



Article: 134

**REVISION
NOTES SERIES**

A2⁹⁶⁰⁹ BUSINESS

Kashif Aziz



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UNIT 1

Business and Its Environment

A-II Level
Business
Teacher's Notes

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Syllabus 2019 –21

- 1.1: Enterprise
- 1.2: Business Structure
 - Local, national and multinational businesses
 - Multinationals
 - Privatisation
- 1.3: Size of business
 - External growth
- 1.4: Business Objectives
- 1.5: Stakeholders in a business
- 1.6: External influences on business activity
 - Political and legal
 - Economic constraints and enablers
 - Social
 - Technological (including the internet)
 - Other businesses
 - Demographic
 - Environmental



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UNIT-1 BUSINESS AND ITS ENVIRONMENT**1.1 Enterprise**

Economic sectors.

Levels of business activity: (As-level)

Primary sector	Secondary sector	Tertiary sector
Sector which will extract raw material from natural resources. In financial term it refers to the sector of an economy which makes direct use of natural resources. It includes the agriculture, forestry and fishing, mining, and extraction of oil and gas sectors.	That sector of an economy which will convert/process raw material into semi-finished or finished products. E.g. a sugar factory, textile unit etc. It is also known as the manufacturing sector.	A sector of economy which is involved in the production / provision of intangible products (services). This segment of the economy provides services to its consumers. It includes a wide range of businesses including financial institutions, schools, transports and restaurants. It is also known as "service industry/sector".

1.2 Business Structure

Organisation:

A group of people working together to achieve certain common objectives.

Limited Companies:

PVT. Ltd co.	PLC
1. Owned and controlled by the private sector.	2. It is also owned and controlled by the private sector.
2. Will only sell shares to friends and family members.	3. It will sell shares to outsiders/general public.
3. Are not registered in stock exchange.	4. Are registered in stock exchange.
4. Minimum 2 and maximum 50 shareholders.	5. Minimum 7 shareholders to start and maximum number will depend on the amount of the authorized share capital.
1. Divorce between ownership and control which means that all shareholders can not manage the business. they will have to elect a board of directors that will run company on their behalf.	6. Divorce between ownership and control which means that all shareholders can not manage the business. they will have to elect a board of directors that will run company on their behalf.
5. Management is conducted by a board of directors consisting of 2 directors.	7. Management is conducted by a board of directors consisting of 7 directors.
6. Are not required to publish accounts.	8. Are required to publish annual accounts.
7. Are likely to face less legal formalities. For example they do not need to publish their accounts.	9. Are likely to face more legal formalities. E.g. high tax rate.

Converting a partnership firm into a PVT. Ltd. Co.

Benefits:

1. Partner's liability will be limited.
2. More capital can be generated by selling shares (Max. 50 shareholders)
3. Business expansion could lead to economies of scale.
4. Profitability might also increase
5. Business might become more competitive

Draw Backs:

1. More legal formalities to be fulfilled.
2. Tax rate might also increase.
3. Divorce between ownership and control.

Converting private Ltd co. into a Plc (Nov 03 Q-6B)

Benefits:

1. Huge amount of capital can be raised by selling shares to general public.
2. Business scale could be expanded.
3. Might help to overcome financial problems.
4. Co. might become more competitive and it could ensure competition against multinational companies.
5. Greater level of economies of scale.
6. Could get in better position to satisfy stakeholders e.g. shareholders, workforce etc.

Draw Backs:

1. Legal formalities will increase. E.g. high tax rate.
2. Business will no longer remain a family business.
3. Will have to public important financial information. E.g. have to publish accounts.
4. Directors will no longer be independent to make decisions.

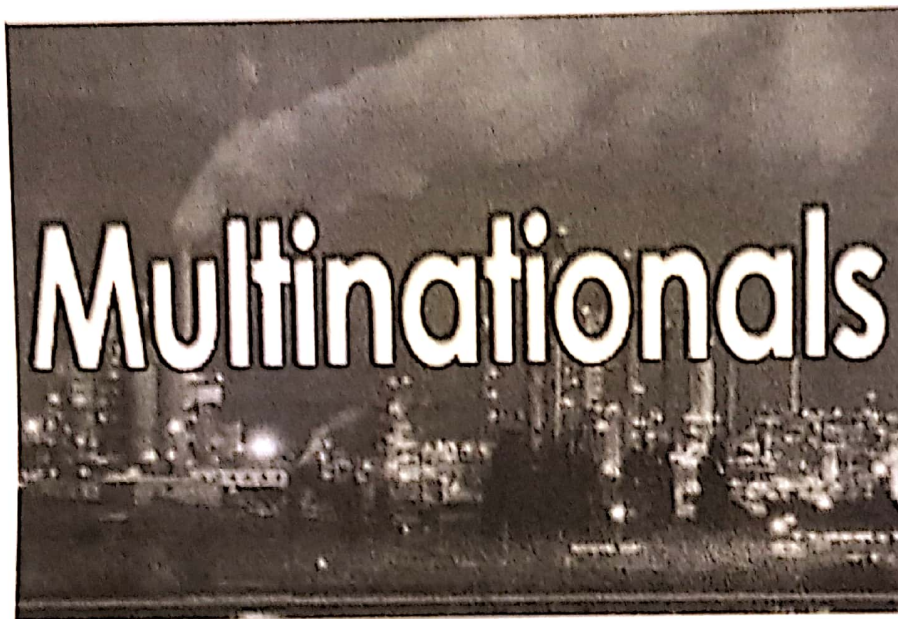
What is mean by Flotation?

The process in which a private limited company becomes a public limited company is called flotation. To become a plc, i.e. to float, a company must:

1. Produce a prospectus giving details about the company e.g. its activities and accounts.
2. Meet the requirements of the company acts and the stock exchange.

Problems of flotation:

1. Cost e.g. of lawyers, accountants, stock holders.
2. May not be able to sell shares at desired price.
3. Loss of control.
4. New owners may have different objectives.



1.2.1 Local, national and multinational business

Local businesses	National businesses	Multinationals
A local business is the one which will produce/provide goods and services for the local population. It could be in terms of a small business, or branch of a company operating in a local area. Local businesses are more likely to be independently owned and operated. Their owners have complete control over the business that might not be possible in case of franchise. Such businesses can cater needs of niche markets. For example, a small scale shoes manufacturer manufacturing shoes for disabled consumers. Normally such businesses do not aim business expansion and they operate in a smart or well defined part of the country.	National businesses are the ones who will sell their products throughout the country. For this they could setup multiple manufacturing units, a distribution channel including warehousing and privately owned delivery vehicles. They may also design appropriate marketing mix to achieve their marketing objectives. Since such businesses are likely to operate at a much larger scale as compared to local businesses so they may be able to enjoy economies of scale. Such businesses would not aim to establish businesses in other countries. Examples of such businesses could be Gourmet etc.	Such business which have their production units and operations (selling) in other countries as well apart from the country of their origin are known as multinational companies. For example, Apple, Sony, KFC, Pizza Hut etc. Such companies are likely to operate at a much larger scale and will produce and sell their products in other countries as well. They are likely to bring many benefits for host countries however there could be certain drawbacks of these as well. Note: Discussed below.

1.2.2 Multinationals

Multinational:

It is defined as a business organisation which has its production units and operations in other countries as well as in the country of its origin. For example, Sony, KFC etc.

International co:

Those companies which will produce goods in their own countries but will sell/export in foreign countries via agents or through any other suitable channel of distribution.

E.g. Royal fans or Shan spices sell their products in Middle East but they only produce in Pakistan.

Why Govt. might attract/encourage/support MNC's to locate in its country?

1. They are likely to create more employment opportunities. This will help to raise the standard of living of local population and crime rate might also decrease in country.
2. These companies will pay taxes to Government so it may increase its revenue. Such increased revenue might be used by Government on sectors such as health, education and infrastructure leading to better standard of living and increased business activity.
3. Since they are more likely to operate at a very large scale so there will be increased gross domestic product leading to faster economic growth.
4. For developing or underdeveloped countries they are of immense importance as they will bring in foreign investment in country which could result in exploration of resources and increased economic activity.
5. They are likely to bring in latest technology in country which will raise quality standard and consumers will get more variety of products. This will also lead to improvement in living standards and secondly increased competition might lead to reduction in price level and domestic firms might be forced to raise their quality standards as well.
6. Multinationals will hire local labor (low wage cost) and they will also train them to operate technology. Such training will result in human resource development. This will create new job opportunities for labor in foreign countries and apart from this well trained human resource might also attract other multinationals to locate in country.
7. Since quality standards of products will improve so they will be able to compete more effectively in international markets resulting into high demand. Increase in exports could help to improve balance of trade of country.
8. Improvement in standard of living as earning of employees will increase and consumers will get better products at reasonable price.
9. There will be improvement in relations between countries as their economic interest shall be mutual. For example, due to China Pakistan economic corridor Pakistan's relations have improved with China as now Chinese security forces are also concerned about the security of Gwadar sea port.
10. Since goods will be locally produced so this could result in reduction in imports of country resulting into improvement in balance of payment.

Why government might be reluctant to allow multinationals to locate in its country?

1. Domestic companies might suffer as their (MNC'S) products might be technologically advanced. For example Japanese refurbished cars imported in Pakistan have better technology as compared to locally produced cars.
2. They have been found guilty of exploiting employees, as they make them work overtime without any extra payment and even in poor working conditions (*sweatshop).
3. They may exploit consumers when they get stable. For example they may charge high price due lack of domestic competitors or create artificial shortage to charge high price.
4. National economy gets dependent on multinationals.
5. They will produce luxuries and will advertise extensively, it may lead to inflation.
6. They will go for Mass production and this could result in increased social costs e.g. environmental pollution.
7. They may pressurize government and try to dictate their own terms.

8. Profits might be sent back to country where the head office is based. This could result in outflow of foreign exchange that might not be desirable from Government point of view.
- *Sweatshop:** a factory or workshop, especially in the clothing industry, where manual workers are employed at very low wages for long hours and under poor conditions.

Why companies might prefer to become a multinational company?

1. They might be able to save transportation cost as they might get near to their target market. For example Apple gets its iphones assembled in china and exports to neighbouring countries.
2. Skilled and economical labor might attract them to locate in foreign countries. For example in case of Apple it thinks that Chinese labor is both economical and skilled to assemble iphones.
3. There might be economical and quality raw material available in foreign countries.
4. There might be lesser overhead costs. E.g. cost of land, labor, tax rate etc.
5. There might be favorable government. policies. E.g. relaxation in tax rate etc.
6. To avoid import restrictions that might have been imposed by the government of host country.

Problems companies might face by becoming multinational:

1. They would need huge initial investment. E.g. setting up cost etc.
2. Risk factor will increase as there will be huge investment and threat of competition from domestic companies.
3. They might not be well aware of foreign conditions. E.g. language and cultural differences, in order to overcome this problem they may have to allocate huge market research budget.
4. They might find it difficult to manage operation at such a large scale. For example managerial diseconomies of scale.
5. Poor communication and coordination with headquarters might lead to misunderstanding, poor decision making etc.
6. Foreign labor might lack in skills, so company might have to allocate huge budget for training & development.
7. Unpredictable policies of foreign government could lead to uncertainty.



1.2.3 Privatisation

When Govt. decides to sell its state owned industries to the private sector then this process is known as privatisation. E.g. Pakistan government sold PTCL to ETISALAT.

Reasons for privatisation:

1. If they are constantly going in loss. For example, steel mills and PIA in Pakistan.
2. If government does not have time to manage these organisations.
3. If government cannot afford to fund these organisations anymore (due to lack of financial resources).
4. If government thinks that private sector can run these organisation more effectively/efficiently. For example, PTCL.
5. If government wants to raise the confidence level of private sector to invest more in economy then it might sell its state owned organisations to show its intentions of not getting involved into commercial activities.

Arguments:

In Favor	Against
1. Enables Govt. to generate funds which can be used for foreign debt repayment or infrastructure development. 2. More employment opportunities, since private sector is likely to work at very large scale. 3. More variety of goods as private sector will produce wide range in order to stay competitive. 4. Increased revenue in terms of tax collection. As when private sector will operate these organisations then it will pay taxes to government. 5. Reduces work burden of Govt. it can spend more time on policy making and foreign affairs. 6. increased rate of economic growth, as private sector will go for mass production. (Increased GDP). 7. Private sector firms might target foreign markets which might help to increase exports. 8. Private sector is likely to spend more on research & development, so their product quality might improve and this could raise standard of living of consumers. 9. Private sector firms might pay higher salaries and provide better working conditions, this could help to raise standard of living of employees. 10. This will raise confidence level of private sector and more private sector firms might decide to start business in the country.	1. Govt. might lose control over strategic/important organisations. E.g. K.electric (Karachi) 2. Private sector will increase price to become profitable, products may not remain affordable for poor people. E.g. public hospitals. 3. In order to become cost effective, management might announce redundancies which could increase un-employment. 4. Private sector will go for mass production and cause more social costs. 5. They might attempt to exploit consumers, if will be in a dominating position. 6. Govt. might have to face criticism from opposition parties which could de-stabilise Govt. hence shaking the confidence level of private sector companies.

1.3 Size of Business

1.3.1 External Growth

External growth:

This method of growth will require much larger sums of money as compared to internal/organic growth. It takes place through the use of mergers and takeovers (often known as growth through amalgamation, or simply integration).

Integration:

It is a form of external growth. It occurs when two or more businesses join together. This might be through merger or a takeover.

Methods of external growth:

1. Mergers
2. Take overs

Merger:

In general,

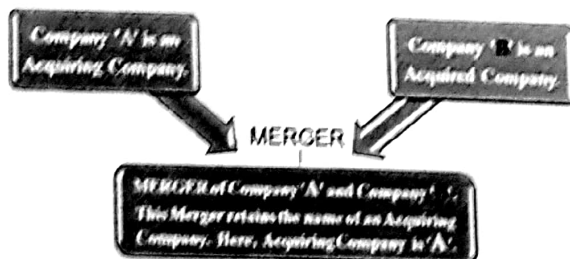
A merger is when two businesses decide to get together with the consent of each other. (Shareholders and directors).

In accounting,

"A merger is an act or process of purchasing equity shares (ownership shares) of one or more companies by a single existing company".

Merger is a technique of business growth. It is not treated as a business combination. Merger is done on permanent basis. Generally, it is done between two companies. However, it can be done among more than two companies. After merger, acquiring company and acquired companies come together to decide and execute a merger agreement between them. After merger, acquiring company survives whereas acquired companies do not survive any more, and they cease (stop) to exist. Merger does not result in the formation of a new company. The management acquiring company continues to lead (direct) the merger.

Example of MERGER



Types of mergers:

Horizontal merger:

The purchase by a company of a competitor or of a company dealing in similar products or services.

When two or more companies working in the same industry decide to get together with the consent of each other then it is known as a horizontal merger.

E.g. NIB bank Ltd. Merged with PICIC and PICIC commercial bank on 31st December, 2007.

Possible reasons /Objectives of horizontal mergers:

- 1 To reduce competition as one competitor will be eliminated as a result of merger.
- 2 To improve financial resources as they will use fund mutually.
- 3 To use mutual expertise to make business more successful (Synergistic effect).
- 4 To compete with large scale competitors in a more competitive manner.
- 5 To ensure survival. (In case of economic recession small firms might merge with large scale firms to ensure survival).
- 6 To achieve economies of scale.
- 7 To expand target market.

Horizontal merger- advantages & disadvantages:

advantages:	disadvantages
1. Businesses can achieve greater economies of scale. 2. Increase in market share. 3. Can become in a dominating position in the market. 4. Reduction in average cost as a result of rationalisation. 5. Increased power over suppliers.	1. Average cost might increase if company is too large and experiencing dis-economies of scale. 2. Clash of culture as businesses that are going to merge might have been operating using different leadership style. 3. There is initially likely to be some extra cost involved in seeking to harmonise for instance wage rates and accounting systems in two companies. 4. It may lead to monopoly, eventually resulting in consumer exploitation.

Vertical Merger:

When companies operating at a different stage of production in the same industry decide to merge, then such an arrangement is known as vertical merger

E.g. A car manufacturing Co. might merge with a tires manufacturing Co.

Types of vertical mergers**Vertical forward merger:**

A company will merge with another co. which might be working in an advanced stage. E.g. for tire manufacturing co. it will be a forward merger.

Vertical backward merger:

Co. will merge with another co. which might be working at the previous stage of production. E.g. for car manufacturer it will be a vertical back ward merger.

Reasons for Vertical Mergers:

1. To ensure timely supply of inputs/reduction in lead time.
2. To ensure standardised quality of inputs.
3. To reduce cost of supplies as retailer's profit margin will be eliminated.
4. To get a competitive advantage over competitors.

Vertical merger- advantages & disadvantages:

advantages:	disadvantages
1. Reduction in cost of inputs. E.g. material. 2. Better control over supplies. 3. Quality of products can be improved further. 4. Might result in maximum consumer satisfaction. (Due to improved quality). 5. Increase entry barriers to potential competitors, for example, if the firm can gain sole access to a scarce resource. 6. Leads to expansion of core competencies.	1. Capacity balancing issues. E.g. firm may need to build excess upstream capacity to ensure that its downstream operations have sufficient supply under all demand conditions. 2. potentially higher costs due to low efficiencies resulting from lack of supplier competition. 3. Decreases ability to increase product variety if significant in-house development is required. 4. Developing new core competencies may compromise existing competencies. 5. Increased bureaucratic costs.

Conglomerate merger:

When two companies having no common business but decides to pool resources for some other reason, the deal is called conglomerate merger. It is also known as lateral merger.

Examples:

A shoe manufacturer buys a biscuit producing business.

Or.

Procter & Gamble (NYSE:PG), a consumer good company, engaged in just such a transaction with its 2005 merger with Gillette. At the time, Procter & Gamble was largely absent from the men's personal care market, a sector led by Gillette. The company's product portfolio was complimentary, however, and the merger created one of the world's biggest consumer product companies.

Takeover:

It is also known as acquisition. It is the buying of one company (the 'target') by another.

Or.

If a business buys controlling shares of another business to exert its control then such an arrangement is known as a takeover.

Examples:

- ✓ In year 2015 PARCO (TOTAL) took over Caltex in Pakistan.
- ✓ In year 2015 Qubee took over Wateen telecom's internet services.
- ✓ In September, 2013 Micro soft took over Nokia for \$7.6billion.
- ✓ In year 2013 Habib bank limited (HBL) in Pakistan took over CITI bank's (Pakistan's operations) consumers business portfolio comprising credit card business, auto financing and personal loans.
- ✓ In Pakistan Metro cash and carry took over Makro cash and carry.

Difference b/w merger and takeover (acquisition):

Merger	takeover(acquisition)
1. Two firms are combined on a relatively co-equal basis. 2. Parent stocks/shares are usually retired and new stocks/shares are issued. 3. Name may be the original or a combination. 4. One of the partners takes over the dominant management.	1. One firm buys another firm. 2. It can be by means of controlling share, a majority or all of the target firm's stock. 3. It can be friendly or hostile. 4. It is usually done through a tender offer.

Friendly takeovers:

In a friendly take-over, the bidder informs the company's board of directors before making an offer for acquiring its shares. Deal will be finalized by the management of both businesses.
E.g. In year 2013 Habib bank limited (HBL) in Pakistan took over CITI bank's (Pakistan's operations) consumers business portfolio comprising credit card business, auto financing and personal loans.

Hostile takeover:

A take-over is considered hostile if:

1. The board rejects the offer but the bidder continues to pursue it, or
2. The bidder makes the offer without informing the board before hand.

For example, Micro soft attempted to takeover yahoo in early 2008.

Takeover/Acquisition- advantages & disadvantages:

advantages:	disadvantages
1. Brand awareness increases as the business expands, allowing more advertising, products and services. 2. It enables to speedily acquire resources and competencies. 3. It allows entry in new products and markets. Risk of new product development decreases. 4. Acquiring company might also gain market power. 5. Acquiring company might overcome market barrier by acquiring an existing organisation. The risk of competitive reactions decreases. 6. Organisation with low share value or low price earning ratio can be acquired to take short term gains through assets stripping..	1. The bigger the business the harder to control. 2. More decision making and high risk. 3. More expensive e.g. more running costs, more demand, more supplies, more products need to be made, new location. 4. Acquiring company usually have to pay a premium/goodwill to take over other business, this means the bidding firm has to earn higher profits to cover initial costs. 5. There might be a clash of culture as now two businesses will work under the same management and there might be different management policies or different leadership style. 6. Diseconomies of scale might occur. E.g. coordination and control.

Assets stripping:

In this acquiring company will buy an undervalued company not for operating it but to sell its assets individually later on at high profit. The individual assets of the company, such as its equipment and property, may be more valuable than the company as whole due to such factors as poor management and poor economic conditions.

Retrenchment:

When a firm decides to withdraw from certain products or markets to focus on its key operation, which might be more profitable and successful.

Synergy:

The concept that the value and performance of two companies combined will be greater than the sum of the separate individual parts. Synergy is a term that is most commonly used in the context of mergers and acquisitions. Synergy, or the potential financial benefit achieved through the combining of companies, is often a driving force behind a merger. Shareholders will benefit if a company's post merger share price increases due to the synergistic effect of the deal. The expected synergy achieved through the merger can be attributed to various factors, such as increased revenues, combined talent and technology, or cost reduction.

Management buy-outs:

When management team in a business becomes the owner, usually by buying the shares from its existing owners. It would raise the finance itself from banks and other institutions.

Management buy-ins:

When an outside management team takes over a business. It normally happens in case of family owned businesses with no clear line of succession when the head of the family retires. One example was F & AE Lodge, a Huddersfield based supermarket chain. Edward Lodge the chairman sold the business to a group of outside managers when the Lodge family decided to retire.

Holding company:

A company that owns enough voting shares/stock in another company to control its board of directors. (And, therefore, controls its policies and management).

E.g. ABC. Limited company owns 60% shares of XYZ. limited company. In this case ABC limited company will be the holding company.

Subsidiary company:

A subsidiary or sister company is a company that is completely or partly owned and partly of wholly controlled by another company that owns more than half of its shares/stock. In some cases it is a government or state owned enterprise. The controlling company is known as holding/parent company.

E.g. ABC. Limited company owns 60% shares of XYZ. limited company. In this case XYZ limited company will be the subsidiary company.

Group companies:

A holding/parent company and all of its subsidiary/sister companies are collectively known as group companies.

Joint ventures

A partnership agreement between two or more than two businesses according to which these businesses decide to carry on a project by sharing their resources. They will share profits and losses in the agreed ratio. They might create a separate division for this project.

Example:

Al Ghurair Giga Pakistan (Private) Ltd is a joint venture between two of the UAE's largest business conglomerates, the Al Ghurair Group and the Giga Group. Involved in projects concerning Real Estate, Banking, Textiles and Gold Refining, they have built a reputation based on the trust of their clients by delivering projects of Sustainable developments of distinction within budget and on time.

Benefits of joint ventures:

1. Businesses can use their mutual expertise to make project more successful.
2. Risk sharing.
3. Foreign companies might be able to avoid barriers to entry imposed by govt.
4. They might be able to reduce cost of production.
5. Might enable them to achieve economies of scale as they will operate at large scale.
6. Enables to access new technology and customers.

Problems of joint ventures:

Partnering with other business can be complex. It takes time and effort to build the right relationship. Problems are likely to arise if:

1. The objectives of venture are not 100% clear and communicated to everyone involved.
2. Partners have different objectives for the joint venture.
3. There is an imbalance in level of expertise, investment or assets brought into the venture by different partners.
4. There might be a clash of culture and management styles which may affect the level of success.
5. The business failure of one of the partners would put the whole project at risk.

Business growth:

Advantages	Disadvantages/problems
1. Economies of scale. 2. More competitiveness. 3. More variety of goods. 4. Better quality standards. 5. Expansion of target market. 6. More promotional budget could lead to increased market share.	1. Could lead to diseconomies of scale. 2. More taxes to be paid. 3. Threat of competition from large scale firms. 4. High risk factor.

External economies of scale: (A2-topic)

External economies of scale are going to be for the whole industry not just for a business. They are not related with the ability, skill, management, education and experience neither these are linked with a specific business. These economies arise due to the expansion of the industry as a whole. When industry is going to expand machinery and raw material will be available to all the firms at cheaper rates. Better means of communication and transportation will also be available.

Trained labor and facility of workshops (ancillary services) will also be available. By product industries, helping industries and research centres will be established. Entry of the new firms enables the firms to produce their output at lower cost.

Types of external economies of scale:

External economies of scale could be:

1 Transportation and communication:

When numbers of firms in an industry are going to increase then service provider firm will provide better communication systems to all of them. Rail, road facilities will become available to all. The advanced transportation system might also reduce cost of transportation.

2 Skilled labor:

When no. of firms are going to increase then it means more employment opportunities will be created and local labor will get more jobs. These firms will train them and such labor might be appointed on daily wages basis hence their skills will improve and in future new firms might get skilled labor without training cost.

3 Facility of workshop:

Due to increased number of firms, demand for workshops will increase for repair & maintenance. This will result in an incentive for technical persons to establish their workshops and hence, all the firms will benefit from these, because they will not be needed to establish their own workshops.

4 Helping industry:

This economy arises because of concentration of firms. In local industry, it becomes possible to split up some of the process, which is taken over by specialist firms. E.g. in Faisalabad with the textile mills dying factories, designing centres, ginning factories and calendaring plants have been established.

5 Banking facilities:

The basic aim of a commercial bank is to maximize profits and for this, they need deposits to provide credit to businesses. In a localized industry or business centers bank opens their branches and all the firms benefit from banks and credit facility. The improvement in banking system help to improve trade and industry.

6 Training courses in local educational institutions:

When number of firms is going to grow in an industry then they will be needed to train their executives. This will encourage educational institutions and other training centres to start training courses. In this case, individual business might not be needed to arrange their training program, as they will send their executives there. E.g., LUMS arranges training courses for business executives on regular basis.

(A level business studies notes by Sir Kashif Aziz for academic session 2016-18).

Diseconomies of scale:

Business growth is not going to be without problems. Apart from having above-mentioned benefits of growth, business might also have to face some problems, which could result in an increase in average cost or in certain non-financial problems. These are termed as "diseconomies of scale". These diseconomies of scale could be:

1 Human relation problems:

When a business is going to expand then it will need more employees. In such a situation, it might get difficult to manage such a large number of workers. In order to manage employees business might have to appoint new managers, which might result in increased fixed cost. Apart from this chain of command will be long and communication gap between management and workers will increase that could lead to misunderstanding eventually resulting into conflicts.

2 External diseconomies:

Increased influence of media and pressure groups has increased awareness of society and consumers about environmental issues. Now these stakeholders are quite concerned about environmental issues. In developed countries, consumers are even going to boycott products of those companies, which are going to cause environmental pollution. Keeping this in mind companies will have to take steps to reduce environmental pollution e.g. waste disposal. This could result in increase in average cost.

Demerger:

In this, a single business is broken into components, either to operate their own, to be sold or to be dissolved. De-merger allows large business such as conglomerate, to split off its various brands to invite or prevent an acquisition, to raise capital by selling off components that are longer part of the business's core product line, or to create separate legal entities to handle different operations.

Demerger-Reasons:

Positive reasons	Negative reasons
1. To focus more on core business operations.	1. To eliminate a loss making or low profitable project/division.
2. Due to lack of synergy between the subsidiary and the core business.	2. To remove a division with low prospects of growth in future.
3. In order to generate finance for core business activities.	3. If business does not have funds to invest in some project.
4. Asset stripping (Business might sell its individual assets at high price).	



1.4 Business Objectives

Objectives:

"Objectives are statements of specific outcomes that are to be achieved".

or

"A specific result that a person or system aims to achieve within a time frame and with available resources".

Objectives are more specific and easier to measure than goals. Objectives are basic tools that underline all planning and strategic activities. They serve as the basis for creating policy and evaluating performance. Some examples of business objectives include minimizing expenses, expanding internationally, or making a profit.

Difference between goal, aim and objective:

Goal	Aim	Objective
A goal is a desired result that a person wishes to achieve. It is a target that a person wants to reach. It is an end point where a person/business sees itself after a certain period of time.	Aim is setting a determined course in order to achieve a set target. Aims are usually long term. Aims can be called as long term goals. Aims determine a set course or a target at the end that a person wants to reach. Objective is actually a part of goal.	Objectives are more concrete and are clearly defined by certain steps that will eventually allow the person/business to fulfill that particular objective. Objectives are often short term and have a limited amount of time frame.

Qualities of business objectives:

Objectives of a business must be 'SMART'.

Specific:

It must set out that what is expected to be achieved.

Measurable:

At the end business should be able to determine that how much it has achieved.

Agreed:

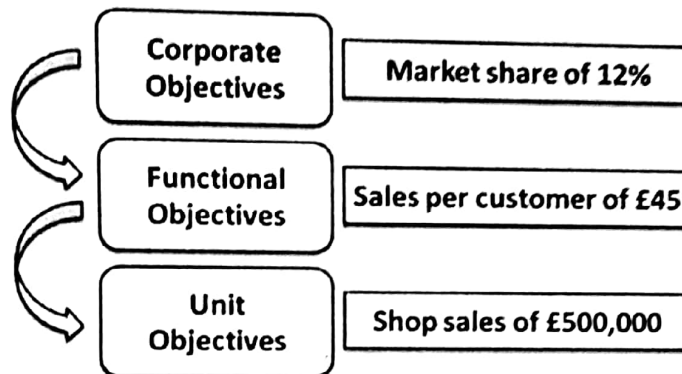
All parties/individuals involved must agree on objectives/targets.

Realistic:

They must be achievable, otherwise they might lead to de-motivation of staff.

Time specific:

They must have time limit in which they should be achieved.

Hierarchy of objectives:**What is a mission statement?**

A statement in which a business will write down all fundamental objectives of its formation. It will be displayed at prominent places in the organisation. It will keep on reminding employees about the expectations of their employer.

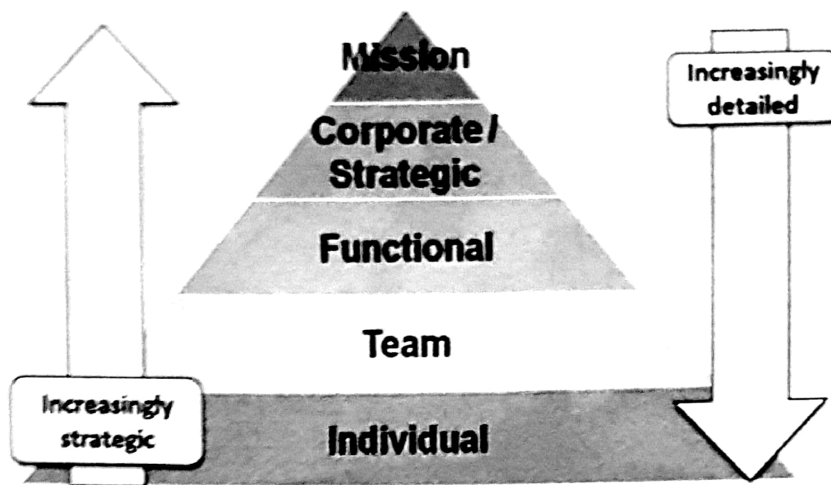
Creating a mission statement is one of the first actions an organisation should take. The mission statement can be the foundation stone of an overall strategy and then be followed through into the development of more specific functional strategies. By defining a mission an organisation is making a clear statement of its purpose.

"A good mission statement captures an organisation's unique and enduring reason for being, and energises stakeholders to pursue common goals. It also enables a focused allocation of organisational resources because it compels a firm to address some tough questions: What is our business? Why do we exist? What are we trying to accomplish?" (Bart, 1998)

Example Mission Statements

Coca Cola -Everything we do is inspired by our enduring mission:

- ✓ To Refresh the World... in body, mind, and spirit.
- ✓ To Inspire Moments of Optimism... through our brands and our actions.
- ✓ To Create Value and Make a Difference everywhere we engage.

The hierarchy of setting objectives:**Importance of having clear objectives:**

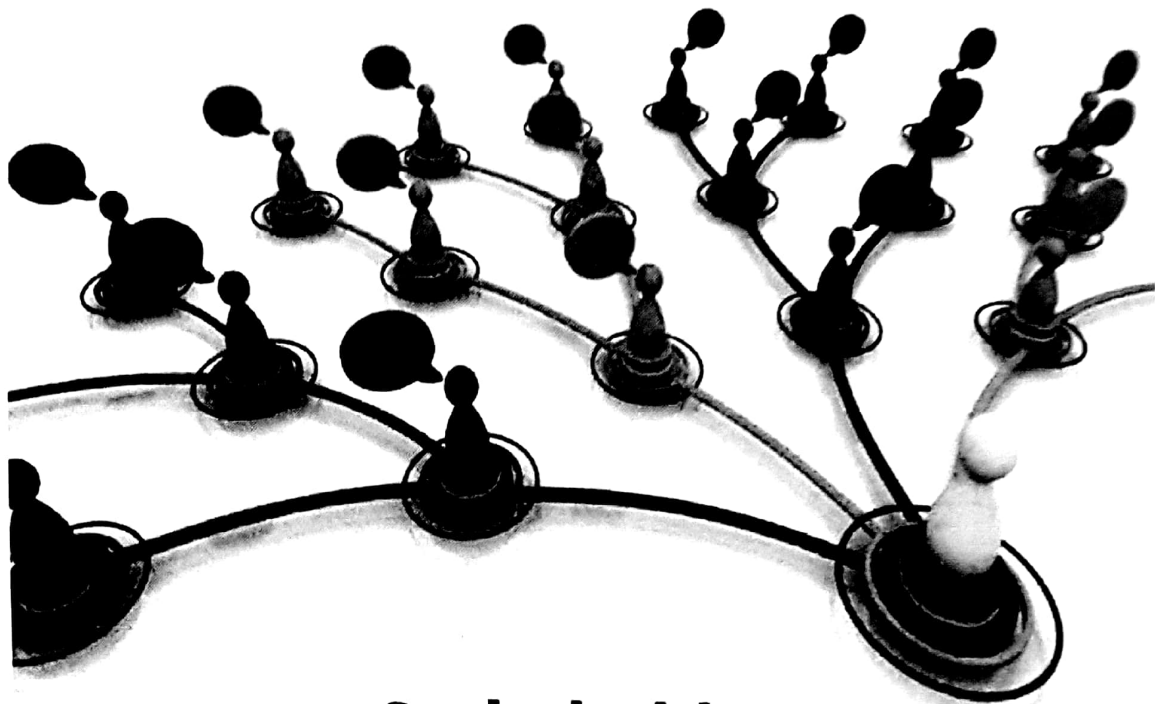
1. Enables management to communicate employees what it expects them to achieve.
2. Gives a clear guide line to employees that what they are supposed to achieve.
3. Provides a base of evaluating performance of different employees. for example if employees will be able to achieve objectives then management will consider them efficient employees or vice versa.
4. Target setting might help to raise level of motivation of employees. For example according to McGregor group 'Y' managers believe that employees respond positively when they are given targets.
5. Organisational resources shall be allocated accordingly hence decreasing the chances of wastage.

Objectives of a private sector business organisatoin:

1. Achieving maximization of consumer satisfaction.
2. To maximise profit.
3. To increase market share.
4. Business expansion/growth.
5. Survival. (during economic recession or during tough competition)
6. Produce quality products.
7. Produce a variety of products to target multiple market segments.
8. To create brand loyalty.
9. To improve company's image.
10. To have a highly motivated and well trained workforce.
11. Be a responsible corporate citizen and minimise social costs. E.g. environmental pollution.
12. Share success with society and provide them some social benefits. E.g. Trust hospital, school etc.
13. Help Govt. in achieving its economic growth targets. E.g. by increasing exports.
14. To meet competition effectively.
15. To achieve economies of scale.

What stops firm to achieve its objectives?

1. Business might not be able to design an appropriate strategy to achieve its objectives.
2. It might not be able to manage and implement its strategy properly to achieve objectives.
3. Competitors might adopt aggressive strategy against co. e.g. they might enter into price war.
4. There might be some economic fluctuations. E.g. economic recession might not enable co. to achieve high market share.
5. Shift in consumer trends could also influence success level of the co.
6. Internal environmental factors e.g. industrial relations, lack of skills of employees might not enable it to achieve desired objectives.



Stakeholders

1.5 Stakeholders in a Business

Stake holders:

All those individuals, groups or organisations who might be having any interest in the business or they might be effected due to the operations of business. This interest of stakeholders is not necessary to be a financial interest. Their interest could be a direct or indirect interest. They will be able to influence decisions of an organisation. A business organisation is required to satisfy their interest both from legal and ethical point of view.

Types of stakeholders:

Internal	External
1. Owners/share holders 2. managers 3. employees	1. Government 2. Consumers 3. Competitors 4. Suppliers 5. Banks 6. Local community 7. Media

Owners/share holders:

1. Achieve maximum level of consumer satisfaction.
2. Profit maximisation.
3. Business growth.
4. Be the market leader/ achieve maximum market share.
5. To create brand loyalty.
6. To have a good reputation in the market.
7. To be a responsible corporate citizen and minimise social costs.
8. Achieve economies of scale.

Managers:

1. Empowerment
2. Career growth opportunities
3. Training opportunities
4. Business growth
5. More salaries and fringe benefits

Employees:

1. Democratic style of leadership.
2. Good working conditions.
3. Reasonable salary and fringe benefits.
4. Job safety (contract).
5. Training opportunities.
6. Business must follow health & safety laws.

External stake holders:**Government:**

1. Should pay due taxes.
2. Should provide maximum job opportunities.
3. Must follow laws.
4. Maximum exports.
5. Minimum social costs.
6. Maximum social benefits.
7. No consumer/employees exploitation.

Consumers:

1. Business must offer quality products.
2. Reasonable price.
3. Maximum variety.
4. More after sales services.
5. Must have good reputation and use environmentally friendly techniques of production.

Competitors:

1. Must not enter into price war.
2. Have better cooperation and understanding so that they can respond collectively to common threats.
E.g. high tax from govt.
3. Have access to publish accounts to conduct financial analysis.
4. Have information regarding future plans of competitors to design its own strategy.

Suppliers:

1. Must be a loyal customer.
2. Must buy in bulk.
3. Must demand minimum credit time.
4. Must allow proper time for delivery of goods.
5. Must not default.

Banks:

1. Must get loans
2. Must maintain accounts with the bank
3. Must make regular payment of loan installments
4. Must be a highly profitable business so that bank can also invest
5. Must also use other banking services e.g. bank draft, letter of credit etc.

Local community:

1. Must provide job opportunities to local community
2. Minimum social cost
3. Maximum social benefits
4. Business must be successful so that value of real estate can increase
5. Must provide training opportunities to youngsters so that their career growth chances can increase

Media:

Must give advertising orders

1. Have access to financial reports of business
2. Should not exploit consumers/employees
3. Must follow laws
4. Its executives must participate in programs of media

1.6 External Influences on Business Activity

External influences on business activity

1.6.1 Political and Legal

The impact of the government and law on business activity

Government is responsible to govern the economy. In order to ensure this government will introduce laws that might constrain decisions and activities of a business organisation. Such government laws fall into the following main categories:

1. Employment practices and conditions of work.
2. Marketing behaviour and consumer rights.
3. Business competition.
4. Location of business.

Employment practices and conditions of work:

Such laws are intended to control relationship between employer and employees. Two main objectives of such laws could be:

1. To prevent employees exploitation by the employer. In this regard, government might set minimum level of health & safety and minimum wage rates.
2. To control excessive use of trade union collective action, for example, strike etc.

Legal constraints usually cover the following areas of employment practices:

- Recruitment, employment contracts and termination of employment.
- Health and safety at work.
- Minimum wages.
- Trade union rights and responsibilities.

Recruitment, employment contracts and termination of employment:

Such laws are intended to protect employees. In this government will pass laws regarding contract of employment, its contents. Such employment contract will create a sense of security among employees as all terms & condition will be documented and in case of violation of any clause employee will be able to provide the evidence. Apart from this other laws might be related to holidays and pension entitlements, minimum wage rate, length of working hours etc. Such legislation will also help to protect discrimination against people during recruitment and selection or while at work on the grounds of race, colour, gender or religion. Government will also try to protect employees against unfair dismissal or redundancies. For example, in EU countries large-scale redundancies have to be discussed with the trade union leaders and with work councils before the court will accept the legality of action. In the same way in case of unfair dismissal, if employee is able to prove that his/her dismissal has been unfair then employer will have to reinstate that employee on his/her job and apart from this, he will have to pay compensation to employee.

Health and safety laws:

Government will also pass health and safety laws. Such laws are intended to protect workers from discomfort physical injury at work. Employees have a right to work in a safe and healthy environment. Providing health and safe environment is a legal responsibility of employer. However, strictness of laws and the efficiency of inspection systems might vary considerably in different countries.

Health and safety laws usually require business to:

- Equip their factories and offices with safety equipment to avoid accidents.
- Providing proper washing and toilet facilities.
- Provide protection from dangerous machinery and material.
- Give adequate breaks and maintain certain workplace temperatures.

Evaluating impact of employment and health & safety laws on businesses:

1. Cost of businesses will increase. For example, supervisory cost etc.
2. Business might have to pay higher wages if it was paying below minimum wage rate currently.

3. Business might have to bear higher costs from giving paid holidays, pension contributions and paid leave for sickness, maternity and paternity leave.
4. In order to ensure that workers will work for standardised hour's business will have to hire additional staff. This could also lead to increased cost.
5. Business might also have to incur expenditure to provide protective clothing and equipment to meet health and safety laws.

Consumer protection laws and marketing behaviour:

Such legislation is made with a view to protect consumers from unfair practices of sellers. Consumer rights and consumer protection law provides a way for individuals to fight back against abusive business practices. Such laws are designed with a view to hold sellers accountable when they seek to profit by taking advantage of a consumer's lack of information or bargaining power. Consumer right laws exist at the provincial and federal level. They enforced by the government agencies, officers of attorneys general, and through individual and class action lawsuits filed by victims.

Importance/needs of consumer protection:

Protection from exploitation:

Such laws are important, as they will help to protect consumers from exploitation. In the absence of consumer protection, consumers might be exploited in many ways e.g. sale of unsafe products, hoarding of goods, using wrong weights and measures etc. when such laws are passed so businesses are under pressure to keep away from exploiting consumers.

Consumer education:

It is also very important to provide education to consumers regarding their rights, responsibilities etc. this could be achieved by organising workshops and seminars. Such activities will give them confidence to take legal action against companies who they are exploiting them.

Redressal of complaints:

The importance of consumer protection is to present the consumer complaints in appropriate consumer courts and make sure that they will get justice from such courts.

Bulletins and periodicals:

It is also important that in order to create consumer awareness about their rights and responsibilities various journals and periodicals can be published. In this wide publicity might be given against unfair trade practices of different business organisations. It will help to increase pressure on such businesses and will help to ensure that they will give fair treatment to consumers.

Encouraging honest businesses:

It is also very important that we must give credit and appreciate those businesses that are operating honestly. We must publish favourable reports in periodicals and journals about them. This will encourage other businesses as well to adopt honest approach.

The law and business competition:

Free and fair competition among businesses must be ensured. This will bring in following benefits for consumers:

1. There will be wider choice for consumers.
2. Keeping in mind competition businesses will keep their price competitive.
3. Quality standards of businesses will improve, as they will aim to gain more market share by using this strategy.

What governments can do?

Governments can attempt to encourage and promote competition between businesses by passing laws that:

1. Investigate and control monopolies and make it possible to prevent mergers.
2. Limit or outlaw uncompetitive practices between firms.

Monopolies:

It is a market situation in which one producer (or a group of producers acting in concert) control supply of goods and services, and where the entry of new producers is prevented or highly restricted. Monopolist firms (in their attempt to maximise profits) keep the price high and restrict output, and show little or no responsiveness to the needs of their customers. Most governments therefore try to control monopolies

by:

1. Imposing price controls.
2. By nationalising such organisations.
3. By breaking them up into two or more competing firms.

How do monopolies develop?

Monopolies can develop due to a variety of reasons:

1. If a firm has exclusive ownership of a scarce resource. For example, Microsoft has the ownership of the Windows operating system brand. It has monopoly power over this resource as it is the only firm that can exploit it.
2. Some industries may have legal protection from government. For example, a government may choose to protect its country's postal service by giving it a legal monopoly for the delivery of letters.
3. Producers may have patents over designs, or copyright over ideas, characters, images, sounds or names, giving them exclusive rights to sell a good or service, such as a song writer having a monopoly over their own material.
4. Merging or taking over other firms in industry.

How are consumers affected by monopolies?

There could be both benefits and drawbacks of monopolies for consumers. These could be:

Benefits	Drawbacks
1. Lower prices if large-scale production by a monopolist reduces average cost of production. 2. Increased output will lead to a decrease in average cost of production. These can be passed onto consumer in terms of low price. 3. Monopolies can make supernormal profit. This can be used by businesses to increase research and development budget and at the same time, they may invest in technology. This will help to improve quality standards of product and variety for consumers.	1. Since there will be less competition so business may not concentrate more on quality so consumers may get poor quality of products. 2. Consumers might be exploited by business by charging high price for product. 3. Monopoly firms are also sometimes known for practicing price discrimination where they charge different prices on the same product for different consumers.

External economic influences on business behavior

1.6.2 Economic Constraints and Enablers

Possible economic objectives of Government:

Every government will set target for the whole economy. Such objectives are referred as 'macroeconomic' objectives. Every government would wish that economy of its country must grow so that its tax collection can be increased along with rate of employment and improvement in standard of living of people. These possible objectives could be:

1. To ensure that more employment opportunities will be created in economy. This will help government to ensure that purchasing power of people will increase that could lead to improvement in their living standards, crime rate in society will decrease and government's tax collection will also increase.
2. To raise the rate of economic growth of country. Mass production must be done by businesses operating in the country which will help to improve gross domestic product (GDP). This will be a positive indicator for government as it will encourage foreign investment; its tax collection will increase and at the same time rate of employment will also increase in economy.
3. Government would also wish to control the rate of inflation in economy. It would wish that inflation must remain in control so that consumer price of goods and services must not increase significantly.
4. Government would also wish to have a healthy balance of payments between the value of imports and the value of exports. It would wish that value of exports must be greater than the value of imports of country.
5. Government would also wish to ensure exchange rate stability. It will try to keep it stable or to avoid wild swings in it so that businesses involved in international trade must not get affected significantly and home currency must remain stable against other currencies.
6. Government would also wish to develop an efficient market in financial services. It will attempt to ensure that it must be able to offer quality services to businesses in order to excel. In order to achieve this objective it might ensure effective supervision through central bank.
7. Government would also wish that it must be able to generate its revenue from the economy and must not take excessive borrowing as its repayment could pass on burden on local population.
8. Government would also wish to maintain a healthy foreign exchange reserves in order to meet its foreign exchange needs.
9. Government would also wish to promote a fair and efficient system of tax and benefit which will offer incentives to work save and invest and at the same time maintain an effective accounting and budgetary frame work to promote high standards of regularity and popularity.

How government objectives could be in conflict:

Unfortunately several of these government objectives could be in conflict with each other.

1 Inflation versus unemployment:

If government will attempt to decrease the rate of unemployment then it might create demand pull inflation as consumers will be having strong purchasing power and they will demand excessive quantity of goods that could lead to shortage and price level might increase. As the employed people will have more disposable income to spend so it may also lead to cost push inflation as labor cost for businesses will increase and they will pass on these higher costs to consumers in terms of high price.

2 Economic growth versus inflation:

With the increased level of economic growth more goods and services will be bought and sold. This could lead to increase in incomes of the employers and employees. Due to increased incomes and profits these people will demand more and more goods and services which could lead to demand pull inflation in the short term.

3 Economic growth versus balance of payments:

When government would aim to achieve strong GDP then level of consumer demand for goods and services will also increase. It could lead to worsening of trade balance as people will demand more foreign imported goods and services.

4 Economic growth versus environmental sustainability:

Rapid economic growth will increase demand for goods and services and this could add extra pressure on scarce environmental resources and could threaten the sustainability of living standard in future.



Economic growth

What is economic growth?

Economic growth is defined as the amount of goods and services produced per head of the population over a certain period of time.

It is measured in terms of gross domestic product (GDP). Gross domestic product is the value of goods and services produced in the country in a year. If GDP of country is increasing as compared to the last year then it is said that economy of that country is growing or vice versa.

Causes of economic growth:

1. Investment in capital goods will increase.
2. Businesses will invest more in technology that will lead to mass production.
3. Improvement in skills of labor force might enable businesses to produce more.
4. Progression/advancement in technology.
5. Improvement in management/entrepreneurial skill could lead to business growth.

Benefits of economic growth:

1. Due to economic growth income of consumers will increase. This improved purchasing power of consumers might enable them to buy more goods and services and raise their standard of living.
2. Since there will be a high demand for goods and services in economy so businesses will increase their scale of production and more job opportunities will be created. This could lead to further increase in demand for goods and services and crime rate in society will decrease.
3. Since government will be able to collect higher amount of taxes due to increased economic activity so it will not be required to borrow loans. Therefore debt to GDP ratio will decrease.
4. Since government's tax collection will increase due to higher level of economic activity so increased revenue can be utilized to improve public services such as health, education, infrastructure development etc.
5. With higher real GDP a society can devote more resources to promote recycling and the use of renewable resources can be increased.
6. Economic growth will be a positive indicator for investors, therefore there is a chance that it could attract more local and foreign investors.

What a business organisation need to cope with economic growth:

To cope with economic growth a business may need:

1. More staff to meet increased market demand for goods and services.
2. More investment in technology in order to achieve mass production.
3. Bigger premises to accommodate machinery and increased man power.

The business cycle

"It is un-natural for the economic growth to be achieved at a steady or constant rate. Economies tend to grow at very different rates overtime. This is known as business cycle".

Or.

"The term business cycle refers to economy wide fluctuations in production, trade, and general economic activity".

Or.

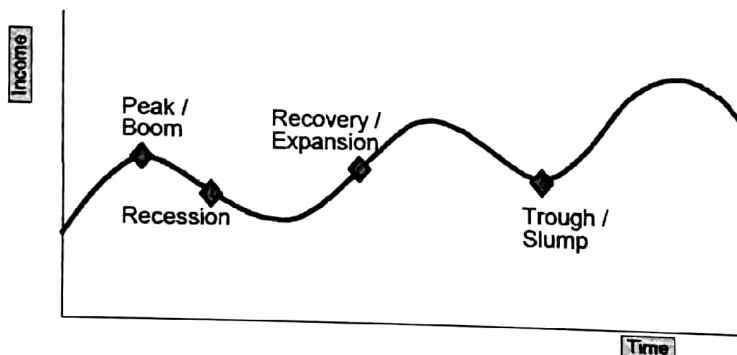
"The business cycle is the four phases of economic growth and subsequent decline. It is more commonly called the boom and bust cycle".

The aim of economic policy is to keep the economy in a healthy growth rate. It must be fast enough to create jobs for everyone who wants one, but slow enough to avoid inflation. Unfortunately life is not so simple. Many factors can cause an economy to spin out of control, or settle into depression.

The most important over-riding factor is confidence of investors, consumers, businesses and politicians. The economy grows when there is confidence in the future and in policymakers, and does the opposite when confidence drops.

The 4 stages of the business cycle:

There are four phases that describe the business cycle. At any point in time you are in one of these stages.



1 Boom:

It is a period of time during which sales of a product or business increases very rapidly.

2 Recession:

It is a period of temporary economic decline. During this time period trade and industrial activity are reduced. It is generally identified by a fall in GDP over a period of six months or more.

3 Recovery/expansion:

It is a time period when economy starts to grow again. In this there will be an upturn in the business cycle. There will be more jobs and demand for goods and services will increase.

4 Trough:

It is when the economy hits bottom, usually in a recession.

What happens at each stage?

Stage of business cycle	Key features	Likely reactions by businesses
Recovery/Expansion	1. Consumer spending will increase. 2. Scale of production will rise. 3. Investment in economy will increase. 4. Confidence of businesses will increase.	1. Business might get an opportunity to increase price. 2. It might encourage new businesses start up. 3. Businesses will increase investment in growth projects. 4. There will be a high rate of capacity utilisation of businesses.
Boom	1. Inflation will increase. 2. Some businesses might not be able to meet market demand. 3. Business will earn high profit but their costs will also increase. 4. Interest rate will increase to control rising inflation.	1. Businesses will increase price of their products. 2. There is expected to be a rise in wage level as trade union will demand wage increase due to rising inflation. 3. Demand for loans is expected to fall due to rise in interest rate.
Recession	1. There will be low demand for goods and services. 2. Investment in economy will fall. 3. Due to low demand for goods and services profits of businesses will also fall.	1. Businesses are expected to explore new markets with a view to extend their product life cycle. 2. Redundancies may be announced by businesses to reduce cost. 3. Small scale businesses might decide to quit.
Slump	1. Interest rate will be low. 2. Businesses might not be able to repay their debts and become bankrupt. 3. There is expected to be a high rate of unemployment. 4. There is expected to be a low level of consumer spending.	1. Businesses might reduce price of their products in order to survive. 2. Some businesses might close down. 3. Business might announce redundancies.

Effect of economic growth on different types of producers:

Type of producer	During economic growth	During economic recession
Luxury products E.g. mobile phones, cars etc.	1. They will expand their product mix by introducing new range. 2. They will increase price to earn more profit. 3. They will allocate more promotional budget. 4. They will increase their scale of production.	1. They might more credit facilities to retailers to increase their affordability. 2. They might decide not to decrease price as it will affect their product image. 3. They might increase sales promotion activities to compensate reduced sales level. 4. They might launch new product range having low price to survive.
Normal goods producers. E.g. organic pasta, noodles.	1. They might produce high value added products to increase sales. 2. They might use their unique selling points to increase sales. 3. Some producers may continue in the same way, as their sales may not be affected due to economic growth.	1. They might decrease price to survive. 2. They might increase promotional budget. 3. Some producers may continue in the same way, as their sales may not be affected due to economic growth.

Inferior goods producers. E.g. public transport.	1. They might decide to expand target market by entering into upmarket segments. E.g. luxury buses. 2. They might decide to produce high value added products. 3. They might decide to expand size of their product mix by launching new product range.	1. They might decide to use their unique selling point in their marketing strategy, "low selling price". 2. They might use free sampling to promote their product. 3. They might expand distribution network to compensate lost sales.
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Inflation



Inflation:

What is inflation?

It is defined as the persistent raise in general price level. Rise in price level means that the internal purchasing power or value of money is going to decrease.

Causes of Inflation:

There are two main causes of inflation:

1. Cost-push Inflation.
2. Demand-pull Inflation.

Cost-push Inflation:

Cost-push inflation occurs when cost of production rises and businesses pass on such increased cost of production to consumers in terms of high price. For example, due to increase in prices of inputs like labor, raw material, etc. supply of these goods might decrease. This could also be due to lower exchange rate. Low exchange rate will push up price of imported raw material and due to this reason price level will increase.

Demand-pull inflation:

It is likely to occur when consumer's aggregate demand for goods and services will increase. For example, in case of economic boom aggregate demand for goods and services is likely to increase as compared to its supply. This gap between demand and supply could lead the price level to increase. Main reasons for demand pull inflation could be full employment of resources, a depreciation of exchange rate etc.

Benefits and drawbacks of inflation:

Benefits	Drawbacks
1. Controlled inflation might create an environment for business growth, as due to strong purchasing power of consumer's demands for goods and services will be high and business will operate near full capacity to meet increased demand. 2. Inflation means the reduction in the value of money. It might be suitable for businesses who have taken loans. Over the years due to reduction in the value of money the real value of debts might decrease. 3. As the general price level will increase due to inflation so this could benefit businesses as their value of fixed assets will increase. (market price) 4. It could also be beneficial for businesses that have a policy of high inventory. If they bought excessive amount of inventory in past then they may get profit as the value of their inventory will increase. E.g. raw material, finished goods. 5. Deflation is potentially very damaging to the economy and can lead to lower consumer spending and lower growth. For example, when prices are falling, consumers are encouraged to delay purchasing.	1. High rate of inflation might cause un-certainty among businesses and could discourage further investment/business growth. 2. Higher inflation might lead to lower international competitiveness as product price will be high as compared to other foreign competitors. E.g. India has benefit over Pakistani products in international markets in terms of low cost. 3. Due to increased inflation cost of living will increase and trade union might demand increase in wage rate that could lead to industrial disputes. E.g. strike etc. 4. Inflation and stagnant wage growth leads to declining incomes. This could affect demand for goods and services/weak purchasing power. 5. Inflation can reduce the real value of savings, which particularly affect old people who live on savings. However, it depends on whether interest rates are higher than the inflation rate. 6. Businesses might face cash flow problems as their costs might be high and consumers might demand more credit time resulting in reduced cash inflows.

What is deflation?

A reduction in general price level in an economy is known as deflation. This could be due to:

1. Falling demand of goods and services.
2. Fall in cost of production.

If inflation is due to falling levels of demand this mean:

1. Falling sales level.
2. The need to rationalize.
3. More redundancies.

However if deflation is due to lower costs then this may make businesses more competitive in international markets. This could lead to more business growth and more employment opportunities.

Is deflation always beneficial?

Deflation (a fall in prices, negative inflation) can be very harmful. During prolonged period of deflation and very low inflation, the Japanese economy has suffered lower growth because of deflationary pressures. When prices are falling people are reluctant to spend money because they are concerned that prices will be cheaper in the future, therefore they keep delaying purchases. Also deflation increases the real value of debts and reduces the disposable income of individuals who are struggling to pay off their debt. When people take on a debt like a mortgage, they generally expect an inflation rate of 2% to help erode the value of debt over time. If this inflation rate of 2% fails to materialize, their debt burden will be greater than expected.

How to control inflation?

1. Central bank might increase interest rates to discourage spending.
2. Procedures of borrowing might be made more complicated to discourage borrowing.
3. Government might increase exchange rate to make imports cheaper.
4. Government might limit pay increases in order to weaken purchasing power of consumers but this may only work in the short run as trade union through industrial action e.g. strike may get pay raise in the long run.



Un-employment:

It is defined as a situation where people are able, available and willing to work and actively seeking it but cannot find any job. It is a negative indicator for any economy as it would lead to low level of GDP, poor living standard and increased crime rate in society.

Possible causes of un-employment:

1. Businesses might decide to shift to capital intensive production (latest machinery) in order to be more efficient, therefore the requirement for manpower will decrease and they may decide to lay off unnecessary staff.
2. There could be a problem of lack of skills among workers. For example, if furniture industry is growing in country so they would need skilled labor, if local labor is not skilled then they will not get employment opportunities and unemployment will increase.
3. There could be a lack of training facilities in country. Untrained staff may not get employment and level of unemployment may increase.
4. Economy might be going through economic recession. In this phase of business cycle organisations normally layoff their excessive staff in order to survive and level of unemployment is likely to rise.
5. If government has withdrawn incentives or has increased tax rate then it might not remain feasible for business organisations to continue to operate in that country, in such situation they will cease their operation and unemployment will rise.

Types of un-employment:

Unemployment could be of following types:

1 Frictional unemployment:

This type of unemployment is likely to occur when people will try to shift to better jobs and they will leave their current job. In other words the time people take move between jobs is known as frictional unemployment. For example, an engineer left his current job as he wants to shift to better job. There will always be some frictional unemployment in an economy because information is not perfect and it takes time to find work.

2 Structural unemployment:

Sometime economic structure might change and in such a situation unemployment caused shall be known as structural unemployment. For example, an economy might shift from agricultural based to industrial based economy. In such a situation unemployment in agricultural sector will increase and it will be termed as structural unemployment.

3 Cyclical unemployment:

Business cycle moves in a cyclical form. For example, during economic boom there will be high rate of employment due to higher demand for goods and services. Every economic boom is followed by economic recession. During this time aggregate demand for goods and services will decrease and organisations will lay off unnecessary staff in order to survive. Such unemployment caused shall be termed as cyclical unemployment.

4 Technological unemployment:

Due to technological advancement in almost every field, businesses prefer to switch over to latest technology in order to be more efficient and reduce their dependency on labor. Such a move towards capital intensive production is likely to reduce the requirement of workforce and businesses will announce redundancies. Such unemployment is known as technological unemployment.

5 Seasonal unemployment:

Some businesses are seasonal by nature. For example air-conditioning business. Its demand is expected to be very high during summer. It means during summer there will be a high rate of employment in such

businesses. During winter there will be no/minimum use of air conditioners so the demand for air-conditioning staff will decrease and such unemployment will be termed as seasonal unemployment.

6 Voluntary unemployment:

Such unemployment occurs when people choose to remain unemployed rather than take job available. For example, if benefits are generous (unemployment benefits), people may prefer to stay on benefits rather than get work. Frictional unemployment is also a type of voluntary unemployment as they are choosing to wait until they find a better job.

Effects of unemployment:

Good	Bad
1. Wage rate will fall as there will be excessive supply of labor in market. 2. Due to high rate of unemployment business will get a variety of applicants 3. Business can afford to delay recruitment as it would know that it will easily get labor/workforce when required.	1. Demand for goods and services will decrease as people will have weak purchasing power. 2. People have less money to spend so due to this reason they will spend less on luxuries. It might be difficult for such businesses to survive. 3. Due to lack of demand in market profit of businesses will fall and they may have to shift to the objective of 'survival'. 4. Crime rate in society is likely to increase as people will not get money from fair means. 5. Government's expenditure on unemployment allowances will increase. 6. Economic growth rate will slow down. (reduction in GDP)

What steps government can take to reduce unemployment?

1. Government can decrease interest rate. This will encourage businesses to borrow money and start new projects to expand their operations. Such expansion in businesses might create new job opportunities and level of unemployment may reduce.
2. Government can decrease tax rate on commodities. This may help to increase demand and in order to meet increased demand businesses will have to increase their scale of production that could lead to creation of more job opportunities.
3. Government can increase its spending on infrastructure development. For example, seaports, airports, flyovers, highways etc. this will result in creation of new job opportunities and level of unemployment might drop.
4. Government can set up training facilities in country in order to train staff that will create desired level of skill in them. Such human resource development might make them eligible for employment opportunities in foreign countries. Apart from reducing rate of unemployment it could also lead to increase in invisible exports.
5. Government can encourage establishment of small businesses and can provide them soft loans. This will lead to self-employment and the level of unemployment will decrease.



Macroeconomic policies

What are macroeconomic policies?

Macroeconomic policy is usually implemented through two sets of tools:

1. Fiscal policy.
2. Monetary policy.

Both these policies are used to stabilize the economy, which usually means boosting the economy to the level of GDP consistent with full employment.

What are the objectives of macroeconomic policies?

In every economy there are four main macroeconomic objectives. These are:

1. Economic growth.
2. Full employment.
3. Price stability.
4. Balance of payments stability.

Macroeconomic policy is aimed at achieving these objectives, with one of them usually selected as the main priority.

Fiscal policy:

The government has no money of its own and it will have to generate revenue from within the economy in order to meet its expenses and spend on country's development. Fiscal policy is the mean by which a government adjusts its spending levels and tax rates to monitor and influence a nation's economy.

It is the sister strategy to monetary policy through which a central bank influences a nation's money supply.

In order to generate funds government will either:

1. Collect taxes from different sectors in the country.
2. Will borrow money from local banks or IMF or World Bank.

Types of fiscal policies:

1 Neutral fiscal policy:

It is a situation where the government's planned expenditure equals its planned revenue. I.e. the government achieves the budget balance.

economy. Interest rate is defined as the percentage reward that is paid by the borrower of money to the lender of money.

In case of rising inflation central bank might decide to increase the rate of interest. This will have an effect on money supply and demand. Supply of money will decrease in economy as increased rate of interest will encourage saving trend among people. Since they will be getting a reasonable rate of return on their investment so they will prefer to deposit their savings in bank accounts rather than spending on luxuries. In the same way demand for money shall decrease due to increase in the rate of interest cost of borrowing will increase for businesses and they will demand lesser amount of loans. Businesses will spend less on growth projects due to the increased cost of borrowing.

As an attempt to control inflation, apart from interest rates central bank can increase the amount of money commercial banks need to keep in vault (bank reserves). Since they will be required to keep more amount as reserve so they will be able to offer lesser amount of loans to businesses and this will also help to control money circulation in economy.

In case of deflation central bank will do opposite. There will be a need to increase money supply in economy. In order to achieve this objective central bank will decrease interest rate. This will encourage businesses to borrow more as there cost of borrowing will decrease and they will spend more on growth project. Saving trend will also decrease due to low rate of return and apart from these consumers will spend more on luxuries either by taking bank loans or by using their credit cards since they will have to pay low percentage of markup. Central bank might also decrease the amount of reserves that commercial banks are required to maintain. This will also increase capability of commercial banks to give more loans to businesses and individuals.

In this way central bank might attempt to control money supply in economy.

How government could influence economy?

Government could influence economy in a number of ways. These could be:

1. It can increase its spending on goods and services. For example, it can construct motorways, can spend on national defence or could increase indirect benefits e.g. pensions.
2. It can increase/decrease both direct and indirect taxes, for example, income tax, corporation tax, sales tax, value added tax.
3. It can pass legislation to influence economy. For example, it can pass labor laws, minimum wage rate, consumer protection laws, and competition policy to prevent unfair competition.
4. It can offer subsidies to businesses, low rents, and soft loans in order to increase employment opportunities.
5. In some countries government can also intervene by allocating resources. For example, in China, the government is deeply involved in allocation of resources. It helps to decide which industries will be promoted.

What will be impact if government does not intervene?

In case of no government intervention there could be following consequences:

1. There may be unfair competition as large scale firms will dominate the market and will dictate their terms and survival of small scale firms might become difficult.
2. There may be more monopolies as businesses will try to become market leader and charge high price for their products in order to be highly profitable.
3. There might be no legal protection for employees. Businesses will exploit labor, problems such as 'sweat shops' (child labor, poor working conditions and low wages) might arise.
4. Since there will be weak consumer protection laws so businesses will try to make their products cheaply even unsafe/hygienic products.
5. In case of lack of government intervention there might be environmental violations as there will be no check and control on businesses so they will continue to use obsolete/outdated machinery in order to save capital expenditure. This could result in higher environmental pollution.

Should Government subsidize firms?

This is debatable statement that whether government should subsidize firms or not. There could be some arguments in favor and against this issue. These could be:

Arguments in favor

1. It may save jobs of people as otherwise businesses might be closed down and unemployment may rise.
2. It will help industries to ensure their survival in short term as they will be able to restructure themselves in order to increase efficiency.
3. If governments will subsidize local firms then they might be able to compete effectively with foreign companies and national economy may not just get dependent on foreign companies.

Arguments against

1. An argument against subsidizing local firms could be that they will get used to subsidies and will remain inefficient.
2. Opportunity cost for government could be very high as it could have spent tax revenue on education, health, infrastructure and national defence. Subsidies would mean lost revenue for government.
3. In order to subsidize an industry, government might have to increase taxes on other sectors. This could affect their competitiveness and add financial burden on them.



Exchange Rates

Daily Currency Exchange Rates

Exchange rate:

What is exchange rate?

It is defined as the value/price of one currency expressed in terms of another currency. For example, if \$1 = 100 Pakistani rupees. Exchange rates in a "free" market economy are determined by the market forces (demand & supply).

Exchange rate fluctuations:

The value of one currency in terms of another currency might increase or decrease. It is known as exchange rate fluctuations. Exchange rate fluctuations are likely to affect all businesses, but business especially involved in international trade (import or export) will be more influenced by exchange rate fluctuations.

Appreciation of exchange rate:

In such a situation the value of home currency will increase against foreign currency. In above mentioned example we assumed that \$1 = 100 Pakistani rupees. An appreciation will be if:

\$1 = 95 Pakistani rupees.

Such situation will be beneficial for importers as the cost of imports will decrease, however, exporters will have a drawback of such situation as demand for their products in international market will decrease as foreign buyers will have to pay more to buy their products.

Depreciation of exchange rate:

In such a situation the value of home currency will decrease against foreign currency. In above mentioned example we assumed that \$1 = 100 Pakistani rupees. Depreciation will be if:

\$1 = 105 Pakistani rupees.

Such situation will be beneficial for exporters as their products will become more economical/cheaper for foreign buyers, however, importers will have to more value of home currency/high price to buy imported goods/raw material.

The effects of exchange rate changes on economy:

Exchange rate	Demand for exports	Demand for imports
Appreciates	Decreases	Increases
Depreciates	Increases	Decreases

What is balance of payments?

BOP is the place where countries will record all the monetary transactions with the rest of the world. Such transactions are either termed as credit or debit. The balance of payments (Bop) measures the level of international trade that takes place.

It can be calculated as:

$$\text{Balance of payments} = \text{Revenue from exports} - \text{Spending on imports}$$

Deficit or surplus:

If a country is spending more money on its exports than on imports then the BOP will be in 'Surplus'.

If a country is spending more money on its imports than on exports then BOP is in 'Deficit'.

A favorable BOP is desirable because:

1. It would mean that more money will be flowing in the flowing out.
2. It increases the demand for locally produced goods and services.
3. It creates more employment opportunities in economy which helps to reduce the rate of unemployment.
4. It helps to ensure competitiveness.

Policies to solve persistent deficit:

1. Government can increase interest rate. Higher interest rate will deflate economy and will help to decrease imports.
2. Government can impose tariffs or quota on imports. They will also help to reduce imports.
3. Government can adopt strict currency control policies, for example, it can impose limit on amount of currency people can take outside the country.
4. It can offer incentives to domestic industry in order to make domestically produced goods more competitive.

Categories of balance of payment:

There are three separate categories under which different transactions are categorised. These categories are:

1. Current account.
2. Capital account.
3. Financial account.

1 Current Account:

In this account we record the inflow and outflow of goods and services into a country. Earnings on investment, both public and private, are also recorded in this account.

2 Capital Account:

In this country will record its physical assets such as building or a factory. It also shows the net change in asset ownership for a nation. The capital account is net result of public and private international investments flowing in and out of a country.

3 Financial Account:

In this country will record assets pertaining to international monetary flows of, for example, business or portfolio investments, are recorded.



SOCIAL ENVIRONMENT

1.6.3 Social

Social environment:

It is defined as the environment developed by humans as a contrasted with the natural environment, society as a whole, especially in its relation to the individual.

What is environmental audit?

It is a process in which a business organisation will assess the impact of its activities on the environment.

What is corporate social responsibility (CSR)?

These are duties that a business has towards the people who are affected by its activities. For example, customers, employees, suppliers and the local community.

The importance of corporate social responsibility for a business:

It is very important for a business organisation to consider corporate social responsibility.

1 The moral benefit/Good public image:

If an organisation is going to give due importance to the corporate social responsibility then it will be able to develop a good public image. Such public relation activities can help it to gain some benefits in terms of consumer loyalty etc.

Can raise the level of motivation of employees:

CSR can help to raise the level of motivation of employees as well. Through corporate social responsibility, individuals can realise their personal values through their business. They feel greater level of achievements and are confident that their work is important for their community and the world. Employees experience fewer regrets. They feel excited going to work each day and would never characterise it as tedious and unrewarding. Corporate social responsibility can be a source of personal pride, and a way to make work interesting and important.

3 Better and more media coverage:

Those businesses who are going to consider corporate social responsibility and are going to give it due importance will be able to attract media. It will give more coverage to the stance of such businesses. This could act as a free of cost publicity for business and can lead to improved image and brand loyalty.

4 Stakeholder's loyalty:

When organisation will identify its stakeholders their needs and their expectations and will make genuine commitments to do them more good and less harm then they respond by making greater commitments to you. Such businesses can ask for more from their employees, customers, and investors and they will respond positively to this. When such organisations will make mistakes, which happen inevitably, they are more readily forgiven.

5 Positive by products:

If an organisation will give due importance to corporate social responsibility then it will often result in efficiencies and cost savings. Companies showing an interest in environment sustainability, for example, often cut costs on energy consumption or resource use. Companies that can create employee loyalty by making the workplace more enjoyable and by committing to social responsibility will not need to pay top dollar to bribe their best talent to stay.

Social audits?

A social audit can be defined as a way of measuring, understanding, reporting and ultimately improving social and ethical performance of an organisation. It helps to narrow gaps between vision/goal and reality, between efficiency and effectiveness.

It is becoming more important for businesses to report annually that how much socially responsible they are. Along with published accounts i.e. income statement (profit and loss), balance sheet etc. an annual social report would help business to indicate that a business organisation had over the same time period. If a business is making high profit at the cost of interests of its stakeholders then it might not be able to satisfy these stakeholders. Due to increased awareness of these stakeholders now businesses are also required to publish their annual social report that is known as 'social audit'.

Benefits	Limitations
1. A social audit will help organisation to determine that to what extent it has fulfilled its social responsibilities and how much it still needs to achieve. 2. It might help organisation setting targets for the coming period of time regarding fulfilling its social responsibilities. 3. It helps to improve image of the organisation that may benefit it in the long run in terms of improved image or brand loyalty.	1. If social audit has not been conducted seriously then it might not be able to satisfy different stakeholders. 2. Shareholders might consider this as an unnecessary cost if it is not legally required. They might think that such expense is decreasing their dividend payment. 3. It also depends on the nature of customers or at the level of consumer awareness. Such audit might increase cost of organisation that will be passed onto consumers in terms of high price. This could become a marketing drawback for organisation.

Factor which determine the extent to which a Co. might be socially responsible?

There are going to be certain factors that might determine the extent to which a business organisation might be socially responsible. These factors could be:

1 Legislation:

First of all it will depend that how strict legal implications are related to social responsibility. For example, in developed countries e.g. USA we find that laws are quite strict related to these issues so we would expect an organisation to be more socially responsible there as compared to Pakistan where implementation of laws related to social issues are not that strict.

2 Consumer awareness:

It is another important factor that will determine the extent to which a business organisation is going to be socially responsible. For example, in developed countries consumer awareness regarding these social issues is quite high, so they will act as a pressure group and businesses will be forced to take a highly ethical stance as compared to other countries where consumer awareness related to such social issue might be low.

3 Competitor's expenditure:

It will also determine the extent to which a business might be social responsible. For example, if a competitor is adopting a highly socially responsible approach then business will also have to adopt the same otherwise he may get competitive advantage over business.

4 Company's policy:

The extent to which a business organisation is going to be socially responsible will also depend on the mindset of its management. For example, if its owners take social responsibility seriously then it would be highly socially responsible or vice versa.

1.6.4 Technological (Including the Internet)

1.6.5 Other Businesses

1.6.6 Demographic

1.6.7 Environmental

Technological environment

Technology- Definition:

Technology is defined as the objective based application of information in the product design, production, and utilisation of goods and services and in the organisation of human resource.

Alternatively it can be defined as machinery and devices developed from scientific knowledge.

Technology has become very important in recent years and now it has been used in all departments of business. For example, production, human resource management, finance and marketing. Technology has created many opportunities for businesses but at the same time it has caused many challenges and threats for business organisations.

Benefits of technology for a business organisation:

1. Businesses can use computer software (CAD) to produce more innovative products. This will not only make business organisations more competitive but will also improve their image.
2. The use of technology in production will help to reduce wastage of resources, for example, raw material. This might make business more cost effective.
3. The use of technology might result in increased level of efficiency and due to this reason business will be able to complete tasks in lesser time.
4. As business will become cost effective and due to the use of capital intensive techniques of production it will be able to do mass production so it might result in achievement in economies of scale. This could lead to increased profitability of business.
5. Due to the use of capital intensive production reliance on skilled labor will reduce so trade union will have less influence on management.
6. Due to the use of technology, for example, internet research & development will become more convenient and cost effective so it might lead to better product development.
7. As business will computer aided manufacturing (CAM), so there will be less chances of errors and quality standards will improve that could lead to greater level of consumer satisfaction eventually leading to brand loyalty.

Problems of introducing technology for a business organisation:

Apart from the above mentioned benefits the introduction of technology could also result in some problems or drawbacks for a business organisation. These possible problems could be:

1. Business will have to incur a capital expenditure to train its staff in order to enable them to operate and handle technology that management is planning to introduce. It will not only result in financial but also in time cost.
2. The introduction of technology in functional areas, for example, accounting & finance and marketing could improve their efficiency but at the same time there will be danger of hacking company's software will increase that could leak out secret information to competitors or in embezzlement of business funds.
3. If business will decide to introduce technology then it will have to arrange huge financial resources for such capital expenditure. This could add financial burden on business and it might also have to change its legal structure, for example, it might to convert into a plc. If it will decide to borrow loans to meet such capital expenditure then it could increase gearing of business.
4. A constant problem with technology is that it keeps on updating. It means that after short span of time business would need to upgrade it in order to stay competitive in market. In other words it will have to continue to incur capital expenditure to upgrade technology and apart from this it might also have to bear loss as technology might be scrapped as it might become obsolete.
5. The introduction of technology could also lead to human relation problems as workers might consider as a threat to their jobs (redundancies) and trade union might launch industrial action (strike). This could affect efficiency level of organisation. Management might have to announce negotiated redundancy schemes to encourage workers to volunteer themselves for redundancy proposal.
6. There will be an increased work burden for management as during the process it will have to redesign jobs of employees, new hiring might be done, and training might be conducted. Such restructuring could lead to demotivation of management staff.

What is internet?

Internet is defined as a global computer network that provides a variety of information and communication facilities, consisting of interconnected networks using standardised communication protocols.

It is defined as a mean of connecting a computer to any other computer anywhere in the world via dedicated routers and servers. When two computers are connected over the internet, they can send and receive all kinds of information such as texts, graphics, and voice, video and computer programs.

How internet can be used in business?

The use of internet can be very useful for a business. It can be used in a number of ways:

1 Market research:

Every market orientated firm needs to conduct market research on continuous basis, in order to ensure that it will continue to produce products according to the requirements of its consumers to remain successful. Market research is considered to be quite an expensive activity as it includes both time and financial cost. Internet can be used as a source of data collection for market research. This will not only help to reduce time but financial cost as well. Business can search secondary data for market research and at the same time it can use it for primary data collection as well. For example, on Facebook it can collect feedback of consumers on certain issues.

2 Marketing & sales:

Business can also use internet for marketing and sales. These days meanings of many concepts have changed. Previously market was defined as a physical place where buyers and sellers used to meet to exchange goods and services, but now improvement in technology has changed this concept and consumers can buy products online (e-commerce). This trend has become quite popular as it saves time and financial cost of both consumers and sellers. Business can develop its website and can collect online orders. It means business would not need to hire shops and will not have to bear other overheads, for example, rent, utility bills, salaries etc. apart from this it will enable business to target a mass market as its web site can be accessed from anywhere in the world.

3 Publicity:

Internet can also be used by a business for publicizing itself. On its website can provide information about its different product range. Consumer's reviews can also be shown there to promote products as new customers would feel more confident to buy the product after reading these consumer reviews about products. This mean of promotion is likely to be less expensive and less time consuming as compared to other means of promotion.

4 Recruitment:

Recruitment is defined as the process of hiring employees to fill in vacant positions in organisation. Like market research it is also considered to be an expensive and time consuming activity. However, the use of internet can help business to reduce these costs. Business can have an icon on its web site, for example, "career opportunities". Interest candidates can submit their resume on the web site and at the time of need business can use this data base and short list candidates for recruitment. Apart from this different recruitments websites, for example, www.rozee.pk can also be used by business to collect information about capable candidates and through its screening process it can select the best candidate. This might be less expensive and less time consuming as compared to other recruitment methods.

5 Can communicate effectively with suppliers:

Effective inventory management is very important for a business organisation. Lean product suggests that business must be linked with suppliers through an 'electronic data interchange'. This can only be ensured by the use of internet services. Through internet businesses can communicate cheaply and efficiently with suppliers and distributors to ensure that they can place orders or receive orders. If one supplier is not able to deliver inventory on time then business can access to other suppliers to whom they can place order and can get delivery on time.

Advantages and disadvantages of internet for a business:

Advantages	Disadvantages
1. Management and employees can be interconnected through a network that will ensure effective coordination between them and communication might become more effective. 2. Required information can be delivered at the right time and at the right place that could lead to effective decision making and greater level of efficiency. 3. Business can sell online to consumers anywhere in the world. This will help business to expand its target market. 4. If business will decide to operate online then it will be accessible 24/7 to customers and can collect their orders at any time. 5. Effective communication network can be established with suppliers and distributors that could help to ensure effective inventory management. 6. If it will decide to only operate online then it will be able to save overhead costs, such as, rent, salaries and utility bills etc.	1. Business will have to incur initial expenditure to buy hardware (computer) and design its website or social media page. 2. It will have to bear the training and development cost of its employees. This could be time consuming and expensive. 3. As there will be so many businesses operating online so business might find it difficult to conduct their 'SWOT' analysis and meet competition effectively from them. There is also a possibility that there could be many unidentified competitors operating online. 4. If business will only sell online without having a physical shop then it might not be able to cater those customers who might wish to buy from a shop due to lack of trust. 5. There will be limited face to face contact with consumers so business might not be able to use its selling skills to convince customers to buy its products. 6. There is a possibility that consumers might not take research of company seriously and they might give negative comments that could influence success level of business.

What is E-commerce?

The process of buying and selling via internet is known as E-commerce. Due to technological improvements E-commerce has become quite popular with customers as they prefer to buy online as it saves their time and financial cost. We have examples of many well-known online sellers, for example, amazon, eBay, souq etc. E-commerce is some time also known as E-tailing.

Electronic or E-commerce brings valuable benefits for businesses and customers as well.

Benefits to businesses	Benefits to consumers
1. Business would not need to hire shops to operate. This will save financial cost of business. 2. Workload of owners will decrease as they will not be bound to be available on shop. Saved time can be used for strategic planning. 3. Business might not have to bear cost of salaries of employees, utility bills etc. 4. Business will be open 24/7 as consumers can access business at any time. 5. Buyers can access company's website from anywhere to place online order so this will provide an opportunity to business to target a mass market. 6. E-commerce increases the productivity of the organisation. It supports "pull" type supply management. In "pull" type supply management, a business process starts when a request comes from a customer and it uses just in time manufacturing method.	1. Since overhead expenses of businesses will be low so they can pass on this benefit to consumers in terms of low price in order to gain a competitive advantage over their competitors. 2. It will save time of consumers as they can place order by staying at their home/office. They would not be needed to go anywhere. 3. Business will be accessible 24/7, so they can order at any time, not necessarily during business hours. 4. Online sellers will be keeping a huge variety of products so consumers can make a choice of the best brand for them. 5. Since different consumers will give their online reviews about a specific brand or product so customers can select that product that has best reviews. This will prevent wastage of consumer money.

UNIT 2

People in Organisations

A-II Level
Business
Teacher's Notes

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Syllabus 2019 –21

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 - Control, authority and trust
 - Centralisation
 - Line and staff
- 2.5: Business communication
 - Purposes of communication
 - Methods of communication
 - Channels of communication
 - Barriers to communication
 - The role of management in facilitating communication

UNIT-2 PEOPLE IN ORGANISATIONS

2.1 Management and Leadership

William Scott:

"Management is a social and technical process which utilizes, resources, influences, human action and facilitates changes in order to accomplish organisational goals".

Peter Drucker:

In his book "The principles of management", he defined management as:
"Management is a multi-purpose organ that manages business and manages managers and manages workers and work".

Note: students can use just one definition or they can also define it in their own words.

Features of management:

Features of Management

1. Continuous and Never Ending Process.
2. Art of Getting Work Done from People.
3. Is Result-Oriented.
4. Multidisciplinary in Nature.
5. Group and Not an Individual Activity.
6. Follows Established Principles or Rules.
7. Aided but Not Replaced by Computers.
8. Situational in Nature.
9. Separate from Ownership.
10. Both an Art as well as a Science.
11. Is All Pervasive.
12. Intangible but its Impact is Felt.
13. Uses a Professional Approach in Work.
14. Dynamic in Nature.

Functions of management:

The 4 basic management functions that make up the management process are described as:

1. Planning.
2. Organising.
3. Influencing and.
4. Controlling.

We may add some more elements in the management process. Such elements are:

5. Motivating.
6. Co-coordinating.
7. Communicating.

1 Planning:

Management will be involved in planning. It will choose tasks that must be performed to achieve organisational objectives, outlining how the tasks must be performed, and indicating when they should be performed.

Planning activity focuses on attaining goals. Managers outline exactly what organisations should do to be successful. Planning is concerned with the success of the organisation in the short term as well as in the long run.

2 Organising:

It can be thought of as assigning the tasks developed in the planning stages, to various individuals or groups within the organisation. Organising is to create a mechanism to put plans into action.

3 Influencing:

It is also referred to as motivating, leading, or directing. Influencing can be defined as guiding the activities of organisation members in the direction that helps the organisation move towards the fulfillment of the goals.

4 Controlling:

It is an important function of management. It is necessary in the case of individuals and departments so as to avoid wrong actions and activities. Employees need to be directed and controlled in order to achieve desired result.

Controlling is the following roles played by the manager:

1. Gather information that measures performance.
2. Compare present performance to pre-established performance norms.
3. Determine the next action plan and modifications for meeting the desired performance parameters.

Controlling is an ongoing process.

5 Coordinating:

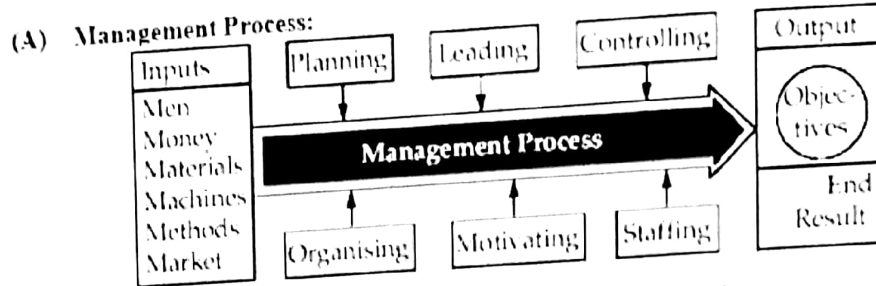
Effective coordination and also integration of activities of different departments are essential for orderly working of an organisation. This suggests the importance of coordinating as management function. Management will be needed to create an effective coordination between different departments in order to ensure that all of them will work towards corporate objectives.

6 Motivating:

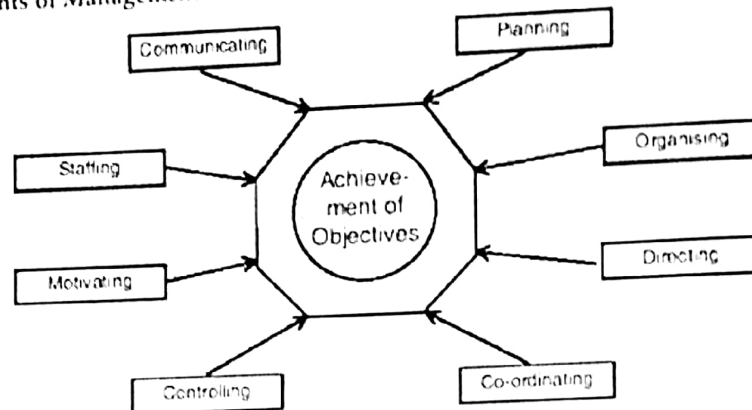
A highly motivated workforce is considered to be the key to success of any organisation. Management will be needed to ensure that effective working environment is provided to employees along with the package of financial and non-financial incentives to achieve desired level of motivation of staff.

7 Communicating:

It is the process of sending and receiving messages. Management is responsible to design such an effective communication in the organisation which will ensure that the required information is delivered at the right time and at the right place. This will lead to quick and quality decision making and apart from this there will be better coordination between departments. Apart from this, it will also reduce the danger of conflicts in the organisation.

Management process:

(B) Elements of Management Process (Functions of Management):

**Leadership:**

"The process of organising, leading, guiding and motivating a group of people to achieve certain common objectives."

Or

"The activity of leading a group of people or an organisation or the ability to do this".

Or

"Leadership is accomplishing tasks through others".

Or

"Leadership means having the dominating power over your people".

Or

"Leadership is directed to change and a better journey".

Difference between leadership and management:

Leadership	management
Leadership often represents a group of individuals that are responsible for inspiring, guiding and leading a group of people that are joined for a common cause. A leader is responsible for leading, inspiring, guiding and influencing a group of people to complete a certain task.	Management is defined as a group of people that run an organisation. Management is the art of getting things done through others by directing their efforts towards achievement of pre-determined goals.

Purpose of leadership:

The function of leadership is to produce more leaders, not followers.

Leadership is a way of focusing and motivating a group to enable them to achieve their aims. It also involves being accountable and responsible for the group as a whole.

A leader should:

1. Provide continuity and momentum.
2. Be flexible in allowing changes of direction.

Ideally, a leader should be a few steps ahead of their team, but not too far for the team to be able to understand and follow them.

Qualities of a good leader:

"A great person attracts great people and knows how to hold them together".

(Johann Wolfgang Von Goethe)

Bill Smith (author of Green Beans and Ice Cream) teaches a leadership course, and whenever he asks what the core traits of a great leader are, he gets a common set of answers. People actually agree that a great leader has the following 12 traits.

1. Must have good/effective communication skills.
2. Must be trustworthy.
3. Must be willing to listen to others. (Democratic).
4. Must be knowledgeable and experienced.
5. Must have good attitude.
6. Must be able to do self accountability and accountability of team members.
7. Must be a good motivator.
8. Must have integrity.
9. Must have courage to take calculated risks.
10. Must have the ability to keep his team members organised.
11. Must have the ability to inspire and respect others.
12. Leadership that sticks (positive reinforcement).

Note:

Most people usually miss #12-Positive Reinforcement. And, yet, according to Sims, it's the most important trait.

Leadership styles:

Leadership style is the manner and approach of providing direction, implementing plans, and motivating people. There are three main leadership styles which are included in As-level syllabus and these can be used by leaders.

These are:

1. Autocratic or authoritarian leadership style.
2. Participative or democratic leadership style.
3. Delegative or laissez-fair leadership style.

Although good leaders use all three styles, with one of them normally dominant, bad leaders tend to stick with one style (normally autocratic).

Autocratic or authoritarian style:

It is an extreme form of transactional leadership, where authorities are centralised with the leader. He will have a lot of power over his/her team members. Team members will have little opportunity to contribute in the process of decision making.

Benefits:

The benefit of autocratic leadership is that it is incredibly efficient. Leader can make quick decision and he can get work done efficiently. This leadership style can be effective for some routine and unskilled jobs. In these situations, the advantage of control may outweigh the disadvantages.

Limitations/disadvantages:

However, most of the team member will resent being treated this way. There will be less flexibility for them and most importantly they will not be able to contribute in the decision making process. This could result in poor level of motivation. Therefore, autocratic leadership can often lead to high levels of absenteeism and high staff turnover.

Autocratic leadership is often best used in crises, when decision must be made quickly and without dissent.

For instance the military often uses an autocratic leadership style, top commanders are responsible for quickly making complex decisions, which allows troops to focus their attention and energy on performing their allotted tasks and missions.

Participative or democratic leadership style:

In this leader will adopt a participative style of management and he/she will involve his/her team members in the decision making process. Leader encourages creativity, and team members are often highly engaged in projects and decisions.

Benefits:

There are many benefits of democratic leadership. Team members tend to have high job satisfaction and are productive because they are more involved in decisions. This style also helps develop people's skills. Team members feel in control of their destiny, so they are motivated to work hard by more than just a financial reward. Employees also believe that it will provide them with career growth chances as they will get opportunity to show their worth. Consultative process might also result in the improvement of decisions, as everyone will contribute innovative ideas in this process. The approach can be most suitable when as a team is essential, and when quality is more important than efficiency or productivity.

Limitations/disadvantages:

As leader will go for consultation and he will involve his team members in the decision making process, so it will take time. This approach can slow decision making process. It can also hinder situations where speed or efficiency is essential. E.g. during a crisis, a team can waste valuable time gathering member's input. Another drawback is that some team members might not have the knowledge or expertise to provide high quality input.

Delegative or laissez-fair leadership style:

This is a French phrase means "leave it be," or "let them do" and it describes leaders who allow their people to work on their own. This type of leadership can also occur naturally, when managers Do not have sufficient control over their work and team members.

Laissez faire leaders may give their team members complete freedom to do their work and set their work and set their own deadlines. The role of the leader will be to provide team support with resources and advice, if needed, but otherwise don't get involved.

This leadership style can be effective if the leader monitors performance and gives feedback to team members regularly. It is most likely to be effective when individual team members are experienced, skilled and like to take initiative.

The main benefit of laissez-faire leadership is that giving team members so much autonomy can lead to high job satisfaction and increase productivity. However, it can be damaging if team members don't manage their time well or if they don't have the knowledge, skills, or motivation to do their work effectively.

McGregor's leadership styles:

According to McGregor, there are managers with two approaches. One are 'X' managers who believe that workers are lazy and they should be dealt by using autocratic style of leadership, while other type are 'Y' managers and they believe that workers are hardworking and they are likely to use democratic style of leadership.

Management style and effect

<u>Theory X</u>	<u>Theory Y</u>
1 People hate work	1 People like work
2 People have to be forced to work	2 people drive themselves and work effectively
3 People prefer to be told what to do	3 People will take the initiative given opportunity
4 People are selfish and have no interest in the organization	4 People will commit themselves to objectives if it is beneficial to them

MacGregor concluded that employee behaviour was the result of the style of management

Factors which might influence choice of leadership style:

1. Time factor. (In case of less time autocratic style might be useful or vice versa).
2. Who has the information-you, your employees, or both?
3. How well your employees are trained and how well you know the task.
4. Stress levels. (If leader has higher stress level then he might prefer to delegate).
5. Type of task. Is it structured, unstructured, complicated, or simple?
6. Are relationships based on respect and trust or on disrespect?
7. Type of the organisation. (E.g. in armed forces only autocratic style is used).
8. Size of group. (E.g. in small groups autocratic style might be used but in bigger groups leader will have to delegate and might use democratic style).
9. Personal approach of the leader. (Some leaders might be dominating by nature so they might go for autocratic style or vice versa).



2.2 Motivation

Motivation-simple definition:

In simple words motivation is defined as the process that initiates, guides and maintains goal-oriented behaviors.

Or,

Definitions by different authors:

Motivation has been defined in various ways and by different authors.

1. Gareth Jones, defines motivation as:

"Psychological forces that determine the direction of a person's behavior, a person's level of effort, and a person's level of persistence in the faces of obstacles".

2. Frank Hawkins defines it as:

"What drives or induces a person to behave in a particular fashion, the internal force which initiates, directs, sustains and terminates all important activities. It influences the level of performance, the efficiency achieved and the time spent on an activity".

Importance of motivation:

Human resource of any organisation is considered to be its real asset and highly motivated workforce is considered to be the key to success of any organisation. Every rational business organisation would wish to achieve the highest level of motivation of its workforce as it will maximize the chances of its success. A highly motivated workforce is expected to return following benefits to an organisation:

1. Maximizes chances of achieving organisational objectives.
2. More innovative ideas are likely to be contributed, hence increasing chances of improved decision/products.
3. Staff turnover is likely to decrease.
4. Increased efficiency.
5. Low rate of absenteeism.
6. Better services will be provided to customers, resulting in improved image of the company.
7. Work force might become loyal to the organisation.
8. There is expected to be less wastage or resources. E.g. raw material etc.
9. Less chances of conflicts.

Less supervision will be required as work force will be self motivated. This could also save cost of employing more managers.

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Possible reasons for the poor level of motivation of employees:

1. Lack of clear job objective.
2. Leadership/management style.
3. Low wage rate.
4. Lack of fringe benefits.
5. Poor working conditions.
6. Lack of delegation.
7. Lack of career growth chances.
8. Lack of training opportunities.
9. Poor organisational culture.
10. Lack of group working.

Problems of having de-motivated work force:

Following could be the problems of having de-motivated workforce:

1. Reduced chances of achievement of organisational objectives.
2. Lack of employee's participation means increase burden on management.
3. Poor level of efficiency.
4. Consumer orders might be delayed, resulting in loss of goodwill.
5. More chances of conflicts.
6. High staff turnover (as employees might leave as they find better jobs).
7. Bad image of the company.
8. High rate of absenteeism.
9. More chances of wastage of resources.
10. Quality standards might be affected.

What actions management shall take to raise level of motivation of employees?

When a poor level of motivation exists in a workforce, then the management should:

1. Develop a strong corporate culture and team spirit.
2. Ensure that pay levels are fair.
3. Redesign jobs of employees and make them more challenging.
4. Introduce decision making at lower levels in the organisation.
5. Give praise and recognition to employees for their efforts and achievements.
6. Ensure two way communication and ensure that communication flows are effective and the relevant messages get to the relevant personnel.
7. Ensure that proper working condition have been provided to employees.
8. Must identify training needs of employees and arrange training programs to ensure that they are able to overcome their weaknesses.
9. Must provide career growth opportunities to employees.
10. Group working must be encouraged.

Extrinsic vs. intrinsic motivation:

Different types of motivation are frequently described as being either extrinsic or intrinsic.

Extrinsic	Intrinsic
Extrinsic motivation is those that arise from outside of the individual and often involve rewards such as money, social recognition or praise from management.	Intrinsic motivation are those that arise from within the individual, such as doing a complicated cross word puzzle purely for the personal gratification of solving problem.

Simple explanation of human needs:

The elements required for survival and normal mental and physical health, such as food, water, shelter, protection, from environmental threats, and love.

In simple words human needs are those things/desires which are necessary to be satisfied for human survival.

Motivation theories:

Several theorists presented their theories of motivation in order to explain that how an organisation shall attempt to motivate its employees. In management circles, probably the most popular explanations of motivation are based on the needs of the individual.

1. Taylor's scientific management theory.
2. Maslow's hierarchy of needs.
3. Elton Mayo's human relations theory.
4. Herzberg's two factor theory.
5. McClelland's theory.
6. Vroom's expectancy theory.

**F.W.Taylor scientific management theory: (1856-1917)****Introduction about theorist:**

Frederick Winslow Taylor is a controversial figure in management history. He was the first person to analyse the management of workers. In his book named "The Principles of Scientific Management", he explained his scientific ways of motivating employees.

Theory:

Taylor considers human beings as an "economic man". According to him money is the sole reason for which people come to work and if any organisation wants to achieve the desired level of success of its employees then it must provide them an opportunity to maximize their earnings. He promoted the idea for a "fair day's pay for a fair day's work".

His scientific approach includes/requires:

1. Select workers to perform the task.
2. Observe them performing the task and note down the key elements.
3. Record the time taken to perform each part of the task.
4. Identify the quickest method recorded.
5. Train all workers to do the task in the quickest way and do not allow them to make changes in it.
6. Supervise workers to ensure that this "best way" is being used by them.
7. Pay workers on the basis of results-based on the theory of economic man. (Piece rate system).

This theory/approach gained popularity initially and Taylor himself supported this notion. He strongly believes that workers are just motivated by financial rewards, as his theory is also named as 'economic man' theory. This approach of Taylor meets the lower level of human needs which are physiological and safety needs.

Taylor's ideas became less popular during 1960's for a number of reasons:

1. There are different human beings with different mindset, not all staff work for the money. They might be having certain other needs as well e.g. social needs, which can just be satisfied by providing non-financial rewards.
2. His "best method" ideas might not suit all workers or all industries.
3. Piece rate system of payment is just suitable for production workers and secondly in this worker's emphasis is maximum productivity not quality.

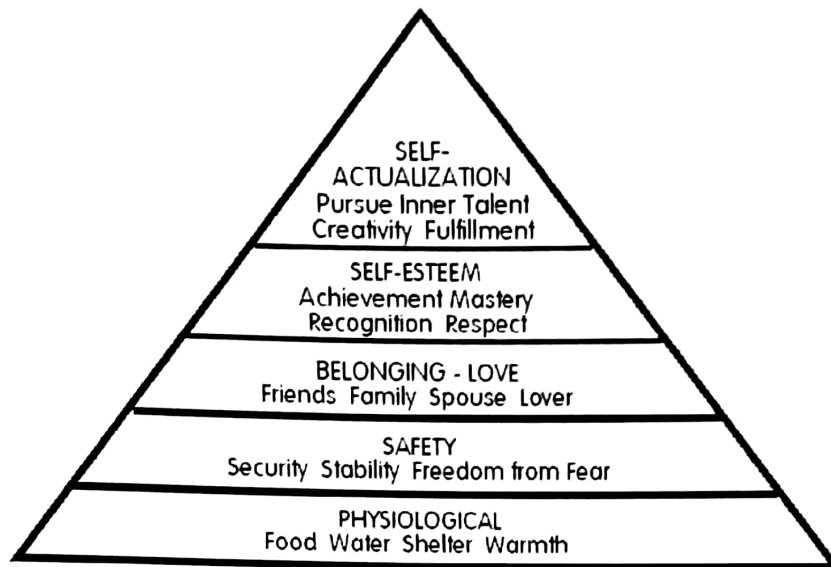
As such Taylor's ideas were often dropped in favor of the new Japanese models of motivation.

Maslow's hierarchy of needs: (1908-1970)**Introduction about theorist:**

Abraham Harold Maslow was an American psychologist who was best known for creating Maslow's hierarchy of needs, a theory of psychological health predicted on fulfilling innate human needs in priority, culminating in self-actualisation.

Theory:

In his theory he classified human needs into five levels. His theory was not solely based on people in the work environment and his findings have significance for students of psychology and sociology too.



In above mentioned pyramid five levels of needs identified by Abraham Maslow are given. According to Maslow human beings have these level of needs and for satisfaction of these they will come out to work. If an organisation can manage to satisfy these needs of its employees then it can expect to achieve desired level of motivation of its staff.

This hierarchy of needs was interpreted by Maslow as follows:

1. Individual needs start on the lowest level. (Physiological needs).
2. Once one level of needs has been satisfied, human beings will try to achieve next level.
3. Self actualization or self fulfillment can never be permanently achieved/satisfied.
4. Once a need has been satisfied, it will no longer motivate employees.

How to satisfy different level of needs:

Higher level need	To satisfy offer:
Self-actualisation needs	1. Creative and challenging work. Self sufficiency, playfulness, meaningfulness. 2. Participation in decision making 3. Job flexibility and autonomy.
Esteem needs.	1. Responsibility of an important job, communicate, training etc. 2. Promotion to higher status job. 3. Praise and recognition of boss.
Lower Level Needs.	To Satisfy Offer:
Social needs	1. Friendly co-workers. 2. Interaction with others (group working) 3. Pleasant supervisor.
Safety needs	1. Safer working conditions. 2. Job security (contract) health, protection, sick leave, pension etc.
Physiological needs	1. Rest and refreshment breaks. 2. Physical comfort on the job (working conditions). 3. Reasonable working hours. 4. A reasonable salary, shelter, sleep etc.

Limitations of Maslow's theory:

Maslow's theory of motivation is very popular all over the world and provides guidelines to managers/management for motivating employees. However, Maslow's theory has many limitations.

1. Maslow's theory is over simplified and is based on human needs only. There is lack of direct cause and effect relationship between need and behavior.
2. The theory has to refer to other motivating factors like expectations, experience and perception.
3. Needs of all employees are not uniform. Many are satisfied only with physiological needs and security of employment.
4. Some levels of hierarchy do not exist in some people. E.g. self-actualization.
5. Some rewards fit into more than one level. E.g. money.
6. Self actualisation never can be permanently achieved.
7. Maslow's assumption of 'need hierarchy' does not hold goods in the present age as each person has plenty of needs to be satisfied, which may necessarily follow Maslow's need hierarchy.

Importance of hierarchy of needs theory:

Although Maslow's theory has been criticized on above grounds, still it holds many advantages or merits. It helps the managers to understand the behavior of their employees. It also helps managers to provide the right financial and non-financial motivation to their employees. This overall helps to increase the efficiency, productivity, and profitability of the organisation.

**Elton Mayo's human relations theory: (1880-1949)****Introduction about theorist:**

George Elton Mayo was an Australian psychologist, sociologist and organisation theorist.

Mayo is known as the founder of the Human Relations Movement, and is known for his research including the Hawthorne Studies and his *The Human Problems of an Industrialised Civilisation* (1933). The research conducted under the Hawthorne studies of the 1930s showed the importance of groups in affecting the behavior of individuals at work.

Theory:

Elton Mayo's work illustrated that manager's involvement is very important to raise the level of motivation of staff. If company or managers took an interest in employees and cared for them, it had a positive impact on their level of motivation. When managers took a greater interest in employees they felt more valued and empowered. His work also showed that employees often work best in teams. He also showed that they were more motivated if they were managed and consulted more. It means that he disagreed with F.W. Taylor that employees just work for money.

Mayo initially believed that workers were motivated by:

1. Working conditions.
2. The skills of workers.
3. Financial incentives.

He conducted a series of experiments at the Hawthorne factory of the Western Electric Company in Chicago. It was put to the test over a five year period.

He isolated two groups of women workers and studied the effect on their productivity levels of changing factors such as lighting and working conditions. He found that changes in working conditions or financial rewards had little effect the motivation level of employees.

Then he made a conclusion that workers are motivated by the way they interact with each other. In other words, working in teams (group working) within which they can make decisions had a major impact on their level of motivation.

Conclusions of Hawthorne effect:

As a result of Hawthorne study Mayo concluded that workers are best motivated by:

1 Better communication:

There must be an effective two way communication between managers and workers. This will boost their confidence and they will feel that they have been given importance by the managers. Apart from this when they will be given an opportunity to give input in decision making process, this will not only improve quality of decision but will also enable management to implement its policies with minimum resistance.

2 Greater manager involvement:

During the Hawthorne study it was found that workers performed well when there was an involvement of managers in their working lives. When managers gave more attention to workers then due to this their level of productivity was increased.

3 Group/team working:

In Hawthorne studies they also experimented with group working. Hawthorne workers did not previously regularly worked in teams. So they observed that group/team working resulted in an increase in the level of motivation of workers. Therefore, it is suggested for organisations to reorganize production to encourage greater use of team working and introduce personnel departments to encourage greater manager involvement in looking after employee's interests. Mayo's theory most closely fits in with a paternalistic style of management/leadership.

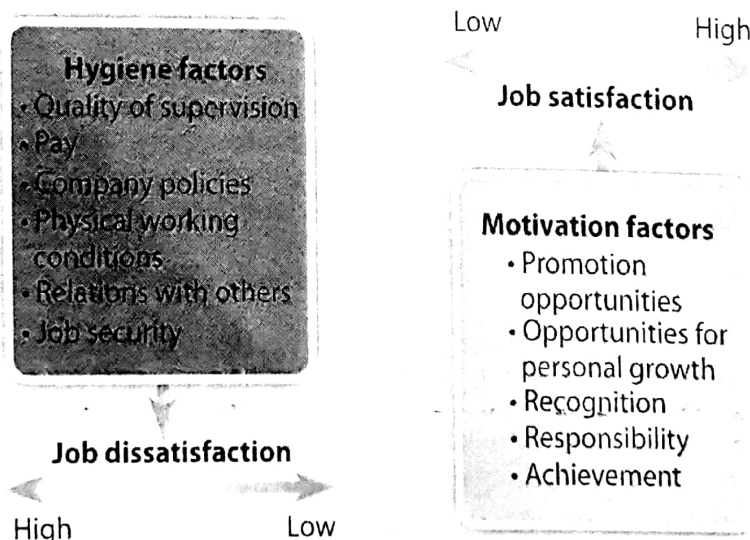
Herzberg's two factor theory: (1923-2000)**Introduction about theorist:**

Frederick Irving Herzberg (April 18, 1923-January 19, 2000) born in Massachusetts was an American psychologist who became one of the most influential names in business management. He is most famous for introducing **Job enrichment** and the **Motivator-Hygiene theory**.

Theory:

Frederick Herzberg selected a sample of 200 workers for his research and asked them what motivated them. From this he developed his **TWO-FACTOR THEORY**. He found that it is possible to divide things that motivate into 2 groups. Instead he split them according to **MOTIVATORS** and **HYGIENE FACTORS**.

According to him these are the two sets of factors that impact motivation in the workplace.



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Hygiene factors:

These factors are not going to motivate but they are going to prevent de-motivation. These factors include salary, job security, working conditions, organisational policies, and technical quality of supervision. Although these factors do not motivate employees, they can cause **dissatisfaction if they are missing**. Something as simple as adding music to the office place or implementing a no-smoking policy can make people less dissatisfied with these aspects of their work. However, these improvements in hygiene factors do not necessarily increase satisfaction.

Motivators:

Those factors which are going to raise the level of motivation of employees. According to Herzberg these could be things such as responsibility, achievement, growth opportunities, and feelings of recognition, and are the key to job satisfaction and motivation. E.g. managers can find out what people really do in their jobs and make improvements, thus increasing job satisfaction and performance.

Relevance of Maslow and Herzberg's theory:

Maslow	Herzberg
self-actualisation	motivators
self-esteem	
social	
safety	hygiene
physiological	

Implications of Herzberg's theory:

If we analyse the theory of Herzberg then we can say that his ideas are based on job enrichment and he believes that non-financial rewards are going to contribute more in the process of motivating employees as compared to financial rewards. The reason for this is that he is taking salary in Hygiene factors, according to him salary does not motivate but it prevents de-motivation.

According to him in order to motivate employees management should:

1. Involve them in the decision making process.
2. Manager's involvement will be important and they should praise and give feedback about their performance.
3. Their jobs should be designed in such a way that they are going to complete a variety of tasks. It is intended to avoid boredom.

Criticism on Herzberg's theory:

His theory can be criticised on following basis:

1. His theory requires providing job enrichment. This could be expensive for the organisation and might add financial burden.
2. In his research he selected a sample of only 200 people, which is quite low.
3. He considers salary as a Hygiene factor, means it does not motivate but prevents de-motivation. Similar surveys conducted later on have obtained different results.

Conclusion:

We can say that by following Herzberg's two-factor theory, managers need to ensure that hygiene factors are adequate then build satisfaction into jobs.

McClelland's theory of needs: (1917-1998)



Introduction about theorist:

David Clarence McClelland (May 20, 1917-March 27, 1998) was an American psychological theorist, noted for his work on need theory, publishing a number of works in the 1950s-1990s and developing new scoring systems for the Thematic Appreciation Test and its descendants. McClelland is credited with developing the achievement motivation theory commonly referred to as need achievement theory.

Theory:

David McClelland's acquired needs theory recognises that there are different human beings with different mind sets or with different school of thoughts and their priorities for needs are different. He also believes that individuals are not born with these needs, but they are actually learned through life experiences. David McClelland's research indicates that individuals are motivated based on three needs.

1 Need for achievement: (N-ach):

The drive to excel, to achieve in relation to a set of standards, to strive to succeed.

2 Need for power (N-pow):

The need to make others behave in a way that they would not have behaved otherwise.

3 Need for affiliation (N-affil):

The desire for friendly and close interpersonal relationships and conflicts avoidance.

McClelland associates each need with a distinct set of work preferences, and managers can help tailor the environment to meet these needs.

High achievers differentiate themselves from others by their desires to do things better. These individuals are strongly motivated by job situations with personal responsibility, feedback, and an intermediate degree of risk. In addition, high achievers often exhibit the following behaviors:

- ✓ Seek personal responsibility for finding solutions to problems.
- ✓ Want rapid feedback on their performances so that they can tell easily whether they are improving or not.
- ✓ Set moderately challenging goals and perform best when they perceive their probability of success as 50-50.

An individual with a high need of power is likely to follow a path of continued promotion over time. Individuals with a high need to power often demonstrate the following behaviors:

- ✓ Enjoy being in charge.
- ✓ Want to influence others.

- ✓ Prefer to be placed into competitive and status-oriented situations.

People with the need for affiliation seek companionship, social approval, and satisfying interpersonal relationships. People needing affiliation display the following behaviors:

- ✓ Take a special interest in work that provides companionship and social approval.
- ✓ Strive for friendship.
- ✓ Prefer cooperative situations rather than competitive ones.
- ✓ Desire relationships involving a high degree of mutual understanding.



Vroom and expectancy theory: (1932-)

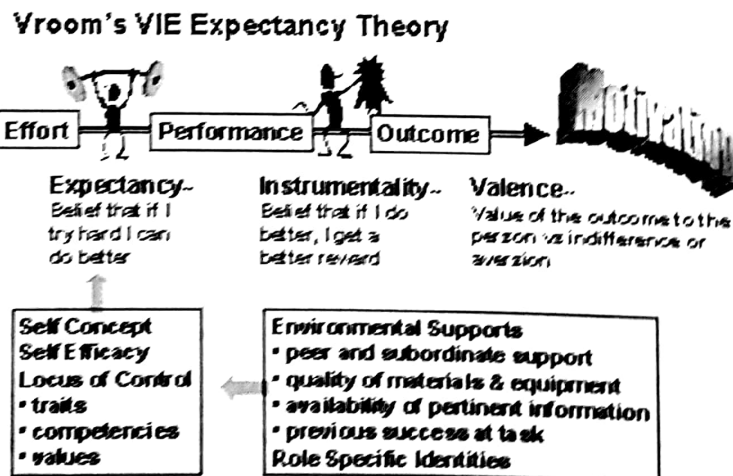
Introduction about theorist:

Victor H. Vroom is a business school professor at the Yale school of management. He holds a PhD from University of Michigan.

Vroom's primary research was on the expectancy theory of motivation, which attempts to explain why individuals choose to follow certain courses of action in organisations, particularly in decision making and leadership. His most well known books are 'Work and motivation, Leadership and decision making' and 'The New Leadership'. Vroom has also been a consultant to a number of corporations such as GE and American Express.

Theory:

Vroom's expectancy theory is based on this fact that human beings work for rewards. If expectancy of employees for getting rewards is high then they will put in extra effort to achieve their job objectives, in other words their level of motivation will be high, but if their expectancy for achieving reward is low then their level of motivation will also be low.



Vroom's theory is based upon the following beliefs:

1 Valence:

It refers to the emotional orientations people hold with respect to outcomes (rewards). The depth of the want of an employee for extrinsic (money, promotion, time off, benefits) or intrinsic (satisfaction) Management must discover what employee's value.

2 Expectancy:

Employees have different expectations and levels of confidence about what they are capable of doing Management must discover what resources, training, or supervision employees need.

3 Instrumentality:

The confidence of employees that they will actually get what they desire, even if it has been promised by the manager.

Implications of the expectancy theory:

- ✓ The managers can correlate the preferred outcomes to the aimed performance levels.
- ✓ The managers must ensure that the employees can achieve the aimed performance levels.
- ✓ The deserving employees must be rewarded for their exceptional performance.
- ✓ The reward system must be fair and just in an organisation.
- ✓ Organisation must design interesting, dynamic and challenging jobs.
- ✓ The employees' motivation level should be continually assessed through various techniques such as questionnaire, personal interviews, etc.

Conclusion of all motivational theories:

In essence, all theories that we have studied, all tell us that workers are different and that only financial rewards cannot motivate employees. In order to achieve the desired level of motivation, organisation must design a mix/package of both financial and non-financial incentives.

Motivation in practice: Financial and non-financial rewards:

All theorists agree on this fact that management needs to offer some incentives or rewards to its employees, in order to achieve their desired level of motivation.

These incentives or rewards are mainly categorised as:

1. Financial rewards.
2. Non-financial rewards.

Financial incentives/rewards:

Pay may be the basic reason why people work, but different kinds of pay can motivate people differently. Here are the most common methods of payment.

1 Wages:

Wages are paid every week, in cash or straight into the bank account, so that the employee does not have to wait long for his/her money. People tend to pay wages to manual workers. Since wages are paid weekly, they must be calculated every week which takes time and money. Wages clerks are paid to do this task. Workers get extra pay for the overtime that they do.

2 Time rate:

In this employees are paid on the basis of hours they are going to work in the organisation. E.g. \$10 per hour. The benefit of this is that employees are encouraged to spend more time in the organisation, this could help to achieve more output level. However, a drawback associated with this is that it only encourages employees to stay for longer hours. In order to maximize their earnings they might slowdown the pace of work. It means efficient and in-efficient both employees will earn same amount and there will be no extra incentive for efficient employees.

3 Piece rate system:

This method is normally suitable for production department where management can directly measure productivity of different workers. In this employees are paid on the basis of output they are going to produce. E.g. \$2 per unit. It means that there is an incentive for all employees to maximize their earning. This method of payment has also been recommended by Taylor in his scientific management theory. With the help of this method efficient employees will be able to maximise their earnings, while there will be an incentive to increase their productivity and match their earnings with efficient employees.

However, there are going to be certain drawbacks of introducing this system. First of all, primary objective of employees will be to produce maximum output and quality will be their secondary priority. Apart from this their earning will not be fixed and they might not be able to prepare budgets. E.g. during economic boom they might be able to increase their earnings but during economic recession their earnings will be low. In this payment system there will be no guaranteed earning/minimum pay for workers so during strikes or due to shortage of raw material there might be no production and their earning will be zero.

4 **Salaries:**

Salaries are paid on monthly basis and normally straight into the bank accounts of employees. This payment system is usually used for white collar employees. A salary is counted as an amount per year that is divided into 12 months accounts. The benefit of this is that organisation can ensure a guaranteed monthly payment to its employees. However there will be no incentive for efficient employees to put in extra effort as at the end both efficient and in-efficient employees will get same amount as salary.

5 **Commission:**

This method is used to pay sales staff. This could be merged with salary or a sales representative could just be appointed on the basis of commission. A percentage is paid, usually to sales staff on the value of goods they have sold. Workers are encouraged to sell more. However, they could persuade customers to buy products they do not really want, making the company look bad. This gives an encouragement to efficient sales people to maximise their earning. Just like the piece rate, in a bad month where there are little sales, worker's pay will fall.

6 **Profit sharing:**

This normally happens in those organisations in which there is going to be an equal opportunity employer, or in those organisations which are going through crisis and cannot pay salary to their employees. They might introduce this payments system. Employees receive a percentage of the profits made. There will be an encouragement for employees to put in extra effort to increase company's profit as eventually their earning will increase. However, they will get nothing if the business does not make a profit.

7 **Bonus:**

A lump sum amount is paid to employees who have done well. It is usually paid at the end of the year or before holidays. E.g. on Eid or Christmas. However, this could cause jealousy between workers. Giving bonuses to a team works better.

8 **Performance related pay:**

In this, employee's pay is linked to the effectiveness of their work. It is often used in organisations where it is hard to measure productivity. It uses the system of appraisal. Employees are observed and their colleagues are interviewed to determine their effectiveness. Afterwards, the immediate superior of the employee has meeting with them to discuss their effectiveness. This is common with managerial and professional workers. E.g. managers, lawyers, teachers etc.

9 **Share ownership:**

In this employer offers employees to buy shares in the company. This will create a sense of ownership in them. They can either benefit dividends (profit) or sell their share when market price will rise.

Non-financial rewards/incentives:

As discussed earlier that there are some human needs which can be satisfied by offering financial rewards, while other needs can be satisfied by offering non-financial rewards. E.g. social/love and belonging needs identified by Abraham Maslow in his hierarchy of needs can be satisfied by providing

them with the opportunity of group working. These non-financial incentives are often called as perks or fringe benefits. E.g. free accommodation, free car etc.
Non-financial rewards include:

1 Delegation:

This occurs when managers pass a degree of authority down to the hierarchy to their subordinates.

2 Empowerment:

When a manager gives his subordinates a degree of power over their work (i.e. it enables subordinates to be fairly autonomous and to decide for themselves the best way to approach a problem).

When subordinates will get authority then it might act as a motivator as they will be involved in decision making, secondly they will be get an opportunity to show their worth.

3 Job enlargement:

There are going to be some employees who will like to have more responsibility. Management might add certain additional tasks in their jobs. These additional tasks are going to be of the same level of management. It is also said that there is going to be a horizontal loading of additional tasks. E.g. a sales manager who is leading group of 10 sales representatives might be given an additional span of control of 5 sales representatives.

Job enlargement might also be used to multi-skill an employee.

4 Job Enrichment:

This is similar to job enlargement. This is a method of motivating employees by giving them more responsibilities and the opportunity to use their initiative. Difference between Job enlargement and job enrichment is that, in this new responsibilities are going to be of a different level of management. It is also said that new responsibilities will be vertically loaded. In other words, these could of higher or lower level of management. E.g. A senior sales representative might be given the role of appointing new sales representatives as sales manager might not be available to do this task.

5 Job rotation:

Some time an employee might get bored due to performing repetitive tasks. In order to restore interest of that employee by providing him change, management might rotate his job to another department (transfer). E.g. a finance officer working in credit control department might be transferred to sales department. This will not only provide change to that employee but will help to develop multi-skilling. After a specific time period he might be called back to his normal job position. (E.g. finance department).

6 Quality circles:

This is a group of workers that meets at regular intervals in order to identify a problem with quality with in production, consider alternative solutions to these problems, and then recommend to management the solution that they believe be the most suitable.

This is intended to satisfy team/group working needs, being identified by different theorists. E.g. Abraham Maslow, Elton Mayo.

7 Team working:

This is the opposite production technique to an assembly line which uses an extreme division of labor. Team working involves a number of employees combining to produce a product, with each employee specializing in a few tasks. Cell production is an example of team working.

8 Work councils:

This is a type of worker participation and it consists of regular discussions between managers and representatives of the workforce over such issues as how the business can improve its processes and procedures.



2.3 Human Resource Management (HRM)

Human resource management (HRM):

Human resource management (HRM) is the function within an organisation that focuses on recruitment of management, and providing direction for the people who work in the organisation. HRM can also be performed by line managers.

Or

The company department charged with finding, screening, recruiting and training job applicants, as well as administering employee benefit programs.

Human resource management includes conducting job analysis, planning personnel needs, recruiting the right people for the job, orienting and training, managing wages and salaries, providing benefits and incentives, evaluating performance, resolving disputes, and communicating with all employees at all levels.

In this dynamic business environment only highly motivated and well trained work force can achieve objectives, so human resource management department will enable business to achieve such a desired workforce.

How employees can add value to an organisation:

Employees can add value to the organisation by:

1. By increasing productivity.
2. By improving quality standards of products.
3. By contributing innovative ideas in the process of product development.
4. By improving customer services to raise their level of satisfaction.

Functions of a human resource management department: (June 2010 p13 Q-3)

Following could be the activities that human resources completes to add value to a company.

1. Human resource or workforce planning.
2. Manage and utilize workforce effectively.
3. Design a performance appraisal system and evaluate performance of different employees to reward those with impressive performance and identify training needs of those not doing well.
4. Providing training to employees to develop competencies that will enhance individual and organisational competencies.
5. Increasing the innovation, creativity and flexibility necessary to enhance competitiveness.
6. Continuously monitor developments and apply new approaches to work process design, succession planning, career development and inter organisational mobility.

- 7 To manage the implementation and integration of technology through improved staffing, training and communication with employees.
- 8 To ensure the working environment is safe for employees.
- 9 To raise awareness of current workplace legislation.
- 10 Developing appropriate salary packages for different staff members depending on their skills and experience.
- 11 Drawing up contracts of employment.
- 12 Informing employees about dismissal or redundancies.
- 13 Involving all managers in the development of their staff.
- 14 Maintaining staff data base.

Do businesses need to have a separate HRM department?

In any organisation there is no doubt human resource department performs various functions and each function, in itself is of great value and requires much expertise for exercising and implementation. For any organisation, staff or man power is the most valuable asset. In this dynamic business environment where computers and information technology have brought revolutionary changes in the progress and performance, human resource factor's importance has become imperative. Organisations consider the human resource management department playing a major role in staffing, training and helping to manage people so that people and the organisations are performing at maximum capability in a highly fulfilling manner.

So many organisations will prefer to have a separate human resource management department.

Note: also include above mentioned functions of HRM department in your answer.

How To Measure Effectiveness Or Human Resource Department (HRD):

Effectiveness of human resource department can be evaluated on the following basis:

1. By the increase in level of motivation of employees.
2. By the reduction in the rate of labor turn over.
3. By the increase in productivity of employees.
4. By multi skilling. (if workers can perform multiple tasks).
5. By the reduction in rate of absenteeism.
6. By the reduction in accident rates.
7. By the quality of output labor is producing.
8. By the level of customer satisfaction.

2.3.1 Approaches to HRM

Approaches to HRM:

Difference between 'hard' and 'soft' HRM:

Human resource management deals with the people side of a business, it ensures that all laws related to employment are properly implemented in organisation. Hr department and management also determines whether HR is meeting its staff training, performance, change management and administrative core objectives and assess how well HR is supporting the company's overall strategy.

Hard Metrics

Hard HR metrics are part of a traditional approach to managing and measuring HR policies and procedures. These use quantifiable data to assess the overall HR function and the processes for which it is responsible. Operational efficiency and cost assessments are prime objectives of hard HR metrics. Calculations determine, for example, the average time it takes to fill open positions, training costs per employee, compensation revenue ratios and revenue per employee.

Soft Metrics

Soft HR metrics is also called human capital metrics. It focuses on human capital value and on the impact human capital has on business results. Soft HR metrics view employees as business assets who are

essential for maintaining a competitive advantage. Qualitative methods assess productivity, performance, adaptability and level of commitment according to a theory that happy, skilled and productive employees increase business efficiency and profitability. Examples include employee engagement or satisfaction ratings, utilization percentages, tenure ratios and performance goal ratios.

Significance

Despite or perhaps because of their obvious differences, hard and soft HR metrics can work together to aid a business in meeting its operational and strategic objectives. While hard metrics focus on the "what" of cost control and getting the function right, soft metrics link to the "how" of business strategies and desired outcomes. Together, hard and soft metrics provide meaningful data businesses can use in moving the business forward by making business decisions that meet the needs of both the business and employees.

Types of employment:

There are variety of employment types that a business can offer to new staff including full time, part time, casual, fixed term employment, traineeships and apprenticeships.

Full time/ permanent work:

This is a regular and ongoing work of between 35 to 45 hours (full time employees are paid a weekly wage and yearly salary) which includes non-wage entitlements and benefits like paid holidays, leave, sick leave and long service leave.

Part time:

Such employees usually work on a regular ongoing basis. They are paid on a pro rata basis. They are entitled to the following:

1. Annual, personal, sick leave and carer's leave.
2. To be paid for public holidays falling on days on which they would otherwise be working, and
3. Long service leave.

Many people enjoy the flexibility of part time work, especially if they have other jobs or responsibilities (like parenting or study). There has been an increase in job sharing which is when two people agree to divide a full time job into two part time jobs.

Casual employees:

Casual employees are employed on an irregular basis as needed. They can work as many hours as agreed (between the employer and the employee). They:

1. Have not expectation of ongoing employment.
2. Are free to refuse offers to work.
3. Are paid a loading (a minimum of 20%, but some awards provide for a higher loading), but no personal or sick leave or annual leave entitlement.

Fixed term or contract:

These employees are hired for a fixed period of time, for example, for a specific project, or to replace an employee on sick leave or parental leave. Management needs to provide the employee with an agreement in writing that sets out the length of the employment contract. Fixed term employees are entitled to the same annual, personal and other leave entitlements as full time employees, but on proportional basis for the period of their employment.

Apprenticeships and traineeships:

These are fixed term employments (usually three to five years) for the purpose of employment training. Apprentices typically learn a trade, such as plumbing, and trainees typically learn non-trades occupations.

such as secretarial work. Apprentices and trainees usually perform work duties on-site and learn about the job off-site as well. A specific base rate of pay is given to cover the employment period, which works like a study based payment.

Self employed:

Workers are also known as independent contractors or sub-contractors. These people work for themselves, so they control the hours and amount of work they do. Many trades' people e.g. are self-employed to be sub-contracted by businesses like real estate agents. There are certain taxation benefits for self-employed workers to compensate for the risks of not finding work. Self-employed workers are reliant on the availability of work in their particular field.

Voluntary work:

It is unpaid work. Many charities (non-profit organisations) rely on voluntary workers, because their main purpose is to provide free services to the community. E.g. during Ramadan Shaukat Khanum hospital assigns the responsibility for zakat collection, or for the sale of fund raising tickets.

Advantages and disadvantages of temporary employees:

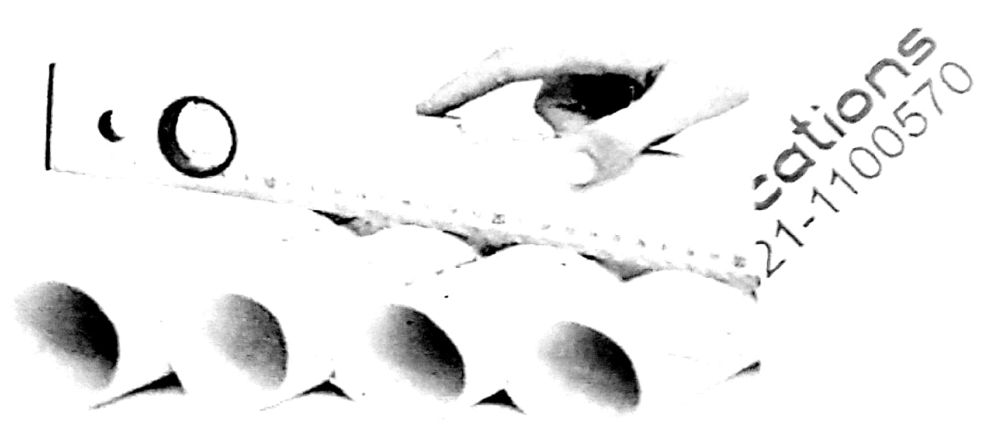
Advantages	Dis-advantages
1. They are not permanent liability for salary payment. They are only paid for the time period for which they are hired. 2. They are more flexible and can give time to business according to its requirement. 3. Through this arrangement business can afford to hire specialist staff that might be too expensive on full time basis. For example, chartered accountants, engineers etc. 4. Such staff is not entitled for certain fringe benefits e.g. pension, provident fund, fringe benefits etc.	1. Since they are hired on temporary basis so they may not be able to develop loyalty with organisation. 2. Since they are temporary employees and may join competitors in future so may leak out business secrets. 3. There could be variation in quality of products as different employees will produce products at different time.

Measuring employee's performance

Performance appraisal:

In simple words, "it is the process of evaluating performance of employees".

It is defined by Cascio as:



Read & Write
www.readwrite.co.uk

People in Organisations
21-1100570

"The systematic description of employee's job relevant, strength and weaknesses".
It may be conducted once in every 6 months or once in a year.

Why an organisation might need to conduct performance appraisal?

An organisation might need to evaluate performance of an employee due to any of the following reasons:

1. To provide feedback about an employee to the top management.
2. To identify strengths and weaknesses of an employee.
3. To evaluate the recruitment system of the organisation.
4. To evaluate the effectiveness of training program of the co.
5. To identify training needs of employees.
6. To give recommendation for promotion of employee.
7. To recommend how much increment (increase in pay) should be given to employee.
8. To set job targets for employee for the coming year.
9. To resolve confusions and misunderstandings.
10. To provide information for human resource planning.

Process of performance appraisal:

1. Set performance standards.
2. Communicate performance standards to employees.
3. Measure performance of employees.
4. Compare employee's performance with standard.
5. Discuss result with employee.
6. Take collective action.
7. Implement and review action.

Methods of conducting performance appraisal:

Feedback from superiors:

This is the first and most commonly used methods. At the end of the year superior/boss will appraise the performance of his subordinate and will file a report about this to the top management. The benefit of this is that he can monitor employee's performance throughout the year and can give findings. However, there might be a danger of 'jealousy' or 'favoritism'.

1 Self appraisal:

In this employee is asked to appraise his/her performance. This might show the confidence of management on employee. However, it would be rare if employee will identify his/her weaknesses, focus is expected to be on strengths.

2 Peer appraisal:

Peer means colleagues. In this a colleague might be asked to evaluate the performance of his other colleague. This could help to identify weaknesses and strengths of an employee. However same danger will be here as off appraisal by superior as there might be an element of 'jealousy' or 'favoritism'.

3 Feedback subordinates:

In this top management might decide to get feedback about a manager from his/her subordinates. Since they will be working with him, so they might be able to provide feedback about him. However, this feedback might be biased as manager might be strict with his subordinates and they might decide to take revenge.

4 Feedback from consumers:

It is likely to be used in service sector business. Management might use consumer's feedback to evaluate the performance of an employee. E.g. if we call a bank's hotline for some service at the end they ask to

give a feedback about the quality of service or if you visit a restaurant at the end they give a feedback card.

5 360 degree appraisal:

We just discussed that in above mentioned methods feedback could be biased or it could be based on favoritism. Even we might get a variety of consumer feedback. I.e. some may be positive while others may be negative. In this type of appraisal management will pick common strengths and weaknesses of an employee identified by above mentioned sources. As a result of this it will develop its final findings for performance appraisal.

Why performance appraisal might fail?

There could be certain reasons for the failure of performance appraisal. These are as follows:

1 Some managers are too nice:

In case of superior appraisal, managers are required to appraise performance of their subordinates. Some people by nature are so nice that they prefer to favor their subordinates. There is a possibility that they might sugarcoat the negativities of their subordinates. In such a case performance appraisal system might not be able to achieve its desired objectives.

2 Lack of continuity to conduct performance appraisal:

Managers have so many things to do and some time they are overburdened. In such situations they may not get time to conduct proper performance appraisal of their subordinates. In this situation as well top management might not be able to achieve targets of an effective performance appraisal system.

3 Biased approach:

If information providers e.g. colleagues, managers etc. are biased with the employee then they will highlight negative aspects of that person. In such a situation appraisal system might not be able to achieve its desired targets.

4 Appraisal criteria:

For the effectiveness of an appraisal system it is important that management must properly communicate the appraisal criteria to its employees. If employee has no idea about the evaluation criteria then he might not be able to perform according to that and performance appraisal might result in de-motivation of employee.

5 Openness and participation:

For the effectiveness of a performance appraisal system employee's participation is really important. Management will have to collect variety of information from different sources. If employees will participate actively to provide information then one can expect that appraisal system shall be able to achieve its desired objectives, otherwise it will be in doubt.

6 Ability of rater's:

Effectiveness of an appraisal system will also depend on the skills of those managers who will be involved in appraising performance of different employees. If they have skills and experience to discharge their duties effectively then performance system might get desired level of success.

Measuring employee's performance:

Business can face problems in case of low productivity of its employees. Business must take steps to ensure that its employees are properly motivated to achieve desired level of efficiency. It is an important function to measure productivity of employees.

Labor productivity:

Labor productivity can be measured on the basis of output they are going to produce in a given period of time.

$$\text{Labor productivity} = \frac{\text{Output in a given time period e.g. a year}}{\text{Total staff employed}}$$

A simple measure is that if productivity per employee is increasing then it is said that employee's performance is improving or vice versa.

Absenteeism rates:

It measures the rate of workforce absence as a proportion of the employee total.

$$\text{Absenteeism (\%)} = \frac{\text{Number of staff absent} \times 100}{\text{Total no. of staff}}$$

High rate of absenteeism reflects the poor level of motivation. Management must take steps to improve level of motivation of its employees in order to reduce absenteeism rate otherwise it will affect productivity which could even result in decreased profitability.

Labor turnover:

Measures the number of employees leaving a firm in a given period compared to the average number employed, as a percentage.

It can be calculated with the help of the following formulae:

$$\text{Labor turnover} = \frac{\text{Numbers of employees leaving} \times 100}{\text{Average number employed}}$$

Reasons for high labor turnover:

Possible reasons could be:

1. Poor working conditions.
2. Low payments.
3. Bad management style.
4. More attractive alternative offers, e.g. from competitor.
5. Lack of promotional chances.
6. Lack of fringe benefits.

Impact of high labor turnover:

1. Cost of recruiting new staff.
2. Cost of training new staff.
3. Variations in quality of product.
4. May discourage future applicants and may make it more difficult to recruit.
5. Product quality might be affected.
6. Company might lose some of its orders.
7. Bad image of the company.

MANAGEMENT BY OBJECTIVES (MBO) A2 is TOPIC.



Management by objectives: (MBO)

According to George Odiorne, MBO is a:

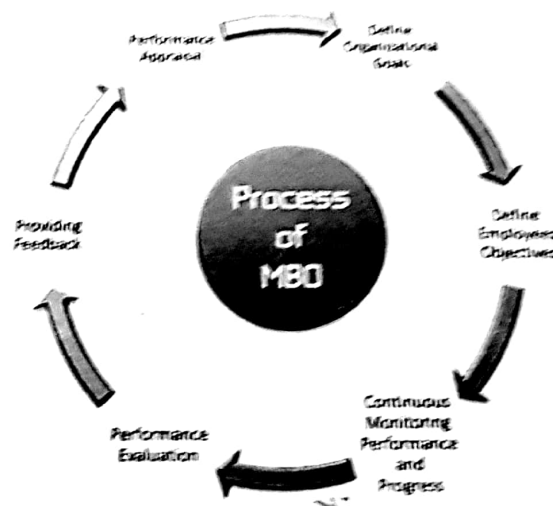
"Process whereby superior and subordinate managers of an organisation jointly define its common goals, define each individual's major areas of responsibility in terms of results expected of him and use these measures as guides for operating the unit and assessing the contribution of each of its members."

MBO was first outlined by Peter Drucker in 1954 in his book 'The Practice of Management'.

Management by objectives (MBO) is a systematic and organised approach that allows management to focus on achievable goals and to attain the best possible results from available resources.

It aims to increase organisational performance by aligning goals and subordinate objectives throughout the organisation. Ideally, employees get strong input to identify their objectives, time lines for completion etc. MBO includes ongoing tracking and feedback in the process to reach objectives.

The MBO process:



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1. To ensure the success of the MBO process a manager's job must be analysed to identify the key areas, role and responsibilities. A list of key roles is drawn up by both the manager concerned and his/her line manager.
2. From this information quantifiable objectives or targets should be set, e.g. sales of Y must increase by 15% over the next 12 months, or the quality of X must increase by 5% over the next 6 months. At the same time targets are set, a means of measuring performance against targets must be identified, e.g. production figures, sales figures, waste levels.
3. At the end of the set period, the tasks set are reviewed to assess how the manager has performed. This review is carried out by the manager and his/her line manager. The line manager will try to encourage the manager to assess how well target have been achieved, identifying areas of progress and points for improvement.
4. Following the review, targets will be set for the next period, based on past performance and what can be realistically attained.

Core concepts:

According to Peter Drucker managers should "avoid the activity trap", getting so involved in their day to day activities that they forget their main purpose or objective. Instead of just a few top managers, all managers should:

1. Participate in the strategic planning process, in order to improve the implement ability of the plan, and
2. Implement a range of performance systems, designed to help the organisation stay on the right track.

Management by objectives-Advantages & disadvantages:

Advantages	disadvantages
1. It increases job enrichment which could lead to increased level of motivation of employees. 2. Since manager and subordinates are in coordination so strategies can be implemented quickly. 3. It is a coordinated and consistent approach. 4. It leads to better understanding between manager and his subordinates which decrease danger of conflicts. 5. It helps to improve the understanding of the whole system. 6. Monitory performance becomes easier (deviation is identified). 7. It helps in setting priorities for subordinates.	1. Manager and his subordinates have to agree on objectives/target, this might consume a lot of time. 2. Businesses operate in a dynamic environment which changes quickly so there are chances that objectives can become outdated quickly. 3. Setting target does not guarantee success, for this continuous monitoring and dedication will be required. 4. Very careful and able leadership is required which is generally difficult to get. 5. The elaborate written goals, careful communication of goals, and detailed performance evaluation required in an MBO program increase the volume of paperwork in an organisation. 6. Sometimes the goals are unachievable which might lead to failure of MBO.

Conclusion:

MBO is often achieved using set targets or goals. MBO introduced the 'SMART' criteria i.e. objectives for MBO must be Specific, Measurable, Agreed, Realistic and Time specific.

As explained earlier MBO was first outlined by Peter Drucker in 1954. In the 90s, Peter Drucker himself decreased the significance of this organisation management method, when he said:

"It's just another tool. It is not the great cure for management inefficiency. Management by objectives works if you know the objectives, 90% of the time you don't."

Group/team working



2.3.3 Cooperation between Management & Workforce

Group working:

Most of the theorists suggested that management must encourage group working, as it will help to satisfy social needs of employees and apart from this quality of decisions will also improve along with the level of motivation of staff.

Types of groups:

1. Formal groups.
2. Informal groups.

Formal group:

A formal group is an official group that is formed to do a specific task in an organisation. Group members are selected by the management and they are assigned certain authorities and responsibilities. They are considered to be the representatives of the management and their communication is considered to be the formal communication. Other employees are required to follow their instructions.

Formal groups in a business:

Departments within a business are good examples of formal groups. From time to time different groups might be set up to cope with different problems or do different tasks. Sometimes people from different tasks. Sometimes people from different departments could come together in a group to do a team project.

Informal group:

An informal group is a group of people which are formed independently by them. They are not official, but the people in the group have a common interest or cause. Both formal and informal groups are needed in business, and let's see why in this example. E.g. a school might create a football team (formal group) but the players need to bond together to play effectively (informal group). These informal groups are not going to be the representatives of management and their communication is termed as informal or grapevine communication.

Informal groups in a business:

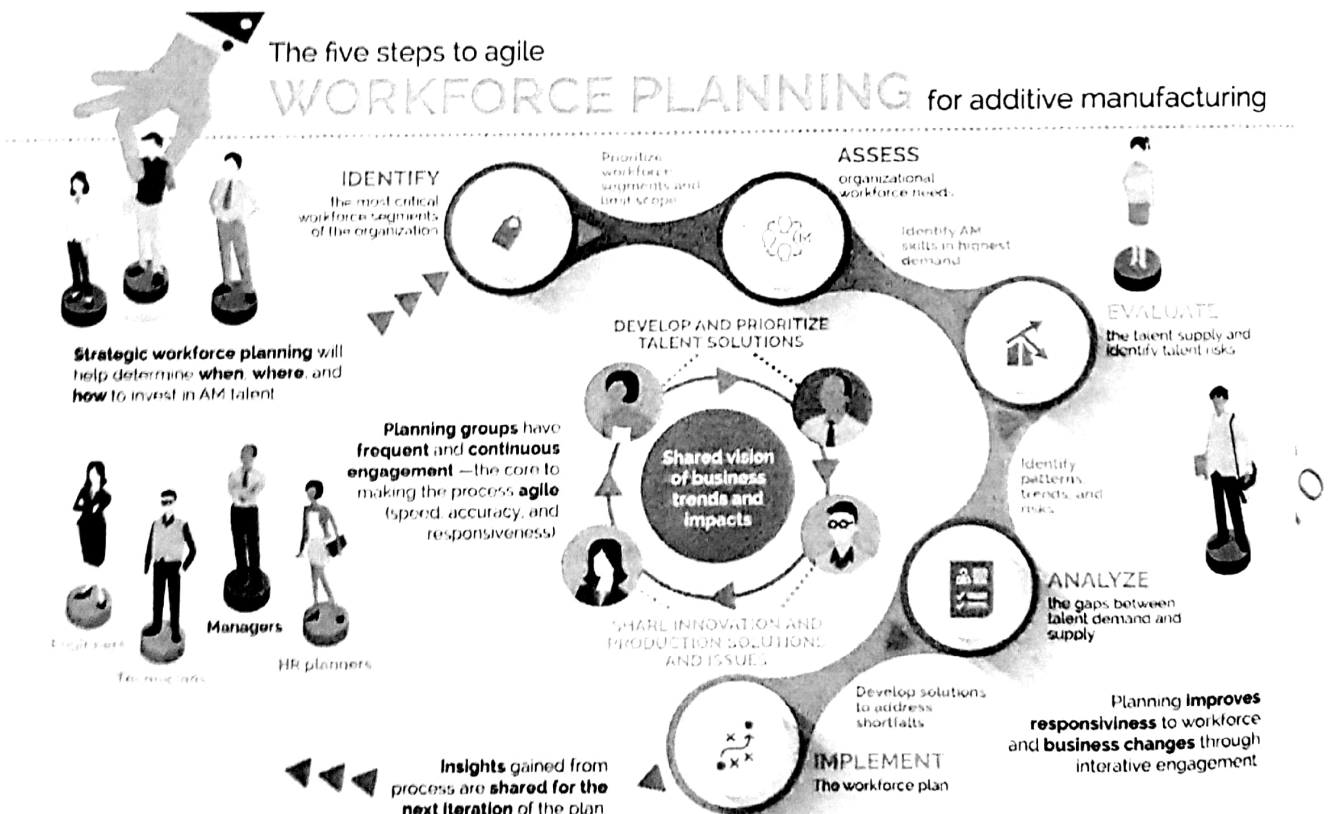
There can be many informal groups in a business that can increase the motivation of workers because they have a true sense of belonging. E.g. there is group of factory workers, who are interested in basket ball, and they form an informal group, as a result, when they get back into their formal group they are likely to co-ordinate better with each other.

There are other scenarios where two departments merge to become one, making them one formal group. However, the people from these former departments still see themselves as separate from each other. These two groups of people will refuse to co-operate until they are also merged into an informal group. Therefore, informal groups should be handled carefully in business to yield the best results. Regular meetings, free, holiday, sporting events and such things could be organised to create informal groups and use them in a more positive way to avoid them getting into the way of business activity.

- How cooperation between management and the workforce can be of benefit to both.

Group working- benefits and problems:

Benefits	Problems
✓ High commitment to the achievement of targets and corporate objectives. ✓ Clear understanding of the role of each person within the group. ✓ Free and open communication between members of the group develops understanding between members. ✓ Group is good at generating ideas. ✓ Management's work load decreases. ✓ Creates competition among group members. ✓ Raises the level of motivation of employees.	✓ Lead to slow decision making. ✓ Leads to grouping. ✓ Might lead to conflicts. ✓ Active members might dominate groups. ✓ Misunderstanding about responsibilities. ✓ Perceived lack of commitment in some group members. ✓ There might be personality clashes.



2.3.4 Workforce Planning

Workforce planning (Human resource planning):

It is defined as a systematic process of planning human resource requirements for the organisation. It includes assessing future demand and supply of the work force. This may lead to plans regarding training, transfers, redundancies or promotion etc.

Or

Workforce planning is a set of procedures that an organisation can implement to maintain the most efficient employee/management team possible, maximizing profits and ensuring long term success.

Categories of workforce planning:

Workforce planning falls into two broad categories:

1. Operational.
2. Strategic.

Operational workforce planning:

Operational workforce planning function on a person to person level and streamlines employee related operations day by day. Examples include:

1. Optimizing work schedules and employee hours.
2. Optimizing the distribution of talent among divisions and departments.
3. Identifying functional needs and hiring new workers to meet those needs.
4. Identify obsolete/outdated functions and reassigning workers as necessary.
5. Ensuring the greatest possible overall worker job satisfaction.

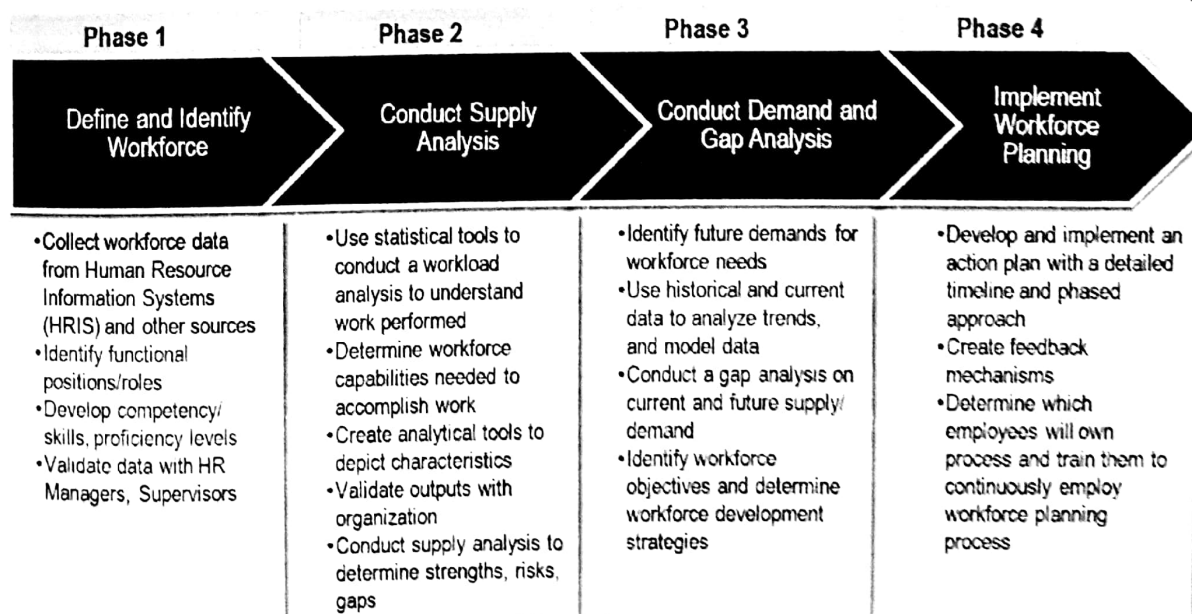
Strategic workforce planning:

Strategic workforce planning deals with broad based issues that evolve over months and years and can encompass all the aspects of an enterprise. Examples include:

1. Forecasting knowledge drain as employees leave the organisation.
2. Forecasting future talent needs.
3. Determine and evaluating likely future sourcing options.
4. Implementing an effective workforce analytics strategy.

Phases/stages in workforce planning:

Following could be the stages in workforce planning:



Benefits of workforce planning:

A business organisation might get following benefits as a result of workforce planning:

1. Workforce planning shall enable business to determine workforce it will be requiring during the coming time period. As a result of this business will design its recruitment policy to hire the right number of staff, hence avoiding the danger of labor shortage.
2. It will also enable business to determine the level of skills and expertise it will be requiring during the coming time period, as a result of this business will prepare job specifications to ensure that it will recruit new employees with desired level of skill and experience.
3. Workforce planning will also enable management to design effective communication system in the organisation. This will ensure better communication within the organisation and better working environment will be created, eventually leading to higher level of motivation of staff.
4. Workforce planning will make managers to adopt a preemptive approach, as they will have to prepare and plan for changes rather than simply reacting to them. It places HRM managers at the heart of strategic decision making.
5. Businesses going through periods of significance change (e.g. technological change in the industry, environmental change) are better able to handle the workforce implications.

Factors which might influence workforce planning:

There are certain factors which business needs to consider in the process of workforce planning otherwise it may not be that successful. These factors could be:

1 Cost factor:

It is one of the most important factors which need to be considered as it will add financial burden on the business. Business must have strong financial resources to support its workforce planning. Every decision made as a result of workforce plan will result in cost. E.g. training program, extra recruitment, redundancy payment in case of redundancies etc.

2 Human relation issues:

A highly motivated and loyal workforce is considered to be the key to success of any business organisation. As a result of workforce planning business will make certain decisions. Some of these may be in favor of workforce, while some may not be. In this situation business will have to design a strategy to manage reaction of workforce (e.g. redundancies) in order to ensure effective implementation of its workforce plan.

3 Business image:

Consumer satisfaction is the prime objective of any business organisation. An effective workforce plan will ensure that there will be an effective coordination between employer and employees. This thing will reflect in consumer services, especially when it is a service oriented business. This will have a positive impact on consumers as they will get better services from staff due to high level of motivation. This could also serve as a competitive advantage for the business.



2.3.5 Role of Trade Unions in HRM

Trade union:

"An organisation whose membership consists of workers and union leaders, united to protect and promote their common interests".

Or,

"A labor union especially one limited in membership to people in the same trade".

Or,

"A group of employees in a particular sector, whose aim is to negotiate with employer over pay, job security, working hours etc, using the collective power of the members".

Functions of a trade union:

1. Obtaining satisfactory rates of pay for its members.
2. Ensure that proper working conditions are provided to workforce.
3. To support training and the professional development of its members.
4. To ensure that its member's interests are considered by the employer when any
5. Decision is made which will affect the workforce.
6. Negotiating bonuses for achieving targets.
7. Obtaining job security for members.
8. Negotiating employment conditions, such as contract of employment or rights relating to redundancy and dismissal.
9. Negotiating grievance procedures. (step by step process an employee must follow to get his or her complaint addressed satisfactorily).
10. Negotiating job descriptions of employees.
11. Bridge the communication gap between management and workforce by creating an effective communication channel.

12. Represent workforce in negotiations with the management/employer.
13. Design and implement an industrial action (e.g. strike), if conflict cannot be resolved through negotiations.

Characteristics of a trade union:

- ✓ Trade unions must register itself as union.
- ✓ It must become affiliated to the Trade Union Congress (although not all do).
- ✓ It must be independent of employer's influence in negotiations.
- ✓ It must regard collective bargaining and the protection of its member's interest as its main functions.
- ✓ It must be prepared to use industrial action to further its member's interests.

Benefits of trade union/ why employees might join trade union?

Benefits to employer	Benefits to employees
1. A channel of communication is developed with the workforce, which might lead to better understanding.	1. It will provide a sense of security among workforce.
2. Better working environment/relationship can be created.	2. It can provide valuable advice to its members. (work force).
3. Employee morale and motivation may be improved if they know that their interests are being protected by union.	3. It can provide them legal services. E.g. in case of unfair dismissal.
4. If role of trade union is positive then it can help employer to develop understanding with employees and implement its policies quickly.	4. It can help them in placement/finding new jobs.
	5. It can ensure that employees will get a fair financial reward for their effort.
	6. It can ensure proper working conditions and fringe benefits for employees.

Why employer might hesitate to allow trade union?

1. It might act as a pressure group against employer.
2. Employees will get into strong position and demand higher wages, which might increase cost.
3. They might threaten an industrial action, e.g. strike, this might delay production.
4. Decreased human resource control.
5. More lawsuits and Arbitrations.

Factors which might determine strength of a union:

1. How many members are its members? If majority is having its membership then it is likely to be strong or vice versa.
2. How much public support it has on the backing of its demand.
3. How much media support it has on the backing of its demand.
4. Management policies or tactics.
5. Legal environment.
6. Labor market situation. E.g. in case of labor shortage management will be forced to accept demands or vice versa.
7. Inflation is high so the demand for increase in pay will appear to be reasonable.

Single union deals:

According to this management will only recognise one union for the purpose of bargaining. Previously there used to be many unions in one organisation, so it was difficult for the employer to develop and communication channel since all used to have small representation of employees.

Beauty contest:

Since employer is going to recognise just a single union in the organisation, so different unions will compete to gain recognition of an employer. Employer will recognise only that union which will have the membership/support of majority of employees.

What is a conflict?

A difference of opinion which results into a dispute. All stakeholders have conflicting objectives which might lead to conflict between them. Conflicts in an organisation might exist between different stakeholder groups but the most common conflict is likely to exist between two internal stakeholder groups. I.e. employer and workforce/trade union.

Possible reasons for a conflict:

1. Management policies. E.g. autocratic style of leadership.
2. Poor working conditions.
3. Low wage rate.
4. Lack of fringe benefits. E.g. medical allowance etc.
5. Unfair dismissal/termination.
6. Change of management policy. E.g. shift from piece rate payment system to a fixed salary payment system.
7. Introduction of technology/threat of redundancies.
8. Lack of promotional/career growth chances.
9. Low increments. (annual pay raise given to employees to meet increased cost of living may be due to rise in inflation).
10. If management is not allowing employees to join trade union.
11. If training opportunities are not provided to employees to overcome their weaknesses or enhance their career growth chances.
12. If labor laws are not properly implemented in the organisation.
13. Long working hours.

How to resolve conflict?

Conflicts can be resolved in two ways:

1. Negotiations/Collective bargaining.
2. Industrial action.

Negotiations/collective bargaining:

The first method of resolving a conflict between employer and employees is that both parties to conflict must sit on the table and negotiate to resolve conflict.

Collective bargaining is one way of minimizing conflict within the workplace. It involves determining conditions of work and terms of employment through **negotiations** between employer and employee representatives such as trade unions.

Requirements of collective bargaining:

1. Employees must be free to join representative bodies, such as trade unions.
2. Employers must recognize such bodies as representative of workers and agree to negotiate with them.
3. Such bodies must be independent of employers and the state.
4. Bodies should negotiate in good faith, in their member's interests.
5. Employers and employees should agree to be bound by agreements without having to use the law to enforce them.

Collective agreement:

The result of collective bargaining is a collective agreement. These agreements are usually written and are signed by the parties and will be binding. Collective agreements can either be:

1. Substantive agreements.
2. Procedural agreements.

1 Substantive agreement:

These are concerned with terms and conditions of employment. They include pay, working conditions and fringe benefits.

2 Procedural agreement:

These agreements set out how the parties in the bargaining should relate to each other on certain issues. They include negotiating, redundancy, dismissal, recruitment and promotion procedures.

Advisory Conciliation Arbitration Service (ACAS):

In order to resolve industrial disputes the government has set **ACAS**, which has three main roles:

1 Conciliation:

It acts as an independent communicator between parties. i.e. employer and trade union.

2 Mediation:

They also propose a settlement, but the parties do not have to accept it.

3 Arbitration:

ACAS listens to suggestions from both sides and then makes a decision.

Types of arbitration:

There are two types of arbitration:

1 Binding:

In this both parties will agree to abide by **ACAS's** decision.

2 Pendulum:

This is where **ACAS** will side with either the trade union or the employer.

Industrial action:

Conflict between employers and employees can lead to industrial action. Industrial action can be taken by both employers against employees and by employees against employers. However, it is in the best interest of both groups to reconcile differences through negotiations and consultation before taking action, although this is not always possible.

Possible industrial actions by employees/trade union:

Employees or trade union can take following industrial actions:

1 Picketing:

In this workers will stand outside the workplace and will not work. This might affect productivity of the organisation.

2 Withdraw of goodwill:

In this employer will offer workers to work overtime but they will refuse to work overtime, in order to pressurize him as he will not be to complete order on time and will have to accept their demand.

1982

3 **Go-slow:**

In this workers will work slowly and will reduce their productivity. This will delay production and consumer orders will not be delivered on time and apart from this employer will have to pay more wages due to go slow policy of employees.

This was used by PIA's pilots association in Pakistan, as they used to come late for their flights and the whole schedule of flights got disturbed and Govt. had to remove MD PIA as it was their demand.

4 **Work to rule:**

In this case workers will only perform those tasks which will be included in their job description. If employer will ask them for multi tasking then they will refuse to do that.

5 **Over time ban:**

Trade union will restrict its employees to work overtime and they will only work for standard hours as decided in their job contracts.

6 **Official strike:**

In this employees will go on strike with the agreement of trade union.

7 **Unofficial strike:**

In this employees will go on strike without the agreement of trade union.

8 **Sit-ins and work-ins:**

Sit-ins and work-ins are mass occupations of premises by workers. A work-in is where employees continue production with the aim of demonstrating that the fact is a viable concern. It is sometimes used when there is a threat of closure.

In a sit-in, production does not continue. The aim is to protest against management decisions and, in the case of factor closure, prevent the transfer of machinery to other factories.

9 **high rate of absentees:**

In this case employees will start utilising their casual leaves and due to this production targets will not be met on time.

10 **High labor turnover:**

In this case employees will start leaving organisation as soon as they will find better alternates. This will increase recruitment and training cost of employer.

Possible industrial actions by employer:

1 **Termination:**

In this case employer might decide to terminate those workers who are instigating others for industrial action. E.g. strike. New employees will be recruited as replacement.

2 **Suspension:**

Employer will suspend activists for industrial action. This will be on temporary basis to pressurize other employees to get back to work or to withdraw their demands.

3 **Withdrawals of fringe benefits:**

In this case employer might accept their demands but will withdraw certain incentives. E.g. reduction in medical allowances etc.

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4 Lockouts:

In this case employer might not let workers enter in the factor/office and he will lock factory. This is going to be on temporary basis to pressurize workers to withdraw their demands.

5 Transfer:

In this case employer might transfer activists to other factories/areas having lesser facilities.

6 Closure:

This is an extreme step. Owner might decide to close his business on permanent basis. All employees will lose their

7 Introduction of capital intensive production:

In this case employer might decide to introduce technology. Since the requirement of workforce will decrease and redundancies might take place.

8 Low increments:

Increment is the annual pay increase, which is given by an employer to his employees in order to enable them to meet increased cost of living, which could be caused due to inflation. This year employer might give low rate of increment to his employees.

Factors influencing the success of employee's industrial action:

There are certain factors which may influence the success of industrial action of employees. These could be:

1 Nature and strength of union:

If union members will be united to face consequences of industrial action then there will be more chances for the success of their industrial action or vice versa.

2 Legal support:

If demands of trade union are legal then there will more chances of success or vice versa.

3 Public support:

This is also going to determine the level of success of industrial action. If trade union leadership is able to gain support of public then pressure on employer will increase and he might accept their demands.

4 Media's support:

Media has become very influential in recent years. If trade union leadership is able to get support of media then there will be more chances for the success of its industrial action or vice versa.

5 Labor market situation:

It will also determine the success level of the industrial action of employees. In case of shortage in labor market employer will have to accept demands of trade union or vice versa.

6 Management tactics:

Union action is likely to be less effective if management action can reduce the problems for business. In the car industry, a strike by employees may not affect a producer if there are stocks of cars and orders can still be met.

Management may encourage non-union workers or even union member to cross picket line and come back to work.

2.4 Organisational Structure

What is an organisation?

"A group of people working together for the accomplishment of common goals".

OR.

"Organisation is a process of dividing work into convenient tasks or duties, of grouping such duties in the form of post, of delegating authority to each post, and of appointing qualified staff to be responsible that the work is carried out as planned." (G. E. Milward, Large Scale Organisation.)

2.4.1 Relationship Between Business Objectives, People and Organisational Structure

Principles of good organisation

Objective should be clearly defined. (Mission Statement)

- ✓ Flexibility.
- ✓ Responsibility.
- ✓ Discipline.

Organisational structure:

In simple words organisation structure refers to how authority and responsibility for decision making are distributed in an organisation.

Or.

Organisational structure is a system used to define a hierarchy within an organisation. It identifies each job, its function and where it reports to within the organisation. This structure is developed to establish how an organisation operates and assists an organisation in obtaining its goals to allow for future growth. The structure is illustrated using an organisational chart.



Organisational structure: Notes by Kashif Aziz.

Why an organisation should develop a structure?

- ✓ An organisational structure gives a clear guideline to its members how they are going to proceed. A clearly established organisational structure gives the group a means to maintain order and resolve disagreements.
- ✓ An organisational structure will also bind members together. It gives meanings and identify to the people who join the group, as well as to the group itself.
- ✓ Structure in any organisation is inevitable. An organisation, by definition, implies a structure. Your group is going to have some structure whether it chooses to or not it might as well be the structure which best matches up with what kind of organisation you have, what kind of people are in it, and what you see yourself doing.

Or.

Purposes of organisational charts:

- ✓ To show relationship between different management positions.
- ✓ To show responsibility of different management positions.
- ✓ Provides a complete picture of an Organisation.

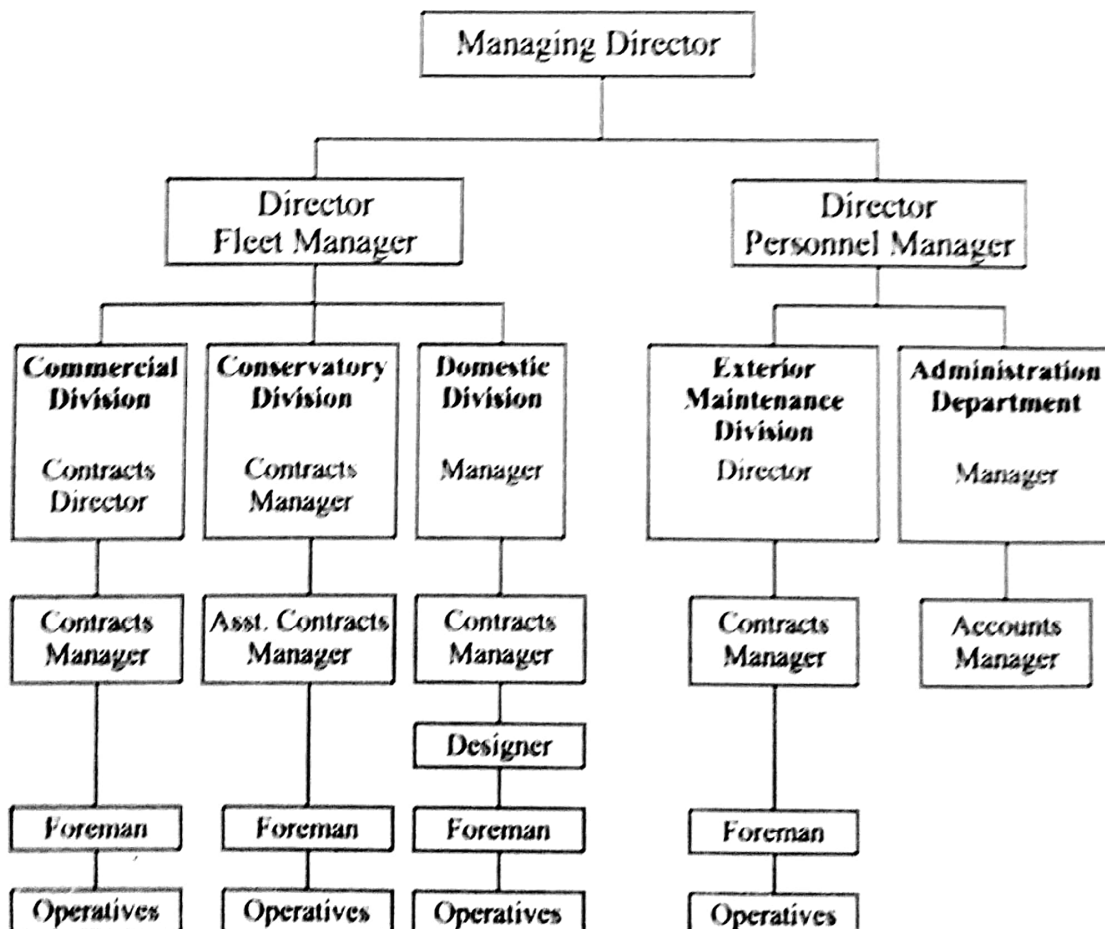
2.4.2 Types of Structure: Functional, Hierarchical (Flat and Narrow), Matrix**Different types of organisational structure:**

An organisation can be structured in different ways:

Hierarchical/Bureaucratic structure:

This is a type of a traditional and recognizable way of structuring an organisation. Many organisations will structure them in this way using a hierarchy. The levels of hierarchy refer to the number of layers within an organisation. Traditional organisations tend to have tall organisational chart with many layers of hierarchy and are often authoritarian in nature.

In a hierarchical organisation employees are ranked at various levels within the organisation, each level is one above the other. At each stage in the chain, one person has a number of workers directly under them, within their span of control. A tall hierarchical organisation has many levels and a flat hierarchical will only have a few. The chain of command (i.e. the way authority is organised) is a typical pyramid shape.



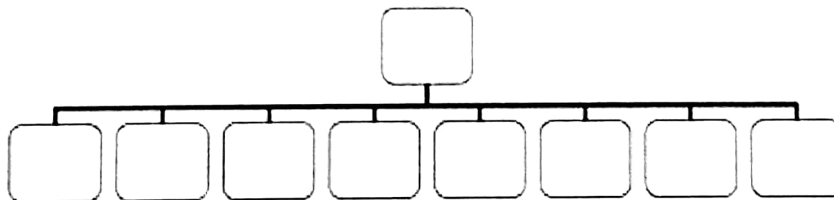
Hierarchical org. structure: Notes by Kashif Aziz.

Hierarchical structure- Advantages & dis-advantages:

Advantages	Dis-advantages
1. Employees at a lower rank know who the boss is. 2. Lower ranks can get promoted. 3. Employees know exactly what position they are in and also know what job they have to do. 4. Ensures systematic management. 5. The hierarchical structure creates clear lines of communication. The lines establishing the relationships between managers and subordinates also provide communication direction. 6. When organising employees according to hierarchy, it makes sense to organise them by job category. This allows employees to do similar jobs to share the resources allocated by managers and for managers to coordinate similar efforts for great effect. This grouping sets the stage for efficient operations and cost savings through economies of scale.	1. Communication problems might arise due to longer chain of command. 2. Jealousy between employees might rise when one gets promoted. 3. Employees may not agree on the changes within the company and unwisely express that. 4. Leads to slow decision making as there are so many authority levels. 5. Hierarchical structures centralises power and authority at the highest level possible. This could cause de-motivation in lower ranks.

Flat structures:

Taking out levels of hierarchy creates flatter organisational structure.

Diagram of flat structure:

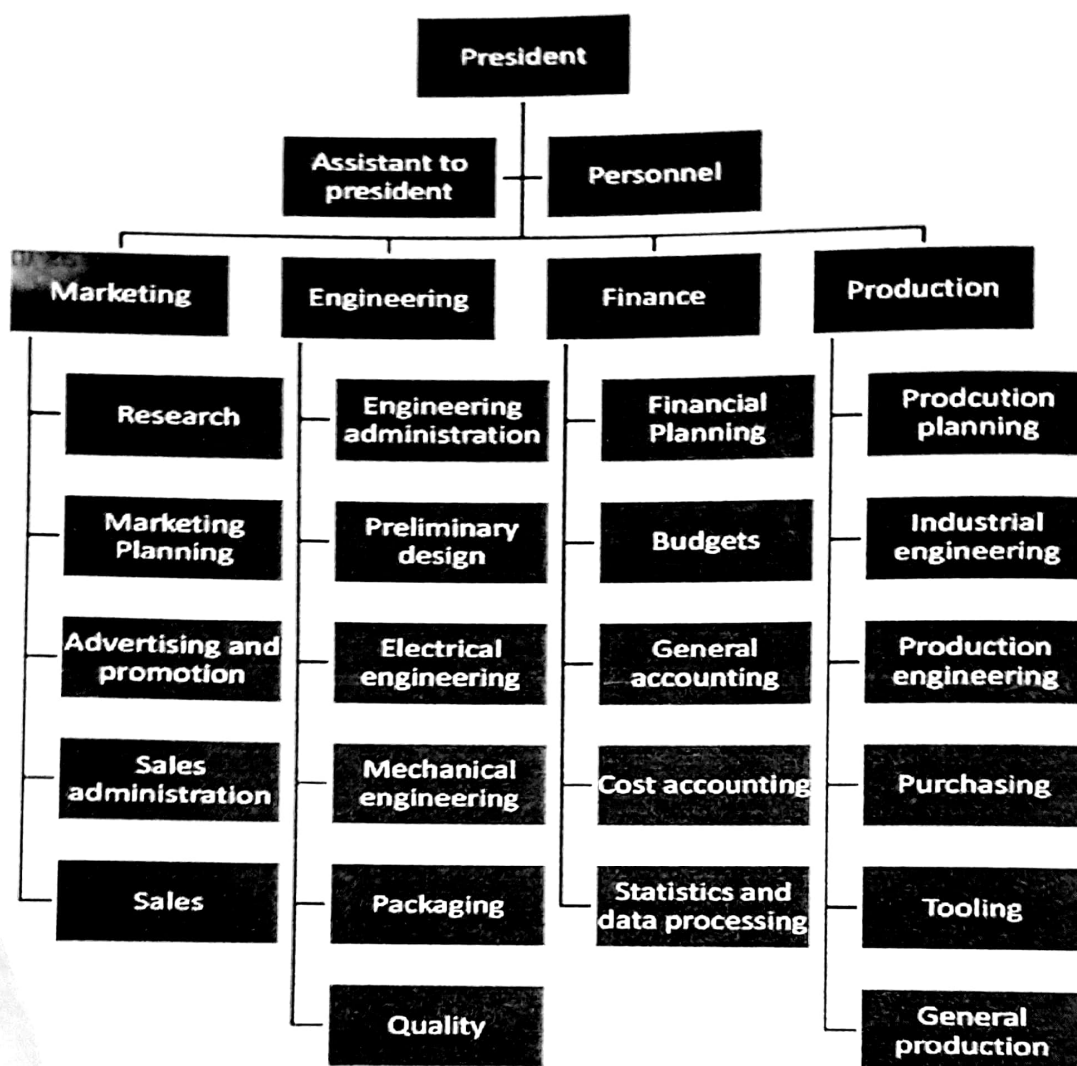
There are fewer levels in the flat structure organisation. In this example structure, there is one person at the top with everyone else reporting into them on an equally level.

Flat structure- Advantages & dis-advantages:

Advantages	Dis-advantages
1. People feel more involved and can take on more responsibility. 2. Greater communication. 3. Better team spirit. 4. Less bureaucracy and decision making. 5. Lower costs as lesser employees are there for salary payment.	1. Decisions can get stuck as a result of consulting with many people. 2. People may have matrix management, with more than one manager. 3. Only suitable for small scale organisations. 4. The function of each department can get blurred as roles merge.

Functional structure:

There are different functions of an organisation. E.g. marketing, production, research, finance, human resource etc. In this an organisation is divided into segments based on the functions when managing. This allows the organisation to enhance the efficiencies of these functional groups. As an example, take a software company. Software engineers will only staff the entire software development department. This way, management of this functional group becomes easy and effective. This type of organisational structure is likely to be successful in large organisations which will be going for mass production at low costs. The low cost can be achieved by such companies due to efficiencies within functional groups.

Functional structure:**Functional structure- Advantages & dis-advantages:**

Advantages	Dis-advantages
1. It is a planned organisational structure which has planned roles within the organisation. 2. It provides flexibility in the organisation. 3. It leads to efficient performance and to specialisation. 4. There is a clear chain of command and span of control which decrease chances of confusion. 5. There are simple lines to control. 6. There are going to be economies of scale with efficient use of resources. 7. There is going to be high quality technical problem solving. 8. In-depth training and skill development within functions. E.g. production, marketing etc.	1. There might be poor communication and coordination across functions. 2. Decision making authority is centralised with the top management which could lead to de-motivation. 3. A loss of clear responsibility for product or service delivery, and slow innovation in response to environmental changes. 4. One of the most serious disadvantages occurs when members of functional departments become overspecialized, develop self-centered, narrow viewpoints, and lose the total system perspective.

Matrix organisation structure:

The matrix structure combines two structures i.e. functional departmental and project structure. This structure uses permanent cross functional teams to integrate functional expertise with a divisional focus. In simple words for each project, an independent project team is established. This project team will have representation from all departments, e.g. marketing, production, finance, etc. These members will work together to make their project successful. Each project team will be responsible

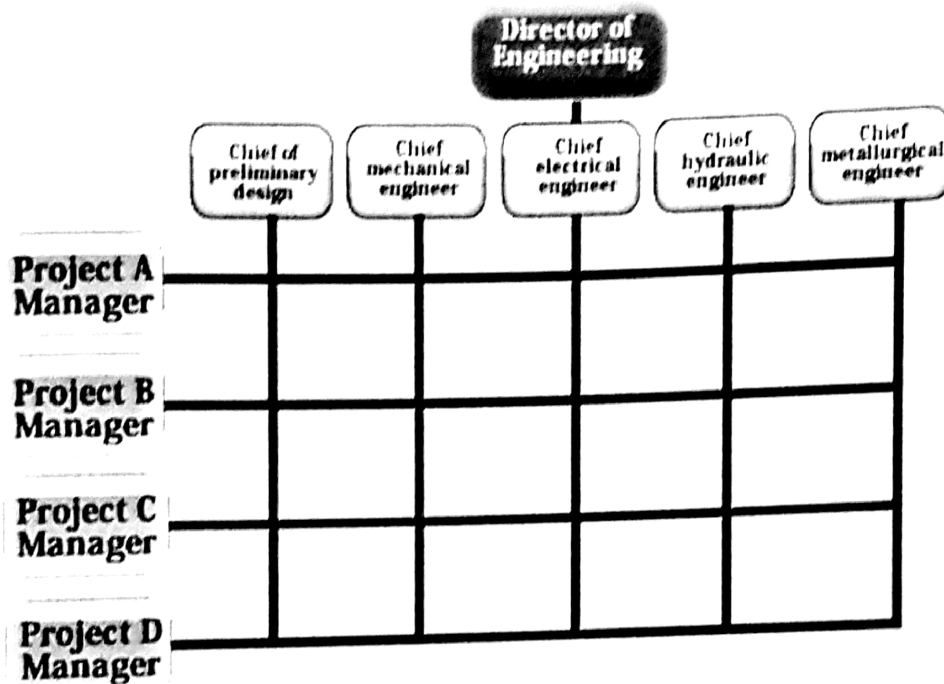
for its own project.

Employees in a matrix structure belong to at least two formal groups at the same time:

1. A functional group
2. Program or project team.

They also report to two bosses, one within the functional group and the other within the team. This structure not only increases employee motivation, but it also allows technical and general management training across functional areas as well.

Diagram of matrix organisation structure:



Matrix structure- Advantages & dis-advantages:

Advantages	Dis-advantages
1. Task of project focus is there. 2. Team working is encouraged. 3. It is a flexible structure. 4. Co-operation and coordination between different departments is encouraged. 5. More chances of success of project. 6. It is motivating and challenging. 7. It helps to develop manager skills. 8. Creativity is encouraged. 9. It releases the top management from the burden of detailed planning. 10. It also encourages de-centralisation. 11. There is going to be a quick response to change in market and technological changes. 12. Point of view of all the members of the structure becomes broader. 13. It is oriented towards end results. 14. There is going to be a clear responsibility, as it pinpoints product-profit responsibility.	1. There is less direct contact so resistance can be there from the top management. 2. There might be a conflict of interest. E.g. finance rep. might want low cost, but marketing person might demand more promotional budget. 3. There is going to be overlapping authority as a representative will be answerable to project manager and then to his departmental manager as well. 4. There will be a power struggle between managers. 5. It is costly to implement as business will have to pay salaries to so many managers. 6. It encourages discussion rather than action so decision making process may be slow. 7. Routine work of the department might be disturbed.

Note:

Matrix organisation is used in industries with highly complex product systems.

E.g. aerospace industry where project teams are created for specific space or weapon systems.

Functional vs. Matrix management:

Functional management	Matrix management
Mangers are organised according to their function, e.g. all the marketing managers are grouped together, and all the finance managers work together and so on. The advantage of this approach is that it keeps specialists working together so they can share their expertise.	It brings together employees who can help solve a particular problem, e.g. someone to deal with the marketing, someone to focus on the finance and so on. This brings together people from different functions that can benefit from each other's skills and experiences. The disadvantage is that employees have two bosses (one is the project leader, the other is their functional manager); this can cause communication problems because there can be confusion over who is in charge.

Why some organisations are structured by product and others by function or geographical area? (2A1-4).

1 Product based structure:

Product based structure is when different department of a business or different businesses work together if they are working same product lines or activities. Each division is likely to operate as a profit centre. This will help to measure the performances of each division. Apart from this health competition may take place between each division. There may be scope for reorganization. An organisation by product provides some flexibility for the future loss making divisions may be closed down. Cooperation may also improve because each division is pursuing the same goal. Organisation might also have some drawbacks it is structured this way. There may be duplication of functions in different departments. Competition between divisions may become counter-productive. This is likely to occur when the divisions compete for the organisation resources. Senior management might lose control over each individual division as well.

2 Geographical area based structure:

In a geographical based structure business has a large number of very similar operations which are widely dispersed. They are operating in a very similar or sometimes identical way. It enables to serve needs of local people more easily and there is going to be improved communication. It may possible to encourage healthy internal competition between different regions in the organisation. However, there could be certain drawbacks of this and one of them could be there is going to be a duplication of resources. Secondly, it is also possible that local managers may begin to introduce their own policies.

E.g. Beacon house and City schools are structured on geographical region basis.

3 Functions based structure:

Already discussed.

Conclusion:

Every organisation needs a structure in order to operate systematically. The organisational structures can be used by an organisation if the structure fits into the nature and the maturity of the organisation. In most cases, organisations evolve through structures when they progress through and enhance their processes and manpower. One company may start as a pre-bureaucratic company and may evolve up to a matrix organisation.

What is Delaying?

The process of removing one or more layers/levels of hierarchy from an organisational structure. E.g. all managers have assistant managers, so management might decide to remove this layer of assistant managers from organisational structure.

Difference between Delaying and downsizing?

Delaying involves removing a whole layer/level of management to flatten an organisation's structure, while downsizing involves closing specific areas of the organisation to cut costs.

Delaying- Advantage & dis-advantages:

Advantages	Dis-advantages
1. Reduces business cost. 2. Shortens the chain of command, resulting into improved communication. 3. Increases span of control results in delegation. 4. May help to raise the level of motivation of staff.	1. Redundancy payments to managers. 2. Increased work load of remaining managers. 3. Might lead to insecurity (de motivation).

2.4.3 Formal and Informal Organisations

Formal and informal organisations:

Formal organisation	Informal organisation
According to Aller: <i>"The formal organisation is a system of well defined jobs, each bearing measure of authority, responsibility and accountability."</i> A formal organisation typically consists of classical hierarchical structure in which position, responsibility, authority, accountability, and the line of command are clearly defined and established. It is a system of well defined jobs with a prescribed pattern of communication, coordination and delegation of authority. Formal organisation must be flexible each and every person is assigned the duties and given the required amount of authority and responsibility to carry out the job. It creates coordination between workers to achieve common goal. The inter relationship of staff members can be shown in the organisation chart and manuals under formal organisation.	Informal organisation is an organisation which establishes the relationship on the basis of member's interaction, communication, personal likings and disliking and social contacts within as well as outside the organisation. It arises naturally on the basis of friendship or example some common interact which may or may not be related for example the typists working in different departments may form informal group due to similarity of work common language, common hobby, common habits may also lead to informal organisation. The informal organisation relationship exists under the formal organisation also. The informal organisation gives a greater job satisfaction to the individuals and results in maximum production.

Features of a formal structure:

1. It is flexible and properly planned.
 2. It is used on principle of division of labor and efficiency in operations.
 3. It concentrates more on the performance jobs and not on the individuals performing the jobs.
- Organisation charts are usually drawn.

Coordination among members and their control are well specified through processes, procedures, rules etc. the responsibility and accountability at all levels of organisation should be clearly defined. Unity of command is normally maintained.

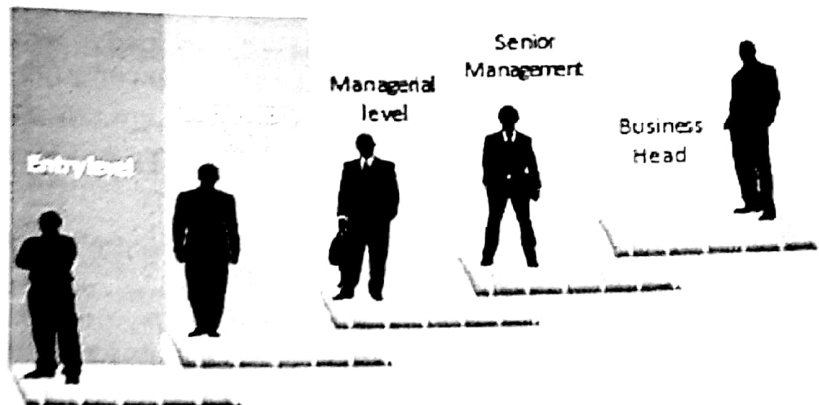
Levels of hierarchy:

In simple words it is defined as:

"Layers of management responsibility from top to bottom of a business."

Or

The arrangement of individuals within a corporation according to power, status and job function. In a public company, usually the board of directors will be at the top, followed by the CEO, who may also be the chairman of the board of directors as well as the president. Below the CEO will be other C-level executives, such as the CFO, CIO, and COO, followed by upper management (vice president/managers/directors), then the employees in each department who are further broken down into levels of experience and authority.

5 levels of hierarchy**Chain of command:**

A system whereby authority passes down from the top through a series of executive positions in which each is accountable to the one directly superior.

**Chain of Command**

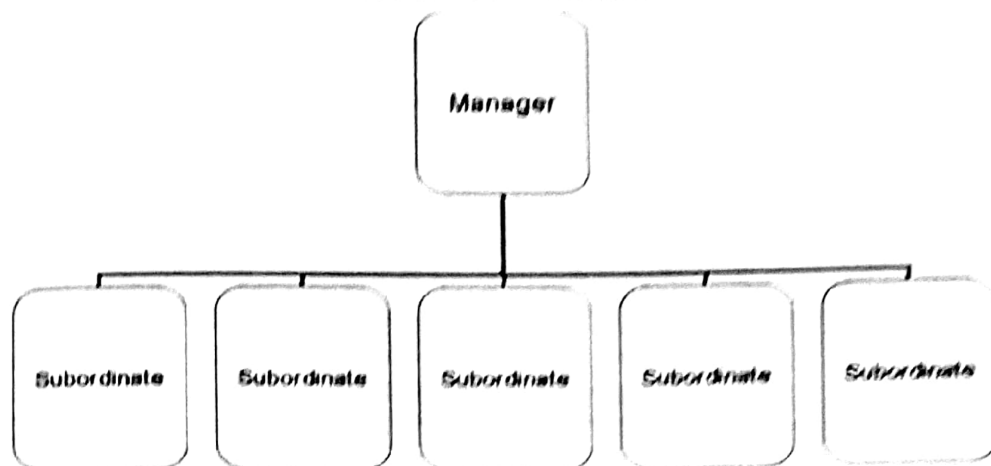
Secretary of State
Deputy Secretary
Under Secretary
Assistant Secretary
Deputy Assistant Secretary
Office Director
Deputy Office Director
Desk/Action Officer

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Span of control:

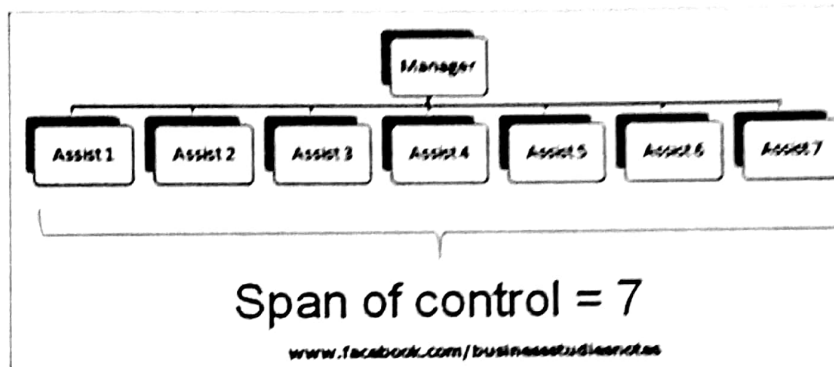
It shows the number of subordinates which are working under the direct control of a management position. E.g. a sales manager is leading a group of 10 sales representatives, so his span of control shall be 10 subordinates.

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Wide span of control:

In this a manager is going to lead a relative bigger group of subordinates. A wide span of control can have positive or negative effects on the employees, or mix of both, depending on how the business handles supervisory duties.

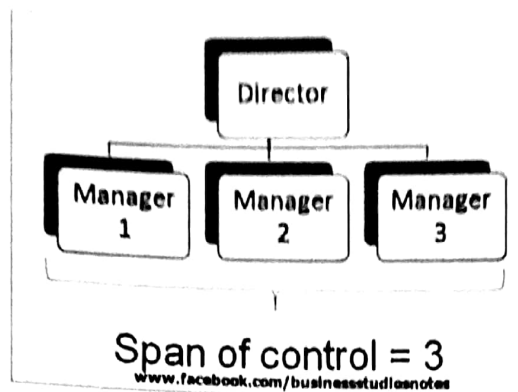


Wide span of control-Advantages & Disadvantages:

Advantages	Dis-advantages
1. Staff is empowered to make their own decisions and to carry out their own tasks without interference by managers. 2. Less number of managers will be required so it will save cost of salaries. 3. Less levels of communication for decisions to pass through. 4. High quality staff should exist.	1. There will be an excessive work burden on managers, so they may make wrong decisions. 2. They will have to supervise too many subordinates; this may affect quality of supervision. 3. Managers may get less time for planning. 4. Subordinates may make decisions they are not trained or capable of making.

Narrow span of control:

In this case a management position will manage a smaller group of subordinates.

Example:**Narrow span of control-Advantages & Disadvantages:**

Advantages	Dis-advantages
1. Better control of managers. 2. Increased morale among staff. 3. Better personal contact. 4. Better health and safety. 5. Better coordination of activities of subordinates. 6. Effective communication. 7. Centralised authority. 8. Quick decisions. 9. More chances of achieving better quality.	1. Lesser delegation as manager has few subordinates to manage. 2. More interference in subordinate's work. 3. Might lead to de-motivation. 4. High cost of salaries as more managers are to be hired. 5. It will result in long chain of command.

Tall and flat organisational structure:**Tall:**

Tall organisational structure is that where the span of control is very narrow means less subordinates are working under one management positions. In this case there would be large hierarchical level.

Flat:

Flat organisational structure would be that in which span of control is broad/wide means more workers would be under a particular management position.

Responsibility:

In simple words:

Responsibility is the duty to perform the tasks which have been assigned by the superior or the boss.

Or.

A duty or obligation to satisfactorily perform or complete a task (assigned by someone or created by one's own promise or circumstances) that one must fulfill, and which has a consequent penalty for failure.

Authority:

In simple words:

Authority is the legitimate power of a management position to make others to follow its instructions and undertake certain tasks.

Or.

It refers to legitimate exercise of power, which, in turn, is the ability to exercise influence over objects, persons or situations. Combining the classical and modern view we can state that the authority is distinguished by three characteristics.

1. It is vested in position, not people.
2. It is accepted by subordinates.

3. It flows down the vertical hierarchy.

2.4.4 Delegation and Accountability

Delegation:

The process of giving responsibility and authority to subordinates to perform/do a task. However, the final responsibility will still lie with the person who delegated the job to subordinate. If organisation is medium or large one, it becomes difficult for the office manager to do the work of the organisation. When he feels the lack of time to do a particular job within a specified time, he entrusts the work to his subordinates. Now the subordinates have the delegation of authority in doing the entrusted work. If the office manager divides the works among his subordinates, he gets time to look after his managerial functions, which are more important to him.

Advantages to managers:

1. By delegating smaller tasks to subordinates, manager can concentrate more on other important tasks.
2. Managers are less likely to make mistakes if tasks are done by specialist's employees.
3. Managers can measure the success of their tasks more easily.
4. It might help managers to raise motivation level of their subordinates.
5. Subordinates might learn new skills and in future delegation can be done to a greater extent.
6. Enables them to evaluate skills or abilities of their subordinates.

Advantages to subordinates:

1. They will get an opportunity to show their worth/capabilities.
2. This might increase promotional/career growth chances.
3. Job satisfaction will increase as their job will become more interesting and rewarding.
4. This might help to satisfy 'self esteem' needs as employees feel important and trusted.
5. They will gain more experience which might be beneficial for business in future.

Why some managers may not delegate?

1. Organisational policy may not allow them to delegate. E.g. armed forces.
2. They might be adopting autocratic style of leadership.
3. They might not be having confidence in their subordinates.
4. They might wish to have total control.
5. Managers might be scared that subordinates will do tasks better than them, making them feeling insecure.
6. They might be having time restriction to complete task.
7. Their subordinates might lack necessary skills.
8. Task might be confidential.

Delegation must mean:

1. A reduction in direct control by managers or supervisors.
2. An increase in trust of workers by managers or supervisors.

What makes an effective delegation?

For effective delegation it is important that:

1. Managers must clearly define objectives which subordinates are expected to achieve.
2. Managers must also clearly define the authority and responsibility of subordinates.
3. Managers should reward their subordinates with proper incentive for accepting responsibility.
4. Subordinates must be given proper training for carrying on tasks which will be delegated by the managers/supervisors.
5. There must be a two way communication between managers and subordinates to ensure that task shall be completed according to the expectations of managers.

2.4.6 Centralisation

Centralisation:

"The act of consolidating power under a central control".

Or.

It means keeping all the important decisions making powers within the head office or the centre of the organisation. There will be minimum delegation to managers in other areas department or division of the business.

Advantages	Dis-advantages
1. Improved decision making as specialists will make decisions. 2. Quick decisions. 3. Proper control of management. 4. Leads to the development of strong coordination between top management. 5. There is going to be a uniformity of policies and plans across the organisation. 6. Total control over organisational resources. 7. There is going to be an effective utilisation of the talents of top management. 8. Secrecy can be maintained.	1. Might lead to de-motivation of staff as there will not be delegation. 2. Might result in low productivity. 3. Might result in high staff turnover. 4. Poor quality of decisions due to lack of ideas/consultation. 5. Excessive work burden on top management. 6. Tense working environment. 7. Might lead to communication problems. 8. No opportunity for lower managers to develop/polish their management skills. 9. The success of organisation depends on the competence of top executives which might be quite risky.

Decentralisation:

Transfer of decision making power and assignment of accountability and responsibility for results. It is accompanied by delegation of commensurate authority to individuals or units at all level of an organisation even those far removed from headquarters or other centers of power.

Advantages	Dis-advantages
1. Involvement of subordinates in decision making process may raise their level of motivation. 2. Quality of decision might improve as more ideas will be contributed. 3. Top management's work burden can decrease and they can concentrate more on strategy formulation. 4. Working environment is likely to improve. 5. More career growth opportunities for subordinates or lower managers. 6. Level of job satisfaction will increase that could lead to labor stability. 7. It facilitates growth and diversification as each product division is given sufficient autonomy for innovation and creativity. 8. Decentralisation requires wider span of control and fewer levels of organisation. It might speed up communication.	1. Top management might lose control. 2. Lack of motivation of top management. 3. Chances of wrong decisions if lower managers are not experienced. 4. Company's image will be at stake. 5. Decentralisation increases the administration expense and each division has to be sufficient in terms of physical facilities and trained personnel. 6. There might be coordination problems. 7. There might be lack of uniformity and inconsistent procedures as each department might have the authority to formulate its own policies and procedures.

2.4.7 Line and Staff

Types of authority:

1 Line authority:

It means the authority a manager has in his department over the subordinates which are working under his direct control. E.g. a sales manager having a span of control of 10 sales representatives will have authority over these 10 sales representatives.

2 Staff authority:

In this manager of one department will have a function in other department but he might not be able to force them to implement his/her decision. E.g. HR department has a staff authority as it might identify training needs of production workers, but the time of training will be decided by the production manager.

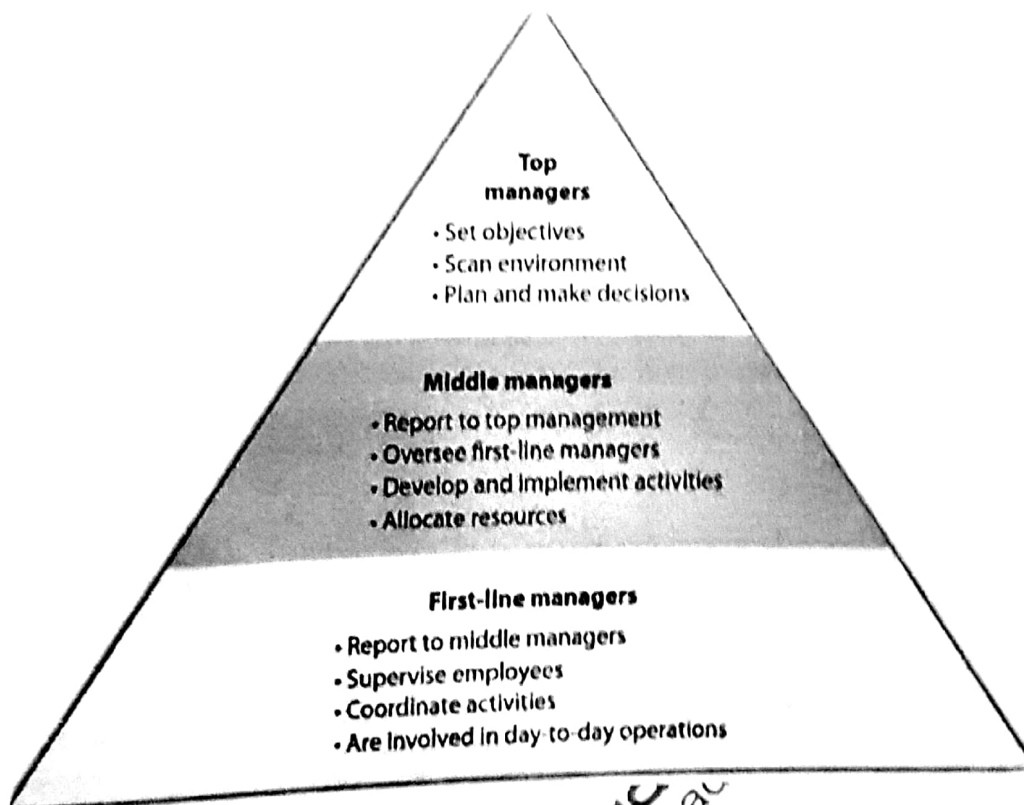
3 Functional authority:

In this manager of one department will have authority in other department and he will also be able to force them to implement his decision.

E.g. Finance manager will have a functional authority in the organisation. He might cut down promotional budget demanded by the marketing department.

Difference between administration and management:

Administration frames the objectives and policies of an organisation while management implements these policies and objectives. The administration is the top level of the organisation with the decisive functions. They are responsible for determining the policies and objectives of the organisation or the firm. Management, on the other hand is middle level executive function. The implement the policies and objectives as decided by the administration.



Difference between CEO and President:

A Chief Executive Officer (CEO) is essentially the highest-ranking executive in the company. He has most of the power. He reports directly to the board of directors. A president, on the other hand, ranks lower than a CEO on the corporate hierarchy. He reports to the CEO. Essentially, the President handles the day-to-day running of the company, and acts as a liaison between the management and the CEO. The CEO, in turn handles the planning and strategy aspect of the business, the long term plans. He also acts as a liaison between the company as a whole and the Board of Directors.



2.5 Business Communication

Communication:

In simple words, it is a process of sending and receiving messages. Communication plays a vital role in success of any organisation. It is said that success of an organisation mainly depends on the fact that how effectively its management shall be able to come up with the right decision and at the right time, and the base of decision making will be information. An effective communication system must ensure that the required information is delivered at the right time and at the right place.

Good communication is as stimulating as black coffee and just as hard to sleep after. Communication is a process by which information is transmitted and understood between two or more people. It should include both transference and the understanding of meaning.

Communication is the life blood of social as well as corporate world. We exist because we communicate a lot.

2.5.1 Purposes of Communication

Purposes/importance of effective communication:

As discussed earlier quality information is very important for quality decision making, so communication will be important for any organisation to increase chances of success.

1 Ensures effective decision making:

An effective communication system is important as it will ensure that the required information is delivered at the right time and at the right place/person. This will enable management to take timely decision to avail an opportunity for profit making/success.

2 Increases efficiency:

Effective communication will also ensure that management will be in regular contact with different levels of hierarchy. This might help to communicate effectively that what are the production targets which are to be achieved. This could motivate employees to achieve those targets.

3 Better co-ordination between departments:

For the achievement of corporate objectives it is very important that all departments must be working towards them. Effective communication will ensure better co-ordination among different departments and this will maximise chances of achieving corporate objectives.

4 Minimisation of chances of conflicts:

The main reason of any conflict is communication gap or misunderstanding. If organisation is having an effective communication system then it will ensure that there is going to be a continuous exchange of information between employees and management. This will lead to better understanding and hence decreasing chances of conflicts.

5 Raises the level of motivation of employees:

As discussed by different theorists on motivation that praise from management is a non-financial reward and it will not consume organisational financial resources but can benefit them a lot. If management will praise employees when they are doing well so it will raise their level of motivation and will also increase their productivity.

Motivation can improve communication because:

- ✓ Motivated people are more willing to discuss issues.
- ✓ Motivated people are more open to new ideas.
- ✓ Motivated people are more interested in discussing work.

6 Leads to the development of innovations:

Communication is expected to be effective when it will be a two way communication. If management will allow employees to contribute their ideas for decision making then it will maximise chances of innovations as more people will give their input/creative ideas in the process of new product development.

7 Keeps customers informed:

A business organisation also has to communicate with external stakeholders. One of the most important external stakeholders is going to be consumers. Business will communicate with them by using different means and most important will be advertisement. Effective communication will help business to inform customers about price/packaging changes, added features etc. This might also enable it to counter negative campaign of competitors as well.

8 Ensures timely response to market changes:

In this era business organisations operate in a dynamic environment which keeps on changing. It is also said that only marketing orientated businesses are likely to succeed in this era. Effective communication will enable business to predict changes in consumer's trends, with the help of which co. will modify its products to ensure that it will continue to meet demands of consumers. Apart from marketing effective communication can also help businesses in other areas as well. E.g. if business can identify possible shortage in labor market then it can recruit employees in advance to avoid shortage of labor.

9 Reduces risks of errors:

Incorrect understanding of a poorly expressed message will lead to incorrect responses. This could lead to many internal problems, such as the wrong products being made or incorrect prices being set. Effective communication will minimise chances of these errors.

6-steps process to ensure effective communication:

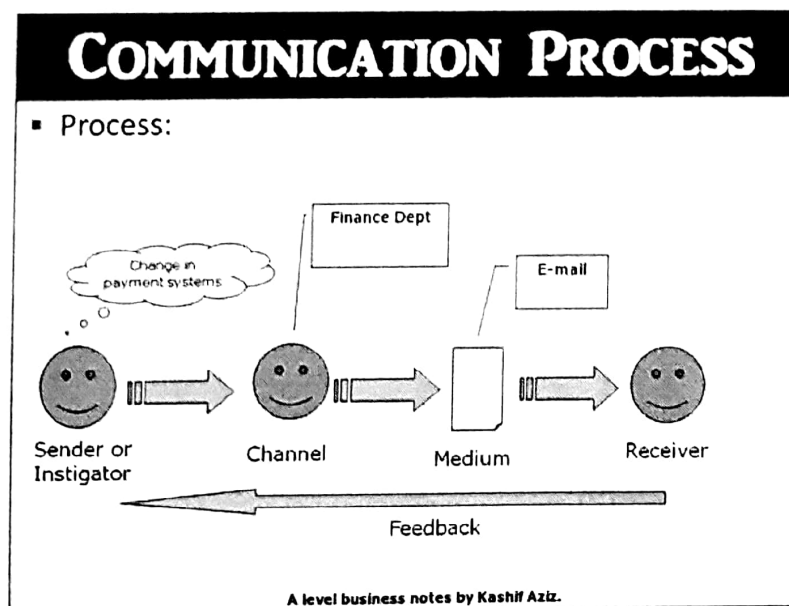
Step 1: Communication need Identified
(Why do we need to communicate?)

Step 2: Audience and objectives
(Who do we need to communicate with?
What do we need our target audience to
do (or not do), know, believe, or
understand as a result of our
communications?)

Step 3: Key messages
(What three important things do we need
to tell our audience?)

Step 4: Tools & timing
(How will we tell them and when?)

Step 5: Implementation
(Communications strategies and tactics
are deployed)

Communication process:**Sender/Instigator/Encoder:**

The one who decides to send a message. In figure 2 it could be top management who decided to make change in payment system. Message should be clear because if it will not be clear then receiver/decoder will not be able to understand it. It is generally a good idea to keep messages short and to the point.

Types of communication based on purpose and style:

Based on style and purpose, there are two main categories of communication and they both bears their own characteristics. Communication types based on style and purpose are:

1. Formal communication.
2. Informal communication.

Formal communication:

Communication between management or between formal groups is regarded as formal communication. In formal communication, certain rules, conventions and principles are followed while communicating message. Formal communication occurs in formal and official style. Usually professional settings, corporate meetings, conferences undergoes in formal pattern.

In formal communication, use of slang and foul language is avoided and correct pronunciation is required. Authority lines are needed to be followed in formal communication. Formal communication can be of two types:

1 Horizontal communication:

An exchange of messages between two management positions which belongs to the same level of management is known as horizontal communication.

E.g. a sales manager communicating with the production manager.

2 Vertical communication:

An exchange of message between two management positions which belong to different levels of management. E.g. a sales director communication with a sales manager.

3 Vertical downward communication:

In this, a higher level of management will communicate with a lower management position.

E.g. in above example if sales director will communicate with the sales manager then it will be a vertical downward communication.

4 Vertical upward communication:

In this, a lower management position will communicate with a higher level of management. E.g. in above example sales manager communicating with the sales director will be considered as vertical upward communication.

Informal communication:

An exchange of messages between employees without the recognition of management is known as informal communication. Informal communication is done using channels that are in contrast with formal communication channels. It is just a casual talk. It is established for societal affiliations or member in an organisation and face to face discussions. It is also termed as 'grapevine' communication.

In informal communication use of slang words, foul language is not restricted. Usually informal communication is done orally and using gestures. It happens among friends and family. Informal communication, unlike formal communication, does not follow authority lines.

In an organisation, it helps in finding out staff grievances as people express more when talking informally. Informal communication helps in building relationships.

Difference between one-and two-way communication:

One way communication	Two-way communications
One way communication is that in which sender will send message to receivers but response might not be there. This would include posting a memo or notice for staff members to read. It is likely to be practiced in those organisations where autocratic leadership/management style will be used.	Two way communication is when sender will send a message and he will also encourage a feedback/response from receiver. This could be done one of doing this to conduct a staff meeting where information is given and staff members are allowed to ask questions and give their feedback. It is likely to be practiced in organisations in which democratic leadership/management style will be used.

Difference between internal and external communication:

Internal communication is the process of exchanging information among the people of different level or internal participants with in the organisation. Such communication may be carried out by the use of business email data base, staff briefings, documents or meetings. More information is on the intranet, which can only be accessed by staff and members.

On the other hand, external communication is an informal exchange of information and messages between an organisation and other organisations, groups or individuals outside its formal structure. The important differences between internal and external communication are as follows:

Basic	Internal communication	External communication
1. Purpose	Main purpose is to exchange information of various departments and division of the organization.	It is done mainly for maintaining relationship with external parties.
2. Type	Two types: Vertical and Horizontal communication.	No such classification.
3. Frequency	It occurs frequently in performing organizational activities.	It occurs less frequently than internal communication.
4. Distance	No significant distance between sender and receiver.	Significant distance exists between sender and receiver.
5. Coverage	Its coverage is limited within the organization.	Its coverage is broad with external bodies.

2.5.3 Channels of Communication**Media or means of external communication:**

There are various means or channels for external communication. These are as follows:

1 Telephone:

It is the most commonly used media for external communication. Now-a-days every medium and large sized organisation has a telephone by which the organisation can communicate externally.

2 Telex and fax:

One of the popular means of external communication is telex and fax. To communicate with foreign organisation/customers telex and fax is the best and quick channel but it is not affordable to the small scale organisations.

3 **Postal and telegraphic service:**

The cheapest means of communication are postal and telegraphic services. They are the old means of business communication.

4 **Face to face conversation:**

Sometimes this media is used to exchange information with other organisations. It is an important means of because both the parties talk face to face.

5 **Mass communication:**

External communication can be performed through mass communication. Now-a-days many organisations take the advantage of mass media to communicate externally. Mass media are newspapers, radio, satellite televisions etc.

6 **internet:**

The fastest media of external communication is internet. Business can develop its website. It connects the world and provides access for prompt transfer of information.

7 **Social media:**

It is the most influential media these days. Almost every business organisation has its pages on social media. E.g. face book, twitter etc. It provides an opportunity to business to remain in touch with its target customers and collect valuable feedback for market research.

Media or means of internal communication:

Business can use a number of methods for internal communication. Prominent methods could be:

1 **Memos:**

This is the most commonly used media for internal communication. It is especially used for communication among departments. A memo provides a format for a concise message. Through this form, information flows across and up and down in the firm. It reflects information, makes request and provides response and presents informal reports.

2 **Telephone:**

The use of telephone is increasing for internal communication. The size, scope and nature of organisation affect the use of telephone for internal communication.

3 **Reports:**

A report is another well known medium of internal communication. A report contains information based on investigation is sent to the authority concerned. It is an excellent means of internal communication. E.g. every regional manager might send his daily, weekly or monthly sales report to head office.

4 **Notice boards:**

Such a board is used by many organisations to send a message to the employees. It must be kept up to date and attractive and should be placed where employees make assembly.

5 **Face to face discussion:**

Executive officers and employees many times call for a discussion and interchange views regarding the current problems. This discussion may be regular or irregular and formal or informal depending on the situation.

6 **Questionnaires and surveys:**

Information about employee attitude, morale and relationship between management and subordinates etc. may be collected through the use of questionnaire and surveys. (Also referred as performance appraisal).

7 **Fax or email:**

When department's branches or units of an organisation are scattered in different places then fax or email system is used for communication.

8 Intranet:

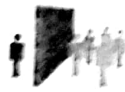
Due to wide use of computers now a day, online system has given a new image in the area of communication. Such a system interconnects all the computers of an organisation to create effective and fast communication.

9 Complaint and suggestion boxes:

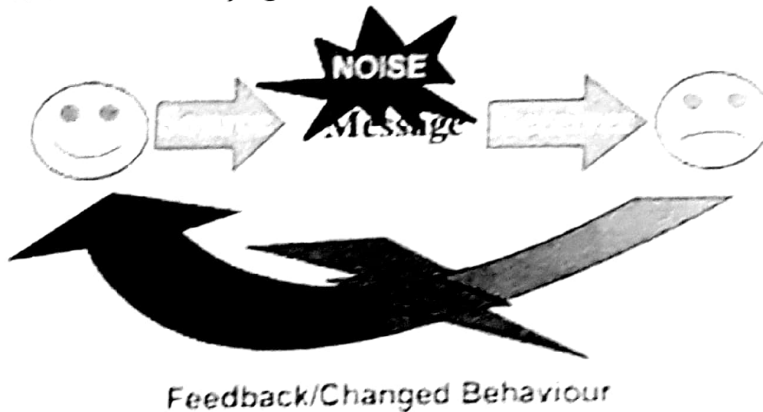
At some convenient places in the office or the factory, complaint and suggestion boxes are placed so that employees can drop their complaints and suggestions, if any, into the box.

10 Posters:

Eye catching posters are used to communicate various norms, rules principles and ideas of an organisation to make its employees aware and up to date.

2.5.4 Barriers to Communication**Barriers to effective communication:**

There are certain factors which might not let message to deliver properly or generate desire response. There are many barriers to communication and these may occur at any stage in the communication process. Barriers may lead to a message becoming distorted and you therefore risk wasting both time and resources by causing confusion and misunderstanding. Effective communication involves overcoming these barriers and conveying a clear and concise message.



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Barrier	Explanation.
1. Emotional state:	If receiver is upset, angry or depressed then he or she can misinterpret message which has been sent by the sender or encoder.
2. Lack of trust	If there is a lack of trust between employer and employee then this will not let effective communication to take place as trade union/workers will not trust commitment of employer or vice versa.
3. Noise	Various things stop a message from getting through or being heard. E.g. poor connection, background noise, distractions, too many people speaking.
4. Cultural differences	The norms of social interaction vary greatly in different cultures, as do the way in which emotions are expressed. E.g. the concept of personal space varies between cultures and between different social settings.
5. Physical barriers to non-verbal communication	Not being able to see the non-verbal cues, gestures, posture and general body language can make communication less effective. E.g. in telephone discussion this might not be possible.
6. Jargon	The use of over complicated, unfamiliar and or technical terms which are not understandable for receivers. E.g. composition of medicine given on packaging.
7. Gaps	Too many intermediaries (e.g. too many layers in hierarchy through which message has to be passed) might prevent or distort the message.
8. Overloading of information.	Message must be specific/to the point. If un-necessary information will prolong message then it might lead to slow decision making.

2.5.5 The Role of Management in Facilitating Communication

Reducing communication barriers:

In order to ensure that communication is effective and barriers to effective communication can be reduced then manager should take following six steps:

1. They must ensure that the message is clear and short but yet detailed.
2. Try to keep the channel of communication short.
3. Make sure that channels of communication are clear to all involved.
4. Communication is not considered effective unless it produces a feedback, so managers must ensure that receiver gives a feedback and if there is a problem in understanding the message it must be cleared.
5. A relationship based on understanding between employer and workers/trade union must be maintained so that they must trust each other's commitment.
6. Ensure that physical conditions are appropriate for messages to be heard or received on other ways.

Results of poor communication:

1. Poor level of motivation of employees.
2. Delay in decision making.
3. More mistakes/errors.
4. Poor decisions.
5. More chances of conflicts.
6. Poor efficiency level.
7. Poor organisational culture.

UNIT 3

Marketing

**A-II Level
Business
Teacher's Notes**

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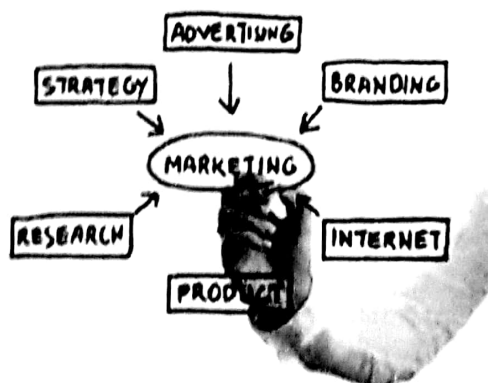
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Syllabus 2019 –21

- 3.1: What is marketing?**
3.2: Market research
3.3: The marketing mix
3.4: Marketing planning
- Market planning
 - Elasticity
 - Product development
 - Forecasting
 - Coordinated marketing mix
- 3.5: Globalisation and international marketing**
- Globalisation
 - Strategies for international marketing

UNIT-3 MARKETING (A LEVEL)**3.1 What is Marketing?****What is marketing?**

- Identifying:** Conduct market research to identify what markets and products are currently sold and potential for new products.
- Anticipating:** Analysis research data to assess what might happen in these markets and how you can design a product for these markets to gain success.
- Satisfying:** Design a product according to the identified needs of consumers to ensure that product is according to tastes and preferences of consumers to gain desired level of success.
- Profitably:** Business must try to add value to the product. This might enable business to charge high price and ensure that price of the product is greater than cost of the inputs.



The evolution to marketing orientation was a multi step process involving many other views along the way. From the beginning of capitalism until the 1950's, it had been assumed that the key requirement of business success was a product of high technical quality.

A marketing orientated firm assumes that it will only survive in the market if it is going to product products according to the requirements of its consumers. In order to achieve this objective before launching the product it will conduct market research in order to identify needs of its consumers. Final product shall be produced according to the identified needs of consumers. A marketing orientated firm shall be flexible in its approach and it will continue to modify its products with the changing trends of consumers. Market research is going to be a continuous process in such firms as it will keep on informing co. about the changing trends of consumers, new opportunities and threats in the markets.

Unit-3

Difference b/w marketing and advertising:

Advertising is mainly about selling the product or services, as opposed to marketing, which is the entire process of developing, branding, designing the product or service to bringing it to the market.

Explain the importance of a market-orientated approach for a business in the consumer goods market. [8] (Nov, 06, Q5-A)

1. There is going to be tough competition in this segment of the market, so only that co. will get success which will produce goods according to the requirements of its consumers.
2. These products are likely to gain more success as they are produced according to consumer's tastes. Business might be able to achieve higher level of market share and profitability.
3. Since these products are intended to satisfy basic needs of consumers which might change with the passage of time. Use of marketing orientated approach will enable co. to modify its products according to the changing trends of consumers as such firms will always be willing to adapt according to the changing trends of market.

Factors which increased importance of marketing concept:

1. Increased competition also increased choice for consumers, so they prefer to buy that product which is according to their tastes and preferences.
2. Globalisation made it easier for companies to access foreign markets.
3. Improvement in media has increased consumer awareness.
4. Improvements in technological sector also lead to the development of innovative products.
5. Consumer's purchasing power has improved and now they are able to buy better quality products at high price. E.g. use of credit cards.



3.2 Market Research

Market research..

A systematic and objective collection, analysis and evaluation of data related to market and marketing.

Market research	Marketing research
It is related only to consumers' product tastes and preferences.	On the other hand marketing research is a wider term which also includes the analysis of marketing strategies related to promotion, pricing distribution and packaging.

It is very important for companies as it will enable them to identify tastes and preferences of consumers with the help of which they will be able to design their products to ensure success.

It is considered to be quite an expensive activity as it involves both time and financial costs. Considering this fact we might find a major variation in the market research budget of different companies.

Methods of market research:

Market research is classified into two types:

1. Primary/field research.
2. Secondary/desk research.

Primary research:

In this co. will use its own resources to collect first hand information directly from consumers. This could be collected through questionnaires or by personal interviews.

It enables co. to collect more reliable information, however it is going to be more expensive and more time consuming as compared to the secondary market research.

Explain why a business might choose to conduct primary market research. (June, 2011, p1, Q1)

1. If co. is planning to launch an innovative product. For innovations information will not be readily available, so for this co. will have to conduct primary market research.
2. If it is co's policy to conduct primary market research.
3. If reliable secondary data is not available then in this case even co. will have to conduct primary market research.
4. If co. wants to use its research as a public relation technique and make its customers realise that their views are very important.

Advantages & dis-advantages of primary research:

Advantages	Dis-Advantages
1. Co. can collect reliable information directly from consumers. 2. Co. can be sure that the information collected is up to date. 3. It might also get a competitive advantage as competitors will not have this information.	1. It is more expensive, therefore might just be suitable for large scale firms. 2. Data collection will require longer time as compared to the secondary market research. 3. It might be difficult to collect data due to the lack of interest of consumers.

Sources of primary data:**Interviews:**

Interviews are one-on-one or small group question and answer sessions. Interviews will provide a lot of information from a small number of people and are useful when you want to get an expert or knowledgeable opinion on a subject.

Surveys:

Surveys are a form of questioning that is more rigid than interviews and that involve larger groups of people. Surveys will provide a limited amount of information from a large group of people and are useful when you want to learn what a larger population thinks.

Observations:

Observations involve taking organized notes about occurrences in the world. Observations provide you insight about specific people, events, or locales and are useful when you want to learn more about an event without the biased viewpoint of an interview.

Analysis:

Analysis involves collecting data and organizing it in some fashion based on criteria you develop. They are useful when you want to find some trend or pattern. A type of analysis would be to record commercials on three major television networks and analyze gender roles.

Questionnaires:

Business can prepare a questionnaire on which it can write different questions. Benefit of this will be that a variety of information can be collected on a page however its limitation will be that it is going to be one way communication.

Secondary/Desk research:

In this co. will use secondary data for its market research. Secondary data is defined as that information which is already available or it has been used in past by some co. for its market research. This type of research is considered to be less expensive and less time consuming as compared to the primary market research.

Reasons for conducting secondary/desk research:

1. If co. is planning to launch a traditional product. e.g. soft drink.
2. If it cannot afford to conduct primary market research.
3. If it does not have enough time to conduct primary research.
4. If reliable secondary data is available:
5. If it is co's policy to conduct secondary market research.

Sources of secondary data:

1. Internet.
2. News papers.
3. Electronic media.
4. Govt. statistics. E.g. economic survey.
5. Buy research of private research agencies.
6. Past promotional data.
7. Published accounts.
8. Past year's sales records of the co.

Advantages & disadvantages of secondary research:

Advantages	Disadvantages
1. Information is readily available. 2. It is less expensive and less time consuming as compared to the primary research. 3. Business can collect variety of information from different sources. 4. Business can find out what competitors are doing.	1 Information collected might be out of date. 2 High risk factor. 3 Information might not be relevant to the requirement of the co.

Types of market research:

There are two types of primary research:

1 Quantitative research:

Quantitative research quantifies the data and generalizes the results from the sample to the population. In quantitative research, data can be collected by two methods:

1. Survey method.
2. Observation method.

2 Qualitative research:

- it refers to why consumers will or will not buy a particular product.
- It discovers the motivational factors behind consumers buying habits.
- This research can be done through personal interviews and in-depth discussions among groups. i.e. focused groups, and consumer panels.

What is a sample?

A group of consumers sharing some common characteristics, which co. decides to consult for its market research. It is used for primary market research.

Advantages of sampling:

1. It is economical and cheaper.
2. Faster to execute.
3. Practical in most situation.
4. Can give comprehensive information.
5. Saves in time and money.

Sampling methods:**1 Random sampling:**

- According to this co. selects respondents for its market research from a data base. E.g. the lottery method, e.g. picking numbers out of a hat or bag.

- The major objective as well as advantage of this method is that the entire survey population has an equal chance of becoming a part of the sample.
- The disadvantage is that by chance the selected people may have similar preferences and so the sample may not be a true representation.

2 Quota sampling:

- In samples selected by quotas, selection is made according to a set proportion of people from particular areas, based on consumer consumption.
- E.g. if research was to be conducted in Pakistan, and a sample of 200 people was to be selected, then 10% might be selected from Baluchistan, 15% from KPK, 50% from Punjab and 25% from Sindh.
- Helps to ensure that each target market segment is given representation in the sample.
- Helps to overcome drawback of random sampling.

3 Stratified sampling:

- In this method, the population is divided into sub-group's samples.
- The sub-group consists of only those people that are interested in the product.
- Therefore, the samples would be a truer representation.
- e.g. if a new magazine is to be printed that would have articles related to teens, then the sub-group would be teenagers.

4 Cluster sampling:

- This sampling is used when a full sampling frame list is not available or when the product is mainly likely to appeal to specified groups of consumers.
- E.g. town or regional newspapers, then cluster sampling will take a sample from just this group – not the whole population.
- Random methods can then be used to select the sample from this group.

5 Multi-staged sampling:

- This method involves the selection of a sample from another larger sample.
- E.g. continent Asia may be decided, then its south-east region, from which Pakistan is selected, then a province, then city and finally a district is decided upon. Similarly a street within a city would be selected and then a particular household on that street.

6 Snow balling:

- Firstly a group of people is selected as the first sample. Then they are asked for one contact or reference who is then added into the sample and so the size increases, the snowball effect.
- Businesses in highly secretive markets use this.
- E.g. firms engaged in producing highly specialized and expensive one-off products for a very limited range of customers may need to rely upon snowballing.



3.3 The Marketing Mix

Marketing mix:

The definition that many marketers learn as they start out in the industry is:

"Putting the right product in the right place, at the right price, at the right time".

Marketing mix is a key part of any firm's marketing plan. It refers to those elements of a marketing strategy, which are designed to meet the needs of the consumers.

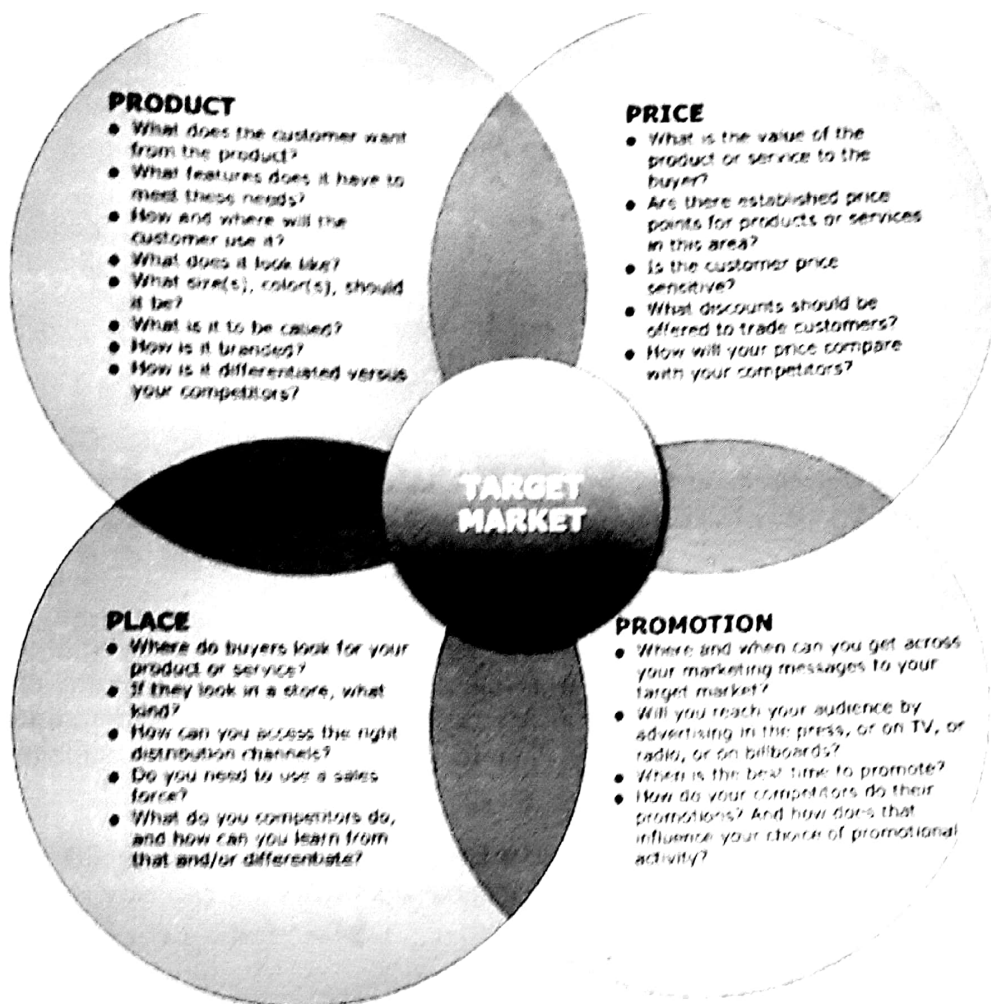
So to meet consumer needs businesses must produce:

1. The right Product
2. At the right Price,
3. Make it available at the right Place, &
4. Let consumers know about it through Promotion.

The elements of marketing mix:

A planned mix of the controllable elements of a product's marketing commonly termed as 4Ps.

1. Product.
2. Price.
3. Placement.
4. Promotion.



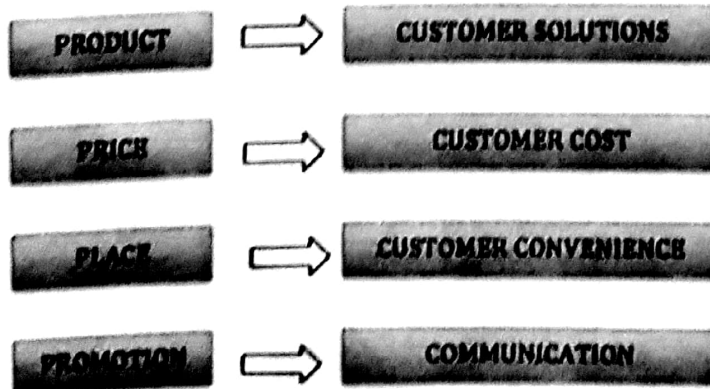
Not all the 4Ps in marketing mix have the same degree of significance in each case. It is vital that these elements should fit together into a coherent and integrated plan. A company should have a coordinated marketing mix. It means that every element of the mix should be in one direction to achieve the marketing and overall objectives of the firms.

These four main elements of the marketing mix can be varied to meet consumer needs more effectively which can increase sales and profits.

4Cs of marketing:

Created in 1993 by Robert Lauterborn, the Four C's is an updated classification system of the Four P's. This model shifts the focus from the producer to the consumer and is a better blueprint to follow for smaller businesses that are marketing to a niche audience.

How the 4Cs relate to the 4Ps



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Consumer replaces product:

Business will have to study consumer wants and needs and then it must produce a product to attract customer that it has developed solutions for their needs and wants.

Price is replaced by cost:

Price is the only one factor in acquiring customers. Cost reflects the cost of using the product, which can include inconveniences (changing from one computer software to another) and customer ethics (such as choosing between organic and non-organic eggs).

Place is replaced by convenience:

Place is replaced by the convenience function. Convenience (whether geographical or through search engines) influences the perceived value of a product. The ease in which a consumer can buy a product is crucial in deciding what business acquires customers.

Promotion is replaced by communication:

Communication enables businesses to focus on customers more than simply promotion. It can include advertising, public relations, personal selling, viral advertising and any other form of communication between business and consumers. Business needs to be innovative and creative to improve communication with its consumers. Modern means could be page on any social website e.g. Face book etc.

The Four C's model is better tuned to the needs of smaller businesses that do not yet have a strong brand name equity. As such, it is crucial that these businesses develop a two way relationship with their target audience.



Marketing planning:

What a marketing plan does?

1. What a business is planning to achieve. (Marketing objectives).

- ### **Importance/benefits of marketing planning:**

1. A marketing plan will help business to ensure success of its marketing operations.
2. It enables management to move ahead to future in a systematic way.
3. Marketing planning helps to coordinate activities that can lead to achieving marketing objectives over time.
4. With the help of marketing planning business will be able to allocate resources in a better way reducing danger of wastage of resources.
5. A marketing plan will provide a framework to continue to review its operations. It will make business to pay more attention to market enlargement rather than marketing maintenance.
6. Marketing planning will help to evaluate performance, capitalize on strength, and minimize weaknesses and threats to finally open up new opportunities.
7. Marketing planning will also enable business to minimise the risk of failure.

8. A marketing plan will promote a comprehensive view of business organisation and it will act as a process of communication and coordination between marketing department and other departments.

Features/characteristics of marketing plan:

1. The success of marketing plan will largely depend to the extent upon human behavior and response. If they will be committed then chances of success will be high or vice versa.
2. The process of preparing marketing plan is quite complicated in nature.
3. Marketing decisions have long term effects on efficiency, profitability and market position of a business organisation.
4. Marketing planning is a rational activity. It will require thinking, imagination and foresight. Market analysis, market projection, consumer behavior analysis and marketing guided conclusions. They will have to be based on data and measurements drawn from internet and external environmental factors.
5. Marketing planning is a formal and systematic approach towards planning of all marketing activities, product positioning, price setting, distribution channels etc.
6. Marketing planning is a forward looking and dynamic process designed to promote market oriented or consumer oriented business actions.

Essential components of a marketing plan:

There are certain essential components of a marketing plan that keeps the sales pipeline full. These are:

1 Market research:

Business would first need to conduct market research. In this it will collect, organise and write down information about customers that are currently buying its products. In this process might need to consider market patterns, target market, market segments, buying pattern of consumers etc.

2 Target market:

A well designed marketing plan must also define target market description, i.e. most likely buyers of company's products.

3 Positioning:

Marketing plan must also identify perception of company's brand in market. For example, if we are a restaurant business selling burgers. We should be able to identify that how does our product relates to the market? What do our target customers need what options/facilities they currently have, what do they need above and beyond current use?

4 Competitive analysis:

We should also conduct competitive or competitor analysis. In this we would need to know that our competitors are. How our products are different from our competitors? We should also analyse pricing strategies of our competitors and what market segment they are aiming to reach? Such analysis of strengths and weaknesses of competitors will enable business to be in a better position to meet competition effectively. Business should be able to develop its "unique selling proposition." That will make it differentiate from its competitors.

5 Mission statement:

Business should also write mission statement related to its marketing plan. In this it might write:

- "Target market": The market it is planning to sell its products.
- "Contribution: What it plans to sell in market.
- "Distinction: What make its unique/different from its competitors?

6 Market strategies:

Business must write down/design its marketing and promotional strategies that it would use to achieve its objectives. In this process business must ask itself "how it will find and attract its target customers?" it is

the core of what the marketing strategy should explain. Apart from this it should also look at the entire marketplace and then break down specific tactics including such as events, direct mail, email, social media, content strategy, direct marketing teams, webinars, seminars, partnerships, and other activities that will help it to gain more customers.

7 Budget:

Business must determine its marketing budget. In this it should decide that what strategies it can afford? What can it do in-house, what it would need to outsource. It should develop monthly budget it plans to spend on marketing activities.

8 Marketing goals:

Business should also define its marketing goals; such goals shall be in quantifiable mode. It means that business should be able to turn its goals into numbers. For example, marketing goals might be to gain 40 new clients or to sell 20 products per week or to increase revenue by 40% this year. Marketing goals could include sales, profits or customer's satisfaction.

9 Monitor you results:

The last step of market planning will be to monitor results achieved due to the implementation of marketing plan. In this business will test and analyse. It will identify strategies that are working. In this process it could:

- Conduct consumer surveys.
- Track sales, visitors to company's website, percentage increase in sales.
- It might research the market, its competitors to determine unique positioning.
- It could identify that how it could position to promote and sell its products more effectively.
- It could also be able to determine whether or not its efforts are generating desired result or its campaign needs redesigning.

Disadvantages of marketing planning:

There could be certain disadvantages of marketing planning. These could be:

1. Market planning could be time consuming and could delay product launch.
2. Marketing environment or conditions keep on changing frequently, considering this it would be difficult for business to make certain assumption while designing its marketing plan.
3. The marketing plan of business could ignore certain situations such as business take over etc.
4. It could lead to faulty marketing decisions if data is not properly analysed.
5. It could result in unrealistic financial projections/forecasts if information is not interpreted correctly.
6. It could also identify weaknesses in overall business plan that could require its redesigning, which could be a complicated and time consuming process.

Elasticity of Demand

3.4.2 Elasticity

Income elasticity of demand (YED):

It measures that change in quantity demanded due to change in income of consumers. Income of consumers is one of the major determinants of quantity demanded. It can be calculated with the help of the following formula:

$$\text{Income elasticity of demand (YED)} = \frac{\% \text{ change in quantity demanded (QD)}}{\% \text{ change in consumer's income (Y)}}$$

Example:

Economy is booming and due to that consumer's income increased by 25% this increase in consumer income leads that demand for goods increased by 15%.

Calculation:

$$\begin{aligned} \text{Income elasticity of demand (YED)} &= \frac{15}{25} \\ \text{Income elasticity of demand (YED)} &= 0.6 \end{aligned}$$

How to use result?

1. If answer is positive (+) then product is said to be a normal product, as consumer's income will increase they will increase spending on such product.
2. If answer is negative (-) then product is said to be an inferior product, as when consumer's income will increase this will increase their purchasing power and they will shift to better quality products and demand for this product will decrease.

Why it matters?

1. As an economy grows and expands, people will enjoy a rising income. In most cases, the demand for goods and services is likely to increase as well.
2. As consumer income will rise the demand for income elastic goods/services will increase because people will have more money to spend. Income elastic goods including luxuries for example, airline travel, movies, restaurants meals and cars.
3. As income rises for income inelastic goods/services tends to increase only marginally. Consumer staples like toothpaste and "sin" items like tobacco tend to fall into this category.
4. Finally, a good/service with negative income elasticity is known as an inferior good (as explained above). In many parts of the world bicycles are an inferior good. As income rises, demand for bicycles decreases as people shift to motor bikes or cars.

Promotional or advertising elasticity of demand (AED):

It measure that change in quantity demanded due to change in promotional/advertising spending of business. It helps to determines promotional spending on a product.

$$\text{Promotional/Advertising elasticity of demand (AED)} = \frac{\% \Delta \text{ in Qty Demanded}}{\% \Delta \text{ in promotion spending}}$$

Value	Description
0	Perfectly inelastic
Under 1	Inelastic
1	Unitary
Over 1	Elastic
Infinity	Perfectly elastic

Why it is calculated?

To determine promotional spending on a product.

How to use result?

Promotional/advertising elastic demand:

1. If AED (answer) is greater than 1 then product is said to have advertising/promotional elastic demand. It means that the demand for the product is highly responsive to changes in advertising expenditure. This means that an increase in advertising expenditure will generate greater increase in demand for the product. luxury goods are more likely to have advertising/promotional elastic demand. For example, restaurants, family holiday packages etc.
2. If AED (answer) is less than 1 then product is said to have promotional/advertising inelastic demand. In other words product is less responsive to advertising expenditure. An increase in advertising expenditure of, say 25%, has led to a growth in demand for the product of less than 15%. The lower the value of the AED, the less effective advertising expenditure has been at boosting demand. Basic necessities such as cooking oil, salt, and pulses are more likely to have advertising inelastic demand.

Factors influencing promotional/advertising elasticity of demand (AED):

1. Type of product i.e. whether the product is existing or new product.
1. Brand name. If brand name is renowned then demand is expected to increase by a greater proportion or percentage.
2. Number of competitors and substitutes in the market.
3. Strategies of competitors. If competitors are using price leadership strategy then increase in advertising might not be able to generate more sales.

4. Frequency of advertisements. If business is not advertising frequently then demand might increase with a lesser percentage or proportion.
5. Mode of advertisements. For example, if business selected inappropriate media then it might not be able to achieve desired increase in sale.
6. Time of advertisements is also very important. It must select that time for advertisement at which its target audience will be watching media at which business is advertising.
7. Other factors influencing demand like tastes, professions, income etc.

Application/uses of AED:

1. Helps in evaluating success of advertising campaign.
2. Helps the firms in deciding advertising expenditure or budget.
3. Helps in choosing more effective media for promotion.
4. Helps in withdrawing ineffective promotional campaigns.
5. Helps in strategic management to respond to competitor's promotional policies.
6. Helps in building brands.

Limitations of the AED value:

1. Value of AED does not help in analyzing effect of advertising a single product.
2. Difficult to analyze the effectiveness of promotional strategies at a particular period of time, especially when the campaigns are over a long period of time
3. The Purpose of campaigns may be to create brands, rather than only influencing size of demand.
4. AED does not take into account effect of other factors influencing demand.

Cross elasticity of demand (XED):

It measures the change in quantity demanded of a product (Product-A) due to the change in price of another product (Product-B)

$$XED = \frac{\% \text{change in QD (Product-A)}}{\% \text{change in price (Product-B)}}$$

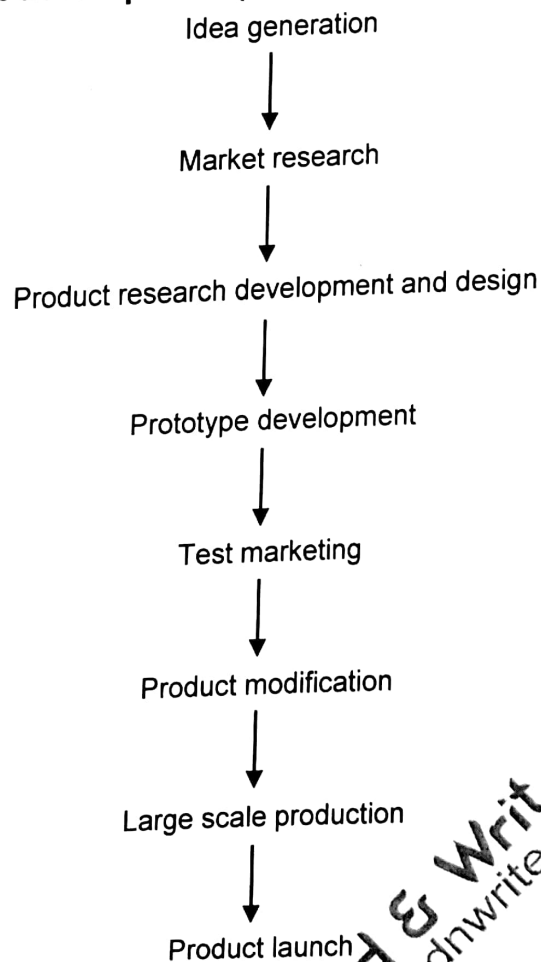
How to use result?

1. If answer is positive then products are said to be substitutes. For example, Coke and Pepsi, petrol and cng etc.
2. If answer is negative then products are said to be complementary products. They will have joint demand. For example, Petrol price and demand for petrol cars or bread and butter etc.
3. Independent goods have a cross-price elasticity of zero, as the price of one good increases the demand for the second good is unchanged.



3.4.3 Product Development

Process of new product development (NPD)



Constraints on new product development

1. Business might be facing shortage of finance to fund new product development.

2. Cost of new product development might be too high, for example, research & development cost.
3. Market conditions might not be suitable for the launch of a new product. For example, market might be going through economic recession.
4. Government policies might not be suitable for the launch of new product. For example, to control inflation central bank might be adopting a policy of increasing interest rate.
5. Required technology for the development of new technology might not be available in country.
6. Law and order situation might not be suitable for market growth.
7. Market might be very competitive and it might be saturating.

Sources of ideas for new product development:

Internal sources	External sources
1. Research & development (R&D) department can research market to identify a market gap and business can develop new product to fill in that market gap and earn profit. 2. Business can encourage group working and such group of employees can come up with an idea of new product development. One recent research showed that almost 45% of the ideas come from the employees.	1. Many companies now use web technology (social media etc) to enable customers give feedback and ideas to company that how they can improve or what new products they should offer to become more successful. 2. Businesses use intermediaries/middle man to distribute their products. Wholesalers, retailers and distributors work very closely with the market and they know consumer requirements. They can give valuable suggestions like new concept, technique or materials which can be used by business to develop new products. 3. Competitors can be another important source for the ideas to develop new products. Business can analyse their competitor's strategies to develop ideas for new product development.

3.4.4 Forecasting

Forecasting:

The process of predicting sales for the coming time is known as sales forecasting. It is very important for a business due to various reasons. For example, it helps to set sales and profit target for the coming time etc.

Levels of sales forecasting:

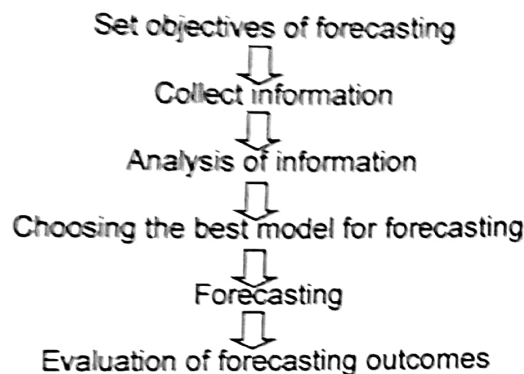
Short term	Medium term	Long term
Forecasting for a time period of 3 months to come. It might be done for tactical matters and in this general trend of sales is less important than short term fluctuations.	In this sales forecasting is done for one year. It is an important part of the process of budgeting.	In this forecasting is done for time period of 3 year or more. It is mainly needed by financial accountants for long term resource planning.

Importance/benefits of sales forecasting:

1. It helps to determine the level of demand for the coming time period with the help of which business shall be able to prepare sales budget and set sales target.
2. It will help to determine production level for the coming time period as business will plan production according to sales forecast.
3. It helps to determine revenue target for the coming time period.
4. Business will be able to determine promotional spending accordingly. For example, if business thinks that it will be able to get enough sales (forecast) then it will spend less on promotion or if forecasted sales is low then it will spend more on promotion to generate more sales.

- 3. It also helps to set profit target for the coming time period.
- 4. It will also help in preparing cash flow forecast statement/budget. For predicting cash inflows business would need the amount of sales which will be provided by the sales forecast.
- 5. It also helps in preparing sales and master budget as business would need to prepare forecasted income statement and for this it would need the amount of forecasted sales revenue which will be provided by the sales forecast.
- 6. It also helps to plan future capital expenditure/growth projects. For example, if sales forecast is for high sales then business will be able to earn more profit and might start growth projects or vice versa.
- 7. It will also help in conducting investment appraisal as to calculate Net cash inflows business would need the amount of sales which will be provided by the sales forecast.

process of sales forecasting:



Limitations of sales forecasting:

1. Sales forecast is just a prediction and cannot guarantee actual result as external environment might change. For example consumer trend might change or a new competitor might launch better range of products in market.
2. If past data is not available then it might be difficult to do sales forecasting. If business is using moving average/trend analysis then past data will be required.
3. If past data is not reliable then there will be a big question mark on reliability of such forecast.
4. Reliability of sales forecast will also depend on the expertise of personals involved in conducting this process. If they are not qualified or experienced then sales forecast might result in variances.
5. If consumer trends are changing frequently then such forecasts might prove wrong.
6. While forecasting sales business will make certain assumptions regarding external environment. If external environment changes more than expectations of business then this forecast might prove wrong.

Methods of sales forecasting:

1 Sales force composite method:

It is a sales forecasting method. In this sales agents forecast sales in their respective areas/regions. After this sales of all sales agents will be consolidated at branch/region/area level and aggregate of all these is consolidated to develop an overall company sales forecast. This forecasting method could be effective as the sales agents will forecast sales themselves so they will put in more effort to achieve these targets. However, since the sales agents are not experts in forecasting sales so they might not be able to employ the sophisticated forecasting techniques properly.

2 Delphi method:

The Delphi technique was invented by Olaf Helmer and Norman Dalkey of the Rand Corporations in 1953 for the purpose of addressing a specific military problem. The objective of Delphi method is to obtain a reliable response to a problem from a group of experts. In a Delphi study, the participants do not interact with one another. In sales forecasting first the group facilitator selects a group of experts based on the topic being examined. Once all participants are confirmed, each member of the group is sent a

questionnaire with the instructions to comment on each topic based on their personal opinion, experience or previous research. The questionnaires are returned to the facilitator who groups the comments and prepares copies of information. A copy of the compiled comments is sent to each participant, along with the opportunity to comment further.

At the end of each comment session all questionnaires are returned to the facilitator who decides if another round is necessary or if the results are ready for publishing. The questionnaire rounds can be repeated as many times as necessary to achieve a general sense of consensus.

The benefit of Delphi method is that it brings geographically dispersed panel experts together, so wide variety of opinion can be collected in limited time. However, lack of face to face interaction could be a disadvantage.

3 Jury of experts:

It is the oldest method of sales forecasting. One or more experts who are experienced and have good knowledge of the market factors predict the expected sales. The executives are responsible while forecasting sales figures through estimates and experiences. They will consider all internal and external factors while forecasting sales. This is a type of commitment approach. This method is simple as experiences and judgments are pooled together in taking a sales forecast figure. If there are many experts, their estimates are averaged in drawing the sales forecast.

The benefit of this method is that it is simple and quick and detailed data is not needed. However, it is not based on factual data and it is also difficult to break down the forecasts into products, markets etc.

4 Consumer surveys:

Consumer survey method is one of the most common and direct method of sales forecasting in the short term. This method focuses on the future purchase plans of consumers and their intentions. In this method, a business will conduct surveys with consumers to determine the demand for their existing products and services and anticipate the future demand accordingly.

5 Moving average method:

A moving average is a technique to get an overall idea of the trends in a set of data, it is an average of any subset of numbers. The moving average is extremely useful for forecasting long term trends. One can calculate it for any period of time.

For example, if business has sales data for a twenty year period it can calculate a five year moving average, a four year moving average, a three year moving average and so on. Stock market analysts will often use a 50 or 200 day moving average to help them see trends in the stock market and forecast where the stocks are headed.

Moving Averages

When using moving averages for forecasting, remember:

1. Moving averages can be simple or weighted.
2. The number of periods you use for your average, and any weights you assign to each are strictly arbitrary.
3. Moving averages smooth out irregular patterns in time series data; the larger the number of periods used for each data point, the greater the smoothing effect.
4. Because of smoothing, forecasting next month's sales based on the most recent few month's sales can result in large deviations because of seasonality, cyclical, and irregular patterns in the data; and
5. The smoothing capabilities of a moving average method can be useful in decomposing a time series for more advanced forecasting methods.

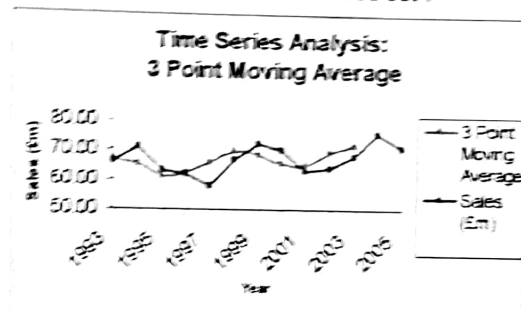
An example of 3 years moving average

- The 3 period moving average is found by adding up every 3 pieces of data, and dividing by 3 to find the average.
- Using the previous data, we would calculate as follows:

Year	Sales (£m)	3 Point Total	3 Point Moving Average
1993	68		
1994	71		
1995	63	202	67.33
1996	62	196	65.33
1997	58	183	61.00
1998	67	187	62.33
1999	72	197	65.67
2000	70	209	69.67
2001	65	205	68.33
2002	64	197	65.67
2003	68	195	65.00
2004	76	208	69.33
2005	74	215	71.67

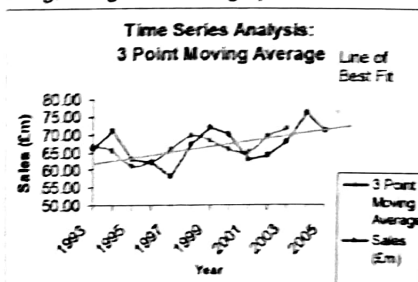
A graphical representation

- It is then possible to plot both the original and trend data, to see how the data has been 'smoothed out'.



Forecasting from the trend

- Having calculated the trend, and illustrated it graphically, it is a simple matter of drawing 'a line of best fit', and extending it to forecast future figures.
- Eg, using our earlier graph:



It is then a simple case of taking a reading from the line of best fit to obtain a future forecast

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The variations

- A reading from the line of best fit is unlikely to be accurate because it does not consider variations in the data, e.g. raw data is rarely plotted as a straight line!
- In order to account for these, and obtain more accurate forecasts it is necessary to calculate the variation.
- This is calculated using the formula:

$$\text{Variation} = \text{Actual Data} - \text{Trend Data}$$

Calculating the variations

- The variations of our earlier 3 period moving average example would be:

Year	Sales (£m)	3 Point Total	3 Point Moving Average	Variation
1993	66			
1994	71	200	66.67	4.33
1995	63	196	65.33	-2.33
1996	62	183	61.00	1.00
1997	58	187	62.33	-4.33
1998	67	197	65.67	1.33
1999	72	209	69.67	2.33
2000	70	205	68.33	1.67
2001	63	197	65.67	-2.67
2002	64	195	65.00	-1.00
2003	68	208	69.33	-1.33
2004	76	215	71.67	4.33
2005	71			

The average variations

- Having calculated the variations it is necessary to add them together, before dividing by the number of variations.
- This will give us the average variation
- In our example the average variation would be:

$$3.33/11 = 0.303 \text{ Million}$$

$$= 303,000 \text{ units}$$
- This means that any reading obtained from a line of best fit would have 303,000 units added.
- In theory this should yield a more accurate forecast

Cyclical Variation
4.33
-2.33
1.00
-4.33
1.33
2.33
1.67
-2.67
-1.00
-1.33
4.33
3.33

Advantages and dis-advantages of moving average method:**Moving average method**

Advantages

1. Easily understood
2. Requires less data than simple average
3. Provides stable forecasts
4. Ignores data that is "too" Old
5. More responsive than simple average

Dis-advantages

1. Requires saving lots of past data points: at least the N periods used in the moving average computation
2. Lags behind a trend
3. Ignores complex relationships in data

3.5 Globalisation and International Marketing

3.5.1 Globalisation

Why enter overseas markets?

Push factors:

1. Saturation in domestic markets.
2. Economic difficulty in domestic markets.
3. Near the end of the product life cycle at home.
4. Excess capacity.
5. Risk diversification.
6. Personal ambition.

Pull factors:

1. The attraction of overseas markets.
2. Increase sales.
3. Enjoy greater economies of scale.
4. Extend the product life cycle.
5. Exploit a competitive advantage.

Factors which promoted globalisation:

1. Tariffs have been eliminated and free trade zones have been created with small or no tariff.
2. Transportation cost has been reduced due to containerization for ocean shipping.
3. Governments have adopted favorable policies related to foreign trade.
4. Countries have eliminated subsidies for local industries in order make them at par with foreign companies to create competitiveness for foreign companies.
5. Countries have recognised intellectual property restrictions. (e.g. patents granted by China would be recognised in the United States).

Benefits of Globalisation:

1. There will be more variety of products available for consumers and they are likely to get due reward for their money. E.g. Pakistani Govt. allowed import of Japanese cars which are more advanced in technology as compared to local brands.
2. Competition is created which could lead to reduction in price.
3. Globalisation will promote specialisation and businesses can specialise in products they are best at making. E.g. Japan specialised in car manufacturing.
4. Foreign relations are likely to improve as there will be mutual economic interests of countries.
5. Standard of living of consumers might be raised due to the availability and affordability of technological advanced products.
6. In order to meet foreign demand companies might outsource production this will help to create new job opportunities for local labor.
7. It leads to standardisation of products. Same products can be made available in many places e.g. Coke, KFC, Pizza Hut etc.

Problems of Globalisation

1. Domestic industry is likely to suffer as foreign companies might be having a competitive advantage over them. e.g. lower cost, technological etc.
2. Companies will try to exploit those segments which will result in high profit due to this gap between rich and poor will increase.
3. Foreign companies might exploit local labor due to lack of implementation of laws.
4. Foreign companies might take their profit back to their home country instead of investing in host country. This might not enable host country to get full advantage of globalisation.
5. Due to the closure of local companies unemployment might rise which could also lead to increased crime rate in society.
6. It will be harder for small scale businesses to establish.

Factors in the choice of which overseas market(s) to enter:

1. Size of the market (population, income).
2. Economic factors (state of the economy).
3. Cultural linguistic factors (e.g. preference for countries with similar cultural background)
4. Political stability (there is usually a preference for stable areas)
5. Technological factors (these affect demand and the ease of trading)

Constraints and difficulties in entering overseas markets

1. Resources.
2. Time.
3. Market uncertainty.
4. Marketing costs.
5. Cultural differences.
6. Linguistic differences.
7. Trade barriers.
8. Regulations and administrative procedures.
9. Political uncertainties.
10. Exchange rates (transactions costs & risks).
11. Problems of financing.
12. Working capital problems.
13. Cost of insurance.
14. Distribution networks.

UNIT 4

Operations & Project Management

**A-II Level
Business
Teacher's Notes**

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Syllabus 2019 –21

- 4.1: The nature of operations**
- 4.2: Operations planning**
 - Enterprise resource planning (ERP)
- 4.3: Inventory management**
- 4.4: Capacity utilisation**
 - Measurement and significance of capacity
 - Increasing capacity utilisation
 - Outsourcing
- 4.5: Lean production and quality management**
 - Lean production
 - Kaizen
 - Just in Time (JIT)
 - Quality control and assurance
 - Total Quality Management
 - Benchmarking
- 4.6: Project management**
 - The need for projects and project management
 - Network diagrams
 - Critical Path Analysis (CPA)

UNIT-4 OPERATIONS MANAGEMENT



4.1 The Nature of Operations

The nature of operations:

The ultimate target of the production process is to make goods and/or services that will meet the demands and needs of prospective customers. Meeting the demands of customers efficiently, quickly, with best quality, allowing competitive pricing is the best way to ensure success. Operations management must be concerned with:

1 Efficiency of production:

The main aim of a business will be to stay competitive in the market and in order to achieve this it must try to keep its cost as low as possible. This can increase profit margin of business and benefits can be passed onto consumers in terms of low price.

2 Quality:

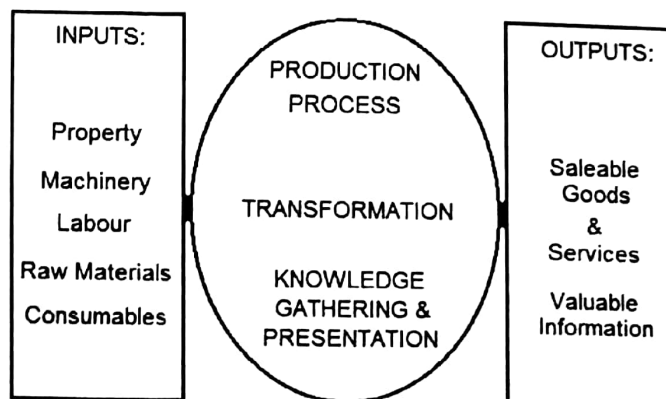
Business must be able to produce quality products in order to achieve the desired level of satisfaction of consumers. Operations management must be able to achieve this objective.

3 Flexibility:

Businesses operate in a dynamic environment. For continued success it is important that they must adapt according to changing trends in environmental factors, e.g. technology, consumer trends etc.

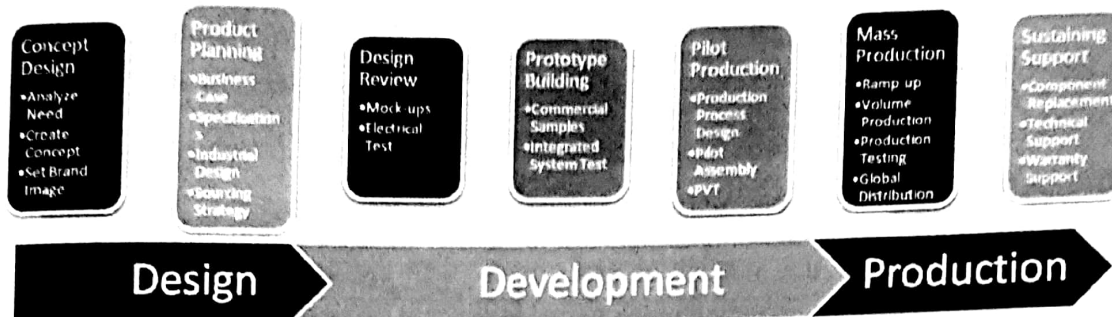
The production process:

The main resources and stages that are involved to make up the production process are shown here below:



Process: from idea/need to final product/service:

Following could be the process of designing and developing a new product.

**Resources-land, labor, capital (including intellectual capital):**

When we start any economic activity then we would need certain resources. In economics they are also known as "factors of production". These resources are:

Land:

This is the first factor of production which includes not only area of the earth surface but all resources that are a gift of nature as mineral deposits, seas, oceans, air etc. The reward paid for land is known as rent.

**Labor:**

This is the second factor of production. A business organisation would need human resources/capital to achieve its objectives. This is termed as 'labor'. The reward paid to labor is known as 'wages'. A business organisation might need two types of workers:

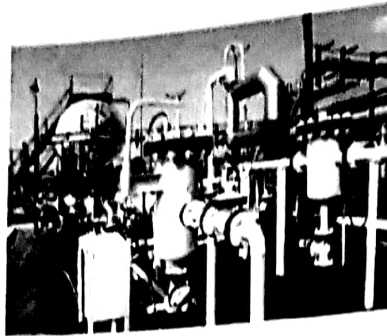
1. Skilled workers.
2. Unskilled workers.

Note: Honorary work or work for enjoyment is excluded.

**Capital:**

Manmade goods which are used to produce other goods are known as capital goods. E.g. plant & machinery, raw material, tools etc. Reward paid for capital is known as 'interest'.

The meaning of capital in economics is more precise and restricted than its meaning to a businessman or an accountant. A stock of money, shares in a company or a private hoard of consumer goods is not capital.



Intellectual capital:

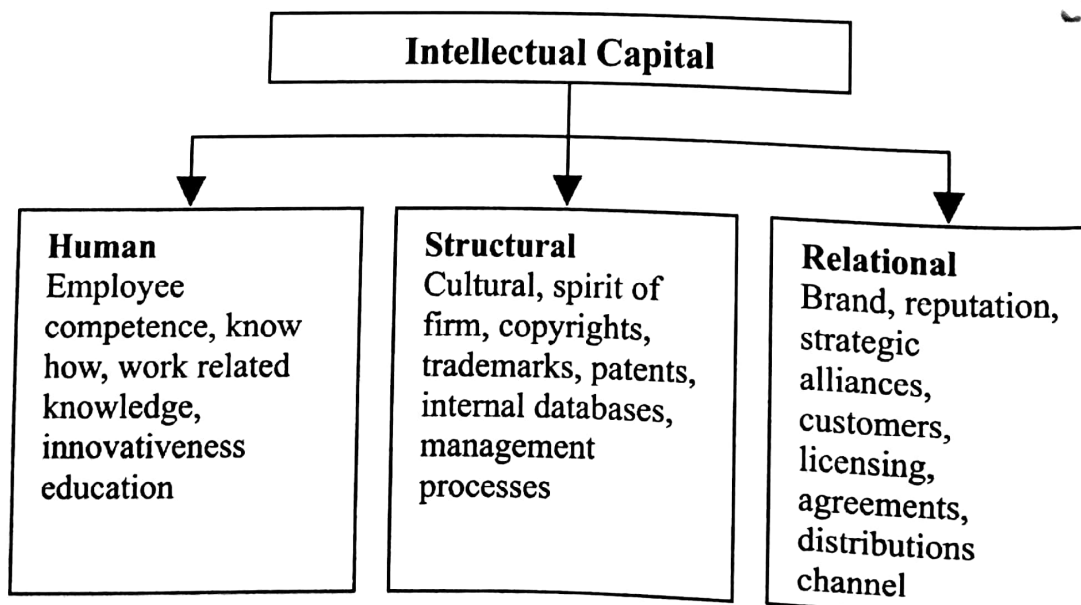
Intellectual capital is knowledge that can be exploited for some money making or other useful purpose. The term combines the idea of the intellect or brain power with the economic concept of capital, the saving of entitled benefits so that they can be invested in producing more goods and services. It can also be explained as the value of company or organisation's employee knowledge, business training and any proprietary information that may provide the company with a competitive advantage. Intellectual capital is considered an asset, and can broadly be defined as the collection of all informational resources a company has at its disposal that can be used to drive profits, gain new customers, create new products, or otherwise improve the business.

$$\begin{aligned}
 &\text{Human capital} \\
 &+ \text{Relational capital} \\
 &+ \text{Organizational capital} \\
 &\hline
 &= \text{Intellectual capital}
 \end{aligned}$$

Some of the subsets of intellectual capital include human capital, information capital, brand awareness and instructional capital. Intellectual capital is a real business asset, although measuring it is a very subjective task. Companies spend millions annually training their employees in business specific topics and otherwise paying for increased competence in their staff. This capital employed provides a return to the company, one that can contribute toward many years worth of business value.

As technology and process improvements become more of a differentiating factor within modern companies, intellectual capital is likely to become even stronger force in the marketplace.

Intellectual capital-continued:



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Effectiveness, efficiency and productivity:**Difference between effectiveness & efficiency:**

Many would think that efficiency and effectiveness are similar terms for measure, however there is a difference between these.

Effectiveness-definition:

The simple definition of effectiveness is "doing the right thing".

Efficiency-definition:

The simple, often used, definition of efficiency is "doing the thing right".

	Effectiveness	Efficiency
Meanings	Effectiveness is about doing the right task, completing activities and achieving goals.	Efficiency is about doing things in an optimal way, e.g. doing it the fastest or in the least expensive way. It could be the wrong thing, but it was done optimally.
Effort oriented	No.	Yes.
Process oriented	No.	Yes.
Goal oriented	Yes.	Yes.
Time oriented	No.	Yes.

Productivity: Measuring efficiency:**Productivity:**

"The ratio of outputs to inputs during production, e.g. output per worker per time period".

Or.

"The amount that can be produced with the resources, that are available".

Productivity is not the same as the level of production and the two should not be confused. **Production** is the process of combining units of inputs (natural, manmade and human resources) to create output (goods and services) capable of satisfying human needs and wants.

Productivity is the increase of output from each unit in the production process. There are several ways of achieving productivity. These include the training of workers and the introduction of machinery and equipment into the production process.

Measures of productivity:

The most popular measures of productivity are:

Labor productivity =

Output
(in a given time period)
No. of employees

Capital productivity =

Output
(in a given time period)
Capital employed

All businesses will normally try to increase productivity as it will ensure optimum utilisation of resources. This can be achieved either by employing skilled labor, raising their level of motivation by adopting appropriate strategies and by using technology as well.

Possible reasons for low productivity levels:

- 1 Low level of salaries.
- 2 Lack of fringe benefits.
- 3 Poor working conditions.
- 4 Leadership style.

5. Lack of technological changes.
6. Poor stock management system.
7. Lack of clear job objectives.

Raising productivity levels:

There are four main ways of improving productivity level in an organisation.

1 By improving skills of workforce:

As discussed earlier, a possible reason for low productivity can be skill of labor. As it is an internal environmental factor so organisation can overcome this by providing training to its workforce. This will enable it to increase its productivity level. However, this could be time consuming and in case of off-the-job training it may affect normal working of the business. Apart from this business will have to bear the burden of financing training program and if training objectives are not clearly defined or it is not managed properly, then it might be wastage of time and other resources.

2 By raising level of motivation of employees:

Another possible reason for low productivity could be poor level of motivation of employees. As discussed in HR section, a highly motivated workforce is considered to be the key to success of an organisation. If an organisation wants to increase its productivity then it will have to offer them a better package of financial and non-financial incentives. However, these additional incentives may increase cost of the organisation and in-efficient/lazy employees might take undue advantage of this.

3 Technological improvement:

Businesses operate in a dynamic environment and technological environment changes rapidly. In order to remain competitive in market, organisation will have to constantly upgrade/update technology. This will enable it to offer more value to consumers and gain a competitive advantage over competitors. However, such developments lead to capital expenditure. This could add financial burden on the organisation as it will have to buy more advanced technology. Apart from this organisation will also have to bear cost of training staff to operate new machinery.

4 Effective management:

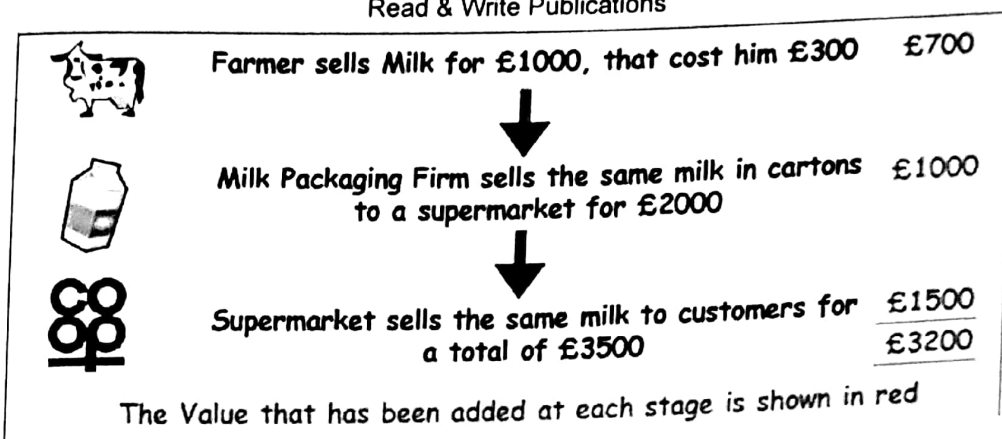
Effective management can help to increase productivity. Effective management can help to ensure effective management of inventory. If raw material supplies will reach on time then orders will be completed on time. Apart from this effective management will lead to team working which can result in greater level motivation of staff.

Value added:

"The enhancement added to a product or service by a company before the product is offered to customers".

Value added enables businesses to compete effectively in the market. With few differences (if any) from that of a competitor, and provides potential customers with a feature or add-on that gives it a great sense of value.

Value add can either increase the price of the product. E.g. offering one year of free support on a new computer would be a value-added feature. Additionally, individuals can bring value add to services that they perform, such as bringing advanced financial modeling skills to a position in which the hiring manager may not have foreseen the need for such skills.



Examples of value added:

Ufone's value added	Zong's value added
Ufone is offering following value added services to its users: • Virtual private network. • Call management. • Missed call notification. • Phone book saver. • Backup all your contacts with Ufone's phone book saver. • Create an account on our website and get access to a host of personalised online services like address book, calendar & planner, POP3 alerts, email address as well as infotainment services that let you subscribe to daily horoscope, quotes, jokes and much more.....	Zong is offering following value added services to its users: • Handsets. • Business solutions. • Games. • General services. • Zong portals. • Zong music. • Zong sms/chat. • Zong sports. • Zong infotainments. • Zong communities. • Zong internet.

Capital versus labor intensity:

Labor intensive:

It is where a business uses more labor as compared to capital equipment to produce its products. Agriculture, construction, and coal mining industries are examples of labor intensive industries.

Labor intensive-benefits & limitations:

Benefits	Limitations
1. More employment opportunities can be offered. 2. Less initial investment is required. 3. Can offer customised services to consumers. 4. More variety can be produced as business will use skilled labor.	1. Not suitable for large scale production. 2. Lack of economies of scale. 3. More suitable for small scale businesses. 4. Variation in quality due to labor intensive production. 5. High level of errors. 6. More chances of wastage of resources. 7. More reliance on labor-exploitation.

Capital intensive:

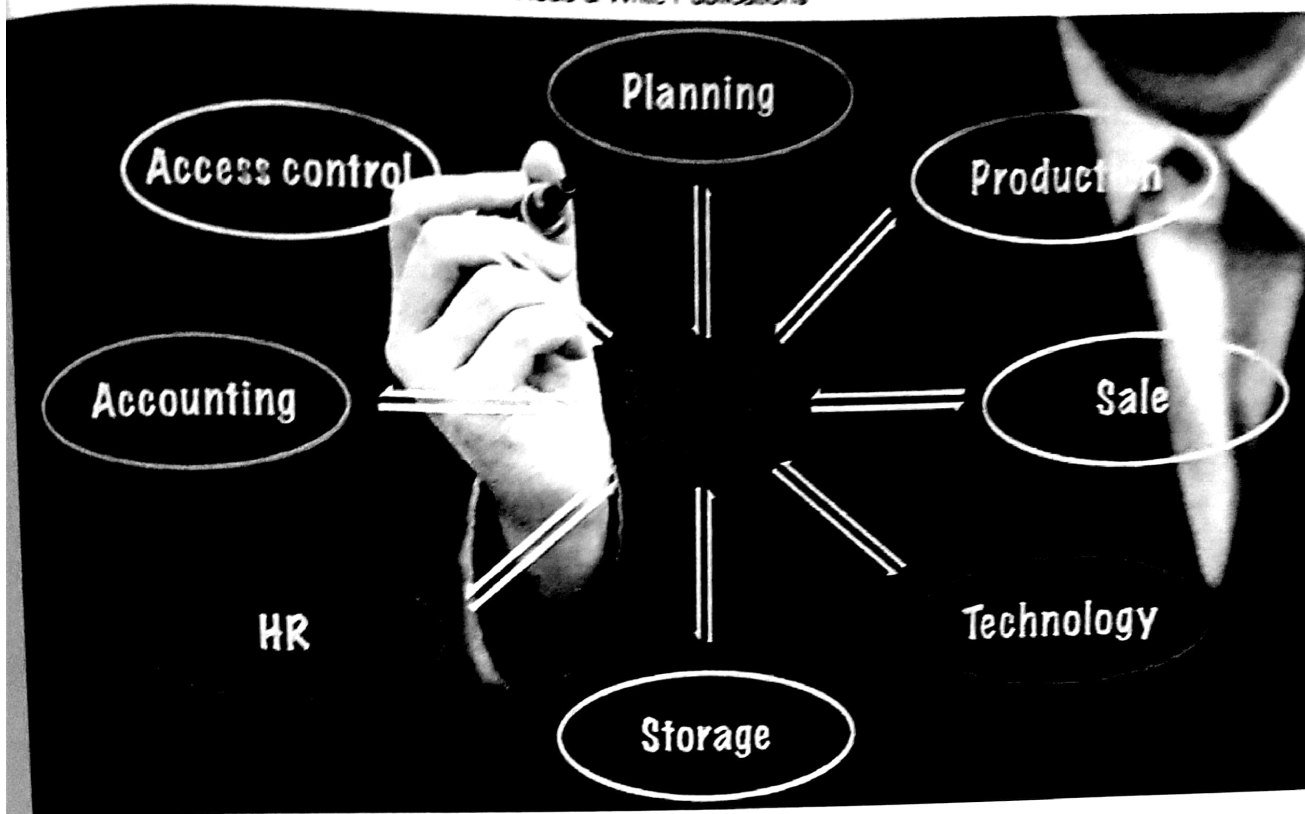
It is where a business uses more capital equipment/technology as compared to labor to produce its products.

Capital intensive-benefits & limitations:**Limitations**

Benefits	Limitations
1. Business can achieve mass production. 2. Economies of scale due to large scale operations. 3. Increased productivity. 4. Less reliance/dependency on labor. 5. Consistent quality can be achieved. 6. Less chances of errors. 7. Increased profits in long term. 8. Less wastage of resources.	1. Workers may get bored due to repetition of work. 2. There will be a need to retrain workers or managers. 3. Profits will decrease in short term. 4. May add financial burden on company as huge initial investment will be required. 5. High cost of maintenance. 6. Technology may get obsolete after short time. 7. Less flexible, as only standardised products can be produced.

Operations decisions:**Computer Aided designing-CAD:**

CAD (computer aided design) software is used by architects, engineers, drafters, artists, and others to create precision drawings or technical illustration. CAD software can be used to create two dimensional (2-D) drawings or three-dimensional (3-D) models.



4.2 Operations Planning

4.2.1 Enterprise Resource Planning (ERP)

Enterprise resource planning:

What is Enterprise resource planning? (ERP)

Enterprise resource planning (ERP) is business process management software that allows an organization to use a system of integrated applications to manage the business and automate many back office functions related to technology, services and human resources. ERP software integrates all facets of an operation, including product planning, development, manufacturing, sales and marketing

Main features of an ERP programme:

1 Financial management:

Financial management or Accounting management is considered as one of the most important modules of ERP solution. The fact behind considering and testing financial management module is that it offers & ensures proper financial reporting. By testing financial management module before implementation you can assure you have a perfect component for financial reporting and Accounting management.

2 Customer relationship management (CRM):

CRM feature deals with your entire customer, leads, and altogether the sale of your business. Nowadays CRM module is key and almost used by every organization who implements ERP solution for their business. A full fledged CRM module ensures proper management of lead, customer, opportunities and altogether better support to your customer and further growth in your business.

3 Human resource management: (HRM):

Human Resource is another key feature and capability of ERP software as it deals with the most important people of your business your employees. Previously HRM module was least considered as it was only managing the basic functionalities such as payroll, employee management and basic reporting.

But today HR module has evolved and move beyond the limitations. Nowadays many key and added features such as performance assessment, time tracking, attendance management, scheduling, KPI are inbuilt in ERP HR module. Therefore it is necessary to check on the HRM functionality of ERP software.

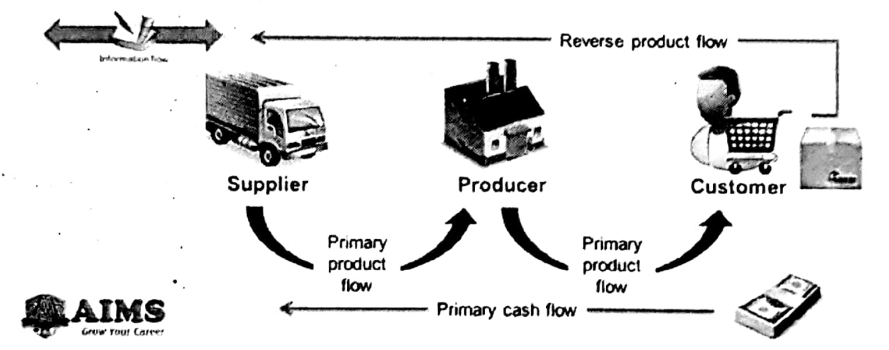
4 Manufacturing:

The manufacturing component of an ERP software package includes tools that enhance the entire end-to-end process of designing and building a product. It streamlines product design, engineering, and configuration; improves tracking and management of product parts; automates the scheduling of production activities; accelerates manufacturing; and improves quality assurance procedures. With ERP software and its manufacturing capabilities, businesses are empowered to create the best possible product in the most efficient and cost-effective manner.

5 Supply chain management (SCM):

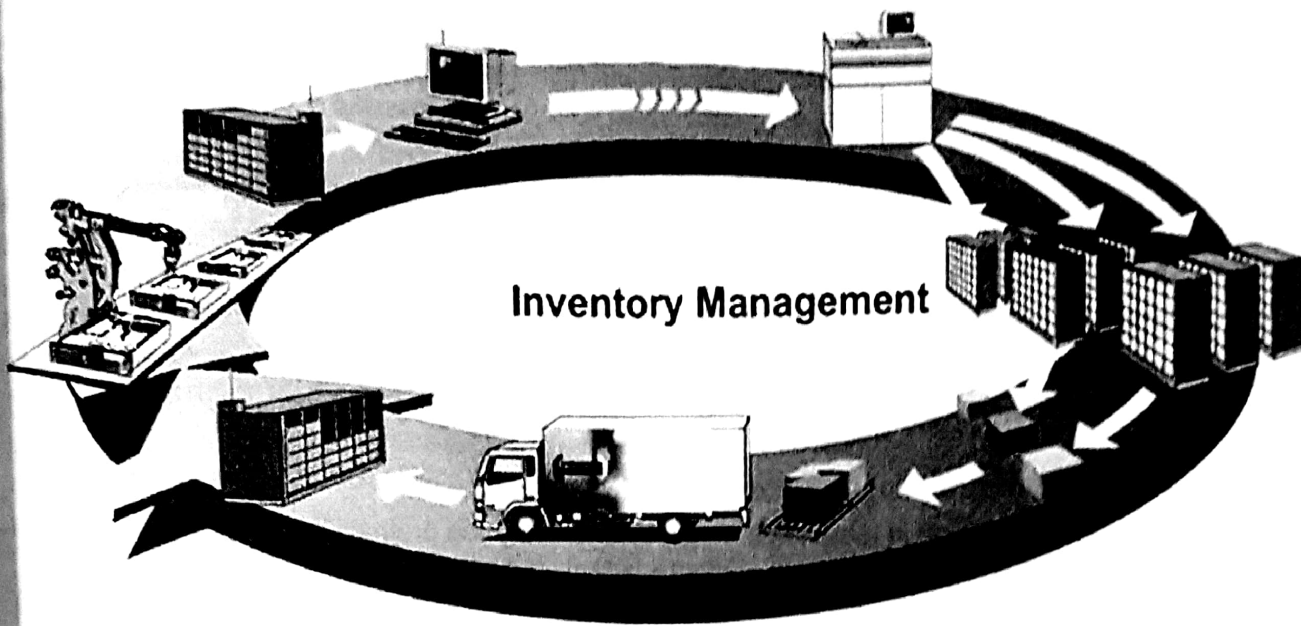
Supply chain management (SCM) is the oversight of materials, information, and finances as they move in a process from supplier to manufacturer to wholesaler to retailer to consumer. Supply chain management involves coordinating and integrating these flows both with and among companies. It is said that the ultimate goal of any effective supply chain management system is to reduce inventory (with the assumption that products are available when needed). As a solution for successful supply chain management, sophisticated software systems with web interfaces are competing with web based application service providers who promise to provide part of all of the SCM service for companies rent their service.

WHAT IS SUPPLY CHAIN MANAGEMENT?



Benefits & limitations of Enterprise resource planning:

ERP Advantages	ERP Disadvantages
• improve employee satisfaction • removing data and processes redundancies • assist the day-to-day activities • assist the management decision making • breakdown the barriers between department • automate the business processes • enhance the organization competitive advantage	• High cost • Duration of implementation • The complication of process reengineer • Difficulty with data migration • Difficult to measure the ROI of ERP immediately • Indirect cost • Risk to meet the failure



4.3 Inventory Management

Inventory/stock Management:

"Effective inventory management is all about knowing what is on hand, where it is in use, and how much finished product results".

Or,

"Inventory management refers mainly to when a firm strives to attain and uphold an optimal inventory of goods while also taking note of all orders, shipping and handling, and other associated costs."

The objective of inventory management is to provide uninterrupted production, sales, and /or customer service levels at the minimum cost. Since for many companies inventory is the largest item in the current assets category, inventory problems can and do contribute to losses or even business failures. It is also called inventory control.

Types of inventory:

1 Raw material:

Things which are used to produce other goods. E.g. for a furniture manufacturer wood will be raw material.

2 Work-in-progress:

Units which are incomplete at the end of a specific period of time. These unfinished goods are known as work in progress/process. E.g. company started producing 100 units in January, at 31st January 10 units are incomplete, so it will be work in progress.

3 Finished goods:

Units that have been completed to the right quality and are waiting to be delivered to customers. E.g. company started producing 100 units in January, at 31st January 90 units are complete, so it will be finished goods inventory.

Factors which might determine inventory level:

There are certain factors which will determine the level of inventory/stock which must be kept by the business. These factors could be:

1 Nature of stock:

If business is dealing in products which are either perishable e.g. food items, or which have unpredictable product life cycle e.g. technological products, fashion items then it is likely to keep low inventory level

2 Availability of storage space:

It will also determine the level of inventory a business is going to maintain. E.g. if business has the availability of storage space then it might go for higher inventory level or vice versa.

3 Company policy:

It will also determine inventory level in a way that if business has policy of just in time then it will only order supplies when it will be needed or vice versa.

4 Production method used by the co:

It will determine inventory level in a way that if business is using job production then inventory level is likely to be low but in case of flow production method it is likely to be high.

5 Government policy:

It will determine inventory level in a way that in case of shortage of goods in the market Govt. does not allow businesses to go for higher inventory level. In such situation inventory level is likely to be low or vice versa.

In order to discourage high inventory level govt. might also impose taxes on stock holding.

6 Sales forecasts:

It will determine inventory level in a way that if business is anticipating economic boom in future then inventory level is likely to be high or in case of predicted economic recession it is likely to be low.

7 Lead time:

If suppliers will demand longer lead time then it means that business will have to keep buffer stock (reserve stock) for more time. In this case inventory level will be high or vice versa.

8 Storage cost:

If storage cost is high e.g. for perishable item such as vegetables, fruits etc. then business is likely to go for low inventory level as it will either result in inventory getting perished or will increase price of product due to excessive overheads which might become a marketing drawback for the business.

Problems of having High stock level:

If business is going to keep higher inventory level then it might have to face certain problems. These problems could be:

1 Stock piling:

If business will keep higher inventory level then it might not be able to sell or use all of them by the end of a specific period of time. It means that it will have to face problem of stock piling.

2 Increased work burden of management:

Management's work burden will increase as it will have to monitor inventory record and supervise it. It means they may get less time for other strategic issues.

3 **Storage cost:**

If business will go for higher inventory level then it means that it will have to bear storage costs, e.g. salaries of warehouse staff, utility bills, rent of warehouse etc. This will increase storage cost which will be passed on to consumers in terms of high price. It could become a marketing drawback for business.

4 **More taxes to be paid:**

As discussed earlier that in order to discourage higher inventory level govt. might impose high taxes on inventory. If at the end of year business is left with inventory in its warehouse then it will have to pay tax on it.

5 **Product quality might be affected:**

This will specifically apply to businesses such as restaurants that they must be using fresh supplies of raw material, e.g. fruits, vegetables etc. if they will use older material then this may affect product quality resulting in consumer dissatisfaction.

6 **Danger of stock getting obsolete:**

As explained earlier that nature of product will determine inventory level. For technological product such as mobile phones, computer accessories business must keep low inventory level as technology changes rapidly. If business will keep higher inventory level for these products then there will always be a danger of getting them obsolete.

7 **More working capital will be required:**

If business will go for higher inventory level then it would mean that it will have to make more payments to suppliers. To make such huge payments more amount of working capital will be required. In order to meet this finance requirement business might have to borrow funds which could increase its gearing.

Problems of having low stock level:

If business will keep lower inventory level then in this case even it will have to face certain problems. These could be:

1 **Stock shortage:**

Lower inventory level means that business will not be able to meet increased or instant consumer demand. This may lead to bad image of business and will also affect its reliability.

2 **Delayed consumer orders:**

As explained earlier that low inventory level could lead to stock shortage. It means business will not be able to deliver consumer orders on time. Apart from bad image it could affect image of business and consumer may even impose legal penalty on delayed delivery of orders.

3 **Suppliers might exploit:**

If business will run out of supplies and in case of shortage in market, suppliers might overcharge it for instant supplies.

4 **Business might have to bear costs:**

Lower inventory level may result in shortage of material, it means that there will be no production. Business will have to bear fixed costs, e.g. rent, salary of supervisors etc.

Inventory/Stock control chart:

A stock control chart is a graphical illustration of a simple approach to stock management over time. This 'saw tooth' shaped diagram is normally shown if sales were steady throughout each month. Whilst this oversimplifies the situation for many businesses, the principles can be adapted to most situations.

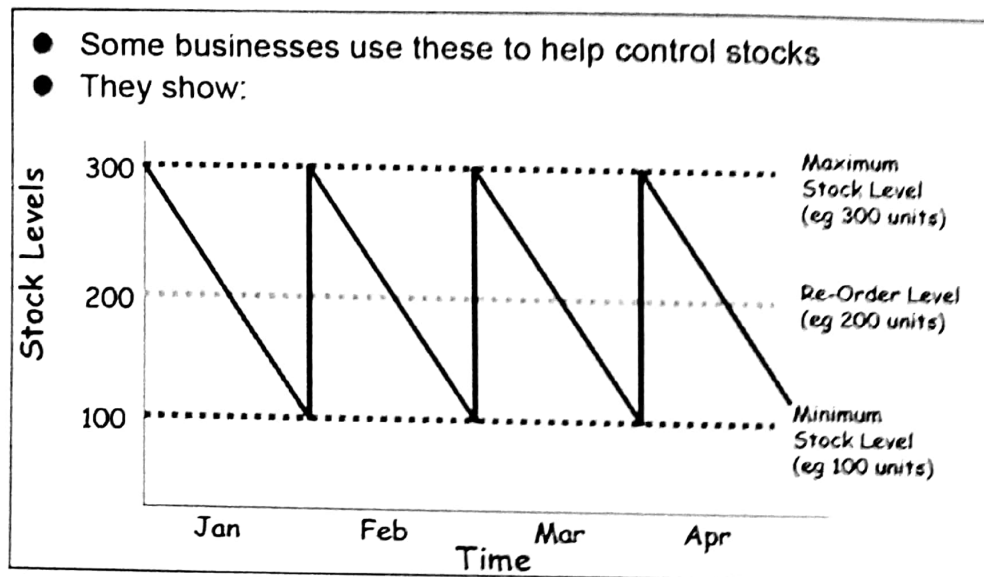
Using a inventory/stock control chart:

Charts are used to maintain favorable stock levels. They are based upon 3 assumptions:

1. All deliveries are made correctly and on time
2. There are no faulty stocks
3. Stock is used up at a constant rate

Inventory/stock control chart will show:

1. Maximum inventory level- the most stock a firm wants to hold,
2. The Re-order level- the level at which a new order is placed.
3. The minimum (Buffer) inventory level- the least stock a firm wants.
4. Re-order Quantity- the number items that are ordered.
5. Lead time- the time between placing the order and receiving it.

Inventory/stock control chart:

Stock ordering methods:

Fixed reorder level

- Minimum stock level is defined and new stock is ordered when stock reaches that level.

Fixed reorder interval

- New stock is ordered after a fixed time interval.

Two bin system

- Store room is divided in two portions (bins) new stock is ordered when one bin gets empty

Just in time stock

- Co. will buy stock when it will be needed.

Economic order quantity

- Most reliable method, demand for stocks is forecasted and co. orders this 'economic order quantity'.

Just in time stock:

Just in time stock management originated in Japan by Toyota in 1950s. It is an inventory strategy which is used to increase efficiency and decrease waste by receiving goods only as they are needed in the production process thereby reducing inventory costs. This method requires that producers are able to accurately forecast demand.

Benefits	Drawbacks
1. Less working capital is required as business will not go for stockholding. 2. Lesser storage cost. 3. Less taxes to be paid due to no stock holding. 4. Reduced work burden of management. 5. No stock piling. 6. Reduced danger of liquidity crisis.	1. Stock shortage. 2. Suppliers might exploit Co. 3. Delayed consumer orders. 4. Quality might be affected. 5. Bad image. 6. Instant consumer orders might not be entertained. 7. Staff de-motivation. 8. May lose the advantage of bulk buying.

Requirements for just in time inventory:

1. JIT relies on excellent relationships with suppliers.
2. JIT requires excellent communication and infrastructure links between suppliers and businesses.
3. It requires state of the art technology.
4. Requires well trained work force.
5. Co. Needs to develop a culture in which customers must be placing advanced orders to the co.



4.4 Capacity Utilisation

What is capacity utilization:

It calculates the current production a business is able to achieve as a percentage of its maximum available capacity.

MAXIMUM CAPACITY

Maximum capacity is the highest output level possible from a business over a particular period of time.

CURRENT OUTPUT

The actual output that firm is producing at present is known as its current output.

$$\text{Capacity utilization} = \frac{\text{Current production}}{\text{Maximum capacity}} \times 100$$

Example:

Business has maximum capacity of 100,000 units and currently it is producing 70,000 units.

$$\text{Capacity utilization} = \frac{70,000}{100,000} \times 100 = 70\%$$

Effects of under capacity:

Effects of Under Capacity?

- Increased unit costs
- Reduced profit margins
- Reduced employee motivation



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Disadvantages related to continuous maximum capacity

1. Workers can get de-motivated and tired at full capacity all the time. No relaxation time.
2. Machinery can get stressed out and get damaged quickly. It would require higher maintenance for which again workers are required.
3. If always working on full capacity then orders may have to be turned down saying that maximum capacity is being used. So priorities may have to be taken into account.
4. Especially in service sector, if hotels and hospitals are always full then potential customers may be turned away and loss of existing customers
5. So firms working at maximum capacity should think about expanding its operations or closing down certain areas of operations

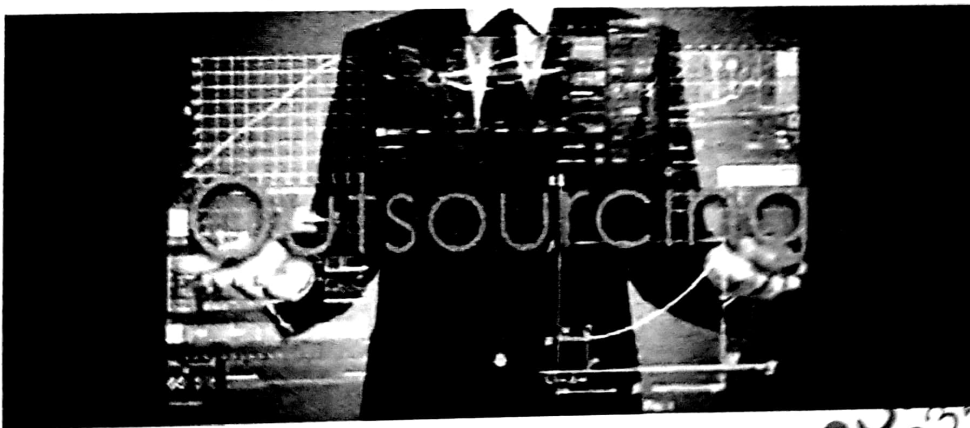
Ways to increase capacity utilization:

- Ways to reduce **under-utilisation of capacity** include:

1. Extend the product range
2. Find new markets
3. Increase demand by **promotion**
4. Rent excess capacity to other businesses
5. In the long run, close **excess capacity** (e.g. sell property or machines and make workers redundant)

- Ways to improve **over-utilisation of capacity** include:

1. Identify and tackle bottlenecks and shortages
2. **Outsource** or **sub-contract** production to other businesses
3. In the long run, invest in increased capacity

4.4.3 Outsourcing**What is outsourcing?**

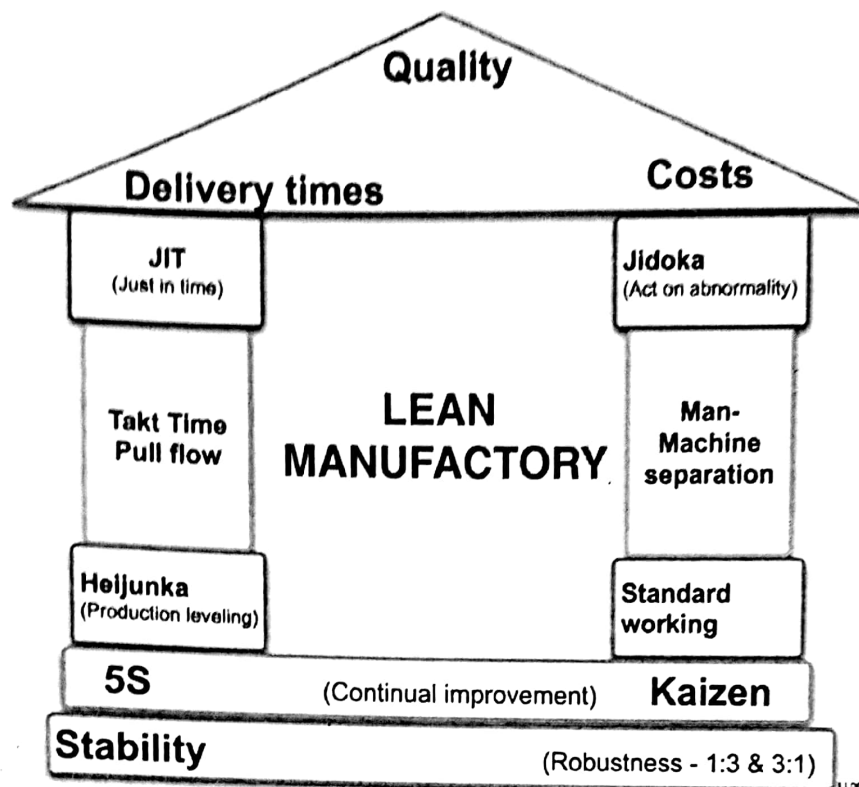
It is when instead of producing product itself business will ask other business to produce product on its behalf.

► manufacturing outsourcing

- Examples
 - Glaxo India is producing ranitidine bulk for Glaxo Wellcome.
 - Ranbaxy outsourcing Cefaclor manufacturing for Eli Lilly.
 - Lupine outsourcing D2 amino butanol for Cynamid.
 - Koprani Research Laboratories Ltd. Outsourcing for Synpac laboratories for supply of Penicillin-G bulk.
- Other outsourcing manufacturing company-
 - Kremoint Pharma Pvt.Ltd
 - Mackur Lab Pvt Ltd
 - Parnax Lab Ltd
 - Mazheal manufacturing Pvt.Ltd etc

Benefits and drawbacks of outsourcing:

Advantages	Dis-advantages
1. Business might not be having spare capacity this arrangement will enable them not to lose customer. 2. Other business might be having lower cost of production. This will help business to increase profitability. 3. Other business might have better quality standards. This might enable business to achieve maximum consumer satisfaction. 4. It might help business to minimize investment in capital intensive facilities (technology) and it might continue with labor intensive production.	1. If delivery is delayed then it might affect reputation of business and it might also have to pay legal compensation to customer for late delivery. 2. Business will not have control over production so in case of poor quality it could lead to bad image. 3. Secret information might be leaked out and next time customer might prefer to buy directly from the manufacturer to whom business outsourced production. 4. The organization might become reactive rather than proactive to customer needs.



4.5 Lean Production and Quality Management

4.5.1 Lean production:

It is an approach to production which attempts to minimise wastage of costs, time and people. The basic aim is to cut costs by making the business more efficient and responsive to market trends. This was developed by the Toyota executive Taiichi Ohno (1912-1990) during post second world war reconstruction period in Japan, and popularized by James P. Womach and Daniel T. Jones in their 1996 book 'Lean thinking'. Also called as lean production. The aim of was to produce products as cheaply as possible. Lean production eliminates those activities which contribute nothing towards productivity, for example, holding of stock, repairing faulty units and unnecessary movement of people and product around the plant.

This approach can be applied to all aspects of a business from design, through production to distribution.

Why industries might adopt lean production?

Industries might adopt lean production due to the following reasons:

1. It helps to eliminate wastage of resources.
2. It helps to minimise inventory level by adopting just in time approach.
3. It helps to maximise flow of production activities.
4. Pull production from customer demand.
5. It enables business to meet consumer's requirement and achieve maximum level of satisfaction.
6. It ensures that there will be no error in product, even first time when business is going to produce it.
7. It helps to empower workers which leads to improvement in quality standards and raises their level of motivation.
8. It is designed for rapid changeover.
9. It helps to partner with suppliers to ensure timely supply of inventory.
10. It creates a culture of continuous improvement. (Kaizen)

Techniques/Aspects of lean production:

- ✓ Just in time (JIT).
- ✓ Cell production.

- ✓ Kaizen continuous improvement.
- ✓ Quality circles.
- ✓ Total quality management. (TQM).
- ✓ Time based management.
- ✓ Simultaneous engineering.

Just in time:

Just in time is an approach according to which inventory/stock will arrive on the production line only when it will be needed. It helps to minimise the inventory level eventually resulting in reduction in cost of storage.

Business will keep inventory levels of:

1. Raw material.
2. Work in progress.
3. And finished goods.

at minimum. Just in time requires careful planning and the used to specialised software in order to plan production for each period of time. It will include ordering the correct stock.

Information is exchanged with suppliers and customers through EDI (Electronic data interchange) to help ensure that details are correct.

Supplies will be delivered directly to the production line when they will be needed. For example, a car manufacturing plant might receive exactly the right number and type of car wheels for a day's production, and the supplier would be expected to deliver them to the correct loading bay on the production line within a very narrow time slot. This process needs to be carried out very accurately or production could come to a standstill.

Advantages & dis-advantages of JIT:

Advantages	Dis-advantages
1. Stock piling is eliminated as business does not go for stock holding.	1. Stock shortage might occur if supplies do not reach in time.
2. Lesser working capital required as business does not need to keep stock.	2. Not suitable for products having unpredictable demand.
3. Lesser danger of product getting obsolete.	3. State of the art technology is required.
4. Reduced work burden of management.	4. Suppliers might exploit business for instant supplies.
5. Low gearing, as business does not need to borrow loans to meet its working capital requirement.	5. Instant consumer demand might not be entertained.
6. Improved product quality as fresh raw material supplies will be used. (Especially for food products).	
7. Storage cost will decrease which means more profit for co. and benefit can be passed onto consumers in terms of low price.	

Cell/cellular production:

As explained in the introductory paragraph that lean production also eliminates unnecessary movement of product in production line, so cell production is intended to achieve this objective. It refers to a manufacturing system wherein the equipment and workstations are arranged in an efficient sequence that allows a continuous and smooth movement of inventories and materials to produce products from start to finish in a single process flow, while incurring minimum transport or waiting time, or any delay.

Each cell is responsible for a complete unit of work. Herzberg sees this as a part of 'Job enrichment'. Cells deal with other cells as if they were customers, and take responsibility for quality in their area.



Advantages & dis-advantages of cell production:

Advantages	Dis-advantages
1. Team working might help to raise the level of motivation of staff. 2. Product quality will improve as each worker will be responsible for quality. 3. Workers will get multi-skilled which can lead to job rotation.	1. Investment in new materials handling and ordering system will be required. 2. It may not allow a firm to use its machinery as intensively as in traditional flow production so output may not be as high as flow production. 3. Business might need to train employees to work according to this technique of production.

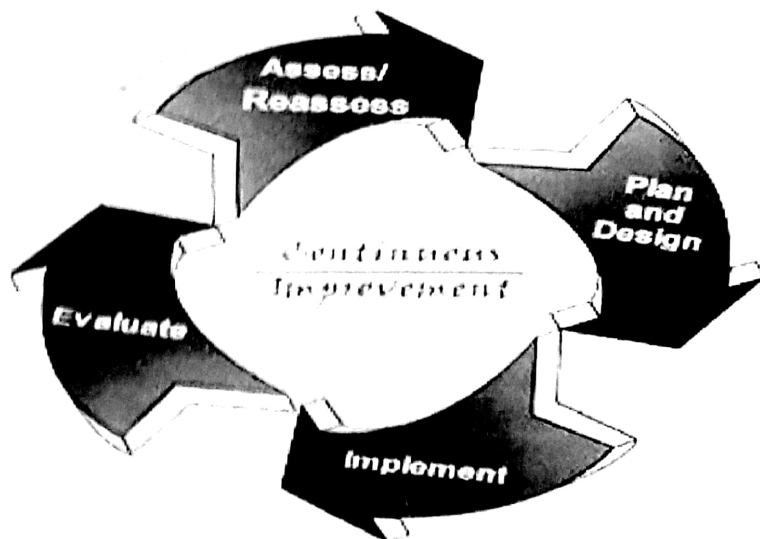
Kaizen continuous improvement:

It is based on the Japanese idea.

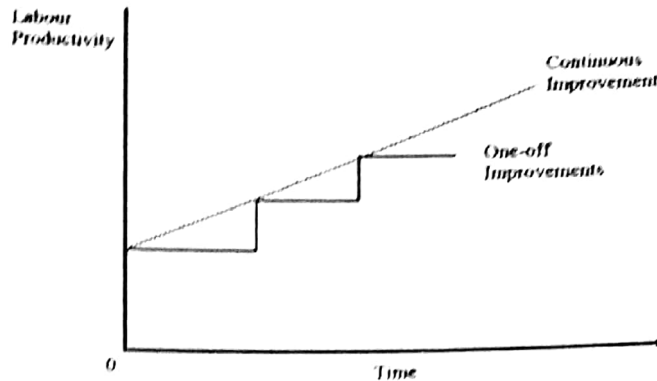
Kai = change

Zen = good

It is also known as continuous improvement. It was originally used to describe a key element of the Toyota production system. It is a long term approach to work that systematically seeks to achieve small, incremental changes in processes in order to improve efficiency and quality. If an organisation will practice kaizen, continuous improvement then it will be the responsibility of every worker, not just a few of them.



The emphasis of Kaizen is on staff participation. Workers need to meet regularly to discuss matters and give their suggestions for improvements. It is considered to be the cheapest method of developing new ideas and techniques which are expected to have a major impact on business. For example, Toyota is well known as one of the leaders in using Kaizen. In 1999 at one U.S plant, 7,000 Toyota employees submitted over 76,000 suggestions, of which 99% were implemented.



Advantages & limitations of Kaizen:

Advantages	Limitations
1. It can be useful in any industry, whether it is ailing or not. Its advantages are: Primarily it puts people first. 2. It rewards effort as well as achievement. 3. It is a method of active problem solving. 4. It also helps to ensure improvement in space utilisation, product quality, use of capital and employee retention. 5. It creates an atmosphere where employee's suggestions are valued. 6. It helps to create awareness that even small improvements are important. 7. It provides a system where such improvements are communicated to other employees. 8. It empowers employees which raises their level of motivation.	1. Kaizen relies on gradual changes but business might be needed to implement certain changes which might not be implemented gradually. 2. Implementation of Kaizen might need a change in organisational culture. Management must be willing to go for empowerment as autocratic style will be misfit with this technique.

Total quality management. (TQM):

It is a system of management that originated in the 1950's. It became more popular since the early 1980's. It is based on the principle that every member of staff must be committed to maintain high standards of work in every aspect of company's operations. It ensures that all activities will happen in the way they will be planned to achieve maximum level of consumer satisfaction.

Main points of TQM:

1. It believes that quality is the responsibility of every one working in the organisation. It is not just the responsibility of production department.
2. It is intended to achieve maximum level of consumer's satisfaction.
3. Different departments are considered as internal customers which means that every department will process according to requirements of each other.
4. It intends to eradicate the need for quality control department.
5. It also emphasizes on empowerment of staff.
6. Group working is encouraged to ensure that workers will share their skills and ideas within the group.
7. Just in time manufacturing is used.
8. Establishment of quality control circles is required.
9. It is intended to ensure 'zero defect'.
10. It also believes in continuous improvement.

Limitations of TQM:

1. It requires change of management culture to decentralisation which might be difficult.

2. It is expensive to implement as it involves costs, such as training, team development, infrastructure improvement etc.
3. It is a long term process which is likely to show its results after years.
4. It focuses on standardizations of tasks to ensure consistency. Creativity and innovation is discouraged.

Time based management:

It intends to ensure effective utilisation of time. It also recognises the importance of time and seeks to reduce the levels of unproductive time in an organisation. Activities which contribute nothing to productivity need to be eliminated.

Benefits of time based management include:

1. Lead time is reduced to ensure that business will meet changing trends of market and consumers.
2. Helps to ensure that business will be able to develop new products quickly.
3. Helps to minimise wastage of resources which could eventually lead to improvement in efficiency level.
4. Like other techniques of lean production it also emphasize on empowerment, team working, and better understanding between management and employees.

Simultaneous engineering:

In this business will organise activities in such a way that they can be done simultaneously. Basic objective is to ensure that these activities will be done as simultaneous activities hence reducing time for the completion of project. (to be discussed in detail in topic of critical path analysis).

Advantages & dis-advantages of simultaneous engineering:

Advantages	Dis-advantage
1. It helps to improve quality of products which enables to achieve maximum level of consumer's satisfaction. 2. The use of just in time approach helps to reduce the requirement of stockholding which eventually leads to reduction in cost. 3. With the help of worker involvement efficiency can be improved. 4. Reduction in lead time and use of cell production can help to decrease cost and profit margin of business can increase. 5. The use of Kaizen can help business to respond to consumer trends more quickly and its flexibility can also increase.	1. Effective planning and able leadership is required which may be difficult to attain. 2. Reliable supplier's links are required which might again be difficult to get. 3. Investment in capital equipment and training of employees will be required. This could add financial burden on business. 4. Active and sincere participation of employees is required. It might be difficult to get.

Quality Circles:

It is an attempt to improve quality of products. Management will form a group of employees which will be assigned the responsibility of looking after matters related to quality. Its members will be selected from different departments. They will meet regularly to discuss problems related to quality and by sharing their mutual expertise they will try to resolve these problems. Apart from this they will also analyse current developments in technological sector and will give recommendations to management to further improve quality standards.

Benchmarking:

It is also an attempt to improve quality standards of company's products. In this business will selector other business in the same industry as an 'ideal'. Selection of such an ideal company/business is known

benchmarking. Later on information related to the quality system of benchmarked company will be collected and business will make necessary changes in its quality control system for improvement.

Advantages & dis-advantages of lean production:

Lean production

Advantages

- ☐ Increased motivation
- ☐ Increased quality of output
- ☐ Improvement in cash flow
- ☐ Higher level of participation
- ☐ Increased output

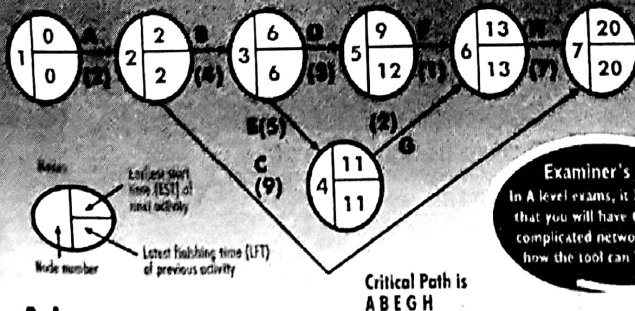
Disadvantages

- ☐ Reduces EoS
- ☐ Requires all staff to be committed
- ☐ May not be able to meet customer demand
- ☐ Relies on a good supply chain

CRITICAL PATH ANALYSIS

A tool that helps a firm to manage complex projects.

Each task that is a part of the overall project can be planned carefully.



Examiner's Tip

In A level exams, it is unlikely that you will have to draw a complicated network. Learn how the tool can be used.

Advantages

- Shows the 'critical' activities
- Aids the planning process
- Helps to assess resource requirements (staff/ machinery/ finance etc.)

4.6 Project Management

Critical path analysis:

Critical path analysis is also known as Network analysis. It is commonly used in manufacturing and construction industries. It is a method which shows that how a lengthy and complex project shall be completed in minimum time. Activities of a complex project are broken down into a number of separate activities and then they are arranged in order of dependency and those activities are identified that can be performed simultaneously.

Network diagram will help to identify critical activities (critical path). Critical path activities are those activities that if they are delayed then they might delay completion of project on time. After the identification of critical activities management will take necessary decisions to ensure that these critical activities shall be completed on time and they will not be able to delay completion of project.

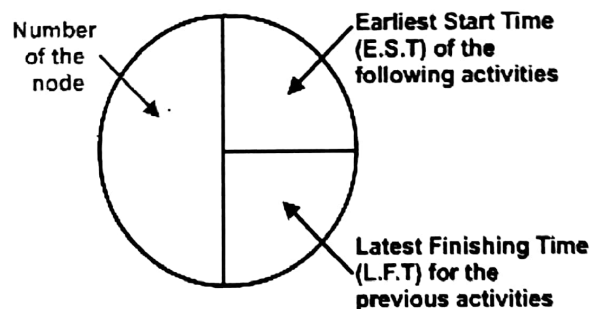
Critical path diagram:

A critical path diagram shows:

1. The order of dependency of each activity/ in simple words the order in which an activity must be performed.
2. The time that will be taken by each activity to complete.
3. The earliest start time (EST) and latest finish time (LFT) of each activity.

Constructing a network diagram:

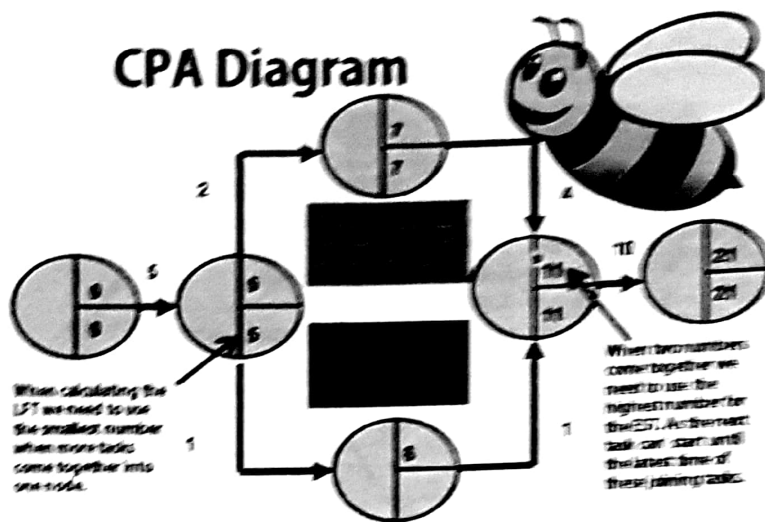
In a network diagram there are going to be nodes. For every activity there are going to be two nodes. previous node will represent start of activity while next node will represent finishing of activity. Finishing node of one activity shall become the starting node of next activity.



A node is going to be a circle which will be divided into three sections.

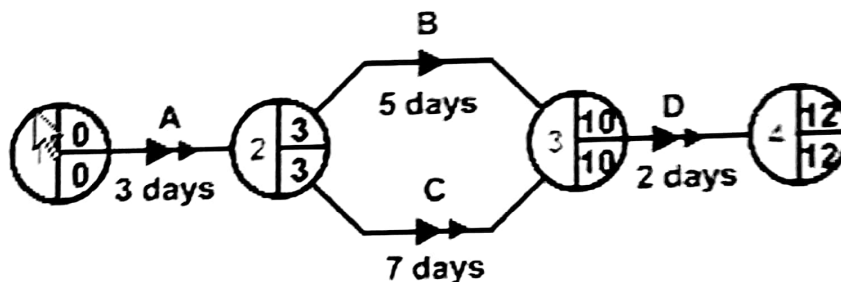
1. Node number.
2. Earliest start time. It is calculated from left to right on the diagram, by adding duration of the previous activity.
3. Latest finish time. It is calculated from the right left after EST's have been calculated. We start from finishing node and keep on subtracting task duration to fill in column of LFT.

Example # 1:



Example #2

- Activity A will start first (duration 3 days)
- Activity B will follow activity A (duration 5 days).
- Activity C will follow activity A (duration 7 days).
- Activity D follows all other activities (duration 2 days).



The critical path in above diagram is ACD, since if any of these activities are delayed then the project shall not be completed in 12 days.

Note:

The critical path is represented by double arrows.

Benefits & drawbacks of critical path analysis:

CRITICAL PATH ANALYSIS	
Benefits	Drawbacks
☐ Maximises efficiency in the use of time ☐ Improve efficiency and generate cost saving in the use of resources ☐ Beneficial to monitoring cash flow	☐ Usefulness may be limited in complex and large scale operations ☐ Necessity of having clear and reliable information ☐ Skilled management and team philosophy is essential

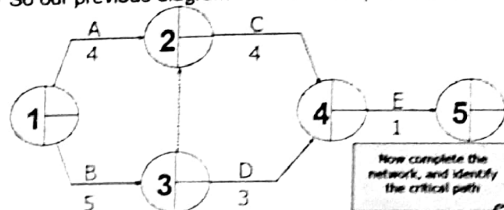
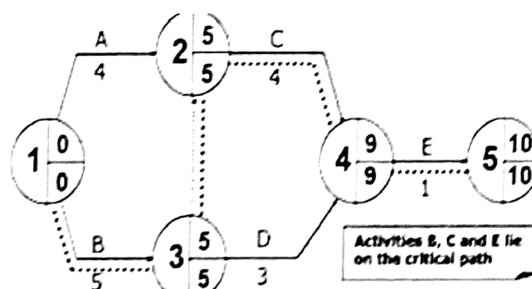
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What is dummy activity?

An activity that can be performed along with other activities without consuming any extra time. On network diagram it is shown with a dotted line.

Dummy Activity

- A dummy activity is one that is created purely to illustrate dependency
- They are not labelled and take up no time
- They are represented by a dotted arrow:
- So our previous diagram would be completed as follows:

**Solved Network diagram with dummy activity:****What is Float?**

Spare time between non-critical activities is known as a float.

Floats	
Total Float	Free Float
- It calculates spare time between non-critical activities and due to this completion of "Whole project" shall not be delayed. - Total float = Est + Task duration - LFT	- It calculates spare time between non-critical activities and due to his completion of "Next Activity" shall not be delayed. - Free float = Est at start + Task duration - Est at end.

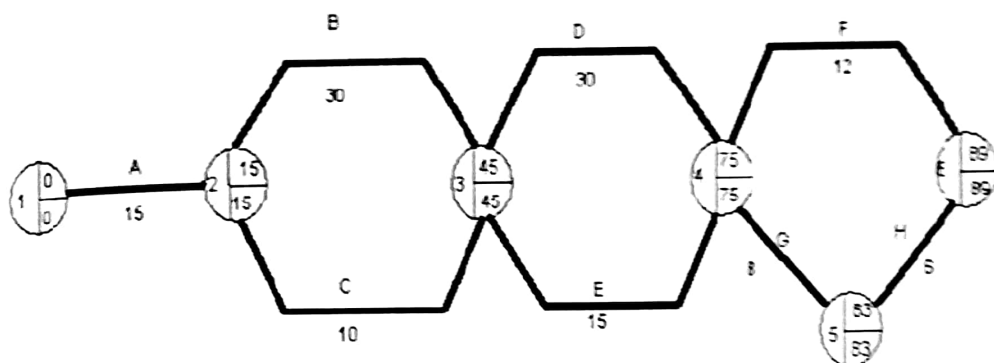
Significance of float

1. It helps to identify free/spare time for which resources shall be idle.
2. As a result of this identification business will not hire machinery or temporary labour that will result in cost reduction.
3. Machinery or other resources can be shifted to other projects that will ensure optimum utilisation of resources.

Unit 4
Calculating floats:

June 2005, Paper-3, Q-4

- 4 (a) Refer to Appendix B. Draw a network diagram of this project showing all earliest start times and latest finish times. [8]



Total float calculations:

JUNE 2005, PAPER3

TOTAL FLOAT CALCULATIONS

NAME OF ACTIVITY	EST	TASK DURATION	LFT	TOTAL FLOAT
A	0	15	15	0
B	15	30	45	0
C	15	10	45	-20
D	45	30	75	0
E	45	15	75	-15
F	75	12	89	-2
G	75	8	83	0
H	83	6	89	0

Note:
Signs will be ignored.

Free float calculation:

JUNE 2018, PAPER 3

TOTAL FLOAT CALCULATION

NAME OF ACTIVITY	EST AT START	TASK DURATION	EST AT END	FREE FLOAT
A	0	15	15	0
B	15	30	45	0
C	15	10	45	-20
D	45	30	75	0
E	45	15	75	-15
F	75	12	89	-2
G	75	8	83	0
H	83	6	89	0

Note:

Signs will be ignored.

Unit-5

UNIT 5

Finance and Accounting (A Level)

A-II Level
Business
Teacher's Notes

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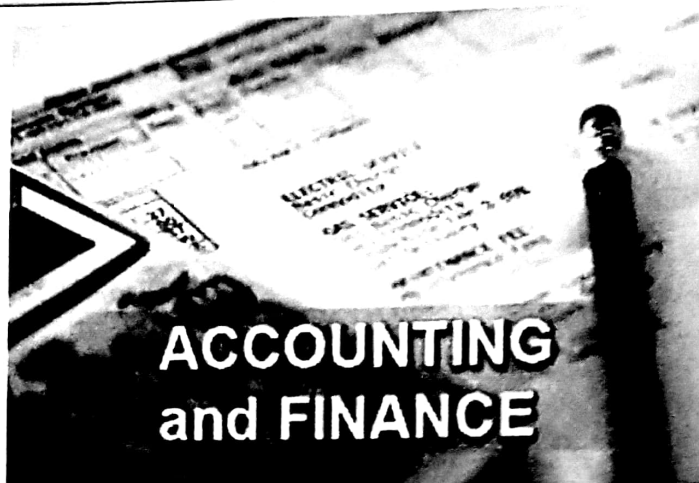
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Syllabus 2019 –21

- 5.1: The need for business finance
- 5.2: Sources of finance
- 5.3: Costs
 - Approaches to costing: full, contribution
 - Solutions to costing problems
- 5.4: Accounting fundamentals
- 5.5: Forecasting and managing cash flows
- 5.6: Budgets
 - The purposes of budgets
 - Variances: adverse, favourable
- 5.7: Contents of published accounts
 - The Income statement
 - The statement of financial position
 - Inventory valuation
 - Depreciation
- 5.8: Analysis of published accounts
 - Profitability ratio
 - Financial efficiency ratios
 - Gearing ratio
 - Investor ratios
 - Practical use of ratio analysis
- 5.9: Investment appraisal
 - The concept of investment appraisal
 - Basic methods: payback, accounting rate of return (ARR)
 - Discounted cash flow methods: discounted payback, net present value (NPV), internal rate of return (IRR)
 - Qualitative factors in investment appraisal

UNIT-5 FINANCE AND ACCOUNTING (A LEVEL)**5.1 The Need for Business Finance****Finance:**

Funds required by a business to operate are called finance. Finance is very important for any organisation as it enables it to meet its expenditures and expansion projects. Every organisation needs to ensure effective management of its financial resources as its shortage could lead to business failure.

Why a business organisation might be needing funds?

1. A business organisation might be needing funds for following reasons:
2. A new business would need owner's investment for initial setup e.g. purchase of equipment, material, for cash payments etc. It may also be termed as startup capital.
3. Most of the private sector businesses set growth as their business objective, for expansion they might be needing funds.
4. Businesses need to expand size of their product mix and for this they need to produce new products to cater new needs of consumers. For new product development they might be needing budget for research & development.
5. In order to meet day to day (revenue) expenditures business needs to have working capital. A reasonable amount of finance would also be needed for this purpose.
6. Technological environment keeps on changing rapidly, keeping this in mind co. would be needed to upgrade technology in order to stay competitive and for this purpose it might also be needing fund.

Expenditures:

Costs which are incurred to produce output.

Expenditures

Capital expenditures	Revenue expenditures
1. Are expected to return benefit for a longer time period. 2. Are normally incurred to buy fixed assets. E.g. building, machinery etc. 3. Huge amount is required for them. 4. Long term sources of finance are most likely to be used for them. 5. Are recorded in balance sheet of the company. 6. Are incurred occasionally.	1. Will return short term benefits. 2. Are incurred to ensure smooth operations. E.g. salaries, bills etc. 3. They need a nominal amount of money. 4. Short term sources are more likely to be used. E.g. working capital. 5. Are recorded in income statement. 6. Are incurred on regular basis.

Explain why different sources of finance are needed for capital expenditures:

1. Require huge amount of capital which can just be provided by long term sources of finance. E.g. share capital, long term bank loan etc.
2. Payback time shall be more than a year so short term sources of finances might not be suitable.

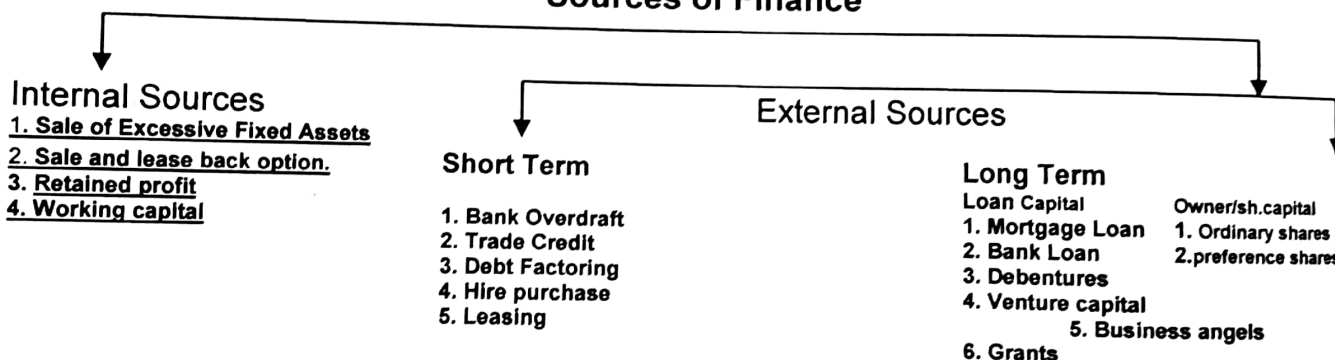


5.2 Sources of Finance

Concept of Separate Entity:

It states that owner and business are two separate persons; it means that while preparing accounts we assume our self as business.

Sources of Finance



Internal Sources:

Sale of excessive fixed assets:

In some situations business might be having some excessive fixed assets. If it needs funds then it may decide to sell out these assets to generate funds for its financial needs. E.g. co. has three vehicles and it has ascertained that it just needs two of them. Third vehicle might be sold to generate funds internally.

Sale and lease back option:

If co. does not have any excessive fixed asset and it is not getting funds from any other source then it might decide to sell its asset to a leasing co. and get it leased back. This will provide funds to the business; however it will have to bear additional fixed cost as it will have to pay rent to the leasing co. for using its asset.

Retained profit:

Out of annual profit every organisation is going to save some amount which is accumulated in an account named as retained profit. In other words it is a saving to meet unforeseen future expenditures. E.g. every year co. saves 10% of its profit and it is kept as retained profit. Co. has been doing this for past 5 years. If it needs funds then it can use this amount as an internal source of finance. However, this could just be available for established businesses as new businesses might not be having any retained profit.

Working capital:

It is the amount which needed by a business to meet its day to day expenditures, pay for raw material and credits offered to debtors. If a business needs funds then it can reduce its working capital to release funds. However it may lead to liquidity problems as business might not be left with enough working capital to meet its day to day expenditures.

Evaluation:

Internal sources of finance is an easy way of raising funds and it does not involve any cost except sales and lease back option as co. will have to make a rental payment. However this could affect expansion projects of the co. and may also lead to liquidity problems in case of withdrawal from working capital. Therefore growing companies mainly depend on external sources of finance.

External sources:**Short term sources of finance:****Bank overdraft:**

A facility which is provided by a commercial bank to its current account holders (Businesses). According to this bank allows business to withdraw more amount as compared to its available balance. E.g. Business has a bank balance of \$50,000 and it issued a cheque of \$55,000 to a creditor. Bank pays this cheque; it means overdraft amount is \$5,000.

Overdraft amount shall be agreed in advance between bank and business. It is normally used by business to improve its cash flow position. Interest rate is comparatively high as compared to bank loan. Overdrawn amount has to be repaid as soon as possible and interest will be charged on the overdrawn amount.

Trade credit:

A facility according to which business will get raw material supplies from its suppliers but payment shall be made after some time. E.g. 3months. This will serve the purpose of source of finance as business will get supplies without instant payments. This is normally without any extra payment; however business might have to sacrifice cash discount for instant payment or trade discount for bulk buying.

Debt factoring:

As a trading practice business will have to sell goods to its customers on credit. Credit customers are then termed as 'debtors'. Selling constantly on credit basis could lead to cash flow problems, as cash inflows will be reduced. In order to overcome this problem business has an option of selling its debtors to a credit loan firm, who is later termed as a 'factor'. In order to explain this let's take an example:

Mr. A sold goods to Mr. B worth \$5,000 on credit and payment is due in November. In July Mr. A needs funds so he goes to a factor (credit loan firm) and requests it to pay him in July and collect payment for Mr. in November. Factor pays \$4500 to Mr. A. Factor will later on collect full payment of \$5,000 from Mr. and \$500 shall be his profit.

Hire purchase:

This is medium term finance. Business might use it to acquire some fixed assets. This could also be termed as installment buying. The use of this method might prevent business making huge payments to buy fixed assets and leading to cash flow problems.

Leasing:

In this business will acquire a fixed asset e.g. a construction co. might acquire a machine from a leasing co. on rental basis. It will continue to make a rental payment to leasing co. till it wants to use machine. Benefit of this will be that business will not have to incur a capital expenditure to buy it. Repair & maintenance asset shall be the responsibility of the leasing co. and business will keep getting latest technology from leasing co. At the end it will not be compulsory for business to buy ownership of asset.

Long term sources of finance:**Owner's capital:****Ordinary shares:**

Co. will sell these shares to its shareholders to collect money. These shareholders will share profit and loss of the co. (for further details consult section-1 notes).

Preference shares:

These shares are also issued by a co. on terms that they will only share profit of the co. and they will earn a fixed %age of dividend every year. (for further details consult section-1 notes).

Loan capital:**Mortgage loans:**

This is a form of secured bank loan. In this borrower will have to pledge some of its property with the bank as a security against loan. Borrower can get huge amount of loans and interest rate is comparatively low as compared to un-secured loans. This type of loan is available for a very long period of time. E.g. 20years.

Long term bank loan:

It is form of un-secured loan. Borrower might not be needed to pledge any property as security for loan. This type of loan can provide a reasonable amount of money to borrower. Interest rate might be comparatively high as compared to secured loans.

Debentures:

It is only available for a public limited company. It is a long term loan given by the general public to a public limited company. As a proof of loan plc issues a certificate known as debenture. Debenture holders will earn a fixed %age of interest every year on their investment and they will be recorded as a long term liability in balance sheet of the co. they will not be concerned with the profitability of the company. Interest is going to be a must payment for the co. In some countries they are also known as bonds, loan stock or note.

Sometime Govt. might also issue these bonds in order to secure capital.

Venture capital:

There are going to be companies (venture capital firms) who might provide finance to business who are either at the initial stage or if they want funds for expansion. This could also be provided to businesses with high potential, high risk growth startup companies. Venture capital is a form of 'risk capital'. In other words capital that is invested in a project (a business) where there is a substantial element of risk relating to the future creation of profits and cash flows. Risk capital is invested as shares (equity) rather than as a loan and investor requires a higher "rate of return" to compensate him for his risk. Venture capitalists assume by investing in smaller and less mature companies, venture capitalists usually get significant control over company decisions. Venture capital firms usually invest for between three and seven years or more. The duration/term of investment is often linked to the growth and profile of the business.

Angel investors/business angels:

Angel investors are wealthy, entrepreneurial individuals and businesses that are interested in helping small businesses survive and grow. Banks generally require security and most venture capital firms are not interested in financing such small amounts. In these circumstances, businesses often have to turn to "Business Angels". They generally invest small sums up to £100,000. Objective of business angels may be more than just focusing on economic returns. Although angel investors often have somewhat of a mission focus, they are still interested in profitability and security for their investment. So they may still make many of the same demands as a venture capitalist.

Angel investors may be interested in the economic development of a specific geographic area in which they are located. Angel investors may focus on earlier stage financing and smaller financing amounts than venture capitalists. Business angels could be personal friends and family, wealthy business contacts, major suppliers and clients of the business.

Government Grants:

Federal and state governments often have financial assistance in the form of grants and/ or tax credits for start-up or expanding businesses. Objective could be to speed up rate of economic growth or to increase employment opportunities in the country.

Factors to be considered while selecting source of finance:

<u>factor in consideration</u>	<u>Explanation</u>
Time factor	If business needs it for less than a year then short term source of finance might be used, but if it needs for more than a year then medium or long term source might be used.
Type of business	Loan from friends and family can be used by businesses such as sole trader or partnership and in the same way debentures are just available for public limited companies.
Amount required	If business needs a nominal amount of money then it might use internal or external short term sources, but in case of huge amount it will have to use external long term sources of finance.
Gearing ratio	If business is highly geared (more loans) then it will prefer to sell share to raise more capital to decrease its gearing or vice versa.
Risk factor	For high risk projects co. might use share or venture capital instead of using loan capital.
Cost factor	Business will obviously select a source of finance with lower/reasonable cost. E.g. rate of dividend or interest rate.
Financing requirements	If bank requires any collateral security and business cannot provide then in this case business will have to use un-secured loan or share capital.



5.3 Costs

5.3.1 Approaches to costing: full, contribution

Costs:

Expenses that are incurred to product output are known as costs.

Cost centres:

It could be defined as a part of business to which costs can be easily identified and calculated. E.g. it could be an individual employee, a product or brand, a department, branch or division. It gives employees or departments targets to work towards. It also enables managers to monitor actual performance against planned performance and keep greater control.

Profit centres:

It could be a part of business to which costs and revenues can be easily identified, meaning that profits can be calculated. Like cost centres it can be an individual employee, a product or brand, a department, branch or division. It enables managers to have greater control over the costs and revenues generated by their area of the business.

Why are they used?

1 Organisational reasons:

More detailed information can be obtained on separate areas of the business, leading to more effective organisation and decision making that is relevant to individual centres.

2 Financial reasons:

Allows comparisons to be made between the most cost-efficient/profitable and least cost-efficient/profitable areas of the business and appropriate action to be taken.

3 Motivational reasons:

It gives individual managers greater responsibility for achieving cost or profit target within their centres.

Full Costing Method:

According to this method indirect costs are apportioned on the basis of the percentage of the direct cost consumed by each product of the firm's product mix. It is considered to be the simplest method of calculating total cost.

Example:

A manufacturer which makes two components code named ZX1 and ZX2 may have the direct costs of producing 1000 of each component contributes to total direct cost.

	Zx1	Zx2
	\$	\$
Direct material	10	12
Direct labor	6	8

Assume that total indirect costs are \$300,000. We need to calculate the percentage each component contributes to total direct cost.

	ZX1 \$	ZX2 \$
Direct material	10,000 (\$10x1000)	12000 (\$12x1000)
Direct labor	6,000 (\$6x1000)	8,000 (\$8x1000)
Total direct cost	16,000	20,000
Add: Indirect cost	133,333 (\$300,000x16/36)	166,667 (\$300,000x20/36)
Total cost	149,333	186,667

Characteristics of full costing method:

1. It is a very simple and easy method of distributing indirect. Costs.
2. Can even be used by an individual with a little accounting knowledge
3. Standardized base of distribution indirect cost is used for all products.
4. It might result in an un-justified distribution of indirect cost to some products as it is not compulsory that if one product has greater direct cost then it must be having greater indirect cost as well.
5. Cost figures calculated might not be reliable due to incorrect distribution of indirect cost.
6. Firm might not be able to evaluate the performance of its products properly as costs and profits figures might not be reliable.

Absorption Costing:

It is a traditional method of cost determination. According to this method proper/ realistic basis are identified for the apportionment of indirect costs. This identification of realistic basis enable firms to ensure that the total cost figure calculated is a reliable one.

How Costs are Apportioned:

1. Costs like rent could be apportioned on the basis of area occupied or time for which the building has been used.
2. Personnel expenditures could be apportioned on the basis of number of employees employed in a particular operation.
3. Depreciation and insurance costs could be apportioned on the basis of book value of assets owned by each department.

Example:

Dudely car exhausts which manufactures three types of exhaust systems, the E1, E2, E3. Factory time and direct cost details (per system) are shown in Table 53.3.

	E1	E2	E3
Direct Material	\$ 6	\$ 8	\$ 10
Direct labor	10	12	14
Area occupied	100	150	200sqmetre

Annual indirect costs include rent, selling costs, overheads and administration. These are \$12,000, \$18,000, \$24,000 and \$4,000 respectively. Rent is apportioned on the basis of area occupied by each system. Selling cost and overheads are apportioned equally between all systems. Administration is apportioned according to the labour input of each system (most administration costs in this case are labor related, eg. Wages). Dudely car exhausts produces 1,000 of each system every year.

	E1 \$	E2 \$	E3 \$
Direct material	6,000	8,000	10,000
Direct labor	10,000	12,000	14,000
Total direct cost	16,000	20,000	24,000
Add: Indirect cost	2,667	4,000	5,333
Rent	(\$12,000x100/450)	(\$12,000x150/450)	(\$12,000x200/450)
Selling cost	6,000 (\$18000x1/3)	6,000 (\$18000x1/3)	6,000 (\$18000x1/3)
Overheads	8000 (\$24000x1/3)	8000 (\$24000x1/3)	8000 (\$24000x1/3)
Administration cost	1,111 (\$4000x10/36)	1,333 (\$4000x12/36)	1,556 (\$4000x14/36)
Total cost	33,778	39,333	44,889

Absorption costing-Advantages & Dis-advantages:**Advantages**

- Comply with IAS2 Stock valuation. Cover all relevant production cost.
- Set competitive and realistic SP
- Over/Under absorption can identify inefficient utilisation of production resources
- Emphasis all costs to be recover in the L/T DM.
- Cost charge fairly to the product

Disadvantages

- Confusion in basis of apportionment. Argument of the basis used.
- Have to adjust the over/under absorbed at the year end. Cannot absorbed correctly.
- Profits are affected by the production volumes. Can be distorted.

Marginal Cost:

Marginal cost is defined as the increase or decrease in total costs which result in an increase in a unit of output. E.g. if co. produces 100units then total cost is \$1000 and if it produces 101units then total cost is \$1010. It means marginal cost is \$10.

Marginal/Contribution Costing:

Marginal costing is also called contribution costing and it is a very important management decision making technique. According to this method we only consider direct costs or variable cost as fixed costs will remain fixed for that time period even if extra activity is not undertaken.

What is Contribution?

The amount contributed by a project or a proposal towards covering:

1. Fixed Cost
2. Desired Profit

Or it can also be defined as the excess of sales revenue over marginal cost.

$$\text{Contribution} = \text{Selling price} - \text{Marginal cost}$$

$$\text{Marginal cost} = \text{direct/variable cost} + \text{increase in fixed cost}$$

How decision is made?

In contribution costing project giving positive or greater contribution shall be selected/ accepted or vice versa. However we also may have to consider some qualitative factors as well in order to make final decision.

Decisions made by using marginal costing technique?

1. To decide whether or not to launch a new product.
2. To know whether or not to increase the production scale.
3. To choose the best production method.
4. To accept a special order which offers lesser selling price as compared to the normal selling price of the business.
5. To set the selling price of the product which at least should cover direct costs if firm is pursuing with the objective of survival.
6. To decide whether to make or buy the product.
7. To decide whether to close or continue with a department which is either going in loss or is not able to generate a desired level of profit for the business.

Note: All above mentioned decisions will be taken on the basis of contribution i.e. option with positive or greater contribution shall be selected.

Notes:

1. Allocated/Normal fixed cost is ignored, only increase/decrease in fixed cost is considered.
2. Only used for some special orders, can't be used as a regular costing system.
3. Not intended to calculate total cost.
4. Contribution is only calculated for the product/department for whom we have to make decision.

Statement showing contribution calculation

Sales Revenue
Less: Marginal cost:
Variable cost:
 D.M
 D.L
 Other direct costs
 Increase/decrease in fixed cost
Contribution

\$	\$
	200,000
40000	
35000	
15000	
25000	
	(115000)
	<u>85000</u>

Non-Financial Considerations:**1 Market Conditions:**

If there is economic recession then instead of profit maximisation business might switch to the objective of survival. In this case it might even decide to accept a project with negative contribution considering that it will be able to retain its labor during this period.

2 Level of competition:

In case of entry new competitors business might even decide to accept a project even with negative contribution, but in case of less competition in the market business might not consider contribution and it will just select that project or proposal which will return high profit.

3 Nature of customer:

If business is getting an order from a customer whom it believes can give huge orders in future. E.g. foreign customer, then for the time being it might even accept his order with negative contribution.

4 Management of product mix:

If business is supposed to decide whether to close a department or withdraw a product then apart from considering contribution it will also have to consider its product mix, because withdrawal of a product or closure of a department might alienate some customers resulting in loss of market share.

Criticism on contribution costing technique:

1. It only considers financial factors, while all non-financial factors are ignored.
2. Decision taken alone on financial basis might not be considered as quality decision.
3. It can only used for some special orders can't be used as a permanent costing method.

Disadvantages of marginal costing:

- The separation of costs into fixed and variable is difficult and sometimes gives misleading results.
- Normal costing systems also apply overhead under normal operation volume and this shows that no advantage is gained by marginal costing.
- Under marginal costing, stocks and work in progress are understate. The exclusion of fixed costs from inventories affect profit, and true and fair view of financial affairs of an

5.4 Accounting Fundamentals

5.7 Contents of Published Accounts

Final/financial accounts:

These accounts are normally prepared at the end of the year, however companies can produce them on half yearly or quarterly basis as well. These are intended to show operating and financial performance of the business at the end of a specific time period. (normally an accounting year).
Public limited companies (plc) are required to produce two sets of final accounts.

Internal use	Published accounts
These are detailed final accounts which are prepared by a plc. They will include all minor details. They will just be available for finance department and directors.	According to companies act public limited companies are required to publish their accounts. In order to maintain secrecy of co. they are going to produce a summarised set of final accounts which will just have summarised details of main cost and profit centres.

Contents of published accounts:

1. Income statement. (Profit and loss account)
2. Balance sheet.
3. Cash flow statement.
4. Notes to the accountants.
5. Accounting policies.
6. Auditor's report.
7. Chairperson's statement.
8. Director's report.

Income statement (Profit and loss account)

It is an operating statement which shows the operating performance of a business during a specific time period of time. (normally an accounting year). This operating performance is assessed in terms of profit and loss.

Income statement (Profit and loss account)

Sales/Turn over	300,000
Less: cost of sales (opening inventory + purchases – closing inventory)	
(100,000)	
Gross profit	200,000
Less: operating/overhead expenses	(50,000)
Operating profit/profit before interest and tax	150,000
Less: Interest	(50,000)
Net profit/profit before tax	100,000
Less: Corporation tax (\$100,000 x 20%)	(20,000)
Profit after tax	80,000
Less: Dividends	(50,000)
Retained profit	30,000

What is retained profit?

The percentage of net earnings not paid out as dividends, but retained by the company to be reinvested in its core business or to pay debt. It is recorded under shareholders' equity in the balance sheet.

Importance/advantages of retained profit:

1. It can be used as an internal source of finance in case of need and does not involve any cost (interest or dividend). Only cost involved could be opportunity cost (cost of next best source).
2. In case of loss it can be used to pay off liabilities. E.g. interest on bank loan, debentures etc.
3. It can be used for expansion of business.
4. They are flexible, management can itself decide that how much dividend it is going to pay and how much it must retain.
5. It also prevents loss of ownership as owners do not require to issue more shares.

Why prepare (uses of) income statement?

1. It is required by law that plc's must prepare income statement to show their operating performance to stake holders.
2. It will summarise all transactions related to costs and revenues.
3. It helps to evaluate financial health of the co.
4. It provides information to calculate ratios and compare current year's performance with the past year's performance.

Limitations of income statement:

1. Income statement shows the details of revenue and costs incurred last year. (historical).
2. It does not predict anything about future, since it is the record of last year's transactions. However business might use it to identify trends.
3. Business might manipulate accounts in order to reduce their tax liabilities. In this case it may not reflect true picture of the business.
4. It does not show any information about cash inflows or outflows.
5. It is a summarised statement (published account) and does not have details of different cost and profit centres.

Statement of financial position/Balance sheet:

A financial statement which shows financial position of a business at the end of a specific time period. (normally an accounting year). It is assessed in terms of assets, liabilities and capital.

Statement of financial positions format**Non-current assets:**

Land and building
Plant & Machinery
Furniture & fixtures
Total Fixed Assets

Currents Assets:

Inventory
Accounts receivables
Cash at bank
Cash in hand

Less: Current Liabilities

Bank overdraft
Accounts payable
Net current assets/working capital
Capital Employed

Less: Non-current liabilities:

12% Debentures
Long term bank loan
Net Assets

\$

\$

X

X

X

X

X

X

X

X

X

X

X

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Share holder Equity/ Capital & Reserves:

Ordinary share capital		X
Preference share capital		X
Reserves		X
Retained profit	X	X

Why prepare (uses of) Statement of financial position/balance sheet?

1. It is a legal requirement to prepare balance sheet at the end of the year.
2. It exhibits the financial soundness of the company as a whole.
3. It gives almost complete picture to any party interested any type of relation with the company.
4. It gives a bird's eyes view of assets and liabilities that co. possess.
5. It provides to calculate ratios and enables co. to compare its current year's financial position with the past year.

Limitations of Statement of financial position/balance sheet:

1. It is a record of financial position of the last year and does not predict anything about future.
2. It does not show true value of assets. Historical cost is criticized for its inaccuracy since it may not reflect current market valuation.
3. Some of the current assets are valued on an estimated basis, so the balance sheet is not in a position to reflect true financial position of the business.
4. It can not reflect those assets which cannot be expressed in monetary terms, such as skill, intelligence, honesty, and loyalty of workers.
5. Fixed assets may be overvalued if they have been depreciated incorrectly.

Users of published accounts:

Internal	External
1 Management.	1 Owners.
2 Employees.	2 Creditors.
	3 Banks.
	4 Government.
	5 Investors.
	6 Customers.
	7 Potential bidders.
	8 Suppliers.

How different stakeholders might use published accounts?**Internal users:****Management:**

- 1 Might analyse costs, if high then they will try to decrease in future.
- 2 Might help to evaluate result of their current business plan. If not satisfied they will try to improve in the coming year.
- 3 Might analyse profitability to demand increase in salary and fringe benefits.
- 4 Might help them to decide whether to continue job in the company or switch over to other.

Employees:

- 1 Might help them to analyse current year's performance and might also motivate them. (in case of achievement of company's target)
- 2 Might use information to demand increase in wages and other benefits.
- 3 To assess whether business is secure enough to pay wages and salaries.
- 4 To determine whether jobs are secure or not.
- 5 To determine whether the business is likely to expand or be reduced in size.

External users:**Owners:**

- 1 Might enable them to analyse current year's performance.
- 2 Might enable them to determine how much profit/dividend they should be paid.
- 3 Might help them to decide whether they should continue their investment in the co. or switch over to another co.
- 4 Might enable them to decide that they should make further investment in business or not.

Creditors:

- 1 Might help them to assess liquidity position of the co.
- 2 Might help them to decide whether they should be giving credit to the business or not.
- 3 Might enable them to assess gearing of the business.
- 4 To decide whether business has satisfactory cash flow position so that it can be pressurized for early payment.

Banks:

- 1 Might help them to decide whether they should give loan to company or not.
- 2 Might also help them to determine that whether business will be able to repay loan installment or not.
- 3 Might also enable them to calculate gearing of the company.
- 4 Might also help them to decide that whether they should be investing in the company or not. (buying shares or debentures).

Government:

- 1 To determine how much tax should be paid by the business.
- 2 To analyse the performance of the company.
- 3 To determine future tax rate which should be imposed on the sector in which co. is operating.
- 4 To determine whether the sector in which co. is working would be needing subsidies or not.

Investors:

- 1 Might help them to determine financial health of the company.
- 2 Might enable them to decide that whether they should be investing in the company or not.
- 3 Might enable them to select mode of investment. (share or debenture).
- 4 Might also enable them to calculate gearing and liquidity ratios.

Customers:

- 1 Might enable them to assess financial health of the co.
- 2 Might help them to decide that whether they should be making advance payment to the business or not.
- 3 They could also be interested in investing in the co, so it might also help them to decide whether they should be investing in co. or not.

Potential bidders:

- 1 Might enable them to decide the current worth of the co.
- 2 Might enable them to decide bidding price. (Including good will).

Suppliers:

- 1 Might enable them to assess liquidity position of the co.
- 2 Might enable them to determine how much credit limit should be assigned to the co.
- 3 Might also help them to determine that how much credit time should be allowed to the co.

Limitations of published accounts:

1. These are the past records and predictions or future plans of Co. are not given.
2. Qualitative (Non financial) information is absent, so decisions made solely on the basis of this might not be considered as quality decisions.
3. Only assets which can be assessed in terms of monetary value are given and assets such as workforce is an asset which isn't shown directly like their commitment and loyalty of the workers.
4. Only quantified info is presented, which is based on bank information.
5. Company might have used window dressing technique to make its accounts attractive for stakeholders.

Window dressing:

A set of actions or manipulations with financial or other information in financial documents (financial statements, reports, etc.) to make this information look more attractive to its users. Even though window dressing can occur at any time, it is commonly used at the end of the period.

Is window dressing illegal?

Generally, window dressing is considered to be an unethical practice because it involves deception and advancement of management's interests instead of interests of information users (i.e., owners, investors, government). From the legal point of view window dressing isn't illegal, but in some cases it can be so. Window dressing can be an illegal or fraudulent action if it contradicts the law or accounting standards.

How accounts can be window dressed?

Beneficiary	Reasons	Window dressing action	Who is mis-lead?
Company	To obtain funding (to borrow money)	Increase profits and liquidity ratios.	Borrowers (banks, other financial institutions)
Company	To reduce tax payments.	Decrease profits by increasing expenses.	Government.
Company	To smooth financial data (sales, expenses, accounts receivable etc.)	Record sales or purchase in an inappropriate period; Give large discounts to debtors for payments received before period end.	owners
Company	To hide some problems (liquidity, profitability, poor management decisions)	Increase cash account balance at the period end, increase useful life of fixed assets.	Owners.

Reasons for window dressing:

1. To show a stronger market position of the business.
2. To influence share price of the co. in stock market.
3. To hide liquidity problems of the co.
4. To present stronger picture of business in order to encourage investors to invest in the co.
5. To reassure lenders that business will be able to repay its debts.
6. To hide poor management decisions.

5.5 Forecasting and Managing Cash Flows

Cash flow statements:

Business will have to produce two types of cash flow statements.

1. Cash flow statement
2. Cash flow forecast statement (Budget)

Cash flow statement:

This statement is prepared by the financial accountants of the co. and it will record all transactions which took place during the year. E.g. Co. will prepare cash flow statement for year 2012 and in this it will record all cash transaction for that time period.

A cash flow statement is a financial accounting document, which shows the cash inflows and the cash outflows for a business over the past 12 months. It indicates those months in which the business suffered a cash flow crisis (where cash out flows were greater than cash inflows) and it will also highlight those months in which the business was cash rich (i.e. more cash inflows than cash outflows).

It allows a business to prepare a cash flow forecast for the forthcoming year, by basing the estimated cash inflows and outflows on the results from the previous year.

What additional information does the Cash Flow Statement give about the financial position of a business?

1. It Discloses information related to any change in long term loans.
2. Provides information regarding new share issue.
3. Provides information regarding new fixed assets investment.
4. Provides information regarding disposal of fixed assets.
5. Provides information regarding dividend payment to shareholders.

Limitations of cash flow statement:

Cash flow statement is a very important tool, but it has its own limitations which must be kept in mind at the time of its use. These limitations could be:

1. It is just like income statement and balance sheet prepared by using past information. It therefore does not provide complete information to assess the future cash flows of a business.
2. As a cash flow statement is based on a cash basis of accounting, it ignores the basic accounting concept of accrual.
3. Cash flow statement are not suitable for judging the profitability of a firm, as non-cash charges are ignored while calculating cash flows from operating activities.

Difference between cash and profit:

Cash	Profit
It is defined as the amount of cash which is available with the Co. to meet its cash requirements	It is defined as the excess of total revenue over total cost
The amount of cash will only increase/decrease with the amount of cash sales/expenses.	Profit = TR - TC In profit calculation we include both cash and credit revenues and expenses.

Profitable firms are not likely to face cash flow problems. Explain whether you agree or dis-agree with this statement:

Profit and cash are two different concepts. Highest profitability cannot guarantee that business is not going to end up with cash flow crisis. There are multiple reasons for this but the main reason is that business does not maintain cash equal to the profitability and the amount of cash and profit cannot be equal due to certain reasons.

Reasons why the amount of cash and profit cannot be equal/ how highly profitable firm can still face cash flow problems?

Cash	Profit
1. Only increases with the amount of cash sales but profit will increase with the amount of total revenue so business will have less cash but high profit. 2. Will decrease due to purchase of fixed assets but profit will not be affected, so business will have less cash but high profit and it might end up with cash flow crisis. 3. Depreciation will not affect cash but profit will decrease, so business will have more cash but low profit. 4. Cash will decrease due to payment of dividend but it will not affect profit, so business will be having low cash but high profit.	1. Will increase with the amount of total revenue. i.e. cash and credit sales, so the amount of profit will be high but co. will be having lesser amount of cash. 2. Purchase of fixed assets will not affect profit as it is not included in income statement. As a result of this business will have high profit but low cash. 3. Depreciation is recorded as an expense therefore it will decrease the amount of profit. So company will be low profitable but still it would be having more cash. 4. Payment of dividend does not affect income statement as it is recorded in appropriation account, but it will result in cash outflow so profit will be high but low cash.



Cash flow forecast statement/ Budget:

A statement prepared to predict future inflows and outflows of cash. It is prepared by the management accountants of the company.

Importance/reasons/benefits of cash flow forecast statement/ Budget:

1. It helps to forecast cash flows for a coming time period.
2. It helps to identify that time period in which cash flow crisis might be expected.
3. It might also help to select a suitable source of finance.
4. It will help to determine whether co. will be able to start a new investment projects or not.
5. It helps to determine credit time to be allowed to credit customers/accounts receivables. E.g. if cash position is expected to be strong then more credit time might be allowed or vice versa.

6. Might be demanded by bank while getting loans as it will help bank to determine whether business will be able to repay loan installments or not.
7. It might help prevent business going into a project that will not be successful.
8. It will help business to spot problems early so it can make plans for the necessary solution. (E.g. it will highlight whether business is holding too much stock or whether its collection is less than it should be or that it will be short of cash at a particular time).
9. It will inspire confidence in lenders and banks that business may have to approach for finance.

Sources of cash inflows and outflows:

Inflows	Outflows
1. Owner's/shareholder's investment.	1. Purchase of fixed assets.
2. Receipts of bank loan.	2. Cash purchases.
3. Interest on savings and investment.	3. Payments to suppliers/accounts payables.
4. Increase in bank overdraft.	4. Expenses payment. E.g. salaries etc.
5. Cash sales.	5. Loan repayments.
6. Receipts from credit customers/accounts receivables.	6. Dividend payment.
7. Government grants.	7. Tax payment.
8. Donations.	8. Advertising.
9. Sale of fixed assets.	

Format of cash flow forecast statement:

£	January	February	March
Opening balance	1050	50	(50)
Cash in:			
cash sales	100	200	400
cash from earlier credit sales	—	200	400
Cash out:			
materials	300	300	300
wages	200	200	200
rent	600	—	—
Closing balance	50	(50)	250

Limitations of cash flow forecast statement/budget:

1. Its preparation will consume a lot of time.
2. It can be a costly process because business will need the assistance of accountant or financial adviser.
3. It is just a forecast and does not guarantee actual results.
4. It only considers financial/quantitative factors and ignores non-financial/qualitative factors.
5. It uses historical data and thus is not a current or totally accurate.
6. It is not a proper "financial statement" of where the business is as it does not include company's assets, shares, debts, savings or future investment.
7. It is produced by the staff of the company who may be over confident and hence it is biased and not fully accurate.

How to improve cash flow position:

- A business can take following steps to improve its cash flow position.
1. It can convince its bank to provide overdraft facility. This will provide instant cash however, interest payment might increase.

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2. It can demand more time from its supplier for payment, however they may demand interest on the overdue amount.
3. It can reduce price of its products with a view to increase sales/cash inflows, however it might reduce profit margin and affect brand image.
1. It can sell goods to its customers on cash rather than on credit. This will increase amount of cash inflows. However, some customers might get alienated resulting in loss of market share.
1. It can sell off some fixed assets. Instant inflows will take place however, business might face shortage of fixed assets.
- Business can reduce its stock level. To get rid of the piled up stock it can announce discount or sales. However, this could result in loss.
- It can convince its credit customers to make early payments by offering them cash discount. However, it might result in decline in profit margin.



5.6 Budgets

Budgeting:

A budget is defined as a statement of financial position that a business hopes to achieve. In other words budget is a plan that outlines that how a business is going to spend money. Budget normally covers a time period of 12 months and each department will prepare its own budget. Considering this fact each departmental manager will be responsible to ensure that he is going to meet budget target and variance is avoided.

If a business is going to prepare budgets then it will allow it to:

1. Define or set clear objectives for employees.
2. Will provide a base to measure level of success or failure.
3. Will help to improve failing areas.
4. Will also help to improve inter-departmental coordination.

Why prepare budgets?

Or

Benefits/importance of budgeting:

1. Budgeting helps business to plan its activities.
2. It helps to coordinate different activities in order to ensure that overall costs are not going to increase than budgeted.
3. It helps to allocate responsibilities to different departments/employees and communicate them that what they are expected to achieve.
4. Through budgeting process management will set targets for its employees which could make their jobs challenging resulting into higher level of motivation.
5. Budgeting also provides a framework for delegation.

Problems/drawbacks of preparing budgets:

1. It might a time consuming process which could affect other activities.
2. It might be difficult to agree on targets.
3. It will reduce flexibility and may not let managers adapt according to changing trends.
4. Managers may resist attempts to set financial targets as it will provide a clear base to top management to evaluate their performance.
5. In order to achieve budget targets managers may take short term decisions rather than taking long term decision which may exceed budget. It means business will get short term benefits rather than getting long term benefits.
6. If budget targets are not realistic then they might demotivate employees.

Methods of budgeting:**1 Objective budget:**

Such budget will set out objectives that employees will be expected to achieve. For example, increase profit this year by 10%.

2 Investment budget:

It is used to evaluate investment decisions. It will help to decide that whether it is beneficial to invest in a project or not. In order to achieve this objective business might use investment appraisal techniques.

3 Zero based budgeting:

It is assumed that business does not have any money to spend. Managers will have to justify that why they should be given a budget. It is to ensure that organisational resources shall be utilised in the most effective manner.

Value/importance/advantages of zero based budgeting:

1. It forces budget setters to examine every item each year and decide if it is going to be necessary for the coming year or not.
2. It will prevent managers demanding more budget for the coming year as they might adjust expenditures with the rising rate of inflation and demand high budget from management.

4 Fixed budget:

A single figure is used as the target. No variation is permitted and management will have to achieve budgeted target. Cost of production must be \$1,000,000.

5 Flexible budgets:

In order to overcome the limitation of fixed budget management defines a "tolerance zone" by giving upper and lower limits either side of the budgeted figure. This will help to minimise chances of variance and will create a little flexibility for managers.

Types of budgets:

A business organisation is likely to prepare following budgets.

Sales/revenue budget:

This type of budget is prepared to forecast revenue for the coming time period.

Production budget:

It will forecast the output level for business. E.g. how many units business is going to produce in the coming time period.

Purchasing budget:

It will help to determine that how much material will be required by business in the budgeted period.

Labor budget:

It will help to determine that how much labor will be required by a business in production budget.

Capital expenditure budget:

It will forecast that how much investment business is likely to make into fixed assets during the budgeted period.

Cash budget/cash flow forecast statement:

It will forecast expected cash inflows and outflow for the coming time period. It is an attempt to ensure effective cash management.

Master budget:

A forecasted income statement and balance sheet is prepared to predict operating and financial position of business for the coming time period. A master budget is a set of interconnected budgets of sales, production costs, purchases, income etc. A master budget serves as planning and control tool to the management since they can plan the business activities during the period on the basis of master budget.

LIMITATIONS OF BUDGETING

1. It is based on estimations and predictions which might go wrong as future is always uncertain.
2. It is a time consuming exercise as it will consume a lot of time to determine budgets.
3. If the budgets are made in a wrong manner due to any reason then serious problems can occur as far as the resource allocation, coordination and monitoring is concerned.
4. Budgets are restricting in nature.
5. Sometime de-motivating for the workers.
6. Creativity is limited if targets are too high.
7. Too low targets – workers can't achieve full potential

What is variance?

The difference between actual and budgeted figures is known as a variance.

Types of variance?

<u>Favorable</u>	<u>Un-favorable/Adverse</u>
If the difference will result in increase in profit.	If the difference will decrease the amount o profit.

Variance calculations-Example:

Skate Company				
Overhead Budget Report				
For the Year Ended December 31, 2013				
	Budget	Actual	Variance	Favorable/ Unfavorable
Production (units)	100,000	125,000		
Indirect materials	\$50,000	\$60,000	(\$10,000)	Unfavorable
Indirect labor	40,000	45,000	(5,000)	Unfavorable
Supervisory salaries	100,000	105,000	(5,000)	Unfavorable
Rent	80,000	80,000	-0-	
Utilities	40,000	45,000	(5,000)	Unfavorable
Depreciation	20,000	20,000	-0-	
Total overhead	\$330,000	\$355,000	(\$25,000)	Unfavorable

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Valuation of assets



5.7.3 Inventory Valuation

Valuation of inventory: (A2 topic)

Stock which is kept by a business. A business organisation might be having following types of inventories:

1. Raw material. (to be used for production)
2. Work in progress/process. (in-complete goods)
3. Finished goods. (ready to be sold)

These inventories are left at the end of the accounting year and they need to be recorded in accounting books. In order to record these in balance sheet accountants are quite clear that inventories should be recorded at their purchase price (historical cost) or their net realisable value whichever of these two is low.

What is net realisable value?

The amount for which an asset (usually an inventory) can be sold minus the cost of selling it. It is only used on balance sheets when net realizable value is estimated to be below historical cost.

Example:

A garments shop purchased 100 suits @ \$50 each. During the month they sold 95 suits and closing inventory comprises of 5 suits. At the end of season they decided to sell them in sale as fashion is expected to change. They determined that each suit can just be sold for \$40. This \$40 shall be considered as the net realizable value. In balance sheet it shall be valued at cost or net realisable value whichever of these two is low, so it will be valued at \$40 each. Conservation principle states that losses should be recorded as soon as they are believed to occur.

5.7.4 Depreciation

Valuation of fixed assets/Depreciation:

It is defined as the reduction in the value of a fixed asset. E.g. Co. bought a car for \$50,000. At the end of year it is expected to have a value of \$45,000, so depreciation will be \$5,000.

Explain why depreciation is recorded in accounting books?

The calculation and reporting of depreciation is based upon two accounting principles:

1 Cost principle:

This principle requires that the depreciation expense reported on the income statement, and the asset amount that is reported on the balance sheet, should be based on the historical (original) cost of the asset. (The amounts should not be based on the cost to replace the asset, or on the current market value of the asset, etc.)

2 Matching principle:

This principle requires that the asset's cost be **allocated** to Depreciation Expense over the life of the asset. In effect the cost of the asset is divided up with some of the cost being reported on each of the income statements issued during the life of the asset. By assigning a portion of the asset's cost to various income statements, the accountant is matching a portion of the asset's cost with each period in which the asset is used. Hopefully this also means that the asset's cost is being matched with the **revenues** earned by using the asset.

Explain how depreciation might affect accounts of the company?

It will have a dual effect on the final accounts of the co.

1. First of all it will be subtracted as an expense in the income statement, so the value of profit shall decrease with the amount of depreciation.
2. Secondly it will be subtracted from the value fixed asset in the balance sheet, therefore the value of fixed assets shall also decrease with the amount of depreciation.

Depreciation and cash flow:

Depreciation is a non-cash expense. It means that it is only recorded in accounting books but not paid to anyone, due to this reason it will not result into any inflow or outflow of cash.

Method of calculating depreciation:

Straight line method:

According to this a fixed amount is subtracted every year as depreciation.

$$\text{Annual depreciation} = \frac{\text{cost of assets} - \text{scrap/residual/salvage value}}{\text{Expected life of asset}}$$

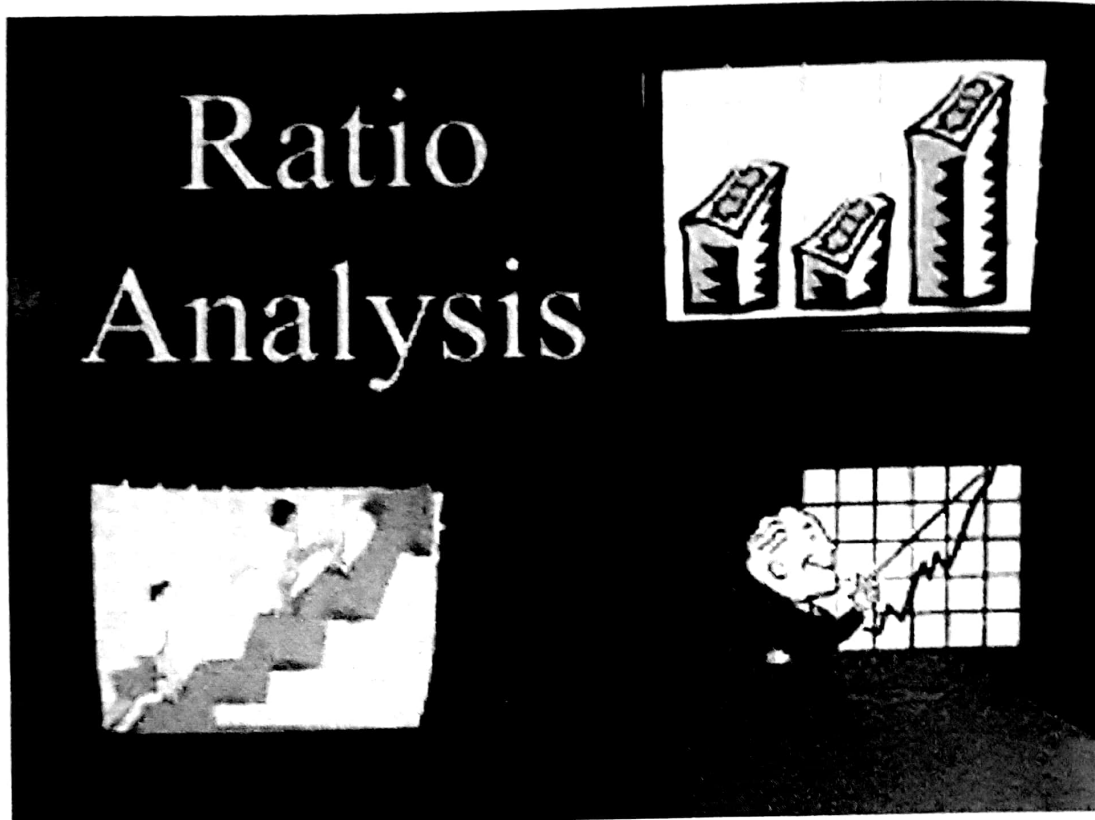
Example: Business purchased machinery on 1st January, 2013 for \$50,000. It is expected to have a life span of 5 years with a residual value of \$5,000. So annual depreciation shall be:

$$\text{Annual depreciation} = \frac{\$50,000 - \$5,000}{5} = \$9,000$$

What is scrap/residual/salvage value?

The value which a co. expects to get by disposing off an asset when it will complete its useful life. E.g. in the above mentioned example scrap/salvage/residual value shall be \$5,000.

Advantages	Dis-advantages
1. A simple method of calculating depreciation 2. Quite useful for assets having consistent use or for those which are not likely to be effected due to change in technology. 3. Provides consistency to co. as every time a fixed amount is subtracted as depreciation 4. Gives equal burden of depreciation expense on the profits throughout the life of asset.	1 Not suitable for assets which are likely to be affected due to the introduction of new technology. 2 scrap value is assumed co. may not be able to recover the same value at the completion of the life of asset.



5.8 Analysis of Published Accounts

What is capital employed?

Total amount of capital, that has been invested in business to earn profit. It includes both owner's/share capital and long term loan capital.

Capital employed = Owner's/share capital + long term loan capital / Non current liabilities.

Or
Capital employed = Non-current assets + current assets - current liabilities.

Return on capital employed (ROCE):

It calculates profit, which a business is able to make as a percentage of capital employed.

Return on capital employed = $\frac{\text{Net profit}}{\text{Capital employed}} \times 100$

Capital employed

Capital employed = Non-current assets + current assets - current liabilities

Capital employed = total assets + Non-current liabilities.

How to comment?

If ratio is increasing as compared to last year then it is said that company's performance is improving. It is likely to increase demand of company's shares.

Financial efficiency ratios:

Inventory turnover ratio:

It calculates that how many times during a year business purchased and sold inventory.

Inventory turnover = $\frac{\text{Cost of sales}}{\text{Average inventory}}$

Average inventory = $\frac{\text{Opening inventory} + \text{Closing inventory}}{2}$

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Note:

If opening inventory is not given then closing inventory shall be considered as average inventory.

How to comment?

If inventory turnover is increasing then it is considered good for the business. It is likely to increase sales revenue and market share.

Accounts receivable turnover ratio:

It calculates average time taken by a business to recover its outstanding debts from its credit customers. If ratio is resulting in lesser days then it means that debt recovery system of business is improving or vice versa. In such situation, business's cash flow position is likely to improve and the danger of facing cash flow crisis shall be minimised.

$$\text{Accounts receivable turnover} = \frac{\text{Accounts receivables} \times 365}{\text{Turnover/Sales}}$$

Gearing Ratio:

It shows the relationship between loan and equity capital. In other words, it will calculate that how much of the total capital of the company has been raised as loan capital. If answer is greater than 50% then firm is said to be a highly geared firm. In other words, it has more loans as compared to equity or share capital or vice versa.

$$\text{Gearing Ratio} = \frac{\text{Non current liabilities} \times 100}{\text{Capital Employed}}$$

Or

$$\text{Gearing Ratio} = \frac{\text{Equity Capital} + \text{Non-current liabilities}}{\text{Capital Employed}}$$

Capital employed = Non-current assets + current assets - current liabilities

How Gearing ratio might be used by a company while selecting a source of finance?

If company is already highly geared then it will prefer to raise additional capital by selling shares. In other words, it will attempt to increase its equity capital to reduce its risk factor. Ordinary shareholders will share profits and losses of the business and secondly they will earn a fluctuating dividend. In this way firm will be able to reduce the risk factor.

Investor's Ratios:**1 Dividend yield Ratio:**

It measures the profit, which a shareholder earns as a percentage of the market price of share.

$$\text{Dividend yield ratio} = \frac{\text{Dividend per share} \times 100}{\text{Market share price}}$$

2 Dividend Cover Ratio:

It calculates how many times company can pay dividend out of the current profit.

$$\text{Dividend Cover Ratio} = \frac{\text{Profit after interest and tax}}{\text{Dividends (paid and proposed)}}$$

3 Return on Equity:

It measures the return on the shareholder's investment in the company.

$$\text{Return on Equity} = \frac{\text{Net profit - tax - preference shares dividend}}{\text{Equity (ordinary share capital + Reserves)}}$$

4 Price earning ratio =

The price earnings ratio is the ratio for valuing a company that measures its current share price relative to its per share earnings.

$$\text{Price earning ratio} = \frac{\text{Market Value per Share}}{\text{Earnings per Share (EPS)}}$$

5 Dividend per share:

It calculates the dividend that a company on per share. (ordinary/equity shares)

$$\text{Dividend per share} = \frac{\text{Dividend paid}}{\text{Number of shares issued}}$$

Investment Appraisal



5.9 Investment Appraisal

Investment appraisal:

A set of techniques used to evaluate different investment proposals on financial bases. They will enable company to select best project for investment.

Techniques of Investment appraisal:

1. Pay back method (PB)
2. Average rate of return (ARR)
3. Discounted cash flow techniques: (DCF)
 - 3.1. Net present value method (NPV)
 - 3.2. Internal rate of return (IRR)

PAYBACK METHOD (P.B):

It helps to calculate the expected time period in which company might recover its initial investment, for example if company is investing \$200,000 in a project then it might wish to know that in how much time it will recover this investment.

HOW DECISION IS MADE?

Project giving minimum payback time is selected for investment.

Formulas:

$$\text{Months} = \frac{\text{Net cash inflow} = \text{Cash receipts during the year} - \text{Cash payments during the year}}{\text{Amount required}} \times 12$$

Next year's net cash inflow

CHARACTERISTICS OF PAYBACK TECHNIQUE:

1. A simple technique which can even be used by an individual with a little accounting knowledge.
2. Quite useful for companies having cash flow problems, as it enables them to select that project for investment which will result in faster cash inflows.
3. It might also help in the selection of a suitable source of finance.
4. Might help to decide whether to invest in a fixed asset or not.

5. These are forecasted cash inflows and may not guarantee actual result.
6. It ignores profitability factor as the decision is just made on the bases of payback time and no attempt is made to calculate profit. Some time company might reject projects with higher % of ARR as they might be having longer payback time.
7. It also ignores the time value of money which might fluctuate over the time period due to the certain factors such as inflation.
8. Like all other investment appraisal techniques it ignores non-financial factors for example government policy, market conditions etc. Decision is just made on financial bases.

Example:

Year	<u>Project-A</u> Net Cash inflow/(outflow) \$	<u>Project-B</u> Net Cash inflow/(outflow) \$	<u>Project-C</u> Net Cash inflow/(outflow) \$
0	(200,000)	(200,000)	(200,000)
1	50,000	50,000	(20,000)
2	50,000	60,000	60,000
3	50,000	70,000	80,000
4	50,000	80,000	100,000
5	50,000	100,000	120,000

Project A:

Payback time = 4years.

Project B:

Payback time = 3years & 3months

Months = $\frac{\$20,000}{\$80,000} \times 12$

Project C:

Payback time = 3years & 9.6months

Months = $\frac{\$80,000}{\$100,000} \times 12$

Average rate of return (A.R.R):

This technique helps to overcome the drawback of payback technique as it ignores profitability. It helps to calculate the average expected profit of an investment proposal as a %age of its initial investment.

How decision is made?

project giving highest percentage of A.R.R is selected for investment

Steps in the calculation of A.R.R:

$$1 \quad \text{Average profit} = \frac{\text{Total of net cash inflows} - \text{initial investment}}{\text{Duration/Life of project}}$$

$$2 \quad \text{A.R.R} = \frac{\text{Average profit} \times 100}{\text{Initial investment}}$$

Example:

Year	Project-A Net Cash Inflow/(outflow) \$
0	(200,000)
1	50,000
2	50,000
3	50,000
4	50,000
5	50,000
Total inflows	250,000

$$\text{Average profit} = \frac{(\$250,000 - \$200,000)}{5} = \$10,000$$

$$\text{A.R.R} = \frac{\$10,000}{\$200,000} \times 100$$

$$\text{A.R.R} = 5\%$$

Characteristics of A.R.R method:

1. It helps to overcome drawback of payback technique as it ignores profitability factor.
2. It enables company to select the highest profitable project for investment which will enable it to achieve highest profitability.
3. It is simple to calculate and easy to understand.
4. It ignores the time value of money which might fluctuate over the time period due to certain factors such as inflation factor.
5. It also ignores non-financial factors for example government policy, market conditions etc. decision is just made on financial basis.

Discounted cash flow techniques:

In simple words these techniques help to calculate the time value of money which might increase or decrease in future due to certain factors such as inflation.

Or

A discounted cash flow or DCF is one of the most important methods used to value a company. A DCF is carried out by estimating the total value of all future cash flows (both inflowing and out flowing), and then discounting them (usually using weighted average cost of capital) to find a present value of that cash. The aim of a discounted cash flow is to estimate the total amount of cash you will receive from an investment, and if this value is higher than the cost of the investment, it is usually worth doing.

How discounted cash flows are calculated?

Annual net cash inflows are discounted with the discount factor to calculate the time value of money.

Net present value (NPV) :

It calculates the net increase or decrease in the value of money over a certain time period.

$$\text{N.P.V} = \text{Discounted cash flows} - \text{Initial Investment}$$

A zero net present value means the project repays original investment plus the required rate of return. A positive net present value means a better return, and a negative net present value means a worse return, than the return from zero net present value. It is one of the two discounted cash flow techniques (the other named internal rate of return) used in comparative appraisal of investment proposals where the flow of income varies overtime.

HOW DECISION IS MADE?

Project giving positive or greater value of N.P.V is selected for investment.

Example:

Year	Project-A Net Cash inflow/(outflow) \$	Discount factor	Discounted cash flows \$
0	(200,000)		
1	50,000	0.91	45,500
2	50,000	0.83	41,500
3	50,000	0.75	37,500
4	50,000	0.68	34,000
5	50,000	0.62	31,000
Total inflows	250,000		189,500

N.P.V = \$189,500 - \$200,000

N.P.V = (\$10500)

CHARACTERISTICS OF NPV METHOD:

1. It helps to calculate the time value of money and enables company to select that project which will not lose its net value.
2. It is quite complex as compared to the other techniques of investment appraisal.
3. Cost of capital is quite difficult to ascertain.
4. With the NPV method, the disadvantage is that the project size is not measured.

Conclusion:

Net present value method is an arithmetically simple procedure that offers easy interpretation as the capital value is expressed in monetary units. Another advantage is the possibility of adapting the discount rates for different periods.

INTERNAL RATE OF RETURN (IRR)

It is the interest rate at which the net present value of all the cash flows (both positive and negative) from a project or investment equal zero. Internal rate of return is used to evaluate the attractiveness of a project or investment.

Note: Calculations of IRR are not included in syllabus.

Qualitative/Non-financial considerations:

These are the factors other than the quantitative/numeric data, which is important for investment decision making. These factors cannot be so easily expressed in numerical yet have a crucial importance on investment decision.

These factors could be:

1. The impact of proposed investment on environment and the local community.
2. Degree of risk taking power of the manager.
3. Approval of the project may not be given by the government or pressure groups may lobby against the project, all after commencement.
4. Ethical and environmental considerations. If investment in new technology will cause more environmental pollution then this decision might be un-ethical.
5. Human relations aspect. If business will plan to introduce technology then it might result in redundancies and labor union might go on strike.
6. Aims, objectives and corporate strategies of a business.
7. Availability of funds required for investment.
8. Current cash flow position of the company.

UNIT 6

Strategic Management (A Level)

**A-II Level
Business
Teacher's Notes**

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Syllabus 2019 –21

- 6.1: What is strategic management?**
- Understanding what strategic management is
- 6.2: Strategic analysis**
- SWOT analysis
 - PET or External Environment analysis
 - Business vision/mission statement and objectives
 - Boston Matrix
 - Porter's Five Forces
 - Core Competencies
- 6.3: Strategic choice**
- The Ansoff Matrix
 - Force Field Analysis
 - Decision trees
- 6.4: Strategic implementation**
- Business plans
 - Corporate culture and strategic implementation
 - Developing a change culture
 - Managing and controlling strategic change
 - Contingency planning and crisis management



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UNIT-6 STRATEGIC MANAGEMENT (A LEVEL)



6.1 What is strategic management?

It is the formula of success of an organisation to continuing and sustainable growth. Organisation will evaluate where it is now, and where it wants to be in future. It will also ensure flawless executing strategic plans to get there.

What is Corporate strategy?

It is hierarchically highest strategic plan of the organization, which defines the global goals and ways of achieving them within strategic management.

What is the difference between strategies and tactics?

Both strategy and tactics are tools to decide how business is going to achieve its goals. Strategic decisions are long term decisions while tactical decisions are short term decision. In order to achieve its goals organization will have to make both tactical and strategic decisions.

The need/importance of strategic management:

1. It helps board members in fulfilling their responsibilities.
2. It helps to identify that what will be the future shape of business.
3. It helps to ensure that management and employees are innovative and creative.
4. It is a method of decentralized management that could motivate employees.
5. It helps in developing a sustainable competitive advantage.
6. It also helps to increase productivity.
7. Clear standards are set in this process that could enable management to measure the performance of staff.
8. It also helps to strengthen brand management.
9. It also helps to identify the best location for project. (Strategy identification and implementation).

10. It helps to draw up financial, marketing, human resource and operational plans (policies and objectives); and comment on the possibility for success (Strategy evaluation).

Problems of not having a strategic management plan:

If company will go without any strategic management plan then it is likely to face certain problems/drawbacks/risks. These could be:

1. Business will not be knowing that where it is heading towards?
2. There will be no responsibility or accountability.
3. It will not be having sufficient resources available and will not be knowing that what resources it will be needing to meet its goals.
4. There will be insufficient marketplace and competitive information available to plan and make smart strategic and tactical decisions.
5. There will be a lack of leadership means no responsibility and accountability and would result in a lot of people fired.
6. Lack of resource plan might result in a delay in completion of project, this could increase costs eventually decreasing profit margin of the company.

Key stages of strategic management process:

Every business organisation has a different approach to the strategic management process. There are various factors that will affect the approach taken by managers, including distinctions between manager's preferences and managerial styles, the size of the organisation, as well as the complexity of strategies. However, there are basic components of strategic management that are commonly utilized in business. There are five major steps for a company to follow when developing a strategy:

1. Assess its competitors and market.
2. Set goals and strategies based on the company's competitive position.
3. Reassess each strategy annually or quarterly (i.e. regularly) to determine how it has been implemented.
4. Reassess each strategy to determine whether it has succeeded or needs replacements by a new strategy to meet changed circumstances. These include new technology, new competitors, a new economic environment, or a new social financial, or political environment.
5. Evaluate and control the business and the industries in which the company is involved.

Chandler's assertion that strategy should determine organizational structure:

The historian Alfred Chandler of Harvard Business School wrote a seminal book that was published in 1977. It was on the history of strategic decision making at the highest level of Corporate America, including DuPont, General Motors, Standard Oil and Sears Roebuck. The book was named as "The Visible Hand". The managerial revolution in American Business. In this work Chandler proclaimed a maxim for the ages that has been followed as doctrine by strategists and consultants alike ever since. General Motors the energy company Standard Oil of New Jersey and the retailer Sears Roebuck developed over time by identifying four sequential stages:

1. Acquisition of resources such as employees and raw material and the buildup of marketing and distribution channels.
2. Establishment of functional structures to increase efficiency.
3. Adoption of growth and diversification strategy, diversification into new markets and products to overcome limits of home market.
4. The creation of the then revolutionary diversionalised form to manage large conglomerates.

The multi division of M-form is a corporate federation of semi independent product or geographic groups a headquarters that oversees the corporate strategy and coordinates interdependencies. Although the organisational M-form was implemented differently by each of the organisation, Chandler showed that the need to restructure arose from a strategic shift driven by new technologies and market

changes. The M-form emerged and co-evolved with the development of the transportation and communication industries thereby creating the opportunity to manage across time and space. He described strategy as the determination of long term goals and objectives, the adoption of courses of action and associated allocation of resources required to achieve goals. He defined structure as the design of the organisation for the successful implementation of the new strategy. Chandler's thesis argued that new organisational forms are no more than a derivative of strategy as the defined it.

His three step approach designs an organisational structure to match a defined strategy:

- Select a basic organisation design.
- Modify the design as needed.
- Supplement it with coordinating mechanisms & communication arrangements.

Pros.	Cons.
1. Chandler's key addition to management literature was to connect strategy and structure since a restructuring effort is a result of a change in strategy, a company must first review its strategy, then pursue a different structure. 2. The adoption of new technology or the penetration of a new market warrants a review in strategy which in turn merits an organisational restructuring. The emergence or evolution of new organisational structure occurs neither in isolation nor by accident. 3. Professional management is essential to increase the chance of successful strategy implementation efforts. Management must devote constant attention to develop a corresponding administrative form. 4. With his work "Structure follows Strategy", Chandler demonstrated the relevance of business history and ensured that it would become part of educational programs in many universities. 5. His work helped him establish strategy as an important topic for organisations and aided the transformation of McKinsey & Company as a specialist in organisational (re)structuring into a strategy consultancy firm.	1. The thesis is oversimplified. The relation between structure and strategy is not necessarily one dimensional. Mintzberg argued that the current organisational form can also be regarded as constraining strategic change. Current views such as Pettigrew's, hold that structure and strategy are to be regarded as equal to one another. Rumelt concluded that structure also followed fashion. 2. Changes in the market structure have implications for a firm's strategy and structure. Chandler stated that a "fit-to-market" between an organisation's form and its market structure reduces its internal coordination costs and provides a better match between the firm's product portfolio and its tactical customer needs. The "fit-to-market" relationship should be secondary to the "fit-to-strategy" connection so as not to inhibit necessary strategic changes. Commercial management and its related bonus schemes represent the "fit-to-market" component in a firm and tend to defend the current status quo. 3. In his case studies, Chandler described the need for leadership to make the transition to the M-form, but did not regard strong leadership as a prerequisite for an efficient corporate re-organisation. 4. The thesis was not based on broad empirical study. The relationship between strategy and structure was described only for a large organisation's growth and diversification strategy. In turbulent environments, the un-orchestrated emergence of new forms and strategies occurs.

How business strategy determines competitive advantage in an increasingly competitive world:

Competitive advantage in simple words is the edge/advantage a business has over its competitors. It allows business to achieve greater sales level or profit margin and or retain more customers as compared to its competitors. Business can have different types of competitive advantage over its competitors. For example, lower cost of production, effective distribution, product differentiation, better after sales services etc.

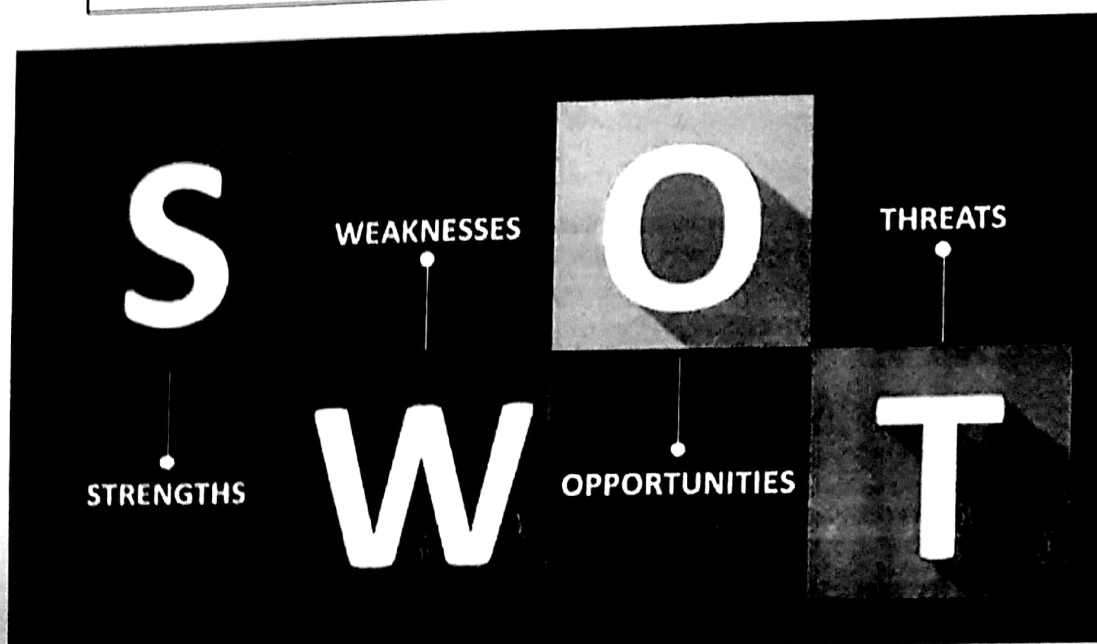
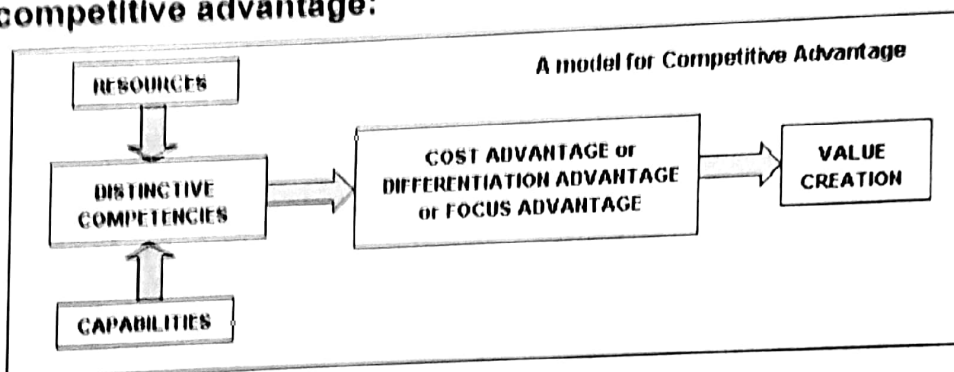
Globalisation has change business environment and now businesses do not just need to compete with local companies but with foreign companies as well. Due to free trade, barriers have been removed and protectionist policies are no longer acceptable to countries as now they believe in free trade.

In order to ensure their survival now companies are required to design strategies to compete effectively with their competitors. In this scenario the concept of competitive advantage has gain popularity. In order to survive or achieve desired level of success they have to use competitive advantage in order to convince customers that their product is better as compared to competitors and they must buy it. This competitive advantage as discussed earlier can be achieved on the basis of lower cost, better quality, mass marketing, better product design, better after sales services etc.

According to Michael Porter, there are two main factors which can lead to a significant competitive advantage. These are:

1. Competitive advantage gained through low cost (prices).
2. Product differentiation. (producing better quality products as compared to competitors). This will allow business to charge high price eventually increasing profitability.

A model of competitive advantage:



6.2.1 SWOT Analysis

SWOT analysis:

SWOT analysis is a useful technique for businesses. It helps them to understand their strengths and weaknesses, and also helps to identify both the Opportunities and Threats it is likely to face.

From an organisation's point of view SWOT will show the following:

SWOT is commonly used as part of strategic planning and looks at:

1. Internal strengths
2. Internal weaknesses
3. Opportunities in the external environment
4. Threats in the external environment

Importance of SWOT Analysis:

SWOT can help management in a business discover:

1. What the business does better than the competition
2. What competitors do better than the business
3. Whether the business is making the most of the opportunities available
4. How a business should respond to changes in its external environment

The result of the analysis is a matrix of positive and negative factors for management to address

	Positive factors	Negative factors
Internal factors	Strengths	Weaknesses
External factors	Opportunities	Threats

The key point to remember about SWOT is that:

Strengths and weaknesses

1. Are internal to the business
2. Relate to the present situation

Opportunities and threats

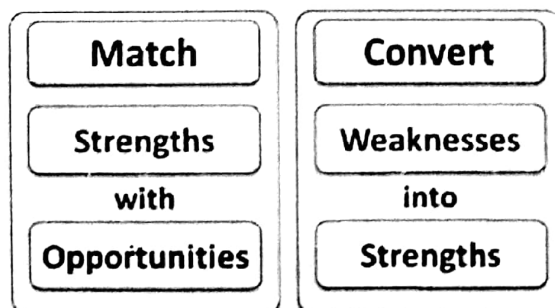
1. Are external to the business
2. Relate to changes in the environment which will impact the business

Using SWOT analysis

There is no point producing a SWOT analysis unless it is actioned! SWOT analysis should be more than a list - it is an analytical technique to support strategic decisions

Strategy should be devised around strengths and opportunities

The key words are **match and convert**:



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A key challenge for any business is to convert weaknesses into strengths. For example:

Weakness	Possible Response
1. Outdated technology	1. Acquire/Take over competitor with leading technology
2. Skills gap	2. Invest in training & more effective recruitment
3. Overdependence on a single product	3. Diversify the product portfolio by entering new markets
4. Poor quality	4. Invest in quality assurance
5. High fixed costs	5. Examine potential for outsourcing or off shoring

Don't forget that for every perceived threat, the same change presents an opportunity for business.

Benefits of SWOT Analysis:

There are certain advantages of SWOT Analysis. The main advantage of conducting a SWOT Analysis is that it has little or no cost involved. Anyone who understands a business can conduct its SWOT Analysis. Business can also use SWOT Analysis when it does not have enough time to address a complex situation. It means that business can take steps to improve without the expense of external consultant or business advisor.

Another advantage of a SWOT Analysis is that it concentrates on the most important factors affecting a business. Using SWOT Analysis a business can:

1. Understand itself in a better way.
2. It can identify and address its weaknesses.
3. It can plan effective to respond to threats in a more effective manner.
4. It can design a strategy to capitalize on opportunities.
5. It can take advantage of its strengths in a more effective manner.
6. It can develop business goals and strategies for achieving them.

Specimen of SWOT analysis of a cosmetic company: (November 2008, P-2)

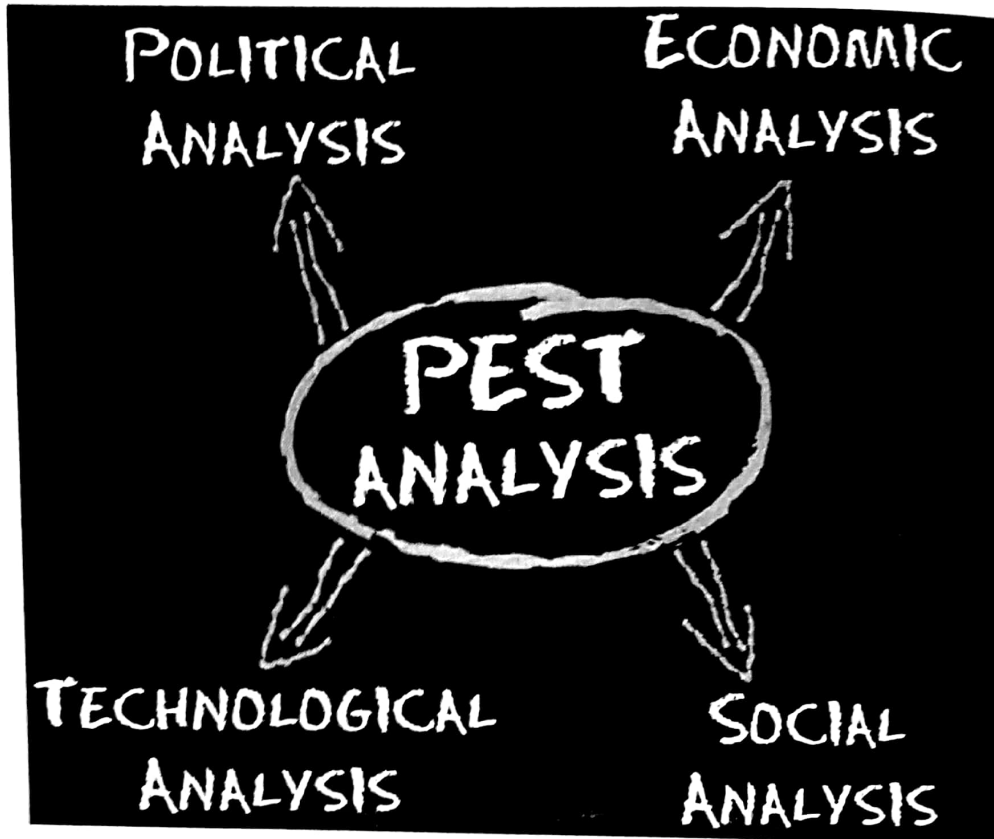
Strengths: • Loyal customer base • Excellent customer care • Highly motivated, committed workforce that willingly takes on responsibilities • 'Family' atmosphere • High quality products • Ethical approach to customers, employees and the environment • Only use natural ingredients • No testing on animals.	Weaknesses: • High costs, particularly wages and materials • No management experience of rapid growth • High prices compared to competitors • High cost of quality control.
Opportunities: • New markets in other countries • Lower production costs at facilities in developing countries.	Threats: • Competitors use cheaper materials and cheap labour • Competition less ethical and able to charge lower prices • Multinational competitors benefit from economies of scale and mass marketing.

Limitations of SWOT Analysis:

When a business is conducting SWOT Analysis then it must keep in mind that it is only one stage of the planning process. For complex issues, business will usually need to conduct more in depth research and analysis to make decisions.

There could be certain limitations of SWOT Analysis:

1. It only identifies issues but does not prioritize them.
2. It also does not provide solutions or offer alternative decisions.
3. Business can generate too many ideas but it cannot help to choose the best one.
4. It can produce a lot of information, but not all will be useful for business.



6.2.2 PEST or External Environment Analysis

PEST Analysis:

For the success of planning or strategy it is essential that while designing them business must consider internal and external environment. PEST is an external environmental analysis which will ensure that business has considered Political, economic, social and technological environment while designing its plan or strategy. Business would need to conduct this analysis along with SWOT analysis. Whether implemented alongside SWOT, or separately, the PEST analysis allows business to look into the future and identify potential obstacles well in advance so that business can do planning to avoid them before they will affect it.

Political factors:

In this business will analyse political factors and government policies. Political factors refer to the degree that government is going to intervene in economy. It could include labor laws, tax policies, consumer protection laws, environmental regulations, and tariff and trade restrictions. In this business must consider:

6. How stable political environment is in the country. If political environment is stable then it might encourage to increased business investment in country.
7. It must also analyse that will government policy will influence laws that could be related to taxation and might affect business.
8. Business must also analyse government's policy on marketing ethics. This will help business to design its marketing campaign. (advertising etc).

9. Business would also need to analyse government's policy on the economy. For example if government policy related to economy is favorable then it could lead to more foreign investment or vice versa.

Economic environment:

It is also a very important external environment factor that business would need to consider. In this business might analyse factors such as, interest rates, inflation and credit availability. In addition to the basic economic factors that influence business, it is also important to consider the trickle down effects, such as how rate of inflation might affect your employees. For example salaries etc. More specifically business will be looking at elements such as current business cycle. Businesses need to consider the state of a trading in the short and long term this is especially true when planning for international marketing business needs to look at:

1. What is the current interest rate? It will help them to determine the rate of inflation and cost of borrowing. For example, if interest rate is low then it would mean that there will be increased demand for goods and services and cost of borrowing money will be low. This could encourage businesses to enter into foreign markets.
2. Business would also need to analyse rate of unemployment. This will enable them to determine labor supply and wage rate. Apart from this it would also need to consider per capita income in economy. It will enable them to determine product mix for the new market and pricing strategy they should use.
3. Business would also need to analyse long term prospects for the economy. For example it might need to analyse gross domestic product (GDP) to determine rate of economic growth in country. If GDP is increasing then it would mean that economy is growing and this would generally be a positive sign for business and encourage it to enter into this market.

Social environment:

Social environment relates to cultural, religion and demographic aspects of society. It is an analysis of macro environment of the business. Social factors include career attributes, age distribution, population and its growth rate, health consciousness and safety awareness in market/country.

The social and cultural influences on business vary from country to country. It is very important that business must consider such factors. These factors could be:

1. What is the dominant religion in country. This will enable business to finalise product mix and promotional campaign.
2. What are the features of foreign products and services in the market/country.
3. How long are the population living? Are the older generation really wealthy.
4. How much time consumers find for leisure.
5. The roles of men and women in society.

Technological environment:

It is also a very important external environmental factor that a business will have to consider/analyse. The increased use of technology is a very important base of measuring growth and success of business. It will have important effects on business operations. No matter the size of a business organisation is technology has both tangible and intangible benefits that will help it make money and produce products consumers demand. Technological infrastructure affects the culture, efficiency and relationship of a business.

In analyzing technological environment business might have to consider

1. Will technology allow products and services to be manufactured more economically.
2. Will technology allow business to improve quality standards of its products and services.
3. Will technology offer consumers and businesses more innovative products and services. For example, internet banking, new generation mobiles etc.
4. How technology will change distribution of products. For example, internet buying, booking tickets online etc.

5. How technology can help business to communicate effectively in internal and external communication.

6.2.3 Business Vision/Mission Statement and Objectives

What is a mission statement?

A statement in which a business will write down all fundamental objectives of its formation. It will be displayed at prominent places in the organisation. It will keep on reminding employees about the expectations of their employer. Creating a mission statement is one of the first actions an organisation should take. The mission statement can be the foundation stone of an overall strategy and then be followed through into the development of more specific functional strategies. By defining a mission an organisation is making a clear statement of its purpose. "A good mission statement captures an organisation's unique and enduring reason for being, and energises stakeholders to pursue common goals. It also enables a focused allocation of organisational resources because it compels a firm to address some tough questions: What is our business? Why do we exist? What are we trying to accomplish?" (Bart, 1998)

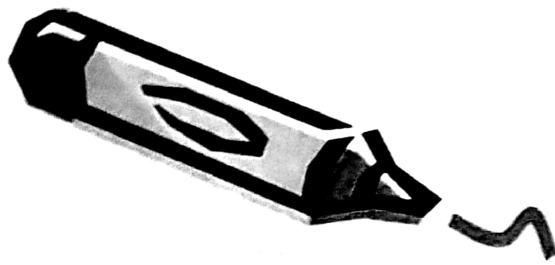
Example Mission Statements

Coca Cola -Everything we do is inspired by our enduring mission:

- To Refresh the World... in body, mind, and spirit.
- To Inspire Moments of Optimism... through our brands and our actions.
- To Create Value and Make a Difference everywhere we engage."

Advantages & disadvantages of mission statement:

Advantages	disadvantages
1. It provides direction to employees that what they are expected to achieve. Without directions businesses might be operating without purpose and this can be dangerous. 2. It will also help to resolve conflicts as members of management can easily make quick reference to mission statement in case of conflict and argument. 3. It will also act as a communication tool. Management or owners of business can use mission statement to communicate to their desire to other members of the company. 4. It will also provide a frame work for decision making as mission statement can be used as a framework that effective managers can easily use as a guide in discharging their everyday management functions.	1. A disadvantage of mission statement is that chances of its design and implementation being wrong are very high. A mission statement could have confusing objectives. Care must be taken to avoid such confusion. 2. If mission statement is not properly developed then it can contradict with other objective and can eventually lead to conflicts. 3. Like other planning activities e.g. budgeting designing a mission statement will be a time consuming exercise and apart from this other resources will also be wasted if ultimate objectives of mission statements are not achieved. 4. Objectives set in mission statement might be unrealistic in reality. Things are not as straight forward in reality as they are on paper. A basic weakness of mission statement is that in most cases objectives turn out to be unrealistic and over optimistic by the time things start to unfold.



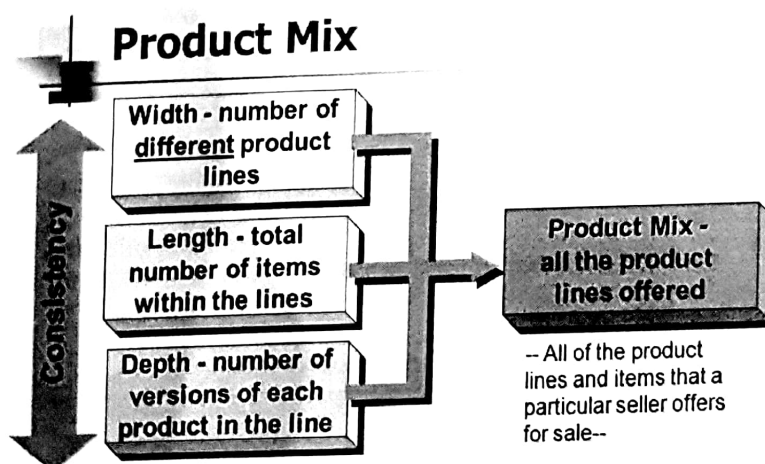
THE PRODUCT MIX



6.2.4 Boston Matrix

What is product mix/portfolio:

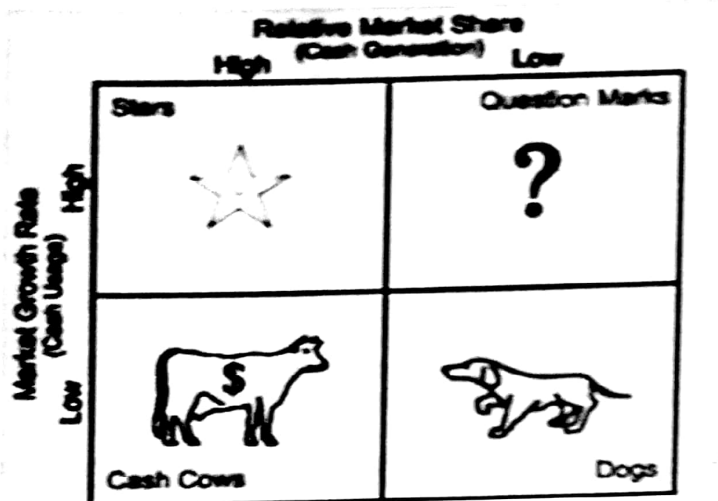
Different products that a company is selling in market are collectively known as its product mix or product portfolio.



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Boston Matrix:

It is quite difficult for companies such as Unilever, Procter & Gamble, Nestle to manage their huge product mix. The Boston consulting group's product portfolio matrix (BCG matrix) is designed to help with long term strategic planning to help businesses consider growth opportunities by reviewing their product portfolio to decide whether to invest to discontinue or develop products. It is also known as Growth/share matrix.

**Stars:**

1. Product has a high market share in a high growth market
2. They are very successful products which create a large amount of revenue for the business
3. They still require a large amount of money to be spent on their promotion, in order to keep ahead of the rival products in the market place.
4. They are at the growth stage of the product life cycle.

Cash cows

1. They have a very high market share in a stable market (i.e. market growth is low)
2. They are at the 'maturity' and 'saturation' stage of their product life cycle.
3. They produce a very large revenue for the business
4. This money is often used to promote the 'problem child' and to develop new products.

Problem child/Question marks/Wild cats

1. Such products have a low market share in a high growth industry/market
2. These products have often been launched quite recently and have not had the necessary time to establish themselves in the market.
3. They will require a significant amount of money to be spent on their promotion
4. in order to achieve a healthy market share.
5. They are at the 'introduction' stage of their product life cycle

Dogs

1. Such products have a very low market share in a low growth market
2. They produce very little revenue for the business and are at the 'decline' stage of the product life cycle
3. The business has to decide whether to try and extend the life cycle and boost sales revenue, or whether to delete the product from the product portfolio

Using the BCG Box to determine strategy

Once a company has classified its SBU's, it must decide what to do with them. In the diagram above, the company has one large cash cow (the size of the circle is proportional to the SBU's sales), a large dog and two, smaller stars and question marks.

Conventional strategic thinking suggests there are four possible strategies for each SBU:

1 Build Share:

Here the company can invest to increase market share (for example turning a "question mark" into a star)

2 Hold:

Here the company invests just enough to keep the SBU in its present position

3 Harvest:

Here the company reduces the amount of investment in order to maximise the short-term cash flows and profits from the SBU. This may have the effect of turning Stars into Cash Cows.

4 Divest:

The company can divest the SBU by phasing it out or selling it - in order to use the resources elsewhere (e.g. investing in the more promising "question marks").

Importance of Boston matrix:

1. It is an important tool to analyse product portfolio of business and make decision related to it.
2. It is particularly beneficial for businesses who are trying to manage their product portfolio as they must ensure a balance between the number of products in each category of the matrix.
3. The use of Boston matrix can help management to identify appropriate time for launching new products onto the market.
4. The information provided by the Boston Matrix can indicate the likely cash flow position of each product within the context of its market.

Limitations of Boston matrix:

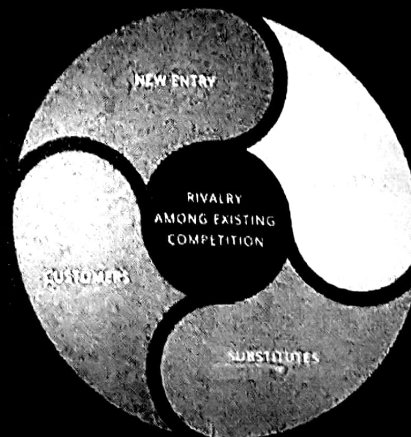
1. Boston Matrix only uses market share and market growth to assess the strength and weaknesses of a product portfolio.
2. Current market share information tells us very little about the future prospects of product.
3. Critics suggest that the analysis provided is too simple and does not reflect economic reality. The Boston Matrix is theoretical model only and therefore cannot take account of all economic activity.
4. There is an assumption that higher rates of profit are directly related to high rate of market share. This may not always be the case. When Boeing launch a new jet, it may gain a high market share quickly but it still has to cover very high development costs.

Porter's Five Forces Analysis

Understand the competitiveness of your business by using Porter's Five Forces analysis. This tool examines the five external forces that shape your business, allowing you to make strategic decisions for your enterprise.

Porter's Five Forces is a framework that helps you understand the competitive environment of your business. It consists of five forces that shape your business:

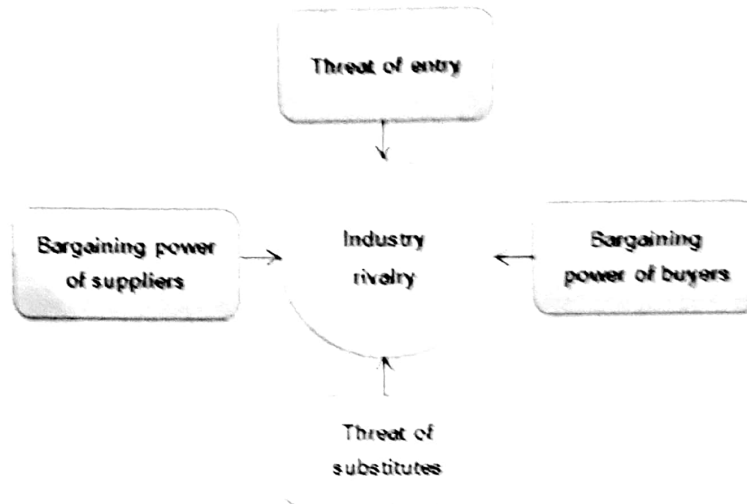
1. **New Entry:** The threat of new entrants into the market. By understanding this force, you can identify potential barriers to entry and develop strategies to maintain your competitive advantage.



6.2.5 Porter's Five Forces

Porter's five forces analysis:

It is an analysis tool which used five industry forces to determine the intensity of competition in an industry and its profitability level. This model was created by M. Porter in 1979 to understand how five key competitive forces can affect an industry. These five forces are:



These forces determine structure of an industry and the level of competition in that industry. The stronger competitive forces in the industry will be the less profitable it will be. And industry with low barriers to entry, having few buyers and suppliers but many substitute products and competitors will be considered as very competitive and thus, not so attractive due to its low profitability.

Attractive Industry-High profits	Unattractive industry-low profits
1. There will be high barriers to entry.	1. There will be low barriers to entry.
2. The bargaining power of suppliers will be weak.	2. The bargaining power of suppliers will be strong.
3. The bargaining power of buyers will also be weak.	3. The buying power of buyers will also be strong.
4. There will be few substitutes available due to less competition.	4. There will be many substitutes available due to high level of competition.

Threats of new entrants:

It will help to determine that how easy (or not) it is to enter an industry. If an industry is profitable and there are few barriers to entry then more competitors will be likely to enter to intensify competition. In this situation businesses will have to compete for market share, and profits will be likely to fall. It would be important for existing businesses to create high barriers to entry to deter new competitors. Threats of new entrants might be high when:

1. There is low amount of capital required to enter market.
2. Existing businesses and retaliating that much.
3. Existing businesses don't have patent right, trade marks etc.
4. There are no government regulations.
5. There is lack of brand loyalty.
6. Businesses can easily achieve economies of scale.

Bargaining power of suppliers:

It is also a very important force according to Porter. If bargaining power of suppliers is strong then it will enable them to sell at high price or they may even sell low quality products. This will definitely affect businesses as their profit margin will decrease due to high cost of inventory.

Suppliers may have strong purchasing power when:

1. There is high demand but low supply.
2. There are few substitutes (raw material) available.
3. Suppliers have scarce resources.

Threats of substitutes:

This force could be really threatening when buyers can easily find substitutes with attractive prices and better quality. For example, to switch from coffee to tea does not cost anything, unlike switching from car to bicycle.

Rivalry among existing competitors:

It is the major determinant on how competitive and profitable an industry is. In case of competitive industry, firms have to compete aggressively for a market share, which results in low profits. Rivalry among firms could be intense when:

1. There will be many competitors in market.
2. Barriers to exit industry are high.
3. Growth of industry is slow or negative.
4. There is low customer loyalty.

At the end we can say that Porter's five forces is a great tool to analyse industry's structure and use the results to formulate strategy of a business. However, it has limitations and requires further analysis to be done, such as SWOT, PEST analysis.



6.2.6 Core Competencies

Core competency is an organization's defining strength which provides the foundation from the business will grow, seize upon new opportunities and deliver value to customers. Core competency of a company not easily replicated by other organisations, whether existing competitors or new entries into its market.

Origin and history:

The concept of core competency grown out of article titled, "The Core Competence of the corporation," written by C.K Prahalad and Gary Hamel and published in Harvard Business Review. In that article, the authors asserted in their opening paragraph that business executives in the 1980's "were judged on their ability to restructure, declutter (to organize and prioritize) and delayer their corporations." But moving forward in the 1990's they would "judged on their ability to identify, cultivate and exploit the core competencies that make growth possible."

Prahalad and Hamel observed that successful enterprises viewed themselves as "a portfolio of competencies versus a portfolio of businesses," and these competencies "empower individual business to adapt quickly to changing opportunities."

6.2.6 Core Competencies and Strategy

The term core competency was coined by the leading management experts, CK Prahalad and Gary Hamel in an article in the famous Harvard Business Review. By providing a basis for firms to compete and achieve sustainable competitive advantage, Prahalad and Hamel pioneered the concept and laid the foundation for companies to follow in practice.

Some core competencies that firms might have include technical superiority, its customer relationship management, and processes that are vastly efficient. In other words, each firm has a specific area in which it does well relative to its competitors, this area of excellence can be reused by the firm in other markets and products, and finally, the area of strength adds value to the consumer. The implications for real world practice are that core competencies must be nurtured and the business model built around them instead of focusing too much on areas where the firm does not have competency. This is not to say that other competencies must be neglected or ignored. Rather, the idea behind the concept is that firms must leverage upon their core strengths and play to their advantages.

Some Examples

If we take the examples from real world companies and evaluate their core competencies, we find that many firms have benefited from the application of this theory and that they have succeeded in attaining competitive advantage and sustainable strategic advantage. For instance, the core competencies of Walt Disney Corporation lie in its ability to animate and design its shows, the art of storytelling that has been perfected by the company, and the operation of its theme parks that is done in an efficient and productive manner. Hence, Walt Disney Corporation would be well advised to configure its strategy around these core competencies and build a business model that complements these competencies.

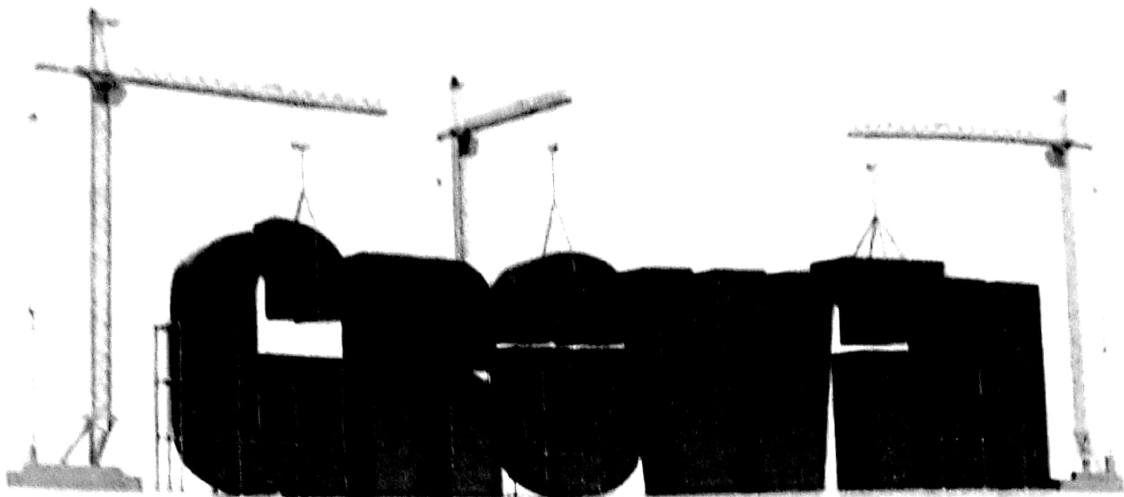
The loss of core competencies:

Businesses also aim to cut or control costs. Such cost cutting moves from businesses might sometimes destroy the ability to build core competencies. For example, decentralisation make it more difficult to build core competencies because autonomous groups rely on outsourcing of critical tasks, and this outsourcing prevents the firm from developing core competencies in those tasks since it no longer consolidates the know how that it spread throughout the organisation.

Failure to recognize core competencies may lead to decisions that could result in their loss. For example, in the 1970's many U.S manufacturers divested themselves of their television manufacturing businesses, reasoning that the industry was mature and that high quality, low cost Models were available from Far East manufacturers. In the process they lost their core competence in video, and this loss resulted in a handicap in the newer digital television industry.

Closing Thoughts

The important aspect to be noted is that core competencies provide the companies with a framework wherein they can identify their core strengths and strategize accordingly. Of course, the identification and evaluation of core competencies must be done as accurately and reliably as possible since the divestment of non-core areas must not lead to the firm missing key areas of operation and competitive advantage. Finally, care must be taken when building the organizational edifice around the core competencies to avoid the situation where many or too few of the competencies are identified leading to redundancies or scarcity.



6.3 Strategic Choice

6.3.1 The Ansoff Matrix



Ansoff's Matrix

Igor Ansoff, in his book "Corporate Strategy" stated that the main factor that a business needs is to identify a competitive advantage. In order to this business would need to analyse whether it needs to continue with its existing products or whether it needs to develop new products.

Igor Ansoff developed these ideas into a matrix. This matrix is used heavily as a marketing tool. It also has implications for long term strategies of a business.

Ansoff Matrix:

		Established Products	New Products
Established Market	Lowest Risk	Market Penetration	Product Expansion
	Medium Risk	Market Expansion	Diversification
New Market	Medium Risk		Highest Risk

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The four main categories

Ansoff's matrix provides four different growth strategies:

1 Market penetration:

In this a business will try to achieve growth by increasing market share of its existing products in its existing/current market segments. This is the lowest risk strategy as product will already have brand image in existing market. However, market penetration will have certain limitations as once market will approach saturation stage then business would need to implement another strategy if business would wish to continue to grow.

2 Market development/expansion:

In this business will decide to launch its existing product a new market. The development of a new market for the existing product may be a good strategy if company's core competencies are related more to the specific product than to its experience with a specific market segment. This is a medium risk strategy as in new market business might have develop brand image of its product. For example, Gourmet launched its bakery in Karachi.

3 Product development/expansion:

In this business will develop a new product and will launch it in its existing market. This strategy may be appropriate if company's strengths are related to its specific customers rather than to the specific product itself. This is also going to be a medium risk strategy as business will have its brand image in existing market segments. For example, Beacon House launched Concordia colleges.

4 Diversification:

In this business will grow by launching a new product in a new market. This is going to be high risk strategy as business will not have any brand goodwill in that market. However, diversification may be a reasonable choice if the high risk is compensated by the chance of a high rate of return (profit). Other advantage that business might gain due to its diversification strategy is that it could get a foothold in an attractive industry and it could also reduce overall business portfolio risk. For example, Gourmet bought Silk Bank and diversified its operations into financial market.

Advantages & dis-advantages of Ansoff Matrix:

Advantages	Dis-advantages
1. It provides knowledge to marketing managers about different strategies that they can use for growth. 2. It helps them to set out aims and objective. For example, whether they would like to adopt low, medium or high risk strategy for business growth. 3. It is presented in form a matrix which is easily presentable to different stakeholders. 4. It will also help business to consider alternative strategies by considering potential problems.	1. It only identifies the degree of risk involved. Risk will still exist and business will not be able to avoid it. 2. Business would still need to use other methods alongside. For example, investment appraisal in order to ensure that it has also considered quantitative/financial factors to ensure quality decisions. 3. Ansoff matrix fails to show that market development and diversification strategies require a change to every day running of the business.

Force Field Analysis

Driving Forces

Restraining Forces



6.3.2 Force Field Analysis

Force field analysis:

Force Field Analysis was developed by Kurt Lewin (1951) and is widely used to inform decision making, particularly in planning and implementing change management programmes in organisations. It is a powerful method of gaining a comprehensive overview of the different forces acting on a potential organisational change issue, and for assessing their source and strength.

Purpose of force field analysis:

Force Field Analysis is a general tool for systematically analyzing the factors found in complex problems. It frames problems in terms of factors or pressures that support the status quo (restraining forces) and those pressures that support change in the desired direction (driving forces). A factor can be people, resources, attitudes, traditions, regulations, values, needs, desires, etc. As a tool for managing change, Force Field Analysis helps identify those factors that must be addressed and monitored if change is to be successful.

Procedure of force field analysis:

1 Define the problem:

What is the nature of our current situation that is unacceptable and needs modification? It is useful to separate the specific problem from those things that are working well.

2 Defining the change objective:

What is the desired situation that would be worth working toward? Be as specific as possible

3 Identify the driving forces:

What are the factors or pressures that support change in the desired direction? What are the relative strengths of these forces? Place these driving forces on the chart on the Force Field Analysis diagram as

labelled arrows with the length of the arrow reflecting the relative strength of each force. What are the inter-relationships among the driving forces?

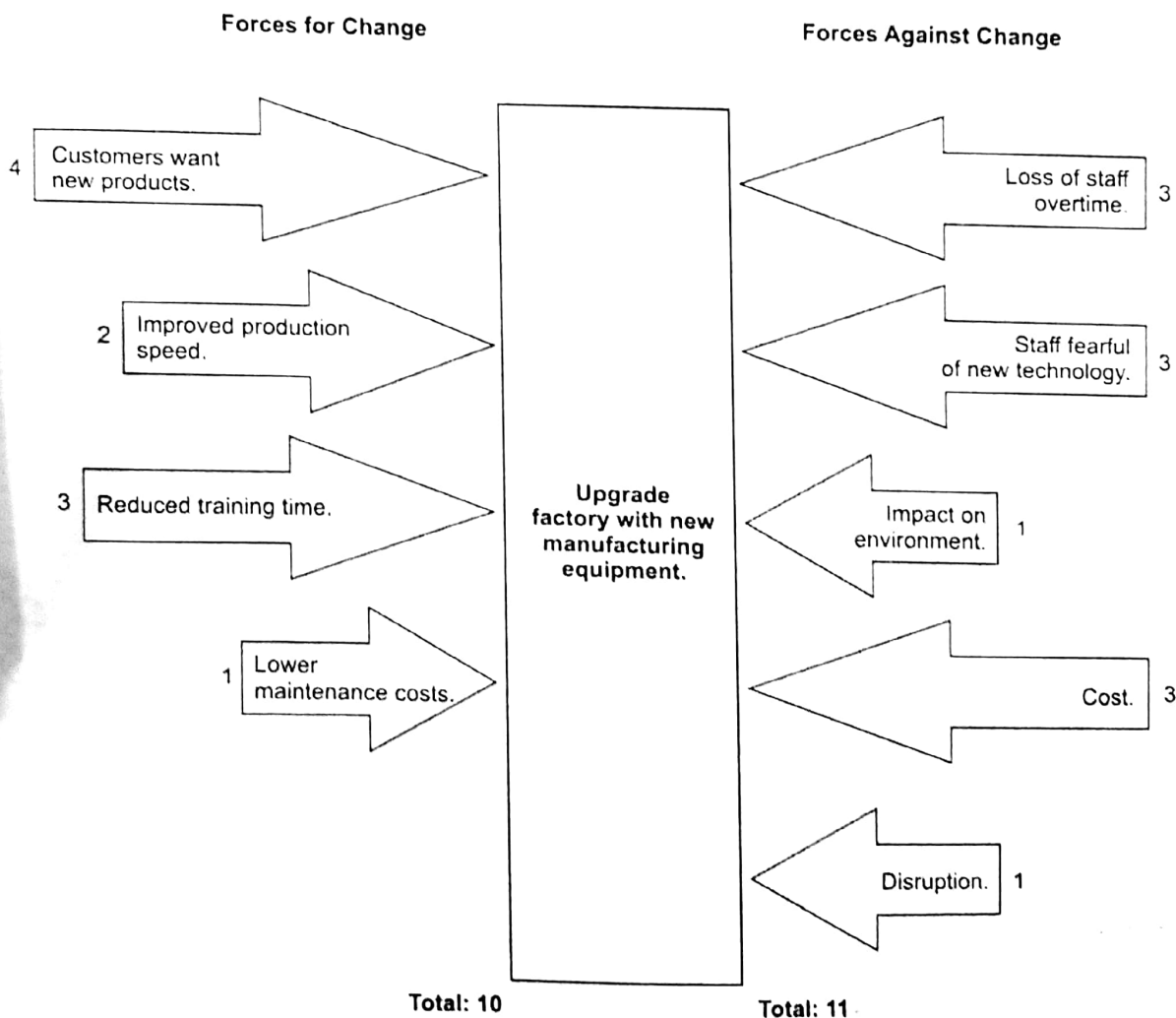
4 Identify the restraining forces:

What are the factors or pressures that resist the proposed change and maintain the status quo? Represent these forces on the diagram as you did those for the driving forces. What are the inter-relationships among the restraining forces?

5 Developing the Comprehensive Change Strategy:

The diagram created in steps three and four reflect what could be called a state of quasi-stationary equilibrium. Although this is a relatively stable state, movement can be achieved altering the factors currently contributing to this equilibrium. Change can occur as a result of any combination of the following: - strengthening any of the driving forces - adding new driving forces (possibly by transforming a former restraining force) - removing or reducing any of the restraining forces Step 5 should also include some consideration of some of the possible unintended consequences when equilibrium forces are altered (e.g. increase resistance, new alliances, fear, etc.).

Force field analysis model:



Using your analysis:

Once you've done your Force Field Analysis, you can use it in two ways:

1. To decide whether or not to move forward with the decision or change.

2. To think about how you can strengthen the forces that supports the change and weakens the forces opposing it, so that the change is more successful.
3. If we had to implement the project in example above, the analysis might suggest a number of changes that management could make to initial plan. For example, management could:
4. Train staff ("Cost" +1) to minimize the fear of technology ("Staff uncomfortable with new technology" -2).
5. Show staff that change is necessary for business survival (new force that supports the change, +2).
6. Show staff that new machines would introduce variety and interest to their jobs (new force that supports the change, +1).
7. Raise wages to reflect new productivity ("Cost" +1, "Loss of overtime" -2).
8. Install slightly different machines with filters that eliminate pollution ("Impact on environment" -1).

These changes would swing the balance from 11:10 (against the plan), to 13:8 (in favor of the plan).

Advantages

- Brings into the open factors which will work for and against the closing of a gap.
- Identified by a needs analysis.
- Helps to recognize circumstances which can and cannot be changed.
- Provides a means to analyze ways to minimize or eliminate barriers to goal attainment.

The Limitations of Force Field Analysis

- Process is subjective and requires collaborative thinking and agreement.
- Concerning forces for and against the solution to a particular problem.
- May oversimplify the relationships between factors that impact a problem.
- All aspects of a problem may not be identified.

6.3.3 Decision Trees



Decision tree:

The basic objective of this technique is to improve quality of decisions. It will help to calculate possible outcomes of alternative decisions and at the end business will select best decision. A decision tree will graphically describe the decisions to be made. It uses branching method to illustrate every possible outcome of a decision. The events that may occur and the possible outcomes associated

with combinations and events are taken into consideration while drawing a decision tree diagram. Probabilities are assigned to the events, and values are determined for each outcome. A decision tree diagram can be drawn by hand or created with a graphic program or specialised software.

Things to remember:

1. The decision tree is laid out from left to right.
2. Every decision tree diagram will start with the decision node. ☐ This is also known as a decision node. It means at this point a decision is to be made.
3. Probabilities are represented by ☐. It is also known as a probability/chance node.
4. Expected monetary value is calculated with the help of the following formula:

$$\text{Expected value} = \text{actual value} \times \text{probability}$$

5. The actual values are always given at the end of each option/probability.

Example:

Abdul Rahim owns a piece of land and he wants to sell it to raise some money for business expansion. He has been suggested two options:

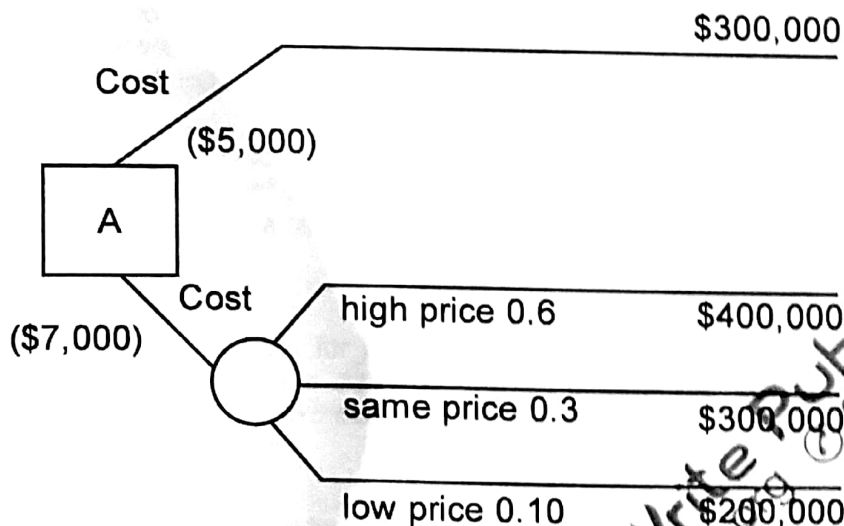
Option # 1:

He could sell the land now for a guaranteed price of \$300,000, with an associated selling cost of \$5,000.

Option # 2:

He could wait for a year for the market price to hopefully rise. In this case selling cost will be \$10,000. Following could be the probabilities.

	<u>Probability</u>	<u>Price</u>
High price	60%	\$400,000
Same price	30%	same as option # 1.
Low price	10%	\$200,000



Option # 1:

Expected profit = Revenue - cost
 Expected profit = \$300,000 - \$5,000
 Expected profit = \$295,000.