Cambridge
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Business Management

for the IB Diploma

SECOND EDITION

Peter Stimpson
and Alex Smith

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- assist students in approaching complex questions, applying critical-thinking skills and forming reasoned answers.

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Contents

Introduction

Nature of the subject

The International Baccalaureate Diploma Programme Business Management is designed to develop an understanding of essential business theory and the ability to apply business principles, practices and skills. It encourages students to analyse the diverse range of business organisations and activities and the cultural and economic context in which businesses operate. The emphasis is placed on strategic decision-making and the business functions of marketing, production, human resource management and finance. Business Management is the study of both the way in which individuals and groups interact in an organisation and of the transformation of resources. It is, therefore, perfectly placed within the group 3 subject area (individuals and societies) of the IB Diploma Programme hexagon.

Who is this book for?

This book accurately and comprehensively follows the 2014 International Baccalaureate (IB) higher level (HL) and standard level (SL) syllabus for Business Management.

If you are a student preparing for the assessments based on this syllabus, or a teacher preparing students for the assessments, you can be confident that this book provides comprehensive coverage of the course. Other students of business management courses at equivalent levels could also greatly benefit from the subject content, activities and advice that this book contains.

What are the aims of the book?

Apart from providing the appropriate subject content for the IB Business Management course, this book aims to:

- introduce business management as a study of the ways in which individuals and groups interact in an organisation and of how resources are transformed by businesses
- explain that business management is a rigorous and rewarding subject that examines dynamic decision-making processes and assesses how these decisions impact on and are affected by internal and external environments
- help students to develop an understanding of business theory and the ability to apply business principles, practices and skills
- encourage students to consider the activities of business in a global market and appreciate cultural diversity
- evaluate the diverse range of business organisations and activities
- develop in students an awareness of the cultural and economic context in which businesses operate
- encourage the appreciation of ethical issues and the concept of social responsibility in the global business environment

- enable the development of decision-making skills through the use of case studies that enhance students' ability to make informed business decisions
- make a clear distinction between higher-level and standard-level content
- help students improve their performance on the internal and external assessments used in the Business Management syllabus
- show how the Business Management syllabus relates to the Theory of Knowledge part of the IB Programme.

The six key concepts that underpin the Diploma Programme are referred to throughout the book. These concepts are featured in the 'Setting the scene' case studies and a key concept question is included in all of the exam practice questions.

What are the key features of this book?

- **Learning objectives** – identifying the key syllabus-related topics and concepts covered in each chapter.
- **'Setting the scene' case studies** – raising important areas for discussion on business issues through case studies drawn from many different countries. These provide a context to the business applications of the material to be covered in each chapter.
- **Clearly laid-out text** – with easy-to-follow subsections and many tables of data and key advantages and disadvantages.
- **Exam tips** – helping to avoid common errors made by students in examinations.
- **Activities** – based on business case studies, these give practice at applying learning.
- **Revision checklists** – allowing monitoring of understanding of key issues.
- **Revision case studies and exam practice questions** – testing the skills of application, analysis and evaluation, using international business situations.
- **Theory of Knowledge assignments** – these reflect the very close relationship between Theory of Knowledge and Business Management.

Skills needed by Business Management students

The skills acquired and developed by successful students of Business Management interlink with the IB learner profile. In particular, decision-making, risk-taking and thinking skills are needed to weigh up and make judgements on a wide range of business strategies, and options will be transferable both to other disciplines and to higher-level undergraduate study at university.

The assessments used in the IB Business Management course will test the following skills:

- **Knowledge and understanding** of business terminology, concepts, principles and theories
- **Application** of skills and knowledge learned to hypothetical and real-business situations
- **Analysis and evaluation** of business decisions and business strategies and practices using critical thinking

- **Decision-making** by identifying the issue(s), selecting and interpreting data, applying appropriate tools and techniques, and recommending suitable solutions
- **Synthesise** knowledge in order to develop a framework for business decision-making.

Difference between higher and standard levels

The HL course in Business Management differs from the SL course in a number of important ways. These differences are reflected in this book by the clear distinction made between SL and HL material with several chapters specifically devoted to HL content. The HL material is supported by more evaluative questions and strategic decision-based tasks within the activities and exam practice questions.

IB assessment

The exam practice questions at the end of each chapter are IB-style questions designed to give students practice at answering examination questions.

The final chapter of the book gives clear guidance on the forms of assessment used at both SL and HL. It explains the requirements for the extended essay coursework, internal assessment and examination papers. Written by a senior IB examiner with many years' experience in preparing students for both levels of the IB Diploma, it is essential reading for all those preparing for the assessment in IB Business Management.

Peter Stimpson
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February 2015

Unit
1

BUSINESS ORGANISATION AND ENVIRONMENT

1.1

Introduction to business management

On completing this chapter you should be able to:

Analyse and apply:

- The role of business (AO2)
- The main business functions and their roles (AO2)
- Primary, secondary, tertiary and quaternary sectors (AO2)
- The nature of business activity (AO2)
- Reasons for starting up a business (AO2)
- Common steps in starting a business (AO2)
- Problems that a new business or enterprise faces (AO2)

Evaluate:

- The role of entrepreneurship and intrapreneurship in overall business activity (AO3)

Setting the scene

ENTERPRISE PAYS OFF

Sean Walsh knew that his retail job was at risk during the economic problems of 2009. He wanted to start his own business to give his family more security. Sean is a keen jet skier and power boater but he cannot afford to own these expensive leisure products. When he tried to hire a jet ski at a large lake in the USA he was surprised by the price – $400 a day – and the refusal of the renting company to offer insurance. Sean did not want to take any uninsured risks – he had a young family to think about – so he decided against renting. On the way home he noticed a large number of boats and jet skis lying idle in drives and parking lots and the idea occurred to him that these could be rented out to people who loved the sport but could not afford a boat. He did some market research and discovered what he considered to be a profitable gap in the market. He set up an online agency putting boat and jet ski owners in touch with people who wanted to rent – taking 25% commission when a rental was agreed. He also arranged insurance for both the renter and the boat owner. That was six years ago – he has since set up his own boatyard buying and selling second-hand power boats and jet skis, paid for from profits of the online rental agency.

Points to consider

- Why do you think Sean decided to own and run his own business?
- What resources (or inputs) does Sean need to run his business successfully?
- What problems do you think Sean experienced when starting up his business?

Key concept link

New enterprises need to differentiate themselves from rivals, many of whom will be well established. One way of achieving this is by innovation – providing either a different type of product or a service which is different from those of competitors or which is delivered in a distinct way.

Introduction – what is a business?

A business is any organisation that uses resources to meet the needs of customers by providing a product or service that they demand. There are several stages in the production of finished goods. Business activity at all stages involves adding value to resources such as raw materials and semi-finished goods and making them more desirable to – and thus valued by – the final purchaser. Without business activity we would all still be entirely dependent on the goods that we could make or grow ourselves – as people in some communities still are. Business activity uses the scarce resources of our planet to produce goods and services that allow us to enjoy a much higher standard of living than would be possible if we remained entirely self-sufficient.

consumer goods: the physical and tangible goods sold to the general public. They include cars and washing machines, which are referred to as durable consumer goods. Non-durable consumer goods include food, drinks and sweets that can only be used once.

consumer services: non-tangible products that are sold to the general public and include hotel accommodation, insurance services and train journeys

capital goods: physical goods that are used by industry to aid in the production of other goods and services such as machines and commercial vehicles

The role of businesses

Businesses identify the needs of consumers or other firms. They then purchase resources, which are the inputs of the business, or factors of production, in order to produce output. The 'outputs' of a business are the goods and services that satisfy consumers' needs, usually with the aim of making a profit. Business activity exists to produce goods or services, which can be classified in several ways: **consumer goods**, **consumer services** and **capital goods**.

What are business 'inputs'?

These are the human, physical and financial resources needed by business to produce goods or services. They are also known as factors of production. Firms will use different combinations of inputs, depending on the product being produced and the size of the business. There are four main inputs:

- **Land** – this general term not only includes land itself but all of the renewable and non-renewable resources of nature such as coal, crude oil and timber.
- **Labour** – manual and skilled labour make up the workforce of the business. Some firms are labour-intensive, that is they have a high proportion of labour inputs to other factors of production, e.g. house-cleaning services.
- **Capital** – this consists of the finance needed to set up a business and pay for its continuing operations as well as all of the man-made resources used in production. These include capital goods such as computers, machines, factories, offices and vehicles. Some firms are capital-intensive, that is they have a high proportion of capital to other factors of production, e.g. power stations.
- **Enterprise** – this is the driving force of business, provided by risk-taking individuals, which combines the other factors of production into a unit that is capable of producing goods and services. It provides a managing, decision-making and coordinating role. Without this essential input, even very high-quality land, labour and capital inputs will fail to provide the goods and services that customers need.

Businesses have many other needs before they can successfully produce the goods and services demanded by customers. Figure 1.1.1 shows the wide range of these needs.

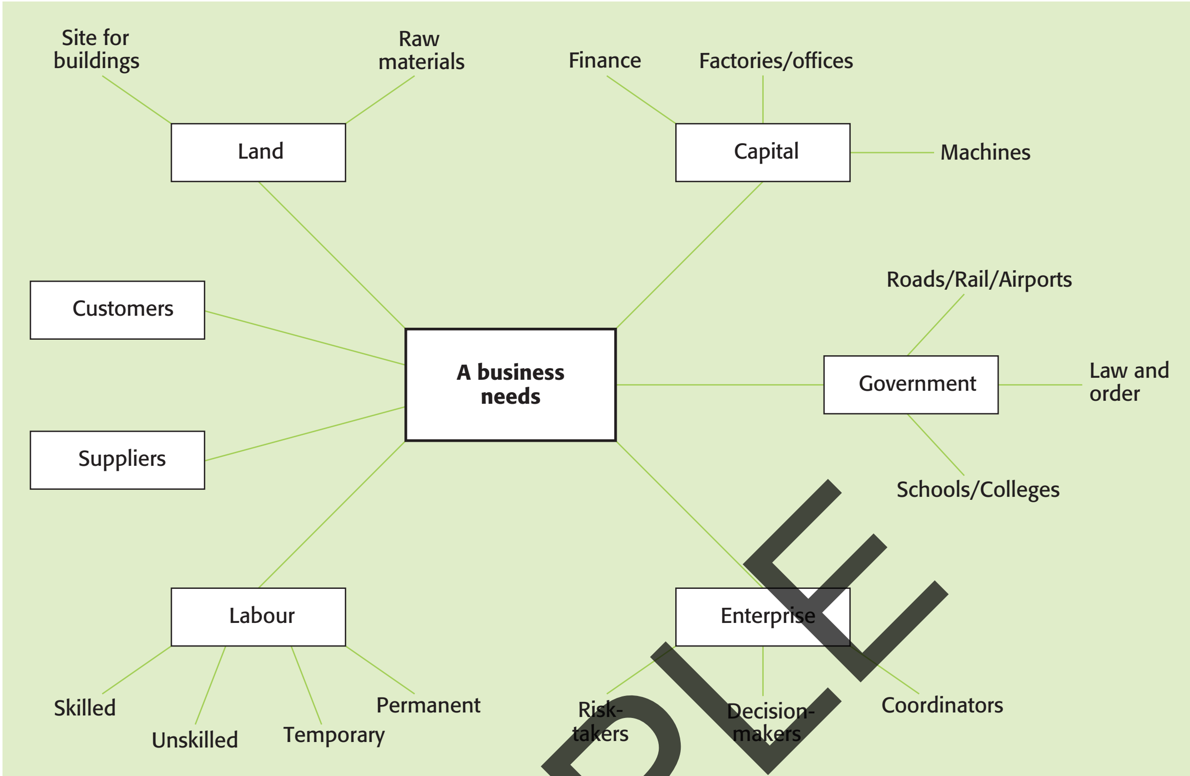


Figure 1.1.1 What businesses need

Business functions

Most businesses have four main functional departments. These will be staffed by people with specific qualifications and experience in the work of the functional areas.

Human resource management

Human resource (HR) management identifies the workforce needs of the business, recruits, selects and trains appropriate employees and provides motivational systems to help retain workers and encourage them to work productively. It also draws up contracts of employment and covers the redundancy or redeployment of employees if these become necessary. The aim of this business function is to manage human resources to help the business achieve its overall objectives.

Finance and accounts

This function has responsibility for monitoring the flow of finance into and out of the business, keeping and analysing accounts and providing financial information to both senior management and other departments. Without adequate finance, no effective decisions can be made within the other functional areas, so finance is a key division of any business.

Marketing

This department is responsible for market research and for analysing the results of such research so that consumer wants can be correctly identified. This information will then be discussed with other departments of the business so that the right product decisions

Primary production – dairy cattle in France

Secondary production – clothing factory in India

Tertiary sector – the breathtaking Burj Al Arab hotel in Dubai

are made. Once a product is available for sale, the marketing function will have to make important decisions concerning its pricing, how and where to promote it and how to sell it and distribute it for sale.

Operations management

Once known simply as the 'production function', operations management has responsibility for ensuring adequate resources are available for production, maintaining production and quality levels and achieving high levels of productive efficiency. This function is important in service industries as well as traditional manufacturing. In service industries, operations management will have the objective of ensuring that the processes for the delivery of the service are well tested, consistent and understood by all employees.

Interrelationship of functions

It should not be assumed that all business decisions taken within these departments are separate and unconnected to the other parts of the business. Nothing could be further from reality! Effective strategic decision-making develops from the functions working closely together. Good communication, cooperation and close interrelationships between functions are essential before major decisions are taken. For example, the decision by BMW to develop and launch its first electric-powered sports car – the i8 – required interaction between:

- marketing – will consumers be prepared to buy this car and at what price?
- finance – do we have the capital needed to develop and produce it?
- HR management – do we need to recruit additional engineers before this project can be turned into a market-ready car?
- operations management – can we produce this product at a cost which allows the marketing department to set a profitable price level? Will quality of the vehicle be up to normal BMW standards?

ACTIVITY 1.1.1

Identify which business function is most likely to undertake the following roles:

Role	Function
Setting prices of new products	
Recruiting a new production manager	
Allocating resources to purchase capital equipment	
Deciding on the appropriate levels of stocks for raw materials	
Finding out if consumers prefer one product design to another	
Determining the level and number of employees the business needs for future operations	

Economic sectors

All production can be classified into four broad types of business activity, or economic sectors. These categories are the three stages involved in turning natural resources, such as oil and timber, into the finished goods and services demanded by consumers plus the 'knowledge-based' support services that businesses require. The four sectors are **primary**, **secondary**, **tertiary** and **quaternary**.

National economic data often makes no distinction between tertiary and quaternary sectors. The balance of the primary, secondary and tertiary sectors in the economy varies substantially from country to country. It depends on the level of industrialisation in each country. The balance between the sectors is often referred to as a country's 'economic structure'. Table 1.1.1 shows the different economic structures of three countries.

Country	Primary	Secondary	Tertiary
United Kingdom	2	17	81
China	42	26	32
Ghana	54	20	26

Table 1.1.1 Employment data 2013 – as percentage of total employment

Changes in economic structure – sectoral change

It is very important to recognise two features of this classification of business activity:

1. The importance of each sector in a country's economic structure changes over time. Industrialisation describes the growing importance of the secondary sector manufacturing industries in developing countries. The relative importance of each sector is measured in terms either of employment levels or output levels as a proportion of the whole economy. In many countries of Africa and Asia, the relative importance of secondary sector activity is increasing. This brings many benefits as well as problems.

Benefits

- Total national output (gross domestic product) increases and this raises average standards of living.
- Increasing output of goods can result in lower imports and higher exports of such products.

primary sector business activity: firms engaged in farming, fishing, oil extraction and all other industries that extract natural resources so that they can be used and processed by other firms

secondary sector business activity: firms that manufacture and process products from natural resources, including computers, brewing, baking, clothing and construction

tertiary sector business activity: firms that provide services to consumers and other businesses, such as retailing, transport, insurance, banking, hotels, tourism and telecommunications

quaternary sector business activity: is focused on information technology (IT) businesses and information service providers such as research and development, business consulting and information gathering

- Expanding manufacturing businesses will result in more jobs being created.
- Expanding and profitable firms will pay more tax to the government.
- Value is added to the country's output of raw materials rather than simply exporting these as basic, unprocessed products.

Problems

- The chance of work in manufacturing can encourage a huge movement of people from the countryside to the towns, which leads to housing and social problems. It may also result in depopulation of rural areas and problems for farmers in recruiting enough workers.
- The expansion of manufacturing industries may make it difficult for a business to recruit and retain sufficient staff.
- Imports of raw materials and components are often needed, which can increase the country's import costs. Business import costs will vary with changes in the exchange rate.
- Pollution from factories will add to the country's environmental problems.
- Much of the growth of manufacturing industry is due to the expansion of multinational companies.

In more economically developed economies, the situation is reversed. There is a general decline in the importance of secondary sector activity and an increase in the tertiary sector. This is known as deindustrialisation. In the UK, the proportion of total output accounted for by secondary industry has fallen by 13% to 20% in 25 years. In South Africa, the relative importance of the secondary manufacturing sector fell from 20% to 17% between 1993 and 2012. The reasons for and possible impact of these changes on business include:

- Rising incomes associated with higher living standards have led consumers to spend much of their extra income on services rather than more goods. There has been substantial growth in tourism, hotels and restaurant services, financial services and so on – yet spending on physical goods is rising more slowly.
- As the rest of the world industrialises, so manufacturing businesses in the developed countries face much more competition and these rivals tend to be more efficient and use cheaper labour. Therefore, rising imports of goods are taking market away from the domestic secondary sector firms and many have been forced to close.
- Employment patterns change – manufacturing workers may find it difficult to find employment in other sectors of industry. This is called structural unemployment.

2. The relative importance of each sector varies significantly between different economies. Table 1.1.1 above gives details of the differences that exist between the economies of different countries and the share of total employment accounted for by each sector of industry.

Exam tip: During your IB Business and Management course it is a good idea to read the business section of newspapers regularly – don't forget that these are often available free online. This will help you to apply the work you have done in class to the world outside. What, for example, was the major business story in your country this week?

ACTIVITY 1.1.2

Business	Primary	Secondary	Tertiary	Quaternary	Description of main activities
Coca-Cola					
HSBC					
FAW (China)					
RTZ					
Wyndham Worldwide					
RR plc					
Capco					

1. Copy out this table. Use the internet or other means of research to:
   a. identify these well-known international companies
   b. identify the main sector of industry that they operate in
   c. give details of their main activities.
2. Research **five** businesses that operate in your country and identify which sector of industry they mainly operate in and what their main activities are.

ACTIVITY 1.1.3

BP OPERATES IN THREE ECONOMIC SECTORS

BP is the third-largest oil company in the world. Here are extracts from three recent newspaper articles about the company:

BP announces another huge oil find

BP has just released details of its third major oil reserve discovery in the US Gulf of Mexico. This will enhance BP's position as one of the largest crude oil suppliers in the USA.

BP Castillon refinery

BP's Castillon refinery is the only oil refinery in this region of Spain. It has the capacity to convert 110,000 barrels of crude oil each day into a range of products used by road vehicles, the aviation industry, chemical manufacturers and the plastic industry.

BP now operates 800 petrol stations in China

BP is a familiar petrol and diesel brand to car and truck drivers in China. The company co-owns over 800 petrol station sites – mainly with PetroChina. BP has a leading position in the petrol retail market.

10 marks, 20 minutes

1. Define the term 'economic sector'. [2]
2. Using examples from these articles, explain the statement that 'BP operates in all economic sectors'. [4]
3. Explain why a decision by BP to open new petrol stations in China will involve effective cooperation between all four business functions. [4]

Starting a business

Why start a business?

Reasons for starting a new business include some or all of the following:

- Losing a job encourages many people to set up a business by themselves, either providing their former employer's product or another product, perhaps based on an interest or skill they have.

- Desire for independence – some people do not like the idea of being told what to do! By creating their own business, they have work flexibility and control over their working lives.
- By talking to friends or family, it might become clear that a business opportunity exists that an entrepreneur could take advantage of.
- A wish to make more money than in the current job – many people setting up their own business believe that they will earn a higher income working for themselves.

Role of the entrepreneur

New business ventures started by **entrepreneurs** can be based on a totally new product or customer service idea or a new way of offering a service. People who set up their own new business show skills of 'entrepreneurship'. People who are given responsibility to develop and market a product within a large corporation show skills of 'intrapreneurship'.

entrepreneur: someone who takes the financial risk of starting and managing a new venture

intrapreneur: someone within a large corporation who takes direct responsibility for turning an idea into a profitable finished product through using 'entrepreneurial talents' such as risk-taking and innovation

Entrepreneurs have:

- had an idea for a new business
- invested some of their own savings and capital
- accepted the responsibility of managing the business
- accepted the possible risks of failure.

Intrapreneurs do not risk their own capital and the consequences of failure are accepted by the organisation that they work for. They can drive forward a new product idea and help make the organisation that they work for more innovative and able to cope with change.

THEORY OF KNOWLEDGE

'The Entrepreneurial Instinct profoundly reveals that exceptional success has more to do with thoughtful risk-taking and agility than school pedigree, I.Q. and even decades of experience. Fear keeps us small, but following your instinct with stamina and passion can lead to greatness.'

Ajay Banga, President and CEO, MasterCard Worldwide

What does Ajay Banga's statement tell us about the importance of sense perception when making business decisions?

The personal qualities and skills needed for entrepreneurs or intrapreneurs to make a success of a new business venture are described below.

Innovative

The entrepreneur may not be a 'product inventor', but they must be able to carve a new niche in the market, attract consumers in innovative ways and present their business as being 'different'. This requires original ideas and an ability to do things innovatively.

Commitment and self-motivation

It is never an easy option to set up and run your own business. It is hard work and may take up many hours of each day. A willingness to work hard, a keen ambition to succeed, energy and focus are all essential qualities of a successful entrepreneur.

Multi-skilled

An entrepreneur will have to make the product or provide the service, promote it, sell it and count the money. These different business tasks require a person with many different qualities such as being keen to learn technical skills, an ability to get on with people and being good at handling money and keeping accounting records.

Leadership skills

An entrepreneur has to lead by example and must have a personality that encourages people in the business to follow them and be motivated by them.

Belief in oneself

Many business start-ups fail, yet this would not discourage a true entrepreneur who would have such self-belief in their abilities and business idea that they would bounce back from any setbacks.

Risk-taker

Entrepreneurs must be willing to take risks in order to see results. Often the risk they take involves investing their own savings in a new business. Intrapreneurs may also have to take risks but the financial consequences – other than the risk of losing their jobs – are borne by the organisation.

LEARNER PROFILE

Risk-takers

According to Bloomberg, eight out of ten entrepreneurs who start businesses fail within the first 18 months. Predicting the success of a business is an incredibly difficult thing to do. People who start businesses and then see them fail can lose large sums of money and suffer what can be the significant emotional pain associated with business failure.

To what extent do new entrepreneurs have to be risk-takers?

Start-up businesses

New business start-ups can be found in nearly all industries. However, there are some industries and sectors of industry where there is a much greater likelihood of new entrepreneurs becoming established. These include:

- primary sector – fishing, market gardening (producing cash crops to sell at local markets)
- secondary sector – jewellery making, dressmaking, craft manufacture, e.g. batik cloth, building trades
- tertiary/service sector – hairdressing, car repairs, cafés and restaurants, childminding
- quaternary sector – IT support, website design, consultancy.

It would be unusual for entrepreneurs to successfully establish themselves in, say, the steel-making industry or car manufacturing because of the vast amount of capital equipment and financial investment that would be required.

Impact of enterprise (and intrapreneurship) on business activity

All governments around the world are following policies that aim to encourage more people to become entrepreneurs. What are the claimed benefits to the economy and business activity of enterprise?

- **Employment creation** In setting up a new business an entrepreneur is employing not only themselves ('self-employment'), but, very often, will employ other people too. Often these are members of their family or friends, but in creating such employment, the national level of unemployment will fall. If the business survives and expands, then there may be additional jobs created in the businesses that supply them.
- **Economic growth** Any increase in output of goods or services from a start-up business will increase the gross domestic product of the country. This is called economic growth, and if enough small businesses are created, it will lead to increased living standards for the population. In addition, increased output and consumption will also lead to increased tax revenues for the government.
- **Firms' survival and growth** Although a high proportion of new firms fail, some survive and a few expand to become really important businesses. These will employ large numbers of workers, add considerably to economic growth and will take the place of declining businesses that may be forced to close due to changing consumer tastes or technology. So, in Trinidad and Tobago, the relative decline of the sugar industry has been balanced out by the growth of the tourist industry, which has itself been boosted by small guesthouse businesses operating as sole traders.
- **Innovation and technological change** New businesses tend to be innovative and this creativity adds dynamism to an economy. This creativity can 'rub off' on other businesses and help to make the nation's business sector more competitive. Many new business start-ups are in the technology sector, e.g. website design. The increased use of IT by these firms, and the IT services they provide to other businesses, can help a nation's business sector become more advanced in its applications of IT, and therefore more competitive.

Common steps in starting a business or enterprise

Identifying market opportunities

Many people say that they want to work for themselves, but they then do not make the leap into entrepreneurship successfully because they have not been able to identify a market opportunity that will generate sufficient demand for their product or service to enable the business to be profitable. The original idea for most new businesses comes from one of several sources including:

- own skills or hobbies, e.g. dressmaking or car bodywork repairer
- previous employment experience, e.g. learning hairdressing skills with an established business
- franchising conferences and exhibitions offering a wide range of new business start-up ideas, e.g. fast-food restaurants
- small-budget market research – the use of the internet allows any user to browse business directories to see how many businesses there are in the local area offering certain goods or services. This low-cost research might indicate gaps in local markets that could be profitably filled by the entrepreneur.

Sourcing capital (finance)

Once the entrepreneur has decided on the business idea or opportunity, the next task is to raise the necessary capital. This will come from various sources but the business owner/entrepreneur will almost certainly have to use some of their own savings in setting up the business. Friends and family might also be asked for financial support. Banks may provide loan finance or an overdraft facility – but bank officials will want to check the business plan contents very rigorously. Venture capitalists may be prepared to invest if the business idea is novel, can be protected or patented and offers significant profit potential. Government grants might be available – perhaps as part of a policy to reduce unemployment by encouraging people to set up new businesses.

Determining a location

A suitable location is vital if the start-up business intends to sell directly to consumers. This raises the problem of costs. Perhaps the most important consideration when choosing the location for a new business is the need to minimise fixed costs. When finance is limited, it is very important to try to keep the break-even level of output – the output level that earns enough revenue to cover all costs – as low as possible. This will greatly increase the chances of survival. Operating from home is the most common way for entrepreneurs to establish their business. This has the great advantage of keeping costs low, but there are drawbacks:

- It may not be close to the area with the biggest market potential.
- It lacks status – a business with its own prestigious premises tends to generate confidence.
- It may cause family tensions.
- It may be difficult to separate private life from working life.

The cost and position of these locations could have a big impact on the business entrepreneur's chance of success.

New businesses that offer a consumer service need to consider location very carefully. Whereas a website designer could operate from home very effectively, as communication with customers will be by electronic means, a hairdresser may need to consider obtaining premises in an area with the biggest number of potential customers. An alternative is to visit customers in their own homes – this way, the entrepreneur may avoid the costs of buying or renting their own premises altogether.

Building a customer base

To survive, a new firm must establish itself in the market and build up customer numbers as quickly as possible. The long-term strength of the business will depend on encouraging customers to return to purchase products again and again. Many small businesses try to encourage this by offering a better service than their larger and better-funded competitors. This better service might include:

- personal customer service
- knowledgeable pre- and after-sales service
- providing for one-off customer requests that larger firms may be reluctant to provide for.

Problems faced by start-ups

Even if an entrepreneur has all the qualities listed above, success with a new business can never be guaranteed. Many businesses fail during their first year of operation. The most common reasons for this are discussed below.

Competition

This is nearly always a problem for new enterprises unless the business idea is unique. More generally, a newly created business will experience competition from older, established businesses with more resources and market knowledge. The entrepreneur may have to offer better customer service to overcome the cost and pricing advantages of bigger businesses.

Lack of record-keeping

Accurate records are vital to pay taxes and bills and chase up debtors. Many entrepreneurs fail to pay sufficient attention to this as they either believe that it is less important than actually meeting customers' needs or they think they can remember everything, which they could not possibly do after a period of time. For example, how can the owner of a new, busy florist's shop remember:

- when the next delivery of fresh flowers was booked for?
- whether the flowers for last week's big wedding have been paid for?
- if the cheque received from an important customer has been paid into the bank yet?
- how many hours the shop assistant worked last week?

Lack of finance and working capital

In an International Labour Organisation (ILO) survey of new business start-ups, the problem of finance came at the top of the list of replies from entrepreneurs regarding the main difficulty. Why is obtaining finance such a major problem for entrepreneurs?

- Lack of sufficient own finance – many entrepreneurs have very limited personal savings, especially if they are setting up their own business because they were previously made redundant.
- Lack of awareness of the financial support and grants available.
- Lack of any trading record to present to banks as evidence of past business success – a trading record would tend to give a bank confidence when deciding whether to lend money for a new venture.
- A poorly produced business plan that fails to convince potential investors of the chances of a business's success. Running short of capital to run day-to-day business affairs is the single most common reason for the failure of new businesses to survive in the first year. Capital is needed for day-to-day cash, for the holding of stocks and to allow the giving of trade credit to customers, who then become debtors. Without sufficient working capital, the business may be unable to buy more stocks or pay suppliers or offer credit to important customers.

Serious working capital shortages can usually be avoided if businesses take several important steps:

- Construct and update a cash flow forecast so that the liquidity and working capital needs of the business can be assessed, month by month.
- Inject sufficient capital into the business at start-up for the first few months of operation when cash flow from customers may be slow to build up.
- Establish good relations with the bank so that short-term problems may be, at least temporarily, overcome with an overdraft.
- Use effective credit control over customers' accounts – do not allow a period of credit which is too long, and quickly chase up late payers.

Poor management skills

Most entrepreneurs have had some form of work experience, but not necessarily at a management level. They may not have gained experience of:

- leadership skills
- cash handling and cash management skills
- planning and coordinating skills

- decision-making skills
- communication skills
- marketing, promotion and selling skills.

Entrepreneurs may be very keen, willing to work hard and with undoubted abilities in their chosen field – for example, a new restaurant owner may be an excellent chef but may be lacking management skills. Some learn these skills very quickly once the business is up and running, but this is a risky strategy. Some entrepreneurs buy in the experience by employing staff with management experience, but this is an expensive option.

It is wrong to think, just because a business is new and small, that enthusiasm, a strong personality and hard work will be sufficient to ensure success. This may prove to be the case, but often it is not. Potential entrepreneurs are encouraged to attend training courses to gain some of these skills before putting their capital at risk or to seek management experience through employment.

Changes in the business environment

Setting up a new business is risky. Not only are there the problems and challenges referred to above but there is also the risk of change, which can make the original business idea much less successful. New businesses may fail if any of the following changes occur, turning the venture from a successful one to a loss-making enterprise:

- new competitors
- legal changes, e.g. outlawing the product altogether
- economic changes that leave customers with much less money to spend
- technological changes that make the methods used by the new business old-fashioned and expensive.

This list of changes could, no doubt, be added to, but even these four factors indicate that the business environment is a dynamic one, and this makes owning and running a business enterprise very risky indeed.

Business plans

business plan: a written document that describes a business, its objectives and its strategies, the market it is in and its financial forecasts

The contents of a typical **business plan** are:

- the executive summary – an overview of the new business and its strategies
- description of the business opportunity – details of the entrepreneur; what is going to be sold, why and to whom
- marketing and sales strategy – details of why the entrepreneur thinks customers will buy what the business plans to sell and how the business aims to sell to them
- management team and personnel – the skills and experience of the entrepreneur and the staff he/she intends to recruit
- operations – premises to be used, production facilities, IT systems
- financial forecasts – the future projections of sales, profit and cash flow, for at least one year ahead.

Table 1.1.2 shows a typical business plan summary for a new business venture.

Name of business	Pizza Piazza Ltd
Type of organisation	Private limited company
Details of business owners	Peter Chun – chef with 15 years' experience Sabrina Singh – deputy manager of restaurant for three years
Business aim	To provide a high-class takeaway pizza service including home delivery
Product	High quality home-cooked pizzas
Price	Average price of \$10 with \$2 delivery charge
Market aimed for	Young people and families
Market research undertaken and the results	Research in the area conducted using questionnaires Also, research into national trends in takeaway sales and local competitors Results of all research in the appendix to this plan
Human resources plan	Two workers (the business owners) to be the only staff to be employed initially
Production details and business costs	Main suppliers – R and R Wholesalers Fixed costs of business – \$70 000 per year Variable costs – approximately \$2 per unit sold
Location of business	Site in shopping street (Brindisi Avenue) just away from the town centre. Leasehold site (ten years)
Main equipment required	Second-hand kitchen equipment – \$6000 Second-hand motorbike – \$2000
Forecast profit	See financial appendix to this plan Summary: In the first year of operations the total costs are forecast to be \$55 000 with revenue of \$85 000. Predicted profit = \$30 000 Level of output to break even – 8750 units per year
Cash flow forecast	See financial appendix to this plan Due to the high set-up and promotion costs there will be negative cash flow in the first year
Finance	\$10 000 invested by each of the owners Request to bank for a further \$10 000 plus an overdraft arrangement of \$5000 per month

Table 1.1.2 Business plan for Pizza Piazza Ltd

Importance of business plans

- Business plans are most important when setting up a new business, but they should be referred to and updated when important strategic choices are being made too. The main purpose of a business plan for a new business is to obtain finance for the start-up. Potential investors or creditors will not provide finance unless clear details about the business proposal have been written down.
- The planning process is very important too. If an entrepreneur went into a new business – even if no external finance was required – without a clear sense of purpose, direction, marketing strategies and what employees to recruit, the chances of success would be much reduced.
- The financial and other forecasts contained in the plan can be used as the targets that the business should aim for.

Users of business plans

Business plans may be of real benefit to the stakeholders of new businesses:

- The plan allows potential investors in the new business – and the bank – to make a judgement about the viability of the idea and the chances of the owners making a success of it. Potential shareholders will not invest without seeing a plan first.
- The financial forecasts in a business plan can act as budgets and control benchmarks for the internal stakeholders such as business managers.
- Updated versions of the plan can be used to apply for additional funding, to attract additional partners or to supply data for the experts if a stock market flotation becomes an option.
- Employees will find that planning helps identify specific objectives and targets and gives focus to their work, which aids motivation.
- Suppliers may be able to tell from the parts of the business plan that are communicated externally whether it is worthwhile establishing a long-term trading relationship with the business.

OVER TO YOU

Revision checklist

1. What is a 'business'?
2. What is a 'business input'?
3. Give **two** examples of primary sector businesses, explaining why they are classified in this sector.
4. Give **two** examples of secondary sector businesses, explaining why they are classified in this sector.
5. Give **two** examples of tertiary sector businesses, explaining why they are classified in this sector.
6. Give **two** examples of quaternary sector businesses, explaining why they are classified in this sector.
7. Allocate each of these decisions into the appropriate business functional department:
   a. deciding on stock levels for an important raw material
   b. deciding between using shops or a website to sell a new range of clothing
   c. deciding whether to promote a manager from within the business or to recruit from another firm
   d. deciding on how to raise $3 million for a factory expansion.
8. Explain why, for a recent major business decision of your choice, it was important for all four business functions to work closely together.
9. Using data from your own country:
   a. How has total output or employment in the secondary sector changed over recent years?
   b. Consider **two** effects of this change on any business in your country.
10. Differentiate between entrepreneur and intrapreneur.
11. Comment on the similar skills needed by both entrepreneurs and intrapreneurs.
12. Explain **two** steps in the process of starting up a business.
13. Explain **two** problems commonly experienced by new business start-ups.
14. Comment on the importance of any two features of a business plan for a start-up enterprise to a potential investor.

Exam practice question

RECESSION SPARKS NEW BUSINESS IDEAS

Disney, McDonald's, Burger King, Procter & Gamble, Johnson & Johnson, Microsoft – what do they all have in common? They all started during a recession or depression.

The message, delivered to around 40 would-be entrepreneurs at a workshop in Stratford, East London, is clear: don't let bad economic headlines put you off. Most of the people at this session are not aiming to create new multinational corporations. But during the coffee break, they seem pretty confident that their ideas can prosper even in the current climate. 'I'm here to find out about starting up a business providing CVs to school leavers,' says Jessica Lyons, wearing a lapel badge with My First CV, the name of the future business, written on it. 'For my particular business idea I think this is the ideal time, because there are more people than ever out there looking for work.'

The recession is causing a spike in interest in setting up small businesses. Another interesting example was from a gym instructor who wants to take his equipment to companies around London, giving people a lunchtime workout without their having to leave their offices. Most of the would-be entrepreneurs in Stratford are looking at potential opportunities in the tertiary sector which don't require large amounts of start-up finance to purchase capital equipment and which rely more on their own skills and interests.

20 marks, 40 minutes

1. Define the term 'tertiary sector'. [2]
2. Outline the factors of production needed to set up the business providing CVs to school leavers. [4]
3. Explain **two** reasons why new businesses might start up in the tertiary sector. [4]
4. Discuss the advantages and disadvantages of setting up a business in a recession. [10]

Key concept question

20 marks, 40 minutes

With reference to one or two organisation(s) that you have studied, evaluate the importance of innovation in starting a new business. [20]

1.2

Types of organisations

On completing this chapter you should be able to:

Analyse and apply:

- The distinction between the private sector and public sector (AO2)

Evaluate:

- The main features of the following types of for-profit (commercial) organisations: sole traders, partnerships and companies/corporations (AO3)
- The main features of the following types of for-profit social enterprises: cooperatives, microfinance providers, public–private partnerships (PPP) (AO3)
- The main features of the following types of non-profit social enterprises: non-governmental organisations, charities (AO3)

Setting the scene

FRENCH TxCELL GOING PUBLIC

TxCell, a French private limited company that specialises in cell immunology, has taken the first steps to converting to a public limited company. Based in Valbonne, France, this company has 105 patents already and has developed a new generation of cell therapy for the treatment of inflammatory diseases. The finance raised from the Initial Public Offering (IPO) of shares to the general public will be used to continue the development and marketing of this important new product.

The first stage for planning of the IPO has already been completed. TxCell has announced the registration of its '*document de base*' (full analysis of the company's activities and finances) with the French *Autorité des marchés financiers* (AMF). Converting to a public limited company will not only allow access to additional capital but will increase the status and prestige of the business, may make it easier to attract the best employees and will allow the original owners to sell some of their share in the business to make money from their initial investments.

Source: Adapted from www.european-biotechnology-news.com

Points to consider

- Why are the owners of TxCell planning to sell shares to the public for the first time?
- Why is it important for potential investors to have a full 'analysis of the company's activities and finances'?
- Would the ownership by TxCell of 105 patents make potential investors more likely to buy shares in the company?

Key concept link

Is the culture of a business organisation partly dependent on its legal form of ownership? It could be the culture of a small sole-trader business is likely to be different from that of a large public limited company, owned by thousands – perhaps millions – of shareholders. The cultural difference could be even greater between 'for-profit' organisations and 'non-profit' social enterprises. The values, atittudes and beliefs of senior management and other employees of a social enterprise will not be the same as those of managers and employees in a profit-centred organisation.

Introduction

The first chapter looked at the classification of business into different economic sectors. This chapter further classifies business activity into:

- the **private sector** and **public sector**
- profit-based and non-profit-based organisations.

Profit-based or for-profit businesses in the private sector can take different legal forms and the advantages and disadvantages of these are very important. The growing importance of non-profit-based and non-governmental organisations is also analysed in this chapter.

public sector: comprises organisations accountable to and controlled by central or local government (the state)

private sector: comprises businesses owned and controlled by individuals or groups of individuals

Private sector and public sector organisations

Industry may be classified by sector: either public or private, and by type of legal organisation. These two types of classification are interlinked as some types of legal structure are only found in the private sector.

The relative importance of the private sector compared to the public sector is not the same in all **mixed economies**. Those economies that are closest to **free-market** systems have very small public sectors. Those countries with central planning **command economies** will have very few businesses in the private sector.

mixed economy: economic resources are owned and controlled by both private and public sectors

free-market economy: economic resources are owned largely by the private sector with very little state intervention

command economy: economic resources are owned, planned and controlled by the state

Distinctions between the sectors

In most mixed economies, certain important goods and services are provided by state-run organisations – they are in the public sector. It is argued that they are too significant to be left to private sector businesses. They include health and education services, defence and law and order (police force). In some countries, important 'strategic' industries are also state-owned and -controlled, such as energy, telecommunications and public transport. These public sector organisations therefore provide essential goods and services for individual citizens and organisations in the private sector, and they often have objectives other than profit – for example:

- ensuring supplies of essential goods and services – perhaps free of charge to the user, e.g. health and education services in some countries
- preventing private monopolies – single firms that dominate an industry – from controlling supply
- maintaining employment
- maintaining environmental standards.

In recent years, there has been a trend towards selling some public sector organisations to the private sector – **privatisation** – and this means that they put profit-making as one of their main objectives.

privatisation: the sale of public sector organisations to the private sector

Private sector organisations are owned and operated by individuals or groups of people. These organisations are usually operated for a profit but not all are. For example, charities are non-profit-making organisations in the private sector; they are not owned and controlled by the government or state.

public corporation: a business enterprise owned and controlled by the state – also known as nationalised industry or public sector enterprise

Exam tip: Public limited companies are in the private sector of industry – but public corporations are not.

Public sector enterprises

The term 'public' is used by business organisations in two different ways, and this often causes confusion. We have already identified public limited companies as being owned by shareholders in the private sector of the economy. Thus, public limited companies are in the private sector. However, in every country there will be some enterprises that are owned by the state – usually central or local government. These organisations are therefore in the public sector and they are referred to as **public corporations**.

Public sector organisations do not often have profit as a major objective. In many countries the publicly owned TV channels have as their main priority the quality of public service programmes. State-owned airlines have safety as a priority. Selling off public corporations to the private sector, known as privatisation, often results in changing objectives from socially orientated ones to profit-driven goals. A summary of the potential advantages and disadvantages of public corporations is given in Table 1.2.1.

Advantages	Disadvantages
• Managed with social objectives rather than solely with profit objectives • Loss-making services might still be kept operating if the social benefit is great enough • Finance raised mainly from the government so not subject to limitations from banks or shareholders	• Tendency towards inefficiency due to lack of strict profit targets • Subsidies from government can encourage inefficiencies • Government may interfere in business decisions for political reasons, e.g. by opening a new branch in a certain area to gain popularity

Table 1.2.1 Public sector organisations – advantages and disadvantages

For-profit organisations

Figure 1.2.1 shows the main types of private sector businesses that are operated for profit.

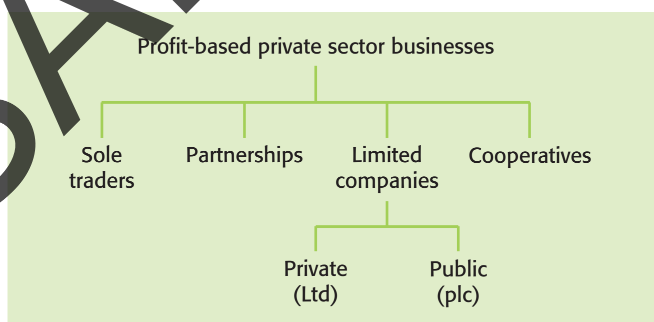


Figure 1.2.1 Private sector businesses

THEORY OF KNOWLEDGE

The personal loan market in many economies has seen the emergence of a huge number of so-called 'payday' lenders. These organisations provide very short-term loans (up to 30/40 days) to borrowers who urgently need cash to cover their living costs or a particular expense until, in theory, they get paid.

One of the most well-known payday lenders is a company called Wonga which started in the UK but is expanding internationally. You can, for example, borrow £111 from Wonga for 33 days and you will be charged interest and fees of £43.95, which means you will end up paying back £154.95. This has a headline interest rate of 5853%!

Payday lenders are for-profit organisations.

Discuss these questions in your class:

- What sort of people take out payday loans?
- What are the aims of payday loan organisations?
- What does this tell us about the 'values' of people who run payday loan organisations?

Sole trader

This is the most common form of business organisation. Although there is a single owner in this business organisation, there may be employees but the firm is likely to remain very small. Although they are great in number, **sole traders** account for only a small proportion of total business turnover. All sole traders have unlimited liability. This means that the owner's personal possessions and property can be taken to pay off the debts of the business should it fail. This can discourage some potential entrepreneurs from starting their own businesses.

sole trader: a business in which one person provides the permanent finance and, in return, has full control of the business and is able to keep all of the profits

Another problem faced by sole traders involves finance for expansion. Many sole traders remain small because the owner wishes to remain in control of their own business, but another reason is the limitations that they have in raising additional capital. As soon as partners or shareholders are sought in order to raise finance, then the sole trader becomes another form of organisation altogether. In order to remain a sole trader the owner is dependent on their own savings, profits made and loans for injections of capital.

This type of business organisation is most commonly established in construction, retailing, hairdressing, car servicing and catering. The advantages and disadvantages of sole traders are summarised in Table 1.2.2.

Advantages	Disadvantages
• Easy to set up – no legal formalities • Owner has complete control – not answerable to anyone else • Owner keeps all profits • Able to choose times and patterns of working • Able to establish close personal relationships with staff (if any are employed) and customers • The business can be based on the interests or skills of the owner – rather than working as an employee for a larger firm	• Unlimited liability – all of owner's assets are potentially at risk • Often faces intense competition from bigger firms, e.g. food retailing • Owner is unable to specialise in areas of the business that are most interesting – is responsible for all aspects of management • Difficult to raise additional capital • Long hours often necessary to make business pay • Lack of continuity – as the business does not have separate legal status, when the owner dies the business ends too

Table 1.2.2 Sole traders – advantages and disadvantages

Partnership

A **partnership** agreement does not create a separate legal unit; a partnership is just a grouping of individuals. Partnerships are formed in order to overcome some of the drawbacks of being a sole trader. When planning to go into partnership it is important to choose business partners carefully – the errors and poor decisions of any one partner are considered to be the responsibility of them all. This also applies to business debts incurred by one partner; in most countries there is unlimited liability for all partners should the business venture fail. It is usual, although not a legal requirement, to draw up a formal 'Deed of Partnership' between all partners. This would provide agreement

partnership: a business formed by two or more people to carry on a business together, with shared capital investment and, usually, shared responsibilities on issues such as voting rights, the distribution of profits, the management role of each partner and who has authority to sign contracts.

Partnerships are the most common form of business organisation in some professions, such as law and accountancy. Small building firms are often partnerships too. Many other owners of businesses prefer the company form of organisation and this is considered next. The advantages and disadvantages of partnerships are summarised in Table 1.2.3.

Advantages	Disadvantages
• Partners may specialise in different areas of business management • Shared decision-making • Additional capital injected by each partner • Business losses shared between partners • Greater privacy and fewer legal formalities than corporate organisations (companies)	• Unlimited liability for all partners (with some exceptions) • Profits are shared • As with sole traders, no continuity and the partnership will have to be reformed in the event of the death of one of the partners • All partners bound by the decisions of any one of them • Not possible to raise capital from selling shares • A sole trader, taking on partners, will lose independence of decision-making

Table 1.2.3 Partnerships – advantages and disadvantages

ACTIVITY 1.2.1

Helene owns a computer repair business – ITfix. She employs three skilled workers. The business operates from rented premises. It owns some machines but leases testing equipment. ITfix is very busy but there is no room for further employees in the small workshop. Helene is proud of her success in starting up and expanding such a profitable business. Despite its success, ITfix has insufficient finance to buy its own premises – Helene believes that this would be a wise investment for the future.

10 marks, 20 minutes

1. Define the term 'sole trader'. [2]
2. Explain **one** advantage and **one** disadvantage for Helene of being a sole trader. [4]
3. Analyse **two** benefits the introduction of a partner would bring to Helene's business. [4]

Limited company

There are three important differences between companies – private limited and public limited companies – and sole traders and partnerships: **limited liability**, legal personality and continuity.

Limited liability

The ownership of companies is divided into small units called **shares**. People can buy these and become '**shareholders**' – they are part-owners of the business. It is possible to buy just one share, but usually these are owned in blocks, and it is possible for one person or organisation to have complete control by owning more than 50% of the shares. Individuals with large blocks of shares often become directors of the business. All shareholders benefit from the advantage of limited liability.

Nobody can make any further claim against shareholders should the company fail. This has two important effects:

• People are prepared to provide finance to enable companies to expand.

limited liability: the only liability – or potential loss – a shareholder has if the company fails is the amount invested in the company, not the total wealth of the shareholder

share: a certificate confirming part ownership of a company and entitling the shareholder to dividends and certain shareholder rights

shareholders: individuals or institutions that buy/own shares in a limited company

- The greater risk of the company failing to pay its debts is now transferred from investors to creditors (those suppliers/lenders who have not been paid). Creditors, as a result, are very interested in both ensuring that the word 'limited' appears in the company name and scrutinising the company's accounts for signs of potential future weakness.

Legal personality

A company is legally recognised as having an identity separate from that of its owners. This means, for example, that if the products sold by a company are found to be dangerous or faulty, the company itself can be prosecuted but not the owners, as would be the case with either a sole trader or a partnership. A company can be sued and can sue others through the courts.

Continuity

In a company, the death of an owner or director does not lead to its break-up or dissolution. All that happens is that ownership continues through the inheritance of the shares, and there is no break in ownership at all.

Private limited companies

The protection that comes from forming a company is therefore substantial. Small firms can gain this protection when the owner(s) create(s) a **private limited company**.

private limited company: a small to medium-sized business that is owned by shareholders who are often members of the same family; this company cannot sell shares to the general public

The word 'Limited' or 'Ltd' ('Pte' in some countries) indicates that the business is a private company. Usually, the shares will be owned by the original sole trader (who may hold a majority of the shares to keep control of the company), relatives, friends and employees. New issues of shares cannot be sold on the open market and existing shareholders may only sell their shares with the agreement of the other shareholders.

Legal formalities must be followed in setting up a private limited company and these can be expensive and time-consuming in some countries. The advantages and disadvantages of private limited companies are summarised in Table 1.2.4.

Advantages	Disadvantages
• Shareholders have limited liability • Separate legal personality • Continuity in the event of the death of a shareholder • Original owner is still often able to retain control • Able to raise capital from sale of shares to family, friends and employees • Greater status than an unincorporated business	• Legal formalities involved in establishing the business • Capital cannot be raised by sale of shares to the general public • Quite difficult for shareholders to sell shares • End-of-year accounts must be sent to Companies House (in UK) – available for public inspection there (less secrecy over financial affairs than sole trader or partnership)

Table 1.2.4 Private limited companies – advantages and disadvantages

Public limited companies

Public limited companies can be recognised by the use of 'plc' or 'Inc.' (Incorporated) after the company name. It is the most common form of legal organisation for large businesses, for the very good reason that they have access to very substantial funds for expansion. Converting a private limited company to public limited company (plc) status is referred to as a stock market flotation.

public limited company (plc): a limited company, often a large business, with the legal right to sell shares to the general public; its share price is quoted on the national stock exchange

A plc has all the advantages of private company status plus the right to advertise its shares for sale and have them quoted on the stock exchange. Public limited companies have the potential to raise large sums from public issues of shares. Existing shareholders may quickly sell their shares if they wish to. This flexibility of share buying and selling encourages the public to purchase the shares in the first instance and thus invest in the business.

The other main difference between private and public companies concerns the 'divorce between ownership and control'. The original owners of a business are usually still able to retain a majority of shares and continue to exercise management control when it converts to private company status. This is most unlikely with public limited companies, due to the volume of shares issued and the number of people and institutions as investors. These shareholders own the company, but they appoint, at the annual general meeting, a board of directors who control the management and decision-making of the business.

This clear distinction between ownership and control can lead to conflicts over the objectives to be set and direction to be taken by the business. The shareholders might prefer short-term maximum-profit strategies, but the directors may aim for long-term growth of the business, perhaps in order to increase their own power and status. Many private limited companies convert to plc status to gain the benefits referred to in Table 1.2.5. It is also possible for the directors or the original owners of a business to convert it back from plc to private limited company status. Richard Branson and the Virgin group are one of the best-known examples. The reasons for doing this are largely to overcome the divorce between ownership and control – in a private limited company it is normal for the senior executives to be the major, majority shareholders. In addition, the owner of a private limited company can take a long-term planning view of the business. It is often said that the major investors in a plc are only interested in short-term gains. 'Short-termism' can be damaging to the long-term investment plans of a business.

A summary of the advantages and disadvantages of public limited companies is given in Table 1.2.5.

Advantages	Disadvantages
• Limited liability • Separate legal identity • Continuity • Ease of buying and selling of shares for shareholders – this encourages investment in plcs • Access to substantial capital sources due to the ability to issue a prospectus to the public and to offer shares for sale	• Legal formalities in formation • Cost of business consultants and financial advisers when creating a plc • Share prices subject to fluctuation – sometimes for reasons beyond business's control, e.g. state of the economy • Legal requirements concerning disclosure of information to shareholders and the public, e.g. annual publication of detailed report and accounts • Risk of takeover due to the availability of the shares on the stock exchange • Directors influenced by short-term objectives of major investors

Table 1.2.5 Public limited companies – advantages and disadvantages

Legal forms of business organisation

Businesses often change their legal form as they expand and as the objectives of the owners change. Many newly formed businesses are sole traders and then accept partners if the aim of the original owner is to expand and share management responsibilities. Conversion to company status is often caused by owners wishing to protect their personal wealth and encourage new shareholder investors. When further expansion is very expensive, perhaps because of the nature of the business activity as with the development of new technology products, conversion to public limited company status is common. However, much depends on the desire for control of the original owners/shareholders. There is often the desire of the original owners to get back overall control from 'short-term-minded' investors by converting a plc back into a private limited company.

ACTIVITY 1.2.2

TWITTER 'GOES PUBLIC'

Twitter founders Evan Williams and Jack Dorsey became multimillionaires overnight when Twitter sold 70 million shares at US$26 each. The decision to convert the business into a public limited company was mainly to allow directors to spend capital on expanding the 'microblogging' business with expensive purchases of other internet businesses.

10 marks, 20 minutes

1. Define the term 'public limited company'. [2]
2. Analyse **two** potential advantages to Twitter of becoming a public limited company. [4]
3. Analyse **two** potential disadvantages to Twitter of becoming a public limited company. [4]

THEORY OF KNOWLEDGE

1. 'All countries have organisations that are part of the private sector; they come in the form of business organisations that exist to create a profit for their owners. All countries also have public sector organisations that exist to improve the welfare of all people in society. As a consequence of this, governments should look to expand the proportion of countries' organisations that are owned by the state.'
   a. Analyse the evidence you would use to prove or disprove this statement.
   b. In the light of this statement, discuss some of the reasons why so many countries have privatised former public sector organisations.
2. 'Organisations always run more efficiently when they are free of government control.'
   In groups, discuss to what extent you agree or disagree with this statement.

For-profit social enterprises

1. Social enterprises

social enterprise: a business with mainly social objectives that reinvests most of its profits into benefiting society rather than maximising returns to owners

Social enterprises are not charities, but they do have objectives that are often different from those of an entrepreneur who is only profit-motivated. Making a profit may be one of the objectives of a social enterprise, but it is usually much less important than the organisation's social objectives.

In other words, a social enterprise is a proper business that makes its money in socially responsible ways and uses most of any surplus made to benefit society. Social entrepreneurs are not running a charity, though – they can and often do keep some of any profit made for themselves.

Social enterprises compete with other businesses in the same market or industry. They use business principles to achieve social objectives. Most social enterprises have these common features:

- They directly produce goods or provide services.

- They have social aims and use ethical ways of achieving them.
- They need to make a surplus or profit to survive as they cannot rely on donations as charities do.

Objectives of social enterprises

Social enterprises often have three main aims:

- Economic – to make a profit or surplus to reinvest back into the business and provide some return to the owners.
- Social – to provide jobs or support for local, often disadvantaged, communities.
- Environmental – to protect the environment and to manage the business in an environmentally sustainable way.

triple bottom line: the three objectives of social enterprises: economic, social and environmental

These aims are often referred to as the **triple bottom line**. This means that profit is not the sole objective of these enterprises.

Below are two examples of social enterprises:

- SELCO in India provides sustainable energy solutions to low-income households and small businesses. In one scheme, solar-powered lighting was provided by SELCO to a silkworm farmer who depended on dangerous and polluting kerosene lamps. The farmer could not afford the upfront cost, so SELCO helped with the finance too.
- The KASHF Foundation in Pakistan provides microfinance (very small loans) and social support services to women entrepreneurs who traditionally find it very difficult to receive help. This enables the women to set up their own businesses in food production, cloth making and other industries. The loans have to be repaid with interest, but the interest rates are much lower than a profit-maximising international bank would charge.

2. Cooperatives

cooperative: a group of people acting together to meet the common needs and aspirations of its members, sharing ownership and making decisions democratically

Cooperatives are not about making big profits for shareholders, but creating value for customers and secure employment for workers – this is what gives cooperatives a unique character, and influences their values and principles.

Cooperatives tend to fall into one of these three groups:

- Retail cooperative – also called consumers' cooperatives. This is a cooperative business owned by customers for their mutual benefits. It is a private sector enterprise that is oriented towards service rather than financial profit. It often takes the form of retail outlets operated and owned by their consumers. The consumers or customers are the people who have provided the capital required to launch or purchase the enterprise and profits are shared either by discounts on products or by a payout to customer owners each year.
- Agricultural cooperative – this exists when farmers pool resources for mutual benefit, for example, in the buying of fertiliser or the marketing of key food products.
- Worker cooperative – often engaged in manufacturing. Workers collectively own the business and make the important decisions.

ACTIVITY 1.2.3

The MONDRAGON Corporation is one of the world's best examples of successful cooperative organisation. It is a federation of worker cooperatives based in the Basque region of Spain. It was founded in the town of Mondragón in 1956 by graduates of a local technical college. Its first product was paraffin heaters. It is the seventh-largest Spanish company in terms of asset turnover and the leading business group in the Basque Country. It employs over 70 000 people in 257 companies and organisations in four areas of activity: finance, industry, retail and IT.

Cooperatives tend to operate much like modern businesses, aiming for improved efficiency, productivity and transparency. Cooperatives are not the ideal business model in all situations. For example, highly democratic procedures can slow down decision-making and reaction times to market developments and, in agricultural cooperatives, women are often underrepresented in decision-making. In other ways however, cooperatives can be more robust than private enterprises: driven by a combination of long-term social, economic and ethical interests rather than high-risk short-term profits; and many have proven particularly resilient in the recent global financial crisis. MONDRAGON cooperatives made virtually no compulsory redundancies between 2010 and 2014 – at a time when the Spanish economy shrank and profit-seeking businesses lost thousands of jobs.

10 marks, 20 minutes

1. Define the term 'cooperative'. [2]
2. Explain **two** reasons why a cooperative like mondragon might be at an advantage compared to a private enterprise. [4]
3. Analyse **two** disadvantages Mondragon might face as a cooperative compared to those of a private enterprise. [4]

3. Microfinance institutions

The **microfinance** approach to providing small capital sums to entrepreneurs is now a very important source of finance in developing, relatively low-income countries. In 1974, Muhammad Yunus, an economics lecturer at the University of Chittagong, Bangladesh, lent $27 to a group of very poor villagers. Not only did they repay this loan in full after their business ideas had been successful, but it led eventually to Yunus winning the Nobel Peace Prize. He founded the Grameen Bank in 1983 to make very small loans – perhaps $20 a time – to poor people with no bank accounts and no chance of obtaining finance through traditional means. Since its foundation, the Grameen Bank has lent $6 billion to over six million Asian people, many of whom have set up their own very small enterprises with the capital.

microfinance: the provision of very small loans by specialist finance businesses, usually not traditional commercial banks

Many business entrepreneurs in Bangladesh and other Asian countries have received microfinance to help start their business. In some of these countries over 75% of successful applicants for microfinance are women. Females have, in some traditional societies, always found it very difficult to obtain loans or banking services from traditional banks. There is evidence that entrepreneurship is greater in regions with microfinance schemes in operation – and that average incomes are rising because of more successful businesses. Empirical evidence shows that, among the poor, those participating in microfinance programmes who had access to financial services were able to improve their well-being – both at the individual and household level – much more than those who did not have access to financial services.

- In Bangladesh, Bangladesh Rural Advancement Committee (BRAC) clients increased household expenditures by 28% and assets by 112%. The incomes of Grameen members were 43% higher than incomes in non-programme villages.
- In El Salvador, the weekly income of FINCA (microfinance provider) clients increased on average by 145%.
- In India, half of SHARE (microfinance provider) clients graduated out of poverty.
- In Ghana, 80% of clients of Freedom from Hunger had secondary income sources, compared to 50% for non-clients.
- In Lombok, Indonesia, the average income of Bank Rakyat Indonesia (BRI) borrowers increased by 112% with 90% of households moving out of poverty.

However, interest rates can be quite high as the administration costs of many very small loans is considerable. Some economists also suggest that if a small business start-up financed by microfinance fails, then the scheme has encouraged very poor people to take on debts that they cannot repay. Microfinance may be inappropriate where conditions pose severe challenges to loan repayment. For example, populations that are geographically dispersed or have a high incidence of disease may not be suitable microfinance clients. In these cases, grants, infrastructure improvements or education and training programmes are more effective. For microfinance to be appropriate, the clients must have the capacity to repay the loan under the terms by which it is provided.

ACTIVITY 1.2.4

Mibanco in Peru plays an important role in the Latin American microfinance sector. The bank issues working capital and loans to micro-entrepreneurs and small and medium-sized businesses. Besides this, it offers current accounts, savings, deposit accounts and insurance products to private individuals – many of whom find it difficult to gain support from traditional commercial banks. In 2014 Mibanco's profit margin fell to under 1% and 12% of its loans to small businesses had not been repaid within one month of the required date; and 61% of its customers had also taken out loans with other banks.

KEY INDICATORS Mibanco at year-end 2013:
- number of loan clients: over 400 000
- percentage female clients: 55%
- percentage rural clients: 23%
- average loan amount: $2800

16 marks, 32 minutes

1. Describe **two** features of the microfinance loans provided by Mibanco. [4]
2. Explain **two** advantages of microfinance to small businesses in a country such as Peru. [4]
3. Assess why microfinance providers such as Mibanco might struggle to be profitable. [8]

Public–private partnership (PPP)

There are three main types of **public–private partnership (PPP)**:

public–private partnership (PPP): involvement of the private sector, in the form of management expertise and/or financial investment, in public sector projects aimed at benefiting the public

- Government-funded – these are privately managed schemes. In this type of venture, the government provides all or part of the funding, but the organisation is managed by a private business that uses private sector methods and techniques to control it as efficiently as possible. For example, the Hope Clinic Lukuli in Kampala, Uganda, receives government funding for its malaria prevention and HIV-testing services. These are managed efficiently and successfully by this private sector, but non-profit-making, clinic. Analysts believe that the clinic operates the health services more efficiently than a government department would with many officials becoming involved.
- Private sector-funded – these are government or state-managed schemes. In this type of venture, which often involves large sums of capital investment, the government is released from the financial burden of finding taxpayers' money to pay for the project. Once the assets have been paid for and constructed, they are then managed and controlled by a government department, which pays rent or a leasing charge to the private sector business that constructed the project. This form of PPP started in Australia and the UK and is known as the **private finance initiative** (PFI).
- Government-directed but with private sector finance and management – this type of PPP encourages both private sector funding and some private sector management control of public projects. For example, a new London hospital has been built using private sector finance – it is leased to the state-controlled health authority which manages and controls the hospital's health services; in Australia, the international bank HBOS has invested in several PFI schemes for public sector projects such as new prisons in Victoria and the new toll road into Melbourne City Centre.

private finance initiative (PFI): investment by private sector organisations in public sector projects

The potential costs and benefits of public–private partnerships are shown in Table 1.2.6.

Costs	Benefits
• The private sector business, if asked to manage the project, could try to increase profits by cutting staff wages and benefits. In effect, workers would no longer have the security of being employed by the public sector. • PFI schemes have been criticised for earning private sector businesses large profits from high rents and leasing charges – these must be paid for by taxpayers. • Private sector organisations may lack the experience needed to operate large public sector projects – such as social housing schemes – and failure of the scheme could leave vulnerable groups in society at risk.	• Many schools, roads, prisons and hospitals have been built through PPP/PFI schemes – it is argued that these would not have been constructed unless the private sector had been involved. • Private sector businesses aim to make profits; their managers will therefore operate services as efficiently as possible. This could mean that costs to the public sector are lower than if the projects were operated by government/public sector managers. • By using private sector business finance, the government can claim that public services are being improved, without an increase in taxes (at least in the short run as the capital cost is not paid for by the government).

Table 1.2.6 Potential costs and benefits of PPPs

ACTIVITY 1.2.5

WASTE – A GOOD CASE FOR PUBLIC–PRIVATE PARTNERSHIP?

Capital Waste Disposal plc was created five years ago when the capital city's rubbish collection service was privatised. As a public sector enterprise, the organisation had been overstaffed and inefficient, but charges for collecting waste were low and the service was popular with local residents. The city government subsidised the waste services and this helped to keep charges down. Shortly after privatisation, the directors announced substantial job cuts to save on costs. The waste collection service was reduced to once a week, yet charges were increased. The city government also announced that the city's rubbish collection services would be opened up to competition.

The business started to make big profits. It invested in new equipment and paid dividends to its shareholders. Last year, for the first time since privatisation, profits fell. This was due to competition from a newly formed waste disposal business. Many of Capital Waste's shareholders wanted the directors to be replaced. The biggest shareholders demanded to be on the board of directors. The chief executive discussed with the bank whether a loan could be obtained to enable him to buy out most of the shares to convert the business into a private limited company. He told the bank manager, 'If I turn the business into a private company, I can run it without any interference from big shareholders and publish less data about the company.'

The government still owns and manages the old and inefficient waste recycling plant in the city. It now wants to involve Capital Waste in a public–private partnership to build a new, environmentally friendly waste recycling plant. The business would be asked to invest capital in the new facility and to use its private sector managers to help manage the new plant. A PPP would help to make sure that it was built quickly. However, some local residents are worried that private sector managers would try to cut costs, and that difficult-to-recycle waste would simply be dumped in the local river.

20 marks, 40 minutes

1. Define the term 'public–private partnership'. [2]
2. Explain **two** possible reasons why the city government decided to create Capital Waste Disposal plc as a privatised business. [4]
3. Analyse **two** disadvantages of the city government privatising waste disposal. [4]
4. Discuss the advantages and disadvantages of the proposed public-private partnership for the building and operation of a new waste recycling plant. [10]

Non-profit social enterprises

Not all organisations in the world aim to make profits. There are many thousands of **non-profit organisations** that have objectives other than profit – for example, charities and pressure groups. Many of these are also termed **non-governmental organisations** (NGOs).

non-profit organisation: any organisation that has aims other than making and distributing profit and which is usually governed by a voluntary board

non-governmental organisation (NGO): a legally constituted body with no participation or representation of any government which has a specific aim and purpose, e.g. supporting disadvantaged groups in developing countries or advocating the protection of human rights

Non-governmental organisations (NGOs)

A non-governmental organisation (NGO) is a not-for-profit group, independent from government, which is organised on a local, national or international level to tackle issues that support the public good. They are task-focused and made up of people sharing a common interest. NGOs perform a variety of services and humanitarian functions, bring public concerns to governments and encourage participation of society's stakeholders at the community level. The objectives of NGOs are not profit-based but are specifically focused on social, environmental or humanitarian objectives. In Russia, the GLOBUS group aims to 'stimulate an effective national response to the HIV/AIDS epidemic'. Also in the humanitarian field, the International AIDS Alliance in Ukraine aims to 'reduce HIV incidence and death rates from AIDS'.

Other examples of NGOs include the following:

- Amnesty International is a worldwide campaigning movement that works to promote internationally recognised human rights for all. It undertakes research and action focused on preventing and ending grave abuses of human rights to physical and mental integrity, freedom of conscience and expression, and freedom from discrimination.
- Article 19 is a human rights organisation with a specific mandate and focus on the defence and promotion of freedom of expression and freedom of information worldwide.
- Avocats Sans Frontières ('Lawyers Without Borders' – ASF) is mostly made up of lawyers, solicitors and magistrates, aiming to contribute, completely independently, to the establishment of a fair, equitable and united society.
- Médecins Sans Frontières (MSF) is an international humanitarian aid organisation that provides emergency medical assistance to populations in danger in more than 80 countries. According to its Charter, MSF 'offers assistance to populations in distress, to victims of natural or man-made disasters and to victims of armed conflict, without discrimination and irrespective of race, religion, creed or political affiliation.'

Médecins Sans Frontières (MSF) is an international humanitarian aid organisation

- Ford Foundation is a resource for innovative people and institutions worldwide, with a view to strengthening democratic values, reducing poverty and injustice, promoting international cooperation, and advancing human achievement.
- MacArthur Foundation supports creative people and effective institutions committed to building a more just, verdant and peaceful world. Among other things, it seeks to further the development of an international system of justice and advance human rights around the globe.
- International Committee of the Red Cross (ICRC) is an impartial, neutral and independent organisation whose exclusively humanitarian mission is to protect the lives and dignity of victims of armed conflict and other situations of violence and to provide them with assistance.

LEARNER PROFILE

Médecins Sans Frontières or Doctors Without Borders is a not-for-profit NGO that provides medical aid and support to developing countries in conflict situations and humanitarian crisis situations. When Typhoon Haiyan hit the Philippines in 2013 MSF was very quickly on the scene with help and support. It has also teams of medical professionals to provide medical support in the Syrian Civil War.

MSF's actions are based on the principles of medical ethics, independence and impartiality. Their primary aim is to go to the most difficult places and situations around the world and provide support to sick and injured people.

'They act with integrity and honesty, with a strong sense of fairness, justice and respect for the dignity of the individual, groups and communities. They take responsibility for their own actions and the consequences that accompany them'.

To what extent can the people of Médecins Sans Frontières be described as principled?

Find another example of an organisation that you would describe as principled and explain to your class why you think your choice of organisation is principled.

Charities

charities: an organisation set up to raise money to help people in need or to support causes that require funding

Most countries have laws about what constitutes charitable work as **charities** are usually allowed tax benefits. The following list is typical of activities accepted as being for 'charitable purposes':

1. prevention or relief of poverty
2. advancement of education
3. advancement of religion
4. advancement of health or the saving of lives
5. advancement of citizenship or community development
6. advancement of the arts, culture, heritage or science
7. advancement of human rights conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity
8. advancement of environmental protection or improvement
9. relief of those in need, by reason of youth, age, ill health, disability, financial hardship or other disadvantage
10. advancement of animal welfare.

Charities often perform useful social and environmental functions that would not be undertaken by private businesses or government-funded organisations. They are dependent on private contributions and these can vary in amount, making it difficult for charity managers to plan. Some charitable work is duplicated – for example, in social care or medical research – and it is argued that such situations can lead to wasteful duplication.

OVER TO YOU

Revision checklist

1. What is the difference between private sector and public sector organisations?
2. State **three** differences between a sole trader and a private limited company.
3. Who (a) owns and (b) controls a public limited company? Explain why this distinction might lead to conflict.
4. Why might the directors of a public limited company decide to convert the business back into a private limited company by buying a majority of the shares?
5. Explain how legal personality and continuity help businesses and companies to operate effectively.
6. In what way does limited liability make it easier for companies to raise finance?
7. Using the examples of a sole-trader business and a public limited company, explain how the relationship between ownership and control differs in these two types of organisations.
8. Using the examples of a partnership and a public limited company, explain how the legal structure of a business affects its ability to raise finance.
9. List **two** organisations in your own country that are in the public sector.
10. Analyse **one** impact of the distinction between ownership and control for:
    a. shareholders of a plc
    b. employees of a plc.
11. Explain **two** potential advantages to a country's economy from microfinance providers.
12. Explain **two** potential advantages and **two** potential disadvantages to a country when its government uses public–private partnerships to pay for and manage health clinics.

Exam practice question

THE GOOGLE™ PHENOMENON

In 1995, Larry Page and Sergey Brin met at Stanford University. The following year they formed a partnership and began collaborating on a search engine called BackRub. In 1997, they decided to rename BackRub and came up with Google (derived from 'googol', a mathematical term for the number represented by the numeral 1 followed by 100 zeros).

With $100 000 support from a backer, Google Inc. was set up in 1998 in a garage in California. Later that year, *PC Magazine* recognised Google's search engine as one of the top 100 websites. In 2000, Google became available in many languages including French, German, Italian and Chinese. By 2004, the Google search index contained six billion items, including 4.28 billion web pages and 880 million images. It moved to an office in California called Googleplex with more than 800 employees and offices all over the world. In the same year, Google became a public limited company offering for sale 19 605 052 shares at an opening price of $85 a share.

Over the next five years, Google refined and added to its search engines a range of products such as Google News, Google Earth, Google Maps and Google Video. Today, Google is a huge multinational corporation worth around $160 billion and its share price is over $500 a share.

20 marks, 40 minutes

1. Define the term 'partnership'. [2]
2. Outline **two** possible benefits to Larry Page and Sergey Brin of starting Google as a partnership. [4]
3. Analyse **two** possible problems Larry Page and Sergey Brin might encounter by starting Google as a partnership. [4]
4. Discuss the advantages and disadvantages to Google of its conversion to a public limited company in 2004. [10]

Key concept question

20 marks, 40 minutes

With reference to one or two organisation(s) that you have studied, evaluate the impact different types of organisational ownership have on business strategy. [20]

1.3

Organisational objectives

On completing this chapter you should be able to:

Know and understand:

- Ethical objectives and corporate social responsibility (AO1)

Analyse and apply:

- Vision statement and mission statement (AO2)

Evaluate:

- Aims, objectives, strategies and tactics and their relationships (AO3)
- The need for organisations to change objectives and innovate in response to changes in internal and external environments (AO3)
- The reasons why organisations set ethical objectives and the impact of implementing them (AO3)
- The evolving role and nature of CSR (AO3)
- SWOT analysis of a given organisation (AO3)
- Ansoff's matrix for different growth strategies of a given organisation (AO3)

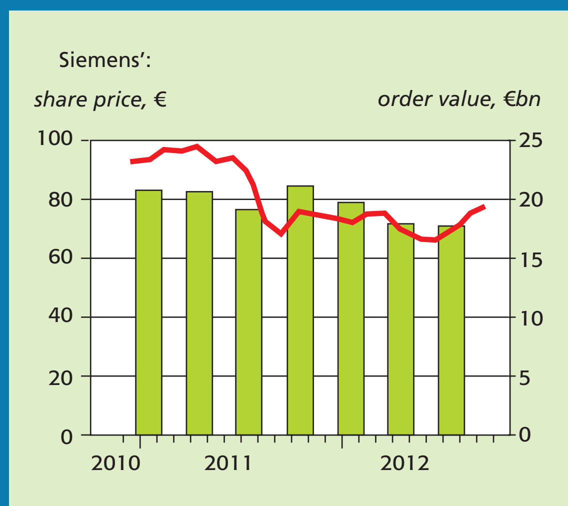
Prepare/construct:

- SWOT analysis of a given organisation (AO4)
- Ansoff's matrix for different growth strategies of a given organisation (AO4)

Setting the scene

SIEMENS' STRATEGY FOR HIGHER PROFITABILITY

Poor planning in recent years is blamed for Siemens' low levels of customer orders and a weak share price performance.



Siemens is now targeting a profit margin of at least 12%. To reach this corporate objective, the company plans to reduce its costs by €6 billion, increase competitiveness and reorganise its structure to become less bureaucratic.

Two stages of this new 'Siemens 2014' strategy have already been decided upon and are being implemented. First, it has acquired LMS International for around €680 million. LMS sells simulation software in 15 countries for evaluating mechatronic systems in aeroplanes and cars. With the acquisition of LMS, Siemens will hold a top position in this software segment and can improve the innovative strength of its customers.

Second, Siemens will restructure its water technology business. In the future, the water business will focus on Siemens' core competencies in automation and advanced equipment, while activities involved in processing and treating water and wastewater will be sold. Other elements of the new strategy include:

- Cost reduction – Cost savings of around €3 billion are expected from the improved integration of the key processes of design, development and production. Around €1 billion is to be saved by increasing global capacity utilisation.

- Go-to-market – The sales setup will be more flexibly adapted to regional circumstances.
- Optimised structure and management – The company's worldwide structure will be further optimised and redundant functions and duplicate processes will be eliminated. The complexity of processes and regulations will be reduced in order to give the company's business units greater entrepreneurial freedom and optimise their work with customers.

Source: www.siemens.com

Points to consider

- What do you understand by the terms 'business objective' and 'strategy' from this case study?
- What are likely to be the benefits to Siemens of having a clear and specific corporate objective?
- Why might Siemens have to change its objectives if there are changes in the external environment?

Key concept link

The objectives of an organisation will reflect its culture. Social enterprises will not focus on profit alone because the people who operate and control them have different values, attitudes and beliefs from those who control and operate profit-seeking organisations. Objectives of any organisation may have to change over time – for example, to reflect a major change in the external environment.

Introduction

Businesses of any size can benefit from setting clear objectives. In small businesses, such as sole traders, these objectives are often not written down or formalised in any way, but the owners will usually have a clear idea of what they are trying to achieve. In partnerships, it is important for partners to agree on the direction their business should take to avoid future disagreements. Limited companies must state the overall objectives of the business in their Memorandum and Articles of Association, but this often lacks much strategic detail. This chapter focuses on the importance of business objectives, the different forms that these can take, including ethical and social objectives, and how they can be used to direct the work of employees in an organisation.

Mission statements and vision statements

Mission statements outline the overall purpose of the organisation. A **vision statement**, on the other hand, describes a picture of the 'preferred future' and outlines how the future will look if the organisation achieves its mission. It is a clear statement of the future position that offers the ideal of what owners and directors want their business organisation to become.

mission statement: a statement of the business's core aims, phrased in a way to motivate employees and to stimulate interest by outside groups

vision statement: a statement of what the organisation would like to achieve or accomplish in the long term

A mission statement is an attempt to condense the central purpose of a business's existence into one short paragraph. It is not concerned with specific, quantifiable goals but tries to sum up the aims of the business in a motivating and appealing way. It can be summed up as a statement about 'who we are and what we do'.

Here are some examples of mission statements:

- College offering IB and A Level qualifications – 'To provide an academic curriculum in a caring and supportive environment'
- BT – 'To be the most successful worldwide telecommunications group'
- Nike, Inc. – 'To bring inspiration and innovation to every athlete in the world'
- Microsoft – 'To enable people and businesses throughout the world to realise their full potential'
- Google – 'To organise the world's information and make it universally accessible and useful'
- Merck – 'Provide society with superior products and services by developing innovations and solutions that improve the quality of life and satisfy customer needs, to provide employees with meaningful work and advancement opportunities and investors with a superior rate of return'.

An effective mission statement should answer three key questions:

- What do we do?
- For whom do we do it?
- What is the benefit?

Table 1.3.1 compares the vision and mission statements of three organisations.

Organisation	Vision statement	Mission statement
Nokia	Our vision is a world where everyone is connected	Nokia exists to connect people with each other and the information that is important to them with easy-to-use and innovative products. Nokia aims to provide equipment, solutions and services for consumers, network operators and corporations.
Minnesota Health Department (USA)	Keeping all residents healthy	To protect, maintain and improve the health of all residents
McDonald's Restaurants	Where the world buys more McDonald's than any other fast food	McDonald's aims to be the world's best quick service restaurant experience. Being the best means providing outstanding quality, service, cleanliness and value so that we make every customer in every restaurant smile.

Table 1.3.1 Comparing vision and mission statements

So what is the link between vision statements, mission statements and strategies? It is simple. Without the direction and focus brought to an organisation by vision and mission statements, planning new strategies will be like trying to steer a ship with no idea of either where it is or the direction it is meant to be heading in. Vision and mission statements give the organisation a sense of purpose and can prevent it from drifting between the tides and currents of powerful events.

THEORY OF KNOWLEDGE

Hewlett-Packard 'loses its way'

Hewlett-Packard has lost its way. The company is in the midst of an existential crisis. It continues to be a large and powerful organisation. It is one of America's largest companies with $127 billion in sales and $7 billion in profits. However, its future trajectory is ominous. Those profits, for example, were 19% lower than the previous year's. HP's business is under siege on almost every front, losing market share and facing declining profit margins.

HP is a traumatised organisation. Morale amongst its employees has hit 'rock bottom'. One top executive says that creativity has been stifled to the point that very little meaningful innovation is possible – 'We don't know who we are or what we do any more'.

The company has not produced a single hit consumer product in recent years. Apple has shown the riches awaiting those who invent hit devices. However, there were no iPhones or iPads in HP's bland array of products. Apple was not the only rival for HP, whose diverse businesses meant it also competed with enterprise hardware and software companies such as IBM and Oracle and consultants such as Accenture.

Work in small groups to research the business of Hewlett-Packard.Prepare a presentation that answers the following questions:

a. What role do reason, self-perception and emotion play in Hewlett-Packard's employees knowing what the mission of the organisation is?

b. How important is 'knowing who you are' in determining the success of an organisation?

Effectiveness of these statements

In recent years, virtually every organisation of any size has devised a vision statement and a mission statement. Do they perform a useful function or are they just another management fad? Below are some arguments in favour of these statements:

- They quickly inform groups outside the business what the central aim and vision are.
- They help to motivate employees, especially where an organisation is looked upon, as a result of its mission statement, as a caring and environmentally friendly body. Employees will then be associated with these positive qualities.
- Where they include ethical statements, they can help to guide and direct individual employee behaviour at work.
- They help to establish in the eyes of other groups 'what the business is about'.

On the other hand, these statements are often criticised for being:

- too vague and general so that they end up saying little which is specific about the business or its future plans
- based on a public relations exercise to make stakeholder groups 'feel good' about the organisation
- virtually impossible to analyse or disagree with
- rather 'woolly' and lacking in specific detail, so it is common for two completely different businesses to have very similar mission statements.

Communicating mission and vision statements is almost as important as establishing them. There is little point in identifying the central vision for a business and then not letting anyone else know about it. Businesses communicate their mission statements in a number of ways, for example in published accounts, communications to shareholders and the corporate plans of the business. Internal company newsletters and magazines may draw their title from part of the mission statement. Advertising slogans or posters are frequently based around the themes of the mission statements – The Body Shop is most effective in incorporating its mission into its eco-friendly campaigns.

On their own, mission statements are insufficient for operational guidelines. They do not tell managers what decisions to take or how to manage the business. Their role is to provide direction for the future and an overall sense of purpose, and in public relations terms, at least, they can prove very worthwhile. It is important that both vision and mission statements are applicable to the business, understood by employees and convertible into genuine strategic actions.

ACTIVITY 1.3.1

1. Use the website www.samples-help.org.uk/mission-statements to look up more mission statements for well-known corporations.
2. Comment on the usefulness of any **one** of these mission statements for planning of future strategies for this business.
3. Suggest how the statements might be communicated to **three** different stakeholder groups.
4. Find out if your school or college has a vision statement and a mission statement. By asking staff, students and parents, attempt to establish whether these statements have had any impact on their view of the school.

corporate aims: the long-term goals which a business hopes to achieve

divisional/operational objectives: short- or medium-term goals or targets – usually specific in nature – which must be achieved for an organisation to attain its corporate aims

Aims, objectives, strategies and tactics

Figure 1.3.1 shows the links between the different stages in the setting of aims and objectives.

Corporate aims

The core of a business's activity is expressed in its **corporate aims** and plans. A typical corporate aim is: 'To increase shareholder returns each year through business expansion'.

Figure 1.3.1 The hierarchy of objectives

This example demonstrates a typical corporate aim. It tells us that the company aims to give shareholders maximum returns on their investment by expanding the business. Other corporate aims tend to concentrate on customer-based goals, such as 'meeting customers' needs', or market-based goals, such as 'becoming the world leader'. Corporate aims are all-embracing, and are designed to provide guidance to the whole organisation, not just a part of it.

Establishing corporate aims has several benefits. They:

- become the starting point for **divisional/operational objectives** on which effective management is based; this is shown by the position of 'aim' at the top of the hierarchy of objectives in Figure 1.3.1

- can help develop a sense of purpose and direction for the whole organisation if they are clearly and unambiguously communicated to the workforce
- allow an assessment to be made, at a later date, of how successful the business has been in attaining its goals
- provide the framework within which the strategies or plans of the business can be drawn up.

A business without a long-term corporate plan or aim is likely to drift from event to event without a clear sense of purpose. This will become obvious to the workforce and customers, who may respond in adverse ways.

Operational objectives should be 'SMART'

Business aims and objectives help to direct, control and review the success of business activity.

The most effective business objectives usually meet the following SMART criteria:

- **S – Specific** Objectives should focus on what the business does and should apply directly to that business. For example, a hotel may set an objective of 75% bed occupancy over the winter period – the objective is specific to this business.
- **M – Measurable** Objectives that have a quantitative value are likely to prove to be more effective targets for directors and staff to work towards – for example, to increase sales in the south-east region by 15% this year.
- **A – Achievable** Objectives must be achievable. Setting objectives that are almost impossible to achieve in a given time will be pointless. They will demotivate staff who have the task of trying to reach these targets.
- **R – Realistic and relevant** Objectives should be realistic when compared with the resources of the company, and should be expressed in terms relevant to the people who have to carry them out. For example, informing a factory cleaner about 'increasing market share' is less relevant than a target of reducing usage of cleaning materials by 20%.
- **T – Time-specific** A time limit should be set when an objective is established. For example, by when does the business expect to increase profits by 5%? Without a time limit it will be impossible to assess whether the objective has actually been met.

Exam tip: Remember the acronym: SMART.

Interlinking aims, objectives and strategies

Corporate aims relate to the whole organisation. They need to be broken down into specific tactical or operational objectives for separate divisions.

Divisional, operational objectives are set by senior managers to ensure:

- coordination between all divisions – if they do not work together, the focus of the organisation will appear confused to outsiders and there will be disagreements between departments
- consistency with strategic corporate objectives
- adequate resources are provided to allow for the successful achievement of the objectives.

Once divisional objectives have been established, these can be further divided into departmental objectives and finally budgets and targets for individual workers. This process is called management by objectives (MBO), as shown in Figure 1.3.2.

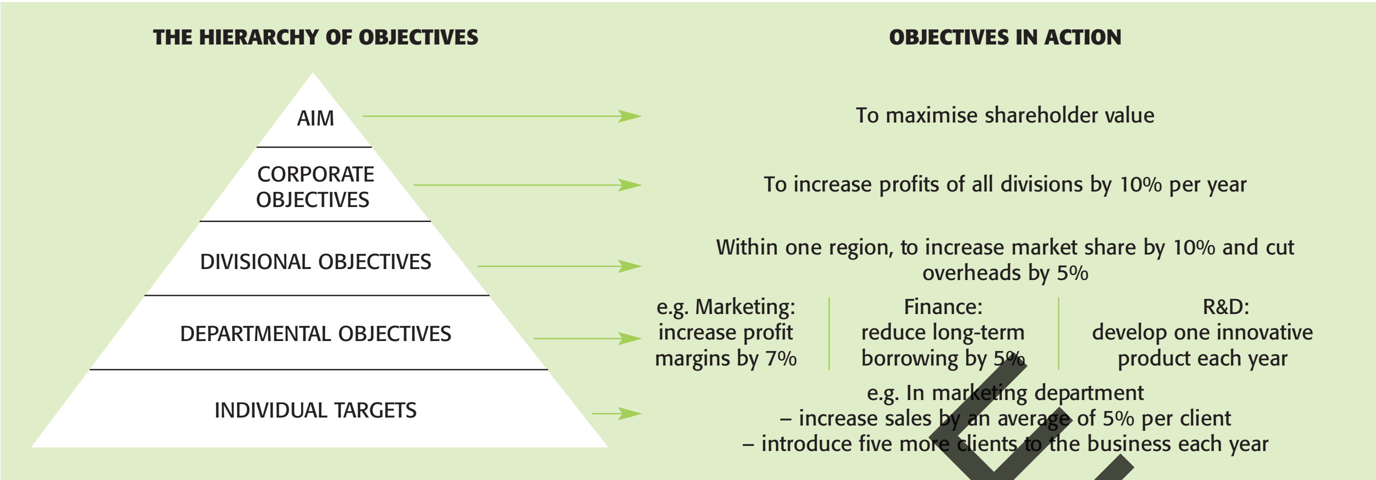


Figure 1.3.2 Management by objectives – how the corporate aim is divided at every level of the organisation

Relationship between aims, objectives, strategy and tactics

Aims and objectives provide the basis and focus for business strategies – the long-term plans of action of a business that focus on achieving its aims. Without a clear objective a manager will be unable to make important strategic decisions. For example, should a marketing manager decide to sell products in new markets or attempt to sell more in existing markets? Without a clear corporate objective, which is then translated into a marketing objective, decisions of this kind become very arbitrary.

For any corporate aim to be successfully achieved, there has to be an appropriate strategy – or detailed plan of action – in place to ensure that resources are correctly directed towards the final goal. This strategy should be constantly reviewed to check whether the business is on target to achieve its objectives. Both the aims of an organisation and the strategies it adopts will often change over time. Indeed, a change of objective will almost certainly require a change of plan too. A poor plan or strategy will lead to failure to reach the target.

These links between objectives and strategies are shown in Figure 1.3.3.

Figure 1.3.3 Links between objectives and strategies

Without clear objectives, decision-making will lack direction and a means of assessing success. Every stage of decision-making – collecting data about options, choosing a strategic option and reviewing success/failure – is made much more meaningful with specific business objectives to refer to.

Strategy and tactics – the key differences

Strategic decisions, e.g. to develop new markets abroad	Tactical decisions, e.g. to sell product in different-sized packaging
Long term	Short to medium term
Difficult to reverse once made – departments will have committed resources to it	Reversible, but there may still be costs involved
Taken by directors and/or senior managers	Taken by less senior managers and subordinates with delegated authority
Cross-functional – will involve all major departments of the business	Impact of tactical decisions is often only on one department

Table 1.3.2 Key differences between tactical decisions and strategic decisions

strategy: a long-term plan of action for the whole organisation, designed to achieve a particular goal

tactic: short-term policy or decision aimed at resolving a particular problem or meeting a specific part of the overall strategy

ACTIVITY 1.3.2

CORPORATE AIMS OF DOMESTIC DETERGENTS INC.

- To increase annual sales from $1 billion to $2 billion in five years
- To enter a new market every 18–24 months
- To achieve 30% of sales each year from products not in the company's product line five years earlier
- To be the lowest cost, highest quality producer in the household products industry
- To achieve a 15% average annual growth in sales, profit and earnings per share

20 marks, 40 minutes

1. Explain what is meant by the term 'SMART objectives'. [4]
2. To what extent are the corporate objectives for Domestic Detergents SMART objectives? [8]
3. Discuss the benefits and limitations to Domestic Detergents of setting specific and time-limited objectives. [8]

Common corporate aims

Profit maximisation

Profits are essential for rewarding investors in a business and for financing further growth, and are necessary to persuade business owners and entrepreneurs to take risks. Profit maximisation means producing at the level of output where the greatest positive difference between total revenue and total costs is achieved – see Figure 1.3.4.

It seems rational to seek the maximum profit available from a given venture. Not to maximise profit is seen as a missed opportunity, but there are limitations with this corporate objective:

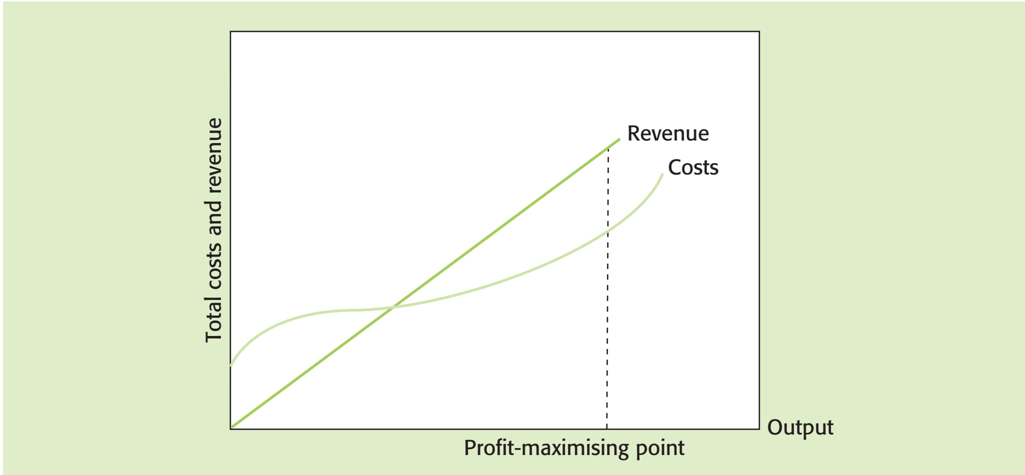


Figure 1.3.4 Profit maximisation – the greatest possible difference between total revenue and total cost

- High short-term profits may lead competitors to enter the market.
- Many businesses seek to maximise sales in order to secure the greatest market share possible, rather than maximise profits. The business would expect to make a target rate of profit from these sales.
- Owners of smaller businesses may be more concerned with issues of independence and keeping control – these may be of more importance than making higher profits.
- Most business analysts assess business performance through return on capital employed – the rate of profit returned on each dollar invested in the business – rather than through total profit.
- Profit maximisation may well be the preferred objective of the owners/shareholders, but other stakeholders will give priority to other issues. Managers cannot ignore these. Hence, the growing concern over job security for the workforce and the environmental concerns of local residents may force profitable business decisions to be modified, giving lower profit levels.
- In practice, it is very difficult to assess whether the point of profit maximisation has been reached, and constant changes to prices or output to attempt to achieve it may well lead to negative consumer reactions.

Profit satisficing

This means aiming to achieve enough profit to keep the owners happy but not aiming to work flat out to make as much profit as possible. This is often the objective of owners of small businesses who wish to live comfortably but do not want to work very long hours in order to earn more profit.

Growth

The growth of a business – in terms of sales or value of output – has many potential benefits for the managers and owners. Larger firms will be less likely to be taken over and should be able to benefit from economies of scale. Managers may gain higher salaries and fringe benefits. Businesses that do not attempt to grow may cease to be competitive and, eventually, will lose their appeal to new investors. Business objectives based on growth have limitations:

- Over-rapid expansion can lead to cash flow problems.
- Sales growth might be achieved at the expense of lower profit margins.

- Larger businesses can experience diseconomies of scale.
- Using profits to finance growth – retained profits – can lead to lower short-term returns to shareholders.
- Growth into new business areas and activities can result in a loss of focus and direction for the whole organisation.

Increasing market share

Closely linked to overall growth of a business is the market share it enjoys within its main market. It is possible for an expanding business to suffer a loss of market share if the market is growing at a faster rate than the business itself. Increasing market share indicates that the marketing mix of the business is proving to be more successful than that of its competitors. Benefits resulting from being the brand leader with the highest market share include:

- Retailers will be keen to stock and promote the best-selling brand.
- Profit margins offered to retailers may be lower than for competing brands as the shops are so keen to stock it – this leaves more profit for the producer.
- Effective promotional campaigns are often based on 'buy our product with confidence – it is the brand leader'.

Survival

This is likely to be the key objective of most new business start-ups. The high failure rate of new businesses means that to survive for the first two years of trading is an important aim for entrepreneurs. Once the business has become firmly established, then other longer-term objectives can be established.

Maximising short-term sales revenue

This could benefit managers and staff when salaries and bonuses are dependent on sales revenue levels. However, if increased sales are achieved by reducing prices, the actual profits of the business might fall.

Maximising shareholder value

Management, especially in public limited companies, take decisions that aim to increase the company share price and dividends paid to shareholders. These targets might be achieved by pursuing the goal of profit maximisation. This shareholder value objective puts the interests of shareholders above those of other stakeholders.

Ethical objectives

Ethical objectives are targets based on a moral code for the business – for example, 'doing the right thing'. The growing acceptance of corporate social responsibility has led to businesses adopting an '**ethical code**' to influence the way in which decisions are taken.

Most decisions have an ethical or moral dimension. For example:

- Should a toy company advertise products to young children so that they 'pester' their parents into buying them?
- Is it acceptable to take bribes in order to place an order with another company?
- Should a bank invest in a company that manufactures weapons or tests new chemicals on animals?
- Is it acceptable to feed genetically modified food to cattle?

ethics: moral guidelines that determine decision-making

ethical code (code of conduct): a document detailing a company's rules and guidelines on staff behaviour that must be followed by all employees

- Do we accept lower profits in the short term by purchasing less-polluting production equipment?
- Should directors receive substantial pay hikes and bonuses when other workers in the business might be being made redundant?
- Is it acceptable to close a factory to save costs and increase profits even though many jobs will be lost and workers may find it hard to get other jobs?
- If legal controls and inspections are weak in a country, is it acceptable to pay very low wages for long hours of work since this policy will reduce the firm's costs?
- Should a business employ child labour to reduce costs compared with employing adults?
- Should a business continue to produce potentially dangerous goods as long as 'no one finds us out'?

These are all examples of ethical dilemmas. The way in which employees behave and take decisions in these cases should be covered and explained by a company's ethical code of conduct. To what extent should businesses take ethics into consideration when making decisions? There is now considerable evidence that more and more companies are considering the ethical dimension of their actions – not just the impact they might have on profits.

Different people will have different answers to these dilemmas. Some managers will argue that any business decision that reduces costs and increases profits is acceptable as long as it is legal – and some might argue that even illegal actions could be justified too. Other managers will operate their business according to strict ethical rules and will argue that, even if certain actions are not illegal, they are not right. Morally, they cannot be justified even if they might cut costs and increase sales.

Evaluating ethical objectives

Adopting and keeping to a strict ethical code in decision-making can be expensive in the short term. For example:

- Using ethical and Fairtrade suppliers can add to a business's costs.
- Not taking bribes to secure business contracts can mean losing out on significant sales.
- Limiting the advertising of toys and other child-related products to an adult audience to reduce 'pester power' may result in lost sales.
- Accepting that it is wrong to fix prices with competitors might lead to lower prices and profits.
- Paying fair wages – even in very low-wage economies – raises costs and may reduce a firm's competitiveness against businesses that exploit workers.

However, in the long term there could be substantial benefits from acting ethically. For example:

- Avoiding potentially expensive court cases can reduce costs of fines.
- While bad publicity from being 'caught' acting unethically can lead to lost consumer loyalty and long-term reductions in sales, ethical policies will lead to good publicity and increased sales.
- Ethical businesses attract ethical customers and, as global pressure grows for corporate social responsibility, this group of consumers is increasing.
- Ethical businesses are more likely to be awarded government contracts.
- Well-qualified staff may be attracted to work for companies that have ethical and socially responsible policies.

ACTIVITY 1.3.3

SIAM CEMENT GROUP (SCG)

The SCG has a strict ethical code of conduct. Its key features are shown in the table below.

Business ethics	Code of conduct
• Fairness to all who have business relationships with the company, including society and environment • Making business gains in a proper manner • No alliances with political parties • Non-discriminatory treatment of all staff and stakeholder groups	• Upholding the principles of honesty and fairness • Protecting the properties and reputation of SCG • Conducting business in the best interests of SCG and its stakeholders • Behaving appropriately at all times towards others

According to a report by Judith Ross, as SCG expanded beyond Thailand managers came under pressure to compromise on its corporate code of ethics. The company's standards on bribes and other improper payments, for example, made it difficult to compete in places where such unethical payments are a way of life. This example demonstrates the classic problem: should firms conform to the standards of the country they operate in or should they try to export their own high moral principles to other lands?

Source: Adapted from http://hbswk.hbs.edu

22 marks, 44 minutes

1. Explain what you understand by the term 'corporate code of ethics'. [4]
2. Discuss how SCG and its employees might benefit from a corporate code of ethics. [8]
3. Should a business such as SCG ever use unethical methods in a country where they are the 'norm' – for example, the giving and accepting of bribes? Justify your answer. [10]

Corporate social responsibility (CSR)

Objectives that focus on meeting social responsibilities are increasingly important for most business organisations.

To whom is business answerable? Should business activity be solely concerned with making profits to meet the objectives of shareholders and investors or should business decisions also be influenced by the needs of other **stakeholders**? When a firm fully accepts its legal and moral obligations to stakeholders other than investors, it is said to be accepting **corporate social responsibility** (CSR).

One important measure of a firm's attitude to its social responsibility is the way in which it deals with environmental issues. Our environment can be greatly affected by business activity. Air and noise pollution from manufacturing processes, road congestion caused by heavy trucks, business expansion into country areas, emissions of gases that can lead to global warming and the use of scarce non-renewable natural resources are all environmental issues that are of increasing concern to people and governments all over the world. How should business managers react to these concerns? Should they respond by adopting environmentally safe or green policies, even if these are expensive, or should they always take the cheapest option no matter what the consequences for the environment might be?

stakeholders: people or groups of people who can be affected by, and therefore have an interest in, any action by an organisation

corporate social responsibility: this concept applies to those businesses that consider the interests of society by taking responsibility for the impact of their decisions and activities on customers, employees, communities and the environment

Other issues connected with the concept of CSR cross over into ethical decisions. In fact, the two concepts are closely linked. Examples of recent CSR developments include:

- the growth in the number of firms that promote organic and vegetarian foods
- increasing numbers of retailers emphasising the proportion of their products made from recycled materials
- businesses that refuse to stock goods that have been tested on animals or foods based on genetically modified ingredients.

In these cases, is the action being taken because trade and reputation might be lost if it is not or because such action is increasingly profitable? Might businesses be criticised for paying lip service to CSR rather than praised for their genuine concern for society and the environment? Conceivably, firms are being ethical or environmentally conscious because they have an objective that Peter Drucker, a famous writer on management, calls 'public responsibility', because they want to behave in these ways. However, many consumer groups and pressure groups are still dubious as to whether these objectives are based on genuinely held beliefs.

Table 1.3.3 looks at the benefits and drawbacks for businesses of adopting CSR policies.

Benefits	Drawbacks
• The image of the business and its products can be improved with a green or socially responsible approach. This could become a major competitive advantage, attracting new customers and loyalty from existing customers. • Attracting the best-motivated and most efficient employees may become easier as many workers will prefer to work for and be associated with socially aware businesses. • Bad publicity and pressure group activity resulting from socially irresponsible behaviour should not arise.	• Short-run costs could increase, e.g. fitting anti-pollution equipment, paying workers above-poverty wage levels, paying suppliers promptly, not exploiting vulnerable groups in advertising. • Shareholders may be reluctant to accept lower short-run profits (even though long-run profitability might increase). • Loss of cost and price competitiveness if rival businesses do not accept social responsibilities and have lower costs as a result.
• The goodwill of other stakeholder groups, resulting from socially responsible behaviour, could lead to better relations with workers, suppliers, customers and the local community. • Higher long-term profitability should result from all of the factors above.	• Consumers may be prepared to pay higher prices for products made in a socially responsible manner, but during an economic recession, they might just prefer low prices and worry less about how products were made. • There could be a considerable social backlash against a business that *claims* to be socially responsible but is discovered to operate in socially irresponsible ways, e.g. a furniture maker claims to use sustainable timber but buys from rainforest suppliers – this is sometimes referred to as 'greenwash'.

Table 1.3.3 Benefits and drawbacks of corporate social responsibility

Changes in corporate responsibility

Attitudes towards corporate responsibility have changed over time. The standards that companies are expected to reach are determined by societal norms, and in most countries these now focus on stakeholders rather than shareholders.

The main reasons for changing corporate approaches to social responsibility include:

- increasing publicity from international pressure groups that use the internet to communicate, blog, raise funds and organise boycotts
- the United Nations Millennium Development Goals, agreed by more than 120 countries in 2000, which includes 'environmentally sustainable growth' – this

has forced many developing nations to insist that new company investment in their economy takes environmental concerns into consideration

- global concern over climate change and the impact this could have on social and economic development – this is forcing companies to confront the climatic consequences of their actions and investments, e.g. the rapid increase in wind-power farms in Germany
- legal changes at local, national and European Union level – these have forced businesses to refrain from certain practices. In most countries, businesses can no longer pay staff very low wages or avoid legal responsibility for their products.

CSR and corporate strategy changes

The changing corporate strategies of the world's mining companies are an excellent example of how firms may adopt different strategies towards their social responsibilities in response to pressure. In the 1970s and 1980s, many mining companies signed mineral extraction deals with undemocratic political regimes. Environmental concerns were given very low priority and the interests of the local or indigenous peoples (displaced by the mine workings) ignored. The Grasberg (West Papua) and Bougainville (Papua New Guinea) gold and copper mines are useful case studies.

- In Bougainville, joint owners of the mine, RTZ and Freeport, allowed the government to use force to put down civil unrest caused by the displacement of people by the mine and its environmental damage. The company took a very tough line and military action took place next to the mine. Eventually, the company was forced to close it.
- The Grasberg mine, which opened later than Bougainville, benefited from a very different objective by RTZ towards its social responsibilities as a result of the poor publicity over its policy in Papua New Guinea. A trust fund has been set up to spend 1% of total mine revenue to fund village development. In addition, one quarter of the total workforce is drawn from local communities.
- RTZ went even further with the Jabiluka uranium mine in northern Australia. Publicity by the local Mirrar tribe and their supporters led to an unprecedented extraordinary general meeting of shareholders, which led to the mine being closed; it has never reopened.

Measuring CSR – social audits

Social audits report on a firm's 'social' performance and are becoming an important way for businesses to report on their corporate social responsibility record. They assess the impact a business has on society and how effectively its ethical behaviour matches up to its ethical objectives. Social audits can include an environmental audit (see above), but they give details of other impacts on society too. These include:

- health and safety record, e.g. number of accidents and fatalities
- contributions to local community events and charities
- proportion of supplies that come from ethical sources, e.g. Fairtrade Foundation suppliers
- employee benefit schemes
- feedback from customers and suppliers on how they perceive the ethical nature of the business's activities.

The social audit will also contain annual targets to be reached to improve a firm's level of social responsibility and details of the policies to be followed to achieve these aims. By researching and publishing these reports, firms are often able to identify potentially

social audit: an independent report on the impact a business has on society. This can cover pollution levels, health and safety record, sources of supplies, customer satisfaction and contribution to the community anti-social behaviour and take steps to root this out of the company's practices. Publishing detailed and independently verified social audits can improve a firm's public image, increase consumer loyalty and give the business a clear direction for future improvements in its social responsibility achievements. The benefits and limitations of social audits are considered in Table 1.3.4.

Benefits	Limitations
• Identifies what social responsibilities the business is meeting – and what still needs to be achieved. • Sets targets for improvement in social performance by comparing audits with the best-performing firms in the industry. • Gives direction to the action plans a business still needs to put into effect to achieve its social/ethical objectives. • Improves a company's public image and this can be used as a marketing tool to increase sales.	• If the social audit is not independently checked – as published accounts must be – will it be taken seriously by stakeholders? • Time and money must be devoted to producing a detailed social audit – is this really necessary if it is not legally required? • Many consumers may just be interested in cheap goods, not whether the businesses they buy from are socially responsible. • A social audit does not prove that a business is being socially responsible.

Table 1.3.4 Benefits and limitations of social audits

Evaluation of social audits

- Until social audits are made compulsory and there is general agreement about what they should include and how the contents will be verified, some observers will not take them seriously.
- Companies have been accused of using them as a publicity stunt or a 'smokescreen' to hide their true intentions and potentially damaging practices.
- They can be very time-consuming and expensive to produce and publish and this may make them of limited value to small businesses or those with very limited finance.

ACTIVITY 1.3.4

CORPORATE SOCIAL RESPONSIBILITY

Corporate social and environmental awareness has become essential for companies as they realise that they must listen to all stakeholders if they are to achieve their objectives.

The combination of environmental responsibility, **business ethics** and profits is one that is attracting increasing attention. Many chief executive officers of leading companies now disagree with the idea that the interests of shareholders and those of other stakeholders (employees, community, customers and so on) must always conflict. Increasingly, corporations seek to weld these two seemingly opposite forces so that 'doing good' and 'doing good business' become the same thing.

Social and environmental responsibility has moved from a 'nice to do' to a 'need to do'. The importance of the employee has been highlighted by the so-called 'war for talent'. Recruiting the brightest and best has become a key concern, says a human resources manager at PricewaterhouseCoopers: 'There is such a limited number of the right type of graduates, and they are choosy about the type of company they will work for. The cost of recruiting and retaining staff is likely to be higher if you are not seen to be an ethical employer and organisation.' A company's reputation also has significant implications for its financial performance. Analysts believe it is one of the key factors in the valuation of companies. One company could have a higher stock market valuation than another solely on account of its good social and environmental reputation.

Shell, a company with traditionally one of the worst reputations among environmental and social pressure groups, has made enormous efforts to reinvent itself as a **socially responsible business**. It has stated its aims as nothing less than to become 'the leading multinational in economic, environmental and social responsibility'. Shell's chairman has said that the reason for Shell's conversion to environmental protection is: 'We won't achieve our business goals unless we are listening to and learning from the full range of our stakeholders in society.'

32 marks, 64 minutes

1. Define the following terms highlighted in the article:
   a. business ethics [2]
   b. socially responsible business. [2]
2. Analyse **two** factors given in the article which could encourage a business to adopt ethical and socially responsible objectives and strategies. [8]
3. Discuss the likely costs and benefits for Shell of the company working towards being seen as 'the leading multinational in economic, environmental and social responsibility'. [10]
4. Examine whether businesses should change their strategies of corporate responsibility over time. [10]

ACTIVITY 1.3.5

VIRGIN'S ENVIRONMENTAL POLICIES – GREEN OR JUST 'GREENWASH'?

The Virgin Atlantic jumbo jet that flew between London and Amsterdam using a proportion of biofuel was a world first. This fuel was derived from Brazilian babassu nuts and coconuts and is much less polluting than ordinary jet kerosene. The airline's boss, Sir Richard Branson, hailed this as a 'vital breakthrough' for the industry. Other well-publicised fuel-saving measures used by the airline are the towing of aircraft to the runways for take-off instead of using their own engines and offering first-class passengers train tickets to travel to the airport in place of chauffeur-driven cars. Unfortunately, very few passengers have taken up this last offer, and towing of aircraft has been stopped as it causes damage to the undercarriage.

Greenpeace's chief scientist has labelled these efforts to make air travel more environmentally friendly 'high altitude greenwash' and said that 'less air travel was the only answer to the growing problem of climate-changing pollution caused by air travel'. A Friends of the Earth spokesperson said that biofuels do little to reduce emissions, and large-scale production of them leads to higher food prices.

18 marks, 36 minutes

1. Analyse why Virgin Atlantic is making efforts to reduce the amount of jet fuel (kerosene) used by its aircraft. [8]
2. To what extent will the company lose or benefit from these well-publicised attempts to reduce air pollution? [10]

LEARNER PROFILE

Africa is Big Tobacco's last frontier, and companies are conquering the continent stick by stick. Even the very poor can afford the cost of a single cigarette. So the world's leading tobacco companies are targeting Africa in the same strategic way any organisation would approach an expanding and profitable market.

Unlike many more developed countries the regulations on cigarette sales in African countries is relatively relaxed. The sale of packs, for example, with fewer than 20 cigarettes is prohibited in countries like the US, whereas selling cigarettes single, or 'one-one,' is allowed in African countries.

Tobacco use is declining in the developed world. It has reached a plateau in the strongest market, Asia. However, it is growing in Africa, because of the continent's booming population and rapidly expanding middle class.

Can you be principled and work for a tobacco company that targets markets in developing countries?

Issues relating to corporate objectives

Some important issues relating to corporate objectives include the following:

- They must be based on the corporate aim and should link in with it.
- They should be achievable and measurable if they are to motivate employees.
- They need to be communicated to employees and investors in the business. Unless staff are informed of the objectives and their own targets that result from these, then the business is unlikely to be successful.
- They form the framework for more specific departmental or strategic objectives – see below.
- They should indicate a time scale for their achievement – remember SMART!

Conflicts between corporate objectives

Conflicts between objectives can often occur. These conflicts will need to be resolved by senior managers and decisions taken on the most significant objective for the next time period. The most common conflicts that can occur are:

- growth versus profit – achieving higher sales by raising promotional expenditure and by reducing prices will be likely to reduce short-term profits
- short term versus long term – lower profits and cash flow may need to be accepted in the short term if managers decide to invest heavily in new technology or the development of new products that might lead to higher profits in the longer term
- stakeholder conflicts – these are covered in detail in Chapter 1.4.

ACTIVITY 1.3.6

IS STS PLC SUCCESSFUL?

STS plc collects waste from houses, offices and factories. Most of the waste is burned to produce heat and electricity for the company's own use. This saves costs and reduces the impact on the environment by not using areas of land to bury the rubbish. A recent increase in customers has meant that not all of the waste can be burned and the company has dumped it in old quarries where it causes smells and gas emissions. Investment in labour-saving equipment has allowed the business to save on wage costs. The company's new mission statement is 'to become the country's number one waste business and to protect the environment for our children's benefit'. This has been explained to all shareholders in a recent letter to them, but the workers of the company were not involved in helping create the mission statement and they have not been informed of it.

The latest company accounts stated: 'We aim to maximise returns to shareholders through a strategy of aggressive growth. Our objectives are to expand year on year.' These accounts contained the following data.

	2011	2012	2013	2014
Sales revenue ($m)	20	25	35	40
Net profit ($m)	3	8	10	20
Total value of country's waste market ($m)	120	140	160	180
Number of employees	1000	950	900	800

26 marks, 52 minutes

1. a. Define the term 'mission statement'. [2]

b. Explain **one** benefit STS might gain from its new mission statement. [4]

2. a. Explain what you understand by SMART objectives. [4]

b. STS's objectives are not completely SMART. Analyse **two** problems that might arise from this. [8]

3. STS's aim is 'to maximise returns to shareholders through a strategy of aggressive growth'. Using the data provided, evaluate the extent to which they are being successful in achieving this objective. [8]

Factors determining corporate objectives

There are several reasons why firms have different objectives.

Corporate culture

This can be defined as the code of behaviour and attitudes that influences the decision-making style of the managers and other employees of the business. Culture is a way of doing things that is shared by all those in the organisation.

If directors are aggressive in pursuit of their aims, keen to take over rival businesses and care little about social or environmental factors, then the objectives of the business will be very different from those of a business owned and controlled by directors with a more 'people'- or 'social'- orientated culture.

Size and legal form of the business

Owners of small businesses may be concerned only with a satisficing level of profit. Larger businesses, perhaps controlled by directors rather than owners, such as most public limited companies, might be more concerned with rapid business growth in order to increase the status and power of the managers. This is often a result of the divorce between ownership and control. Directors and managers may be more concerned about their bonuses, salaries and fringe benefits – which often depend on sheer business size – than on maximising returns to shareholders.

Public sector or private sector businesses

State-owned organisations tend not to have profit as a major objective. Quality of service targets are often set, however, such as the maximum days for a patient to wait for an operation. Even businesses earning revenue in the public sector, such as the postal service, may have among their objectives the target of maintaining services in non-profitable locations.

Well-established businesses

Newly formed businesses are likely to be driven by the desire to survive at all costs – the failure rate of new firms in the first year of operation is very high. Later, once well established, the business may pursue other objectives such as growth and profit.

Changing business objectives

Businesses can change their corporate objectives over time. These changes will be in response to internal factors, such as resource constraints, or external factors, such as changes in the social and economic environment.

Some of the most significant reasons for businesses changing their objectives include the following:

- A business may have satisfied the survival objective by operating for several years and now the owners wish to pursue objectives of growth or increased profit. The internal resources of the business might have increased which will allow the objective of growth to be realistically established.
- An important senior manager responsible for international expansion might leave the business, which leads to focusing on growing the business in domestic markets until an effective replacement can be found.
- The external competitive and economic environment may change. The entry into the market of a powerful rival or an economic recession may lead a firm to switch from growth to survival as its main aim. The UK airline British Airways (BA) has responded to the dual impact of increased low-fare competition and the recession by focusing less on its objectives to increase business-class and first-class market share and more on cost-cutting and low fares. This has led to serious disputes with trade unions representing BA cabin staff.
- A short-term objective of growth in sales or market share might be replaced by a longer-term objective of maximising profits from the higher level of sales.

Business objectives need to be flexible enough to be adapted to reflect internal and external changes, but they should not be changed too dramatically or frequently as this may result in the loss of many of the benefits of setting SMART targets, including a loss of focus, sense of direction and specific measures to judge present performance. Before making a significant change to objectives, senior managers need to consider:

- Is the internal or external change significant and long-lasting enough to make a change in objectives necessary?
- What would be the risks of not adapting objectives to meet the new situation?
- What would be the cost and other consequences of new business objectives for the business and its staff?
- How can changed objectives – and the strategies needed to achieve them – be effectively managed within the business?

Air pollution is one way in which business activity can damage the environment: should companies be forced to use cleaner production methods?

ACTIVITY 1.3.7

PEUGEOT CITROËN SET CLEAR OBJECTIVES

The chairman of the car manufacturer Peugeot Citroën has set the company the aim of becoming the 'most competitive carmaker in Europe in 2015'. This overall aim is supported by more specific and measurable objectives. The profit margin of each car sold is targeted to increase from 2% to 7% by 2015. The overall sales objective was to reach four million car sales a year by 2010. One million car sales are aimed for in the emerging markets by 2015. In Europe, one of the most competitive car markets in the world, the target is to increase sales by 300000 cars a year by the same date.

Departmental operating targets have also been established. For example, the human resources department must prepare for up to 8000 job losses and operations must aim to cut fixed manufacturing costs by 30% and costs of purchasing car parts by 4–6% a year. Marketing must plan to launch 12 new models in the Chinese market.

The chairman also announced his intention to take both car brands upmarket and establish them as premium car brands that increasing numbers of customers will want to own.

Source: www.timesonline.co.uk

26 marks, 52 minutes

1. Analyse whether Peugeot Citroën's objectives fit the SMART criteria. [6]
2. Analyse the importance of the chairman not only setting an overall aim for the company but also establishing departmental objectives. [10]
3. To what extent might the chairman's new objectives meet with the needs of the company's shareholders? [10]

SWOT analysis: a form of strategic analysis that identifies and analyses the main internal strengths and weaknesses and external opportunities and threats that will influence the future direction and success of a business

SWOT analysis

A **SWOT analysis** provides information that can be helpful in matching the firm's resources and strengths to the competitive environment in which it operates. It is, therefore, useful in strategy formulation and selection. It comprises:

- **S = strengths** These are the internal factors about a business that can be looked upon as real advantages. These could be used as a basis for developing a competitive advantage. They might include experienced management, product patents, loyal workforce and good product range. These factors are identified by undertaking an internal audit of the firm. This is often undertaken by specialist management consultants who analyse the effectiveness of the business and the effectiveness of each of its departments and major product ranges.
- **W = weaknesses** These are the internal factors about a business that can be seen as negative factors. In some cases, these can be the flip side of a strength. For example, whereas a large amount of spare manufacturing capacity might be a strength in times of a rapid economic upturn, if it continues to be unused it could add substantially to a firm's average costs of production. Weaknesses might include: poorly trained workforce, limited production capacity and ageing equipment. This information would also have been obtained from an internal audit.
- **O = opportunities** These are the potential areas for expansion of the business and future profits. These factors are identified by an external audit of the market the firm operates in and its major competitors. Examples include: new technologies, export markets expanding faster than domestic markets, and lower rates of interest increasing consumer demand.
- **T = threats** These are also external factors, gained from an external audit. This audit analyses the business and economic environment, market conditions and the strength of competitors. Examples of threats are: new competitors entering the market, globalisation driving down prices, changes in the law regarding the sale of the firm's products and changes in government economic policy.

This information is usually presented in the form of a four-box grid as shown in Table 1.3.5.

	Strengths	**Weaknesses**
Internal	• Specialist marketing expertise • A new, innovative product or service • Location of your business • Quality products and processes • Any other aspect of your business that adds value to your product or service	• Lack of marketing expertise • Undifferentiated products or services (i.e. in relation to your competitors) • Location of your business • Poor-quality goods or services • Damaged reputation
	Opportunities	**Threats**
External	• A developing market such as the internet • Mergers, joint ventures or strategic alliances • Moving into new market segments that offer improved profits • A new international market • A market vacated by an ineffective competitor	• A new competitor in your home market • Price wars with competitors • A competitor has a new, innovative product or service • Competitors have superior access to channels of distribution • Taxation of your product or service

Table 1.3.5 SWOT analysis – some common issues

SWOT and strategic objectives

The SWOT diagram focuses on the key issues under each heading. A brief outline of each of these could then accompany the grid to make it more useful to the managers responsible for strategic planning. This approach helps managers assess the most likely successful future strategies and the constraints on them. A business should not necessarily pursue the most profitable opportunities. It may stand a better chance of developing a competitive advantage by identifying a good 'fit' between the firm's strengths and potential opportunities. In many cases, a business may need to overcome a perceived weakness in order to take advantage of a potential opportunity. SWOT is a common starting point for developing new corporate strategies, but it is rarely sufficient. Further analysis and planning are usually needed before strategic choices can be made.

SWOT evaluation

Subjectivity is often a limitation of a SWOT analysis as no two managers would necessarily arrive at the same assessment of the company they work for. It is not a quantitative form of assessment so the 'cost' of correcting a weakness cannot be compared with the potential 'profit' from pursuing an opportunity. SWOT should be used as a management guide for future strategies, not a prescription. Part of the value of the process of SWOT analysis is the clarification and mutual understanding that senior managers gain by the focus that SWOT analysis provides.

Exam tip: Some examination questions may ask you to undertake a SWOT analysis while others will ask you to evaluate the technique for a particular business; read the question carefully to grasp its key requirements.

ACTIVITY 1.3.8

STRATEGIC ANALYSIS OF LVM LTD

LVM owns a major assembly plant for laptop computers. It supplies products to some of the major brand names in the computer industry but, at present, it does not sell any under its own name. Every six months the managers hold a key strategic review meeting to consider the current position of the business and the long-term plans. The following are extracts from the most recent of these meetings:

Imran Khan – marketing director: 'Sales of our latest TFT screen models have exceeded expectations and the switch towards laptops from desktop PCs is expected to continue. The chance for computer companies to break into the expanding Asian market when trade barriers are lifted should lead to increased orders too. We need to undertake some market research in Asia as this market has higher growth potential than Europe, where most of our computers are marketed. The uncertainty over the newest mobile phone technology and links with the internet remain a concern for us. We decided two years ago not to develop this technology, and, if our competitors succeed in getting a major breakthrough, then sales of our laptops will dive in some markets.'

Liz Collins – operations manager: 'The automation of the screen-assembly section is now complete. We managed to push this through while maintaining excellent staff relationships. This was helped by our continued expansion, which meant that no jobs were lost. We had to turn down a large order from a big-name brand last month due to too little factory capacity and shortages of skilled labour. I do urge you to agree to my plan to extend the factory space by 35% and to train more new recruits. Research into the lighter, faster computer model that was agreed on last year is making excellent progress and we will soon have to decide whether to proceed into the production stage.'

Lukas Klimas – finance director: 'Our profits are holding steady, but cash flow remains a concern due to the expenditure on automated machines and research costs. We would need to borrow substantially to finance a factory extension. We would be in trouble if interest rates increased – there is already some government concern about inflation rising. There is a new range of grants available for businesses relocating into areas of high unemployment. We must constantly be aware of exchange rate movements too – the recent depreciation helped our international competitiveness.'

30 marks, 60 minutes

1. Prepare a SWOT analysis based on your assessment of the internal and external factors that influence LVM's success. [10]
2. Evaluate the usefulness of SWOT to a business such as LVM. [10]
3. Evaluate **two** potential strategic options available to LVM Ltd by using the SWOT analysis prepared in question 1. [10]

Ansoff's matrix

This analytical tool is one of the most widely referred-to means of portraying alternative corporate growth strategies.

Ansoff popularised the idea that long-term business success was dependent upon establishing business strategies and planning for their introduction. His best-known contribution to strategic planning was the development of **Ansoff's matrix**, which represented the different options open to a marketing manager when considering new opportunities for sales growth.

Ansoff's matrix: a model used to show the degree of risk associated with the four growth strategies of: market penetration, market development, product development and diversification

He considered that the two main variables in a strategic marketing decision are:

- the market in which the firm is going to operate
- the product(s) intended for sale.

In terms of the market, managers have two options:

- to remain in the existing market
- to enter new ones.

In terms of the product, the two options are:

- selling existing products
- developing new ones.

When put on a matrix, these options can be presented as shown in Figure 1.3.5.

As there are two options each for markets and for products, this gives a total of four distinct strategies that businesses can adopt when planning to increase sales. These are shown on the matrix and can be summarised as follows:

Market penetration

In 2013 Samsung reduced the European prices of its range of 4K TV's by up to €200. This was in response to price cuts by other manufacturers – but Samsung's reductions were larger in an attempt to increase market share. **Market penetration** is the least risky of all the four possible strategies in that there are fewer 'unknowns' – the market and product parameters remain the same. However, it is not risk-free as, if low prices are the method used to penetrate the market, they could lead to a potentially damaging price war that reduces the profit margins of all firms in the industry.

market penetration: achieving higher market shares in existing markets with existing products

product development: the development and sale of new products or new developments of existing products in existing markets

Product development

The launch of Diet Pepsi took an existing product, developed it into a slightly different version and sold it in the soft drinks market where Pepsi was already available. **Product development** often involves innovation – as with 4G mobile (cell) phones – and these brand new products can offer a distinctive identity to the business.

Figure 1.3.5 Ansoff's matrix

Market development

Market development could include exporting goods to overseas markets or selling to a new market segment. Lucozade used to be promoted as a health tonic for people with cold and influenza. It was successfully repositioned into the sports-drink market, appealing to a new, younger range of consumers. Dell or HP can use existing business-computer systems and repackage them for sale to consumer markets.

market development: the strategy of selling existing products in new markets

Diversification

The Virgin Group is constantly seeking new areas for growth; the expansion from a media empire to an airline and then a train operator, then into finance, is a classic

diversification: the process of selling different, unrelated goods or services in new markets

example of **diversification**, which was continued with the bid for the National Lottery in the UK. Tata Industries in India is another classic example of a very diversified business, making a huge range of products from steel to tea bags. Related diversification, e.g. backward and forward vertical integration in the existing industry, can be less risky than unrelated diversification, which takes the business into a completely different industry.

As the diversification strategy involves new challenges in both markets and products, it is the most risky of the four strategies. It may also be a strategy that is outside the core competences of the firm. However, diversification may be a possible option if the high risk is balanced out by the chance of a high profit. Other advantages of diversification include the potential to gain a foothold in an expanding industry and the reduction of overall business-portfolio risk.

Evaluation of Ansoff's matrix

Clearly, the risks involved in these four strategies differ substantially. By opening up these options, Ansoff's matrix does not direct a business towards one particular future strategy. However, by identifying the different strategic areas in which a business could expand, the matrix allows managers to analyse the degree of risk associated with each one. Managers can then apply decision-making techniques to assess the costs, potential gains and risks associated with all options. In practice, it is common for large businesses, in today's fiercely competitive world, to adopt multiple strategies for growth at the same time.

While Ansoff's analysis helps to map the strategic business options, it has limitations too. It only considers two main factors in the strategic analysis of a business's options – it is important to consider SWOT and STEEPLE (Chapter 1.5) analysis too in order to give a more complete picture. Recommendations based purely on Ansoff would tend to lack depth and hard environmental evidence.

Management judgement, especially based on experience of the risks and returns from the four options, may be just as important as any one analytical tool for making the final choice.

The matrix does not suggest – and to be fair to Ansoff, it was never intended to – actual detailed marketing options. For instance, market development may seem to be the best option but: which market/country and with which of the existing products produced by the business? Further research and analysis will be needed to supply answers to these questions.

ACTIVITY 1.3.9

CAFFÈ NERO AND ASDA – CONTRASTING STRATEGIES TO ACHIEVE GROWTH

Although both companies have similar objectives – sales growth, leading to profitability – Caffè Nero and Asda present an interesting contrast in business strategy. The coffee-bar operator is going for market development. Gerry Ford, Caffè Nero's chairman, has set a target of 100 branches to be opened in Turkey. He said that he was 'also looking around Europe and scouting out China'. He is confident of success in Turkey. He has appointed Isik Asur, a Harvard Business School graduate, who used to run the Starbucks operation in the country. He knows all about the changing consumer tastes in the country as well as the political, social and economic environment there.

Asda – the number-two supermarket chain in the UK – has decided on the strategies of market penetration and product development to build sales growth. New food stores will be opened in the next few years in an attempt to gain ground on Tesco. It aims to be the lowest-price supermarket to increase food sales further. In addition, it is expanding rapidly into non-food retailing. It plans to open ten new Asda Living stores, selling a huge range of items for the home – but not food.

Different businesses in different markets will often decide on different strategies for the future – even though overall objectives may be similar.

44 marks, 88 minutes

1. Analyse **two** reasons why companies like Caffè Nero and Asda need long-term plans to help them achieve their objectives. [8]
2. a. Identify **three** possible aspects of the Turkish consumer market that Caffè Nero might find useful in their strategic decision-making. [6]
   b. Analyse **two** reasons why an understanding of the Turkish consumer market would be useful to Caffè Nero. [8]
3. Using Ansoff's matrix, compare and contrast the different strategies being adopted by Caffè Nero and Asda. [10]
4. Discuss the factors that might influence the long-term plans or strategies adopted by businesses such as Caffè Nero and Asda. [12]

OVER TO YOU

Revision checklist

1. Differentiate clearly, with examples, between mission statements and vision statements.
2. What are often considered to be the practical limitations of mission statements?
3. State **four** factors that would help to ensure that corporate objectives are effective in assisting a business to achieve its aim.
4. Give an example of a SMART objective that could be set for your school or college.
5. Explain, with **two** examples, what corporate objectives a car manufacturing business could establish.
6. Why might short-term profit maximisation not be an appropriate objective for a car manufacturer?
7. Explain the meaning of the corporate objective 'increasing shareholder value'.
8. Why might the owners/directors of a small private limited company set a profit-satisficing objective?
9. Why might the objective of increasing shareholder value conflict with corporate social responsibility?
10. Why should departmental objectives be coordinated?
11. Why are more companies adopting objectives that include corporate social responsibility?
12. What do you understand by the term 'ethical code of conduct'?
13. Explain the possible benefits to a clothing retailer of strictly observing an ethical code when choosing and checking on its suppliers.
14. Why might some firms decide not to act ethically in a competitive market?
15. Using a business example from your own country, explain why its key corporate objectives might change over time.
16. Identify **two** factors under each of the SWOT headings for any business that operates in your country.
17. Select a business that operates in your country and give an example of how it could adopt a 'market penetration strategy'.
18. Select a business that operates in your country and give an example of how it could adopt a 'market development strategy'.
19. Select a business that operates in your country and give an example of how it could adopt a 'product development strategy'.
20. Select a business that operates in your country and give an example of how it could adopt a 'diversification strategy'.

Exam practice question

CORPORATE AND SOCIAL RESPONSIBILITY AT NIKE, INC.

The Nike 'Swoosh' logo is one of the most famous corporate symbols in the world. Nike, Inc. is an organisation that people look to as a leading sports brand and a business that encapsulates US corporate power and globalisation.

Nike, Inc.'s mission statement has two elements:

- To bring inspiration and innovation to every athlete in the world.
- If you have a body you are an athlete.

Much of Nike, Inc.'s success is based on the way it focuses on consumers in a sporting context and provides products which strongly support this. In recent years it has, like many multinational companies, suffered from adverse publicity on issues such as working conditions in its factories. It has tried to answer its critics by becoming a socially responsible organisation and communicating this to its stakeholders.

The following is a short extract from Nike, Inc.'s website (www.nikebiz.com) on its corporate social responsibility:

> Nike, Inc. shares the widely held view that climate change is a serious issue requiring immediate and meaningful action across government, industry, consumers and society. Nike, Inc. has made cutting greenhouse gas emissions across our operations, incorporating sustainability into the design of our products and reducing the overall environmental footprint a cornerstone of our environmental efforts.

Source: Adapted from www.nike.com

25 marks, 50 minutes

1. Explain the reason for Nike, Inc. having a mission statement. [4]
2. Analyse **two** strategic objectives that Nike, Inc. might try to achieve. [6]
3. Using Nike, Inc. as an example, outline the main components you might expect to see in its environmental audit. [6]
4. Evaluate the advantages and disadvantages to Nike, Inc. of aiming to be a socially responsible organisation. [9]

Key concept question

20 marks, 40 minutes

With reference to one or two organisation(s) that you have studied, discuss how organisational objectives may differ in two cultures that you are familiar with. [20]

1.4

Stakeholders

On completing this chapter you should be able to:

Analyse and apply:

- The interests of internal stakeholders (AO2)
- The interests of external stakeholders (AO2)

Evaluate:

- Possible areas of mutual benefit and conflict between stakeholders' interests (AO3)

Setting the scene

TATA NANO – WHICH STAKEHOLDERS BENEFIT FROM IT?

What makes the Nano so cheap?

It is three metres long, seats four, does 100 kilometres per hour and, when launched, aimed to revolutionise travel for millions. The 'People's Car' is also the cheapest in the world at 100 000 rupees (US$2600) – about the same price as a DVD player in a Lexus. When Ratan Tata, the company's chairman, unveiled the cute, snub-nosed car it was believed that it would allow millions of Asia's emerging middle classes to buy a car for the first time. 'This will change the way people travel in India and Asia. This is a car that will be affordable to millions of consumers for the first time,' he said when the car was launched. However, sales levels are currently way below those forecast – just 554 units in December 2013. Customers are being 'put off' by the car's poor safety record and the title of 'the world's cheapest car'. Tata plans to relaunch the car at a higher price with an improved specification under the advertising headline of 'celebrating awesomeness' – hoping to make the car profitable for shareholders once more.

The car is built in a factory in Sanand, Gujarat, offering relatively well-paid factory employment to many workers for the first time. India gains export revenue when the car is sold abroad. The steel and other materials used in the car are purchased from Asian suppliers, which help to boost local economies and suppliers.

The idea of millions of cheap cars such as the Nano on the road alarms environmental groups. Rajendra Pachauri, the UN's chief climate scientist, said that he was 'having nightmares' about the environmental impact. New Delhi, where air pollution levels are more than twice the safe limit, is registering 1000 new cars a day. Average speed of traffic at rush hour is 10 kilometres per hour and the government might be forced to spend much more on building new roads if Nano's ownership becomes more widespread. Bus operators also fear increased competition from private car users.

1.4

Points to consider

- List the groups of people who benefit from Nano's car production.
- List the groups who might be badly affected by the use of large numbers of small, cheap cars.
- Do you think Tata should attempt to reduce the potential conflicts between the interests of these groups?

Key concept link

Innovations such as 'the world's cheapest car' can have multiple impacts on stakeholder groups. Not all innovative products are commercially successful and the strategy of introducing the Tata Nano to the Indian market as a very cheap car seems to have failed. With the benefit of hindsight, how could this strategy have been implemented more successfully?

Introduction

The traditional view of business is often referred to as the shareholder concept. As the shareholders are the owners of the company, the firm has a legally binding duty to take decisions that will increase shareholders' value. Since directors and managers ultimately owe their position to shareholders, it is important to keep them satisfied. In recent times, this limited view of business responsibility has been extended to include the interests not just of the investors/owners but also of suppliers, employees and customers. This approach to business responsibilities does not end with these four groups, however. The **stakeholder concept** or theory is that there are many other parties involved and interested in business activity and that the interests of these groups – local communities, the public, government and pressure groups such as environmental lobbyists – should be considered by business decision-makers.

stakeholder concept: the view that businesses and their managers have responsibilities to a wide range of groups, not just shareholders

Who are the stakeholders?

Internal stakeholders

There are three main groups of internal stakeholders, each with their own set of interests in the business's activities. They include:

- employees
- managers
- shareholders.

External stakeholders

The external stakeholders and their interests include:

- customers
- suppliers
- government
- banks and other creditors

- special interest groups such as:
  - pressure groups that want to change a business's policy towards pollution or testing of chemicals on animals
  - community action groups concerned about the local impact of business activity
- competitors – fairness of competitive practices, strategic plans of the business.

Exam tip: Do not confuse the terms 'stakeholder' and 'shareholder'. Stakeholder is a much broader term that covers many groups, including shareholders.

Stakeholders' interests

Table 1.4.1 outlines specific interests that each stakeholder group has. It also outlines the responsibilities that businesses are often considered to have towards stakeholders.

Conflicting stakeholders' interests

Business decisions and activities can have both positive and negative effects on stakeholders, but it is rare for all stakeholders to be either positively or negatively affected by any one business activity. It is also possible for any one stakeholder group to experience both negative and positive effects from the same business decision. This is why conflicts of interest between stakeholder groups, with different objectives and interests, can arise. Table 1.4.2 outlines some business decisions and the conflict of stakeholders' interests that can result.

THEORY OF KNOWLEDGE

The fall of the Stanford Financial Group

In 2009 the world fell in on the billionaire Allen Stanford, owner of the Stanford Financial Group. It also fell in for the different stakeholders in Stanford Financial Group's organisation.

Stanford was one of the world's richest men. His $100 million fleet of private jets, the yacht off the coast of his adopted home of Antigua and the $10 million faux castle in Florida were certainly the trappings of a very rich man and owner of a successful (on the surface) finance business.

Antigua had become known as Stanford-land – he had a private terminal at the airport, had built a much-needed hospital, was so well-connected politically he was said to attend cabinet meetings and, with a fortune exceeding the island's GDP, was one of its biggest employers.

The 2008 financial crisis toppled his empire which was based on a giant Ponzi scheme. A Ponzi scheme is a fraudulent scheme where investors are offered very high return on their investments to attract in funds. The newly attracted funds are used to pay investors high returns and the owner (Stanford) even higher returns. The scheme works as long as new funds are attracted in but fails when this source of funds dries up.

Source: Adapted from www.telegraph.co.uk

1. Consider the different stakeholder groups affected by the Stanford Financial Group.
2. What role does knowledge play in establishing Ponzi schemes like Stanford's?
3. Discuss in your class the conflict between emotion and reason when individuals are offered financial rewards which are seen as 'too good to be true'.

Exam tip: Many examination questions involve the conflict of stakeholders' objectives. Remember that it is difficult for a business to meet all its responsibilities to all stakeholders at any one time. Compromise might be necessary – meeting as many stakeholders' objectives as possible or meeting the needs of the most important group in each situation.

	Stakeholders' interests	Business's responsibilities to stakeholders
Employees	• Employment security • Wage levels and benefits that compare well with similar jobs in other businesses • Good conditions of employment, e.g. health and safety • Some participation in decision-making within the business	• Adhere to country's laws that outline business responsibilities to workers – such laws are stricter in some countries than in others • Some businesses also provide training and job security, pay more than minimum wages, offer good working conditions, involve staff in some decision-making
Managers	• Employment security • Salary and benefits that compare well to similar posts of responsibility in other businesses • Responsibilities offered and status of the post • Opportunity for profit sharing or share purchase scheme	• Job security • Competitive salaries and other benefits • Opportunities for responsibility and career advancement
Shareholders	• Annual dividends at a level at least comparable to similar businesses • Share price rising over time • Security of investment • Ability to sell shares when required	• Incorporated businesses should be operated in accordance with company's law • Annual accounts presented to shareholders • Strategies taken to increase shareholders' value over time
Customers	• Value for money • Product quality and safety • Guarantees • Service levels • Long-term rewards for loyalty	• Not to break the laws on consumer protection and accurate advertising • Not taking advantage of vulnerable customers, such as the elderly, and not using high-pressure selling tactics • Giving customers assurances about quality, delivery dates, service levels and continued supplies of vital components and materials
Suppliers	• Speed of payment • Level and regularity of orders • Fairness of treatment, e.g. not being exploited by a very large customer business	• Establish effective two-way relationships that are of benefit to the business and suppliers • Avoid excessive pressure on smaller or weaker suppliers to cut prices • Pay fair prices and pay invoices promptly
Government	• Creation of jobs and incomes that boost the economy • Taxes paid, e.g. Profit tax • Value of output produced as this adds to GDP • Impact on wider society, e.g. is production environmentally sustainable?	• Pay profit tax • Keep accurate accounting records so true profit can be shown • Provide information to government as requested • Keep within all legal limits, e.g. on employment contracts and pollution levels
Banks and other creditors	• Security of their loans and the ability of the business to repay them • Prompt payment of interest and capital owed by the business	• Pay interest • Pay back capital owed
Special interest groups	• Pressure groups – campaigning to achieve a change in business decisions/activities • Local community – encouraging business to act in community's interests and to avoid harmful production methods	• Pressure groups – recognise genuine concern over business activity; business may respond by changing decisions or operations • Local community – avoid pollution and other damaging operations; support for local groups
Competitors	• Fairness of competitive practices • Strategic plans of the business	• To compete fairly and within the law • It is *not* a responsibility of business to provide details of its strategic plans to competitors

Table 1.4.1 Stakeholders' interests and business's responsibilities to stakeholders

ACTIVITY 1.4.1

MAJOR PALM OIL COMPANIES ACCUSED OF BREAKING ETHICAL PROMISES

Palm oil is one of the world's most versatile raw materials. It is estimated that it is an ingredient in 50% of all products sold by a typical supermarket. It is used in a wide range of products from margarine, cereals, crisps, sweets and baked goods to soaps, washing powders and cosmetics but it is often listed as just 'vegetable oil'. So, its production benefits customers of these products. In addition, an estimated 1.5 million small farmers grow the crop in Indonesia, along with about 500 000 people directly employed in the sector in Malaysia, plus those connected with related industries. The governments of these countries have encouraged production as it is a major export for these economies.

Destruction caused by palm oil production

However, the industry has a poor image. Palm oil production has led to deforestation with a resulting negative impact on climate change. There has been substantial loss of wildlife habitat, even endangering the orangutan. Palm oil companies have been accused by community groups of driving native people off their land which is then used for palm oil production. **Socially responsible businesses**, such as KL Kepong in Malaysia, have agreed to an ethical code which aims to make palm oil production 'sustainable' with fair treatment for all local populations affected by it. However, many companies have been accused of breaking the code as there is no strong world body to stop them behaving irresponsibly. In any case, food manufacturers want to **maximise profits** and final consumers want the cheapest raw materials possible.

27 marks, 54 minutes

1. Define the following terms highlighted in the article:
   a. socially responsible business [2]
   b. maximise profits. [2]
2. Explain the interests of any **two** of KL Kepong's stakeholder groups. [6]
3. Analyse the impact on these **two** stakeholder groups of a decision by KL Kepong to close one of its palm oil plantations. [8]
4. Discuss why an expansion of the palm oil industry in either Malaysia or Indonesia is likely to cause conflicting views between stakeholder groups. [9]

ACTIVITY 1.4.2

Business decision/ activity	Impact on:	
	Employees	**Local community**
Expansion of the business	✔ More job and career opportunities ✘ More complex lines of communication after expansion	✔ More jobs for local residents and increased spending in other local businesses ✘ External costs caused by increased traffic and loss of green fields for amenity use
Takeover of a competing firm (horizontal integration)	✔ The larger business may be more secure and offer career promotion opportunities ✘ Rationalisation may occur to avoid waste and cut costs – jobs might be lost	✔ If the business expands on the existing site, local job vacancies and incomes might increase ✘ Rationalisation of duplicated offices or factories might lead to closures and job losses
New IT introduced into production methods	✔ Training and promotion opportunities might be offered ✘ Fewer untrained staff will be required and those unable to learn new skills may be made redundant	✔ Local businesses providing IT services could benefit from increased orders ✘ Specialist workers may not be available locally, so more staff may need to commute

Table 1.4.2 Potential conflicts of interest between stakeholder groups

15 marks, 30 minutes

1. In the three examples in Table 1.4.2, analyse the likely positive and negative effects on **two** other stakeholder groups. [6]
2. State **two** other examples of business decisions. Try to use actual and recent examples from your own country. Analyse the potential conflicts of interest between any **three** stakeholder groups. [9]

Can all stakeholders benefit from business activity?

Is it misleading to suggest that business decisions or activities always lead to significant conflict between stakeholder groups? Possibly, yes. Read the following case study activity. It indicates that business can be operated in ways that lead to mutual benefits for most – if not all – stakeholders.

ACTIVITY 1.4.3

JLP – ARE ALL STAKEHOLDERS SATISFIED?

The success of the John Lewis Partnership (owning John Lewis department stores and Waitrose supermarkets) shows that giving all employees a substantial stake in the performance of a business and opportunities to influence management decisions has advantages. The 2013 annual employee profit share bonus was 17% of their salaries – up from the 14% of the previous year. This annual bonus is one reason why JLP has the lowest rate of labour turnover of any major UK business.

According to Charlie Mayfield, the chairman of the Partnership, the 'we're all in this together' spirit is central to the modern growth of John Lewis and Waitrose. Sales at JLP outlets are rising at a faster rate than for other competing retailers, showing that customers increasingly appreciate the 'never knowingly undersold' promise of the business and its huge range of quality, value for money products. Local communities and central government benefit from the huge investment programme of JLP – it spent £200 million on new stores and refitting existing ones even when the UK economy was in recession. Suppliers are competing strongly with each other to make sure that their products are displayed in the JLP stores as it gives brands additional prestige. JLP claims that all major strategies consider ethical and CSR issues as well as their potential profitability.

Perhaps only JLP's competitors might feel aggrieved at the success of this business. But some business analysts claim that even rival retailers can benefit from JLP's growth – for example, by copying some of its practices and business models. The performance of the Sports Direct stores has been transformed since the business introduced a generous employee share ownership scheme.

16 marks, 32 minutes

1. Explain how **two** internal stakeholder groups and **two** external stakeholder groups can benefit from rising sales and profits at JLP. [8]
2. Discuss whether stakeholders can gain mutual benefits in all business organisations. [8]

THEORY OF KNOWLEDGE

Imperial Tobacco to close factories in UK and France

Despite recently announcing a 16.7% rise in annual profit to £1.26 billion, Imperial Tobacco is closing two of its last cigarette-making factories in Western Europe – in the UK and France. Up to 1000 jobs will be lost at the two factories and trade unions have promised to oppose the closures. Union leaders accuse Imperial Tobacco management of putting shareholders first by relocating production to low-labour cost countries in Eastern Europe. An Imperial Tobacco spokesperson said that these decisions had been partly driven by falling cigarette sales in high-income countries as a result of government and pressure groups' campaigns against smoking which highlight the serious health risks. The lack of this kind of bad publicity in countries such as Turkey, Greece and Russia means that these are the markets Imperial Tobacco is targeting – and these are the countries in which cigarettes will, increasingly, be produced.

1. Comment on the conflict in stakeholders' interests that arises from the article.
2. Discuss the ethical questions businesses face when they make job cuts.

Evaluating stakeholder conflict

One way of reducing conflict is to compromise. For example, a business aiming to reduce costs may close one of its factories in stages rather than immediately to allow workers time to find other jobs but, as a result, business costs will fall more slowly. Plans to build a new chemical plant may have to be adapted to move the main site away from a housing estate to protect the local community, but the new site might be more expensive. The introduction of 24-hour flights at an airport – to the benefit of the airlines and passengers – may only be accepted if local residents are offered sound insulation in their homes, thereby increasing costs for the airport and airlines.

Clearly, senior management must establish its priorities in these situations. They need to decide who the most important stakeholders are in each case, what the extra cost of meeting the needs of each stakeholder group will be, and whether bad publicity resulting from failure to meet the interests of one group will lead to lost revenue – perhaps this will be greater than the cost savings of not satisfying this group.

Table 1.4.3 considers methods available to businesses to reduce stakeholder conflict, and the potential advantages and disadvantages of each.

Method of conflict resolution	Advantages	Disadvantages
Arbitration – to resolve industrial disputes between workers and managers	An independent arbitrator will hear the arguments from both sides and decide on what they consider to be a fair solution. Both sides can agree beforehand whether this settlement is binding, that is they have to accept it.	Neither stakeholder group will be likely to receive exactly what they wanted. The costs of the business might rise if the arbitrator proposes higher wages or better work conditions than the employer was originally offering.
Worker participation – to improve communication, decision-making and reduce potential conflicts between workers and managers, e.g. works councils, employee directors	Workers have a real contribution to make to many business decisions. Participation can motivate staff to work more effectively.	Some managers believe that participation wastes time and resources, e.g. in meetings that are just 'talking shops', and that the role of the manager is to manage, not the workers. Some information cannot be disclosed to staff other than senior managers, e.g. sensitive details about future product launches.

Table 1.4.3 Methods to reduce stakeholder conflict – advantages and disadvantages [*table continues over*]

Method of conflict resolution	Advantages	Disadvantages
Profit-sharing schemes – to reduce conflict between workers and shareholders over the allocation of profits and to share the benefits of company success	The workforce is allocated a share of annual profits before these are paid out in dividends to shareholders. Sharing business profits can encourage workers to work in ways that will increase long-term profitability.	Paying workers a share of the profits can reduce retained profits (used for expansion of the business) and/or profits paid out to shareholders, unless the scheme results in higher profits due to increased employee motivation.
Share-ownership schemes – to reduce conflict between workers, managers and shareholders	These schemes, including share options (the right to buy shares at a specified price in the future) aim to allow employees (at all levels including directors) to benefit from the success of the business as well as shareholders. Share ownership should help to align the interests of employees with those of shareholders.	Administration costs, negative impact on employee motivation if the share price falls, dilution of ownership – the issue of additional shares means that each owns a smaller share of the company. Employees may have to stay with the company for a certain number of years before they qualify, so the motivation effect on new staff may be limited.

Table 1.4.3 *Continued*

LEARNER PROFILE

Communicators

Communicators understand and express ideas and information confidently and creatively in more than one language and in a variety of modes of communication. – IB learner profile

Samsung is one of the world's biggest companies. It is a giant Korean conglomerate that produces everything from mobile phones to ships to televisions. It is even involved in services like insurance and theme parks. Its turnover is $268 billion and it employs 427 000 people.

Dr Oh-Hyun Kwon is the CEO of Samsung. Dr Kwon has a BSc in Electrical Engineering from Seoul National University, an MSc in Electrical Engineering from KAIST (Korea Advanced Institute of Science and Technology) and a PhD in Electrical Engineering from Stanford University, USA. He has been with the business since 1985.

Source: Adapted from www.samsung.com

Discuss with your class the importance of the chief executive officer (CEO) of a business being an effective communicator like Dr Oh-Hyun Kwon, the CEO of Samsung.

ACTIVITY 1.4.4

DAILY RECORD: 'MERGER RESULTS IN JOB LOSSES'

The merger of two of the largest airlines in the country will lead to job losses, reports the *Daily Record*. Special Air and Flights4U have announced a huge merger which will result in a business worth over $2 billion. The long-term plans are to offer more routes and cheaper prices to passengers. The merger has the support of the government as it is expected to keep inflation down and boost tourist numbers into the country.

Non-profitable routes to small regional airports are to be closed, together with Special Air's headquarters in New City. More than 500 staff are expected to lose their jobs, resulting in annual savings of over $10 million. Trade union leaders are threatening to take industrial action to support workers who will lose their jobs. The local governments in the towns which are losing routes are very worried about the impact on local suppliers of fuel and food to the airlines. The chief executive of Flights4U said: 'Sure, there will be losers from this merger, but there will be many more winners as we expand our operations from the major cities.'

32 marks, 64 minutes

1. Are the two airlines focused on shareholders' interests or other stakeholders' interests? Explain your answer. [10]
2. Why is it difficult in this case for the two merging companies to meet their responsibilities to all stakeholder groups? [6]
3. Why might the negative impact on some stakeholders mean that the merger will not turn out to be as profitable as expected? [6]
4. Discuss how the newly merged business could attempt to meet some of its responsibilities to the stakeholder groups worst affected by this decision. [10]

OVER TO YOU

Revision checklist

1. Distinguish between the shareholder concept and the stakeholder concept.
2. Explain why a business might experience lower profits by meeting its stakeholders' objectives.
3. Explain why a business might experience higher profits by meeting its stakeholders' objectives.
4. Outline the responsibilities a business in the oil industry might have towards **two** stakeholder groups.
5. Outline the responsibilities a tertiary sector business might have towards **two** stakeholder groups.
6. What do you understand by the term 'conflicts between stakeholders' interests'?
7. Explain an example, from your own country, of a business decision that involves a conflict of stakeholders' interests.
8. Explain **three** examples of potential stakeholder conflict of interests.
9. Evaluate how each of the conflicts you identified in question 8 might be resolved.

Exam practice question

FURY AT BANGLADESH MINE SCHEME

A huge open-cast coal-mining project by a British firm, which would involve moving the homes of up to 130 000 workers in Bangladesh, is at the centre of an international row. The company, GCM, plans to extract up to 570 million tonnes of coal in a project that will displace people from Phulbari, in north-west Bangladesh. A river will have to be diverted and the mangrove forest, which is a world heritage site, would be destroyed too.

The project has attracted widespread hostility. In protests against the scheme 18 months ago, three people were killed in an area now said to be controlled by the armed forces. Many international campaign groups have written to the Asian Development Bank demanding that it turns down a $200 million loan for the project. The World Development Movement is claiming that the social and environmental damage can never be repaired if the scheme receives government approval. A spokesperson for GCM, on the other hand, stressed the importance of jobs, incomes and exports to one of the world's poorest countries.

25 marks, 50 minutes

1. Using examples from the case study, explain the differences between internal and external stakeholders. [4]
2. Explain the benefits of any **two** stakeholder groups resulting from this mine project. [6]
3. Explain the disadvantages to any **two** stakeholder groups resulting from this mine project. [6]
4. Discuss the ways in which GCM could reduce the impact of the disadvantages it has created for stakeholder groups negatively affected by the mine. [9]

Protests in Dhaka over the mine project

Key concept question

20 marks, 40 minutes

With reference to one organisation that you have studied, examine the influence of culture and ethics on different stakeholder groups. [20]

1.5

External environment

On completing this chapter you should be able to:

Analyse, apply and prepare:

- STEEPLE analysis of a given organisation (AO2) and (AO4)

Evaluate:

- Consequences of a change in any of the STEEPLE factors for a business's objectives and strategy (AO3)

Setting the scene

US CREATES 288 000 JOBS IN JUNE AS UNEMPLOYMENT RATE DROPS TO 6.1%

Job creation data far exceeds analysts' expectations as US economy records fifth straight month of job growth. Pressure to increase interest rates rises. Dollar exchange rate weakens against pound sterling.

CHINA INTRODUCES NEW CONSUMER PROTECTION LAW

The new law introduces a number of important reforms to the Chinese retail environment: in allegations of counterfeiting, the onus of proof is now on the retailer to prove their innocence for the first six months after the sale, rather than on the consumer to prove wrongdoing all the time, as previously took place. Penalties for fraud and false advertising have been increased; retailers are now required to accept goods for return within seven days of purchase unless agreed otherwise; for online and other types of delivery purchases, consumers are not required to provide a reason for returns.

JAPAN'S POPULATION SUFFERS BIGGEST FALL IN HISTORY

The population across the Japanese archipelago dropped by around 284 000 to an estimated 127.5 million by October 2013, according to figures compiled by the government's Internal Affairs and Communications Ministry. The number of elderly people aged 65 or over surpassed 30 million for the first time, accounting for as much as 24% of the population – in contrast to children aged 14 and under which decreased to a record low of 13%.

Points to consider

- These three examples of external environmental factors were all reported on in 2014. Explain how each one might affect a retailing business operating in the countries concerned.
- Explain why businesses should analyse the external environment in which they operate.
- Give two further examples of recent changes in the external business environment in your country.

Key concept link

Business strategy should be centred on the objectives of the organisation but must also consider internal strengths, weaknesses, opportunities and threats (SWOT). A further important influence on strategy is the macro-environment – the external factors that can impact on business activities. STEEPLE analysis considers these external constraints and opportunities and business often adapts strategies or adopts new ones after this analysis.

Introduction

This chapter assesses the importance of external influences on business performance and decision-making. Businesses depend for their survival on understanding and responding to external factors that are beyond their control. Many of the factors are 'constraints' because they may limit the nature of decisions that business managers can take. The legal requirements imposed by governments, on environmental pollution for example, are one of the most obvious constraining influences on business activity. However, external influences can also create opportunities and enable a business to become even more successful – introducing new technology in advance of rival firms is one example.

STEEPLE analysis

This is an outline of the **STEEPLE** factors:

Social: Social factors include population size and structure, lifestyle, age groups and education levels

Technological: Factors include the state of the technological advancement and introduction of new technologies

Economic: Factors such as the GDP growth rate, inflation rates, interest rates, exchange rates

Environmental: Includes weather and climate of the region, the flora and fauna of the region, environmental pressure group activity

Political: Factors such as the type of government that exists and its ideology as shown by its attitude to free markets, imposition of tariffs, business incentives offered and the stability of the government

Legal: The legal factors include any law influencing business activity, e.g. competition law, health and safety at work, consumer protection, employee protection

Ethics: The general code of ethics followed by most people in the country, and the tendency of people to be ethical.

STEEPLE analysis: an acronym standing for social, technological, economic, environmental, political, legal and ethical external factors that impact on business; it refers to a framework for analysing the external environmental factors affecting business objectives and strategies

Managers undertake STEEPLE analysis to assess the importance of the major external influences and future changes in them on their organisation's future activities. It is particularly useful when a business is planning new strategies such as entering new markets or developing new products.

STEEPLE analysis may be conducted regularly to allow a business to review its objectives and strategies in the light of external changes. Some businesses may only do this form of analysis as a one-off instance when a major decision needs to be taken. This is likely to be less effective than regular STEEPLE reviews which monitor changes to the external environment. It is the responsibility of managers to decide which of the key STEEPLE factors are relevant to their business. The analysis itself can be undertaken by managers alone or with the participation of other workers. It is often combined with SWOT analysis which assesses internal factors that could influence future business objectives and strategies.

Preparing STEEPLE analysis

Table 1.5.1 shows the structure of a simplified STEEPLE analysis for McDonald's restaurants which the company would carry out when planning to enter a national market for the first time. The company would seek answers to all the following questions before judging the suitability of this country for expansion. Other businesses might consider different factors as being important.

internet: the worldwide web of communication links between computers

Social issues	Technological issues
• How are dietary trends changing and how different are customer tastes from those in other countries (e.g. cultural and religious factors)? • What proportion of couples both work – less time to prepare meals? • Growing health consciousness – is the demand for healthy foods increasing? • Is the population ageing? Do the elderly buy more or fewer fast-food meals than the young? • Is the population growing?	• Can the food production process be automated? Is technical support available? • Online selling – is full **internet**/broadband coverage available? Will customers order online? • Are IT support services available locally?
Economic issues	**Environmental issues**
• **Economic growth** – is this slowing or even negative (**recession**)? • **Unemployment** – is this rising and reducing consumer incomes? • Interest rates – are these high or low? • **Exchange rate** – is this likely to appreciate or depreciate? • Is the government's fiscal policy likely to lead to increases or reductions in consumer incomes?	• Environment – is environmentally friendly packaging technically possible and available in this country? • Are waste-recycling facilities available? • Is sustainable/renewable energy available in this country? • Are environmental pressure groups powerful in this country?
Political issues	**Legal issues**
• Is the government stable and are there likely to be any demonstrations against the government? • Are government grants available for setting up in the country? • Is the government committed to increasing or reducing taxes? • Does the country belong to a free-trade area or political unions? • Does the government put tariffs or quotas on imported goods? For example, supplies needed from the USA for McDonald's restaurants.	• Political stability of the country – is civil unrest likely? • Employee and consumer protection laws – how restrictive are these, e.g. health and safety laws? • Trade restrictions or membership of free-trade bloc – can food be imported without tariffs? • Environmental regulations – what forms of packaging of fast food are allowed? • Health concerns about fast food – could the government pass new laws about the contents of fast-food products?
Ethical issues	
• Are there high ethical standards in public and commercial life in this country? • Do suppliers treat workers ethically? • Is bribery and corruption widespread in this country?	

Table 1.5.1 Example of possible STEEPLE analysis for McDonald's restaurants

economic growth: increases in the level of a country's gross domestic product or GDP (total value of output)

recession: six months (two quarters) of falling GDP (negative growth)

unemployment: the number of people in an economy willing and able to work who cannot find employment

exchange rate: the value of one currency in terms of another currency

ACTIVITY 1.5.1

Prepare a STEEPLE analysis for a foreign fashion retailer planning to set up a chain of shops for the first time in your country.

Social and cultural influences

The structure of society is constantly evolving. The changes occurring in many countries include:

- an ageing population with reduced birth rates and longer life expectancy, although in some nations the average age is falling due to high birth rates
- changing role of women – increasingly seeking employment and posts of responsibility in industry
- improved education facilities – resulting in increasing literacy and more skilled and adaptable workforces
- early retirement in many high-income countries – leading to more leisure time for a growing number of relatively wealthy pensioners
- rising divorce rates (in some countries) – creating increasing numbers of single-person households
- job insecurity, often created by the forces of globalisation – forcing more employees to accept temporary and part-time employment (some workers prefer this option)
- increased levels of immigration – resulting in changing and widening consumer tastes as different ethnic groups tend to have different preferences, e.g. for clothing and food.

This list is by no means complete. You could add to it from your knowledge of the changes occurring in your own society. How do these changes impact on business objectives and strategies? We will look at two of these changes – an ageing population and patterns of employment – but the analysis used can be adapted when considering the impact of the many other social changes.

An ageing population

The main effects associated with an ageing population are:

- a larger proportion of the population over the age of retirement
- a smaller proportion of the population in lower age ranges, e.g. 0–16 years old
- a smaller number of workers in the economy but a larger number of dependants, that is below working age or retired – this puts a higher tax burden on the working population.

Business objectives and strategy will need to adapt to:

- patterns of demand – there will be more 'grey' consumers than teenagers and they buy different products. Therefore, a construction company might switch from building large apartments for families to smaller units with special facilities for the elderly. Market research will be important for a business that believes the demand for its portfolio of products could change as the population ages.
- change in the age structure of the workforce – there may be reduced numbers of youthful employees available, and businesses may need to adapt their workforce planning to enable the employment of older workers, or to keep existing workers beyond retirement age. Although younger employees are said to be more adaptable and easier to train in new technologies, older workers may show more loyalty to a business and will have years of experience that could improve customer service.

Changing patterns of employment

The main features of changing patterns of employment include:

- an increase in the number of women in employment and in the range of occupations in which they are employed

- an increase in student employment on a part-time basis – some industries are substantially staffed by students and part-timers, e.g. McDonald's; most other fast-food shops and supermarkets are largely staffed in this way
- an increase in temporary, part-time and flexible employment contracts – these are introduced by employers to reduce the fixed costs of full-time and salaried posts and to allow for flexibility when faced with seasonal demand or uncertainties caused by increasing globalisation
- more women taking maternity leave and then returning to work.

Many countries are increasingly multicultural and this also has an effect on the pattern of women at work. In the UK, 33% of women of Pakistani origin and 20% of women of Bangladeshi origin seek full-time employment. In the UK as a whole, 75% of women seek full-time employment.


Many businesses employ mainly part-time staff – this can be beneficial for both the employer and the workers

Firms can make these changes work to their benefit, while accepting some of the cost implications. Part-time workers can offer a firm much greater flexibility by being available at peak times and this will help to keep down overheads. Yet part-time and temporary staff can be difficult to mould into a team and may not contribute as much as a result.

By employing more females and removing barriers to their progress and promotion, firms can benefit from a wider choice of staff and improved motivation among women workers. However, there will be the increased costs of maternity leave and of providing staff cover for this. As with all other external influences on business behaviour, the most successful firms will be those that adapt to changes the most quickly and attempt to turn them to their own competitive advantage.

ACTIVITY 1.5.2

Consider Table 1.5.2 and then answer the questions that follow.

	2000		2010		2020 (estimated)	
	(000s)	%	(000s)	%	(000s)	%
Total labour force	7042.0		9572.5		12 939.6	
Age distribution		**100.0**		**100.0**		**100.0**
15–24	2014.0	28.6	2498.4	26.1	3118.4	24.1
25–34	2204.1	31.3	2977.0	31.1	4114.8	31.8
35–54	2436.5	34.6	3608.8	37.7	4994.7	38.6
55–64	387.4	5.5	488.2	5.1	711.7	5.5
Educational attainment		**100.0**		**100.0**		**100.0**
Primary only	2380.2	33.8	2604.3	27.2	1643.3	12.7
Lower and middle secondary	4042.1	57.4	5624.5	58.8	6767.4	52.3
Tertiary (university)	619.7	8.8	1343.7	14.0	4528.9	35.0
Labour force participation rate		**65.3**		**65.5**		**68.1**
Male		85.6		85.4		86.4
Female		44.1		44.5		49.0

Table 1.5.2 Profile of a country's labour force, 2000–2020 (in 000s)

20 marks, 40 minutes

1. Calculate the forecasted percentage increase in the labour force between 2000 and 2020. [2]
2. Using the data in the table, describe the changes that are forecasted to take place in the age distribution of the working population of the country. [4]
3. Using the data in the table, describe the changes that are forecasted to take place in the educational attainment of the population of the country. [4]
4. Discuss the impact the changes in demography and educational attainment shown in the table might have on a business's human resource management. [10]

Impact of technology

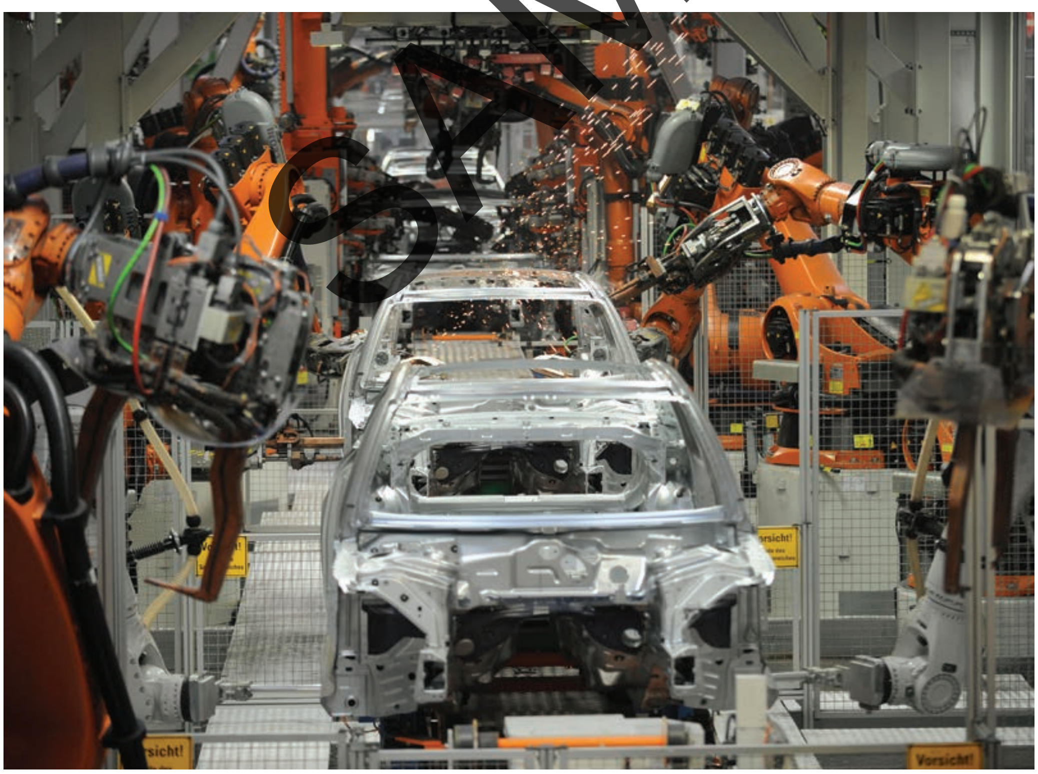
In its simplest form, technology means the use of tools, machines and science in industry. This section assesses the impact on businesses of the relatively recent introduction of high-technology machines and processes that are based on **information technology** (IT).

information technology (IT): the use of electronic technology to gather, store, process and communicate information

Technological change is affecting all businesses and all departments within business. Table 1.5.3 explains some of the most common business applications of IT, the departments likely to benefit most from them and the potential advantages to be gained.

In addition to these uses of technology, advances in technical knowledge are opening up new product markets, such as hydrogen-powered cars and 'flexible' mobile phones. The use of technology to develop new products is part of the research and development function of businesses.

Exam tip: It is wrong to assume that a business must always use the latest technology in all circumstances. There are substantial costs to be paid and some businesses thrive on using old-fashioned methods. For example, handmade designer furniture will sell because each piece is unique and computer-controlled robots might be completely impractical.



The use of computer-controlled robots has increased productivity in car manufacturing

Impact on objectives and strategies

Technological developments have led to businesses focusing their objectives on IT-based capabilities and adopting new strategies to embrace and fully exploit new opportunities.

Focus on new product development

Information technology has reduced the time it takes new products to reach the market. Companies quickly establish new product requirements by gathering market information from databases, customers and sales representatives. Computer-assisted design and manufacturing software speed up manufacturing, while communication technologies allow global teams to work on different components of a product simultaneously. From innovations in microprocessors to efficient consumer payment systems, IT helps businesses respond quickly to changing customer requirements and this is now the focus of the objectives set by most businesses.

Improve stakeholder communication

Improving communication with all stakeholders is another important objective of information technology. Using global 24/7 interconnectivity, a customer service call originating in Paris, France, ends up in a call centre in Manila, Philippines, where a service agent could look up the relevant information on servers based in corporate headquarters in Auckland, New Zealand, or in Frankfurt, Germany. Public limited companies use their investor relations' websites to communicate with shareholders and financial analysts.

Developing new and better processes

Process improvement is another important IT business objective. Enterprise resource planning (ERP) systems allow managers to review sales, costs and other operating data on one integrated software platform and communicate with suppliers and customers about each order or contract. An ERP system may replace many old technology systems for finance, human resources and procurement making internal processes more efficient and cost-effective.

Cost benefits

Initial IT purchase and implementation costs can be substantial and there will be employee training costs – and possibly redundancy expenses too. However, the resulting long-term cost savings usually justify the investment. IT allows companies to reduce many operational costs. IT-based operational solutions, from word processing to email and the internet, have allowed companies to save on the costs of duplication, postage and promotion, while maintaining and improving product quality and customer service.

Competitive advantage

All of the preceding benefits could allow a business to improve its competitive advantage in the marketplace. If a smartphone developer announces a new device with innovative touchscreen features and a larger screen, the competitors must quickly follow suit with similar products or risk losing market share. Companies can use rapid software simulations and other IT-based systems to bring a product to market cost-effectively and rapidly.

Outsourcing and offshoring – the impact of globalisation

IT developments have been at the core of operating systems essential for globalisation, such as telecommuting and outsourcing. A company can outsource most of its non-core functions, such as human resources and call centres, to offshore companies and use network technologies to stay in contact with its overseas employees, customers and suppliers.

Information technology application	Common business applications	Impact on business
Spreadsheet programs	• Financial and management accounting records can be updated and amended. • Cash flow forecasts and budgets can be updated in the light of new information. • Changes in expected performance can be inputted to the spreadsheet and changes in total figures made automatically. • Income statements and balance sheets can be drawn up frequently.	• Flexibility and speed – changes to accounting records can be made quickly and the impact of these on total figures can be demonstrated instantly. • 'What-if' scenarios in budgeting and sales forecasting can be demonstrated, e.g. what would happen to forecasted profits if sales rose by 10% following a 5% cut in price?
Computer-aided design (CAD)	• Nearly all design and architectural firms now use these programs for making and displaying designs, e.g. cars, house plans, furniture, garden designs. • Designs can be shown in 3D and 'turned around' to show effect from all angles.	• Saves on expensive designer salaries as work can be done more quickly. • More flexibility of design as each customer's special requirements can be easily added. • Can be linked to other programs to obtain product costings and to prepare for ordering of required supplies.
Computer-aided manufacturing (CAM)	• Programs are used to operate robotic equipment that replaces many labour-intensive production systems. • Used in operations management in manufacturing businesses.	• Labour costs are reduced as machines replace many workers. • Productivity is increased and variable costs per unit are lower than in non-computerised processes. • Accuracy is improved – less scope for human error. • Flexibility of production is increased – modern computer-controlled machinery can usually be adapted to make a number of different variations of a standard product, and this helps meet consumers' needs for some individual features. • All of these benefits can add to a firm's competitive advantage.

Table 1.5.3 Impact of applications of technology on business [*table continues over*]

computer-aided design (CAD): using computers and IT when designing products

computer-aided manufacturing (CAM): the use of computers and computer-controlled machinery to speed up the production process and make it more flexible

Information technology application	Common business applications	Impact on business
Internet/intranet	• Marketing department – for promoting to a large market and taking orders online (see Chapter 4.8 for discussion of e-commerce). • Operations management – business-to-business (B2B) communication via the internet is used to search the market for the cheapest suppliers. • Human resources uses these systems for communicating within the organisation. • Intranets allow all staff to be internally connected via computers.	• Cost savings from cheap internal and external communications. • Access to a much larger potential market than could be gained through non-IT methods. • Web pages project a worldwide image of the business. • Online ordering is cheaper than paper-based systems. • B2B communications can obtain supplies at lower costs. • Internal communication is quicker than traditional methods.

Table 1.5.3 *Continued*

ACTIVITY 1.5.3

Research task: Use the internet to research one of the following and write a report explaining the potential impact on objectives and strategy of any one well-known business in your country: CAD, CAM and RFID (Radio Frequency ID tagging).

Impact on management and labour relations

Labour relations can be damaged if technological change is not explained and presented to workers in a positive way with the reasons for it fully justified. If many jobs are being lost during the process of change, then remaining workers may suffer from reduced job security, and this could damage their motivation levels. Trade unions can oppose technological change if it puts members' jobs at risk. However, if the issue is handled sensitively, including effective communication with and participation of employees, introducing new technology in the right way can improve industrial relations.

Some managers fear change as much as their workforce, especially if they are not very computer literate themselves. In addition, recognising the need for change and managing the technological change process require a great deal of management skill. However, IT can improve productivity greatly and lead to improved company efficiency – for example, the use of database programs to control stock ordering to achieve just-in-time advantages. Technology has other benefits too:

- Managers can obtain data frequently from all departments and regional divisions of the business.
- Computers can be used to analyse and process the data rapidly so that managers can interpret data and take decisions quickly on the basis of the analysis.
- It accelerates the process of communicating decisions to other managers and staff.

Information gives managers the opportunity to review and control the operations of the business. IT-based management information systems provide substantial power to centralised managers. Although this could be used for improving the performance of a business, there are potential drawbacks:

- The ease of transferring data electronically can lead to so many messages and communications that 'information overload' occurs. This is when the sheer volume of information prevents decision-makers from identifying the most important information and decisions.
- The power which information brings to central managers could be abused and could lead to a reduction in the authority and empowerment extended to work teams and middle managers. Information used for central control in an oppressive way could reduce job enrichment and hence motivation levels.

Effective managers will apply the information provided by the modern IT systems to improve and speed up decision-making. They should not allow it to change their style of leadership to a centralised or authoritarian one, using data to control all aspects of the organisation.

ACTIVITY 1.5.4

MORE CHIPS PLEASE?

The major European supermarkets have been putting IT at the front of their drive for lower costs, improved customer service and more information about their customers. Applications include barcodes, checkout scanners, automatic product reordering systems, automated stock control programs, robot-controlled transport systems in warehouses, chip and pin machines for payment, loyalty cards that record each individual shopper's purchases and internet shopping for customers.

Some of these systems have been controversial. For example, centralised ordering and delivery of products reduced the independence and control of individual store managers. The rapid growth of internet shopping left some companies with a shortage of stock and delivery vehicles, which led to poor service. Some smaller suppliers who have been unable to cope with the cost of introducing compatible IT systems to take orders from the huge retailers have been dropped.

The latest development is causing further controversy. RFID or radio frequency ID tagging involves putting a small chip and coiled antenna, at the initial point of production, into every item sold through the supermarkets. Unlike barcodes that are manually scanned, the RFID simply broadcasts its presence and data, such as sell-by date, to electronic receivers or readers. German supermarket chain Metro already uses RFID and claims that food can be easily traced back to the farm where it is produced, queues at tills no longer exist as customers' bills are calculated instantly as they pass by a receiver and all products are tracked at each stage of the supply chain – 'We know where everything is!'

Consumer groups are concerned that shoppers will be tracked and traceable too – not just the goods they have bought. Is this an invasion of privacy? Unions are opposed to it as it could lead to many redundancies due to its non-manual operation. Some supermarket managers fear yet another IT initiative that will mean even more central control. They fear breakdowns in the system and lack of training.

20 marks, 40 minutes

1. Define the term 'information technology'. [2]
2. Outline how the increased use of IT by supermarkets is likely to benefit their customers. [4]
3. Analyse the likely benefits of supermarkets using RFID to trace and collect data from every product they sell. [4]
4. Discuss the advantages and disadvantages of the wider use of IT in supermarket retailing on individual supermarket businesses. [10]

LEARNER PROFILE

Your working life is dominated by email, text, Facebook, Twitter . . . the list of areas where the modern employee has to face and master IT is endless. If you are one of those people whose first instinct when they wake up in the morning is to check for new messages on your smartphone you will know what I mean. There are over 200 million smartphones in the USA and, in 2014, 1.75 billion globally and the numbers are growing all the time. For businesses and their stakeholders this brings with it a fantastic range of opportunities and threats.

In your class discuss the impact the growth of IT has had on individuals in business organisations as inquirers and thinkers. Do you think the growth in IT is always a good thing for business?

Economic influences

Changes in the economic environment can have a very significant impact on business objectives and strategies. The global downturn of 2009–10 forced many international businesses to revise their growth and profit targets and adapt their product and marketing strategies to a world in which credit was in short supply and consumers became much less willing to spend, especially on luxury goods. The euro crisis of 2011 is having lingering effects on consumer confidence and government debt levels in many European Union economies.

Other economic factors present businesses with opportunities rather than constraints such as the opening up of China's consumer market following its membership of the World Trade Organisation in 2001.

Other changes in the economic environment result from changes in government economic policies. These policies – mainly monetary and **fiscal policies** – aim to help governments achieve four main macro-economic objectives:

- economic growth and rising living standards
- low levels of inflation
- low levels of unemployment
- balance of payments equilibrium, over time, between the value of imports and exports.

The important economic factors that businesses should monitor and respond to are explained in Table 1.5.4.

fiscal policy: changes in government spending levels and tax rates

inflation: the rate of change in the average level of prices

cost-push inflation: caused by rising costs forcing businesses to increase prices

demand-pull inflation: caused by excess demand in an economy, e.g. an economic boom, allowing businesses to raise prices

Main economic influences and government economic policies	Impact on business objectives and strategies
Economic growth and Recession	• During a period of economic growth, demand for most goods and services will increase as consumers have higher incomes – businesses may plan to expand. However, inferior goods may be rejected by consumers who now have higher incomes. • A recession will have the reverse impact – it can lead to business retrenchment, closures and redundancies. Suppliers of cheaper, inferior goods may benefit from this. • Business flexibility will be important for survival and profitability in both cases, e.g. aiming to have a product portfolio with a wide range of products to appeal to market segments with different income levels.
Interest rates – the use of monetary policy	• An increase in interest rates will reduce consumer demand for many products bought on credit, e.g. houses and cars. Businesses may offer their own credit deals to customers. • Increased loan capital costs will reduce profits for a business with high debt. Selling assets or new shares to reduce debt may be considered. • Business expansion plans may be delayed or cancelled – the expected profit may be below the interest cost on the loans required. • The country's currency is likely to appreciate as more investment finance from abroad is attracted to the country – see effects below.
Exchange rates – increases (appreciation) and decreases (depreciation) in the value of a currency value against other currencies	• A depreciation of currency (e.g. when €1: $1 changes to 1€: $0.80 there is a depreciation of the euro) will make imported goods more expensive. It also offers the opportunity for domestic firms to charge less for exports, leading to a possible increase in demand, especially if demand for them is price-elastic – i.e. responsive to price changes. • More expensive imports can raise a business's costs if it has to buy materials or components from other countries – they might try to buy more supplies from domestic suppliers. • Businesses might target foreign markets more and change their strategies towards exporting rather than selling in the domestic market. • Foreign businesses may decide to locate in the country with the depreciating currency – it will avoid the risk of its goods becoming too expensive to import into the country. • The opposite would occur in the event of an appreciation.
Tax changes through the use of **fiscal policy**	• Higher rates of income tax reduce consumers' disposable incomes – demand for luxury and income-elastic products will fall so businesses selling such products may offer lower-priced alternatives or be forced to enter other markets. • Higher rates of tax on profits (corporation tax) will reduce the profits after tax of companies. A decision to relocate to a country with lower rates of tax might be made. Poland has recently experienced an increase in foreign investment after reducing its corporation tax rate to 10%.
Unemployment	• Higher numbers of workers without employment will give businesses more choice in employee recruitment. As there are many workers applying for each vacancy, a decision may be taken to reduce wage rates, or not increase them in line with inflation, which will benefit business costs. • Average consumer incomes are likely to fall with extensive unemployment – the demand for budget ranges of cheaper goods, e.g. supermarket own brands, could increase and production of these will have to rise to meet demand.
Inflation (**cost-push** and **demand-pull**)	• Higher wage demands from workers to maintain real incomes during inflation and higher costs of materials and components will lead to cost-push inflation. If businesses cannot increase prices for fear of demand falling, profit margins will fall. Businesses might seek cheaper sources of supply or more efficient production methods to help in lowering costs per unit. • Demand-pull inflation will encourage firms to raise prices to increase profit margins. • Substantial increases in inflation will lead to action being taken by the government or country's central bank to increase interest rates – see the effects of these above.

Table 1.5.4 Economic factors and their influence on business objectives and strategies

monetary policy: changes in the level of interest rates which make loan capital more or less expensive

ACTIVITY 1.5.5

CHINA TO TAKE ACTION AGAINST INFLATION

The Chinese government is becoming increasingly concerned about higher rates of inflation. Rising oil and petrol prices have increased costs to industry and firms are being forced to raise their prices to cover these higher costs. In addition, rising demand for food from a wealthier population, together with supply problems resulting in excess demand, have led to the price of pork rising by 63% and fresh vegetable prices by 46%.

The People's Bank of China increased interest rates by a further 0.27%. This was the third increase in less than a year. A spokesman from Goldman Sachs, the investment bank, reported that the increase shows that the central bank is now much more prepared to use interest rates to manage the economy and tighten **monetary policy** at the first signs of the booming economy overheating. Partly as a result of these increases in interest rates, China's GDP increased by 7.7% in 2013, and some analysts believe this should be more sustainable than the much higher rates experienced in 2007–08. However, Chinese leaders still face conflicting pressures in balancing the top priority of maintaining high-speed economic growth to create millions of new jobs each year, with managing growing environmental problems and rising cost-push pressures causing higher inflation.

20 marks, 40 minutes

1. Define the term 'inflation'. [2]
2. Explain **two** effects rising inflation in China might have on businesses in China. [4]
3. Analyse how an increase in Chinese interest rates might have an impact on demand for a firm's products and on a firm's costs. [4]
4. Evaluate the consequences of 'high-speed' economic growth in China on businesses in China. [10]

Environmental influences

These factors include all those that influence or are determined by the surrounding physical environment. This aspect of the STEEPLE analysis is crucial for certain industries, particularly for example tourism, farming, agriculture and mineral extraction. Table 1.5.5 outlines some of the most important environmental influences.

Environmental influences	Impact on business objectives and strategies
Environmental controls on business activities such as waste disposal, use of sustainable energy, reducing packaging	Strict environmental controls could increase business costs and make a country less attractive for new investment. However, observing such controls could be used as a basis for good publicity.
Threats from natural events such as drought, earthquakes and floods	These threats could make it unwise to consider operating in the areas most likely to be affected – especially if the business activity is itself potentially dangerous as with chemicals products.
Natural resources	Abundant natural resources are likely to attract inward investment from mining and oil businesses for example. Political factors (see Table 1.5.6) might be important too if these resources are in politically unstable regions.
Infrastructure – road and air transport facilities, for example	Poor infrastructure makes business activity more difficult and often more costly. Multinational businesses often request governments to improve transport links before they will consider an investment in the country.

Table 1.5.5 Impact of environmental influences

ACTIVITY 1.5.6

AIR POLLUTION IN INDIA

In 2014 India ranked 174th out of 178 countries on air pollution in the Yale Environmental Performance Index. India's Central Pollution Control Board said that in 180 cities in 2010, particulate matter in the air was six times higher than World Health Organisation standards.

Car sales in India have boomed, and diesel is the most common fuel. Monitoring pollution in India is not well co-ordinated, and many industries continue to defy the existing environmental laws as they know that even if they are caught the prosecution process will take a very long time.

India's Environmental Pollution Control authority has reported that the level of air pollution is the cause of more than 3000 child deaths each year in Delhi alone. The report recommends a number of measures including:

- 30% tax on the sale of diesel vehicles
- higher automobile registration and parking fees
- Supreme Court should use its authority to order compliance with pollution laws
- India's national air quality standards must be made legally binding

16 marks, 32 minutes

1. Explain **two** reasons for India's growing air pollution problems. [6]
2. Discuss how the measures proposed by the Environmental Pollution Control Authority could influence the objectives and strategies of multinational businesses operating in India. [10]

THEORY OF KNOWLEDGE

Even as the USA churns out more fossil fuels, evidence abounds that alternative energy in general – and solar in particular – is staging a comeback. And the halo effect has spread to solar businesses.

Observers credit an increase in solar capacity, falling photovoltaic (PV) costs and the extension of tax credits in some countries for renewable energy for the sector's revival. Solar energy is carving a niche in creating electricity.

Solar power has the ability to create very local opportunities where you do not have to be interconnected to a whole network of infrastructure – such as the solar panels on people's houses.

According to the Energy Information Administration, renewable power for electric generation surged 23% over the last year, becoming the second biggest source for new generator capacity. At the same time, natural gas – rapidly becoming the dominant source for generating electricity – appeared to plateau.

As business becomes increasingly concerned with protecting the environment, examine the roles reason and ethics play in the market for energy.

Political influences

These factors include the nature and stability of the government, whether the country is a democracy – and if not, who controls the government and what are the ruler's main objectives – and the policies of the government towards business, trade and private ownership of assets. Table 1.5.6 outlines some important political influences and their impact on business objectives and strategies.

Political influences	Impact on business objectives and strategies
Government stability	If the government is constantly changing then this could lead to frequent changes in laws relating to business activity. The changes could make it difficult to plan future business strategies. Generally, business managers prefer stable government that has public support.
Form of political structure, e.g. democracy	Businesses might find it difficult to convince their stakeholders that it is wise to operate in or trade with an autocratic dictatorship – especially if there are concerns over human rights. The global trade embargo against South Africa helped to bring down the non-democratic pre-Mandela regime. Businesses that did trade with this government were heavily criticised.
Government's attitude to private ownership	If a government is committed to nationalisation of private businesses and high taxes on private wealth then this will discourage privately owned businesses from setting up or expanding in this country.
Trade policies and membership of free-trade areas or Customs Unions (e.g. EU)	If a government wants to restrict free trade with tariffs and quotas this will discourage business investment – apart from in industries that are protected by such measures. Global business operations tend to expand and locate in those countries which encourage free trade and are members of important free-trade groupings.

Table 1.5.6 Impact of political influences

ACTIVITY 1.5.7

POLITICAL INSTABILITY AFFECTING RUSSIA'S INVESTMENT CLIMATE

The Russian takeover of Crimea was as much a shock to Russia's business leaders as it was to the politicians in Brussels and Washington. It is forcing foreign businesses to reconsider investments in Russia.

Russia attracted $94 billion of foreign direct investment (FDI) in 2013. This is expected to fall substantially as political instability and Western government trade and finance sanctions against Russia make it a less attractive place for multinationals to invest in. Swedish car producer Volvo said it was thinking again about a proposed partnership with Russian state-owned railway equipment and tank maker Uralvagonzavod (UVZ) worth about $100 million to make modern armoured cars, thanks to the situation in Ukraine. Financial sanctions are making it more difficult for Russian companies to seek public limited company status on Western stock exchanges. The public listing plans of several large companies are now in doubt.

Source: Russia Beyond the Headlines, http://rbth.co.uk

20 marks, 40 minutes

Examine the influence political instability might have on businesses in Crimea. [20]

Legal constraints

In most countries, political and legal constraints on a business fall into the following main categories:

- employment laws
- consumer protection laws

- business competition laws
- political changes resulting from a new government, e.g. policies towards foreign direct investment by multinationals
- major policy changes, such as nationalising some UK banks after the 2008–09 crisis.

Table 1.5.7 shows the possible impact of some legal factors on business objectives and strategies.

Examples of legal factors	Impact on business objectives and strategies
Improved employee legal protection, e.g. better health and safety at work, redundancy pay, protection from discrimination, minimum pay levels, maternity pay	• Increases cost of employing staff – businesses may be reluctant to expand in this country by taking on extra staff. • Encourages businesses to increase labour productivity to pay for the cost of these legal improvements. For example, Germany has some of the most rigorous laws protecting workers' rights, yet labour productivity is one of the highest in the world. • If employers are seen to be positive about these legal changes and accept them fully, they will appear to be a caring business that will encourage well-motivated employees to work for them. Some businesses offer benefits above the legal minimum for this reason.
Consumer protection laws that constrain businesses from advertising inaccurately or inappropriately, selling faulty goods or those described incorrectly, high-pressure selling tactics, not allowing consumers to change their minds after signing credit agreements	• Sales staff will need training in the legal rights of consumers – breaking consumer laws will lead to expensive legal claims. • Design and production of new products will have to put customers' safety and product quality as priorities. • Full disclosure of any safety problems is needed to minimise risks to customers. • All of these strategies will add to costs. However, if a business is seen to put customers and customer service first, it may benefit from good publicity, word-of-mouth promotion and customer loyalty.
Competition laws can restrict unfair competition or restrictive practices by businesses, monopoly exploitation of consumers, mergers and takeovers (external growth) that could lead to a monopoly	• Collusive agreements with competitors are not permitted. • Internal growth is less likely to lead to reports and action by the competition regulators than external growth. • Expand into other countries rather than growing in existing country which can lead to monopoly market share.

Table 1.5.7 Legal factors and their impact on business objectives and strategies

ACTIVITY 1.5.8

EMPLOYMENT RIGHTS IN YOUR COUNTRY

In China, current employment rights are governed by the PRC Employment Law of 1995. There are 13 sections to this law which cover almost all aspects of employment relationships. These include working hours, holidays, health and safety, training, social welfare, disputes and discrimination on the grounds of race, sex, disability or age.

1. Why do you think the Chinese government introduced such a wide-ranging law as this, covering all aspects of employer–employee relationships?
2. Do these laws help or damage business interests? Explain your answer.
3. **Research task:** Find out about the main employment laws in your country and the main rights they offer to workers. Do you think that these laws need changing in any way? If so, how and why?

ACTIVITY 1.5.9

CONSUMER RIGHTS IN YOUR COUNTRY

In Malaysia, the 1999 Consumer Protection Act is an important law protecting the interests of consumers. It has 14 main sections which include outlawing all misleading and deceptive conduct by firms, outlawing false advertising claims, providing guarantees in respect of supply of goods and strict liability for defective and potentially dangerous products.

In India, the 1986 Consumer Protection Act provides for the regulation of all trade and competitive practices, creates national- and state-level consumer protection councils and lists unfair and uncompetitive trade practices.

1. Why do you think governments, as in Malaysia and India, pass laws to protect consumer rights?
2. Do you think that such laws help or damage business interests?
3. **Research task**: Find out the main consumer protection laws in your country. Give examples of how firms try to break these laws. Are the laws strict enough? If not, why not?

Ethical influences

These are well covered in other sections of the book – for example, in Chapters 1.3, 2.1, 2.3, 2.6, 4.1 and 4.4.

There are national differences in the values and attitudes held by the majority of the population. These differences can be seen in the contrasting ways in which countries approach issues such as:

- child labour
- corruption in business practices
- advertising and promotional material and the advertising of products directly to children.

These are just three of the ethical dilemmas that businesses must confront, especially when they operate in several countries. Failure to follow a strict and consistent ethical code in all markets being traded in could lead to major damage to the reputation of a business – bad news regarding ethical infringements can be transferred almost instantaneously by social media.

OVER TO YOU

Revision checklist

1. Why is STEEPLE important to a business planning a major change in strategy?
2. Give **one** example of how a business strategy might be affected by a consumer protection law.
3. Give **one** example of how a business strategy might be affected by an employment law.
4. Explain how an increase in interest rates might lead to a change of business strategy.
5. Explain how a depreciation of your country's currency might lead to a business in your country changing one of its strategies.
6. Do you think an economic recession in your country would lead to the soft drinks manufacturer Coca-Cola changing the strategies used to sell its products in your country?
7. Identify **two** recent social changes in your country that could have an impact on a business's objectives and strategy.

8. Give **one** example of how technology has changed production methods in an industry that you have studied.
9. Give **one** example of how technology has led to a recently introduced innovative product.
10. Explain **one** example of how environmental considerations have affected the strategy of a business.
11. Why should a business consider the political situation in a country that it plans to expand into?
12. Explain **one** problem that a business might experience if it did not account for different ethical standards in the countries it operates in.

Exam practice question

STARBUCKS BRINGS ITS CULTURE TO VIETNAM

The South-east Asian nation – known for its nerve-jangling strong coffee, often sweetened with condensed milk – has its own deep-rooted coffee culture that could prove challenging to Starbucks, the Seattle-based coffee chain. The company launched a flagship two-storey store in Ho Chi Minh City in February. So far sales at the new location are exceeding expectations, according to Starbucks' Chief Executive and Chairman Howard Schultz.

Starbucks decorated the downtown store with local art and artefacts to create a distinctly Vietnamese flavour. It also came up with a drink, the Asian Dolce Latte, to appeal to local palates. For food, it serves roast-duck wraps and French-style baguettes. But some say the chain could do more. One customer said, 'Starbucks should use drip filters perched on top of glass mugs, the way the Vietnamese do.' He added, 'If Starbucks want to succeed in Vietnam, they have to change the way they serve,' he said.

Starbucks is attracted by rapid economic growth in Vietnam and the low costs of opening and running a coffee outlet. It is a market that has huge potential sales in a country of nearly 90 million people and a desire to buy in to global brands like Starbucks. There are challenges though; the regulatory framework around business start-ups is quite bureaucratic and there is some unease amongst local politicians about the opening of a Starbucks.

20 marks, 40 minutes

1. Define the term 'economic growth'. [2]
2. Outline **two** reasons why Starbucks might be attracted to open outlets in Vietnam. [4]
3. Analyse **two** problems Starbucks might face when opening outlets in Vietnam. [4]
4. Evaluate the possible usefulness of a STEEPLE analysis to Starbucks as it tries to enter the Vietnamese market for coffee. [10]

Key concept question

20 marks, 40 minutes

With reference to one or two organisation(s) that you have studied, discuss how increased globalisation and cultural change impacts on business strategy. [20]

1.6

Growth and evolution

On completing this chapter you should be able to:

Analyse and apply:

- The main types of economies and diseconomies of scale (AO2)
- The difference between internal and external growth (AO2)

Evaluate:

- The relative merits of small versus large organisations (AO3)
- External growth methods: mergers and acquisitions and takeovers (AO3)
- The role and impact of globalisation on the growth and evolution of businesses (AO3)
- Reasons for the growth of multinational businesses (MNCs) (AO3)
- The impact of MNCs on host countries (AO3)

Setting the scene

CHINESE GIANT TAKES OVER SMITHFIELD FOODS INC.

Shuanghui Holdings Ltd, the largest meat producer in China, has taken over Smithfield Foods Inc., a US-based public limited company. 96% of Smithfield's shareholders agreed to the buyout deal, which is worth US$34 per share, a total of US$4.7 billion. Workers in Smithfield's factories are pleased with the deal; existing US managers will not be replaced and pay levels are not changing.

Smithfield is one of the largest meat-producing and -processing businesses in the USA. The takeover will give Shuanghui a huge new source of meat to supply its meat-processing plants in China. The demand for meat is increasing in the world's most populated country as incomes rise with economic growth. The importation of US-produced meat by China will increase the already close trade links between the two countries.

In the past, many Chinese companies have preferred to set up joint ventures or strategic alliances with foreign businesses but they increasingly have the spare capital that allows them to take over companies outright.

Points to consider

- Why do you think Smithfield's shareholders agreed to this takeover?
- What do you think are the benefits to Shuanghui of its takeover of Smithfield?
- Do you think Shuanghui will experience any problems as a result of this form of expansion?

Key concept link

Some businesses have grown so large that their decisions can have a major impact on some national economies. The growth in the number and size of multinational companies has been a major consequence of globalisation. Ethical issues are raised by the ability of these companies to take decisions that can act against the interest of the governments of the countries they operate in – such as paying tax on all global operations in the lowest tax country they are based in.

Introduction

There is a huge difference between the **scale of operations** of a small business – perhaps operated by just one person – and the largest companies in the world. Some of the latter have total annual sales exceeding the GDP of many countries! In 2013, ExxonMobil recorded sales of over US$430 billion, yet the GDP of Thailand, for example, was US$365 billion.

scale of operation: the maximum output that can be achieved using the available inputs (resources) – this scale can only be increased in the long term by employing more of all inputs

Increasing the scale of operations

There are risks and costs involved in increasing the scale of production – purchasing land, buildings, equipment, employing more staff – and the capital used for this will always have alternative uses. Firms expand capacity by increasing the scale of production to avoid turning business away and to increase market share, but they also benefit from the advantages of large-scale production – these are called **economies of scale**.

economies of scale: reductions in a firm's unit (average) costs of production that result from an increase in the scale of operations

Economies of scale

These cost benefits can be so substantial in some industries that smaller firms will be unlikely to survive due to lack of competitiveness, such as in oil refining or soft drink production. The cost benefits arise for five main reasons.

1. Purchasing economies

These economies are often known as bulk-buying economies. Suppliers often offer substantial discounts for large orders. This is because it is cheaper for them to process and deliver one large order than several smaller ones.

2. Technical economies

There are two main sources of technical economies. Large firms are more likely to be able to justify the cost of flow production lines. If these are worked at a high capacity level, then they offer lower unit costs than other production methods. The latest and most advanced technical equipment – such as computer systems – is often expensive and can usually only be afforded by big firms. Such expense can only be justified by larger firms with high output levels – so that average fixed costs can be reduced.

Exam tip: Do not confuse 'producing more' with increasing the scale of operation. More can be produced from existing resources by increasing capacity utilisation. Changing the scale of operation means using more (or less) of all resources – for example, opening a new factory with additional machines and workers.

3. Financial economies

Large organisations have two cost advantages when it comes to raising finance. First, banks often show preference for lending to a big business with a proven track record and a diversified range of products. Interest rates charged to these firms are often lower than the rate charged to small, especially newly formed, businesses. Secondly, raising finance by 'going public' or by further public issues of shares for existing public limited companies is very expensive. Therefore, the average cost of raising the finance will be lower for larger firms selling many millions of dollars' worth of shares.

ACTIVITY 1.6.1

OPERATING AT FULL CAPACITY

Ben Rishi is operations manager for a factory making saucepans. The weekly maximum capacity of the factory is 3000 units. The main limit on capacity is the old-fashioned machine for stamping out the metal pans from sheet metal. Purchasing another machine would be expensive – and would require an extension to the building.

Workers are working very long shifts. Ben has also been working long days to ensure that all the factory works at full capacity. For the last three months, demand has been high and last week there were orders for 3100 pots. Ben is under pressure from his managing director to see that this number is produced. Ben is unsure whether to recommend purchasing the new machine or to buy in components from another firm in the city that has spare capacity.

12 marks, 24 minutes

1. Outline the **two** problems facing Ben because his factory is operating at full capacity. [4]
2. Explain why Ben Rishi might choose to purchase a new machine rather than buy in components from another firm. [4]
3. Analyse **two** cost advantages Ben's business might gain if it expands its scale of production. [4]

4. Marketing economies

Marketing costs obviously rise with the size of a business, but not at the same rate. Even a small firm will need a sales force to cover the whole of the sales area. It may employ an advertising agency to design adverts and arrange a promotional campaign. These costs can be spread over a higher level of sales for a big firm and this offers a substantial economy of scale.

5. Managerial economies

Small firms often employ general managers who have a range of management functions to perform. As a firm expands, it should be able to afford to attract specialist functional managers who should operate more efficiently than general managers, helping to reduce average costs.

Exam tip: When answering IB questions about economies of scale, make sure your answer is applied to the business in the question.

Diseconomies of scale

If there were no disadvantages to large-scale operations, nearly all industries would be dominated by huge corporations. Some are, of course, as with oil exploration, refining and retailing – the benefits of large-scale production are so substantial that smaller firms find it increasingly difficult to operate profitably. In other industries, the impact of '**diseconomies of scale**' prevents one or just a few firms from being able to completely dominate.

diseconomies of scale: factors that cause average costs of production to rise when the scale of operation is increased

Diseconomies of scale are those factors that increase unit costs as a firm's scale of operation increases beyond a certain size. These diseconomies are related to the management problems of trying to control and direct an organisation with many thousands of workers, in many separate divisions, often operating in several different countries. There are three main causes of management problems.

1. Communication problems

Large-scale operations will often lead to poor feedback to workers, excessive use of non-personal communication media, communication overload with the volume of messages being sent, and distortion of messages caused by the long chain of command. Poor feedback reduces worker incentives.

These problems may lead to poor decisions being made, due to inadequate or delayed information, and management inefficiency.

2. Alienation of the workforce

The bigger the organisation, the more difficult it is to directly involve every worker and to give them a sense of purpose and achievement. They may feel insignificant in the overall business plan and become demotivated, failing to do their best. Larger manufacturing firms are the ones most likely to adopt flow-line production and workforce alienation is a real problem due to repetitive and boring tasks.

3. Poor coordination and slow decision-making

Business expansion often leads to many departments, divisions and products. The number of countries a firm operates in often increases too. The problems for senior management are to coordinate these operations and take rapid decisions in such a complex organisation. Smaller businesses with much tighter control over operations and much quicker and more flexible decision-making may benefit from lower average production costs as a result.

Large-scale production – unit costs

The combined effect of economies of scale and diseconomies of scale on unit (average) costs of production is shown in Figure 1.6.1. There is not a particular point of operation at which economies of scale cease and diseconomies begin. The process is more difficult to measure than this, as certain economies of scale may continue to be received as scale increases, but the growing significance of diseconomies gradually begins to take over and average costs may rise. It is often impossible to state at what level of output this process occurs, which is why many managers may continue to expand their business unaware that the forces causing diseconomies are building up significantly.

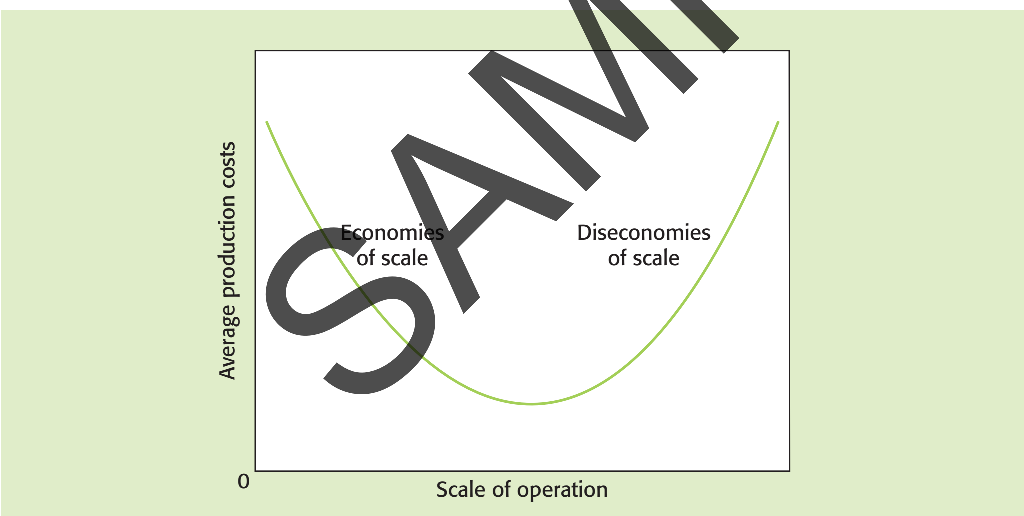


Figure 1.6.1 The impact of economies and diseconomies of scale on average costs

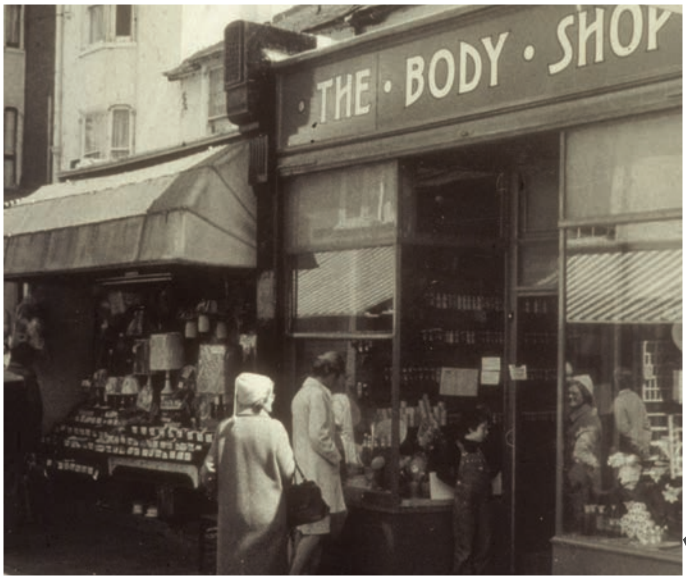
Merits of small and large organisations

Significance of small and micro-businesses

There is no universally agreed definition of small firms. However, they usually employ few people and have a low turnover compared to other firms. It is now common to make a further distinction for very small businesses known as 'micro-enterprises'. The European Union definitions are shown in Table 1.6.1.

Business category	Employees	Sales turnover	Capital employed
Medium	51–250	over €10 million to €50 million	over €10 million to €34 million
Small	11–50	over €2 million to €10 million	over €2 million to €10 million
Micro	10 or fewer	up to €2 million	up to €2 million

Table 1.6.1 EU classifications of business size



The Body Shop opened its first shop in Brighton, England, in 1976

Small firms (including micro-enterprises) are very important to all economies:

- Many jobs are created by small firms and the small business sector employs a very significant proportion of the working population in most countries.
- Small businesses are often run by dynamic entrepreneurs, with new ideas for consumer goods and services leading to wider consumer choice.
- Small firms create competition for larger businesses. Without this competition, larger firms could exploit consumers with high prices and poor service. For example, the cost of air travel has fallen in recent years due to the establishment of small airlines competing with the large, established companies.
- Small firms often supply specialist goods and services to important industries, such as car manufacturing, allowing them to specialise in large-scale assembly.
- All great businesses were small at one time. The Body Shop, for example, began in one small rented store in 1976. The large firms of the future are the small firms today. The more small firms are encouraged to become established and expand, the greater the chances that an economy will benefit from large-scale organisations in the future.
- Small firms may have lower average costs than larger ones and this benefit could be passed on to the consumer too. Costs could be lower because of lower wage rates paid, or the cost of the administration and management of bigger enterprises may increase their average costs dramatically.

Small versus large organisations

The advantages and disadvantages of small and large business organisations are summarised in Tables 1.6.2 and 1.6.3.

Small businesses	Large businesses
• Can be managed and controlled by the owner(s) • Often able to adapt quickly to meet changing customer needs • Offer personal service to customers • Find it easier to know each worker, and many staff prefer to work for a smaller, more 'human' business • Average costs may be low due to no diseconomies of scale and low overheads • Easier communication with workers and customers	• Can afford to employ specialist professional managers • Benefit from cost reductions associated with large-scale production • May be able to set prices that other firms have to follow • Have access to several different sources of finance • May be diversified in several markets and products, so risks are spread • More likely to be able to afford research and development into new products and processes

Table 1.6.2 Potential advantages of small and large businesses

Small businesses	Large businesses
• May have limited access to sources of finance • May find the owner(s) has to carry a large burden of responsibility if unable to afford to employ specialist managers • May not be diversified, so there are greater risks of negative impact of external change • Unlikely to benefit from economies of scale	• May be difficult to manage, especially if geographically spread • May have potential cost increases associated with large-scale production • May suffer from slow decision-making and poor communication due to the structure of the large organisation • May often suffer from a divorce between ownership and control that can lead to conflicting objectives

Table 1.6.3 Potential disadvantages of small and large businesses

What is an appropriate scale of operation?

It is easy just to focus on the benefits of small businesses in certain industries – for example, in service industries such as hairdressing. However, large businesses supply most of the world's consumer goods and they do so with increasing efficiency and, in most cases, improving levels of quality. There is no rule that can be applied when deciding on the most appropriate scale of operation. Business owners must weigh up and assess:

- owners' objectives – they may wish to keep the business small and easy to manage
- capital available – if limited, growth is less likely
- size of the market the firm operates in – very small markets do not need large-scale production
- number of competitors – the market share of each firm may be small if there are many rivals
- scope for economies of scale – if these are substantial, as in water supply, each business is likely to operate on a large scale.

Exam tip: If an examination question asks you to consider the most appropriate scale of production in a given situation, you will need to assess these five factors.

THEORY OF KNOWLEDGE

Some people have the erroneous idea that a small business cannot effectively compete against larger competitors. This concept is quite far from the truth. For example, if someone were to ask you, 'What is a major source of job formations in America today?' what would you answer? If you said small business, you would be right. How about this question: 'What is the major source of newly formed individual wealth in a given country today?' Again, the small business is the answer. Why, then, is there such misinformation about the strength, versatility and wealth of small businesses? The answer is that usually large corporations get the lion's share of publicity.

Source: e-commerce times

In the light of this article, discuss the view that in the corporate world bigger is always better.

Business growth

The owners of many businesses do not want the firm to remain small – although some do for reasons of remaining in control, avoiding taking too many risks and preventing workloads from becoming too heavy. Why do other business owners and directors of companies seek growth for their business? There are a number of possible reasons including:

- increased profits
- increased market share
- increased economies of scale
- increased power and status of the owners and directors
- reduced risk of being a takeover target.

Internal and external growth

Business growth can be achieved in a number of ways and these forms of growth can lead to differing effects on stakeholder groups, such as customers, workers and competitors. The different forms of growth can be grouped into **internal** and **external growth**, as shown in Figure 1.6.2.

internal growth: expansion of a business by means of opening new branches, shops or factories (also known as organic growth)

external growth: business expansion achieved by means of merging with or taking over another business, from either the same or a different industry

An example of internal growth would be a retailing business opening more shops in towns and cities where it previously had none.

The different forms of external growth are shown in Figure 1.6.3.

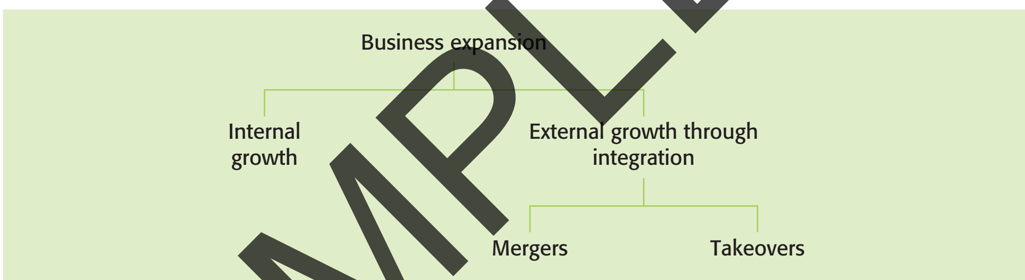


Figure 1.6.2 Different forms of growth

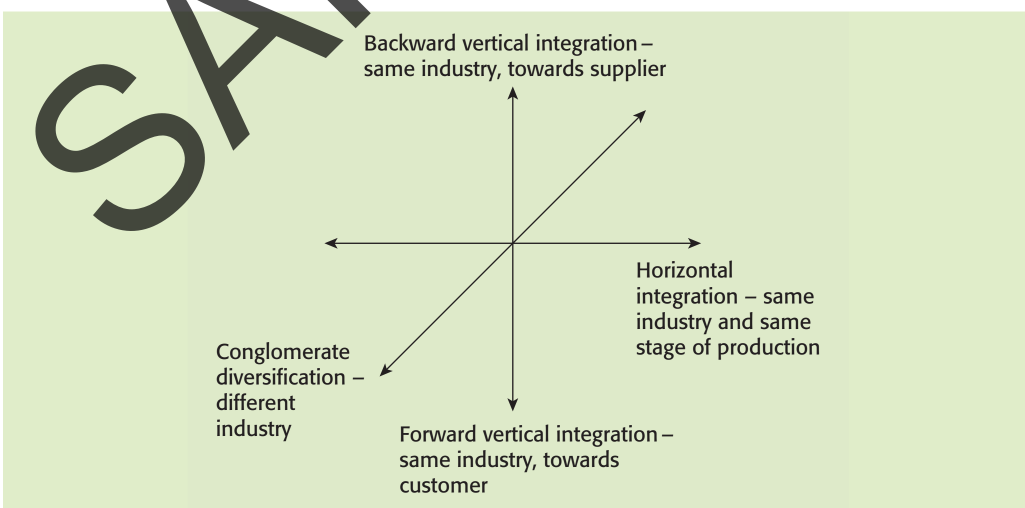


Figure 1.6.3 Forms of external growth

ACTIVITY 1.6.2

STARBUCKS CONFIRMS RAPID-GROWTH STRATEGY

Howard Schultz, the chairman of Starbucks, confirmed growth plans for the world's largest chain of coffee shops. The business will open at least 10 000 new cafés over the next four years by using internal growth. Schultz said at the company's annual meeting that he planned to double the size of the business eventually.

China will be the main focus of this growth strategy. The US giant opened its first Chinese branch in 1999 and has plans to open 1000 outlets there. 'No market potentially has the opportunities for us as China hopefully will,' said Schultz. Like many Western retailers, Starbucks sees China as its key growth area due to its fast-growing economy, lack of strong local competitors and sheer size of population.

There are plans to increase sales of non-coffee products to reduce its reliance on just hot drinks. It has expanded its sale of audio books and music, and Sir Paul McCartney, the former Beatles member, became the first artist to release an album on Starbucks' Hear Music label.

This rapid internal expansion has not been without problems. *Consumer Reports* magazine recently ranked McDonald's coffee ahead of Starbucks', saying it tastes better and costs less. The chairman has also criticised the time-saving policy of designing stores uniformly rather than with some local decoration. In 2013 Starbucks was criticised for charging high prices to consumers in China but the company responded by stating that operating costs were higher than in some other countries and high investment in China had to be paid for.

20 marks, 40 minutes

1. Define the term 'internal growth'. [2]
2. Outline **two** reasons why Starbucks has adopted a rapid expansion strategy. [4]
3. Analyse the possible advantages of Starbucks focusing growth in China. [4]
4. Evaluate the potential economies of scale that Starbucks might experience from further expansion. [10]

Exam tip: If an examination question refers to a **merger** or **takeover**, you should start by identifying what type it is. Do not forget that mergers and takeovers often cause businesses as many problems as they solve.

External growth is often referred to as integration as it involves bringing together two or more firms. Table 1.6.4 provides a guide to the different types of integration, their common advantages and disadvantages and the impact they often have on stakeholder groups.

THEORY OF KNOWLEDGE

Facebook buys Instagram photo-sharing network for $1 billion

Instagram – the popular photo-sharing smartphone app – is to be bought by Facebook who will pay $1bn (£629 million) in cash and stock for the takeover.

October 2010 saw the launch of Instagram as a free iPhone app that allowed users to apply various filters to their photographs before they were uploaded. A version for the Android market followed later. The free app has been a great success and Instagram state they have more than 30 million users, with 5 million pictures uploaded every day.

The chief executive of Facebook, Mark Zuckerberg, has promised that Instagram will continue to develop as a separate brand, meaning it will continue to allow users to post to rival social networking sites.

When one organisation takes over another organisation it is often said it is about the takeover organisation's desire to have control and power over a market.

Discuss in your class the human instinct to have power and control in business situations.

merger: an agreement by shareholders and managers of two businesses to bring both firms together under a common board of directors with shareholders in both businesses owning shares in the newly merged business

takeover: when a company buys over 50% of the shares of another company and becomes the controlling owner – often referred to as 'acquisition'

horizontal integration: integration with a firm in the same industry and at the same stage of production

forward vertical integration: integration with a business in the same industry but a customer of the existing business

backward vertical integration: integration with a business in the same industry but a supplier of the existing business

conglomerate integration: merger with or takeover of a business in a different industry

Type of integration	Advantages	Disadvantages	Impact on stakeholders
Horizontal integration	• Eliminates one competitor • Possible economies of scale • Scope for rationalising production, e.g. concentrating output on one site instead of two • Increased power over suppliers	• Rationalisation may bring bad publicity • May lead to monopoly investigation if the combined business exceeds certain size limits	• Consumers have less choice • Workers may lose job security as a result of rationalisation
Forward vertical integration	• Business is able to control the promotion and pricing of its own products • Secures an outlet for the firm's products – may now exclude competitors' products	• Consumers may suspect uncompetitive activity and react negatively • Lack of experience in this sector of the industry – a successful manufacturer does not necessarily make a good retailer	• Workers may have greater job security because the business has secure outlets • There may be more varied career opportunities • Consumers may resent lack of competition in the retail outlet because of the withdrawal of competitor products
Backward vertical integration	• Gives control over quality, price and delivery times of supplies • Encourages joint research and development into improved quality of supplies of components • Business may control supplies of materials to competitors	• May lack experience of managing a supplying company – a successful steel producer will not necessarily make a good manager of a coal mine • Supplying business may become complacent having a guaranteed customer	• Possibility of greater career opportunities for workers • Consumers may obtain improved quality and more innovative products • Control over supplies to competitors may limit competition and choice for consumers
Conglomerate integration	• Diversifies the business away from its original industry and markets • This should spread risk and may take the business into a faster-growing market	• Lack of management experience in the acquired business sector • There could be a lack of clear focus and direction now that the business is spread across more than one industry	• Greater career opportunities for workers • More job security because risks are spread across more than one industry

Table 1.6.4 Types of business integration

ACTIVITY 1.6.3

JET AIRWAYS, AIR SAHARA AND ETIHAD

India's largest private airline, Jet Airways, bought out its smaller rival, Air Sahara, for US$640 million in 2007. The takeover gave the airline a combined market share of about 32%. Jet Airways acquired the aircraft, equipment and landing and take-off rights at the airports Air Sahara had. Jet Airways founder and chairman, Naresh Goyal, believed that the external growth of Jet Airways would benefit shareholders. Some analysts predicted substantial synergy from this takeover. Better discounts from aircraft manufacturers were expected. Streamlining the two head offices into one unit would reduce fixed costs. The interlinking of the different air routes allowed more passengers to be offered connecting flights with the new enlarged airline.

The takeover had to be approved by the Indian Ministry of Company Affairs. There was some concern that the takeover could lead to a monopolistic position, as Jet Airways now enjoys a dominant position on many domestic air routes. In 2013 Jet Airways sold 24% of its shares to Etihad Airways, which injected US$379 million into the airline to finance new aircraft and more routes. This partial takeover was called a 'strategic alliance'.

MERCEDES SELLS CHRYSLER AFTER FAILED MERGER

After nine years of trying to make the merger of two large carmakers work successfully, Mercedes-Benz has at last admitted defeat and sold its 80% stake in the US-based operator Chrysler. The merger never increased returns to shareholders and it failed in its original aim of creating a global motor company to compete effectively with General Motors, Ford and Toyota.

Management problems in controlling the merged businesses were huge. Distance between Germany (Mercedes-Benz) and the USA (Chrysler) made communication difficult. The car ranges of the two companies had very little in common, so there were few shared components and economies of scale were less than expected. Culture clashes between the two management approaches led to top-level director disputes over the direction the merged business should take.

20 marks, 40 minutes

1. State the **two** types of integration taking place in the two case studies. [2]

2. If Jet Airways were now to merge with an aircraft manufacturer:

a. Explain the type of integration this would involve. [4]

b. Analyse **two** potential benefits to Jet Airways of this type of merger. [4]

3. Evaluate the likely impact of the Jet Airways takeover of Air Sahara on any **two** stakeholder groups. [10]

LEARNER PROFILE

Risk-takers

In April 2010, Hewlett-Packard purchased the company synonymous with mobile devices: Palm. Unfortunately, Palm had last been synonymous with mobile devices about a decade earlier. Palm particularly struggled against Blackberry who, in turn, suffered at the hands of the iPhone and Android. After a US$1.2 billion purchase, Palm became part of Hewlett-Packard.

The speed with which Hewlett-Packard realised its mistake was remarkable. By the summer of 2011, HP had moved well past the point of looking to find a buyer for its Palm subsidiary and instead decided to discontinue the entire thing. Even a revamped operating system, Palm's critically acclaimed WebOS, was not enough to salvage the erstwhile bright star. The mobile operating system exists today as a small open-source project.

Major business decisions often involve failure. As 'risk-takers', how can business people effectively manage the risks they take when making major decisions like takeovers?

Joint ventures, strategic alliances and franchising

Joint ventures

joint venture: two or more businesses agree to work closely together on a particular project and create a separate business division to do so

A **joint venture** is not the same as a merger, but it may lead to a merger of the businesses if their joint interests coincide and if the joint venture is successful. The reasons for joint ventures are:

- Costs and risks of a new business venture are shared – this is a major consideration when the cost of developing new products is rising rapidly.
- Different companies might have different strengths and experiences and they, therefore, fit well together.
- They might have their major markets in different countries and they could exploit these with the new product more effectively than if they both decided to 'go it alone'.

Such agreements are not without their risks:

- Styles of management and culture might be so different that the two teams do not blend well together.
- Errors and mistakes might lead to one blaming the other.
- The business failure of one of the partners would put the whole project at risk.

Strategic alliances

strategic alliances: agreements between firms in which each agrees to commit resources to achieve an agreed set of objectives

Strategic alliances can be made with a wide variety of stakeholders, for example:

- With a university – finance provided by the business to allow new specialist training courses that will increase the supply of suitable staff for the firm.
- With a supplier – to join forces in order to design and produce components and materials that will be used in a new range of products. This may help to reduce the total development time for getting the new products to market, gaining competitive advantage.
- With a competitor – to reduce risks of entering a market that neither firm currently operates in. Care must be taken that, in these cases, the actions are not seen as being 'anti-competitive' and, as a result, against the laws of the country whose market is being entered.

Franchising

franchise: a business that uses the name, logo and trading systems of an existing successful business

A **franchise** contract allows the franchisee to use the name, logo and marketing methods of the franchiser. The franchisee can, separately, decide which form of legal structure to adopt. Franchises are a rapidly expanding form of business operation. They have allowed certain multinational businesses, such as McDonald's and Ben and Jerry's, to expand much more rapidly than they could otherwise have done. Why would a business entrepreneur want to use the name, style and products of another firm? Consider Activity 1.6.4, which includes all the main features of a typical franchise contract.

ACTIVITY 1.6.4

HARRY GOES IT ALONE

Harry was really bored with his job as second chef in a top-of-the-market hotel. He did not like being ordered around by the head chef. He hoped to use his talents preparing food for customers in his own restaurant. The main problem was his lack of business experience. Harry had just been to a business conference and had been interested in the franchising exhibition there. One of the businesses offering to sell franchises was Pizza Delight. This firm sold a new type of pizza recipe to franchisees and provided all the ingredients, marketing support and help with staff training. They had already opened 100 restaurants in other countries and offered to sell new franchises for a one-off payment of US$100 000. If Harry signed one of these franchising contracts, then he would have to agree to:

- buy materials only from Pizza Delight
- fit out the restaurant in exactly the way the franchiser wanted
- make an annual payment to Pizza Delight of a percentage of total turnover.

Harry would have to find and pay for suitable premises and recruit and motivate staff. Pizza Delight claimed that their brand and products were so well known that 'success was guaranteed'. As the product had been tested already, there would be none of the initial problems that small firms often experience and Pizza Delight would pay for national advertising campaigns. Harry was told that no other Pizza Delight restaurant could open within five kilometres of one already operating.

20 marks, 40 minutes

1. Define the term 'franchise'. [2]

2. Explain **two** potential benefits Harry would enjoy if he were to open a franchised Pizza Delight restaurant. [4]

3. Analyse **two** potential drawbacks to Harry if he agreed to the terms of the franchise contract. [4]

4. Using all the evidence, advise Harry on whether to take out a franchise with Pizza Delight. Justify your answer. [10]

Table 1.6.5 summarises the benefits and disadvantages of a franchised business for the franchisee.

Benefits	Possible limitations
• Less chance of new business failing as an established brand and product are being used • Advice and training offered by the franchiser • National advertising paid for by franchiser • Supplies obtained from established and quality-checked suppliers • Franchiser agrees not to open another branch in the local area	• Share of profits or sales revenue has to be paid to franchiser each year • Initial franchise licence fee can be expensive • Local promotions may still have to be paid for by franchisee • No choice of supplies or suppliers to be used • Strict rules over pricing and layout of the outlet reduce owners' control over own business

Table 1.6.5 Franchises – benefits and disadvantages to the franchisee

globalisation: the growing integration of countries through increased freedom of global movement of goods, capital and people

free trade: no restrictions or trade barriers exist that might prevent or limit trade between countries

protectionism: using barriers to free trade, such as tariffs and quotas, to protect a country's own domestic industries

Globalisation

It is often stated that **globalisation** has 'shrunk the world'. It has led to substantial improvements in global communications and substantial reductions in barriers to trade and movement of capital and goods. This 'shrinking' of the world is having a major impact on business activity, especially from multinationals. The **free-trade** movement, which campaigns against **protectionism**, and the increasing use of the internet are reducing the differences that once existed between national markets, reducing the importance of national borders and making it easier for businesses to trade with and locate in many countries. This is forcing firms, which were once protected by national governments, to become internationally competitive.

Some of the critics of globalisation have stated that the process of globalisation has exploited hundreds of thousands of people in developing countries all around the world. It has, it is claimed, caused great disruption to lives and produced very few noticeable benefits in return.

The supporters of globalisation point to the huge reductions in the numbers of people in poverty achieved by some countries which have embraced globalisation, such as the thriving economies of India, China, Vietnam and Uganda.

What are the benefits of globalisation and free trade between nations?

- Buying products from other nations (importing) means consumers are offered a much wider choice of goods and services.
- Imports of raw materials can allow a developing economy to increase its rate of industrialisation.
- Importing products creates additional competition for domestic industries and this should encourage them to keep costs and prices down and make their goods as well designed and of as high quality as possible.
- Countries can begin to specialise in those products they are best at making if they import those that they are less efficient at as compared to other countries. This is called comparative advantage.
- Specialisation can lead to economies of scale and further cost and price benefits.
- By trading in this way, the living standards of all consumers of all countries trading together should increase as they are able to buy products more cheaply than those that were produced just within their own countries.
  - Movements of international capital have increased foreign investment in both developed and developing countries.
  - Businesses can more easily recruit workers/managers from other countries, increasing the pool of skilled labour to draw from.

In recent years, there have been moves towards free trade by reducing international trade restrictions such as tariffs (taxes on imports) and quotas (quantity limits on import). These measures have been a major factor driving the 'globalisation' process.

multinational company or business: business organisation that has its headquarters in one country, but with operating branches, factories and assembly plants in other countries

Multinational businesses

Multinational companies have benefited greatly from the freedoms offered by globalisation. They are more than just importers and exporters; they actually produce goods and services in more than one country. The biggest multinationals have annual sales turnovers exceeding the size of many countries' entire economies. This sheer size – and the power and influence it can bring – can lead to many problems for nations that deal with such companies. Many multinationals have their head offices in Western European countries or in the USA, yet have many of their operating bases in less-developed countries with much smaller economies. If the companies need to save costs by reducing the size of their workforces, often the *last* countries to lose jobs will be the ones where the head offices are based.

Exam tip: When defining a multinational business, it is not enough to state that such businesses 'sell products in more than one country'.

Why become a multinational?

There are several reasons why businesses start to operate in countries other than their main base.

1. Closer to main markets – this will have a number of advantages:
   - lower transport costs for the finished goods
   - better market information about consumer tastes as a result of operating closer to them
   - may be viewed as a local company and gain customer loyalty as a consequence.
2. Lower costs of production – apart from lower transport costs of the completed items, there are likely to be other cost savings:
   - lower labour rates e.g. much lower demand for local labour in developing countries compared to developed economies
   - cheaper rent and site costs, again resulting from lower demand for commercial property – these cost savings can make the 'local' production very efficient in terms of the market in the rest of the world and can lead to substantial exports
   - government grants and tax incentives designed to encourage the industrialisation of such countries.
3. Avoid import restrictions – by producing in the local country there will be no import duties to pay and no other import restrictions.
4. Access to local natural resources – these might not be available in the company's main operating country.

ACTIVITY 1.6.5

BORGES NOW OPERATES IN 100 COUNTRIES

Spanish food multinational Borges is aiming to develop olive plantations in India, following the setting up of its 100% subsidiary in the country. The company is also going to open a manufacturing unit in India, which will be part of the R's 65 million investment planned for the country over the next three years. The investment is being encouraged by the Indian government, which until recently protected its own manufacturers and producers.

'Plantations of olives in India will reduce the comparative cost price. It will result in a huge employment opportunity. It will contribute to the society,' said the managing director of Borges India.

For the moment, the company will concentrate on its three ranges of olive oil – extra virgin, light and pure categories – targeting the fast-growing markets in Delhi, Mumbai, Bangalore, Hyderabad, Chennai and Pune. Next year, the company will expand to 36 cities. Borges hopes that, with its newly created 100% owned subsidiary in India, it will achieve an 18% share of the olive oil market. The company's extra light olive oil was conceived primarily for the Indian consumer, since it will not interfere with the flavours and the aroma of the domestic cuisine and yet remain a healthy cooking medium.

The company's products, which include nuts, dry fruits, table olives, vinegars and salad dressings, have a presence in over 100 countries. The group was founded in 1896 and has plantations in Spain and the USA (California), besides sourcing from other countries.

10 marks, 20 minutes

1. Define the term 'subsidiary'. [2]
2. Analyse **two** possible benefits to Borges of establishing operations in India. [4]
3. Analyse **two** problems Borges might encounter establishing operations in India. [4]

Potential problems for multinationals

Setting up operating plants in foreign countries is not without risks. Communication links with headquarters may be poor. Language, legal and culture differences with local workers and government officials could lead to misunderstandings. Coordination with other plants in the multinational group will need to be carefully monitored to ensure that products that might compete with each other on world markets are not produced or that conflicting policies are not adopted. Finally, it is likely that the skill levels of the local employees will be low and this could require substantial investment in training programmes.

ACTIVITY 1.6.6

SOUTH AFRICA ACCELERATES ITS CAR PRODUCTION

South Africa is now a profitable production and export base for some of the world's household names in auto manufacture, despite the country's geographical remoteness, its reputation for labour militancy and political uncertainties. South Africa has also become a key supplier of motor-industry components, providing everything from windscreens to exhaust pipes for some of the most demanding markets in the world. This did not happen by accident. It is the result of a deliberate strategy by the government to draw the world's best car manufacturers into South Africa, and make the domestic car industry more competitive.

BMW has invested Rand 1 billion upgrading its Rosslyn plant near Pretoria, which will export 75% of the 40 000 3-Series cars produced each year to Britain, Germany, Japan, America, Australia, Hong Kong, Singapore, New Zealand, Taiwan and Iran. Daily output has increased fivefold since 1989 and this has helped create 900 new jobs at the Rosslyn plant, and an estimated 18 000 jobs in the car-component industry.

The Eastern Cape remains one of the poorest regions in the country. Average black disposable income stands at a low Rand 5000 a year, compared with the white population's Rand 45 000 a year. Little wonder that when Volkswagen were looking for 1300 workers to replace those who were sacked for participating in the illegal strike, 23 000 turned up outside the factory gates in the hope of being chosen. Port Elizabeth and East London, the province's two main cities, are rapidly emerging as South Africa's new carmaking centres. The extra incomes created by the industry help to boost other local industries such as retailing and house construction. The success of multinationals 'has been a huge confidence booster for us,' says Anthony Black, an economist at Cape Town University who helped create the governments Motor Industry Development Programme. 'It has enabled us to bring about big productivity improvements, stabilise employment, reduce the real cost of new vehicles, and give consumers more choice.'

20 marks, 40 minutes

1. List **two** examples of multinational companies that have invested in South Africa. [2]
2. Explain **two** possible reasons for multinational companies setting up factories in South Africa. [4]
3. Analyse **two** possible benefits South Africa might gain from investment by multinational companies. [4]
4. Evaluate whether the South African government should continue to support investment by multinational businesses in its economy. [10]

The impact on 'host' countries of multinational operations

The potential benefits are clear:

- The investment will bring in foreign currency and, if output from the plant is exported, further foreign exchange can be earned.
- Employment opportunities will be created and training programmes will improve the quality and efficiency of the local workforce.
- Local firms are likely to benefit from supplying services and components to the new factory and this will generate additional jobs and incomes.
- Local firms will be forced to bring their quality and productivity up to international standards either to compete with the multinational or to supply to it.
- Tax revenues to the government will be boosted from any profits made by the multinational.
- Management expertise in the community will slowly improve when and if the 'foreign' supervisors and managers are replaced by local staff, once they are suitably qualified.
- The total output of the economy will be increased and this will raise gross domestic product.

It will not be all good news, however. The expansion of multinational corporations into a country could lead to the following drawbacks:

- Exploitation of the local workforce might take place. Due to the absence of strict labour and health and safety rules in some countries, multinationals can employ cheap labour for long hours with few of the benefits that the staff in their 'home' country would demand. Recent poor publicity has forced the Gap and Nike clothing companies to improve their monitoring of the employment of illegal child workers at factories that produce their clothes in Thailand. How many large businesses would not care about these practices, especially as the factories are so far removed from Western media investigation?
- Pollution from plants might be at higher levels than allowed in other countries. This could be either because of slack rules or because the 'host' government is afraid of driving the multinational away if it insists on environmentally acceptable practices. This is a sign of the great influence multinationals can have.
- Local competing firms may be squeezed out of business due to inferior equipment and much smaller resources than the large multinational.
- Some large Western-based businesses, such as McDonald's and Coca-Cola, have been accused of imposing 'Western' culture on other societies by the power of advertising and promotion. This could lead to a reduction in cultural identity.

Exam tip: In case study questions on multinational business activity, you may have the opportunity to use examples from your own country as well as from the case study to support your answers.

- Profits may be sent back to the country where the head office of the company is based, rather than kept for reinvestment in the host nation.
- Extensive depletion of the limited natural resources of some countries has been blamed on some large multinational corporations. The argument is that they have little incentive to conserve these resources, as they are able to relocate quickly to other countries once resources have run out.

OVER TO YOU

Revision checklist

1. List **four** benefits to the economy of your country that would result from a growth in the number of small firms.
2. A computer manufacturer is planning to expand. Explain to its management the difference between internal and external growth.
3. A producer of fruit drinks in your country has asked you to explain the difference between vertical forward and backward integration. Give examples of each that would be relevant for this business.
4. Two large banks in your country plan to merge. Examine the advantages and disadvantages to the businesses that could result from this integration.
5. In the example used in question 4 identify **two** stakeholder groups that could be affected by this planned merger.
6. In the example in question 4 explain the possible advantages and disadvantages to these two groups from the proposed merger.
7. Explain **three** reasons why the owner of a small business might decide not to expand the business.
8. Differentiate between a joint venture and a strategic alliance.
9. Explain how globalisation has encouraged the growth of multinational companies.
10. Explain **two** benefits and **two** disadvantages to your country resulting from the operations of a well-known multinational company.

Exam practice question

TALE OF TWO INDUSTRIES

The size of the average Indian steel plant compared to the size of the average Indian retail shop could not be more different. Steel plants employ thousands of workers, have millions of dollars of capital invested in advanced equipment and produce annual output valued in the millions too. Tata, one of the largest steel makers in the world, has recently grown and become a truly multinational company by taking over European steel giant Corus and UK carmakers Jaguar and Land Rover. It has been able to do this because of easier capital flows, which are a sign of increased globalisation.

Contrast this company with typical Indian retail outlets. The small shopkeepers and street hawkers that presently account for over 95% of Indian retail sales often employ just a few workers with little investment in modern technology. But all this could be about to change. There is a growing trend of mergers and takeovers in the retail sector. Large retail groups, such as Reliance and Walmart, are becoming established. It is claimed that the market share of this organised sector will be 25% by 2015. A pressure group of small retailers, the National Movement for Retail Democracy, is organising demonstrations to demand that big corporations leave the retail industry.

20 marks, 40 minutes

1. Define the term 'merger'. [2]
2. Explain why average costs of production might fall as a business increases its scale of operations. [4]
3. Analyse **one** potential benefit and **one** potential drawback to consumers of steel, such as carmakers, from a takeover of Corus by Tata. [4]
4. Evaluate whether Indian consumers would benefit from more shops owned by large retail corporations. [10]

Key concept question

20 marks, 40 minutes

With reference to one organisation that you have studied, examine what changes globalisation has had on the activities of multinational organisations. [20]

1.7

H

Organisational planning tools

On completing this chapter you should be able to:

Analyse and apply:

- The following planning tools in a given situation:
  - Fishbone diagram
  - Decision tree
  - Force-field analysis
  - Gantt chart (all AO3)

Evaluate:

- The value to an organisation of these planning tools (AO3)

Calculate/complete/construct:

- Examples of these planning tools (AO4)

Setting the scene

BUILDING A NEW BRIDGE

The Eastern Construction Co. has just received its first major bridge-building contract from a foreign government. Jimmy Chen has been appointed project manager for this key contract. He has seen government officials on several occasions to obtain agreement on:

- the exact size and specifications of the bridge
- the expected completion date
- the value of the contract – the price the government has agreed to pay for the completed bridge.

Jimmy has a team of managers to help him plan and calculate the exact materials and equipment needs of this building project – they will take responsibility for seeing the project through to the finish. IT specialists have been asked to draw up a Gantt chart program showing all the different tasks of the project, the estimated time for each task and the resources needed for each. This chart has shown that some tasks can be done together – such as laying the tarmac on the road and painting the steel structure, and other tasks must be completed before any other work can start – such as building an access road and laying foundations for the bridge.

After six months, building work has started and the project is on time – so far. Both Jimmy and his senior managers hope that if the project is seen as a success, other bridge contracts will be awarded to the company.

Points to consider

- Why is careful planning of this project particularly important to this company?
- Why would a chart showing the different activities and their duration be useful to Jimmy and his team?
- What problems might there be in making sure this chart was as accurate as possible?

Key concept link

To implement new strategies successfully organisations must plan necessary resources effectively. Major changes brought about by changes in 'strategic direction' require long-term planning and organising and monitoring of resources and activities.

Introduction

organisational planning: process of identifying an organisation's immediate and long-term objectives, and formulating and monitoring specific strategies to achieve them; it also involves employee and resource allocation to allow for the effective completion of projects

project: a specific and temporary activity with a start and end date, clear goals, defined responsibilities and a budget

All organisations need to plan. **Organisational planning** includes preparing for new **projects** and managing them as effectively as possible. Projects are specific tasks which result from the need for an organisation to change. The need for change might be relatively minor – such as the opening of a new shop for a retail company that has 200 outlets already – or it could be major – such as a car manufacturer developing a hybrid vehicle for the first time in response to environmental pressures.

Other examples of business projects include:

- setting up a new IT system
- relocating company operations
- installing new machinery
- marketing products in another country
- building a factory.

Project managers must simultaneously manage the four basic elements of any project:

- **Resources** – the people, equipment and materials needed.
- **Time** – each activity will need to be timed so that an overall project duration can be worked out.
- **Money** – the project must be kept to budget and the expected profit from it should be aimed for.
- **Scope** – the overall size and scale of the project must be established and the specific objectives for it set.

To be completed successfully, a project needs to be planned and managed, costs determined and time allocated, problems dealt with and, eventually, concluded. Formal methods of **project management** offer clear guidelines and deadlines.

project management: using modern management techniques to plan, carry out and complete a project from start to finish in order to achieve preset targets of quality, time and cost

fishbone diagram: a visual identification of many potential causes of a problem

This chapter considers four tools of organisational planning.

The fishbone diagram

The **fishbone diagram** – also known as a cause-and-effect diagram or an Ishikawa diagram – may be used to analyse a problem or situation. An example is given in Figure 1.7.1, which is based on a brainstorming session where a team is attempting to establish all of the possible causes of iron contaminating a food product.

In this example, six main potential causes of the problem of iron in the product were identified. These are the most common main 'bones' that feature on the fishbone diagram. They are sometimes called the 6Ms:

- Methods – are the bottles used clean?
- Machines – are there rusty pipes in the production machines?
- Manpower – is the workforce skilled enough?
- Materials – are the raw materials to blame?
- Measurement – is the calibration incorrect?
- 'Mother nature' (the environment) – is the working environment contaminated?

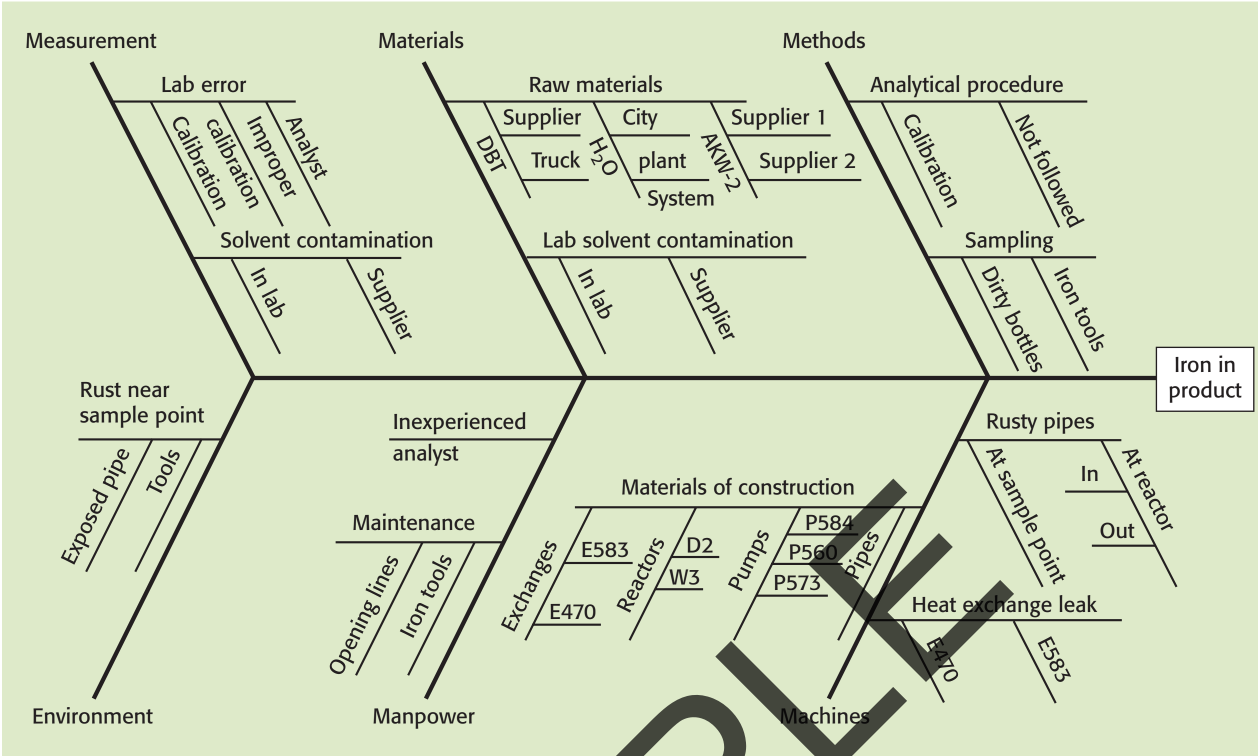


Figure 1.7.1 Example of a fishbone diagram

Source: Nancy R. Tague (2004) *The Quality Toolbox* (ASR Quality Press, 2nd edition)

More detailed discussion of each of these causes led to the factors laid out in the form of the 'smaller bones' of the fish.

Stages in the fishbone process include:

1. Agree on the problem statement and write this in the centre of the whiteboard or screen.
2. Brainstorm the main categories of the causes of the problem, or use the common generic ones (the 6Ms). These become the six main bones of the fish.
3. Brainstorm all of the detailed reasons why problems might occur under each of these headings – the small fish bones.
4. Analyse the findings of the group as shown on the diagram. Investigate the most likely causes of the problem – more research might now be necessary to arrive at a conclusion.

Once this process has been completed the business can put strategies in place to remove the most likely causes of the problem, perhaps by adopting different quality assurance systems or improving training.

Fishbone diagram – an evaluation

The fishbone diagram is a simple and easy-to-understand approach which aids the discussion and resolution of business problems. Used effectively, it can encourage employee participation. This planning tool also offers a model for building a system of performance improvements in order to resolve actual or potential problems such as training and motivation techniques.

However, it does have limitations. Its relative simplicity can be a weakness as well as a strength. The nature of the diagram may make it difficult to represent the interrelated nature of many business problems – which often may not stem from just one cause – and it cannot effectively be used to illustrate really complex problems.

ACTIVITY 1.7.1

Explain how the fishbone diagram tool could help in analysing the decline in student numbers at a high school for 16- to 19-year-old students.

Decision tree

decision tree: a diagram that sets out the options connected with a decision and the outcomes and economic returns that may result

A **decision tree** is a technique that considers the value of the options available and the chances of them occurring.

This technique is based on a diagram that is drawn to represent four main features of a business decision:

- all the options open to a manager
- the different possible outcomes resulting from these options
- the chances of these outcomes occurring
- the economic returns from these outcomes.

By comparing the likely financial results from each option, the manager can minimise the risks involved and maximise the potential returns.

Constructing decision trees

The tree is a diagram which has the following features:

- It is constructed from left to right.
- Each branch of the tree represents an option together with a range of consequences or outcomes and the chances of these occurring.
- Decision points are denoted by a square – these are decision nodes.
- A circle shows that a range of outcomes may result from a decision – a chance node.
- Probabilities are shown alongside each of these possible outcomes. These probabilities are the numerical values of an event occurring – they measure the 'chance' of an outcome occurring.
- The economic returns are the expected financial gains or losses of a particular outcome – the 'pay-offs'.

Working out 'expected values'

expected value: the likely financial result of an outcome obtained by multiplying the probability of an event occurring by the forecast economic return if it does occur

Using the formula above, the **expected value** of tossing a coin and winning \$5 if it comes down heads is 0.5 × \$5 = \$2.50. In effect, the average return, if you repeated this a number of times, would be to win \$2.50 – this is the expected value. The purpose of a decision tree is to show that option which gives the most beneficial expected value.

For example, the manager of an events-organising business has to decide between holding a fundraising auction indoors or outdoors. The financial success of the event depends not only on the weather, but also on the decision to hold it indoors or outdoors.

Table 1.7.1 shows the expected financial returns or 'economic returns' from the event for each of these different circumstances. From past weather records for August, there is a 60% chance of fine weather and a 40% chance of it being poor. The indoor event will cost \$2000 to arrange and the outdoor event will cost \$3000.

Weather	Indoors	Outdoors
Fine	$5000	$10000
Poor	$7000	$4000

Table 1.7.1 The possible economic returns from the alternative options

The decision tree of the event is shown in Figure 1.7.2. This diagram demonstrates the main advantages of decision trees:

- They force the decision-maker to consider all the options and variables related to a decision.
- They put these on an easy-to-follow diagram, which allows for numerical considerations of risk and economic returns to be included.
- The approach encourages logical thinking and discussion among managers.

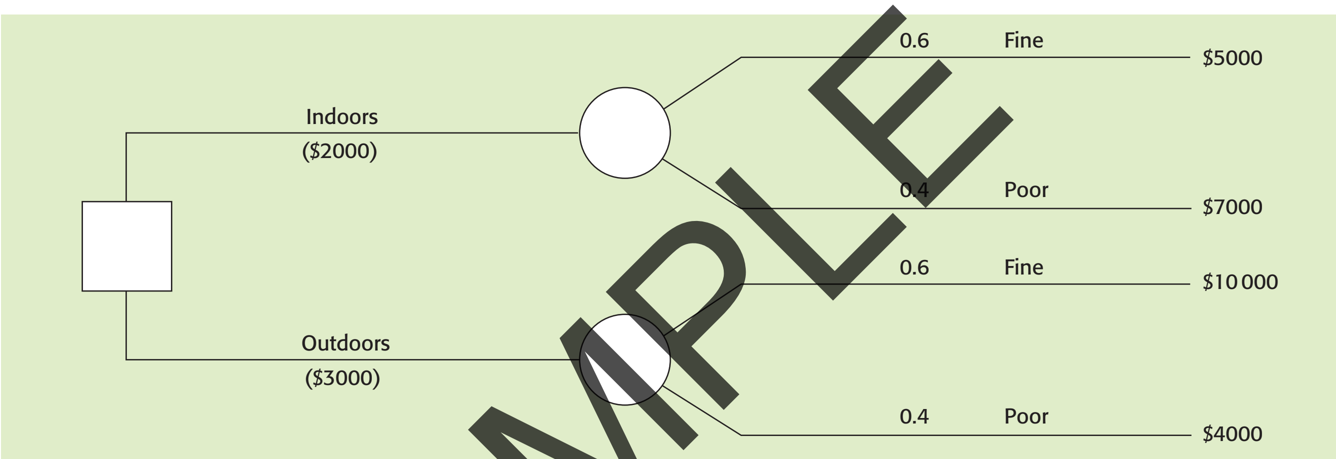


Figure 1.7.2 Decision tree for the fundraising auction

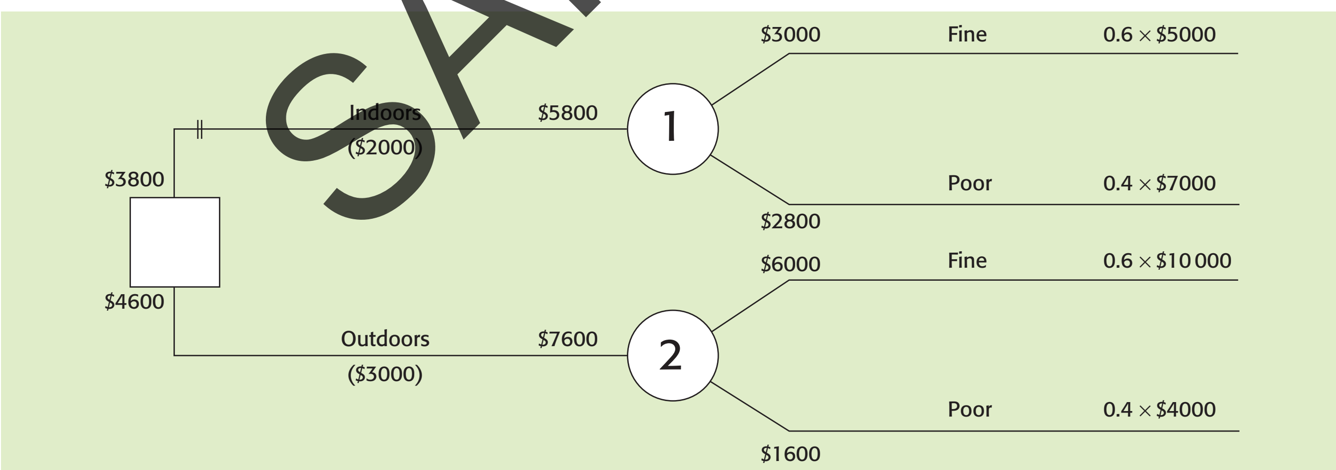


Figure 1.7.3 Calculating expected values – working from right to left

Using the tree diagram in Figure 1.7.3, which option would give the highest expected value – holding the event indoors or outdoors? The answer is gained by calculating the expected value at each of the chance nodes. This is done by multiplying the probability by the economic return of both outcomes and adding the results. The cost of each option is then subtracted from this expected value to find the net return.

This is done by working through the tree from right to left, as follows (see Figure 1.7.3):

- The expected value at node 1 is \$5800.
- The expected value at node 2 is \$7600.
- Subtract the cost of holding the event either indoors or outdoors.
- Indoors = \$5800 – \$2000 = \$3800
- Outdoors = \$7600 – \$3000 = \$4600

Therefore, the events manager would be advised to hold the event outdoors as, on average, this will give the highest expected value. The other option is 'blocked off' with a double line in the figure to indicate that this decision will not be taken.

THEORY OF KNOWLEDGE

Decision trees are fantastic as a mathematical model that gives the decision-maker a precise outcome on a decision at the mercy of future uncertainty. Where would you be without such mathematical models?

Consider the statement: Mathematical models enable us to make sense of future chaos. To what extent do you think this is true?

Decision trees – an evaluation

This technique has many benefits:

- It allows the visual representation of decisions and possible outcomes from them.
- It forces managers to consider not only the possible financial outcomes from a decision but also the likely chances of success or failure.
- The calculation of expected monetary values is a good starting point for the quantitative assessment of different options.

However, when decision-making is planned there are limitations to using decision trees too:

- The primary limitation concerns the accuracy of the data used. Estimated economic returns may be quite accurate when they concern projects where experience has been gained from similar decisions. In other cases, they may be based on forecasts of market demand or 'guestimates' of the most likely financial outcome. In these cases, the scope for inaccuracy of the data makes the results of decision-tree analysis a useful guide, but no more.
- The probabilities of events occurring may be based on past data, but circumstances may change. What was a successful launch of a new store last year may not be repeated in another location if the competition has opened a shop there first.

ACTIVITY 1.7.2

EXPANSION DECISION

The owner of a service station is planning to expand the business. The two options are to build a forecourt to sell petrol or to construct a showroom to sell cars. The estimated building costs are: petrol forecourt – \$100 000; car showroom – \$150 000. The forecast economic consequences or pay-offs during the expected lives of these investments will depend on the level of demand in the economy, as shown in the table below. The probability of demand being low during the lifespan of these investments is 0.2 and the probability of high demand is 0.8.