

Fundamentals of Business: Canadian Edition

Fundamentals of Business: Canadian Edition

Canadian Edition

*BUSINESS FACULTY FROM ONTARIO COLLEGES AND
ECAMPUSONTARIO PROGRAM MANAGERS*

ECAMPUSONTARIO



Fundamentals of Business: Canadian Edition by Pamplin College of Business and Virginia Tech Libraries is licensed under a [Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License](https://creativecommons.org/licenses/by-nc-sa/4.0/), except where otherwise noted.

Dedication

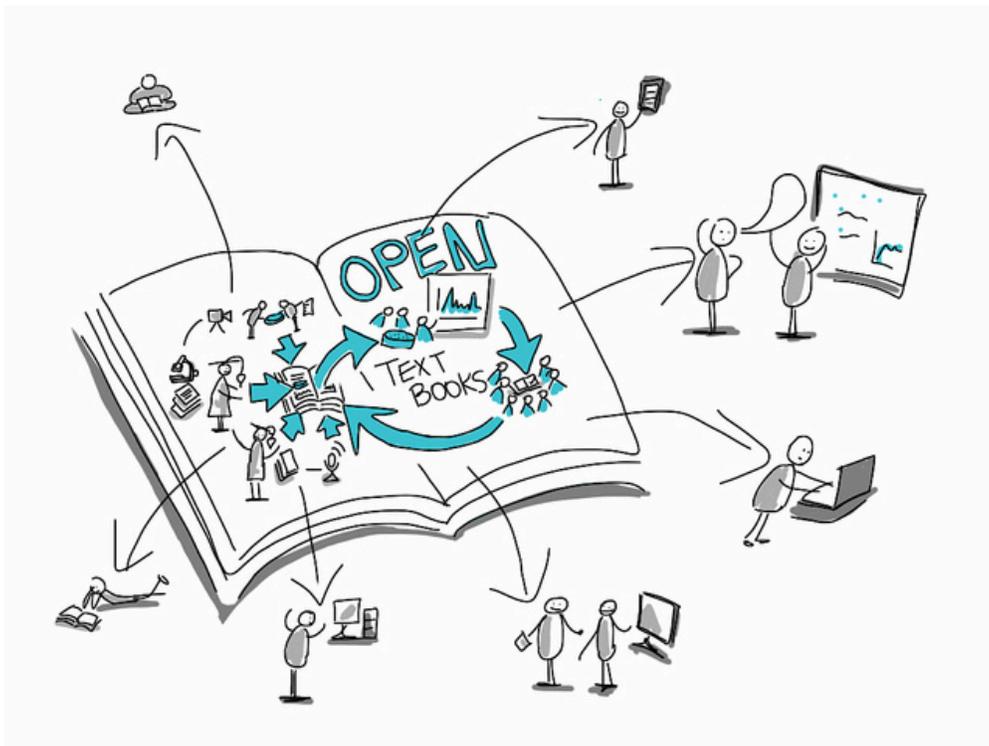
One of the original authors, Stephen J. Skripak, dedicated this book to reducing the cost of education in business.

eCampusOntario, sponsor of the Canadian edition, dedicates this book to adventurous Ontario instructors of business exploring open resources and committing to saving students money. eCampusOntario and your colleagues from Lambton, Conestoga, and Fanshawe colleges are hopeful the updates to this book and its attention to Ontario standards and Canadian content make Business Fundamentals a valuable addition to your course.

If you adopt this book, as a core or supplemental resource, please report your adoption in order for us to celebrate your support of students' savings. Report your commitment at www.openlibrary.ecampusontario.ca.

We invite you to further adapt this book to meet you and your students' needs. Please let us know if you do! If you would like to use Pressbooks, the platform used to make this book, contact eCampusOntario for an account using open@ecampusontario.ca.

If this text does not meet your needs, please check out our other adaptation, Communication for Business Professionals. Use, mix, match, and/or extend them with other, open business materials to customize your learning materials.



Open textbooks by Giulia Forsythe licensed CC BY | flickr

Contents

<u>Canadian Edition 2018</u>	1
<u>Fundamentals of Business</u>	1
<u>Acknowledgements</u>	4
<u>The Original from Virginia Tech 2016</u>	4
<u>Acknowledgements: eCampusOntario</u>	5
<u>Preface</u>	6
<u>Part I. Chapters</u>	
1. <u>Teamwork in Business</u>	9
<u>Learning Objectives</u>	9
<u>Show What You Know</u>	9
<u>The Team and the Organization</u>	10
<u>Why Organizations Build Teams</u>	10
<u>Why Teamwork Works</u>	14
<u>The Team and Its Members</u>	16
<u>Key Takeaways</u>	23
2. <u>Foundations of Business</u>	24
<u>Learning Objectives</u>	24
<u>Show What You Know</u>	24
<u>Why Is Apple Successful?</u>	25
<u>Getting Down to Business</u>	27
<u>Functional Areas of Business</u>	29
<u>External Forces that Influence Business Activities</u>	31
<u>Key Takeaways</u>	33

3. Economics and Business	34
Learning Objectives	34
Show What You Know	34
What is Economics?	35
Perfect Competition and Supply and Demand	39
Monopolistic Competition, Oligopoly, and Monopoly	41
Measuring the Health of the Economy	43
Government's Role in Managing the Economy	50
Key Takeaways	52
4. Ethics and Social Responsibility	54
Learning Objectives	54
Show What You Know	54
Canada's Leader: Passing or Failing the "Smell Test"?	55
What is Business Ethics?	58
Identifying Ethical Issues and Dilemmas	59
Corporate Social Responsibility	63
Ethical Organizations	69
The Individual Approach to Ethics	71
Case Study: How a Bottle Cap Restored a Reputation (Temporarily)	72
Key Takeaways	76
Article: Carroll's Corporate Social Responsibility Pyramid	77
5. Business in a Global Environment	84
Learning Objectives	84
Show What You Know	84
The Globalization of Business	85
Opportunities in International Business	90
The Global Business Environment	97
Trade Controls	102
Reducing International Trade Barriers	104
Key Takeaways	109

6. Forms of Business Ownership	111
Learning Objectives	111
Show What You Know	111
The Ice Cream Men	112
The Canadian Landscape	112
Factors to Consider	113
Mergers and Acquisitions	122
Key Takeaways	126
7. Entrepreneurship: Starting a Business	127
Learning Objectives	127
Show What You Know	127
Arts and Crafts for Adults: Collective Beer	128
The Nature of Entrepreneurship	129
The Importance of Small Business to the Canadian Economy	132
What Industries Are Small Businesses In?	135
Advantages and Disadvantages of Business Ownership	137
Starting a Business	138
Why Some Businesses Fail and Where to Get Help	141
Key Takeaways	143
8. Management and Leadership	144
Learning Objectives	144
Show What You Know	144
Noteworthy Management	145
The Management Process	145
Managerial Skills	156
Applying Your Skills at Notes-4-You	159
Key Takeaways	160
9. Structuring Organizations	161
Learning Objectives	161
Show What You Know	161
Organizing	162
Organizational Structure: How Companies Get the Job Done	164
Key Takeaways	173

10. Operations Management	174
Learning Objectives	174
Show What You Know	174
The Challenge: Producing Quality Jetboards	175
Operations Management in Manufacturing	176
Managing the Production Process in a Manufacturing Company	182
Graphical Tools: Gantt and PERT Charts	184
The Technology of Goods Production	186
Operations Management for Service Providers	187
Producing for Quality	195
Key Takeaways	198
11. Motivating Employees	199
Learning Objectives	199
Show What You Know	199
Motivation	200
Hierarchy of Needs Theory	200
Two-Factor Theory	202
Expectancy Theory	203
Equity Theory	205
Key Takeaways	207
12. Managing Human Resources	208
Learning Objectives	208
Show What You Know	208
The Grounds of a Great Work Environment	209
Human Resource Management	210
Developing Employees	215
What Makes a Great Place to Work?	218
Compensation and Benefits	222
Performance Appraisal	224
Key Takeaways	230
13. Union Management Issues	231
Learning Objectives	231
Show What You Know	231
Unions	232
Key Takeaways	239

14. <u>Marketing: Providing Value</u>	240
<u>Learning Objectives</u>	240
<u>Show What You Know</u>	240
<u>A Robot with Attitude</u>	241
<u>What Is Marketing?</u>	241
<u>The Marketing Mix</u>	244
<u>Developing a Product</u>	245
<u>Promoting a Product</u>	252
<u>Interacting with Customers</u>	258
<u>A New Marketing Model</u>	263
<u>Key Takeaways</u>	265
15. <u>Accounting and Financial Information</u>	266
<u>Learning Objectives</u>	266
<u>Show What You Know</u>	266
<u>Most Valuable Player</u>	267
<u>The Role of Accounting</u>	268
<u>Understanding Financial Statements</u>	271
<u>Financial Statement Analysis</u>	279
<u>Key Takeaways</u>	285
16. <u>Personal Finances</u>	286
<u>Learning Objectives</u>	286
<u>Show What You Know</u>	286
<u>The World of Personal Credit</u>	287
<u>Financial Planning</u>	292
<u>Banking</u>	298
<u>Key Takeaways</u>	300

Canadian Edition 2018

Fundamentals of Business

On the first weekend in March 2018, Program Managers from eCampusOntario gathered with Business faculty from Ontario colleges to adapt existing Business resources in openlibrary.ecampusontario.ca for use in foundations of business courses. Two teams worked to update and align the existing open resources to Ontario college introductory business outcomes and objectives.

Fundamentals of Business Redux

Team Fun college faculty, see table below for members, worked their way through the text offering suggestions for updates and highlighted spots where interactivities would assist comprehension. College faculty also began to create helpful supplementary materials to aid adoption and use of the text in Ontario college classrooms – physical or virtual. These included: diagnostic quizzes for each chapter; PowerPoint slides for each chapter, and a quiz bank to assess end-of-chapter understanding.

From there, eCampusOntario Program Managers along with Matt Hutchinson sourced Canadian statistics and examples. Program Managers built interactivities using H5P and other, open educational technologies to engage students and solidify understanding. They edited the figures, charts, and text and cited sources using proper MLA citation style.

Major Enhancements

1. Recent additions to Pressbooks, supported by eCampusOntario, allow for more engagement and interactivity within each chapter. Adding a quick check in quiz or drag and drop activity at the student's point of need helps solidify understanding throughout the chapters and text.
2. Enabling [hypothes.is](https://web.hypothes.is/), another eCampusOntario improvement, facilitates individual and collaborative notetaking. It also empowers educators to connect the readings to in-class expectations and activities. Learn more about the power and potential of [hypothes.is](https://web.hypothes.is/): <https://web.hypothes.is/>
3. Injecting Canadian content was a focus. Where appropriate, American information and statistics were replaced with Canadian examples and numbers.
4. Learning objectives and text content were updated to align with programs at Ontario colleges and more recent statistics and business practices.
5. The majority of graphics were remade with original files included. This will allow future adapters to re-brand more easily e.g., institutional colours, fonts.

The Teams

Team Fun: Fundamentals of Business Textbook (This book!)	Communication for Business Professionals
Nitsa Andres, Fanshawe College	Michelle Grimes, Conestoga College
Matt Hutchinson, Lambton College	Shauna Roch, Fanshawe College
Jim Johnston, Fanshawe College	David Simon, Lambton College
Anela Tomac, Conestoga College	Terry Greene, eCampusOntario
Joanne Kehoe, eCampusOntario	Jenni Hayman, eCampusOntario
Peggy French, eCampusOntario	

Gratitude to Luke Wilson for editing the final draft and adding his expertise to the content.

About eCampusOntario

eCampusOntario is a not-for-profit corporation funded by the Government of Ontario. It serves as a centre of excellence in online and technology-enabled learning for all publicly funded colleges and universities in Ontario and has embarked on a bold mission to widen access to post-secondary education and training in Ontario. This textbook is part of eCampusOntario's open textbook library, which provides free learning resources in a wide range of subject areas. These open textbooks can be assigned by instructors for their classes and can be downloaded by learners to electronic devices or printed. These free and open educational resources are customizable to meet a wide range of learning needs, and we invite instructors to review and adopt the resources for use in their courses.

Upcoming changes

To save a tree, or at least several branches, we chose not to print the Sources or Works Cited pages. However,

they are available online and available for future printing on demand. All changes to this edition are recorded in the [Version History](#) page at the back of the web version.

Acknowledgements

The Original from Virginia Tech 2016

Fundamentals of Business (2016) was an openly licensed ([CC BY NC SA 3.0](#)) textbook designed for use in Virginia Tech's Pamplin College of Business introductory level business course, MGT 1104 Foundations of Business.

This work was a project of University Libraries and the Pamplin College of Business, Virginia Tech.

Lead Author: Stephen J. Skripak

Contributors: Richard Parsons, Anastasia Cortes, Anita Walz

Layout: Anastasia Cortes

Selected graphics: Brian Craig <http://bcraigdesign.com>

Cover design: Trevor Finney

Student Reviewers: Jonathan De Pena, Nina Lindsay, Sachi Soni

Project Manager: Anita Walz

Content in the Preface, Chapters 1-14 and 16-17 was adapted from the Saylor Foundation's <http://www.saylor.org/site/textbooks/Exploring%20Business.docx> by Virginia Tech under a Creative Commons Attribution-NonCommercial-ShareAlike 3.0 License. The Saylor Foundation previously adapted this work under a Creative Commons Attribution-NonCommercial-ShareAlike 3.0 License without attribution as requested by the work's original creator or licensee.

Acknowledgements: eCampusOntario

Share

If you adopt this book, as a core or supplemental resource, please report your adoption in order for us to celebrate your support of students' savings. Report your commitment at www.openlibrary.ecampusontario.ca.

We invite you to adapt this book further to meet your and your students' needs. Please let us know if you do! If you would like to use Pressbooks, the platform used to make this book, contact eCampusOntario for an account using open@ecampusontario.ca.

If this text does not meet your needs, please check out our full library at www.openlibrary.ecampusontario.ca. If you still cannot find what you are looking for, connect with colleagues and eCampusOntario to explore creating your own open education resource (OER).

About eCampusOntario

eCampusOntario is a not-for-profit corporation funded by the Government of Ontario. It serves as a centre of excellence in online and technology-enabled learning for all publicly funded colleges and universities in Ontario and has embarked on a bold mission to widen access to post-secondary education and training in Ontario. This textbook is part of eCampusOntario's open textbook library, which provides free learning resources in a wide range of subject areas. These open textbooks can be assigned by instructors for their classes and can be downloaded by learners to electronic devices or printed for a low cost by our printing partner, The University of Waterloo. These free and open educational resources are customizable to meet a wide range of learning needs, and we invite instructors to review and adopt the resources for use in their courses.

Preface

These sixteen, fundamental chapters introduce learners to the discipline of business. Experienced Ontario faculty collaborated to align these chapters to the Ministry's Program Standards for General Business, with content appropriate for an introductory course. If you use this resource, feel free to clone the book to move, add, and | or delete chapters to suit how you deliver the concepts these chapters contain. Don't forget to report your adoption: [https://openlibrary.ecampusontario.ca/report-an-adoption/!](https://openlibrary.ecampusontario.ca/report-an-adoption/)

PART I
CHAPTERS

I. Teamwork in Business

Learning Objectives

By the end of this chapter, you should be able to:

1. Define different types of teams and describe key characteristics.
2. Explain why organizations use teams.
3. Identify factors that contribute to team cohesion or division.
4. Describe the importance of learning to participate in team-based activities.
5. Identify the skills needed by team members and the roles that members of a team might play.
6. Explain the skills and behaviours that foster effective team leadership.



Show What You Know



An interactive or media element has been excluded from this version of the text.

You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=26>

The Team and the Organization

What Is a Team? How Does Teamwork Work?

A team (or a work team) is a group of people with complementary skills who work together to achieve a specific goal.^[1]

Teams Versus Groups

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 group is different. A group of department-store managers, for example, might meet monthly to discuss their progress in cutting plant costs. However, each manager is focused on the goals of his or her department because each is held accountable for meeting those goals.

Some Key Characteristics of Teams

To put teams in perspective, let's identify five key characteristics.

Teams:^[2]

1. Share accountability for achieving specific common goals
2. Function interdependently
3. Require stability
4. Hold authority and decision-making power
5. Operate in a social context

Why Organizations Build Teams

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.^[3]

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.^[4]

The Effect of Teams on Performance

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 Improvement
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%

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.

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.^[5] 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 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.^[6]



Coaching by Rob can Hiten licensed CC BY | flickr

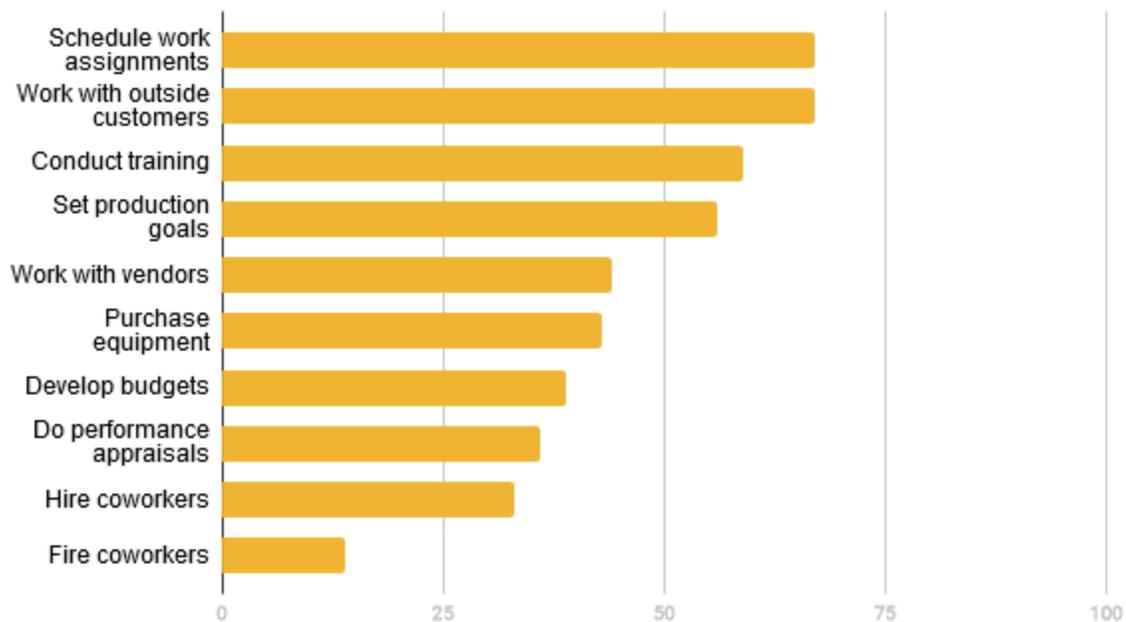
Self-Managing Teams

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.^[7]

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.

How teams manage themselves: Allowed tasks in percentages



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.^[8]

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.^[9]

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.^[10] 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.

Team size does not seem to be an obstacle when it comes to virtual-team meetings; in building the F-35 Strike Fighter, U.S. defense contractor Lockheed Martin staked the \$225 billion project on a virtual product-team of unprecedented global dimension, drawing on designers and engineers from the ranks of eight international partners from Canada, the United Kingdom, Norway, and Turkey.^[11]

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 this section, we’ll explore why teams are often effective and when they are ineffective.

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. [\[12\]](#)

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. [\[13\]](#)

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.^[14]

Other Factors that Erode Performance

Let's take a quick look at three other obstacles to success in introducing teams into an organization.^[15]

- 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.

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.^[16]

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.”^[17]

She’s right. 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.^[18] 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.”^[19] 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.^[20]

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.^[21] 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.

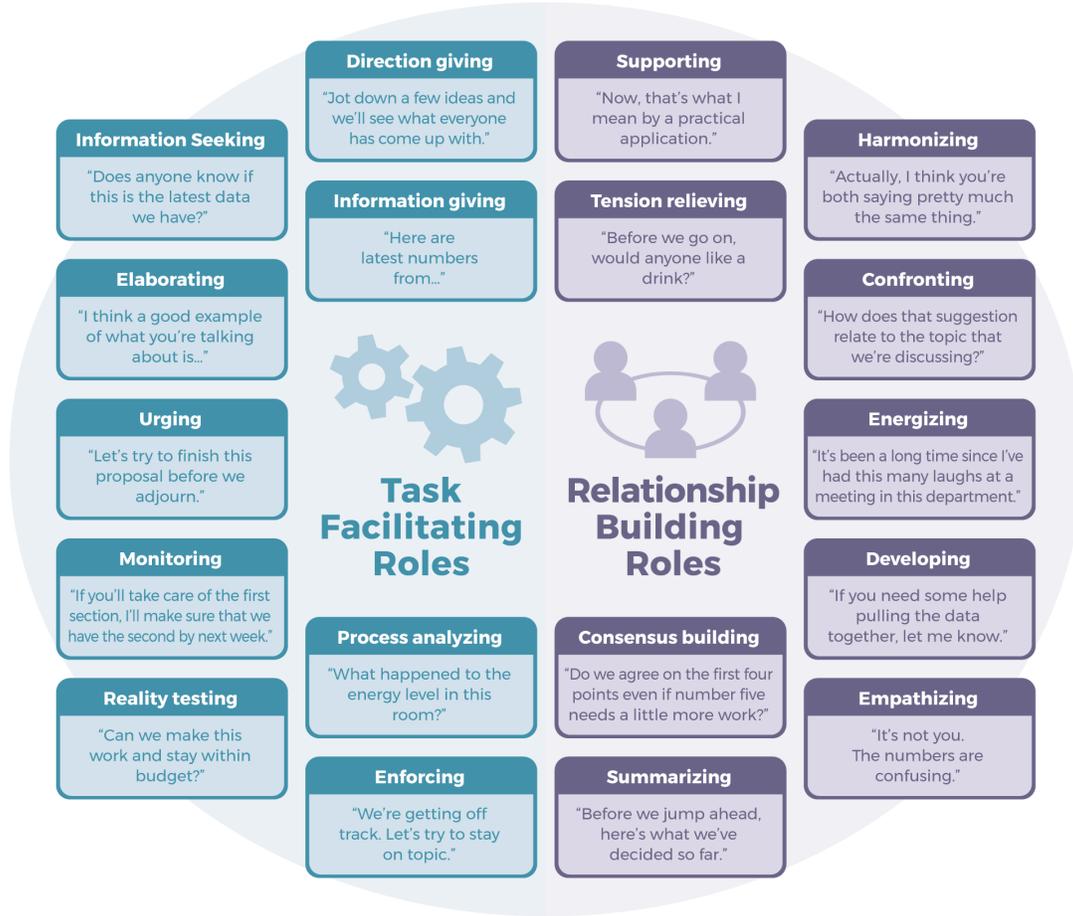
What Roles Do Team Members Play?

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.^[22]

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.^[23] 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 behaviours and the tactics used when someone is using the behaviour. 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.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=26>

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.^[24]

- 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.^[25] As one team of researchers puts it, team leaders are more effective when they work with members rather than on them.^[26] 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.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=26>

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 interdependently.
 - 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 drawn 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, membership is quite satisfying to its members; if it's low in cohesiveness, members are unhappy with it and may even try to leave it.
5. As the business world depends more and more on teamwork, it's increasingly important for incoming members of the workforce to develop skills and experience in team-based activities.
6. 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.

2. Foundations of Business

Learning Objectives

By the end of the chapter, you should be able to:

- Describe the concept of stakeholders and identify the stakeholder groups relevant to an organization
- Discuss and be able to apply the macro-business-environment model to an industry or emerging technology
- Explain other key terms related to this chapter including: entrepreneur; profit; revenue



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=33>

Why Is Apple Successful?

In 1976 Steve Jobs and Steve Wozniak created their first computer, the Apple I.^[1] They invested a mere \$1,300 and set up business in Jobs' garage. Three decades later, their business—Apple Inc.—has become one of the world's most influential and successful companies. Jobs and Wozniak were successful entrepreneurs: those who take the risks and reap the rewards associated with starting a new business enterprise.

Did you ever wonder why Apple flourished while so many other young companies failed? How did it grow from a garage start-up to a company generating over \$233 billion in sales in 2015? How was it able to transform itself from a nearly bankrupt firm to a multinational corporation with locations all around the world? You might conclude that it was the company's products, such as the Apple I and II, the Macintosh, or more recently its wildly popular iPod, iPhone, and iPad. Or, you could decide that it was its dedicated employees, management's wiliness to take calculated risks, or just plain luck – that Apple simply was in the right place at the right time.



Steve Jobs 1955-2011 by segagman licensed CC BY | flickr

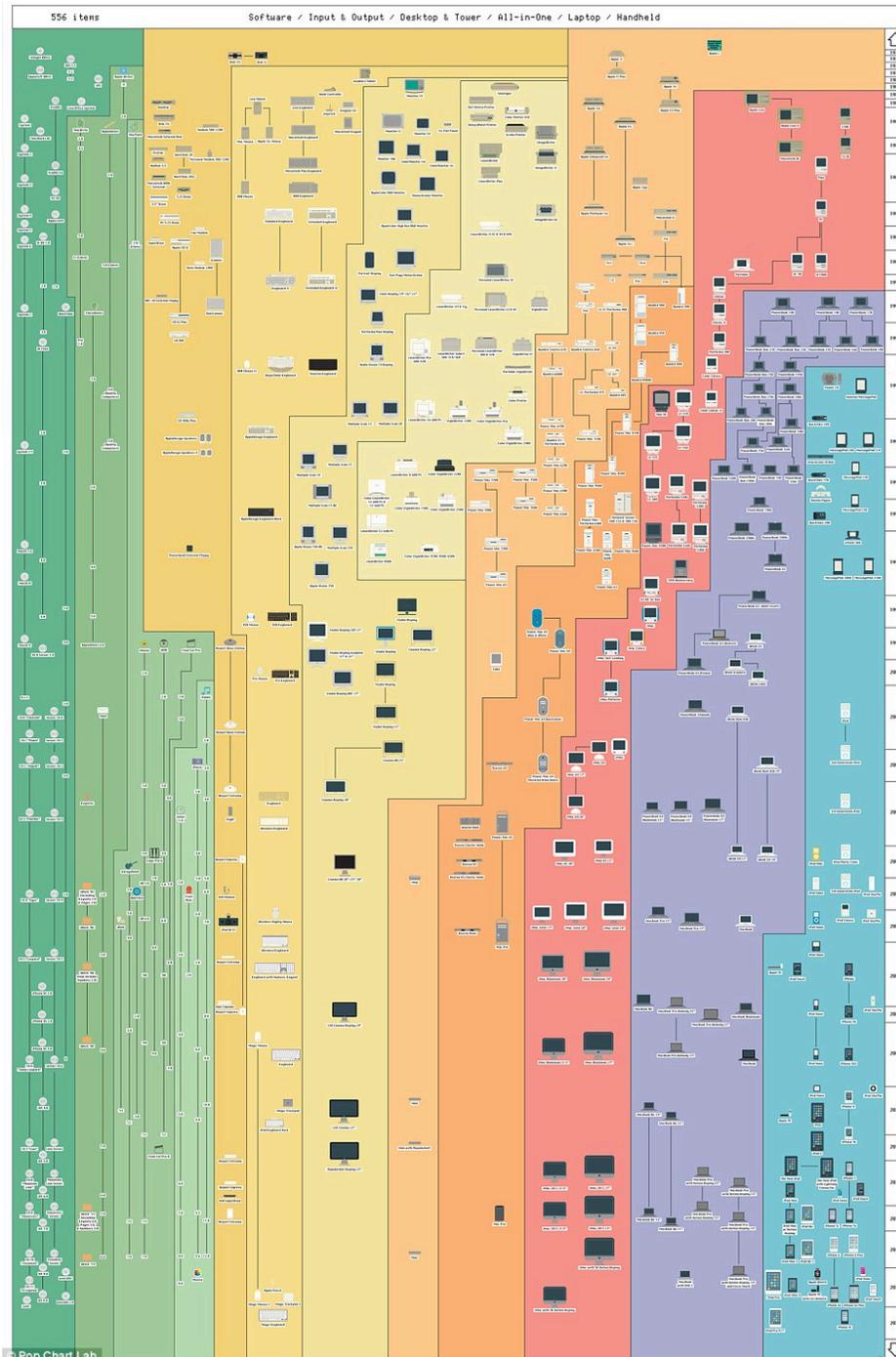
Before you draw any conclusions about what made Apple what it is today and what will propel it into a successful future, you might like to learn more about Steve Jobs, the company's co-founder and former CEO. Jobs was instrumental in the original design of the Apple I and, after being ousted from his position with the company, returned to save the firm from destruction and lead it onto its current path. Growing up, Jobs had an interest in computers. He attended lectures at Hewlett-Packard after school and worked for the company during the summer months. He took a job at Atari after graduating from high school and saved his money to make a pilgrimage to India in search of spiritual enlightenment. Following his India trip, he attended Steve Wozniak's "Homebrew Computer Club" meetings, where the idea for building a personal computer surfaced.^[2] "Many colleagues describe Jobs as a brilliant man who could be a great motivator and positively charming. At the same time his drive for perfection was so strong that employees who did not meet his demands [were] faced with blistering verbal attacks."^[3] Not everyone at Apple appreciated Jobs' brilliance and ability to motivate. Nor did they all go along with his willingness to do whatever it took to produce an innovative, attractive, high-quality product. So at age thirty, Jobs found himself ousted from Apple by John Sculley, whom Jobs himself had hired as president of the company several years earlier. It seems that Sculley wanted to cut costs and thought it would be easier to do so without Jobs around. Jobs sold \$20 million of his stock and went on a two-month vacation to figure out what he would do for the rest of his life. His solution: start a new personal computer company called NextStep. In 1993, he was invited back to Apple (a good thing, because neither his new company nor Apple was doing well).

Steve Jobs was definitely not known for humility, but he was a visionary and had a right to be proud of his accomplishments. Some have commented that "Apple's most successful days occurred with Steve Jobs at the helm."^[4]

Jobs did what many successful CEOs and managers do: he learned, adjusted, and improvised.^[5] Perhaps the most

important statement that can be made about him is this: he never gave up on the company that once turned its back on him. So now you have the facts. Here's a multiple-choice question that you'll likely get right: Apple's success is due to (a) its products, (b) its customers, (c) luck, (d) its willingness to take risks, (e) Steve Jobs, or (f) some combination of these options.

Take a moment to consider this one company's impact on technology with its over 500 devices. [Pop Chart Art](#) completed a comprehensive snapshot of the evolution of Apple.



Source: Pop Chart Lab

Introduction

As the story of Apple suggests, today is an interesting time to study business. Advances in technology are bringing rapid changes in the ways we produce and deliver goods and services. The Internet and other improvements in communication (such as smartphones, video conferencing, and social networking) now affect the way we do business. Companies are expanding international operations, and the workforce is more diverse than ever. Corporations are being held responsible for the behavior of their executives, and more people share the opinion that companies should be good corporate citizens. Because of the role they played in the worst financial crisis since the Great Depression, businesses today face increasing scrutiny and negative public sentiment.^[6]

Economic turmoil that began in the housing and mortgage industries as a result of troubled subprime mortgages quickly spread to the rest of the economy. In 2008, credit markets froze up and banks stopped making loans. Lawmakers tried to get money flowing again by passing a \$700 billion Wall Street bailout, now-cautious banks became reluctant to extend credit. Without money or credit, consumer confidence in the economy dropped and consumers cut back on spending. Unemployment rose as troubled companies shed the most jobs in five years, and 760,000 Americans marched to the unemployment lines.^[7] The stock market reacted to the financial crisis and its stock prices dropped by 44 percent while millions of Americans watched in shock as their savings and retirement accounts took a nosedive. In fall 2008, even Apple, a company that had enjoyed strong sales growth over the past five years, began to cut production of its popular iPhone. Without jobs or cash, consumers would no longer flock to Apple's fancy retail stores or buy a prized iPhone.^[8] Since then, things have turned around for Apple, which continues to report blockbuster sales and profits. But not all companies or individuals are doing so well. The economy is still struggling, unemployment is high (particularly for those ages 16 to 24), and home prices have not fully rebounded from the crisis.

As you go through the course with the aid of this text, you'll explore the exciting world of business. We'll introduce you to the various activities in which business people engage—accounting, finance, information technology, management, marketing, and operations. We'll help you understand the roles that these activities play in an organization, and we'll show you how they work together. We hope that by exposing you to the things that business people do, we'll help you decide whether business is right for you and, if so, what areas of business you'd like to study further.

Getting Down to Business

A business is any activity that provides goods or services to consumers for the purpose of making a profit. Be careful not to confuse the terms revenue and profit. Revenue represents the funds an enterprise receives in exchange for its goods or services. Profit is what's left (hopefully) after all the bills are paid. When Steve Jobs and Steve Wozniak launched the Apple I, they created Apple Computer in Jobs' family garage with the hope of making a profit. Before we go on, let's make a couple of important distinctions concerning the terms in our definitions. First, whereas Apple produces and sells goods (Mac, iPhone, iPod, iPad, Apple Watch), many businesses provide services. Your bank is a service company, as is your Internet provider. Hotels, airlines, law firms, movie theaters, and hospitals are also service companies. Many companies provide both goods and services. For example, your local car dealership sells goods (cars) and also provides services (automobile repairs).

Second, some organizations are not set up to make profits for individual stakeholders. Many are established to provide social or educational services for the entire public. Such not-for profit (or nonprofit), organizations include the United Way of America, Habitat for Humanity, the Boys and Girls Clubs, the Sierra Club, the American Red Cross, and many colleges and universities. Most of these organizations, however, function in much the same way as a business. They establish goals and work to meet them in an effective, efficient manner. Thus, most of the business principles introduced in this text also apply to nonprofits.

Business Participants and Activities

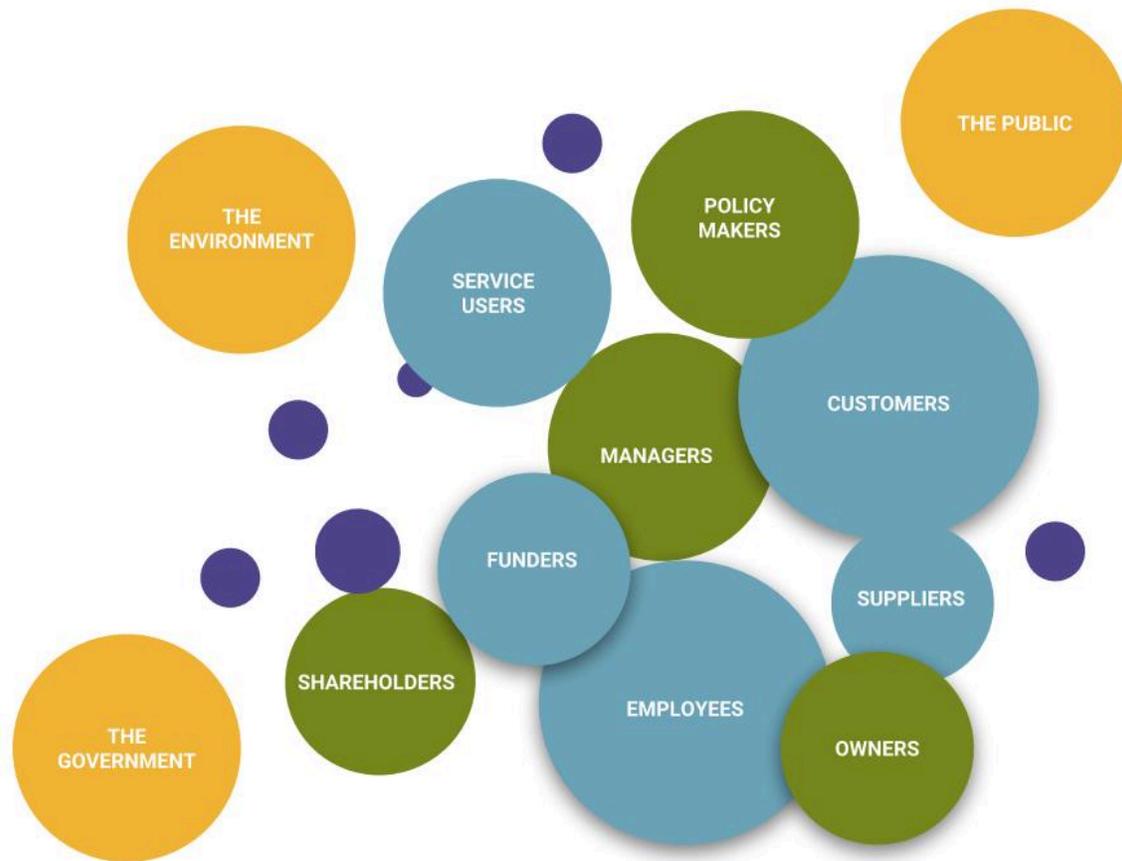
Let's begin our discussion of business by identifying the main participants of business and the functions that most businesses perform. Then we'll finish this section by discussing the external factors that influence a business' activities.

Participants

Every business must have one or more owners whose primary role is to invest money in the business. When a business is being started, it's generally the owners who polish the business idea and bring together the resources (money and people) needed to turn the idea into a business. The owners also hire employees to work for the company and help it reach its goals. Owners and employees depend on a third group of participants— customers. Ultimately, the goal of any business is to satisfy the needs of its customers in order to generate a profit for the owners.

Stakeholders

Consider your favorite restaurant. It may be an outlet or franchise of a national chain (more on franchises in a later chapter) or a local “mom and pop shop” without affiliation to a larger entity. Whether national or local, every business has stakeholders – those with a legitimate interest in the success or failure of the business and the policies it adopts. Stakeholders include customers, vendors, employees, landlords, bankers, and others (see Figure 1.2). Other stakeholders include the general public, the environment and all the various government departments which impact the business. All have a keen interest in how the business operates, in most cases for obvious reasons. If the business fails, employees will need new jobs, vendors will need new customers, and banks may have to write off loans they made to the business. Stakeholders do not always see things the same way – their interests sometimes conflict with each other. For example, lenders are more likely to appreciate high profit margins that ensure the loans they made will be repaid, while customers would probably appreciate the lowest possible prices. Pleasing stakeholders can be a real balancing act for any company.



Functional Areas of Business

The activities needed to operate a business can be divided into a number of functional areas. Examples include: human resources, operations, marketing, accounting, finance and information technology. Let's briefly explore each of these areas.

Human Resources

HR managers are responsible for ensuring that the organization has all of the skills and capabilities necessary to run the business. HR managers develop staffing plans, recruit and select new employees, monitor the performance management process, and develop succession plans for advancement and replacement. They develop standards for compensation and benefits and assist managers with staff issues.

Operations

All companies must convert resources (labour, materials, money, information, and so forth) into goods or services. Some companies, such as Apple, convert resources into tangible products—Macs, iPhones, etc. Others, such as hospitals, convert resources into intangible products – e.g., health care. The person who designs and oversees the transformation of resources into goods or services is called an operations manager. This individual is also responsible for ensuring that products are of high quality. In many organizations, operations management includes managing the supply chain which controls the delivery of raw materials and the distribution of finished goods.

Marketing

Marketing consists of everything that a company does to identify customers' needs (i.e. market research) and design products to meet those needs. Marketers develop the benefits and features of products, including price and quality. They also decide on the best method of delivering products and the best means of promoting them to attract and keep customers. They manage relationships with customers and make them aware of the organization's desire and ability to satisfy their needs.

Accounting

Managers need accurate, relevant and timely financial information, which is provided by accountants. Accountants measure, summarize, and communicate financial and managerial information and advise other managers on financial matters. There are two fields of accounting. Financial accountants prepare financial statements to help users, both inside and outside the organization, assess the financial strength of the company. Managerial accountants prepare information, such as reports on the cost of materials used in the production process, for internal use only.

Finance

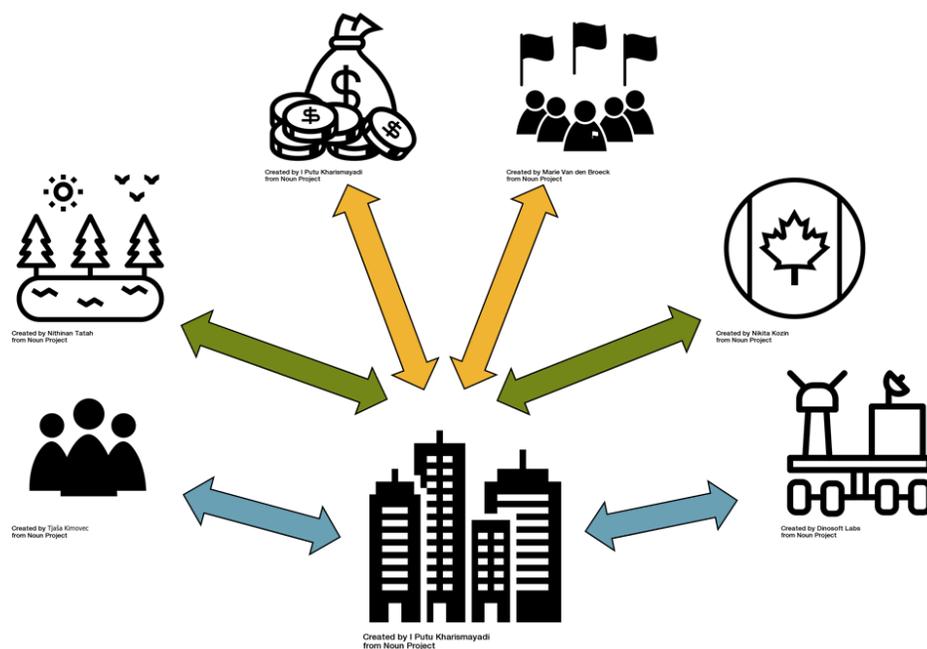
Finance involves planning for, obtaining, and managing a company's funds. Financial managers address such questions as the following: How much money does the company need? How and where will it get the necessary money? How and when will it pay the money back? What investments should be made in plant and equipment? How much should be spent on research and development? Good financial management is particularly important when a company is first formed because new business owners usually need to borrow money to get started.

Information Technology

Information is one of the critical assets of most businesses. Businesses such as Facebook are entirely information based businesses. Information technology (IT) managers are concerned with building computer and network infrastructure, implementing security protocols, and developing user interfaces and apps for customers. Usually, there is a high level of integration between the businesses website or application and other departments within the business, such as finance, marketing and operations. Often, businesses must develop interfaces to send and receive information from other companies, including suppliers, logistics and shipping suppliers.

External Forces that Influence Business Activities

Apple and other businesses don't operate in a vacuum: they're influenced by a number of external factors. These include the economy, government, consumer trends, technological developments, public pressure to act as good corporate citizens, and other factors. Collectively, these forces constitute what is known as the "macro environment" – essentially the big picture world outside over which the business exerts very little if any control.



*The company surrounded by its environmental forces: demographic, natural, economic, political, cultural, and technological.
Source: All icons from the Noun Project*

"Business and Its Environment" sums up the relationship between a business and the external forces that influence its activities. One industry that's clearly affected by all these factors is the fast-food industry. Companies such as Taco Bell, McDonald's, Tim Hortons and others all compete in this industry. Here are a few statements to show the way external factors impact business. For instance, a strong economy means people have

more money to eat out. Food standards are monitored by a government agency, the Canadian Food and Drug Inspection Agency at the federal level with entities at both the provincial and municipal levels following through with adherence. Preferences for certain types of foods are influenced by consumer trends (fast food companies are being pressured to make their menus healthier).

This example shows the large scale impact of external forces. The Ministry of Health and Long Term Care's [Newsroom on December 30, 2016](#):

Starting January 1, 2017 Ontario will be the first province in Canada to require food service providers with 20 or more locations in the province – such as restaurants, coffee shops, convenience stores, grocery stores and movie theatres – to include the number of calories for each food and beverage item on their menus, labels or tags.

Finally, a number of decisions made by the industry result from its desire to be a good corporate citizen. For example, several fast-food chains have responded to environmental concerns by eliminating Styrofoam containers.^[9]



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=33>

Of course, all industries are impacted by external factors, not just the food industry. As people have become more conscious of the environment, they have begun to choose new technologies, like all-electric cars to replace those that burn fossil fuels. Both established companies, like Nissan with its Nissan Leaf, and brand new companies like Tesla have entered the market for all-electric vehicles. While the market is still small, it is expected to grow at a compound annual growth rate of 19.2% between 2013 and 2019.^[10]

As you move through this text, you'll learn more about these external influences on business.

Key Takeaways

Important terms and concepts

1. The main participants in a business are its owners, employees, and customers.
2. Every business must consider its stakeholders, and their sometimes conflicting interests, when making decisions.
3. The activities needed to run a business can be divided into functional areas. The business functions correspond fairly closely to many majors found within a typical college of business.
4. Businesses are influenced by such external factors as the economy, government, and other forces external to the business.

3. Economics and Business

Learning Objectives

By the end of the chapter, you should be able to:

1. Describe the foundational philosophies of capitalism and socialism.
2. Discuss private property rights and why they are key to economic development.
3. Discuss the concept of GDP (gross domestic product).
4. Explain the difference(s) between fiscal and monetary policy.
5. Discuss the concept of the unemployment rate measurement.
6. Discuss the concepts of inflation and deflation.
7. Explain other key terms related to this chapter including: supply; demand; equilibrium price; monopoly; recession; depression.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=44>

What is Economics?

To appreciate how a business functions, we need to know something about the economic environment in which it operates. We begin with a definition of economics and a discussion of the resources used to produce goods and services.

Resources: Inputs and Outputs

Economics is the study of how individuals, businesses, governments and nations allocate their limited resources to satisfy their unlimited wants and needs. The allocation of resources is concerned with the production, distribution, and consumption of goods and services. Resources are the inputs used to produce outputs. Resources may include any or all of the following and their connections with one another:

- Land and other natural resources
- Labour (physical and mental)
- Capital, including buildings and equipment
- Entrepreneurship
- Knowledge

Resources are combined to produce goods and services. Land and natural resources provide the needed raw materials. Labour transforms raw materials into goods and services. Capital (equipment, buildings, vehicles, cash, and so forth) are needed for the production process. Entrepreneurship provides the skill, drive and creativity needed to bring the other resources together to produce a good or service to be sold to the marketplace.

Because a business uses resources to produce things, we also call these resources factors of production. The factors of production used to produce a shirt would include the following:

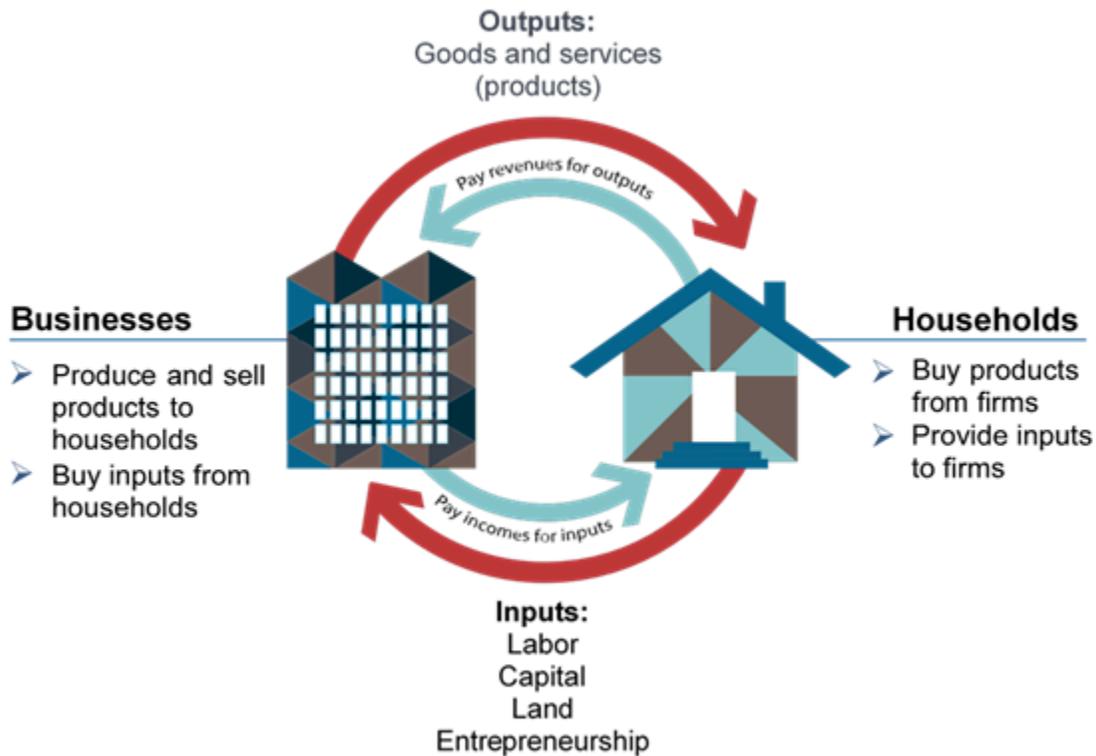
- The land that the shirt factory sits on, the electricity used to run the plant, and the raw cotton from which the shirts are made
- The labourers who make the shirts
- The factory and equipment used in the manufacturing process, as well as the money needed to operate the factory
- The entrepreneurship skills and production knowledge used to coordinate the other resources to make the shirts and distribute them to the marketplace

Input and Output Markets

Many of the factors of production are provided to businesses by households. For example, households provide businesses with labour (as workers), land and buildings (as landlords), and capital (as investors). In turn, businesses pay households for these resources by providing them with income, such as wages, rent, and interest. The resources obtained from households are then used by businesses to produce goods and services, which are sold to provide businesses with revenue. The revenue obtained by businesses is then used to buy additional

resources, and the cycle continues. This is described in the figure below, “The Circular Flow of Inputs and Outputs”, which illustrates the dual roles of households and businesses:

- Households not only provide factors of production (or resources) but also consume goods and services
- Businesses not only buy resources but also produce and sell both goods and services



Economic Systems

Economists study the interactions between households and businesses and look at the ways in which the factors of production are combined to produce the goods and services that people need. Basically, economists try to answer three sets of questions:

1. What goods and services should be produced to meet consumers' needs? In what quantity? When?
2. How should goods and services be produced? Who should produce them, and what resources, including technology, should be combined to produce them?
3. Who should receive the goods and services produced? How should they be allocated among consumers? The answers to these questions depend on a country's economic system—the means by which a society (households, businesses, and government) makes decisions about allocating resources to produce products and about distributing those products. The degree to which individuals and business owners, as opposed to the government, enjoy freedom in making these decisions varies according to the type of economic system.

Generally speaking, economic systems can be divided into two systems: planned systems and free market systems.

Planned Systems

In a planned system, the government exerts control over the allocation and distribution of all or some goods and services. The system with the highest level of government control is communism. In theory, a communist economy is one in which the government owns all or most enterprises. Central planning by the government dictates which goods or services are produced, how they are produced, and who will receive them. In practice, pure communism is practically nonexistent today, and only a few countries (notably North Korea and Cuba) operate under rigid, centrally planned economic systems.

Under socialism, industries that provide essential services, such as utilities, banking, and health care, may be government owned. Some businesses may also be owned privately. Central planning allocates the goods and services produced by government-run industries and tries to ensure that the resulting wealth is distributed equally. In contrast, privately owned companies are operated for the purpose of making a profit for their owners. In general, workers in socialist economies work fewer hours, have longer vacations, and receive more health care, education, and child-care benefits than do workers in capitalist economies. To offset the high cost of public services, taxes are generally steep. Examples of countries that lean towards a socialistic approach include Venezuela, Sweden, and France.

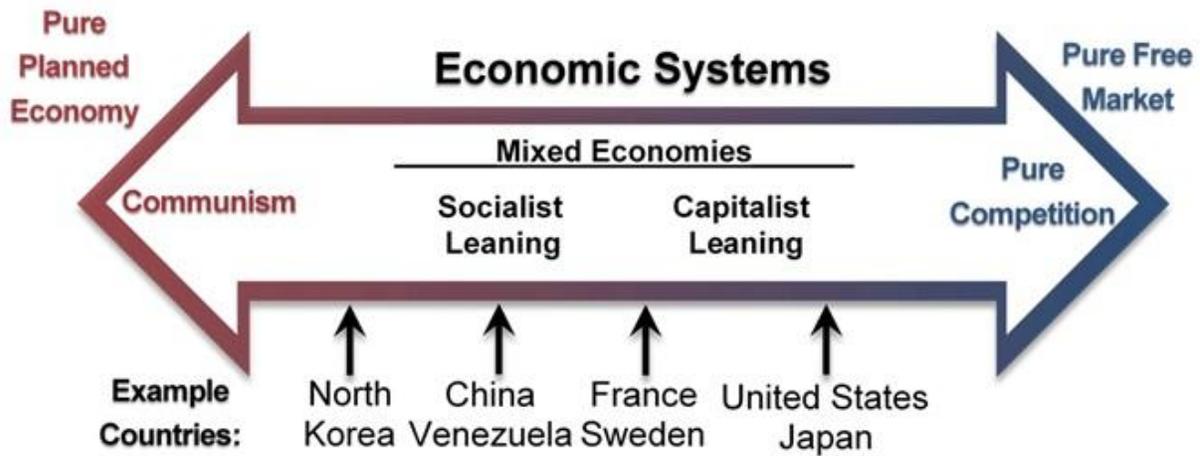
Free Market System

The economic system in which most businesses are owned and operated by individuals is the free market system, also known as capitalism. In a free market economy, competition dictates how goods and services will be allocated. Business is conducted with more limited government involvement concentrated on regulations that dictate how businesses are permitted to operate. A key aspect of a free market system is the concept of private property rights, which means that business owners can expect to own their land, buildings, machines, etc., and keep the majority of their profits, except for taxes. The profit incentive is a key driver of any free market system. The economies of the United States and other countries, such as Japan, are based on capitalism. However, a purely capitalistic economy is as rare as one that is purely communist. Imagine if a service such as police protection, one provided by government in the United States, were instead allocated based on market forces. The ability to pay would then become a key determinant in who received these services, an outcome that few in American society would consider to be acceptable.

How Economic Systems Compare

In comparing economic systems, it can be helpful to think of a continuum with communism at one end and pure capitalism at the other, as in the following Economic Systems Figure. As you move from left to right, the amount of government control over business diminishes. So, too, does the level of social services, such as

health care, child-care services, social security, and unemployment benefits. Moving from left to right, taxes are correspondingly lower as well.



Wikimedia Commons | Designed for Virginia Tech by B. Craig licensed CC BY

Mixed Market Economies

Though it's possible to have a pure communist system, or a pure capitalist (free market) system, in reality many economic systems are mixed. A mixed market economy relies on both markets and the government to allocate resources. In practice, most economies are mixed, with a leaning towards either free market or socialistic principles, rather than being purely one or the other. Some previously communist economies, such as those of Eastern Europe and China, are becoming more mixed as they adopt more capitalistic characteristics and convert businesses previously owned by the government to private ownership through a process called privatization. By contrast, Venezuela is a country that has moved increasingly towards socialism, taking control of industries such as oil and media through a process called nationalization.

The Canadian Economic System

Like most countries, Canada features a mixed market system much like its neighbor to the south: though the Canadian and U.S. economic systems are primarily free market systems, the federal government controls some basic services, such as the postal service and air traffic control. The Canadian economy also has some characteristics of a socialist system, such as providing social security retirement benefits to retired workers or free health care to its population.

The free market system was espoused by Adam Smith in his book [The Wealth of Nations](#), published in 1776. According to Smith, competition alone would ensure that consumers received the best products at the best prices. In the kind of competition he assumed, a seller who tries to charge more for his product than other sellers would not be able to find any buyers. A job-seeker who asks more than the going wage won't be hired. Because the "invisible hand" of competition will make the market work effectively, there won't be a need to regulate

prices or wages. Almost immediately, however, a tension developed among free market theorists between the principle of laissez-faire—leaving things alone—and government intervention. Today, it's common for the Canadian government to intervene in the operation of the economic system. For example, government exerts influence on the food and pharmaceutical industries through Canada's Food and Drug Act and Regulations, which protect consumers by preventing unsafe or mislabeled products from reaching the market.

To appreciate how businesses operate, we must first get an idea of how prices are set in competitive markets. The next section, "Perfect Competition and Supply and Demand," begins by describing how markets establish prices in an environment of perfect competition.

Perfect Competition and Supply and Demand

Under a mixed economy, such as we have in Canada, businesses make decisions about which goods to produce or services to offer and how they are priced. Because there are many businesses making goods or providing services, customers can choose among a wide array of products. The competition for sales among businesses is a vital part of our economic system. Economists have identified four types of competition—perfect competition, monopolistic competition, oligopoly, and monopoly. We'll introduce the first of these—perfect competition—in this section and cover the remaining three in the following section.

Perfect Competition

Perfect competition exists when there are many consumers buying a standardized product from numerous small businesses. Because no seller is big enough or influential enough to affect price, sellers and buyers accept the going price. For example, when a commercial fisher brings his fish to the local market, he has little control over the price he gets and must accept the going market price.

The Basics of Supply and Demand

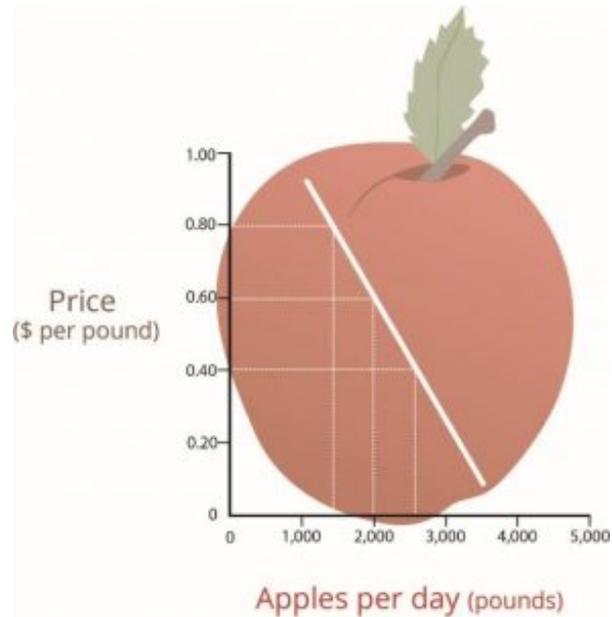
To appreciate how perfect competition works, we need to understand how buyers and sellers interact in a market to set prices. In a market characterized by perfect competition, price is determined through the mechanisms of supply and demand. Prices are influenced both by the supply of products from sellers and by the demand for products by buyers.

To illustrate this concept, let's create a supply and demand schedule for one particular good sold at one point in time. Then we'll define demand and create a demand curve and define supply and create a supply curve. Finally, we'll see how supply and demand interact to create an equilibrium price—the price at which buyers are willing to purchase the amount that sellers are willing to sell.

Demand and the Demand Curve

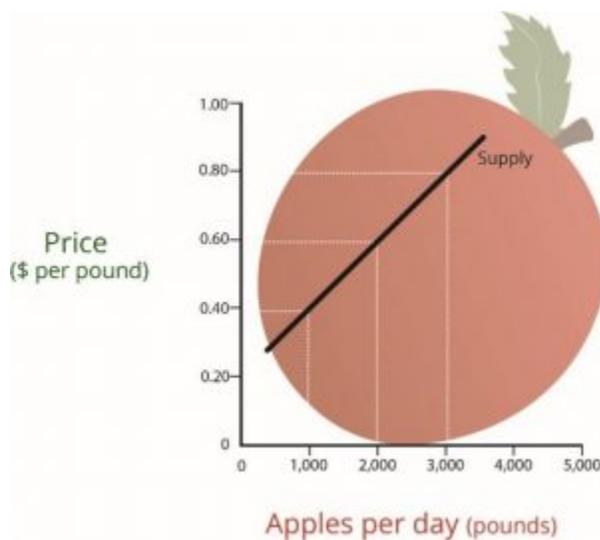
Demand is the quantity of a product that buyers are willing to purchase at various prices. The quantity of a product that people are willing to buy depends on its price. You're typically willing to buy less of a product when prices rise and more of a product when prices fall. Generally speaking, we find products more attractive at lower prices, and we buy more at lower prices because our income goes further.

Using this logic, we can construct a demand curve that shows the quantity of a product that will be demanded at different prices. Let's assume that the diagram "The Demand Curve" represents the daily price and quantity of apples sold by farmers at a local market. Note that as the price of apples goes down, buyers' demand goes up. Thus, if a pound of apples sells for \$0.80, buyers will be willing to purchase only fifteen hundred pounds per day. But if apples cost only \$0.60 a pound, buyers will be willing to purchase two thousand pounds. At \$0.40 a pound, buyers will be willing to purchase twenty-five hundred pounds.



The Demand Curve

Supply and the Supply Curve



The Supply Curve

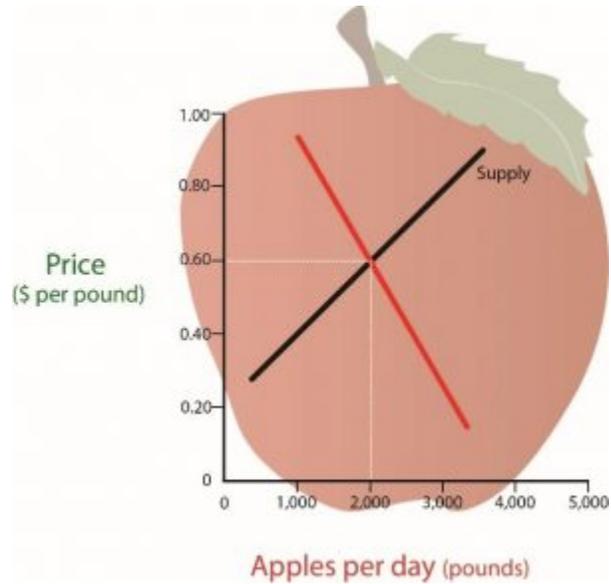
Supply is the quantity of a product that sellers are willing to sell at various prices. The quantity of a product that a business is willing to sell depends on its price. Businesses are more willing to sell a product when the price rises and less willing to sell it when prices fall. Again, this fact makes sense: businesses are set up to make profits, and there are larger profits to be made when prices are high.

Now we can construct a supply curve that shows the quantity of apples that farmers would be willing to sell at different prices, regardless of demand. As you can see in "The Supply Curve", the supply curve goes in the opposite direction from the demand curve: as prices rise, the quantity of apples that farmers are willing to sell also goes up. The supply curve shows that farmers are willing to sell only a thousand pounds of apples when the price is \$0.40 a pound, two thousand pounds when the price is \$0.60, and three thousand pounds when the price is \$0.80.

Equilibrium Price

We can now see how the market mechanism works under perfect competition. We do this by plotting both the supply curve and the demand curve on one graph, as we've done in the figure below, "The Equilibrium Price". The point at which the two curves intersect is the equilibrium price.

You can see in "The Equilibrium Price" that the supply and demand curves intersect at the price of \$0.60 and quantity of two thousand pounds. Thus, \$0.60 is the equilibrium price: at this price, the quantity of apples demanded by buyers equals the quantity of apples that farmers are willing to supply. If a single farmer tries to charge more than \$0.60 for a pound of apples, he won't sell very many because other suppliers are making them available for less. As a result, his profits will go down. If, on the other hand, a farmer tries to charge less than the equilibrium price of \$0.60 a pound, he will sell more apples but his profit per pound will be less than at the equilibrium price. With profit being the motive, there is no incentive to drop the price.



The Equilibrium Price

What have you learned in this discussion? Without outside influences, markets in an environment of perfect competition will arrive at an equilibrium point at which both buyers and sellers are satisfied. But you must be aware that this is a very simplistic example. Things are much more complex in the real world. For one thing, markets rarely operate without outside influences. Sometimes, sellers supply more of a product than buyers are willing to purchase; in that case, there's a surplus. Sometimes, they don't produce enough of a product to satisfy demand; then we have a shortage.

Circumstances also have a habit of changing. What would happen, for example, if incomes rose and buyers were willing to pay more for apples? The demand curve would change, resulting in an increase in equilibrium price. This outcome makes intuitive sense: as demand increases, prices will go up. What would happen if apple crops were larger than expected because of favorable weather conditions? Farmers might be willing to sell apples at lower prices rather than letting part of the crop spoil. If so, the supply curve would shift, resulting in another change in equilibrium price: the increase in supply would bring down prices.

Monopolistic Competition, Oligopoly, and Monopoly

As mentioned previously, economists have identified four types of competition—perfect competition, monopolistic competition, oligopoly, and monopoly. Perfect competition was discussed in the last section; we'll cover the remaining three types of competition here.

Four Major Market Structures

Characteristic	Perfect Competition	Monopolistic Competition	Oligopoly	Pure Monopoly
Number of firms	Very many	Many	A few	One
Types of product	Homogeneous	Differentiated	Homogeneous or differentiated	Homogeneous
Barriers to entry or exit from industry	No substantial barriers	Minor barriers	Considerable barriers	Extremely great barriers
Examples	Agriculture	Retail trade	Banking	Public utilities

Monopolistic Competition

In monopolistic competition, we still have many sellers (as we had under perfect competition). Now, however, they don't sell identical products. Instead, they sell differentiated products—products that differ somewhat, or are perceived to differ, even though they serve a similar purpose. Products can be differentiated in a number of ways, including quality, style, convenience, location, and brand name. Some people prefer Coke over Pepsi, even though the two products are quite similar. But what if there was a substantial price difference between the two? In that case, buyers could be persuaded to switch from one to the other. Thus, if Coke has a big promotional sale at a supermarket chain, some Pepsi drinkers might switch (at least temporarily).

How is product differentiation accomplished? Sometimes, it's simply geographical; you probably buy gasoline at the station closest to your home regardless of the brand. At other times, perceived differences between products are promoted by advertising designed to convince consumers that one product is different from another—and better than it. Regardless of customer loyalty to a product, however, if its price goes too high, the seller will lose business to a competitor. Under monopolistic competition, therefore, companies have only limited control over price.

Oligopoly

Oligopoly means few sellers. In an oligopolistic market, each seller supplies a large portion of all the products sold in the marketplace. In addition, because the cost of starting a business in an oligopolistic industry is usually high, the number of firms entering it is low. Companies in oligopolistic industries include such large-scale enterprises as automobile companies and airlines. As large firms supplying a sizable portion of a market, these

companies have some control over the prices they charge. But there's a catch: because products are fairly similar, when one company lowers prices, others are often forced to follow suit to remain competitive. You see this practice all the time in the airline industry: When American Airlines announces a fare decrease, Continental, United Airlines, and others do likewise. When one automaker offers a special deal, its competitors usually come up with similar promotions.

Monopoly

In terms of the number of sellers and degree of competition, a monopoly lies at the opposite end of the spectrum from perfect competition. In perfect competition, there are many small companies, none of which can control prices; they simply accept the market price determined by supply and demand. In a monopoly, however, there's only one seller in the market. The market could be a geographical area, such as a city or a regional area, and doesn't necessarily have to be an entire country.

There are few monopolies in the United States because the government limits them. Most fall into one of two categories: natural and legal. Natural monopolies include public utilities, such as electricity and gas suppliers. Such enterprises require huge investments, and it would be inefficient to duplicate the products that they provide. They inhibit competition, but they're legal because they're important to society. In exchange for the right to conduct business without competition, they're regulated. For instance, they can't charge whatever prices they want, but they must adhere to government-controlled prices. As a rule, they're required to serve all customers, even if doing so isn't cost efficient.

A legal monopoly arises when a company receives a patent giving it exclusive use of an invented product or process. Patents are issued for a limited time, generally twenty years.^[1] During this period, other companies can't use the invented product or process without permission from the patent holder. Patents allow companies a certain period to recover the heavy costs of researching and developing products and technologies. A classic example of a company that enjoyed a patent-based legal monopoly is Polaroid, which for years held exclusive ownership of instant-film technology.^[2] Polaroid priced the product high enough to recoup, over time, the high cost of bringing it to market. Without competition, in other words, it enjoyed a monopolistic position in regard to pricing.

Measuring the Health of the Economy

Every day, we are bombarded with economic news (at least if you watch the business news stations). We're told about things like unemployment, home prices, and consumer confidence trends. As a student learning about business, and later as a business manager, you need to understand the nature of the Canadian economy and the terminology that we use to describe it. You need to have some idea of where the economy is heading, and you need to know something about the government's role in influencing its direction.

Economic Goals

The world's economies share three main goals:

- Growth
- High employment
- Price stability

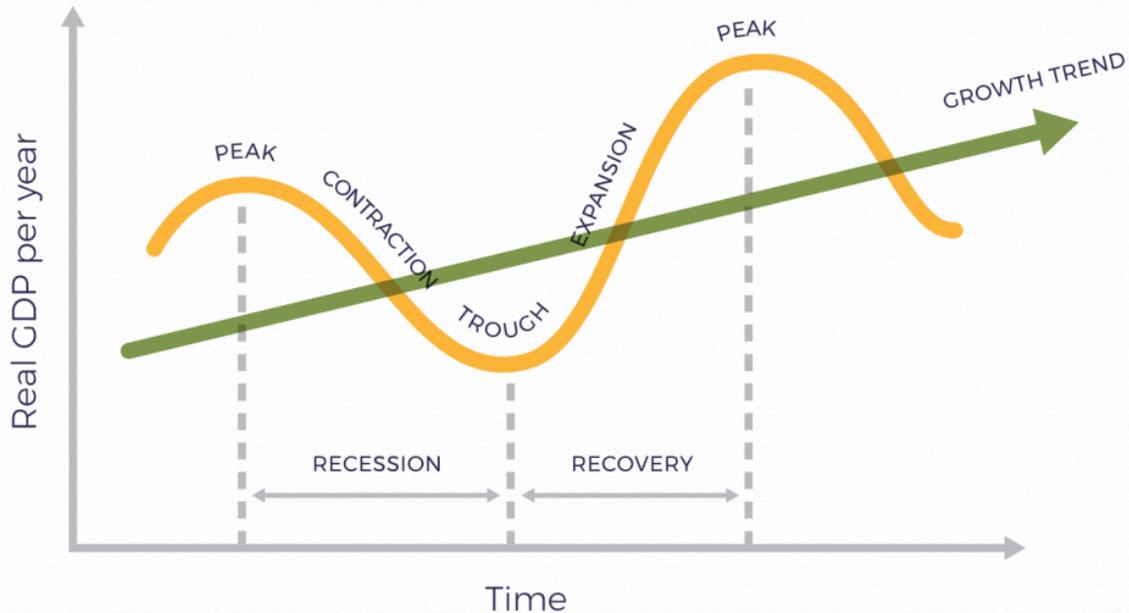
Let's take a closer look at each of these goals, both to find out what they mean and to show how we determine whether they're being met.

Economic Growth

One purpose of an economy is to provide people with goods and services—cars, computers, video games, houses, rock concerts, fast food, amusement parks. One way in which economists measure the performance of an economy is by looking at a widely used measure of total output called the gross domestic product (GDP). The GDP is defined as the market value of all goods and services produced by the economy in a given year. The GDP includes only those goods and services produced domestically; goods produced outside the country are excluded. The GDP also includes only those goods and services that are produced for the final user; intermediate products are excluded. For example, the silicon chip that goes into a computer (an intermediate product) would not count directly because it is included when the finished computer is counted. By itself, the GDP doesn't necessarily tell us much about the direction of the economy. But change in the GDP does. If the GDP (after adjusting for inflation, which will be discussed later) goes up, the economy is growing. If it goes down, the economy is contracting. There is some debate amongst economists that GDP provides the most accurate measure of an economy's performance. Many economists believe that GDP per capita, which is the measure of total production of goods and services divided by the number of households, is a better indicator of an economy's performance. For example, according to [The World Bank](#), as of 2017, India's GDP ranked 7th in the world at \$2.439 trillion (USD) while Canada's GDP ranked 10th at \$1.640 trillion (USD). However, as of 2017, Canada's GDP per capita ranks 18th at \$44,773 per household, compared to India's GDP per capita which ranked 142nd in the world at \$1,852 per household.

Business Cycle

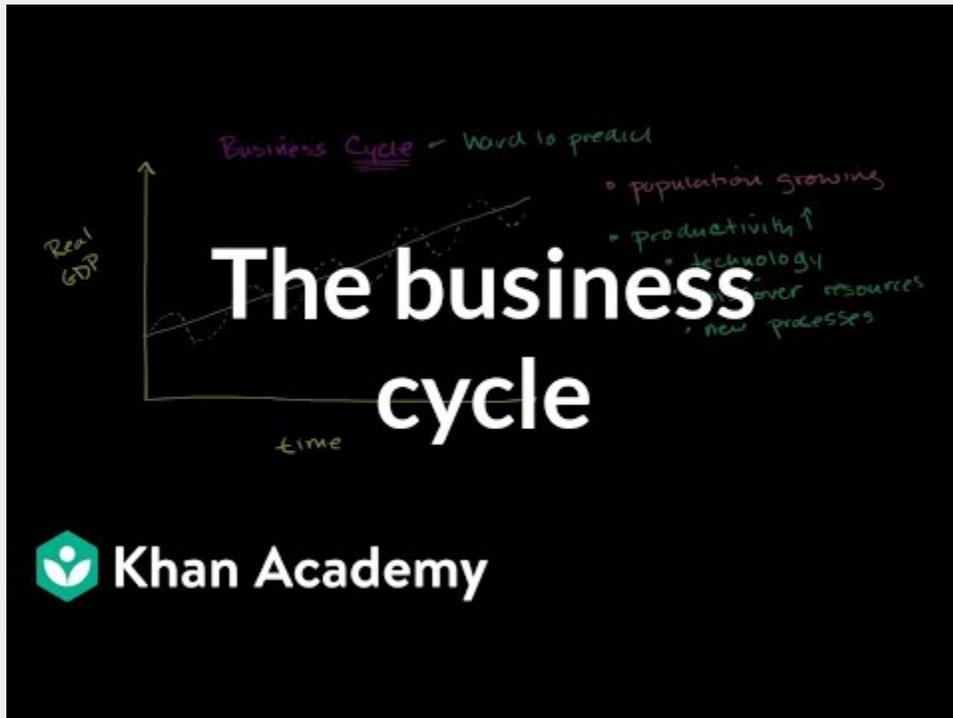
Short-term fluctuations in the economy relative to the long-term trend in output.



The economic ups and downs resulting from expansion and contraction constitute the business cycle. Similar to a product lifecycle, as a business cycle introduces new products, those products grow, mature and decline, when all business cycles in an economy are combined it creates an economy's business cycle. A typical cycle runs from three to five years but could last much longer. Though typically irregular, a cycle can be divided into four general phases of prosperity, recession, depression (which the cycle generally skips), and recovery:

- During prosperity, the economy expands, unemployment is low, incomes rise, and consumers buy more products. Businesses respond by increasing production and offering new and better products.
- Eventually, however, things slow down. GDP decreases, unemployment rises, and because people have less money to spend, business revenues decline. This slowdown in economic activity is called a recession.
- Economists often say that we're entering a recession when GDP goes down for two consecutive quarters.
- Generally, a recession is followed by a recovery or expansion in which the economy starts growing again.
- If, however, a recession lasts a long time (perhaps a decade or so), while unemployment remains very high and production is severely curtailed, the economy could sink into a depression. Unlike for the term recession, economists have not agreed on a uniform standard for what constitutes a depression, though they are generally characterized by their duration. Though not impossible, it's unlikely that the United States will experience another severe depression like that of the 1930s. The federal government has a number of economic tools (some of which we'll discuss shortly) with which to fight any threat of a depression.

If you want or need a more interactive examples of the business cycle, this 10 minute video provides more details:



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=44>

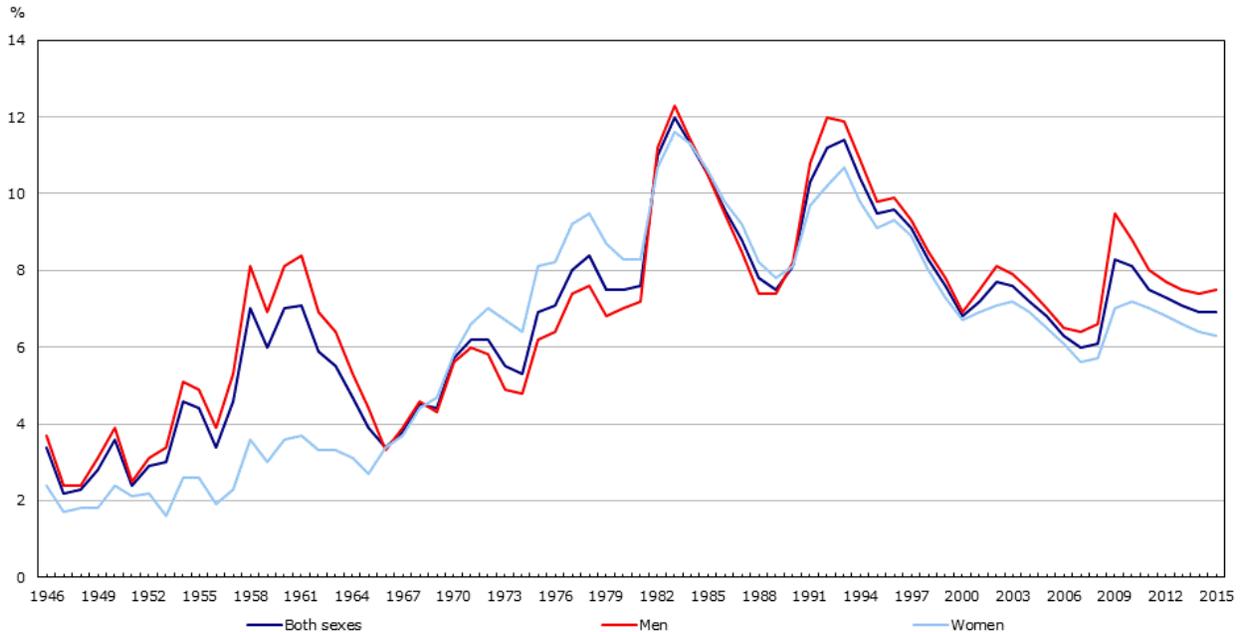
The Unemployment Rate

Statistics Canada tracks unemployment and reports the unemployment rate: the percentage of the labour force that's unemployed and actively seeking work. The unemployment rate is an important measure of economic health. It goes up during recessionary periods because companies are reluctant to hire workers when demand for goods and services is low. Conversely, it goes down when the economy is expanding and there is high demand for products and workers to supply them.

"The Canadian Unemployment Rate, 1946-2015" traces the Canadian unemployment rate between 1946 and 2015. Please be aware that there are multiple measures of unemployment and that this graph is based on what is known as R4, the most commonly used measurement and is comparable to the U.S. unemployment measure,

U3. Another measurement, R8, is considered to provide a broader picture of unemployment in Canada and includes unemployed workers that are discouraged by their job search, involuntary part-time workers and those unemployed workers that are awaiting confirmation for new work. Since by definition, R8 is always higher than R4, it is likely that R4 is discussed more often because it paints a more favourable, if not completely accurate, picture.

Chart 4
Unemployment rate by sex, 1946 to 2015



Notes: From 1946 to 1965, rates are based on the population aged 14 years and older. From 1966 to 2015, rates are based on the population aged 15 years and older. Newfoundland was included in the LFS in the fourth quarter of 1949.
Sources: Statistics Canada, Labour Force Survey, annual averages.

Canada's Unemployment Rates 1946-2015 | Statistics Canada

Pick a peak; view a valley.

Consider what was happening in Canada and/or the world that helps explain one of the peaks or one of the valleys?

Full Employment

To keep the economy going strong, people must spend money on goods and services. A reduction in personal expenditures for things like food, clothing, appliances, automobiles, housing, and medical care could severely reduce GDP and weaken the economy. Because most people earn their spending money by working, an important goal of all economies is making jobs available to everyone who wants one. In principle, full

employment occurs when everyone who wants to work has a job. In practice, we say that we have full employment when about 95 percent of those wanting to work are employed.

Price Stability

A third major goal of all economies is maintaining price stability. Price stability occurs when the average of the prices for goods and services either doesn't change or changes very little. Rapidly rising prices are troublesome for both individuals and businesses. For individuals, rising prices mean people have to pay more for the things they need. For businesses, rising prices mean higher costs, and, at least in the short run, businesses might have trouble passing on higher costs to consumers. When the overall price level goes up, we have inflation. The graph shows inflationary trends in the Canadian economy since 1915. The inflation rate in Canada averaged 3.15 percent from 1915 until 2018, reaching an all time high of 21.60 percent in June of 1920 and a record low of -17.80 percent in June of 1921.



Canada's Inflation Rate 1915-2018

When the price level goes down (which rarely happens), we have deflation. A deflationary situation can also be damaging to an economy. When purchasers believe they can expect lower prices in the future, they may defer making purchases, which has the effect of slowing economic growth. Japan experienced a long period of deflation which contributed to economic stagnation in that country from which it is only now beginning to recover.

The Consumer Price Index

The most widely publicized measure of inflation is the consumer price index (CPI), which is reported monthly by

Statistics Canada. The CPI measures the rate of inflation by determining price changes of a hypothetical basket of goods, such as food, housing, clothing, medical care, appliances, automobiles, and so forth, bought by a typical household.

The Bank of Canada currently measures prices against the base year of 2002, and the basket for that year is given the value of 100. In 2012 the CPI averaged 121.7, which means that what you could buy for \$100 in 2002 cost \$121.70 in 2012. The difference registers the effect of inflation. In fact, that's what an inflation rate is—the percentage change in a price index.

The Bank of Canada created an inflation calculator: <https://www.bankofcanada.ca/rates/related/inflation-calculator/>. Compare the costs of consumer goods then and now. For example, ask a parent or an older neighbour what they paid for their first car, first house, or first formal wear.

Economic Forecasting

In the previous section, we introduced several measures that economists use to assess the performance of the economy at a given time. By looking at changes in the GDP, for instance, we can see whether the economy is growing. The CPI allows us to gauge inflation. These measures help us understand where the economy stands today. But what if we want to get a sense of where it's headed in the future? To a certain extent, we can forecast future economic trends by analyzing several leading economic indicators.

Economic Indicators

An economic indicator is a statistic that provides valuable information about the economy. There's no shortage of economic indicators, and trying to follow them all would be an overwhelming task. So in this chapter, we'll only discuss the general concept and a few of the key indicators.

Lagging and Leading Indicators

Statistics that report the status of the economy a few months in the past are called lagging economic indicators. One such indicator is average length of unemployment. If unemployed workers have remained out of work for a long time, we may infer that the economy has been slow. Indicators that predict the status of the economy three to twelve months into the future are called leading economic indicators. If such an indicator rises, the economy is more likely to expand in the coming year. If it falls, the economy is more likely to contract.

It is also helpful to look at indicators from various sectors of the economy—labour, manufacturing, and housing. One useful indicator of the outlook for future jobs is the number of new claims for unemployment insurance. This measure tells us how many people recently lost their jobs. If it's rising, it signals trouble ahead because unemployed consumers can't buy as many goods and services as they could if they had paychecks.

To gauge the level of goods to be produced in the future (which will translate into future sales), economists look at a statistic called average weekly manufacturing hours. This measure tells us the average number of hours worked per week by production workers in manufacturing industries. If it's on the rise, the economy will

probably improve. For assessing the strength of the housing market, housing starts is often a good indicator. An increase in this statistic—which tells us how many new housing units are being built—indicates that the economy is improving. Why? Because increased building brings money into the economy not only through new home sales but also through sales of furniture and appliances to furnish them.

Since employment is such a key goal in any economy, the Canadian Industry Statistics in collaboration with Statistics Canada tracks total non-farm payroll employment from which the number of net new jobs created can be determined.

Government's Role in Managing the Economy

Monetary Policy

Monetary policy is exercised by the The Bank of Canada, which is empowered to take various actions that decrease or increase the money supply and raise or lower short-term interest rates, making it harder or easier to borrow money. When The Bank of Canada believes that inflation is a problem, it will use contractionary policy to decrease the money supply and raise interest rates. When rates are higher, borrowers have to pay more for the money they borrow, and banks are more selective in making loans. Because money is “tighter”—more expensive to borrow—demand for goods and services will go down, and so will prices. In any case, that's the theory.

The Bank of Canada will typically tighten or decrease the money supply during inflationary periods, making it harder to borrow money.

To counter a recession, The Bank of Canada uses expansionary policy to increase the money supply and reduce interest rates. With lower interest rates, it's cheaper to borrow money, and banks are more willing to lend it. We then say that money is “easy.” Attractive interest rates encourage businesses to borrow money to expand production and encourage consumers to buy more goods and services. In theory, both sets of actions will help the economy escape or come out of a recession.

Fiscal Policy

Fiscal policy relies on the government's powers of spending and taxation. Both taxation and government spending can be used to reduce or increase the total supply of money in the economy—the total amount, in other words, that businesses and consumers have to spend. When the country is in a recession, government policy is typically to increase spending, reduce taxes, or both. Such expansionary actions will put more money in the hands of businesses and consumers, encouraging businesses to expand and consumers to buy more goods and services. Expansionary fiscal policy is used to increase government expenditures and/or decrease taxes which causes the government's budget deficit to increase or its budget surplus to decrease. When the economy is experiencing inflation, the opposite policy is adopted: the government will decrease spending or increase taxes, or both. Because such contractionary measures reduce spending by businesses and consumers, prices

come down and inflation eases. Contractionary fiscal policy is used to decrease government expenditures and/or increase taxes which causes the government's budget deficit to decrease or its budget surplus to increase.

The National Debt

If, in any given year, the government takes in more money (through taxes) than it spends on goods and services (for things such as defense, transportation, and social services), the result is a budget surplus. If, on the other hand, the government spends more than it takes in, we have a budget deficit (which the government pays off by borrowing through the issuance of Treasury bonds). Historically, deficits have occurred much more often than surpluses; typically, the government spends more than it takes in. Consequently, the Canadian government now has a total national debt of more than \$1.154 trillion.

This number is moving too quickly for the authors to keep the graph current – you can see the current debt at <https://www.nationaldebtclocks.org/debtclock/canada>.

Key Takeaways

Important terms and concepts

1. Economics is the study of the production, distribution, and consumption of goods and services.
2. Economists address these three questions: (1) What goods and services should be produced to meet consumer needs? (2) How should they be produced, and who should produce them? (3) Who should receive goods and services?
3. The answers to these questions depend on a country's economic system. The primary economic systems that exist today are planned and free market systems.
4. In a planned system, such as communism and socialism, the government exerts control over the production and distribution of all or some goods and services.
5. In a free market system, also known as capitalism, business is conducted with only limited government involvement. Competition determines what goods and services are produced, how they are produced, and for whom.
6. In a free market system, buyers and sellers interact in a market to set prices.
7. When the market is characterized by perfect competition, many small companies sell identical products. The price is determined by supply and demand.
8. Supply is the quantity of a product that sellers are willing to sell at various prices. Price also influences the quantity of a product that producers are willing to supply: they'll sell more of a product when prices are high and less when they're low.
9. Demand is the quantity of a product that buyers are willing to purchase at various prices. The quantity of a product that people will buy depends on its price: they'll buy more when the price is low and less when it's high.
10. In a competitive market, the decisions of buyers and sellers interact until the market reaches an equilibrium price—the price at which buyers are willing to buy the same amount that sellers are willing to sell.
11. There are four types of competition in a free market system: perfect competition, monopolistic competition, oligopoly, and monopoly.
12. Under perfect competition, many sellers offer differentiated products—products that differ slightly but serve similar purposes. By making consumers aware of product differences, sellers exert some control over price.
13. In an oligopoly, a few sellers supply a sizable portion of products in the market. They exert some control over price, but because their products are similar, when one company lowers prices, the others follow.
14. In a monopoly, there is only one seller in the market. The market could be a geographical area, such as a city or a regional area, and does not necessarily have to be an entire country. The single seller is able to control prices.
15. Most monopolies fall into one of two categories: natural and legal.
16. Natural monopolies include public utilities, such as electricity and gas suppliers. They inhibit

competition, but they're legal because they're important to society.

17. A legal monopoly arises when a company receives a patent giving it exclusive use of an invented product or process for a limited time, generally twenty years. Economies share three goals: growth, high employment, and price stability.
18. Growth. An economy provides people with goods and services, and economists measure its performance by studying the gross domestic product (GDP)—the market value of all goods and services produced by the economy in a given year. If the GDP goes up, the economy is growing; if it goes down, the economy is contracting.

4. Ethics and Social Responsibility

Learning Objectives

By the end of the chapter, you should be able to:

1. Define business ethics and explain what it means to act ethically in business.
2. Explain why we study business ethics.
3. Identify ethical issues that you might face in business, such as insider trading, conflicts of interest, and bribery, and explain rationalizations for unethical behaviour.
4. Identify steps you can take to maintain your honesty and integrity in a business environment.
5. Define corporate social responsibility and explain how organizations are responsible to their stakeholders, including owners, employees, customers, and the community.
6. Discuss how you can identify an ethical organization, and how organizations can prevent behaviour like sexual harassment.
7. Recognize how to avoid an ethical lapse, and why you should not rationalize when making decisions.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=53>

Canada's Leader: Passing or Failing the "Smell Test"?

Ethics is not always black and white; the ethical decision is not always obvious to all. Even leaders can fail to act ethically all the time. Recent decisions impacted two leaders.



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=53>

CBC News's reporter, E. Thompson, filed the following story on December 21, 2017. It provides a detailed account of the ethical issues surrounding Prime Minister Trudeau's trip to Aga Khan's private island.



Aga Khan could face lobbying probe for Trudeau trip

[Democracy Watch](#) files complaint, saying Bahamas vacation violated lobbying law.

The Aga Khan could face an investigation into allegations he violated Canada's Lobbying Act by giving Prime Minister Justin Trudeau and his family free vacations on his private island in the Bahamas at the same time as he was discussing funding for projects.

Democracy Watch sent a letter to the Commissioner of Lobbying late Wednesday, urging her to investigate whether Prince Shah Karim Al Hussaini Aga Khan IV “violated the Lobbyists Code by giving Prime Minister Trudeau and Liberal MP Seamus O’Regan the gifts of trips to his island home”.

In the letter, Democracy Watch co-founder Duff Conacher says the Aga Khan’s actions have put Trudeau and O’Regan in a conflict of interest. It is also against the law to give a public office holder a gift that could create a sense of obligation.

“Your position must be that anyone working for or associated with a company that is registered to lobby a public office holder who gives to or does anything for that office holder... that is more than an average voter does... puts that office holder in an apparent conflict of interest,” he wrote.

The Aga Khan is the spiritual leader of millions of Ismaili Muslims and is listed as a member of the board of directors of the Aga Khan Foundation Canada. The foundation, which has received millions of dollars in federal government development aid over the years, is registered to lobby several federal government departments including the Prime Minister’s Office, although the Aga Khan is not listed among those registered to lobby on its behalf.

A search of the lobbyist registry shows the foundation has filed 132 reports since 2011 outlining its meetings with government decision makers. However, none of those reports list any meetings with Trudeau.

Representatives of the Aga Khan Foundation of Canada contacted by CBC News have yet to comment.

The call for a lobbying investigation comes in the wake of a scathing report by Ethics Commissioner Mary Dawson on Wednesday.

Dawson found that Trudeau violated four sections of the Conflict of Interest Act when he accepted a vacation on the island in the Bahamas and a ride in the Aga Khan’s personal helicopter.

While Trudeau and his family got a tropical vacation, Canadian taxpayers got a bill for more than \$215,000 in transportation and staffing costs – far more than the government initially disclosed to Parliament.

Dawson also revealed that Trudeau’s trip during last year’s Christmas holidays was one of three that Trudeau or members of his family had made to the island. Dawson disclosed that Sophie Grégoire-Trudeau stayed on the island in March 2016 with a friend and their children.

Neither the Aga Khan, nor any member of his family, was on the island during their stay.

Dawson said the Aga Khan was on the island during the Trudeaus’ Christmas-time visit last year as was a “senior American official of a previous administration,” who she did not name.

In her report, Dawson describes the relationship between Trudeau and the Aga Khan, the times they met and the questions they discussed.

Among them was a bilateral meeting on May 17, 2016 that was arranged by “representatives” of the Aga Khan. After a 15-minute chat between the two men about “personal matters, the Ismaili community in general and geopolitics,” they were joined by three of the Aga Khan’s representatives, Heritage Minister Mélanie Joly, staff members from the Prime Minister’s Office and senior officials of the Privy Council Office.

Dawson’s report says the government had found a funding mechanism to allow it to contribute to the Global

Centre for Pluralism's endowment fund and Trudeau reaffirmed the government's \$15 million commitment during the meeting.

The Aga Khan's pitch for government funding for a \$200 million riverfront renewal plan in Ottawa was also discussed.

Dawson ruled that Trudeau should have recused himself from two discussions in May 2016 involving the \$15 million grant.

"Two months prior to the May 2016 occasions, Mr. Trudeau's family accepted a gift from the Aga Khan that might reasonably be seen to have been given to influence Mr. Trudeau in the exercise of an official power, duty or function as Prime Minister," she wrote.

"For this reason, the discussions with the Privy Council Office and later with the Aga Khan about the outstanding \$15 million grant to the endowment fund provided an opportunity to improperly further the private interests of the Global Centre for Pluralism."

While the Aga Khan is not paid to lobby government (one of the criteria under the law) Conacher said he believes the Aga Khan violated the lobbying rules. Otherwise, it would create a giant loophole, he said.

"Every single corporation, business, union, non-profit organization would start using board members to give gifts to politicians if this loophole were opened up by the lobbying commissioner."

Conacher is also calling for outgoing lobbying commissioner Karen Shepherd and incoming lobbying commissioner Nancy Bélanger to recuse themselves from ruling on the investigation because of the way Shepherd's contract was renewed and the way Bélanger was chosen in "a secretive, PMO-controlled process."

Manon Dion, spokeswoman for the lobbying commissioner's office, said she cannot reveal whether they are already looking into the issue.

Thompson, E. (Dec. 21, 2017). Aga Khan could face lobbying probe for Trudeau trip. Retrieved from <http://www.cbc.ca/news/politics/trudeau-aga-khan-bahamas-lobbying-1.4459561>

Point to Ponder

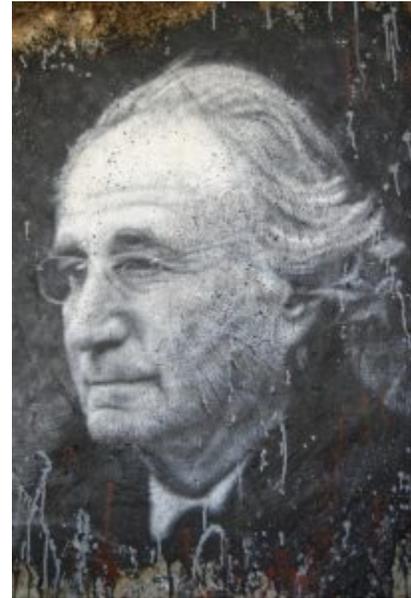
Could the Prime Minister and family have taken an ethical version of this vacation? If yes, how? If not, why not?

[The Prime Minister's Response](http://www.cbc.ca/news/politics/trudeau-ethics-aga-khan-1.4458220): <http://www.cbc.ca/news/politics/trudeau-ethics-aga-khan-1.4458220>

[The Ethics Commissioner's Report](https://www.documentcloud.org/documents/4334047-The-Trudeau-Report.html): <https://www.documentcloud.org/documents/4334047-The-Trudeau-Report.html>

Moving Ethics To the Business World

Perhaps you have heard of Bernie Madoff, founder of Bernard L. Madoff Investment Securities and former chairman of the NASDAQ stock exchange.^[1] Madoff is alleged to have run a giant Ponzi scheme^[2] that cheated investors of up to \$65 billion. His wrongdoings won him a spot at the top of Time Magazine's Top 10 Crooked CEOs. According to the SEC charges, Madoff convinced investors to give him large sums of money. In return, he gave them an impressive 8 percent to 12 percent return a year. But Madoff never really invested their money. Instead, he kept it for himself. He got funds to pay the first investors their return (or their money back if they asked for it) by bringing in new investors. Everything was going smoothly until the fall of 2008, when the stock market plummeted and many of his investors asked for their money. As he no longer had it, the game was over and he had to admit that the whole thing was just one big lie. Thousands of investors, including many of his wealthy friends, not-so-rich retirees who trusted him with their life savings, and charitable foundations, were financially ruined. Those harmed by Madoff either directly or indirectly were likely pleased when he was sentenced to jail for one-hundred and fifty years.



*Bernie Madoff by thierry ehrmann
licensed CC BY | flickr*

What is Business Ethics?

The Idea of Business Ethics

It's in the best interest of a company to operate ethically. Trustworthy companies are better at attracting and keeping customers, talented employees, and capital. Those tainted by questionable ethics suffer from dwindling customer bases, employee turnover, and investor mistrust.

Let's begin this section by addressing this question: What can individuals, organizations, and government agencies do to foster an environment of ethical behaviour in business? First, of course, we need to define the term.

What Is Ethics?

You probably already know what it means to be ethical: to know right from wrong and to know when you're practising one instead of the other. Business ethics is the application of ethical behaviour in a business context. Acting ethically in business means more than simply obeying applicable laws and regulations. It also means being honest, doing no harm to others, competing fairly, and declining to put your own interests above those of your company, its owners, and its workers. If you're in business you obviously need a strong sense of what's right and

wrong. You need the personal conviction to do what's right, even if it means doing something that's difficult or personally disadvantageous.

Why Study Ethics?

Ideally, prison terms, heavy fines, and civil suits would discourage corporate misconduct, but, unfortunately, many experts suspect that this assumption is a bit optimistic. Whatever the condition of the ethical environment in the near future, one thing seems clear: the next generation entering business—which includes most of you—will find a world much different than the one that waited for the previous generation. Recent history tells us in no uncertain terms that today's business students, many of whom are tomorrow's business leaders, need a much sharper understanding of the difference between what is and isn't ethically acceptable. As a business student, one of your key tasks is learning how to recognize and deal with the ethical challenges that will confront you. Asked what he looked for in a new hire, Warren Buffet, the world's most successful investor, replied: "I look for three things. The first is personal integrity, the second is intelligence, and the third is a high energy level." He paused and then added: "But if you don't have the first, the second two don't matter."^[3]

Identifying Ethical Issues and Dilemmas

Ethical issues are the difficult social questions that involve some level of controversy over what is the right thing to do. Environmental protection is an example of a commonly discussed ethical issue, because there can be trade-offs between environmental and economic factors.

Tips to maintain honesty and integrity

- Follow your own code of personal conduct; act according to your own convictions rather than doing what's convenient (or profitable) at the time.
- While at work, focus on your job, not on non-work related activities, such as emails and personal phone calls.
- Don't appropriate office supplies or products or other company resources for your own use.
- Be honest with customer, management, coworkers, competitors, and the public.
- Remember that it's the small seemingly trivial, day-to-day activities and gestures that build your character.

Make no mistake about it: when you enter the business world, you'll find yourself in situations in which you'll have to choose the appropriate behaviour. How, for example, would you answer questions like the following?

1. Is it OK to accept a pair of sports tickets from a supplier?
2. Can I buy office supplies from my brother-in-law?

3. Is it appropriate to donate company funds to a local charity?
4. If I find out that a friend is about to be fired, can I warn her?

Obviously, the types of situations are numerous and varied. Fortunately, we can break them down into a few basic categories: issues of honesty and integrity, conflicts of interest and loyalty, bribes versus gifts, and whistle-blowing. Let's look a little more closely at each of these categories.

Issues of Honesty and Integrity

Master investor Warren Buffet once told a group of business students the following: "I cannot tell you that honesty is the best policy. I can't tell you that if you behave with perfect honesty and integrity somebody somewhere won't behave the other way and make more money. But honesty is a good policy. You'll do fine, you'll sleep well at night and you'll feel good about the example you are setting for your coworkers and the other people who care about you."^[4]

If you work for a company that settles for its employees' merely obeying the law and following a few internal regulations, you might think about moving on. If you're being asked to deceive customers about the quality or value of your product, you're in an ethically unhealthy environment.

Think about this story:

"A chef put two frogs in a pot of warm soup water. The first frog smelled the onions, recognized the danger, and immediately jumped out. The second frog hesitated: The water felt good, and he decided to stay and relax for a minute. After all, he could always jump out when things got too hot (so to speak). As the water got hotter, however, the frog adapted to it, hardly noticing the change. Before long, of course, he was the main ingredient in frog-leg soup."^[5]

So, what's the moral of the story? Don't sit around in an ethically toxic environment and lose your integrity a little at a time; get out before the water gets too hot and your options have evaporated.

Conflicts of Interest

Conflicts of interest occur when individuals must choose between taking actions that promote their personal interests over the interests of others or taking actions that don't. A conflict can exist, for example, when an employee's own interests interfere with, or have the potential to interfere with, the best interests of the company's stakeholders (management, customers, and owners). Let's say that you work for a company with a contract to cater events at your college and that your uncle owns a local bakery. Obviously, this situation could create a conflict of interest (or at least give the appearance of one—which is a problem in itself). When you're called on to furnish desserts for a luncheon, you might be tempted to send some business your uncle's way even if it's not in the best interest of your employer. What should you do? You should disclose the connection to your boss, who can then arrange things so that your personal interests don't conflict with the company's.

The same principle holds that an employee shouldn't use private information about an employer for personal financial benefit. Say that you learn from a coworker at your pharmaceutical company that one of its most profitable drugs will be pulled off the market because of dangerous side effects. The recall will severely hurt the company's financial performance and cause its stock price to plummet. Before the news becomes public, you sell all the stock you own in the company. What you've done is called insider trading – acting on information that is not available to the general public, either by trading on it or providing it to others who trade on it. Insider trading is illegal, and you could go to jail for it.

Conflicts of Loyalty

You may one day find yourself in a bind between being loyal either to your employer or to a friend or family member. Perhaps you just learned that a coworker, a friend of yours, is about to be downsized out of his job. You also happen to know that he and his wife are getting ready to make a deposit on a house near the company headquarters. From a work standpoint, you know that you shouldn't divulge the information. From a friendship standpoint, though, you feel it's your duty to tell your friend. Wouldn't he tell you if the situation were reversed? So what do you do? As tempting as it is to be loyal to your friend, you shouldn't tell. As an employee, your primary responsibility is to your employer. You might be able to soften your dilemma by convincing a manager with the appropriate authority to tell your friend the bad news before he puts down his deposit.

Bribes Versus Gifts

It's not uncommon in business to give and receive small gifts of appreciation, but when is a gift unacceptable? When is it really a bribe?

There's often a fine line between a gift and a bribe. The following information may help in drawing it, because it raises key issues in determining how a gesture should be interpreted: the cost of the item, the timing of the gift, the type of gift, and the connection between the giver and the receiver. If you're on the receiving end, it's a good idea to refuse any item that's overly generous or given for the purpose of influencing a decision. Because accepting even small gifts may violate company rules, always check on company policy.

Read through Bell Canada's *Code of Business Conduct* detailing its recommendations for gifts. If you cannot access the image below, find it on [page 10 of the document](#).

Code of Business Conduct

2.3 Loans, Gifts and Entertainment

2.3.1 Loans from Bell

We do not accept, whether directly or indirectly, any loan or guarantee of obligations from Bell that are for our personal benefit.

2.3.2 Business Gifts & Entertainment

Do not solicit, accept or give gifts, gratuities, favours or unusual hospitality from or to suppliers or customers, which may compromise - or appear to compromise - our ability to make fair, objective, business decisions or may unfairly influence a business interaction.

Do not solicit or encourage gifts, hospitality, entertainment or any other thing for personal use.

Do not accept gifts having a monetary value; for example, gift certificates, cash, services, discounts or loans.

These guidelines do not change during traditional gift giving season.

We recognize, however, that building relationships with customers and suppliers is an integral part of doing business.

You may offer and accept reasonable hospitality in certain cases. You should consult your manager or contact the Business Conduct Help Line when in doubt about the appropriateness of a particular situation.

You may participate in unsolicited business entertainment depending on the function or services you perform for Bell and if the entertainment is clearly intended to facilitate business goals. If for example, tickets to a sporting or cultural event are offered, then the person offering the tickets should plan to attend the event as well.

You may sponsor events/activities for customers or potential customers where the purpose is to strengthen business relationships; however it is your responsibility to know and be sensitive to the customer's own code of conduct on these issues. Solicitation of modest gifts or prizes for Bell sponsored events which provide clear benefits to the sponsor and/or charitable organization is permitted upon approval by your manager.

You may accept unsolicited, nominal value hospitality, gifts or mementos that are customary or business related.

You may accept business entertainment in the form of meals as long as it is modest, infrequent, and as far as possible on a reciprocal basis.

Factors which you and your manager should consider when assessing the proper course of action include:

- Is Bell potentially involved in a major procurement activity with the company offering the gift or entertainment?
- Would the gift or entertainment be considered appropriate or customary, taking into account the nature of the function or services you perform for Bell?
- Would it be perceived as insulting or damaging to the business relationship to return the gift or decline the hospitality?
- Can the gift or hospitality be applied to benefit all team members rather than certain individuals?

Source: Bell. (2017). Code of business conduct: Our moral compass. Retrieved from <http://www.bce.ca/>

Whistleblowing

Whistleblowing was defined in 1972 by Ralph Nader as “an act of a man or a woman who, believing in the public interest overrides the interest of the organization he serves, publicly blows the whistle if the organization is involved in corrupt, illegal, fraudulent or harmful activity”.

While there are increasing incentives from governments and regulators for whistleblowers to go public about corporate misconduct, protections for whistleblowers are still very limited. Few Canadian laws pertain directly to whistleblowing and therefore whistleblowers are mostly unprotected by statute.

There is, however, a patchwork of protection provisions for whistleblowers under the Canadian *Criminal Code*, *Public Servants Disclosure Protection Act (PSDPA)*, the *Public Service of Ontario Act, 2006* as well as the *Securities Act*.

[Section 425.1](#) of the *Criminal Code*, for example, states that employers may not threaten or take disciplinary action against, demote or terminate an employee in order to deter her/him from reporting information regarding an offence s/he believes has or is being committed by her/his employer to the relevant law enforcement authorities.

An employer cannot threaten an employee with negative repercussions to deter them from contacting law enforcement with information about the employer’s offence. Punishment for employers who make such threats or reprisals can include up to five years imprisonment and/or fines.

In early 2018, a Canadian whistleblower received worldwide recognition for disclosing the amount and kinds of data harvested by Cambridge Analytica through personal Facebook accounts. However, there are other, [prominent Canadian whistleblowers](#).

Corporate Social Responsibility

Corporate social responsibility (CSR) refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders when making legal, economical, ethical, and social decisions. Remember that we previously define stakeholders as those with a legitimate interest in the success or failure of the business and the policies it adopts. The term social responsibility refers to the approach that an organization takes in balancing its responsibilities toward their various stakeholders.

What motivates companies to be “socially responsible”? We hope it’s because they want to do the right thing, and for many companies, “doing the right thing” is a key motivator. The fact is, it’s often hard to figure out what the “right thing” is: what’s “right” for one group of stakeholders isn’t necessarily “right” for another. One thing, however, is certain: companies today are held to higher standards than ever before. Consumers and other groups consider not only the quality and price of a company’s products but also its character. If too many groups see a company as a poor corporate citizen, it will have a harder time attracting qualified employees, finding investors, and selling its products. Good corporate citizens, by contrast, are more successful in all these areas.

[Included in this chapter is an optional open access article](#) updating Carroll's Pyramid by Carroll himself and diving deeper into CSR.

Excerpted from: Carroll, A. B. (2016). Carroll's pyramid of CSR: Taking another look. *International Journal of Corporate Social Responsibility*, 1(3). <https://doi.org/10.1186/s40991-016-0004-6>

Another Lens

Carroll's Pyramid is a well-respected resource for situating corporate social responsibility. Another view of corporate social responsibility is from the perspective of a company's relationships with its stakeholders. In this model, the focus is on managers—not owners—as the principals involved in these relationships. Owners are the stakeholders who invest risk capital in the firm in expectation of a financial return. Other stakeholders include employees, suppliers, and the communities in which the firm does business. Proponents of this model hold that customers, who provide the firm with revenue, have a special claim on managers' attention. The arrows indicate the two-way nature of corporation-stakeholder relationships. All stakeholders have some claim on the firm's resources and returns, and management's job is to make decisions that balance these claims.^[13]



Management's relationship with stakeholders

Let's look at some of the ways in which companies can be “socially responsible” in considering the claims of various stakeholders.

Owners

Owners invest money in companies. In return, the people who run a company have a responsibility to increase

the value of owners' investments through profitable operations. Managers also have a responsibility to provide owners (as well as other stakeholders having financial interests, such as creditors and suppliers) with accurate, reliable information about the performance of the business. Clearly, this is one of the areas in which WorldCom managers fell down on the job. Upper-level management purposely deceived shareholders by presenting them with fraudulent financial statements

Managers

Managers have what is known as a fiduciary responsibility to owners: they're responsible for safeguarding the company's assets and handling its funds in a trustworthy manner. Yet managers experience what is called the agency problem; a situation in which their best interests do not align with those of the owners who employ them. To enforce managers' fiduciary responsibilities for a firm's financial statements and accounting records, Ontario's Keeping the Promise for a Strong Economy Act (Budget Measures) 2002, also known as Bill 198, (Canadian equivalent to Sarbanes-Oxley Act of 2002 in the United States) requires CEOs and CFOs to attest to their accuracy. The law also imposes penalties on corporate officers, auditors, board members, and any others who commit fraud. You'll learn more about this law in your accounting and business law courses.

Employees

Companies are responsible for providing employees with safe, healthy places to work—as well as environments that are free from sexual harassment and all types of discrimination. They should also offer appropriate wages and benefits. In the following sections, we'll take a closer look at these areas of corporate responsibility.

Wages and Benefits

At the very least, employers must obey laws governing minimum wage and overtime pay. A minimum wage is set by the provincial government. As of January 1, 2018, the Ontario rate is \$14.00 with another increase to \$15.00 set for January 1, 2019. By law, employers must also provide certain benefits—Canadian Pension Plan (CPP -retirement funds), unemployment insurance (protects against loss of income in case of job loss), and depending on the industry, workers' compensation (covers lost wages and medical costs in case of on-the-job injury). Most large companies pay most of their workers more than minimum wage and offer broader benefits, including medical, dental, and vision care, as well as savings programs, in order to compete for talent.

Safety and Health

Though it seems obvious that companies should guard workers' safety and health, some simply don't. For over four decades, for example, executives at Johns Manville suppressed evidence that one of its products, asbestos, was responsible for the deadly lung disease developed by many of its workers.^[14] The company concealed chest X-rays from stricken workers, and executives decided that it was simply cheaper to pay workers' compensation

claims than to create a safer work environment. A New Jersey court was quite blunt in its judgment: Johns Manville, it held, had made a deliberate, cold-blooded decision to do nothing to protect at-risk workers, in blatant disregard of their rights.^[15]

In The Globe and Mail's 2017 article, "Statistics Canada looks to close data gap on workplace death, injuries" examines the different, Canadian landscape on safety and health.

Currently, responsibility for workers' compensation and occupational health and safety issues falls largely to provinces or territories – and each jurisdiction has different approaches in capturing data. As a result, there's an "uneven landscape" of health and safety research capacity, said Barbara Neis, co-founder and senior research associate at the SafetyNet Centre for Occupational Health and Safety Research at Memorial University.

The last time Statistics Canada produced a national analysis was in 1996.

Responsibility for fatality and injury counts, which are based on accepted workers' compensation claims, shifted over to the Association of Workers' Compensation Boards at that time. Detailed data must be purchased, and researchers say these counts don't represent the whole workforce, partly because not all sectors or types of workers are included in the workers' compensation system.

Available workers' compensation numbers show about 350 Canadians die each year from an on-the-job injury at work. If longer-term work-related illnesses (such as mesothelioma from asbestos exposures, or lung cancers from silica dust) are factored in, this number climbs to about 1,000 deaths a year.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=53>

Customers

The purpose of any business is to satisfy customers, who reward businesses by buying their products. Sellers are also responsible—both ethically and legally—for treating customers fairly. This means customers have:

1. The right to safe products. A company should sell no product that it suspects of being unsafe for buyers. Thus, producers have an obligation to safety-test products before releasing them for public consumption. The automobile industry, for example, conducts extensive safety testing before introducing new models (though recalls remain common).
2. The right to be informed about a product. Sellers should furnish consumers with the product information that they need to make an informed purchase decision. That's why pillows have labels identifying the materials used to make them, for instance.
3. The right to choose what to buy. Consumers have a right to decide which products to purchase, and sellers should let them know what their options are. Pharmacists, for example, should tell patients when a prescription can be filled with a cheaper brand-name or generic drug. Telephone companies should explain alternative calling plans.

4. The right to be heard. Companies must tell customers how to contact them with complaints or concerns. They should also listen and respond.

Companies share the responsibility for the legal and ethical treatment of consumers with several government agencies.

From the federal Office of Consumer Affairs (<https://www.ic.gc.ca>):

In Canada, consumer complaints are regulated by different levels of government, as well as non-government organizations. Finding the right place to direct your complaint is not always easy, but understanding your rights as a consumer is an important part of the complaint filing process.

Provincial and territorial consumer protection legislation

Many consumer complaints fall under provincial and territorial jurisdiction, including issues related to:

- buying goods and services;
- contracts;
- the purchase, maintenance or repair of motor vehicles;
- credit reporting agencies and the practices of collection agencies.

Federal consumer protection legislation

The Government of Canada has an important role in consumer awareness and protection.

Federal agencies and departments are responsible for enforcing legislation related to various issues, including:

- consumer product safety;
- food safety;
- consumer product packaging and labelling;
- anti-competitive practices, such as price fixing and misleading advertising;
- privacy complaints.

Additional resources to remember

Follow or bookmark this link for some of the more relevant areas where federal agencies and departments regulate consumer issues: <https://www.ic.gc.ca/eic/site/oca-bc.nsf/eng/ca02965.html>

In Ontario, customers have the added protection of the [Consumer Protection Act](#).



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=53>

Communities

For obvious reasons, most communities see getting a new business as an asset and view losing one—especially a large employer—as a detriment. After all, the economic impact of business activities on local communities is substantial: they provide jobs, pay taxes, and support local education, health, and recreation programs. Both big and small businesses donate funds to community projects, encourage employees to volunteer their time, and donate equipment and products for a variety of activities. Larger companies can make greater financial contributions. Let's start by taking a quick look at the philanthropic activities of a few U.S. corporations.

Philanthropy

Many large corporations support various charities, an activity called philanthropy. Some donate a percentage of sales or profits to worthwhile causes. Retailer Target, for example, donates 5 percent of its profits—about \$2 million per week—to schools, neighborhoods, and local projects across the country; its store-based grants underwrite programs in early childhood education, the arts, and family-violence prevention.^[17] The late actor Paul Newman donated 100 percent of the profits from “Newman’s Own” foods (salad dressing, pasta sauce, popcorn, and other products sold in eight countries). His company continues his legacy of donating all profits and distributing them to thousands of organizations, including the Hole in the Wall Gang camps for seriously ill children.^[18]

Across the border, Canadian companies also show their philanthropic side. Tim Horton’s Children’s Foundation sends 19,000 kids to camp each summer, who would otherwise not have the resources to attend.^[19] Its Timbits Minor Sports Program supports the participation of 300 000 kids in their pursuit of hockey, soccer, lacrosse, softball, baseball, and ringette.^[20] In 2017, Loblaw Companies and its President’s Choice Children’s Charity pledged \$150 million over the next decade to address childhood hunger in Canada.^[21] These are just two examples of Canadian companies giving back at the local and national levels.

Ethical Organizations

How Can You Recognize an Ethical Organization?

One goal of anyone engaged in business should be to foster ethical behaviour in the organizational environment. How do we know when an organization is behaving ethically? Most lists of ethical organizational activities include the following criteria:

- Treating employees, customers, investors, and the public fairly
- Holding every member personally accountable for his or her action
- Communicating core values and principles to all members
- Demanding and rewarding integrity from all members in all situations^[22]

Employees at companies that consistently make Business Ethics magazine's list of the "100 Best Corporate Citizens" regard the items on the previous list as business as usual in the workplace. Companies at the top of the 2016 list include Microsoft, Hasbro, Ecolab, Bristol-Myers-Squibb, and Lockheed Martin.^[23]

By contrast, employees with the following attitudes tend to suspect that their employers aren't as ethical as they should be:

- They consistently feel uneasy about the work they do.
- They object to the way they're treated.
- They're uncomfortable about the way coworkers are treated.
- They question the appropriateness of management directives and policies.^[24]

Sexual Harassment

Sexual harassment occurs when an employee makes "unwelcome sexual advances, requests for sexual favours, and other verbal or physical conduct of a sexual nature" to another employee. It's also considered sexual harassment when "submission to or rejection of this conduct explicitly or implicitly affects an individual's employment, unreasonably interferes with an individual's work performance or creates an intimidating, hostile or offensive work environment."^[25]

Sexual harassment rocketed to the top of news reports and social media when on October 5, 2017, *The New York Times* broke the story of Harvey Weinstein's decades of harassment in Hollywood. In March of 2018, [CBC News collated the allegations of sexual harassment against prominent Canadians](#). The list, including only those allegations reported by CBC, highlight the prevalence of this issue.

To prevent sexual harassment—or at least minimize its likelihood—a company should adopt a formal anti-harassment policy describing prohibited conduct, asserting its objections to the behaviour, and detailing penalties for violating the policy. Employers also have an obligation to investigate harassment complaints. Failure to enforce anti-harassment policies can be very costly. At the end of 2017, 353 women had submitted and finalized sexual harassment, discrimination or intimidation claims against the RCMP with as many as another 650 expected to file. To settle these claims, the government of Canada has set aside \$100 million.

Workforce Diversity | Inclusive Workplaces

In addition to complying with equal employment opportunity laws, many companies make special efforts to recruit employees who are underrepresented in the workforce according to sex, race, or some other characteristic. In helping to build more inclusive workforces, such initiatives contribute to competitive advantage for two reasons:

1. People from diverse backgrounds bring new talents and fresh perspectives to an organization, typically enhancing creativity in the development of new products.
2. By more accurately reflecting the demographics of the marketplace, a diverse workforce improves a company's ability to serve an ethnically diverse population.

Each year [The Globe and Mail, reports on Canada's Top 100 Employers](#). Peruse the list of industry winners and follow through to highlights detailing why the company topped the list.

Please note the selection process:

To determine this year's winners of the *Canada's Best Diversity Employers* competition, Mediacorp editors reviewed diversity and inclusiveness initiatives at employers that applied for the Canada's Top 100 Employers project. From this applicant pool, a smaller short-list of employers with noteworthy and unique diversity initiatives was developed. The short-listed candidates' programs were compared to those of other employers in the same field. The finalists chosen represent the diversity leaders in their industry and region of Canada.

The Individual Approach to Ethics

How can you make sure that you do the right thing in the business world? How should you respond to the kinds of challenges that you'll be facing? Because your actions in the business world will be strongly influenced by your moral character, let's begin by assessing your current moral condition. Which of the following best applies to you (select one)?

1. I'm always ethical.
2. I'm mostly ethical.
3. I'm somewhat ethical.
4. I'm seldom ethical.
5. I'm never ethical.

Now that you've placed yourself in one of these categories, here are some general observations. Few people put themselves below the second category. Most of us are ethical most of the time, and most people assign themselves to category number two— "I'm mostly ethical." Why don't more people claim that they're always ethical?

Apparently, most people realize that being ethical all the time takes a great deal of moral energy. If you placed yourself in category number two, ask yourself this question: How can I change my behaviour so that I can move up a notch? The answer to this question may be simple. Just ask yourself an easier question: How would I like to be treated in a given situation?^[28]

Unfortunately, practising this philosophy might be easier in your personal life than in the business world. Ethical challenges arise in business because companies, especially large ones, have multiple stakeholders who sometimes make competing demands. Making decisions that affect multiple stakeholders isn't easy even for seasoned managers; and for new entrants to the business world, the task can be extremely daunting. You can, however, get a head start in learning how to make ethical decisions by looking at two types of challenges that you'll encounter in the business world: ethical dilemmas and ethical decisions.



Case Study: How a Bottle Cap Restored a Reputation (Temporarily)

Addressing Ethical Dilemmas

An ethical dilemma is a morally problematic situation: you must choose between two or more acceptable but often opposing alternatives that are important to different groups. Experts often frame this type of situation as a “right-versus-right” decision. It’s the sort of decision that Johnson & Johnson (known as J&J) CEO James Burke had to make in 1982.^[29] On September 30, twelve-year-old Mary Kellerman of Chicago died after her parents gave her Extra-Strength Tylenol. That same morning, twenty-seven-year-old Adam Janus, also of Chicago, died after taking Tylenol for minor chest pain. That night, when family members came to console his parents, Adam’s brother and his wife took Tylenol from the same bottle and died within forty-eight hours. Over the next two weeks, four more people in Chicago died after taking Tylenol. The actual connection between Tylenol and the series of deaths wasn’t made until an off-duty fireman realized from news reports that every victim had taken Tylenol. As consumers panicked, J&J pulled Tylenol off Chicago-area retail shelves. Researchers discovered Tylenol capsules containing large amounts of deadly cyanide. Because the poisoned bottles came from batches originating at different J&J plants, investigators determined that the tampering had occurred after the product had been shipped.^[30]

So J&J wasn’t at fault. But CEO Burke was still faced with an extremely serious dilemma: Was it possible to respond to the tampering cases without destroying the reputation of a highly profitable brand?

Burke had two options:

1. He could recall only the lots of Extra-Strength Tylenol that were found to be tainted with cyanide. In 1991, Perrier executives recalled only tainted product when they discovered that cases of their bottled water had been poisoned with benzene. This option favoured J&J financially but possibly put more people at risk.
2. Burke could order a nationwide recall—of all bottles of Extra-Strength Tylenol. This option would reverse the priority of the stakeholders, putting the safety of the public above stakeholders’ financial interests.

Burke opted to recall all 31 million bottles of Extra-Strength Tylenol on the market. The cost to J&J was \$100 million, but public reaction was quite positive. Less than six weeks after the crisis began, Tylenol capsules were reintroduced in new tamper-resistant bottles, and by responding quickly and appropriately, J&J was eventually able to restore the Tylenol brand to its previous market position. When Burke was applauded for moral courage, he replied that he'd simply adhered to the long-standing J&J credo that put the interests of customers above those of other stakeholders. His only regret was that the perpetrator was never caught. ^[31]



Source: CNBC

If you're wondering what your thought process should be if you're confronted with an ethical dilemma, you might wish to remember the mental steps listed here—which happen to be the steps that James Burke took in addressing the Tylenol crisis:

1. Define the problem: How to respond to the tampering case without destroying the reputation of the Tylenol brand.
2. Identify feasible options: (1) Recall only the lots of Tylenol that were found to be tainted or (2) order a nationwide recall of all bottles of Extra-Strength Tylenol.
3. Assess the effect of each option on stakeholders: Option 1 (recalling only the tainted lots of Tylenol) is cheaper but puts more people at risk. Option 2 (recalling all bottles of Extra-Strength Tylenol) puts the safety of the public above stakeholders' financial interests.
4. Establish criteria for determining the most appropriate action: Adhere to the J&J credo, which puts the interests of customers above those of other stakeholders.
5. Select the best option based on the established criteria: In 1982, Option 2 was selected, and a nationwide recall of all bottles of Extra-Strength Tylenol was conducted.

Making Ethical Decisions

In contrast to the “right-versus-right” problem posed by an ethical dilemma, an ethical decision entails a “right-versus-wrong” decision—one in which there is clearly a right (ethical) choice and a wrong (unethical or illegal) choice. When you make a decision that's unmistakably unethical or illegal, you've committed an ethical lapse. If you're presented with this type of choice, asking yourself the following questions and increase your odds of making an ethical decision.

1. **Is the action illegal?**
2. **Is it unfair to some stakeholders?**
3. **If I do it, will I feel badly about it?**
4. **Will I be ashamed to tell my family friends, coworkers, or boss?**
5. **Will I be embarrassed if my action is written up in the newspaper?**

To test the validity of this approach, consider a point-by-point look at Trudeau's decisions.

Here use the five-question process for ethical decision-making in Chapter 3 to determine if Trudeau made an ethical choice in his decision to vacation on the Aga Khan's private island. Your response is anonymous and will be added to responses from other institutions using this textbook chapter.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=53>

If you answer yes to any one of these five questions when considering an ethical dilemma, odds are that you're about to do something you shouldn't.

Revisiting Johnson & Johnson

As discussed earlier, Johnson & Johnson received tremendous praise for the actions taken by its CEO, James Burke, in response to the 1982 Tylenol catastrophe. However, things change. To learn how a company can destroy its good reputation, let's fast forward to 2008 and revisit J&J and its credo, which states, "We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality."^[32] How could a company whose employees believed so strongly in its credo find itself under criminal and congressional investigation for a series of recalls due to defective products?^[33] In a three-year period, the company recalled twenty-four products, including Children's, Infants' and Adults' Tylenol, Motrin, and Benadryl;^[34] 1-Day Acuvue TruEye contact lenses sold outside the U.S.;^[35] and hip replacements.^[36]

Unlike the Tylenol recall, no one had died from the defective products, but customers were certainly upset to find they had purchased over-the-counter medicines for themselves and their children that were potentially contaminated with dark particles or tiny specks of metal;^[37] contact lenses that contained a type of acid that caused stinging or pain when inserted in the eye;^[38] and defective hip implants that required patients to undergo a second hip replacement.^[39]

Who bears the responsibility for these image-damaging blunders? Two individuals who were at least partially responsible were William Weldon, CEO, and Colleen Goggins, Worldwide Chairman of J&J's Consumer Group. Weldon has been criticized for being largely invisible and publicly absent during the recalls.^[40] Additionally, he admitted that he did not understand the consumer division where many of the quality control problems originated.^[41] Goggins was in charge of the factories that produced many of the recalled products. She was heavily criticized by fellow employees for her excessive cost-cutting measures and her propensity to replace experienced scientists with new hires.^[42] In addition, she was implicated in scheme to avoid publicly disclosing another J&J recall of a defective product.

After learning that J&J had released packets of Motrin that did not dissolve correctly, the company hired contractors to go into convenience stores and secretly buy up every pack of Motrin on the shelves. The instructions given to the contractors were the following: "You should simply 'act' like a regular customer while making these purchases. THERE MUST BE NO MENTION OF THIS BEING A RECALL OF THE PRODUCT!"^[43] In

May 2010, when Goggins appeared before a congressional committee investigating the “phantom recall,” she testified that she was not aware of the behaviour of the contractors^[44] and that she had “no knowledge of instructions to contractors involved in the phantom recall to not tell store employees what they were doing.” In her September 2010 testimony to the House Committee on Oversight and Government Reform, she acknowledged that the company in fact wrote those very instructions.

Refusing to Rationalize

Despite all the good arguments in favour of doing the right thing, why do many reasonable people act unethically (at least at times)? Why do good people make bad choices? According to one study, there are four common rationalizations (excuses) for justifying misconduct.^[45]

1. My behaviour isn't really illegal or immoral. Rationalizers try to convince themselves that an action is OK if it isn't downright illegal or blatantly immoral. They tend to operate in a gray area where there's no clear evidence that the action is wrong.
2. My action is in everyone's best interests. Some rationalizers tell themselves: “I know I lied to make the deal, but it'll bring in a lot of business and pay a lot of bills.” They convince themselves that they're expected to act in a certain way.^[46]
3. No one will find out what I've done. Here, the self-questioning comes down to “If I didn't get caught, did I really do it?” The answer is yes. There's a simple way to avoid succumbing to this rationalization: always act as if you're being watched.
4. The company will condone my action and protect me. This justification rests on a fallacy.

If you find yourself having to rationalize a decision, it's probably a bad one.

What to Do When the Light Turns Yellow

Like our five questions, some ethical problems are fairly straightforward. Others, unfortunately, are more complicated, but it will help to think of our five-question test as a set of signals that will warn you that you're facing a particularly tough decision— that you should think carefully about it and perhaps consult someone else. The situation is like approaching a traffic light. Red and green lights are easy; you know what they mean and exactly what to do. Yellow lights are trickier. Before you decide which pedal to hit, try posing our five questions. If you get a single yes, you'll almost surely be better off hitting the brake.^[47]

Key Takeaways

Important terms and concepts

1. Business ethics is the application of ethical behaviour in a business context. Ethical (trustworthy) companies are better able to attract and keep customers, talented employees, and capital.
2. Acting ethically in business means more than just obeying laws and regulations. It also means being honest, doing no harm to others, competing fairly, and declining to put your own interests above those of your employer and coworkers.
3. In the business world, you'll encounter conflicts of interest: situations in which you'll have to choose between taking action that promotes your personal interest and action that favors the interest of others.
4. Corporate social responsibility refers to the approach that an organization takes in balancing its responsibilities toward different stakeholders (owners, employees, customers, and the communities in which they conduct business) when making legal, economic, ethical, and social decisions.
5. Managers have several responsibilities: to increase the value of owners' investments through profitable operations, to provide owners and other stakeholders with accurate, reliable financial information, to safeguard the company's assets, and to handle its funds in a trustworthy manner.
6. Companies have a responsibility to pay appropriate wages and benefits, treat all workers fairly, and provide equal opportunities for all employees. In addition, they must guard workers' safety and health and to provide them with a work environment that's free from sexual harassment.
7. Consumers have certain legal rights: to use safe products, to be informed about products, to choose what to buy, and to be heard. Sellers must comply with these requirements.
8. Business people face two types of ethical challenges: ethical dilemmas and ethical decisions.
9. An ethical dilemma is a morally problematic situation in which you must choose competing and often conflicting options which do not satisfy all stakeholders.
10. An ethical decision is one in which there's a right (ethical) choice and a wrong (unethical or downright illegal) choice.

Article: Carroll's Corporate Social Responsibility Pyramid

[Corporate Social Responsibility](#)

The basis of our modern understanding of corporate social responsibility is greatly influenced by Archie Carroll's work and his creation of the CSR pyramid. In 2016, he re-thought his initial concepts and wrote "Carroll's pyramid of CSR: Taking another look". Excerpts from the article, from the expert, provide a thorough overview of this important concept.



Introduction

The modern era of CSR, or social responsibility as it was often called, is most appropriately marked by the publication by Howard R. Bowen of his landmark book *Social Responsibilities of the Businessman* in 1953. Bowen's work proceeded from the belief that the several hundred largest businesses in the United States were vital centres of power and decision making and that the actions of these firms touched the lives of citizens in many ways. The key question that Bowen asked that continues to be asked today was "what responsibilities to society may businessmen reasonably be expected to assume?" (Bowen [1953](#), p. xi) As the title of Bowen's book suggests, this was a period during which business women did not exist, or were minimal in number, and thus they were not acknowledged in formal writings. Things have changed significantly since then. Today there are countless business women and many of them are actively involved in CSR.

Much of the early emphasis on developing the CSR concept began in scholarly or academic circles. From a scholarly perspective, most of the early definitions of CSR and initial conceptual work about what it means in theory and in practice was begun in the 1960s by such writers as Keith Davis, Joseph McGuire, Adolph Berle, William Frederick, and Clarence Walton (Carroll [1999](#)). Its' evolving refinements and applications came later, especially after the important social movements of the 1960s, particularly the civil rights movement, consumer movement, environmental movement and women's movements.

Dozens of definitions of corporate social responsibility have arisen since then. In one study published in 2006, Dahlsrud identified and analyzed 37 different definitions of CSR and his study did not capture all of them (Dahlsrud [2006](#)).

In this article, however, the goal is to revisit one of the more popular constructs of CSR that has been used in the

literature and practice for several decades. Based on his four-part framework or definition of corporate social responsibility, Carroll created a graphic depiction of CSR in the form of a pyramid. CSR expert Dr. Wayne Visser has said that “Carroll’s CSR Pyramid is probably the most well-known model of CSR...” (Visser [2006](#)). If one goes online to Google Images and searches for “Carroll’s Pyramid of CSR,” well over 100 variations and reproductions of the pyramidal model are presented there ([Google Images](#)) and over 5200 citations of the original article are indicated there ([Google Scholar](#)).

The purpose of the current commentary is to summarize the Pyramid of CSR, elaborate on it, and to discuss some aspects of the model that were not clarified when it was initially published in 1991. The ensuing discussion explains briefly each of the four categories that comprise Carroll’s four-part definitional framework upon which the pyramidal model is constructed.

Review

The four-part definitional framework for CSR

Carroll’s four part definition of CSR was originally stated as follows: Corporate social responsibility encompasses the economic, legal, ethical, and discretionary (philanthropic) expectations that society has of organizations at a given point in time. This set of four responsibilities creates a foundation or infrastructure that helps to delineate in some detail and to frame or characterize the nature of businesses’ responsibilities to the society of which it is a part. In the first research study using the four categories it was found that the construct’s content validity and the instrument assessing it were valid. The study found that experts were capable of distinguishing among the four components. Further, the factor analysis conducted concluded that there are four empirically interrelated, but conceptually independent components of corporate social responsibility. This study also found that the relative values or weights of each of the components as implicitly depicted by Carroll, approximated the relative degree of importance the 241 executives surveyed placed on the four components—economic = 3.5; legal = 2.54; ethical = 2.22; and discretionary/philanthropic = 1.30. Later research supported that Aupperle’s instrument measuring CSR using Carroll’s four categories was valid and useful. In short, the distinctiveness and usefulness in research of the four categories have been established through a number of empirical research projects. A brief review of each of the four categories of CSR follows.

Economic responsibilities

As a fundamental condition or requirement of existence, businesses have an economic responsibility to the society that permitted them to be created and sustained. At first, it may seem unusual to think about an economic expectation as a social responsibility, but this is what it is because society expects, indeed requires, business organizations to be able to sustain themselves and the only way this is possible is by being profitable and able to incentivize owners or shareholders to invest and have enough resources to continue in operation. In its origins, society views business organizations as institutions that will produce and sell the goods and services society needs and desires. As an inducement, society allows businesses to take profits. Businesses create profits when they add value, and in doing this they benefit all the stakeholders of the business.

Profits are necessary both to reward investor/owners and also for business growth when profits are reinvested back into the business. CEOs, managers, and entrepreneurs will attest to the vital foundational importance of

profitability and return on investment as motivators for business success. Virtually all economic systems of the world recognize the vital importance to the societies of businesses making profits. While thinking about its' economic responsibilities, businesses employ many business concepts that are directed towards financial effectiveness – attention to revenues, cost-effectiveness, investments, marketing, strategies, operations, and a host of professional concepts focused on augmenting the long-term financial success of the organization. In today's hypercompetitive global business environment, economic performance and sustainability have become urgent topics. Those firms that are not successful in their economic or financial sphere go out of business and any other responsibilities that may be incumbent upon them become moot considerations. Therefore, the economic responsibility is a baseline requirement that must be met in a competitive business world and so economic responsibility is a critical part of corporate social responsibility.

Legal responsibilities

Society has not only sanctioned businesses as economic entities, but it has also established the minimal ground rules under which businesses are expected to operate and function. These ground rules include laws and regulations and in effect reflect society's view of "codified ethics". They articulate fundamental notions of fair business practices as established by lawmakers at federal, state and local levels. Businesses are expected and required to comply with these laws and regulations as a condition of operating. It is not an accident that compliance officers now occupy an important and high level position in company organization charts. While meeting these legal responsibilities, important expectations of business include their

- Performing in a manner consistent with expectations of government and law
- Complying with various federal, state, and local regulations
- Conducting themselves as law-abiding corporate citizens
- Fulfilling all their legal obligations to societal stakeholders
- Providing goods and services that at least meet minimal legal requirements

Ethical responsibilities

The normative expectations of most societies hold that laws are essential but not sufficient. In addition to what is required by laws and regulations, society expects businesses to operate and conduct their affairs in an ethical fashion. Taking on ethical responsibilities implies that organizations will embrace those activities, norms, standards and practices that even though they are not codified into law, are expected nonetheless. Part of the ethical expectation is that businesses will be responsive to the "spirit" of the law, not just the letter of the law. Another aspect of the ethical expectation is that businesses will conduct their affairs in a fair and objective fashion even in those cases when laws do not provide guidance or dictate courses of action. Thus, ethical responsibilities embrace those activities, standards, policies, and practices that are expected or prohibited by society even though they are not codified into law. The goal of these expectations is that businesses will be responsible for and responsive to the full range of norms, standards, values, principles, and expectations that reflect and honor what consumers, employees, owners and the community regard as consistent with respect to the protection of stakeholders' moral rights. The distinction between legal and ethical expectations can often be tricky. Legal expectations certainly are based on ethical premises. But, ethical expectations carry these further. In essence, then, both contain a strong ethical dimension or character and the difference hinges upon the mandate society has given business through legal codification.

While meeting these ethical responsibilities, important expectations of business include their

- Performing in a manner consistent with expectations of societal mores and ethical norms
- Recognizing and respecting new or evolving ethical/moral norms adopted by society
- Preventing ethical norms from being compromised in order to achieve business goals
- Being good corporate citizens by doing what is expected morally or ethically
- Recognizing that business integrity and ethical behaviour go beyond mere compliance with laws and regulations

As an overlay to all that has been said about ethical responsibilities, it also should be clearly stated that in addition to society's expectations regarding ethical performance, there are also the great, universal principles of moral philosophy such as rights, justice, and utilitarianism that also should inform and guide company decisions and practices.

Philanthropic responsibilities

Corporate philanthropy includes all forms of business giving. Corporate philanthropy embraces business's voluntary or discretionary activities. Philanthropy or business giving may not be a responsibility in a literal sense, but it is normally expected by businesses today and is a part of the everyday expectations of the public. Certainly, the quantity and nature of these activities are voluntary or discretionary. They are guided by business's desire to participate in social activities that are not mandated, not required by law, and not generally expected of business in an ethical sense. Having said that, some businesses do give partially out of an ethical motivation. That is, they want to do what is right for society. The public does have a sense that businesses will "give back," and this constitutes the "expectation" aspect of the responsibility. When one examines the social contract between business and society today, it typically is found that the citizenry expects businesses to be good corporate citizens just as individuals are. To fulfill its perceived philanthropic responsibilities, companies engage in a variety of giving forms – gifts of monetary resources, product and service donations, volunteerism by employees and management, community development and any other discretionary contribution to the community or stakeholder groups that make up the community.

Although there is sometimes an altruistic motivation for business giving, most companies engage in philanthropy as a practical way to demonstrate their good citizenship. This is done to enhance or augment the company's reputation and not necessarily for noble or self-sacrificing reasons. The primary difference between the ethical and philanthropic categories in the four part model is that business giving is not necessarily expected in a moral or ethical sense. Society expects such gifts, but it does not label companies as "unethical" based on their giving patterns or whether the companies are giving at the desired level. As a consequence, the philanthropic responsibility is more discretionary or voluntary on business's part. Hence, this category is often thought of as good "corporate citizenship." Having said all this, philanthropy historically has been one of the most important elements of CSR definitions and this continues today.

In summary, the four part CSR definition forms a conceptual framework that includes the economic, legal, ethical, and philanthropic or discretionary expectations that society places on businesses at a given point in time. And, in terms of understanding each type of responsibility, it could be said that the economic responsibility is "required" of business by society; the legal responsibility also is "required" of business by society; the ethical responsibility is "expected" of business by society; and the philanthropic responsibility is "expected/desired" of

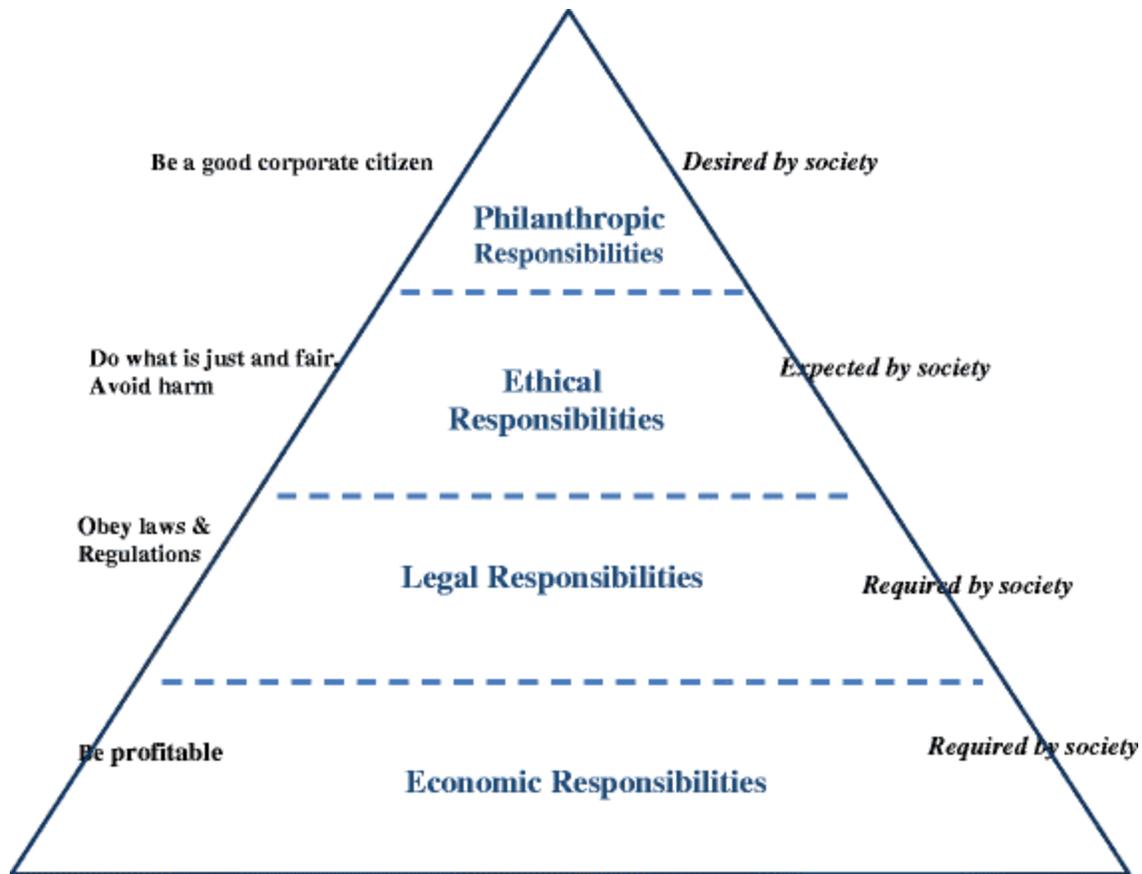
business by society. As time passes what exactly each of these four categories means may change or evolve as well.

The pyramid of CSR

The four-part definition of CSR was originally published in 1979. In 1991, Carroll extracted the four-part definition and recast it in the form of a CSR pyramid. The purpose of the pyramid was to single out the definitional aspect of CSR and to illustrate the building block nature of the four part framework. The pyramid was selected as a geometric design because it is simple, intuitive, and built to withstand the test of time. Consequently, the economic responsibility was placed as the base of the pyramid because it is a foundational requirement in business. Just as the footings of a building must be strong to support the entire edifice, sustained profitability must be strong to support society's other expectations of enterprises. The point here is that the infrastructure of CSR is built upon the premise of an economically sound and sustainable business.

At the same time, society is conveying the message to business that it is expected to obey the law and comply with regulations because law and regulations are society's codification of the basic ground rules upon which business is to operate in a civil society. If one looks at CSR in developing countries, for example, whether a legal and regulatory framework exists or not significantly affects whether multinationals invest there or not. A legal infrastructure is imperative to provide a foundation for legitimate business growth.

In addition, business is expected to operate in an ethical fashion. This means that business has the expectation, and obligation, that it will do what is right, just, and fair and to avoid or minimize harm to all the stakeholders with whom it interacts. Finally, business is expected to be a good corporate citizen, that is, to give back and to contribute financial, physical, and human resources to the communities of which it is a part. In short, the pyramid is built in a fashion that reflects the fundamental roles played and expected by business in society. Below is a graphical depiction of Carroll's Pyramid of CSR.



Carroll's Pyramid of Corporate Social Responsibility

The pyramid is an integrated, unified whole

The Pyramid of CSR is intended to be seen from a stakeholder perspective wherein the focus is on the whole not the different parts. The CSR pyramid holds that firms should engage in decisions, actions, policies and practices that simultaneously fulfill the four component parts. The pyramid should not be interpreted to mean that business is expected to fulfill its social responsibilities in some sequential, hierarchical fashion, starting at the base. Rather, business is expected to fulfill all responsibilities simultaneously. The positioning or ordering of the four categories of responsibility strives to portray the fundamental or basic nature of these four categories to business's existence in society. As said before, economic and legal responsibilities are required; ethical and philanthropic responsibilities are expected and desired. The representation being portrayed, therefore, is that the total social responsibility of business entails the concurrent fulfillment of the firm's economic, legal, ethical, and philanthropic responsibilities. Stated in the form of an equation, it would read as follows: Economic Responsibilities + Legal responsibilities + Ethical Responsibilities + Philanthropic Responsibilities = Total Corporate Social Responsibility. Stated in more practical and managerial terms, the CSR driven firm should strive to make a profit, obey the law, engage in ethical practices and be a good corporate citizen. When seen in this way, the pyramid is viewed as a unified or integrated whole.

The pyramid is a sustainable stakeholder framework

Each of the four components of responsibility addresses different stakeholders in terms of the varying priorities in which the stakeholders might be affected. Economic responsibilities most dramatically impact shareholders and employees because if the business is not financially viable both of these groups will be significantly affected. Legal responsibilities are certainly important with respect to owners, but in today's litigious society, the threat of litigation against businesses arise most often from employees and consumer stakeholders. Ethical responsibilities affect all stakeholder groups. Shareholder lawsuits are an expanding category. When an examination of the ethical issues business faces today is considered, they typically involve employees, customers, and the environment. Finally, philanthropic responsibilities most affect the community and nonprofit organizations, but also employees because some research has concluded that a company's employees' morale and engagement is significantly related to its philanthropic involvement.

The pyramid should be seen as sustainable in that these responsibilities represent long term obligations that overarch into future generations of stakeholders as well. Though the pyramid could be perceived to be a static snapshot of responsibilities, it is intended to be seen as a dynamic, adaptable framework the content of which focuses both on the present and the future. A consideration of stakeholders and sustainability, today, is inseparable from CSR. Indeed, there have been some appeals in the literature for CSR to be redefined as Corporate Stakeholder Responsibility and others have advocated Corporate Sustainability Responsibilities. These appeals highlight the intimate nature of these interrelated topics. Furthermore, Ethical Corporation Magazine which emphasizes CSR in its Responsible Summit conferences integrates these two topics – CSR and Sustainability—as if they were one and, in fact, many business organizations today perceive them in this way; that is, to be socially responsible is to invest in the importance of sustainability which implicitly is concerned with the future. Annual corporate social performance reports frequently go by the titles of CSR and/or Sustainability Reports but their contents are undifferentiated from one another; in other words, the concepts are being used interchangeably by many.

5. Business in a Global Environment

Learning Objectives

By the end of the chapter, you should be able to:

1. Explain why nations and companies participate in international trade and how they measure that trade.
2. Describe the concepts of absolute and comparative advantage.
3. Define importing and exporting.
4. Explain how companies enter the international market through licensing agreements or franchises.
5. Describe how companies reduce costs through contract manufacturing and outsourcing.
6. Explain how cultural, economic, legal, and political differences between countries create challenges to successful business dealings.
7. Discuss the various initiatives designed to reduce international trade barriers and promote free trade.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=64>

The Globalization of Business

Do you wear Nike shoes or Timberland boots? Listen to Beyoncé, Pitbull, Twenty One Pilots, or The Neighborhood on Spotify? If you answered yes to either of these questions, you're a global business customer. Both Nike and Timberland manufacture most of their products overseas. Spotify is a Swedish enterprise.

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, and Chanel. 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

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.

The globalization of business is bound to affect you. Not only will you buy products manufactured overseas, but it's 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 ~ evidenced in the figure below, The Expanded Circular Flow Model. Therefore, it makes sense to learn more about how globalization works.



Orchard Road by Michael Spencer licensed CC BY | flickr

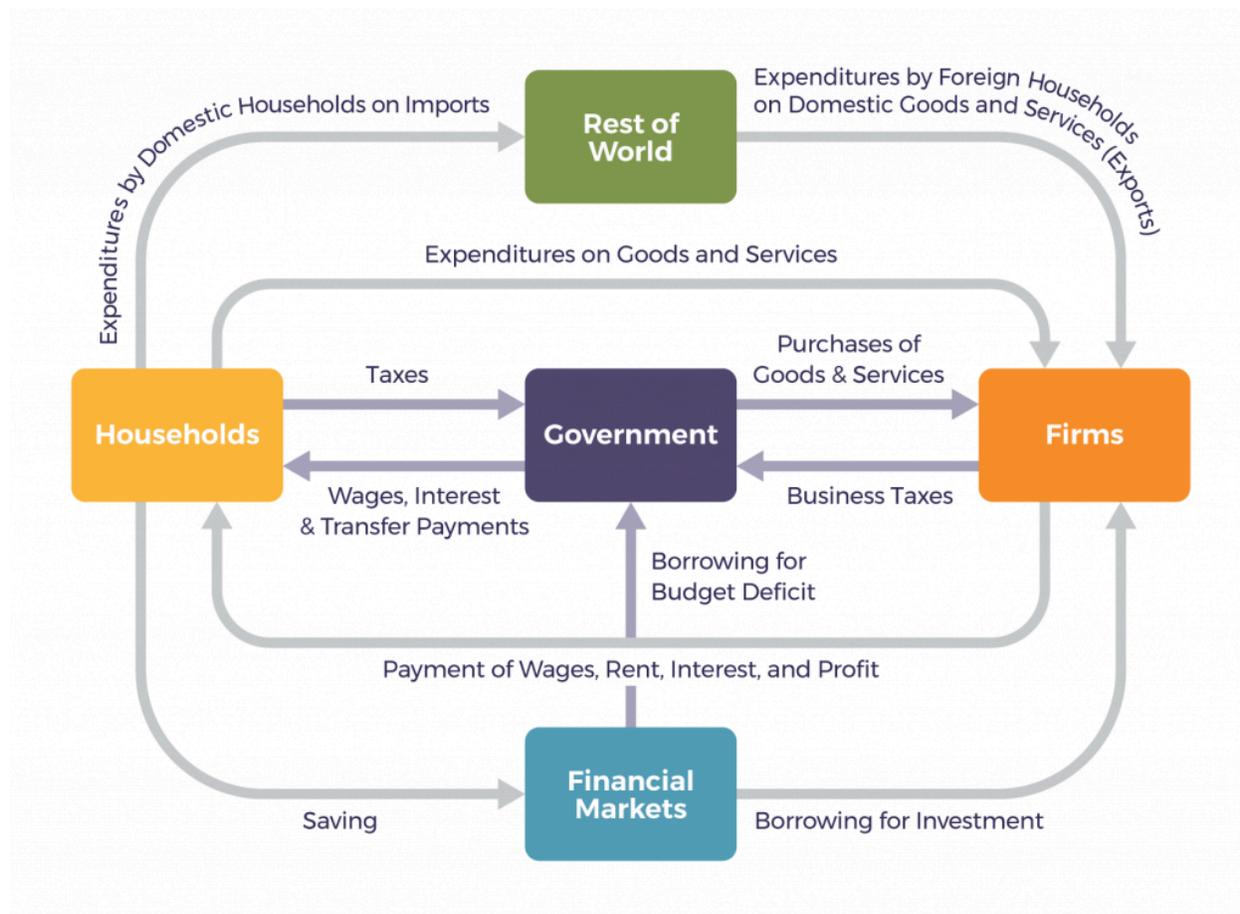


Diagram illustrating the reciprocal inputs and outputs from businesses to households.

Never before has business spanned the globe the way it does today and will continue to do in the future. But why is international business important? Why do companies and nations engage in international trade? What strategies do they employ in the global marketplace? How do governments and international agencies promote and regulate international trade? These questions and others will be addressed in this chapter. Let's start by looking at the more specific reasons why companies and nations engage in international trade.

Why Do Nations Trade?

Why does Canada 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 lumber products 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. (We'll discuss importing and exporting in greater detail later in the chapter.) The monetary value of international trade is enormous. In 2016, the total value of worldwide trade in merchandise and commercial services was \$20.208 trillion.^[1]

Absolute and Comparative Advantage

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 labour, 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.

Absolute Advantage

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 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, the United States, and more recently Canada. 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.

Comparative Advantage

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

Since resources are limited, every time you make a choice about how to use them, you are also choosing to forego other options. Economists use the term opportunity cost to indicate what must be given up to obtain something that is desired. A fundamental principle of economics is that every choice has an opportunity cost.

- If you sleep through your economics class (not recommended, by the way), the opportunity cost is the learning you miss.
- If you spend your income on video games, you cannot spend it on movies.
- If you choose to marry one person, you give up the opportunity to marry anyone else.

In short, opportunity cost is all around us.

The idea behind opportunity cost is that the cost of one item is the lost opportunity to do or consume something else; in short, opportunity cost is the value of the next best alternative.

Since people and businesses must choose, they inevitably face trade-offs in which they have to give up things they desire to get other things they desire more.

Opportunity Cost and Individual Decisions

In some cases, recognizing the opportunity cost can alter personal behaviour. Imagine, for example, that you spend \$10 on lunch every day at work. You may know perfectly well that bringing a lunch from home would cost only \$3 a day, so the opportunity cost of buying lunch at the restaurant is \$7 each day (that is, the \$10 that buying lunch costs minus the \$3 your lunch from home would cost). Ten dollars each day does not seem to be that much. However, if you project what that adds up to in a year—250 workdays a year \times \$10 per day equals \$2 500—it is the cost, perhaps, of a decent vacation. If the opportunity cost were described as “a nice vacation” instead of “\$10 a day” you might make different choices.

Opportunity Cost and Societal Decisions

Opportunity cost also comes into play with societal decisions. Universal health care would be nice, but the opportunity cost of such a decision would be less housing, environmental protection, or national defense. These trade-offs also arise with government policies. For example, after the terrorist plane hijackings on September 11, 2001, many proposals, such as the following, were made to improve air travel safety:

- The federal government could provide armed “sky marshals” who would travel inconspicuously with the rest of the passengers. The cost of having a sky marshal on every flight would be roughly \$3 billion per year.
- Retrofitting all U.S. planes with reinforced cockpit doors to make it harder for terrorists to take over the plane would have a price tag of \$450 million.
- Buying more sophisticated security equipment for airports, like three-dimensional baggage scanners and cameras linked to face-recognition software, would cost another \$2 billion.

Lost time can be a significant component of opportunity cost.

However, the single biggest cost of greater airline security does not involve money. It is the opportunity cost of additional waiting time at the airport. According to the United States Department of Transportation, more than 800 million passengers took plane trips in the United States in 2012. Since the 9/11 hijackings, security screening has become more intensive, and consequently, the procedure takes longer than in the past. Say that, on average, each air passenger spends an extra 30 minutes in the airport per trip. Economists commonly place a value on time to convert an opportunity cost in time into a monetary figure. Because many air travelers are relatively highly paid business people, conservative estimates set the average “price of time” for air travelers at \$20 per hour. Accordingly, the opportunity cost of delays in airports could be as much as 800 million (passengers) \times 0.5 hours \times \$20/hour—or, \$8 billion per year. Clearly, the opportunity costs of waiting time can be just as substantial as costs involving direct spending.

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 favourable balance, called a trade surplus. If it buys more than it sells, it has an unfavourable balance, or a trade deficit.

For many years, Canada 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 China and Taiwan, which manufacture high volumes 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 Canada in the 1990s and early 2000s. Some experts, however, are alarmed by trade deficits. Investment guru Warren Buffet, 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. "A nation's credit card," he warns, "charges truly breathtaking amounts. But that card's credit line is not limitless."^[2]

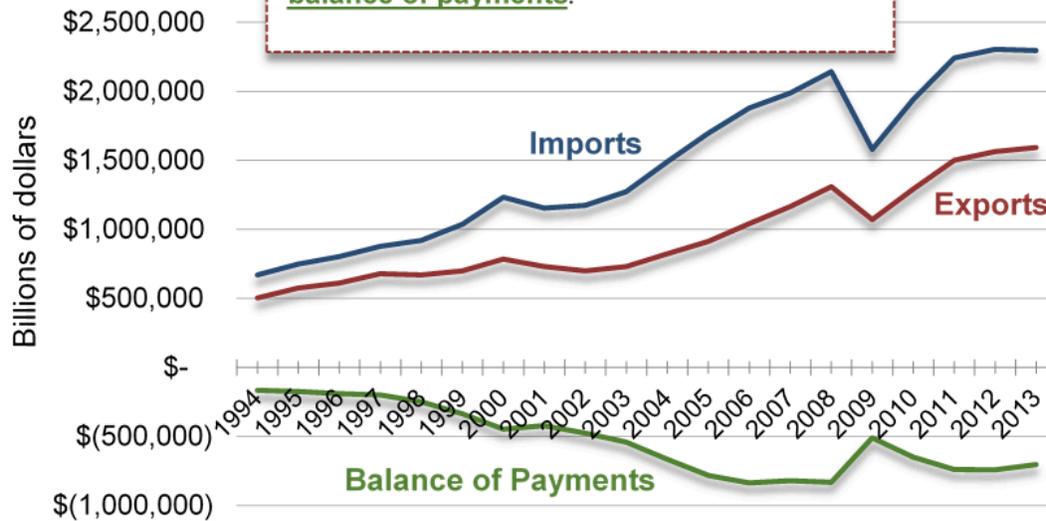
By the same token, trade surpluses aren't necessarily good for a nation's consumers. Japan's export-fueled economy produced high economic growth in the 1970s and 1980s. But most domestically made consumer goods were priced at artificially high levels inside Japan itself—so high, in fact, that many Japanese 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.^[3]

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 flows 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 Canadian company buys some real estate in a foreign country, that investment counts in the Canadian 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. Canada has experienced unfavorable balances of payments since the turn of the century which has forced the government to cover its debt by borrowing from other countries.^[4] The graph below provides an example of the balance of payments over time.

Because we buy more products from foreign companies than we sell to foreign companies and consumers, we must **import** more than we **export**. The gap between what we spend and what we take in is reflected in our national **balance of payments**.



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.^[5] 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.^[6] American farmers now export over \$9 billion worth of soybeans to China every year.^[7]

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 licensee 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 labour costs, many U.S. companies manufacture their products in countries where labour 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.^[8]

Thanks to twenty-first-century information technology, non-manufacturing functions can also be outsourced to nations with lower labour costs. Canadian companies are increasingly drawing on a vast supply of relatively inexpensive skilled labour 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 centre for software development and customer-call centres. 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.^[9]

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.^[10]

Foreign Direct Investment and Subsidiaries

Many of the approaches to global expansion that we’ve discussed so far allow companies to participate in

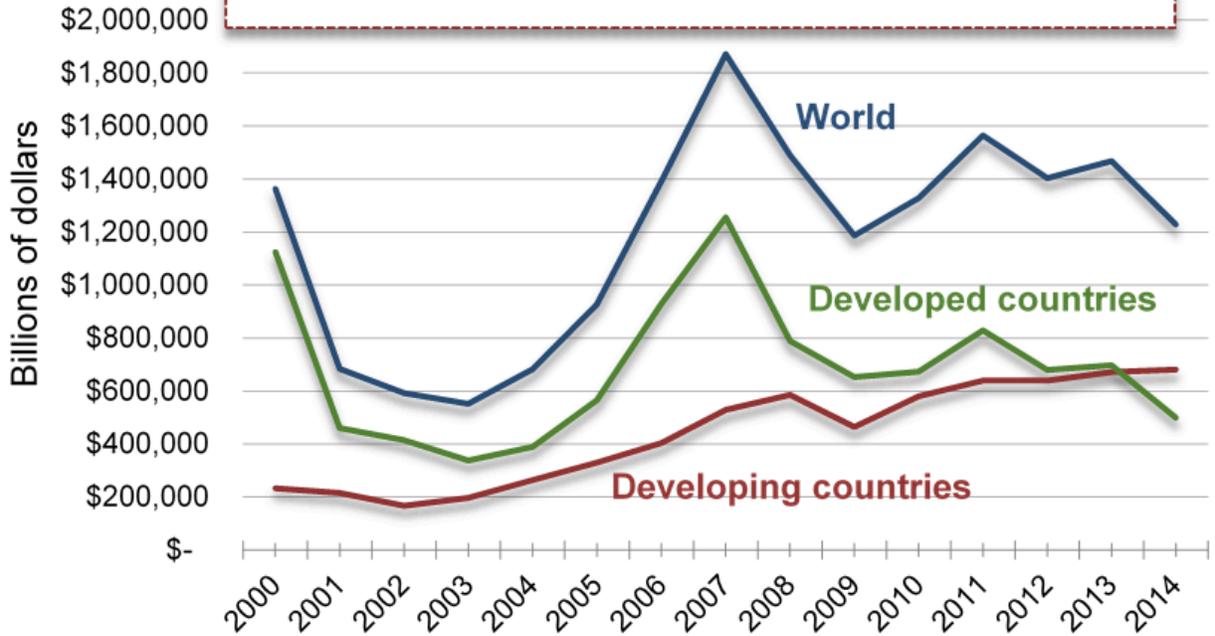
international markets without investing in foreign plants and facilities. As markets expand, however, a firm might decide to enhance its competitive advantage by making a direct investment in operations conducted in another country. Foreign direct investment (FDI) refers to the formal establishment of 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.^[1]

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.

Where FDI goes

Through 2008, developing countries received substantially less in foreign direct investment than developed countries did. In 2009, things changed, and developing countries (especially China and India) received more global foreign direct investments. In 2014, FDI in developing countries surpassed FDI in developed countries for the first time.



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.

Fortune Top 6 Multinational Firms by Revenue

Company	Industry	Headquarters	Revenue in 2014 (in billions of dollars)	Profits in 2014 (in billions of dollars)
1. Walmart	General Merchandise	USA	\$485.9	\$13.6
2. State Grid	Utilities	China	\$315.2	\$9.6
3. Sinopec	Petroleum	China	\$267.5	\$1.3
4. China National Petroleum	Petroleum	China	\$262.6	\$1.8
5. Toyota	Automobile	Japan	\$254.7	\$16.9
6. Volkswagen	Automobile	Germany	\$240.3	\$5.9

Curious where Apple, Amazon, and other giants landed? For the full Global 500 list from Fortune as well as in-depth background and breakdown, explore: <http://fortune.com/global500/list/>

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.^[12] 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.^[13] McDonald's provides a vegetarian menu in India, where religious convictions affect the demand for beef and pork.^[14] In Germany, McDonald's caters to local tastes by offering beer in some restaurants and a Shrimp Burger in Hong Kong and Japan.^[15]

A quick tour of McDonald's around the world



An interactive or media element has been excluded from this version of the text. You can view it online

here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=64>

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.^[16]

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 labour 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.”^[17]

The Global Business Environment

In the classic movie *The Wizard of Oz*, a magically misplaced Midwest farm girl takes a moment to survey the bizarre landscape of Oz and then comments to her little dog, “I don’t think we’re in Kansas anymore, Toto”. That sentiment probably echoes the reaction of many businesspeople who find themselves in the midst of international ventures for the first time. The differences between the foreign landscape and the one with which they’re familiar are often huge and multifaceted. Some are quite obvious, such as differences in language, currency, and everyday habits (say, using chopsticks instead of silverware). But others are subtle, complex, and sometimes even hidden.

Success in international business means understanding a wide range of cultural, economic, legal, and political differences between countries. Let’s look at some of the more important of these differences.

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)^[18]

- 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.^[19]

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," (see Figure 4.8) which it defines as "the abuse of entrusted power for private gain."^[20]

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
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

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.^[22] 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.^[23]

An extreme form of quota is the embargo, which, for economic or political reasons, bans the import or export of certain goods to or from a specific country.

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.

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.^[24]

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.^[25]

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.^[26] 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 labour 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 4.10).

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.



Source: Member states of the European Union from <https://en.wikipedia.org>

The Euro

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.^[27]

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.^[28] 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.^[29] Many economists fear that the financial crisis precipitated by these financially irresponsible countries threaten the very survival of the euro.^[30] 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.

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?

Key Takeaways

Important terms and concepts

1. Nations trade because they don't produce all the products that their inhabitants need.
2. The cost of labour, 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, economists use the concepts of absolute and comparative advantage: A nation has an absolute advantage if it's 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 imported over a period of time. They're 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.
10. 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 the goods).
11. Free trade is encouraged by a number of agreements and organizations 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 Organization (WTO) encourages global commerce and lower trade barriers, enforces international rules of trade, and provides a forum for resolving disputes.
12. The International Monetary Fund (IMF) and the World Bank both provide monetary assistance to the world's poorest countries.
13. 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.
 - Examples include the North American Free Trade Association (NAFTA) (United States, Canada, and Mexico) and the European Union (EU), a group of twenty-seven countries that have eliminated trade barriers among themselves.

6. Forms of Business Ownership

Learning Objectives

By the end of the chapter, you should be able to:

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.



Show What You Know



An interactive or media element has been excluded from this version of the text.

You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=71>

The Ice Cream Men

Who would have thought it? Two ex-hippies with strong interests in social activism would end up starting one of the best-known ice cream companies in the country—Ben & Jerry’s. Perhaps it was meant to be. Ben Cohen (the “Ben” of Ben & Jerry’s) always had a fascination with ice cream. As a child, he made his own mixtures by smashing his favorite cookies and candies into his ice cream.

But it wasn’t until his senior year in high school that he became an official “ice cream man,” happily driving his truck through neighborhoods filled with kids eager to buy his ice cream pops. After high school, Ben tried college but it wasn’t for him. He attended Colgate University for a year and a half before he dropped out to return to his real love: being an ice cream man. He tried college again—this time at Skidmore, where he studied pottery and jewelry making—but, in spite of his selection of courses, still didn’t like it.



Ben Cohen and Jerry Greenfield from <https://commons.wikimedia.org> licensed CC BY SA

In the meantime, Jerry Greenfield (the “Jerry” of Ben & Jerry’s) was following a similar path. He majored in pre-med at Oberlin College in the hopes of one day becoming a doctor. But he had to give up on this goal when he was not accepted into medical school. On a positive note, though, his college education steered him into a more lucrative field: the world of ice cream making. He got his first peek at the ice cream industry when he worked as a scooper in the student cafeteria at Oberlin. So, fourteen years after they first met on the junior high school track team, Ben and Jerry reunited and decided to go into ice cream making big time. They moved to Burlington, Vermont—a college town in need of an ice cream parlor—and completed a \$5 correspondence course from Penn State on making ice cream. After getting an A in the course—not surprising, given that the tests were open book—they took the plunge: with their life savings of \$8,000 and \$4,000 of borrowed funds they set up an ice cream shop in a made-over gas station on a busy street corner in Burlington.^[1] The next big decision was which form of business ownership was best for them. This chapter introduces you to their options.

The Canadian Landscape

Innovation, Science and Economic Development Canada (ISED) defines a business based upon the number of paid employees. For this reason, self-employed and “indeterminate” businesses are generally not included in the present publication as they do not have paid employees.

Accordingly, this publication defines an SME (small-to-medium enterprise) as a business establishment with 1–499 paid employees, more specifically:

- A small business has 1 to 99 paid employees.
- A medium-sized business has 100 to 499 paid employees.
- A large business has 500 or more paid employees.

ISED also categorizes businesses with 1-4 employees as micro-enterprises.

“As of December 2015, there were 1.17 million employer businesses in Canada, as shown in Table 1.1-1. Of these, 1.14 million (97.9 percent) businesses were small businesses, 21,415 (1.8 percent) were medium-sized businesses and 2,933 (0.3 percent) were large enterprises.” (Industry Canada)

Total Number of Employer Businesses by Size and Number of Small and Medium-Sized Businesses per 1,000 Provincial Population					
Provinces/ Territories	Employer Businesses				Number of SMEs per 1,000 Population (aged 15+ years)
	Small (1–99)	Medium (100–499)	Large (500+)	Total	
Newfoundland and Labrador	17,174	307	45	17,526	39.1
Prince Edward Island	5,838	83	14	5,935	48.7
Nova Scotia	29,298	556	68	29,922	37.3
New Brunswick	25,002	443	64	25,509	40.0
Quebec	235,075	4,301	590	239,966	34.7
Ontario	407,175	8,437	1,189	416,801	36.3
Manitoba	37,776	829	107	38,712	37.3
Saskatchewan	40,453	644	88	41,185	45.5
Alberta	165,792	3,076	437	169,305	50.0
British Columbia	176,014	2,623	329	178,966	45.2
Yukon	1,723	34	0	1,757	57.3
Northwest Territories	1,606	51	1	1,658	48.5
Nunavut	704	31	1	736	29.6
Canada	1,143,630	21,415	2,933	1,167,978	39.2
Percentage	97.9	1.8	0.3	100.0	

Source: Statistics Canada, Business Register, December 2015

Factors to Consider

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.

1. In setting up your business, do you want to minimize the costs of getting started? Do you hope to avoid complex government regulations and reporting requirements?
2. How much control would you like? How much responsibility for running the business are you willing to share? What about sharing the profits?
3. Do you want to avoid special taxes?

4. Do you have all the skills needed to run the business?
5. Are you likely to get along with your co-owners over an extended period of time?
6. Is it important to you that the business survive you?
7. What are your financing needs and how do you plan to finance your company?
8. How much personal exposure to liability are you willing to accept? Do you feel uneasy about accepting personal liability for the actions of fellow owners?

No single form of ownership will give you everything you desire. You'll have to make some trade-offs. Because each option has both advantages and disadvantages, your job is to decide which one offers the features that are most important to you. In the following sections we'll compare three ownership options (sole proprietorship, partnership, corporation) on these eight dimensions.

Sole Proprietorship and Its Advantages



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=71>

In a sole proprietorship, you make all important decisions and are generally responsible for all day-to-day activities. In exchange for assuming all this responsibility, you get all the income earned by the business. Profits earned are taxed as personal income, so you don't have to pay any special federal and provincial income taxes.

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

A partnership (or general partnership) is a business owned jointly by two or more people. About 10 percent of U.S. businesses are partnerships^[2] and though the vast majority are small, some are quite large. For example, the big four public accounting firms, Deloitte, PwC, Ernst & Young, and KPMG, are partnerships. Setting up a partnership is more complex than setting up a sole proprietorship, but it's still relatively easy and inexpensive. The cost varies according to size and complexity. It's possible to form a simple partnership without the help of a lawyer or an accountant, though it's usually a good idea to get professional advice.

Professionals can help you identify and resolve issues that may later create disputes among partners.

Provincial and federal governments also support small businesses and offer free resources as well as opportunities for funding. [Canada Business Network](#) (@canadabusiness #SMEPME) is a collaborative arrangement among federal departments and agencies, provincial and territorial governments and not-for-profit entities.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=71>

It offers webinars and other learning events across the country. For example, Ontario's [Small Business Access](#), offers workshops, a help line, funding, and provides up-to-date information on legal requirements.

The 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 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. Most large 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 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 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 more costly 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.^[3] 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 provincial 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.

The Canadian Comparison

“Incorporation: Tax savings, but more paperwork”, a 2017 article in *The Globe and Mail*, puts incorporation in to the Canadian perspective:

In Ontario, an incorporated business pays a tax rate of 15 per cent on the first \$500,000 of income each year, thanks to the small business tax deduction, and 26.5 per cent for anything beyond that. Rates vary by province. A lower tax rate is one of the key advantages to incorporating a business. However, accountants make the distinction that the taxes aren’t being saved, but instead deferred. That’s because, when the money is taken out of the corporation for personal use, through salary or dividends, the individual winds up paying approximately the same tax rate as if they were a sole proprietor. It’s known as the “theory of integration” in the Canadian tax system.

Most accountants recommend business owners incorporate if they can afford to leave money in the company longer-term with the goal of watching the value of the assets grow.

Another tax advantage comes when it’s time to sell the business. The shares of most Canadian private corporations are eligible for a lifetime capital-gains exemption. In 2016, that exemption amounts to the first \$824,176 of capital gains from personal income tax, per shareholder. If the business were a sole proprietorship, any gain from the sale of a private corporation would be taxed.

Another advantage to incorporating is the opportunity to use income splitting among family members. If one spouse makes more money, you can income-split. Over all, both spouses will be in a lower income-tax bracket.

Another advantage of incorporation, beyond taxes, is the ability to shift liability to the corporation and away from the individual. Incorporating can also add credibility; some larger companies require contractors to be incorporated before they can be hired.

The disadvantages to incorporation are increased paperwork and administration. That includes the one-

time cost to set up the corporation, including accounting and legal fees, which can run to more than \$1,000. Owners also have to file two tax returns, a personal one and a more complicated one for the business.

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.”^[4] 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.^[5] 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.^[6] More than three hundred thousand farmers obtain products they need for production—feed, seed, fertilizer, farm supplies, fuel—through the Southern States Cooperative.^[7] Co-ops also exist outside agriculture. For example, MEC (Mountain Equipment Co-op), which sells quality outdoor gear, has more than 5 million members across the country, who have each paid \$5 for their lifetime memberships. The company shares its financial success with its members and also gives back 1% of its sales to maintain participation in the outdoors.



Source: MEC in Ottawa retrieved from <https://commons.wikimedia.org/>

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 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.

Since Statistics Canada ended its deep collection of nonprofit statistics in 2008, the most recent data available is:

- 170,000 charitable and non profit organizations in Canada
- 85,000 of these are registered charities (recognized by the Canada Revenue Agency).
- The charitable and nonprofit sector contributes an average of 8.1% of total Canadian GDP, more than the retail trade industry and close to the value of the mining, oil and gas extraction industry.
- Two million Canadians are employed in the charitable and nonprofit sector.
- Over 13 million people volunteer for charities and nonprofits

Do you think these numbers have increased or decreased over the last decade? Why?

Mergers and Acquisitions



Track how quickly you can match some of the more recent, larger mergers or major corporations.

If you do not see the embedded match game, [access it: https://quizlet.com/274512349/match](https://quizlet.com/274512349/match).



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=71>

The headline read, “Wanted: More than 2,000 in Google hiring spree”.^[8] 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 providers 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 company. An acquisition is the purchase of one company by another.

The Canadian Landscape

In June 2013, Shoppers Drug Mart, Canada's biggest pharmacy chain merged with Loblaw, Canada's largest grocery retailer, in a 12.4 billion dollar deal. Rather than cutting into each other's market share, the deal allows the two companies to play on each other's strengths. Shoppers has about \$1 billion in food sales annually, versus Loblaw's \$30 billion. But Loblaw's share of the pharmacy market is only five per cent, so adding Shoppers health products and services to Loblaw grocery stores allows the food retailer to expand its services in what it sees as a growing sector: health, wellness and nutrition. (www.cbc.ca). Contrast this merger with an acquisition in that same year. Sobeys acquired 200 Safeway stores in Western Canada under a 5.8 billion dollar deal. According to news reports, along with 213 Safeway grocery stores – more than 60 percent of which are in Calgary, Vancouver, Edmonton and Winnipeg – Sobeys will also acquire:

- 199 in-store pharmacies;
- 62 gas stations;
- 10 liquor stores;
- 4 primary distribution centres and a related wholesale business; and
- 12 manufacturing facilities.

Sobeys will also get \$1.8 billion worth of real estate in the deal.

Another example of an acquisition is the purchase of Reebok by Adidas for \$3.8 billion.^[9] 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

- Shoppers Drug Mart began to sell President's Choice products in its merger with Loblaw.
- Loblaw is able to add Shoppers health care products to its shelves.
- Sobeys gains Safeway's gas stations and liquors stores in its acquisition.

Attain New Markets or Distribution Channels

- Sobey's acquired access to 12 manufacturing facilities, 4 distribution centres, and a related wholesale business.
- Loblaw increases access to urban centres where Shoppers are already located, bringing a wider variety of products to customers in densely populated areas.

Realize Synergies

- Integration of the companies' loyalty programs will provide the two with a vast knowledge base of consumers' buying habits and provide economies of scale – which, the companies estimate, will translate into savings of about \$300 million annually.
- Loblaw's share of the pharmacy market is only five per cent so adding Shoppers health products and services to its grocery stores will allow the food retailer to expand its services in what it sees as a growing sector: health, wellness and nutrition.

The Less-Friendly Option

Hostile Takeovers: Ben and Jerry's

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, the Ice Cream Men from above, 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.^[10] Despite fears that the company's social mission 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.

Solidifying the Vocabulary

Use this quick activity to ensure you understand the vocabulary related to mergers and acquisitions.



An interactive or media element has been excluded from this version of the text. You can view it online

here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=71>

Key Takeaways

Important terms and concepts

1. A sole proprietorship is a business owned by only one person.
 - 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.
2. A general partnership is a business owned jointly by two or more people.
 - 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.
3. 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.
4. 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.
5. A limited liability company (LLC) is similar to an C-corporation, but it has fewer rules and restrictions than an C-corporation. For example, an LLC can have any number of members.
6. 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.
7. A not-for-profit corporation is an organization formed to serve some public purpose rather than for financial gain. It enjoys favorable tax treatment.
8. A merger occurs when two companies combine to form a new company.
9. 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.

7. Entrepreneurship: Starting a Business

Learning Objectives

By the end of the chapter, you should be able to:

1. Define entrepreneur and describe the three characteristics of entrepreneurial activity.
2. Identify five potential advantages to starting your own business.
3. Define a small business and explain the importance of small businesses to the Canadian economy.
4. Explain why small businesses tend to foster innovation more effectively than large ones.
5. Describe the goods-producing and service-producing sectors of an economy.
6. Explain what it takes to start a business and evaluate the advantages and disadvantages starting a business from scratch, buying an existing business, or obtaining a franchise.
7. Explain why some businesses fail.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=76>

Arts and Crafts for Adults: Collective Beer

Canadian Business often profiles innovative entrepreneurs and gathered [15 of its finest profiles online](#). Here is one of those spotlights:

Matt Johnston was stone-cold sober when he signed the lease to a 55,000-square-foot brewery in Hamilton and sunk major money into beer-making equipment, though his actions might have suggested a tippie or two. He hadn't even secured a business loan yet.

But how was he to know his plan to expand his craft beer company would get rejected by almost every major Canadian bank? Or that structural setbacks would delay construction by six months and put him \$1 million over budget? "It was one of the scarier points of our journey to date," Johnston admits.

Things were better back in September 2013, when the 41-year-old launched his company, [Collective Arts Brewing](#), with co-founder Bob Russell. The Hamilton-born buddies pooled their expertise (Johnston knew ales; Russell knew art) to create a beer that would connect drinkers to creative types by featuring an ever-changing array of wall-art-worthy labels designed and illustrated by artists and musicians. Scan a label with a free app called [Blippar](#) (no ugly QR code here), and you'll see a music video or artist's bio.



Collective Arts Brewery retrieved from <http://ontariobev.net>

Since inception, more than 350 labels have been carefully culled from thousands of submissions; featured artists have included Canadian band [The Strumbellas](#), Spanish illustrator [Eduardo Bertone](#) and U.S. painter [Lola Gil](#). "Craft beer is meant to be about creativity, so why put the same boring label on the bottles for the next 10 years?" says Johnston.

The beer is pretty good, too. Rhyme & Reason—their flagship hop-happy extra pale ale with notes of pine and tropical fruits, was initially produced by brewer Nickel Brook Brewery in Burlington, Ont. It is one of the top-selling craft beers at the Liquor Control Board of Ontario. Their second brew, the citrus-infused Saint of Circumstance, is in the Top 30.

Given Collective Arts' surging popularity, Nickel Brook couldn't keep up with demand. Collective Arts had to decide: find a new supplier or build something for themselves. Since Nickel Brook was looking to expand as well, they teamed up to leverage their strengths and resources, and bought an empty space once occupied by former beer giant Lakeport Brewery Company in Hamilton. "We sort of said to ourselves, we can't succeed as individuals. Building a brewery is an expensive undertaking, and neither of us could afford it, so it only made sense to work together," says Johnston.

The partnership proved even more beneficial when they found out the land couldn't support the weight of their tanks, meaning 6,000 square feet of concrete would have to be cut out of the foundation so 150 helical steel plates could be screwed into more stable soil, increasing the ground's bearing capacity. Having the resources of two companies helped mitigate the cost. "When you partner up, you cut the risk in half and double the chance of success," Johnston says.

And then there was the problem of getting a loan. Any small business, particularly a young and revenueless

one, will face a financing fight. For craft brewers, it's more like a combat mission. There are currently 166 craft brewers in Ontario vying for investors, shelf space and bar taps. Craft beer sales in the province may have grown by 575% from 2006 to 2013, but they still only represented 4% of all beer sales.

Luckily, Collective Arts found a saviour. After being rejected by at least five Canadian banks, one foreign financial institution believed in their grassroots idea and contributed a little less than half of the \$7 million investment they needed to get the new brewery going. The rest of the funds come from the two breweries themselves.

They're now set to look west, where markets appear more encouraging (craft beer accounts for around 15% of British Columbia's beer sales). Their good-looking beer will hit the four western provinces this year (article written in 2015), with distribution to all of Canada and some U.S. states by 2016.

Their next big move is cutting the ribbon for the new brewery this spring. They named it Arts & Science Brewing, as a nod to the craft and chemistry behind beer. While the two companies will operate separately, they will share 30 employees and the production facilities, which can produce up to 12 million bottles in the first year. The site also includes a 400-person music venue, an art gallery, a tap room and a beer garden—a “dream space” where they can directly sell their bevy of brews, plus invite some of their favourite bands to play. The scares he's had running this business have left a bitter taste, but so long as the beers attract new fans for his featured artists, he'll swallow it. “When someone sees our label and tweets, ‘I love The Strumbellas,’ that's a win for me.”

The Nature of Entrepreneurship

If we look a little more closely at the definition of entrepreneurship, we can identify three characteristics of entrepreneurial activity:^[1]

1. Innovation. Entrepreneurship generally means offering a new product, applying a new technique or technology, opening a new market, or developing a new form of organization for the purpose of producing or enhancing a product.
2. Running a business. A business, as we saw in Chapter 1 “The Foundations of Business,” combines resources to produce goods or services. Entrepreneurship means setting up a business to make a profit.
3. Risk taking. The term risk means that the outcome of the entrepreneurial venture can't be known. Entrepreneurs, therefore, are always working under a certain degree of uncertainty, and they can't know the outcomes of many of their decisions. Consequently, many of the steps they take are motivated mainly by their confidence in the innovation and in their understanding of the business environment in which they're operating.

It is easy to recognize these characteristics in the entrepreneurial experience of the craft brewers. They certainly had an innovative idea. But was it a good business idea? In a practical sense, a “good” business idea has to become something more than just an idea. If, like Collective Arts, you're interested in generating income from your idea, you'll probably need to turn it into a product—something that you can market because it satisfies a need. If you want to develop a product, you'll need some kind of organization to coordinate the resources necessary to make it a reality (in other words, a business). Risk enters the equation when you make the decision to start up a business and when you commit yourself to managing it.

To jumpstart your thinking around entrepreneurship, [take this short quiz](#) to align your thinking to Richard

Branson, Warren Buffett, Marissa Mayer, or another famous businessperson. Please note: This quiz is very general and not scientific. It is just to prompt your thinking.

A Few Things to Know About Going into Business for Yourself

Mark Zuckerberg founded Facebook while a student at Harvard. By age 27 he built up a personal wealth of \$13.5 billion. By age 31, his net worth was \$37.5 billion. Regardless of hurdles his company faced in early 2018, his success as an entrepreneur is solidified.

So what about you? Do you ever wonder what it would be like to start your own business? You might even turn into a “serial entrepreneur” like Marcia Kilgore.^[2] After high school, she moved from Canada to New York City to attend Columbia University. But when her financial aid was delayed, Marcia abandoned her plans to attend college and took a job as a personal trainer (a natural occupation for a former bodybuilder and middleweight title holder). But things got boring in the summer when her wealthy clients left the city for the Hamptons. To keep busy, she took a skin care course at a Manhattan cosmetology institute. As a teenager, she was self-conscious about her complexion and wanted to know how to treat it herself. She learned how to give facials and work with natural remedies. She started giving facials to her fitness clients who were thrilled with the results. As demand for her services exploded, she started her first business—Bliss Spa—and picked up celebrity clients, including Madonna, Oprah Winfrey, and Jennifer Lopez. The business went international, and she sold it for more than \$30 million.^[3]

But the story doesn't end here; she launched two more companies: Soap and Glory, a supplier of affordable beauty products sold at Target, and FitFlops, which sells sandals that tone and tighten your leg muscles as you walk. Oprah loves Kilgore's sandals and plugged them on her show.^[4] You can't get a better endorsement than that. Kilgore never did finish college, but when asked if she would follow the same path again, she said, “If I had to decide what to do all over again, I would make the same choices...I found by accident what I'm good at, and I'm glad I did.”

So, a few questions to consider if you want to go into business for yourself:

- How do I come up with a business idea?
- Should I build a business from scratch, buy an existing business, or invest in a franchise?
- What steps are involved in developing a business plan?
- Where could I find help in getting my business started?
- How can I increase the likelihood that I'll succeed?

In this chapter, we'll provide some answers to questions like these.

Why Start Your Own Business?

What sort of characteristics distinguishes those who start businesses from those who don't? Or, more to the point, why do some people actually follow through on the desire to start up their own businesses? The most common reasons for starting a business are the following:

- To be your own boss
- To accommodate a desired lifestyle
- To achieve financial independence
- To enjoy creative freedom
- To use your skills and knowledge

How can you translate characteristics into potential success? Experts suggest that you assess your strengths and weaknesses by asking yourself a few relevant questions:^[5]

- Am I a self-starter? You'll need to develop and follow through on your ideas.
- How well do I get along with different personalities? Strong working relationships with a variety of people are crucial.
- How good am I at making decisions? Especially under pressure.....
- Do I have the physical and emotional stamina? Expect six or seven work days of about twelve hours every week.
- How well do I plan and organize? Poor planning is the culprit in most business failures.
- How will my business affect my family? Family members need to know what to expect: long hours and, at least initially, a more modest standard of living.

Before we discuss why businesses fail we should consider why a huge number of business ideas never even make it to the grand opening. One business analyst cites four reservations (or fears) that prevent people from starting businesses:^[6]

- Money. Without cash, you can't get very far. What to do: line up initial financing early or at least have done enough research to have a plan to raise money.
- Security. A lot of people don't want to sacrifice the steady income that comes with the nine-to-five job. What to do: don't give up your day job. Run the business part-time or connect with someone to help run your business – a “co-founder”.
- Competition. A lot of people don't know how to distinguish their business ideas from similar ideas. What to do: figure out how to do something cheaper, faster, or better.
- Lack of ideas. Some people simply don't know what sort of business they want to get into. What to do: find out what trends are successful. Turn a hobby into a business. Think about a franchise. Find a solution to something that annoys you – entrepreneurs call this a “pain point” – and try to turn it into a business.

If you're still interested in going into business for yourself, try to regard such drawbacks as mere obstacles to be overcome by a combination of planning and creative thinking.

Sources of Early-Stage Financing

As noted above, many businesses fail, or never get started, due to a lack of funds. But where can an entrepreneur raise money to start a business? Many first-time entrepreneurs are financed by friends and family, at least in the very early stages. Others may borrow through their personal credit cards, though quite often, high interest rates make this approach unattractive or too expensive for the new business to afford.

An entrepreneur with a great idea may win funding through a pitch competition; local municipalities and

government agencies understand that economic growth depends on successful new businesses, and so they will often conduct such competitions in the hopes of attracting them.

Crowd funding has become more common as a means of raising capital. An entrepreneur using this approach would typically utilize a crowd funding platform like Kickstarter or GoFundMe to attract investors. The entrepreneur might offer tokens of appreciation in exchange for funds, or perhaps might offer an ownership stake for a substantial enough investment. Take a few moments to peruse [Kickstarter](#) or another site and see what types of businesses are proposed in your area or which are trending globally.

Some entrepreneurs receive funding from angel investors, affluent investors who provide capital to start-ups in exchange for an ownership position in the company. Many angels are successful entrepreneurs themselves and invest not only to make money, but also to help other aspiring business owners to succeed.

Venture capital firms also invest in start-up companies, although usually at a somewhat later stage and in larger dollar amounts than would be typical of angel investors. Like angels, venture firms also take an ownership position in the company. They tend to have a higher expectation of making a return on their money than do angel investors.

Distinguishing Entrepreneurs from Small Business Owners

Though most entrepreneurial ventures begin as small businesses, not all small business owners are entrepreneurs. Entrepreneurs are innovators who start companies to create new or improved products. They strive to meet a need that's not being met, and their goal is to grow the business and eventually expand into other markets.

In contrast, many people either start or buy small businesses for the sole purpose of providing an income for themselves and their families. They do not intend to be particularly innovative, nor do they plan to expand significantly. This desire to operate is what's sometimes called a "lifestyle business"^[7]. The neighbourhood pizza parlour or beauty shop, the self-employed consultant who works out of the home, and even a local printing company—many of these are typically lifestyle businesses.

The Importance of Small Business to the Canadian Economy

What Is a "Small Business"?

To assess the value of small businesses to the Canadian economy, we first need to know what constitutes a small business. Let's start by looking at the criteria used by Industry Canada. In 2012 Industry Canada defined it: "small business" is firms that have fewer than 100 employees. A small business is one that is independently owned and operated, exerting little influence in its industry.

Why Are Small Businesses Important?

However, small business constitutes a force in the Canadian and other economies. The millions of individuals who have started businesses have helped shape the business world as we know it today. Some small business founders like Henry Ford and Thomas Edison have even gained places in history. Others, including Bill Gates (Microsoft), Mike Lazaridis (Research in Motion), Steve Jobs (Apple Computer), and Larry Page and Sergey Brin (Google), have changed the way global business is done today.

Aside from contributions to our general economic well-being, founders of small businesses also contribute to growth and vitality in specific areas of economic and socio-economic development. In particular, small businesses do the following:

- Create jobs
- Spark innovation
- Provide opportunities for many people, including women and minorities, to achieve financial success and independence

In addition, they complement the economic activity of large organizations by providing them with components, services, and distribution of their products. Let's take a closer look at each of these contributions.

Job Creation

The majority of Canadian workers first entered the business world working for small businesses. Although the split between those working in small companies and those working in big companies is about even, small firms hire more frequently and fire more frequently than do big companies.^[8] Why is this true? At any given point in time, lots of small companies are started and some expand. These small companies need workers and so hiring takes place. But the survival and expansion rates for small firms is poor, and so, again at any given point in time, many small businesses close or contract and workers lose their jobs. Fortunately, over time more jobs are added by small firms than are taken away, which results in a net increase in the number of workers.

The size of the net increase in the number of workers for any given year depends on a number of factors, with the economy being at the top of the list. A strong economy encourages individuals to start small businesses and expand existing small companies, which adds to the workforce. A weak economy does just the opposite: discourages start-ups and expansions, which decreases the workforce through layoffs.

Innovation

Given the financial resources available to large businesses, you'd expect them to introduce virtually all the new products that hit the market. Yet according to the United States's Small Business Administration (SBA), small companies develop more patents per employee than do larger companies. During a recent four-year period, large firms generated 1.7 patents per hundred employees, while small firms generated an impressive 26.5 patents per

employee.^[9] Although similar statistics are not available for Canada, our business practices tend to align with our neighbours in the United States.

Over the years, the list of important innovations by small firms has included the airplane, air-conditioning, DNA “fingerprinting”, and overnight national delivery.^[10]

Small business owners are also particularly adept at finding new ways of doing old things. In 1994, for example, a young computer-science graduate working on Wall Street came up with the novel idea of selling books over the Internet. During the first year of operations, sales at Jeff Bezos’ new company—Amazon.com—reached half a million dollars. In less than twenty years, annual sales had topped \$107 billion.^[11] Not only did his innovative approach to online retailing make Bezos enormously rich, but it also established a viable model for the e-commerce industry. In 2018, Amazon’s model is creeping into the physical. Shortly after entering the grocery market by acquiring Whole Foods, it prototyped a cashier-less and checkout-less store where your purchases are charged against your Amazon account via an app. It hopes to revolutionize grocery shopping just as it did book buying.



Source: Amazon Go store in Seattle WA licensed CC BY | <https://en.wikipedia.org>

Why are small businesses so innovative? For one thing, they tend to offer environments that appeal to individuals with the talent to invent new products or improve the way things are done. Fast decision making is encouraged, their research programs tend to be focused, and their compensation structures typically reward top performers.

According to one SBA study, the supportive environments of small firms are roughly thirteen times more innovative per employee than the less innovation-friendly environments in which large firms traditionally operate.^[12]

The success of small businesses in fostering creativity has not gone unnoticed by big businesses. In fact, many large companies have responded by downsizing to act more like small companies. Some large organizations now have separate work units whose purpose is to spark innovation. Individuals working in these units can focus their attention on creating new products that can then be developed by the company.

Opportunities for Women

Small business is the portal through which many people enter the economic mainstream. Business ownership allows individuals to achieve financial success, as well as pride in their accomplishments. While the majority of small businesses are still owned by white males, the past two decades have seen a substantial increase in the number of businesses owned by women.

Canada’s 2018 budget had continued investment in women entrepreneurs. On February 28, 2018, the Financial Post reported:

“By far, the largest net new impact on Canada’s entrepreneurial class is the \$1.65 billion in new financing being

made available to women business owners, to be delivered over three years through the Business Development Bank of Canada and Export Development Canada.”



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=76>

What Industries Are Small Businesses In?

If you want to start a new business, you probably should avoid certain types of businesses. You'd have a hard time, for example, setting up a new company to make automobiles or aluminum, because you'd have to make tremendous investments in property, plant, and equipment, and raise an enormous amount of capital to pay your workforce. These large, up-front investments present barriers to entry.

Fortunately, plenty of opportunities are still available. Many types of businesses require reasonable initial investments, and not surprisingly, these are the ones that usually present attractive small business opportunities.

Industries by Sector

Let's define an industry as a group of companies that compete with one another to sell similar products. We'll focus on the relationship between a small business and the industry in which it operates, dividing businesses into two broad types of industries, or sectors: the goods-producing sector and the service-producing sector.

- The goods-producing sector includes all businesses that produce tangible goods. Generally speaking, companies in this sector are involved in manufacturing, construction, and agriculture.
- The service-producing sector includes all businesses that provide services but don't make tangible goods. They may be involved in retail and wholesale trade, transportation, finance, entertainment, recreation, accommodations, food service, and any number of other ventures.

About 20% of small businesses in the United States are concentrated in the goods-producing sector. The remaining 80% are in the service sector.^[13] The high concentration of small businesses in the service-producing sector reflects the makeup of the overall U.S. economy. Over the past fifty years, the service-producing sector has been growing at an impressive rate. In 1960, for example, the goods-producing sector accounted for 38 percent of GDP, the service-producing sector for 62 percent. By 2015, the balance had shifted dramatically, with the goods-producing sector accounting for only about 21 percent of GDP.^[14]

Goods-Producing Sector

The largest areas of the goods-producing sector are construction and manufacturing. Construction businesses are often started by skilled workers, such as electricians, painters, plumbers, and home builders, and they generally work on local projects. Though manufacturing is primarily the domain of large businesses, there are exceptions. BTIO/Realityworks, for example, is a manufacturing enterprise (components come from Ohio and China, and assembly is done in Wisconsin).

How about making something out of trash? Daniel Blake never followed his mother's advice at dinner when she told him to eat everything on his plate. When he served as a missionary in Puerto Rico, Aruba, Bonaire, and Curacao after his first year in college, he noticed that the families he stayed with didn't either. But they didn't throw their uneaten food into the trash. Instead they put it on a compost pile and used the mulch to nourish their vegetable gardens and fruit trees. While eating at an all-you-can-eat breakfast buffet back home at Brigham Young University, Blake was amazed to see volumes of uneaten food in the trash. This triggered an idea: why not turn the trash into money? Two years later, he was running his company—EcoScraps—collecting 40 tons of food scraps a day from 75 grocers and turning it into high-quality potting soil that he sells online and to nurseries. His profit has reached almost half a million dollars on sales of \$1.5 million.^[15]

Service-Producing Sector

Many small businesses in this sector are retailers—they buy goods from other firms and sell them to consumers, in stores, by phone, through direct mailings, or over the Internet. In fact, entrepreneurs are turning increasingly to the Internet as a venue for start-up ventures. Take Tony Roeder, for example, who had a fascination with the red Radio Flyer wagons that many of today's adults had owned as children. In 1998, he started an online store through Yahoo! to sell red wagons from his home. In three years, he turned his online store into a million-dollar business.^[16]

Other small business owners in this sector are wholesalers—they sell products to businesses that buy them for resale or for company use. A local bakery, for example, is acting as a wholesaler when it sells desserts to a restaurant, which then resells them to its customers. A small business that buys flowers from a local grower (the manufacturer) and resells them to a retail store is another example of a wholesaler.

A high proportion of small businesses in this sector provide professional, business, or personal services. Doctors and dentists are part of the service industry, as are insurance agents, accountants, and lawyers. So are businesses that provide personal services, such as dry cleaning and hairdressing.

David Marcks, for example, entered the service industry about fourteen years ago when he learned that his border collie enjoyed chasing geese at the golf course where he worked. While geese are lovely to look at, they can make a mess of tees, fairways, and greens. That's where Marcks' company, Geese Police, comes in: Marcks employs specially trained dogs to chase the geese away. He now has twenty-seven trucks, thirty-two border collies, and five offices. Golf courses account for only about 5 percent of his business, as his dogs now patrol corporate parks and playgrounds as well.^[17]

Advantages and Disadvantages of Business Ownership

Do you want to be a business owner someday? Before deciding, you might want to consider the following advantages and disadvantages of business ownership.^[18]

Advantages of Small Business Ownership

Being a business owner can be extremely rewarding. Having the courage to take a risk and start a venture is part of the North American dream. Success brings with it many advantages:



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=76>

Disadvantages of Small Business Ownership

As the little boy said when he got off his first roller-coaster ride, “I like the ups but not the downs!” Here are some of the risks you run if you want to start a small business:



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=76>

In spite of these and other disadvantages, most small business owners are pleased with their decision to start a business. A survey conducted by the Wall Street Journal and Cicco and Associates indicates that small business owners and top-level corporate executives agree overwhelmingly that small business owners have a more satisfying business experience.

Interestingly, the researchers had fully expected to find that small business owners were happy with their choices; they were, however, surprised at the number of corporate executives who believed that the grass was greener in the world of small business ownership.^[19]

Starting a Business

Starting a business takes talent, determination, hard work, and persistence. It also requires a lot of research and planning. Before starting your business, you should appraise your strengths and weaknesses and assess your personal goals to determine whether business ownership is for you.^[20]

Questions to Ask Before You Start a Business

If you're interested in starting a business, you need to make decisions even before you bring your talent, determination, hard work, and persistence to bear on your project.

Here are the basic questions you'll need to address:

- What, exactly, is my business idea? Is it feasible?
- What industry do I want to enter?
- What will be my competitive advantage?
- Do I want to start a new business, buy an existing one, or buy a franchise?
- What form of business organization do I want?

After making these decisions, you'll be ready to take the most important step in the entire process of starting a business: you must describe your future business in the form of a business plan—a document that identifies the goals of your proposed business and explains how these goals will be achieved. Think of a business plan as a blueprint for a proposed company: it shows how you intend to build the company and how you intend to make sure that it's sturdy. You must also take a second crucial step before you actually start up your business: You need to get financing—the money that you'll need to get your business off the ground.

The Business Idea

For some people, coming up with a great business idea is a gratifying adventure. For most, however, it's a daunting task. The key to coming up with a business idea is identifying something that customers want—or, perhaps more importantly, filling an unmet need. Your business will probably survive only if its purpose is to satisfy its customers—the ultimate users of its goods or services. In coming up with a business idea, don't ask, "What do we want to sell?" but rather, "What does the customer want to buy?"^[21]

To come up with an innovative business idea, you need to be creative. The idea itself can come from various sources. Prior experience accounts for the bulk of new business idea and also increases your chances of success. Take Sam Walton, the late founder of Wal-Mart. He began his retailing career at JCPenney and then became a successful franchisor of a Ben Franklin five-and-dime store. In 1962, he came up with the idea of opening large stores in rural areas, with low costs and heavy discounts. He founded his first Wal-Mart store in 1962, and when he died thirty years later, his family's net worth was \$25 billion.^[22]

Industry experience also gave Howard Schultz, a New York executive for a housewares company, his

breakthrough idea. In 1981, Schultz noticed that a small customer in Seattle—Starbucks Coffee, Tea and Spice—ordered more coffeemaker cone filters than Macy’s and many other large customers. So he flew across the country to find out why. His meeting with the owner-operators of the original Starbucks Coffee Co. resulted in his becoming part-owner of the company. Schultz’s vision for the company far surpassed that of its other owners. While they wanted Starbucks to remain small and local, Schultz saw potential for a national business that not only sold world-class-quality coffee beans but also offered customers a European coffee-bar experience. After attempting unsuccessfully to convince his partners to try his experiment, Schultz left Starbucks and started his own chain of coffee bars, which he called Il Giornale (after an Italian newspaper). Two years later, he bought out the original owners and reclaimed the name Starbucks.^[23]

Ownership Options

As we’ve already seen, you can become a small business owner in one of three ways— by starting a new business, buying an existing one, or obtaining a franchise. Let’s look more closely at the advantages and disadvantages of each option.

Starting from Scratch

The most common—and the riskiest—option is starting from scratch. This approach lets you start with a clean slate and allows you to build the business the way you want. You select the goods or services that you’re going to offer, secure your location, and hire your employees, and then it’s up to you to develop your customer base and build your reputation. This was the path taken by Andres Mason who figured out how to inject hysteria into the process of bargain hunting on the Web. The result is an overnight success story called Groupon.^[24] Here is how Groupon (a blend of the words “group” and “coupon”) works: A daily email is sent to over 6.5 million people in over 70 cities across the United States and Canada offering a deeply discounted deal to buy something or to do something in their city. If the person receiving the email likes the deal, he or she commits to buying it. But, here’s the catch, if not enough people sign up for the deal, it is cancelled. Groupon makes money by keeping half of the revenue from the deal. The company offering the product or service gets exposure. But stay tuned: the “daily deals website isn’t just unprofitable—it’s bleeding hundreds of millions of dollars.”^[25] As with all start-ups cash is always a challenge.

Buying an Existing Business

If you decide to buy an existing business, some things will be easier. You’ll already have a proven product, current customers, active suppliers, a known location, and trained employees. You’ll also find it much easier to predict the business’s future success.

There are, of course, a few bumps in this road to business ownership. First, it’s hard to determine how much you should pay for a business. You can easily determine how much things like buildings and equipment are worth, but how much should you pay for the fact that the business already has steady customers?

In addition, a business, like a used car, might have performance problems that you can't detect without a test drive (an option, unfortunately, that you don't get when you're buying a business). Perhaps the current owners have disappointed customers; maybe the location isn't as good as it used to be. You might inherit employees that you wouldn't have hired yourself. Careful study called due diligence is necessary before going down this road.

Getting a Franchise

Lastly, you can buy a franchise. A franchisor (the company that sells the franchise) grants the franchisee (the buyer—you) the right to use a brand name and to sell its goods or services. Franchises market products in a variety of industries, including food, retail, hotels, travel, real estate, business services, cleaning services, and even weight-loss centres and wedding services. Figure 6.7 lists the top ten franchises according to Entrepreneur magazine for 2018. Franchises apply to be on the list and are then assessed used Entrepreneur's [five pillars](#).

Ranking	2018
1	McDonald's
2	7-Eleven Inc.
3	Dunkin'Donuts
4	The UPS Store
5	RE/MAX LLC
6	Sonic Drive-in
7	Great Clips
8	Taco Bell
9	Hardee's
10	Sport Clips

In Canada, 1 out of every 14 workers is directly or indirectly employed by the franchise industry and there are an estimated 1,300 franchise brands operating in Canada. Individual investments vary widely – from \$10,000 to millions. KFC franchises, for example, require a total investment of \$1.3 million to \$2.5 million each. This fee includes the cost of the property, equipment, training, start-up costs, and the franchise fee—a one-time charge for the right to operate as a KFC outlet. McDonald's is in the same price range (\$1 million to \$2.3 million). SUBWAY sandwich shops offer a more affordable alternative, with expected total investment ranging from \$116,000 to \$263,000. Visit [Canadian Franchising Opportunities](#)^[26] to see franchises by level of investment required.

In addition to your initial investment, you'll have to pay two other fees on a monthly basis—a royalty fee (typically from 3 to 12 percent of sales) for continued support from the franchisor and the right to keep using the

company's trade name, plus an advertising fee to cover your share of national and regional advertising. You'll also be expected to buy your products from the franchisor.^[27]

But there are disadvantages. The cost of obtaining and running a franchise can be high, and you have to play by the franchisor's rules, even when you disagree with them. The franchisor maintains a great deal of control over its franchisees. For example, if you own a fast-food franchise, the franchise agreement will likely dictate the food and beverages you can sell; the methods used to store, prepare, and serve the food; and the prices you'll charge. In addition, the agreement will dictate what the premises will look like and how they'll be maintained. As with any business venture, you need to do your homework before investing in a franchise.

Why Some Businesses Fail and Where to Get Help

Why Do Some Businesses Fail?

If you've paid attention to the occupancy of shopping malls over a few years, you've noticed that retailers come and go with surprising frequency. The same thing happens with restaurants—indeed, with all kinds of businesses. By definition, starting a business—small or large—is risky, and though many businesses succeed, a large proportion of them don't. The most recent, official statistics for Canada, from 2013, report the following for the births and deaths of SMEs. Consult the table below or find the equivalent, text information from [Industry Canada](#). Note: These statistics do not deal directly with entrepreneurs, but with small and medium enterprises or SMEs.

As disappointing as these statistics on business survival are, some industries are worse than others. If you want to stay in business for a long time, you might want to avoid some of these risky industries. Even though your friends think you make the best pizza in the world, this doesn't mean you can succeed as a pizza parlour owner. Opening a restaurant or a bar is one of the riskiest ventures (and, therefore, start-up funding is hard to get).

You might also want to avoid the transportation industry. Owning a taxi might appear lucrative until you find out what a taxi license costs. It obviously varies by city, but in New York City the price tag is upward of \$400,000. No wonder taxi companies are resisting Uber and Lyft with all the energy they can muster. And setting up a shop to sell clothing can be challenging. Your view of "what's in" may be off, and one bad season can kill your business. The same is true for stores selling communication devices: every mall has one or more cell phone stores so the competition is steep, and business can be very slow.^[28]

Businesses fail for any number of reasons, but many experts agree that the vast majority of failures result from some combination of the following problems:

- **Bad business idea.** Like any idea, a business idea can be flawed, either in the conception or in the execution. If you tried selling snow blowers in Hawaii, you could count on little competition, but you'd still be doomed to failure.
- **Cash problems.** Too many new businesses are underfunded. The owner borrows enough money to set up the business but doesn't have enough extra cash to operate during the start-up phase, when very little money is coming in but a lot is going out.
- **Managerial inexperience or incompetence.** Many new business owners have no experience in running a

business; many have limited management skills. Maybe an owner knows how to make or market a product but doesn't know how to manage people. Maybe an owner can't attract and keep talented employees. Maybe an owner has poor leadership skills and isn't willing to plan ahead.

- Lack of customer focus. A major advantage of a small business is the ability to provide special attention to customers. But some small businesses fail to seize this advantage. Perhaps the owner doesn't anticipate customers' needs or keep up with changing markets or the customer-focused practices of competitors.
- Inability to handle growth. You'd think that a sales increase would be a good thing. Often it is, of course, but sometimes it can be a major problem. When a company grows, the owner's role changes. He or she needs to delegate work to others and build a business structure that can handle the increase in volume. Some owners don't make the transition and find themselves overwhelmed. Things don't get done, customers become unhappy, and expansion actually damages the company.

Some Canadian Considerations

This chapter provided some solid, foundational knowledge on entrepreneurship. But take a few moments to see who might be left behind in the growth of entrepreneurship.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=76>

Key Takeaways

Important terms and concepts

1. An entrepreneur is someone who identifies a business opportunity and assumes the risk of creating and running a business to take advantage of it.
2. The three characteristics of entrepreneurial activity are innovating, running a business, and risk taking.
3. A small business is independently owned and operated, exerts little influence in its industry, and has fewer than one hundred employees.
4. An industry is a group of companies that compete with one another to sell similar products. There are two broad types of industries, or sectors: the goods-producing sector and the service-producing sector.
5. Once you decide to start a business, you'll need to create a business plan—a document that identifies the goals of your proposed business and explains how it will achieve them.

8. Management and Leadership

Learning Objectives

By the end of the chapter, you should be able to:

1. Identify the four interrelated functions of management: planning, organizing, leading, and controlling.
2. Explain the process by which a company develops and implements a strategic plan.
3. Explain how managers direct others and motivate them to achieve company goals.
4. Describe the process by which a manager monitors operations and assesses performance.
5. Explain what benchmarking is and its importance for managing organizations.
6. Describe the skills needed to be a successful manager.



Show What You Know



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=83>

Noteworthy Management

Consider this scenario: you're halfway through the semester and ready for midterms. You open your class notes and declare them "pathetic." You regret scribbling everything so carelessly and skipping class so many times. That's when it hits you: what if there was a note-taking service on campus? When you were ready to study for a big test, you could buy complete and legible class notes. You've heard that there are class-notes services at some larger schools, but there's no such thing on your campus. So you ask yourself, why don't I start a note-taking business? Your upcoming set of exams may not be salvageable, but after that, you'd always have great notes. And in the process, you could learn how to manage a business (isn't that what majoring in business is all about?).

You might begin by hiring a bunch of students to take class notes. Then the note takers will e-mail them to your assistant, who'll get them copied (on a special type of paper that can't be duplicated). The last step will be assembling packages of notes and, of course, selling them. You decide to name your company "Notes-4-You."

It sounds like a great idea, but you're troubled by one question: why does this business need you? Do the note takers need a boss? Couldn't they just sell the notes themselves? This process could work, but it would work better if there was someone to oversee the operations: a manager—to make sure that the operations involved in preparing and selling notes were performed in both an effective and an efficient manner. You'd make the process effective by ensuring that the right things got done and that they all contributed to the success of the enterprise. You'd make the process efficient by ensuring that activities were performed in the right way and used the fewest possible resources.

The Management Process

The effective performance of your business will require solid management: the process of planning, organizing, leading, and controlling resources to achieve specific goals. A plan enables you to take your business concept beyond the idea stage. It does not, however, get the work done. For that to happen, you have to organize things effectively. You'll have to put people and other resources in place to make things happen. And because your note-taking venture is supposed to be better off with you in charge, you need to be a leader who can motivate your people to do well. Finally, to know whether things are in fact going well, you'll have to control your operations—that is, measure the results and compare them with the results that you laid out in your plan. The management process below summarizes the interrelationship between planning and the other functions that managers perform. This chapter will explore planning, leading, and controlling in some detail. Organizing

is an especially complex topic, and deserves its own chapter.



Planning

Without a plan, it's hard to succeed at anything. The reason is simple: if you don't know where you're going, you can't move forward. Successful managers decide where they want to be and then figure out how to get there; they set goals and determine the best way to achieve them. As a result of the planning process, everyone in the organization knows what should be done, who should do it, and how to do it.

Developing a Strategic Plan

Coming up with an idea—say, starting a note-taking business—is a good start, but it's only a start. Planning for it is a step forward. Planning begins at the highest level and works its way down through the organization. Step one is usually called strategic planning: the process of establishing an overall course of action. To begin this process, you should ask yourself a couple of very basic questions: why, for example, does the organization exist? What value does it create? Sam Walton posed these questions in the process of founding Wal-Mart: his new chain of stores would exist to offer customers the lowest prices with the best possible service. [\[1\]](#)

Once you've identified the purpose of your company, you're ready to take the remaining steps in the strategic-planning process:

- Write a mission statement that tells customers, employees, and others why your organization exists.
- Identify core values or beliefs that will guide the behavior of members of the organization.

- Assess the company's strengths, weaknesses, opportunities, and threats.
- Establish goals and objectives, or performance targets, to direct all the activities that you'll perform to achieve your mission.
- Develop and implement tactical and operational plans to achieve goals and objectives.

In the next few sections, we'll examine these components of the strategic-planning process.

Mission Statement

As we saw in an earlier chapter, the mission statement describes the purpose of your organization—the reason for its existence. It tells the reader what the organization is committed to doing. It can be very concise, like the one from Mary Kay Inc. (the cosmetics company): “To enrich the lives of women around the world.”^[2] Or it can be as detailed as the one from Harley-Davidson: “We fulfill dreams inspired by the many roads of the world by providing extraordinary motorcycles and customer experiences. We fuel the passion for freedom in our customers to express their own individuality.”^[3]

A mission statement for Notes-4-You could be the following: “To provide high-quality class notes to college students.” On the other hand, you could prepare a more detailed statement that explains what the company is committed to doing, who its customers are, what its focus is, what goods or services it provides, and how it serves its customers.

It is worth noting that some companies no longer use mission statements, preferring to communicate their reason for being in other manners.

Core Values

Whether or not your company has defined a mission, it is important to identify what your organization stands for in terms of its values and the principles that will guide its actions. In the chapter, “Business Ethics and Social Responsibility”, we explained that the small set of guiding principles that you identify as crucial to your company are known as core values—fundamental beliefs about what's important and what is and isn't appropriate in conducting company activities. Core values affect the overall planning processes and operations. At Volvo, three values— safety, quality, and environmental care—define the firm's “approach to product development, design and production.”^[4] Core values should also guide the behavior of every individual in the organization. At Coca-Cola, for instance, the values of leadership, collaboration, integrity, accountability, passion, diversity and quality tell employees exactly what behaviors are acceptable.^[5] Companies communicate core values to employees and hold them accountable for putting them into practice by linking their values to performance evaluations and compensation.

In choosing core values for Notes-4-You, you're determined to be unique. After some thought, you settle on teamwork, trust, and dependability. Why these three? As you plan your business, you realize that it will need a workforce that functions as a team, trusts each other, and can be depended on to satisfy customers. In building your workforce, you'll seek employees who'll embrace these values.

Conduct a SWOT Analysis

The next step in the strategic-planning process is to assess your company's fit with its environment. A common approach to environmental analysis is matching the strengths of your business with the opportunities available to it. It's called SWOT analysis because it calls for analyzing an organization's Strengths, Weaknesses, Opportunities, and Threats. The next two paragraphs or [this video](#) explains the ins and outs of a SWOT analysis.



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=83>

Hint: Use the cog to increase the speed; the video is a tad slow-moving.

It begins with an examination of external factors that could influence the company in either a positive or a negative way. These could include economic conditions, competition, emerging technologies, laws and regulations, and customers' expectations.

One purpose of assessing the external environment is to identify both opportunities that could benefit the company and threats to its success. For example, a company that manufactures children's bicycle helmets would view a change in federal law requiring all children to wear helmets as an opportunity. The news that two large sports-equipment companies were coming out with bicycle helmets would be a threat.

The next step is to evaluate the company's strengths and weaknesses, internal factors that could influence company performance in either a positive or negative way. Strengths might include a motivated workforce, state-of-the-art technology, impressive managerial talent, or a desirable location. The opposite of any of these

strengths could signal a potential weakness (poor workforce, obsolete technology, incompetent management, or poor location). Armed with a good idea of internal strengths and weaknesses, as well as external opportunities and threats, managers will be better positioned to capitalize on opportunities and strengths. Likewise, they want to improve on any weak areas and protect the organization from external threats.

For example, Notes-4-You might say that by providing excellent service at a reasonable price while we're still small, it can solidify its position on campus. When the market grows due to increases in student enrollment, the company will have built a strong reputation and be in a position to grow. So even if a competitor comes to campus (a threat), the company expects to be the preferred supplier of class notes. This strategy will work only if the note-takers are dependable and if the process does not alienate the faculty or administration.

Set Goals

Your mission statement affirms what your organization is generally committed to doing, but it doesn't tell you how to do it. So the next step in the strategic-planning process is establishing goals and objectives. Goals are major accomplishments that the company wants to achieve over a long period. In order to challenge and yet manage, SMART is an often-applied acronym that guides the development of goals. A SMART goal is one that is:



Specific: The who, what, where, when, why, and the which involved with the goal. Define the goal as much as possible with no ambiguous language.

Measurable: Can you track the progress and measure the outcome? How much, how many, how will I know when my goal is accomplished?

Attainable: Is the goal reasonable enough to be accomplished? Make sure the goal is not out of reach or below standard performance.

Relevant: Is the goal worthwhile and will it meet your and your organization's needs? Is each goal consistent with other established goals, plans, and timelines?

Timely: Your goal should include a time limit. It will establish a sense of urgency and prompt better time management.

Set objectives

Objectives are shorter-term performance targets that direct the activities of the organization toward the attainment of a goal. They should be clearly stated, achievable, and measurable: they should give target dates for the completion of tasks and stipulate who's responsible for taking necessary actions.^[6]

An organization will have a number of goals and related objectives. Some will focus on financial measures, such as profit maximization and sales growth. Others will target operational efficiency or quality control. Still others will govern the company's relationships with its employees, its community, its environment, or all three.

Finally, goals and objectives change over time. As a firm reassesses its place in its business environment, it rethinks not only its mission but also its approach to fulfilling it. The reality of change was a major theme when the late McDonald's CEO Jim Cantalupo explained his goal to revitalize the company:

"The world has changed. Our customers have changed. We have to change too. Growth comes from being better, not just expanding to have more restaurants. The new McDonald's is focused on building sales at existing restaurants rather than on adding new restaurants. We are introducing a new level of discipline and efficiency to all aspects of the business and are setting a new bar for performance."^[7]

This change in focus was accompanied by specific performance objectives—annual sales growth of 3 to 5 percent and income growth of 6 to 7 percent at existing restaurants, plus a five-point improvement (based on customer surveys) in speed of service, friendliness, and food quality.

In setting strategic goals and performance objectives for Notes-4-You, you should keep things simple. Because you need to make money to stay in business, you could include a financial goal (and related objectives). Your mission statement promises "high-quality, dependable, competitively priced class notes," so you could focus on the quality of the class notes that you'll be taking and distributing. Finally, because your mission is to serve students, one goal could be customer oriented. Your list of goals and objectives might look like this:

- Goal 1: Achieve a 10 percent return on profits in your first five years.
- Objective: Sales of \$20,000 and profit of \$2,000 for the first 12 months of operation.
- Goal 2: Produce a high-quality product.
- Objective: First-year satisfaction scores of 90 percent or higher on quality of notes (based on survey responses on understandability, readability, and completeness).
- Goal 3: Attain 98 percent customer satisfaction by the end of your fifth year.
- Objective: Making notes available within two days after class, 95 percent of the time.

Consider how SMART these goals and objectives are.

Tactical Plans

The overall plan is broken down into more manageable, shorter-term components called tactical plans. These plans specify the activities and allocation of resources (people, equipment, money) needed to implement the strategic plan over a given period. Often, a long-range strategic plan is divided into several tactical plans; a five-year strategic plan, for instance, might be implemented as five one-year tactical plans.

Operational Plans

The tactical plan is then broken down into various operational components that provide detailed action steps to be taken by individuals or groups to implement the tactical and strategic plans. Operational plans cover only a brief period—say, a month or two. At Notes-4-You, note-takers might be instructed to submit typed class notes five hours earlier than normal on the last day of the semester (an operational guideline). The goal is to improve the customer-satisfaction score on dependability (a tactical goal) and, as a result, to earn the loyalty of students through attention to customer service (a strategic goal).

Plan for Contingencies and Crises

Even with great planning, things don't always turn out the way they're supposed to. Perhaps your plans were flawed, or maybe something in the environment shifted unexpectedly. Successful managers anticipate and plan for the unexpected. Dealing with uncertainty requires contingency planning and crisis management.

Contingency Planning

With contingency planning, managers identify those aspects of the business that are most likely to be adversely affected by change. Then, they develop alternative courses of action in case an anticipated change does occur. You engage in contingency planning any time you develop a backup or fallback plan.

Crisis Management

Organizations also face the risk of encountering crises that require immediate attention. Rather than waiting until such a crisis occurs and then scrambling to figure out what to do, many firms practice crisis management. Some, for instance, set up teams trained to deal with emergencies. Members gather information quickly and respond to the crisis while everyone else carries out his or her normal duties. The team also keeps the public, the employees, the press, and government officials informed about the situation and the company's response to it.

An example of how to handle crisis management involves Wendy's. After learning that a woman claimed she found a fingertip in a bowl of chili she bought at a Wendy's restaurant in San Jose, California, the company's public relations team responded quickly. Within a few days, the company announced that the finger didn't come from an employee or a supplier. Soon after, the police arrested the woman and charged her with attempted

grand larceny for lying about how the finger got in her bowl of chili and trying to extort \$2.5 million from the company. But the crisis wasn't over for Wendy's. The incident was plastered all over the news as a grossed-out public sought an answer to the question, "Whose finger is (or was) it?" A \$100,000 reward was offered by Wendy's to anyone with information that would help the police answer this question. The challenge Wendy's faced was how to entice customers to return to its fifty San Francisco-area restaurants (where sales had plummeted) while keeping a low profile nationally. Wendy's accomplished this objective by giving out free milkshakes and discount coupons to customers in the affected regions and, to avoid calling attention to the missing finger, by making no changes in its national advertising. The crisis-management strategy worked and the story died down (though it flared up temporarily when the police arrested the woman's husband, who allegedly bought the finger from a coworker who had severed it in an accident months earlier).^[8]

Even with crisis-management plans in place, however, it's unlikely that most companies will emerge from a potentially damaging episode as unscathed as Wendy's did. For one thing, the culprits in the Wendy's case were caught, and the public was willing to forgive an organization it viewed as a victim. Given the current public distrust of corporate behaviour, however, companies whose reputations have suffered due to questionable corporate judgement usually don't fare as well.

Consider how this crisis from 2005 would have played out differently in today's media culture and climate. The more recent example from 2017, provides a glimpse. Pepsi seemed to miss a lot of red flags when it created its campaign based on peace and understanding, set against a backdrop of protest against police brutality. Within minutes after the promotion was released, users of social media called for an immediate boycott against Pepsi and accused the company of undermining the Black Lives Matter movement, as well as exploiting it to sell products. Pepsi apologized and removed the ad, but it lived on in social media. See different collections of the Twitter backlash; [Twitter is tearing apart Kendall Jenner's Pepsi ad](#).



Twitter screen capture responding to Pepsi ad featuring Kendall Jenner

Leading

The third management function is leading—providing focus and direction to others and motivating them to achieve organizational goals. [Yes, ORGANIZING was skipped as it has the option of coverage in an additional chapter.] As owner and president of Notes-4-You, you might think of yourself as an orchestra conductor. You have given your musicians (employees) their sheet music (plans). You've placed them in sections (departments) and arranged the sections (organizational structure) so the music will sound as good as possible. Now your job is to tap your baton and lead the orchestra so that its members make beautiful music together.^[9] Don't appreciate the conductor metaphor? What metaphor would you use to describe the process of leading?

Which characteristics should a leader possess? You might consider a leader you know personally e.g., a boss, team captain or think of a leader on the larger stage e.g., politics, sports, business. Which attributes make the person an effective leader or capable of leading a team? Google this and you get 50,000,000 hits, but many of the results list common elements. Take a look at a sound representative of the results from Brian Tracey (using this infographic does not endorse him or his product).



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=83>

7 Leadership Qualities and Attributes of Great Leaders – An infographic by the team at [Brian Tracy International](#)

Leadership Styles

As a conductor, it's fairly easy to pick up a baton, cue each section, and strike up the band; but it doesn't mean the music will sound good. What if your cues are ignored or misinterpreted or ambiguous? Maybe your musicians don't like your approach to making music and will just walk away. On top of everything else, you don't simply want to make music: you want to inspire your musicians to make great music. How do you accomplish this goal? How do you become an effective leader, and what style should you use to motivate others to achieve organizational goals?

Unfortunately, there are no definitive answers to questions like these. Over time, every manager refines his or her own leadership style, or way of interacting with and influencing others. Despite a vast range of personal differences, leadership styles tend to reflect one of the following approaches to leading and motivating people: the autocratic, the democratic (also known as participative), or the free rein.

- Autocratic style. Managers who have developed an autocratic leadership style tend to make decisions without soliciting input from subordinates. They exercise authority and expect subordinates to take responsibility for performing the required tasks without undue explanation.
- Democratic style. Managers who favor a democratic leadership style generally seek input from subordinates while retaining the authority to make the final decisions. They're also more likely to keep

subordinates informed about things that affect their work.

- Free-rein style. In practising a free rein leadership style, managers adopt a “hands-off” approach and provide relatively little direction to subordinates. They may advise employees but usually give them considerable freedom to solve problems and make decisions on their own.

At first glance, you'd probably not want to work for an autocratic leader. After all, most people don't like to be told what to do without having any input. Many like the idea of working for a democratic leader; it's flattering to be asked for your input. And though working in a free rein environment might seem a little unsettling at first, the opportunity to make your own decisions is appealing to many people. Each leadership style can be appropriate in certain situations.

To illustrate, let's say that you're leading a group of fellow students in a team project for your class. Are there times when it would be best for you to use an autocratic leadership style? What if your team was newly formed, unfamiliar with what needs to be done, under a tight deadline, and looking to you for direction? In this situation, you might find it appropriate to follow an autocratic leadership style (on a temporary basis) and assign tasks to each member of the group. In an emergency situation, such as a fire, or in the final seconds of a close ball game, there is generally not time for debate – the leader or coach must make a split second decision that demands an autocratic style.

But since most situations are non-emergency and most people prefer the chance to give input, the democratic leadership style is often favored. People are simply more motivated and feel more ownership of decisions (i.e., buy-in) when they have had a chance to offer input. Note that when using this style, the leader will still make the decision in most cases. As long as their input is heard, most people accept that it is the leader's role to decide in cases where not everyone agrees.

How about free rein leadership? Many people function most effectively when they can set their own schedules and do their work in the manner they prefer. It takes a great deal of trust for a manager to employ this style. Some managers start with an assumption of trust that is up to the employee to maintain through strong performance. In other cases, this trust must be earned over a period of time. Would this approach always work with your study group? Obviously not. It will work if your team members are willing and able to work independently and welcome the chance to make decisions. On the other hand, if people are not ready to work responsibly to their best of their abilities, using the free rein style could cause the team to miss deadlines or do poorly on the project.

The point being made here is that no one leadership style is effective all the time for all people or in all corporate cultures. While the democratic style is often viewed as the most appropriate (with the free rein style a close second), there are times when following an autocratic style is essential. Good leaders learn how to adjust their styles to fit both the situation and the individuals being directed.

Transformational Leadership

Theories on what constitutes effective leadership evolve over time. One theory that has received a lot of attention in the last decade contrasts two leadership styles: transactional and transformational. So-called transactional leaders exercise authority based on their rank in the organization. They let subordinates know what's expected of them and what they will receive if they meet stated objectives. They focus their attention on identifying mistakes and disciplining employees for poor performance. By contrast,

transformational leaders mentor and develop subordinates, providing them with challenging opportunities, working one-on-one to help them meet their professional and personal needs, and encouraging people to approach problems from new perspectives. They stimulate employees to look beyond personal interests to those of the group.

So, which leadership style is more effective? You probably won't be surprised by the opinion of most experts. In today's organizations, in which team building and information sharing are important and projects are often collaborative in nature, transformational leadership has proven to be more effective. Modern organizations look for managers who can develop positive relationships with subordinates and motivate employees to focus on the interests of the organization. Leaders who can be both transactional and transformational are rare, and those few who have both capacities are very much in demand.^[10]

Controlling

Let's pause for a minute and reflect on the management functions that we've discussed so far—planning, organizing, and leading. As founder of Notes-4-You, you began by establishing plans for your new company. You defined its mission and set objectives, or performance targets, which you needed to meet in order to achieve your mission. Then, you organized your company by allocating the people and resources required to carry out your plans. Finally, you provided focus and direction to your employees and motivated them to achieve organizational objectives. Is your job finished? Can you take a well-earned vacation? Unfortunately, the answer is no: your work has just begun. Now that things are rolling along, you need to monitor your operations to see whether everything is going according to plan. If it's not, you'll need to take corrective action. This process of comparing actual to planned performance and taking necessary corrective action is called controlling.

A Five-Step Control Process

1. Set the standards by which performance will be measured.
2. Measure performance.
3. Compare actual performance with the standard and identify any deviations from the standard.
4. Determine the reasons for the deviation.
5. Take corrective action if needed.

You can think of the control function as the five-step process outlined above. Let's see how this process might work at Notes-4-You. Let's assume that, after evaluating class enrollments, you estimate that you can sell one hundred notes packages per month to students taking a popular first year geology course. So you set your standard at a hundred units. At the end of the month, however, you look over your records and find that you sold only eighty. In talking with your salespeople, you learn why you came up twenty packages short: it turns out that the copy machine broke down so often that packages frequently weren't ready on time. You immediately take corrective action by increasing maintenance on the copy machine.

Now, let's try a slightly different scenario. Let's say that you still have the same standard (one hundred packages) and that actual sales are still eighty packages. In investigating the reason for the shortfall, you find that you over-estimated the number of students taking the geology course. Calculating a more accurate number of students,

you see that your original standard—estimated sales—was too high by twenty packages. In this case, you should adjust your standards to reflect expected sales of eighty packages.

In both situations, your control process has been helpful. In the first instance, you were alerted to a problem that cut into your sales. Correcting this problem would undoubtedly increase sales and, therefore, profits. In the second case, you encountered a defect in your planning and learned a good managerial lesson: plan more carefully.

Benchmarking

Benchmarking could be considered as a specialized kind of control activity. Rather than controlling a particular aspect of performance (say, defects for a specific product), benchmarking aims to improve a firm's overall performance. The process of benchmarking involves comparisons to other organizations' practices and processes with the objective of learning and improvement in both efficiency and effectiveness. Benchmarking exercises can be conducted in a number of ways:

- Organizations often monitor publicly available information to keep tabs on the competition. Annual reports, news articles, and other sources are monitored closely in order to stay aware of the latest developments. In academia, universities and colleges often use published rankings tables to see how their programs compare on the student satisfaction, salaries of graduates, and other important dimensions.
- Organizations may also work directly with companies in unrelated industries in order to compare those functions of the business which are similar. A manufacturer of aircraft would not likely have a great deal in common with a company making engineered plastics, yet both have common functions such as accounting, finance, information technology, and human resources. Companies can exchange ideas that help each other improve efficiency, and often at a very low cost to either.
- In order to compare more directly with competition without relying solely on publicly available data, companies may enter into benchmarking consortiums in which an outside consultant would collect key data from all participants, anonymize it, and then share the results with all participants. Companies can then gauge how they compare to others in the industry without revealing their own performance to others.

Managerial Skills

To be a successful manager, you'll have to master a number of skills. To get an entry-level position, you'll have to be technically competent at the tasks you're asked to perform. To advance, you'll need to develop strong interpersonal and conceptual skills. The relative importance of different skills varies from job to job and organization to organization, but to some extent, you'll need them all to forge a managerial career.

Throughout your career, you'll also be expected to communicate ideas clearly, use your time efficiently, and reach sound decisions.

Technical Skills

You'll probably be hired for your first job based on your technical skills—the ones you need to perform specific tasks—and you'll use them extensively during your early career. If your college major is accounting, you'll use what you've learned to prepare financial statements. If you have a marketing degree and you join an ad agency, you'll use what you know about promotion to prepare ad campaigns. Technical skills will come in handy when you move up to a first-line managerial job and oversee the task performance of subordinates. Technical skills, though developed through job training and work experience, are generally acquired during the course of your formal education.

Interpersonal Skills

As you move up the corporate ladder, you'll find that you can't do everything yourself: you'll have to rely on other people to help you achieve the goals for which you're responsible. That's why interpersonal skills, also known as relational skills—the ability to get along with and motivate other people—are critical for managers in mid-level positions. These managers play a pivotal role because they report to top-level managers while overseeing the activities of first-line managers. Thus, they need strong working relationships with individuals at all levels and in all areas. More than most other managers, they must use “people skills” to foster teamwork, build trust, manage conflict, and encourage improvement.^[11]

Conceptual Skills

Managers at the top, who are responsible for deciding what's good for the organization from the broadest perspective, rely on conceptual skills—the ability to reason abstractly and analyze complex situations. Senior executives are often called on to “think outside the box”—to arrive at creative solutions to complex, sometimes ambiguous problems. They need both strong analytical abilities and strong creative talents.

Communication Skills

Effective communication skills are crucial to just about everyone. At all levels of an organization, you'll often be judged on your ability to communicate, both orally and in writing. Whether you're talking informally or making a formal presentation, you must express yourself clearly and concisely. Talking too loudly, rambling, and using poor grammar reduce your ability to influence others, as does poor written communication. Confusing and error-riddled documents (including emails) don't do your message any good, and they will reflect poorly on you.^[12]

Time-Management Skills

Managers face multiple demands on their time, and their days are usually filled with interruptions. Ironically, some technologies that were supposed to save time, such as voicemail and email, have actually increased workloads. Unless you develop certain time-management skills, you risk reaching the end of the day feeling that you've worked a lot but accomplished little. What can managers do to ease the burden? Here are a few common-sense suggestions:

- Prioritize tasks, focusing on the most important things first.
- Set aside a certain time each day to return phone calls and answer email.
- Delegate routine tasks.
- Don't procrastinate.
- Insist that meetings start and end on time, and stick to an agenda.
- Eliminate unnecessary paperwork. [\[13\]](#)

Decision-Making Skills

Every manager is expected to make decisions, whether alone or as part of a team. Drawing on your decision-making skills is often a process in which you must define a problem, analyze possible solutions, and select the best outcome. As luck would have it, because the same process is good for making personal decisions, we'll use a personal example to demonstrate the process approach to decision making. Consider the following scenario: you're upset because your midterm grades are much lower than you'd hoped. To make matters worse, not only are you in trouble academically, but also the other members of your business-project team are annoyed because you're not pulling your weight. Your lacrosse coach is very upset because you've missed too many practices, and members of the mountain-biking club of which you're supposed to be president are talking about impeaching you if you don't show up at the next meeting. And your significant other is feeling ignored.

A Six-Step Approach to Decision Making

Assuming that your top priority is salvaging your GPA, let's tackle your problem by using a six-step approach to solving problems that don't have simple solutions.

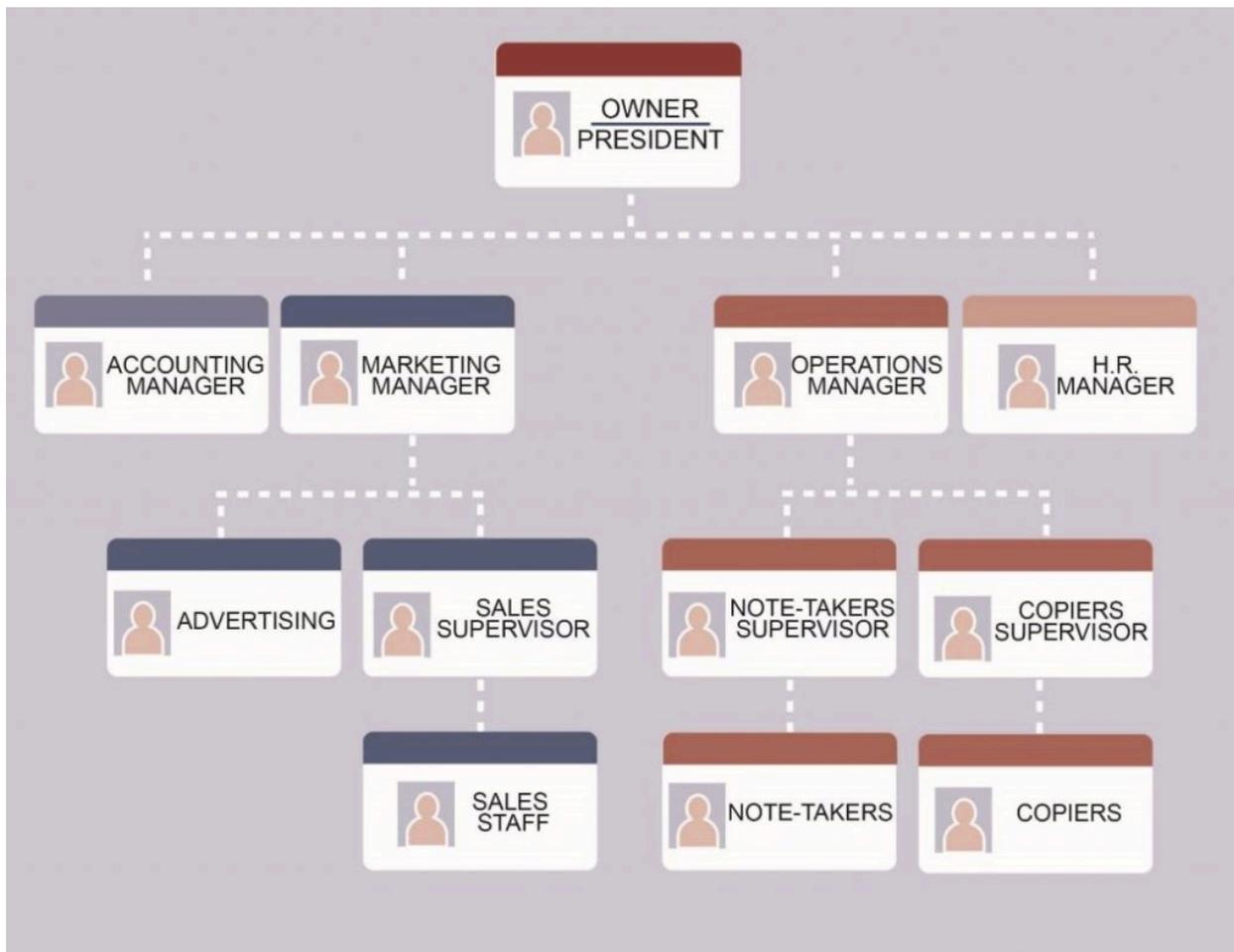


An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=83>

Applying Your Skills at Notes-4-You

So, what types of skills will managers at Notes-4-You need? To oversee note-taking and copying operations, first-line managers will require technical skills, probably in operations and perhaps in accounting. Middle managers will need strong interpersonal skills to maintain positive working relationships with subordinates and to motivate them. As president (the top manager), because you have to solve problems and come up with creative ways to keep the business growing, you'll need conceptual skills. And everyone will have to communicate effectively: after all, because you're in the business of selling written notes, it would look pretty bad if your employees wrote poorly. Finally, everyone will have to use time efficiently and call on problem-solving skills to handle the day-to-day crises that seem to plague every new company. Here is an example of an organization structure Notes-4-You might employ:



Potential organization chart for the Note-4-You company

Key Takeaways

Important terms and concepts

1. Management must include both efficiency (accomplishing goals using the fewest resources possible) and effectiveness (accomplishing goals as accurately as possible).
2. The management process has four functions: planning, organizing, leading, and controlling.
3. Planning for a business starts with strategic planning—the process of establishing an overall course of action.
4. Management first identifies its purposes, creates a mission statement, and defines its core values.
5. A SWOT analysis assesses the company's strengths and weaknesses and its fit with the external environment.
6. Goals and objectives, or performance targets, are established to direct company actions, and tactical plans and operational plans implement objectives.
7. A manager's leadership style varies depending on the manager, the situation, and the people being directed. There are several management styles:
 - An autocratic manager tends to make decisions without input and expects subordinates to follow instructions.
 - Managers who prefer a democratic style seek input into decisions.
 - A free rein manager provides no more guidance than necessary and lets subordinates make decisions and solve problems.
8. Transactional style managers exercise authority according to their rank in the organization, let subordinates know what's expected of them, and step in when mistakes are made.
9. Transformational style managers mentor and develop subordinates and motivate them to achieve organizational goals.
10. The control process can be viewed as a five-step process: (1) establish standards, (2) measure performance, (3) compare actual performance with standards and identify any deviations, (4) determine the reason for deviations, and (5) take corrective action if needed. Benchmarking is a process for improving overall company efficiency and effectiveness by comparing performance to competitors.
11. Top managers need strong conceptual skills, while those at midlevel need good interpersonal skills and those at lower levels need technical skills.
12. All managers need strong communication, decision-making, and time management skills.

9. Structuring Organizations

Learning Objectives

By the end of the chapter, you should be able to:

1. Identify the three levels of management and the responsibilities at each level.
2. Discuss various options for organizing a business, and create an organization chart.
3. Explain how specialization helps make organizations more efficient.
4. Discuss the different ways that an organization can departmentalize.
5. Explain other key terms related to this chapter such as chain of command, delegation of authority, and span of control.



Show What You Know



An interactive or media element has been excluded from this version of the text.

You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=91>

Organizing

If you read our chapter “Management and Leadership”, you will recall developing a strategic plan for your new company, Notes-4-You. Once a business has completed the planning process, it will need to organize the company so that it can implement that plan. A manager engaged in organizing allocates resources (people, equipment, and money) to achieve a company’s objectives. Successful managers make sure that all the activities identified in the planning process are assigned to some person, department, or team and that everyone has the resources needed to perform assigned activities.

Levels of Management: How Managers Are Organized

A typical organization has several layers of management. Think of these layers as forming a pyramid, with top managers occupying the narrow space at the peak, first-line managers the broad base, and middle-managers the levels in between.



As you move up the pyramid, management positions get more demanding, but they carry more authority and responsibility (along with more power, prestige, and pay). Top managers spend most of their time in planning and decision making, while first-line managers focus on day-to-day operations. For obvious reasons, there are far more people with positions at the base of the pyramid than there are at the other two levels. Let’s look at each management level in more detail.

Top Managers

Top managers are responsible for the health and performance of the organization. They set the objectives, or performance targets, designed to direct all the activities that must be performed if the company is going to fulfill its mission. Top-level executives routinely scan the external environment for opportunities and threats, and they redirect company efforts when needed. They spend a considerable portion of their time planning and making major decisions. They represent the company in important dealings with other businesses and government agencies, and they promote it to the public. Job titles at this level typically include chief executive officer (CEO), chief financial officer (CFO), chief operating officer (COO), president, and vice president.

Middle | Mid-level Managers

Middle managers are in the centre of the management hierarchy: they report to top management and oversee the activities of first-line managers. They're responsible for developing and implementing activities and allocating the resources needed to achieve the objectives set by top management. Common job titles include operations manager, division manager, plant manager, and branch manager.

First-Line Managers

First-line managers supervise employees and coordinate their activities to make sure that the work performed throughout the company is consistent with the plans of both top and middle management. It's at this level that most people acquire their first managerial experience. The job titles vary considerably but include such designations as manager, group leader, office manager, foreman, and supervisor.

Let's take a quick survey of the management hierarchy at Notes-4-You. As president, you are a member of top management, and you're responsible for the overall performance of your company. You spend much of your time setting performance targets, to ensure that the company meets the goals you've set for it— increased sales, higher-quality notes, and timely distribution.

Several middle managers report to you, including your operations manager. As a middle manager, this individual focuses on implementing two of your objectives: producing high-quality notes and distributing them to customers in a timely manner. To accomplish this task, the operations manager oversees the work of two first-line managers—the note-taking supervisor and the copying supervisor. Each first-line manager supervises several non-managerial employees to make sure that their work is consistent with the plans devised by top and middle management.

If you covered the chapter on Management and Leadership, admirable qualities were discussed. You may think all these qualities and more are necessary for sound leadership, but you do need more of

some sound characteristics at the different levels. Consider which qualities align better with the different levels and why.

If you have an hypothesis account, feel free to annotate the section and suggest appropriate attributes for the three, different levels.

Organizational Structure: How Companies Get the Job Done

Building an organizational structure engages managers in two activities: job specialization (dividing tasks into jobs) and departmentalization (grouping jobs into units). An organizational structure outlines the various roles within an organization, which positions report to which, and how an organization will departmentalize its work. Take note that an organizational structure is an arrangement of positions that's most appropriate for your company at a specific point in time. Given the rapidly changing environment in which businesses operate, a structure that works today might be outdated tomorrow. That's why you hear so often about companies restructuring—altering existing organizational structures to become more competitive once conditions have changed. Let's now look at how the processes of specialization and departmentalization are accomplished.

Specialization

Organizing activities into clusters of related tasks that can be handled by certain individuals or groups is called specialization. This aspect of designing an organizational structure is twofold:

1. Identify the activities that need to be performed in order to achieve organizational goals.
2. Break down these activities into tasks that can be performed by individuals or groups of employees.

Specialization has several advantages. First and foremost, it leads to efficiency. Imagine a situation in which each department was responsible for paying its own invoices; a person handling this function a few times a week would likely be far less efficient than someone whose job was to pay the bills. In addition to increasing efficiency, specialization results in jobs that are easier to learn and roles that are clearer to employees. But the approach has disadvantages, too. Doing the same thing over and over sometimes leads to boredom and may eventually leave employees dissatisfied with their jobs. Before long, companies may notice decreased performance and increased absenteeism and turnover (the percentage of workers who leave an organization and must be replaced).

Departmentalization

The next step in designing an organizational structure is departmentalization—grouping specialized jobs into

meaningful units. Depending on the organization and the size of the work units, they may be called divisions, departments, or just plain groups.

Traditional groupings of jobs result in different organizational structures, and for the sake of simplicity, we'll focus on two types—functional and divisional organizations.

Functional Organizations

A functional organization groups together people who have comparable skills and perform similar tasks. This form of organization is fairly typical for small to medium-size companies, which group their people by business functions: accountants are grouped together, as are people in finance, operations, marketing and sales, human resources, production, and research and development. Each unit is headed by an individual with expertise in the unit's particular function.

There are a number of advantages to the functional approach. The structure is simple to understand and enables the staff to specialize in particular areas; everyone in the marketing group would probably have similar interests and expertise. But homogeneity also has drawbacks: it can hinder communication and decision making between units and even promote interdepartmental conflict. The marketing department, for example, might butt heads with the accounting department because marketers want to spend as much as possible on advertising, while accountants want to control costs.

Divisional Organizations

Large companies often find it unruly to operate as one large unit under a functional organizational structure. Sheer size makes it difficult for managers to oversee operations and serve customers. To rectify this problem, most large companies are structured as divisional organizations. They are similar in many respects to stand-alone companies, except that certain common tasks, like legal work, tends to be centralized at the headquarters level. Each division functions relatively autonomously because it contains most of the functional expertise (production, marketing, accounting, finance, human resources) needed to meet its objectives. The challenge is to find the most appropriate way of structuring operations to achieve overall company goals. Toward this end, divisions can be formed according to products, customers, processes, or geography.

Product Divisions

Product division means that a company is structured according to its product lines. General Motors, for example, has four product-based divisions: Buick, Cadillac, Chevrolet, and GMC.^[1] Each division has its own research and development group, its own manufacturing operations, and its own marketing team. This allows individuals in the division to focus all their efforts on the products produced by their division. A downside is that it results in higher costs as corporate support services (such as accounting and human resources) are duplicated in each of the four divisions.

Customer Divisions

Some companies prefer a customer division structure because it enables them to better serve their various categories of customers. Thus, Johnson & Johnson's two hundred or so operating companies are grouped into three customer-based business segments: consumer business (personal-care and hygiene products sold to the general public), pharmaceuticals (prescription drugs sold to pharmacies), and professional business (medical devices and diagnostics products used by physicians, optometrists, hospitals, laboratories, and clinics).^[2]

Process Divisions

If goods move through several steps during production, a company might opt for a process division structure. This form works well at Bowater Thunder Bay, a Canadian company that harvests trees and processes wood into newsprint and pulp. The first step in the production process is harvesting and stripping trees. Then, large logs are sold to lumber mills and smaller logs are chopped up and sent to Bowater's mills. At the mill, wood chips are chemically converted into pulp. About 90 percent is sold to other manufacturers (as raw material for home and office products), and the remaining 10 percent is further processed into newspaper print. Bowater, then, has three divisions: tree cutting, chemical processing, and finishing (which makes newsprint).^[3]

Geographical Divisions

Geographical division enables companies that operate in several locations to be responsive to customers at a local level. Adidas, for example, is organized according to the regions of the world in which it operates. They have 5 different regions, and each one reports its performance separately in their annual reports.^[4]



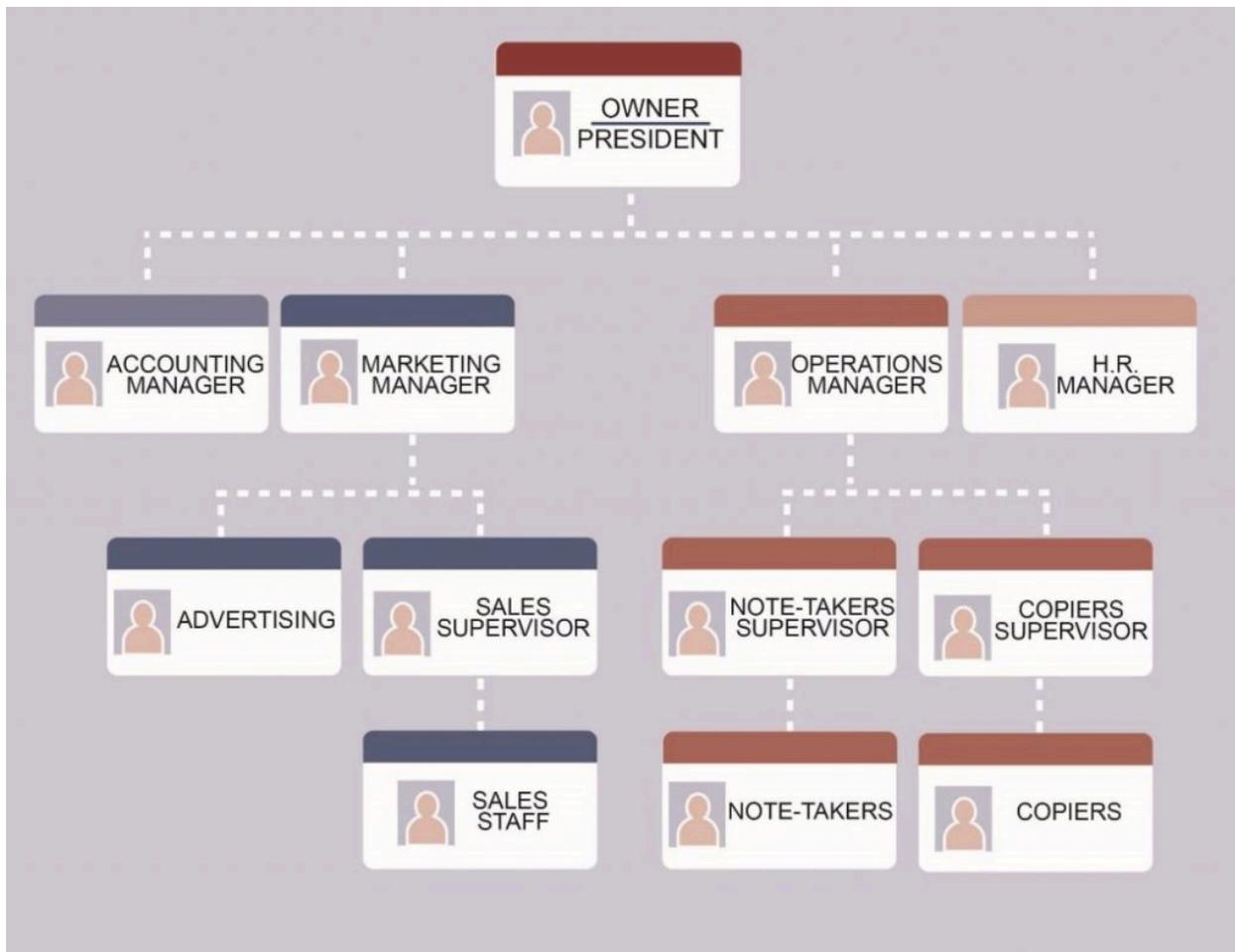
Source: Adidas Group

Summing Up Divisional Organizations

There are pluses and minuses associated with divisional organization. On the one hand, divisional structure usually enhances the ability to respond to changes in a firm's environment. If, on the other hand, services must be duplicated across units, costs will be higher. In addition, some companies have found that units tend to focus on their own needs and goals at the expense of the organization as a whole.

The Organization Chart

Once an organization has set its structure, it can represent that structure in an organization chart: a diagram delineating the interrelationships of positions within the organization. Here is an example of this type of organization chart:



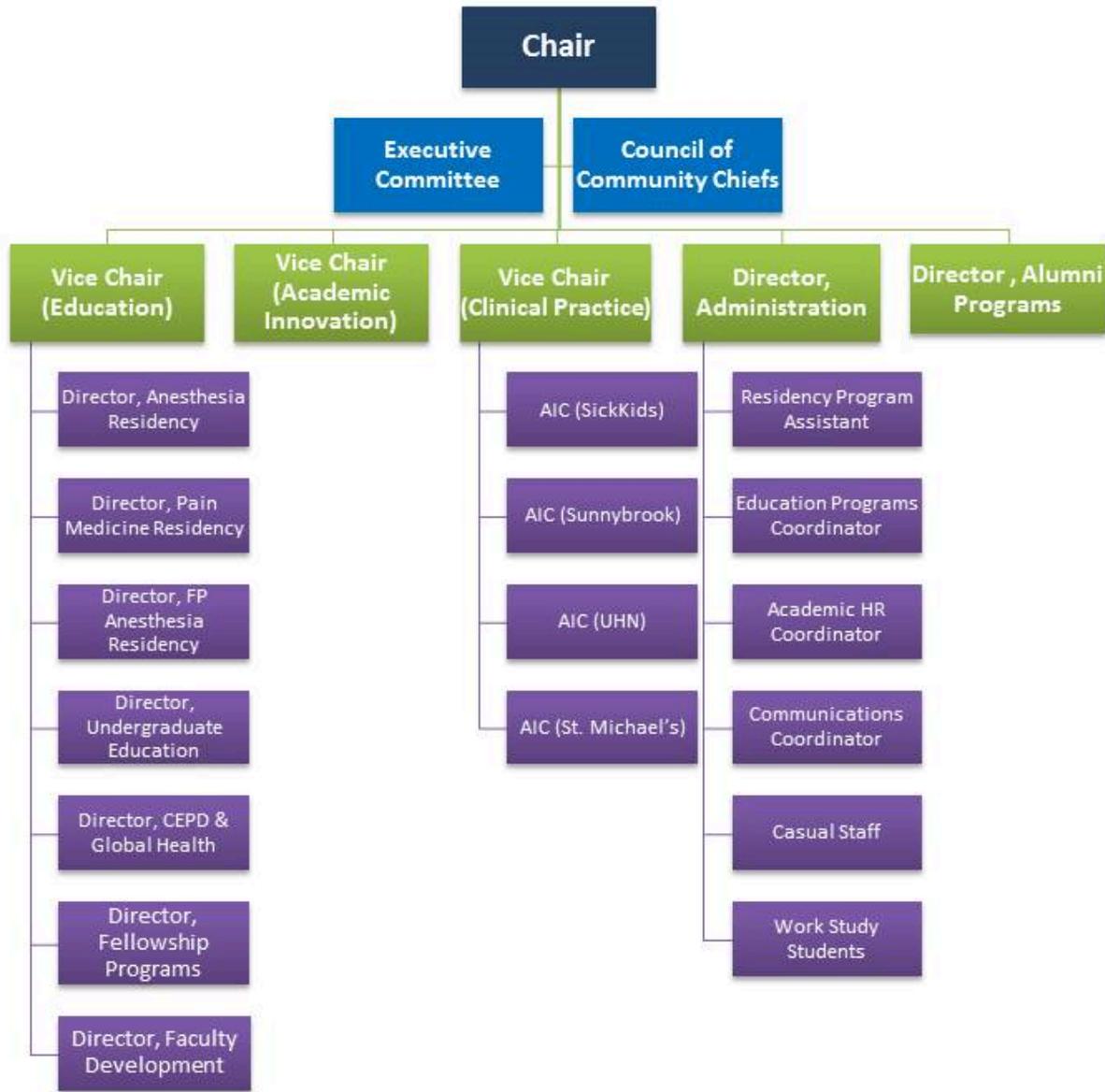
Potential organization chart for the Note-4-You company

Imagine putting yourself at the top of the chart, as the company's president. You would then fill in the level directly below your name with the names and positions of the people who work directly for you—your accounting, marketing, operations, and human resources managers. The next level identifies the people who work for these managers. Because you've started out small, neither your accounting manager nor your human resources manager will be currently managing anyone directly. Your marketing manager, however, will oversee one person in advertising and a sales supervisor (who, in turn, oversees the sales staff). Your operations manager will oversee two individuals—one to supervise note-takers and one to supervise the people responsible for making copies. The lines between the positions on the chart indicate the reporting relationships; for example, the Note-Takers Supervisor reports directly to the Operations Manager.

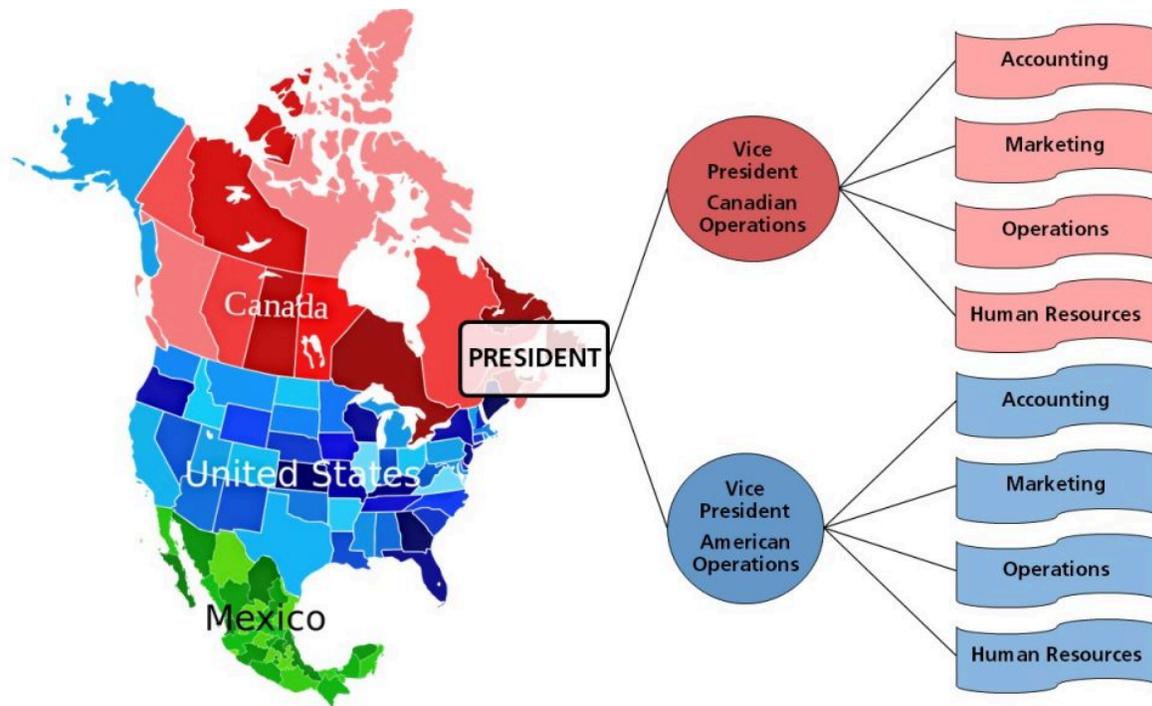
Although the structure suggests that you will communicate only with your four direct reports, this isn't the way things normally work in practice. Behind every formal communication network there lies a network of informal communications—unofficial relationships among members of an organization. You might find that over time, you receive communications directly from members of the sales staff; in fact, you might encourage this line of communication.

Now let's look at the chart of an organization that relies on a divisional structure. Educational institutions are

a good example – either as a whole or even at the departmental level. Use the one below as an example or take a look at your own institution's organization chart. Many companies with a divisional structure organize by product, services, or customer base. Educational institutions reflect a mix of those divisional structure options.



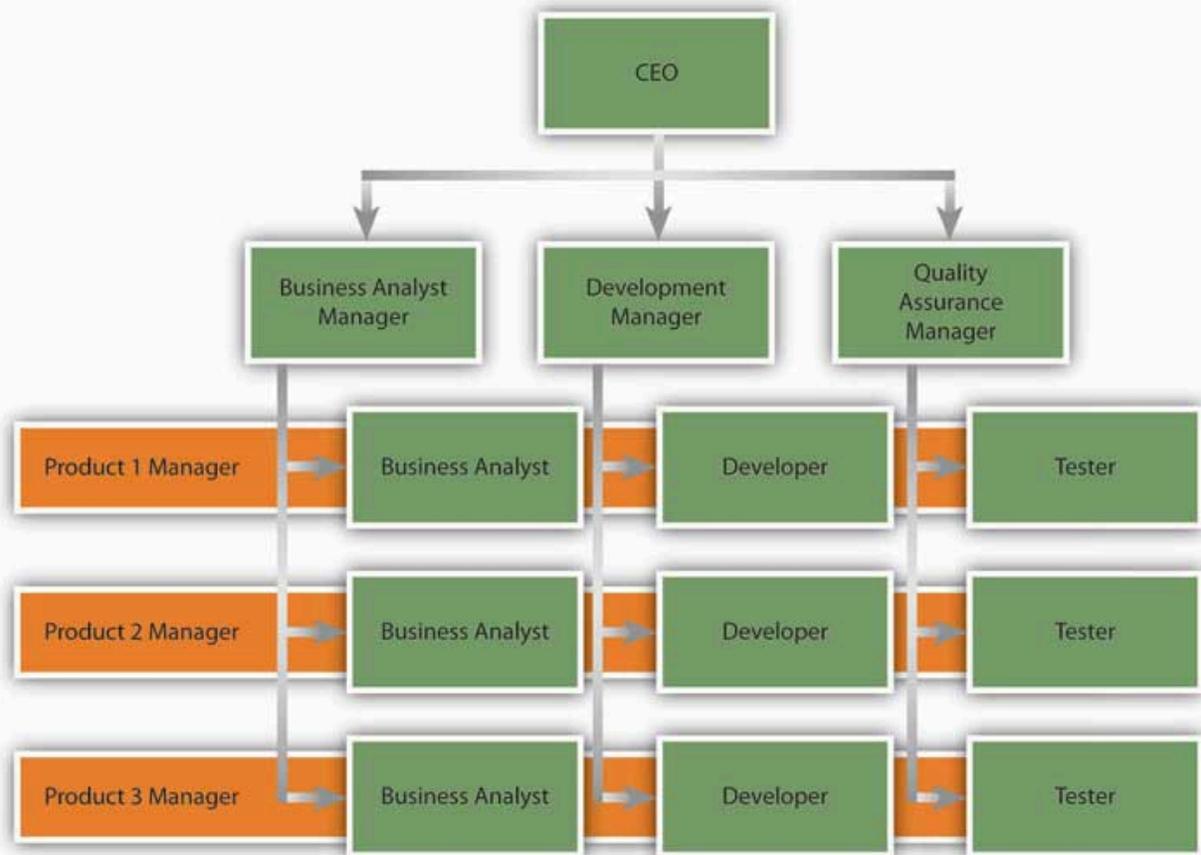
Over time, companies revise their organizational structures to accommodate growth and changes in the external environment. It's not uncommon, for example, for a firm to adopt a functional structure in its early years. Then, as it becomes bigger and more complex, it might move to a divisional structure—perhaps to accommodate new products or to become more responsive to certain customers or geographical areas. Some companies might ultimately rely on a combination of functional and divisional structures. This could be a good approach for a credit card company that issues cards in both the United States and Canada. An outline of this firm's organization chart might look like the following diagram.



Chain of Command

The vertical connecting lines in the organization chart show the firm's chain of command: the authority relationships among people working at different levels of the organization. That is to say, they show who reports to whom. When you're examining an organization chart, you'll probably want to know whether each person reports to one or more supervisors: to what extent, in other words, is there unity of command? To understand why unity of command is an important organizational feature, think about it from a personal standpoint. Would you want to report to more than one boss? What happens if you get conflicting directions? Whose directions would you follow?

There are, however, conditions under which an organization and its employees can benefit by violating the unity-of-command principle. Under a matrix structure, for example, employees from various functional areas (product design, manufacturing, finance, marketing, human resources, etc.) form teams to combine their skills in working on a specific project or product. This matrix organization chart might look like the one in the following figure.



<https://courses.lumenlearning.com/principlesmanagement/chapter/7-3-contemporary-forms-of-organizational-structures/>

Nike sometimes uses this type of arrangement. To design new products, the company may create product teams made up of designers, marketers, and other specialists with expertise in particular sports categories—say, running shoes or basketball shoes. Each team member would be evaluated by both the team manager and the head of his or her functional department.

Span of Control

Another thing to notice about a firm's chain of command is the number of layers between the top managerial position and the lowest managerial level. As a rule, new organizations have only a few layers of management—an organizational structure that's often called flat. Let's say, for instance, that a member of the Notes-4-You sales staff wanted to express concern about slow sales among a certain group of students. That person's message would have to filter upward through only two management layers—the sales supervisor and the marketing manager—before reaching the president.

As a company grows, however, it tends to add more layers between the top and the bottom; that is, it gets taller. Added layers of management can slow down communication and decision making, causing the organization to become less efficient and productive. That's one reason why many of today's organizations are restructuring to become flatter.

There are trade-offs between the advantages and disadvantages of flat and tall organizations. Companies determine which trade-offs to make according to a principle called span of control, which measures the number of people reporting to a particular manager. If, for example, you remove layers of management to make your organization flatter, you end up increasing the number of people reporting to a particular supervisor. If you refer back to the organization chart for Notes-4-You, you'll recall that, under your present structure, four managers report to you as the president: the heads of accounting, marketing, operations, and human resources. In turn, two of these managers have positions reporting to them: the advertising manager and sales supervisor report to the marketing manager, while the notetakers supervisor and the copiers supervisor report to the operations manager. Let's say that you remove a layer of management by getting rid of the marketing and operations managers. Your organization would be flatter, but what would happen to your workload? As president, you'd now have six direct reports rather than four: accounting manager, advertising manager, sales manager, notetaker supervisor, copier supervisor, and human resources manager.

So what's better—a narrow span of control (with few direct reports) or a wide span of control (with many direct reports)? The answer to this question depends on a number of factors, including frequency and type of interaction, proximity of subordinates, competence of both supervisor and subordinates, and the nature of the work being supervised. For example, you'd expect a much wider span of control at a nonprofit call centre than in a hospital emergency room.

Delegating Authority

Given the tendency toward flatter organizations and wider spans of control, how do managers handle increased workloads? They must learn how to handle delegation—the process of entrusting work to subordinates. Unfortunately, many managers are reluctant to delegate. As a result, they not only overburden themselves with tasks that could be handled by others, but they also deny subordinates the opportunity to learn and develop new skills.

Responsibility and Authority

As owner of Notes-4-You, you'll probably want to control every aspect of your business, especially during the start-up stage. But as the organization grows, you'll have to assign responsibility for performing certain tasks to other people. You'll also have to accept the fact that responsibility alone—the duty to perform a task—won't be enough to get the job done. You'll need to grant subordinates the authority they require to complete a task—that is, the power to make the necessary decisions. (And they'll also need sufficient resources.) Ultimately, you'll also hold your subordinates accountable for their performance.

Centralization and Decentralization

If and when your company expands (say, by offering note-taking services at other schools), you'll have to decide whether most decisions should still be made by individuals at the top or delegated to lower-level employees. The first option, in which most decision making is concentrated at the top, is called centralization. The second option, which spreads decision making throughout the organization, is called decentralization.

Centralization has the advantage of consistency in decision-making. Since in a centralized model, key decisions are made by the same top managers, those decisions tend to be more uniform than if decisions were made by a variety of different people at lower levels in the organization. In most cases, decisions can also be made more quickly provided that top management does not try to control too many decisions. However, centralization has some important disadvantages. If top management makes virtually all key decisions, then lower-level managers will feel under-utilized and will not develop decision-making skills that would help them become promotable. An overly centralized model might also fail to consider information that only front-line employees have or might actually delay the decision-making process. Consider a case where the sales manager for an account is meeting with a customer representative who makes a request for a special sale price; the customer offers to buy 50% more product if the sales manager will reduce the price by 5% for one month. If the sales manager had to obtain approval from the head office, the opportunity might disappear before she could get approval – a competitor's sales manager might be the customer's next meeting.

An overly decentralized decision model has its risks as well. Imagine a case in which a company had adopted a geographically-based divisional structure and had greatly decentralized decision making. In order to expand its business, suppose one division decided to expand its territory into the geography of another division. If headquarters approval for such a move was not required, the divisions of the company might end up competing against each other, to the detriment of the organization as a whole. Companies that wish to maximize their potential must find the right balance between centralized and decentralized decision making.

Key Takeaways

Important terms and concepts

1. Managers coordinate the activities identified in the planning process among individuals, departments, or other units and allocate the resources needed to perform them.
2. Typically, there are three levels of management: top managers, who are responsible for overall performance; middle managers, who report to top managers and oversee lower-level managers; and first-line managers, who supervise employees to make sure that work is performed correctly and on time.
3. Management must develop an organizational structure, or arrangement of people within the organization, that will best achieve company goals.
4. The process begins with specialization—dividing necessary tasks into jobs; the principle of grouping jobs into units is called departmentalization.
5. Units are then grouped into an appropriate organizational structure. Functional organization groups people with comparable skills and tasks; divisional organization creates a structure composed of self-contained units based on product, customer, process, or geographical division. Forms of organizational division are often combined.
6. An organization's structure is represented in an organization chart—a diagram showing the interrelationships of its positions.
 - This chart highlights the chain of command, or authority relationships among people working at different levels.
 - It also shows the number of layers between the top and lowest managerial levels. An organization with few layers has a wide span of control, with each manager overseeing a large number of subordinates; with a narrow span of control, only a limited number of subordinates reports to each manager.

10. Operations Management

Learning Objectives

By the end of this chapter, you should be able to:

1. Define operations management and discuss the role of the operations manager in a manufacturing company.
2. Describe the decisions and activities of the operations manager in overseeing the production process in a manufacturing company.
3. Explain the importance of both PERT and Gantt charts.
4. Explain how manufacturing companies use technology to produce and deliver goods in an efficient, cost-effective manner.
5. Describe the decisions made in planning the product delivery process in a service company.
6. Identify the characteristics that distinguish service operations from manufacturing operations and identify the activities undertaken to manage operations in a service organization.
7. Explain how total quality management provides value to customers.
8. Explain how outsourcing provides value to customers.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=101>

The Challenge: Producing Quality Jetboards



The Powerski jetboard in action!

The product development process can be complex and lengthy. It took sixteen years for Bob Montgomery and others at his company to develop the PowerSki Jetboard, and this involved thousands of design changes. It was worth it, though: the Jetboard was an exciting, engine-propelled personal watercraft – a cross between a high-performance surfboard and a competition water-ski/wakeboard that received extensive media attention and rave reviews. It was showered with honours, including Time magazine’s “Best Invention of the Year” award.^[1] Stories about the Jetboard appeared in more than fifty magazines around the world, and it was featured in several movies, over twenty-five TV shows, and on YouTube.^[2]

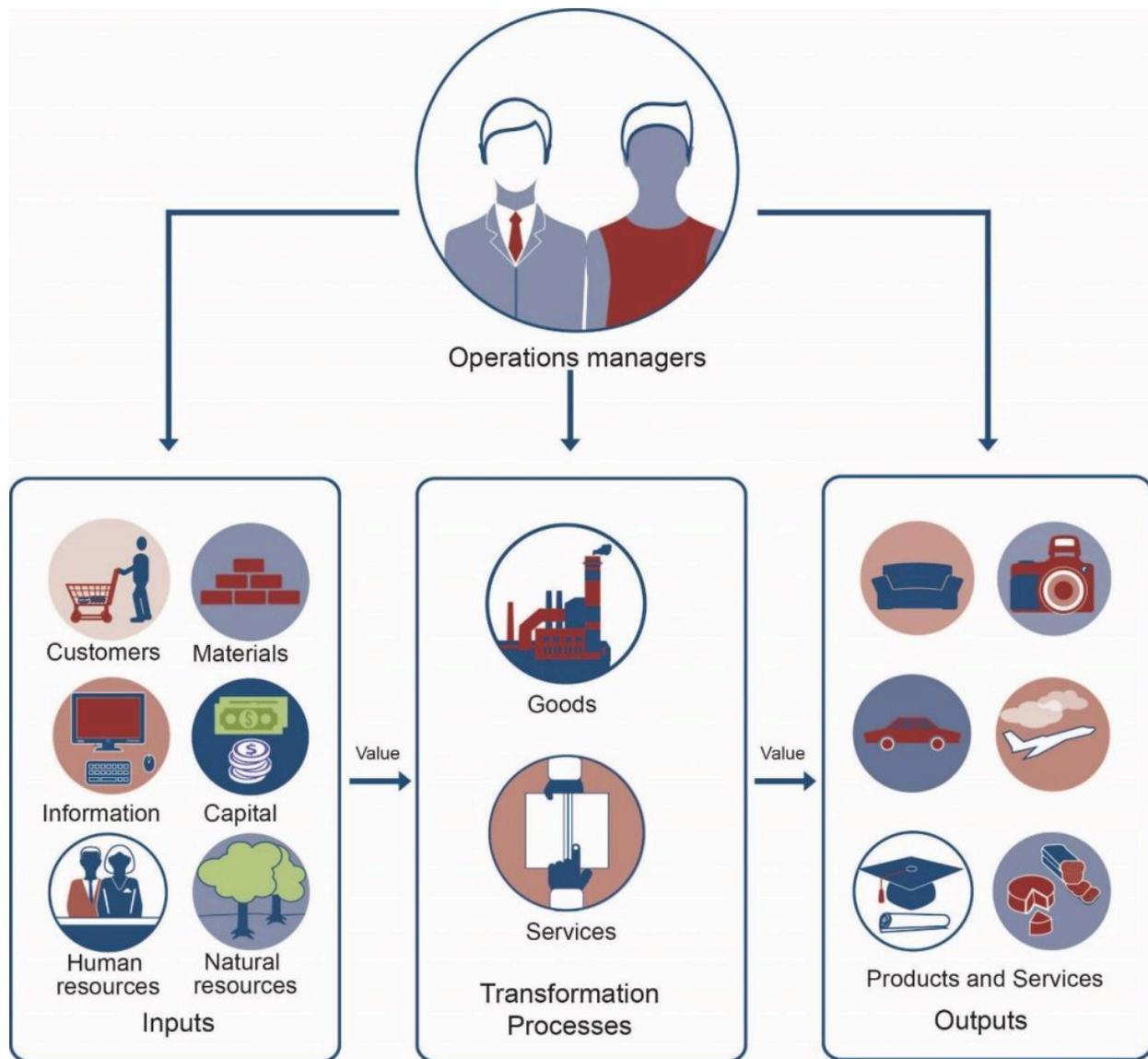
Montgomery and his team at PowerSki enjoyed taking their well-deserved bows for the job they did designing the product, but having a product was only the beginning for the company. The next step was developing a system that would produce high-quality Jetboards at reasonable prices. Before putting this system in place, PowerSki managers had to address several questions.

- What kind of production process should they use to make the Jetboards?
- How large should their production facilities be, and where should they be located?
- Where should they buy needed materials?
- What systems will be needed to control the production process and ensure a quality product?

Answering these and other questions helped PowerSki set up a manufacturing system through which it could accomplish the most important task that it had set for itself: efficiently producing quality Jetboards.

Operations Management in Manufacturing

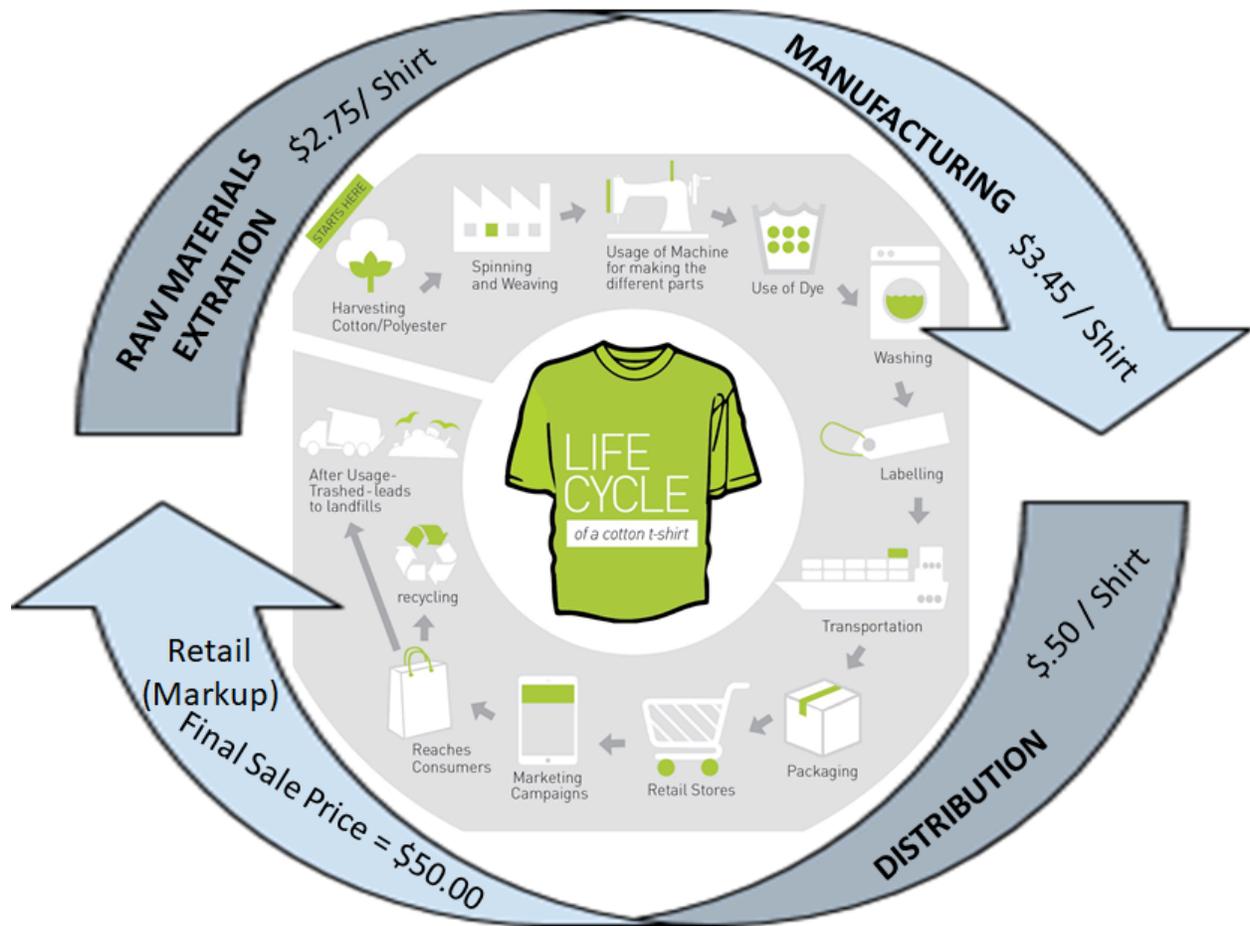
Like PowerSki, every organization—whether it produces goods or provides services— sees job #1 as furnishing customers with quality products. Thus, to compete with other organizations, a company must convert resources (materials, labour, money, information) into goods or services as efficiently as possible. The upper-level manager who directs this transformation process is called an operations manager. The job of operations management (OM) consists of all the activities involved in transforming a product idea into a finished product. Hence, because of the complexity of organizing all the activities in an organization it is more important than ever for Operations Management to ensure due diligence is utilized to structure operations. Due diligence is the important actions taken by directors or managers of an organization to ensure that all potential risks and errors are mitigated entirely. In addition, operations managers are involved in planning and controlling the systems that produce goods and services. In other words, operations managers manage the process that transforms inputs into outputs. The figure below illustrates these traditional functions of operations management.



Transformation Process

Like PowerSki, all manufacturers set out to perform the same basic function: to transform resources into finished goods. To perform this function in today's business environment, manufacturers must continually strive to improve operational efficiency. They must fine-tune their production processes to focus on quality, to hold down the costs of materials and labour, and to eliminate all costs that add no value to the finished product.

The Supply Chain identifies the process of transforming a product idea into a finished product, and how the process will convert raw materials into goods or services as efficiently as possible. The Value Chain identifies how value is added throughout the creation of the final good or service produced and how operational activities costs represent a proportion of the final sale price of the good or service.



Lifecycle of a cotton shirt

Another job of operations managers is making the decisions involved in the effort to attain this operational organization and its goals. Their responsibilities can be grouped as follows:

- Production planning. During production planning, managers determine how goods will be produced, where production will take place, and how manufacturing facilities will be laid out.
- Production control. Once the production process is under way, managers must continually schedule and monitor the activities that make up that process. They must solicit and respond to feedback and make adjustments where needed. At this stage, they also oversee the purchasing of raw materials and the handling of inventories.
- Quality control. The operations manager is directly involved in efforts to ensure that goods are produced according to specifications and that quality standards are maintained.

Let's take a closer look at each of these responsibilities.

Planning the Production Process

The decisions made in the planning stage have long-range implications and are crucial to a firm's success. Before making decisions about the operations process, managers must consider the goals set by marketing managers. Does the company intend to be a low-cost producer and to compete on the basis of price? Or does it plan to focus on quality and go after the high end of the market? Many decisions involve trade-offs. For example, low cost doesn't normally go hand in hand with high quality. All functions of the company must be aligned with the overall strategy to ensure success.

With these thoughts in mind, let's look at the specific types of decisions that have to be made in the production planning process. We've divided these decisions into those dealing with production methods, site selection, facility layout, and components and materials management.

Production-Method Decisions

The first step in production planning is deciding which type of production process is best for making the goods that your company intends to manufacture. For example, this is depicted in figure above, illustrating the associated production process for a cotton shirt. In reaching this decision, you should answer such questions as:

- Am I making a one-of-a-kind good based solely on customer specifications, or am I producing high-volume standardized goods to be sold later?
- Do I offer customers the option of "customizing" an otherwise standardized good to meet their specific needs?

One way to appreciate the nature of this decision is by comparing three basic types of processes or methods: make-to-order, mass production, and mass customization. The task of the operations manager is to work with other managers, particularly marketers, to select the process that best serves the needs of the company's customers.

Make-to-Order

At one time, most consumer goods, such as furniture and clothing, were made by individuals practising various crafts. By their very nature, products were customized to meet the needs of the buyers who ordered them. This process, which is called a make-to-order strategy, is still commonly used by such businesses as print or sign shops that produce low-volume, high-variety goods according to customer specifications. This level of customization often results in a longer production and delivery cycle than other approaches.

Mass Production

By the early twentieth century, a new concept of producing goods had been introduced: mass production (or

make-to-stock strategy), the practice of producing high volumes of identical goods at a cost low enough to price them for large numbers of customers. Goods are made in anticipation of future demand (based on forecasts) and kept in inventory for later sale. This approach is particularly appropriate for standardized goods ranging from processed foods to electronic appliances. It generally results in shorter cycle times than a make-to-order process. This type of production also takes advantage of economies of scale, which refers to the reduced costs per unit that is realized from increased total number of units produced.

Mass Customization

There is at least one big disadvantage to mass production: customers, as one old advertising slogan put it, can't "have it their way." They have to accept standardized products as they come off assembly lines. Increasingly, however, customers are looking for products that are designed to accommodate individual tastes or needs but can still be bought at reasonable prices. To meet the demands of these consumers, many companies have turned to an approach called mass customization, which combines the advantages of customized products with those of mass production.

This approach requires that a company interact with the customer to find out exactly what the customer wants and then manufacture the good, using efficient production methods to hold down costs. One efficient method is to mass-produce a product up to a certain cut-off point and then to customize it to satisfy different customers.

One of the best-known mass customizers is Nike, which has achieved success by allowing customers to configure their own athletic shoes, apparel, and equipment through NikeiD program. The Web has a lot to do with the growth of mass customization. Levi's, for instance, lets customers find a pair of perfect fitting jeans by going through an online fitting process. Oakley offers customized sunglasses, goggles, watches, and backpacks, while Mars, Inc. can make M&M's in any color the customer wants (say, school colours) as well as add text and even pictures to the candy.

Naturally, mass customization doesn't work for all types of goods. Most people don't care about customized detergents or paper products. And while many of us like the idea of customized clothes, footwear, or sunglasses, we often aren't willing to pay the higher prices they command.



Personalized M&M's: Keep in mind for a year or two in the future!

Facilities Decisions

After selecting the best production process, operations managers must then decide where the goods will be manufactured, how large the manufacturing facilities will be, and how those facilities will be laid out.

Site Selection

In site selection (choosing a location for the business), managers must consider several factors:

- To minimize shipping costs, managers often want to locate plants close to suppliers, customers, or both.
- They generally want to locate in areas with ample numbers of skilled workers.
- They naturally prefer locations where they and their families will enjoy living.
- They want locations where costs for resources and other expenses—land, labour, construction, utilities, and taxes—are low.
- They look for locations with a favourable business climate—one in which, for example, local governments might offer financial incentives (such as tax breaks) to entice them to do business in their locales. For example, an enterprise zone is an area in which incentives are used to attract investments from private companies.

Managers rarely find locations that meet all these criteria. As a rule, they identify the more important criteria and aim at satisfying them. In deciding to locate in San Clemente, California, for instance, PowerSki was able to satisfy three important criteria: (1) proximity to the firm's suppliers, (2) availability of skilled engineers and technicians, and (3) favourable living conditions. These factors were more important than operating in a low-cost region or getting financial incentives from local government. Because PowerSki distributes its products throughout the world, proximity to customers was also unimportant.

Capacity Planning

Now that you know where you're going to locate, you have to decide on the quantity of products that you'll produce. You begin by forecasting demand for your product, which isn't easy. To estimate the number of units that you're likely to sell over a given period, you have to understand the industry that you're in and estimate your likely share of the market by reviewing industry data and conducting other forms of research.

Once you've forecasted the demand for your product, you can calculate the capacity requirements of your production facility—the maximum number of goods that it can produce over a given time under normal working conditions. In turn, having calculated your capacity requirements, you're ready to determine how much investment in plant and equipment you'll have to make, as well as the number of labour hours required for the plant to produce at capacity and meet demand.

Like forecasting, capacity planning is difficult. Unfortunately, failing to balance capacity and projected demand can be seriously detrimental to your bottom line. If you set capacity too low (and so produce less than you should), you won't be able to meet demand, and you'll lose sales and customers. If you set capacity too high (and turn out more units than you should), you'll waste resources and inflate operating costs. Therefore continuous review, the process of routinely reviewing the organization's processes to determine where improvements can be made to increase organizational efficiency, is very important in the capacity planning process to avoid producing too much or too little.

Managing the Production Process in a Manufacturing Company

Operations managers engage in the daily activities of materials management, which encompasses the activities of purchasing, inventory control, and work scheduling.

Purchasing and Supplier Selection

The process of acquiring the materials and services to be used in production is called purchasing (or procurement). For many products, the costs of materials make up about 50 percent of total manufacturing costs. Not surprisingly, materials acquisition gets a good deal of the operations manager's time and attention. As a rule, there's no shortage of vendors willing to supply materials, but the trick is finding the best suppliers. Operations managers must consider questions such as:

- Can the vendor supply the needed quantity of materials at a reasonable price?
- Is the quality good?
- Is the vendor reliable (will materials be delivered on time)?
- Does the vendor have a favourable reputation?
- Is the company easy to work with?

Getting the answers to these questions and making the right choices—a process known as supplier selection—is a key responsibility of operations management.

Procurement

Technology has changed the way businesses buy things. Through modern procurement, companies use the Internet to interact with suppliers. The process is similar to the one you'd use to find a consumer good—say, a high-definition TV—over the Internet. To choose a TV, you might browse the websites of manufacturers like Sony then shop prices and buy at Amazon, the world's largest online retailer.

If you were a purchasing manager using the Internet to buy parts and supplies, you'd follow basically the same process. You'd identify potential suppliers by going directly to private websites maintained by individual suppliers or to public sites that aggregate information on numerous suppliers. You could do your shopping through online catalogs, or you might participate in an online marketplace by indicating the type and quantity of materials you need and letting suppliers bid. Finally, just as you paid for your TV electronically, you could use a system called electronic data interchange (EDI) to process your transactions and transmit all your purchasing documents.

The Internet provides an additional benefit to purchasing managers by helping them communicate with suppliers and potential suppliers. They can use the Internet to give suppliers specifications for parts and supplies, encourage them to bid on future materials needs, alert them to changes in requirements, and give them instructions on doing business with their employers. Using the Internet for business purchasing cuts the costs of purchased products and saves administrative costs related to transactions. It's also faster for procurement and fosters better communications.

Inventory Control

If a manufacturer runs out of the materials it needs for production, then production stops. In the past, many companies guarded against this possibility by keeping large inventories of materials on hand. It seemed like the thing to do at the time, but it often introduced a new problem—wasting money. Companies were paying for parts and other materials that they wouldn't use for weeks or even months, and in the meantime, they were running up substantial storage and insurance costs. If the company redesigned its products, some parts might become obsolete before ever being used.

Most manufacturers have since learned that to remain competitive, they need to manage inventories more efficiently. This task requires that they strike a balance between two threats to productivity: losing production time because they've run out of materials and wasting money because they're carrying too much inventory. The process of striking this balance is called inventory control, and companies now regularly rely on a variety of inventory-control methods.

Just-in-Time Production

One method is called just-in-time (JIT) production: the manufacturer arranges for materials to arrive at production facilities just in time to enter the manufacturing process. Parts and materials don't sit unused for long periods, and the costs of "holding" inventory are significantly cut. JIT, however, requires considerable communication and cooperation between the manufacturer and the supplier. The manufacturer has to know what it needs and when. The supplier has to commit to supplying the right materials, of the right quality, at exactly the right time.

Education, although not a business, still adopts business innovations to boost efficiency. Many institutions are moving to JIT printing or printing on demand. Rather than estimating the need and then ordering textbooks, only to return the vast majority, more and more educational bookstores are printing your textbook when you order it. New technologies allow the bookstores to produce a high-quality, bound textbook on site. The open library from eCampusOntario is harnessing this efficiency. You can order a low cost, high-quality print version of our textbooks thanks to our partnership with the University of Waterloo and its commitment to student savings.

Material Requirements Planning

A software tool called material requirements planning (MRP), relies on sales forecasts and ordering lead times for materials to calculate the quantity of each component part needed for production and then determine when they should be ordered or made. The detailed sales forecast is turned into a master production schedule (MPS), which MRP then expands into a forecast for the needed parts based on the bill of materials for each item in the forecast. A bill of materials is simply a list of the various parts that make up the end product. The role of MRP is to

determine the anticipated need for each part based on the sales forecast and to place orders so that everything arrives just in time for production.

Graphical Tools: Gantt and PERT Charts

To control the timing of all operations, managers set up schedules: they select jobs to be performed during the production process, assign tasks to work groups, set timetables for the completion of tasks, and make sure that resources will be available when and where they're needed. There are a number of scheduling techniques. We'll focus on two of the most common—Gantt and PERT charts.

Gantt Charts

A Gantt chart, named after the designer, Henry Gantt, is an easy-to-use graphical tool that helps operations managers determine the status of projects. Let's say that you're in charge of making the "hiking bear" offered by the Toronto Teddy Bear Company. Below is a Gantt chart for the production of one hundred of these bears. As you can see, it shows that several activities must be completed before the bears are dressed: the fur has to be cut, stuffed, and sewn; and the clothes and accessories must be made. Our Gantt chart tells us that by day six, all accessories and clothing have been made. The sewing and stuffing, however (which must be finished before the bears are dressed), isn't scheduled for completion until the end of day eight. As operations manager, you'll have to pay close attention to the progress of the sewing and stuffing operations to ensure that finished products are ready for shipment by their scheduled date.

Activity Day	1	2	3	4	5	6	7	8	9	10	11	12	13
Cut fur	■	■											
Sew and stuff fur			■	■	■	■	○	○					
Cut material	■	■											
Sew clothes			■	■									
Embroider t-shirt					■	■							
Cut accessories	■												
Sew accessories			■	■									
Dress bears									○	○	○		
Package bears												○	
Ship bears													○
Lot size: 100 bears													
All activities are scheduled to start at their earliest start time													
Completed work	■												
Work to be completed	○												

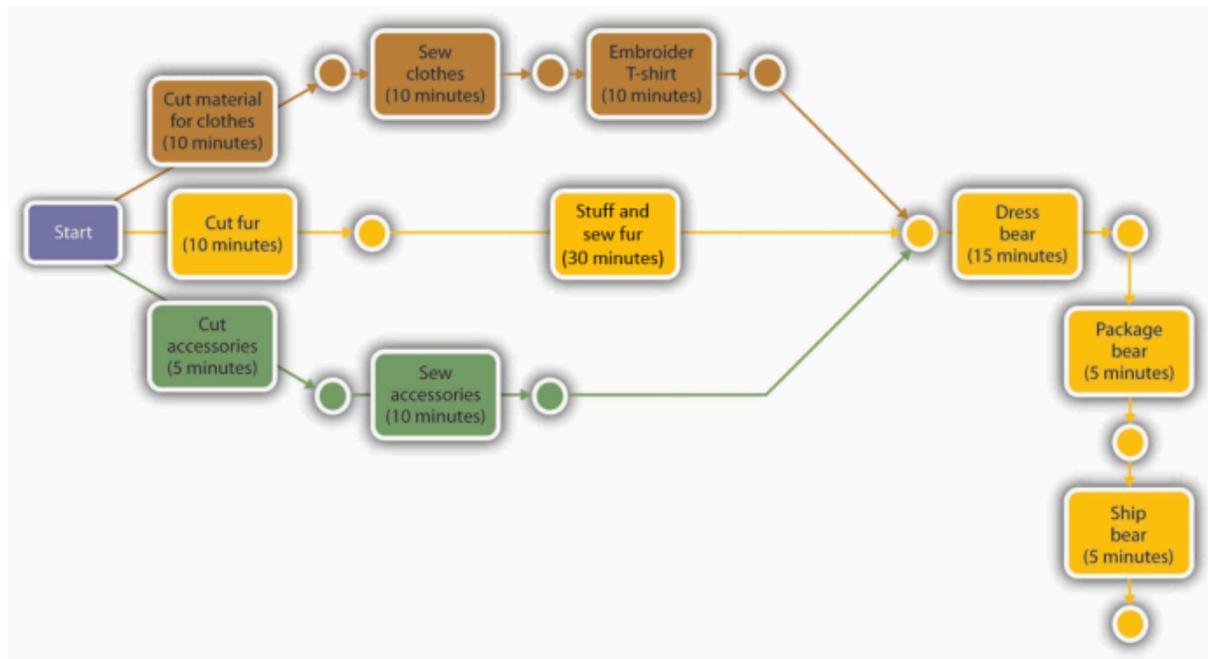
Gantt chart for producing Toronto teddy bears

PERT Charts

Gantt charts are useful when the production process is fairly simple and the activities aren't interrelated. For more complex schedules, operations managers may use PERT charts. PERT (which stands for Program Evaluation and Review Technique) is designed to diagram the activities required to produce a good, specify the time required to perform each activity in the process, and organize activities in the most efficient sequence. It also identifies a critical path: the sequence of activities that will entail the greatest amount of time. Below is a PERT diagram showing the process for producing one "hiker" bear at Toronto Teddy Bear.

Our PERT chart shows how the activities involved in making a single bear are related. It indicates that the production process begins at the cutting station. Next, the fur that's been cut for this particular bear moves first to the sewing and stuffing stations and then to the dressing station. At the same time that its fur is moving through this sequence of steps, the bear's clothes are being cut and sewn and its T-shirt is being embroidered. Its backpack and tent accessories are also being made at the same time. Note that fur, clothes, and accessories all meet at the dressing station, where the bear is dressed and outfitted with its backpack. Finally, the finished bear is packaged and shipped to the customer's house.

What was the critical path in this process? The path that took the longest amount of time was the sequence that included cutting, stuffing, dressing, packaging, and shipping—a sequence of steps taking sixty-five minutes. If you wanted to produce a bear more quickly, you'd have to save time on this path. Even if you saved the time on any of the other paths, you still wouldn't finish the entire job any sooner: the finished clothes would just have to wait for the fur to be sewn and stuffed and moved to the dressing station. We can gain efficiency only by improving our performance on one or more of the activities along the critical path.



PERT chart for Toronto teddy bears

The Technology of Goods Production

PowerSki founder and CEO Bob Montgomery spent sixteen years designing the Jetboard and bringing it to production. At one point, in his efforts to get the design just right, he'd constructed thirty different prototypes. Montgomery thought that he could handle the designing of the engine without the aid of a computer. Before long, however, he realized that it was impossible to keep track of all the changes.

Computer-Aided Design

That's when Montgomery turned to computer technology for help and began using a computer-aided design (CAD) software package to design not only the engine but also the board itself and many of its components. The CAD program enabled Montgomery and his team of engineers to test the product digitally and work out design problems before moving to the prototype stage.

The sophisticated CAD software allowed Montgomery and his team to put their design paper in a drawer and to start building both the board and the engine on a computer screen. By rotating the image on the screen, they could even view the design from every angle. Having used their CAD program to make more than four hundred design changes, they were ready to test the Jetboard in the water. During the tests, onboard sensors transmitted data to computers, allowing the team to make adjustments from the shore while the prototype was still in the water. Nowadays, PowerSki uses collaboration software to transmit design changes to the suppliers of the 340 components that make up the Jetboard. In fact, a majority of design work these days is done with the aid of computers, which add speed and precision to the process.

Computer-Aided Manufacturing

For many companies, the next step is to link CAD to the manufacturing process. A computer-aided manufacturing (CAM) software system determines the steps needed to produce the component and instructs the machines that do the work. Because CAD and CAM programs can "talk" with each other, companies can build components that satisfy exactly the requirements set by the computer-generated model. CAD/CAM systems permit companies to design and manufacture goods faster, more efficiently, and at a lower cost, and they're also effective in helping firms monitor and improve quality. CAD/CAM technology is used in many industries, including the auto industry, electronics, and clothing. If you have ever seen how a 3-D printer works, you have a pretty good idea of how CAM works too.

Computer-Integrated Manufacturing

By automating and integrating all aspects of a company's operations, computer-integrated manufacturing (CIM) systems have taken the integration of computer-aided design and manufacturing to a higher level—and are in fact revolutionizing the production process. CIM systems expand the capabilities of CAD/CAM. In addition to

design and production applications, they handle such functions as order entry, inventory control, warehousing, and shipping. In the manufacturing plant, the CIM system controls the functions of industrial robots—computer-controlled machines used to perform repetitive tasks that are also hard or dangerous for human workers to perform.

Operations Management for Service Providers

As the Canadian economy has changed from a goods producer to a service provider over the last sixty years, the dominance of the manufacturing sector has declined substantially. Today, only about 10 percent of Canadian workers are employed in manufacturing, in contrast to 30 percent in 1950.^[3] Most of us now hold jobs in the service sector, which accounts for approximately 80 percent of Canadian jobs.^[4] In 2013, Wal-Mart was America's largest employer, followed by McDonald's, United Parcel Service (UPS), Target and Kroger. Not until we drop down to the ninth-largest employer—Hewlett Packard—do we find a company with a manufacturing component.^[5]

Though the primary function of both manufacturers and service providers is to satisfy customer needs, there are several important differences between the two types of operations. Let's focus on three of them:

- **Intangibility.** Manufacturers produce tangible products—things that can be touched or handled, such as automobiles and appliances. Service companies provide intangible products, such as banking, entertainment, or education.
- **Customization.** Most manufactured goods are standardized. Services, by contrast, are often customized to satisfy the specific needs of a customer. For example, when you go to the hairdresser, you ask for a haircut that looks good on you because of the shape of your face and the texture of your hair.
- **Customer contact.** You could spend your entire working life assembling cars in Detroit and never meet a customer who bought a car that you helped to make. But if you were a restaurant server, you'd interact with customers every day. In fact, their satisfaction with your product would be determined in part by the service that you provided. Unlike manufactured goods, many services are bought and consumed at the same time.



Here is just one of the over twelve thousand Burger King restaurants across the globe. Not surprisingly, operational efficiency is just as important in service industries as

it is in manufacturing. To get a better idea of the role of operations management in the service sector, we'll look closely at Burger King (BK). BK has grown substantially since selling the first Whopper (for \$0.37) almost half a century ago. The instant success of the fire-grilled burger encouraged the Miami founders of the company to expand by selling franchises.

Today, there are BK company- and independently-owned franchised restaurants in 100 countries, and they employ over 34,000 people.^[6] More than eleven million customers visit BK each day.^[7] Burger King even purchased Tim Hortons in December of 2014. The acquisition was made for \$12 billion making Burger King the third largest fast food service restaurant chain in the world. The company even moved its headquarters to Canada to assume a new tax nationality in order to reduce the corporate taxes the organization pays in the U.S.

Operations Planning

When starting or expanding operations, businesses in the service sector must make a number of decisions quite similar to those made by manufacturers:

- What services (and perhaps what goods) should they offer?
- Where will they locate their business, and what will their facilities look like?
- How will they forecast demand for their services?

Let's see how service firms like BK answer questions such as these.^[8]

Operations Processes

Service organizations succeed by providing services that satisfy customers' needs. Companies that provide transportation, such as airlines, have to get customers to their destinations as quickly and safely as possible. Companies that deliver packages, such as FedEx, must pick up, sort, and deliver packages in a timely manner. Companies that provide both services and goods, such as Domino's Pizza, have a dual challenge: they must produce a quality good and deliver it satisfactorily.

Service providers that produce goods can adopt either a make-to-order or a make-to-stock approach to producing them. BK, which encourages patrons to customize burgers and other menu items, uses a make-to-order approach, building sandwiches one at a time. Meat patties, for example, go from the grill to a steamer for holding until an order comes in. Although many fast food restaurants have adopted the make-to-order model, a few continue to make-to-stock. For example, Dunkin' Donuts does not customize doughnuts, and so they do not have to wait for customer orders before making them.

Like manufacturers, service providers must continuously look for ways to improve operational efficiency. Throughout its sixty-year history, BK has introduced a number of innovations that have helped make the company (as well as the fast-food industry itself) more efficient. BK, for example, was the first to offer drive-through service (which now accounts for over 50 percent of its sales^[9]).

It was also BK Vice President David Sell, who came up with the idea of moving the drink station from behind the counter so that customers could take over the time-consuming task of filling cups with ice and beverages. BK

was able to cut back one employee per day at every one of its more than eleven thousand restaurants. Material costs also went down because customers usually fill cups with more ice, which is cheaper than a beverage. Moreover, there were savings on supply costs because most customers don't bother with lids, and many don't use straws. On top of everything else, most customers liked the system (for one thing, it allowed them to customize their own drinks by mixing beverages), and as a result, customer satisfaction went up. Overall, the new process was a major success and quickly became the industry standard.

Facilities

When starting or expanding a service business, owners and managers must invest a lot of time in selecting a location, determining its size and layout, and forecasting demand. A poor location or a badly designed facility can cost customers, and inaccurate estimates of demand for products can result in poor service, excessive costs, or both.

Site Selection

Site selection is also critical in the service industry, but not for the same reasons as in the manufacturing industry. Service businesses need to be accessible to customers. Some service businesses, such as cable-TV providers, package-delivery services, and e-retailers, go to their customers. Many others, however—hotels, restaurants, stores, hospitals, and airports—have to attract customers to their facilities. These businesses must locate where there's a high volume of available customers. In picking a location, BK planners perform a detailed analysis of demographics and traffic patterns; the most important factor is usually traffic count—the number of cars or people that pass by a specific location in the course of a day. In Canada, where we travel almost everywhere by car, BK looks for busy intersections, highway interchanges with easy off and on ramps, or such “primary destinations” as shopping malls, tourist attractions, downtown business areas, or movie theaters. In Europe, where public transportation is much more common, planners focus on subway, train, bus, and trolley stops.

Once planners find a site with an acceptable traffic count, they apply other criteria. It must, for example, be easy for vehicles to enter and exit the site, which must also provide enough parking to handle projected dine-in business. Local zoning must permit standard signage, especially along major highways. Finally, expected business must be high enough to justify the cost of the land and building.

Size and Layout

In the service sector, most businesses must design their facilities with the customer in mind: they must accommodate the needs of their customers while keeping costs as low as possible. Let's see how BK has met this challenge.

For its first three decades, almost all BK restaurants were pretty much the same. They all sat on one acre of land (located “through the light and to the right”), had about four thousand square feet of space, and held seating for

seventy customers. All kitchens were roughly the same size. As long as land was cheap and sites were readily available, this system worked well. By the early 1990s, however, most of the prime sites had been taken, if not by BK itself, then by one of its fast-food competitors or other businesses needing a choice spot, including gas stations and convenience stores. With everyone bidding on the same sites, the cost of a prime acre of land had increased from \$100,000 to over \$1 million in a few short years.

To continue growing, BK needed to change the way it found and developed its locations. Planners decided that they had to find ways to reduce the size of a typical BK restaurant. For one thing, they could reduce the number of seats, because the business at a typical outlet had shifted over time from 90 percent inside dining to a 50-50 split between drive through and eat-in service.

David Sell (the same executive who had recommended letting customers fill their own drink cups) proposed to save space by wrapping Whoppers in paper instead of serving them in the cardboard boxes that took up more space. So BK switched to a single paper wrapper with the label “Whopper” on one side and “Cheese Whopper” on the other. To show which product was inside, employees just folded the wrapper in the right direction. Ultimately, BK replaced pallets piled high with boxes with just a few boxes of wrappers.

Ideas like these helped BK trim the size of a restaurant from four thousand square feet to as little as one thousand. In turn, smaller facilities enabled the company to enter markets that were once cost prohibitive. Now BK could locate profitably in airports, food courts, strip malls, centre-city areas, and even schools.

Capacity Planning

Estimating capacity needs for a service business isn't the same thing as estimating those of a manufacturer. Service providers can't store their products for later use: hairdressers can't “inventory” haircuts, and amusement parks can't “inventory” roller-coaster rides. Service firms have to build sufficient capacity to satisfy customers' needs on an “as-demanded” basis. Like manufacturers, service providers must consider many variables when estimating demand and capacity:

- How many customers will I have?
- When will they want my services (which days of the week, which times of the day)?
- How long will it take to serve each customer?
- How will external factors, such as weather or holidays, affect the demand for my services?

Forecasting demand is easier for companies like BK, which has a long history of planning facilities, than for brand-new service businesses. BK can predict sales for a new restaurant by combining its knowledge of customer-service patterns at existing restaurants with information collected about each new location, including the number of cars or people passing the proposed site and the effect of nearby competition.

Managing Operations

Overseeing a service organization puts special demands on managers, especially those running firms, such as hotels, retail stores, and restaurants, who have a high degree of contact with customers. Service firms provide

customers with personal attention and must satisfy their needs in a timely manner. This task is complicated by the fact that demand can vary greatly over the course of any given day. Managers, therefore, must pay particular attention to employee work schedules and, in many cases, inventory management.

Managing service operations is about more than efficiency of service. It is about finding a balance between profitability, innovation, customer satisfaction and associate satisfaction, sometimes referred to as the balanced scorecard. The balance scorecard model utilizes 360 degree feedback, a process of collecting feedback from all of a businesses stakeholders, in order to improve operational efficiency.

In his book titled Moments of Truth, Jan Carlzon, former Chief Executive Office of SAS Group, refers to those moments when an employee interacts with a customer.^[10] Moments can range from calling a help line, checking in at an airline counter, the greeting from a hostess in a restaurant to having a maintenance problem resolved in a hotel guest room. The quality of staff a company hires, how they train their employees, and the focus management places on creating a culture of service will determine how successful the company is in service delivery and maximizing the impact of these moments of truth.

The Ritz-Carlton hotel company maximizes their moments of truth by living their motto, “We are Ladies and Gentleman serving Ladies and Gentleman”. Ritz-Carlton Three Steps of Service are:

1. A warm and sincere greeting. Use the guest’s name.
2. Anticipation and fulfillment of each of the needs of each guest.
3. Fond farewell. Give a warm good-bye and use the guest’s name.^[11]

Ritz-Carlton reinforces this service culture daily in short meetings with all staff at the beginning of each shift.

Chick-fil-A is recognized as an industry leader in service for the fast food industry in the United States. Chick-fil-A uses the term “my pleasure” which founder S. Truett Cathy credits to Ritz-Carlton.^[12] The company follows customer-centred leadership. Staff focus on being swift and attentive to customer needs. Chick-fil-A uses this YouTube video as part of their employee orientation and training: [“Every life has a story”](#).



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=101>

Well-known blogger and marketing consultant Marcus Sheridan explains his view of the success of Chick-Fil-A in this blog post:^[13]

Dang I love it when I see great people and great businesses kicking butt at what they do. Such was the case recently when the fam and I stopped into a local Chick-fil-A restaurant here in Virginia and I was treated to a free course entitled, “This is How To Run a Business that Kicks Butt and Takes Names....”, or at least that something like that

As the kids were all eating their food and I was busy being blown away by this perfect company and business model, I decided to ask my 9 year old daughter a simple question:

Me: Danielle, what do you notice about this restaurant that’s different than others?

Danielle (by now used to weird business questions from her father): Well, first of all everyone that works here is happy.

Me: Yes, they are, aren’t they? How’s that make you feel to see them smiling?

Danielle: It makes me feel good inside.

Me: I agree...What else do you notice?

Danielle: There are pictures everywhere. And writings on the walls. And it's really clean.

Me: Good observations dear. Danielle, you're looking at the most well run business in America.

For any of you that have been to Chick-fil-A before, you may already understand and appreciate what I'm talking about. If you haven't gone to one and would like 4 years' worth of business school wrapped up in 45 minutes, then take a stroll on over to one of their restaurants for lunch and just sit, watch, and observe.

But to make what could be a long blog much shorter, allow me to quickly list the 8 reasons why Chick-fil-A has the best business model in America.

Happy Employees/Service: It's unbelievable what type of employees this company has. Heck, while we were eating our meal the other day, an employee with a big smile came over and asked us if we'd like refills on our drinks. For a fast food company, this is utterly unheard of in our society these days. It's obvious that Chick-fil-A doesn't go cheap on their people nor their way of doing things. I'm sure they pay decent wages but they also create an atmosphere that attracts great people. What a wonderful model this is for any business.

They're Clean!: Somewhere along the lines sanitation and cleanliness became a lost art in the fast food industry. Notwithstanding this trend, Chick-fil-A has bucked the system and their restaurants, as well as their bathrooms, are almost always immaculate. I don't know about you, but I'll pay more for clean any day of the week.

They Know What They're GREAT At: Most businesses try to be a jack of all trades, which ends up causing them to be master of none. That's why Chick-fil-A will never have a burger on their menu. Why? Because they don't care. They know they'll never be the best at beef but they sure as heck have created a culture around the chicken sandwich. Wow, what a lesson this is for those businesses out there with no identity, niche, or individual greatness.

They Ain't Cheap: Yep, having high prices is actually a GOOD business model. I don't know about you, but the idea of having to sell a lot to make a little stinks. Chick-fil-A has prices a good bit higher than most of their fast food competitors, notwithstanding they are always full of smiling customers, just waiting to spend the extra green stamps. These higher prices lead to better employees, service, food quality, customers, etc. I'm sure never once has their management even asked, "How can we be the cheapest?" But I'd bet my home they've asked, "How can we be the best, regardless of what it costs?"

Ambiance: The next time you go to Chick-fil-A check out all the little things they do to make their restaurants warm and attractive. They have photos of employees, quotes on the walls, paintings from local children, etc. Everywhere you look in one of their stores you'll find something that makes you smile.

Community Involvement: Wow do they do this better than any fast food company. In fact, this one isn't even close. They are constantly doing promos within the community for youth teams, causes, etc. In fact, it's like they've taken social media to another level because for them it's not just about using Facebook and the like, it's about actually being involved and in the trenches. Huge props to Chick-fil-A for this.

Awesome Website: All of you that read this blog know how I feel about the importance of having a great website and web presence in order to be a successful business. If you want to see what a great business website looks like, head on over. Whether it's bios of the employees, social media links, customers stories, etc—this site is spot-on.

The Food is Actually Good: Ahh yes, lest we forget this other forgotten trait of fast food restaurants—great food. Everybody likes Chick-fil-A. Nothing on their menu is poor quality. They're proud of their food and they have every right to be.

So there you have it folks—the 8 qualities of the best business model in America. What's great is that every business can copy the way Chick-fil-A has built their company. The qualities listed above are simply principles that can be applied to any business or any website for that matter. So if you're lacking inspiration for your business, it might be time for a Chicken Sandwich and waffle fries.

**Author's Note: It goes without saying that I have no affiliation with Chick-fil-A, I just happen to write about greatness when I see it.

Scheduling

In manufacturing, managers focus on scheduling the activities needed to transform raw materials into finished goods. In service organizations, they focus on scheduling workers so that they're available to handle fluctuating customer demand. Each week, therefore, every BK store manager schedules employees to cover not only the peak periods of breakfast, lunch, and dinner, but also the slower periods in between. If he or she staffs too many people, labour cost per sales dollar will be too high. If there aren't enough employees, customers have to wait in lines. Some get discouraged, and even leave, and many may never come back.

Scheduling is made easier by information provided by a point-of-sale device built into every BK cash register. The register sends data on every sandwich, beverage, and side order sold by the hour, every hour of the day, every day of the week to a computer system that helps managers set schedules. To determine how many people will be needed for next Thursday's lunch hour, the manager reviews last Thursday's data, using sales revenue and a specific BK formula to determine the appropriate staffing level. Each manager can adjust this forecast to account for other factors, such as current marketing promotions or a local sporting event that will increase customer traffic.

Inventory Control

Businesses that provide both goods and services, such as retail stores and auto-repair shops, have the same inventory control problems as manufacturers: keeping levels too high costs money, while running out of inventory costs sales. Technology, such as the point-of-sale registers used at BK, makes the job easier. BK's system tracks everything sold during a given time and lets each store manager know how much of everything should be kept in inventory. It also makes it possible to count the number of burgers and buns, bags and racks

of fries, and boxes of beverage mixes at the beginning or end of each shift. Because there are fixed numbers of supplies—say, beef patties or bags of fries—in each box, employees simply count boxes and multiply. In just a few minutes, the manager knows whether the inventory is correct (and should be able to see if any theft has occurred on the shift).

Producing for Quality

What do you do if your brand-new phone doesn't work when you get it home? What if you were late for a test because it took you twenty minutes to get a burger and fries at a drive-through window? Like most people, you'd probably be more or less disgruntled. As a customer, you're constantly assured that when products make it to market, they're of the highest possible quality, and you tend to avoid brands that have failed to live up to your expectations or to producers' claims.

But what is quality? According to the American Society for Quality, the term quality refers to “the characteristics of a product or service that bear on its ability to satisfy stated or implied needs.”^[14] When you buy a mobile phone, you expect it to be able to easily connect and communicate. When you go to a drive-through window, you expect to be served in a reasonable amount of time. If your expectations are not met, you'll conclude that you're the victim of poor-quality.

Quality Management

Total quality management (TQM), or quality assurance, includes all the steps that a company takes to ensure that its goods or services are of sufficiently high quality to meet customers' needs. Generally speaking, a company adheres to TQM principles by focusing on three tasks:

1. Customer satisfaction
2. Employee involvement
3. Continuous improvement

Let's take a closer look at these three principles.

I. Customer Satisfaction

Companies that are committed to TQM understand that the purpose of a business is to generate a profit through customer satisfaction. Thus, they let their customers define quality by identifying desirable product features and then offering them. They encourage customers to tell them how to offer services that work the right way.

Armed with this knowledge, they take steps to make sure that providing quality is a factor in every facet of their operations—from design, to product planning and control, to sales and service. To get feedback on how well

they're doing, many companies routinely use surveys and other methods to monitor customer satisfaction. By tracking the results of feedback over time, they can see where they need to improve.

2. Employee Involvement

Successful TQM requires that everyone in the organization, not simply upper-level management, commits to satisfying the customer. When customers wait too long at a drive-through window, it's the responsibility of a number of employees, not the manager alone. A mobile phone isn't solely the responsibility of the manufacturer's quality control department; it's the responsibility of every employee involved in its design, production, and even shipping. To get everyone involved in the drive for quality assurance, managers must communicate the importance of quality to subordinates and motivate them to focus on customer satisfaction. Employees have to be properly trained not only to do their jobs but also to detect and correct quality problems.

In many companies, employees who perform similar jobs work as teams, sometimes called quality circles, to identify quality, efficiency, and other work-related problems, to propose solutions, and to work with management in implementing their recommendations.

3. Continuous Improvement

An integral part of TQM is continuous improvement: the commitment to making constant improvements in the design, production, and delivery of goods and services.

Improvements can almost always be made to increase efficiency, reduce costs, and improve customer service and satisfaction. Everyone in the organization is constantly on the lookout for ways to do things better.

Statistical Process Control

Companies can use a variety of tools to identify areas for improvement. A common approach in manufacturing is called statistical process control. This technique monitors production quality by testing a sample of output to see whether goods in process are being made according to predetermined specifications. An example of a statistical process control method is Six Sigma. A Six-Sigma process is one in which 99.99966% of all opportunities to perform an operation are free of defects. This percentage equates to only 3.4 defects per million opportunities.

Assume for a moment that you work for Kellogg's, the maker of Raisin Bran cereal. You know that it's the company's goal to pack two scoops of raisins in every box of cereal.

How can you test to determine whether this goal is being met? You could use a statistical process control method called a sampling distribution. On a periodic basis, you would take a box of cereal off the production line and measure the amount of raisins in the box. Then you'd record that amount on a control chart designed to compare actual quantities of raisins with the desired quantity (two scoops). If your chart shows that several samples in a row are low on raisins, you'd take corrective action.

Outsourcing

PowerSki's website states that "PowerSki International has been founded to bring a new watercraft, the PowerSki Jetboard, and the engine technology behind it, to market."^[15] That goal was reached in May 2003, when the firm emerged from a lengthy design period. Having already garnered praise for its innovative product, PowerSki was ready to begin mass-producing Jetboards. At this juncture, the management team made a strategic decision; rather than producing Jetboards in-house, they opted for outsourcing: having outside vendors manufacture the engines, fiberglass hulls, and associated parts. Assembly of the final product took place in a manufacturing facility owned by All American Power Sports in Moses Lake, Washington. This decision doesn't mean that the company relinquished control over quality; in fact, every component that goes into the PowerSki Jetboard is manufactured to exact specifications set by PowerSki. One advantage of outsourcing its production function is that the management team can thereby devote its attention to refining its product design and designing future products.

Outsourcing in the Manufacturing Sector

Outsourcing has become an increasingly popular option among manufacturers. For one thing, few companies have either the expertise or the inclination to produce everything needed to make a product. Today, more firms, like PowerSki, want to specialize in the processes that they perform best—and outsource the rest. Like PowerSki, they also want to take advantage of outsourcing by linking up with suppliers located in regions with lower labour costs. Outsourcing can be local, regional, or even international, and companies can outsource everything from parts for their products, like automobile manufacturers do, to complete manufacturing of their products, like Nike and Apple do.

Outsourcing in the Service Sector

Outsourcing is by no means limited to the manufacturing sector. Service providers also outsource many of their non-core functions. Some universities, for instance, outsource functions such as food services, maintenance, bookstore sales, printing, grounds keeping, security, and even residence operations. For example, there are several firms, like RGIS, who offer inventory services. They will send a team to your company to count your inventory for you. As RGIS puts it, "Our teams deliver the hands-on help needed to complete a wide variety of retail projects of all sizes, allowing your team to keep customer service as the number one priority."^[16] Some software developers outsource portions of coding as a cost-saving measure. If you've ever had to get phone or chat assistance on your laptop, there's a good chance you spoke with someone in an outsourced call centre. The centre itself may have even been located offshore. This kind of arrangement can present unique challenges in quality control as differences in accents and the use of slang words can sometimes inhibit understanding. Nevertheless, in this era of globalization, expect the trend towards outsourcing offshore to continue.

Key Takeaways

Important terms and concepts

1. Operations management oversees the process of transforming resources into goods and services.
2. During production planning, managers determine how goods will be produced, where production will take place, and how manufacturing facilities will be laid out.
3. In selecting the appropriate production process, managers consider three basic methods:
 - make-to-order
 - mass production
 - mass customization
4. In site selection for a company's manufacturing operations, managers look for locations that minimize shipping costs, have an ample supply of skilled workers, provide a favourable community for workers and their families, offer resources at low cost, and have a favourable business climate.
5. Commonly used inventory control methods include just-in-time (JIT) production, by which materials arrive just in time to enter the manufacturing process, and material requirements planning (MRP), a software tool to determine material needs.
7. Gantt and PERT charts are two common tools used by operations managers.
 - A Gantt chart helps operations managers determine the status of projects.
 - PERT charts diagram the activities and time required and identify the critical path—the sequence of activities that will require the greatest amount of time.
8. Service firms provide intangible products that are often customized to satisfy specific needs. Unlike manufactured goods, many services are bought and consumed at the same time.
9. Estimating capacity needs for a service business is more difficult than for a manufacturer because service providers can't store their services for later use.
10. Many companies deliver quality goods and services by adhering to principles of total quality management (TQM).
11. Outsourcing can save companies money by using lower cost, specialized labour, located domestically or abroad.

II. Motivating Employees

Learning Objectives

By the end of the chapter, you should be able to:

1. Define motivation, and understand why it is important in the workplace.
2. Explain the difference between intrinsic and extrinsic motivation.
3. Explain the basics of major theories of motivation:
 - The Hierarchy of Needs theory
 - The Two-Factor theory
 - Expectancy theory
 - Equity theory



Show What You Know



An interactive or media element has been excluded from this version of the text.

You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=109>

Motivation

Motivation refers to an internally generated drive to achieve a goal or follow a particular course of action. Highly motivated employees focus their efforts on achieving specific goals. It's the manager's job, therefore, to motivate employees—to get them to try to do the best job they can. Motivated employees call in sick less frequently, are more productive, and are less likely to convey bad attitudes to customers and coworkers. They also tend to stay in their jobs longer, reducing turnover and the cost of hiring and training employees. But what motivates employees to do well? How does a manager encourage employees to show up for work each day and do a good job? Paying them helps, but many other factors influence a person's desire (or lack of it) to excel in the workplace. What are these factors, are they the same for everybody, and do they change over time? To address these questions, we'll examine four of the most influential theories of motivation: hierarchy-of-needs theory, two-factor theory, expectancy theory, and equity theory.

Extrinsic and Intrinsic Motivation



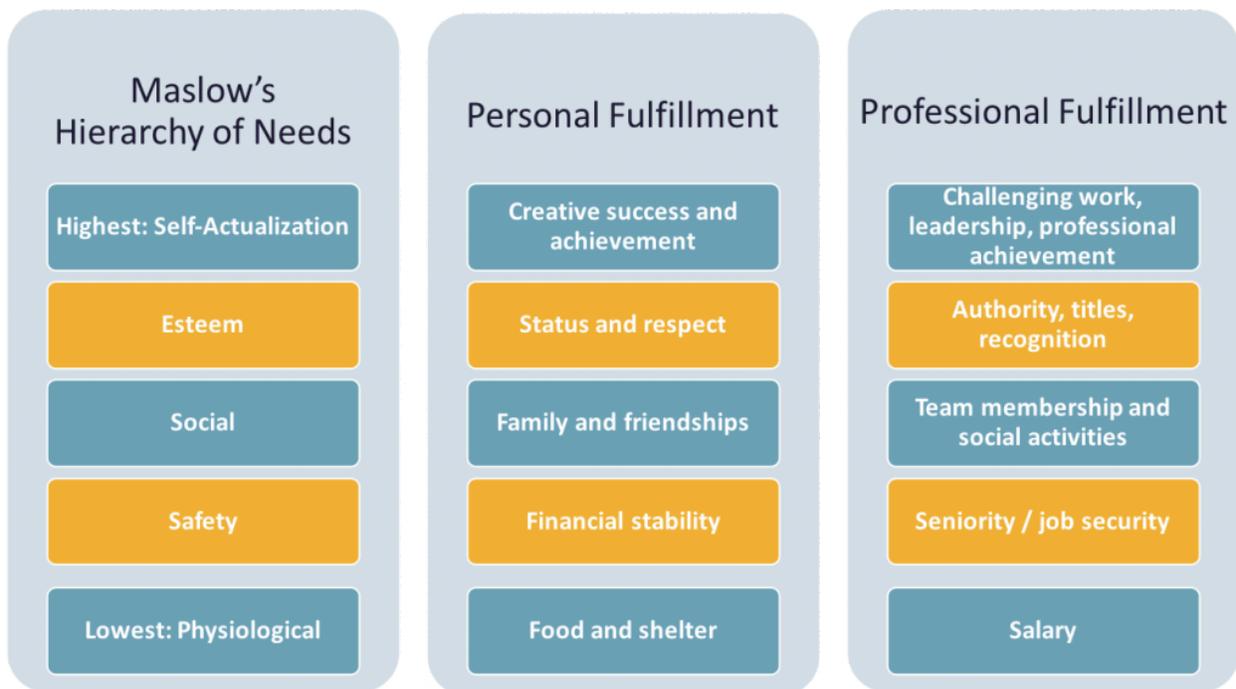
Before we begin our discussion of the various theories of motivation, it is important to establish the distinction between intrinsic and extrinsic motivation. Simply put, intrinsic motivation comes from within: the enjoyment of a task, the satisfaction of a job well done, and the desire to achieve are all sources of intrinsic motivation. On the other hand, extrinsic motivation comes about because of external factors such as a bonus or another form of reward. Avoiding punishment or a bad outcome can also be a source of extrinsic motivation; fear, it is said, can be a great motivator.

Hierarchy of Needs Theory

Psychologist Abraham Maslow's [hierarchy of needs theory](#) proposed that we are motivated by the five initially

unmet needs, arranged in the hierarchical order shown below, which also lists specific examples of each type of need in both the personal and work spheres of life. Look, for instance, at the list of personal needs in the middle column. At the bottom are physiological needs (such life-sustaining needs as food and shelter). Working up the hierarchy we experience safety needs (financial stability, freedom from physical harm), social needs (the need to belong and have friends), esteem needs (the need for self-respect and status), and self-actualization needs (the need to reach one's full potential or achieve some creative success). There are two key things to remember about Maslow's model:

1. We must satisfy lower-level needs before we seek to satisfy higher-level needs.
2. Once we've satisfied a need, it no longer motivates us; the next higher need takes its place.



Let's say, for example, that for a variety of reasons that aren't your fault, you're broke, hungry, and homeless. Because you'll probably take almost any job that will pay for food and housing (physiological needs), you go to work repossessing cars. Fortunately, your student loan finally comes through, and with enough money to feed yourself, you can go back to school and look for a job that's not so risky (a safety need). You find a job as a night janitor in the library, and though you feel secure, you start to feel cut off from your friends, who are active during daylight hours. You want to work among people, not books (a social need). So now you join several of your friends selling pizza in the student centre. This job improves your social life, but even though you're very good at making pizzas, it's not terribly satisfying. You'd like something that your friends will respect enough to stop teasing you about the pizza job (an esteem need). So you study hard and land a job as an intern in the governor's office. On graduation, you move up through a series of government appointments and eventually run for state senator. As you're sworn into office, you realize that you've reached your full potential (a self-actualization need) and you comment to yourself, "It doesn't get any better than this."

Needs Theory and the Workplace

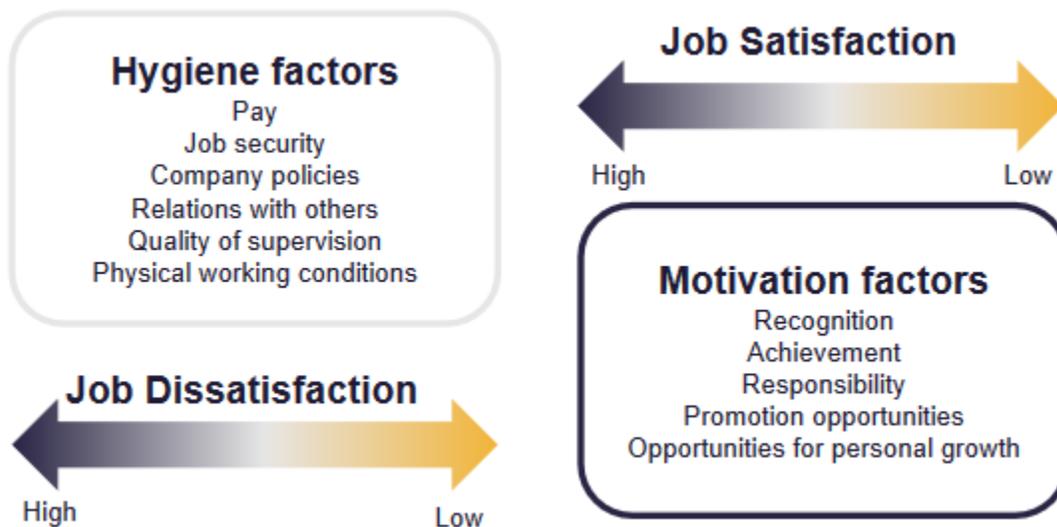
What implications does Maslow's theory have for business managers? There are two key points: (1) Not all employees are driven by the same needs, and (2) the needs that motivate individuals can change over time. Managers should consider which needs different employees are trying to satisfy and should structure rewards and other forms of recognition accordingly. For example, when you got your first job repossessing cars, you were motivated by the need for money to buy food. If you'd been given a choice between a raise or a plaque recognizing your accomplishments, you'd undoubtedly have opted for the money. As a city councillor, by contrast, you may prefer public recognition of work well done (say, election to higher office) to a pay raise.

Two-Factor Theory

Another psychologist, Frederick Herzberg, set out to determine which work factors (such as wages, job security, or advancement) made people feel good about their jobs and which factors made them feel bad about their jobs. He surveyed workers, analyzed the results, and concluded that to understand employee satisfaction (or dissatisfaction), he had to divide work factors into two categories:

- Motivation factors. Those factors that are strong contributors to job satisfaction
- Hygiene factors. Those factors that are not strong contributors to satisfaction but that must be present to meet a worker's expectations and prevent job dissatisfaction

The graphic below illustrates Herzberg's two-factor theory. Note that motivation factors (such as promotion opportunities) relate to the nature of the work itself and the way the employee performs it. Hygiene factors (such as physical working conditions) relate to the environment in which it's performed.



Herzberg's Two-Factor theory: Poor hygiene factors will increase job dissatisfaction, while good motivators will increase satisfaction.

Two-Factor Theory and the Workplace

We'll ask the same question about Herzberg's model as we did about Maslow's: What does it mean for managers? Suppose you're a senior manager in an accounting firm, where you supervise a team of accountants, each of whom has been with the firm for five years. How would you use Herzberg's model to motivate the employees who report to you? Let's start with hygiene factors. Are salaries reasonable? What about working conditions? Does each accountant have his or her own workspace, or are they crammed into tiny workrooms? Are they being properly supervised or are they left on their own to sink or swim? If hygiene factors like these don't meet employees' expectations, they may be dissatisfied with their jobs.

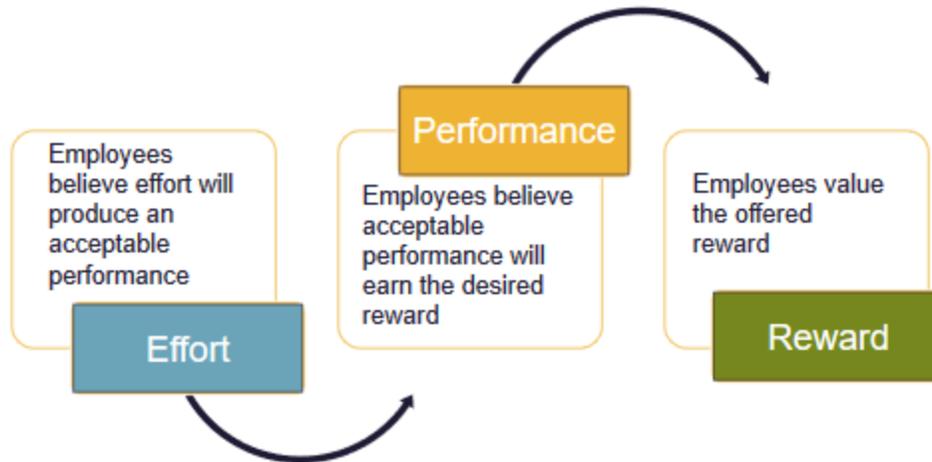
Fixing problems related to hygiene factors may alleviate job dissatisfaction, but it won't necessarily improve anyone's job satisfaction. To increase satisfaction (and motivate someone to perform better), you must address motivation factors. Is the work itself challenging and stimulating? Do employees receive recognition for jobs well done? Will the work that an accountant has been assigned help him or her to advance in the firm? According to Herzberg, motivation requires a twofold approach: eliminating "dissatisfiers" and enhancing satisfiers.

Expectancy Theory

If you were a manager, wouldn't you like to know how your employees decide whether to work hard or goof off? Wouldn't it be nice to know whether a planned rewards program will have the desired effect—namely, motivating them to perform better in their jobs? These are the issues considered by psychologist Victor Vroom in his expectancy theory, which proposes that employees will work hard to earn rewards that they value and that they consider "attainable".

As you can see from the figure below, Vroom argues that an employee will be motivated to exert a high level of effort to obtain a reward under three conditions – the employee:

1. believes that his or her efforts will result in acceptable performance.
2. believes that acceptable performance will lead to the desired reward.
3. values the reward.



Expectancy Theory

Expectancy Theory and the Workplace

To apply expectancy theory to a real-world situation, let's analyze an automobile-insurance company with one hundred agents who work from a call centre. Assume that the firm pays a base salary of \$2,000 a month, plus a \$200 commission on each policy sold above ten policies a month. In terms of expectancy theory, under what conditions would an agent be motivated to sell more than ten policies a month?

1. The agent would have to believe that his or her efforts would result in policy sales (that, in other words, there's a positive link between effort and performance).
2. The agent would have to be confident that if he or she sold more than ten policies in a given month, there would indeed be a bonus (a positive link between performance and reward).
3. The \$200 bonus per policy would have to be of value to the agent.

Now let's alter the scenario slightly. Say that the company raises prices, thus making it harder to sell the policies. How will agents' motivation be affected? According to expectancy theory, motivation will suffer. Why? Because agents may be less confident that their efforts will lead to satisfactory performance. What if the company introduces a policy whereby agents get bonuses only if buyers don't cancel policies within ninety days? Now agents may be less confident that they'll get bonuses even if they do sell more than ten policies. Motivation will decrease because the link between performance and reward has been weakened. Finally, what will happen if bonuses are cut from \$200 to \$25? Obviously, the reward would be of less value to agents, and, again, motivation will suffer. The message of expectancy theory, then, is fairly clear: managers should offer rewards that employees value, set performance levels that they can reach, and ensure a strong link between performance and reward.

Equity Theory

What if you spent thirty hours working on a class report, did everything you were supposed to do, and handed in an excellent assignment (in your opinion). Your roommate, on the other hand, spent about five hours and put everything together at the last minute. You know, moreover, that he ignored half the requirements and never even ran his assignment through a spell-checker. A week later, your teacher returns the reports. You get a C and your roommate gets a B+. In all likelihood, you'll feel that you've been treated unfairly relative to your roommate.

Your reaction makes sense according to the [equity theory of motivation](#), which focuses on our perceptions of how fairly we're treated relative to others. Applied to the work environment, this theory proposes that employees analyze their contributions or job inputs (hours worked, education, experience, work performance) and their rewards or job outcomes (salary, bonus, promotion, recognition). Then they create a contributions/rewards ratio and compare it to those of other people. The basis of comparison can be any one of the following:

- Someone in a similar position
- Someone holding a different position in the same organization
- Someone with a similar occupation
- Someone who shares certain characteristics (such as age, education, or level of experience)
- Oneself at another point in time



Equity Theory

When individuals perceive that the ratio of their contributions to rewards is comparable to that of others, they perceive that they're being treated fairly or equitably; when they perceive that the ratio is out of balance, they perceive inequity. Occasionally, people will perceive that they're being treated better than others. More often, however, they conclude that others are being treated better (and that they themselves are being treated worse). This is what you concluded when you saw your grade in the previous example. You've calculated your ratio of contributions (hours worked, research and writing skills) to rewards (project grade), compared it to your roommate's ratio, and concluded that the two ratios are out of balance.

What will an employee do if he or she perceives an inequity? The individual might try to bring the ratio into balance, either by decreasing inputs (working fewer hours, not taking on additional tasks) or by increasing outputs (asking for a raise). If this strategy fails, an employee might complain to a supervisor, transfer to another job, leave the organization, or rationalize the situation (e.g., deciding that the situation isn't so bad after all). Equity theory advises managers to focus on treating workers fairly, especially in determining compensation, which is, naturally, a common basis of comparison.

Key Takeaways

Important terms and concepts

1. Motivation describes a generated drive that propels people to achieve goals or pursue particular courses of action.
2. There are four influential theories of motivation: hierarchy-of-needs theory, two-factor theory, expectancy theory, and equity theory:
 - Hierarchy-of-needs theory proposes that we're motivated by five unmet needs—physiological, safety, social, esteem, and self-actualization— and must satisfy lower-level needs before we seek to satisfy higher-level needs.
 - Two-factor theory divides work factors into motivation factors (those that are strong contributors to job satisfaction) and hygiene factors (those that, though not big contributors to satisfaction, must be present to prevent job dissatisfaction).
 - Expectancy theory proposes that employees work harder to obtain a reward when they value the reward, believe that their efforts will result in acceptable performance, and believe that acceptable performance will lead to a desired outcome or reward.
 - Equity theory focuses on our perceptions of how fairly we're treated relative to others. This theory proposes that employees create rewards ratios that they compare to those of others and will be less motivated when they perceive an imbalance in treatment.

12. Managing Human Resources

Learning Objectives

By the end of the chapter, you should be able to:

1. Define human resource management and explain how managers develop and implement a human resource plan.
2. Explain how companies train and develop employees, and discuss the importance of a diverse workforce.
3. Identify factors that make an organization a good place to work, including competitive compensation and benefits packages.
4. Explain how managers evaluate employee performance and retain qualified employees.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=117>

The Grounds of a Great Work Environment

[Howard Schultz](#) has vivid memories of his father slumped on the couch with his leg in a cast.^[1] The ankle would heal, but his father had lost another job—this time as a driver for a diaper service. It was a crummy job; still, it put food on the table, and if his father couldn't work, there wouldn't be any money. Howard was seven, but he understood the gravity of the situation, particularly because his mother was seven months pregnant, and the family had no insurance.

This was just one of the many setbacks that plagued Schultz's father throughout his life—an honest, hard-working man frustrated by a system that wasn't designed to cater to the needs of common workers. He'd held a series of blue-collar jobs (cab driver, truck driver, factory worker), sometimes holding two or three at a time. Despite his willingness to work, he never earned enough money to move his family out of Brooklyn's federally-subsidized housing projects. Schultz's father died never having found fulfillment in his work life—or even a meaningful job. It was the saddest day of Howard's life.

As a kid, did Schultz ever imagine that one day he'd be the founder and chairman of Starbucks Coffee Company? Of course not. But he did decide that if he was ever in a position to make a difference in the lives of people like his father, he'd do what he could. Remembering his father's struggles and disappointments, Schultz has tried to make Starbucks the kind of company where he wished his father had worked. "Without even a high school diploma," Schultz admits, "my father probably could never have been an executive. But if he had landed a job in one of our stores or roasting plants, he wouldn't have quit in frustration because the company didn't value him. He would have had good health benefits, stock options, and an atmosphere in which his suggestions or complaints would receive a prompt, respectful response."^[2]



Starbucks Founder Howard Schultz

Schultz is motivated by both personal and business considerations: "When employees have self-esteem and self-respect," he argues, "they can contribute so much more: to their company, to their family, to the world."^[3] His commitment to his employees is embedded in Starbucks's mission statement, whose first objective is to "provide a great work environment and treat each other with respect and dignity."^[4] Those working at Starbucks are called partners because Schultz believes working for his company is not just a job, it's a passion.^[5]

Point to Ponder

In April 2018, two black men were arrested for trespassing in a Philadelphia Starbucks. They hadn't ordered anything as they were waiting on a friend. Employees asked them to leave and when they did not, the police were called. Starbucks refrained from pressing charges and the men were released.

However, the incident sparked debate and criticism of Starbucks. Starbucks issued apologies and closed all stores nationwide on May 29th for all employees to experience diversity training. What do you think of Starbucks's reaction?

Human Resource Management

Employees at Starbucks are vital to the company's success. They are its public face, and every dollar of sales passes through their hands.^[6] According to Howard Schultz, they can make or break the company. If a customer has a positive interaction with an employee, the customer will come back. If an encounter is negative, the customer is probably gone for good. That's why it's crucial for Starbucks to recruit and hire the right people, train them properly, motivate them to do their best, and encourage them to stay with the company. Thus, the company works to provide satisfying jobs, a positive work environment, appropriate work schedules, and fair compensation and benefits. These activities are part of Starbucks's strategy to deploy human resources in order to gain competitive advantage. The process is called **human resource management (HRM)**, which consists of all actions that an organization takes to attract, develop, and retain quality employees. Each of these activities is complex. Attracting talented employees involves the recruitment of qualified candidates and the selection of those who best fit the organization's needs. Development encompasses both new-employee orientation and the training and development of current workers. Retaining good employees means motivating them to excel, appraising their performance, compensating them appropriately, and doing what's possible to keep them.

Human Resource Planning

How does Starbucks make sure that its worldwide retail locations are staffed with just the right number of committed employees? How does Norwegian Cruise Lines make certain that when the Norwegian Dawn pulls out of New York harbor, it has a complete, fully trained crew on board to feed, entertain, and care for its passengers? Managing these tasks is a matter of strategic human resource planning—the process of developing a plan for satisfying an organization's human resources (HR) needs.

A strategic HR plan lays out the steps that an organization will take to ensure that it has the right number of employees with the right skills in the right places at the right times. HR managers begin by analyzing the company's mission, objectives, and strategies. Starbucks's objectives, for example, include the desire to “develop enthusiastically satisfied customers” as well as to foster an environment in which employees treat both customers and each other with respect.^[7] Thus, the firm's HR managers look for people who are “adaptable, self-motivated, passionate, creative team members.”^[8] The main goal of Norwegian Cruise Lines—to lavish passengers with personal attention—determines not only the type of employee desired (one with exceptionally good customer-relation skills and a strong work ethic) but also the number needed (one for every two passengers on the Norwegian Dawn).^[9]

Job Analysis

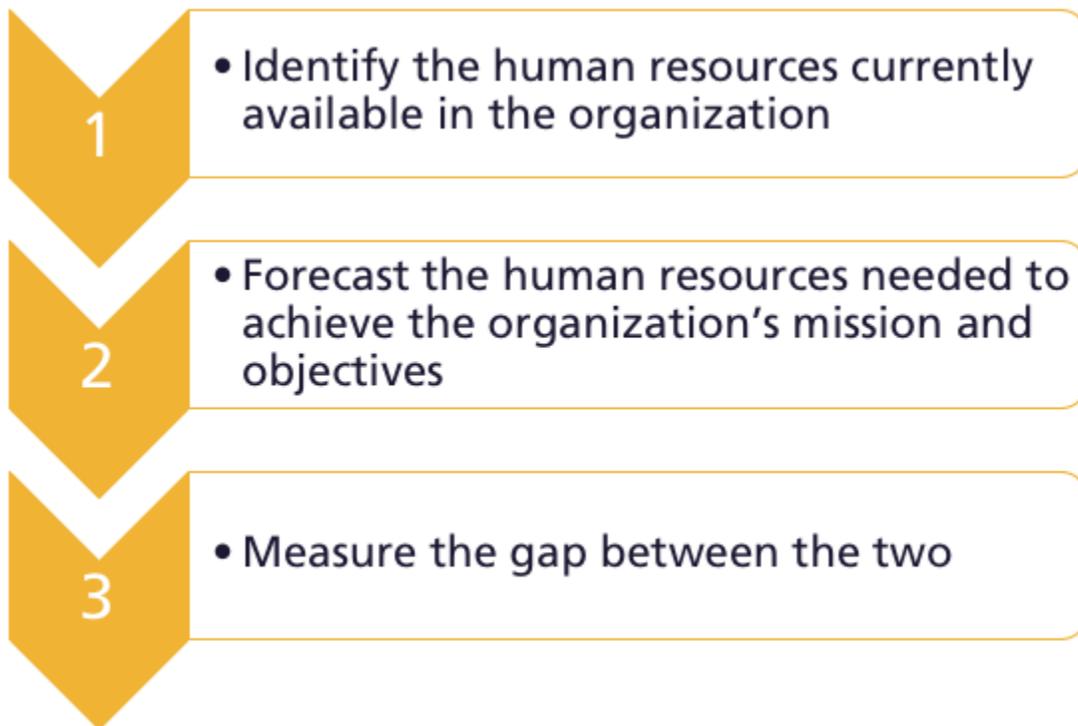
To develop an HR plan, HR managers must be knowledgeable about the jobs that the organization needs performed. They organize information about a given job by performing a job analysis to identify the tasks, responsibilities, and skills that it entails, as well as the knowledge and abilities needed to perform it. Managers also use the information collected for the job analysis to prepare two documents:

- A job description, which lists the duties and responsibilities of a position
- A job specification, which lists the qualifications—skills, knowledge, and abilities— needed to perform the job

HR Supply and Demand Forecasting

Once they've analyzed the jobs within the organization, HR managers must forecast future hiring (or firing) needs. This is the three-step process summarized below.

Starbucks, for instance, might find that it needs three hundred new employees to work at stores scheduled to open in the next few months. Disney might determine that it needs two thousand new cast members to handle an anticipated surge in visitors. The Norwegian Dawn might be short two dozen restaurant workers because of an unexpected increase in reservations.



How to Forecast Hiring (and Firing) Needs

After calculating the disparity between supply and future demand, HR managers must draw up plans for bringing the two numbers into balance. If the demand for labour is going to outstrip the supply, they may hire more workers, encourage current workers to put in extra hours, subcontract work to other suppliers, or introduce labour-saving initiatives. If the supply is greater than the demand, they may deal with overstaffing by not replacing workers who leave, encouraging early retirements, laying off workers, or (as a last resort) firing workers.

Recruiting Qualified Employees

Armed with information on the number of new employees to be hired and the types of positions to be filled, the HR manager then develops a strategy for recruiting potential employees. Recruiting is the process of identifying suitable candidates and encouraging them to apply for openings in the organization.

Before going any further, we should point out that in recruiting and hiring, managers must comply with anti-discrimination laws; violations can have legal consequences. Discrimination occurs when a person is treated unfairly on the basis of a characteristic unrelated to ability. Under Section 3 of the [Canadian Human Rights Act](#), it's illegal to discriminate on the basis of "race, national or ethnic origin, colour, religion, age, sex, sexual orientation, gender identity or expression, marital status, family status, genetic characteristics, disability or conviction for an offence for which a pardon has been granted or in respect of which a record suspension has been ordered."

The Canadian Human Rights Commission and Canada's Charter of Rights and Freedoms protects and enforces a number of federal employment laws and protects each Canadian's right to equal treatment under the law, including the following:

Equal Pay: Section 11 of the CHRA which protects male and female employees who do substantially equal work from a difference in wages.

Other Factors: Section 15(1) of the Charter protects every Canadian's right to equal treatment with respect to employment regardless of race, national or ethnic origin, colour, religion, sex, age or mental or physical disability

In Canada, each jurisdiction (3 territories and 10 provinces) is governed by its own Human Rights Code, or a version of it which offers its citizens an additional layer of protection against discriminatory practices. For example, in Ontario it is the Ontario Human Rights Act.

The Employment Equity Act of 1986 identifies specific populations which are protected from discrimination (women, visible minorities, indigenous peoples, and people with disabilities). Individuals who feel that they have been discriminated against can take their case to the Canadian Human Rights Tribunal. Other legislation includes the Canadian Human Rights Act and the Canadian Labour code.

Where to Find Candidates

The first step in recruiting is to find qualified candidates. Where do you look for them, and how do you decide whether they're qualified? Companies must assess not only the ability of a candidate to perform the duties of

a job, but also whether he or she is a good “fit” for the company– i.e., how well the candidate’s values and interpersonal style match the company’s values and culture.

Internal Versus External Recruiting

Where do you find people who satisfy so many criteria? Basically, you can look in two places: inside and outside your own organization. Both options have pluses and minuses. Hiring internally sends a positive signal to employees that they can move up in the company—a strong motivation tool and a reward for good performance. In addition, because an internal candidate is a known quantity, it’s easier to predict his or her success in a new position. Finally, it’s cheaper to recruit internally. On the other hand, you’ll probably have to fill the promoted employee’s position. Going outside gives you an opportunity to bring fresh ideas and skills into the company. In any case, it’s often the only alternative, especially if no one inside the company has just the right combination of skills and experiences. Entry-level jobs are usually filled from the outside.

How to Find Candidates

Whether you search inside or outside the organization, you need to publicize the opening. If you’re looking internally in a small organization, you can alert employees informally. In larger organizations, HR managers generally post openings on bulletin boards (often online) or announce them in newsletters. They can also seek direct recommendations from various supervisors.

Recruiting people from outside is more complicated. It’s a lot like marketing a product to buyers: in effect, you’re marketing the virtues of working for your company. Starbucks uses the following outlets to advertise openings:

- A dedicated section of the corporate web site (“Job Centre,” which lists openings, provides information about the Starbucks experience, and facilitates the submission of online applications)
- College and university campus recruiting (holding on-campus interviews and information sessions and participating in career fairs)
- Internships designed to identify future talent among college students
- Announcements on employment web sites like [LinkedIn](#), [Workopolis](#), [Indeed](#), [LeapOut](#), [JobBank](#), [Eluta](#).
- Social Media
- Local job fairs
- In-store recruiting posters
- Informative “business cards” for distribution to customers^[10]



College job fair

When asked what it takes to attract the best people, Starbucks’s senior executive Dave Olsen replied, “Everything matters.” Everything Starbucks does as a company bears on its ability to attract talent. Accordingly, everyone

is responsible for recruiting, not just HR specialists. In fact, the best source of quality applicants is often the company's own labour force.^[11]

The Selection Process

Recruiting gets people to apply for positions, but once you've received applications, you still have to select the best candidate—another complicated process.

The selection process entails gathering information on candidates, evaluating their qualifications, and choosing the right one. At the very least, the process can be time-consuming—particularly when you're filling a high-level position—and often involves several members of an organization.

Let's examine the selection process more closely by describing the steps that you'd take to work for the Canadian Security Intelligence Service.^[12] Most business students don't generally aspire to become CSIS agents, but CSIS is quite interested in business graduates—especially if you have a major in accounting or finance. With one of these backgrounds, you'll be given priority in hiring. Why?

Unfortunately, there's a lot of white-collar crime that needs to be investigated, and people who know how to follow the money are well suited for the task.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=117>

Contingent Workers

Though most people prefer to hold permanent, full-time positions, there's a growing number of individuals who work at temporary or part-time jobs, either by choice or as the only available option. Many of these are contingent workers hired to supplement a company's permanent workforce. Most of them are independent contractors, consultants, or freelancers who are paid by the firms that hire them. Others are on-call workers who work only when needed, such as substitute teachers. Still others are temporary workers (or "temps") who are employed and paid by outside agencies or contract firms that charge fees to client companies.

Rise of the "gig economy": Take 8 minutes to learn more about the likely future of work:



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=117>

The Positives and Negatives of Temp Work

The use of contingent workers provides companies with a number of benefits. Because they can be hired and fired easily, employers can better control labour costs. When things are busy, they can add temps, and when business is slow, they can release unneeded workers. Temps are often cheaper than permanent workers, particularly because they rarely receive costly benefits. Employers can also bring in people with specialized skills and talents to work on special projects without entering into long-term employment relationships. Finally, companies can “try out” temps: if someone does well, the company can offer permanent employment; if the fit is less than perfect, the employer can easily terminate the relationship. There are downsides to the use of contingent workers, including increased training costs and decreased loyalty to the company. Also, many employers believe that because temps are usually less committed to company goals than permanent workers, productivity suffers.

Developing Employees

Because companies can't survive unless employees do their jobs well, it makes economic sense to train them and

develop their skills. This type of support begins when an individual enters the organization and continues as long as he or she stays there.

New-Employee Orientation

Have you ever started your first day at a new job feeling upbeat and optimistic only to walk out at the end of the day thinking that maybe you've taken the wrong job? If this happens too often, your employer may need to revise its approach to orientation—the way it introduces new employees to the organization and their jobs. Starting a new job is a little like beginning college; at the outset, you may be experiencing any of the following feelings:

- Somewhat nervous but enthusiastic
- Eager to impress but not wanting to attract too much attention
- Interested in learning but fearful of being overwhelmed with information
- Hoping to fit in and worried about looking new or inexperienced^[13]

The employer who understands how common such feelings are is more likely not only to help newcomers get over them but also to avoid the pitfalls often associated with new-employee orientation:

- Failing to have a workspace set up for you
- Ignoring you or failing to supervise you
- Neglecting to introduce you to coworkers
- Swamping you with facts about the company^[14]

A good employer will take things slowly, providing you with information about the company and your job on a need-to-know basis while making you feel as comfortable as possible. You'll get to know the company's history, traditions, policies, and culture over time. You'll learn more about salary and benefits and how your performance will be evaluated. Most importantly, you'll find out how your job fits into overall operations and what's expected of you.

Training and Development

It would be nice if employees came with all the skills they need to do their jobs. It would also be nice if job requirements stayed the same: once you've learned how to do a job, you'd know how to do it forever. In reality, new employees must be trained; moreover, as they grow in their jobs or as their jobs change, they'll need additional training. Unfortunately, training is costly and time-consuming. How costly? The Conference Board of Canada reported that Canadian companies spent \$688 per employee for training in 2010.

Many Canadian companies focus much of their training on diversity skills. What's the payoff? They create a more inclusive workplace and bring new voices and ideas to their way of doing business. Some of these companies also get additional rewards by being recognized as being [Canada's Best Diversity Employers](#).^[15] At Booz Allen Hamilton, consultants specialize in finding innovative solutions to client problems, and their employer makes sure that they're up-to-date on all the new technologies by maintaining a “technology petting zoo” at its training headquarters. It's called a “petting zoo” because employees get to see, touch, and interact with new and emerging

technologies. For example, a Washington Post reporter visiting the “petting zoo” in 2007 saw fabric that could instantly harden if struck by a knife or bullet, and “smart” clothing that could monitor a wearer’s health or environment.^[16]

At Booz Allen Hamilton’s technology “petting zoo,” employees are receiving off-the-job training. This approach allows them to focus on learning without the distractions that would occur in the office. More common, however, is informal on-the-job training, which may be supplemented with formal training programs. This is the method, for example, by which you’d move up from mere coffee maker to a full-fledged “barista” if you worked at Starbucks.^[17] You’d begin by reading a large spiral book (titled Starbucks University) on the responsibilities of the barista, pass a series of tests on the reading, then get hands-on experience in making drinks, mastering one at a time.^[18] Doing more complex jobs in business will likely require even more training than is required to be a barista.

Equity, Inclusion, and Diversity in the Workplace

The makeup of the Canadian workforce has changed dramatically over the past 50 years. In the 1950s, more than 70 percent was composed of males.^[19] Today’s workforce reflects the broad range of differences in the population—differences in gender, race, ethnicity, age, physical ability, religion, education, and lifestyle. As you can see below, more women have entered the workforce.^[20]

	Females	Males
Population	50.7%	49.3%
Workforce	47.4%	52.6%
Relative Participation Rate	0.93	1.06

Employment by Gender Group, 2017

Most companies today strive for diverse workforces. HR managers work hard to recruit, hire, develop, and retain a diverse workforce. In part, these efforts are motivated by legal concerns: discrimination in recruiting, hiring, advancement, and firing is illegal under federal law and is prosecuted by the Canadian Human Rights Tribunal.^[21] Companies that violate anti-discrimination laws are subject to severe financial penalties and also risk reputational damage.

Reasons for building a diverse workforce go well beyond mere compliance with legal standards. It even goes beyond commitment to ethical standards. It’s good business. People with diverse backgrounds bring fresh points of view that can be invaluable in generating ideas and solving problems. In addition, they can be the key to connecting with an ethnically diverse customer base. In short, capitalizing on the benefits of a diverse workforce means that employers should view differences as assets rather than liabilities.

What Makes a Great Place to Work?

Every year, [Great Place to Work Canada](#) analyzes comments from thousands of employees and compiles a list of “The 100 Best Companies to Work for in Canada,” which is published in Fortune magazine. Having compiled its list for more than twenty years, the institute concludes that the defining characteristic of a great company to work for is trust between managers and employees. Employees overwhelmingly say that they want to work at a place where employees “trust the people they work for, have pride in what they do, and enjoy the people they work with.”^[22] They report that they’re motivated to perform well because they’re challenged, respected, treated fairly, and appreciated. They take pride in what they do, are made to feel that they make a difference, and are given opportunities for advancement.^[23] The most effective motivators, it would seem, are closely aligned with Maslow’s higher-level needs and Herzberg’s motivating factors. The top ten companies are listed below.

Job Redesign

Rank	Organization
1	Google
2	Kruger Products
3	Hydro-Québec
4	SAP
5	Vitalité Health Network
6	Queen's University
7	Concordia University
8	Siemens
9	SaskTel
10	Ottawa-Carleton District School Board

The average employee spends more than two thousand hours a year at work. If the job is tedious, unpleasant, or otherwise unfulfilling, the employee probably won’t be motivated to perform at a very high level. Many companies practice a policy of job redesign to make jobs more interesting and challenging. Common strategies include job rotation, job enlargement, and job enrichment.

Job Rotation

Specialization promotes efficiency because workers get very good at doing particular tasks. The drawback is the tedium of repeating the same task day in and day out. The practice of job rotation allows employees to rotate from one job to another on a systematic basis, often but not necessarily cycling back to their original tasks. A computer maker, for example, might rotate a technician into the sales department to increase the employee's awareness of customer needs and to give the employee a broader understanding of the company's goals and operations. A hotel might rotate an accounting clerk to the check-in desk for a few hours each day to add variety to the daily workload. Through job rotation, employees develop new skills and gain experience that increases their value to the company. So great is the benefit of this practice that many companies have established rotational training programs that include scheduled rotations during the first 2-3 years of employment. Companies benefit because cross-trained employees can fill in for absentees, thus providing greater flexibility in scheduling, offer fresh ideas on work practices, and become promotion-ready more quickly.

Job Enlargement

Instead of a job in which you performed just one or two tasks, wouldn't you prefer a job that gave you many different tasks? In theory, you'd be less bored and more highly motivated if you had a chance at job enlargement—the policy of enhancing a job by adding tasks at similar skill levels. The job of sales clerk, for example, might be expanded to include gift-wrapping and packaging items for shipment. The additional duties would add variety without entailing higher skill levels.

Job Enrichment

Merely expanding a job by adding similar tasks won't necessarily "enrich" it by making it more challenging and rewarding. Job enrichment is the practice of adding tasks that increase both responsibility and opportunity for growth. It provides the kinds of benefits that, according to Maslow and Herzberg, contribute to job satisfaction: stimulating work, sense of personal achievement, self-esteem, recognition, and a chance to reach your potential.

Consider, for example, the evolving role of support staff in the contemporary office. Today, employees who used to be called "secretaries" assume many duties previously in the domain of management, such as project coordination and public relations. Information technology has enriched their jobs because they can now apply such skills as word processing, desktop publishing, creating spreadsheets, and managing databases. That's why we now use a term such as administrative assistant instead of secretary.^[24]

Life | Work Quality

Building a career requires a substantial commitment in time and energy, and most people find that they aren't left with much time for non-work activities. Fortunately, many organizations recognize the need to help employees strike a balance between their work and home lives.^[25] By helping employees combine satisfying careers and

fulfilling personal lives, companies tend to end up with a happier, less-stressed, and more productive workforce. The financial benefits include lower absenteeism, turnover, and health care costs.

Alternative Work Arrangements

The accounting firm KPMG LLP, which has consistently made the list of the “Canada’s Top Family-Friendly Employers,”^[26] and is committed to help “employees balance work and their personal lives through a variety of flexible work options.”^[27]

Flextime

Employers who provide for flextime set guidelines that allow employees to designate starting and quitting times. Guidelines, for example, might specify that all employees must work eight hours a day (with an hour for lunch) and that four of those hours must be between 10 a.m. and 3 p.m. Thus, you could come in at 7 a.m. and leave at 4 p.m., while coworkers arrive at 10 a.m. and leave at 7 p.m. With permission you could even choose to work from 8 a.m to 2 p.m., take two hours for lunch, and then work from 4 p.m. to 6 p.m.

Compressed Workweeks

Rather than work eight hours a day for five days a week, you might elect to earn a three-day weekend by working ten hours a day for four days a week.

Job Sharing

Under job sharing, two people share one full-time position, splitting the salary and benefits of the position as each handles half the job. Often they arrange their schedules to include at least an hour of shared time during which they can communicate about the job.

Telecommuting

Telecommuting means that you regularly work from home (or from some other non-work location). You’re connected to the office by computer and cell phone. You save on commuting time, enjoy more flexible work hours, and have more opportunity to spend time with your family. A study of 5,500 IBM employees (one-fifth of whom telecommute) found that those who worked at home not only had a better balance between work and home life but also were more highly motivated and less likely to leave the organization.^[28]

Though it’s hard to count telecommuters accurately, Statistics Canada estimates that, in 2008, 11% of employees

work from home.^[29] Telecommuting isn't for everyone. Working at home means that you have to discipline yourself to avoid distractions, such as TV, personal phone calls, and home chores and also not be impacted by feeling isolated from the social interaction in the workplace.

Family-Friendly Programs

In addition to alternative work arrangements, many employers, including KPMG LLP and BASF Canada, offer programs and benefits designed to help employees meet family and home obligations while maintaining busy careers. As exemplar companies, they offer the following benefits.^[30]

Dependent Care

Caring for dependents—young children and elderly parents—is of utmost importance to some employees, but combining dependent-care responsibilities with a busy job can be particularly difficult. Through its Personal Care program, KPMG LLP provides employees with up to 50 hours of paid time off annually to help with a range of personal matters. They also offer emergency backup dependent care all year round, either at a provider's facility or in the employee's home. KPMG LLP also has a Working Parents Network, Special Parents Network, offering support for parents raising children with physical, emotional and behavioural (virtual support group for parents raising children with physical, emotional and behavioural issues. Meanwhile, BASF Canada offers its employees a privately-run on-site child care facility.

Parental Leave and Support

New parents in Canada are guaranteed paid leave via Employment Insurance Maternity and Parental Benefits. BASF Canada tops-up these payments for new parents to 100% of salary for up to 17 weeks. KPMG LLP further supports new parents by providing those on leave support with their transition back to work.

Caring for Yourself

Both KPMG LLP and BASF Canada offer employees comprehensive health and dental benefit coverage programs. They also provide employees with generous vacation allowances and personal days for employees to use in any way they want. Both organizations also offer an Employee Assistance Program for employees experiencing personal and/or work-related problems that may negatively affect their job performance and overall well-being. If staying fit makes you happier and more productive, BASF Canada offers a \$400 fitness club subsidy and KPMG LLP offers the equivalent of 1.25% of an employee's salary for home gym equipment.^[31]

Unmarried Without Children

You've undoubtedly noticed by now that many programs for balancing work and personal lives target married people, particularly those with children. Single individuals also have trouble striking a satisfactory balance between work and non-work activities, but many single workers feel that they aren't getting equal consideration from employers.^[32] They report that they're often expected to work longer hours, travel more, and take on difficult assignments to compensate for married employees with family commitments.

Needless to say, requiring singles to take on additional responsibilities can make it harder for them to balance their work and personal lives. It's harder to plan and keep personal commitments while meeting heavy work responsibilities. Frustration can lead to increased stress and job dissatisfaction. In several studies of stress in the accounting profession, unmarried workers reported higher levels of stress than any other group, including married people with children.^[33]

With singles, as with married people, companies can reap substantial benefits from programs that help employees balance their work and non-work lives. PepsiCo, for example, offers a "concierge service," which maintains a dry cleaner, travel agency, convenience store, and fitness centre on the premises of its national office in Somers, New York.^[34] Single employees seem to find these services helpful, but what they value most of all is control over their time. In particular, they want predictable schedules that allow them to plan social and personal activities. They don't want employers assuming that being single means that they can change plans at the last minute. It's often more difficult for singles to deal with last-minute changes because, unlike married coworkers, they don't have the at-home support structure to handle such tasks as tending to elderly parents or caring for pets.

Compensation and Benefits

Though paychecks and benefits packages aren't the only reasons why people work, they do matter. Competitive pay and benefits also help organizations attract and retain qualified employees. Companies that pay their employees more than their competitors generally have lower turnover. Consider, for example, The Container Store, which regularly appears on Fortune magazine's list of "The 100 Best Companies to Work For."^[35] The U.S. retail chain staffs its stores with fewer employees than its competitors but pays them more—in some cases, three times the industry average for retail workers. This strategy allows the company to attract extremely talented workers who, moreover, aren't likely to leave the company. Low turnover is particularly valuable in the retail industry because it depends on service-oriented personnel to generate repeat business. In addition to salary and wages, compensation packages often include other financial incentives, such as bonuses and profit-sharing plans, as well as benefits, such as medical insurance, vacation time, sick leave, and retirement accounts.

Wages and Salaries

The largest, and most important, component of a compensation package is the payment of wages or salary. If you're paid according to the number of hours you work, you're earning wages. Counter personnel at McDonald's, for instance, get wages, which are determined by multiplying an employee's hourly wage rate by the number

of hours worked during the pay period. On the other hand, if you're paid for fulfilling the responsibilities of a position—regardless of the number of hours required to do it— you're earning a salary. The McDonald's manager gets a salary for overseeing the operations of the restaurant. He or she is expected to work as long as it takes to get the job done, without any adjustment in compensation.

Piecework and Commissions

Sometimes it makes more sense to pay workers according to the quantity of product that they produce or sell. North Nova Seafoods Ltd., a seafood processing plant in Pictou, Nova Scotia, pays workers on piecework: workers' pay is based on the amount of fish they have cut, cleaned and trimmed, or the number of lobsters they have disjointed and picked meat from. If you're working on commission, you're probably getting paid a percentage of the total dollar amount you sell. If you were a sales representative for an insurance company, like The Co-operators, you'd get a certain amount of money for each automobile or homeowner policy you sold.

Incentive Programs

In addition to regular paychecks, many people receive financial rewards based on performance, whether their own, their employer's, or both. Other incentive programs designed to reward employees for good performance include bonus plans and stock options.

Bonus Plans

Cisco Systems Canada's year-end bonuses—annual income given in addition to salary—are based on individual and company-wide performance. If the company has a profitable year, and if you contributed to that success, you'll get a bonus. They refer to it as “rewarding people for their performance, not their seniority”.^[36]

Bonus plans have become quite common, and the range of employees eligible for bonuses has widened in recent years. In the past, bonus plans were usually reserved for managers above a certain level. Today, companies have realized the value of extending plans to include employees at virtually every level. The magnitude of bonuses still favors those at the top.

Profit-Sharing Plans

Nature's Path Foods ^[37] and Canadian Tire^[38] both have profit-sharing arrangements with employees. Today, many Canadian companies offer some type of profit-sharing program.

Canadian Tire's plan has long been part of its operating principles —having been around since the late 1960's. Here's how it works. An employee's profit share is paid annually as a percentage of the employee's earnings and is based on the company's net profit. Profits in the most recent years have averaged to be about 10%. Interestingly,

because this profit share is part of an employee's retirement savings, it is put into a deferred profit-sharing account. ^[39]

Stock-Option Plans

WestJet's compensation plan also gives employees the right to participate in their Employee Share Purchase Plan. This enables employees to purchase WestJet shares amounting to up to 20 per cent of their gross salary and the company will match their contributions. This is used as an incentive to attract and retain good people.

U.S.-based Starbucks, by contrast, isn't nearly as selective in awarding stock options. At Starbucks, all employees can earn "Bean Stock"—the Starbucks employee stock-option plan. Both full- and part-time employees get Starbucks shares based on their earnings and their time with the company. If the company does well and its stock goes up, employees make a profit. CEO Howard Schultz believes that Bean Stock pays off because employees are rewarded when the company does well, they have a stronger incentive to add value to the company (and so drive up its stock price). Starbucks has a video explaining their employee stock option program on this [webpage](#).^[40]

Benefits

Another major component of an employee's compensation package is benefits— compensation other than salaries, hourly wages, or financial incentives. Types of benefits include the following:

- Legally required benefits (Employment Insurance, Canada Pension Plan, Workplace Safety and Insurance Boards)
- Paid time off (vacations, holidays, sick leave)
- Insurance (health benefits, life insurance, disability insurance)
- Retirement benefits

The cost of providing benefits is staggering. According to a 2015 survey by the Conference Board of Canada, it costs employers an average of \$8,330 to provide benefits for each full-time employee. More than half of the employers surveyed indicated a rise in benefit costs, with an average 6.2 percent increase between 2013 and 2014.^[41]

Many workers received benefits in addition to those required by law, including vision care, semi-private hospital stays and out-of-country medical coverage. ^[42] Plus the majority of companies surveyed indicated that they provided benefits to permanent part-time employees who work a minimum number of hours per week. Part-timers often receive no benefits at all. ^[43]

Performance Appraisal

Employees generally want their managers to tell them three things: what they should be doing, how well they're

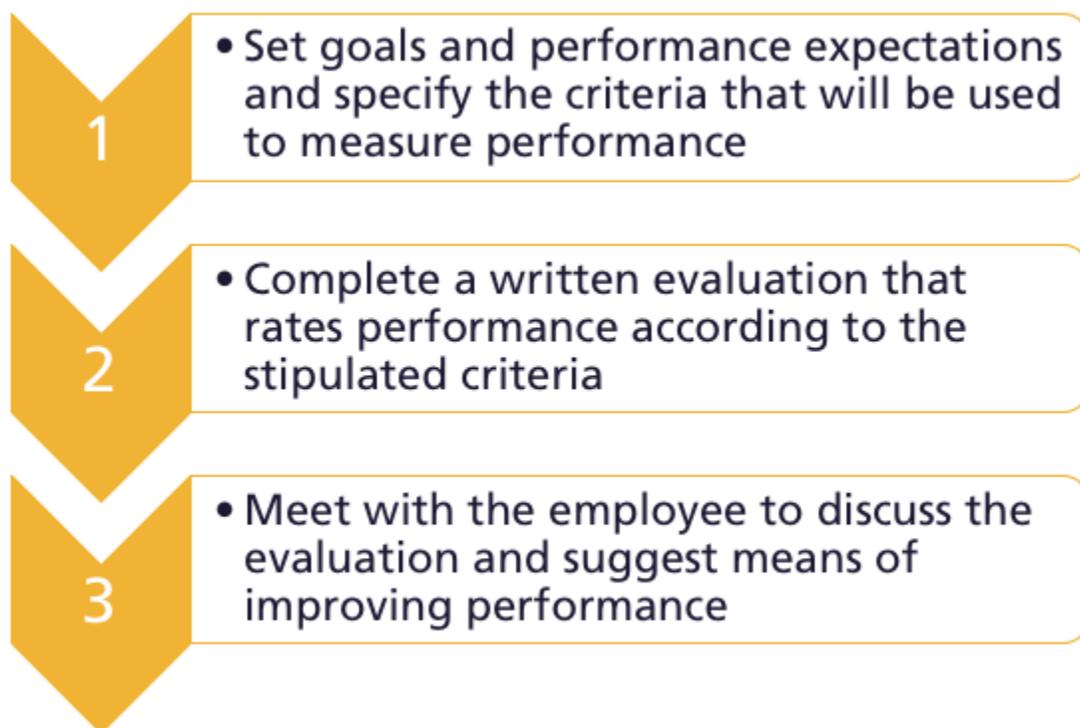
doing it, and how they can improve their performance. Good managers address these issues on an ongoing basis. On a semiannual or annual basis, they also conduct formal performance appraisals to discuss and evaluate employees' work performance.

The Basic Three-Step Process

Appraisal systems vary both by organization and by the level of the employee being evaluated, but as you can see in Figure 11.8, it's generally a three-step process:

1. Before managers can measure performance, they must set goals and performance expectations and specify the criteria (such as quality of work, quantity of work, dependability, initiative) that they'll use to measure performance.
2. At the end of a specified time period, managers complete written evaluations that rate employee performance according to the predetermined criteria.
3. Managers then meet with each employee to discuss the evaluation. Jointly, they suggest ways in which the employee can improve performance, which might include further training and development.

It sounds fairly simple, but why do so many managers report that, except for firing people, giving performance appraisals is their least favorite task?^[44] To get some perspective on this question, we'll look at performance appraisals from both sides, explaining the benefits and identifying potential problems with some of the most common practices.



The Performance Appraisal Process

Among other benefits, formal appraisals provide the following:

- An opportunity for managers and employees to discuss an employee's performance and to set future goals and performance expectations
- A chance to identify and discuss appropriate training and career-development opportunities for an employee
- Formal documentation of the evaluation that can be used for salary, promotion, demotion, or dismissal purposes^[45]

As for disadvantages, most stem from the fact that appraisals are often used to determine salaries for the upcoming year. Consequently, meetings to discuss performance tend to take on an entirely different dimension: the manager may appear judgmental (rather than supportive), and the employee may get defensive. This adversarial atmosphere can make many managers not only uncomfortable with the task but also less likely to give honest feedback. (They may give higher marks in order to avoid delving into critical evaluations.) HR professionals disagree about whether performance appraisals should be linked to pay increases. Some experts argue that the connection eliminates the manager's opportunity to use the appraisal to improve an employee's performance. Others maintain that it increases employee satisfaction with the process and distributes raises on the basis of effort and results.^[46]

360-Degree and Upward Feedback

Instead of being evaluated by one person, how would you like to be evaluated by several people—not only those above you in the organization but those below and beside you? The approach is called 360-degree feedback, and the purpose is to ensure that employees (mostly managers) get feedback from all directions—from supervisors, reporting subordinates, coworkers, and even customers. If it's conducted correctly, this technique furnishes managers with a range of insights into their performance in a number of roles.

Some experts, however, regard the 360-degree approach as too cumbersome. An alternative technique, called upward feedback, requires only the manager's subordinates to provide feedback. Computer maker Dell uses this approach as part of its manager-development plan. Every year, forty thousand Dell employees complete a survey in which they rate their supervisors on a number of dimensions, such as practising ethical business principles and providing support in balancing work and personal life. Dell uses survey results for development purposes only, not as direct input into decisions on pay increases or promotions.^[47]

Retaining Valuable Employees

When a valued employee quits, the loss to the employer can be serious. Not only will the firm incur substantial costs to recruit and train a replacement, but it also may suffer temporary declines in productivity and lower morale among remaining employees who have to take on heavier workloads. Given the negative impact of turnover—the permanent separation of an employee from a company—most organizations do whatever they can to retain qualified

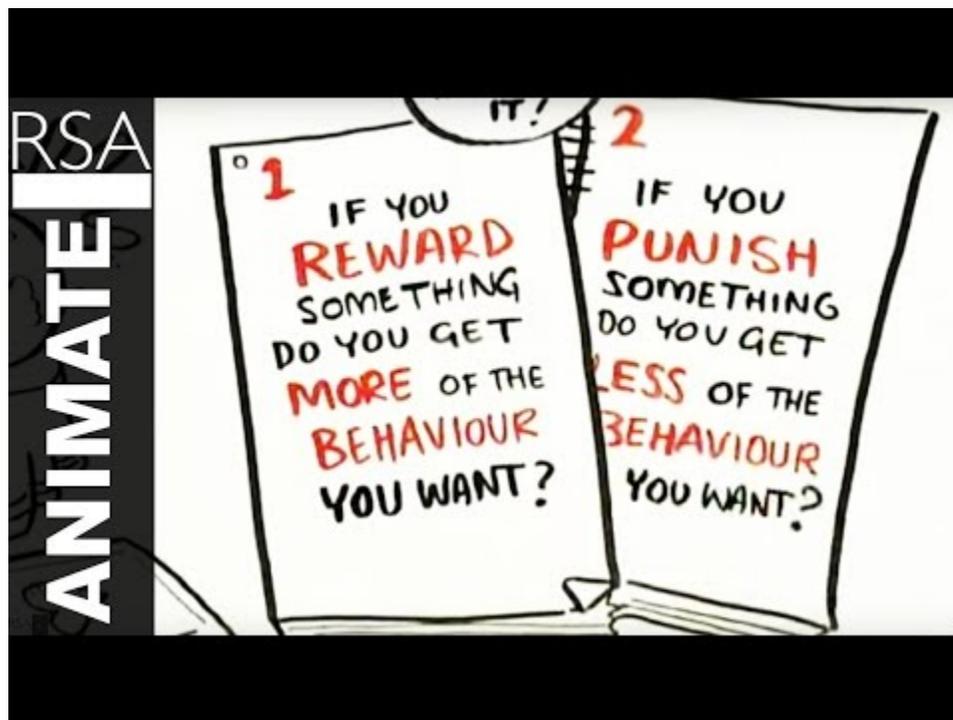
employees. Compensation plays a key role in this effort: companies that don't offer competitive compensation

packages tend to lose employees. Other factors also come into play, such as training and development, as well as helping employees achieve a satisfying work/non-work balance. In the following sections, we'll look at a few other strategies for reducing turnover and increasing productivity.^[48]

Creating a Positive Work Environment

Employees who are happy at work are more productive, provide better customer service, and are more likely to stay with the company. Vancouver-based Telus Corp., tracks their employee engagement with the help of a human resources consulting firm, with a 31% increase from 2007 to 2014. This increase was shown to have an impact on higher customer satisfaction, in addition to low turnover rates, an increase in job applications as well as an increase in their stock price.

^[49] Take a few moments and watch the [RSA Shorts "Drive" video](#) from Daniel Pink, which summarizes recent research on motivation and comes to some interesting conclusions.



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=117>

The Employee-Friendly Workplace

What sort of things improve employee attitudes? The 12,000 employees of software maker SAS Institute fall into the category of “happy workers.” They choose the furniture and equipment in their offices, eat subsidized meals at one of three on-site restaurants, and enjoy other amenities like a 77,000 square-foot fitness centre. They also have job security: no one’s ever been laid off because of an economic downturn. The employee-friendly work environment helps SAS employees focus on their jobs and contribute to the attainment of company goals.^[50] Not surprisingly, it also results in very low 3 percent turnover.

Recognizing Employee Contributions

Thanking people for work done well is a powerful motivator. People who feel appreciated are more likely to stay with a company than those who don’t.^[51] While a personal thank-you is always helpful, many companies also have formal programs for identifying and rewarding good performers. The US-based Container Store rewards employee accomplishments in a variety of ways. For example, employees with 20 years of service are given a “dream trip”—one employee went on a seven day Hawaiian cruise.^[52] The company is known for its supportive environment and in 2016 celebrated its seventeenth year on Fortune’s 100 Best Companies to Work For®.^[53]

Involving Employees in Decision Making

Companies have found that involving employees in decisions saves money, makes workers feel better about their jobs, and reduces turnover. Some have found that it pays to take their advice. When General Motors asked workers for ideas on improving manufacturing operations, management was deluged with more than forty-four thousand suggestions during one quarter. Implementing a few of them cut production time on certain vehicles by 15 percent and resulted in sizable savings.^[54]

Similarly, in 2001, Edward Jones, a personal investment company, faced a difficult situation during the stock-market downturn. Costs had to be cut, and laying off employees was one option. Instead, however, the company turned to its workforce for solutions. As a group, employees identified cost savings of more than \$38 million. At the same time, the company convinced experienced employees to stay with it by assuring them that they’d have a role in managing it.^[55]

Why People Quit

As important as such initiatives can be, one bad boss can spoil everything. The way a person is treated by his or her boss may be the primary factor in determining whether an employee stays or goes. People who have quit their jobs cite the following behavior by superiors:

- Making unreasonable work demands
- Refusing to value their opinions

- Failing to be clear about what's expected of subordinates
- Showing favoritism in compensation, rewards, or promotions^[56]

Holding managers accountable for excessive turnover can help alleviate the “bad-boss” problem, at least in the long run. In any case, whenever an employee quits, it's a good idea for someone—other than the individual's immediate supervisor—to conduct an exit interview to find out why. Knowing why people are quitting gives an organization the opportunity to correct problems that are causing high turnover rates.

Involuntary Termination

Before we leave this section, we should say a word or two about termination—getting fired. Though turnover—voluntary separations—can create problems for employers, they're not nearly as devastating as the effects of involuntary termination on employees. Losing your job is what psychologists call a “significant life change,” and it's high on the list of “stressful life events” regardless of the circumstances. Sometimes, employers lay off workers because revenues are down and they must resort to downsizing—to cutting costs by eliminating jobs. Sometimes a particular job is being phased out, and sometimes an employee has simply failed to meet performance requirements.

Employment at Will

Is it possible for you to get fired even if you're doing a good job and there's no economic justification for your being laid off? In some cases, yes—especially if you're not working under a contract. Without a formal contract, you're considered to be employed at will, which means that both you and your employer have the right to terminate the employment relationship at any time. You can quit whenever you want, but your employer can also fire you whenever they want.

Fortunately for employees, over the past several decades, the courts have made several decisions that created exceptions to the employment-at-will doctrine.^[57] Since managers generally prefer to avoid the expense of fighting wrongful discharge claims in court, many no longer fire employees at will. A good practice in managing terminations is to maintain written documentation so that employers can demonstrate just cause when terminating an employee. If it's a case of poor performance, the employee would be warned in advance that his or her current level of performance could result in termination and then be permitted an opportunity to improve performance. When termination is necessary, communication should be handled in a private conversation, with the manager explaining precisely why the action is being taken.

Key Takeaways

Important terms and concepts

1. The process of human resource management consists of actions that an organization takes to attract, develop, and retain quality employees.
2. Human resource managers engage in strategic human resource planning—the process of developing a plan for satisfying the organization’s human resource needs.
3. The HR manager forecasts future hiring needs and begins the recruiting process to fill those needs.
4. In recruiting and hiring, managers must comply with antidiscrimination laws enforced by the Equal Employment Opportunity Commission (EEOC). They cannot treat people unfairly on the basis of a characteristic unrelated to ability, such as race, color, religion, sex, national origin, age, or disability.
5. HR managers also oversee employee training, from the first orientation to continuing on- or off-the-job training.
6. Attracting a diverse workforce goes beyond legal compliance and ethical commitments, because a diverse group of employees can offer perspectives that may be valuable in generating ideas, solving problems, and connecting with an ethnically diverse customer base.
7. Employees are motivated to perform well when they’re challenged, respected, treated fairly, and appreciated.
8. Some other factors that contribute to employee satisfaction include job redesign to make jobs more interesting and challenging, job rotation, which allows employees to rotate from one job to another, job enlargement, which enhances a job by adding tasks at similar skill levels, and job enrichment, which adds tasks that increase both responsibility and opportunity for growth.
9. Many organizations recognize the need to help employees strike a balance between their work and home lives and offer a variety of work arrangements to accommodate different employee needs, such as flextime (flexible scheduling), job sharing (when two people share a job), and telecommuting (working from outside the office).
10. Compensation includes pay and benefits. Workers who are paid by the hour earn wages, while those who are paid to fulfill the responsibilities of the job earn salaries. Some people receive commissions based on sales or are paid for output, based on a piecework approach.
11. In addition employees can may receive year-end bonuses, participate in profit-sharing plans, or receive stock options.
12. Managers conduct performance appraisals to evaluate work performance.
13. Turnover is the permanent separation of an employee from a company and may happen if an employee is unsatisfied with their job, or because the organization is not satisfied with the employee. Sometimes, firms lay off workers, or downsize, to cut costs.

13. Union Management Issues

Learning Objectives

By the end of the chapter, you should be able to:

1. Explain why workers unionize and how unions are structured, and describe the collective-bargaining process.
2. Discuss key terms associated with union/management issues, such as mediation and arbitration.
3. Identify the tactics used by each side to support its negotiating position: strikes, picketing, boycotting, and lockouts.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=123>

Unions

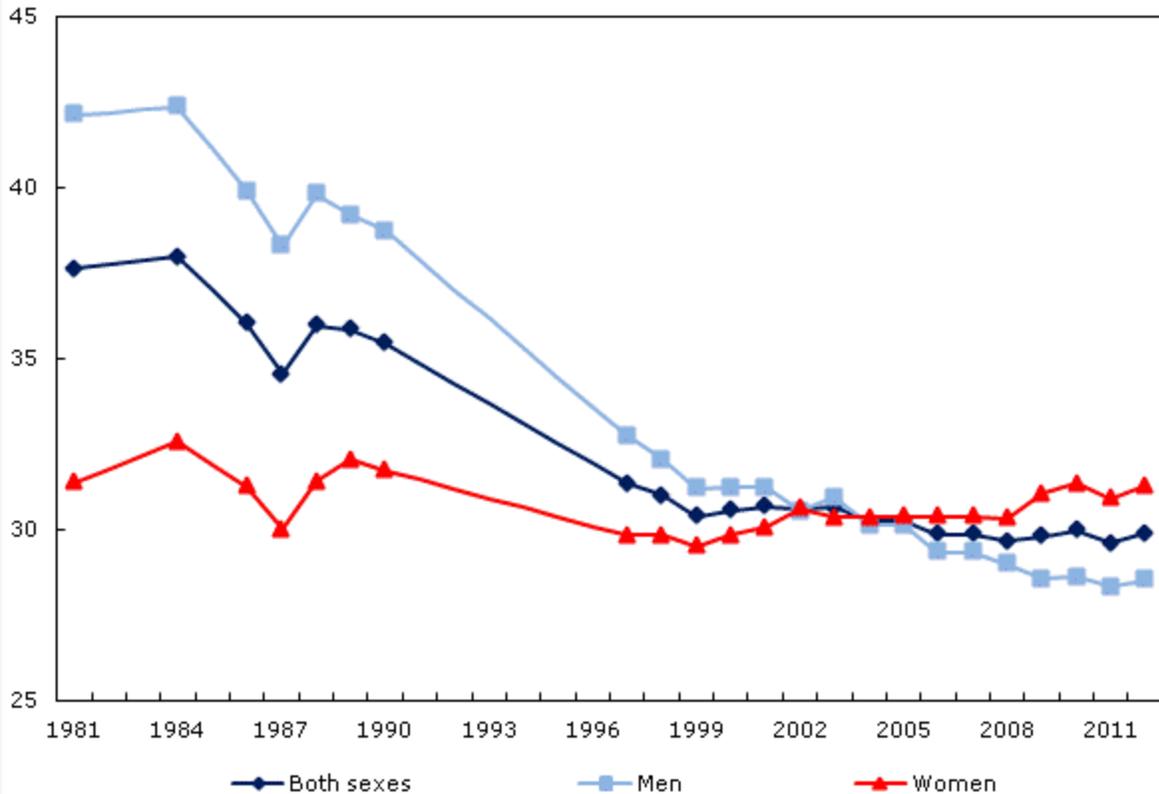
As we saw in “Motivating employees”, Maslow believed that individuals are motivated to satisfy five levels of unmet needs (physiological, safety, social, esteem, and self-actualization). From this perspective, employees hope that full-time work will satisfy at least the two lowest-level needs: they want to be paid wages that are sufficient for them to feed, house, and clothe themselves and their families, and they expect safe working conditions and hope for some degree of job security.

Organizations also have needs: they need to earn profits that will satisfy their owners. They need to keep other stakeholders satisfied as well, which can cost money. Consider a metal-plating business that uses dangerous chemicals in its manufacturing processes; wastewater treatment is essential – and expensive. Sometimes, the needs of employees and employers are consistent: the organization can pay decent wages and provide workers with safe working conditions and job security while still making a satisfactory profit. At other times, there is a conflict—real, perceived, or a little bit of both—between the needs of employees and those of employers. In such cases, workers may be motivated to join a [labour union](#)—an organized group of workers that bargains with employers to improve its members’ pay, job security, and working conditions.

The following chart demonstrates that there has been an overall decrease in the percentage of workers in Canada who are union members from 1981 to 2012. It is interesting to note that this trend is not true for women in the workforce, where the participation rate has been fairly steady over that same 30 year period. The overall decrease is due to a number of factors. First, there has been a shift away from traditional manufacturing industries towards service industries, which are not as likely to be unionized. Some large multinational corporations have a strong anti-union stance, making it more difficult for employees to form unions in those companies.

Chart 1
Unionization rates of employed individuals aged 17 to 64,
1981 to 2012

percentage



Source: Statistics Canada <https://www.statcan.gc.ca/pub/75-006-x/2013001/article/11878-eng.htm>

Union Structure

Unions have a pyramidal structure much like that of large corporations. At the bottom are locals that serve workers in a particular geographical area. Certain members are designated as stewards to serve as go-betweens in disputes between workers and supervisors. Locals are usually organized into national unions that assist with local contract negotiations, organize new locals, negotiate contracts for entire industries, and lobby government bodies on issues of importance to organized labour. In turn, national unions may be linked by a labour federation, such as the Canadian Labour Congress (CLC), which provides assistance to member unions and serves as a principal political organ for organized labour.

Collective Bargaining

In a non-union environment, the employer makes largely unilateral, i.e., one-sided decisions on issues affecting its labour force, such as salary and benefits. Typically, employees are in no position to bargain for better deals. At the same time, however, employers have a vested interest in treating workers fairly. As we saw in Chapter 11, a reputation for treating employees well, for example, is a key factor in attracting talented people. Most employers want to avoid the costs involved in managing a unionized workforce; as a result, many offer generous pay and benefit packages in the hopes of keeping their workers happy – and un-unionized.

The process of setting pay and benefit levels is a lot different in a unionized environment. Union workers operate on a contract which usually covers some agreed-upon, multi-year period. When a given contract period begins to approach expiration, union representatives determine with members what they want in terms of salary increases, benefits, working conditions, and job security in their next contract. Union officials then tell the employer what its workers want and ask what they're willing to offer. When there's a discrepancy between what workers want and what management is willing to give—as there usually is—union officials serve as negotiators on behalf of their workforce, with the objective of extracting the best package of salary, benefits, and other conditions possible. The process of settling differences and establishing mutually agreeable conditions under which employees will work is called collective bargaining.

The Negotiation Process

Negotiations start when each side states its position and presents its demands. As in most negotiations, these opening demands simply stake out starting positions. Both parties usually expect some give-and-take and realize that the final agreement will fall somewhere between the two positions. If everything goes smoothly, a tentative agreement can be reached and then voted on by union members. If they accept the agreement, the process is complete and a contract is put into place to govern labour-management relations for a stated period. If workers reject the agreement, negotiators from both sides must go back to the bargaining table.

Mediation and Arbitration

If negotiations stall, the sides may call in outsiders. One option for engaging outside parties is called mediation, under which an impartial third party assesses the situation and makes recommendations for reaching an agreement. A mediator's advice can be accepted or rejected by either side. If mediation does not result in an agreement, because one or both sides are unwilling to accept the decision of the third party, they may opt instead for arbitration, under which the third party studies the situation and arrives at a binding agreement. The key difference between mediation and arbitration is the word “binding” – whatever the third party says goes, because both the union and management have agreed to accept the decision of the third party as a condition of entering into the arbitration process.

Grievance Procedures

Another difference between union and non-union environments is the handling of grievances—worker complaints on contract-related matters. When non-union workers feel that they've been treated unfairly, they can take up the matter with supervisors, who may or may not satisfy their complaints. When unionized workers have complaints (such as being asked to work more hours than stipulated under their contract), they can call on union representatives to resolve the problem, in conjunction with supervisory personnel, who are part of company management. If the outcome isn't satisfactory to the worker, the union can choose to take the problem to higher-level management on his or her behalf. If there is still no resolution, the union may submit the grievance to an arbitrator.

At times, labour and management can't resolve their differences through collective bargaining or formal grievance procedures. When this happens, each side may resort to a variety of tactics to win support for its positions and force the opposition to agree to its demands.

Union Tactics

Unions have several options at their disposal to pressure company management into accepting the terms and conditions union members are demanding. The tactics available to the union include striking, picketing, and boycotting. When they go on strike, workers walk away from their jobs and refuse to return until the issue at hand has been resolved. As undergraduates at York University discovered when they arrived on campus in 2007, the effects of a strike can engulf parties other than employers and strikers: with two-hundred food services workers on strike, students had to scramble to find food at local mini-markets. The strike lasted from February 2nd to March 7th, and in the end, the workers got what they wanted: fairer wages, work protection and improvements to their health and dental plans.^[1]

Though a strike sends a strong message to management, it also has consequences for workers, who don't get paid when they're on strike. Unions often ease the financial pressure on strikers by providing cash payments, which are funded from the dues members pay to the unions. It is important to note that some unionized workers may not have the right to strike. For example, strikes by federal employees, such as air-traffic controllers, can be declared illegal if they jeopardize the public interest.

When you see workers parading with signs outside a factory or an office building (or even a school), they're probably using the tactic known as picketing (see Figure). The purpose of picketing is informative—to tell people that a workforce is on strike or to publicize some



Ontario College Faculty picketing during a strike in October 2017.

management practice that is unacceptable to the union. In addition, because other union workers typically won't cross picket lines, marchers can sometimes interrupt the daily activities of the targeted organization. In 2009, approximately 24,000 City of Toronto Municipal Workers, unhappy about wages and loss of the right to bank and

cash out unused sick leave, went on a five-week strike. At first, many citizen supported this right, but some of the most noticeable effects of the strike, including the halting of waste collection and the cancellation of summer recreation programming, created widespread concern and negative reactions from the Toronto population.^[2]

The final tactic available to unions is boycotting, in which union workers refuse to buy a company's products and try to get other people to follow suit. The tactic is often used by the Canadian Labour Congress, who often endorse national boycotts. In 2009, for example, they called for a [boycott of Old Dutch snack products](#) in support of 170 locked out union workers at their Calgary plant.

Management Tactics

Management doesn't typically sit by passively, especially if the company has a position to defend or a message to get out. One available tactic is the lockout—closing the workplace to workers—though it's rarely used because it's legal only when unionized workers pose a credible threat to the employer's financial viability. If you are a fan of professional basketball, you may remember the NBA lockout in 2011 (older fans may remember a similar scenario that took place in 1999) which took place because of a dispute regarding the division of revenues and the structure of the salary cap.

Lockout tactics were also used in the 2011 labour dispute between the National Football League (NFL) and the National Football League Players Association when club owners and players failed to reach an agreement on a new contract. Prior to the 2011 season, the owners imposed a lockout, which prevented the players from practising in team training facilities. Both sides had their demands: the players wanted a greater percentage of the revenues, which the owners were against. The owners wanted the players to play two additional regular season games, which the players were against. With the season drawing closer, an agreement was finally reached in July 2011 bringing the 130-day lockout to an end and ensuring that the 2011 football season would begin on time.^[3]



Two football referees conversing

Another management tactic is replacing striking workers with strikebreakers—non-union workers who are willing to cross picket lines to replace strikers. Though the law prohibits companies from permanently replacing striking workers, it's often possible for a company to get a court injunction that allows it to bring in replacement workers. For example, the NFL employed replacement referees in 2012, a move which led to a number of very questionable calls on the field.^[4]

Why Managers Often Resist Unionization Efforts

No union organizing campaign ever started with the premise that by unionizing, employees would receive lower wages or weaker benefit programs. To the contrary, unions approach prospective members with promises like higher pay, better health insurance, and more vacation time. Not surprisingly, then, business managers resist

unions because they generally add to the cost of doing business. Higher costs can be addressed in several ways. Managers could accept lower profits, though such an outcome is unlikely given that owners/shareholders benefit from higher profits. They could raise prices and pass the higher costs along to customers, but doing so could hurt their competitiveness in the marketplace. Alternatively, they could find other ways to offset the increase in costs, but since managers are already supposed to be paying attention to costs, finding offsets can be quite difficult.

Another reason managers sometimes resist unionization is that unions often attempt to negotiate work rules that are to the benefit of their members. Business people who have worked in union environments have often complained of the lack of flexibility and the difficulty unions sometimes create in dealing with poor performing union employees. The grievance process can sometimes be long, cumbersome, and costly to administer.

Some companies find working with unions to be so unpleasant that they decide to voluntarily increase pay and benefits to preempt unions in advertising these benefits.

The History of Unions

Excerpted from CBC's [Highlights in Canadian Labour History](#), P. Philips writes:

Celebrated across the country, the holiday is often thought of as the last hurrah before kids head back to school and the long, hot days of summer give way to the crisp, fading days of autumn.

But Labour Day is more than just the unofficial end to summer – a fact many Canadians tend to forget.

The Labour Day holiday, however, was established to recognize the contribution that ordinary working people have made to the Canadian way of life, said Ken Georgetti, president of the Canadian Labour Congress.

This includes the right to fair wages, safe working conditions and compensation for injury, and equitable labour relations.

“Lots of people lost their lives in order to establish the right to refuse unsafe work and the right to be treated fairly and without discrimination,” said Georgetti. “We’ve done a lot and we’re very proud of it.”



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=123>

The Future of Unions

Union membership in Canada and the United States have been declining for some time. In Canada, the unionization rate fell from 37.6% in 1981 to 28.8% in 2014. So will membership continue to decline causing unions

to lose even more power? The American Federation of Labour and Congress of Industrial Organization (AFL-CIO) is optimistic about union membership, pointing out recent gains in membership among women and immigrants, as well as health care workers, graduate students, and professionals.^[5]

Convincing workers to unionize is still more difficult than it used to be and could become even harder in the future. Given their resistance to being unionized, employers have developed strategies for dissuading workers from unionizing—in particular, tactics for withholding job security. If unionization threatens higher costs for wages and benefits, management can resort to part-time or contract workers. They can also outsource work, eliminating jobs entirely. Many employers are now investing in technology designed to reduce the amount of human labour needed to produce goods or offer services. While it is impossible to predict the future, it is likely that unions and managers will remain adversaries for the foreseeable future.

Key Takeaways

Important terms and concepts

1. Labour unions are organized groups of workers that bargain with employers to improve members' pay, job security, and working conditions.
2. When there's a discrepancy between what workers want in terms of salary increases, benefits, working conditions, and job security and what management is willing to give, the two sides engage in a process called collective bargaining.
3. If negotiations break down, the sides may resort to mediation (in which an impartial third party makes recommendations for reaching an agreement) or arbitration (in which the third party imposes a binding agreement).
4. When unionized workers feel that they've been treated unfairly, they can file grievances—complaints over contract-related matters that are resolved by union representatives and employee supervisors.
5. If labour differences can't be resolved through collective bargaining or formal grievance procedures, each side may resort to a variety of tactics. The union can do the following.
 - Call a strike (in which workers leave their jobs until the issue is settled)
 - Organize picketing (in which workers congregate outside the workplace to publicize their position)
 - Arrange for boycotting (in which workers and other consumers are urged to refrain from buying an employer's products).
6. Management may resort to a lockout—closing the workplace to workers—or call in strikebreakers (non-union workers who are willing to cross picket lines to replace strikers).

14. Marketing: Providing Value

Learning Objectives

By the end of the chapter, you should be able to:

1. Define the terms marketing, marketing concept, and marketing strategy.
2. Outline the tasks involved in selecting a target market.
3. Identify the four P's of the marketing mix.
4. Explain how to conduct marketing research.
5. Discuss various branding strategies and explain the benefits of packaging and labelling.
6. Describe the elements of the promotion mix.
7. Explain how companies manage customer relationships.
8. Identify the advantages and disadvantages of social media marketing.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=139>

A Robot with Attitude

Mark Tilden used to build robots for NASA that ended up being destroyed on Mars, but after seven years of watching the results of his work meet violent ends thirty-six million miles from home, he decided to specialize in robots for earthlings. He left the space world for the toy world and teamed up with Wow Wee Toys Ltd. to create “Robosapien,” an intelligent robot with an attitude.^[1] The fourteen-inch-tall robot, which is operated by remote control, has great moves. In addition to walking forward, backward, and turning, he dances, raps, and gives karate chops. He can pick up small objects and even fling them across the room, and he does everything while grunting, belching, and emitting other “bodily” sounds.

Robosapien gave Wow Wee Toys a good head start in the toy robot market: in the first five months, more than 1.5 million Robosapiens were sold.^[2] The company expanded the line to more than a dozen robotics and other interactive toys, including FlyTech Bladestar, a revolutionary indoor flying machine that won a Popular Mechanics magazine Editor’s Choice Award in 2008).^[3]



M. Tilden and his creation, Robosapien

What does Robosapien have to do with marketing? The answer is fairly simple: though Mark Tilden is an accomplished inventor who has created a clever product, Robosapien wouldn’t be going anywhere without the marketing expertise of Wow Wee. In this chapter, we’ll look at the ways in which marketing converts product ideas like Robosapien into commercial success.

What Is Marketing?

When you consider the functional areas of business—accounting, finance, management, marketing, and operations—marketing is the one you probably know the most about. After all, as a consumer and target of all sorts of advertising messages, you’ve been on the receiving end of marketing initiatives for most of your life. What you probably don’t appreciate, however, is the extent to which marketing focuses on providing value to the customer. According to the American Marketing Association, “Marketing is the activity, set of institutions, and processes for creating, communicating, delivering, and exchanging offerings that have value for customers, clients, partners, and society at large.”^[4]

In other words, marketing isn’t just advertising and selling. It includes everything that organizations do to satisfy customer needs:

- Coming up with a product and defining its features and benefits
- Setting its price
- Identifying its target market
- Making potential customers aware of it

- Getting people to buy it
- Delivering it to people who buy it
- Managing relationships with customers after it has been delivered

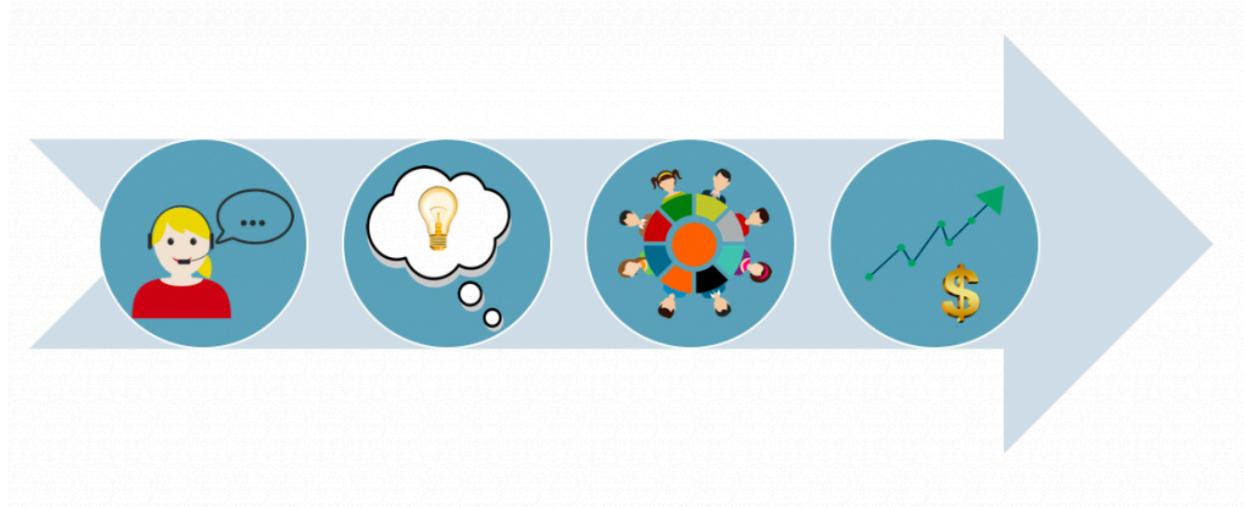
Think about a typical business—a local movie theater, for example. It’s easy to see how the person who decides what movies to show is involved in marketing: he or she selects the product to be sold. It’s even easier to see how the person who puts ads in the newspaper works in marketing: he or she is in charge of advertising—making people aware of the product and getting them to buy it. What about the ticket seller and the person behind the counter who gets the popcorn and soda or the projectionist? Are they marketing the business? Absolutely. The purpose of every job in the theater is satisfying customer needs, and as we’ve seen, identifying and satisfying customer needs is what marketing is all about. Marketing is a team effort involving everyone in the organization.

If everyone is responsible for marketing, can the average organization do without an official marketing department? Not necessarily: most organizations have marketing departments in which individuals are actively involved in some marketing-related activity—product design and development, pricing, promotion, sales, and distribution. As specialists in identifying and satisfying customer needs, members of the marketing department manage, plan, organize, lead, and control the organization’s overall marketing efforts.

The Marketing Concept

The following flowchart is designed to remind you that to achieve company profitability goals, you need to start with three things:

1. Find out what customers or potential customers need.
2. Develop products to meet those needs.
3. Engage the entire organization in efforts to satisfy customers.



The Marketing Concept Leads to Company Profit

At the same time, you need to achieve organizational goals, such as profitability and growth. This basic philosophy—satisfying customer needs while meeting organizational goals—is called the marketing concept, and when it’s effectively applied, it guides all of an organization’s marketing activities.

The marketing concept puts the customer first: as your most important goal, satisfying the customer must be the goal of everyone in the organization. But this doesn’t mean that you ignore the bottom line; if you want to survive and grow, you need to make some profit. What you’re looking for is the proper balance between the commitments to customer satisfaction and company survival. Consider the case of [Medtronic](#), a manufacturer of medical devices, such as pacemakers and defibrillators. The company boasts more than 50 percent of the market in cardiac devices and is considered the industry standard setter.^[5] Everyone in the organization understands that defects are intolerable in products that are designed to keep people alive. Thus, committing employees to the goal of zero defects is vital to both Medtronic’s customer base and its bottom line. “A single quality issue,” explains CEO Arthur D. Collins Jr., “can deep-six a business.”^[6]

Selecting a Target Market

Businesses earn profits by selling goods or providing services. It would be nice if everybody in the marketplace was interested in your product, but if you tried to sell it to everybody, you’d probably spread your resources too thin. You need to identify a specific group of consumers who should be particularly interested in your product, who would have access to it, and who have the means to buy it. This group represents your target market, and you need to aim your marketing efforts at its members.

Identifying Your Market

How do marketers identify target markets? First, they usually identify the overall market for their product—the individuals or organizations that need a product and are able to buy it. This market can include either or both of two groups:

1. A consumer market—buyers who want the product for personal use
2. An industrial market—buyers who want the product for use in making other products

You might focus on only one market or both. A farmer, for example, might sell blueberries to individuals on the consumer market and, on the industrial market, to bakeries that will use them to make muffins and pies.

Segmenting the Market

The next step in identifying a target market is to divide the entire market into smaller portions, or market segments—groups of potential customers with common characteristics that influence their buying decisions. You can use a number of characteristics to narrow a market. Let’s look at some of the most useful categories in detail.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=139>

Clustering Segments

Typically, marketers determine target markets by combining, or “clustering,” segmenting criteria. What characteristics does Starbucks look for in marketing its products? Three demographic variables come to mind: age, geography, and income. Buyers are likely to be males and females ranging in age from about twenty-five to forty (although college students, aged eighteen to twenty-four, are moving up in importance). Geography is a factor as customers tend to live or work in cities or upscale suburban areas. Those with relatively high incomes are willing to pay a premium for Starbucks specialty coffee and so income—a socioeconomic factor—is also important.

The Marketing Mix

After identifying a target market, your next step is developing and implementing a marketing program designed to reach it. As the graphic below shows, this program involves a combination of tools called the marketing mix, often referred to as the “four P’s” of marketing:

1. Developing a **product** that meets the needs of the target market
2. Setting a **price** for the product
3. Distributing the product—getting it to a **place** where customers can buy it
4. **Promoting** the product—informing potential buyers about it



The Marketing Mix

Developing a Product

The development of Robosapien was a bit unusual for a company that was already active in its market.^[12] Generally, product ideas come from people within the company who understand its customers' needs. Internal engineers are then challenged to design the product. In the case of Robosapien, the creator, Mark Tilden, had conceived and designed the product before joining Wow Wee Toys. The company gave him the opportunity

to develop the product for commercial purposes, and Tilden was brought on board to oversee the development of Robosapien into a product that satisfied Wow Wee's commercial needs.

Robosapien is not a "kid's toy," though kids certainly love its playful personality. It's a home-entertainment product that appeals to a broad audience—children, young adults, older adults, and even the elderly. It's a big gift item, and it has developed a following of techies and hackers who take it apart, tinker with it, and even retrofit it with such features as cameras and ice skates.

Conducting Marketing Research

Before settling on a strategy for Robosapien, the marketers at Wow Wee did some homework. First, to zero in on their target market, they had to find out what various people thought of the product. More precisely, they needed answers to questions like the following:

- Who are our potential customers?
- What do they like about Robosapien? What would they change?
- How much are they willing to pay for it?
- Where will they expect to buy it?
- How can we distinguish it from competing products?
- Will enough people buy Robosapien to return a reasonable profit for the company?

The last question would be left up to Wow Wee management, but, given the size of the investment needed to bring Robosapien to market, Wow Wee couldn't afford to make the wrong decision. Ultimately, the company was able to make an informed decision because its marketing team provided answers to key questions through marketing research—the process of collecting and analyzing the data that are relevant to a specific marketing situation. This data had to be collected in a systematic way. Market research seeks two types of data:

1. Marketers generally begin by looking at secondary data—information already collected, whether by the company or by others, that pertains to the target market.
2. With secondary data in hand, they're prepared to collect primary data—newly collected information that addresses specific questions.

Secondary data can come from inside or outside the organization. Internally available data includes sales reports and other information on customers. External data can come from a number of sources. [Statistics Canada](#), for example, posts demographic information on Canadian households (such as age, income, education, and number of members), both for the country as a whole and for specific geographic areas.

Population data from U.S. Census Bureau (the American equivalent to Statistics Canada), helped Wow Wee estimate the size of its potential U.S. target market. Other secondary data helped the firm assess the size of foreign markets in regions around the world, such as Europe, the Middle East, Latin America, Asia, and the Pacific Rim. This data helped position the company to sell Robosapien in eighty-five countries, including Canada, England, France, Germany, South Africa, Australia, New Zealand, Hong Kong, and Japan.

Using secondary data that is already available (and free) is a lot easier than collecting your own information. Unfortunately, however, secondary data didn't answer all the questions that Wow Wee was asking in this

particular situation. To get these answers, the marketing team had to conduct primary research, working directly with members of their target market. First they had to decide exactly what they needed to know, then determine who to ask and what methods would be most effective in gathering the information.

We know what they wanted to know—we've already listed example questions. As for whom to talk to, they randomly selected representatives from their target market. There is a variety of tools for collecting information from these people, each of which has its advantages and disadvantages. To understand the marketing-research process fully, we need to describe the most common of these tools:

- Surveys. Sometimes marketers mail questionnaires to members of the target market. The process is time consuming and the response rate generally low. Online surveys are easier to answer and so get better response rates than other approaches.
- Personal interviews. Though time consuming, personal interviews not only let you talk with real people but also let you demonstrate the product. You can also clarify answers and ask open-ended questions.
- Focus groups. With a focus group, you can bring together a group of individuals (perhaps six to ten) and ask them questions. A trained moderator can explain the purpose of the group and lead the discussion. If sessions are run effectively, you can come away with valuable information about customer responses to both your product and your marketing strategy.

Wow Wee used focus groups and personal interviews because both approaches had the advantage of allowing people to interact with Robosapien. In particular, focus-group sessions provided valuable opinions about the product, proposed pricing, distribution methods, and promotion strategies.

Researching your target market is necessary before you launch a new product, but the benefits of marketing research don't extend merely to brand-new products. Companies also use it when they're deciding whether or not to refine an existing product or develop a new marketing strategy for an existing product. PepsiCo Canada, for example, relaunched the Doritos Ketchup chip in 2014 as a limited-time-only retro flavour and it was a tremendous success. Because of this positive customer feedback, instead of looking for a new chip flavour the following year, they announced that they would continue the ketchup version, accompanied it with a 'hold on to your phone' contest and app that awarded winners with a years-supply of the chips, as well as the limited availability of a dozen 'ketchup roses' during Valentine's season. ^[13]



*"Limited Time Only" Ketchup Doritos
(Canada) | theimpulsivebuy | flickr licensed
CC BY*

Branding

Armed with positive feedback from their research efforts, the Wow Wee team was ready for the next step: informing buyers—both consumers and retailers—about their product. They needed a brand—some word, letter, sound, or symbol that would differentiate their product from similar products on the market. They chose the brand name Robosapien, hoping that people would get the connection between homo sapiens (the human species) and Robosapien (the company's coinage for its new robot "species"). To prevent other companies from coming out with their own "Robosapiens," they took out a trademark: a symbol,

word, or words legally registered or established by use as representing a company or product. Trademarking requires registering the name with the [Canadian Intellectual Property Office](#). Though this approach—giving a unique brand name to a particular product—is a bit unusual, it isn't unprecedented. Kraft Foods, for example, established a separate brand for Nabob Coffee, and Labatt Brewing Company sells beer under the brand name Alexander Keith's. Note, however, that the more common approach, which is taken by such companies as Dare Foods, McCain Foods and Lululemon Athletica, calls for marketing all the products made by a company under the company's brand name.

Branding Strategies

Companies can adopt one of three major strategies for branding a product:

1. With private branding (or private labelling), a company makes a product and sells it to a retailer who in turn resells it under its own name. A soft-drink maker, for example, might make cola for Walmart to sell as its Great Value Cola.
2. With generic branding, the maker attaches no branding information to a product except a description of its contents. Customers are often given a choice between a brand-name prescription drug or a cheaper generic drug with the same formula.
3. With manufacturer branding, a company sells one or more products under its own brand names. Adopting a multi-product branding approach, it sells all its products under one brand name (generally the company name). Using a multi-branding approach, it will assign different brand names to different products covering different segments of the market. Automakers generally use multi-branding. For example, the Volkswagen group of brands also includes Audi, Bentley, and even Lamborghini.



Brands by B. Jordan | flickr licensed CC BY

Branding is used in hotels to allow chains (Marriott, Hyatt, Hilton) to offer hotel brands that meet various customers' travel needs while still maintaining their loyalty to the chain. The same customer who would choose an Extended Stay hotel with a full kitchen when on a long term assignment might stay at a convention hotel when attending a trade show and then stay in a resort property when traveling with their family. By segmenting different types of hotel locations, amenities, room sizes and décor, hotel chains can meet the needs of a wide variety of travelers. In the past decade “soft” branding has become common to allow unique hotels to take advantage of being part of a chain reservation system and loyalty program. For example, Marriott has over 100 affiliated independent hotels in its Autograph Collection. ^[14]

Type of Hotel	Marriott	Hilton	Hyatt
Luxury	Ritz Carlton	Waldorf Astoria	Park Hyatt
	JW Marriott	Conrad	<u>Andaz</u>
Independent	Autograph Collection	Curio Collection	Unbound Collection
Full Service	Marriott	Hilton	Hyatt
	Renaissance	Canopy	
	Gaylord	Doubletree	
Select Service	Courtyard by Marriott	Hilton Garden Inn	Hyatt Place
	AC Hotels	Hampton Inn	
Extended Stay	Residence Inn	Homewood Suites	Hyatt House

Major Hotel Chains and Their Hotels

Loyalty programs are heavily used in the hospitality industry, especially airlines and hotels, as part of their Customer Relationship Management programs. Some example of popular Canadian Loyalty programs include Air Miles, Canadian Tire Rewards, Aeroplan, HBC Rewards and PC Optimum. Airline loyalty programs such as Air Canada Loyalty, are often targeted to high value business travelers with less price sensitivity. They achieve loyalty status and perks while traveling as well as earning points to use for personal travel rewards. Once a loyalty program member obtains elite status with significant associated perks such as guaranteed room availability, airport club lounge access, etc., the customer is much less likely to use other brands.

Building Brand Equity

Wow Wee went with the multi-branding approach, deciding to market Robosapien under the robot's own brand name. Was this a good choice? The answer would depend, at least in part, on how well the product sells. Another consideration is the impact on Wow Wee's other brands. If Robosapien fared poorly, its failure would not reflect badly on Wow Wee's other products. On the other hand, if customers liked Robosapien, they would have no reason to associate it with other Wow Wee products. In this case, Wow Wee wouldn't gain much from its brand equity—any added value generated by favorable consumer experiences with Robosapien. To get a better idea of how valuable brand equity is, think for a moment about the effect of the name Dell on a product. When you have a positive experience with a Dell product—say, a laptop or a printer—you come away with a positive opinion of the entire Dell product line and will probably buy more Dell products. Over time, you may even develop brand loyalty: you may prefer—or even insist on—Dell products. Not surprisingly, brand loyalty can be extremely valuable to a company. Because of customer loyalty, Apple's brand tops [Interbrand's Best Global Brands 2017 ranking](#) with a value of over \$184 billion. Google's brand is valued at \$142 billion, Microsoft is estimated at \$80 billion and Coca-Cola and Amazon round out the top five, with brands valued at \$70 and \$65 billion respectively. ^[15]

Packaging and Labelling

Packaging can influence a consumer's decision to buy a product or pass it up. Packaging gives customers a glimpse of the product, and it should be designed to attract their attention, with consideration given to color choice, style of lettering, and many other details. Labelling not only identifies the product but also provides information on the package contents: who made it and where or what risks are associated with it (such as being unsuitable for small children).

How has Wow Wee handled the packaging and labelling of Robosapien? The robot is fourteen inches tall, and is also fairly heavy (about seven pounds), and because it's made out of plastic and has movable parts, it's breakable. The easiest, and least expensive, way of packaging it would be to put it in a square box of heavy cardboard and pad it with Styrofoam. This arrangement would not only protect the product from damage during shipping but also make the package easy to store. However, it would also eliminate any customer contact with the product inside the box (such as seeing what it looks like). Wow Wee, therefore, packages Robosapien in a container that is curved to his shape and has a clear plastic front that allows people to see the whole robot. Why did Wow Wee go to this much trouble and expense? Like so many makers of so many products, it has to market the product while it's still in the box.



Robosapien in its package

Meanwhile, the labelling on the package details some of the robot's attributes. The name is highlighted in big letters above the descriptive tagline "A fusion of technology and personality." On the sides and back of the package are pictures of the robot in action with such captions as "Dynamic Robotics with Attitude" and "Awesome Sounds, Robo-Speech & Lights." These colorful descriptions are conceived to entice the consumer to make a purchase because its product features will satisfy some need or want.

Packaging can serve many purposes. The Robosapien package attracts attention to the product's features. For other products, packaging serves a more functional purpose. Kraft Foods packages some of its snacks— Oreos and Chips Ahoy, and—in "100 Calorie Packs." The packaging makes life simpler for people who are keeping track of calories.

Place

A great deal is involved in getting a product to the place in which it is ultimately sold. If you're a fast food retailer, for example, you'll want your restaurants to be in high-traffic areas to maximize your potential business. If your business is selling beer, you'll want it to be offered in bars, restaurants, grocery stores, convenience stores, and even stadiums. Placing a product in each of these locations requires substantial negotiations with the owners

of the space, and often the payment of slotting fees, an allowance paid by the manufacturer to secure space on store shelves.

Retailers are marketing intermediaries that sell products to the eventual consumer. Without retailers, companies would have a much more difficult time selling directly to individual consumers, no doubt at a substantially higher cost. The most common types of retailers are summarized in the Figure below. You will likely recognize many of the examples provided. It is important to note that many retailers do not fit neatly into only one category. For example, WalMart, which began as a discount store, has added groceries to many of its outlets, also placing it in competition with supermarkets.

Type of Retailer	Description	Examples
Category Killer	Sells a wide variety of products of a particular type, selling at a low price due to their large scale	Chapters-Indigo
Convenience Store	Offers food, beverages, and other products, typically in individual servings, at a higher price, and geared to fast service	Circle K
Department Store	Offers a wide assortment of products grouped into different departments (e.g., jewelry, apparel, perfume)	Hudson's Bay
Discount Store	Organized into departments, but offer a range of merchandise generally seen as lower quality and at a much lower price	Walmart, Dollarama
Specialty Store	Offers goods typically confined to a narrow category; high level of personal service and higher prices than other retailers	Local running shops or jewelry stores
Supermarket	Offers mostly consumer staples such as food and other household items	Metro, Sobey's
Warehouse Club Stores	Offers a wide variety of products in a warehouse-style setting; sells many products in bulk; usually requires membership fee	Costco

Promoting a Product

Your promotion mix—the means by which you communicate with customers—may include advertising, personal selling, sales promotion, and publicity. These are all tools for telling people about your product and persuading potential customers to buy it. Before deciding on an appropriate promotional strategy, you should consider a few questions:

- What's the main purpose of the promotion?
- What is my target market?
- Which product features should I emphasize?
- How much can I afford to invest in a promotion campaign?
- How do my competitors promote their products?

To promote a product, you need to imprint a clear image of it in the minds of your target audience. What

do you think of, for instance, when you hear “Ritz-Carlton”? What about “Motel 6”? They’re both hotel chains, that have been quite successful in the hospitality industry, but they project very different images to appeal to different clientele. The differences are evident in their promotions. The [Ritz-Carlton website](#) describes itself as the “gold standard” and promises that the chain provides “the finest personal service and facilities throughout the world”.^[16] Motel 6, by contrast, characterizes its facilities as “no frills ” and assures you that you’ll pay “the lowest price”.^[17]

Promotional Tools

We’ll now examine each of the elements that can go into the promotion mix– advertising, personal selling, sales promotion, and publicity. Then we’ll see how Wow Wee incorporated them into a promotion mix to create a demand for Robosapien.

Advertising

Advertising is paid, non-personal communication designed to create an awareness of a product or company. Ads are everywhere–in print media (such as newspapers, magazines, mailers), on billboards, in broadcast media (radio and TV), and, increasingly, online. It’s hard to escape the constant barrage of advertising messages; it’s estimated that the average consumer is confronted by about 5,000 ad messages each day (compared with about 500 ads a day in the 1970s).^[18] For this very reason, ironically, ads aren’t as effective as they used to be. Because we’ve learned to tune them out, companies now have to come up with innovative ways to get through to potential customers. A New York Times article^[19] claims that “anywhere the eye can see, it’s likely to see an ad.” Subway cars are plastered with ads for cell phone companies. Restaurant placemats are decorated with ads, and social media feeds are peppered with ‘suggested products’.^[20] Advertising is still the most prevalent form of promotion.



Downtown Toronto at night | AILAFa | flickr licensed CC BY-NC-SA

The choice of advertising media depends on your product, target audience, and budget. A travel agency selling spring-break getaways to college students might post flyers on campus bulletin boards or run ads in campus newspapers. The co-founders of Sleep Country Canada found radio ads particularly effective, ingraining their catchy jingle, “why buy a mattress anywhere else?” into listeners nationwide.

Personal Selling

Personal selling refers to one-on-one communication with customers or potential customers. This type of interaction is necessary in selling large-ticket items, such as homes, and it's also effective in situations in which personal attention helps to close a sale, such as sales of cars and insurance policies.

Many retail stores depend on the expertise and enthusiasm of their salespeople to persuade customers to buy. Home Depot has grown into a home-goods giant in large part because it fosters one-on-one interactions between salespeople and customers. The real difference between Home Depot and everyone else isn't the merchandise; it's the friendly, easy-to-understand advice that sales people give to novice homeowners, according to one of its co-founders.^[21] Best Buy's knowledgeable sales associates make them "uniquely positioned to help consumers navigate the increasing complexity of today's technological landscape" according to CEO Hubert Joly.^[22]



Personal selling at Best Buy

Sales Promotion



Sales promotion at Walmart

It's likely that at some point, you have purchased an item with a coupon or because it was advertised as a buy-one-get-one special. If so, you have responded to a sales promotion – one of the many ways that sellers provide incentives for customers to buy. Sales promotion activities include not only those mentioned above but also other forms of discounting, sampling, trade shows, in-store displays, and even sweepstakes. Some promotional activities are targeted directly to consumers and are designed to motivate them to purchase now. You've probably heard advertisers make statements like "limited time only" or "while supplies last". If so, you've encountered a sales promotion directed at consumers. Other forms of sales promotion are directed at dealers and intermediaries. Trade shows are one example of a dealer-focused promotion. Mammoth convention centres such as the Enercare Centre in Toronto host enormous events in which manufacturers can display their new products to retailers and other interested parties. At food shows, for example, potential buyers can sample products that manufacturers hope to launch to the market. Feedback from prospective buyers can even result in changes to new

product formulations or decisions not to launch.

Losing money to make money

A **loss leader** (also **leader**) is a pricing strategy where a product is sold at a price below its market cost to stimulate other sales of more profitable goods or services. With this sales promotion/ marketing strategy, a “leader” is used as a related term and can mean any popular article, i.e., one sold at a normal price.

One use of a loss leader is to draw customers into a store where they are likely to buy other goods. The vendor expects that the typical customer will purchase other items at the same time as the loss leader and that the profit made on these items will be such that an overall profit is generated for the vendor.

“Loss lead” describes the concept that an item is offered for sale at a reduced price and is intended to “lead” to the subsequent sale of other services or items, the sales of which will be made in greater numbers, or greater profits, or both. The loss leader is offered at a price below its minimum profit margin—not necessarily below cost. The firm tries to maintain a current analysis of its accounts for both the loss lead and the associated items, so it can monitor how well the scheme is doing, as quickly as possible, thereby never suffering an overall net loss.

From [Wikipedia](#)

Publicity and Public Relations

Free publicity—say, getting your company or your product mentioned or pictured in a newspaper or on TV—can often generate more customer interest than a costly ad. When Dr. Dre and Jimmy Iovine were finalizing the development of their Beats headphones, they sent a pair to LeBron James. He liked them so much he asked for 15 more pairs, and they “turned up on the ears of every member of the 2008 U.S. Olympic basketball team when they arrived in Shanghai. ‘Now that’s marketing,’ says Iovine.”^[23] It wasn’t long before the pricey headphones became a must-have fashion accessory for everyone from celebrities to high school students.



Beats headphones by Dr. Dre

Consumer perception of a company is often important to a company’s success. Many companies, therefore, manage their public relations in an effort to garner favorable publicity for themselves and their products. When the company does something noteworthy, such as sponsoring a fund-raising event, the public relations department may issue a press release to promote the event. When the company does something negative, such as selling a prescription drug that has unexpected side effects, the public relations department will work to control the damage to the company. Each year the Hay Group and Korn

Ferry survey more than a thousand company top executives, directors, and industry leaders in twenty countries to identify companies that have exhibited exceptional integrity or commitment to corporate social responsibility. The rankings are published annually as Fortune magazine's "World's Most Admired Companies."^[24] Topping the list in 2016 are Apple, Alphabet (Google), Amazon, Berkshire Hathaway, and Starbucks.^[25]

Marketing Robosapien

Now let's look more closely at the strategy that Wow Wee pursued in marketing Robosapien in the United States. The company's goal was ambitious: to promote the robot as a must-have item for kids of all ages. As we know, Wow Wee intended to position Robosapien as a home-entertainment product, not as a toy. The company rolled out the product at Best Buy, which sells consumer electronics, computers, entertainment software, and appliances. As marketers had hoped, the robot caught the attention of consumers shopping for TV sets, DVD players, home and car audio equipment, music, movies, and games. Its \$99 price tag was a little lower than the prices of other merchandise, and that fact was an important asset: shoppers were willing to treat Robosapien as an impulse item—something extra to pick up as a gift or as a special present for children, as long as the price wasn't too high.

Meanwhile, Robosapien was also getting lots of free publicity. Stories appeared in newspapers and magazines around the world, including the New York Times, La Presse, the Times of London, Time magazine, and National Parenting magazine. Commentators on CBC News, The Today Show, The Early Show, CNN, ABC News, and FOX News all covered it. The product received numerous awards, and experts predicted that it would be a hot item for the holidays.

At Wow Wee, Marketing Director Amy Weltman (who had already had a big hit with the Rubik's Cube) developed a New York gala event to showcase the product. From mid- to late August, actors dressed in six-foot robot costumes roamed the streets of Manhattan, while the fourteen-inch version of Robosapien performed in venues ranging from Grand Central Station to city bars. Everything was recorded, and film clips were sent to TV stations.

The stage was set for expansion into other North American stores. Macy's ran special promotions, floating a twenty-four-foot cold-air robot balloon from its rooftop and lining its windows with armies of Robosapien's. Wow Wee trained salespeople to operate the product so that they could help customers during in-store demonstrations. Other retailers, including Best Buy and Toys "R" Us, carried Robosapien, as did e-retailers such as Amazon.ca. The product was also rolled out (with the same marketing flair) in Europe and Asia.

When national advertising hit in September, all the pieces of the marketing campaign came together—publicity, sales promotion, personal selling, and advertising. Wow Wee ramped up production to meet anticipated fourth-quarter demand and waited to see whether Robosapien would live up to commercial expectations.

Just For Fun



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=139>



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=139>

Interacting with Customers

Customer-Relationship Management

Customers are the most important asset that any business has. Without enough good customers, no company can survive. Firms must not only attract new customers but also retain current customers. In fact, repeat customers are more profitable. It's estimated that it costs as much as five times more to attract and sell to a new customer than to an existing one.^[26] Repeat customers also tend to spend more, and they're much more likely to recommend you to other people.

Retaining customers is the purpose of customer-relationship management—a marketing strategy that focuses on using information about current customers to nurture and maintain strong relationships with them. The underlying theory is fairly basic: to keep customers happy, you treat them well, give them what they want, listen to them, reward them with discounts and other loyalty incentives, and deal effectively with their complaints.

Take Caesars Entertainment Corporation, which operates more than fifty casinos under several brands, including Caesars, Harrah's, Bally's, and Horseshoe. Each year, it sponsors the World Series of Poker with a top prize in the millions. Caesars gains some brand recognition when the twenty-two-hour event is televised on ESPN, but the real benefit derives from the information cards filled out by the seven thousand entrants who put up \$10,000 each. Data from these cards is fed into Caesars database, and almost immediately every entrant starts getting special attention, including party invitations, free entertainment tickets, and room discounts. The program is all part of Harrah's strategy for targeting serious gamers and recognizing them as its best customers.^[27]

Sheraton Hotels uses a softer approach to entice return customers. Sensing that its resorts needed both a new look and a new strategy for attracting repeat customers, Sheraton launched its “Year of the Bed” campaign; in addition to replacing all its old beds with luxurious new mattresses and coverings, it issued a “service promise guarantee”—a policy that any guest who's dissatisfied with his or her Sheraton stay will be compensated. The program also calls for a customer-satisfaction survey and discount offers, both designed to keep the hotel chain in touch with its customers.^[28]

Another advantage of keeping in touch with customers is the opportunity to offer them additional products. Amazon is a master at this strategy. When you make your first purchase at Amazon, you're also making a lifelong “friend”—one who will suggest (based on what you've bought before) other things that you might like to buy. Because Amazon continually updates its data on your preferences, the company gets better at making suggestions.

Social Media Marketing

In the last several years, the popularity of social media marketing has exploded. You already know what social media is – Facebook, Twitter, Instagram LinkedIn, YouTube, and any number of other online sites that allow you to network, share your opinions, ideas, photos, etc. Social media marketing is the practice of including social media as part of a company's marketing program.

Why do businesses use social media marketing? Before responding, ask yourself these questions: how much time do I spend watching TV? When I watch TV, do I sit through the ads? Do I read newspapers or magazines and flip right past the ads? Now, put yourself in the place of Tammy Sadinsky, global chief marketing officer of Tim Hortons. Does it make sense for her to spend millions of dollars to place an ad for Tim Hortons on TV or in a newspaper or magazine? Or should she instead spend the money on social media marketing initiatives that have a high probability of connecting to Tim Horton's market?

For companies like Tim Horton's, the answer is clear. The days of trying to reach customers through ads on TV, in newspapers, or in magazines are over. Most television watchers skip over commercials, and few Tim Horton's customers read newspapers or magazines, and even if they do, they don't focus on the ads. Social media marketing provides a number of advantages to companies, including enabling them to:^[29]

- create brand awareness;
- connect with customers and potential customers by engaging them in two-way communication;
- build brand loyalty by providing opportunities for a targeted audience to participate in company-sponsored activities, such as contests;
- offer and publicize incentives, such as special discounts or coupons;
- gather feedback and ideas on how to improve products and marketing initiatives;
- allow customers to interact with each other and spread the word about a company's products or marketing initiatives; and
- take advantage of low-cost marketing opportunities by being active on free social sites, such as Facebook.

To get an idea of the power of social media marketing, think of the ALS Ice Bucket Challenge. According to the ALS Association: “the ALS Ice Bucket Challenge started in the summer of 2014 and became the world's largest global social media phenomenon. More than 17 million people uploaded their challenge videos to Facebook; these videos were watched by 440 million people a total of 10 billion times.”^[30] The ALS Association raised \$115 million in six weeks (their usual annual budget was only \$20 million).^[31] To see how companies try to harness this power, let's look at social media campaigns of two leaders in this field: PepsiCo (Mountain Dew) and Starbucks.

Even our Prime Minister, before he became PM, participated:



A YouTube element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=139>

Mountain Dew (PepsiCo)

When PepsiCo announced it wouldn't show a television commercial during the 2010 Super Bowl game, it came as a surprise (probably a pleasant one to its competitor, Coca-Cola, who had already signed on to show several Super Bowl commercials). What PepsiCo planned to do instead was invest \$20 million into social media marketing campaigns. One of PepsiCo's most successful social media initiatives has been the DEWmocracy campaign, which two years earlier, resulted in the launch of product—Voltage—created by Mountain Dew fans.^[32] Now called DEWcision, the 2016 campaign asks fans to vote between two rival flavors of Mountain Dew. The campaign engages a number of social media outlets with challenges for fans to earn votes for their favorite flavor, including Twitter, Instagram, and Facebook.^[33] The example here is for a challenge to dye your hair the color of your favorite flavor, then Tweet the picture with the hashtag #DewDye. According to



Dye Dews

Mountain Dew's director of marketing, "PepsiCo looks at social media as the best way to get direct dialog with their fans and for the company to hear from those fans without filters. 'It's been great for us to have this really unique dialogue that we normally wouldn't have,' he said. 'It really has opened our eyes up.'"^[34]

Starbucks

One of most enthusiastic users of social media marketing is Starbucks. Let's look at a few of their promotions: a discount for "Foursquare" mayors and free coffee on Tax Day via Twitter's promoted tweets and a free pastry day promoted through Twitter and Facebook.^[35]

Discount for "Foursquare" Mayors of Starbucks

This promotion was a joint effort of Foursquare and Starbucks. Foursquare is a mobile social network, and in addition to the handy "friend finder" feature, you can use it to find new and interesting places around your neighborhood to do whatever you and your friends like to do. It even rewards you for doing business with sponsor companies, such as Starbucks. The individual with the most "check in's" at a particular Starbucks holds the title of mayor. For a period of time, the mayor of each store got \$1 off a Frappuccino. Those who used Foursquare were particularly excited about Starbucks's nationwide mayor rewards program because it brought attention to the marketing possibilities of the location-sharing app.^[36]

Free Coffee on Tax Day (via Twitter's Promoted Tweets)

Starbucks was not the only company to give away freebies on the United States's Tax Day, April 15, 2010.^[37] But it was the only company to spread the message of their giveaway on the then-new Twitter's Promoted Tweets platform (which went into operation on April 13, 2010). Promoted Tweets are Twitter's means of making money

by selling sponsored links to companies.^[38] Keeping with Twitter's 140 characters per tweet rule, Starbucks's Promoted Tweet read, "On 4/15 bring a reusable tumbler and we'll fill it with brewed coffee for free. Let's all switch from paper cups". The tweet also linked to a page that detailed Starbucks's environmental initiatives.^[39]

Free Pastry Day (Promoted through Twitter and Facebook)

Starbucks's "free pastry day" was promoted on Facebook and Twitter.^[40] As the word spread from person to person in digital form, the wave of social media activity drove more than a million people to Starbucks's stores around the country in search of free food.^[41]

As word of the freebie offering spread, Starbucks became the star of Twitter, with about 1 percent of total tweets commenting on the brand. That's almost ten times the number of mentions on an average day. It performed equally well on Facebook's event page where almost 600,000 people joined their friends and signed up as "attendees."^[42] This is not surprising given that Starbucks is the most popular brand on Facebook and has over 36 million "likes" in 2016.^[43]

How did Starbucks achieve this notoriety on Facebook? According to social media marketing experts, Starbucks earned this notoriety by making social media a central part of its marketing mix, distributing special offers, discounts, and coupons to Facebook users and placing ads on Facebook to drive traffic to its page. As explained by the CEO of Buddy Media, which oversees the brand's social media efforts, "Starbucks has provided Facebook users a reason to become a fan."^[44]

Social Media Marketing Challenges

The main challenge of social media marketing is that it can be very time consuming. It takes determination and resources to succeed. Small companies often lack the staff to initiate and manage social media marketing campaigns.^[45] Even large companies can find the management of media marketing initiatives overwhelming. A recent study of 1,700 chief marketing officers indicates that many are overwhelmed by the sheer volume of customer data available on social sites, such as Facebook and Twitter.^[46] This is not surprising given that in 2017, Facebook had more than 2.1 billion active users,^[47] and five hundred million tweets are sent each day.^[48] The marketing officers recognize the potential value of this data but are not always capable of using it. A chief marketing officer in the survey described the situation as follows: "The perfect solution is to serve each consumer individually. The problem? There are 7 billion of them."^[49] In spite of these limitations, 82 percent of those surveyed plan to increase their use of social media marketing over the next 3 to 5 years. To understand what real-time information is telling them, companies will use analytics software, which is capable of analyzing unstructured data. This software is being developed by technology companies, such as IBM, and advertising agencies.

The bottom line: what is clear is that marketing, and particularly advertising, has changed forever. As Simon Pestridge, Nike's global director of marketing for Greater China, said about Nike's marketing strategy, "We don't do advertising any more. Advertising is all about achieving awareness, and we no longer need awareness. We need to become part of people's lives, and digital allows us to do that."^[50]

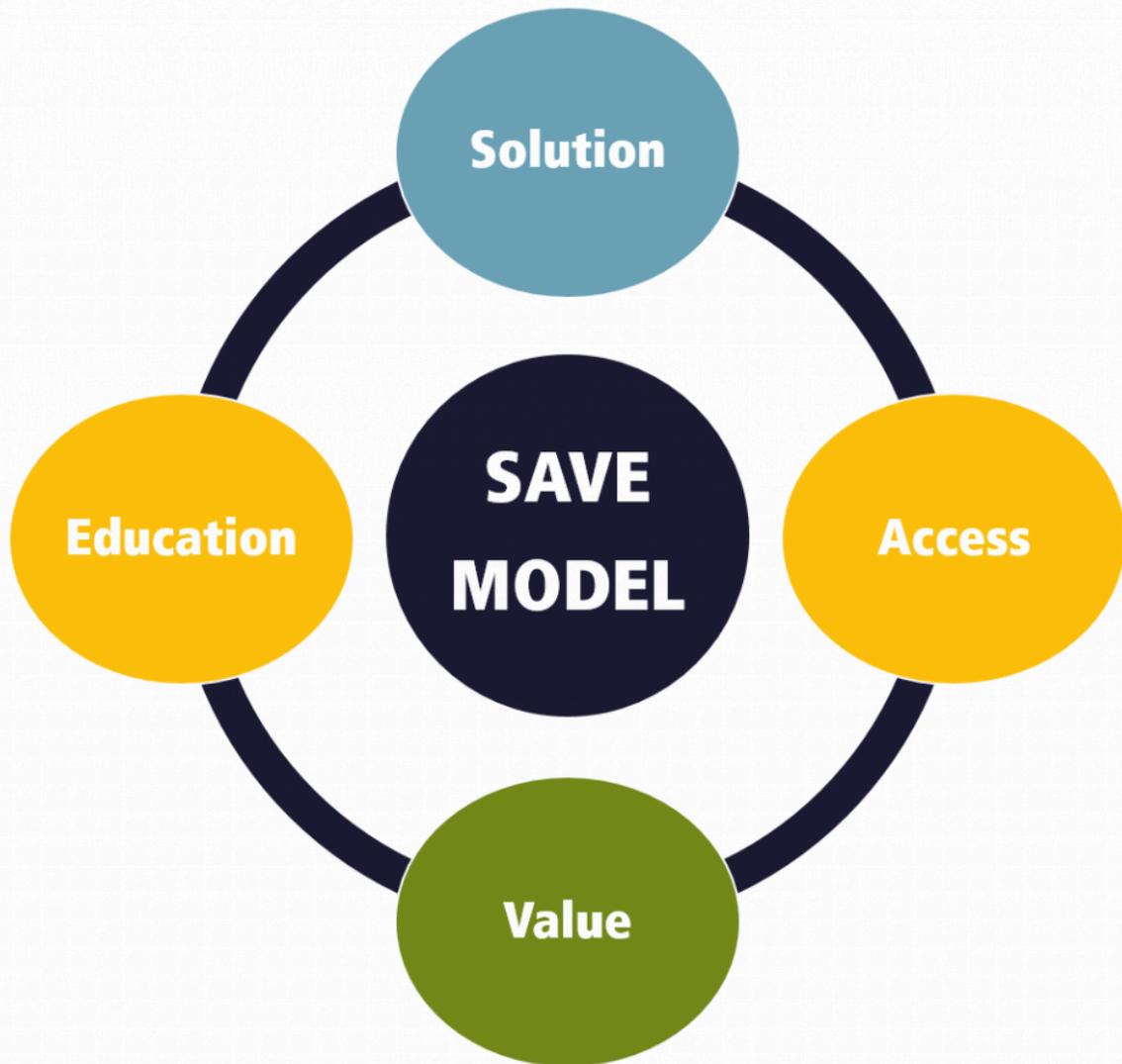
A New Marketing Model

The 4 P's have served marketers well for generations, but new innovations can disrupt even the most tried-and-true ways of doing business. A new framework is taking hold in marketing – the SAVE method. SAVE is an acronym that stands for Solution, Access, Value and Education. The framework was developed by Richard Ettenson, Eduardo Conrado, and Jonathan Knowles, and was first published in Harvard Business Review in 2013.^[5] The authors advocate replacing the 4P's with SAVE as companies define their offerings. The essence of the SAVE framework is as follows:



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=139>



SAVE model

The SAVE framework appears to be gaining traction, and it may eventually replace Marketing's 4 Ps altogether.

Key Takeaways

Important terms and concepts

1. **Marketing** is a set of processes for creating, communicating, and delivering value to customers and for improving customer relationships.
2. A **target market** is a specific group of consumers who are particularly interested in a product, would have access to it, and are able to buy it.
3. Target markets are identified through **market segmentation**—finding specific subsets of the overall market that have common characteristics that influence buying decisions.
4. Markets can be segmented on a number of variables including **Demographics, Geographics, Behaviour, and Psychographics** (or lifestyle variables).
5. Developing and implementing a marketing program involves a combination of tools called the **marketing mix: product, price, place, and promotion**.
6. Before settling on a marketing strategy, marketers often do **marketing research** to collect and analyze relevant data.
7. Methods for collecting primary data include **surveys, personal interviews, and focus groups**.
8. To protect a **brand** name, companies register trademarks.
9. There are three major **branding strategies**:
 - With **private branding**, the maker sells a product to a retailer who resells it under its own name.
 - Under **generic branding**, a no-brand product contains no identification except for a description of the contents.
 - Using **manufacturer branding**, a company sells products under its own brand names.
10. When consumers have a favorable experience with a product, it builds **brand equity**.
 - If consumers are loyal to it over time, it enjoys **brand loyalty**.
11. **Retailers** are intermediaries that sell to the end consumer. Types of retailers include **category killers, convenience stores, department stores, discount stores, specialty stores, supermarkets, and warehouse club stores**.
12. The **promotion mix** includes all the tools for telling people about a product and persuading potential customers to buy it. It can include **advertising, personal selling, sales promotion, and publicity**.

15. Accounting and Financial Information

Learning Objectives

By the end of the chapter, you should be able to:

1. Explain the differences between managerial accounting and financial accounting.
2. Identify some of the users of accounting information and explain how they use it.
3. Explain the function of the income statement.
4. Calculate revenue, expenses and net profit.
5. Explain the function of the balance sheet.
6. Calculate assets, liabilities, and shareholders equity.
7. Explain the function of the cash flow statement.
8. Calculate a breakeven point given the necessary information.
9. Evaluate a company's performance using financial statements and ratio analysis.



Show What You Know



An interactive or media element has been excluded from this version of the text.
You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=148>

Most Valuable Player



Apple Headquarters in Cupertino, California

Apple Inc. is the most valuable company in the world. This statement is based on market value, which in April 2018 was roughly \$841 billion. Although markets can fluctuate, sometimes wildly, if you are reading this chapter for a course later in 2018 or in 2019, it is not unlikely that Apple will have retained its leadership position. Its value as of April 2018 was more than \$80 billion greater than that of the next largest company, Amazon. Apple has briefly ceded the leadership position to Alphabet, the parent company of Google, on a couple of occasions, but for the most part, it has been the leader for quite some time.^[1]

You may wonder what kind of information is used to make these determinations. How does the market know that Apple should be valued more than \$120 billion higher than Alphabet?^[2] Do investors just make their decisions on instinct? Well, some do, but it's not a formula for sustained success. In most cases, in deciding how much to pay for a company, investors rely on published accounting and financial information released by publicly-traded companies. This chapter will introduce you to the subject of accounting and financial information so you can begin to get an understanding for how the valuation process works.

The Role of Accounting

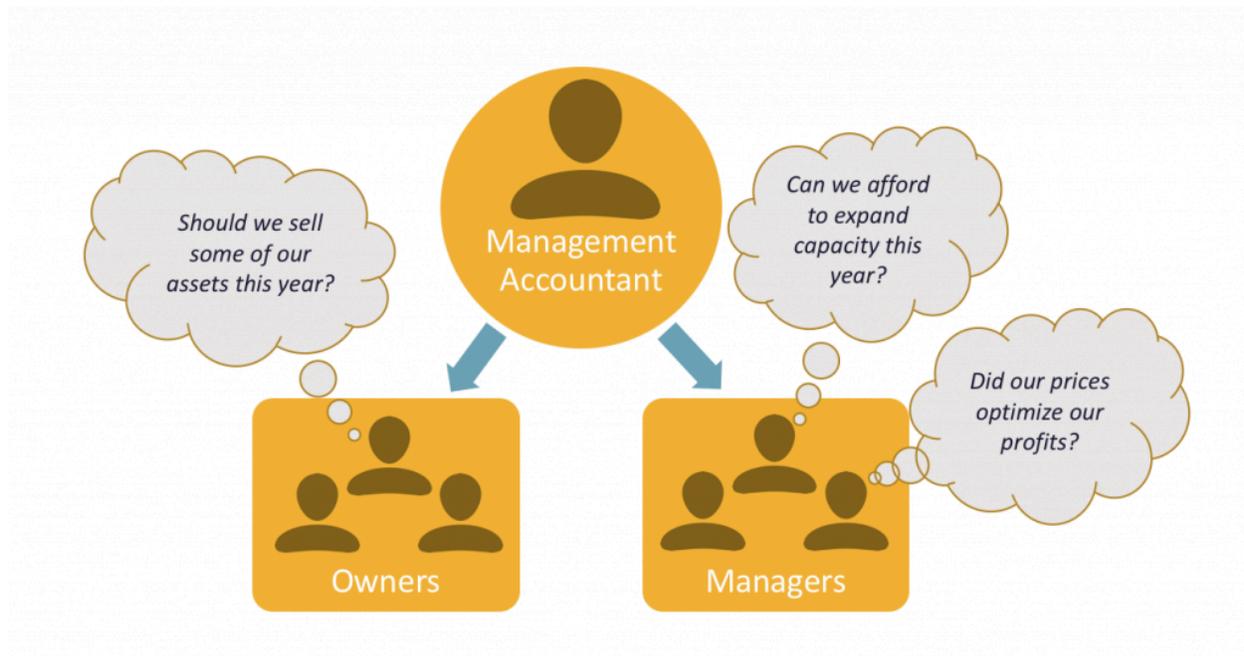
Accounting is often called “the language of business” because it communicates so much of the information that owners, managers, and investors need to evaluate a company’s financial performance. These people are stakeholders in the business—they’re interested in its activities because they’re affected by them. The financial futures of owners and other investors may depend heavily on strong financial performance from the business, and when performance is poor, managers may be replaced or laid off in a downsizing. In fact, a key purpose of accounting is to help stakeholders make better business decisions by providing them with financial information. You shouldn’t try to run an organization or make investment decisions without accurate and timely financial information, and it is the accountant who prepares this information. More importantly, accountants make sure that stakeholders understand the meaning of financial information, and they work with both individuals and organizations to help them use financial information to deal with business problems. Actually, collecting all the numbers is the easy part. The hard part is analyzing, interpreting, and communicating the information. Of course, you also have to present everything clearly while effectively interacting with people from every business discipline. In any case, we’re now ready to define accounting as the process of measuring and summarizing business activities, interpreting financial information, and communicating the results to management and other decision makers.

Fields of Accounting

Accountants typically work in one of two major fields. Management accountants provide information and analysis to decision makers inside the organization in order to help them run it. Financial accountants furnish information to individuals and groups both inside and outside the organization in order to help them assess its financial performance. Their primary focus, however, is on external parties. In other words, management accounting helps you keep your business running while financial accounting tells the outside world how well you’re running it.

Management Accounting

Management accounting, also known as managerial accounting, plays a key role in helping managers carry out their responsibilities. Because the information that it provides is intended for use by people who perform a wide variety of jobs, the format for reporting information is flexible. Reports are tailored to the needs of individual managers, and the purpose of such reports is to supply relevant, accurate, timely information that will aid managers in making decisions. In preparing, analyzing, and communicating such information, accountants work with individuals from all the functional areas of the organization—human resources, operations, marketing, etc.



Role of Managerial Accounting

Financial Accounting

Financial accounting is responsible for preparing the organization's financial statements—including the income statement (also called the profit/loss statement), the statement of owner's equity, the balance sheet, and the statement of cash flows—that summarize a company's past performance and evaluate its current financial condition. If a company is traded publicly on a stock market such as the TSX (Toronto Stock Exchange), these financial statements must be made public, which is not true of the internal reports produced by management accountants. In preparing financial statements, Canadian financial accountants adhere to a uniform set of rules called international financial reporting standards (IFRS)—the basic principles for financial reporting issued by an independent agency called the Financial Accounting Standards Board (FASB). Users want to be sure that financial statements have been prepared according to IFRS because they want to be sure that the information reported in them is accurate. They also know that when financial statements have been prepared by the same rules, they can be compared from one company to another.

Who Uses Financial Accounting Information?

The users of managerial accounting information are pretty easy to identify—basically, they're a firm's managers. We need to look a little more closely, however, at the users of financial accounting information, and we also need to know a little more about what they do with the information that accountants provide them. Publicly Traded companies will provide their financial accounting information to a wider set of stakeholders, including shareholders, potential investors, etc., than compared to a privately held company that will generate a single set

of financial statements according to the International Financial Reporting Standards. Publicly Traded companies will also provide their financial accounting information to the general public in order to showcase to potential investors the company's performance. Therefore, Publicly Traded companies will typically generate two sets of financial statements, one set of detailed statements in accordance with Canadian International Financial Reporting Standards (IFRS) and another set of simplified financial statements that can be more easily consumed by the general public. For example, Tim Hortons provides access to their simplified financial statements through annual reports which can be found at <http://www.rbi.com/Annual-Reports>

Owners and Managers

In summarizing the outcomes of a company's financial activities over a specified period of time, financial statements are, in effect, report cards for owners and managers. They show, for example, whether the company did or didn't make a profit and furnish other information about the firm's financial condition. They also provide some information that managers and owners can use in order to take corrective action, though reports produced by management accountants offer a much greater level of depth.

Investors and Creditors

Investors and creditors furnish the money that a company needs to operate, and not surprisingly, they want to know how that business is performing. Because they know that it's impossible to make smart investment and loan decisions without accurate reports on an organization's financial health, they study financial statements to assess a company's performance and to make decisions about continued investment.

According to the world's most successful investor, Warren Buffett, the best way to prepare yourself to be an investor is to learn all the accounting you can. Buffett, chairman and CEO of Berkshire Hathaway, a company that invests in other companies, turned an original investment of \$10,000 into a net worth of \$66 billion^[3] in four decades, and he did it, in large part, by paying close attention to financial accounting reports.

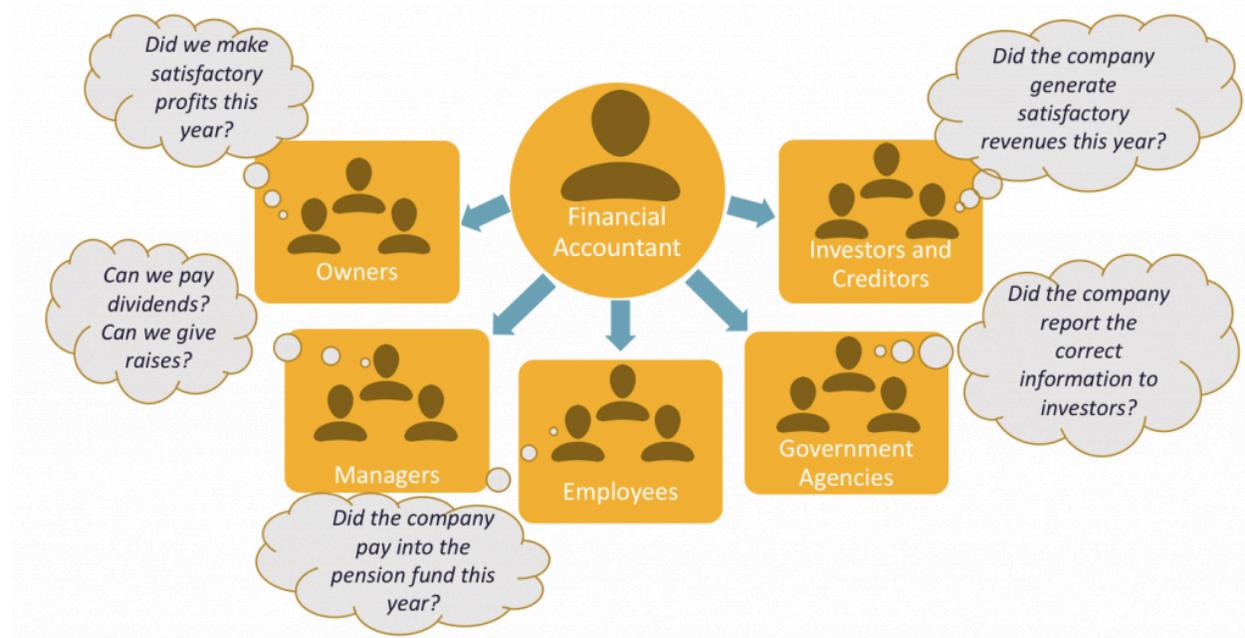


Warren Buffet, Presidential Medal of Freedom recipient in 2011

Government Agencies

Businesses are required to furnish financial information to a number of government agencies. Publicly-owned companies, for example—the ones whose shares are traded on a stock exchange—must provide annual financial reports to their respective provincial Securities Commission. For example, companies located in Ontario would provide financial reports to the Ontario Securities Commission (OSC), a federal agency that regulates stock trades and which is charged with ensuring that companies tell the

truth with respect to their financial positions. Companies must also provide financial information to the Canadian Revenue Agency (CRA).



The Role of Financial Accounting

Other Users

A number of other external users have an interest in a company's financial statements. Suppliers, for example, need to know if the company to which they sell their goods is having trouble paying its bills or may even be at risk of going under. Employees and labour unions are interested because salaries and other forms of compensation are dependent on an employer's performance.

The previous figures illustrate the main users of management and financial accounting and the types of information produced by accountants in the two areas. In the rest of this chapter, we'll learn how to prepare a set of financial statements and how to interpret them. We'll also discuss issues of ethics in the accounting communities and career opportunities in the accounting profession.

Understanding Financial Statements

We hope that, so far, at least one thing is clear: If you're in business, you need to understand financial statements. The law no longer allows high-ranking executives to plead ignorance or fall back on delegation of authority when it comes to responsibility for a firm's financial reporting. In a business environment tainted by episodes of fraudulent financial reporting and other corporate misdeeds, top managers are now being held responsible for the financial statements issued by the people who report to them. Top managers need to know how well the

company is performing. Financial information helps managers identify signs of impending trouble before it is too late.

The Function of Financial Statements

Put yourself in the place of Connor, who runs Connor’s Confections out of his home. He loves what he does, and he feels that he’s doing pretty well. In fact, he has an opportunity to take over a nearby store at very reasonable rent, and he can expand by getting a modest bank loan and investing some more of his own money. So it’s decision time for Connor: He knows that the survival rate for start-ups isn’t very good, and before taking the next step, he’d like to get a better idea of whether he’s actually doing well enough to justify the risk. The basic financial statements will give him some answers. Here, three common statement types are introduced.

Income Statement = Shows sales, expenses, and whether or not a profit was made.

Balance Sheet = Show assets and liabilities, the amount invested in the business.

Statement of Cash Flows = Show how much cash is coming in and going out.

Even from this basic overview, match which financial statement answers each of Connor’s questions.



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=148>



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=148>

Since this book is for an introductory course, attention is on the income statement, balance sheet, and cash flow statement only, even though other financial statements are mentioned.

Toying with a Business Idea

To bring this concept closer to home, let’s assume that you need to earn money while you’re in college and that you’ve decided to start a small business. Your business will involve selling stuff to other college students, and to keep things simple, we’ll assume that you’re going to operate on a “cash” basis: you’ll pay for everything with cash, and everyone who buys something from you will pay in cash.

You may have at least a little cash on you right now—some currency, or paper money, and coins. In accounting, however, the term cash refers to more than just paper money and coins. It also refers to the money that you have in checking and savings accounts and includes items that you can deposit in these accounts, such as money orders and different types of cheques.

Your first task is to decide exactly what you're going to sell. You've noticed that with homework, exams, social commitments, and the hectic lifestyle of the average college student, you and most of the people you know always seem to be under a lot of stress. Sometimes you wish you could just lie back between meals and bounce a ball off the wall. And that's when the idea hits you: Maybe you could make some money by selling a product called the "Stress-Buster Play Pack." Here's what you have in mind: you'll buy small toys and other fun stuff—instant stress relievers—at a local dollar store and pack them in a rainbow-colored plastic treasure chest labeled "Stress-Buster."

And here's where you stand: You have enough cash to buy a month's worth of plastic treasure chests and toys. After that, you'll use the cash generated from sales of Stress-Buster Play Packs to replenish your supply. Each plastic chest will cost \$1.00, and you'll fill each one with a variety of five simple toys, all of which you can buy for \$1.00 each.

You plan to sell each Stress-Buster Play Pack for \$10 from a rented table stationed outside a major dining hall. Renting the table will cost you \$20 a month. In order to make sure you can complete your school work, you decide to hire fellow students to staff the table at peak traffic periods. They'll be on duty from noon until 2:00 p.m. each weekday except Fridays, and you'll pay them a generous \$7.50 an hour. Wages, therefore, will cost you \$240 a month (2 hours \times 4 days \times 4 weeks = 32 hours \times \$7.50). Finally, you'll run ads in the college newspaper at a monthly cost of \$40. Thus your total monthly costs will amount to \$300 (\$20 + \$240 + \$40).

The Income Statement

Let's say that during your first month, you sell one hundred play packs. Not bad, you say to yourself, but did I make a profit? To find out, you prepare an income statement showing revenues, or sales, and expenses—the costs of doing business. You divide your expenses into two categories:

- Cost of goods sold: the total cost of the goods that you've sold
- Operating expenses: the costs of operating your business except for the costs of things that you've sold.

Now you need to do some subtracting:

- The difference between sales and cost of goods sold is your gross profit, also known as gross margin.
- The difference between gross profit and operating expenses is your net income or profit, which is the proverbial "bottom line." Note we've assumed you're making money, but businesses can also have a net loss.

Below is your income statement for the first month. (Remember that we've made things simpler by handling everything in cash.)

Stress-Buster Company
Income Statement
Month Ended April 30, 2018

Sales (100 x \$10.00)	\$1,000
Less cost of goods sold (100 x \$6)	\$600
Gross profit (100x (\$10 - \$6))	\$400
Less operating expenses	
Salaries	\$240
Advertising	\$40
Table rental	\$20
	\$300
Net income (Profit) (\$400-\$300)	\$100

Did You Make Any Money?

What does your income statement tell you? It has provided you with four pieces of valuable information:

1. You sold 100 units at \$10 each, bringing in revenues or sales of \$1,000.
2. Each unit that you sold cost you \$6 - \$1 for the treasure chest plus 5 toys costing \$1 each. So your cost of goods sold is \$600 (100 units × \$6 per unit).
3. Your gross profit—the amount left after subtracting cost of goods sold from sales—is \$400 (100 units × \$4 each).
4. After subtracting operating expenses of \$300 - the costs of doing business other than the cost of products sold—you generated a positive net income or profit of \$100.

The Balance Sheet

A balance sheet reports the following information:

- **Assets:** the resources from which it expects to gain some future benefit
- **Liabilities:** the debts that it owes to outside individuals or organizations
- **Owner's equity:** the investment in the business

Whereas your income statement tells you how much income you earned over some period of time, your balance sheet tells you what you have at a specific point in time.

Companies prepare financial statements on at least a twelve-month basis—that is, for a fiscal year which ends on December 31 or some other logical date, such as June 30 or September 30. Fiscal years can vary because companies generally pick a fiscal-year end date that coincides with the end of a peak selling period; thus a crabmeat processor might end its fiscal year in October, when the crab supply has dwindled. Most companies also produce financial statements on a quarterly or monthly basis. For Stress-Buster, you'll want to prepare them monthly to stay on top of how your new business is doing. Let's prepare a balance sheet at the start and end of your first month in business.

The Accounting Equation

To prepare a balance sheet, one must first understand the fundamental accounting equation:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

This simple but important equation highlights the fact that a company's assets came from somewhere: either from investments made by the owners (owner's equity) or from loans (liabilities). This means that the asset section of the balance sheet on the one hand and the liability and owner's-equity section on the other must be equal, or balance. Thus the term balance sheet.

Let's prepare the two balance sheets we mentioned: one for the first day you started and one for the end of your first month of business. We'll assume that when you started Stress-Buster, you borrowed \$400 from your parents and put in \$200 of your own money. If you look at your first balance sheet below, you'll see that your business has \$600 in cash (your assets): Of this total, you borrowed \$400 (your liabilities) and invested \$200 of your own money (your owner's equity). So far, so good: your assets section balances with your liabilities and owner's equity section as follows:

Stress-Buster Company	
Balance Sheet	
As of April 1, 2018	
Assets	
Cash	\$600
Liabilities and Owner's Equity	
Liabilities	\$400
Owner's Equity	\$200
Total Liabilities and Owner's Equity	\$600

Now let's see how things have changed by the end of the month. Recall that Stress- Buster earned \$100 during the month of September and that you decided to leave these earnings in the business. This \$100 profit increases two items on your balance sheet: the assets of the company (its cash) and your investment in it (its owner's equity). Below shows what your balance sheet will look like on April 30. You now have \$700 in cash: \$400 that you borrowed plus \$300 that you've invested in the business (your original \$200 investment plus the \$100 profit from the first month of operations, which you've kept in the business).

Stress-Buster Company	
Balance Sheet	
As of April 30, 2018	
Assets	
Cash (original \$600 plus \$100 earned)	\$700
Liabilities and Owner's Equity	
Liabilities	\$400
Owner's Equity (\$200 invested by owner plus \$100 profits retained)	\$300
Total Liabilities and Owner's Equity	\$700

Breakeven Analysis

Let's take a short detour to see how this information might be put to use. As you look at your first financial statements, you might ask yourself: is there some way to figure out the level of sales you need to avoid losing money—to “break even”? This can be done using breakeven analysis. To break even (have no profit or loss), your total sales revenue must exactly equal all your expenses (both variable and fixed). Variable costs depend on the quantity produced and sold; for example, each Stress-Buster includes the treasure chest and the toys inside. Fixed costs don't change as the quantity sold changes; for example, you'll pay for your advertising whether you sell Stress-Busters or not. The balance between revenue and expenses will occur when gross profit equals all other (fixed) costs. To determine the level of sales at which this will occur, you need to do the following (using data from the previous example):

1. Determine your total fixed costs: **Fixed costs = \$240 salaries + \$40 advertising + \$20 table = \$300**
2. Identify your variable costs on a per-unit basis: **Variable cost per unit = \$6 (\$1 for the treasure chest and \$5 for the toys)**
3. Determine your contribution margin per unit: **Selling price per unit – variable cost per unit: Contribution margin = \$10 selling price – \$6 variable cost per unit = \$4**
4. Calculate your breakeven point in units: fixed costs: **Contribution margin per unit: Breakeven in units =**

\$300 fixed costs : \$4 contribution margin per unit = 75 units

Your calculation means that if you sell 75 units, you'll end up with zero profit (or loss) and will exactly break even. To test your calculation, you can prepare a what-if income statement for 75 units in sales (your breakeven number). The resulting statement is shown in the table below.

Of course you want to do better than just break even, so you could modify this analysis to a targeted level of profit by adding that amount to your fixed costs and repeating the calculation. Breakeven analysis is rather handy. It enables you to determine the level of sales that you must reach to avoid losing money and the level of sales that you have to reach to earn a certain profit. Such information will be vital to planning your business.

Stress-Buster Company
Income Statement
Month Ended April 30, 2018
(at breakeven level of sales = 75 units)

Sales (75 x \$10.00)	\$750
Less cost of goods sold (75 x \$6)	\$450
Gross profit (\$75 x (\$10 - \$6))	\$300
Less operating expenses	
Salaries	\$240
Advertising	\$40
Table rental	\$20
	\$300
Net income (Profit) (\$300 - \$300)	\$0

The Cash Flow Statement

The Cash Flow Statement provides valuable information about a company's expenses and receipts and allows insights into its future income needs in order to be able to meet its future obligations (expenses and receipts). The cash flow statement reports cash inflows and outflows, and it will identify the amount of cash the company currently holds, which is also reported in the balance sheet.

Typically the cash flow statement is reported on a month to month basis, however, a statement of cash flow will consolidate month to month cash flow to meet the requirements of the International Financial Reporting Standards.

A statement of cash flow will report cash in three distinct areas of business:

- Cash from Operations
- Cash from Investing
- Cash from Financing

Now let's prepare the statement of cash flow for Stress-Buster company for the one month period ending April 30, 2018. Stress-Buster would have incurred cash from Operations in the form of Net Income incurred after deducting the month's expenses from the month's revenues and would have also incurred cash from Financing from the initial \$400 loan taken out to start the business and the additional \$200 of personal income. As Stress-Buster did not invest in new equipment, machinery or other assets for the business or use prior cash flows and/or retained earnings to earn further investment income, Stress-Buster would not report any cash from investing activities.

Stress-Buster Company		
Statement of Cash Flow		
Month Ended April 30, 2018		
Beginning Cash		\$0
Operating Activities		\$100
Net Income from Operations	\$100	
Investing Activities		\$0
Financing Activities		\$600
Increase in Short Term Debt	\$400	
Increase in Retained Earnings	\$200	
Ending Cash Balance		\$700
(Net Change)		\$700

Financial Statement Analysis

Now that you know a bit about financial statements, let's see how they're used to help owners, managers, investors, and creditors assess a firm's performance and financial strength. You can glean a wealth of information from financial statements, but first you need to learn a few basic principles for "unlocking" it.

Trend Analysis from the Income Statement

Apple Inc.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited) (In millions, except number of shares which are reflected in thousands and per share amounts)

	Three Months Ended	
	December 30, 2017	December 31, 2016
Net sales	\$ 88,293	\$ 78,351
Cost of sales ⁽¹⁾	54,381	48,175
Gross margin	33,912	30,176
Operating expenses:		
Research and development ⁽¹⁾	3,407	2,871
Selling, general and administrative ⁽¹⁾	4,231	3,946
Total operating expenses	7,638	6,817
Operating income	26,274	23,359
Other income/(expense), net	756	821
Income before provision for income taxes	27,030	24,180
Provision for income taxes	6,965	6,289
Net income	\$ 20,065	\$ 17,891
Earnings per share:		
Basic	\$ 3.92	\$ 3.38
Diluted	\$ 3.89	\$ 3.36
Shares used in computing earnings per share:		
Basic	5,112,877	5,298,661
Diluted	5,157,787	5,327,995
Cash dividends declared per share	\$ 0.63	\$ 0.57
⁽¹⁾ Includes share-based compensation expense as follows:		
Cost of sales	\$ 252	\$ 229
Research and development	\$ 646	\$ 589
Selling, general and administrative	\$ 398	\$ 438

Apple Inc. – Consolidated statements of operations (income statement)

Peruse an abbreviated financial statement for Apple for 2017 taken directly from their website. You will note that instead of showing only the current year's results, the company has shown data for the prior year as well.

From this relatively simple exhibit, considerable information about Apple's performance can be obtained.

For example:

- Apple sales grew at 12.7% from 2016 to 2017, not bad for a company with such a large base of sales already, but certainly not the rapid-growth company it once was. When making yearly comparisons this is commonly referred to as performing a horizontal analysis.
- Net income as a percent of sales (a ratio also known as return on sales) was 22.7% in 2017 – or in other words, for every \$5 in sales, Apple turned more than \$1 of it into profit. That is substantial! When calculating ratios as a percent of a larger figure (i.e., Net income as a percent of sales, or cash as a percent of Total Assets) this is commonly referred to as performing a vertical analysis.

Many other calculations are possible from Apple's data, and we will look at a few more as we explore ratio analysis.

Ratio Analysis

How do you compare Apple's financial results with those of other companies in your industry or with the other companies whose stock is available to investors? And what about your balance sheet? Are there relationships on this statement that also warrant investigation? These issues can be explored by using ratio analysis, a technique for evaluating a company's financial performance.

Remember that a ratio is just one number divided by another, with the result expressing the relationship between the two numbers. It's hard to learn much from just one ratio, or even a number of ratios covering the same period. Rather, the deeper value in ratio analysis lies in looking at the trend of ratios over time and in comparing the ratios for several time periods with those of other companies. There are a number of different ways to categorize financial ratios.

Apple Inc.

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

(In millions, except number of shares which are reflected in thousands and par value)

	December 30, 2017	September 30, 2017
ASSETS:		
Current assets:		
Cash and cash equivalents	\$ 27,491	\$ 20,289
Short-term marketable securities	49,662	53,892
Accounts receivable, less allowances of \$59 and \$58, respectively	23,440	17,874
Inventories	4,421	4,855
Vendor non-trade receivables	27,459	17,799
Other current assets	11,337	13,936
Total current assets	<u>143,810</u>	<u>128,645</u>
Long-term marketable securities	207,944	194,714
Property, plant and equipment, net	33,679	33,783
Goodwill	5,889	5,717
Acquired intangible assets, net	2,149	2,298
Other non-current assets	13,323	10,162
Total assets	<u>\$ 406,794</u>	<u>\$ 375,319</u>
LIABILITIES AND SHAREHOLDERS' EQUITY:		
Current liabilities:		
Accounts payable	\$ 62,985	\$ 49,049
Accrued expenses	26,281	25,744
Deferred revenue	8,044	7,548
Commercial paper	11,980	11,977
Current portion of long-term debt	6,498	6,496
Total current liabilities	<u>115,788</u>	<u>100,814</u>
Deferred revenue, non-current	3,131	2,836
Long-term debt	103,922	97,207
Other non-current liabilities	43,754	40,415
Total liabilities	<u>266,595</u>	<u>241,272</u>
Commitments and contingencies		
Shareholders' equity:		
Common stock and additional paid-in capital, \$0.00001 par value: 12,600,000 shares authorized; 5,081,651 and 5,126,201 shares issued and outstanding, respectively	36,447	35,867
Retained earnings	104,593	98,330
Accumulated other comprehensive income/(loss)	(841)	(150)
Total shareholders' equity	<u>140,199</u>	<u>134,047</u>
Total liabilities and shareholders' equity	<u>\$ 406,794</u>	<u>\$ 375,319</u>

Apple Inc. – Consolidated balance sheets

Here's one set of categories:

- Profitability ratios tell you how much profit is made relative to the amount invested (return on investment) or the amount sold (return on sales).

- Liquidity ratios tell you how well positioned a company is to pay its bills in the near term. Liquidity refers to how quickly an asset can be turned into cash. For example, share of stock is substantially more liquid than a building or a machine.
- Debt ratios look at how much borrowing a company has done in order to finance the operations of the business. The more borrowing, the more risk a company has taken on, and so the less likely it would be for new lenders to approve loan applications.
- Efficiency ratios tell you how well your assets are being managed.

We could employ many different ratios, but we'll focus on a few key examples.

Profitability Ratios

Earlier we looked at the return on sales for Apple. Another profitability ratio on which the financial markets focus is earnings per share, also known as EPS. This ratio divides net income by the number of shares of stock outstanding. According to the earlier exhibit, Apple saw its EPS increase from \$3.38 in 2016 to \$3.92 in 2017, which indicates a profit of about 15% an excellent return for a company that is already among the world's largest. Well-paid analysts will spend hours to understand how these results were achieved every time Apple issues new financial statements.

Liquidity Ratios

Liquidity ratios are one element of measuring the financial strength of a company. They assess its ability to pay its current bills. A key liquidity ratio is called the current ratio. It simply examines the relationship between a company's current assets and its current liabilities. On December 30, 2017 (remember that balance sheets reflect a point in time), Apple had \$68.5 billion in current assets and \$63.5 billion in current liabilities. Simply, what this means is that Apple has more money on hand than they need to pay their bills. When a company has a current ratio greater than 1, they are in good shape to pay their bills; companies selling to Apple on credit would not need to worry that it is likely to run out of money.

$$\text{Apple's current ratio} = \$68.5 \text{ Billion} / \$63.5 \text{ Billion} = 1.08 \text{ (greater than } > \text{) } 1$$

Now, let's look quickly at something that is not part of the ratio; look down one line on the balance sheet to long-term marketable securities and see that Apple owns \$207.9 billion. While they are long term and so not part of the current ratio, these securities are still easily convertible to cash. So Apple has far more cushion than the current ratio reflects, even though it reflected a healthy financial position already.

Debt Ratios

A key debt ratio, which tells us how the company is financed, is the debt-to-equity ratio, which calculates the relationship between funds acquired from creditors (debt) and funds invested by owners (equity). For this ratio calculation, we use Apple's total liabilities, not just the line on the balance sheet that says long-term debt,

because in effect, Apple is borrowing from those who it owes but has not yet paid. Apple's total liabilities at the end of 2017 were \$266.6 billion versus owner's equity of \$140.2 billion, a ratio of 1.9, which means Apple has borrowed more than it has invested in the business.

Apple's debt to equity ratio: \$266.6 / \$140.2 Billion = 1.9

To some investors, that high level of debt might seem alarming. But remember that Apple has \$207.9 billion invested in marketable securities. If it wished to do so, Apple could sell some of those securities and pay down its debts, thus improving its ratio. It's likely that anyone thinking about lending money to Apple and seeing these figures would be confident that Apple has the ability to pay back what they borrow.

Efficiency and Effectiveness Ratios

There are many more ratios which we could apply to Apple to more completely understand its performance. Yet going deeper into ratios would be beyond the scope of an introductory business course. If you continue your study of business, you will get ample exposure to these ratios in your accounting and finance courses. So we'll leave the rest for another day.

Key Takeaways

Important terms and concepts

1. Accounting is the process of measuring and summarizing business activities, interpreting financial information, and communicating the results to management and other decision makers.
2. Managerial accounting deals with information produced for internal users, while financial accounting deals with external reporting.
3. The income statement captures sales and expenses over a period of time and shows how much a firm made or lost in that period.
4. The balance sheet reflects the financial position of a firm at a given point in time, including its assets, liabilities, and owner's equity. It is based on the following equation: $\text{assets} - \text{liabilities} = \text{owner's equity}$.
5. Breakeven analysis is a technique used to determine the level of sales needed to break even—to operate at a sales level at which you have neither profit nor loss.
6. Ratio analysis is used to assess a company's performance and financial condition over time and to compare one company to similar companies or to an overall industry.
7. Categories of ratios include: profitability ratios, liquidity ratios, debt ratios, and efficiency and effectiveness ratios.

16. Personal Finances

Learning Objectives

By the end of the chapter, you should be able to:

1. Describe strategies to minimize and manage debt.
2. Explain how to manage monthly income and expenses.
3. Define personal finances and financial planning.
4. Explain the financial planning life cycle.
5. Discuss the advantages of a college education in meeting short-term and long-term financial goals.
6. Explain compound interest and the time value of money.
7. Discuss the value of getting an early start on your plans for saving.



Show What You Know



An interactive or media element has been excluded from this version of the text.

You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=155>

The World of Personal Credit



Do you sometimes wonder where your money goes? Do you worry about how you'll pay off your student loans? Would you like to buy a new car or even a home someday and you're not sure where you'll get the money? If these questions seem familiar to you, you could benefit from help in managing your personal finances, which this chapter will seek to provide.

Let's say that you're twenty-eight and single. You have a good education and a good job—you're pulling down \$60K working with a local accounting firm. You have \$6,000 in a retirement savings account, and you carry three credit cards. You plan to buy a condo in two or three years, and you want to take your dream trip to the world's hottest surfing spots within five years. Your only big worry is the fact that you're \$70,000 in debt, due to student loans, your car loan, and credit card debt. In fact, even though you've been gainfully employed for a total of six years now, you haven't been able to make a dent in that \$70,000. You can afford the necessities of life and then some, but you've occasionally wondered if you're ever going to have enough income to put something toward that debt.^[1]

You're not alone! The average student in Canada will graduate in 2018 having accumulated over \$27,000 in student debt. But this is not the only financial problem in Canada. Canadian household debt has reached a record high of over \$2.08 trillion as of September 2017, that is \$1.68 of debt for every \$1 of income.

The Organization for Economic Cooperation and Development began measuring the financial literacy of its OECD countries using a 5 question survey. This simple 5 question survey tests basic financial literacy knowledge.

[Take the survey!](#)

Personal financial literacy is more important than ever in Canada. As a country we need to improve our financial literacy. The Bank for International Settlements, an “international watchdog” regarding country economic risk, has warned that Canada's banking system is at risk due to the rising collective household debt level. In the coming chapter you will learn the basics of personal financial literacy.

Time Is Money

The fact that you have to choose a career at an early stage in your financial life cycle isn't the only reason that you need to start early, on your financial planning. Let's assume, for instance, that it's your eighteenth birthday and that on this day you take possession of \$10,000 that your grandparents put in trust for you. You could, of course, spend it; in particular, it would probably cover the cost of flight training for a private pilot's license—something you've always wanted but were convinced that you couldn't afford right away. Your grandfather, of course, suggests that you put it into some kind of savings account. This way, your \$10,000 could take advantage of something called interest. Interest is the charge for the privilege of borrowing money, typically expressed as an annual percentage rate, or is the payment made to you from the investing institution on top of the principal amount you invested of \$10,000. If you just wait until you finish college, he says, and if you can find a savings plan that pays 5 percent interest, you'll have the \$10,000 plus about another \$2,000 for something else or to invest.

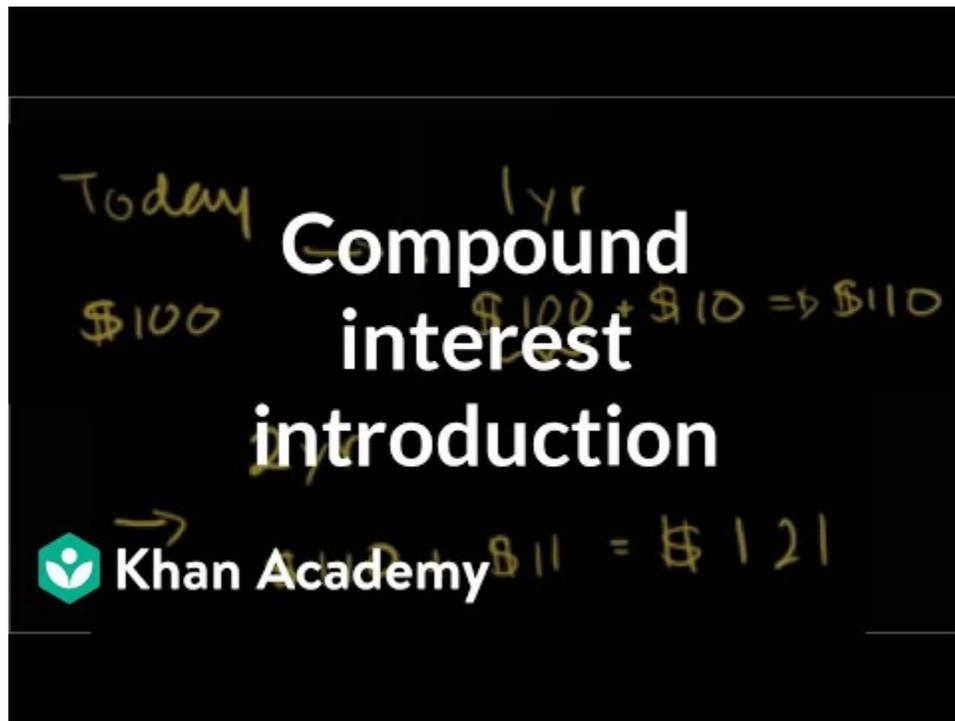
The total amount you'll have—\$12,000—piques your interest. If that \$10,000 could turn itself into \$12,000 after sitting around for four years, what would it be worth if you actually held on to it until you did retire—say, at age sixty-five? A quick trip to the Internet to find a compound-interest calculator informs you that, forty-seven years later, your \$10,000 will have grown to \$104,345 (assuming a 5 percent interest rate). That's not really enough to retire on, but it would be a good start. On the other hand, what if that four years in college had paid off the way you planned, so that once you get a good job you're able to add, say, another \$10,000 to your retirement savings account every year until age sixty-five? At that rate, you'll have amassed a nice little nest egg of slightly more than \$1.6 million.

Compound Interest

In your efforts to appreciate the potential of your \$10,000 to multiply itself, you have acquainted yourself with two of the most important concepts in finance. As we've already indicated, one is the principle of compound interest, which refers to the effect of earning interest on your interest.

Let's say, for example, that you take your grandfather's advice and invest your \$10,000 (your principal) in a savings account at an annual interest rate of 5 percent. Over the course of the first year, your investment will earn \$500 in interest and grow to \$10,500. If you now reinvest the entire \$10,500 at the same 5 percent annual rate, you'll earn another \$525 in interest, giving you a total investment at the end of year 2 of \$11,025. And so forth. And that's how you can end up with \$81,496.67 at age sixty-five.

Prefer a video to help you decipher and understand compound interest? [Watch Khan Academy's seven minute explanation:](#)



A YouTube element has been excluded from this version of the text. You can view it online here:

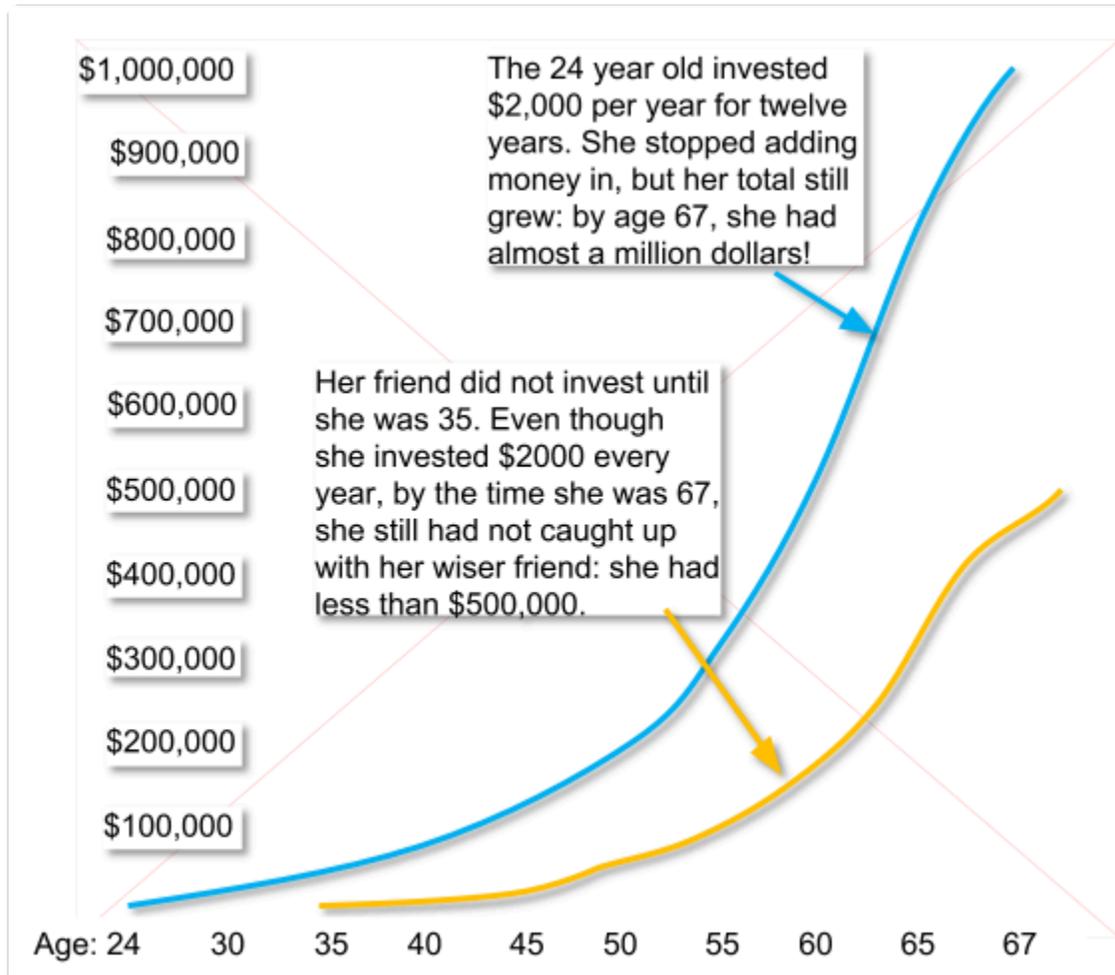
<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=155>

Time Value of Money

You've also encountered the principle of the time value of money—the principle whereby a dollar received in the present is worth more than a dollar received in the future. If there's one thing that we've stressed throughout this chapter so far, it's the fact that most people prefer to consume now rather than in the future. If you borrow money from me, it's because you can't otherwise buy something that you want at the present time. If I lend it to you, I must forego my opportunity to purchase something I want at the present time. I will do so only if I can get some compensation for making that sacrifice, and that's why I'm going to charge you interest. And you're going to pay the interest because you need the money to buy what you want to buy now. How much interest should we agree on? In theory, it could be just enough to cover the cost of my lost opportunity, but there are, of course, other factors. Inflation, which is the general increase in prices of goods and services and the corresponding decrease in the purchasing power of money, for example, will have eroded the value of my money by the time I get it back from you. In addition, while I would be taking no risk in loaning money to the Canadian government, I am taking a risk in lending it to you. Our agreed-on rate will reflect such factors.^[2]

Finally, the time value of money principle also states that a dollar received today starts earning interest sooner than one received tomorrow. Let's say, for example, that you receive \$2,000 in cash gifts when you graduate from college. At age twenty-three, with your college degree in hand, you get a decent job and don't have an immediate

need for that \$2,000. So you put it into an account that pays 10 percent compounded and you add another \$2,000 (\$167 per month) to your account every year for the next eleven years.^[3] The blue line in the graph below shows how much your account will earn each year and how much money you'll have at certain ages between twenty-four and sixty-seven.



The power of compound interest

As you can see, you'd have nearly \$52,000 at age thirty-six and a little more than \$196,000 at age fifty; at age sixty-seven, you'd be just a bit short of \$1 million. The yellow line in the graph shows what you'd have if you hadn't started saving \$2,000 a year until you were age thirty-six. As you can also see, you'd have a respectable sum at age sixty-seven—but less than half of what you would have accumulated by starting at age twenty-three. More important, even to accumulate that much, you'd have to add \$2,000 per year for a total of thirty-two years, not just twelve.

Here's another way of looking at the same principle. Suppose that you're twenty years old, don't have \$2,000, and don't want to attend college full-time. You are, however, a hard worker and a conscientious saver, and one of your financial goals is to accumulate a \$1 million retirement nest egg. As a matter of fact, if you can put \$33 a month into an account that pays 12 percent interest compounded,^[4] you can have your \$1 million by age sixty-

seven. That is, if you start at age twenty. As you can see from the figure below, if you wait until you're twenty-one to start saving, you'll need \$37 a month. If you wait until you're thirty, you'll have to save \$109 a month, and if you procrastinate until you're forty, the ante goes up to \$366 a month.^[5] Unfortunately in today's low interest rate environment, finding 10 to 12% return is not likely. Nevertheless, these figures illustrate the significant benefit of saving early.

How to save a million dollars by age 67

<i>Make your first payment at age:</i>	<i>And this is what you'll have to save each month:</i>
20	\$33
21	\$37
22	\$42
23	\$47
24	\$53
25	\$60
26	\$67
27	\$76
28	\$85
30	\$109
35	\$199
40	\$366
50	\$1,319
60	\$6,253

The reason should be fairly obvious: a dollar saved today not only starts earning interest sooner than one saved tomorrow (or ten years from now) but also can ultimately earn a lot more money in the long run. Starting early means in your twenties—early in stage 1 of your financial life cycle. As one well-known financial advisor puts it,

“If you’re in your 20s and you haven’t yet learned how to delay gratification, your life is likely to be a constant financial struggle.”^[6]

Financial Planning

Before we go any further, we need to nail down a couple of key concepts. First, just what, exactly, do we mean by personal finances? Finance itself concerns the flow of money from one place to another, and your personal finances concern your money and what you plan to do with it as it flows in and out of your possession. Essentially, then, personal finance is the application of financial principles to the monetary decisions that you make either for your individual benefit or for that of your family.

Second, as we suggested earlier, monetary decisions work out much more beneficially when they’re planned rather than improvised. Thus our emphasis on financial planning—the ongoing process of managing your personal finances in order to meet goals that you’ve set for yourself or your family.

Financial planning requires you to address several questions, some of them relatively simple:

- What’s my annual income?
- How much debt do I have, and what are my monthly payments on that debt?

Others will require some investigation and calculation:

- What’s the value of my assets?
- How can I best budget my annual income?

Still others will require some forethought and forecasting:

- How much wealth can I expect to accumulate during my working lifetime?
- How much money will I need when I retire?

The Financial Planning Life Cycle

Another question that you might ask yourself—and certainly would do if you worked with a professional in financial planning—is: “How will my financial plans change over the course of my life?” The figure below illustrates the financial life cycle of a typical individual—one whose financial outlook and likely outcomes are probably a lot like yours.^[7] As you can see, our diagram divides this individual’s life into three stages, each of which is characterized by different life events (such as beginning a family, buying a home, planning an estate, retiring).

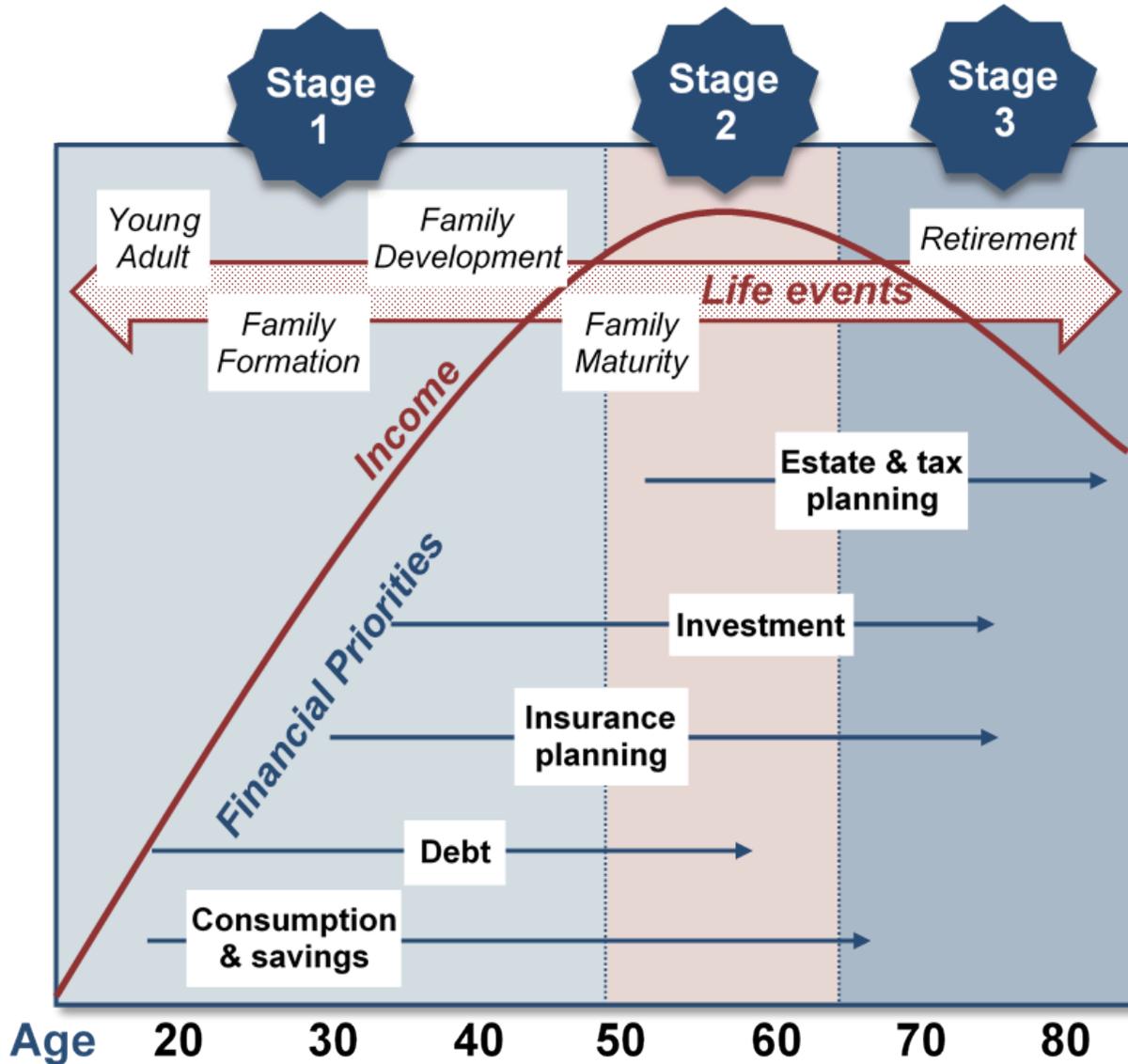
At each stage, there are recommended changes in the focus of the individual’s financial planning:

- Stage 1 focuses on building wealth.
- Stage 2 shifts the focus to the process of preserving and increasing wealth that one has accumulated and

continues to accumulate.

- Stage 3 turns the focus to the process of living on (and, if possible, continuing to grow) one's saved wealth after retirement.

At each stage, of course, complications can set in—changes in such conditions as marital or employment status or in the overall economic outlook, for example. Finally, as you can also see, your financial needs will probably peak somewhere in stage 2, at approximately age fifty-five, or ten years before typical retirement age.



The Financial Life Cycle

Choosing a Career

Until you're on your own and working, you're probably living on your parents' wealth right now. In our hypothetical life cycle, financial planning begins in the individual's early twenties. If that seems like rushing things, consider a basic fact of life: this is the age at which you'll be choosing your career—not only the sort of work you want to do during your prime income-generating years, but also the kind of lifestyle you want to live. What about college? Most readers of this book, of course, have decided to go to college. If you haven't yet decided, you need to know that college is an extremely good investment of both money and time.

The figure below summarizes the most recent, 2015, findings from Statistics Canada.^[8] A quick review shows that people who graduate from high school can expect to enjoy average annual earnings of just under \$50,000, and those who go on to finish college can expect to generate 17 percent more annual income than high school graduates who didn't attend college. With better access to health care—and, studies show, with better dietary and health practices—college graduates will also live longer. And so will their children.^[9]

Education	Average Income: Canadian Women	Average Income: Canadian Men
High school diploma	\$43,254	\$55,774
College diploma	\$48,599	\$67,965
Bachelor's degree	\$68,342	\$82,082

What about the student-loan debt that so many people accumulate? At an average cost of \$27,000 (the average amount of debt accumulated by post-secondary students upon graduation) and an average increase in earnings of \$263,000 over an average work-life expectancy of 30 years, you would need to invest that \$27,000 for 30 years at an average annual rate of return of 8%.^[10] At that rate of return, you should be able to pay off your student loans (unless, of course, you fail to practice reasonable financial planning).

Naturally, there are exceptions to these average outcomes. You'll find some college graduates stocking shelves at 7-Eleven, and you'll find college dropouts running multibillion-dollar enterprises. Microsoft co-founder Bill Gates dropped out of college after two years, as did his founding partner, Paul Allen. Though exceptions to rules (and average outcomes) certainly can be found, they fall far short of disproving them: in entrepreneurship as in most other walks of adult life, the better your education, the more promising your financial future. One expert in the field puts the case for the average person bluntly: educational credentials “are about being employable, becoming a legitimate candidate for a job with a future. They are about climbing out of the dead-end job market”.^[11]

Bringing Down Those Monthly Bills

So to be able to practice reasonable financial planning you must first be able to identify how you can bring down your monthly bills? If you want to take a gradual approach, one financial planner suggests that you perform the following “exercises” for one week:^[12]

- Keep a written record of everything you spend and total it at week's end.
- Keep all your ATM receipts and count up the fees.

- Take \$100 out of the bank and don't spend a penny more.
- Avoid gourmet coffee shops.

You'll probably be surprised at how much of your money can quickly become somebody else's money. If, for example, you spend \$3 every day for one cup of coffee at a coffee shop, you're laying out nearly \$1,100 a year just for coffee. If you use your ATM card at a bank other than your own, you'll probably be charged a fee that can be as high as \$3. The average person pays more than \$60 a year in ATM fees. If you withdraw cash from an ATM twice a week, you could be racking up \$300 in annual fees.^[13] Another idea – eat out as a reward, not as a rule. A sandwich or leftovers from home can be just as tasty and can save you \$6 to \$10 a day, even more than our number for coffee! In 2013, the website DailyWorth asked three women to try to cut their spending in half. After tracking her spending, one participant discovered that she had spent \$175 eating out in just one week; do that for a year and you'd spend over \$9,000!^[14] If you think your cable bill is too high, consider alternatives like Playstation Vue or Sling. Changing channels is a bit different, but the savings can be substantial.

The Latte Factor is actually trademarked by financial guru David Bach. He and other financial advisors recommend that everyone calculate her/his latte factor. He even developed a calculator that shows how much money, over time, you could save by cutting out a small, unnecessary thing from your daily/weekly expenses. Even if you assume a low interest rate e.g., 1%, the savings add up. [Find your latte factor!](#)

You may or may not be among the Canadian consumers who purchased more than 3 billion cans, 2 billion bottles and 40 million kegs of beer, in 2016 alone, or purchased one or more of the over 2 billion Tim Hortons coffees sold each year. You may not be one of the 37% percent of Canadian consumers that regret spending outside of your means.^[15] Bottom line – if, at age twenty-eight, you have a good education and a good job, a \$60,000 income, and \$70,000 in debt—by no means an implausible scenario—there's a very good reason why you should think hard about controlling your debt: your level of indebtedness will be a key factor in your ability—or inability—to reach your longer-term financial goals, such as home ownership, a dream trip, and, perhaps most importantly, a reasonably comfortable retirement.

One of the best ways to manage your money and personal finances is to build a personal budget.



Personal budget

You will need to have all your information gathered. This includes what you bring in – from employment to student loans – and what goes out – for food, entertainment, health and wellness, rent, utilities, etc. Be honest and thorough.

The Government of Canada, through the Financial Agency of Canada, created a tool that provides an in-depth account of your personal finances. [Use the Budget Calculator](#) to document your situation. Export your budget as an Excel spreadsheet. You will now be able to make improvements, if appropriate. If your balance is negative, or when your expenses exceed your income, you need to make some choices based on what you learned when you tracked your spending. Ask yourself some tough questions:

- What can be eliminated from my expenses?
- What can be reduced from my expenses?
- In what areas can I be a smarter consumer?
- Where does my money seem to get gobbled up?

After you have made some difficult choices, turn back to the budget worksheet and create a new “revised” column. You will want to work toward achieving a positive balance.

Should you end up with a surplus or positive balance, you need to make some choices about what to do with the extra money. Perhaps you could put it toward your financial SMARTER goal. Avoid the temptation to spend it.

Now let’s suppose that while browsing through a magazine in the doctor’s office, you run across a short personal-finances self-help quiz. There are six questions (recreated here):



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfundn/?p=155>

You took the quiz and added your response values.

Personal-finances experts tend to utilize the types of questions on the quiz: if you had 1s or 2s on any of the first three questions, you have a problem with splurging; if any questions from four through six got 1s or 2s, your monthly bills are too high for your income.

Building a Good Credit Rating

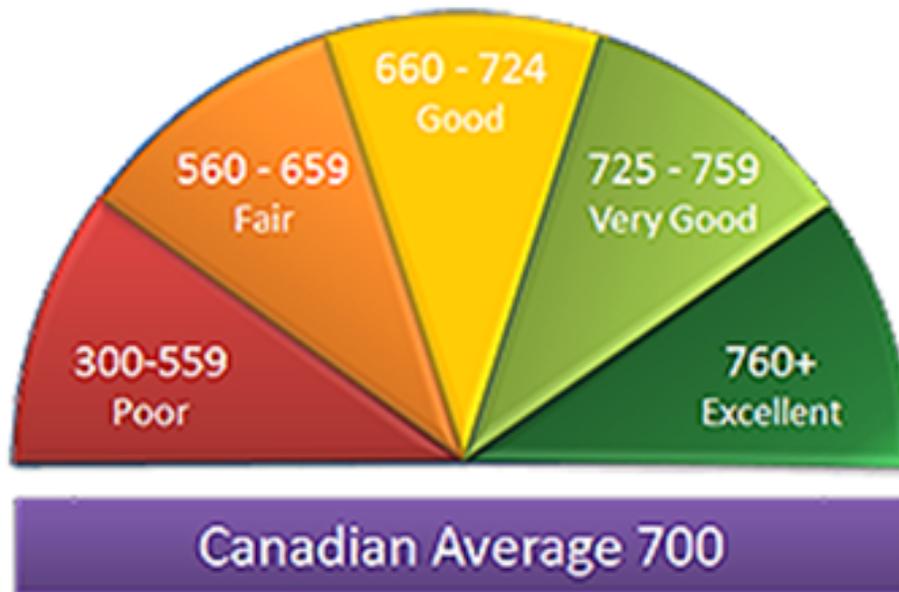
So, you may or may not have a financial problem. According to the quick test you took, do you splurge? Are your bills too high for your income? If you get in over your head and can’t make your loan or rent payments on time, you risk hurting your credit rating—your ability to borrow in the future.

How do potential lenders decide whether you’re a good or bad credit risk? If you’re a poor credit risk, how does this affect your ability to borrow, or the rate of interest you have to pay? Whenever you use credit, those from whom you borrow (retailers, credit card companies, banks) provide information on your debt and payment habits to two national credit bureaus: Equifax, and TransUnion. The credit bureaus use the information to compile a numerical credit score, called a FICO score; it ranges from 300 to 900, with the majority of people falling in the 600–700 range. In compiling the score, the credit bureaus consider five criteria: However, the main factors that are used to calculate your score include:

- Payment history
- Use of available credit
- Length of credit history
- Number of inquiries
- Types of credit

The credit bureaus share their score and other information about your credit history with their subscribers.^[16]

So what does this do for you? It depends. If you pay your bills on time and don't borrow too heavily, you'd likely have a high FICO score and lenders would like you, probably giving you reasonable interest rates on the loans you requested. But if your FICO score is low, lenders won't likely lend you money (or would lend it to you at high interest rates). A low FICO score can even affect your chances of renting an apartment or landing a particular job. So it's very important that you do everything possible to earn and maintain a high credit score.



Credit score ranges

As a young person, though, how do you build a credit history that will give you a high FICO score? Based on feedback from several financial experts, Emily Starbuck Gerson and Jeremy Simon of CreditCards.com compiled the following list of ways students can build good credit.^[17]

- Become an authorized user on a parent's account.
- Obtain your own credit card.
- Get the right card for you.
- Use the credit card for occasional, small purchases.
- Avoid big-ticket buys, except in case of emergency.
- Pay off your balance each month.
- Pay all your other bills on time.

- Don't cosign for your friends.
- Don't apply for several credit cards at one time.
- Use student loans for education expenses only, and pay on time.

If you meet the qualifications to obtain your own credit card, look for a card with a low interest rate and no annual fee.

A Few More Words about Debt

What should you do to turn things around—to start getting out of debt? According to many experts, you need to take two steps:

- Cut up your credit cards and start living on a cash-only basis.
- Do whatever you can to bring down your monthly bills.

Although credit cards can be an important way to build a credit rating, many people simply lack the financial discipline to handle them well. If you see yourself in that statement, then moving to a pay-as-you go basis, i.e., cash or debit card only, may be for you. Be honest with yourself; if you can't handle credit, then don't use it.

Banking

Suppose you want to save or invest – do you know how or where to do so? You probably know that your branch bank can open a savings account for you, but interest rates on such accounts can be pretty unattractive. Investing in individual stocks or bonds can be risky, and usually require a level of funds available that most students don't have. In those cases, mutual funds can be quite interesting. A mutual fund is a professionally managed investment program in which shareholders buy into a group of diversified holdings, such as stocks and bonds. Any of the big 5 banks in Canada (RBC, CIBC, BMO, TDCanada, or Scotiabank) offer a range of investment options including indexed funds, which track with well-known indices such as the Toronto Stock Exchange, a.k.a. the TSX. Minimum investment levels in such funds can actually be within the reach of many students, and the funds accept electronic transfers to make investing more convenient.

We'll leave a more detailed discussion of investment vehicles to your more advanced courses.

You may choose to do your banking with a major bank, or with a local credit union. Most people never notice the differences between credit unions and banks. They offer similar products and services, but they're not the same. The following are some key points which highlight the differences:

Major Banks:

- Funds are secure
- Profitability– usually shareholders own a bank and expect financial performance from bank management
- Offer a wide range of competitive and advanced banking products
- Inter-branch banking = convenience

Credit Unions:

- Customers are “members”; deposits are called “shares”
- Credit Unions are non-profit organizations that strive for service over profitability. They are NOT charities; credit unions must make sound financial decisions, collect revenue, pay salaries, and compete with other institutions.
- May not have all the banking products as major banks
- Inter-branch banking is limited
- Funds are also secure

Choose an Institution that is Right for You



An interactive or media element has been excluded from this version of the text. You can view it online here:

<https://ecampusontario.pressbooks.pub/businessfuncdn/?p=155>

As a college or university student, you might be out on your own for the first time. Part of handling your own finances will be choosing a banking institution or institutions that best suit your needs. Banks are eager to gain new clientele and establish brand loyalty early on. It should come as no surprise, then, that just about every major banking institution in Canada offers student-banking plans.

Now you are ready to start planning for your financial future.

Key Takeaways

Important terms and concepts

1. Credit worthiness is measured by the FICO score – or credit rating – which can range from 300-850. The average ranges from 680-719.
2. To maintain a satisfactory score, pay your bills on time, borrow only when necessary, and pay in full whenever you do borrow.
3. 81% of financial planners recommend eating out less as a way to reduce your expenses.
4. Personal finance is the application of financial principles to the monetary decisions that you make.
5. Financial planning is the ongoing process of managing your personal finances in order to meet your goals, which vary by stage of life.
6. Time value of money is the principle that a dollar received in the present is worth more than a dollar received in the future due to its potential to earn interest.
7. Compound interest refers to the effect of earning interest on your interest. It is a powerful way to accumulate wealth.