**MINISTRY OF HIGHER AND SECONDARY SPECIALIZED EDUCATION OF THE REPUBLIC OF UZBEKISTAN**

**TASHKENT STATE UNIVERSITY OF ECONOMICS**

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# FUNDAMENTALS OF BUSINESS

***(Kredit-modul bo‘yicha)***

***O‘zbekiston Respublikasi Oliy va o‘rta maxsus ta’lim vazirligi tomonidan o‘quv qo‘llanma sifatida tavsiya etilgan***

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The general background within which an economy operates including earnings, sales, wage rates, taxes, an inflation. Improving business fundamentals are generally viewed as bullish for stocks, although stock prices at any given point already include some of the expected improvement of the business fundamentals. It covers the following topics in business like: teamwork, economics, ethics, entrepreneurship, business ownership, management, and leadership, organizational structures and operations management, human resources and motivating employees, managing in labor union contexts, marketing and pricing strategy, hospitality and tourism, accounting and finance, and personal finances.

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## INTRODUCTION

A business is defined as an organization or enterprising entity engaged in commercial, industrial, or professional activities. Businesses can be for-profit entities or they can be non-profit[1] organizations that operate to fulfill a charitable mission or further a social cause.

The term "business" also refers to the organized efforts and activities of individuals to produce and sell goods and services for profit. Businesses range in scale from a sole proprietorship[2] to an international corporation. Several lines of theory are engaged with understanding business administration including organizational behavior, organization theory, and strategic management. Understanding a business, generally, a business begins with a business concept “the idea and a name”. Depending on the nature of the business, extensive market research may be necessary to determine whether turning the idea into a business is feasible and if the business can deliver value to consumers. The business name can be one of the most valuable assets of a firm careful consideration should thus be given when choosing it. Businesses operating under fictitious names must be registered with the state.

Businesses most often form after the development of a business plan, which is a formal document detailing a business's goals and objectives, and its strategies of how it will achieve the goals and objectives. Business plans are almost essential when borrowing capital to begin operations. It is also important to determine the legal structure of the business. Depending on the type of business, it may need to secure permits, adhere to registration requirements, and obtain licenses to legally operate. In many countries, corporations are

[1] A nonprofit organization (NPO)

[2] A sole proprietorship also referred to as a sole trader or a proprietorship, is an unincorporated business that has just one owner who pays personal income tax on profits earned from the business. A sole proprietorship is the easiest type of business to establish or take apart, due to a lack of government regulation. As such, these types of businesses are very popular among sole owners of businesses, individual self-contractors, and consultants. Many sole proprietors do business under their own names because creating a separate business or trade name isn't necessary.

considered to be juridical persons, meaning that the business can own property, take on debt, and be sued in court.

What Is a Business? A business is defined as an organization or enterprising entity engaged in commercial, industrial, or professional activities. The term "business" also refers to the organized efforts and activities of individuals to produce and sell goods and services for profit. The definition of business is an occupation or trade and the purchase and sale of products or services to make a profit. An example of business is farming. An example of business is a house sale. There are three mains legal forms a business can take: sole proprietorship, partnership, and corporation. Each of these legal forms has distinct characteristics as well as advantages and disadvantages.

For example - A sole proprietorship is a business organization, or lack thereof, where the business owner and the business itself is one entity. For example, if you made some lemonade and sold it at the end of your road, you would be considered a sole proprietorship. No legal documents need to be created for filed to start a sole prop. It starts as soon as you start your business. The main disadvantage of a sole prop is that the owner is not protected with limited liability[3].

A partnership is an organization where a few partners join to form a business. The partners can be individuals, partnerships, or even corporations. There are many different types of partnerships including LLCs, LLPs, and other various. All of these have different advantages and disadvantages, but the main advantage to a partnership is that multiple partners can own the business and work together to generate profits.

[3] Limited liability is a type of legal structure for an organization where a corporate loss will not exceed the amount invested in a partnership or limited liability company (LLC). In other words, investors' and owners' private assets are not at risk if the company fails.

# CHAPTER 1. TEAMWORK IN BUSINESS

Every team is organized around a shared objective … there is something to accomplish.

*"Teamwork is the ability to work together toward a common vision. The ability to direct individual accomplishments toward organizational objectives. It is the fuel that allows common people to attain uncommon results." – Andrew Carnegie*

A team (or a work team) is a group of people with complementary skills who work together to achieve a specific goal.

Why do major organizations now rely so much on teams to improve operations? Executives at Xerox have reported that team-based operations are 30 percent more productive than conventional operations. General Mills says that factories organized around team activities are 40 percent more productive than traditionally organized factories. FedEx says that teams reduced service errors lost packages, incorrect bills by 13 percent in the first year. Today it seems obvious that teams can address a variety of challenges in the world of corporate activity. Before we go any further, however, we should remind ourselves that the data we've just cited aren't necessarily definitive. For one thing, they may not be objective — companies are more likely to report successes than failures. As a matter of fact, teams don't always work. According to one study, team-based projects fail 50 to 70 percent of the time.

Research shows that companies build and support teams because of their effect on overall workplace performance, both organizational and individual. If we examine the impact of team-based operations according to a wide range of relevant criteria, we find that overall organizational performance generally improves. The following figure lists several areas in which we can analyze workplace performance and indicates the percentage of companies that have reported improvements in each area.

| *Area of Performance* | *Firms Reporting Improvements*[4] |
|---|---|
| Product and service quality | 70% |
| Customer service | 67% |
| Worker satisfaction | 66% |
| Quality of work life | 63% |
| Productivity | 61% |
| Competitiveness | 50% |
| Profitability | 45% |
| Absenteeism \| turnover | 23% |

## 1.1. TYPES OF TEAMS

Teams, then, can improve company and individual performance in a number of areas. Not all teams, however, are formed to achieve the same goals or charged with the same responsibilities. Nor are they organized in the same way. Some, for instance, are more autonomous than others—less accountable to those higher up in the organization. Some depend on a team leader who's responsible for defining the team's goals and making sure that its activities are performed effectively. Others are more or less self- governing: though a leader lays out overall goals and strategies, the team itself chooses and manages the methods by which it pursues its goals and implements its strategies. Teams also vary according to their membership. Let's look at several categories of teams.

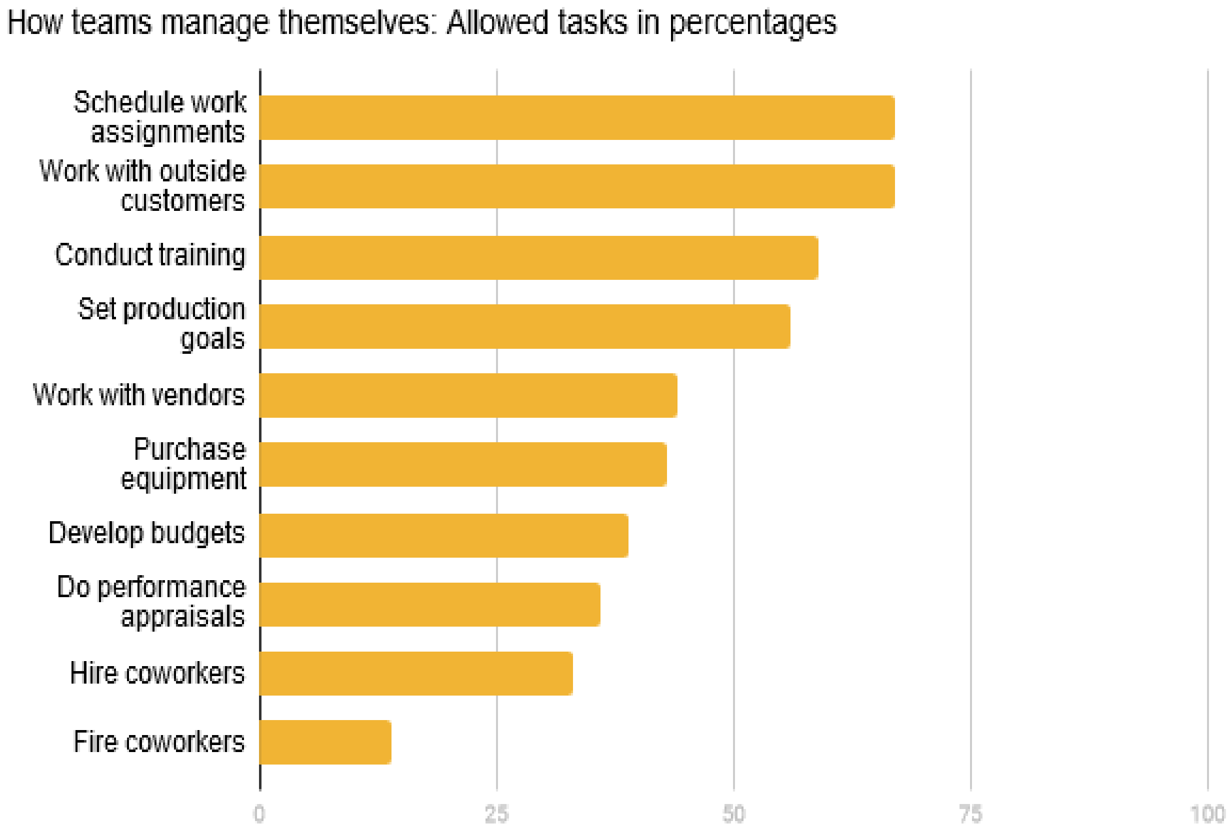
**MANAGER-LED TEAMS -** As its name implies, in the manager-led team the manager is the team leader and is in charge of setting team goals, assigning tasks, and monitoring the team's performance. The individual team members have relatively little autonomy. For example, the key employees of a professional football team (a manager-led team) are highly trained (and highly paid) athletes, but

[4] Adapted from Lawler, E. E., Mohaman, S. A., & Ledford, G. E. (1992). *Creating high performance organizations: Practices and results of employee involvement and total quality in Fortune 1000 Companies.* San Francisco: Wiley.

their activities on the field are tightly controlled by a head coach. As team manager, the coach is responsible both for developing the strategies by which the team pursues its goal of winning games and for the outcome of each game and season. He's also solely responsible for interacting with managers above him in the organization. The players are responsible mainly for executing plays.

**SELF-MANAGING TEAMS** - Self-managing teams also known as self-directed teams have considerable autonomy. They are usually small and often absorb activities that were once performed by traditional supervisors. A manager or team leader may determine overall goals, but the members of the self-managing team control the activities needed to achieve those goals. Self-managing teams are the organizational hallmark of Whole Foods Market, the largest natural-foods grocer in the United States. Each store is run by ten departmental teams, and virtually every store employee is a member of a team. Each team has a designated leader and its own performance targets. Team leaders also belong to a store team, and store-team leaders belong to a regional team.) To do its job, every team has access to the kind of information—including sales and even salary figures—that most companies reserve for traditional managers.

Not every self-managed team enjoys the same degree of autonomy. Companies vary widely in choosing which tasks teams are allowed to manage and which ones are best left to upper-level management only. As you can see, self-managing teams are often allowed to schedule assignments, but they are rarely allowed to fire coworkers.




**CROSS-FUNCTIONAL TEAMS** - Many companies use cross-functional teams – teams that, as the name suggests, cut across an organization's functional areas operations, marketing, finance, and so on. A cross-functional team is designed to take advantage of the special expertise of members drawn from different functional areas of the company. When the Internal Revenue Service, for example, wanted to study the effects on employees of a major change in information systems, it created a cross-functional team composed of people from a wide range of departments. The final study reflected expertise in such areas as job analysis, training, change management, industrial psychology, and ergonomics. Cross-functional teams figure prominently in the product-development process at Nike, where they take advantage of expertise from both inside and outside the company.

Typically, team members include not only product designers, marketing specialists, and accountants but also sports-research experts, coaches, athletes, and even consumers. Nike's team was a cross-functional team; responsibility for developing the new product wasn't passed along from the design team to the engineering team but rather was entrusted to a special team composed of both designers and engineers.

Committees and task forces, both of which are dedicated to specific issues or tasks, are often cross-functional teams. Problem-solving teams, which are created to study such issues as improving quality or reducing waste, may be either intradepartmental or cross-functional.

**VIRTUAL TEAMS -** Technology now makes it possible for teams to function not only across organizational boundaries like functional areas but also across time and space. Technologies such as videoconferencing allow people to interact simultaneously and in real time, offering a number of advantages in conducting the business of a virtual team. Members can participate from any location or at any time of day, and teams can "meet" for as long as it takes to achieve a goal or solve a problem—a few days, weeks, or months.

Why teamwork works now that we know a little bit about how teams work, we need to ask ourselves why they work. Not surprisingly, this is a fairly complex issue. In next section, we'll explore why teams are often effective and when they ineffective.

## 1.2. FACTORS IN EFFECTIVE TEAMWORK

First, let's begin by identifying several factors that contribute to effective teamwork. Teams are most effective when the following factors are met:

- Members communicate effectively.
- Members depend on each other. When team members rely on each other to get the job done, team productivity and efficiency tend to be high.
- Members trust one another.
- Members work better together than individually. When team members perform better as a group than alone, collective performance exceeds individual performance.
- Members become boosters. When each member is encouraged by other team members to do his or her best, collective results improve.
- Team members enjoy being on the team.
- Leadership rotates.

Some of these factors may seem intuitive. Because such issues are rarely clear-cut, we need to examine the issue of group effectiveness from another perspective—one that considers the effects of factors that aren't quite so straightforward.

**GROUP COHESIVENESS** - The idea of group cohesiveness refers to the attractiveness of a team to its members. If a group is high in cohesiveness, membership is quite satisfying to its members. If it's low in cohesiveness, members are unhappy with it and may try to leave it.

***WHAT MAKES A TEAM COHESIVE?*** - Numerous factors may contribute to team cohesiveness, but in this section, we'll focus on five of the most important:

1. Size. The bigger the team, the less satisfied members tend to be. When teams get too large, members find it harder to interact closely with other members; a few members tend to dominate team activities, and conflict becomes more likely.
2. Similarity. People usually get along better with people like themselves, and teams are generally more cohesive when members perceive fellow members as people who share their own attitudes and experience.
3. Success. When teams are successful, members are satisfied, and other people are more likely to be attracted to their teams.
4. Exclusiveness. The harder it is to get into a group, the happier the people who are already in it. Team status also increases members' satisfaction.
5. Competition. Membership is valued more highly when there is motivation to achieve common goals and outperform other teams.

Maintaining team focus on broad organizational goals is crucial. If members get too wrapped up in immediate team goals, the whole team may lose sight of the larger organizational goals toward which it's supposed to be working. Let's look at some factors that can erode team performance.

***GROUPTHINK*** - It's easy for leaders to direct members toward team goals when members are all on the same page—when there's a basic willingness to conform to the team's rules. When there's too much conformity, however, the group can become ineffective: it may resist fresh ideas and, what’s worse, may end up adopting its own dysfunctional tendencies as its way of doing things. Such tendencies may also encourage a phenomenon known as groupthink — the tendency to conform to group pressure in making decisions, while failing to think critically or to consider outside influences.

Groupthink is often cited as a factor in the explosion of the space shuttle Challenger in January 1986: engineers from a supplier of components for the rocket booster warned that the launch might be risky because of the weather but were persuaded to set aside their warning by NASA officials who wanted the launch to proceed as scheduled.

**MOTIVATION AND FRUSTRATION** - Remember that teams are composed of people, and whatever the roles they happen to be playing at a given time, people are subject to psychological ups and downs. As members of workplace teams, they need motivation, and when motivation is low, so are effectiveness and productivity. The difficulty of maintaining a high level of motivation is the chief cause of frustration among members of teams. As such, it’s also a chief cause of ineffective teamwork, and that’s one reason why more employers now look for the ability to develop and sustain motivation when they’re hiring new managers.

***Other Factors that Erode Performance*** - Let’s take a quick look at three other obstacles to success in introducing teams into an organization:

- Unwillingness to cooperate. Failure to cooperate can occur when members don’t or won’t commit to a common goal or set of activities. What if, for example, half the members of a product-development team want to create a brand-new product and half want to improve an existing product? The entire team may get stuck on this point of contention for weeks or even months. Lack of cooperation between teams can also be problematic to an organization.
- Lack of managerial support. Every team requires organizational resources to achieve its goals, and if management isn’t willing to commit the needed resources— say, funding or key personnel—a team will probably fall short of those goals.
- Failure of managers to delegate authority. Team leaders are often chosen from the ranks of successful supervisors—first-line managers

give instructions on a day-to-day basis and expect to have them carried out. This approach to workplace activities may not work very well in leading a team—a position in which success depends on building a consensus and letting people make their own decisions.

## 1.3. THE TEAM AND ITS MEMBERS

"Life Is all about Group Work" - "I'll work extra hard and do it myself, but please don't make me have to work in a group." Like it or not, you've probably already notice that you'll have team-based assignments in college. More than two-thirds of all students' report having participated in the work of an organized team, and if you're in business school, you will almost certainly find yourself engaged in team-based activities.

Why do we put so much emphasis on something that, reportedly, makes many students feel anxious and academically drained? Here's one college student's practical-minded answer to this question: "In the real world, you have to work with people. You don't always know the people you work with, and you don't always get along with them. Your boss won't particularly care, and if you can't get the job done, your job may end up on the line. Life is all about group work, whether we like it or not. And school, in many ways, prepares us for life, including working with others."

In placing so much emphasis on teamwork skills and experience, business colleges are doing the responsible thing—preparing students for the business world. A survey of Fortune 1000 companies reveals that 79 percent use self-managing teams and 91 percent use other forms of employee work groups. Another survey found that the skill that most employers value in new employees is the ability to work in teams. Consider the advice of former Chrysler Chairman Lee Iacocca: "A major reason that capable people fail to advance is that they don't work well with their colleagues". The importance of the ability to work in teams was confirmed in a survey of leadership practices of more than sixty of the world's top organizations. When top executives in these organizations were asked what causes the careers of high-potential leadership candidates to derail, 60 percent of the organizations cited “inability to work in teams.” Interestingly, only 9 percent attributed the failure of these executives to advance to “lack of technical ability.” To put it in plain terms, the question is not whether you’ll find yourself working as part of a team. You will. The question is whether you’ll know how to participate successfully in team-based activities.

**WILL YOU MAKE A GOOD TEAM MEMBER? -** What if your instructor decides to divide the class into teams and assigns each team to develop a new product plus a business plan to get it on the market? What teamwork skills could you bring to the table, and what teamwork skills do you need to improve? Do you possess qualities that might make you a good team leader?

**WHAT SKILLS DOES THE TEAM NEED? -** Sometimes we hear about a sports team made up of mostly average players who win a championship because of coaching genius, flawless teamwork, and superhuman determination. But not terribly often. In fact, we usually hear about such teams simply because they’re newsworthy—exceptions to the rule. Typically, a team performs well because its members possess some level of talent. Members’ talents must also be managed in a collective effort to achieve a common goal. In the final analysis, a team can succeed only if its members provide the skills that need managing. In particular, every team requires some mixture of four sets of skills:

- Communication Skills. Because how you communicate can positively and negatively affect relationships within the team and outside the team with managers, customers, vendors, etc.
- Technical skills. Because teams must perform certain tasks, they need people with the skills to perform them. For example, if your project calls for a lot of math work, it’s good to have someone with the necessary quantitative skills.
- Decision-making and problem-solving skills. Because every task is subject to problems, and because handling every problem means deciding on the best solution, it’s good to have members who are skilled in identifying problems, evaluating alternative solutions, and deciding on the best options.

- Interpersonal skills. Because teams need direction and motivation and depend on communication, every group benefits from members who know how to listen, provide feedback, and resolve conflict. Some members must also be good at communicating the team's goals and needs to outsiders.

The key is ultimately to have the right mix of these skills. Remember, too, that no team needs to possess all these skills—never mind the right balance of them—from day one. In many cases, a team gains certain skills only when members volunteer for certain tasks and perfect their skills in the process of performing them. For the same reason, effective teamwork develops over time as team members learn how to handle various team-based tasks. In a sense, teamwork is always work in progress.

## WHAT ROLES DO TEAM MEMBERS PLAY?

As a student and later in the workplace, you'll be a member of a team more often than a leader. Team members can have as much impact on a team's success as its leaders. A key is the quality of the contributions they make in performing non-leadership roles.

What, exactly, are those roles? At this point, you've probably concluded that every team faces two basic challenges:

1. Accomplishing its assigned task
2. Maintaining or improving group cohesiveness

Whether you affect the team's work positively or negatively depends on the extent to which you help it or hinder it in meeting these two challenges. We can thus divide teamwork roles into two categories, depending on which of these two challenges each role addresses. These two categories (task-facilitating roles and relationship-building roles) are summarized here:

## TASK-FACILITATING ROLES

Task-facilitating roles address challenge number one—accomplishing the team goals. As you can see from Table P.6, such roles include not only providing information when someone else needs it but also asking for it when you need it. In addition, it includes monitoring (checking on progress) and enforcing (making sure that team decisions are carried out). Task facilitators are especially valuable when assignments aren't clear or when progress is too slow.

## RELATIONSHIP-BUILDING ROLES

When you challenge unmotivated behavior or help other team members understand their roles, you're performing a relationship-building role and addressing challenge number two—maintaining or improving group cohesiveness. This type of role includes activities that improve team "chemistry," from empathizing to confronting.

Bear in mind three points about this model: (1) Teams are most effective when there's a good balance between task facilitation and relationship-building; (2) it's hard for any given member to perform both types of roles, as some people are better at focusing on tasks and others on relationships; and (3) overplaying any facet of any role can easily become counterproductive. For example, elaborating on something may not be the best strategy when the team needs to make a quick decision; and consensus building may cause the team to overlook an important difference of opinion.

**Blocking Roles -** Finally, show what you know in terms of blocking behaviors and the tactics used when someone is using the behavior. So-called blocking roles consist of behavior that inhibits either team performance or that of individual members. Every member of the team should know how to recognize blocking behavior. If teams don't confront dysfunctional members, they can destroy morale, hamper consensus building, create conflict, and hinder progress.

## CLASS TEAM PROJECTS

In your academic career you'll participate in a number of team projects. To get insider advice on how to succeed on team projects in college, let's look at some suggestions offered by students who have gone through this experience.

- Draw up a team charter. At the beginning of the project, draw up a team charter that includes: the goals of the group; ways to ensure that each team member's ideas are considered; timing and frequency of meeting. A more informal way to arrive at a team charter is to simply set some ground rules to which everyone agrees.

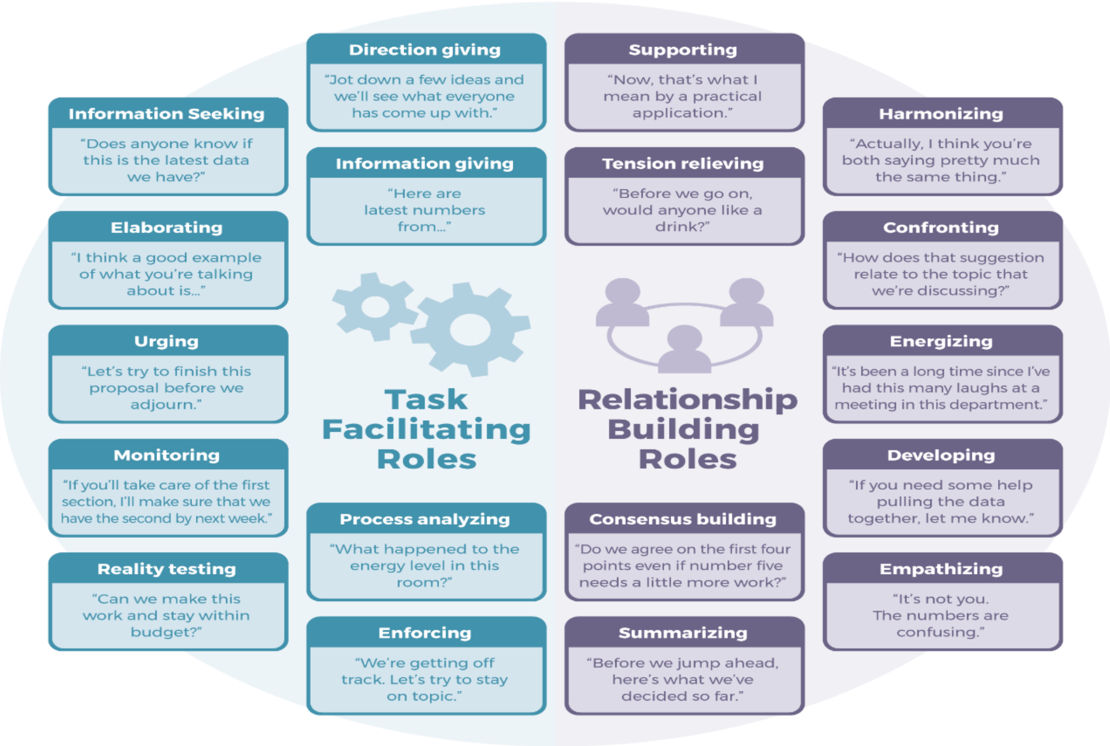
Your instructor may also require you to sign an existing team contract or charter similar to the one below.

- Contribute your ideas. Share your ideas with your group. The worst that could happen is that they won't be used (which is what would happen if you kept quiet).
- Never miss a meeting or deadline. Pick a weekly meeting time and write it into your schedule as if it were a class. Never skip it.
- Be considerate of each other. Be patient, listen to everyone, involve everyone in decision making, avoid infighting, build trust.
- Create a process for resolving conflict. Do so before conflict arises. Set up rules to help the group decide how conflict will be handled.
- Use the strengths of each team member. All students bring different strengths. Utilize the unique value of each person.
- Don't do all the work yourself. Work with your team to get the work done. The project output is often less important than the experience.

## WHAT DOES IT TAKE TO LEAD A TEAM?

To borrow from Shakespeare, "Some people are born leaders, some achieve leadership, and some have leadership thrust upon them." At some point in a successful career, you will likely be asked to lead a team. What will you have to do to succeed as a leader?

Like so many of the questions that we ask in this book, this question doesn't have any simple answers. We can provide one broad answer: a leader must help members develop the attitudes and behavior that contribute to team success: interdependence, collective responsibility, shared commitment, and so forth. Team leaders must be able to influence their team members. Notice that we say influence: except in unusual circumstances, giving commands and controlling everything directly doesn't work very well. As one team of researchers puts it, team leaders are more effective when they work with members rather than on them. Hand-in-hand with the ability to influence is the ability to gain and keep the trust of team members. People aren't likely to be influenced by a leader whom they perceive as dishonest or selfishly motivated.




Assuming you were asked to lead a team, there are certain leadership skills and behaviours that would help you influence your team members and build trust. Let's look briefly at some of them:

- Demonstrate integrity. Do what you say you'll do and act in accordance with your stated values. Be honest in communicating and follow through on promises.
- Be clear and consistent. Let members know that you're certain about what you want and remember that being clear and consistent reinforces your credibility.
- Generate positive energy. Be optimistic and compliment team members. Recognize their progress and success.
- Acknowledge common points of view. Even if you're about to propose some kind of change, recognize the value of the views that members already hold in common.
- Manage agreement and disagreement. When members agree with you, confirm your shared point of view. When they disagree, acknowledge both sides of the issue and support your own with strong, clearly-presented evidence.

- Encourage and coach. Buoy up members when they run into new and uncertain situations and when success depends on their performing at a high level.
- Share information. Give members the information they need and let them know that you're knowledgeable about team tasks and individual talents. Check with team members regularly to find out what they're doing and how the job is progressing.

For this course, we will be using teams to learn in and outside of our formal class time. A team contract is important to ensure all members have input on how the team will work together. This contract can also be referenced if a team member is not working to the expectations.

## KEY TAKEAWAYS – IMPORTANT TERMS AND CONCEPTS

1. A team or a work team is a group of people with complementary skills and diverse areas of expertise who work together to achieve a specific goal.

**2.** Work teams have five key characteristics:
They are accountable for achieving specific common goals.
They function interpedently.
They are stable.
They have authority.
They operate in a social context.

**3.** Work teams may be of several types:
In the traditional manager – led team, the leader defines the team`s goals and activities and is responsible for its achieving its assigned goals.

The leader of a self –managing team may determine overall goals, but employees control the activities needed to meet them.
A cross-functional team is designed to take advantage of the special expertise of members drown from different functional areas of the company.
On virtual teams, geographically dispersed members interact electronically in the process of pursuing a common goal.

4. Group cohesiveness refers to the attractiveness of a team to its members. If a group is high in cohesiveness, members are unhappy with it and may even try to live it.

5. As the business world depends more and more on teamwork, it is increasingly important for incoming members of the workforce to develop skills and experience in team-based activities. Every team requires some mixture of three skill sets:
Technical skills: skills needed to perform specific tasks.
Decision-making and problem-solving skills: skills needed to identify problems, evaluate alternative solutions, and decide on the best options.
Interpersonal skills: skills in listening, providing feedback, and resolving conflict.


Team Contract
Participation
Communication
Meetings
Conduct
Conflict resolution
Team members
Share your team contract

## CHAPTER 2. THE FOUNDATIONS OF BUSINESS

Businesses continue to tell their stakeholders that they are committed to “embedding” responsible practices into their companies. They want to avoid the accusation that corporate responsibility is a separate, bolt-on and instead present it as a core part of the organization’s DNA. But corporate foundations are growing in number. These distinct legal entities contribute to community causes on a company’s behalf. They are the effective ‘outsourcing’ of community contributions through an arms-length body that is technically independent.

Human needs are unlimited. Human can fulfill their unlimited needs with the supply of products and services by business. Business can help us to get different products / services from manufacturer and service provider. In addition, business helps us to earn profit. Therefore, nobody should wait for job only and if you have, some ideas about business so you can be easily start business and help to be self-dependent.To start any business successfully peoples offcourse want to get some concepts , objectives, features , requisites etc. about business.In our society some people don,t want to do their jobs under supervision of any manager.This group of people alaways want to be boss not subordinate.Business is only the field which can help anybody to be the boss in their own field.From this chapter anybody can get some ideas about business,and its features, objectives, scope, requisites etc.

Business is a process which can help us to earn prfits and exchange mutual benefites. Why we do business? Offcourse there are some specific reasons or objectives behind this question. Mainly we do business for profits, besides this business can helps to survive our life style and ensure to assign our responsibility for the society.

Business is the exchange of goods, services or money for mutual benefit or profit. Literally speaking business means business. In simple words, business means the state of being busy. Broadly, business involves activities connected with the production of wealth. It is an organized & systematized, human activity involving production & purchase of goods & services with the objective to selling them at a profit. According to prof. Own, “Business is an enterprise engaged in production & distribution of goods for sell in market or rendering services for a price Finally, we can tell that business concerns with buying & selling goods, manufacturing goods or providing services in order to earn profit.

## FEATURES OF BUSINESS

There are different features of business from above description as follows:

1. Sale or transfer of goods for value--One of the basic features of business is that it involves sale or transfer of Goods & Services for value.
2. Dealing in goods & services--Infect implies dealing in goods & services like bread, cloths watch etc.
3. Recurrence of dealings--Business involves recurring or repeated transactions of sell & Purchase for sell.
4. Profit motive--Profit motive is the biggest & powerful stimulus. For running a of Business, Business involves production & purchase of goods & services With the Motive of selling them at profit.
5. Risk involved--Business risk also. Profit or depends upon the degree of risk involves. The business is rewarded in tarns of profit for his/her risk bearing capacity.

## THE OBJECTIVES OF BUSINESS

Business must achieve these objectives to, Remain in operation. Lists of Business objectives generally include such factors as-

1. Survivable, Growth & social responsibilities--Survival is an obvious objective and growth is another objective because business does not stand still.

In recent years, meeting social responsibilities has been recognized as an important objective of business.

2. Profit--The profit objective plays the major role in business. Successful business organization earn a profit because their goods & services effectively meet customers' needs & demands. Profit rewards a business enterprise conducting a number activity.

## 2.1. SCOPE OF BUSINESS

Having gun through the definition & characterizes of business let us now know the scope or component of business. It includes industry, commerce & trade. In brief industry is concerned with the production of goods & material while trade & commerce are concerned with their distribution. Let us discussed these in more detail-

A) Industry- in simply ward industry refers to the process of interactions & production of goods sent for final consummation or use by another industry for us production. According to nature industry are broadly classify into four times.

1. Interactive Industries- This industry is concerned with the extraction & utilization of natural recourses from the earth, sea & air.
2. Genetic Industries- these industries include Breeding of plants, seeds, cattle Breeding farm, fish hatcheries, poultry farms
3. Manufacturing Industries- manufactories are engaged in the conversion of rentals or semi-finished goods into finished goods, manufactories industry can further be classified into following five types-
    1. Analytical industry
    2. Processing industry
    3. Synthetic industry
    4. Serves industry
    5. Assembly industry
4. Construction industries- these industries are concerned with the creation of infrastructural facilities for face lifting other activating like construction of building bridge roads etc.

B) Commerce- Commerce is the gather major components of business. It includes all those activities which are necessary to bring goods & services from, the place of their production to the place of their consumptions. In simple words commerce include trade & aid to trade. The principle functions. Of trade are to remain the following hindrances-

I. Hindrances of persons

II. Hindrances of Exchanges

III. Hindrances of place

IV. Hindrances of time

V. Hindrances of information

C) Trade in fact is a branch of commerce itself. In a way, it is a final stat of business activity involving sale & purchase of goods on the basic of its coverage & volume trade is normally classified into the following types:

1. On the basis of value-

a) Whole sale trade

b) Retail trade

2. On the basis of coverage-

a) Regional trade

b) National trade

c) International trade

## REQUISITES OF A SUCCESSFUL BUSINESS

Today the business has become very competitive & complies. It is said that, "Business has become a bed of thorns". A businessperson has to give proper thought to this consideration in order to make his business a successful one. The important requisites for success in a modern business are listed as follows:

1. Clear objective
2. Planning
3. Sound origination
4. Market research capability
5. Finance
6. Proper plant location layout & size
7. Effective Management
8. Harmonious relations with the employees
9. Risk taking capacity.

## DIFFERENCES BETWEEN BUSINESS AND PROFESSION

**Business** is the exchange of goods and services for mutual benefits or profits.

**Profession:** Profession means a kind of vocation, which creates with it a specialized skill & knowledge the individual has acquired. A professional man renders his specialized services to his client in return for a predetermined fee like doctors, lawyers, teachers etc.

The main differences between business & profession are given below:

| Business | Profession |
|---|---|
| Legal formalities like registration are to be fulfilled. | Become the member of concerned professional body. |
| The primary objective of business is earning profit. | Profession is primarily guided by service motive |
| There is no code of conduct for business firm. | However, professions are guided by specific professional ethics. |
| Business has client in general. | Profession has only specific clients. |
| Profit is rewarded in business | In profession, reward is professional fee. |
| Risk is involved in business from beginning to end. | The element of risk involved in profession is negligible. |

**Self – Assessment Questions**

1. What requisites are important for business?
2. Discuss the scope of business.
3. Show the differences between business and profession.

**Key Points** – the key points of this chapter are as follows:

1. Business
2. Industry
3. Commerce
4. Trade

5. Profit
6. Profession

**Practice Test**

Essay Type Questions

1. Define Business? Explain its features.
2. Discuss the objectives of business.

Essay Type Questions

1. Describe the scope of business.
2. What are the differences between business and profession?

**Short Type Questions**

1. Mention the requisites of successful business?
2. What is profession?

## 2.2. HOW TO READ A P&L STATEMENT AND OTHER FINANCE SKILLS?

No matter the nature of their businesses, all new entrepreneurs must understand the economic basics that help keep their companies thriving. That's true for everyone, but probably especially true for those who consider themselves more creative than business-savvy.

Without a solid background in the business side of business, being in charge can feel overwhelming. Understanding how to read a balance sheet and a P&L statement is just as important as understanding how to make the product or perform the service you provide. Here are five things you'll need to know (or know how to do) as a successful entrepreneur:

Becoming financially literate is one of the most important investments you can make in your startup. While you'll almost certainly hire skilled financial experts to handle your company's accounting, bookkeeping or tax needs, it's crucial that you grasp the basics. Can you read a profit and loss statement? Do you understand the difference between financing through debt and financing through equity, and what each can mean for a young business? Do you know how to create a budget?

If the answer to any of these questions is "no," then you'll want to invest in your own financial education as soon as possible. These concepts aren't terribly difficult to grasp, but you should grasp them well before you open your doors for business.

Budgeting is just the first step. You must also understand the concept of cash flow projections. How much money can your startup reasonably expect to earn? How much of that total will be profit, and how much will fund day to day operations? It's essential to do the real work on this task and take a cold, hard, fact-based look at what you can reasonably anticipate in the near future from your business.

Understanding cash flow also means having a basic grasp of financing and fund-raising options. They include venture capital[5], angel investors, crowdfunding, self-funding, grants, loans and more.

Which one is the wisest choice for your business in its early stages? The answer can mean the difference between a thriving business or having to look for another W-2 job. All businesses are sensitive to certain financial, economic and legal frameworks. For most new small businesses in the U.S. that means ensuring all regulatory and legal requirements have been met. Legal aspects of your business include your:

- Business structure (the most common are LLC, corporation, partnership and sole proprietorship)
- Business name (make sure it doesn't infringe on anyone else's IP rights)
- Tax IDs (federal and state)
- Permits and licenses (including business licenses)

Understanding the legalities of doing business also means managing your intellectual property as well as maintaining the right to do business. Does intellectual property like trademarks, copyrights or patents support your business? If so, you'll need to know from the start how that IP is defined and what you need to do to protect it.

[5] **Venture capital** (**VC**) is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long-term growth potential. **Venture capital** generally comes from well-off investors, **investment** banks, and any other financial institutions.

Finally, as a means of managing risk and reducing legal exposure, insurance is crucial to a vital, growing business at any stage of development. Educate yourself first about the different kinds of insurance products available (i.e., general liability, professional liability, workers compensation, and others).

Last but far from least, every new entrepreneur must understand the basics of marketing. You can't expect to open your doors to a steady stream of new customers or clients on the first day. People simply don't make purchasing decisions that quickly. They need to be coaxed, persuaded and reassured. That's basically what good marketing does. You need to understand the process each customer takes on the way to making a purchase, and you have to at least grasp the basic marketing techniques that help the customer take each successive step.

# CHAPTER 3. ECONOMICS AND BUSINESS

Business economics is a field of applied economics that studies the financial, organizational, market-related, and environmental issues faced by corporations. Business economics encompasses subjects such as the concept of scarcity, product factors, distribution, and consumption. 6 fundamentals of business management?

Generally, the six functional areas of business management involve strategy, marketing, finance, human resources, technology and equipment, and operations.

Fundamentals of business model is a framework for how a company will create value. Ultimately, it distills the potential of a business down to its essence. It answers fundamental questions about the problem you are going to solve, how you will solve it, and the growth opportunity within a given market.

7 fundamentals of management in business are:

- 1 – Customer Focus. The primary focus of quality management is to meet customer requirements and to strive to exceed customer expectations. ...
- 2 – Leadership. ...
- 3 – Engagement of People. ...
- 4 – Process Approach. ...
- 5 – Improvement. ...
- 6 – Evidence-based Decision Making. ...
- 7 – Relationship Management.

## 3.1. HOW TO START BUSINESS FROM

Whether you’re just starting a business, or you’ve been in business for a long time, in can be easy to get overwhelmed by all the different areas of your business. Going back to basics, and reviewing all the different areas of your business, can help you feel less overwhelmed and see the wood for the trees.

But, what ARE all the different areas of your business? And, which are most important?

I believe that all the areas of your business can be grouped into 8 fundamental areas. It's important to understand the part each of these areas play, and regularly consider how well each of them are performing.

So let's look at what the 8 Business Fundamentals are:

### 1. THE BUSINESS OWNERS/MANAGERS

The first Business Fundamental is actually YOU – the Business Owner.

This can often surprise people. Why are you the very first area of your business to review? Because habits good or bad start at the top and trickle down. If you're living in chaos and not managing your time well, chances are the team will be struggling too.

Fundamental systems to have in place for Business Owners/Managers include:

Good calendar management, task and project management, great health habits.

### 2. YOUR GOALS & PLANNING

If you're determined to achieve business growth, a strong and detailed business plan is not optional. Your plan doesn't have to be complicated. A simple one-pager or visual business board can be perfect! This fundamental is all about:

Defining your why; why are you doing what you're doing?
Your WHAT (what do you offer?)
Your WHO (who are both your ideal team and ideal customer?)
Your WHEN (think launch dates etc)
and most importantly Your HOW (how are you going to achieve all these goals?).

### 3.YOUR BUSINESS FINANCES

Money is the number 1 reason businesses go bust. So, it's vital not to neglect this fundamental. **When considering your Business Financial Systems, we suggest you consider:**

Your sales/cash flow systems
Your bookkeeping systems
How you manage your assets
Your measuring and reporting and
Your financial compliance.

## 4.THE OPERATIONAL SYSTEMS & PROCESSES

This fundamental is where most businesses get stuck when they're in rapid growth mode and trying to scale. If you're stuck at a level, and can't seem to budge because either you or the team are burning out, this is the business fundamental for you to focus on. Systems to consider are:

How you manage your customers
How information flows through your business
How you communicate between the team and your clients
How you track your sales/jobs
How you track all your marketing.

## 5.YOUR TEAM

A team that is performing in their genius, and feels appreciated, will reward you by performing their best.

It's also important to make sure businesses are compliant with their required paperwork and tax obligations. Team systems to consider are:

Team roles
Your paperwork compliance
How you monitor the key performance indicators
The team climate
Your team fit/personalities.

## 6.THE BRAND

A consistent brand is so much more than a logo; it is more what your brand is known for. For example – your values, the experience people have dealing with you, your messaging, the quality of your products/services.

Believe it or not, there are systems around your brand to make sure that you are putting a consistent brand out to the world.

Brand systems to consider are:

If your logo is consistent
If your website gives the message and experience you want it to
If you have a brand style guide for people to follow
Do you have templates set up for ease of use?

## 7.SALES & MARKETING PLANS

Marketing and sales are everything to your bottom line. For the majority of businesses coming through ours. this is an area they need to improve on, and sadly, it shows in their cash flow score.

Sales and Marketing Systems to consider are:

Your overall promotion/sales plan
Your overall marketing plan
Your social media marketing plan

If you're not sure the difference:

A sales plan in a plan to promote a specific product or service, for a specific amount of time, to achieve a specific amount of revenue.

A marketing plan is about growing your general brand awareness in the marketplace.

A social media plan supports both the other plans. It's the "HOW" in helping you achieve your sales and marketing objectives.

## 8.CUSTOMER EXPERIENCE

Last but certainly not least, it's important to consider your systems around ensuring your customers have a consistent and positive experience when dealing with your business. It's easier to upsell or cross-sell to existing customers than it is to go out and find a new customer. So, it's therefore important we look after our customers wisely so that they continue to trust us and want to continue a relationship with us.

Customer System to consider are:

How you manage and consider your customer feedback What your wait times are like

How effective you are at communicating with your clients, no wonder most Small Business Owners and Entrepreneurs feel overwhelmed! So, how do you make sure you're doing it all? Well, quite honestly, it's impossible to do all of that well?

The thing is – businesses change so rapidly as they grow that one minute we think we've got it mastered, and the next things are in pieces again or, we're feeling the heat of the growth.

## 3.2. WHAT IS BUSINESS ECONOMICS?

Business economics is a field of applied economics that studies the financial, organizational, market-related, and environmental issues faced by corporations.

Business economics assesses certain factors impacting corporations—business organization, management, expansion, and strategy—using economic theory and quantitative methods. Research topics in the field of business economics might include how and why corporations expand, the impact of entrepreneurs, interactions among corporations, and the role of governments in regulation.

KEY TAKEAWAYS

- Business economics is a field of applied economics that studies the financial, organizational, market-related, and environmental issues faced by corporations.
- Business economics encompasses subjects such as the concept of scarcity, product factors, distribution, and consumption.
- Managerial economics is one important offshoot of business economics.
- The National Association for Business Economics[6] (NABE) is the professional association for business economists in the U.S.

[6] NABE is the premier professional association for business economists and others who use economics in the workplace. Since 1959, NABE has attracted the most prominent figures in economics, business, and academia to its membership with highly-regarded conferences, educational and career development offerings, industry surveys, and its unrivaled networking opportunities. Past presidents of NABE include former Chairman of the Board of Governors for the Federal Reserve System, Alan Greenspan, several former Federal Reserve Governors, and other senior business leaders. The NABE membership is organized into subject-oriented

- In the broadest sense, economics refers to the study of the components and functions of a particular marketplace or economy—such as supply and demand—and the impact of the concept of scarcity. Within economics, production factors, distribution methods, and consumption are important subjects of study. Business economics focuses on the elements and factors within business operations and how they relate to the economy as a whole.
- The field of business economics addresses economic principles, strategies, standard business practices, the acquisition of necessary capital, profit generation, the efficiency of production, and overall management strategy. Business economics also includes the study of external economic factors and their influence on business decisions such as a change in industry regulation or a sudden price shift in raw materials.

## 3.3. TYPES OF BUSINESS ECONOMICS

Managerial economics is a field of study within business economics that focuses on the microeconomic factors that influence the decision-making processes with an organization. The strategic decisions of corporations result in either a profit or a loss for the company. Managerial economic principles are intended to influence and guide corporate strategy and decisions toward the best outcomes for a company.

The study of managerial economics is applied to both the public and private sectors, as well as to for-profit and not-for-profit organizations. All of these types of organizations must effectively assess the economic climate in order to remain solvent because all organizations require a source of funding to continue operations. Across all sectors of the business world, the main goal of managerial economics is to use all available resources within an organization, specifically maximizing production while at the same time minimizing any waste.

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Roundtables including: Data/Statistics, Energy, Financial, Health Economics, International, Manufacturing/Industry, Policy, Real Estate/Construction, Regional/Utility, Small Business/Entrepreneurship, Tech Economics, Transfer Pricing, and Transportation.

## BUSINESS ECONOMICS FOR NONPROFIT ORGANIZATIONS

While nonprofit organizations and for-profit organizations may have different goals, both of these types of organizations perform similar business functions and require similar expertise. In addition, they must also strive to limit waste and maximize the overall usefulness of their available resources in order to maintain their viability as enterprises. Both nonprofit organizations and for-profit organizations have to maintain the necessary capital to continue working within the economy, this requires them to use many of the same principles. For example, all types of organizations engage in advertising, community, or customer support and need leadership to make appropriate strategic decisions. So, for example Special Considerations there are various organizations associated with the field of business economics. In the U.S., the National Association for Business Economics (NABE) is the professional association for business economists. NABE is the largest international association of applied economists, strategists, academics, and policy-makers committed to the application of economics the mission of the organization is "to provide leadership in the use and understanding of economics".

In the United Kingdom, the equivalent organization is the Society of Business Economists (SPE). SPE is the leading organization serving professional economists in the U.K. and Europe[7].

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[7] The **Society of Professional Economists** is a British network of professional economists. Its members are drawn from all areas of the discipline including financial and professional services, business, journalism, government, consultancy, business schools and universities. Membership is open to anyone who has a degree with substantial economic content and/or works in an area of economic endeavor or investigation. The Society of Professional Economists organizes networking events, professional development and education as well as a high-profile conferences and an annual dinner. It provides a monthly newsletter with updates on these events, links to events organized by other professional bodies, new members and economic news. The Society also reviews books and provides a forum for members to advertise job opportunities and their own events. The Society exists to help all those who use economics in their professional work. Its activities aim to demonstrate the use of economic analysis as a tool to support business decision-making and to enhance the standing of the professional economist working outside academia. It provides a forum for its members to

## CHAPTER 4. ETHICS AND SOCIAL RESPONSIBILITY

The concept has come to mean various things to various people, but generally it's coming to know what it right or wrong in the workplace and doing what's right this is in regard to effects of products/services and in relationships with stakeholders. Wallace and Pekel[8] explain that attention to business ethics is critical during times of fundamental change times much like those faced now by businesses, both nonprofit or for-profit. In times of fundamental change, values that were previously taken for granted are now strongly questioned. Many of these values are no longer followed. Consequently, there is no clear moral compass to guide leaders through complex dilemmas about what is right or wrong. Attention to ethics in the workplace sensitizes leaders and staff to how they should act. Perhaps most important, attention to ethics in the workplaces helps ensure that when leaders and managers are struggling in times of crises and confusion, they retain a strong moral compass. Note that many people react that business ethics, with its continuing attention to "doing the right thing," only asserts the obvious like "be good," "don't lie," etc., and so these people don't take business ethics seriously. For many of us, these principles of the obvious can go right out the door during times of stress. Consequently, business ethics can be strong preventative medicine.

**Business ethics** also known as **corporate ethics** is a form of applied ethics or professional ethics, that examines ethical principles and moral or ethical problems that can arise in a business environment. It applies to all aspects of business conduct and is relevant to the conduct of individuals and entire organizations. These ethics originate from individuals, organizational statements or the legal

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discuss and debate economic issues and helps them keep in touch with practical and theoretical developments within the discipline.

The Society particularly welcomes younger members to engage through its social networks on Facebook and LinkedIn and has membership packages aimed specifically at those who are embarking on a career in the profession. The Society also offers affiliate membership to individuals who are interested in economics but not practicing.

[8] https://managementhelp.org/businessethics/10-Step-Method-Short-Version.pdf

system. These norms, values, ethical, and unethical practices are the principles that guide a business.

Business ethics refers to contemporary organizational standards, principles, sets of values and norms that govern the actions and behavior of an individual in the business organization. Business ethics have two dimensions, normative business ethics or descriptive business ethics. As a corporate practice and a career specialization, the field is primarily normative. Academics attempting to understand business behavior employ descriptive methods. The range and quantity of business ethical issues reflects the interaction of profit-maximizing behavior with non-economic concerns. Interest in business ethics accelerated dramatically during the 1980s and 1990s, both within major corporations and within academia. For example, most major corporations today promote their commitment to non-economic values under headings such as ethics codes and social responsibility charters.

Adam Smith[9] said in 1776, "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices". Governments use laws and regulations to point business

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[9] Adam Smith FRSA (c. 16 June [O.S. c. 5 June] 1723[1] – 17 July 1790) was a Scottish[a] economist, philosopher as well as a moral philosopher, a pioneer of political economy, and a key figure during the Scottish Enlightenment,[6] also known as "The Father of Economics"[7] or "The Father of Capitalism".[8] Smith wrote two classic works, *The Theory of Moral Sentiments* (1759) and *An Inquiry into the Nature and Causes of the Wealth of Nations* (1776). The latter, often abbreviated as *The Wealth of Nations*, is considered his *magnum opus* and the first modern work of economics. In his work, Adam Smith introduced his theory of absolute advantage. Smith studied social philosophy at the University of Glasgow and at Balliol College, Oxford, where he was one of the first students to benefit from scholarships set up by fellow Scot John Snell. After graduating, he delivered a successful series of public lectures at the University of Edinburgh,[10] leading him to collaborate with David Hume during the Scottish Enlightenment. Smith obtained a professorship at Glasgow, teaching moral philosophy and during this time, wrote and published *The Theory of Moral Sentiments*. In his later life, he took a tutoring position that allowed him to travel throughout Europe, where he met other intellectual leaders of his day. Smith laid the foundations of classical free market economic theory. *The Wealth of Nations* was a precursor to the modern academic discipline of economics. In this and other works, he developed the concept of division of labour and expounded upon how rational self-interest and competition can lead to economic prosperity. Smith was controversial in his own day and his general approach and writing style were often satirised by writers such as Horace Walpole.[11]

behavior in what they perceive to be beneficial directions. Ethics implicitly regulates areas and details of behavior that lie beyond governmental control. The emergence of large corporations with limited relationships and sensitivity to the communities in which they operate accelerated the development of formal ethics regimes. Maintaining an ethical status is the responsibility of the manager of the business. According to a 1990 article in the Journal of Business Ethics, "Managing ethical behavior is one of the most pervasive and complex problems facing business organizations today".

## 4.1. HISTORY OF ETHICS AND SOCIAL RESPONSIBILITY

Business ethics reflects the philosophy of business, of which one aim is to determine the fundamental purposes of a company. If a company's purpose is to maximize shareholder returns, then sacrificing profits for other concerns is a violation of its fiduciary responsibility. Corporate entities are legal persons but this does not mean they are legally entitled to all of the rights and liabilities as natural persons.

Ethics are the rules or standards that govern our decisions on a daily basis. Many consider "ethics" with conscience or a simplistic sense of "right" and "wrong." Others would say that ethics is an internal code that governs an individual's conduct, ingrained into each person by family, faith, tradition, community, laws, and personal mores. Corporations and professional organizations, particularly licensing boards, generally will have a written code of ethics that governs standards of professional conduct expected of all in the field. It is important to note that "law" and "ethics" are not synonymous, nor are the "legal" and "ethical" courses of action in a given situation necessarily the same. Statutes and regulations passed by legislative bodies and administrative boards set forth the "law." Slavery once was legal in the US, but one certainly wouldn't say enslaving another was an "ethical" act.

Economist Milton Friedman wrote that corporate executives' "responsibility ... generally will be to make as much money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom". Friedman also said, "the only entities who can have responsibilities are individuals ... A business cannot have responsibilities. So the question is, do corporate executives, provided they stay within the law, have responsibilities in their business activities other than to make as much money for their stockholders as possible? And my answer to that is, no, they do not». This view is known as the Friedman doctrine. A multi-country 2011 survey found support for this view among the "informed public" ranging from 30 to 80%. Ronald Duska and Jacques Cory have described Friedman's argument as consequentialist or utilitarian rather than pragmatic: Friedman's argument implies that unrestrained corporate freedom would benefit the most people in the long term.Duska argued that Friedman failed to differentiate two very different aspects of business: (1) the motive of individuals, who are generally motivated by profit to participate in business, and (2) the socially sanctioned purpose of business, or the reason why people allow businesses to exist, which is to provide goods and services to people. So Friedman was wrong that making a profit is the only concern of business, Duska argued.

Peter Drucker once said, "There is neither a separate ethics of business nor is one needed", implying that standards of personal ethics cover all business situations. However, Drucker in another instance said that the ultimate responsibility of company directors is not to harm—primum non nocere.

Another view of business is that it must exhibit corporate social responsibility (CSR): an umbrella term indicating that an ethical business must act as a responsible citizen of the communities in which it operates even at the cost of profits or other goals. In the US and most other nations, corporate entities are legally treated as persons in some respects. For example, they can hold title to property, sue and be sued and are subject to taxation, although their free speech rights are limited. This can be interpreted to imply that they have independent ethical responsibilities. Duska argued that stakeholders expect a business to be ethical and that violating that expectation must be counterproductive for the business.

Ethical issues include the rights and duties between a company and its employees, suppliers, customers and neighbors, its fiduciary responsibility to its shareholders. Issues concerning relations between different companies include hostile takeovers and industrial espionage. Related issues include corporate governance; corporate social entrepreneurship; political contributions legal issues such as the ethical debate over introducing a crime of corporate manslaughter and the marketing of corporations' ethics policies. According to research published by the Institute of Business Ethics and Ipsos MORI in late 2012, the three major areas of public concern regarding business ethics in Britain are executive pay, corporate tax avoidance and bribery and corruption.

Ethical standards of an entire organization can be damaged if a corporate psychopath is in charge. This will not only affect the company and its outcome but the employees who work under a corporate psychopath. The way a corporate psychopath can rise in a company is by their manipulation, scheming, and bullying. They do this in a way that can hide their true character and intentions within a company.

## 4.2. MANAGING ETHICS PROGRAMS IN THE WORKPLACE

Organizations can manage ethics in their workplaces by establishing an ethics management program. Brian Schrag, Executive Secretary of the Association for Practical and Professional Ethics, clarifies. "Typically, ethics programs convey corporate values, often using codes and policies to guide decisions and behavior, and can include extensive training and evaluating, depending on the organization. They provide guidance in ethical dilemmas." Rarely are two programs alike. "All organizations have ethics programs, but most do not know that they do", wrote business ethics professor Stephen Brenner in the Journal of Business Ethics (1992, V11, pp. 391-399). "A corporate ethics program is made up of values, policies and activities which impact the propriety of organization behaviors". Bob Dunn, President and CEO of San Francisco-based Business for Social Responsibility, adds: "Balancing competing values and reconciling them is a basic purpose of an ethics management program. Business people need more practical tools and information to understand their values and how to manage them".

**DEVELOPING CODES OF ETHICS -** According to Wallace[10], "A credo generally describes the highest values to which the company aspires to operate. It contains the `thou shalts.' A code of ethics specifies the ethical rules of operation. It's the `thou shalt nots." In the latter 1980s, The Conference Board, a leading business membership organization, found that 76% of corporations surveyed had codes of ethics. Some business ethicists disagree that codes have any value. Usually they explain that too much focus is put on the codes themselves, and that codes themselves are not influential in managing ethics in the workplace. Many ethicists note that it's the developing and continuing dialogue around the code's values that is most important. Ethics can be defined as a set of principles of right conduct. It can also be defined as a theory or a system of moral values. Organizational ethics is the application of moral standards to the situations under which the organization is operating. Organizational ethics are developed by the passage of time and custom. A custom differs from one organization to another. If a custom is adopted and accepted by the organization and public, then that custom becomes an ethic. Organizational ethics is applicable to every type of organization. The social responsibility of the organization also requires that the organization must observe ethics in its operations.

**DEVELOPING CODES OF CONDUCT -** If your organization is quite large, e.g., includes several large programs or departments, you may want to develop an overall corporate code of ethics and then a separate code to guide each of your programs or departments. Codes should not be developed out of the Human Resource or Legal departments alone, as is too often done. Codes are insufficient if intended only to ensure that policies are legal. All staff must see the ethics program being driven by top management.

Note that codes of ethics and codes of conduct may be the same in some organizations, depending on the organization's culture and operations and on the ultimate level of specificity in the code(s).

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[10] The concept has come to mean different things to different people, but generally it consists of knowing what is right or wrong in the workplace and doing what is right with regards to the effects of products/ services and in relationships with the stakeholders. Wallace and Pekel explain that attention to organizational ethics is critical during times of fundamental change which is the times much like those faced now by organizations. In times of fundamental change, values that were previously taken for granted are now strongly questioned. Many of these values are no longer followed.

**ETHICAL BEHAVIOR** is the behavior that conforms to the ethics which is individual beliefs and social standards about what is right and good. Ethics are important for getting along with others, living with oneself, and having a good character. Organizational ethics is concerned with the ethical behavior of the organization while carrying out its operations. Unethical practices create problems within the organization. The life and growth of the organization depends upon the ethics practiced by its management and employees. Organizational ethics means the behavior of the organization while conducting its operations, by observing morality in its activities. It is nothing but the application of ethics in the organization. It is the application of general ethical ideas to organizational behavior. Ethical behavior facilitates and promotes good to society, improves profitability, fosters customer relations and employee productivity. The concept of ethics in the organization has come to mean various things to various people, but generally it is coming to know what it right or wrong in the workplace and doing what is right. Organizational behavior has effects on products and services and on the relationships with stakeholders.

**CORE VALUES OF ORGANIZATIONAL ETHICS -** Ethical behavior is based on values such as trustworthiness, respect, responsibility, caring, fairness and justice, and good citizenship. It also depends on the adherence to moral rules Organizational values tell what is important and this, in turn, helps in making decisions about right and wrong. Morals are the rules for deciding what is good and what is bad. The following are the six core ethical values of the organizational ethics which influences the ethical behavior.

- **Trustworthiness** – It is the broadest and most complicated of the core ethical values. It is a broad value concerned with all the qualities and behavior that makes a person worthy of trust especially integrity, honesty, promise keeping, and loyalty.
- **Respect –** Respect focuses on the moral obligation to honor the essential worth and dignity of the individual. It is expressed in terms of positive qualities such as civility, courtesy, dignity, autonomy, tolerance, and acceptance. It also involves prohibitions against such conduct as violence, humiliation, manipulation, and exploitation etc.
- **Responsibility** – It speaks of the moral obligations to be accountable, perusal of excellence, and exercising of the self-restraint.

- **Fairness and justice –** Fairness and justice embodies concern with equity, equality, impartiality, proportionality, openness, and due process.
- **Caring** – It is the central value relating to sincere and abiding concern for the well-being of others. Concepts of charity, kindness, compassion, empathy, and sharing are included under caring.
- **Citizenship –** The concept of citizenship includes civic virtues and duties that prescribe how the organization ought to behave as part of a community. The exercise of good citizenship requires doing one's share to make society work and demonstrating a concern for future generations. A good citizen, for example, respects the law, reports crimes, serves on juries, votes, pays taxes and protects the environment.

## 4.3. CHARACTERISTICS OF ORGANIZATIONAL ETHICS

The important characteristics of the organizational ethics are given below.

- Organizational ethics are the principles, which govern and guide the management to perform organizational functions in a discipline manner.
- Organizational ethics continuously test the rules and moral standards and is dynamic in nature.
- Organizational ethics is based on theological principles such as sincerity, human welfare, service, and good behavior etc.
- Organizational ethics is based on reality and social customs prevailing in business environment. Many of the ethical principles develop the personal dignity.
- Organizational ethics studies the activities, decisions and behavior which are related to human beings and has universal application.
- Organizational ethics keeps harmony between different roles of management and employees, with customer, suppliers, investors, and society.

**PRINCIPLES OF ORGANIZATIONAL ETHICS -** The principles of organizational ethics are as follows.

- Sacredness of means and ends **–** This principle of organizational ethics emphasizes that the means and techniques adopted to serve the organization ends must be sacred and pure. It means that a good end cannot be attained with wrong means, even if it is beneficial to the society.
- Not to do any evil – It is unethical to do a major evil to another or to oneself, whether this evil is a means or an end.
- Principle of proportionality – This principle suggests that one should make proper judgment before doing anything so that others do not suffer from any loss or risk of evils by the conducts of the organization.
- Non-cooperation in evils – This principle clearly points out that the organization should not cooperate with any one for doing any evil acts.
- Cooperation with others -This principle states that the organization should help others only under condition when others deserve for help.
- Publicity – Anything that is being done or to be done, should be brought to the knowledge of everyone. If everyone knows, none gets opportunity to do an unethical act.
- Equivalent price – Everyone is entitled to get goods equivalent to the value of the money that he pays.
- Universal value – According to this principle the conduct of the organization should be done on the basis of universal values**.**
- Human dignity – As per this principle, employee should not be treated as a factor in production and human dignity must be maintained.
- Nonviolence – If the organization hurts the interests and rights of the society and exploits the consumer by overlooking their interests this is equivalent to violence and unethical act.

**IMPORTANCE OF BUSINESS ETHICS -** There are many reasons for organizational ethics to be regarded as an important area since it helps the organization in evaluating its activities and helps the management in improving the decision making process. Good organizational ethics promotes the operation of the organization in the following way.

- The power and influence of an organization in society is greater than ever before. Organizational ethics help the management to understand why this is happening, what its implications might be, and how to address the situation.
- The organization has the potential to provide a major contribution to the society, in terms of producing the products and services that it needs, providing employment, paying taxes, and acting as an engine for economic development and thereby increases the goodwill[11].
- Malpractices have the potential to inflict enormous harm on individuals, on communities and on the environment. Through helping the organization to understand more about the causes and consequences of these malpractices, organizational ethics helps to create mutual trust and confidence in relationship.
- The demands being placed on the organization to be ethical by its various stakeholders are constantly becoming more complex and more challenging. Organizational ethics provides the means to appreciate and understand these challenges more clearly, in order that the organization can meet these ethical expectations more effectively.
- Organizational ethics can help to improve ethical decision making by providing management with the appropriate knowledge and tools that allow it to correctly identify, diagnose, analyze, and provide solutions to the ethical problems and dilemmas it is confronted with.
- Organization can prosper on the basis of good ethical standards. Organizational ethics helps to retain the operations for longer period.

[11] Goodwill = *P-(A-L)*, where: P = Purchase price of the target company, A = Fair market value of assets, L = Fair market value of liabilities. Goodwill is an intangible asset that is associated with the purchase of one company by another. Specifically, goodwill is the portion of the purchase price that is higher than the sum of the net fair value of all of the assets purchased in the acquisition and the liabilities assumed in the process. The value of a company's brand name, solid customer base, good customer relations, good employee relations, and proprietary technology represent some reasons why goodwill exists.

- Organizational ethics provides the management the ability to assess the benefits and problems associated with the different ways of managing different issues in the organization.
- In the age of complexity in the markets, competition is increasing day by day. Good ethical standard helps the organization to face the challenges.

**ETHICAL MANAGEMENT -** Implementation of organizational ethics in the organization needs certain steps. Ethical or unethical behavior of individual employees is influenced in the workplace both by their own moral development and the influence that the organization culture exerts on them. They are influenced by a group of forces that surround them such as their peers, their supervisors, and superiors, the reward system, group norms, organizational values and policies and the manner of their implementation. Ethical behavior can be developed and managed in a number of ways. Human resource management (HRM) plays the pivotal role in the management and development of the ethical behavior amongst the employees. HRM department can execute this through training, communication and discipline. In some of the organizations, there may be ethics officers who are entrusted with the responsibility to implement ethics in the organization. Further HRM department must prepare a sound ethical program which should include the following components.

- Formal code of conduct
- Ethics committee
- Ethical communication
- Ethics officer
- Ethics training programme
- Disciplinary system in the organization
- Establishing an ombudsperson.
- Monitoring

**NECESSITY FOR ORGANIZATIONAL ETHICS -** The following are the ten necessities for an organization to implement organizational ethics.

- To satisfy shareholder expectations
- To protect the reputation of the organization
- To build trust with those groups with which the organization works
- To guard against unethical employees and competitors
- To establish a working environment that matches the core values
- To ensure that the organization is an equal opportunity employer
- To maintain a safe working environment for employees
- To engage actively with local communities as a partner
- To maintain high standards of integrity
- To adhere to the practice of full disclosure on the quality of goods and services.

# CHAPTER 5.
# BUSINESS IN A GLOBAL ENVIRONMENT

Do you wear Nike shoes or Timberland boots? Buy groceries at Tops Friendly Markets, Giant Stores, Carrefour or Stop & Shop? Listen to Beyonce, Pitbull, Britney Spears, Jennifer Lopez, the Dixie Chicks, Foster the People, or the Dave Matthews Band, Dua Lipa and Elton John? If you answered yes to any of these questions, you're a global business customer. Both Nike and Timberland manufacture most of their products overseas. The Dutch firm Royal Ahold owns all three supermarket chains. Sony Music, the label that records Beyonce, J. Lo, the Dixie Chicks, and the other artists mentioned, belongs to a Japanese company.

Take an imaginary walk down Orchard Road, the most fashionable shopping area in Singapore. You'll pass department stores such as Tokyo-based Takashimaya and London's very British Marks & Spencer, both filled with such well-known international labels as Ralph Lauren Polo, Burberry, Chanel, and Nokia. If you need a break, you can also stop for a latte at Seattle-based Starbucks.

When you're in the Chinese capital of Beijing, don't miss Tiananmen Square. Parked in front of the Great Hall of the People, the seat of Chinese government, are fleets of black Buicks, cars made by General Motors in Flint, Michigan. If you're adventurous enough to find yourself in Faisalabad, a medium-size city in Pakistan, you'll see locals riding donkeys, camels pulling carts piled with agricultural produce, and Hamdard University, located in a refurbished hotel. Step inside its computer labs, and the sensation of being in a faraway place will likely disappear: on the computer screens, you'll recognize the familiar Microsoft flag—the same one emblazoned on screens in Microsoft's hometown of Seattle and just about everywhere else on the planet.

## 5.1. THE GLOBALIZATION OF BUSINESS

The globalization of business is bound to affect you. Not only will you buy products manufactured overseas, but it's highly likely that you'll meet and work with individuals from various countries and cultures as customers, suppliers, colleagues, employees, or employers. The bottom line is that the globalization of world commerce has an impact on all of us. Therefore, it makes sense to learn more about how globalization works.

Never before has business spanned the globe the way it does today. But why is international business important? Why do companies and nations engage in international trade? What strategies do they employ in the global marketplace? What challenges do companies face when they do business overseas? How do governments and international agencies promote and regulate international trade? Is the globalization of business a good thing? What career opportunities are there for you in global business? How should you prepare yourself to take advantage of them? These are the questions that we'll be addressing in this paragraph. Let's start by looking at the more specific reasons why companies and nations engage in international trade.

How can we predict, for any given country, which products will be made and sold at home, which will be imported, and which will be exported? This question can be answered by looking at the concept of comparative advantage, which exists when a country can produce a product at a lower opportunity cost compared to another nation. But what's an *opportunity cost*? Opportunity costs are the products that a country must decline to make in order to produce something else. When a country decides to specialize in a particular product, it must sacrifice the production of another product.

Let's simplify things by imagining a world with only two countries—the Republic of High Tech and the Kingdom of Low Tech. We'll pretend that each country knows how to make two and only two products: wooden boats and telescopes. Each country spends half its resources labor and capital on each good.

**WHY DO NATIONS TRADE?** - Why does the United States import automobiles, steel, digital phones, and apparel from other countries? Why don't we just make them ourselves? Why do other countries buy wheat, chemicals, machinery, and consulting services from us? Because no national economy produces all the goods and services that its people need. Countries are *importers* when they buy goods and services from other countries; when they sell products to other nations, they're *exporters*.

The monetary value of international trade is enormous. In 2010, the total value of worldwide trade in merchandise and commercial services was $18.5 *trillion*. World Trade Organization[12], press release, "Trade growth to ease in 2011 but despite 2010 record surge, crisis hangover persists" To understand why certain countries import or export certain products, you need to realize that every country (or region) can't produce the same products. The cost of labor, the availability of natural resources, and the level of know-how vary greatly around the world. Most economists use the concepts of *absolute advantage* and *comparative advantage* to explain why countries import some products and export others.

A nation has an absolute advantage if (1) it's the only source of a particular product or (2) it can make more of a product using the same amount of or fewer resources than other countries. Because of climate and soil conditions, for example, France had an absolute advantage in wine making until its dominance of worldwide wine production was challenged by the growing wine industries in Italy, Spain, and the United States. Unless an absolute advantage is based on some limited natural resource, it seldom lasts. That's why there are few, if any, examples of absolute advantage in the world today.

**HOW DO WE MEASURE TRADE BETWEEN NATIONS? -** To evaluate the nature and consequences of its international trade, a nation looks at two key indicators. We determine a country's balance of trade by subtracting the value of its imports from the value of its exports. If a country sells more products than it buys, it has a favorable balance, called a trade surplus. If it buys more than it sells, it has an unfavorable balance, or a trade deficit. For many years, the United States has had a trade deficit: we buy far more goods from the rest of the world than we sell overseas. This fact shouldn't be surprising. With high income levels, we not only consume a sizable portion of our own domestically produced goods but enthusiastically buy imported goods. Other countries, such as

[12] The **World Trade Organization** (**WTO**) is an intergovernmental organization that regulates and facilitates international trade between nations. It officially commenced operations on 1 January 1995, pursuant to the 1994 Marrakesh Agreement, thus replacing the General Agreement on Tariffs and Trade (GATT) that had been established in 1948. The WTO is the world's largest international economic organization, with 164 member states representing over 96% of global trade and global GDP.

China and Taiwan, which manufacture primarily for export, have large trade surpluses because they sell far more goods overseas than they buy.

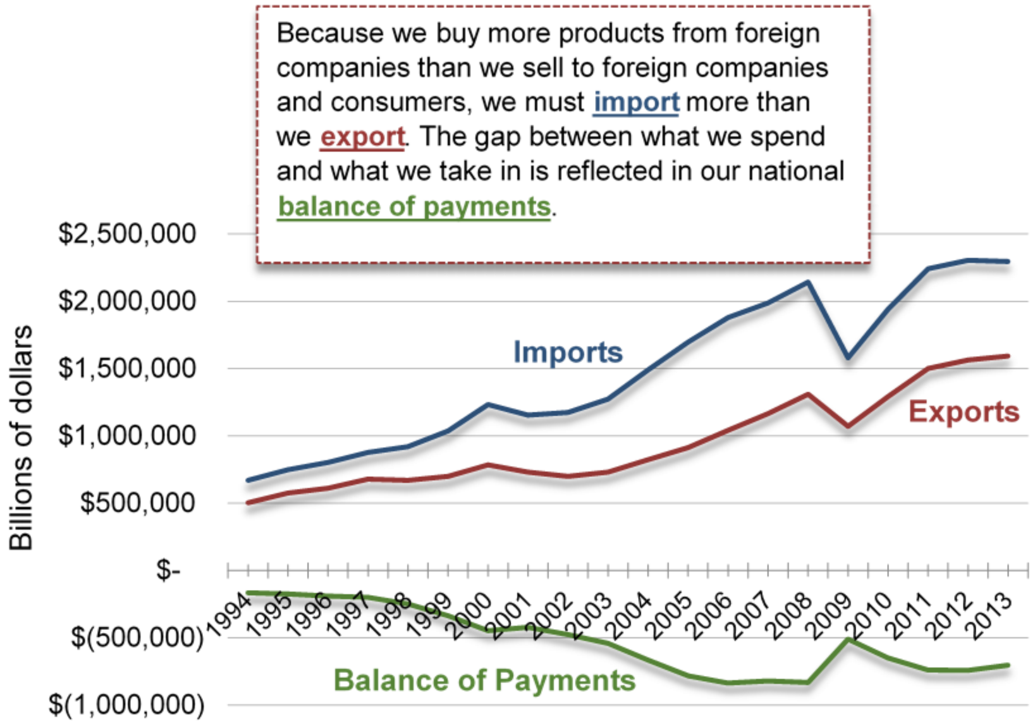
**MANAGING THE NATIONAL CREDIT CARD -** Are trade deficits a bad thing? Not necessarily. They can be positive if a country's economy is strong enough both to keep growing and to generate the jobs and incomes that permit its citizens to buy the best the world has to offer. That was certainly the case in the United States in the 1990s. Some experts, however, are alarmed at our rapidly accelerating trade deficit. Investment guru Warren Buffet[13], for example, cautions that no country can continuously sustain large and burgeoning trade deficits. Why not? Because creditor nations will eventually stop taking IOUs from debtor nations, and when that happens, the national spending spree will have to cease. "Our national credit card," he warns, "allows us to charge truly breathtaking amounts. But that card's credit line is not limitless". Warren E. Buffet, "Why I'm Not Buying the U.S. Dollar," *Wall Street Week with Fortune*, http://www.pbs.org/wsw/news/fortunearticle_20031026_03.html (accessed May 25, 2006).

By the same token, trade surpluses aren't necessarily good for a nation's consumers. Japan's export-fueled economy produced high economic growth in the 1970s and 1980s. But most domestically made consumer goods were priced at artificially high levels inside Japan itself—so high, in fact, that many Japanese traveled overseas to buy the electronics and other high-quality goods on which Japanese trade was dependent. CD players and televisions were significantly cheaper in Honolulu or Los Angeles than in Tokyo. How did this situation come about? Though Japan manufactures a variety of goods, many of them are made for export. To secure shares in international markets, Japan prices its exported goods competitively. Inside Japan, because competition is limited, producers can put artificially high prices on Japanese-made goods. Due to a number of factors (high demand for a limited supply of imported goods, high shipping and distribution costs, and other costs incurred by importers in a nation that tends to protect its own industries), imported goods are also expensive. «Why Are Prices in Japan So Damn

[13] **Warren Edward Buffett** (/ˈbʌfɪt/ *BUFF-itt*; born August 30, 1930)[2] is an American investor, business tycoon, philanthropist, and the chairman and CEO of Berkshire Hathaway. He is considered one of the most successful investors in the world and has a net worth of over US$100.6 billion as of April 2021, making him the world's seventh-wealthiest person.

High?” *The Japan FAQ*, http://www.geocities.com/japanfaq/FAQ-Prices.html (accessed May 25, 2006).

**BALANCE OF PAYMENTS -** The second key measure of the effectiveness of international trade is balance of payments: the difference, over a period of time, between the total flow of money coming into a country and the total flow of money going out. As in its balance of trade, the biggest factor in a country’s balance of payments is the money that comes in and goes out as a result of imports and exports. But balance of payments includes other cash inflows and outflows, such as cash received from or paid for foreign investment, loans, tourism, military expenditures, and foreign aid. For example, if a U.S. company buys some real estate in a foreign country, that investment counts in the U.S. balance of payments, but not in its balance of trade, which measures only import and export transactions. In the long run, having an unfavorable balance of payments can negatively affect the stability of a country’s currency. Some observers are worried about the U.S. dollar, which has undergone an accelerating pattern of unfavorable balances of payments since the 1970s. For one thing, carrying negative balances has forced the United States to cover its debt by borrowing from other countries.



## 5.2. OPPORTUNITIES IN INTERNATIONAL BUSINESS

The fact that nations exchange billions of dollars in goods and services each year demonstrates that international trade makes good economic sense. For a company wishing to expand beyond national borders, there are a variety of ways it can get involved in international business. Let's take a closer look at the more popular ones.

**IMPORTING AND EXPORTING -** Importing buying products overseas and reselling them in one's own country and exporting selling domestic products to foreign customers are the oldest and most prevalent forms of international trade. For many companies, importing is the primary link to the global market. American food and beverage wholesalers, for instance, import for resale in U.S. supermarkets the bottled waters Evian and Fiji from their sources in the French Alps and the Fiji Islands respectively. Other companies get into the global arena by identifying an international market for their products and becoming exporters. The Chinese, for instance, are fond of fast foods cooked in soybean oil. Because they also have an increasing appetite for meat, they need high-protein soybeans to raise livestock. American farmers now export over $9 billion worth of soybeans to China every year.

**LICENSING AND FRANCHISING -** A company that wants to get into an international market quickly while taking only limited financial and legal risks might consider licensing agreements with foreign companies. An international licensing agreement allows a foreign company (the licensee) to sell the products of a producer (the licensor) or to use its intellectual property (such as patents, trademarks, copyrights) in exchange for what is known as royalty fees. Here's how it works: You own a company in the United States that sells coffee-flavored popcorn. You're sure that your product would be a big hit in Japan, but you don't have the resources to set up a factory or sales office in that country. You can't make the popcorn here and ship it to Japan because it would get stale. So you enter into a licensing agreement with a Japanese company that allows your license to manufacture coffee-flavored popcorn using your special process and to sell it in Japan under your brand name. In exchange, the Japanese licensee would pay you a royalty fee – perhaps a percentage of each sale or a fixed amount per unit.

Another popular way to expand overseas is to sell franchises. Under an international franchise agreement, a company the franchiser grants a foreign company the franchisee the right to use its brand name and to sell its products or services. The franchisee is responsible for all operations but agrees to operate according to a business model established by the franchiser. In turn, the franchiser usually provides advertising, training, and new-product assistance. Franchising is a natural form of global expansion for companies that operate domestically according to a franchise model, including restaurant chains, such as McDonald's and Kentucky Fried Chicken, and hotel chains, such as Holiday Inn and Best Western.

**CONTRACT MANUFACTURING AND OUTSOURCING –**

Because of high domestic labor costs, many U.S. companies manufacture their products in countries where labor costs are lower. This arrangement is called international contract manufacturing, a form of outsourcing. A U.S. company might contract with a local company in a foreign country to manufacture one of its products. It will, however, retain control of product design and development and put its own label on the finished product. Contract manufacturing is quite common in the U.S. apparel business, with most American brands being made in a number of Asian countries, including China, Vietnam, Indonesia, and India. Thanks to twenty-first-century information technology, non-manufacturing functions can also be outsourced to nations with lower labor costs. Canadian companies are increasingly drawing on a vast supply of relatively inexpensive skilled labor to perform various business services, such as software development, accounting, and claims processing. With a large, well-educated population with English language skills, India has become a center for software development and customer-call centers. In the case of India, as you can see in the graph below, the attraction is not only a large pool of knowledge workers but also significantly lower wages.

**SELECTED HOURLY WAGES, CANADA AND INDIA**

| Occupation | Canada Wage per Hour (per year) | Indian Wage per Hour (per year) |
|---|---|---|
| Accountant | $32 per hour (~$64,000 per year) | $3.15 per hour (~$6,300 per year) |
| Information Technology Consultant | $35 per hour (~$65,750 per year) | $22.40 per hour (~$44,800 per year) |
| Cleaner | $15.00 per hour (~$30,000 per year) | $2.10 per hour (~$4,200 per year) |

**STRATEGIC ALLIANCES AND JOINT VENTURES -** What if a company wants to do business in a foreign country but lacks the expertise or resources? Or what if the target nation's government doesn't allow foreign companies to operate within its borders unless it has a local partner? In these cases, a firm might enter into a strategic alliance with a local company or even with the government itself.

A strategic alliance is an agreement between two companies (or a company and a nation) to pool resources in order to achieve business goals that benefit both partners. For example, Viacom (a leading global media company) has a strategic alliance with Beijing Television to produce Chinese-language music and entertainment programming.

An alliance can serve a number of purposes:

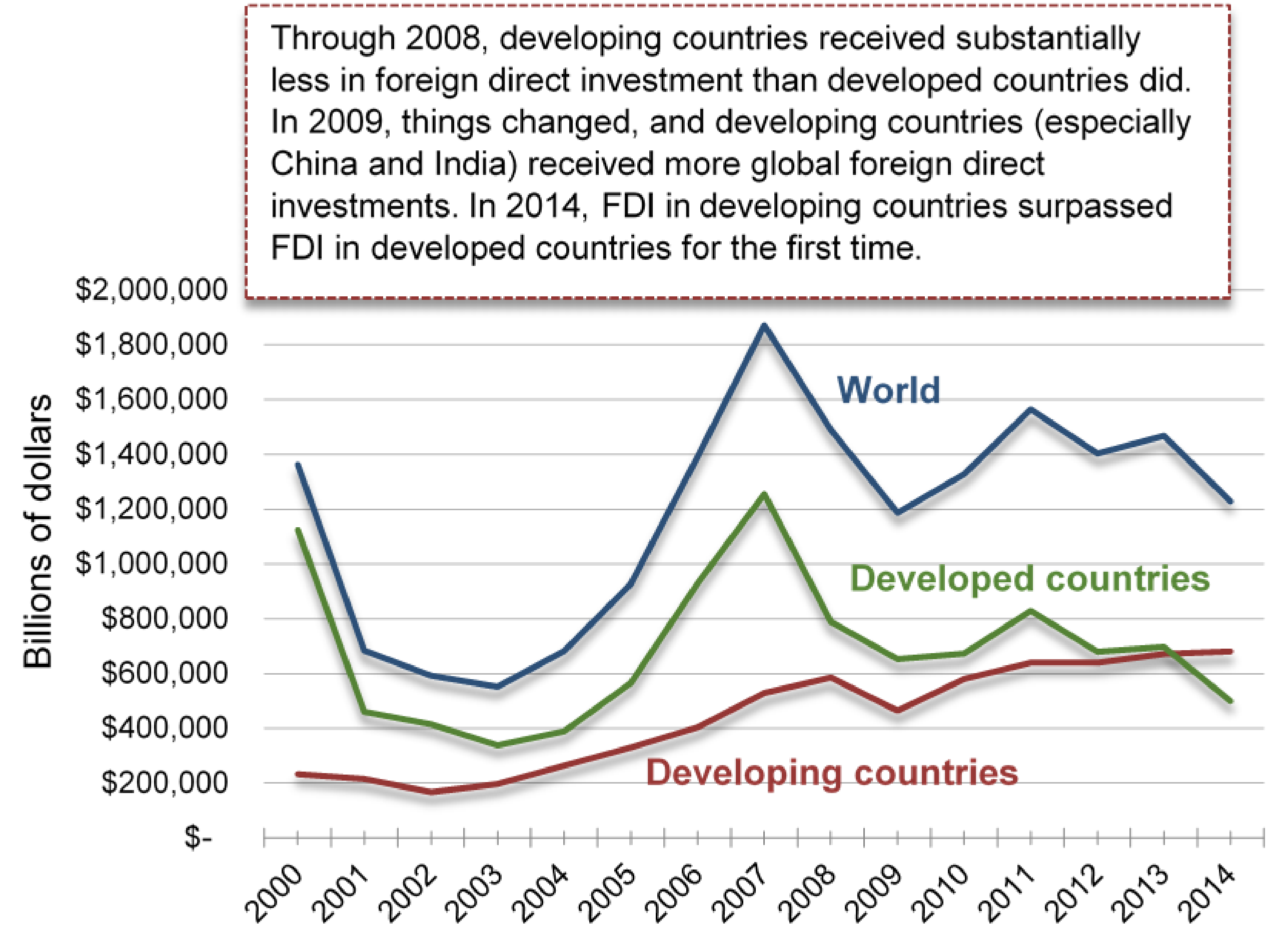
- Enhancing marketing efforts
- Building sales and market share
- Improving products
- Reducing production and distribution costs
- Sharing technology

Alliances range in scope from informal cooperative agreements to joint ventures— alliances in which the partners fund a separate entity (perhaps a partnership or a corporation) to manage their joint operation. Magazine publisher Hearst, for example, has joint ventures with companies in several countries. So, young women in Israel can read Cosmo Israel in Hebrew, and Russian women can pick up a Russian-language version of Cosmo that meets their needs. The North American edition serves as a starting point to which nationally appropriate material is added in each different nation. This approach allows Hearst to sell the magazine in more than fifty countries.

**FOREIGN DIRECT INVESTMENT AND SUBSIDIARIES -** Many of the approaches to global expansion that we've discussed so far allow companies to participate in international markets without investing in foreign plants and facilities. As markets expand, however, a firm might decide to enhance its competitive advantage by making a direct investment in operations conducted in another country. Foreign direct investment (FDI) refers to the formal establishment of business operations on foreign soil—the building of factories, sales offices, and distribution networks to serve local markets in a nation other than the company's home country. On the other hand, offshoring occurs when the facilities set up in the foreign country replace Canadian manufacturing facilities and are used to produce goods that will be sent back to Canada for sale. Shifting production to low-wage countries is often criticized as it results in the loss of jobs for Canadian workers.

FDI is generally the most expensive commitment that a firm can make to an overseas market, and it's typically driven by the size and attractiveness of the target market. For example, German and Japanese automakers, such as BMW, Mercedes, Toyota, and Honda, have made serious commitments to the U.S. market most of the cars and trucks that they build in plants in the South and Midwest are destined for sale in the United States.

A common form of FDI is the foreign subsidiary an independent company owned by a foreign firm (called the parent). This approach to going international not only gives the parent company full access to local markets but also exempts it from any laws or regulations that may hamper the activities of foreign firms. The parent company has tight control over the operations of a subsidiary, but while senior managers from the parent company often oversee operations, many managers and employees are citizens of the host country. Not surprisingly, most very large firms have foreign subsidiaries. IBM and Coca-Cola, for example, have both had success in the Japanese market through their foreign subsidiaries (IBM-Japan and Coca-Cola–Japan). FDI goes in the other direction, too, and many companies operating in the United States are in fact subsidiaries of foreign firms. Gerber Products, for example, is a subsidiary of the Swiss company Novartis, while Stop & Shop and Giant Food Stores belong to the Dutch company Royal Ahold. Where does most FDI capital end up? The graph below provides an overview of amounts, destinations (high to low income countries), and trends.




All these strategies have been employed successfully in global business. But success in international business involves more than finding the best way to reach international markets. Global business is a complex, risky endeavor. Over time, many large companies reach the point of becoming truly multi-national.

**MULTINATIONAL CORPORATIONS** - A company that operates in many countries is called a multinational corporation (MNC). Fortune magazine's roster of the top 500 MNCs speaks for the growth of non-U.S. businesses. Only one of the top 6 MNCs are headquartered in the United States ~ Wal-Mart (number 1). The others are non-U.S. firms. Also interesting is the difference between company revenues and profits: the list would look quite different arranged by profits instead of revenues!

MNCs often adopt the approach encapsulated in the motto "Think globally, act locally". They often adjust their operations, products, marketing, and distribution to mesh with the environments of the countries in which they operate. Because they understand that a "one-size-fits-all" mentality doesn't make good business sense when they're trying to sell products in different markets, they're willing to accommodate cultural and economic differences. Increasingly, MNCs supplement their mainstream product line with products designed for local markets. Coca-Cola, for example, produces coffee and citrus-juice drinks developed specifically for the Japanese market. When Nokia and Motorola design cell phones, they're often geared to local tastes in color, size, and other features. For example, Nokia introduced a cell phone for the rural Indian consumer that has a dust-resistant keypad, anti-slip grip, and a built-in flashlight. McDonald's provides a vegetarian menu in India, where religious convictions affect the demand for beef and pork. In Germany, McDonald's caters to local tastes by offering beer in some restaurants and a Shrimp Burger in Hong Kong and Japan.

Likewise, many MNCs have made themselves more sensitive to local market conditions by decentralizing their decision making. While corporate headquarters still maintain a fair amount of control, home-country managers keep a suitable distance by relying on modern telecommunications. Today, fewer managers are dispatched from headquarters; MNCs depend instead on local talent. Not only does decentralized organization speed up and improve decision making, but it also allows an MNC to project the image of a local company. IBM, for instance, has been quite successful in the Japanese market because local customers and suppliers perceive it as a Japanese company.

Crucial to this perception is the fact that the vast majority of IBM's Tokyo employees, including top leadership, are Japanese nationals.

**CRITICISM OF MNCS -** The global reach of MNCs is a source of criticism as well as praise. Critics argue that they often destroy the livelihoods of home-country workers by moving jobs to developing countries where workers are willing to labor under poor conditions and for less pay. They also contend that traditional lifestyles and values are being weakened, and even destroyed, as global brands foster a global culture of American movies; fast food; and cheap, mass-produced consumer products. Still others claim that the demand of MNCs for constant economic growth and cheaper access to natural resources do irreversible damage to the physical environment. All these negative consequences, critics maintain, stem from the abuses of international trade—from the policy of placing profits above people, on a global scale. These views surfaced in violent street demonstrations in Seattle in 1999 and Genoa, Italy, in 2000, and since then, meetings of the International Monetary Fund (IMF) and World Bank have regularly been assailed by protestors.

**IN DEFENSE OF MNCS** - Supporters of MNCs respond that huge corporations deliver better, cheaper products for customers everywhere; create jobs; and raise the standard of living in developing countries. They also argue that globalization increases cross-cultural understanding. Anne O. Kruger, first deputy managing director of the IMF, says the following:

"The impact of the faster growth on living standards has been phenomenal. We have observed the increased well-being of a larger percentage of the world's population by a greater increment than ever before in history. Growing incomes give people the ability to spend on things other than basic food and shelter, in particular on things such as education and health. This ability, combined with the sharing among nations of medical and scientific advances, has transformed life in many parts of the developing world. Infant mortality has declined from 180 per 1,000 births in 1950 to 60 per 1,000 births. Literacy rates have risen from an average of 40 percent in the 1950s to over 70 percent today. World poverty has declined, despite still-high population growth in the developing world”.

**THE CULTURAL ENVIRONMENT -** Even when two people from the same country communicate, there’s always a possibility of misunderstanding. When people from different countries get together, that possibility increases substantially. Differences in communication styles reflect differences in culture: the system of shared beliefs, values, customs, and behaviors that govern the interactions of members of a society. Cultural differences create challenges to successful international business dealings. Let’s look at a few of these challenges.

**LANGUAGE -** English is the international language of business. The natives of such European countries as France and Spain certainly take pride in their own languages and cultures, but nevertheless English is the business language of the European community.

Whereas only a few educated Europeans have studied Italian or Norwegian, most have studied English. Similarly, on the South Asian subcontinent, where hundreds of local languages and dialects are spoken, English is the official language. In most corners of the world, English-only speakers—such as most Canadians—have no problem finding competent translators and interpreters. So why is language an issue for English speakers doing business in the global marketplace? In many countries, only members of the educated classes speak English. The larger population—which is usually the market you want to tap—speaks the local tongue. Advertising messages and sales appeals must take this fact into account. More than one English translation of an advertising slogan has resulted in a humorous (and perhaps serious) blunder.

**LOST IN TRANSLATION**

- In Belgium, the translation of the slogan of an American auto-body company, *Body by Fisher*, came out as *Corpse by Fisher*.
- Translated into German, the slogan, *Come Alive with Pepsi* became *Come Out of the Grave with Pepsi.*

• A U.S. computer company in Indonesia translated “software” as “underwear”.

• A German chocolate product called “Zit” didn’t sell well in the U.S.

• An English-speaking car wash company in Francophone Quebec advertised itself as a “lavement d’auto” or “car enema” instead of the correct “lavage d’auto.

• In the 1970s, General Motors’ Chevy Nova didn’t get on the road in Puerto Rico, in part because “nova” in Spanish means “it doesn’t go”.

Furthermore, relying on translators and interpreters puts you as an international businessperson at a disadvantage. You’re privy only to interpretations of the messages that you’re getting, and this handicap can result in a real competitive problem. Maybe you’ll misread the subtler intentions of the person with whom you’re trying to conduct business. The best way to combat this problem is to study foreign languages. Most people appreciate some effort to communicate in their local language, even on the most basic level. They even appreciate mistakes you make resulting from a desire to demonstrate your genuine interest in the language of your counterparts in foreign countries. The same principle goes doubly when you’re introducing yourself to non- English speakers in Canada. Few things work faster to encourage a friendly atmosphere than a native speaker’s willingness to greet a foreign guest in the guest’s native language.

**TIME AND SOCIABILITY -** North Americans take for granted many of the cultural aspects of our business practices. Most of our meetings, for instance, focus on business issues, and we tend to start and end our meetings on schedule. These habits stem from a broader cultural preference: we don’t like to waste time. (It was an American, Benjamin Franklin, who coined the phrase “Time is money.”) This preference, however, is by no means universal. The expectation that meetings will start on time and adhere to precise agendas is common in parts of Europe (especially the Germanic countries), as well as in Canada, but elsewhere—say, in Latin America and the Middle East—people are often late to meetings.

**HIGH-AND LOW-CONTEXT CULTURES -** Likewise, don't expect businesspeople from these regions—or businesspeople from most of Mediterranean Europe, for that matter—to "get down to business" as soon as a meeting has started. They'll probably ask about your health and that of your family, inquire whether you're enjoying your visit to their country, suggest local foods, and generally appear to be avoiding serious discussion at all costs. For Canadians, such topics are conducive to nothing but idle chitchat, but in certain cultures, getting started this way is a matter of simple politeness and hospitality.

**INTERCULTURAL COMMUNICATION -** Different cultures have different communication styles—a fact that can take some getting used to. For example, degrees of animation in expression can vary from culture to culture. Southern Europeans and Middle Easterners are quite animated, favoring expressive body language along with hand gestures and raised voices. Northern Europeans are far more reserved. The English, for example, are famous for their understated style and the Germans for their formality in most business settings. In addition, the distance at which one feels comfortable when talking with someone varies by culture. People from the Middle East like to converse from a distance of a foot or less, while North Americans prefer more personal space.

Finally, while people in some cultures prefer to deliver direct, clear messages, others use language that's subtler or more indirect. North Americans and most Northern Europeans fall into the former category and many Asians into the latter. But even within these categories, there are differences. Though typically polite, Chinese and Koreans are extremely direct in expression, while Japanese are indirect: They use vague language and avoid saying "no" even if they do not intend to do what you ask. They worry that turning someone down will result in their "losing face", i.e., an embarrassment or loss of credibility, and so they avoid doing this in public.

In summary, learn about a country's culture and use your knowledge to help improve the quality of your business dealings. Learn to value the subtle differences among cultures, but don't allow cultural stereotypes to dictate how you interact with people from any culture. Treat each person as an individual and spend time getting to know what he or she is about.

**THE ECONOMIC ENVIRONMENT -** If you plan to do business in a foreign country, you need to know its level of economic development. You also should be aware of factors influencing the value of its currency and the impact that changes in that value will have on your profits.

**ECONOMIC DEVELOPMENT -** If you don't understand a nation's level of economic development, you'll have trouble answering some basic questions, such as: Will consumers in this country be able to afford the product I want to sell? Will it be possible to make a reasonable profit? A country's level of economic development can be evaluated by estimating the annual income earned per citizen. The World Bank, which lends money for improvements in underdeveloped nations, divides countries into four income categories, World Bank Country and Lending Groups (by Gross National Income per Capita 2015).

- High income—$12,736 or higher (United States, Germany, Japan, Canada)
- Upper-middle income—$4,126 to $12,735 (China, South Africa, Mexico)
- Lower-middle income—$1,046 to $4,125 (Kenya, Philippines, India)
- Low income—$1,045 or less (Afghanistan, South Sudan, Haiti)

Note that that even though a country has a low annual income per citizen, it can still be an attractive place for doing business. India, for example, is a lower-middle-income country, yet it has a population of a billion, and a segment of that population is well educated—an appealing feature for many business initiatives.

The long-term goal of many countries is to move up the economic development ladder. Some factors conducive to economic growth include a reliable banking system, a strong stock market, and government policies to encourage investment and competition while discouraging corruption. It's also important that a country have a strong infrastructure—its systems of communications (telephone, Internet, television, newspapers), transportation (roads, railways, airports), energy (gas and electricity, power plants), and social facilities (schools, hospitals). These basic systems will help countries attract foreign investors, which can be crucial to economic development.

**CURRENCY VALUATIONS AND EXCHANGE RATES -** If every nation used the same currency, international trade and travel would be a lot easier. Of course, this is not the case. There are around 175 currencies in the world some you've heard of, such as the British pound; others are likely unknown to you, such as the manat, the official currency of Azerbaijan. If you were in Azerbaijan, you would exchange your Canadian dollars for Azerbaijan manats. The day's foreign exchange rate will tell you how much one currency is worth relative to another currency and so determine how many manats you will receive. If you have traveled abroad, you already have personal experience with the impact of exchange rate movements.

**THE LEGAL AND REGULATORY ENVIRONMENT -** One of the more difficult aspects of doing business globally is dealing with vast differences in legal and regulatory environments. Canada, for example, has an established set of laws and regulations that provide direction to businesses operating within its borders. But because there is no global legal system, key areas of business law—for example, contract provisions and copyright protection—can be treated in different ways in different countries. Companies doing international business often face many inconsistent laws and regulations. To navigate this sea of confusion, Canadian business people must know and follow both Canadian laws and regulations and those of nations in which they operate. Business history is filled with stories about North American companies that have stumbled in trying to comply with foreign laws and regulations. Coca-Cola, for example, ran afoul of Italian law when it printed its ingredients list on the bottle cap rather than on the bottle itself. Italian courts ruled that the labelling was inadequate because most people throw the cap away. One approach to dealing with local laws and regulations is hiring lawyers from the host country who can provide advice on legal issues. Another is working with local business people who have experience in complying with regulations and overcoming bureaucratic obstacles.

**FOREIGN CORRUPT PRACTICES ACT -** One Canadian law that creates unique challenges for Canadian firms operating overseas is the Corruption of Foreign Public Officials Act (CFPOA), which prohibits the distribution of bribes and other favors in the conduct of business. Despite the practice being illegal in Canada, such tactics as kickbacks and bribes are business-as-usual in many nations.

According to some experts, Canadian business people are at a competitive disadvantage if they're prohibited from giving bribes or undercover payments to foreign officials or business people who expect them. In theory, because the Corruption of Foreign Public Officials Act warns foreigners that Canadians can't give bribes, they'll eventually stop expecting them.

Where are business people most likely and least likely to encounter bribe requests and related forms of corruption? Transparency International, an independent German-based organization, annually rates nations according to "perceived corruption," which it defines as "the abuse of entrusted power for private gain".

Transparency International reports on corruption and publishes an annual Corruption Perceptions Index that rates the world's countries. A score of 100 would be perfect (corruption free) and anything below 30 establishes that corruption is rampant.

| Rank | Country | CPI Score[14] |
|---|---|---|
| 1 | New Zealand | 89 |
| 2 | Denmark | 88 |
| 3 | Finland | 85 |
| 3 | Norway | 85 |
| 3 | Switzerland | 85 |
| 4 | Singapore | 84 |
| 4 | Sweden | 84 |
| 5 | Canada | 82 |
| 176 | Yemen | 16 |
| 176 | Sudan | 16 |
| 177 | Afghanistan | 15 |
| 178 | Syria | 14 |
| 179 | South Sudan | 12 |
| 180 | Somalia | 9 |

[14] CORRUPTION PERCEPTIONS INDEX. https://www.transparency.org/en/cpi/2020/index/nzl

**TRADE CONTROLS -** The debate about the extent to which countries should control the flow of foreign goods and investments across their borders is as old as international trade itself. Governments continue to control trade. To better understand how and why, let's examine a hypothetical case. Suppose you're in charge of a small country in which people do two things—grow food and make clothes. Because the quality of both products is high and the prices are reasonable, your consumers are happy to buy locally made food and clothes. But one day, a farmer from a nearby country crosses your border with several wagonloads of wheat to sell. On the same day, a foreign clothes maker arrives with a large shipment of clothes. These two entrepreneurs want to sell food and clothes in your country at prices below those that local consumers now pay for domestically made food and clothes. At first, this seems like a good deal for your consumers: they won't have to pay as much for food and clothes. But then you remember all the people in your country who grow food and make clothes. If no one buys their goods (because the imported goods are cheaper), what will happen to their livelihoods? And if many people become unemployed, what will happen to your national economy? That's when you decide to protect your farmers and clothes makers by setting up trade rules. Maybe you'll increase the prices of imported goods by adding a tax to them; you might even make the tax so high that they're more expensive than your homemade goods. Or perhaps you'll help your farmers grow food more cheaply by giving them financial help to defray their costs. The government payments that you give to the farmers to help offset some of their costs of production are called subsidies. These subsidies will allow the farmers to lower the price of their goods to a point below that of imported competitors' goods. What's even better is that the lower costs will allow the farmers to export their own goods at attractive, competitive prices.

Canada has a long history of subsidizing farmers. Subsidy programs guarantee farmers including large corporate farms a certain price for their crops, regardless of the market price. This guarantee ensures stable income in the farming community but can have a negative impact on the world economy. How? Critics argue that in allowing Canadian farmers to export crops at artificially low prices, Canadian agricultural subsidies permit them to compete unfairly with farmers in developing countries. A reverse situation occurs in the steel industry, in which a number of countries—China, Japan, Russia, Germany, and Brazil—subsidize domestic producers. In 2017, trade with the United States accounted for $411 billion, 75% of Canada's exports, but Canada only imported $370 billion from the U.S., achieving a positive trade balance of more than $40 billion. U.S. trade unions charge that trade subsidy practices gives an unfair advantage to foreign producers and hurts American industries, which can't compete on price with subsidized imports. Whether they push up the price of imports or push down the price of local goods, such initiatives will help locally produced goods compete more favorably with foreign goods. Both strategies are forms of trade controls—policies that restrict free trade. Because they protect domestic industries by reducing foreign competition, the use of such controls is often called protectionism. Though there's considerable debate over the pros and cons of this practice, all countries engage in it to some extent. Before debating the issue, however, let's learn about the more common types of trade restrictions: tariffs, quotas, and, embargoes.

**TARIFFS -** Tariffs are taxes on imports. Because they raise the price of the foreign-made goods, they make them less competitive. Tariffs are also used to raise revenue for a government. Donald Trump, President of The United States, for example, announced in March of 2018 that the U.S. would increase tariffs on imported steel products from 10% to 25% as a means of enhancing the American steel industry and protecting U.S steel manufacturers.

**QUOTAS -** A quota imposes limits on the quantity of a good that can be imported over a period of time. Quotas are used to protect specific industries, usually new industries or those facing strong competitive pressure from foreign firms. Canadian import quotas take two forms. An absolute quota fixes an upper limit on the amount of a good that can be imported during the given period. A tariff-rate quota permits the import of a specified quantity and then adds a high import tax once the limit is reached. Sometimes quotas protect one group at the expense of another. To protect sugar beet and sugar cane growers, for instance, the United States imposes a tariff-rate quota on the importation of sugar—a policy that has driven up the cost of sugar to two to three times world prices. These artificially high prices push up costs for American candy makers, some of whom have moved their operations elsewhere, taking high-paying manufacturing jobs with them. Life Savers, for example, were made in the United States for ninety years but are now produced in Canada, where the company saves $9 million annually on the cost of sugar.

**DUMPING -** A common political rationale for establishing tariffs and quotas is the need to combat dumping: the practice of selling exported goods below the price that producers would normally charge in their home markets (and often below the cost of producing the goods). Usually, nations resort to this practice to gain entry and market share in foreign markets, but it can also be used to sell off surplus or obsolete goods. Dumping creates unfair competition for domestic industries, and governments are justifiably concerned when they suspect foreign countries of dumping products on their markets. They often retaliate by imposing punitive tariffs that drive up the price of the imported goods.

## 5.3. THE PROS AND CONS OF TRADE CONTROLS

Opinions vary on government involvement in international trade. Proponents of controls contend that there are a number of legitimate reasons why countries engage in protectionism. Sometimes they restrict trade to protect specific industries and their workers from foreign competition—agriculture, for example, or steel making. At other times, they restrict imports to give new or struggling industries a chance to get established. Finally, some countries use protectionism to shield industries that are vital to their national defense, such as shipbuilding and military hardware.

Despite valid arguments made by supporters of trade controls, most experts believe that such restrictions as tariffs and quotas—as well as practices that don’t promote level playing fields, such as subsidies and dumping—are detrimental to the world economy. Without impediments to trade, countries can compete freely. Each nation can focus on what it does best and bring its goods to a fair and open world market. When this happens, the world will prosper, or so the argument goes. International trade is certainly heading in the direction of unrestricted markets.

**REDUCING INTERNATIONAL TRADE BARRIERS -** A number of organizations work to ease barriers to trade, and more countries are joining together to promote trade and mutual economic benefits. Let's look at some of these important initiatives.

**TRADE AGREEMENTS AND ORGANIZATIONS -** Free trade is encouraged by a number of agreements and organizations set up to monitor trade policies. The two most important are the General Agreement on Tariffs and Trade and the World Trade Organization.

**GENERAL AGREEMENT ON TARIFFS AND TRADE -** After the Great Depression and World War II, most countries focused on protecting home industries, so international trade was hindered by rigid trade restrictions. To rectify this situation, twenty-three nations joined together in 1947 and signed the General Agreement on Tariffs and Trade (GATT), which encouraged free trade by regulating and reducing tariffs and by providing a forum for resolving trade disputes. The highly successful initiative achieved substantial reductions in tariffs and quotas, and in 1995 its members founded the World Trade Organization to continue the work of GATT in overseeing global trade.

**WORLD TRADE ORGANIZATION -** Based in Geneva, Switzerland, with nearly 150 members, the World Trade Organization (WTO) encourages global commerce and lower trade barriers, enforces international rules of trade, and provides a forum for resolving disputes. It is empowered, for instance, to determine whether a member nation's trade policies have violated the organization's rules, and it can direct "guilty" countries to remove disputed barriers (though it has no legal power to force any country to do anything it doesn't want to do). If the guilty party refuses to comply, the WTO may authorize the plaintiff nation to erect trade barriers of its own, generally in the form of tariffs. Affected members aren't always happy with WTO actions.

In 2002, for example, President George Bush's administration imposed a three-year tariff on imported steel. In ruling against this tariff, the WTO allowed the aggrieved nations to impose counter-tariffs on some politically sensitive American products, such as Florida oranges, Texas grapefruits and computers, and Wisconsin cheese. Reluctantly, the administration lifted its tariff on steel.

## FINANCIAL SUPPORT FOR EMERGING ECONOMIES: THE IMF AND THE WORLD BANK

A key to helping developing countries become active participants in the global marketplace is providing financial assistance. Offering monetary assistance to some of the poorest nations in the world is the shared goal of two organizations: The International Monetary Fund and the World Bank. These organizations, to which most countries belong, were established in 1944 to accomplish different but complementary purposes.

**THE INTERNATIONAL MONETARY FUND** - The International Monetary Fund (IMF) loans money to countries with troubled economies, such as Mexico in the 1980s and mid-1990s and Russia and Argentina in the late 1990s. There are, however, strings attached to IMF loans: in exchange for relief in times of financial crisis, borrower countries must institute sometimes painful financial and economic reforms. In the 1980s, for example, Mexico received financial relief from the IMF on the condition that it privatize and deregulate certain industries and liberalize trade policies. The government was also required to cut back expenditures for such services as education, health care, and workers' benefits.

**THE WORLD BANK** - The World Bank is an important source of economic assistance for poor and developing countries. With backing from wealthy donor countries (such as Canada, the United States, Japan, Germany, and United Kingdom), the World Bank has committed $42.5 billion in loans, grants, and guarantees to some of the world's poorest nations. Loans are made to help countries improve the lives of the poor through community-support programs designed to provide health, nutrition, education, infrastructure, and other social services.

**TRADING BLOCS: NAFTA AND THE EUROPEAN UNION -** So far, our discussion has suggested that global trade would be strengthened if there were no restrictions on it—if countries didn't put up barriers to trade or perform special favors for domestic industries. The complete absence of barriers is an ideal state of affairs that we haven't yet attained. In the meantime, economists and policymakers tend to focus on a more practical question: Can we achieve the goal of free trade on the regional level? To an extent, the answer is yes. In certain parts of the world, groups of countries have joined together to allow goods and services to flow without restrictions across their mutual borders. Such groups are called trading blocs. Let's examine two of the most powerful trading blocs—NAFTA and the European Union.

**NORTH AMERICAN FREE TRADE ASSOCIATION -** The North American Free Trade Association (NAFTA) is an agreement among the governments of the United States, Canada, and Mexico to open their borders to unrestricted trade. The effect of this agreement is that three very different economies are combined into one economic zone with almost no trade barriers. From the northern tip of Canada to the southern tip of Mexico, each country benefits from the comparative advantages of its partners: each nation is free to produce what it does best and to trade its goods and services without restrictions.

When the agreement was ratified in 1994, it had no shortage of skeptics. Many people feared, for example, that without tariffs on Mexican goods, more U.S. and Canadian manufacturing jobs would be lost to Mexico, where labor is cheaper. Almost two decades later, most such fears have not been realized, and, by and large, NAFTA has been a success.

Since it went into effect, the value of trade between Canada and Mexico has grown substantially, and Canada and Mexico are now the United States' top trading partners.

**THE EUROPEAN UNION -** The forty-plus countries of Europe have long shown an interest in integrating their economies. The first organized effort to integrate a segment of Europe's economic entities began in the late 1950s, when six countries joined together to form the European Economic Community (EEC). Over the next four decades, membership grew, and in the late 1990s, the EEC became the

European Union. Today, the European Union (EU) is a group of twenty-seven countries that have eliminated trade barriers among themselves (see the map in Figure). At first glance, the EU looks similar to NAFTA. Both, for instance, allow unrestricted trade among member nations. But the provisions of the EU go beyond those of NAFTA in several important ways. Most importantly, the EU is more than a trading organization: it also enhances political and social cooperation and binds its members into a single entity with authority to require them to follow common rules and regulations. It is much like a federation of states with a weak central government, with the effect not only of eliminating internal barriers but also of enforcing common tariffs on trade from outside the EU. In addition, while NAFTA allows goods and services as well as capital to pass between borders, the EU also allows people to come and go freely: if you possess an EU passport, you can work in any EU nation[15].


[15] Source: Member states of the European Union from https://en.wikipedia.org

**THE EURO**[16] **-** A key step toward unification occurred in 1999, when most (but not all) EU members agreed to abandon their own currencies and adopt a joint currency. The actual conversion occurred in 2002, when a common currency called the euro replaced the separate currencies of participating EU countries. The common currency facilitates trade and finance because exchange-rate differences no longer complicate transactions.

Its proponents argued that the EU would not only unite economically and politically distinct countries but also create an economic power that could compete against the dominant players in the global marketplace. Individually, each European country has limited economic power, but as a group, they could be an economic superpower. Over time, the value of the euro has been questioned. Many of the "euro" countries (Spain, Italy, Greece, Portugal, and Ireland in particular) have been financially irresponsible, piling up huge debts and experiencing high unemployment and problems in the housing market. But because these troubled countries share a common currency with the other "euro countries", they are less able to correct their economic woes. Many economists fear that the financial crisis precipitated by these financially irresponsible countries threaten the very survival of the euro. The UK voted to leave the EU in 2016, although this does not necessarily mean the UK will indeed leave the EU, as that will ultimately be finalized in 2019, the UK has performed well since the vote to leave the EU.

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[16] The **euro** (symbol: **€**; code: **EUR**) is the official currency of 19 of the 27 member states of the European Union. This group of states is known as the Eurozone or euro area and includes about 343 million citizens as of 2019.The euro, which is divided into 100 cents, is the second-largest and second-most traded currency in the foreign exchange market after the United States dollar. The currency is also used officially by the institutions of the European Union, by four European microstates that are not EU members, the British Overseas Territory of Akrotiri and Dhekelia, as well as unilaterally by Montenegro and Kosovo. Outside Europe, a number of special territories of EU members also use the euro as their currency. Additionally, over 200 million people worldwide use currencies pegged to the euro.

The euro is the second-largest reserve currency as well as the second-most traded currency in the world after the United States dollar. As of December 2019, with more than €1.3 trillion in circulation, the euro has one of the highest combined values of banknotes and coins in circulation in the world.

Only time will tell whether the trend toward regional trade agreements is good for the world economy. Clearly, they're beneficial to their respective participants; for one thing, they get preferential treatment from other members. But certain questions still need to be answered more fully. Are regional agreements, for example, moving the world closer to free trade on a global scale—toward a marketplace in which goods and services can be traded anywhere without barriers?

## IN CONCLUSION OF THE CHAPTER WE CAN MENTION THE IMPORTANT TERMS AND CONCEPTS

1. Nations trade because they do not produce all the products that their inhabitants need.
2. The cost of labor, the availability of natural resources, and the level of know-how vary greatly around the world, so not every country has the same resources or is good at producing the same products.
3. To explain how countries, decide what products to import and export, economist use the concepts of absolute and comparative advantage. A nation has an absolute advantage if it is the only source of a particular product or can make more of a product with the same amount of or fewer resources than other countries. A comparative advantage exists when a country can produce a product at a lower opportunity cost than other nations.
4. We determine a country`s balance of trade by subtracting the value of its imports from the value of its exports. If a country sells more products than it buys, it has a favorable balance, called a trade surplus. If it buys more than it sells, it has an unfavorable balance, or a trade deficit.
5. The balance of payments is the difference, over a period of time, between the total flow coming into a country and the total flow going out. The biggest factor in a country`s balance of payments is the money that comes in and goes out as a result of exports and imports.
6. A company that operates in many countries is called a multinational corporation (MNC).
7. For a company in Canada wishing to expand beyond national borders, there are a variety of ways to get involved in international business:

- Importing involves purchasing products from other countries and reselling them in one`s own.
- Exporting entails selling products to foreign customers
- Under a franchise agreement, a company grants a foreign company the right to use its brand name and sell its products.
- A licensing agreement allows a foreign company to sell a company`s products or use its intellectual property in exchange for royalty fees.
- Through international contract manufacturing or outsourcing, a company has its products manufactured or services provided in other countries.
- A joint venture is a type of strategic alliance in which a separate entity funded by the participating companies is formed.
- Foreign direct investment (FDI) refers to the formal establishment of business operations on foreign soil.
- A common form of FDI is the foreign subsidiary, an independent company owned by a foreign firm.

8. Success in international business requires an understanding an assortment of cultural, economic and legal / regulatory differences between countries. Cultural challenges stem from differences in language, concepts of time and sociability, and communication styles.
9. Because they protect domestic industries by reducing foreign competition, the use of controls to restrict free trade is often called protectionism.

- Tariffs are taxes on imports.
- Because they raise the price of the foreign-made goods, they make them less competitive.
- Quotas are restrictions on imports that impose a limit on the quantity of a good that can be improved over a period of time. They are used to protect specific industries, usually new industries or those facing strong competitive pressure from foreign firms.
- An embargo is a quota that, for economic or political reasons, bans the import or export of certain goods to or from a specific country.
- A common rationale for tariffs and quotas is the need to combat dumping – the practice of selling exported goods below the

price that producers would normally charge in their home markets (and often below the costs of producing set up to monitor trade policies.

- The General Agreement on Tariffs and Trade (GATT) regulates free trade, reduces tariffs and provides a forum for resolving trade disputes.
- The World Trade Organizations (WTO) encourages global commerce and lower trade barriers, enforces international rules of trade, and provides a forum for resolving disputes.
- The International Monetary Fund (IMF) and the World Bank both provide monetary assistance to the world`s poorest countries.
- In certain parts of the world, groups of countries have formed trading blocs to allow goods and services to flow without restrictions across their mutual borders.
- Exemples include the North American Trade Association (NAFTA)The United States, Canada and Mexico and the European Union (EU), a group of twenty-seven countries that have eliminated trade barriers among themselves.

## CHAPTER 6. FORMS OF BUSINESS OWNERSHIP

In this chapter we will learn how to build the business ownership: 1) Identify the questions to ask in choosing the appropriate form of ownership for a business.

2) Describe the sole proprietorship and partnership forms of organization, and specify the advantages and disadvantages.

3) Identify the different types of partnerships, and explain the importance of a partnership agreement.

4) Explain how corporations are formed and how they operate.

5) Discuss the advantages and disadvantages of the corporate form of ownership.

6) Examine special types of business ownership, including limited liability companies, cooperatives, and not-for-profit corporations.

7) Define mergers and acquisitions, and explain why companies are motivated to merge or acquire other companies.

If you're starting a new business, you have to decide which legal form of ownership is best for you and your business. Do you want to own the business yourself and operate as a sole proprietorship? Or, do you want to share ownership, operating as a partnership or a corporation? Before we discuss the pros and cons of these three types of ownership, let's address some of the questions that you'd probably ask yourself in choosing the appropriate legal form for your business.

### DISADVANTAGES OF SOLE PROPRIETORSHIPS

For many people, however, the sole proprietorship is not suitable. The flip side of enjoying complete control is having to supply all the different talents that may be necessary to make the business a success. And when you're gone, the business dissolves. You also have to rely on your own resources for financing: in effect, you are the business and any money borrowed by the business is loaned to you personally. Even more important, the sole proprietor bears unlimited liability for any losses incurred by the business. The principle of unlimited personal liability means that if the business incurs a debt or suffers a catastrophe (say, getting sued for causing an injury to someone), the owner is personally liable. As a sole proprietor, you put your personal assets (your bank account, your car, maybe even your home) at risk for the sake of your business. You can lessen your risk with insurance, yet your liability exposure can still be substantial. Given that Ben and Jerry decided to start their ice cream business together (and therefore the business was not owned by only one person), they could not set their company up as a sole proprietorship.

### PARTNERSHIP AGREEMENT

The impact of disputes can be lessened if the partners have executed a well-planned partnership agreement that specifies everyone's rights and responsibilities. The agreement might provide such details as the following:

- Amount of cash and other contributions to be made by each partner
- Division of partnership income (or loss)
- Partner responsibilities who does what
- Conditions under which a partner can sell an interest in the company
- Conditions for dissolving the partnership
- Conditions for settling disputes

### UNLIMITED LIABILITY AND THE PARTNERSHIP

A major problem with partnerships, as with sole proprietorships, is unlimited liability: in this case, each partner is personally liable not only for his or her own actions but also for the actions of all the partners. If your partner in an architectural firm makes a mistake that causes a structure to collapse, the loss your business incurs impacts you just as much as it would him or her. And here's the really bad news: if the business doesn't have the cash or other assets to cover losses, you can be personally sued for the amount owed. In other words, the party who suffered a loss because of the error can sue you for your personal assets. Many people are understandably reluctant to enter into partnerships because of unlimited liability. Certain forms of businesses allow owners to limit their liability. These include limited partnerships and corporations.

## LIMITED PARTNERSHIPS

The law permits business owners to form a limited partnership which has two types of partners: a single general partner who runs the business and is responsible for its liabilities, and any number of limited partners who have limited involvement in the business and whose losses are limited to the amount of their investment.

## ADVANTAGES AND DISADVANTAGES OF PARTNERSHIPS

The partnership has several advantages over the sole proprietorship. First, it brings together a diverse group of talented individuals who share responsibility for running the 120 Download this book for free at: Chapter 5 http://hdl.handle.net/10919/70961 business. Second, it makes financing easier: the business can draw on the financial resources of a number of individuals. The partners not only contribute funds to the business but can also use personal resources to secure bank loans. Finally, continuity needn't be an issue because partners can agree legally to allow the partnership to survive if one or more partners die. Still, there are some negatives. First, as discussed earlier, partners are subject to unlimited liability. Second, being a partner means that you have to share decision making, and many people aren't comfortable with that situation. Not surprisingly, partners often have differences of opinion on how to run a business, and disagreements can escalate to the point of jeopardizing the continuance of the business. Third, in addition to sharing ideas, partners also share profits. This arrangement can work as long as all partners feel that they're being rewarded according to their efforts and accomplishments, but that isn't always the case. While the partnership form of ownership is viewed negatively by some, it was particularly appealing to Ben Cohen and Jerry Greenfield. Starting their ice cream business as a partnership was inexpensive and let them combine their limited financial resources and use their diverse skills and talents. As friends they trusted each other and welcomed shared decision making and profit sharing. They were also not reluctant to be held personally liable for each other's actions.

## CORPORATION

A corporation (sometimes called a regular or C-corporation) differs from a sole proprietorship and a partnership because it's a legal entity that is entirely separate from the parties who own it. It can enter into binding contracts, buy and sell property, sue and be sued, be held responsible for its actions, and be taxed. Once businesses reach any substantial size, it is advantageous to organize as a corporation so that its owners can limit their liability. Corporations, then, tend to be far larger, on average, than businesses using other forms of ownership. As Figure 5.2 shows, corporations account for 18 percent of all U.S. businesses but generate almost 82 percent of the revenues.3 Largest well-known businesses are corporations, but so are many of the smaller firms with which likely you do business.

## OWNERSHIP AND STOCK

Corporations are owned by shareholders who invest money in the business by buying shares of stock. The portion of the corporation they own depends on the percentage of stock they hold. For example, if a corporation has issued 100 shares of stock, and you own 30 shares, you own 30 percent of the company. The shareholders elect a board of directors, a group of people (primarily from outside the corporation) who are legally responsible for governing the corporation. The board oversees the major policies and decisions made by the corporation, sets goals and holds management accountable for achieving them, and hires and evaluates the top executive, generally called the CEO (chief executive officer). The board also approves the distribution of income to shareholders in the form of cash payments called dividends.

## BENEFITS OF INCORPORATION

The corporate form of organization offers several advantages, including limited liability for shareholders, greater access to financial resources, specialized management, and continuity.

## LIMITED LIABILITY

The most important benefit of incorporation is the limited liability to which shareholders are exposed: they are not responsible for the obligations of the corporation, and they can lose no more than the amount that they have personally invested in the company. Limited liability Figure 5.2: Types of U.S. Businesses 122 Download this book for free at: Chapter 5 http://hdl.handle.net/10919/70961 would have been a big plus for the unfortunate individual whose business partner burned down their dry cleaning establishment. Had they been incorporated, the corporation would have been liable for the debts incurred by the fire. If the corporation didn't have enough money to pay the debt, the individual shareholders would not have been obligated to pay anything. They would have lost all the money that they'd invested in the business, but no more.

**FINANCIAL RESOURCES**

Incorporation also makes it possible for businesses to raise funds by selling stock. This is a big advantage as a company grows and needs more funds to operate and compete. Depending on its size and financial strength, the corporation also has an advantage over other forms of business in getting bank loans. An established corporation can borrow its own funds, but when a small business needs a loan, the bank usually requires that it be guaranteed by its owners.

**SPECIALIZED MANAGEMENT**

Because of their size and ability to pay high sales commissions and benefits, corporations are generally able to attract more skilled and talented employees than are proprietorships and partnerships.

**CONTINUITY AND TRANSFERABILITY**

Another advantage of incorporation is continuity. Because the corporation has a legal life separate from the lives of its owners, it can (at least in theory) exist forever. Transferring ownership of a corporation is easy: shareholders simply sell their stock to others. Some founders, however, want to restrict the transferability of their stock and so choose to operate as a privately-held corporation. The stock in these corporations is held by only a few individuals, who are not allowed to sell it to the general public. Companies with no such restrictions on stock sales are called public corporations; stock is available for sale to the general public.

## DRAWBACKS TO INCORPORATION

Like sole proprietorships and partnerships, corporations have both positive and negative aspects. In sole proprietorships and partnerships, for instance, the individuals who own and Chapter 5 Download this book for free at: 123 http://hdl.handle.net/10919/70961 manage a business are the same people. Corporate managers, however, don't necessarily own stock, and shareholders don't necessarily work for the company. This situation can be troublesome if the goals of the two groups differ significantly.

Managers, for example, are often more interested in career advancement than the overall profitability of the company. Stockholders might care more about profits without regard for the well-being of employees. This situation is known as the agency problem, a conflict of interest inherent in a relationship in which one party is supposed to act in the best interest of the other. It is often quite difficult to prevent self-interest from entering into these situations. Another drawback to incorporation—one that often discourages small businesses from incorporating—is the fact that corporations are costlier to set up. When you combine filing and licensing fees with accounting and attorney fees, incorporating a business could set you back by $1,000 to $6,000 or more depending on the size and scope of your business.4 Additionally, corporations are subject to levels of regulation and governmental oversight that can place a burden on small businesses. Finally, corporations are subject to what's generally called "double taxation." Corporations are taxed by the federal and state governments on their earnings. When these earnings are distributed as dividends, the shareholders pay taxes on these dividends. Corporate profits are thus taxed twice—the corporation pays the taxes the first time and the shareholders pay the taxes the second time. Five years after starting their ice cream business, Ben Cohen and Jerry Greenfield evaluated the pros and cons of the corporate form of ownership, and the "pros" won. The primary motivator was the need to raise funds to build a $2 million manufacturing facility. Not only did Ben and Jerry decide to switch from a partnership to a corporation, but they also decided to sell shares of stock to the public (and thus become a public corporation). Their sale of stock to the public was a bit unusual: Ben and Jerry wanted the community to own the company, so instead of offering the stock to anyone interested in buying a share, they offered stock to residents of Vermont only. Ben believed that “business has a responsibility to give back to the community from which it draws its support.”5 He wanted the company to be owned by those who lined up in the gas station to buy cones. The stock was so popular that one in every hundred Vermont families bought stock in the company.6 Eventually, as the company continued to expand, the stock was sold on a national level.

**OTHER TYPES OF BUSINESS OWNERSHIP**

In addition to the three commonly adopted forms of business organization sole proprietorship, partnership, and regular corporations some business owners select other forms of organization to meet their particular needs. We’ll look at several of these options:

Limited-liability companies

Cooperatives

Not-for-profit corporations

**LIMITED-LIABILITY COMPANIES**

How would you like a legal form of organization that provides the attractive features of the three common forms of organization (corporation, sole proprietorship and partnership) and avoids the unattractive features of these three organization forms? The limited-liability company (LLC) accomplishes exactly that. This form provides business owners with limited liability (a key advantage of corporations) and no “double taxation” (a key advantage of sole proprietorships and partnerships). Let’s look at the LLC in more detail. In 1977, Wyoming became the first state to allow businesses to operate as limited liability companies. Twenty years later, in 1997, Hawaii became the last state to give its approval to the new organization form. Since then, the limited-liability company has increased in popularity. Its rapid growth was fueled in part by changes in state statutes that permit a limited-liability company to have just one member. The trend to LLCs can be witnessed by reading company names on the side of trucks or on storefronts in your city. It is common to see names such as

Jim Evans Tree Care, LLC, and For-Cats-Only Veterinary Clinic, LLC. But LLCs are not limited to small businesses. Companies such as Crayola, Domino's Pizza, Ritz-Carlton Hotel Company, and iSold It (which helps people sell their unwanted belongings on eBay) are operating under the limited-liability form of organization. In a limited-liability company, owners (called members rather than shareholders) are not personally liable for debts of the company, and its earnings are taxed only once, at the personal level (thereby eliminating double taxation).

We have touted the benefits of limited liability protection for an LLC. We now need to point out some circumstances under which an LLC member (or a shareholder in a corporation) might be held personally liable for the debts of his or her company. A business owner can be held personally liable if he or she:

Personally guarantees a business debt or bank loan which the company fails to pay.

Fails to pay employment taxes to the government.

Engages in fraudulent or illegal behavior that harms the company or someone else.

Does not treat the company as a separate legal entity, for example, uses company assets for personal uses.

## COOPERATIVES

A cooperative (also known as a co-op) is a business owned and controlled by those who use its services. Individuals and firms who belong to the cooperative join together to market products, purchase supplies, and provide services for its members. If run correctly, cooperatives increase profits for its producer-members and lower costs for its consumer members. Cooperatives are fairly common in the agricultural community. For example, some 750 cranberry and grapefruit member growers market their cranberry sauce, fruit juices, and dried cranberries through the Ocean Spray Cooperative.7 More than three hundred thousand farmers obtain products they need for production—feed, seed, fertilizer, farm supplies, fuel—through the Southern States Cooperative.8 Co-ops also exist outside agriculture. For example, REI (Recreational Equipment Incorporated), which sells quality outdoor gear, is the largest consumer cooperative in the United

States, with more than three million active members. The company shares its financial success each year with its members, who get a refund each year based on their eligible purchases.

## 6.1. NOT-FOR-PROFIT CORPORATIONS

A not-for-profit corporation (sometimes called a nonprofit) is an organization formed to serve some public purpose rather than for financial gain. As long as the organization's activity is for charitable, religious, educational, scientific, or literary purposes, it can be exempt Figure 5.3: The Ocean Spray™ logo 126 Download this book for free at: Chapter 5 http://hdl.handle.net/10919/70961 from paying income taxes. Additionally, individuals and other organizations that contribute to the not-for-profit corporation can take a tax deduction for those contributions. The types of groups that normally apply for nonprofit status vary widely and include churches, synagogues, mosques, and other places of worship; museums; universities; and conservation groups. There are more than 1.5 million not-for-profit organizations in the United States.10 Some are extremely well funded, such as the Bill and Melinda Gates Foundation, which has an endowment of approximately $40 billion and has given away $36.7 billion since its inception.11 Others are nationally recognized, such as United Way, Goodwill Industries, Habitat for Humanity, and the Red Cross. Yet the vast majority is neither rich nor famous, but nevertheless makes significant contributions to society.

## 6.2. MERGERS AND ACQUISITIONS

The headline read, "Wanted: More than 2,000 in Google Hiring Spree."12 The largest Web search engine in the world was disclosing its plans to grow internally and increase its workforce by more than 2,000 people, with half of the hires coming from the United States and the other half coming from other countries. The added employees will help the company expand into new markets and battle for global talent in the competitive Internet information provider's industry. When properly executed, internal growth benefits the firm. An alternative approach to growth is to merge with or acquire another company. The rationale behind growth through merger or acquisition is that 1 + 1 = 3: the combined company is more valuable than the sum of the two separate companies. This rationale is attractive to companies facing competitive pressures. To grab a bigger share of the market and improve profitability, companies will want to become more cost efficient by combining with other companies.

Though they are often used as if they're synonymous, the terms merger and acquisition mean slightly different things. A merger occurs when two companies combine to form a new Chapter 5 Download this book for free at: 127 http://hdl.handle.net/10919/70961 company. An acquisition is the purchase of one company by another. An example of a merger is the merging in 2013 of US Airways and American Airlines. The combined company, the largest carrier in the world, flies under the name American Airlines. Another example of an acquisition is the purchase of Reebok by Adidas for $3.8 billion.13 The deal was expected to give Adidas a stronger presence in North America and help the company compete with rival Nike. Once this acquisition was completed, Reebok as a company ceased to exist, though Adidas still sells shoes under the Reebok brand.

## MOTIVES BEHIND MERGERS AND ACQUISITIONS

Companies are motivated to merge or acquire other companies for a number of reasons, including the following.

Gain Complementary Products Acquiring complementary products was the motivation behind Adidas's acquisition of Reebok. As Adidas CEO Herbert Hainer stated in a conference call, "This is a once-in a life time opportunity. This is a perfect fit for both companies, because the companies are so complementary…. Adidas is grounded in sports performance with such products as a motorized running shoe and endorsement deals with such superstars as British soccer player David Beckham. Meanwhile, Reebok plays heavily to the melding of sports and entertainment with endorsement deals and products by Nelly, Jay-Z, and 50 Cent. The combination could be deadly to Nike." Of course, Nike has continued to thrive, but one can't blame Hainer for his optimism.

## ATTAIN NEW MARKETS OR DISTRIBUTION CHANNELS

Gaining new markets was a significant factor in the 2005 merger of US Airways and America West. US Airways was a major player on the East Coast, the Caribbean, and Europe, while America West was strong in the West. The expectations were that combining the two carriers would create an airline that could reach more markets than either carrier could do on its own.

## REALIZE SYNERGIES

The purchase of Pharmacia Corporation (a Swedish pharmaceutical company) by Pfizer 128 Download this book for free at: Chapter 5 http://hdl.handle.net/10919/70961 (a research-based pharmaceutical company based in the United States) in 2003 created one of the world's largest drug makers and pharmaceutical companies, by revenue, in every major market around the globe.16 The acquisition created an industry giant with more than $48 billion in revenue and a research-and-development budget of more than $7 billion. Each day, almost forty million people around the globe are treated with Pfizer medicines.17 Its subsequent $68 billion purchase of rival drug maker Wyeth further increased its presence in the pharmaceutical market.18 In pursuing these acquisitions, Pfizer likely identified many synergies: quite simply, a whole that is greater than the sum of its parts. There are many examples of synergies. A merger typically results in a number of redundant positions; the combined company does not likely need two vice-presidents of marketing, two chief financial officers, and so on. Eliminating the redundant positions leads to significant cost savings that would not be realized if the two companies did not merge. Let's say each of the companies was operating factories at 50% of capacity, and by merging, one factory could be closed and sold. That would also be an example of a synergy. Companies bring different strengths and weaknesses into the merged entity. If the newly-combined company can take advantage of the marketing capabilities of the stronger entity and the distribution capabilities of the other (assuming they are stronger), the new company can realize synergies in both of these functions.

## HOSTILE TAKEOVER

What happens, though, if one company wants to acquire another company, but that company doesn't want to be acquired? The outcome could be a hostile takeover—an act of assuming control that's resisted by the targeted company's management and its board of directors. Ben Cohen and Jerry Greenfield found themselves in one of these situations: Unilever—a very large Dutch/British company that owns three ice cream brands—wanted to buy Ben & Jerry's, against the founders' wishes. Most of the Ben & Jerry's stockholders sided with Unilever. They had little confidence in the ability of Ben Cohen and Jerry Greenfield to continue managing the company and were frustrated with the firm's social-mission focus. The stockholders liked Unilever's offer to buy their Ben & Jerry's stock at almost twice its current market price and wanted to take their profits. In the end, Unilever won; Ben & Jerry's was acquired by Unilever in a hostile takeover.19 Despite fears that the company's social mission Chapter 5 Download this book for free at: 129 http://hdl.handle.net/10919/70961 would end, it didn't happen. Though neither Ben Cohen nor Jerry Greenfield are involved in the current management of the company, they have returned to their social activism roots and are heavily involved in numerous social initiatives sponsored by the company.

KEY TAKE-AWAYS:

- A sole proprietorship, a business owned by only one person, accounts for 72% of all U.S. businesses. Advantages include: complete control for the owner, easy and inexpensive to form, and owner gets to keep all of the profits.

Disadvantages include: unlimited liability for the owner, complete responsibility for talent and financing, and business dissolves if the owner dies.

- A general partnership is a business owned jointly by two or more people, and accounts for about 10% of all U.S. businesses. Advantages include: more resources and talents come with an increase in partners, and the business can continue even after the death of a partner. Disadvantages include: partnership disputes, unlimited liability, and shared profits.
- A limited partnership has a single general partner who runs the business and is responsible for its liabilities, plus any number of limited

partners who have limited involvement in the business and whose losses are limited to the amount of their investment.

- A corporation is a legal entity that's separate from the parties who own it, the shareholders who invest by buying shares of stock. Corporations are governed by a Board of Directors, elected by the shareholders. Advantages include: limited liability, easier access to financing, and unlimited life for the corporation. Disadvantages include: the agency problem, double taxation, and incorporation expenses and regulations.

A limited-liability company (LLC) is similar to an S-corporation, but it has fewer rules and restrictions than an S-corporation. For example, an LLC can have any number of members. A cooperative is a business owned and controlled by those who use its services. Individuals and firms who belong to the cooperative join together to market products, purchase supplies, and provide services for its members. A not-for-profit corporation is an organization formed to serve some public purpose rather than for financial gain. It enjoys favorable tax treatment. A merger occurs when two companies combine to form a new company. An acquisition is the purchase of one company by another with no new company being formed. A hostile takeover occurs when a company is purchased even though the company's management and Board of Directors do not want to be acquired.

# CHAPTER 7.
# ENTREPRENEURSHIP STARTING A BUSINESS

Starting a business entails understanding and dealing with many issues - legal, financing, sales and marketing, intellectual property protection, liability protection, human resources and more. But interest in entrepreneurship is at an all – time high. And there have been spectacular success stories of early stage startups growing to be multi-billion-dollar companies, such as Uber, Facebook, WhatsApp, Airbnb, and many others.

## 7.1. UNDERSTAND THE COMMITMENT AND CHALLENGES INVOLVED IN STARTING A BUSINESS

Understand the Commitment and Challenges Involved in Starting a Business is a huge commitment. Entrepreneurs often fail to appreciate the significant amount of time, resources, and energy needed to start and grow a business. Here are some of the biggest challenges to starting and growing a business:

- Coming up with a great and unique product or service;
- Having a strong plan and vision for the business;
- Having sufficient capital and cash flow;
- Funding great employees;
- Firing bad employees quickly in a way that doesn`t result in legal liability;
- Working more than you expected;
- Not getting discouraged by rejections from customers;
- Managing your time efficiently;
- Maintaining a reasonable work/life balance;
- Knowing when to pivot your strategy;
- Maintaining the stamina to keep going even when it`s tough.

## 7.2. PROTECT YOUR PERSONAL ASSETS BY FORMING THE BUSINESS AS A CORPORATION OR LLC

Never start a business as a "sole proprietorship" which can result in your personal assets being at risk for the debts and liabilities of the business. You will almost always want to start the business as an S corporation (giving you favorable flow through tax treatment), a C corporation (which is what most venture capital investors expect to see), or a limited company (LLC). None of these are particularly expensive or difficult to set up. My personal preference is to start the business as an S corporation, which can then easily be converted to a C corporation as you bring in investors and issue multiple classes of stock. Many business owners, however, are under the mistaken impression that they are completely protected from personal liability by filing a Certificate of Incorporation for a corporation. This is not true. The mere process of incorporating does not completely protect the business owners. To lessen the likelihood of such personal or shareholder liability, you should make sure to adhere to certain procedures:

- **Always use the corporate name.** The name of the corporation should be used in full, including "Inc" or "Corp" on all contracts, invoices, or documents used by the corporation. This clearly indicates the existence of the corporation as a separate entity.
- **Always use proper signature.** This means that you will sign on behalf of the corporation, using the name of the corporation and your title. You should typically use the following format when signing contracts on behalf of the corporation.

CORPORATE NAME

By: ______________________________________

Your name – authorized signing officer and corporate title

Your name – authorized signing officer and corporate title

directors, recording the meeting minutes and following other corporate formalities.

- **Follow all corporate formalities.** This includes following by laws, issuing stock properly, holding meetings of the Board of

Directors, recording the meeting minutes, and following other corporate formalities.

- **Make sure to keep funds separate.** Corporate funds and the funds of individual shareholders should not be in the same accounts or combined for any reason.
- **Make sure to keep taxation separate.** The company taxes should be paid entirely from corporate accounts and separate tax returns filed for the corporation.
- **All transactions made by the corporation should be clearly separate from any individual transactions.** Essentially, by never blurring the line between individual shareholders, owners or the Board of Directors, and the company which stand as s separate entity), you run less risk of any personal liabilities for the debts of the business.

## 7.3. COME UP WITH A GREAT NAME FOR YOUR BUSINESS

Selecting the right name for your startup can have a significant impact on your business success. The wrong name could result in insurmountable legal and business success. The wrong name could result in insurmountable legal and business hurdles. Here are some basic tips on how to name your startup:

- Avoid hard – to –spell names.
- Don`t pick a name that could be limiting as your business grows.
- Conduct a thorough Internet search on a proposed name.
- Get a ".com" domain name (as opposed to ".net" or another variant).
- Conduct a thorough trademark search.
- Make sure you and your employees will be happy saying the name.
- Come up with five names you like and test market the name with prospective employees, partners, investors and potential customers.

Build a Great Website for Your Company – You should devote time and effort to building a great website for your business. Prospective investors, customers and partners are going to check out your site, and you want to impress them with a professional product. Here are some tips for building a great company website:

- Check out competitor sites.
- Start by sketching out a template for your site.
- Come up with five or six sites you can share with your web site developer to convey what you like.
- Be sure the site is search engine optimized and thus more likely to show up early on Google search results.
- Produce high – quality original content.
- Make sure your site is optimized for mobile devices.
- Make sure the site loads quickly.
- Keep it clean and simple, visual clutter will drive visitors away.
- Make sure you have a Terms of Use Agreement and Privacy Policy and comply with the European GDPR rules[17].
- Make the navigation bars prominent.
- Obtain and use a memorable ".com" domain name.
- Make the site visually interesting.
- Make sure it is easy for site visitors to contact you or buy your product.

## PERFECT YOUR ELEVATOR PITCH

An "elevator" pitch is intended to be a concise, compelling introduction to your business. You should be able to slightly modify

[17] The General Data Protection Regulation is a comprehensive EU data protection law, effective from the 25th May 2018. Replacing the 1995 Data Protection Directive it brings in new rights for individuals and new responsibilities for organizations processing personal data. It also provides data protection authorities with stronger powers, including large fines and the ability to stop organizations from processing personal data. The law applies to all processing of personal data within the EU, and can apply to organizations processing personal data outside of the EU, if that data is about EU data subjects.

your elevator pitch depending on whether you are pitching to prospective investors, customers, employees or partners. Here are a few tips for developing and delivering a great elevator pitch:

- Start out strong.
- Be positive and enthusiastic in your delivery.
- Remember that practice makes perfect.
- Keep it to 60 seconds in length.
- Avoid using industry jargon.
- Convey why your business is unique.
- Pitch the problem you are solving.
- Invite participation or interruption by the listener – this shows they are interested and engaged.

**MAKE THE DEAL CLEAR WITH CO –FOUNDERS**

If you start your company with co – founders, you should agree early on about the details of your business relationship. Not doing so can potentially cause significant legal problems down the read a good example of this is the infamous Zuckerberg/Winklevoss Facebook litigation. In a way, think of the founder agreement as a form of "pre-nuptial agreement". Here are the key deal terms your written founder agreement needs to address:

- How is the equity split among the founders?
- Is the percentage of ownership subject to visiting based on continued participation in the business?
- What are the and responsibilities of the founders?
- If one founder leaves, does the company or the other founder have the right to buy back that founder`s shares? At what price?
- How much time commitment to the business is expected of each founder?
- What salaries if any are the founders entitled to? How can that be changed?
- How are key decisions and day-to-day decisions of the business to be made?
- Under what circumstances can a founder be removed as an employee of the business?
- What assets or cash does each founder contribute or invest into the business?

- How will a sale of the business be decided?
- What happens if one founder is not living up to expectations under the founder agreement? How will it be resolved?
- What is the overall goal and vision for the business?
- If one founder wants to leave the business, does the company have the right to buy back his or her shares? A what price?

## OBTAIN A TAX ID

In most instances, you will need to get a tax ID from the IRS for your company.

This is also known as an “Employer Identification Number” (EIN), and it is similar to a Social Security number, but for businesses. Banks will ask for your EIN when you open a company bank account.

## SET UP A GOOD ACCOUNTING AND BOOKKEEPING SYSTEM

You will need to set up a bookkeeping / accounting system to keep track of your finances-income, expenses, capital expenditures, EBITDA, profit and loss, etc. This is important in order to understand your business`s cash flow situation and also tax-filling purposes.

## PERFORM A COMPREHENSIVE REFERENCE CHECK BEFORE YOU HIRE AN EMPLOYEE

Many employers conduct a limited and incomplete reference check when interviewing job candidates, which can result in hiring people who are unable to perform their required duties or who do not work well with others. A comprehensive reference check includes:

- Verification of job titles and dates of employment
- Verification of starting and ending salary
- Verification of prior job role and responsibilities
- Inquiry as to why the applicant left the prior employer
- Conversations with prior supervisors as to the applicant`s strengths and weaknesses

- Inquiry as to the applicant`s ability to get along well with other employees and customers
- Inquiry as to the applicant`s ability to take on the new role
- Inquiry as to punctuality or absenteeism issues
- Reference checks with other people not listed by the applicant as s reference.

The purpose of these checks is to make sure that the applicant will fit into the company`s culture and to ensure that they have been truthful and accurate in their resume and employment application. However, the process is carefully regulated by the federal government. It is also useful to require all prospective employees to complete an employment application.

**MAKE SURE ALL EMPLOYEES SIGN A CONFIDENTLY AND INVENTION ASSIGNMENT AGREEMENT**

Companies pay employees to come up with ideas, work product, and inventions thay may be useful to the business. Employees have access to a good deal of their company`s confidential information, which can be very valuable, especially in technology companies. One basic way to protect property company information is through the use of a Confidentiality and Invention Assignment Agreement. This type of agreement deals with confidentiality issues, but can also ensure that the ideas, work product, and inventions the employee creates that are related to company business belong to the company – not the employee.

A good Employee Confidentiality and invention Assignment Agreement will cover the following key points:

- The employee may not use or disclose any of the company`s confidential information for their own benefit or use, or for the benefit of others, without authorization.
- The employee must promptly disclose to the company any inventions, ideas, discoveries, and work product related to the company`s business that they make during the period of employment.

- The company is the owner of such inventions, ideas, discoveries, and work product, which the employee must assign to the company.
- The employee’s employment with the company does not and will not breach any agreement or duty that the employee has with anyone else, nor may the employee disclose to the company or use on its behalf any confidential information belonging to others.
- Upon termination of employment, the employee must return any and all confidential information and company property.
- While employed, the employee will not complete with the company or perform any services for any competitor of the company.
- The employee`s confidentiality and invention assignment obligations under the agreement will continue after termination of employment.
- The agreement does not by itself represent any guarantee of continued employment.

Venture capitalists and other investors in startups expect to see that all employees of the company have signed these kinds of agreements.

As an example a sample form of Employee Confidentiality and Invention Assignment Agreement can be found at the Forms and Agreements section of AllBusiness.com

## CONSIDER THE STEPS YOU SHOULD TAKE TO PROTECT YOUR INTELLECTUAL PROPERTY

It is important to protect your company`s intellectual property (IP). Ever wary of minimizing burn rate, startups may be tempted to defer investment in intellectual property protection. To those who have not tried to protect intellectual property, it feels complex and expensive. Too often, startups end up forfeiting intellectual property rights by neglecting to protect their ideas and inventions.

Some simple and cost-effective techniques can minimize the anxiety, yet help protect core assets. Companies sometimes think that patient protection is the only way to protect themselves. Technology startups frequently ignore the value of non-patent intellectual property.

While patents can be incredibly valuable, it does not necessarily ensure that a company`s product is a good product or that it will sell well. Trade secrets, cybersecurity policies, trade makers, and copyrights can all be forms of IP that can be protected.

Here is a summary of the types of intellectual property protections available:

- **Patents**. Patents are the best protection you can get for a new product. A patient gives its inventor the right to prevent others from making, using, or selling the patented subject matter described in the patent`s claims. The key issues in determining whether you can get a patent are:

1) Only the concrete embodiment of an idea, formula, or product is patentable;
2) The invention must be new or novel;
3) The invention must not have been patented or described in a printed publication previously;
4) The invention must have some useful purpose. In the United States you obtain a patent from the U.S. Patent and Trademark Office, but this process can take several years and be complicated.

- **Copyrights.** Copyrights cover original works of authorship, such as art, advertising copy, books, articles, music, movies, software, etc. A copyright gives the owner the exclusive right to make copies of the work and to prepare derivative works such as sequels or revisions based on the work.
- **Trademarks.** A trademark right protects the symbolic value of a word, name, symbol, or device that the trademark owner uses to identify or distinguish its goods from those of others. Some well-known trademarks include the Coca-Cola trademark, American Express trademark, and IBM trademark. You obtain rights to a trademark by actually using the mark in commerce.
- **Service Marks.** Service marks resemble trademarks and are used to identify services.
- **Trade Secrets.** Trade secrets can be a great asset for startups. They are cost effective and last for us long as the trade secret maintains its confidential status and derives value through its secrecy. A trade secret right allows the owner of the right to take action against

anyone who breaches an agreement or confidential relationship, or uses other improper means to obtain secret information. Trade secrets can range from computer programs to customer lists to the formula for Coca-Cola.

- **Confidentially Agreements.** These are also referred to as Non-Disclosure Agreements [18]or NDAs. The purpose of the agreement is to allow the holder of confidential information such as a product of business idea to share it with a third party. But then the third party is obligated to keep the information confidential and not use it whatsoever, unless allowed by the owner of the information. There are usually standard exceptions to the confidentially obligations such as if the information is already in the public domain.
- **Confidentially Agreement for Employees and Consultants.** Every employee and consultant should be required to sign such an agreement, as discussed above.
- **Terms of Service and Privacy Policy.** If you are a company that conducts its business on the internet, it is important to have a terms of service agreements that limits what users can or cannot do on your website and with the information on your site. Closely related is your Privacy Policy, which sets forth what

[18] A **non-disclosure agreement** (also referred to as an NDA or confidentiality agreement) is a contract between two parties promising to keep certain information confidential. Confidential information is often sensitive, technical, commercial, or valuable in nature (e.g., trade secrets, proprietary information). Both parties sign the non-disclosure agreement, creating a binding contract to keep the confidential information secret. Be sure you understand how to write an NDA before drafting your own.

# CHAPTER 8.
# MANAGEMENT AND LEADERSHIP

Most businesses are managed by manager's great businesses are led by leaders. A manager may be a leader, a manager may not be a leader, but a leader may emerge who is not a manager. Therefore, it is possible for the roles of managers and leader not be connected at all. However, for an organization business or non-business to be effective, managers must learn how to become leaders by developing effective leadership skills.

Individuals employed as managers in a firm which does not recognize the need for leaders must develop their own strategy towards their leadership skills if they wish to become more effective and influential within the firm and its environment. A combination of personal vision, values, inspiration and an understanding of effective leadership tools and techniques will result in leadership skills being developed.

People often mistake leadership and management as the same thing but in essence, they are very different. The main difference between the two is that leaders have people that follow them, while managers have people who simply work for them. Particularly in small businesses, for a small business owner to be successful they need to be both a strong leader and manager to get their team on board with working towards their vision of success. Leadership is about getting people to comprehend and believe in the vision you set for the company and to work with you on achieving your goals, while management is more about administering and making sure the day-to-day activities are happening as they should. Leadership and management must go hand in hand. They are not the same thing, but they are necessarily linked and complementary to one another. Any effort to separate the two within an organization is likely to cause more problems than it solves. For any company to be successful, it needs management that can plan, organize and coordinate its staff, while also inspiring and motivating them to perform to the best of their ability.

## LEADERSHIP IS ABOUT INSPIRING AND MANAGEMENT IS ABOUT PLANNING

Leaders have a tendency to praise success and drive people, whereas managers work to find faults. They paint a picture of what they see as possible for the company and work to inspire and engage their people in turning that vision into reality. Rather than seeing individuals as just a particular set of skills, they think beyond what they do and activate them to be part of something much bigger. They're well aware of how high-functioning teams can accomplish a lot more when working together than individuals working autonomously are ever able to achieve.

For both sides to understand what they have to do, and to achieve excellence in doing it, they need to comprehend the essence of the difference between them. This is a matter of definition – understanding how the roles are different and how they might overlap. Managers, on the other hand, will focus on setting, measuring and achieving goals by controlling situations to reach or exceed their objectives.

| **Management** | **Leadership** |
|---|---|
| Managers give directions | Leaders ask questions |
| Managers have subordinates | Leaders have followers |
| Managers use an authoritarian style | Leaders have a motivational style |
| Managers tell people what to do | Leaders show people what to do |
| Managers have good ideas | Leaders implement good ideas |
| Managers react to change | Leaders create change |
| Managers try to be heroes | Leaders make heroes of everyone around them |
| Managers exercise power over people | Leaders develop power with people |

You must think of one without the other to truly see the differences that exist between them. Management without leadership controls resources to maintain.

There are many different types of leadership and management styles where different situations, groups, or cultures, may require the use of different styles in order to set a direction or ensure that it is followed. One way to decipher which of the two you may be is to count the number of people outside your reporting hierarchy who come to you for advice. The more that do, the more likely it is that you are perceived to be a leader.

John Kotter, Professor of Leadership at Harvard University fears that too often, employers use the terms synonymously. If an organization is run effectively, leadership and management will exist in tandem.

Mentoring and formal training can help employees utilize and use their leadership skills. According to research by the Chartered Management Institute, 90% of members who have completed a management and leadership qualification found the experience improved their performance at work. There was also a “ripple effect”, with 81% of those surveyed passing on their knowledge to colleagues.

Celebrating individual leaders can also cause some to forget that it is never just one person running the show. Not everyone who is in charge of a team is both a leader and a manager, in order to have a successful organization, there needs to be a mixture of both. Many people are both, having managed people but realized that you cannot buy people to follow you down a difficult path, and so act as leaders too. The challenge lies in making sure you are both leading your team as well as managing your day to day operation. Those who are able to do both, will create a competitive advantage.

Mindset can also have a powerful effect on the success of a leader, Understanding Emotional Contagion[19] can be a tool to success.

## 8.1. THE MAJOR LEADERSHIP THEORIES

What is it that makes some people excel in leadership roles? Leadership theories seek to explain how and why certain people become leaders. Such theories often focus on the characteristics of leaders, but some attempt to identify the behaviors that people can adopt to improve their own leadership abilities in different situations.

Early debates on the psychology of leadership often suggested that such skills were simply abilities that people were born with. In other words, these theories proposed that certain people were simply "born leaders." Some more recent theories propose that possessing certain traits may help make people nature leaders, but that experience and situational variables also play a critical role.

**WHAT IS LEADERSHIP -** Leadership is a process by which an executive can direct, guide and influence the behavior and work of others towards accomplishment of specific goals in a given situation. Leadership is the ability of a manager to induce the subordinates to work with confidence and zeal. Leadership is the potential to influence behaviour of others. It is also defined as the capacity to influence a group towards the realization of a goal. Leaders are required to develop future visions, and to motivate the organizational members to want to achieve the visions. According to Keith Davis, “Leadership is the ability to persuade others to seek defined objectives

[19] Emotional Contagion is the ability to influence the emotions and behaviors of others, either directly or indirectly. The etymology of “Contagion” in emotional contagion comes from the conscious and unconscious acts of sharing our emotions with others via verbal or physical expression.

enthusiastically. It is the human factor which binds a group together and motivates it towards goals.”

## CHARACTERISTICS OF LEADERSHIP

1. It is an inter-personal process in which a manager is into influencing and guiding workers towards attainment of goals.
2. It denotes a few qualities to be present in a person which includes intelligence, maturity and personality.
3. It is a group process. It involves two or more people interacting with each other.
4. A leader is involved in shaping and muddling the behavior of the group towards accomplishment of organizational goals.
5. Leadership is situation bound. There is no best style of leadership. It all depends upon tackling with the situations.

## ROLE OF A LEADER

Following are the main roles of a leader in an organization:

1. **Required at all levels-** Leadership is a function which is important at all levels of management. In the top level, it is important for getting co-operation in formulation of plans and policies. In the middle and lower level, it is required for interpretation and execution of plans and programs framed by the top management. Leadership can be exercised through guidance and counseling of the subordinates at the time of execution of plans.
2. **Representative of the organization-** A leader, i.e., a manager is said to be the representative of the enterprise. He has to represent the concern at seminars, conferences, general meetings, etc. His role is to communicate the rationale of the enterprise to outside public. He is also representative of the own department which he leads.
3. **Integrates and reconciles the personal goals with organizational goals-** A leader through leadership traits helps in reconciling/ integrating the personal goals of the employees with the organizational goals. He is trying to co-ordinate the efforts of people towards a common purpose and thereby achieves objectives. This can be done only if he can influence and get willing co-operation and urge to accomplish the objectives.

4. **He solicits support-** A leader is a manager and besides that he is a person who entertains and invites support and co-operation of subordinates. This he can do by his personality, intelligence, maturity and experience which can provide him positive result. In this regard, a leader has to invite suggestions and if possible implement them into plans and programs of enterprise. This way, he can solicit full support of employees which results in willingness to work and thereby effectiveness in running of a concern.

5. **As a friend, philosopher and guide-** A leader must possess the three dimensional traits in him. He can be a friend by sharing the feelings, opinions and desires with the employees. He can be a philosopher by utilizing his intelligence and experience and thereby guiding the employees as and when time requires. He can be a guide by supervising and communicating the employees the plans and policies of top management and secure their co-operation to achieve the goals of a concern. At times he can also play the role of a counselor by counseling and a problem-solving approach. He can listen to the problems of the employees and try to solve them.

A leader has got multidimensional traits in him which makes him appealing and effective in behavior. The following are the requisites to be present in a good leader:

1. **Physical appearance-** A leader must have a pleasing appearance. Physique and health are very important for a good leader.

2. **Vision and foresight-** A leader cannot maintain influence unless he exhibits that he is forward looking. He has to visualize situations and thereby has to frame logical programs.

3. **Intelligence-** A leader should be intelligent enough to examine problems and difficult situations. He should be analytical who weighs pros and cons and then summarizes the situation. Therefore, a positive bent of mind and mature outlook is very important.

4. **Communicative skills-** A leader must be able to communicate the policies and procedures clearly, precisely and effectively. This can be helpful in persuasion and stimulation.

5. **Objective-** A leader has to be having a fair outlook which is free from bias and which does not reflect his willingness towards a particular individual. He should develop his own opinion and should base his judgement on facts and logic.

6. **Knowledge of work-** A leader should be very precisely knowing the nature of work of his subordinates because it is then he can win the trust and confidence of his subordinates.

7. **Sense of responsibility-** Responsibility and accountability towards an individual's work is very important to bring a sense of influence. A leader must have a sense of responsibility towards organizational goals because only then he can get maximum of capabilities exploited in a real sense. For this, he has to motivate himself and arouse and urge to give best of his abilities. Only then he can motivate the subordinates to the best.

8. **Self-confidence and will-power-** Confidence in himself is important to earn the confidence of the subordinates. He should be trustworthy and should handle the situations with full will power.

9. **Humanist-**This trait to be present in a leader is essential because he deals with human beings and is in personal contact with them. He has to handle the personal problems of his subordinates with great care and attention. Therefore, treating the human beings on humanitarian grounds is essential for building a congenial environment.

10. **Empathy-** It is an old adage "Stepping into the shoes of others". This is very important because fair judgement and objectivity comes only then. A leader should understand the problems and complaints of employees and should also have a complete view of the needs and aspirations of the employees. This helps in improving human relations and personal contacts with the employees.

From the above qualities present in a leader, one can understand the scope of leadership and its importance for scope of business. A leader cannot have all traits at one time. But a few of them helps in achieving effective results.

## 8.2. DIFFERENCES BETWEEN LEADERSHIP AND MANAGEMENT

Leadership differs from management in a sense that:

1. While managers lay down the structure and delegates authority and responsibility, leaders provides direction by developing the

organizational vision and communicating it to the employees and inspiring them to achieve it.

2. While management includes focus on planning, organizing, staffing, directing and controlling; leadership is mainly a part of directing function of management. Leaders focus on listening, building relationships, teamwork, inspiring, motivating and persuading the followers.

3. While a leader gets his authority from his followers, a manager gets his authority by virtue of his position in the organization.

4. While managers follow the organization's policies and procedure, the leaders follow their own instinct.

5. Management is more of science as the managers are exact, planned, standard, logical and more of mind. Leadership, on the other hand, is an art. In an organization, if the managers are required, then leaders are a must/essential.

6. While management deals with the technical dimension in an organization or the job content; leadership deals with the people aspect in an organization.

7. While management measures/evaluates people by their name, past records, present performance; leadership sees and evaluates individuals as having potential for things that can't be measured, i.e., it deals with future and the performance of people if their potential is fully extracted.

8. If management is reactive, leadership is proactive.

9. Management is based more on written communication, while leadership is based more on verbal communication.

The organizations which are over managed and under-led do not perform up to the benchmark. Leadership accompanied by management sets a new direction and makes efficient use of resources to achieve it. Both leadership and management are essential for individual as well as organizational success.

## IMPORTANCE OF LEADERSHIP

Leadership is an important function of management which helps to maximize efficiency and to achieve organizational goals. The following points justify the importance of leadership in a concern.

1. **Initiates action-** Leader is a person who starts the work by communicating the policies and plans to the subordinates from where the work actually starts.
2. **Motivation-** A leader proves to be playing an incentive role in the concern's working. He motivates the employees with economic and non-economic rewards and thereby gets the work from the subordinates.
3. **Providing guidance-** A leader has to not only supervise but also play a guiding role for the subordinates. Guidance here means instructing the subordinates the way they have to perform their work effectively and efficiently.
4. **Creating confidence-** Confidence is an important factor which can be achieved through expressing the work efforts to the subordinates, explaining them clearly their role and giving them guidelines to achieve the goals effectively. It is also important to hear the employees with regards to their complaints and problems.
5. **Building morale-** Morale denotes willing co-operation of the employees towards their work and getting them into confidence and winning their trust. A leader can be a morale booster by achieving full co-operation so that they perform with best of their abilities as they work to achieve goals.
6. **Builds work environment-** Management is getting things done from people. An efficient work environment helps in sound and stable growth. Therefore, human relations should be kept into mind by a leader. He should have personal contacts with employees and should listen to their problems and solve them. He should treat employees on humanitarian terms.
7. **Co-ordination-** Co-ordination can be achieved through reconciling personal interests with organizational goals. This synchronization can be achieved through proper and effective co-ordination which should be primary motive of a leader.

## AUTHORITY VS LEADERSHIP

The authority exercised is a kind of legitimate power and people follow figures exercising it, because their positions demand so irrespective of the person holding the position. Leaders in organizations and elsewhere may have formal authorities but they mostly rely on the informal authority that they exercise on people to influence them. Leaders are trusted for their judgment and respected for their expertise, integrity etc and hence followed and not because they hold a certain position. For e.g. M.K. Gandhi for most part did not hold any official position to lead the Indian freedom struggle.

It is also important to understand that a formal authority and power emerging from it, might not always be able to influence people in the desired manner as; in times of crisis and difficulties people view it as coercion. On the other hand, leadership tends to create followers out of free will and choice without forcing them to accept anything thrown their way. Authority rarely provides a scope for feedback, constructive criticism or opinions of the people on whom it is exercised however leaders provide ample platform to their followers to voice their thoughts and feedback.

When dealing with adults, the sole use of authority to direct and discipline them hardly works, leadership provides a better approach of sharing and involving thus building rapports with followers and creating long term relationships. Authority can hardly make people change their attitudes and behaviors with lasting effects and results however a leader inspires followers through self-modeled ways and hence leadership displays greater effectiveness in addressing attitudes and behaviors of people.

Exercising authority sometimes limits the approaches to arrive at solutions for issues and problems while leadership encourages people to look beyond the obvious and think innovatively and sometimes emerge with radical solutions.

Apart from it, the biggest difference between the two as cited by Stephen R Covey is the moral authority held by leaders over the followers which is absent in the case of power from authority. Within the organizational setup when leaders also have moral authority on their subordinates by establishing a synchrony in their words and actions; the rest of the structure and processes of the organization also get aligned to it, thus creating a robust and transparent culture.

Authoritative way of working also encourages individuals to work in silos while in the organizations of today; the leaders need to have a complete picture and coordinate with other functions and departments as and when required. It is indeed difficult for mangers and leaders to move out of their circle of authority and coordinate and interact with external people. However, the need of the hour and the more effective approach to leadership and management is when leaders come out of their comfort zone and move from exercising authority on a small group to leading the entire organization.

Individuals, who do not rely on authority but lead people, are the ones who enjoy the privilege of their ideologies and thoughts practiced by later generations long after they are gone. Even with individuals who held positions of responsibilities, the ones who actually led their people are the ones remembered and followed.

## 8.3. EMOTIONAL INTELLIGENCE FOR LEADERS

An organization is made up of people and when people are involved, emotions automatically come into play, and a workplace is no different. It would be unwise to assume that a workplace is all objective, no-emotion only performance kind of a packed room where hormones have no scope to creep in however the fact is that emotions alone are the biggest motivator or de-motivator of an employee. The emotions alone, govern the performance and efficiency of a worker and had it not been the case, we would have never talked about the importance of work-life balance and for the present context, the need of emotionally intelligent leaders.

The current times are very dynamic not just economically but also socially where the social fabric is rapidly evolving due to globalization and other influences. The average age of the workforce is reducing and the leaders now look forward to managing people belonging to different cultures and backgrounds. In such a situation, it is important for a leader to be highly sensitized to the emotional aspects of his/her transactions with people. Emotional Intelligence is basically the ability to recognize and understand one’s own feelings and emotions as well as those of others and use that information to manage emotions and relationships. The 4 important aspects of EI as proposed by Daniel Goleman are:

- Self Awareness

- Self Management
- Social Awareness
- Relationship Management or Social Skills

A leader tends to have a huge influence on the thoughts and motivation of people. He/she has the capacity to enthuse optimism and confidence in the followers and lead them to constructive endeavors which is called resonance and on the other hand they can negatively influence them to destruct, e.g of such leaders being Hitler and d Osama Bin Laden which is opposite to resonance called dissonance.

Leaders are closely observed in terms of their body language, facial expressions etc. So, it is important for a leader to consider the non-verbal form of expressions as well, which may positively or negatively influence followers. Therefore, if a leader is talking about ethics in business with a slightly unconvinced and bemused look on his face, the followers make a note of it and the message is not received by them. A leader has to act as a role model too, supporting his statements, ideologies and values with appropriate actions.

As a leader one also has to be aware of one's own capabilities and weaknesses, it is difficult to accept guidance from a leader who is not self-aware. As managers, leaders have to empathize as well with the situations, emotions, aspirations and motivations of the subordinates. A decreasing performance of a team member might be because of a number of reasons, a disruptive worker might be facing motivation issues and a subordinate who uses abusive language with others might be lacking confidence in his own abilities. A leader needs to discern facts and try and reach to deeper levels and understand things beyond obvious.

Apart from the above reasons, Emotional Intelligence is also important because the followers or subordinate expect it from their leaders. A subordinate working closely with the manager would expect the manager to understand his situation and priorities. And not surprisingly, whether manger does so or not, affects his level of commitment and performance at work. A leader has to suitably know and understand when he/she needs to be directive and when he needs to delegate. He/she needs to be aware, when the team members are acting as one unit and when there are differences.

It is sometimes awkward to address emotional aspects of transactions between people but leaders need to understand the importance and relevance of it as it has a huge impact on the performance outcomes. While conducting reviews and development dialogues, the feedback has to be delivered in a manner which is acceptable. The leader needs to be sensitive to the insecurities and apprehensions of the subordinates which sometimes might be expressed and sometimes kept undisclosed. At the senior level it is all the more important as the senior executives find it hard to clearly outline their anxieties and differences and the leader has to anticipate some of them.

So, to be able to attract and retain talented subordinates and keep them motivated, a leader needs to brush up on his people skills and emotional intelligence, as all of them are not born with the charisma to hold people. Fortunately, emotional intelligence with practice and carefully directed efforts can be increased.

# CHAPTER 9.
# STRUCTURING ORGANIZATIONS

Organizations need strong leadership for optimum effectiveness. Leadership, as we know, is a trait which is both inbuilt and can be acquired also. Organizational leadership deals with both human psychology as well as expert tactics. Organizational leadership emphasizes on developing leadership skills and abilities that are relevant across the organizations. It means the potential of the individuals to face the hard times in the industry and still grow during those times. It clearly identifies and distinguishes the leaders from the managers. The leader should have potential to control the group of individuals.

An ideal organizational leader should not dominate over others. He should guide the individuals under him, give them a sense of direction to achieve organizational goals successfully and should act responsibly. He should be optimistic for sure. He should be empathetic and should understand the need of the group members. An organizational leader should not only lead others individually but also manage the actions of the group.

Individuals who are highly ambitious, have high energy level, an urge to lead, self-confidence, intelligence, have thorough knowledge of job, are honest and flexible are more likely to succeed as organizational leaders. Individuals who learn the organizational leadership develop abilities and skills of teamwork, effective communication, conflict resolution, and group problem solving techniques. Organizational leaders clearly communicate organizational mission, vision and policies; build employees morale, ensure efficient business operations; help employees grow professionally and contribute positively towards organizations mission.

**Tips for Effective Organizational Leadership**

1. A leader must lead himself, only then he can lead others. He must be committed on personal and professional front, and must be responsible. He must be a role model for others and set an example for them.

2. A leader must boost up the morale of the employees. He should motivate them well so that they are committed to the

organization. He should be well acquainted with them, have concern for them and encourage them to take initiatives. This will result in more efficient and effective employees and ensure organizational success.

3. A leader must work as a team. He should always support his team and respect them. He should not hurt any employee. A true leader should not be too bossy and should not consider him as the supreme authority. He should realize that he is part of the organization as a whole.

Organizational leadership involves all the processes and possible results that lead to development and achievement of organizational goals. It includes employees' involvement, genuineness, effective listening and strategic communication.

## 9.1. LEADERSHIP AND MOTIVATION

Motivation is a goal-oriented characteristic that helps a person achieve his objectives. It pushes an individual to work hard at achieving his or her goals. An executive must have the right leadership traits to influence motivation. However, there is no specific blueprint for motivation.

As a leader, one should keep an open perspective on human nature. Knowing different needs of subordinates will certainly make the decision-making process easier.

Both an employee as well as manager must possess leadership and motivational traits. An effective leader must have a thorough knowledge of motivational factors for others. He must understand the basic needs of employees, peers and his superiors. Leadership is used as a means of motivating others.

Given below are important guidelines that outline the basic view of motivation:

- Harmonize and match the subordinate needs with the organizational needs. As a leader, the executive must ensure that the business has the same morals and ethics that he seeks in his employees. He should make sure that his subordinates are encouraged and trained in a manner that meets the needs of the business.

- Appreciation and rewards are key motivators that influence a person to achieve a desired goal. Rewarding good/ exceptional behavior with a small token of appreciation, certificate or letter can be a great motivator. If a certificate is awarded to a person, it should mention the particular act or the quality for which the individual is being rewarded.
- Being a role model is also a key motivator that influences people in reaching their goals. A leader should set a good example to ensure his people to grow and achieve their goals effectively.
- Encouraging individuals to get involved in planning and important issues resolution procedure not only motivates them, but also teaches the intricacies of these key decision-making factors. Moreover, it will help everyone to get better understanding of their role in the organization. The communication will be unambiguous and will certainly attract acknowledgement and appreciation from the leader.
- Developing moral and team spirit certainly has a key impact on the well-being of an organization. The metal or emotional state of a person constitutes his or her moral fabric. A leader's actions and decisions affect the morale of his subordinates. Hence, he should always be aware of his decisions and activities. Team spirit is the soul of the organization. The leader should always make sure his subordinates enjoy performing their duties as a team and make themselves a part of the organization's plans.
- A leader should step into the shoes of the subordinates and view things from subordinate's angle. He should empathize with them during difficult times. Empathizing with their personal problems makes them stronger-mentally and emotionally.
- A meaningful and challenging job accomplished inculcates a sense of achievement among employees. The executive must make their employees feel they are performing an important work that is necessary for the organization's well-being and success. This motivational aspect drives them to fulfill goals.

Remember, "**To become an efficient leader, you must be self-motivated**". You must know your identity, your needs and you must have a strong urge to do anything to achieve your goals. Once you are self-motivated, only then you can motivate others to achieve their goals and to harmonize their personal goals with the common goals of the organization.

## 9.2. LEADERSHIP ETHICS - TRAITS OF AN ETHICAL LEADER

Ethics refer to the desirable and appropriate values and morals according to an individual or the society at large. Ethics deal with the purity of individuals and their intentions. Ethics serve as guidelines for analyzing “what is good or bad” in a specific scenario. Correlating ethics with leadership, we find that ethics is all about the leader’s identity and the leader’s role.

Ethical theories on leadership talk about two main things: (a) The actions and behaviour of leaders; and (b) the personality and character of leaders. It is essential to note that “**Ethics are an essential to leadership**”. A leader drives and influences the subordinates / followers to achieve a common goal, be it in case of team work, organizational quest, or any project. It is an ethical job of the leader to treat his subordinates with respect as each of them has unique personality. The ethical environment in an organization is built and developed by a leader as they have an influential role in the organization and due to the fact that leaders have an influence in developing the organizational values.

**An effective and ethical leader has the following traits / characteristics:**

**Dignity and respectfulness:** He respects others. An ethical leader should not use his followers as a medium to achieve his personal goals. He should respect their feelings, decision and values. Respecting the followers implies listening effectively to them, being compassionate to them, as well as being liberal in hearing opposing viewpoints. In short, it implies treating the followers in a manner that authenticate their values and beliefs.

**Serving others:** He serves others. An ethical leader should place his follower’s interests ahead of his interests. He should be humane. He must act in a manner that is always fruitful for his followers.

**Justice:** He is fair and just. An ethical leader must treat all his followers equally. There should be no personal bias. Wherever some followers are treated differently, the ground for differential treatment should be fair, clear, and built on morality.

**Community building:** He develops community. An ethical leader considers his own purpose as well as his followers' purpose, while making efforts to achieve the goals suitable to both of them. He is considerate to the community interests. He does not overlook the followers' intentions. He works harder for the community goals.

**Honesty:** He is loyal and honest. Honesty is essential to be an ethical and effective leader. Honest leaders can be always relied upon and depended upon. They always earn respect of their followers. An honest leader presents the fact and circumstances truly and completely, no matter how critical and harmful the fact may be. He does not misrepresent any fact.

It is essential to note that leadership is all about values, and it is impossible to be a leader if you lack the awareness and concern for your own personal values. Leadership has a moral and ethical aspect. These ethics define leadership. Leaders can use the above mentioned traits as yardsticks for influencing their own behaviour.

## 9.3. LEADERSHIP STRATEGY - WHICH LEADERSHIP STYLE TO FOLLOW?

Without an effective leadership strategy, it is believed, that the organizational strategies do not work. Best players in a team do not guarantee success without a great coach, similarly, work teams may not function effectively if leaders do not follow an appropriate leadership strategy.

**To understand leadership styles here are three scenarios:**

*Scenario 1* - A Teacher gives a question to the class full of students, however, solves it for them;

*Scenario 2* - A Teacher gives the question to the students and observes how students solve them;

*Scenario 3* - A Teacher gives a question to the students and moves around the class, observes the students, and helps wherever required.

Scenario 1 was "Leading from the Front", Scenario 2 was "**Supportive Leadership Style**", and Scenario 3 was "**Interactive Leadership Style**". Besides this the leadership styles / strategies could be based on personality traits like Directive Leadership, Structured Leadership, Intuitive Leadership, or Process Driven leadership.

Here are some tips while selecting leadership strategy / style:

A leader must be aware of his / her personality traits and those of his team members / followers to understand which leadership style will be most effective.

A leader may not adopt a consistent leadership all through his / her career. Situational Leadership helps addressing varied needs / expectations of the followers as he the leader adopts a strategy based on a situation he / she is in. In case a leader has a self-reliant team, he needs to be using a directive leadership style or lead form the front. He could instead delegate and provide inputs where necessary.

A common mistake especially a lot of new leaders make is to copy established / well know leaders. Remember, each situation is unique and so are the followers. A leadership style which may be suited to a well-known leader may not be appropriate for your team. Make no mistake here - do not try and imitate other leaders.

A leader will never be afraid of trying new approach to solve a work problem or address a conflicting situation. It is quite a possibility that a leader adopts a style that is not by the book.

A leader must keep enhancing his / her leadership skills. While on the job experience matters a lot, getting enrolled into leadership courses after detailed evaluation of the program and feedback of the participants will help implementing a leadership style more effectively.

It is often said that good leaders are born and not made; however, good leaders are those who are aware of their personality traits and also of their followers. They know which leadership style is to be adopted in a particular situation. Once this is done, there is a little challenge left for a leader to become a "good / great" leader.

## LEADERSHIP STYLES

All leaders do not possess same attitude or same perspective. As discussed earlier, few leaders adopt the carrot approach and a few adopt the stick approach. Thus, all of the leaders do not get the things done in the same manner. Their style varies. The leadership style varies with the kind of people the leader interacts and deals with. A perfect/standard leadership style is one which assists a leader in getting the best out of the people who follow him.

**Some of the important leadership styles are as follows:**

**Autocratic leadership style:** In this style of leadership, a leader has complete command and hold over their employees/team. The team cannot put forward their views even if they are best for the team's or organizational interests. They cannot criticize or question the leader's way of getting things done. The leader himself gets the things done. The advantage of this style is that it leads to speedy decision-making and greater productivity under leader's supervision. Drawbacks of this leadership style are that it leads to greater employee absenteeism and turnover. This leadership style works only when the leader is the best in performing or when the job is monotonous, unskilled and routine in nature or where the project is short-term and risky.

**The Laissez Faire Leadership Style:** Here, the leader totally trusts their employees/team to perform the job themselves. He just concentrates on the intellectual/rational aspect of his work and does not focus on the management aspect of his work. The team/employees are welcomed to share their views and provide suggestions which are best for organizational interests. This leadership style works only when the employees are skilled, loyal, experienced and intellectual.

**Democrative/Participative leadership style:** The leaders invite and encourage the team members to play an important role in decision-making process, though the ultimate decision-making power rests with the leader. The leader guides the employees on what to perform and how to perform, while the employees communicate to the leader their experience and the suggestions if any. The advantages of this leadership style are that it leads to satisfied, motivated and more skilled employees. It leads to an optimistic work environment and also encourages creativity. This leadership style has the only drawback that it is time-consuming.

**Bureaucratic leadership:** Here the leaders strictly adhere to the organizational rules and policies. Also, they make sure that the employees/team also strictly follow the rules and procedures. Promotions take place on the basis of employees' ability to adhere to organizational rules. This leadership style gradually develops over time. This leadership style is more suitable when safe work conditions and quality are required. But this leadership style discourages creativity and does not make employees self-contented.

## HOW TO CREATE A PERSONAL LEADERSHIP BRAND?

Every leader has a personal leadership brand which might be carefully cultivated or intuitively perceived by leaders themselves and their followers. A personal leadership brand is an exclusive and a specific approach of a leader to address challenges and manage his/her transactions with their subordinates or followers. The best part of having a leadership brand is that it allows the flexibility to the leaders to define their own leadership objectives and then position themselves appropriately as per the need and situation. For example, Lee Iacocca promulgated a leadership brand which was resolute, determined, persuasive and ready to take risks which helped him turn around Chrysler similarly Gandhi's leadership brand was that of integrity, honesty, principles, strength of character and above all truth.

It is essential for a leader to practice his/her leadership brand in thoughts and actions. How can a leader build up a leadership brand if they do not have one already? A leadership brand helps distinguish leaders and also outlines their approach, values, beliefs etc.

1. The first step definitely is identifying and establishing the results one wants to achieve by the end of a specific time period with a focus on preserving the interests of key stakeholders.
2. The second step becomes those distinguishing features with

which one wants to be known as a leader. For e.g. one might identify drive for result as one’s core strength area and can create a leadership brand based on the same

3. The next step becomes defining your identity. One might choose two or three word phrases to define their approach to leadership like Innovating to Excel etc

4. The last step becomes coming up with a leadership statement which conjuncts what one wants to be known for and what one wants to achieve

It is also important for leaders to check their leadership brand with seniors, subordinates and other stake-holders to understand their expectations from the role; and if any disconnect is pointed out, it needs to be incorporated.

Apart from the above aspects, leaders need to role model themselves and redefine their perceptions and ambitions to encompass the entire institution, which they represent. A leader needs to put the interests of the organization and stakeholders before his/her personal ambition and goals and strive to create success which is sustainable and does not need their constant presence.

The leaders need to understand that a personal leadership brand cannot be created overnight but credibility is earned the hard way, through years of perseverance. Once a leadership brand is created its acceptance and stability is established only after results are achieved. So, if a leader identifies certain goals but fails to achieve them, there are no takers for that leadership brand, similarly if a leader displays behaviors contradictory to what is outlined by his brand values, then also the credibility and respect of the brand is lost.

## LEADERSHIP

We have always associated leadership with a very visible and popular role which gives you recognition and a larger than life status as a leader however the level 5 leadership proposes quite opposing characteristics of a successful leader. Jim Collins and his research team were exploring the factors that made good companies great way back in the 1960s. It was then that they stumbled upon the Level 5 leaders who were invariably at the helm of affairs of all the companies which went on to become great in their respective fields. Who exactly is a Level 5 leader? Collins describes Level 5 leader as Humility + Will = Level 5. They are the nurturing leaders who do not want credit but want success to sustain over a longer period of time, long after they are gone.

Level 5 leaders are modest, shy and fearless and possess the capability to transform an organization from good to great without portraying themselves as wizards with magic wands. They prefer talking about the company and the contribution of other people but rarely about their role or achievements. Let us have a look at the hierarchical level of leadership identified:


The Level 5 leadership clearly reestablishes the facts about a simply living and high thinking with an emphasis on personal humility taught by the older generations. The financial breakthroughs achieved by level 5 leaders prove that these characteristics can achieve tangible results as well. The most important example in this context can be cited of great world leaders like M.K. Gandhi and Abraham Lincoln, who always put their vision ahead of their egos. They came across as shy and defenseless people in their mannerism and speech but were hardly so when it came to actions. The other example from the business leaders who fitted perfectly into this category was Darwin E Smith who was the CEO of the paper company Kimberly-Clark and turned it around to become the biggest consumer paper product company. He was a unique mix of personal humility and will; combined with risk taking ability which made him a role model for the business leaders of today.

There are certain actions performed by Level 5 leaders which separate them from the rest of the leaders and senior executives.

- The first step if their ability to identify and include right people with them towards achieving goals. Unlike the traditional method of building strategies and then looking for the right people to carry them out, they take a different route. It's about getting the right people on board and then deciding on the destination.
- They also do not shy away from facing and accepting brutal truths and realities of data, numbers and situations but at the same time they do not lose hope of a better future.
- They also strive towards aligning consistent efforts towards a goal, rather than giving one massive push they believe in small but firm pushes to bring in the momentum.
- They also exercise their judgment to understand an aspect, in depth and thoroughly, rather than burdening themselves with myriad information.
- They practice and encourage a disciplined approach towards their work life and as visionaries use carefully identified technologies to give their businesses strategic advantage.

With the new concept of Level 5 leadership we come back to an age old question, can Level 5 leadership be learnt, if yes then how. According to Collins it is farfetched to suitably see whether it can be learnt or not but he surely identifies two categories of people, one who have the Level 5 Leadership in them, dormant, latent or unexpressed and others who do not have it.

So leaders who cannot look beyond their personal role, fame, achievements etc can hardly become Level 5 leaders. Only when they can put the larger good ahead of them, they transcend to the next level. This transition is not general but can be brought by some tragic accident, near death experiences or a life changing incident, as came across by Collins in his research. It would be appropriate to mention the name of M.K. Gandhi to understand it better. For Gandhi who had lived a comfortable life with a law degree from England had no experience of being oppressed by the ruling class until he was thrown out of a train despite carrying a first class ticket. His transition began from there, which later made him actively participate in the Indian Freedom Struggle.

Level 5 leadership is difficult to find and leaders who display it are a cut above the rest.

## HOW TO BE A GOOD LEADER - WHAT MAKES LEADERSHIP EFFECTIVE?

Leadership is a significant aspect of management. In order to ensure organizational success, co-operation from subordinates as well as greater efficiency, it is important for a manager to be a great, effective and a true leader. An effective and true leader is one who does not put himself before others. He is very humble, deferential and altruistic.

The required aspects of effective leadership are as follows:

- Motivation
- Commitment
- Self-sacrifice
- Honesty
- Determination
- Resourcefulness
- Daring
- Knowledge
- Good communication skills
- Passion
- Responsibility
- Judgement

Leadership is boosting an individual's performance to a greater benchmark, the developing of an individual's personality crossing its standard boundaries. It is a combo of mindframes, traits, skills, and knowledge. Leadership means adhering to the following principles:

- Respect your followers.
- Acknowledge the follower's efforts if there is success, and do not blame them for any failure.
- Encourage participation of all in decision-making.
- Make the goals clear to all.

- Support the followers in accomplishing the objectives and in reaching their potential.
- Discover efficient and economical ways of performing the task.
- Ensure proper and effective communication with the followers. There should be no place for misunderstanding and misinterpretations.
- Be a trainer and not an opponent/critic.

An effective leader is one who meets the job requirements, team requirements as well as individual requirements. While concentrating on the job, a leader would synchronize the departmental goals with the organizational goals. He would ensure that the employees have the required skills and competencies for performing the job effectively and efficiently. He would provide the employees the essential resources for performing the job such as time, knowledge and equipment. He would ensure that employees have no difficulty in performing the tasks assigned to them. And finally, an effective leader would review progress and give the employees a feedback of their performance.

When a leader is focusing on people, he must be compassionate and empathic. He should listen to the employees with understanding. He must respect their views and ideas. He must train and coach them and make an effort to eliminate unnecessary obstacles from the employees' work responsibilities.

Finally, when an effective leader focuses on team, he should coordinate team's efforts. He must celebrate team's success. He should review and promote friendly and social environment. He should develop a team spirit and achievement sense among the employees as a team.

# CHAPTER 10.
# OPERATIONS MANAGEMENT

**Operations management** is an area of management concerned with designing and controlling the process of production and redesigning business operations in the production of goods or services. It involves the responsibility of ensuring that business operations are efficient in terms of using as few resources as needed and effective in terms of meeting customer requirements. Operations management is primarily concerned with planning, organizing and supervising in the contexts of production, manufacturing or the provision of services.

It is concerned with managing an entire production or service system which is the process that converts inputs (in the forms of raw materials, labor, consumers, and energy) into outputs (in the form of goods and/or services for consumers). Operations produce products, manage quality and create services. Operation management covers sectors like banking systems, hospitals, companies, working with suppliers, customers, and using technology. Operations is one of the major functions in an organization along with supply chains, marketing, finance and human resources. The operations function requires management of both the strategic and day-to-day production of goods and services.

Ford Motor car assembly line: the classical example of a manufacturing production system.

In managing manufacturing or service operations several types of decisions are made including operations strategy, product design, process design, quality management, capacity, facilities planning, production planning and inventory control. Each of these requires an ability to analyze the current situation and find better solutions to improve the effectiveness and efficiency of manufacturing or service operations.

The history of production and operation systems begins around 5000 B.C. when Sumerian priests developed the ancient system of recording inventories, loans, taxes, and business transactions. The next major historical application of operation systems occurred in 4000 B.C. It was during this time that the Egyptians started using planning, organization, and control in large projects such as the construction of the pyramids. By 1100 B.C., labor was being specialized in China; by about 370 B.C., Xenophon described the advantages of dividing the various operations necessary for the production of shoes among different individuals in ancient Greece:

"...In large cities, on the other hand, inasmuch as many people have demands to make upon each branch of industry, one trade alone, and very often even less than a whole trade, is enough to support a man: one man, for instance, makes shoes for men, and another for women; and there are places even where one man earns a living by only stitching shoes, another by cutting them out, another by sewing the uppers together, while there is another who performs none of these operations but only assembles the parts. It follows, therefore, as a matter of course, that he who devotes himself to a very highly specialized line of work is bound to do it in the best possible manner."

Shoemakers, 1568

In the Middle Ages, kings and queens ruled over large areas of land. Loyal noblemen maintained large sections of the monarch's territory. This hierarchical organization in which people were divided into classes based on social position and wealth became known as the feudal system. In the feudal system, vassals and serfs produced for themselves and people of higher classes by using the ruler's land and resources. Although a large part of labor was employed in agriculture, artisans contributed to economic output and formed guilds. The guild system, operating mainly between 1100 and 1500, consisted of two types: merchant guilds, who bought and sold goods, and craft guilds, which made goods. Although guilds were regulated as to the quality of work performed, the resulting system was rather rigid, shoemakers, for example, were prohibited from tanning hides.

Services were also performed in the Middle Ages by servants. They provided service to the nobility in the form of cooking, cleaning and providing entertainment. Court jesters were considered service providers. The medieval army could also be considered a service since they defended the nobility.

The industrial revolution was facilitated by two elements: interchangeability of parts and division of labor. Division of labor has been a feature from the beginning of civilization, the extent to which the division is carried out varied considerably depending on period and location. Compared to the Middle Ages, the Renaissance and the Age of Discovery were characterized by a greater specialization in labor, which was a characteristic of the growing cities and trade networks of Europe. An important leap in manufacturing efficiency came in the late eighteenth century as Eli Whitney popularized the concept of interchangeability of parts when he manufactured 10,000 muskets. Up to this point in the history of manufacturing, each product (e.g. each musket) was considered a special order, meaning that parts of a given musket were fitted only for that particular musket and could not be used in other muskets. Interchangeability of parts allowed the mass production of parts independent of the final products in which they would be used. An entire new market to fill the need for the sale and manufacturing of muskets began at this time.

In 1883, Frederick Winslow Taylor introduced the stopwatch method for accurately measuring the time to perform each single task of a complicated job. He developed the scientific study of productivity and identifying how to coordinate different tasks to eliminate wasting of time and increase the quality of work. The next generation of scientific study occurred with the development of work sampling and predetermined motion time systems (PMTS). Work sampling is used to measure the random variable associated with the time of each task. PMTS allows the use of standard predetermined tables of the smallest body movements (e.g. turning the left wrist by 90°), and integrating them to predict the time needed to perform a simple task. PMTS has gained substantial importance due to the fact that it can predict work measurements without observing the actual work. The foundation of PMTS was laid out by the research and development of Frank B. and Lillian M.

Gilbreth around 1912. The Gilbreths took advantage of taking motion pictures at known time intervals while operators were performing the given task.

Service Industries: At the turn of the twentieth century, the services industries were already developed, but largely fragmented. In 1900 the U.S. service industry consisted of banks, professional services, schools, general stores, railroads and telegraph. Services were largely local in nature (except for railroads and telegraph) and owned by entrepreneurs and families. The U.S. in 1900 had 31% employment in services, 31% in manufacturing and 38% in agriculture.

The idea of the production line has been used multiple times in history prior to Henry Ford: the Venetian Arsenal (1104); Smith's pin manufacturing, in the Wealth of Nations (1776) or Brunel's Portsmouth Block Mills (1802). Ransom Olds was the first to manufacture cars using the assembly line system, but Henry Ford developed the first auto assembly system where a car chassis was moved through the assembly line by a conveyor belt while workers added components to it until the car was completed. During World War II, the growth of computing power led to further development of efficient manufacturing methods and the use of advanced mathematical and statistical tools. This was supported by the development of academic programs in industrial and systems engineering disciplines, as well as fields of operations research and management science (as multi-disciplinary fields of problem solving). While systems engineering concentrated on the broad characteristics of the relationships between inputs and outputs of generic systems, operations researchers concentrated on solving specific and focused problems. The synergy of operations research and systems engineering allowed for the realization of solving large scale and complex problems in the modern era. Recently, the development of faster and smaller computers, intelligent systems, and the World Wide Web has opened new opportunities for operations, manufacturing, production, and service systems.

## INDUSTRIAL REVOLUTION

Marshall's flax mill in Holbeck. The textile industry is the prototypical example of the English industrial revolution.

Before the First industrial revolution work was mainly done through two systems: domestic system and craft guilds. In the domestic system merchants took materials to homes where artisans performed the necessary work, craft guilds on the other hand were associations of artisans which passed work from one shop to another, for example: leather was tanned by a tanner, passed to curriers, and finally arrived at shoemakers and saddlers.

The beginning of the industrial revolution is usually associated with 18th century English textile industry, with the invention of flying shuttle by John Kay in 1733, the spinning jenny by James Hargreaves in 1765, the water frame by Richard Arkwright in 1769 and the steam engine by James Watt in 1765. In 1851 at the Crystal Palace Exhibition the term American system of manufacturing was used to describe the new approach that was evolving in the United States of America which was based on two central features: interchangeable parts and extensive use of mechanization to produce them.

## SECOND INDUSTRIAL REVOLUTION AND POST-INDUSTRIAL SOCIETY

Henry Ford was 39 years old when he founded the Ford Motor Company in 1903, with $28,000 capital from twelve investors. The model T car was introduced in 1908, however it was not until Ford implemented the assembly line concept, that his vision of making a popular car affordable by every middle-class American citizen would be realized. The first factory in which Henry Ford used the concept of the assembly line was Highland Park (1913), he characterized the system as follows:

"The thing is to keep everything in motion and take the work to the man and not the man to the work. That is the real principle of our production, and conveyors are only one of many means to an end".

This became one of the central ideas that led to mass production, one of the main elements of the Second Industrial Revolution, along with emergence of the electrical industry and petroleum industry. The post-industrial economy was noted in 1973 by Daniel Bell.[11] He stated that the future economy would provide more GDP and employment from services than from manufacturing and have a great effect on society. Since all sectors are highly interconnected, this did not reflect less importance for manufacturing, agriculture, and mining but just a shift in the type of economic activity.

## SKILLS REQUIRED OF AN OPERATIONS MANAGER

There are strong parallels between the skills required for effective operations management and those needed in both logistics and supply chain management. Excellent organizational ability is crucial in successfully enhancing efficiency and driving productivity as an operations manager.

One must be able to understand the series of processes within a company to get them to flow seamlessly, and in this sense the role is directly related to supply chain management. Meanwhile, the coordination involved in setting up these processes in practice represents logistics; the combination of understanding and coordinating the work of a company are central to becoming a successful operations manager. The operations manager is able to transcend industries so exact job functions can vary based on the company you work for. At the base level, the two main streams an operations manager might belong to can be reduced to companies with a concentration on manufacturing and production, or those that provide services.

Operations management roles within say, a pharmaceutical company fall under the category of production. Planning and coordinating the use of resources to ensure products are designed, created and dispatched to hospitals, chemists and so on, ensure not only that these products are prepared, but also that they are available to customers.

Meanwhile, an airline company will often see the operations manager focus on services – transporting passengers and/or cargo from one place to another.

In addition, it is likely that a manufacturing focus on the delivery of a tangible product will involve less direct contact with customers than a services role.

These examples illustrate the clear distinction between the roles of an operations manager in two distinct industries.

However, in reality most companies will not fit easily into one category or the other in the entirety of its operations. A car company doesn't simply manufacture cars, it also services them. A café serving coffee might very easily also produce their own coffee. There is also what is known as *quasi-manufacturing organizations*, which seem more like manufacturing firms, but are clearly providing a service, such as an automated warehouse dispatching goods.

The more one analyses the question of what operations management is, the more one sees how integral the position can be to any given company, be it small or large. There can be strong overlap with supply chain management, logistics or engineering, but there are many other industries and areas where operations function and the skills of an effective operations manager are strongly tied to an organization's lasting success.

## 10.1. MOTIVATING EMPLOYEES


Motivation in the workplace is the kind of priority that must not be neglected. A happy and motivated employee is a productive employee. In your business, you are the leader. The one that motivates everyone else. And luckily for you, motivating your employees does not require physical resources of any kind. All it needs is to clear some space of your schedule, every day, for your employees. Every small business owner needs to make an effort to maximize business profit and productivity. In other words, their staff must be as efficient as possible. Motivation is the key. And you need to start somewhere. Here are some steps that will help you motivate your employees to the best of their abilities.

- Be available for communication with your employees

You do not want to be just the name signing an email or the face behind the desk. You want your employees to have a reason to work for you and meet your goals. You want them to be motivated**.** And what better way to motivate them than to give them the value they deserve. Talk to your employees face-to-face. Do so, frequently. Let them know that they are an essential part of your business. If they feel appreciated they will do their best for the good of the company.

- Let them know their opinion matters

They should have a say in how they do their job. Their input is important and they need to know that. Especially on how to improve their performance. Most employees already know, what they are good at and what they are bad at. And they know what they need, to improve their results. Listen to what they have to say and let them try and do things their own way.

Give your employees the authority to make important decisions on the job. Let them choose what kinds of services they will provide to the customers. They need to know that, up to a certain point, they can work without needing to get prior approval. This will motivate them to focus more and make the right decisions.

- Be the example they need

Your employees will not work hard if you do not work hard. They will not be motivated if you are not motivated. If they see you as a person excited and ready to work, they will do the same. In other words, don't just tell them what you want. Show them. Don't forget that a good mood is always ''infectious''.

- Let them know they can advance in the company

Everyone wants to go places. Everyone wants to know that they can evolve into something better. Working towards a promotion is always a big motivation in the workplace. Let your employees know that there is always room for improvement and the opportunity for advancement.

- Reward your employees

Rewards will always be a great motivation booster. You don't have to go to great lengths. Offer simple things like an extra paid day off. Perhaps a ticket to the movies or even a gift card for the local convenient store. These incentives can be refreshing and very motivating.

A key factor to the correct and profitable evolution for a business is motivation. The motivation that your employees need, to work harder and aim for the best. You need to constantly try to motivate your employees. That will maintain their current good performance and improve it even more.

## 10.2. MANAGING HUMAN RESOURCES

Managing human resources refers to the functions that a manager performs relative to the organization's employees. Managing Human Resources can also refer to the act of providing the management actions the employees of the Human Resource Department Managing human resources includes, but is not limited to - **Planning and Allocating Resources.** No business has unlimited resources. Managers must divide salary budgets among their employees. Workloads must be divided. Managers decide who gets what training and who gets the best projects. Who gets the newest computer and who is stuck with the old one until the new budgeting cycle rolls around? In addition to physical resources, where does a manager spend her time? Who does she help? All of these things are part of the planning and allocating resources.

**What Is a Human Resource? -** A human resource is a single person or employee within an organization and part of the overall personnel or workforce of that company. Learn more about human resources so you can better understand their role in an effective organization.

A human resource is one person within a company's overall workforce, with each person lending their skills and talents to the organization to help it succeed. Any person willing to trade their labor, knowledge, or time for compensation in an effort to improve the organization is a human resource. It doesn't matter if they're part-time, full-time, freelance, or contract employees. While a company usually has many different kinds of assets (capital, equipment, supplies, or facilities, for example), its people are its most significant asset.

Employees must be hired, satisfied, motivated, developed, and retained. A human resources department is the department that manages a company's human resources. Humans need more management than other resources and a different approach, so that's why it's useful to have an entire department devoted to them. Whether it's mediating interpersonal conflicts or setting up a retirement plan, the human resources department is trained to handle it.

- Alternate definition: Human resources is the field that deals with managing people, pay, and training.
- Alternate name: Human capital
- Acronym: HR

How Does Human Resources Work? - The goal of human resources is to use a company's people most effectively. Human resources might deal with issues such as:

- Compensation and benefits
- Recruiting and hiring employees
- Onboarding
- Performance management
- Training
- Organization development and culture

These areas each contribute to employee satisfaction and performance. By attending to these different concerns, human resources can ensure a high-functioning and effective workforce, which in turn helps the company reach its goals and objectives more efficiently. The human resources department also ensures the company is adhering to labor regulations and works to keeps the environment free from harassment and other impediments to a strong workforce. Human resources staff help to create and implement workplace policies as well, such as vacation policies or dress codes. These policies ensure the fair and consistent application of the rules across the workforce.

For example, imagine Chris is a sales rep for a company. Chris is one of the company's human resources: an employee. If Chris has concerns about her employee benefits or questions about an enrollment form, she would contact the Human Resources department for assistance. If Chris and another employee or manager have a conflict, the human resources department can help find a solution. And the department makes sure that Chris and the other members of her team are receiving appropriate training so that they can perform their duties efficiently.

**Criticism of Human Resources -** Some people take issue with regarding employees as "resources." In their view, to consider workers as human resources commodifies them and reduces them to a figure on a balance sheet, or a means to an end. Instead, they promote renaming "human resources" to better encourage the full development of the human workforce.

**Alternatives to Human Resources -** Many of the functions of a human resource may in some cases be executed by non-human resources. In other words, robots or computers sometimes replace human employees, especially in hazardous conditions or for repetitive tasks. This is called automation, and it can greatly improve efficiency.

For example, you may often find robots on production lines, such as for cars. Automating certain parts of the production can increase production speed, but humans are still needed for some tasks, especially those that involve critical thinking. Human resources functions may also be executed by specialized departments or staff. Instead of a general human resources manager, there may be a compensation and benefits manager, a training supervisor, or an employee recruitment specialist. Such specialization allows for greater efficiency and, often, improved profitability.

**KEY TAKEAWAYS**

- A human resource is a single person in a company's workforce.
- Human resources also refer to the department charged with managing personnel.
- A human resource department has many functions, including recruiting, overseeing compensation, monitoring performance, and providing training.
- Find out the answers to frequently asked questions about HR.

## PROVIDING DIRECTION, VISION, AND GOALS

A manager should be the leader of the group. Managers not only divide the work but direct how employees should accomplish the work. They set the goals. Depending on the type and level of the group, managers may set overarching goals, allowing the employees the opportunity to set their own lower-level goals, or they may take

control of the entire process. Both are appropriate, depending on the situation.
Vision is a key task in managing your human resources. If your employees cannot see the big picture, they are less likely to perform to their highest level. Managers need to have a vision and share it properly with the team.

## DEVELOPING AN ENVIRONMENT IN WHICH EMPLOYEES CHOOSE MOTIVATION AND CONTRIBUTION

Managers determine what type of environment is best for their department. Good managers ensure that gossips, bullies, and slackers are all either coached into proper performance or terminated. Bad managers allow these people to overrun the department, creating a tense and unhappy environment. A good environment will motivate employees, and they will choose to perform at a high level.

Supplying or Asking for the Metrics that Tell People How Successfully They Are Performing Managers must provide feedback. Without that framework, employees don't know where they need to improve and where they are doing well. This is most successful when metrics are built around clear, measurable goals.

## OFFERING OPPORTUNITIES FOR BOTH FORMAL AND INFORMAL DEVELOPMENT

A manager's job isn't just to get the work done but to help his or her reporting employees succeed. Managers should personally coach employees, and provide opportunities for formal developmental training, such as classes and stretch projects. You can provide coaching through formal mentoring relationships or by providing feedback on a regular basis. Setting an Example in Work Ethics, Treatment of People, and Empowerment Worthy of Being Emulated by Others a good manager shows her staff how to behave. She is ethical, treats people fairly, and gives people the independence they've earned. Managers who play favorites, steal credit or discriminate against their staff are damaging the business's most important resource - their people.

## LEADING ORGANIZATION EFFORTS TO LISTEN TO AND SERVE CUSTOMERS

Managers often see the customers as more important than their own staff. This is not true - good staff management leads to good relationships with the customers. Customer relationships are critical and the business profits by managers who make customer service a priority. Managers have a duty to both the customer and employees, and when she takes care of both, success is more likely. Removing Obstacles that Impede the Employees' Progress Managers help their people when they clear the path for success. Should employees need approval from senior leadership for something, the manager helps facilitate the approval. Should an employee need a training course, or specialized instructions, or assistance with a project, the manager helps facilitate that.

A manager is interested in her employees' success and works hard to clear the pathway for that success. A manager who wishes to succeed focuses her efforts on ensuring the success of her employees.

## 10.3. UNION/MANAGEMENT ISSUES

Trade unions were developed in Europe during the Industrial Revolution, when employees had little skill and thus the entirety of power was shifted to the employer. When this power shifted, many employees were treated unfairly and underpaid. In the United States, unionization increased with the building of railroads in the late 1860s. Wages in the railroad industry were low and the threat of injury or death was high, as was the case in many manufacturing facilities with little or no safety laws and regulations in place. As a result, the Bortherhood of Locomotive Engineers and several other brotherhoods (focused on specific tasks only, such as conductors and brakemen) were formed to protect workers' rights, although many workers were fired because of their membership.

The first local unions in the United States were formed in the eighteenth century, in the form of the National Labor Union (NLU). The National Labor Union, formed in 1866, paved the way for other labor organizations. The goal of the NLU was to form a national labor federation that could lobby government for labor reforms on behalf of the labor organizations. Its main focus was to limit the workday to eight hours. While the NLU garnered many supporters, it excluded Chinese workers and only made some attempts to defend the rights of African-Americans and female workers. The NLU can be credited with the eight-hour workday, which was passed in 1862. Because of a focus on government reform rather than collective bargaining, many workers joined the Knights of Labor in the 1880s.

The Knights of Labor started as a fraternal organization, and when the NLU dissolved, the Knights grew in popularity as the labor union of choice. The Knights promoted the social and cultural spirit of the worker better than the NLU had. It originally grew as a labor union for coal miners but also covered several other types of industries. The Knights of Labor initiated strikes that were successful in increasing pay and benefits. When this occurred, membership increased. After only a few years, though, membership declined because of unsuccessful strikes, which were a result of a too autocratic structure, lack of organization, and poor management. Disagreements between members within the organization also caused its demise. The American Federation of Labor (AFL) was formed in 1886, mostly by people who wanted to see a change from the Knights of Labor. The focus was on higher wages and job security. Infighting among union members was minimized, creating a strong organization that still exists today. In the 1930s, the Congress of Industrial Organizations (CIO) was formed as a result of political differences in the AFL. In 1955, the two unions joined together to form the AFL-CIO. Currently, the AFL-CIO is the largest federation of unions in the United States and is made up of fifty-six national and international unions. The goal of the AFL-CIO isn't to negotiate specific contracts for employees but rather to support the efforts of local unions throughout the country.

Currently in the United States, there are two main national labor unions that oversee several industry-specific local unions. There are also numerous independent national and international unions that are not affiliated with either national union:

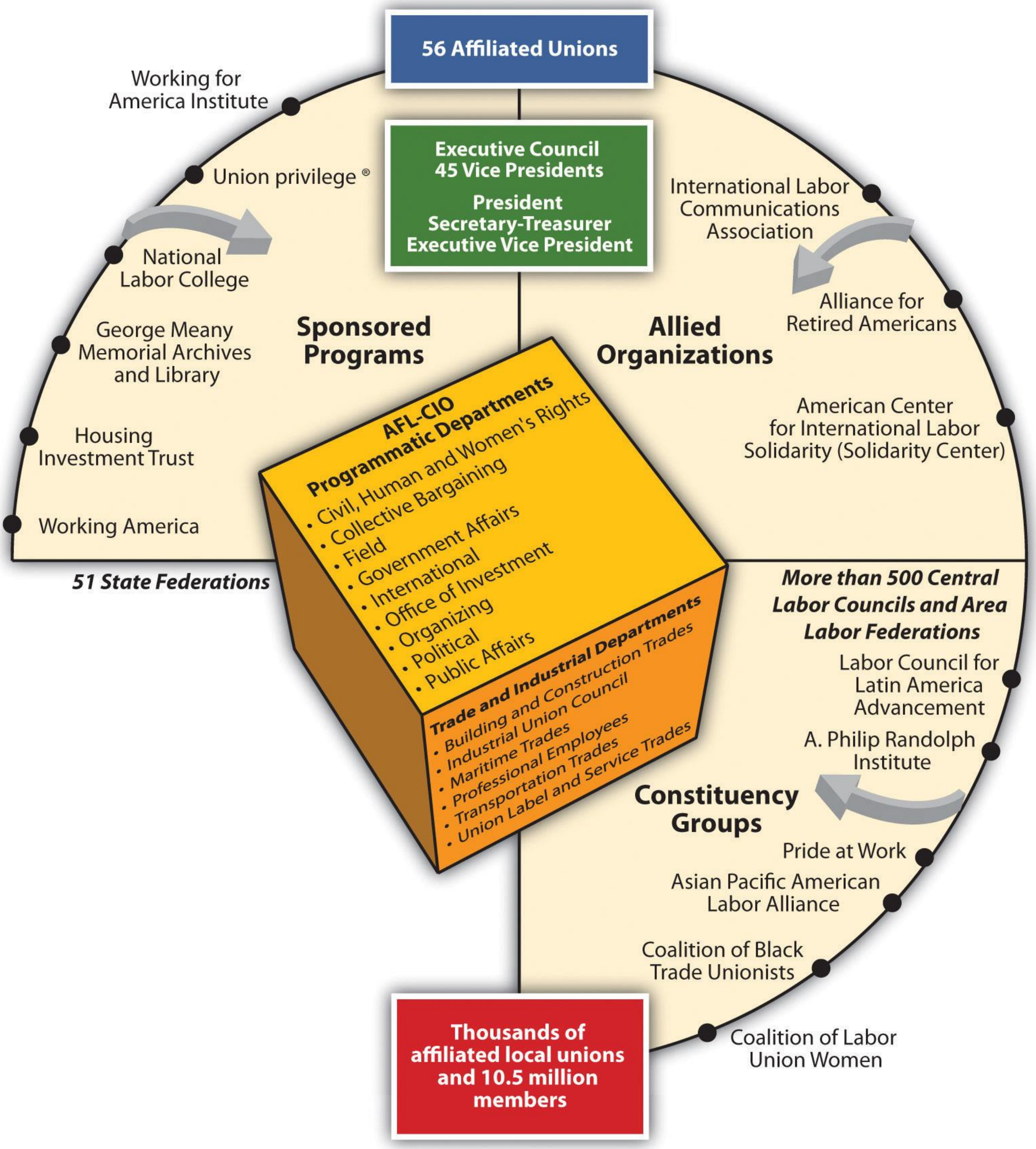
1. AFL-CIO: local unions include Airline Pilots Association, American Federation of Government Employees, Associated Actors of America, and Federation of Professional Athletes
2. CTW (Change to Win Federation): includes the Teamsters, Service Employees International Union, United Farm Workers of America, and United Food and Commercial Workers
3. Independent unions: Directors Guild of America, Fraternal Order of Police, Independent Pilots Association, Major League Baseball Players Association

The national union plays an important role in legislative changes, while the local unions focus on collective bargaining agreements and other labor concerns specific to the area. Every local union has a union steward who represents the interests of union members. Normally, union stewards are elected by their peers.

A national union, besides focusing on legislative changes, also does the following:

1. Lobbies in government for worker rights laws
2. Resolves disputes between unions
3. Helps organize national protests
4. Works with allied organizations and sponsors various programs for the support of unions

For example, in 2011, the national Teamsters union organized demonstrations in eleven states to protest the closing of an Ontario, California, parts distribution center. Meanwhile, Teamster Local 495 protested at the Ontario plant[2].




Trade unions rose to prominence at a point when industrialized countries were growing at a staggering rate, employee safety was often secondary to profits and job security was non-existent. Today, many of those issues have been corrected, in large part by the work of unions. Modern unions have shifted their focus to a number of targeted issues and work with management to protect the interests of its members in those areas.

**Job Stability –** One of the most fundamental issues for union leaders and members is long-term job stability. Unions believe that companies have a duty to retain hard – working employees and fight layoffs and terminations. In many cases, they argue for job stability in a community, fighting against company plans to reduce the number of employees even through attrition. Company management often argues that this prevents the organization from keeping pace with technology. They also feel that the protection of jobs at all costs prevents the company from getting of poor performance.

**Pension Protection –** Unions have become increasingly interested in protecting the pension plans offered to its members as part of their compensation plan. Usually pension plans that were badly managed by employers, to the detriment of the staff, have brought the issue to the forefront. Unions fight hard for appropriate oversight of the funds, which they believe are rightfully owned by their members. Company executives feel that as the contributors to the funds, they have the right to manage them as part of the corporate portfolio, benefiting from tax reductions and credits. They argue that a few high-profile failures do not constitute a pattern of mismanagement.

**Collective Bargaining –** The power of trade unions lies in their ability to negotiate with management on behalf of the entire unionized workforce. Their strongest weapon is right to stop work, should the negations fail. They use collective bargaining to fight for higher wages, better benefits and safer work conditions. Company executives do not always agree with collective bargaining because it treats the entire workforce as equals and does not recognize the difference between workers who excel and thrive and those who perform poorly. They argue that compensating employees on performance is better for the company than compensating the collective.

**Current Union Challenges -** The labor movement is currently experiencing several challenges, including a decrease in union membership, globalization, and employers' focus on maintaining nonunion status. As mentioned in the opening of this section, the United States has seen a steady decline of union membership since the 1950s. In the 1950s, 36 percent of all workers were unionized (Friedman, 2010), as opposed to just over 11 percent today.

Claude Fischer, a researcher from University of California Berkeley, believes the shift is cultural. His research says the decline is a result of American workers preferring individualism as opposed to collectivism (Fischer, 2010). Other research says the decline of unions is a result of globalization, and the fact that many jobs that used to be unionized in the manufacturing arena have now moved overseas. Other reasoning points to management, and that its unwillingness to work with unions has caused the decline in membership. Others suggest that unions are on the decline because of themselves. Past corruption, negative publicity, and hard-line tactics have made joining a union less favorable.

To fully understand unions, it is important to recognize the global aspect of unions. Statistics on a worldwide scale show union in all countries declining but still healthy in some countries. For example, in eight of the twenty-seven European Union member states, more than half the working population is part of a union. In fact, in the most populated countries, unionization rates are still at three times the unionization rate of the United States (Federation of European Employers, 2011). Italy has a unionization rate of 30 percent of all workers, while the UK has 29 percent, and Germany has a unionization rate of 27 percent.

In March 2011, Wisconsin governor Scott Walker proposed limiting the collective bargaining rights of state workers to save a flailing budget. Some called this move “union busting” and said this type of act is illegal, as it takes away the basic rights of workers. The governor defended his position by saying there is no other choice, since the state is in a budget crisis. Other states such as Ohio are considering similar measures. Whatever happens, there is a clear shift for unions today.

Globalization is also a challenge in labor organizations today. As more and more goods and services are produced overseas, unions lose not only membership but union values in the stronghold of worker culture. As globalization has increased, unions have continued to demand more governmental control but have been only somewhat successful in these attempts. For example, free trade agreements such as the North American Free Trade Agreement (NAFTA) have made it easier and more lucrative for companies to manufacture goods overseas.

There are a number of reasons why companies do not want unions in their organizations, which we will discuss in greater detail later. One of the main reasons, however, is increased cost and less management control. As a result, companies are on a quest to maintain a union-free work environment. In doing so, they try to provide higher wages and benefits so workers do not feel compelled to join a union. Companies that want to stay union free constantly monitor their retention strategies and policies.

**LABOR UNION LAWS**

The Railway Labor Act (RLA) of 1926 originally applied to railroads and in 1936 was amended to cover airlines. The act received support from both management and unions. The goal of the act is to ensure no disruption of interstate commerce. The main provisions of the act include alternate dispute resolution, arbitration, and mediation to resolve labor disputes. Any dispute must be resolved in this manner before a strike can happen. The RLA is administered by the National Mediation Board (NMB), a federal agency, and outlines very specific and detailed processes for dispute resolution in these industries.

The Norris-LaGuardia Act of 1932 (also known as the anti-injunction bill), barred federal courts from issuing injunctions (a court order that requires a party to do something or refrain from doing something) against nonviolent labor disputes and barred employers from interfering with workers joining a union. The act was a result of common yellow-dog contracts, in which a worker agreed not to join a union before accepting a job. The Norris-LaGuardia Act made yellow-dog contracts unenforceable in courts and established that employees were free to join unions without employer interference.

In 1935, the Wagner Act (sometimes called the National Labor Relations Act) was passed, changing the way employers can react to several aspects of unions. The Wagner Act had a few main aspects:

1. Employers must allow freedom of association and organization and cannot interfere with, restrain, or coerce employees who form a union.

2. Employers may not discriminate against employees who form or are part of a union, or those who file charges.

3. An employer must bargain collectively with representation of a union.

The National Labor Relations Board (NLRB) oversees this act, handling any complaints that may arise from the act. For example, in April 2011, the NLRB worked with employees at Ozburn-Hessey Logistics in Tennessee after they had been fired because of their involvement in forming a union. The company was also accused of interrogating employees about their union activities and threatened employees with loss of benefits should they form a union. The NLRB utilized their attorney to fight on behalf of the employees, and a federal judge ordered the company to rehire the fired employees and also to desist in other antiunion activities.


The Taft-Hartley Act prevents certain types of strikes, even in unionized companies.

Michael Fleshman – fastfoodstrike! – CC BY-NC 2.0.

The Taft-Hartley Act also had major implications for unions. Passed in 1947, Taft-Hartley amended the Wagner Act. The act was introduced because of the upsurge of strikes during this time period. While the Wagner Act addressed unfair labor practices on the part of the company, the Taft-Hartley Act focused on unfair acts by the unions. For example, it outlawed strikes that were not authorized by the union, called wildcat strikes. It also prohibited secondary actions (or secondary boycotts) in which one union goes on strike in sympathy for another union. The act allowed the executive branch of the federal government to disallow a strike should the strike affect national health or security. One of the most famous injunctions was made by President Ronald Reagan in 1981. Air traffic controllers had been off the job for two days despite their no-strike oath, and Reagan ordered all of them (over eleven thousand) discharged because they violated this federal law.

The Landrum Griffin Act, also known as the Labor Management Reporting and Disclosure (LMRDA) Act, was passed in 1959. This act required unions to hold secret elections, required unions to submit their annual financial reports to the U.S. Department of Labor, and created standards governing expulsion of a member from a union. This act was created because of racketeering charges and corruptions charges by unions. In fact, investigations of the Teamsters Union found they were linked to organized crime, and the Teamsters were banned from the AFL-CIO. The goal of this act was to regulate the internal functioning of unions and to combat abuse of union members by union leaders.

| | |
|---|---|
| **Railway Labor Act** | • Covers railroad and airlines<br>• Alternate dispute resolution methods instead of striking for these two industries |
| **Norris-LaGuardia Act** | • As a result of yellow-dog contracts<br>• Barred federal courts from issuing injunctions against nonviolent labor disputes |
| **Wagner Act** | • Allowed for freedom to join a union without interference<br>• May not discriminate against union employees<br>• Set collective bargaining rules |

| | |
|---|---|
| **Taft-Hartley Act** | • Amended Wagner Act<br>• Focus was on unfair practices by the union |
| **Landrum-Friffing Act** | • Required unions to hold secret elections<br>• Financial reporting of unions required |

**THE UNIONIZATION PROCESS**

There are one of two ways in which a unionization process can begin. First, the union may contact several employees and discuss the possibility of a union, or employees may contact a union on their own. The union will then help employees gather signatures to show that the employees want to be part of a union. To hold an election, the union must show signatures from over 30 percent of the employees of the organization.

| | |
|---|---|
| **Employee Dissatisfaction** | • Union contacts employees or employees contact union |
| **Initial Organization Meeting** | • Initial meeting with union to gather employee support. |
| **Signatures** | • Must have 30% of employee signatures to move forward with unionization process. |
| **Secret Ballot Election or Card Check Method** | • Once 30% of signatures are gathered, a secret ballot election is administered by the National Labor Relations Board (if the company does not accept the card check method). |
| **Voting and Contract** | • If the vote is "yes" (51% majority), the National Labor Relations Board certifies the union as the legal bargaining representative of the employees. |

Once the signatures are gathered, the National Labor Relations Board is petitioned to move forward with a secret-ballot election. An alternative to the secret-ballot election is the card check method, in which the union organizer provides the company with authorization cards signed by a simple majority (half plus one). The employer can accept the cards as proof that the employees desire a union in their organization. The NLRB then certifies the union as the employees' collective bargaining representative.

If the organization does not accept the card check method as authorization for a union, the second option is via a secret ballot. Before this method is used, a petition must be filed by the NLRB, and an election is usually held two months after the petition is filed. In essence, the employees vote whether to unionize or not, and there must be a simple majority (half plus one). The NLRB is responsible for election logistics and counting of ballots. Observers from all parties can be present during the counting of votes. Once votes are counted, a decision on unionization occurs, and at that time, the collective bargaining process begins.

Once the NLRB is involved, there are many limits as to what the employer can say or do during the process to prevent unionization of the organization. It is advisable for HR and management to be educated on what can legally and illegally be said during this process. It is illegal to threaten or intimidate employees if they are discussing a union. You cannot threaten job, pay, or benefits loss as a result of forming a union.

Things That Shouldn't Be Said to Employees during a Unionization Process

Obviously, it is in the best interest of the union to have as many members as possible. Because of this, unions may use many tactics during the organizing process. For example, many unions are also politically involved and support candidates who they feel best represent labor. They provide training to organizers and sometimes even encourage union supporters to apply for jobs in nonunion environments to actively work to unionize other employees when they are hired. This practice is called union salting. Unions, especially on the national level, can be involved in corporate campaigns that boycott certain products or companies because of their labor practices. The United Food and Commercial Workers (UFCW), for example, has a "Wake Up Walmart Campaign" that targets the labor practices of this organization.

## STRATEGIES COMPANIES USE TO AVOID UNIONIZATION

Most organizations feel the constraints of having a union organization are too great. It affects the cost to the organization and operation efficiency. Collective bargaining at times can put management at odds with its employees and cost more to produce products and services. Ideally, companies will provide safe working conditions, fair pay, and benefits so the employees do not feel they need to form a union. There are three main phases of unionization:

1. Phase 1: Your organization is union free and there is little or no interest in unionizing.
2. Phase 2: You learn that some employees are discussing unionization or you learn about specific attempts by the union to recruit employees.
3. Phase 3: You receive a petition from the National Labor Relations Board filed by a union requesting a unionization vote.

Because of increased costs and operational efficiency, it is normally in a company's best interest to avoid unionization. While in phase 1, it is important to review employee relations programs including pay, benefits, and other compensation. Ensure the compensation plans are fair so employees feel fairly treated and have no reason to seek the representation of a union.

Despite your best efforts, you could hear of unionization in your organization. The goal here is to prevent the union from gaining support to ask for a National Labor Relations Board election. Since only 30 percent of employees need to sign union cards for a vote to take place, this phase to avoid unionization is very important. During this time, HR professionals and managers should respond to the issues the employees have and also develop a specific strategy on how to handle the union vote, should it get that far.

In phase 3, familiarization with all the National Labor Relations Board rules around elections and communications is important. With this information, you can organize meetings to inform managers on these rules. At this time, you will likely want to draw up an antiunion campaign and communicate that to managers, but also make sure it does not violate laws. To this end, develop specific strategies to encourage employees to vote "no" for the union. Some of the arguments that might be used include talking with the employee and mentioning the following:

1. Union dues are costly.
2. Employees could be forced to go on strike.
3. Employees and management may no longer be able to discuss matters informally and individually.
4. Unionization can create more bureaucracy within the company.
5. Individual issues may not be discussed.
6. Many decisions within a union, such as vacation time, are based on seniority only.

With unionization in decline, it is likely you may never need to handle a new union in your organization. However, organizations such as Change to Win are in the process of trying to increase union membership. This organization has four affiliated unions, with a goal to strengthen the labor movement. Teamsters, United Food and Commercial Workers, United Farm Workers, and Service Employees International Union are all unions affiliated with this organization (Change to Win, 2011). The next few years will be telling as to the fate of unions in today's organizations.

## FORTUNE *500 FOCUS*

Perhaps no organization is better known for its antiunion stance than Walmart. Walmart has over 3,800 stores in the United States and over 4,800 internationally with $419 billion in sales[4]. Walmart employs more than 2 million associates worldwide[4]. The billions of dollars Walmart earns do not immunize the company to trouble. In 2005, the company's vice president, Tom Coughlin, was forced to resign after admitting that between $100,000 and $500,000 was spent for undeclared purposes, but it was eventually found that the money was spent to keep the United Food and Commercial Workers union (UFCW) out of Walmart (Los Angeles Times Wire Services, 2011) (he was found guilty and sentenced to two years of house arrest).

Other claims surrounding union busting are the closing of stores, such as the Walmart Tire and Lube Express in Gatineau, Quebec (UFCW Canada, 2011), when discussions of unionization occurred. Other reports of union busting include the accusation that company policy requires store managers to report rumors of unionizing to corporate headquarters. Once the report is made, all labor decisions for that store are handled by the corporate offices instead of the store manager. According to labor unions in the United States, Walmart is willing to work with international labor unions but continues to fiercely oppose unionization in the United States. In one example, after butchers at a Jacksonville, Texas, Walmart voted to unionize, Walmart eliminated all US meat-cutting departments.

A group called OUR Walmart (Organization United for Respect), financed by the United Food and Commercial Workers* (UFCW) union, has stemmed from the accusations of union busting. Walmart spokesperson David Tovar says he sees the group as a Trojan horse assembled by labor organizations to lay the groundwork for full-fledged unionization and seek media attention to fulfill their agenda. While the organization's activities may walk a fine line between legal and illegal union practices under the Taft-Hartley Act, this new group will certainly affect the future of unionization at Walmart in its US stores.

*Note: UFCW was part of the AFL-CIO until 2005 and now is an independent national union.

## THE IMPACT OF UNIONS ON ORGANIZATIONS

You may wonder why organizations are opposed to unions. As we have mentioned, since union workers do receive higher wages, this can be a negative impact on the organization. Unionization also impacts the ability of managers to make certain decisions and limits their freedom when working with employees. For example, if an employee is constantly late to work, the union contract will specify how to discipline in this situation, resulting in little management freedom to handle this situation on a case-by-case basis. In 2010, for example, the Art Institute of Seattle faculty filed signatures and voted on unionization[5]. Some of the major issues were scheduling issues and office space, not necessarily pay and benefits. While the particular National Labor Relations Board vote was no to unionization, a yes vote could have given less freedom to management in scheduling, since scheduling would be based on collective bargaining contracts. Another concern about unionization for management is the ability to promote workers. A union contract may stipulate certain terms (such as seniority) for promotion, which means the manager has less control over the employees he or she can promote.

## KEY TAKEAWAYS

- Union membership in the United States has been slowly declining. Today, union membership consists of about 11.9 percent of the workforce, while in 1983 it consisted of 20 percent of the workforce.
- The reasons for decline are varied, depending on whom you ask. Some say the moving of jobs overseas is the reason for the decline, while others say unions’ hard-line tactics put them out of favor.
- Besides declining membership, union challenges today include globalization and companies’ wanting a union-free workplace.
- The United States began its first labor movement in the 1800s. This was a result of low wages, no vacation time, safety issues, and other issues.

- Many labor organizations have disappeared, but the *American Federation of Labor (AFL)* still exists today, although it merged with the *Congress of Industrial Organizations (CIO)* and is now known as the AFL-CIO. It is the largest labor union and represents local labor unions in a variety of industries.
- The United States has a low number of union members compared with other countries. Much of Europe, for example, has over 30 percent of their workforce in labor unions, while in some countries as much as 50 percent of the workforce are members of a labor union.
- Legislation has been created over time to support both labor unions and the companies who have labor unions. The *Railway Labor Act* applies to airlines and railroads and stipulates that employees may not strike until they have gone through an extensive dispute resolution process. The *Norris-LaGuardia Act* made *yellow-dog contracts* illegal and barred courts from issuing injunctions.
- The *Wagner Act* was created to protect employees from retaliation should they join a union. The *Taft-Hartley Act* was developed to protect companies from unfair labor practices by unions.
- The *National Labor Relations Board* is the overseeing body for labor unions, and it handles disputes between companies as well as facilitates the process of new labor unions in the developing stages. Its job is to enforce both the Wagner Act and the Taft-Hartley Act.
- The *Landrum Griffin Act* was created in 1959 to combat corruption in labor unions during this time period.
- To form a union, the organizer must have signatures from 30 percent of the employees. If this occurs, the National Labor Relations Board will facilitate a card check to determine more than 50 percent of the workforce at that company is in agreement with union representation. If the company does not accept this, then the NLRB holds secret elections to determine if the employees will be unionized. A collective bargaining agreement is put into place if the vote is yes.
- Companies prefer to not have unions in their organizations because it affects costs and operational productivity. Companies will usually try to prevent a union from organizing in their workplace.
- Managers are impacted when a company does unionize. For example, management rights are affected, and everything must be guided by the contract instead of management prerogative.

## EXERCISES

1. Visit the National Labor Relations Board website. View the "weekly case summary" and discuss it in at least two paragraphs, stating your opinion on this case.
2. Do you agree with unionization within organizations? Why or why not? List the advantages and disadvantages of unions to the employee and the company.
3. [1]"Union Members: 2010," Bureau of Labor Statistics, US Department of Labor, news release, January 21, 2011, accessed April 4, 2011, http://www.bls.gov/news.release/pdf/union2.pdf.
4. [2]"Teamsters Escalate BMW Protests across America," PR Newswire, August 2, 2011, accessed August 15, 2011, http://www.teamster.org/content/teamsters-escalate-bmw-protests-across-america.
5. [3]"Federal Judge Orders Employer to Reinstate Three Memphis Warehouse Workers and Stop Threatening Union Supporters While Case Proceeds at NLRB," Office of Public Affairs, National Labor Relations Board, news release, April 7, 2011, accessed April 7, 2011, http://www.nlrb.gov/news/federal-judge-orders-employer-reinstate-three-memphis-warehouse-workers- and-stop-threatening-un.
6. [4]"Investors," Walmart Corporate, 2011, accessed August 15, 2011, http://investors.walmartstores.com/phoenix.zhtml?c=112761&p=irol-irhome.
7. [5]"Union Push in For-Profit Higher Ed," *Inside Higher Ed*, May 24, 2010, accessed August 15, 2011, http://www.insidehighered.com/news/2010/05/24/union.

# CHAPTER 11.
# MARKETING: PROVIDING VALUE TO CUSTOMERS

**Marketing** is a set of activities related to creating, communicating, delivering, and exchanging offerings that have value for others. In business, the function of marketing is to bring value to customers, whom the business seeks to identify, satisfy, and retain. This module will emphasize the role of marketing in business, but many of the concepts will apply to non-profit organizations, advocacy campaigns, and other activities aimed at influencing perceptions and behavior.

Marketing as a discipline involves all the actions a company undertakes to draw in customers and maintain relationships with them. Networking with potential or past clients is part of the work too, and may include writing thank you emails, playing golf with prospective clients, returning calls and emails quickly, and meeting with clients for coffee or a meal. At its most basic level, marketing seeks to match a company's products and services to customers who want access to those products. Matching products to customers ultimately ensures profitability.

Product, price, place, and promotion are the Four Ps of marketing. The Four Ps collectively make up the essential mix a company needs to market a product or service. Neil Borden popularized the idea of the marketing mix and the concept of the Four Ps in the 1950s.

**Product -** Product refers to an item or items the business plans to offer to customers. The product should seek to fulfill an absence in the market, or fulfill consumer demand for a greater amount of a product already available. Before they can prepare an appropriate campaign, marketers need to understand what product is being sold, how it stands out from its competitors, whether the product can also be paired with a secondary product or product line, and whether there are substitute products in the market.

**Price -** Price refers to how much the company will sell the product for. When establishing a price, companies must consider the unit cost price, marketing costs, and distribution expenses. Companies must also consider the price of competing products in the marketplace and whether their proposed price point is sufficient to represent a reasonable alternative for consumers.

**Place -** Place refers to the distribution of the product. Key considerations include whether the company will sell the product through a physical storefront, online, or through both distribution channels. When it's sold in a storefront, what kind of physical product placement does it get? When it's sold online, what kind of digital product placement does it get?

**Promotion -** Promotion, the fourth P, is the integrated marketing communications campaign. Promotion includes a variety of activities such as advertising, selling, sales promotions, public relations, direct marketing, sponsorship, and guerrilla marketing[20]**.**

Promotions vary depending on what stage of the product life cycle the product is in. Marketers understand that consumers associate a product’s price and distribution with its quality, and they take this into account when devising the overall marketing strategy. Marketing refers to any activities undertaken by a company to promote the buying or selling of a service.

Special Considerations

As of 2017, approximately 62% of consumers buy items online each month. Experts expect online sales in the U.S. to increase from $587 billion in 2019 to over $735 billion by 2023.

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[20] Guerrilla marketing is an advertisement strategy in which a company uses surprise and/or unconventional interactions in order to promote a product or service. It is a type of ppublicity. The term was popularized by Jay Conrad Levinson's 1984 book *Guerrilla Marketing*.

Guerrilla marketing uses multiple techniques and practices in order to establish direct contact with the customers. One of the goals of this interaction is to cause an emotional reaction in the clients, and the ultimate goal of marketing is to get people to remember products or brands in a different way than they are accustomed to.

Taking these statistics into consideration, online marketing is a critical element of a complete marketing strategy. It is vital for marketers to use online tools such as social media and digital advertising, both on website and mobile device applications, and internet forums. Considering an appropriate distribution channel for products purchased online is also an important step.

## 11.1. WHAT ARE THE 4 PS?

The four Ps of marketing are the key factors that are involved in the marketing of a good or service. They are the product, price, place, and promotion of a good or service. Often referred to as the marketing mix, the four Ps are constrained by internal and external factors in the overall business environment, and they interact significantly with one another.

The 4 Ps are used by companies to identify some key factors for their business, including what consumers want from them, how their product or service meets or fails to meet those needs, how their product or service is perceived in the world, how they stand out from their competitors, and how they interact with their customers.

**KEY TAKEAWAYS**

- The four Ps are the four essential factors involved in marketing a good or service to the public.
- These are the four Ps: the product the good or service, the price what the consumer pays, the place the location where a product is marketed, and promotion the advertising.
- The concept of the four Ps has been around since the 1950s; as the marketing industry has evolved, the concepts of people, process, and physical evidence have become important components of marketing a product, too.

**UNDERSTANDING THE 4 PS**

Neil Borden popularized the idea of the marketing mix—and the concepts that would later be known primarily as the four Ps—in the 1950s. Borden was an advertising professor at Harvard University. His 1964 article titled "The Concept of the Marketing Mix" demonstrated the ways that companies could use advertising tactics to engage their consumers. Decades later, the concepts that Borden popularized are still being used by companies to advertise their goods and services.

When they were first introduced, Borden's ideas were very influential in the business world and were developed and refined over a number of years by other key players in the industry. It was actually E. Jerome McCarthy, a marketing professor at Michigan State University, who refined the concepts in Borden's book and created the idea of the "4 Ps," a term that is still used today. In 1960, McCarthy co-wrote the book "Basic Marketing: A Managerial Approach," further popularizing the idea of the 4 Ps. At the time the concept was first coined, the marketing mix helped companies account for the physical barriers that prevented widespread product adoption. Today, the Internet has helped businesses achieve a greater level of integration between businesses and consumers, and also to overcome some of these barriers. People, process, and physical evidence are extensions of the original 4 Ps, and are more relevant to the current trends in marketing.

Any successful marketing strategy requires revisiting over time. If you are developing a 4 Ps strategy for your business, it's important to understand that the elements of the first marketing mix you create are not intended to be static; they are meant to be adjusted and refined as your company's product grows and as your potential buyer’s change.

## HOW THE FOUR PS WORK

**Product** refers to a good or service that a company offers to customers. Ideally, a product should fulfill an existing consumer demand. Or a product may be so compelling that consumers believe they need to have it and it creates a new demand. To be successful, marketers need to understand the life cycle of a product, and business executives need to have a plan for dealing with products at every stage of their life cycle. The type of product also partially dictates how much businesses can charge for it, where they should place it, and how they should promote it in the marketplace.

Many of the most successful products have been the first in their category. For example, Apple was the first to create a touchscreen smartphone that could play music, browse the Internet, and make phone calls. As of November 2018, Apple stopped providing public sales figures for the iPhone. However, as of November 1, 2018, total sales of the iPhone equaled $2.2 billion. Apple revealed that it had sold its one billionth iOS device on November 22, 2014. And in 2018, the company announced they were approaching selling their two billionth iOS device.

**Price** is the cost consumers pay for a product. Marketers must link the price to the product's real and perceived value, but they also must consider supply costs, seasonal discounts, and competitors' prices. In some cases, business executives may raise the price to give the product the appearance of being a luxury. Alternatively, they may lower the price so more consumers can try the product. Marketers also need to determine when and if discounting is appropriate. A discount can sometimes draw in more customers, but it can also give the impression that the product is less exclusive or less of a luxury compared to when it is priced higher.

UNIQLO[21], headquartered in Japan, is a clothing manufacturer of global casual wear. Like its competitors—other famous causal wear brands such as Gap and Zara—UNIQLO creates low-price, daily-use garments. What makes UNIQLO unique is that it creates innovative, high-quality products. It is able to accomplish this by procuring its fabric from its material manufacturer partners, securing stable, high-quality materials at low cost by ordering in large volumes, and continuously seeking the highest-quality and lowest-cost material in the world. The company also directly negotiates with its manufacturers and has built strategic partnerships with high-quality and innovative Japanese manufacturers.

UNIQLO also outsources its production to partner factories; because it doesn't own its own factories, it has the flexibility to change production partners if the best production location changes over time. Finally, the company employs a team of skilled textile artisans that it sends to its partner factories all over the world for quality control. In addition, production managers visit factories once a week to resolve quality problems.

[21] https://www.uniqlo.com/us/en/home/

**Place -** When a company makes decisions regarding place, they are trying to determine where they should sell a product and how to deliver the product to the market. The goal of business executives is always to get their products in front of the consumers that are the most likely to buy them. In some cases, this may refer to placing a product in certain stores, but it also refers to the product's placement on a specific store's display. In some cases, placement may refer to the act of including a product on television shows, in films, or on web pages in order to garner attention for the product.

The 1995 movie Goldeneye was the seventeenth installment in the James Bond movie franchise. It was the first Bond movie not to feature an Aston Martin car. Instead, the British actor Pierce Brosnan got into a Z3 by BMW. Although the Z3 was not released until months after the film had left theaters, BMW received 9,000 orders for the car the month after the movie opened.

**Promotion -** includes advertising, public relations, and promotional strategy. The goal of promoting a product is to reveal to consumers why they need it and why they should pay a certain price for it. Marketers tend to tie promotion and placement elements together so they can reach their core audiences. For example, In the digital age, the "place" and "promotion" factors are as much online as they are offline. Specifically, where a product appears on a company's web page or social media, as well as which types of search functions trigger corresponding, targeted ads for the product.

The Swedish vodka brand Absolut sold only 10,000 cases of its vodka in 1980. But by 2000, the company had sold 4.5 million cases, thanks in part to its iconic advertising campaign. The images in the campaign featured the brand's signature bottle styled as a range of surreal images: a bottle with a halo, the bottle made of stone, or as the outline of trees on a ski slope. To date, this Absolut advertising campaign is one of the longest-running continuous ad campaigns of all time, from 1981 to 2005.

The marketing mix helps you define the marketing elements for successfully positioning your market offer. One of the best-known models is the 4Ps of Marketing, which helps you define your marketing options in terms of product, place, price, and promotion.

# CHAPTER 12.
# PRICING STRATEGY

Price is the value that is put to a product or service and is the result of a complex set of calculations, research and understanding and risk taking ability. A pricing strategy takes into account segments, ability to pay, market conditions, competitor actions, trade margins and input costs, amongst others. It is targeted at the defined customers and against competitors. A business can use a variety of pricing strategies when selling a product or service. To determine the most effective pricing strategy for a company, senior executives need to first identify the company's pricing position, pricing segment, pricing capability and their competitive pricing reaction strategy. Pricing strategies and tactics vary from company to company. They also differ across countries, cultures, and industries – and over time, with the maturing of industries and markets and changes in wider economic conditions.

Pricing strategies determine the price companies set for their products. The price can be set to maximize profitability for each unit sold or from the market overall. It can also be used to defend an existing market from new entrants, to increase market share within a market or to enter a new market. Pricing strategies can bring both competitive advantages and disadvantages to its firm and often dictate the success or failure of a business; thus, it is crucial to choose the right strategy.

***Premium pricing:*** high price is used as a defining criterion. Such pricing strategies work in segments and industries where a strong competitive advantage exists for the company. Example: Porche in cars and Gillette in blades.

***Penetration pricing:*** price is set artificially low to gain market share quickly. This is done when a new product is being launched. It is understood that prices will be raised once the promotion period is over and market share objectives are achieved. Example: Mobile phone rates in India; housing loans etc.

***Economy pricing:*** no-frills price. Margins are wafer thin; overheads like marketing and advertising costs are very low. Targets the mass market and high market share. Example: Friendly wash detergents; Nirma; local tea producers.

***Skimming strategy:*** high price is charged for a product till such time as competitors allow after which prices can be dropped. The idea is to recover maximum money before the product or segment attracts more competitors who will lower profits for all concerned. Example: the earliest prices for mobile phones, VCRs and other electronic items where a few players ruled attracted lower cost Asian players.

Deciding how much to charge for your product requires more thought than simply calculating your costs and adding a mark-up. “How much the customer is willing to pay for the product has very little to do with cost and has very much to do with how much they value the product or service they are buying, “says Eric Dolansky, Associate Professor of Marketing at Brock University in St.Catharines, Ont. Figuring out how much the customer values your product or service and pricing it accordingly is called value-based pricing. It is a technique Dolansky believes more entrepreneurs should use.

How do you arrive at value – based price? Dolansky provides the following advice for entrepreneurs who want to determine a value-based price.

- Pick a product that is comparable to yours and find out what the customer pays for it.
- Find all of the ways that your product is different from the comparable product.
- Place a financial value on all of these differences, add everything that is positive about your product and subtract any negatives to come up with a potential price.
- Make sure the value to the customer is higher than your costs;
- Demonstrate to customers why the price will be acceptable, which includes talking to them.
- If there is an established market, the current price range will help educate you about the customer`s price expectations.

## 5 COMMON PRICING STRATEGIES

Pricing a product is one of the most important aspects of your marketing strategy.

Generally, pricing strategies include the following five strategies. 1. Cost – plus pricing simply calculating your costs and adding a mark-up;

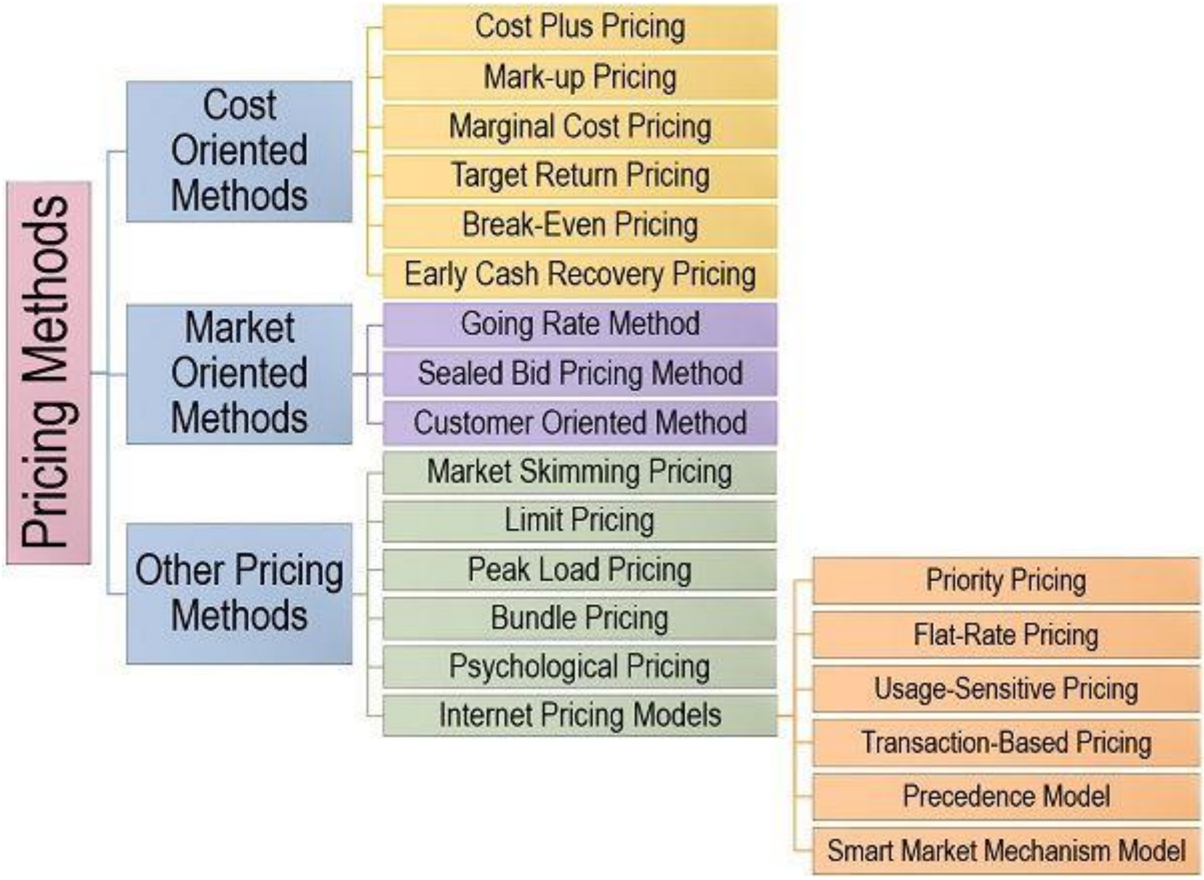
2. Competitive pricing – setting a price based on what the competition charges;

3. Pricing skimming – setting a high price and lowering it as the market evolves;

4. Penetration pricing – setting a low price to enter a competitive market and raising it later.

## 12.1. PRICING METHODS

1. Cost-Oriented Methods
   - Cost Plus Pricing
   - Mark-up Pricing
   - Marginal Cost Pricing
   - Target Return Pricing
   - Break-Even Pricing
   - Early Cash Recovery Pricing
2. Market Oriented Methods
   - Going Rate Method
   - Sealed Bid Pricing Method
   - Customer-Oriented Method
3. Other Pricing Methods
   - Market Skimming Pricing
   - Limit Pricing
   - Peak Load Pricing
   - Bundle Pricing
   - Psychological Pricing
   - Internet Pricing Models




**Cost-Oriented Methods -** These are the traditional methods of product pricing. The major factors which influence the product price are the fixed cost, variable cost other overheads incurred in manufacturing the products.

Let us now go through the different cost-oriented pricing models below:

**Cost Plus Pricing -** Cost-plus pricing is one of the simplest ways of price determination. A certain percentage of cost is added as a profit margin to the value of the product to acquire the selling price.

**Mark-up Pricing -** It is a form of cost-plus pricing, but here the profit margin is presented as a percentage of expected return on sales. The formula for mark-up pricing is:

$$\text{Mark} - \text{up Price} = \frac{\text{Unit Cost (Fixed + Variable)}}{1 - \text{Percentage of Expected Return on Sales}}$$

*Example*: If the unit cost of manufacturing a bag is ₹100 and the expected return on sales is 25%, determine the mark-up price.

**Mark-up Price=Unit Cost (Fixed+Variable)/(1-Percentage of Expected Return on Sales)**

Mark-up Price=100/1-25%

Mark-up Price=₹133.33

**Marginal Cost Pricing -** The primary aim of the company adopting this pricing method is to meet its marginal cost and overheads. The marginal costing method is suitable for entering the industries which are dominated by giant players, posing a fierce competition for the organization to sustain in the business.

**Target Return Pricing -** The pricing objective in target return method is to attain a certain level of ROI (Return on Investment). The formula for determining the target return price is:

$$\text{Target Return Price} = \frac{\text{Total Cost} + \text{Desired Return on Investment}}{\text{Total Sales in Units}}$$

To find out the desired return on investment:

$$\text{Desired Return on Investment} = \text{Desired \%ROI} \times \text{Total Investment Value}$$

*Example*: If the total business investment is ₹80000, the desired ROI is 25%; the total cost incurred is ₹30000 and the expected sales are 5000 units, determine the target return price.

Target Return Price=(Total Cost+Desired Return on Investment)/Total Sales in Units Desired Return on Investment=Desired %ROI×Total Investment Value

Desired Return on Investment=25%×80000

Desired Return on Investment=₹20000

Target Return Price=(30000+20000)/5000

Target Return Price=₹10

**Break-Even Pricing**

This method is similar to break-even analysis, here the company needs to price the products such that it generates profit after recovering the fixed and variable costs. The selling price should be equal to or more than the break-even price (the point at which the sales revenue matches the cost of goods sold).

The formula for ascertaining the break-even limit is:

$$\text{Break} - \text{Even Limit} = \frac{\text{Total Fixed Cost}}{\text{Selling Price Per Unit} - \text{Variable Cost Per Unit}}$$

*For instance*, a company incurs ₹500000 as fixed cost and ₹25 as a variable cost. If the selling price is Rs.75, find out the break-even limit.

Break-Even Limit=Total Fixed Cost/(Selling Price Per Unit-Variable Cost Per Unit)
Break-Even Limit=500000/(75-25)
Break-Even Limit=10000 Units

Thus, the organization either needs to sell more than 10000 units or price the product higher than Rs.75 to earn a profit.

**Early Cash Recovery Pricing -** When it comes to rapidly growing technological products or the ones with a short life cycle, the cost needs to recover as early as possible. This method is very similar to target return pricing; the only difference is that it considers a high value of return on investment owing to a short recovery period.

**Market-Oriented Methods -** In a highly competitive market, the company cannot survive with cost-oriented pricing. Hence, it needs to price its products according to the market demand and competitor's pricing strategy. To understand the three primary market-oriented models of pricing, read below:

**Going Rate Method -** 'Follow the crowd' method is based on market competition, where the company price its product similar to the competitor's product price. If the market leader reduces the price of its product, the organization also needs to decrease its product price, even if the latter's cost of production is high.

**Sealed Bid Pricing Method -** When it comes to industrial marketing or government projects, the supplier needs to bid specific product price, which he/she assumes to be the lowest, in a sealed quotation. In other words, the organization needs to fill a tender, which indicates its costing and competitiveness. The pricing should be done smartly by estimating the profit margin at different price levels and enclosing the most competitive price.

**Customer-Oriented Method -** This method is also called perceived value pricing. It is demand-based pricing where the company determines the product price on value perception in terms of consumer demand for the particular goods or service. This perceived value is based on the following constituents:

- **Acquisition Value**: The acquisition value is based on the opportunity cost of a product or service, which is estimated through the comparison of the perceived benefit and the perceived sacrifice.
- **Transaction Value**: The comparison of the customer's reference price (assumed or quoted price) with the actual price paid for the product or service is the transaction value.

The other methods to find out the perceived value are as follows:

- **Direct Price Rating Method**: The customers need to determine the price of products displayed to them, where each product belong to a different brand.

- **Direct Perceived Value Rating**: The buyers rate the different brand products on a scale of 0-100 according to their preference. The highest-rated product has the maximum perceived value.

- **Economic Value to the Customer**: To determine the target market segment, the companies correlate its total product cost to the consumer benefits of the current product.

- **Diagnostic Method**: The customers evaluate products of multiple brands on various parameters or attributes. Each attribute has an importance weight, and on multiplying it with the given ratings, the perceived value of each brand can be determined.

**Other Pricing Methods -** There are specific other methods for determining the price of a product or service, other than considering the cost or market competition as the basis. These are explained in detail below:

**Market Skimming Pricing -** The skimming method is usually implemented in case of speciality, luxury or innovative products. Here, the company avails the profit opportunity in the initial stage of marketing by selling the products at a high price in a non-price-sensitive market segment. Later, the prices are dropped down gradually to sustain in the market.

**Limit Pricing -** This is defensive pricing strategy. The company price its products immensely low (and this price is known as entry forestalling price), to retain the monopoly in the market. It is done to discourage the entry of competitors by presenting the business as unattractive and non-profitable.

**Peak Load Pricing -** The peak load method is demand-based pricing, where the companies charge high prices in the peak seasons or period when the demand for the product is quite high. However, in the off-peak time or season when the demand falls, the prices are kept low. It is applied for seasonal product pricing, airline travel pricing, tourism package pricing, etc.

**Bundle Pricing -** Bundling refers to compiling of two or more products together and selling it as a single product. The company prices the complete bundle at a single price known as the offer price. An organization can either opt for pure bundling, where the products in a bunch are strictly not available individually. Or it may go for a mixed bundling, i.e. the products in a bundle can be sold separately but at a higher price.

**Psychological Pricing -** This pricing method aims to influence the consumers mentally by posing a low product price. Here, the product is priced slightly less than a round figure, for instance: a product is priced at ₹99 instead of ₹100 or 1.98$ instead of 2$. This makes the consumer assume that the product price lies within the range of ₹100 or 2$ and therefore it is worth buying.

**Internet Pricing Models -** Internet is a modern communication platform and therefore, provides vast scope for carrying out marketing activities. The different pricing methods for internet services (as a product) are as follows:

**Priority Pricing**: The consumer's priority for service quality determines the price of internet services; thus, the price increases with the quality of internet service.

**Flat-Rate Pricing**: The consumer is charged a fixed amount for availing the internet services for a defined period irrespective of the sage.

**Usage-Sensitive Pricing**: The utility tariff is divided into two sections, the provider first charges for the service connection and then for the usage in terms of price per unit (bit).

**Transaction-Based Pricing**: Here, the price is first charged for service connection and then each transaction is separately chargeable.

**Precedence Model**: The pricing here, is based on the security provided to the existing customers by setting up the priority of different applications. Data packets are formed based on network preference and are given different precedence numbers. In case of congestion, the packets are sent in the sequence of their assigned precedence numbers.

**Smart Market Mechanism Model**: This model is purely dependent on network congestion. It functions through a dynamic bidding system where the bit price fluctuates with the level of congestion or traffic in the network. The bidder with the highest bit or unit price wins the deal.

Every business organization has a different objective; not all the companies aim at profit-making. Some may look forward to capturing the market and others may focus on long term existence. Thus, these organizational goals determine the pricing methods to some extent. However, the prevailing market trends or industry type also influence these decisions massively.

# CHAPTER 13. HOSPITALITY AND TOURISM

Hospitality and tourism is a massive, collective industry consisting of tourism and other hospitality-related businesses. Tourism companies are technically considered hospitality businesses because they rely on strong customer service to generate revenue. They must provide a welcoming, enjoyable experience to their guests. Otherwise, those guests won't return in the future, and some guests may share their bad experience with friends or family members.

All hospitality businesses, even those residing outside of the tourism sector, follow a similar approach with their operations by emphasizing the importance of strong, positive customer service.

So, what is the Hospitality industry? First, it is important to define what we mean by the hospitality industry. After all, it is a broad field and while most people have a basic idea of the types of businesses that count as hospitality brands, a far smaller number are able to provide a coherent and satisfactory explanation of what the industry is, and what it is not. Put simply, the hospitality industry refers to a variety of businesses and services linked to leisure and customer satisfaction. A defining aspect of the hospitality industry is also the fact that it focuses on ideas of luxury, pleasure, enjoyment and experiences, as opposed to catering for necessities and essentials.

## THE DIFFERENCE BETWEEN THE HOSPITALITY INDUSTRY AND THE TRAVEL INDUSTRY

The hospitality industry and the travel industry are closely connected, but there are also some subtle differences to be aware of. On a basic level, the travel or tourism industry is concerned with services for people who have travelled away from their usual place of residence, for a relatively short period of time.

By contrast, the hospitality industry is concerned with services related to leisure and customer satisfaction. This may well mean offering services to tourists, but it can also include the provision of services to people who are not tourists, such as locals enjoying their free time, or people coming to an area for reasons other than tourism.

**1) ACCOMMODATION**

The accommodation sector of the hospitality industry is concerned with providing customers with a place to stay, on a temporary basis. It is most commonly associated with the tourism industry, where people book holidays or trips and require lodgings, but the accommodation sector also caters to local people seeking a short break from their everyday routine, or those who require temporary accommodation for almost any other purpose.

**BED & BREAKFASTS**

Bed & breakfasts, also known as B&Bs, are small establishments, which offer overnight stays and breakfast in the morning. Most B&Bs owners live in the property, while guests are provided with a private room and, in most cases, they will also have a private or en suite bathroom. However, bathroom facilities are sometimes shared.

**HOTELS**

Arguably the most obvious form of accommodation that falls within the hospitality industry, hotels cater to people who require overnight or longer-term stays. Aside from offering lodgings, they tend to provide various other services, including room service, housekeeping, and facilities for eating and drinking.

**MOTELS**

Motels are similar to hotels, but are specifically designed for use as overnight accommodation by motorists. With this in mind, they are generally situated at the roadside, and will have free car parking facilities. Unlike hotels, however, motels usually offer little in the way of additional services or amenities.

**HOSTELS**

Hostels are a form of communal accommodation, where multiple guests will usually sleep in a shared room, with the guests effectively renting a bed. Bathroom and kitchen facilities are usually shared and hostels offer less privacy than hotels. Yet, they are usually significantly cheaper, making them a solid option for those with a low budget.

**RESORTS**

A resort is similar to a hotel, but it will provide a wider range of facilities and amenities. This means that guests are able to access sleeping facilities, food and drink facilities, entertainment facilities, shopping facilities and other amenities without needing to leave the resort. Many resorts also offer all-inclusive pricing.

**SERVICED APARTMENTS**

Another form of accommodation that shares similarities with hotels, serviced apartments are self-contained units, which are supplied for either short-term or long-term stays. These apartments will typically be fully furnished, will contain a kitchen, and may include various hotel-like services, such as laundry and cleaning.

**TIME SHARING**

Finally, time shared accommodation is a type of accommodation where ownership or usage rights are shared between multiple people. It may be a house, condo, or similar type of property and each owner will typically be allocated a particular time of the year where they will have right of use.

**2) FOOD & DRINKS**

While food and drinks are necessities, most food and drinks services also fall under the hospitality industry umbrella, due to the fact that they offer people a way of spending their leisure time and disposable income, as well as an opportunity to socialise and enjoy an experience. Again, the food and drinks sector caters to a wide range of customers, including tourists, locals, ex-pats and passers-by.

**RESTAURANTS**

Restaurants provide customers with food and drinks services, with the food either being eaten in the establishment, or taken away for consumption. This section of the hospitality industry includes fine dining restaurants, takeaway restaurants, fast food restaurants and a variety of other restaurant types.

**CATERING**

Catering services are food services provided within a particular site, or in a more remote location, where food and drink are not necessarily the main service provided. Examples of this include catering provided at parks, arenas, stadiums, hotels, event venues and on certain forms of public transport.

**BARS & CAFÉS**

Bars and cafés provide customers with options to go out, socialize and enjoy food and drinks. They also tend to be a more casual option than most sit-in restaurants. Cafés generally focus on coffee, tea and light snacks, while bars tend to prioritize alcoholic drinks and soft drinks, and may also offer additional entertainment.

**NIGHTCLUBS**

Nightclubs are one of the main ways the hospitality industry caters to people in search of night-time entertainment. They serve alcoholic drinks, are kept open until late, and often place an emphasis on both music and dancing. Many nightclubs have specific themes and they may cater for locals, as well as visitors or tourists.

**TEA & COFFEE SHOPS**

Tea rooms and coffee shops provide a similar function to cafés, primarily serving varieties of tea and coffee, as the name suggests. With that being said, tea and coffee shops are often individual room within larger buildings, such as hotels, and they may also sell products to be taken away, such as tea bags and coffee beans.

## 3) TRAVEL AND TOURISM

It is important to understand that the hospitality industry and the travel industry are closely linked. Many of the services that are classed as travel industry offerings are also hospitality offerings, because they are linked to leisure, customer satisfaction, pleasure, experiences and the use of disposable income. Importantly, the cross-over between the tourism industry and the hospitality industry centres on services, rather than end-products.

### TRAVEL AGENTS

Essentially, travel agents serve to sell travel products to customers, on behalf of suppliers. They will often receive a commission for successful sales and can be a convenient option for inexperienced travelers, providing them with advice on the best travel products for their particular needs.

### TOUR OPERATORS

A tour operator offers a combination of travel and tour products, combining them into a package, which is then sold to customers. This might, for instance, include travel to a destination, transfers from a hotel or train station to a hotel, as well a number of trips, activities or experiences throughout the customer’s stay.

### ONLINE TRAVEL AGENCIES (OTAS)

Online travel agents, or OTAs, perform many of the same functions as traditional travel agents, albeit over the internet. However, the use of online platforms means customers often have access to a greater level of self-service, with the OTAs helping users to search for the travel products that best suit their requirements.

**CRUISES**

Cruises are voyages on cruise ships, undertaken for pleasure, rather than for the sole purpose of transportation. A cruise may have various stops along the way, but passengers will spend the vast majority of their time aboard the cruise ship, which will provide them with lodgings, entertainment, catering and more.

**CAR RENTAL**

Car rental services cater to customers who require short-term access to a car. In many cases, these services are used by tourists travelling to other parts of the world, although some locals may also wish to rent a car, especially if they do not have regular access to one, or if they require a larger number of passenger seats.

**CASINOS**

Finally, a casino is an entertainment establishment, which provides customers with opportunities to gamble. These gambling opportunities are predominantly offered via luck-based games. In addition to the gambling component, many casinos also stage live performances, offer food and drinks, and are connected to hotels.

**THE LATEST HOSPITALITY TRENDS**

It is important for businesses operating within the hospitality industry to keep up with the latest hospitality trends, in order to avoid being left behind. Furthermore, keeping pace with the wider industry is one of the ways owners can help to ensure their business is delivering an excellent customer experience

**HOSPITALITY TECHNOLOGY TRENDS**

As in every industry these days, technology is becoming also tremendously important within the hospitality industry. It helps companies operating in the industry to innovate processes and customer experiences. Furthermore, guests are used to a variety of technologies at home, so they also expect at least the same level when they are on holiday. Keeping up with the latest technology is essential, because the industry is extremely competitive.

**HOSPITALITY MARKETING TRENDS**

Introducing the most effective hospitality marketing tools to your business is essential for attracting new customers and increasing your brand’s reputation. Marketing your business through digital platforms is a powerful way to gain maximum exposure. Knowing how users plan and book their accommodation and tours online will help you utilize the most powerful marketing strategies.

**THE RELEVANCE OF REVENUE MANAGEMENT FOR THE HOTEL AND HOSPITALITY INDUSTRY**

Every industry is competitive, and hospitality industry is no different. An effective revenue management strategy can help to maximize profits, not just for the hotel sector, but also for resorts, cruises, restaurants, casinos, and any other hospitality sector. Revenue management utilises a revenue optimisation method that helps businesses in the hotel and hospitality industry exploit their full potential for higher profitability. Learn about the definition of revenue management and its importance in this article, 'Revenue Management; clearly explained!'.

**FIND TRAVEL AGENCIES TO GENERATE MORE BOOKINGS IN THE HOSPITALITY INDUSTRY**

When people look for travel products or services online, rather than going to individual company websites, they often turn to travel agencies. For this reason, the hospitality industry can potentially benefit from linking to a travel agency platform, because the agency will be able to generate incremental bookings for you.

Read "Find Travel Agencies to Generate More Bookings" and you will have access to a list of the main travel agencies to partner with, along with further information about why working with travel agencies is so important.

**HOSPITALITY MANAGEMENT**

Hospitality is an industry that includes restaurants, hotels, casinos, amusement parks, events, cruises, entertainment, and other tourism-related services. As such, this industry isn't just important to businesses, but also to customers, employees, and economies. Providing customers with an excellent service is the primary goal of hospitality managers as they focus on creating high-standard services and environments for the purpose of making their customers feel welcomed at their establishments. 'Hospitality Management: The Essentials About Hospitality' is a comprehensive guide that explains how to kick-start your career in the hospitality sector.

## AN OVERVIEW OF DIFFERENT HOSPITALITY CAREERS

The hospitality industry is so diverse that those who are seeking hospitality careers have a substantial number of different job roles to choose from. Whether you want to work in food and drinks service, a front office position, cleaning and maintenance, or in a managerial role, it is vital to understand the different options available.

Read "An Overview of Different Hospitality Careers" for a breakdown of the most common and important hospitality positions that are available, complete with a description of what each job actually entails.

## HOSPITALITY COURSE: AN OVERVIEW OF HOSPITALITY INDUSTRY EDUCATION

The hospitality industry offers many different job roles and while some of these are entry-level positions, others will require more advanced skills and knowledge. This means that there may be some career options that will require you to take a hospitality course first. Fortunately, there is a diverse range of options to choose from.

If you would like to learn more about the hospitality courses that exist, what they cover, how they can benefit you, and where you can find them, read "Hospitality Course: An Overview of Courses & Hospitality Educators".

## FREE ONLINE GUIDE ON REVENUE MANAGEMENT & MARKETING STRATEGIES

Excellent facilities, a first-class service, the most comfortable rooms, and a great location may all be the highlights of your hotel, but the question is, are your potential customers aware of these? Having a perfect hotel without anyone knowing about it is no use unless you use the most effective hotel marketing strategies. The 'Free Guide: Revenue Management & Hotel Marketing Strategies' will show you how to market your hotel business effectively by utilising some important strategies.

## HOW THE CORONA VIRUS EPIDEMIC HAS AFFECTED THE HOSPITALITY INDUSTRY?

The global impact of the corona virus on businesses, especially the hotel and hospitality industry, has meant fewer people are able to travel due to the imposed travel restrictions. Almost all the local and international events have been cancelled or postponed to a later date, with examples including the Olympic Games in Japan, the 2020 UEFA EURO, and the largest travel trade fair, ITB Berlin, to name some of the few. With almost every business facing restrictions, and people worrying about their job security, it’s no wonder that no-one is keen to book their holidays for 2020 or even 2021. The hospitality industry is one of the sectors that’s been hit the hardest. Some hotels have lost up to 90 per cent in occupancy, and some restaurants and hotels had no choice but to make their staff redundant in order to stop their recurring costs. As a result, many businesses have been forced to deal with their own cash flow problems and facing an uncertain future.

In the category “Corona” you find a selection of tips which helps businesses operating in the hospitality and travel industry to recover and prepare for better times.

Ultimately, the hospitality industry should be classed as a section of the service industry, which focuses on leisure and customer satisfaction, rather than on necessities and end-products. It is a broad industry, containing multiple sectors, as well as a wide range of different businesses and products.

## WANT TO LEARN MORE ABOUT RELATED INDUSTRIES?

The hospitality industry is part of the travel industry and the hotel industry is part of the hospitality industry. All of these industries have in common that they are large service industries in the world and increasingly important in the modern age. But what is the difference between the travel and tourism industry? And what are all hospitality sectors within the hospitality industry? In the following articles you learn more about related industries.

- Travel Industry; An Overview of One of the Largest Service Industries
- Hotel Industry; An Overview of All Different Types of Accommodations
- Tourism Industry; Everything You Need to Know About Tourism
- What is the Difference Between the Travel and Tourism Industry?

- Airline Industry: All You Need to Know About The Airline Sector
- Aviation Industry: Everything You Need to Know About the Aviation Sector
- Everything You Need to Know About the Cruise Industry
- Space Tourism: 5 Space Companies That Will Make You An Astronaut

## 13.1. WHAT ARE THE 4 SEGMENTS OF THE HOSPITALITY INDUSTRY?

While many business niches are composed of only a handful of different businesses, the hospitality industry applies to nearly any company that deals with customer satisfaction and is focused on meeting leisurely needs rather than basic ones.

With the broadness of this industry, some defining aspects are important to understanding. The hospitality industry is a broad category of fields within service industry that includes lodging, event planning, theme parks, transportation, cruise line, and additional fields within the tourism industry.

A hospitality unit such as a restaurant, hotel, or an amusement park consists of units such as facility maintenance and direct operations (servers, housekeepers, porters, kitchen workers, bartenders, management, marketing, and human resources, etc.).

The hospitality industry is a multibillion-dollar industry that depends on the availability of leisure time, disposable income, and complete customer satisfaction. There are four segments of the hospitality industry: Food and beverages, Travel and Tourism, lodging, and recreation.

1. **FOOD AND BEVERAGES**

The food and beverage sector which is professionally known by its initials as F&B is the largest segment of the hospitality industry.

The F&B industry is estimated to provide 50% of all meals eaten in the US today. It comprises of establishments primarily engaged in preparing meals, snacks, and beverages for immediate consumption on and off the premises. When a restaurant is part of a hotel, services it renders can enhance the guest experience by providing excellent food and first-class customer service.

It can symbiotically function as part of other businesses, such as in bowling alleys or movie theaters.

2. **TRAVEL AND TOURISM**

Travel and tourism deal with services related to moving people from place to place. Buses, cabs, planes, ships, trains and so on are all part of the travel industry.

Leisure travel is when a person spends money on lodging, food, and recreation while taking a vacation trip, and business travel is when a person travels for work and spends money on lodging and food. Some people also spend on recreation while on a business travel.

The major function of the tourism is to encourage people to travel. When people travel, either for business or leisure, they spend money on hospitality.

3. **LODGING**

Lodging means accommodation for a period or a place to sleep for one or more nights. Fancy hotels, youth hostels, elder hostels, campgrounds, motels and other businesses that provide a place for people to sleep overnight are all in the lodging industry.

Lodging businesses markets to other market segments such as business travelers, leisure travelers, long-stay travelers, budget travelers, and special travelers like people working with the government, airlines, and military.

4. **RECREATION**

Recreation is any activity that people do for rest, relaxation, and enjoyment. The goal of recreation is to refresh a person's body and mind. Any business that provides activities for rest, relaxation and enjoyment, to refresh a person's body and mind is in the recreation business.

Entertainment businesses which provide shows such as movie or theater, attractions which are places of special interest of visits such as zoos and museums, spectator sports and participatory sports are all parts of the recreation business.

## 13.2. WHAT ARE THE TOP TRENDS FOR 2021?

What are the latest trends in the hospitality industry? Well, it goes without saying that the coronavirus outbreak and ensuing safety measures have had a significant impact on hospitality throughout 2020 and will no doubt spill over into 2021 and beyond. Some responses to this extraordinary situation, attempting to **entice patrons back into food and beverage outlets** and assure holidaygoers that it is indeed safe to enjoy a hotel stay, have **accelerated existing hospitality industry trends** and triggered lasting change.

Meanwhile, evolution at the societal level - consequence in part of shifted values in the aftermath of the pandemic's most acute phase and in part of increased consumer awareness of all things sustainable and purposeful - has set new benchmarks for hospitality enterprises. EHL Insights presents to your current trends in the hospitality industry.

### #1 - STAYCATIONS

In stark contrast to last year's no. 5 hospitality industry trend "booming global tourism", travel restrictions in 2020 have facilitated the rise of the staycation. Some vacationers may also be choosing to stay closer to home for environmental or budgeting reasons, with this year having seen a marked uptick in holidays spent more locally. Surging online content promising to "create a balcony haven" or "a garden oasis to be proud of" are a sign of the times.

### #2 - DIGITALIZED GUEST EXPERIENCES & CONTACTLESS TECHNOLOGY

Apps, in particular, are increasingly important in the way hoteliers manage the services they provide to their customers and can now control many aspects of the guest cycle and experience.

Needless to say, the trend towards digital and contactless services has gained new momentum in 2020. Traditionally customer-facing services are being given an overhaul, thanks to the more widespread use of technology-assisted options, such as mobile check-in, contactless payments, voice control and biometrics.

Consumers who have become accustomed to unlocking their smartphones and laptops using facial and fingerprint recognition will soon come to expect the same convenience in accessing their hotel rooms, say. Unfortunately for the establishments looking to welcome them, however, these upgrades may be costly to install and maintain. If you want to stay ahead of the curve, we recommend you dig deep and make the investment.

### #3 - PERSONALIZATION

Today's guests have grown to expect to be recognized and treated as individuals. Establishments are going the extra mile to personally greet their guests, while tools such as Mailchimp and Zoho have made personalized e-mail marketing accessible to the masses, ensuring highly target audience-specific communications. Far beyond simply adding the customer's name to email greetings, data provides insight into past buying habits, enabling hotels to tailor their offers and promotions and automatically provide similar services to previous stays.

### #4 - EXPERIENCE ECONOMY & ESSENTIALISM

Customers request extreme personalization, unique experiences, and so on. This could very well lead to *the death of the travel agent* and the rise of the *independent traveler*.

Travel guilt is real. Minimalism has reinvigorated the otherwise somewhat dusty saying "less is more". Travelers are decreasingly seeking lavish displays of wealth, preferring instead to spend wisely, purposefully and make a positive impact on the world. Unique experiences that give back to local communities in meaningful ways are in demand, as are niche properties, adventurous holidays and relaxation retreats.

### #5 - NEW HOSPITALITY SKILLS & ASSET MANAGEMENT

The asset-light approach has become prevalent in the industry. The separation between the management of operations and real-estate assets now allows hospitality companies to focus on their core business, thus improving efficiencies.

It however induces additional complexity and potential agency problems, explaining the emergence of new types of jobs, such as asset managers.

In addition, new job profiles have emerged following the increasing complexity of the hospitality industry. In parallel, the need for quantitative competencies (for forecasting, budgeting, etc.) has also increased.

## #6 - SOLO TRAVELERS

In the age of mindfulness, many have embraced the meditative value of spending time alone and venturing out into the big wide world unencumbered, interacting and making friends to whatever degree suits. In an effort to make solo travelers feel comfortable, barriers between hotel staff and guests are being lowered, interior design choices made to evoke a sense of homeliness and an informal atmosphere cultivated. This, along with a less stark divide between guests and locals, encourages a feeling of hotel community.

## #7 - GENERATIONS X AND Y

These new generations have different requirements and needs compared to older generations. A respondent said "*Older generations think about hotels and car rentals. Younger generations think about Airbnb and Uber.*"

## #8 - SUSTAINABILITY

Last but not least, a hospitality trend that is both current and a hallmark of recent years: "sustainability" once again assumes rank no. 10. A natural extension of avoiding disposable plastics, eliminating unnecessary paper consumption thanks to opt-in receipts and reducing food waste, more far-reaching ethical and environmental considerations are shaping decisions made at the hospitality management level. Decisions about things as simple as which towel rails to install during renovations have disproportionate repercussions when implemented at scale. Simple eco-friendly switches include replacing miniature toiletries with larger, locally sourced dispensers, choosing ethically produced bedsheets made from organic materials and reducing energy consumption with smart bulbs, etc. Vegetarian and vegan options also harbor well-known environmental advantages.

People are becoming increasingly sensitive to environmental and social issues. A respondent said that this *"has to be considered in* *branding, but beware of green-washers: consumers are now well-aware that window-dressing exists, and they will not buy it.”*

## #9 - VIRTUAL & AUGMENTED REALITY

Following on from the orientation towards visually appealing content, it seems only natural that businesses in the hospitality industry should seek to capitalize on features such as virtual tours, conjuring up a digital environment for consumers to picture themselves in. Videos providing 360-degree views of restaurant ambiance, sweet little café terraces enveloped in greenery or hotel beachfront locations, for instance, are just the ticket to make an establishment stand out this year. As ever, keeping the access threshold low is key to reaching as broad an audience as possible with virtual reality material: making content accessible on a variety of devices, without the need for a VR headset.

Once on site, guests should be able to whip out their trusty sidekick – their smartphone – and simply point it at real-world artefacts to summon up additional information. Augmented reality uses graphical or informational overlays to enhance in-situ environments. Once they have downloaded the respective app, guests can use this tool to access restaurant opening times, reviews or interactive tourist information maps or even create user-generated content.

## #10 - AUTOMATION & TECHNOLOGY

This broad, sweeping category speaks to the technological developments that have been seen to reduce waiting times, “outsource” menial tasks to robots and use big data to optimize processes, for example. AI-powered chatbots have proven to be a customer service asset both during the booking process and in responding to the recurring questions on the protective measures pertaining to COVID-19.

Hotel operations more generally are increasingly shaped by the use of management systems to monitor and optimize revenues, customer relationships, property, channels and reputation. Mobile, cloud-based and integrated solutions are especially sought-after. Not to mention the rising importance of integrated messaging, predictive analytics, customer profiling and middleware, which seeks to connect any disparate systems. (See the respective infographic based on research undertaken by SiteMinder et al.).

## CHAPTER 14. WHAT ARE FINANCIAL STATEMENTS?

Financial statements are written records that convey the business activities and the financial performance of a company. Financial statements are often audited by government agencies, accountants, firms, etc. to ensure accuracy and for tax, financing, or investing purposes. Financial statements include:

- Balance sheet
- Income statement
- Cash flow statement.

KEY TAKEAWAYS

- Financial statements are written records that convey the business activities and the financial performance of a company.
- The balance sheet provides an overview of assets, liabilities, and stockholders' equity as a snapshot in time.
- The income statement primarily focuses on a company's revenues and expenses during a particular period. Once expenses are subtracted from revenues, the statement produces a company's profit figure called net income.
- The cash flow statement (CFS) measures how well a company generates cash to pay its debt obligations, fund its operating expenses, and fund investments.

### USING FINANCIAL STATEMENT INFORMATION

Investors and financial analysts rely on financial data to analyze the performance of a company and make predictions about its future direction of the company's stock price. One of the most important resources of reliable and audited financial data is the annual report, which contains the firm's financial statements. The financial statements are used by investors, market analysts, and creditors to evaluate a company's financial health and earnings potential. The three major financial statement reports are the balance sheet, income statement, and statement of cash flows.

### UNDERSTANDING BALANCE SHEETS

The balance sheet provides an overview of a company's assets, liabilities, and stockholders' equity as a snapshot in time. The date at the top of the balance sheet tells you when the snapshot was taken, which is generally the end of the fiscal year.

The Balance Sheet Formula

{Assets}={Liabilities}+{Owner's Equity}Assets=Liabilities+Owner's Equity

The balance sheet totals will be calculated already, but here's how you identify them.

1. Locate total assets on the balance sheet for the period.
2. Total all liabilities, which should be a separate listing on the balance sheet. It may not include contingent liabilities.
3. Locate total shareholder's equity and add the number to total liabilities.
4. Total assets should equal the total of liabilities and total equity.

**DATA FROM THE BALANCE SHEET**

The balance sheet identifies how assets are funded, either with liabilities, such as debt, or stockholders' equity, such as retained earnings and additional paid-in capital. Assets are listed on the balance sheet in order of liquidity.

Liabilities are listed in the order in which they will be paid. Short-term or current liabilities are expected to be paid within the year, while long-term or non-current liabilities are debts expected to be paid in over one year.

Items Included in the Balance Sheet

Below are examples of items listed on the balance sheet.

**ASSETS**

- Cash and cash equivalents are liquid assets, which may include Treasury bills and certificates of deposit.
- Accounts receivables are the amount of money owed to the company by its customers for the sale of its product and service.
- Inventory

**LIABILITIES**

- Debt including long-term debt
- Wages payable
- Dividends payable

**SHAREHOLDERS' EQUITY**

- Shareholders' equity is a company's total assets minus its total liabilities. Shareholders' equity represents the amount of money that would be returned to shareholders if all of the assets were liquidated and all of the company's debt was paid off.

- Retained earnings are part of shareholders' equity and are the amount of net earnings that were not paid to shareholders as dividends.

Example of a Balance Sheet

Below is a portion of Exxon Mobil Corporation's (XOM) balance sheet as of September 30, 2018.

- Total assets were $354,628.
- Total liabilities were $157,797.
- Total equity was $196,831.
- Total liabilities and equity were $354,628, which equals the total assets for the period.

**INCOME STATEMENTS**

Unlike the balance sheet, the income statement covers a range of time, which is a year for annual financial statements and a quarter for quarterly financial statements. The income statement provides an overview of revenues, expenses, net income and earnings per share. It usually provides two to three years of data for comparison.

Income Statement Formula and Calculation

{Net Income} ={Revenue}-{Expenses} Net Income=(Revenue−Expenses)

1. Total all revenue or sales for the period.
2. Total all expenses and costs of operating the business.
3. Subtract total expenses from revenue to achieve net income or the profit for the period.

**DATA FROM INCOME STATEMENTS**

An income statement is one of the three important financial statements used for reporting a company's financial performance over a specific accounting period. Also known as the profit and loss statement or the statement of revenue and expense, the income statement primarily focuses on a company’s revenues and expenses during a particular period.

Once expenses are subtracted from revenues, the statement produces a company's profit figure called net income.

**TYPES OF REVENUE**

Operating revenue is the revenue earned by selling a company's products or services. The operating revenue for an auto manufacturer would be realized through the production and sale of autos. Operating revenue is generated from the core business activities of a company.

Non-operating revenue is the income earned from non-core business activities. These revenues fall outside the primary function of the business. Some non-operating revenue examples include:

- Interest earned on cash in the bank
- Rental income from a property
- Income from strategic partnerships like royalty payment receipts
- Income from an advertisement display located on the company's property

Other income is the revenue earned from other activities. Other income could include gains from the sale of long-term assets such as land, vehicles, or a subsidiary.

**TYPES OF EXPENSES**

Primary expenses are incurred during the process of earning revenue from the primary activity of the business. Expenses include the cost of goods sold (COGS), selling, general and administrative expenses (SG&A), depreciation or amortization, and research and development (R&D). Typical expenses include employee wages, sales commissions, and utilities such as electricity and transportation.

Expenses that are linked to secondary activities include interest paid on loans or debt. Losses from the sale of an asset are also recorded as expenses.

The main purpose of the income statement is to convey details of profitability and the financial results of business activities. However, it can be very effective in showing whether sales or revenue is increasing when compared over multiple periods. Investors can also see how well a company's management is controlling expenses to determine whether a company's efforts in reducing the cost of sales might boost profits over time.

Example of an Income Statement

Below is a portion of Exxon Mobil Corporation's (XOM) income statement as of September 30, 2018.

- Total revenues were $76,605 for the period.

- Total costs were $67,525.
- Net income or profit was $6,240.[1]

**THE CASH FLOW STATEMENT**

The cash flow statement (CFS) measures how well a company generates cash to pay its debt obligations, fund its operating expenses, and fund investments. The cash flow statement complements the balance sheet and income statement.

**DATA FROM THE CASH FLOW STATEMENT**

The CFS allows investors to understand how a company's operations are running, where its money is coming from, and how money is being spent. The CFS also provides insight as to whether a company is on a solid financial footing.

There is no formula, per se, for calculating a cash flow statement. Instead, it contains three sections that report cash flow for the various activities for which a company uses its cash. Those three components of the CFS are listed below.

Operating Activities

The operating activities on the CFS include any sources and uses of cash from running the business and selling its products or services. Cash from operations includes any changes made in cash, accounts receivable, depreciation, inventory, and accounts payable. These transactions also include wages, income tax payments, interest payments, rent, and cash receipts from the sale of a product or service.

**INVESTING ACTIVITIES**

Investing activities include any sources and uses of cash from a company's investments into the long-term future of the company. A purchase or sale of an asset, loans made to vendors or received from customers or any payments related to a merger or acquisition is included in this category.

Also, purchases of fixed assets such as property, plant, and equipment (PPE) are included in this section. In short, changes in equipment, assets, or investments relate to cash from investing.

**FINANCING ACTIVITIES**

Cash from financing activities include the sources of cash from investors or banks, as well as the uses of cash paid to shareholders. Financing activities include debt issuance, equity issuance, stock repurchases, loans, dividends paid, and repayments of debt.

The cash flow statement reconciles the income statement with the balance sheet in three major business activities.

Example of a Cash Flow Statement

Below is a portion of Exxon Mobil Corporation's (XOM) cash flow statement as of September 30, 2018. We can see the three areas of the cash flow statement and their results.

- Operating activities generated a positive cash flow of $27,407 for the period.
- Investing activities generated negative cash flow or cash outflows of -$10,862 for the period. Additions to property, plant, and equipment made up the majority of cash outflows, which means the company invested in new fixed assets.
- Financing activities generated negative cash flow or cash outflows of -$13,945 for the period. Reductions in short-term debt and dividends paid out made up the majority of the cash outflows.

**FINANCIAL STATEMENT LIMITATIONS**

Although financial statements provide a wealth of information on a company, they do have limitations. The statements are open to interpretation, and as a result, investors often draw vastly different conclusions about a company's financial performance.

For example, some investors might want stock repurchases while other investors might prefer to see that money invested in long-term assets. A company's debt level might be fine for one investor while another might have concerns about the level of debt for the company. When analyzing financial statements, it's important to compare multiple periods to determine if there are any trends as well as compare the company's results its peers in the same industry.

## 14.1. WHAT IS A FINANCIAL PERFORMANCE ANALYSIS?

Financial analysis refers to the process of studying and assessing a company’s financial statements—a collection of data and figures organized according to recognized accounting principles. The aim is to understand the company's business model, the profitability (or loss) of its operations, and how it's spending, investing, and generally using its money—summarizing the company by the numbers, so to speak.

A financial performance analysis examines the company at a specific period in time—usually, the most recent fiscal quarter or year. The balance sheet, the income statement, and the cash flow statement are three of the most significant financial statements used in performance analysis.

Financial performance analysis can focus on different areas. Types of analysis can include a specific examination of a firm's:

- Working capital: the difference between a company’s current assets, such as cash, accounts receivable (customers’ unpaid bills) and inventories of raw materials and finished goods, and its current liabilities
- Financial structure: the mix of debt and equity that a company uses to finance its operations
- Activity analysis: the factors involved in the cost and pricing of goods and services
- Profitability analysis: how much money the business actually clears, after expenses and taxes

## HOW CAN I IMPROVE MY FINANCIAL PERFORMANCE?

A company's financial performance can be improved in a number of ways. Of course, trying to identify any roadblocks or friction points—and the source of these problems—is the first step. Other strategies include:

- Improving cash flow: keep better track of income/outgoes, step up collection of accounts receivable, adjust payment options and prices if necessary
- Selling unwanted/unused assets
- Revamping budgets
- Reducing expenses
- Consolidating or refinancing current debt; applying for government loans or grants
- Analyzing financial statements and performance indicators, ideally with a professional's help

What Are the Types of Financial Statements?

While there are many types of financial statements, the big three are:

1. Balance sheet, which lists a business' assets/revenues, liabilities/obligations, and owners' equity at a specific point in time.

2. Income statement, which summarizes results from business operations—revenues, expenses, and profits or losses during a specific period.

3. Cash flow statement, which complements the balance sheet and income statement. Categorized into operating, investing, and financing activities, it captures how funds are employed—literally, how the cash flows—throughout the business.

**THE BOTTOM LINE**

The financial performance of a company is based on numbers. But in the end, it imparts an impression about the company and its soundness. A financial analysis of a company's financial statements, summarized in annual reports and Form K-10s—is essential for any serious investor seeking to understand and value a company properly.

However, it's also important to realize that financial performance reflects the past, and is never an exact indicator of the future. Nor does it exist in a vacuum. Those evaluating a company's financial performance should always consider it in light of other, comparable businesses; the overall industry; and the company's own history.

## 14.2. PROFIT AND LOSS STATEMENT (P&L)

The profit and loss (P&L) statement is a financial statement that summarizes the revenues, costs, and expenses incurred during a specified period, usually a fiscal quarter or year. The P&L statement is synonymous with the income statement.

These records provide information about a company's ability or inability to generate profit by increasing revenue, reducing costs, or both. Some refer to the P&L statement as a statement of profit and loss, income statement, statement of operations, statement of financial results or income, earnings statement, or expense statement.

For non-profit organizations, revenues and expenses are generally tracked in a financial report called the statement of activities (sometimes called statement of financial activities or statement of support).

P&L management refers to how a company handles its P&L statement through revenue and cost management.

**KEY TAKEAWAYS**

- The P&L statement is a financial statement that summarizes the revenues, costs, and expenses incurred during a specified period.
- The P&L statement is one of three financial statements every public company issues quarterly and annually, along with the balance sheet and the cash flow statement.
- It is important to compare P&L statements from different accounting periods, as the changes in revenues, operating costs, R&D spending, and net earnings over time are more meaningful than the numbers themselves.
- Together with the balance sheet and cash flow statement, the P&L statement provides an in-depth look at a company's financial performance.

Understanding a Profit and Loss Statement (P&L)

The P&L statement is one of three financial statements every public company issues quarterly and annually, along with the balance sheet and the cash flow statement. It is often the most popular and common financial statement in a business plan as it quickly shows how much profit or loss was generated by a business.

The income statement, like the cash flow statement, shows changes in accounts over a set period. The balance sheet, on the other hand, is a snapshot, showing what the company owns and owes at a single moment. It is important to compare the income statement with the cash flow statement since, under the accrual method of accounting, a company can log revenues and expenses before cash changes hands.

The income statement follows a general form as seen in the example below. It begins with an entry for revenue, known as the top line, and subtracts the costs of doing business, including the cost of goods sold, operating expenses, tax expenses, and interest expenses. The difference, known as the bottom line, is net income, also referred to as profit or earnings. You can find many templates for creating a personal or business P&L statement online for free.

It is important to compare income statements from different accounting periods, as the changes in revenues, operating costs, research and development spending, and net earnings over time are more meaningful than the numbers themselves. For example, a company's revenues may grow, but its expenses might grow at a faster rate.

Profit and Loss Statement (P&L) Example

Below is Caterpillar Inc.'s income or P&L statement for 2013 and 2014 (all figures in USD millions except per-share data):[1]

| **Twelve Months Ended December 31,** | **2014** | **2013** |
|---|---|---|
| **Sales and revenues:** | | |
| Sales of Machinery, Energy & Transportation | 52,142 | 52,694 |
| Revenues of Financial Products | 3,042 | 2,962 |
| Total sales and revenues | 55,184 | 55,656 |
| **Operating costs:** | | |
| Cost of goods sold | 39,767 | 40,727 |
| Selling, general and administrative expenses | 5,697 | 5,547 |
| Research and development expenses | 2,135 | 2,046 |
| Interest expense of Financial Products | 624 | 727 |
| Other operating (income) expenses | 1,633 | 981 |
| Total operating costs | 49,856 | 50,028 |
| **Operating profit** | 5,328 | 5,628 |
| Interest expense excluding Financial Products | 484 | 465 |
| Other income (expense) | 239 | (35) |
| **Consolidated profit before taxes** | 5,083 | 5,128 |
| Provision (benefit) for income taxes | 1,380 | 1,319 |
| Profit of consolidated companies | 3,703 | 3,809 |
| Equity in profit (loss) of unconsolidated affiliated companies | 8 | (6) |
| **Profit of consolidated and affiliated companies** | 3,711 | 3,803 |
| Less: Profit (loss) attributable to noncontrolling interests | 16 | 14 |
| **Profit** [footnote 1: Profit attributable to common shareholders] | 3,695 | 3,789 |
| **Profit per common share** | 5.99 | 5.87 |
| **Profit per common share – diluted** [footnote 2: Diluted by assumed exercise of stock-based compensation awards using the treasury stock method] | 5.88 | 5.75 |

| | | |
|---|---|---|
| **Weighted-average common shares outstanding (millions)** | | |
| **- Basic** | 617.2 | 645.2 |
| **- Diluted** [see footnote 2] | 628.9 | 658.6 |
| **Cash dividends declared per common share** | 2.70 | 2.32 |

One can use the income statement to calculate several metrics, including the gross profit margin, the operating profit margin, the net profit margin, and the operating ratio. Together with the balance sheet and cash flow statement, the income statement provides an in-depth look at a company's financial performance.

**FREQUENTLY ASKED QUESTIONS**

What is a profit and loss (P&L) statement?

A P&L statement is one of the three types of financial statements prepared by companies, the other two being the balance sheet and the cash flow statement. The purpose of the P&L statement is to show the revenues and expenditures of the company over a specified period of time, usually one fiscal year.

Using this information, investors and analysts can assess the profitability of the company, often combining this information with insights from the other two financial statements. For instance, an investor might calculate a company’s return on equity (ROE) by comparing its net income (as shown on the P&L) to its level of shareholder’s equity (as shown on the balance sheet).

What is the difference between a P&L statement and a balance sheet?

Whereas the P&L shows the income, expenditures, and profitability of a company over a period of time, the balance sheet provides a snapshot of the company’s assets and liabilities as of a certain date. Typically, the balance sheet is presented as of the last day of the company’s fiscal year. Investors use the balance sheet to understand the financial strength of the company, comparing the amount and quality of its assets against its liabilities.

Are all companies required to prepare P&L statements?

Publicly traded companies are required to prepare P&L statements and must file their financial statements with the Securities and Exchange Commission (SEC) so that they can be scrutinized by investors, analysts, and regulators. In preparing these statements, public companies must comply with a set of rules and guidelines known as generally accepted accounting principles (GAAP)[22].

Private companies, on the other hand, are not necessarily required to comply with GAAP.

## 14.3. WHAT IS CASH FLOW FROM INVESTING ACTIVITIES?

Cash flow from investing activities is one of the sections on the cash flow statement that reports how much cash has been generated or spent from various investment-related activities in a specific period. Investing activities include purchases of physical assets, investments in securities, or the sale of securities or assets.

Negative cash flow is often indicative of a company's poor performance. However, negative cash flow from investing activities might be due to significant amounts of cash being invested in the long-term health of the company, such as research and development.

Understanding Cash Flow from Investing Activities

Before analyzing the different types of positive and negative cash flows from investing activities, it's important to review where a company's investment activity falls within its financial statements. There are three main financial statements: the balance sheet, income statement, and cash flow statement.

The balance sheet provides an overview of a company's assets, liabilities, and owner's equity as of a specific date. The income statement provides an overview of company revenues and expenses during a period. The cash flow statement bridges the gap between the income statement and the balance sheet by showing how much cash is generated or spent on operating, investing, and financing activities for a specific period.

**KEY TAKEAWAYS**

- Cash flow from investing activities is a section of the cash flow statement that shows the cash generated or spent relating to investment activities.

[22] Generally Accepted Accounting Principles

- Investing activities include purchases of physical assets, investments in securities, or the sale of securities or assets.
- Negative cash flow from investing activities might not be a bad sign if management is investing in the long-term health of the company.

**TYPES OF CASH FLOW**

Overall, the cash flow statement provides an account of the cash used in operations, including working capital, financing, and investing. There are three sections–labeled activities–on the cash flow statement.

**CASH FLOW FROM OPERATING**

Operating activities include any spending or sources of cash that's involved in a company's day-to-day business activities. Any cash spent or generated from the company's products or services is listed in this section, including:

- Cash received from the sale of goods and services
- Interest payments
- Salary and wages paid
- Payments to suppliers for inventory or goods needed for production
- Income tax payments

**CASH FLOW FROM FINANCING**

Cash generated or spent on financing activities shows the net cash flows involved in funding the company's operations. Financing activities include:

- Dividend payments
- Stock repurchases
- Bond offerings–generating cash

**CASH FLOW FROM INVESTING**

Cash flows from investing activities provides an account of cash used in the purchase of non-current assets–or long-term assets– that will deliver value in the future.

Investing activity is an important aspect of growth and capital. A change to property, plant, and equipment (PPE), a large line item on the balance sheet, is considered an investing activity. When investors and analysts want to know how much a company spends on PPE, they can look for the sources and uses of funds in the investing section of the cash flow statement.

Capital expenditures (CapEx), also found in this section, is a popular measure of capital investment used in the valuation of stocks. An increase in capital expenditures means the company is investing in future operations. However, capital expenditures are a reduction in cash flow. Typically, companies with a significant amount of capital expenditures are in a state of growth.

Below are a few examples of cash flows from investing activities along with whether the items generate negative or positive cash flow.

- Purchase of fixed assets–cash flow negative
- Purchase of investments such as stocks or securities–cash flow negative
- Lending money–cash flow negative
- Sale of fixed assets–cash flow positive
- Sale of investment securities–cash flow positive
- Collection of loans and insurance proceeds–cash flow positive

If a company has differences in the values of its non-current assets from period-to-period (on the balance sheet), it might mean there's investing activity on the cash flow statement.

Example of Cash Flow from Investing Activities

Below is the cash flow statement from Apple Inc. (AAPL) according to the company's 10-Q report issued on June 29, 2019.

The three sections of Apple's statement of cash flows are listed with operating activities at the top and financing activities at the bottom of the statement (highlighted in orange). In the center, are the investing activities (highlighted in blue).

Investing activities that were cash flow negative are highlighted in red and include:[2]

- Purchases of marketable securities for $21.9 billion
- Payments acquiring property, plant, and equipment for $7.7 billion
- Payments for business acquisitions and non-marketable securities

Investing activities that were cash flow positive are highlighted in green and include:

- Proceeds from maturities of marketable securities for $26.7 billion
- Proceeds from the sale of marketable securities for $49.5 billion

The net cash flow generated from investing activities were $46.6 billion for the period ending June 29, 2019. Overall Apple had a positive cash flow from investing activity despite spending nearly $8 billion on new property, plant, and equipment.[2]

As with any financial statement analysis, it's best to analyze the cash flow statement in tandem with the balance sheet and income statement to get a complete picture of a company's financial health.

**FREQUENTLY ASKED QUESTIONS**

What is cash flow from investing activities?

Cash flow from investing activities is the cash that has been generated (or spent) on non-current assets that are intended to produce a profit in the future. Types of activities that this may include are capital expenditures, lending money, and sale of investment securities. Along with this, expenditures in property, plant and equipment fall within this category as they are a long-term investment. Cash flow from investing activities is stated on the cash flow statement.

How do you calculate cash flow from investing activities?

Consider a hypothetical example of Google's net annual cash flow from investing activities. For the year, the company spent $30 billion on capital expenditures, of which the majority were fixed assets. Along with this, it purchased $5 billion in investments and spent $1 billion on acquisitions. The company also realized positive inflow of $3 billion from the sale of investments. To calculate the cash flow from investing activities, the sum of these items would be added together, to arrive at the annual figure of -$33 billion.

Why is cash flow from investing activities important?

Cash flow from investing activities is important because it shows how a company is allocating cash for the long-term. For instance, a company may invest in fixed assets such as property, plant, and equipment to grow the business. While this signals a negative cash flow from investing activities in the short-term, it may help the company generate cash flow in the longer-term. A company may also choose to invest cash in short-term marketable securities to help boost profit.

## HOW DO YOU CALCULATE A COMPANY'S EQUITY?

The equity of a company, or shareholders' equity, is the net difference between a company's total assets and its total liabilities. A company's equity is used in fundamental analysis to determine its net worth.

Shareholders' equity represents the net value of a company, or the amount of money left over for shareholders if all assets were liquidated and all debts repaid.

KEY TAKEAWAYS

- A company's equity represents its owners' (shareholders') residual claim to the company's profits.
- All the information needed to compute a company's shareholder equity is available on its balance sheet.
- It is calculated by subtracting total liabilities from total assets.
- If equity is positive, the company has enough assets to cover its liabilities.
- If negative, the company's liabilities exceed its assets. When prolonged, this is considered balance sheet insolvency.

How to Calculate Shareholders' Equity?

The formula for calculating shareholders' equity is:

{Shareholder's Equity} = {Total Assets} - {Total Liabilities}

{aligned}Shareholder’s Equity=Total Assets−Total Liabilities

Finding the Relevant Data

All the information required to compute shareholders' equity is available on a company's balance sheet. Total assets include current and non-current assets. Current assets are assets that can be converted to cash within a year (e.g., cash, accounts receivable, inventory). Long-term assets are assets that cannot be converted to cash or consumed within a year (e.g. investments; property, plant, and equipment; and intangibles, such as patents).

Total liabilities consist of current and long-term liabilities. Current liabilities are debts typically due for repayment within one year (e.g. accounts payable and taxes payable). Long-term liabilities are obligations that are due for repayment in periods longer than one year (e.g., bonds payable, leases, and pension obligations). Upon calculating the total assets and liabilities, shareholders' equity can be determined.

If you own shares in a company, you own a piece of its equity value!

Example of Shareholders' Equity

Below is the balance sheet for Apple Inc. (AAPL) as of September 2020. For that period:

- Total assets (in green) were $323.888 billion
- Total liabilities (in red) were $258.549billion

Shareholders' equity was therefore $65.339 billion ($323.888 - $258.549).

Looking at the same period one year earlier, we can see that the year-on-year change in equity was a decrease of $25.15 billion. The balance sheet shows this decrease is due to both a reduction in assets and an increase in total liabilities.

Apple Balance Sheet.

The value of $65.339 billion in shareholders' equity represents the amount left for shareholders if Apple liquidated all of its assets and paid off all of its liabilities.

An alternative calculation of company equity is the value of share capital and retained earnings less the value of treasury shares.

Shareholders' equity is an effective metric for determining the net worth of a company, but it should be used in tandem with analysis of all financial statements, including the balance sheet, income statement, and cash flow statement.

Why Is Shareholders' Equity Important?

Shareholders' equity can be negative or positive. If it reads positive, the company has enough assets to cover its liabilities. If negative, the company's liabilities exceed its assets; if prolonged, it amounts to balance sheet insolvency.

As such, many investors view companies with negative shareholders' equity as risky or unsafe. However, shareholders' equity alone is not a definitive indicator of a company's financial health; however, used in conjunction with other tools and metrics, an investor can accurately analyze the health of an organization.

Market analysts and investors prefer a balance between the amount of retained earnings that a company pays out to investors in the form of dividends and the amount retained to reinvest back into the company.

Shareholders' equity is an essential metric to consider when determining the return being generated versus the total amount invested by equity investors. For example, ratios like return on equity (ROE), which is the result of a company's net income divided by shareholders' equity, are used to measure how well a company's management is using its equity from investors to generate profit.

How to Calculate a Company's Equity FAQS

What Is a Company's Equity?

Equity, also referred to as stockholders' or shareholders' equity, is the corporation's owners' residual claim on assets after debts have been paid.

What Is Equity on a Balance Sheet?

A company's equity position can be found on its balance sheet, where there is an entry line for total equity on the right side of the table.

How Do You Calculate Equity in a Private Company?

Unlike public corporations, private companies do not need to report financials nor disclose financial statements. Nevertheless, the owners and private shareholders in such a company can still compute the firm's equity position using the same formula and method as with a public one.

What Is the Formula to Calculate Equity?

Shareholders' equity is equal to a firm's total assets minus its total liabilities.

What Is Included in Total Equity?

Total equity effectively represents how much a company would have left over in assets if the company went out of business immediately.

# CHAPTER 15. PERSONAL FINANCE

## WHAT IS PERSONAL FINANCE?

Personal finance is a term that covers managing your money as well as saving and investing. It encompasses budgeting, banking, insurance, mortgages, investments, retirement planning, and tax and estate planning. The term often refers to the entire industry that provides financial services to individuals and households and advises them about financial and investment opportunities.

Personal finance is about meeting personal financial goals, whether it's having enough for short-term financial needs, planning for retirement, or saving for your child's college education. It all depends on your income, expenses, living requirements, and individual goals and desires—and coming up with a plan to fulfill those needs within your financial constraints. To make the most of your income and savings, it's important to become financially literate, so you can distinguish between good and bad advice and make smart decisions.

**KEY TAKEAWAYS**

- Few schools have courses in how to manage your money, so it is important to learn the basics through free online articles, courses, blogs, and podcasts, or at the library.
- Smart personal finance involves developing strategies that include budgeting, creating an emergency fund, paying off debt, using credit cards wisely, saving for retirement, and more.
- Being disciplined is important, but it's also good to know when to break the rules—for example, young adults who are told to invest 10% to 20% of their income for retirement may need to take some of those funds to buy a home or pay off debt instead.

Ten Personal Finance Strategies

The sooner you start financial planning, the better, but it's never too late to create financial goals to give yourself and your family financial security and freedom. Here are the best practices and tips for personal finance.

1. **DEVISE A BUDGET**

A budget is essential to living within your means and saving enough to meet your long-term goals. The 50/30/20 budgeting method offers a great framework. It breaks down like this:

- Fifty percent of your take-home pay or net income (after taxes, that is) goes toward living essentials, such as rent, utilities, groceries, and transport.
- Thirty percent is allocated to discretionary expenses, such as dining out and shopping for clothes. Giving to charity can go here, as well.
- Twenty percent goes toward the future—paying down debt and saving both for retirement and emergencies.

It's never been easier to manage money, thanks to a growing number of personal budgeting apps for smartphones that put day-to-day finances in the palm of your hand. Here are just two examples: YNAB (an acronym for You Need a Budget) helps you track and adjust your spending so that you are in control of every dollar you spend.[1]

Meanwhile, Mint streamlines cash flow, budgets, credit cards, bills, and investment tracking all from one place. It automatically updates and categorizes your financial data as info comes in, so you always know where you stand financially. The app will even dish out custom tips and advice.[2]

2. **CREATE AN EMERGENCY FUND**

It's important to "pay yourself first" to ensure money is set aside for unexpected expenses, such as medical bills, a big car repair, day-to-day expenses if you get laid off, and more. Between three and six months' worth of living expenses is the ideal safety net. Financial experts generally recommend putting away 20% of each paycheck every month. Once you've filled up your emergency fund, don't stop. Continue funneling the monthly 20% toward other financial goals, such as a retirement fund or a down payment on a house.

3. **LIMIT DEBT**

It sounds simple enough: To keep debt from getting out of hand, don't spend more than you earn. Of course, most people do have to borrow from time to time, and sometimes going into debt can be advantageous, if, for example, it leads to acquiring an asset. Taking out a mortgage to buy a house might be one such case. Still, leasing can sometimes be more economical than buying outright, whether you're renting a property, leasing a car, or even getting a subscription to computer software.

4. **USE CREDIT CARDS WISELY**

Credit cards can be major debt traps, but it's unrealistic not to own any in the contemporary world. Furthermore, they have applications beyond buying things. Not only are they crucial to establishing your credit rating; they're also a great way to track spending, which can be a big budgeting aid.

Credit just needs to be managed correctly, which means that you should pay off your full balance every month, or at least keep your credit utilization ratio at a minimum (that is, keep your account balances below 30% of your total available credit). Given the extraordinary rewards incentives on offer these days (such as cash back), it makes sense to charge as many purchases as possible if you can pay your bills in full. Most important: Avoid maxing out credit cards at all costs and always pay bills on time. One of the fastest ways to ruin your credit score is to constantly pay bills late—or even worse, miss payments (see tip five).

Using a debit card, which takes money directly from your bank account, is another way to ensure that you will not be paying for accumulated small purchases over an extended period with interest.

5**. MONITOR YOUR CREDIT SCORE**

Credit cards are the main vehicle through which your credit score is built and maintained, so watching credit spending goes hand in hand with monitoring your credit score. If you ever want to obtain a lease, mortgage, or any other type of financing, you'll need a solid credit report. There are a variety of credit scores available, but the most popular one is the FICO score.

Factors that determine your FICO score include:[4]

- Payment history (35%)
- Amounts owed (30%)
- Length of credit history (15%)
- Credit mix (10%)
- New credit (10%)

FICO scores are calculated between 300 and 850. Here's how your credit is rated:[4]

- Exceptional: 800 to 850
- Very good: 740 to 799
- Good: 670 to 739

- Fair: 580 to 669
- Very poor: 300 to 579

To pay bills, set up direct debiting where possible (so you never miss a payment) and subscribe to reporting agencies that provide regular credit score updates. By monitoring your credit report, you will be able to detect and address mistakes or fraudulent activity. Federal law allows you to obtain free credit reports once a year from the three major credit bureaus: Equifax, Experian, and TransUnion.[5]

Reports can be obtained directly from each agency, or you can sign up at AnnualCreditReport.com, a federally authorized site sponsored by the Big Three.[6] You can also get a free credit score from sites such as Credit Karma, Credit Sesame, or WalletHub.[7][8][9] Some credit card providers, such as Capital One, will provide customers with complimentary, regular credit score updates, though it may not be your FICO score.[10] All of the above offer your VantageScore.

Due to the COVID-19 pandemic, the three major credit bureaus are providing free credit reports once a week at least through April 2022.

6. **CONSIDER YOUR FAMILY**

To protect the assets in your estate and ensure that your wishes are followed when you die, be sure you make a will and—depending on your needs—possibly set up one or more trusts. You also need to look into insurance: auto, home, life, disability, and long-term care (LTC) insurance. And periodically review your policy to make sure it meets your family's needs through life's major milestones.

Other critical documents include a living will and healthcare power of attorney. While not all these documents directly affect you, all of them can save your next of kin considerable time and expense when you fall ill or become otherwise incapacitated.

And while your children are young, take the time to teach them about the value of money and how to save, invest, and spend wisely.

7. **PAY OFF STUDENT LOANS**

There are myriad loan repayment plans and payment reduction strategies available to graduates. If you're stuck with a high interest rate, paying off the principal faster can make sense. On the other hand, minimizing repayments (to interest only, for instance), can free up income to invest elsewhere or put into retirement savings while you're young, when your nest egg will get the maximum benefit from compound interest (see tip eight). Some private and federal loans are even eligible for a rate reduction if the borrower enrolls in auto pay.[12][13] Flexible federal repayment programs worth checking out include:

- Graduated repayment—Progressively increases the monthly payment over 10 years
- Extended repayment—Stretches the loan out over a period that can be as long as 25 years
- Income-driven repayment—Limits payments to 10% to 20% of your income (based on your income and family size)

8. Plan (and save) for retirement

Retirement may seem like a lifetime away, but it arrives much sooner than you'd expect. Experts suggest that most people will need about 80% of their current salary in retirement. The younger you start, the more you benefit from what advisors like to call the magic of compounding interest—how small amounts grow over time.

Setting aside money now for your retirement not only allows it to grow over the long term; it can also reduce your current income taxes if funds are placed in a tax-advantaged plan, such as an individual retirement account (IRA), a 401(k), or a 403(b). If your employer offers a 401(k) or 403(b) plan, start paying into it right away, especially if your employer matches your contribution. By not doing so, you're giving up free money. Take time to learn the difference between a Roth 401(k) and a traditional 401(k) if your company offers both.

Investing is only one part of planning for retirement. Other strategies include waiting as long as possible before opting to receive Social Security benefits (which is smart for most people) and converting a term life insurance policy to a permanent life one.

9. **MAXIMIZE TAX BREAKS**

Due to an overly complex tax code, many individuals leave hundreds or even thousands of dollars sitting on the table every year. By maximizing your tax savings, you'll free up money that can be invested in the reduction of past debts, your enjoyment of the present, and your plans for the future.

You need to start each year saving receipts and tracking expenditures for all possible tax deductions and tax credits. Many office supply stores sell helpful “tax organizers” that have the main categories already labeled. After you’re organized, you’ll want to focus on taking advantage of every tax deduction and credit available, as well as deciding between the two when necessary. In short, a tax deduction reduces the amount of income you are taxed on, whereas a tax credit actually reduces the amount of tax you owe. This means that a $1,000 tax credit will save you much more than a $1,000 deduction.

10. **GIVE YOURSELF A BREAK**

Budgeting and planning can seem full of deprivations. Make sure you reward yourself now and then. Whether it’s a vacation, a purchase, or an occasional night on the town, you need to enjoy the fruits of your labor. Doing so gives you a taste of the financial independence you’re working so hard for.

Last but not least, don’t forget to delegate when needed. Even though you might be competent enough to do your own taxes or manage a portfolio of individual stocks, it doesn’t mean you should. Setting up an account at a brokerage and spending a few hundred dollars on a certified public accountant (CPA) or financial planner—at least once—might be a good way to jump-start your planning.

Three key character traits can help you avoid innumerable mistakes in managing your personal finances: discipline, a sense of timing, and emotional detachment.

**PERSONAL FINANCE PRINCIPLES**

Once you’ve established some fundamental procedures, you can start thinking about philosophy. The key to getting your finances on the right track isn’t learning a new set of skills. Rather, it’s about understanding that the principles that contribute to success in business and your career work just as well in personal money management. The three key principles are prioritization, assessment, and restraint.

- **Prioritization—**This means that you’re able to look at your finances, discern what keeps the money flowing in, and make sure you stay focused on those efforts.
- **Assessment—**This is the key skill that keeps professionals from spreading themselves too thin. Ambitious individuals always have a list of ideas about other ways they can hit it big, whether it is a side

business or an investment idea. While there is absolutely a place and time for taking a flyer, running your finances like a business means stepping back and honestly assessing the potential costs and benefits of any new venture.

- **Restraint—**This is that final big-picture skill of successful business management that must be applied to personal finances. Time and again financial planners sit down with successful people who somehow still manage to spend more than they make. Earning $250,000 a year won't do you much good if you spend $275,000 annually. Learning to restrain spending on non-wealth-building assets until after you've met your monthly savings or debt-reduction goals is crucial in building net worth.

Learn About Personal Finance

Few schools offer courses in managing your money, which means most of us will need to get our personal finance education from our parents (if we're lucky) or pick it up ourselves. Fortunately, you don't have to spend much money to find out how to better manage it. You can learn everything you need to know for free online and in library books. Almost all media publications regularly dole out personal finance advice, too.

Online Blogs

A great way to start learning about personal finance is to read personal finance blogs. Instead of the general advice you'll get in personal finance articles, you'll learn exactly which challenges real people are facing and how they are addressing those challenges.

Mr. Money Mustache has hundreds of posts full of irreverent insights on how to escape the rat race and retire extremely early by making unconventional lifestyle choices.[15] CentSai helps you navigate myriad financial decisions via first-person accounts.[16] Million Mile Secrets and the Points Guy teach you how to travel for a fraction of the retail price by using credit card rewards.[17][18] FareCompare helps you find the best deals on flights.[19] These sites often link to other blogs, so you'll discover more sites as you read.

Of course, we can't help tooting our own horn in this category. Investopedia offers a wealth of free personal finance education. You might start with our special sections on budgeting, buying a home, and planning for retirement—or the thousands of other articles in our personal finance section. And don't forget to listen to The Investopedia Express with Caleb Silver, our weekly podcast and sign up for Investopedia newsletters.

At the Library

You may need to visit your library in person to get a library card, but after that you can check out personal finance audiobooks and eBooks online without leaving home. Some of the following bestsellers may be available from your local library: *I Will Teach You to Be Rich, The Millionaire Next Door, Your Money or Your Life*, and *Rich Dad Poor Dad*. Personal finance classics such as *Personal Finance for Dummies*, *The Total Money Makeover*, T*he Little Book of Common Sense Investing*, and *Think and Grow Rich* are also available as audio books.

Free Online Classes

If you enjoy the structure of lessons and quizzes, try one of these free digital personal finance courses:

- **Morningstar Investing Classroom** offers a place for beginning and experienced investors alike to learn about stocks, funds, bonds, and portfolios. Some of the courses you'll find include "Stocks Versus Other Investments," "Methods for Investing in Mutual Funds," "Determining Your Asset Mix," and "Introduction to Government Bonds." Each course takes about 10 minutes and is followed by a quiz to help you make sure you understood the lesson.[20]
- **EdX** is an online learning platform created by Harvard University and the Massachusetts Institute of Technology.[21] It offers at least three courses that cover personal finance: "How to Save Money: Making Smart Financial Decisions" from the University of California at Berkeley, "Personal Finance" from Purdue University, and "Finance for Everyone: Smart Tools for Decision-Making" from the University of Michigan. These courses will teach you things such as how credit works, which types of insurance you might want to carry, how to maximize your retirement savings, how to read your credit report, and what the time value of money is.[22][23][24]
- **"Planning for a Secure Retirement"** is another online course from Purdue. It's broken up into 10 main modules, and each has four to six sub-modules on topics such as Social Security, 401(k) and 403(b) plans, and IRAs. You'll learn about your risk tolerance, think

about what kind of retirement lifestyle you want, and estimate your retirement expenses.[25]

- **Missouri State University's "Personal Finance"** is a free online video course through iTunes. This basic course is good for beginners who want to learn about personal financial statements and budgets, how to use consumer credit wisely, and how to make decisions about cars and housing.[26]

Podcasts

Personal finance podcasts are a great way to learn how to manage your money if you're short on free time. While you're getting ready in the morning, exercising, driving to work, running errands, or getting ready for bed, you can listen to expert advice on becoming more financially secure.

- **"The Dave Ramsey Show"** is a call-in program that you can listen to anytime through your favorite podcast app. You'll learn about the financial problems real people are facing and how a multimillionaire who was once broke himself recommends solving them.[27]
- **"Freakonomics Radio" and NPR's "Planet Money"** both make economics interesting by using it to explain real-world phenomena such as "how we got from mealy, nasty apples to apples that actually taste delicious," the Wells Fargo faux-accounts scandal, and whether we should still be using cash.
- **American Public Media's "Marketplace"** helps make sense of what's going on in the business world and the economy.[30]
- **"So Money with Farnoosh Torabi"** combines interviews with successful business people, expert advice, and listeners' personal finance questions.

The most important thing is to find resources that work for your learning style and that you find interesting and engaging. If one blog, book, course, or podcast is dull or difficult to understand, keep trying until you find something that clicks.

Education shouldn't stop once you learn the basics. The economy changes, and new financial tools, such as those budgeting apps, are always being developed. Find resources you enjoy and trust and keep refining your money skills from now to retirement and even after it.

## Things Classes Can’t Teach You

Personal finance education is a great idea for consumers, especially youthful ones, who need to understand investing basics or credit management. However, understanding the basic concepts is not a guaranteed path to fiscal sense. Human nature can often derail the best of intentions aimed at achieving a perfect credit score or building a substantial retirement nest egg. These three key character traits can help you stay on track:

### Discipline

One of the most important tenets of personal finance is systematic saving. Say your net earnings are $60,000 per year and your monthly living expenses—housing, food, transportation, and the like—amount to $3,200 per month. There are choices to make surrounding your remaining $1,800 in monthly salary. Ideally, the first step is to establish an emergency fund or perhaps a tax-advantaged health savings account (HSA)—to be eligible for one, your health insurance must be a high-deductible health plan (HDHP)—to meet out-of-pocket medical expenses. Let’s say that your friends like to go out several times a week, eating away at your spare cash. Lacking the discipline required to save rather than spend could keep you from saving the 10% to 15% of gross income that could have been stashed in a money market account for short-term needs.

Then there’s investing discipline once you get to that point; it’s not just for thick-skinned institutional money managers who make their living buying and selling stocks. The average investor would do well to set a target on profit-taking and abide by it. As an example, imagine that you bought Apple Inc. stock in February 2016 at $93 and vowed to sell when it crossed $110, as it did two months later. Alas, when it did, you broke that vow and held on to the stock. It went back down, and you ended up exiting the position in July 2016 at $97, giving up gains of $13 per share and the possible opportunity for profit from another investment.

### A Sense of Timing

Three years out of college, you’ve established the emergency fund, and it is time to reward yourself. A Jet Ski costs $3,000. Investing in growth stocks can wait another year, you think; there is plenty of time to launch an investment portfolio, right? Putting off investing for one year, however, can have significant consequences. The opportunity cost of buying the watercraft can be illustrated through the above-mentioned time value of money. The $3,000 used to buy the Jet Ski would have amounted to nearly $49,000 in 40 years at 7% interest, a reasonable average annual return for a growth mutual fund over the long haul. Thus, delaying the decision to invest wisely may likewise delay the ability to reach your goal of retiring at age 62.

Doing tomorrow what you could do today also extends to debt payment. A $3,000 credit card balance takes 222 months (that’s 18.5 years) to retire if the minimum payment of $75 is made each month. And don't forget the interest you’re paying: At an 18% annual percentage rate (APR), it comes to $3,923 over those months. Plunking down $3,000 to erase the balance in the current month offers substantial savings—nearly $1,000 over the cost of the Jet Ski.

Emotional Detachment

Personal finance matters are business, and business should not be personal. A difficult but necessary facet of sound financial decision-making involves removing the emotion from a transaction. Making impulsive purchases feels good but can have a big impact on long-term investment goals. So can making unwise loans to family members. Your cousin Fred, who has already burned your brother and sister, will likely not pay you back either—so the smart answer is to decline his requests for help. The key to prudent personal financial management is to separate feelings from reason. This should not, by the way, keep you from making seriously needed loans—or even gifts—to help out, especially in times of real trouble. Just try not to take it out of your savings and investment fund.

Breaking Personal Finance Rules

The personal finance realm may have more guidelines and smart tips to follow than any other. Although these rules are good to know about, everyone has individual circumstances. Here are some rules that prudent people, especially young adults, are never supposed to break—but should consider breaking anyway.

Saving or investing a set portion of your income

An ideal budget includes saving a portion of your paycheck every month for retirement—usually around 10% to 20%. While being fiscally responsible is important, and thinking about your future is crucial, the general rule of saving a given amount each period for your retirement may not always be the best choice, especially for young people just getting started in the real world. For one, many young adults and students need to think about paying for the biggest expenses of their lifetime, such as a new car, home, or post-secondary education. Taking away potentially 10% to 20% of available funds would be a definite setback in making those purchases.

Additionally, saving for retirement doesn’t make a whole lot of sense if you have credit cards or interest-bearing loans that need to be paid off. The 19% interest rate on your Visa card would probably negate the returns you get from your balanced mutual fund retirement portfolio five times over.

Finally, saving some money to travel and experience new places and cultures can be especially rewarding for a young person who’s still not sure about their path in life.

Long-term investing/investing in riskier assets

The rule of thumb for young investors is that they should have a long-term outlook and stick to a buy-and-hold philosophy. This rule is one of the easier ones to justify breaking. Being able to adapt to changing markets can be the difference between making money or limiting your losses versus sitting idly by and watching as your hard-earned savings shrink. Short-term investing has its advantages at any age.

Now, if you’re no longer married to the idea of long-term investing, you can stick to safer investments as well. The logic was that as young investors have such a long investment time horizon, they should be investing in higher risk ventures; after all, they have the rest of their lives to recover from any losses they may suffer. However, if you don’t want to take on undue risk in your short- to medium-term investments, you don’t have to. The idea of diversification is an important part of creating a strong investment portfolio; this includes both the riskiness of individual stocks and their intended investment horizon.

At the other end of the age spectrum, investors near and at retirement are encouraged to cut back to the safest investments, even though these may yield less than inflation, in order to preserve capital. It’s important to take fewer risks as the number of years you have to earn money and recover from bad financial times dwindles, but at age 60 or 65 you could have 20, 30, or even more years to go. Some growth investments could still make sense for you.

## CONCLUSION

The Internet has reduced the cost and increased the speed of information transfer. This has transformed the economic landscape, allowing new and exciting ways to generate revenue that include and differ from traditional economic models. Through studying and contrasting several large internet businesses, we have examined the attention, free, network and gift economic models. In order to explain in more detail how these models work, we have looked at Google as a unique business case study, because it has used elements of all of the models we studied throughout its history.

Google started off by offering a gift economy with an aim to organize and make information accessible over the internet. Over time, this developed into an attention economy which gained financial return from monetizing the traffic to its pages through a customized advertising platform that tailors advertisements to viewers. By continuing to offer products and services it uses a free economic model to create an online community of users who continually return to the site (networked economy) to use Google's services.

By presenting simple explanations of the different economic models and applying them to the chosen case study, we have outlined the principles and practices which sustain internet commerce in a way that is easy to follow and understand. Through reviewing multiple online businesses, we were able to focus on one that utilized multiple economic models to help explain the similarities and differences between the different ways of conducting business online.

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**CONTENT**

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# *FUNDAMENTALS OF BUSINESS*

***Tutorial***

***Toshkent – «INNOVATSION RIVOJLANISH NASHRIYOT-MATBAA UYI» – 2021***

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