output against these agreed quality standards. The key differences between the two methods are that quality assurance:

- puts much more emphasis on prevention of poor quality by designing products for easy fault-free manufacture, rather than inspecting for poor-quality products – ‘getting it right first time’

- stresses the need for workers to get it right the first time and reduces the chances of faulty products occurring or expensive reworking of faulty goods
- establishes quality standards and targets for each stage of the production process – for both goods and services
- checks components, materials and services bought into the business at the point of arrival or delivery – not at the end of the production process by which stage much time and many resources may have been wasted.

The quality-assurance department will need to consider all areas of the fi rm. Agreed standards must be established at all stages of the process from initial product idea to it finally reaching the consumer:

- Product design – will the product meet the expectations of consumers?
- Quality of inputs – quality must not be let down by bought-in components. Suppliers will have to accept and keep to strict quality standards.
- Production quality – this can be assured by total quality management (TQM) and emphasizing with workers that quality levels must not drop below pre-set standards.
- Delivery systems – customers need goods and services delivered at times convenient to them. The punctuality and reliability of delivery systems must be monitored.
- Customer service including after-sales service – continued customer satisfaction will depend on the quality of contact with consumers after purchase.

Quality assurance has the following advantages:

- It makes everyone responsible for quality – this can be a form of job enrichment.
- Self-checking and making efforts to improve quality increases motivation.
- The system can be used to ‘trace back’ quality problems to the stage of the production process where a problem might have been occurring.
- It reduces the need for expensive final inspection and correction or reworking of faulty products.