Fundamentals of Business

Fundamentals of Business

British Columbia Edition 2024

FLORENCE DADDEY AND RACHAEL NEWTON

DOUGLAS COLLEGE

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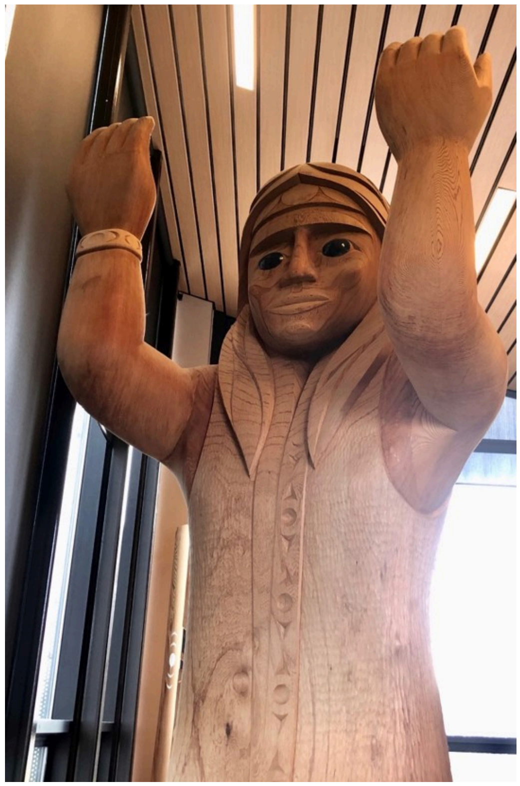

Douglas College Welcoming Pole

The Welcoming Pole located at the Aboriginal Gathering Place (New Westminster campus) is by Musqueam artist Susan Point. The Coast Salish peoples use poles carved with a welcoming figure – often making a gesturing motion – by way of greeting guests arriving on their territories.

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The eCampusOntario's Fundamentals of Business – Canadian Edition

eCampusOntario is a not-for-profit corporation funded by the Government of Ontario. eCampusOntario funded the development of the Fundamentals of Business: Canadian Edition, from which the current edition has been adapted. In developing the Canadian Edition, program managers from eCampusOntario and business faculty from Ontario colleges collaborated to update and align the existing open resources to Ontario college introductory business outcomes and objectives. The key contributors were Nitsa Andres, Fanshawe College; Matt Hutchinson, Lambton College; Jim Johnston, Fanshawe College; Anela Tomac, Conestoga College; Joanne Kehoe, eCampusOntario; and Peggy French, eCampusOntario. Luke Wilson also edited the final draft and added his expertise to the content.

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Fundamentals of Business – British Columbia Edition 2024

The *Fundamentals of Business – British Columbia Edition* 2024 (https://pressbooks.bccampus.ca/fundamentalsbusiness/) has been adapted to highlight current business issues and trends, focusing not only on Canadian content, but also on cases and stories from British Columbia. In addition to British Columbia content, the update makes learning richer for students by incorporating case studies from business stakeholders who are

Indigenous, Peoples of Colour, LGBTQIA2S+, and people with disabilities within the business communities across British Columbia and in Canada.

This adaptation, completed by Douglas College, was funded by BCcampus Open Education. BCcampus Open Education (https://open.bccampus.ca/) began in 2012 as the B.C. Open Textbook Project with the goal of making post-secondary education in British Columbia more accessible by reducing students' costs through the use of open textbooks and other OER. BCcampus (https://bccampus.ca/about-us/) supports the post-secondary institutions of British Columbia as they adapt and evolve their teaching and learning practices to enable powerful learning opportunities for the students of B.C. BCcampus Open Education is funded by the British Columbia Ministry of Post-Secondary Education and Future Skills (https://www2.gov.bc.ca/gov/content/governments/organizational-structure/ministries-organizations/ministries/post-secondary-education-and-future-skills) and the Hewlett Foundation (http://www.hewlett.org/).

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Introduction to the Fundamentals of Business: British Columbia Edition

Thanks to a grant from BCcampus, Douglas College adapted the Fundamentals of Business (British Columbia Edition 2024) from Fundamentals of Business: Canadian Edition 2018 (https://ecampusontario.pressbooks.pub/businessfuncdn/), which was written by business faculty from Ontario Colleges and eCampusOntario program managers.

The Fundamentals of Business (British Columbia Edition 2024) has been adapted to highlight current business issues and trends, focusing not only on Canadian content, but also on cases and stories from British Columbia. In addition to British Columbia content, the update makes learning richer for students by incorporating case studies from business stakeholders who are Indigenous, Peoples of Colour, LGBTQIA2S+, and people with disabilities within the business communities across British Columbia and in Canada.

These chapters introduce learners to business, its environment, participants, stakeholders, and functions. Experienced British Columbia faculty collaborated to align these chapters to be suitable for most British Columbia introductory business courses.

The authors would love to hear how you use or adapt the content of this edition. Please feel free to connect with them via email: daddeyf@douglascollege.ca (mailto:daddeyf@douglascollege.ca) and newtonr@douglascollege.ca (mailto:newtonr@douglascollege.ca).

Organization of Content

This book is organized into three parts. It starts with introducing key business concepts, then moves to discussing business in today's world, and brings it all together with a discussion of managing businesses today.

Part A: Introducing Business in Canada

> Part A introduces students to the exciting and challenging world of business in British Columbia, Canada, and the rest of the world. This part discusses the various components and disciplines that make up a business. For a business to prosper and survive, business organizations must respond to the changing environment. While the environment provides opportunities for businesses, it also presents threats to and limitations on the business organization's ability to achieve its goals and objectives. The interrelationships between the various components and integration of the basic unifying themes of business will be discussed, as well as the importance of working collaboratively and the reasons teamwork is crucial in business.

Part B: The Contemporary Business World

> Part B builds for students a foundation of the contemporary business world. It discusses how existing

businesses are being changed by new ways of doing business due to technology, the COVID-19 pandemic, the need to embrace equity, inclusion and diversity, and the steps that businesses are taking to be sustainable and environmentally friendly. This part covers business and economics, business in the global environment, the external environment's influence, forms of business ownership, entrepreneurship (starting a business), and business conduct, including ethics and social responsibility.

Part C: Understanding the Business of Managing

Part C discusses the elements, processes, procedures and issues in managing the business organization from different perspectives: employers, employees, consumers and investors. This part focuses on the role of the managers, structure and organization of large and small businesses, human resources management, employee motivation, operations management and marketing processes, and consumer behaviour. Part C also discusses elements and processes of financial information and management systems, as well as the role of financial institutions, financial planning, and managing risk with diversification, stock market, mutual funds and securities.

What to Expect in Each Chapter

Each part includes chapters that introduce students to different core business elements. Each chapter includes the following sections.

- **Learning Objectives:** The Learning Objectives section describes in general terms the information that the students are expected to understand upon completion of the chapter and its associated assessments. The learning objectives section is intended to provide readers with a guide to getting the most out of the content.
- **Show What You Know:** Because learning is an active process, to foster students' engagement we have incorporated H5P tools to provide learning checks and reflections.
- **Topics:** This section discusses topics that present a clear and concise description of the most important concepts contained in the chapter.
- **Case Studies:** Case studies may provide information and opportunities for students to apply critical thinking and problem-solving skills.
- **Comprehension Check:** This is a series of questions or an activity related to the chapter content for students to self-test their level of knowledge after reading the chapter.
- **Key Takeaways:** This is a summary of important terms and concepts.
- **Glossary:** Key terms are highlighted, and definitions are provided in the glossary at the end of the book.

PART A - INTRODUCING BUSINESS IN CANADA

This first section of the book introduces you to the Canadian business environment and the factors or forces that provide opportunities, threats and limitations on business organizations, as well as the ability of the organization to achieve its goals and objectives. It will discuss the interrelationships between the various components and the integration of the basic unifying themes of business. The section also discusses the importance of teamwork in business and why it is crucial in business to work collaboratively in teams.

Chapter 1 - Foundations of Business

Learning Objectives

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

1. identify and describe the primary and secondary participants in a business;
2. describe the concept of stakeholders and identify the stakeholder groups relevant to an organization;
3. discuss and identify types of influences from the external environment on the business;
4. describe what takes place within each of the functional areas of business; and
5. explain **key terms** highlighted in the chapter.

Show What You Know

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Raven Reads: Promoting the Indigenous Economy

Raven Reads is a growing British Columbia subscription box service that now has a global reach, and it all started with Nicole McLaren's desire to meaningfully engage in business and community.

In particular, Nicole was compelled by a desire to educate others on the overwhelming impact of residential schools.[1] The residential schools scattered throughout Canada formally started in 1883 and lasted as late as the 1990s in some areas. At least 150,000 First Nations, Métis, and Inuit students were subjected to a school system that targeted removing most, if not all, of the students' cultural identities. Generations of First Nations, Métis, and Inuit students endured unhealthy and abusive environments.[2] The Truth and Reconciliation Reports and Calls to Action[3] highlighted these and other atrocities and offered calls to action. After reading these reports, Nicole found herself asking "what does reconciliation mean and what role can I play in this?"[4]

Figure 1.1 Raven Reads subscription boxes curate products that promote Indigenous Peoples and the Indigenous economy.

Nicole focused on her desire to educate others on the overwhelming impact of residential schools[5] so she started a book club in 2016. That book club then turned into a small home business in which she curated Indigenous created content, books, and products and then delivered them to customers. The business struck a nerve and grew rapidly. Today, it is a thriving subscription box business and distribution center operating out of Kamloops, BC with customers worldwide.

From its inception and at its core, Raven Reads is an impact-driven company that focuses on curating Indigenous content and products to support and help grow the Indigenous economy. Seventy percent of Raven Reads suppliers are impact ventures that support Indigenous communities, charities, and social impact initiatives.[6] Raven Reads is an exemplary business of today. It is rooted in an empowering compassion, supports the Indigenous economy, and gives back so others can do the same.

1. Dunne, D. (2022, May 30). *Meet Nicole McLaren, Raven Reads*. BC Marketplace. https://marketplacebc.ca/meet-nicole-mclaren-raven-reads/
2. Miller, J. R. (2012). *Residential Schools in Canada.* The Canadian Encyclopedia. https://www.thecanadianencyclopedia.ca/en/article/residential-schools
3. University of Manitoba. (2022). *Reports: National Centre for Truth and Reconciliation.* https://nctr.ca/records/reports/
4. Raven Reads. (n.d.). *About us.* https://ravenreads.org/pages/about-us
5. Dunne, D. (2022). *Meet Nicole McLaren, Raven Reads*. BC Marketplace. https://marketplacebc.ca/meet-nicole-mclaren-raven-reads/
6. Raven Reads. (n.d.). *Press Kit.* https://ravenreads.org/pages/press-kit

What do you think?

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https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=37#h5p-44 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=37#h5p-44)

Discussion Questions

1. What are the primary reasons for the success of Raven Reads?
2. What are the greatest challenges facing Raven Reads today?

Introducing the Business Context

Canadian **businesses** operate within a dynamic environment and multiple disciplines and interrelationships between various components that make up business. If we look at these components together we can gain a basic understanding of how businesses are making decisions within an ever-changing set of needs. To survive, business organizations have to respond to changing macro environmental factors. The **macro environment** provides opportunities for businesses to adapt and innovate, and also represents threats to and limitations on an organization's ability to achieve its objectives.

The world is made up of inspiring and diverse businesses and a range of business opportunities. Businesses can be big or small, traditional brick and mortar or online, broad or niche, established or new, successful or unsuccessful, and local, domestic or global. 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.[7]

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

Decision Making within the External Environment

With respect to decision making within the external environment, there are two main perspectives to adopt.

Figure 1.2 Comparing Two Views of Management
Move the line left or right to compare the two common views of management.

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Figure 1.2 On one side of the image is the view, Managers "Know Best", where decision making is under the control of the managers and should rely on managers' capabilities. In the view of Managers "Know Best", managers have ultimate accountability; if the company is successful, the managers get the credit, and if the company is not successful, the managers get the blame. The other side of the image shows the view, The Environment Decides, where decision making is in response to the environment; however, it is limited as the business can only do what the environment sustains. In the view of The Environment Decides, a company's success comes from reacting well to the environment, and a company's failure is because of an unfavorable environment.

One perspective takes the boardroom approach, where everything is viewed from management's perspective; managers "know best," meaning that managers have the skills and knowledge to make the best decisions for the company. Correspondingly, managers are held accountable for any missteps of the company. The top managers are responsible for either outcome.

The second perspective for making decisions stresses the need for critical analysis and evaluation of the external environment. The company must focus on the external environment, particularly on the perspectives of other stakeholders including customers, employees, competitors, investors, lenders, government and the general public. In doing so, they will be able to respond to the environment's needs. The challenge with this perspective is that the decision makers can put so much emphasis on the influence of the external environment that they sometimes miss

7. Hilsenrath, J., Ng, S., & Paletta, D. (2008, September 18). *Worst Crisis Since '30s, With No End Yet in Sight*. WSJ. https://www.wsj.com/articles/SB122169431617549947

opportunities to take control of a situation. For example, during the early days of the COVID-19 pandemic, the external business environment shifted dramatically. Businesses that emphasized the control of the external environment did not adapt the ways they provided their products to people. Consequently, many of them did not survive. Businesses with this external influence perspective would have said that they closed because of the pandemic, not because they were not adaptable.

As the story of Raven Reads suggests, today is an interesting time to study business. More than ever, businesses have to pay attention to what is happening around them. The political, economic, legal, social/cultural, technological, and natural environmental factors are constantly shifting. Being too dependent on managers' know-how or attributing too much control to the environment is problematic. Thus, most Canadian businesses have adopted a hybrid approach.

Figure 1.3 Blending the Two Views – A Hybrid Approach

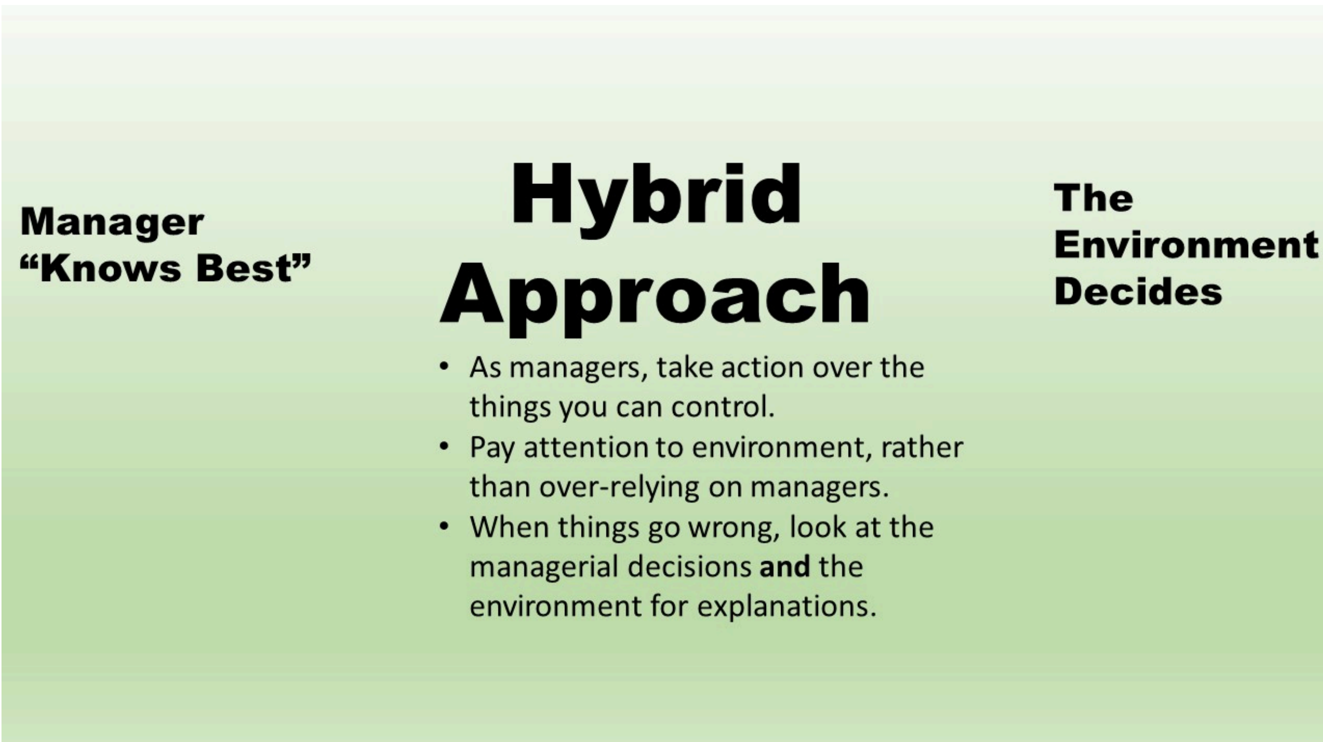


Figure 1.3 When using the Hybrid Approach as managers, take action over the things you can control. Pay attention to the environment rather than over-relying on managers. When things go wrong, look at the managerial decisions and the environment for explanations.

The hybrid approach draws on the strength of both perspectives and limits the negatives of each perspective. Namely, it emphasizes that managers can have control, but that they are also limited by the environment. As a result, managers should pay close attention to what's happening around the business so that they can adapt to the changing trends.

What Is Business?

Before we move on to a deeper discussion of business, it is important to clearly define 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.

Many businesses provides products or 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 non-profit organizations include the United Way, Habitat for Humanity, the Boys and Girls Clubs, the Canadian 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 non-profits.

Business Participants, Stakeholders, and Functional Areas of Business

We will begin our discussion of business by identifying the main **participants** of business, the **stakeholders** of business, and the **functions** that most businesses perform. We will finish this section by discussing the external factors that influence a business's 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 is 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. Other participants can include suppliers and even **competitors**.

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, suppliers, landlords, competitors, bankers, and others (see Figure 1.3). Other stakeholders include the general public, the environment and all the various government departments that 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.

Figure 1.4 Common Business Stakeholders

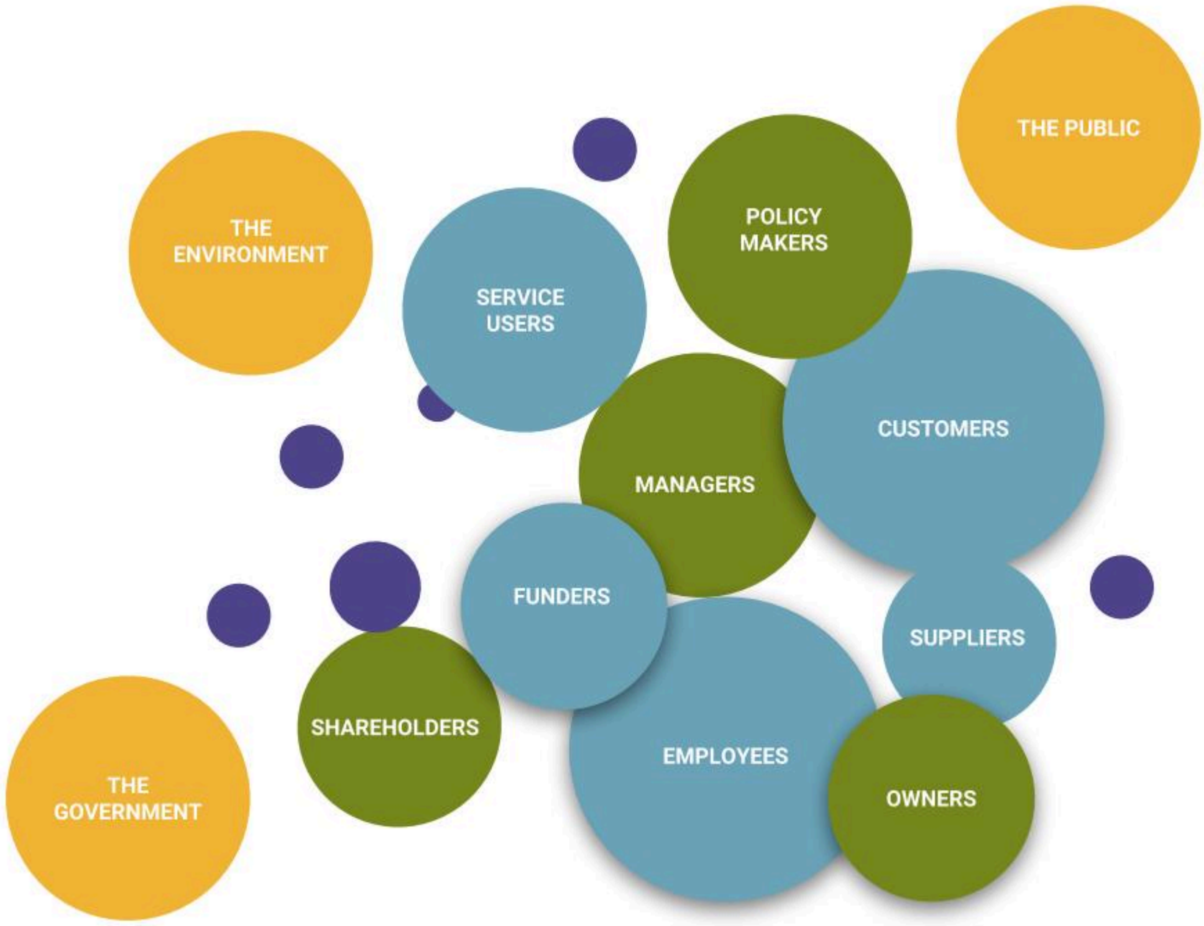


Figure 1.4 Common Business Stakeholders include: the environment, service users, policy makers, the public, managers, customers, the government, shareholders, funders, employees, suppliers, and owners.

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 us 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 — iPads, 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 ensure that products are designed 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 customers 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:

- 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 the company's 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.

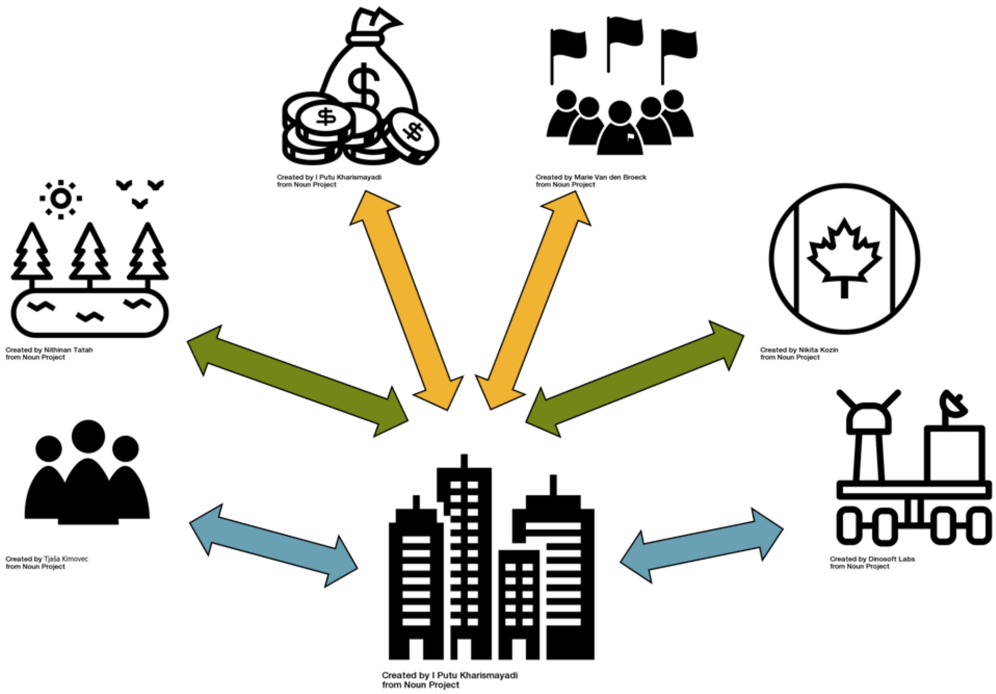
Information Technology

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 and privacy protocols, and developing user interfaces and apps for customers. Usually, there is a high level of integration between the business's 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, and logistics and shipping providers. The global pandemic has also made it necessary for businesses to establish and improve their virtual presences. As the use of technology increases so do the number of threats and vulnerabilities. The number of potential risks involved in using information technology is rising, creating a security gap between the expectations of users and the ability of technology suppliers to meet those expectations. Data privacy concerns, protection and security now play an important role. Cybersecurity is changing the way things are done today more than ever before.

External Influences on Business Activities

Raven Reads and other businesses do not operate in a vacuum; they are influenced by a number of external factors. These include the **economy**, **government**, consumer trends, **information technology**, **legal factors**, 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.

Figure 1.5 Common Influences from the Business's External Environment



(https://thenounproject.com)

Figure 1.5 *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 is clearly affected by all these factors is the fast food industry, in which companies such as Taco Bell, McDonald's, Tim Hortons and others all compete. Here are a few statements to show the way external factors impact business. For instance, in a strong economy people have more money to eat out. Food standards are monitored by the Canadian Food and Drug Inspection Agency at the federal level, with entities at both the provincial and municipal levels monitoring adherence. Preferences for certain types of foods are influenced by consumer trends (fast food companies are being pressured to make their menus healthier).

> In 2017 Ontario became 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.[8]

Of course, all industries, not just the food industry, are impacted by external factors. 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. Established companies like Nissan, with its Nissan Leaf, and brand new companies like Tesla have entered the market for all-electric vehicles. The global electric vehicle market was valued at US$ 113.6 Bn in 2020. It is estimated to expand at a Compound Annual Growth Rate (CAGR) of 26.62% from 2021 to 2031.[9]

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

Comprehension Check

Use the image below to test yourself by:

- defining each key term;
- identifying each term as a participant, stakeholder, function or external influence (remember some can be more than one); and
- providing an example of why each term is important to a business.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=37#h5p-43 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=37#h5p-43)

8. Baron, D. P., Eunsin, L., Huggett, J., Rigoglioso, M., Snyder, B. & Zich, J. (2003). *Facing Off in Public*. Stanford Business. Retrieved from: https://www.gsb.stanford.edu/sites/gsb/files/2003August.pdf
9. Transparency Market Research. (2021). *Electric Vehicles Market – Global Industry Analysis, Size, Share, Growth, Trends and Forecast*, 2021 – 2031. http://www.transparencymarketresearch.com/electric-vehicles-market.html

Key Takeaways

Important Terms and Concepts:

1. The primary participants in a business are its owners, investors, employees, and often its customers. The secondary participants are customers, competitors, and suppliers.
2. Every business must consider its stakeholders, and their sometimes conflicting interests, when making decisions.
3. Businesses are influenced by factors such as the economy, government, and other forces external to the business.
4. The activities needed to run a business can be divided into functional areas.

Chapter 2 - 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; and
7. explain **key terms** in the chapter.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=32#h5p-1
(https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=32#h5p-1)

What Is a Team?

Figure 2.1 "International Year of the World's Indigenous People, 1993" by United Nations Photo is licensed under CC BY-NC-ND 2.0

People working together is a concept that has long been part of our history. Humans and their ancestors began working together in hunter-gatherer societies over two million years ago. Only fairly recently in human history, 12,000 years ago,[1] many societies shifted to an agrarian focus. In hunter-gatherer and agrarian societies people needed to work together towards a shared goal. As we look at teams and teamwork today, we often look to the fields of business, sociology, or psychology to explain what to do and how to do it, but working together is woven into our history and our survival as a species.

With that in mind, we want to recognize that each person also has an innate understanding of how to work together. That individual understanding of the concept of shared work stems from many influences, including our personal culture, the culture, experience, and history of our caregivers, and the places and people we have lived among. Now, in a global society, we face new challenges of how those influences are sometimes at odds with one another. In a team of ten people, we likely to find ten different views of how to work together.

Historically, powerful nations or peoples often chose to face these challenges with force and domination, resulting in the devastation of long, meaningful human ways of being. Today, we have the opportunity to make better choices. We can look at each person's uniqueness and the perspectives that their culture, identity, history and experiences give them. We can thus choose ways of working together that empower equitable contributions towards mutually developed goals, for the benefit of our team, our groups, and our species.

Characteristics of Teams in Business Today

In business today, we often define a team (or a work team) as a group of people with complementary skills who work together to achieve a specific goal. Every **team** is organized around a shared objective — 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 their department because each is held accountable for meeting those goals. To put teams in perspective, let us identify five key characteristics.

Teams:

1. National Geographic. (2021). *Hunter gather culture*. https://www.nationalgeographic.org/encyclopedia/hunter-gatherer-culture/

1. share accountability for achieving specific common goals;
2. function interdependently;
3. require stability;
4. hold authority and decision-making power; and
5. operate in a social context.[2]

The Team and the Organization

Why do major organizations now rely so heavily 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. 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.

2. Thompson, L. L. (2008). *Making the Team: A Guide for Managers*. Upper Saddle River, NJ: Pearson Education.
3. Thompson, L. L. (2008). *Making the Team: A Guide for Managers*. Upper Saddle River, NJ: Pearson Education, pp. 4-5. See also Alderfer, C.P. (1977). Group and Intergroup Relations. In J. R. Hackman & J. L. Suttle (Eds.), *Improving Life at Work* (pp. 277–96). Palisades, CA: Goodyear.
4. Fisher, K. (1999). *Leading Self-Directed Work Teams: A Guide to Developing New Team Leadership Skills* (rev. ed). New York: McGraw-Hill Professional. See also Greenberg, J., & Baron R. A. (2008). *Behavior in Organizations (9th ed.)*. Upper Saddle River, NJ: Pearson Education.

Table 2.1 Effects of Team-Based Operations on Performance[5]

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%

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, i.e., less accountable to those higher up in the organization. Some depend on a team leader who is responsible for defining the team's goals and making sure that its activities are performed effectively. Others are more or less self-governing; a leader lays out overall goals and strategies but the team itself chooses and manages the methods by which it pursues its goals and implements its strategies.[6] Teams also vary according to their membership. Let us look at several categories of teams.

5. (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.)
6. Greenberg, J., & Baron R. A. (2008). *Behavior in Organizations (9th ed)*. Upper Saddle River, NJ: Pearson Education. See also Thompson, L. L. (2008). *Making the Team: A Guide for Managers*. Upper Saddle River, NJ: Pearson Education.

Manager-Led Teams


Figure 2.2 Coaching by Rob can Hiten licensed CC BY | flickr

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 for developing and choosing the strategies by which the team pursues its goal of winning games, and for the outcome of each game and season. The coach is also solely responsible for interacting with managers above them in the organization. The players are responsible mainly for executing plays.[7]

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.[8]

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.

7. Thompson, L. L. (2008). *Making the Team: A Guide for Managers*. Upper Saddle River, NJ: Pearson Education.
8. Thompson, L. L. (2008). *Making the Team: A Guide for Managers*. Upper Saddle River, NJ: Pearson Education.

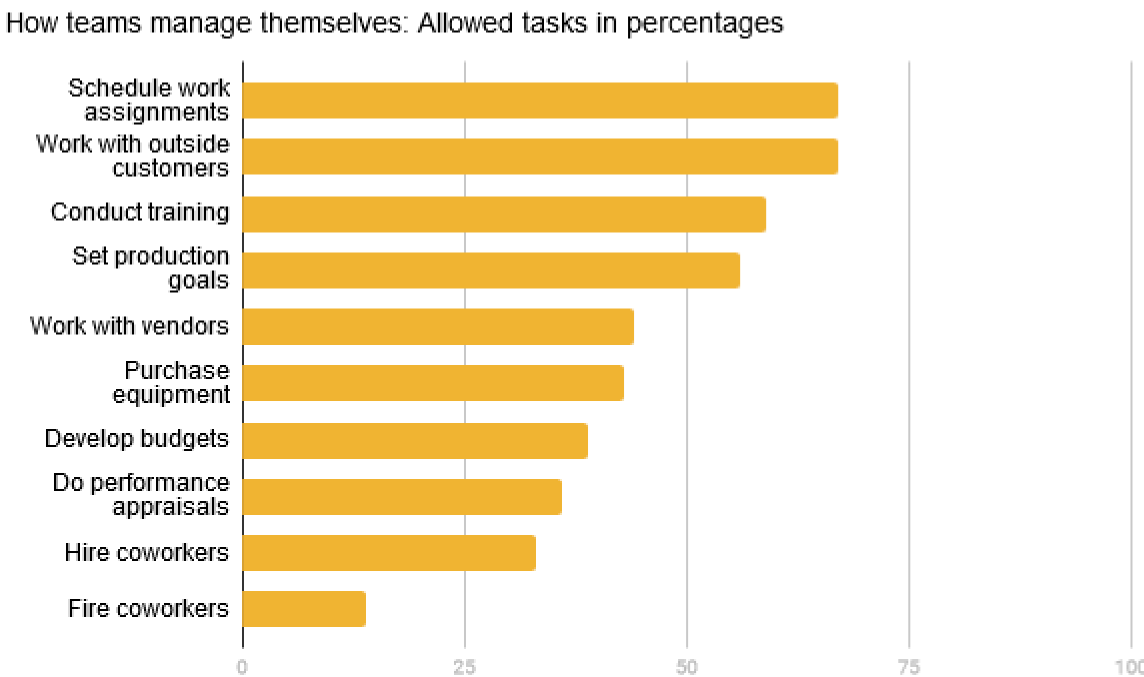


Chart 2.1 A graph shows various tasks that teams manage themselves; schedule work assignments (70%), work with outside customers (70%), conduct training (60%), set production goals (55%), work with vendors (45%), purchase equipment (42%), develop budgets (37%), do performance appraisals (33%), hire coworkers (30%), and fire coworkers (15%).

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.[9]

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.

9. Fishman, C. (2008). *Whole Foods Is All Teams*. http://www.fastcompany.com/26671/whole-foods-all-teams

Problem-solving teams, which are created to study such issues as improving quality or reducing waste, may be either intradepartmental or cross-functional.[10]

Virtual Teams

The speed of transformation from traditional teams to **virtual teams** reached its peak and became a trend in the workplace due to the Covid-19 global pandemic. This crisis forced some companies to create virtual teams for the first time in their history. 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.[11] 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.[12]

Topaloglu, M,. & Anac S. A., (2021),[13] in their research, explored major factors affecting virtual team performance which include: Leadership, Communication, Collaboration, Cohesion, Commitment, Conflict, Interpersonal Relations, Knowledge Sharing, Feedback, Recognition, Trust, Diversity and Empowerment.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=32#h5p-46 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=32#h5p-46)

Factors and Processes Affecting Teamwork

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 will explore why teams are often effective and when they are ineffective.

10. Human Resources Development Council. (n.d). *Organizational Learning Strategies: Cross-Functional Teams*. http://www.humtech.com/ForestService/sites/GRTL/ols/ols3.htm
11. Robbins, S. P., & Timothy A. J. (2009). *Organizational Behavior (13th ed.)*. Upper Saddle River, NJ: Pearson Education.
12. George, J. M., & Jones G. R. (2008). *Understanding and Managing Organizational Behavior (5th ed.)*. Upper Saddle River, NJ: Pearson Education.
13. Adept Scientific. (2009). *Lockheed Martin Chooses Mathcad as a Standard Design Package for F-35 Joint Strike Fighter Project. Adept Science*, September 23, 2003

Stages of Team Development

In the 1960s, Bruce W. Tuckman described the processes that teams generally go through as they develop. He proposed that the stages of team development are linked to the effectiveness and performance of teams. The stages of team development are described below:

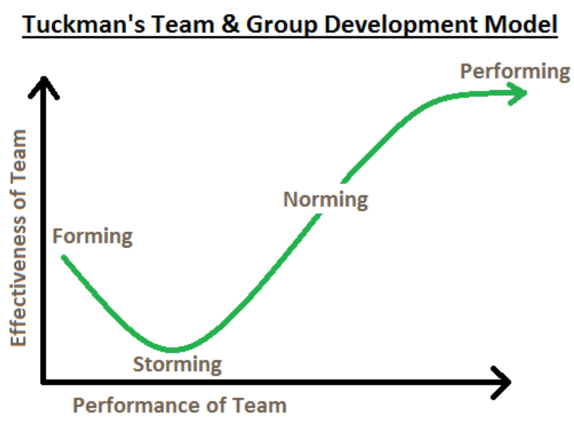


Chart 2.2 Tuckman's Team & Group Development Model. From forming, effectiveness falls to storming, where performance and effectiveness rise steadily through the norming and performing stages.

Forming

In Tuckman's first stage of team development, team members are excited to work together, but they may face challenges in playing a role from lack of role clarity or lack of personal confidence. To deal with these challenges, team members should ask questions, clarify roles, and identify their goals. This takes time away from being productive, but it is important for setting up the team for later success.

Storming

Inevitably, team members will face challenges as they start to work towards their goals, which is the hallmark of the storming stage. Essentially, as team members focus on achieving their goals, conflict can arise, including mistakenly overstepping on someone else's role/work, missing the assignment of an important task, seeing the task, goal, and/or process differently, or just rubbing each other the wrong way personality-wise. Regardless of the cause, the storming stage is a natural part of the team process.

If team members can focus on identifying the cause of the challenges, using positive communication to find solutions, and then creating plans for improvement, they will get through the storming phase stronger than they started. However, many teams have members who do not want to talk about these issues and choose to ignore them, causing their team to get stuck in the storming phase indefinitely.

Norming

If the team members in the storming phase work on identifying problems, using positive communication, and creating solutions, they often find good practices or “norms” for their team. In the norming phase, teams begin to find rhythms that work for them in terms of how they work, who does different types of tasks, and how they communicate with one another. They also often start to develop camaraderie.

Overall, the team is generally effective at planned activities. However, to progress to the next stage, the team needs to be willing to focus on continually improving and developing more than one way to work together. If teams get too comfortable with the way they structure the work and the specific roles that certain members play they will not have the flexibility to address unplanned tasks that come their way. Consequently, they will not progress to the performing stage of development. Many teams get too comfortable in the norming stage and never show the creativity and adaptability of the performing stage.

Performing

In the performing stage, teams are able to work well together on planned and unplanned tasks. They demonstrate efficiency (doing things right), effectiveness (doing the right things), and creativity as they accomplish their goals. In their work, they are not stuck in one structure or process for tasks, but instead they are able to adapt how they work and vary who does the work based on the task at hand.

To sustain the performing stage of development, teams continually need to ensure that they are communicating well, evaluating their processes, sharing leadership and responsibilities, and improving their flexibility overall. In doing so, they will be able to adapt nimbly to almost anything they face.

Adjourning

In the adjourning stage the team will be finishing and wrapping up the task and, as a result, breaking up. This will be difficult for some team members, especially those who enjoyed working on the task or developed good friendships. A leader can help by working with team members to plan their futures.

Takeaways from Stages of Team Development

Tuckman’s stages of team development describe the common ways teams progress as they work together. As discussed in each stage, members need to focus on specific behaviours in order for their team to progress and not get stuck in one stage. Tuckman’s 5 Stages of Team Development has since formed the basis of many team and group models, and is used extensively by management consultants, and in team-building exercises and activities. Tuckman’s model helps managers, leaders and team members to:

- recognize different stages in their team development and support team members as they deal with inevitable conflicts and changes during team development;
- support teams and groups to accelerate through the group stages with awareness and compassion for each other;

and
- improve team performance, which is the ultimate goal.

Factors for Effective Teamwork

Let us explore more deeply what team members can do to help their team be successful. Teams are most effective when members:

- communicate effectively;
- recognize and celebrate each other's uniqueness and diverse points of view, rather than forcing conformity;
- seek win-win situations rather defaulting to compromising;
- rely on each other to get the job done, resulting in high team productivity and efficiency;
- trust one another;
- work better together than individually, causing collective performance to exceed individual performance;
- encourage other team members to do their best, improving collective results;
- enjoy being on the team; and
- rotate leadership.

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 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 is 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 will focus on five of the most important ones:

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.

6. **Equitable and inclusive practices.** Members value and celebrate each person's authenticity, identity, and the unique perspectives that come with those; as well, the team members work to create inclusive and equitable practices in their day-to-day teamwork.

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 is supposed to be working. Let us look at some factors that can erode team performance.

Skills for Effective Teamwork

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.[14] But not terribly often. In fact, we usually hear about such teams simply because they are 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.** The ways in which members communicate can positively and negatively affect relationships within the team and outside the team with managers, customers, vendors, etc.
- **Technical skills.** Teams must perform certain tasks, therefore they need people with the skills to perform them. For example, if your project calls for a lot of math work, it is 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 is 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 a work in progress.

Later in this chapter, in the Team and Its Members section, we will dive deeper into what makes teams work by focusing on behaviours that promote effective teamwork.

14. Iacocca, L., & Novak. W. (2007). *Iacocca.* New York: Bantam.

What Keeps Teamwork from Working?

Just as there are factors and behaviours that contribute to teams working well together, there are some common factors that keep teams from working well together. In this section, we will touch on a few of those. Specific behaviours, or "blocking" behaviours, that team members have are discussed later in the chapter as well.

Groupthink

It is easy for leaders to direct members toward team goals when members are all on the same page, i.e., when there is a basic willingness to conform to the team's rules. When there is too much conformity, however, the group can become ineffective; it may resist fresh ideas and, what's worse, end up adopting its own dysfunctional tendencies as its way of doing things. Such tendencies may also encourage a phenomenon known as **groupthink,** or the tendency to conform to group pressure in making decisions, while failing to think critically or 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 they were persuaded to set aside their warning by NASA officials who wanted the launch to proceed as scheduled.[15]

Motivation and Frustration

Remember that teams are composed of people, and regardless of whatever 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 is also a chief cause of ineffective teamwork, and that is one reason why more employers now look for the ability to develop and sustain motivation when they are hiring new managers.[16]

Other Factors that Erode Performance

Let us take a quick look at three other obstacles to success in introducing teams into an organization:

- **Unwillingness to cooperate.** Failure to cooperate can occur when members do not or would not commit to a common goal or set of activities. What if, for example, half the members of a product development team want to

15. Whetten, D. A., & Cameron, K. S. (2007). *Developing Management Skills (7th ed.)*. Upper Saddle River, NJ: Pearson Education. See also Topaloglu, M., & Anac, S. A. (2021). *Exploring Major Factors Affecting Virtual Team Performance*. European Journal of Business and Management Research DOI: 10.24018/ejbmr.2021.6.5.1071
16. Robbins, S. P., & Judge, T. A. (2009). *Organizational Behavior (13th ed.)*. Upper Saddle River, NJ: Pearson Education.

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 is not willing to commit the needed resources, e.g., 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 who 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, the success of which depends on building consensus and letting people make their own decisions.[17]

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 have probably already notice that you will 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 are in business school, you will almost certainly find yourself engaged in team-based activities.[18]

Why do we put so much emphasis on something that, reportedly, makes many students feel anxious and academically drained? Here is one college student's practical-minded answer to this question:

"In the real world, you have to work with people. You do not always know the people you work with, and you do not always get along with them. Your boss would not particularly care, and if you cannot 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 is 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.[19] Consider the advice of former Chrysler Chairman Lee Iacocca: "A major reason that capable people fail to advance is that they do not work well with

17. Greenberg, J., & Baron R. A. (2008). *Behavior in Organizations (9th ed.).* Upper Saddle River, NJ: Pearson Education.
18. Thompson, L. L. (2008). *Making the Team: A Guide for Managers.* Upper Saddle River, NJ: Pearson Education.
19. Whetten, D. A, & Cameron K. S. (1991). *Developing Management Skills (7th ed.).* Upper Saddle River, NJ: Pearson Education.

their colleagues".[20] 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.[21]

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 will find yourself working as part of a team. You will. The question is whether you will 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? How can you get your team out of the storming stage and on the road to productivity?

As a student and later in the workplace, you will 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 factor is the quality of the contributions they make in performing non-leadership roles.[22]

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

1. accomplishing its assigned task; and
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: task-facilitating roles and relationship-building roles.

The diagram below summarizes behaviors associated with the two roles:

Figure 2.3 Behaviors associated with Task-Facilitating Roles and Relationship-Building Roles

20. Flavin, B. (2018, July 3). *The Importance of Teamwork Skills in Work and School*. Rasmussen University. https://www.rasmussen.edu/student-experience/college-life/importance-of-teamwork-skills-in-work-and-school/
21. Whetten, D. A., & Cameron K. S. (1991). *Developing Management Skills (7th ed.)*. Upper Saddle River, NJ: Pearson Education.
22. The Hay Group. (n.d.). *What Makes Great Leaders: Rethinking the Route to Effective Leadership*. http://www.lrhartley.com/seminars//great-leaders.pdf
23. Schwartz, J., & Wald, M. L. (2003, March 9). *The Nation: NASA's Curse?; "Groupthink" Is 30 Years Old, And Still Going Strong*. The New York Times. https://www.nytimes.com/2003/03/09/weekinreview/the-nation-nasa-s-curse-groupthink-is-30-years-old-and-still-going-strong.html

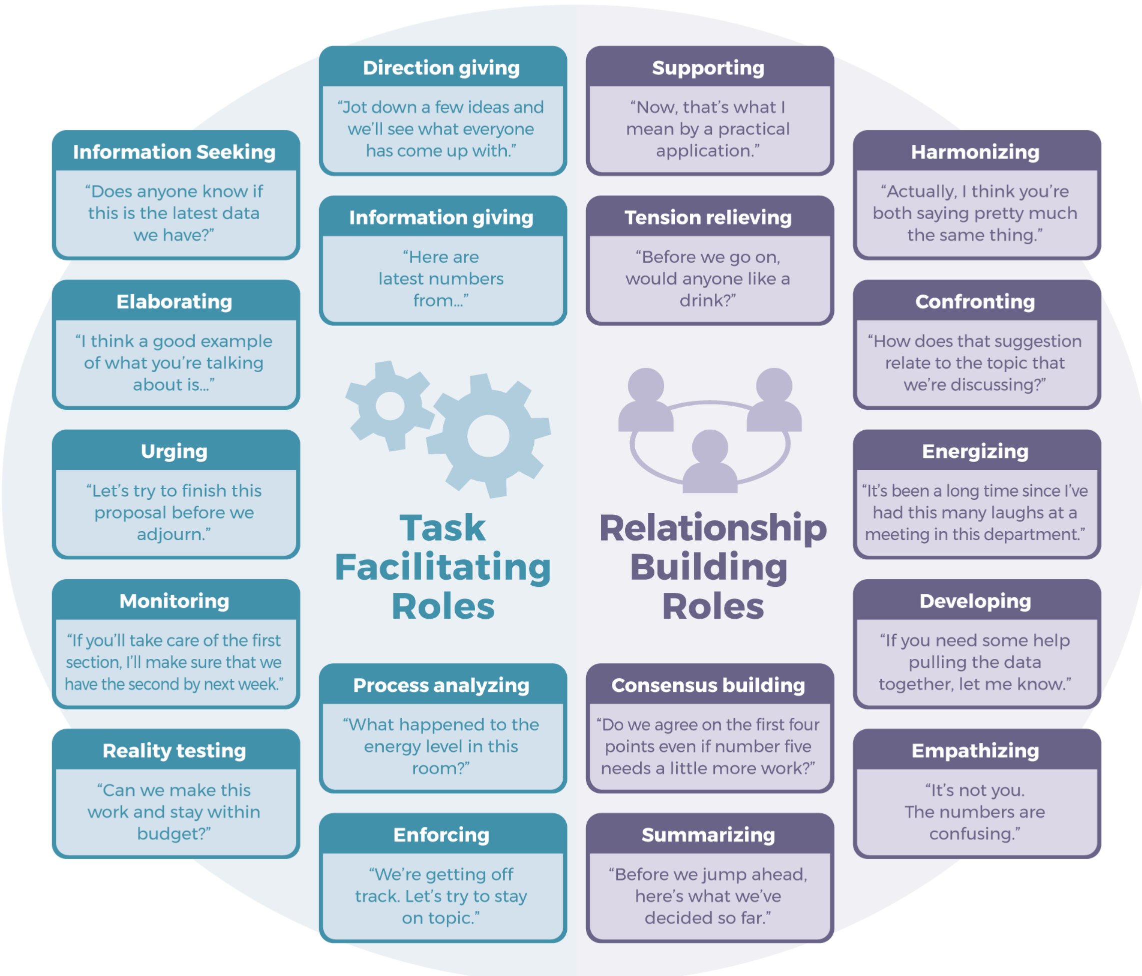


Figure 2.3 Behaviors associated with Task-Facilitating Roles and Relationship-Building Roles

Below are the two types of behaviours described in Figure 2.3:

- **Behaviours in task-facilitating roles include:**
  - **direction giving**: "Jot down a few ideas and we'll see what everyone has come up with."
  - **information seeking**: "Does anyone know if this is the latest data we have?"
  - **information giving**: "Here are the latest numbers from…"
  - **elaborating**: I think a good example of what you're talking about is…"
  - **urging**: "Let's try to finish this proposal before we adjourn."
  - **monitoring**: "If you'll take care of the first section, I'll make sure that we have the second by next week."
  - **process analyzing**: " What happened to the energy level in this room?"
  - **reality testing**: "Can we make this work and stay within budget?"
  - **enforcing**: We're getting off track. Let's try to stay on topic."
- **Behaviours in relationship-building roles include:**

- **supporting**: "Now, that's what I mean by a practical application."
- **harmonizing:** "Actually, I think you're both saying pretty much the same thing."
- **tension relieving**: "Before we go on, would anyone like a drink?"
- **confronting: "**How does that suggestion relate to the topic that we're discussing?"
- **energizing**: "It's been a long time sing I've had this many laughs at a meeting in this department."
- **developing**: "If you need some help pulling the data together, let me know."
- **consensus building**: "Do we agree on the first four points even if the number five needs a little more work?"
- **empathizing:** "It's not you. The numbers are confusing."
- **summarizing**: "Before we jump ahead, here's what we've decided so far."

Task-Facilitating Roles

Task-facilitating roles address challenge number one — accomplishing the team goals. 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 are not clear or when progress is too slow.

Relationship-Building Roles

When you challenge unmotivated behavior or help other team members understand their roles, you are 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 is a good balance between task facilitation and relationship-building; (2) it is 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 do not confront dysfunctional members, they can destroy morale, hamper consensus building, create conflict, and hinder progress.

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Class Team Projects

In your academic career you will participate in a number of team projects. To get insider advice on how to succeed on team projects in college, let us 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.
- Do not do all the work yourself. Work with your team to get the work done. The project output is often less important than the experience.
- Celebrate diversity and be inclusive. Find ways to celebrate the personal, cultural, and social events and practices of your team members. Recognize that different backgrounds mean richer opportunities. Work with each other to figure out what makes you each thrive in a team.

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 has no simple answers. We can provide one broad answer; a leader must help members develop the attitudes and behavior that contribute to team success, including interdependence, collective responsibility, and shared commitment.

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 does not work very well.[25] As one team of

24. Whetten, D. A., & Cameron K. S. (1991). *Developing Management Skills (7th ed.)*. Upper Saddle River, NJ: Pearson Education.
25. Whetten, D. A., & Cameron K. S. (1991). *Developing Management Skills (7th ed.)*. Upper Saddle River, NJ: Pearson Education.

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 us look briefly at some of them:

- Encourage diverse ways of thinking. Each person comes with a unique view of the world and can bring that to your project. Find ways to engage them in that unique perspective. Feeling safe to think differently is the basis of creativity and innovation!
- Promote active listening and questioning. Rather than sharing your point of view too often, make your default mode actively listening to people and asking questions that help people unpack their ideas. This allows you to help everyone feel that their perspective is valued and increase the likelihood of them participating in the future.
- Demonstrate integrity. Do what you say you will do and act in accordance with your stated values. Be authentic in communicating and follow through on promises. Saying what you think and acting consistently upon it helps to reinforce that your word can be trusted.
- Generate positive energy. Be optimistic and compliment team members. Recognize their progress and success.
- Acknowledge common points of view. Even if you are 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 are knowledgeable about team tasks and individual talents. Check with team members regularly to find out what they are doing and how the job is progressing.

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

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=32#h5p-3 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=32#h5p-3)

26. Feenstra, K. (n.d.). *Study Skills: Teamwork Skills for Group Projects*. Issues I Face. https://issuesiface.com/magazine/work-skills-for-group-projects

Comprehension Check

1. What is the difference between a team and a group?
2. What are recognized as common stages that teams go through in their development?
3. What are the two types of roles that team members can play? What are example behaviours of each? How do these roles help the team accomplish their goals and overcome challenges?
4. What are the specific challenges and benefits of self-managed teams, cross-functional teams, virtual teams, and class project teams?
5. What skills and behaviours are needed to lead a team well? What are some examples of how you can work on those skills in a team setting in your life now?

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; and
    - interpersonal skills: skills in listening, providing feedback, and resolving conflict.

PART B - THE CONTEMPORARY BUSINESS WORLD

This second section of the book discusses how existing businesses are being changed by new ways of doing business due to technology, the COVID-19 pandemic, the need to embrace equity, inclusion and diversity, and the steps that businesses are taking to be sustainable and environmentally friendly. This part covers business and economics, business in the global environment, the external environment's influence, forms of business ownership, entrepreneurship (starting a business), and business conduct including ethics and social responsibility.

Chapter 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; and
7. explain other **key terms** related to this chapter including: supply, demand, equilibrium price, monopoly, recession and depression.

Show What You Know

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https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=46#h5p-6
(https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=46#h5p-6)

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; and
- 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) is 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 in 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; and
- 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.

Figure 3.1 The Circular Flow of Inputs and Outputs

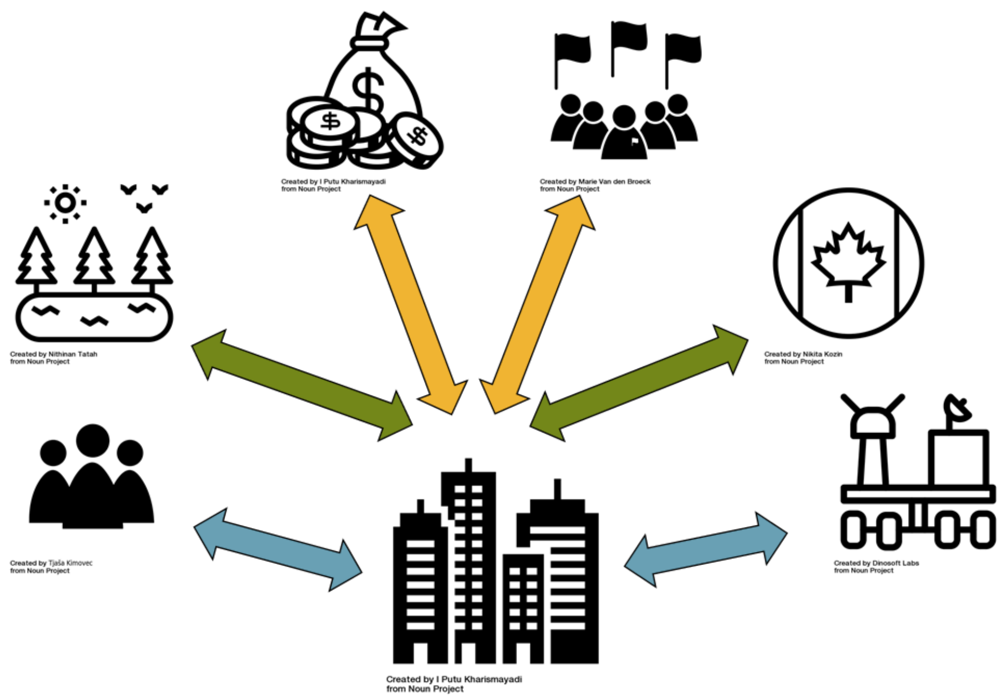


*Figure 3.1 The Circular Flow of Inputs and Outputs illustrates the dual roles of households and businesses. Households not only provide factors of production (or resources) but also consume goods and services. Businesses not only buy resources but also produce and sell both goods and services. Outputs include goods and services (or products). Inputs include labor, capital, land, and entrepreneurship.**

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.

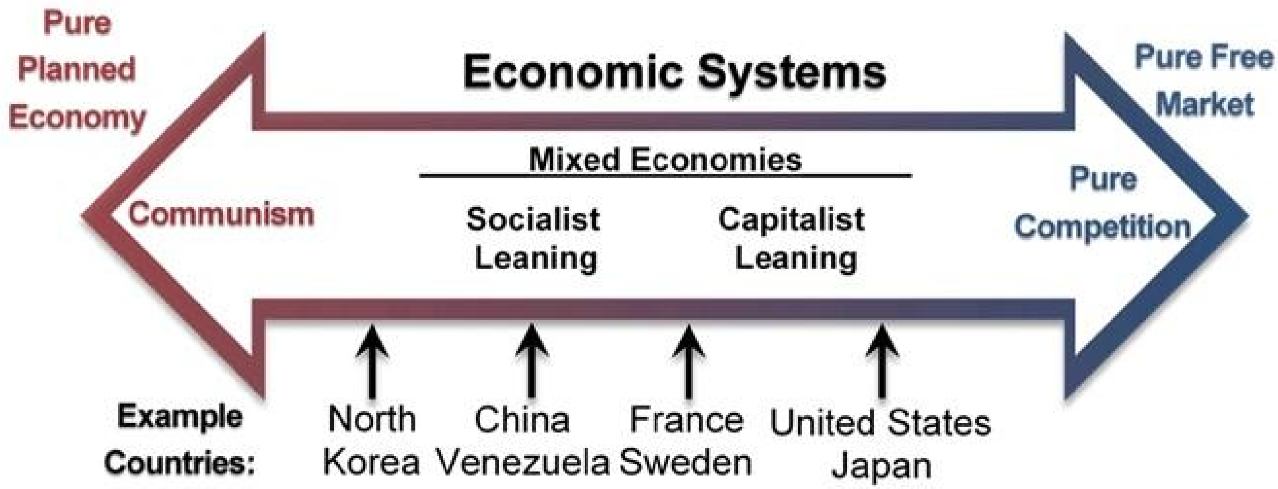
Free Market System

The **free market system** is an economic system in which most businesses are owned and operated by individuals, 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.

Figure 3.2 Economic Systems



(https://commons.wikimedia.org/wiki/File:Fundamentals_of_Business_-_Fig._2.2_-_Economic_Systems.jpghttp://)
Figure 3.2 Wikimedia Commons | Designed for Virginia Tech by B. Craig licensed CC BY

Mixed Market Economies

Though it is possible to have a pure communist system, or a pure capitalist (free market) system, in reality many economic systems are **mixed market** economies. 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 is 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 will 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 us 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

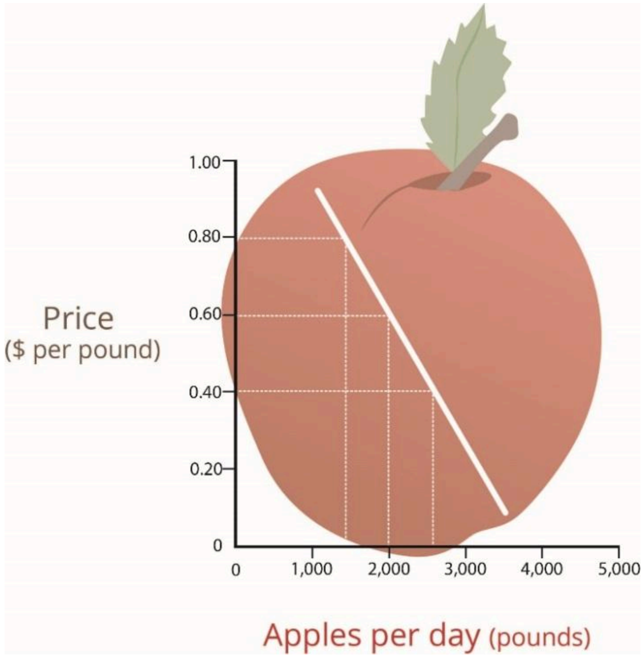


Chart 3.1 The Demand Curve for apples per day and price.

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.

Supply and the Supply Curve

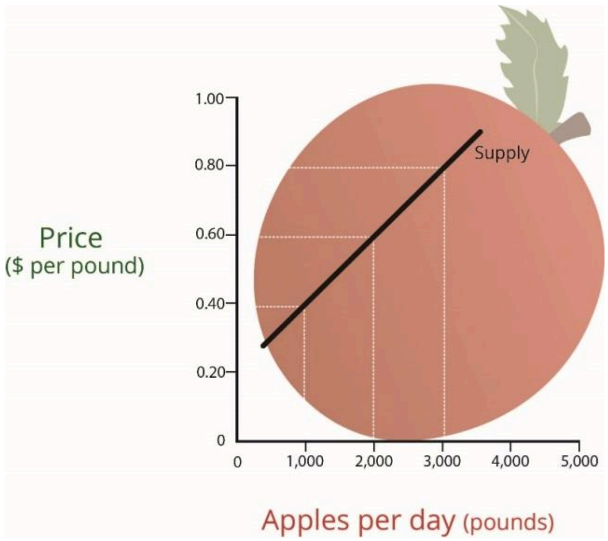


Chart 3.2 The Supply Curve for apples per day and price.

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 have done in the figure below, "**The Equilibrium Price**". The point at which the two curves intersect is the equilibrium price.

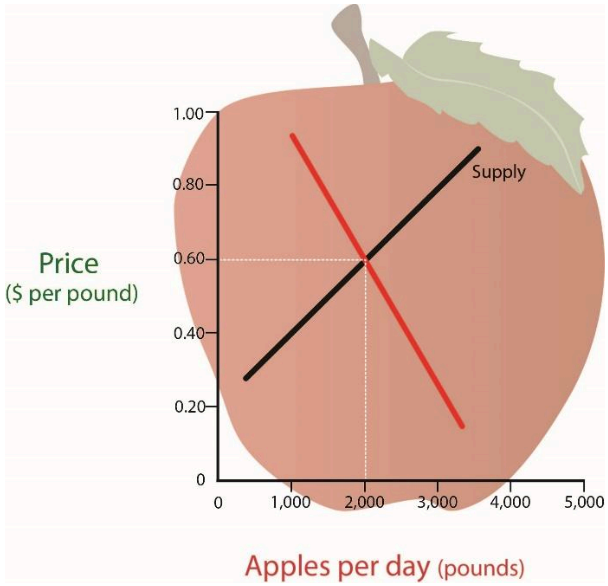


Chart 3.3 The Equilibrium Price

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.

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

The Canadian economy is founded on the principles of private enterprise; private property rights, freedom of choice, profits and competition. 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 will cover the remaining three types of competition here.

Table 3.1 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 do not 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 an- other — 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 Canada 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; 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, 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 are 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; and

- price stability.

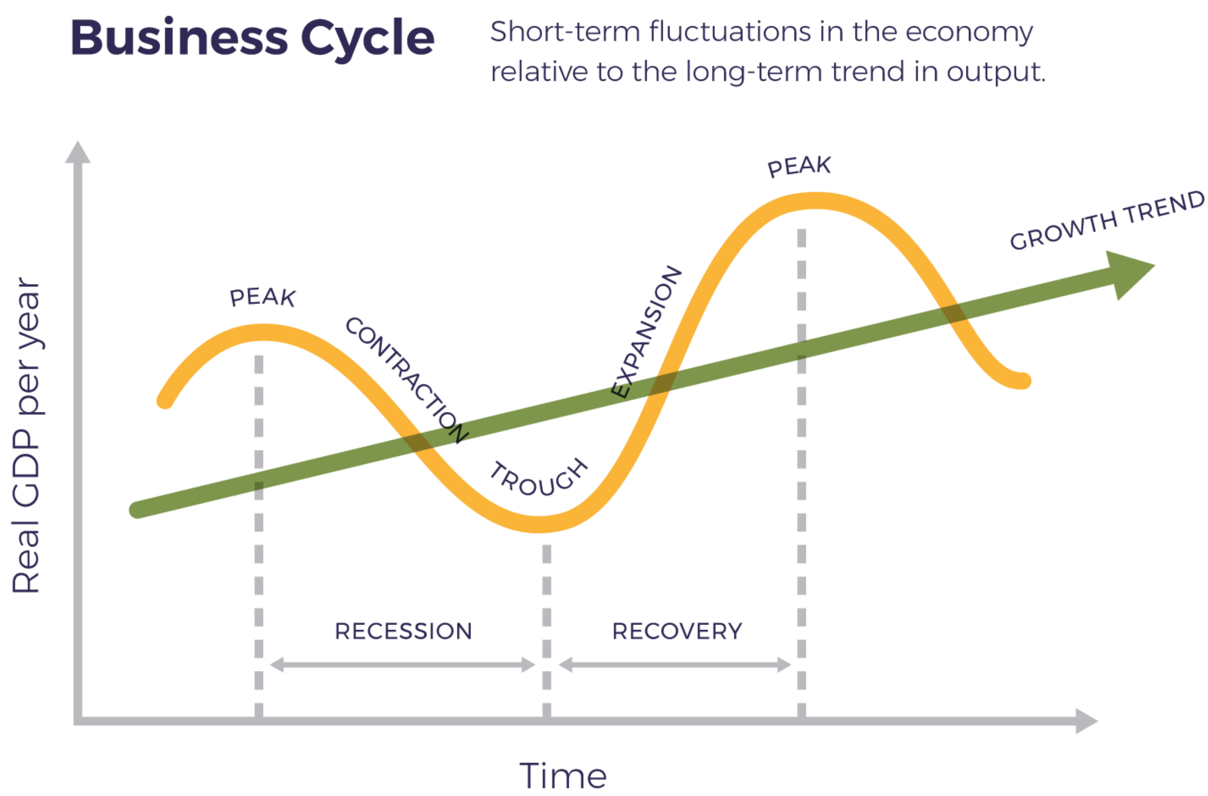
Let us take a closer look at each of these goals, both to find out what they mean and to show how we determine whether or not they're being met.

Economic Growth

One purpose of an economy is to provide people with goods and services such as cars, computers, video games, houses, rock concerts, fast food, and 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.

Gross national product (GNP) is another metric used for measuring a nation's economic output. Gross national product (GNP) is the value of all products and services produced by the citizens of a country both domestically and internationally minus income earned by foreign residents. For instance, if Canada has production facilities in the USA, its GNP would account for both the production output in Canada and in the USA.

Chart 3.4 Business Cycle



(https://en.wikipedia.org/wiki/Business_cyclehttp://)
Chart 3.4 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 an economy's business cycle is created. 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 are 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. While economists have defined recession, they have not agreed on a uniform standard for what constitutes a depression, though they are generally characterized by their duration. Though not impossible, it is unlikely that Canada 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:

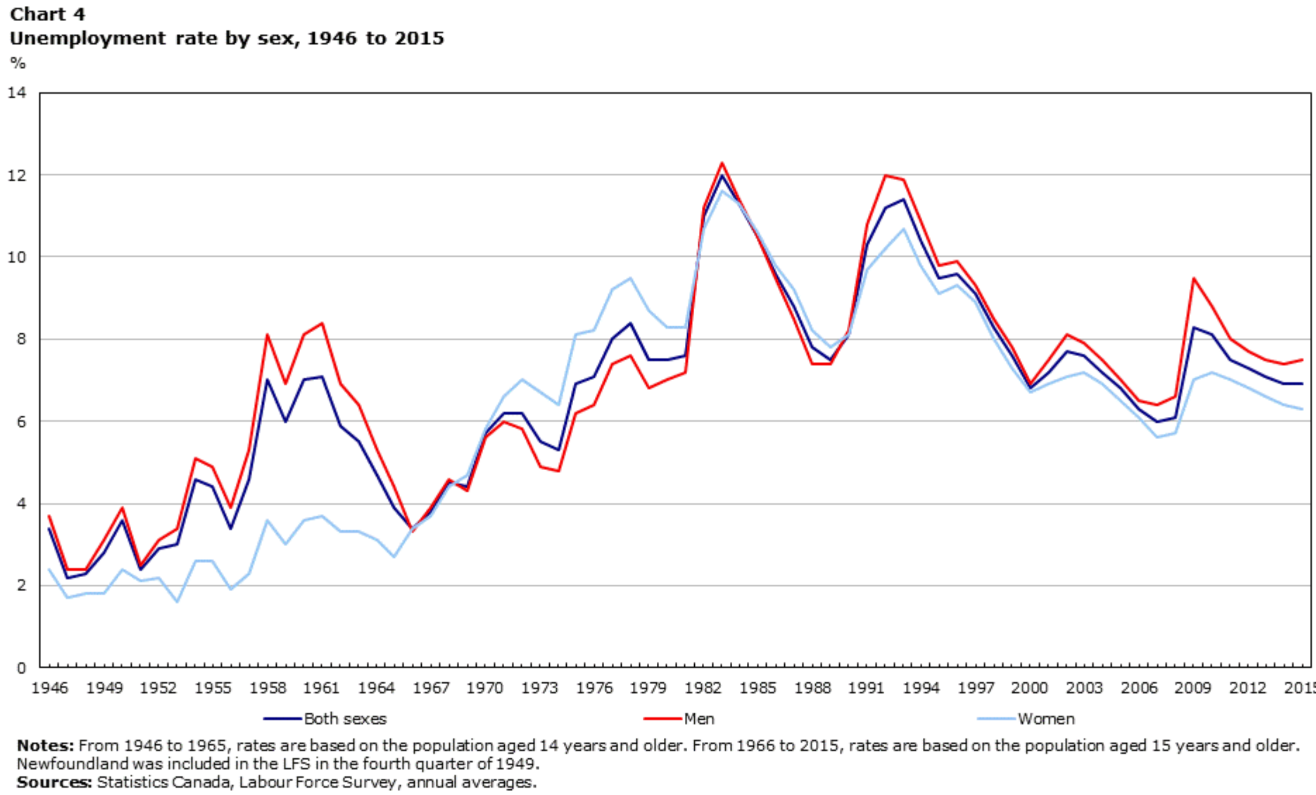
One or more interactive elements has been excluded from this version of the text. You can view them online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=46#oembed-1 (#oembed-1)

The Unemployment Rate

Statistics Canada tracks unemployment and reports the **unemployment rate**: the percentage of the labour force that is 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 of 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 favorable, if not completely accurate, picture.

Chart 3.5 Unemployment Rate by Sex



(http://www.statcan.gc.ca/pub/75-005-m/75-005-m2016001-eng.pdf)

Chart 3.5 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 does not 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.

Chart 3.6 Canada's Inflation Rate 1915-2018

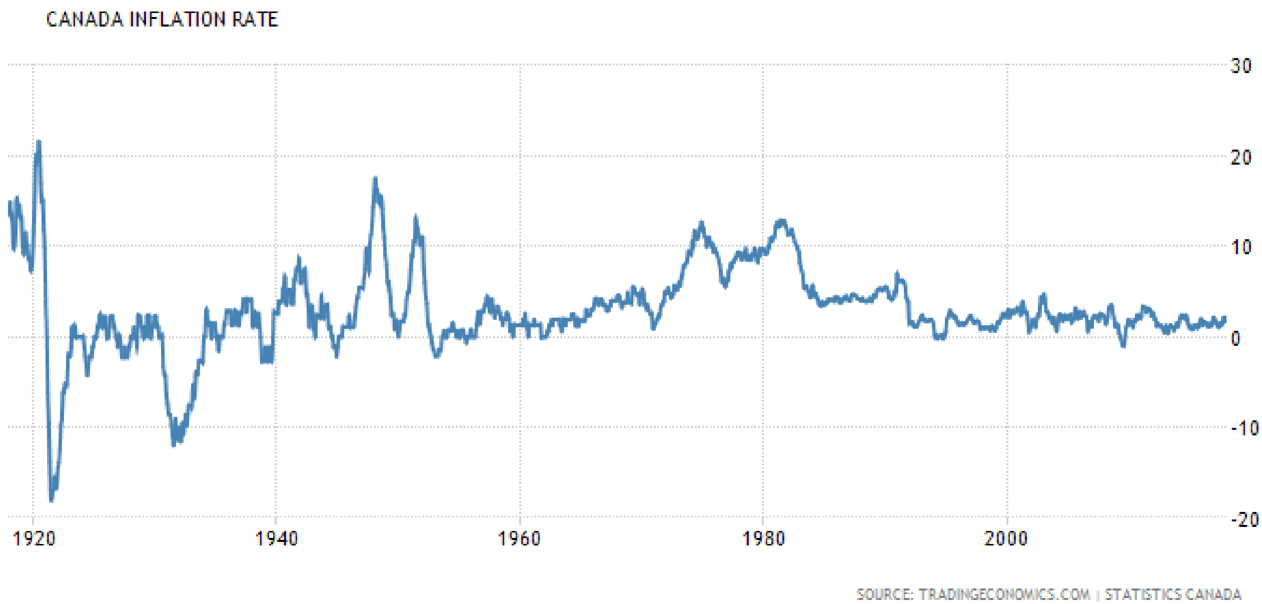


Chart 3.6 Canada's Inflation Rate 1915-2018. Source: Tradingeconomics.com. Statistics Canada.

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/) to 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 will only discuss the general concept and a few of the key indicators.

Leading, Coincident and Lagging Indicators

Canadian economic indicators can be expressed in three main indicators — **leading indicators**, **coincident indicators** and **lagging 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 is on the rise, the economy will probably improve. For assessing the strength of the housing market, the number of 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

The Canadian government, including federal, provincial and municipal governments, plays many roles within the Canadian economic system, and therefore influences business activities. Government plays many roles and influences business activities in many ways. The roles government plays are as follows:

- Government as customer
- Government as a competitor
- Government as a regulator – promoting competition, protecting consumers, achieving social goals and protecting the environment
- Government as a taxation agent
- Government as a provider of incentives
- Government as a protector of consumers or customers
- Government as a provider of essential services.

Businesses may also influence government through lobbying, joining trade associations, making political donations and trying to convince voters to support or oppose certain regulations and policies.

In managing the economy three main policies may be used by the government: Monetary policy, Fiscal policy and National Debt management.

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

The **national debt** is also referred to as Canada's public debt. According to the Department of Finance Canada, Government Debt in Canada (https://tradingeconomics.com/canada/government-debt) increased to 1134.49 CAD Billion in 2022 from 1048.75 CAD Billion in 2021. The expected rise is due to the massive new borrowing to cover COVID-19 pandemic responses.

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.

This number is moving too quickly for the authors to keep the graph current – you can see the current debt at Canadian National Debt Clock (https://www.nationaldebtclocks.org/debtclock/canada.).

Put It Into Practice

1. Search credible business press and Internet for recent examples of Canadian business outlook and answer the following questions:

1. Is the current level of unemployment rising or falling?
2. Is the current level of inflation rate rising or falling?
3. What do economist expect will happen to unemployment rates and inflation in the near future?

2. Get together in groups of four selected by your instructor.

PART A – Pick any three items from the following list:

- litre of milk;
- litre of gas;
- roundtrip airline ticket between Vancouver and Toronto;
- large cheese pizza;
- monthly cost of internet; and
- quarter-pound burger.

PART B – Each member of the team should check the prices of the three items, using his or her own sources. Then, get together and compare the prices found by team members. Based on your findings, answer the following questions as a group:

1. Are the prices of given products similar, or do they vary?
2. Why do the prices of some products vary while those of others are similar?
3. Can any price differences be explained by applying the concepts of supply and demand or types of competition?

Comprehension Check

1. Distinguish between the main types of economic systems and describe their unique characteristics.
2. Using the principles of supply and demand, what happens to the price when there is more supply than demand? What happens to the price when there is more demand than supply? What do you call the point at which supply and demand meet?
3. What are the types of competition? What are the opportunities and challenges with operating within each type of competition?
4. What are the key indicators of economic growth and how does each one indicate economic health?

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.

Chapter 4 - 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; and
8. explain **key terms** in the chapter.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=61#h5p-11 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=61#h5p-11)

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 are a global business customer. Both Nike and Timberland manufacture most of their products overseas. Spotify is a Swedish enterprise.

Figure 4.1 Orchard Road by Michael Spencer licensed CC BY | flickr

Take an imaginary walk down Orchard Road, the most fashionable shopping area in Singapore. You will 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 are in the Chinese capital of Beijing, do not 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 are adventurous enough to find yourself in Faisalabad, a medium-sized city in Pakistan, you will 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.

Chart 4.1 The Expanded Circular Flow Model

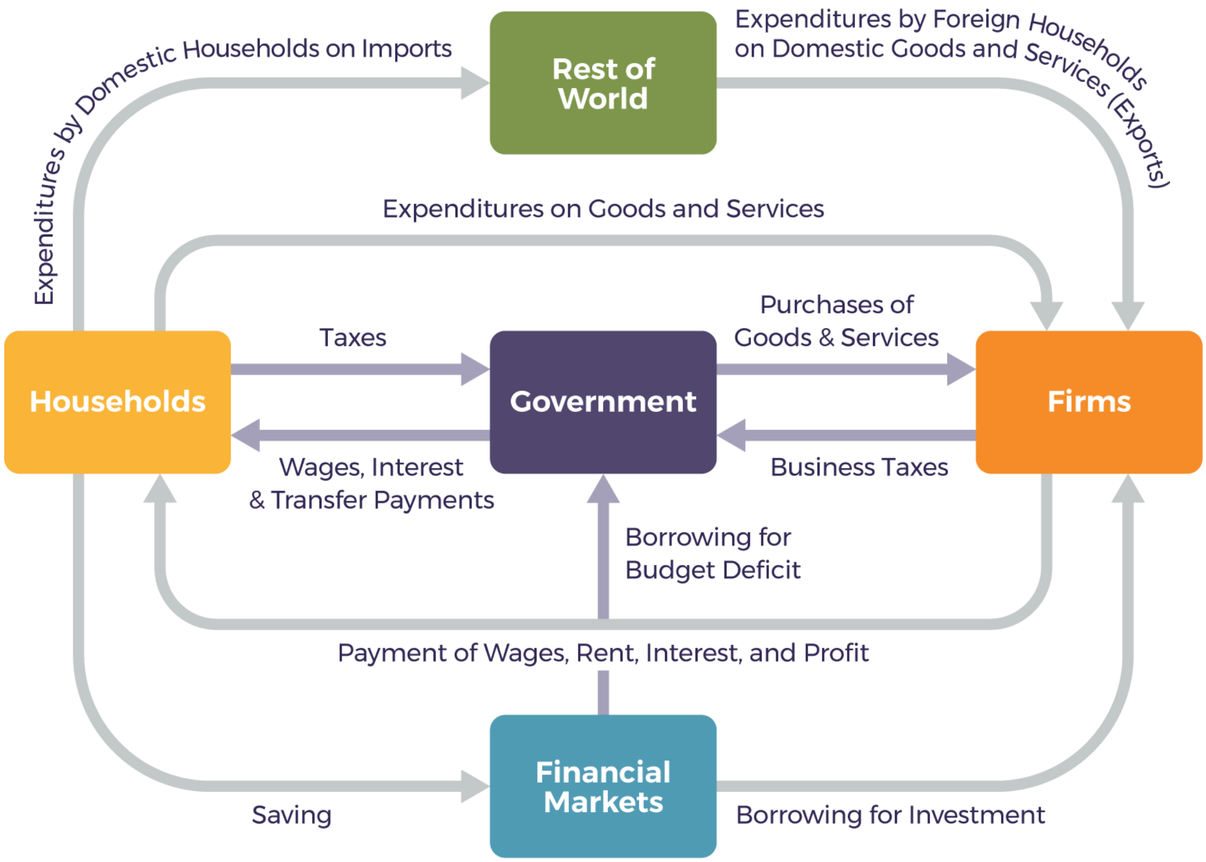


Chart 4.1 The Expanded Circular Flow Model. It shows how money circulates through the economy from households, firms, financial institutions, government and the rest of the world.

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 not 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 are exporters. (We will 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 not 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 that nation has the ability to produce something more efficiently than any other country. Absolute advantage implies that (1) the nation is the only source of a particular product or (2) it can make more of a product using fewer resources than other countries. For example, because of the climate and soil conditions, 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 is why there are few, if any, examples of absolute advantage in the world today.

Comparative Advantage

Comparative advantage is the ability for a country to produce some products more efficiently than others. 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 is 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

1. World Trade Organization. (2017). *Merchandise trade and trade in commercial services.* https://www.wto.org/english/res_e/statis_e/wts2017_e/WTO_Chapter_04_e.pdf

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 × $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.
- All U.S. planes could be retrofitted with reinforced cockpit doors to make it harder for terrorists to take over the plane; this would have a price tag of $450 million.
- Airports could install more sophisticated security equipment, like three-dimensional baggage scanners and cameras linked to face-recognition software, at a cost of 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) × 0.5 hours × $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 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

2. Buffet, W. E., & Loomis, C. (2003, November 10). *America's Growing Trade Deficit Is Selling The Nation Out From Under Us. Here's A Way To Fix The Problem–And We Need To Do It Now.* Fortune. http://archive.fortune.com/magazines/fortune/fortune_archive/2003/11/10/352872/index.htm

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]

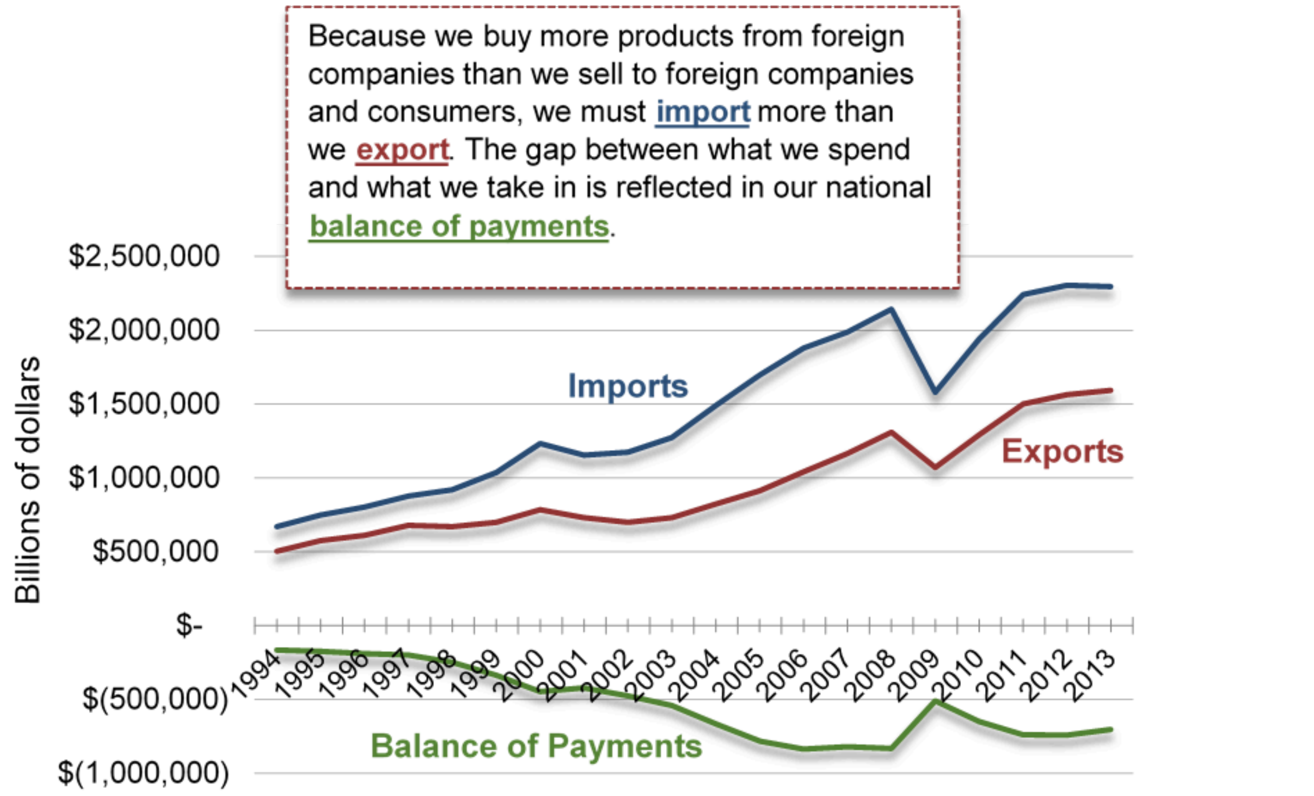
Balance of Payments

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.

Graph 4.1 Balance of Payments

Imports, Exports and the Balance of Payments.

3. Anonymous. (2003). *Why Are Prices in Japan So Damn High*? The Japan FAQ.com. http://www.thejapanfaq.com/FAQ-Prices.html
4. Trading Economics. (n.d.). *Canada current account*. https://tradingeconomics.com/canada/current-account



Graph 4.1 Balance of Payments over time. Years from 1994 to 2013 along the X axis and dollars in the billions from -1 000 000 to +2 500 000 along the Y axis. It shows we buy more product from foreign companies than we sell to fprign companies and consumers, and that we must import more than we export. The gap between what we spend and what we take is is reflected in our national balance of payments, which is a growing negative number.

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 many ways it can get involved in international business. Let us 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. Canadian firms both large and small export many products and services internationally. For example, McCain Foods, which began in New Brunswick, now has an international presence; their products are sold in supermarkets across the world. Target Marine Hatcheries, based in Sechelt, British Columbia, is Canada's lone producer of certified organic farmed sturgeons; the company produces caviar under the brand name of Northern Divine and sells it to clients in Japan, Europe and Australia.

American food and beverage wholesalers 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 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 Agreements 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 is how it works. You own a company in Canada that sells coffee-flavored popcorn. You are sure that your product would be a big hit in Japan, but you do not have the resources to set up a factory or sales office in that country. You cannot 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 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 KFC, 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

5. Fine Waters Media. (2016). *Evian*. http://www.finewaters.com/bottled-waters-of-the-world/france/evian and Fiji Water (2016). *The Water*. https://www.fijiwater.com/pages/the-water
6. Gale, F. (2003). *China's Growing Affluence: How Food Markets Are Responding*. U.S. Department of Agriculture. https://www.ers.usda.gov/amber-waves/2003/june/chinas-growing-affluence/
7. American Soybean Association (2010). *ASA Testifies on Importance of China Market to U.S. Soybean Export*. https://soygrowers.com/asa-testifies-on-importance-of-china-market-to-u-s-soybean-exports/

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.

Table 4.1 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; and
- sharing technology.

Alliances range in scope from informal cooperative agreements to **joint ventures**— alliances in which the partners fund

8. Gereffi, G., & Frederick, S. (2010). *The Global Apparel Value Chain, Trade and the Crisis: Challenges and Opportunities for Developing Countries*. The World Bank, Development Research Group, Trade and Integration Team.
9. IndianTelevision.com. (2004). *Viacom in Chinese content production deal with Beijing* TV. http://www.indiantelevision.com/headlines/y2k4/sep/sep273.htm

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 (FDI)and Subsidiaries

Many of the approaches to global expansion that we have 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.[11]

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.

Graph 4.2 Where FDI goes

10. Clothing, Makeup and Beauty Tips. (2012). *Lihi Griner Cosmopolitan Israel.* http://www.magxone.com/cosmopolitan/lihi-griner-cosmopolitan-israel-may-2012/attachment/lihi-griner-cosmopolitan-israel/ and CountryMagazines.Blogspot.com. (2015). http://country-magazines.blogspot.com/2015/09/tennis-maria-sharapova-cosmopolitan.html
11. Mandel, M. (2007). *The Real Cost of Offshoring. Bloomberg BusinessWeek.* http://www.bloomberg.com/news/articles/2007-06-17/the-real-cost-of-offshoring

Graph 4.2 Graph with years from 2000-2014 on the X axis and billions of dollars from 0 to $2 000 000 the Y axis. It shows, 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.

Table 4.2 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 the rankings at Fortune.com. (https://fortune.com/ranking/)

Multinational Corporations

A company that operates in many countries is called a **multinational corporation** (MNC). Fortune magazine's (https://fortune.com/) roster of the top 500 MNCs speaks for the growth of non-U.S. businesses. Only one of the top 6 MNCs is 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 are trying to sell products in different markets, they are 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 design cell phones, it is often geared to local tastes in color, size, and other features. For example, Nokia introduced a cell phone for the rural Indian consumer that has a dust-resistant keypad, anti-slip grip, and a built-in flashlight. McDonald's provides a vegetarian menu in India, where religious convictions affect the demand for beef and pork. In Germany, McDonald's caters to local tastes by offering beer in some restaurants and a Shrimp Burger in Hong Kong and Japan.

A quick tour of McDonald's around the world

An interactive H5P element has been excluded from this version of the text. You can view it online here:

12. Morgan, J. C. & Morgan, J. J. (1991). *Cracking the Japanese Market.* New York: Free Press.

https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=61#h5p-12 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=61#h5p-12)

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

Criticism of MNCs

The global reach of MNCs is a source of criticism as well as praise. Critics argue that they often destroy the livelihoods of home-country workers by moving jobs to developing countries where workers are willing to 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 demands 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 — 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."[13]

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 us look at some of the more important of these differences.

The Cultural Environment

Even when two people from the same country communicate, there is 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 governs the interactions of members of a society. Cultural differences create challenges to successful international business dealings. Let us 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 as a second language, 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 only 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.

13. Krueger, A. O. (2002). *Supporting Globalization.* IMF. http://www.imf.org/external/np/speeches/2002/092602a.htm

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 are privy to only interpretations of the messages that you are 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, do not 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 will probably ask about your health and that of your family, inquire whether you are 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 is 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 do not 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)[14]:

- 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); and
- low income—$1,045 or less (Afghanistan, South Sudan, Haiti).

14. World Bank Group. (2016). *Country and Lending Groups*. http://data.worldbank.org/about/country-and-lending-groups

Note 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 is 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.[15]

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.

15. Ricks, D. (1999). *Blunders in International Business.* Malden, MA: Blackwell.

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 cannot give bribes, they will 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."[16]

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.

Table 4.3 Corruption Perceptions Index

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

16. Transparency International. (2020, August 10). *What is corruption?* Transparency.org. https://www.transparency.org/en/what-is-corruption

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 us examine a hypothetical case. Suppose you are 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 is when you decide to protect your farmers and clothes-makers by setting up trade rules. Maybe you will increase the prices of imported goods by adding a tax to them; you might even make the tax so high that they are more expensive than your homemade goods. Or perhaps you will 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 is 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 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.[17] 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.[18]

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 **trade 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 do not 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

17. Edwards, C. (2007). *The Sugar Racket.* CATO Institute Tax and Budget Bulletin. http://www.cato.org/pubs/tbb/tbb_0607_46.pdf
18. Pritchard, J. (2002). *Sole U.S. Life Savers plant closing, moving to Canada.* Southeast Missourian. http://www.semissourian.com/story/70976.html

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 us 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 are not 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.[19]

19. Becker, E. (2003, November 11). *U.S. Tariffs on Steel Are Illegal, World Trade Organization Says*. The

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.[20]

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.[21] 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: Canada United States Mexico Agreement (CUSMA formerly NAFTA) and the European Union (EU)

So far, our discussion has suggested that global trade would be strengthened if there were no restrictions on it — if countries did not 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 have not 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

New York Times. http://www.nytimes.com/2003/11/11/business/us-tariffs-on-steel-are-illegal-world-trade-organization-says.html?pagewanted=all

20. Sanders, B. (1998). *The International Monetary Fund Is Hurting You.* Z Magazine. http://www.thirdworldtraveler.com/IMF_WB/IMF_Sanders.html
21. The World Bank. (2016). Fiscal Year Data 2011-15. http://www.worldbank.org/en/about/annual-report/fiscalyeardata#1

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 us examine two of the most powerful trading blocs — the Canada United States Mexico Agreement (CUSMA formerly NAFTA) and the European Union (EU).

Canada United States Mexico Agreement (CUSMA)

The Canada United States Mexico Agreement (CUSMA), formerly known as The North American Free Trade Association (NAFTA), is an agreement among the governments of Canada, United States 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 top trading partners of the United States. On September 30, 2018, the USA, Mexico and Canada agreed to a new revised deal and a new name — CUSMA.

The CUSMA is a mutually beneficial win for North American workers, farmers, ranchers, and businesses. The Agreement has created a more balanced, reciprocal trade that supports high-paying jobs for Canadians and the growth of the North American economy. Key points from Canadian perspectives include:

- 3.59% of the Canadian dairy market opened up to the US.
- Revised automotive rules of origin require higher levels of North American content (from 62.5% to 75%).

See Government of Canada News Release, October 26, 2018, and comments from the Minister of Foreign Affairs.

> "The CUSMA is good for Canada's economy and good for Canada's middle-class workers and families. It addresses modern-day trade issues and supports prosperity for Canadians by ensuring that our businesses, entrepreneurs, workers, ranchers, farmers and fishers continue to have preferential access to our largest market."
>
> *– The Honourable Chrystia Freeland, Minister of Foreign Affairs.*

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 CUSMA. Both, for instance, allow unrestricted trade among member nations. But the provisions of the EU go beyond those of CUSMA 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 CUSMA 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.

Figure 4.2 Map of the European Union

Figure 4.2 Shows a map with countries in the European Union highlighted. These countries include: Austria, Belgium, Bulgaria, Croatia, Republic of Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain and Sweden.

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.[22]

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.[23] Over time, the value of the euro has been questioned. Many of the countries that use the euro (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 countries that use the euro, they are less able to correct their economic woes.[24] Many economists fear that the financial crisis precipitated by these financially irresponsible countries threaten the very survival of the euro.[25] The UK voted to leave the EU in 2016, and at the end of 31 January 2020 they began the transition period that ended on 31 December 2020; during that period the UK and EU negotiated their future relationship.

Only time will tell whether the trend toward regional trade agreements is good for the world economy. Clearly, regional trade agreements are beneficial to their respective participants, who, for one thing, 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?

New Agreements (TPP and CETA)

22. European Commission. (2015). Euro Area. http://ec.europa.eu/economy_finance/euro/why/index_en.htm
23. European Commission. (2015). Euro Area. http://ec.europa.eu/economy_finance/euro/why/index_en.htm
24. Fresh Air. (2011, January 25). *Paul Krugman: The Economic Failure of the Euro.* NPR (National Public Radio). http://www.npr.org/2011/01/25/133112932/paul-krugman-the-economic-failure-of-the-euro
25. Buiter, W. (2010, December 10). *Three Steps to Survival for Euro Zone.* The Wall Street Journal. http://online.wsj.com/article/SB10001424052748703766704576009423447485768.html

Canada is engaged in negotiating new trade agreements including the following:

- Trans-Pacific Partnership (TPP). The TPP is a comprehensive and progressive agreement that is made up of 11 member countries. TPP will increase Canada's foothold in Asia Pacific and create opportunities to open new markets, such as Canadian beef and pork producers gaining access to the Japanese market. Opponents of the TPP agreement highlights the impact on the dairy industry, the auto sector, and other groups.
- Canadian-European Union Comprehensive Economic and Trade Agreement (CETA). With CETA, Canada has negotiated trade deals in which 98% of Canadian goods are now duty-free and eventually 99% of tariffs will be eliminated.
- Canada started negotiations with Mercosur (made up of the following: Argentina, Brazil, Uruguay, Paraguay and Venezuela) in 2018.

Other Free Trade Agreements and Blocs

Groups of nations are getting together to form regional trade associations for their own benefits, including the following:

- ASEAN Free Trade Area;
- The Asia-Pacific Economic Cooperation;
- The Economic Community of Central African States;
- The Gulf Cooperation Council; and
- BRICS – Brazil, Russia, India, China and South Africa.

Comprehension Check

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=61#h5p-49 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=61#h5p-49)

Key Takeaways

Important terms and concepts:

1. Nations trade because they do not produce all the products that their inhabitants need.

2. The cost of labor, the availability of natural resources, and the level of knowhow 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 is the only source of a particular product or can make more of a product with the same amount of, or fewer resources than, other countries.
    - A comparative advantage exists when a country can produce a product at a lower opportunity cost than other nations.
4. We determine a country's balance of trade by subtracting the value of its imports from the value of its exports. If a country sells more products than it buys, it has a favorable balance, called a trade surplus. If it buys more than it sells, it has an unfavorable balance, or a trade deficit.
5. The balance of payments is the difference, over a period of time, between the total flow coming into a country and the total flow going out. The biggest factor in a country's balance of payments is the money that comes in and goes out as a result of exports and imports.
6. A company that operates in many countries is called a multinational corporation (MNC).
7. For a company in Canada wishing to expand beyond national borders, there are various 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.
8. 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.
9. Through international contract manufacturing, or outsourcing, a company has its products manufactured or services provided in other countries.
10. 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.
11. A common form of FDI is the foreign subsidiary, an independent company owned by a foreign firm.
12. Success in international business requires an understanding of 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. Because they protect domestic industries by reducing foreign competition, the use of controls to restrict free trade is often called protectionism.
13. Tariffs are taxes on imports. Because they raise the price of foreign-made goods, they make them less competitive.
14. 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 protect specific industries, usually new industries or those facing strong competitive pressure from foreign firms.
15. 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.
16. 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).

17. Free trade is encouraged by a number of agreements and organizations set up to monitor trade policies.
18. The General Agreement on Tariffs and Trade (GATT) regulates free trade, reduces tariffs and provides a forum for resolving trade disputes.
19. The World Trade Organization (WTO) encourages global commerce and lower trade barriers, enforces international rules of trade, and provides a forum for resolving disputes.
20. The International Monetary Fund (IMF) and the World Bank both provide monetary assistance to the world's poorest countries.
21. 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 Canada United States Mexico Agreement (CUSMA) and the European Union (EU), which have eliminated trade barriers among themselves.

Chapter 5 - 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. list the stages of corporate responsibility;
7. discuss how you can identify an ethical organization, and how organizations can prevent behaviour like sexual harassment;
8. recognize how to avoid an ethical lapse, and why you should not rationalize when making decisions; and
9. explain **key terms** in the chapter.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here:
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(https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-7)

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

Ethics are 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.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#oembed-1 (#oembed-1)

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 (https://www.google.com/url?q=http://democracywatch.ca/&sa=D&ust=1524160309659000) 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.[1]

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1. Thompson, E. (2017, December 21). *Aga Khan could face lobbying probe for Trudeau trip*. 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 (https://www.google.com/url?q=http://www.cbc.ca/news/politics/trudeau-ethics-aga-khan-1.4458220&sa=D&ust=1524160309664000): 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.google.com/url?q=https://www.documentcloud.org/documents/4334047-The-Trudeau-Report.html&sa=D&ust=1524160309665000)

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.[2] Madoff is alleged to have run a giant Ponzi scheme[3] 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.

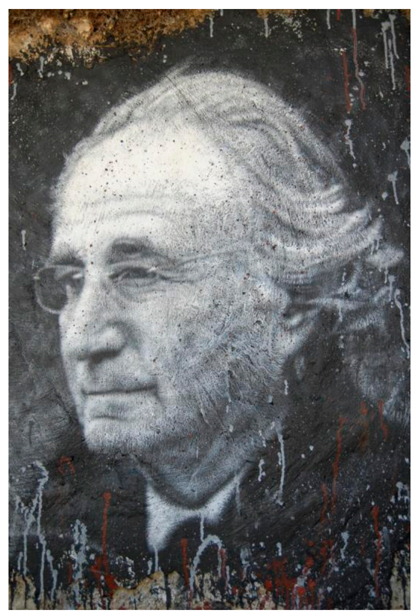


Figure 5.1 Bernie Madoff by Thierry Ehrmann licensed CC BY | flickr

2. Time Magazine. (2009). *Top 10 Crooked* CEOs. http://content.time.com/time/specials/packages/article/0,28804,1903155_1903156_1903160,00.html
3. Langan, F. (2008, December 15). *The $50-billion* BMIS *Debacle: How a Ponzi Scheme Works*. CBC News. http://www.cbc.ca/news/business/the-50-billion-bmis-debacle-how-a-ponzi-scheme-works-1.709409

The Idea of Business Ethics

It is 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 us 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 **"ethics"**.

What Is "Ethics"?

You probably already know what it means to be ethical: to know right from wrong and to know when you are practicing 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 are in business you obviously need a strong sense of what is 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 is not 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 do not have the first, the second two do not matter".[4]

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.

4. Gostick, A., & Telford D. (2003). *The Integrity Advantage*. Salt Lake City: Gibbs Smith.

Tips to maintain honesty and integrity

- Follow your own code of personal conduct; act according to your own convictions rather than doing what is 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.
- Do not appropriate office supplies or products or other company resources for your own use.
- Be honest with customers, management, coworkers, competitors, and the public.
- Remember that it is 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 will find yourself in situations in which you will 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 us 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 not tell you that if you behave with perfect honesty and integrity somebody somewhere would not behave the other way and make more money. But honesty is a good policy. You will do fine, you will sleep well at night and you will feel good about the example you are setting for your coworkers and the other people who care about you".[5]

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 are being asked to deceive customers about the quality or value of your product, you are 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.

5. Gostick, A., & Telford D. (2003). *The Integrity Advantage*. Salt Lake City: Gibbs Smith.

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."[6]

So, what is the moral of the story? Do not 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 do not. 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 us 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 are called on to furnish desserts for a luncheon, you might be tempted to send some business your uncle's way even if it is 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 should not 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 should not divulge the information. From a friendship standpoint, though, you feel it is your duty to tell your friend. Would he not tell you if the situation were reversed? So what do you do? As tempting as it is to be loyal to your friend, you should not 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.

6. Gostick, A., & Telford D. (2003). *The Integrity Advantage*. Salt Lake City: Gibbs Smith.

Bribes Versus Gifts

It is 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 is often a fine line between a gift and a bribe. The following information may help to draw that line, 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 are on the receiving end, it is a good idea to refuse any item that is 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 (http://www.bce.ca/governance/code-of-business-conduct/2017-august-code-of-business-conduct.pdf).[7]

Figure 5.2 Bell Canada's *Code of Business Conduct*

7. Bell. (2023). *Code of business conduct*. https://www.bce.ca/about-bce/governance

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?

Figure 5.2 Bell Canada Code of Conduct from the Company website

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 (http://laws-lois.justice.gc.ca/eng/acts/C-46/page-90.html#h-113) 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 that you can find at the Centre for Free Expressions – Toronto Metropolitan University.

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 is 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 is "right" for one group of stakeholders is not 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 (http://rc-openlibrary-pb.ecampusontario.ca/

businessfuncdn/chapter/article-carrolls-corporate-social-responsibility-pyramid/) updating Carroll's Pyramid by Carroll himself and diving deeper into CSR.[8]

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.[9]

Chart 5.1 Management's relationship with stakeholders or interested parties.

8. 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
9. Baron, D. P. (2003). *Business and Its Environment (4th ed.)*. Upper Saddle River, NJ: Prentice Hall.

Chart 5.1 Management's relationship with stakeholders or interested parties. Source: All icons from the Noun Project

The following examine some 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 (protection against loss of income in case of job loss), and depending on the industry, workers' compensation (insurance to cover 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.[10] 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.[11]

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 is 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 do not 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 H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-8 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-8)

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

10. Gellerman, S. W. (1986, July). *Why "Good" Managers Make Bad Ethical Choices*. Harvard Business Review on Corporate Ethics. https://hbr.org/1986/07/why-good-managers-make-bad-ethical-choices
11. Gellerman, S. W. (1986, July). *Why "Good" Managers Make Bad Ethical Choices*. Harvard Business Review on Corporate Ethics. https://hbr.org/1986/07/why-good-managers-make-bad-ethical-choices

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 (https://www.google.com/url?q=https://www.ic.gc.ca&sa=D&ust=1524160309701000)):

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; and
- 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 (https://www.google.com/url?q=https://www.ic.gc.ca/eic/site/oca-bc.nsf/eng/ca02965.html&sa=D&ust=1524160309704000)

In Ontario, customers have the added protection of the *Consumer Protection Act (https://www.ontario.ca/page/your-rights-under-consumer-protection-act)*.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-9 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-9)

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.

The Environment

The injection of harmful substances into the environment is a significant social responsibility challenge for organizations. Concerns about air, water and land pollution has led to an increasing emphasis on the development of clean, renewable energy such as solar, wind and hydroelectric power as a way of reducing the pollution caused by burning fossil fuels. Further, the recycling industry and stricter legislation for disposing of toxic waste, as well as banning single use plastics by 2030 has increased awareness and consciousness about land and water pollution.

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.[12] 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.[13]

Canadian companies also show their philanthropic side. Each summer, Tim Horton's Children's Foundation sends to

12. Target. (2012, October 30). $4 *million every week: a brief history of Target's community giving*. Target Corporate. https://corporate.target.com/article/2012/10/4-million-every-week-a-brief-history-of-target-s-c
13. Barrett, J. (2003, November 2). A *secret recipe for success*. Newsweek. http://www.newsweek.com/secret-recipe-success-133673

camp 19,000 kids who would otherwise not have the resources to attend.[14]Its Timbits Minor Sports Program supports the participation of 300 000 kids in their pursuit of hockey, soccer, lacrosse, softball, baseball, and ringette.[15] 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.[16] These are just two examples of Canadian companies giving back at the local and national levels.

Corporate Social Responsibility and Sustainable Development Goals

In September 2015, all of the United Nations Member States adopted a "shared blueprint for peace and prosperity for people and the planet, now and into the future". The 17 **Sustainable Development Goals** (SDGs) are "an urgent call for action by all countries" — developed and developing — in a global partnership. They recognize that ending poverty must go hand-in-hand with strategies that build economic growth, and address a range of social needs, including education, health, equality and job opportunities, while tackling climate change and working to preserve our ocean and forests.[17]

Figure 5.3 The 17 Sustainable Development Goals (SDGs)

14. Tim Hortons Foundation Camps. (2015). *Camps*. https://www.timhortons.com/ca/en/childrens-foundation/camps.php
15. Tim Hortons Corporate. (2018). *Timbits Minor Sports Program*. https://www.timhortons.com/ca/en/corporate/timbits-minor-sports-program.php
16. Loblaw Companies Limited. (2017). *Loblaw's President's Choice Children's Charity committed $150 million to childhood hunger and nutrition*. https://www.loblaw.ca/en/loblaws-presidents-choice-childrens-charity-commits-150-million-dollars-to-childhood-hunger-and-nutrition
17. United Nations (n.d.). *Sustainable Development Goals* (SDGs). https://unosd.un.org/content/sustainable-development-goals-sdgs

Figure 5.3 UNESCO's The 17 Sustainable Development Goals (SDGs). UNESCO

The SDGs are as follows:

1. No poverty.
2. Zero hunger.
3. Good health and well-being.
4. Quality education.
5. Gender equality.
6. Clean water and sanitation.
7. Affordable and clean energy.
8. Decent work and economic growth.
9. Industry, innovation, and infrastructure.
10. Reduced inequalities.
11. Sustainable cities and communities.
12. Responsible consumption and production.
13. Climate action.
14. Life below water.
15. Life on land.
16. Peace, justice, and strong institutions.
17. Partnerships for the goals.

The 17 SDGs contain targets for building a better world for people & planet by 2030. Businesses, non-profits, NGOs, and educational institutions have developed their own frameworks to address the SDGs and meet individual targets. Sustainable development can be part of a company's corporate social responsibility program.

On January 16, 2019, The Washington Post reported that Microsoft has pledged $500 million to address homelessness and build affordable housing units in the Seattle and Puget Sound area, a region that has grown prosperous as the technology industry has swelled but is increasingly plagued by an affordable housing crisis. This is an example of how a business such as Microsoft enacted progress on these SDG goals, serving to benefit society and, at the same time, acting in its own economic interest.

The Five Faces of Corporate Responsibility

We expect companies to recognize issues of social importance and to address them responsibly. The companies that do this earn reputations as good corporate citizens and enjoy certain benefits, such as the ability to keep satisfied customers, attract capital, and recruit and retain talented employees. But companies don't become good corporate citizens overnight. Learning to identify and develop the capacity to address social concerns takes time and requires commitment. The task is arduous because so many different issues are important to so many different members of the public — issues ranging from the environment to worker well-being (both at home and abroad), fairness to customers, and respect for the community in which a company operates.

Faced with public criticism of a particular practice, how does a company respond? What actions does it take to demonstrate a higher level of corporate responsibility? According to Harvard University's Simon Zadek, exercising greater corporate responsibility generally means going through the series of five different stances summarized in Figure 5.4.

Figure 5.4 Stages of Corporate Responsibility

Figure 5.4 Stages of Corporate Responsibility by Zadex 2004

1. *Defensive*. When companies are first criticized over some problem or issue, they tend to take a defensive, often legalistic stance. They reject allegations of wrongdoing and refuse to take responsibility, arguing that fixing the problem or addressing the issue isn't their job.
2. *Compliant*. During this stage, companies adopt policies that acknowledge the wishes of the public. As a rule, however, they do only what they have to do to satisfy their critics, and little more. They're acting mainly to protect brands or reputations and to reduce the risk of litigation.

3. *Managerial*. When it becomes clear that the problem won't go away, companies admit that they need to take responsibility and action, so they look for practical long-term solutions.
4. *Strategic*. At this point, they may start to reap the benefits of acting responsibly. They often find that responding to public needs gives them a competitive edge and enhances long-term success.
5. *Civil*. Ultimately, many companies recognize the importance of getting other companies to follow their lead. They may promote participation by other firms in their industries, endorsing the principle that the public is best served through collective action.

Approaches to Social Responsibility

A socially responsible organization attempts to remain ethical, putting morals ahead of profits. There are four approaches that businesses take in order to be more responsible. Some businesses are obstructive or defensive, while others are accommodating or proactive. Companies that take an obstructive approach demonstrate far less social responsibility than those that are more proactive about social responsibility.

Companies that take an obstructive stance to social responsibility do not make social responsibility an effort, instead making profits the most important aspect of their businesses. When faced with specific social demands, obstructive companies often deny any wrongdoing and may even use obstacles to deliberately delay or divert investigation of their practices.

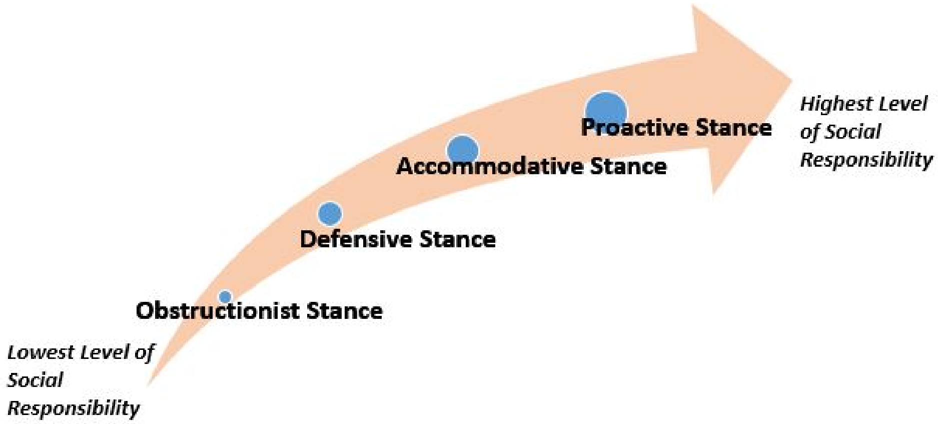
Companies that take a defensive stance towards social responsibility are not particularly responsible. Such companies make a point of following the law to ensure that others cannot take legal action against them. For example, a company may create more waste than necessary, but it will remove the waste in a legal method rather than dumping it illegally.

Companies that take an accommodating stance indicate that the company believes social responsibility is important — perhaps as important as making a profit. Such a company does not attempt to hide its actions and remains open about why it takes specific actions. For example, it may decrease its creation of waste, source products that are not tested on animals and pay its employees a fair wage. The company would keep its records open to the public. Though these companies are often socially responsible, they may change their policies in response to criticism.

Companies that take a proactive stance make social responsibility a priority, even if doing so cuts into their profits. Instead of reacting to criticism, a proactive company attempts to remain ahead of the curve when it comes to social responsibility. It may make ethics part of its mission statement and attempt to avoid any harm to the environment or its employees. A proactive company may go out of its way to institute new recycling programs, give all of its employees a living wage and benefits, and donate a portion of its profits to charity.

Figure 5.5 Approaches to Social Responsibility

Figure 5.5 Approaches to Social Responsibility



Social Responsibility – SKWACHÀYS LODGE

Figure 5.6 Skwachàys Lodge – 29W Pender Street Vancouver

The Vancouver Native Housing Society (VNHS) opened the first Indigenous boutique art hotel in Canada in June 2012. The socially responsible accommodation and gallery showcase Indigenous art and culture. The business sustains a supportive housing program with studio space for Indigenous artists. The hotel and gallery create a space for learning and relationship building between Indigenous and non-Indigenous cultures through art, hospitality and community building. The rooftop Smudge Room and Longhouse Patio support cultural practice and create a space for Indigenous artists and staff to share ceremony and culture with hotel guests. Skwachàys is committed to sourcing environmentally friendly products for the business, as well as supplies from Indigenous-owned companies.

How Can You Recognize an Ethical Organization?

One goal of anyone engaged in business should be to foster ethical behavior 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; and
- demanding and rewarding integrity from all members in all situations[18].

18. Axelrod, A. (2007). *My First Book of Business Ethics*. Philadelphia: Quirk Books.

Employees at companies that consistently make Business Ethics Magazine's list, "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 2021 list include Owens Corning, General Mills, HP, Cisco Systems and Intel Corporation[19].

By contrast, employees with the following attitudes tend to suspect that their employers are not 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.[20]

Canadian businesses regularly publish sustainability reports that explain how companies are performing on issues such as the environment, employee relations, workplace diversity, and business ethics. A study by Stratos Inc., based in Ottawa, found that 60% of the 100 largest Canadian companies report at least some sustainability performance information, which includes social audits and sustainability developments.

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."[21]

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 (http://www.cbc.ca/radio/day6/here-s-a-list-of-well-known-men-in-canada-called-out-for-alleged-sexual-misconduct-since-weinstein-1.4428132). The list, including only those allegations reported by CBC, highlights 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.

19. 3BL MEDIA. (2016). *100 Best Corporate Citizens for 2016*. https://100best.3blmedia.com/?_ga=2.152845628.467356796.1634236287-1529998415.1634236287
20. Axelrod, A. (2007). *My First Book of Business Ethics*. Philadelphia: Quirk Books.
21. U.S. Equal Employment Opportunity Commission. (2016). *Facts about Sexual Harassment*. https://www.eeoc.gov/facts/fs-sex.html

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 and community, a diverse workforce improves a company's ability to serve an ethnically diverse population.

Attracting workers who are not all alike is an important first step in the process of achieving greater diversity. However, managers cannot stop there. Their goals must also encompass inclusion, or the engagement of all employees in the corporate culture. "The far bigger challenge is how people interact with each other once they're on the job," says Howard J. Ross, founder and chief learning officer at Cook Ross, a consulting firm specializing in diversity. "Diversity is being invited to the party; inclusion is being asked to dance. Diversity is about the ingredients, the mix of people and perspectives. Inclusion is about the container—the place that allows employees to feel they belong, to feel both accepted and different."[22]

Companies need to expand their definition of diversity beyond race and gender. For example, differences in age, experience, and country of residence may result in a more refined global mind-set and cultural fluency, which can help companies succeed in international business. A salesperson may know the language of customers or potential customers from a specific region or country, for example, or a customer service representative may understand the norms of another culture. Diverse product-development teams can grasp what a group of customers may want that is not currently being offered.

In Canada, Equity, Diversity, and Inclusion (EDI) programs are tools that are utilized to address inequality in the workplace, including the inequities experienced by Indigenous populations in corporate environments. EDI initiatives that are designed for Indigenous populations in Canada must first become informed about the historic relationship between the settler government and its First Nations, Métis, and Inuit inhabitants. Corporations attempt to address the anti-Indigenous racism within their own companies by providing opportunities for their employees to engage with Indigenous culture, language, and art, and offering financial support for Indigenous community non-profit organizations and the advancement of Indigenous education. If EDI principles are not sufficiently applied, corporations have established protocols and policies that are built to do so in their place. Dr Russell Evans, an Indigenous professor at the University of Windsor, speaks about the manner in which EDI and Indigenization serves to improve corporate culture for Indigenous populations and other marginalized groups.

Corporate Indigenous Inclusion (https://uwindsor.yuja.com/V/Video?v=508756&node=2106721&a=1869312696&autoplay=1)

22. Novid Parsi, "Workplace Diversity and Inclusion Gets Innovative," Society for Human Resource Management, January 16, 2017. https://www.shrm.org/topics-tools/news/hr-magazine/workplace-diversity-inclusion-gets-innovative

The Challenges of a Diverse Workforce

Diversity is not always an instant success; it can sometimes introduce workplace tensions and lead to significant challenges for a business to address. Some employees simply are slow to come around to a greater appreciation of the value of diversity because they may never have considered this perspective before. Others may be prejudiced and consequently attempt to undermine the success of diversity initiatives in general.

As inclusion initiatives and considerations of diversity become more prominent in employment practices, wise leaders should be prepared to fully explain the advantages to the company of greater diversity in the workforce as well as making the appropriate accommodations to support it. Accommodations can take various forms. For example, if you hire more women, should you change the way you run meetings so everyone has a chance to be heard? Have you recognized that women returning to work after childrearing may bring improved skills such as time management or the ability to work well under pressure? If you are hiring more people of different faiths, should you set aside a prayer room? Should you give out tickets to football games as incentives? Or build team spirit with trips to a local bar? Your managers may need to accept that these initiatives may not suit everyone. Adherents of some faiths may abstain from alcohol, and some people prefer cultural events to sports. Many might welcome a menu of perquisites ("perks") from which to choose, and these will not necessarily be the ones that were valued in the past. Mentoring new and diverse peers can help erase bias and overcome preconceptions about others. However, all levels of a company must be engaged in achieving diversity, and all must work together to overcome resistance.

Each year The Globe and Mail, reports on Canada's Top 100 Employers (http://www.canadastop100.com/diversity/). 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 aimed 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 will 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 have 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 are 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?[23]

Unfortunately, practicing 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 is not easy even for seasoned managers; 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

23. Maxwell, J. C. (2003). *There's No Such Thing as "Business Ethics": There's Only One Rule for Making Decisions*. New York: Warner Books.

1982.[24] 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.[25]

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 benzine. 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.

(https://www.cnbc.com/id/21100105)
Figure 5.7 Tylenol brand Source: CNBC

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.[26]

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.

24. Kaplan, T. (1998). *The Tylenol Crisis: How Effective Public Relations Saved Johnson & Johnson*. Aero Biological Engineering. https://studylib.net/doc/15994752/the-tylenol-crisis–how-effective-public-relations-saved-
25. Kaplan, T. (1998). *The Tylenol Crisis: How Effective Public Relations Saved Johnson & Johnson*. Aero Biological Engineering. https://studylib.net/doc/15994752/the-tylenol-crisis–how-effective-public-relations-saved-
26. Yaakov, W. (1999, June 13). *CEO Saves Company's Reputation, Products*. New Sunday Times. https://web.archive.org/web/20030712124829/http:/adtimes.nstp.com.my/jobstory/jun13.htm

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 have committed an ethical lapse. If you are presented with this type of choice, ask 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 to determine if Trudeau made an ethical choice in his decision to vacation on the Aga Khan's private island. You response is anonymous.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-10 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-10)

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

Johnson & Johnson (J&J) 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 us 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."[27] 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?[28] In a three-year period, the company recalled twenty-four products, including Children's, Infants' and Adults' Tylenol, Motrin, and Benadryl,[29] 1-Day Acuvue TruEye contact lenses sold outside the U.S.,[30] and hip replacements.[31]

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,[32] contact lenses that contained a type of acid that caused stinging or pain when inserted in the eye;[33] and defective hip implants that required patients to undergo a second hip replacement.[34]

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.[35] Additionally, he admitted that he did not understand the consumer division where many of the quality control problems originated.[36] 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.[37] In addition, she was implicated in a 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

27. Johnson and Johnson. (2016). *Our Credo*. Johnson & Johnson. http://www.jnj.com/about-jnj/jnj-credo
28. Kimes, M. (2010, August 19). *Why J&J's Headache Won't Go Away*. Fortune. http://archive.fortune.com/2010/08/18/news/companies/jnj_drug_recalls.fortune/index.htm
29. McNeil Consumer Healthcare. (2011). *Product Recall Information*.
30. Berkrot, B. (2010, December 1). *J&J Confirms Widely Expanded Contact Lens Recall*. Reuters. http://www.reuters.com/article/us-jandj-recall-idUSTRE6B05G620101201
31. Singer, N. (2010, August 27). *Johnson & Johnson Recalls Hip Implants*. The New York Times. http://www.nytimes.com/2010/08/27/business/27hip.html
32. Kimes, M. (2010, August 18). *Why J&J's Headache Won't Go Away*. Fortune. http://archive.fortune.com/2010/08/18/news/companies/jnj_drug_recalls.fortune/index.htm
33. Rockoff, J. D., & Kamp J. (2010, August 24). *J&J Contact Lenses Recalled*. The Wall Street Journal. http://online.wsj.com/article/SB10001424052748703846604575447430303567108.html
34. Singer, N. (2010, August 27). *Johnson & Johnson Recalls Hip Implants*. The New York Times. http://www.nytimes.com/2010/08/27/business/27hip.html
35. Kimes, M. (2010, August 18). *Why J&J's Headache Won't Go Away*. Fortune. http://archive.fortune.com/2010/08/18/news/companies/jnj_drug_recalls.fortune/index.htm
36. Perrone, M. (2011). *J&J CEO Gets 3% Raise, but Bonus Is Cut*. USA Today. http://usatoday30.usatoday.com/money/industries/health/2011-02-25-jnj_N.htm
37. Kimes, M. (2010, August 18). *Why J&J's Headache Won't Go Away*. Fortune. http://archive.fortune.com/2010/08/18/news/companies/jnj_drug_recalls.fortune/index.htm

MUST BE NO MENTION OF THIS BEING A RECALL OF THE PRODUCT!"[38] In May 2010, when Goggins appeared before a congressional committee investigating the "phantom recall", she testified that she was not aware of the behavior of the contractors[39] 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 favor 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:[40]

1. My behavior is not 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.[41]
3. No one will find out what I have 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

38. Kimes, M. (2010, August 18). *Why J&J's Headache Won't Go Away*. Fortune. http://archive.fortune.com/2010/08/18/news/companies/jnj_drug_recalls.fortune/index.htm
39. Johnson and Johnson. (2010). *Testimony of Ms. Colleen A. Goggins, Worldwide Chairman, Consumer Group, Johnson & Johnson, before the Committee on Oversight and Government Reform, U.S. House of Representatives*. http://graphics8.nytimes.com/packages/pdf/business/20100930_GogginsTestimony.PDF
40. Gellerman, S. W. (1986, July). *Why "Good" Managers Make Bad Ethical Choices*. Harvard Business Review. https://hbr.org/1986/07/why-good-managers-make-bad-ethical-choices
41. Gostick, A., & Telford, D. (2003). *The Integrity Advantage*. Salt Lake City: Gibbs Smith.

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.[42]

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-56 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=53#h5p-56)

Comprehension Check

1. Nonprofit organizations (such as your college or university) have social responsibilities to their stakeholders. Identify your school's stakeholders. For each category of stakeholder, indicate the ways in which your school is socially responsible to that group.
2. What basic factors should be considered in any ethical decision?
3. What are the major areas of social responsibility with which businesses should be concerned?
4. What are the four basic approaches to social responsibility?
5. In what ways do you think your personal code of ethics might clash with the operations of some companies? How might you try to resolve these differences?

Key Takeaways

Important terms and concepts:

1. Business ethics is the application of ethical behavior 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.

42. Online Ethics Center for Engineering and Science. (2004). *Advice from the Texas Instruments Ethics Office: Article Number 280: What do you do when the light turns yellow*? Onlineethics. https://web.archive.org/web/20060517161459/http://onlineethics.org/corp/help.html

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.
3. 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.
4. 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.
5. 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.
6. 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.
7. Business people face two types of ethical challenges: ethical dilemmas and ethical decisions.
8. An ethical dilemma is a morally problematic situation in which you must choose competing and often conflicting options which do not satisfy all stakeholders.
9. An ethical decision is one in which there's a right (ethical) choice and a wrong (unethical or downright illegal) choice.

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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. (https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6)" 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 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR3&sa=D&ust=1524160309672000)1953 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR3&sa=D&ust=1524160309673000), 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 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR7&sa=D&ust=1524160309673000)1999 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR7&sa=D&ust=1524160309673000)). 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 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR17&sa=D&ust=1524160309674000)2006 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR17&sa=D&ust=1524160309674000)).

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 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR32&sa=D&ust=1524160309674000)2006 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR32&sa=D&ust=1524160309675000)). 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 (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR22&sa=D&ust=1524160309675000)) and over 5200 citations of the original article are indicated there (Google Scholar (https://www.google.com/url?q=https://jcsr.springeropen.com/articles/10.1186/s40991-016-0004-6%23CR23&sa=D&ust=1524160309675000)).

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.

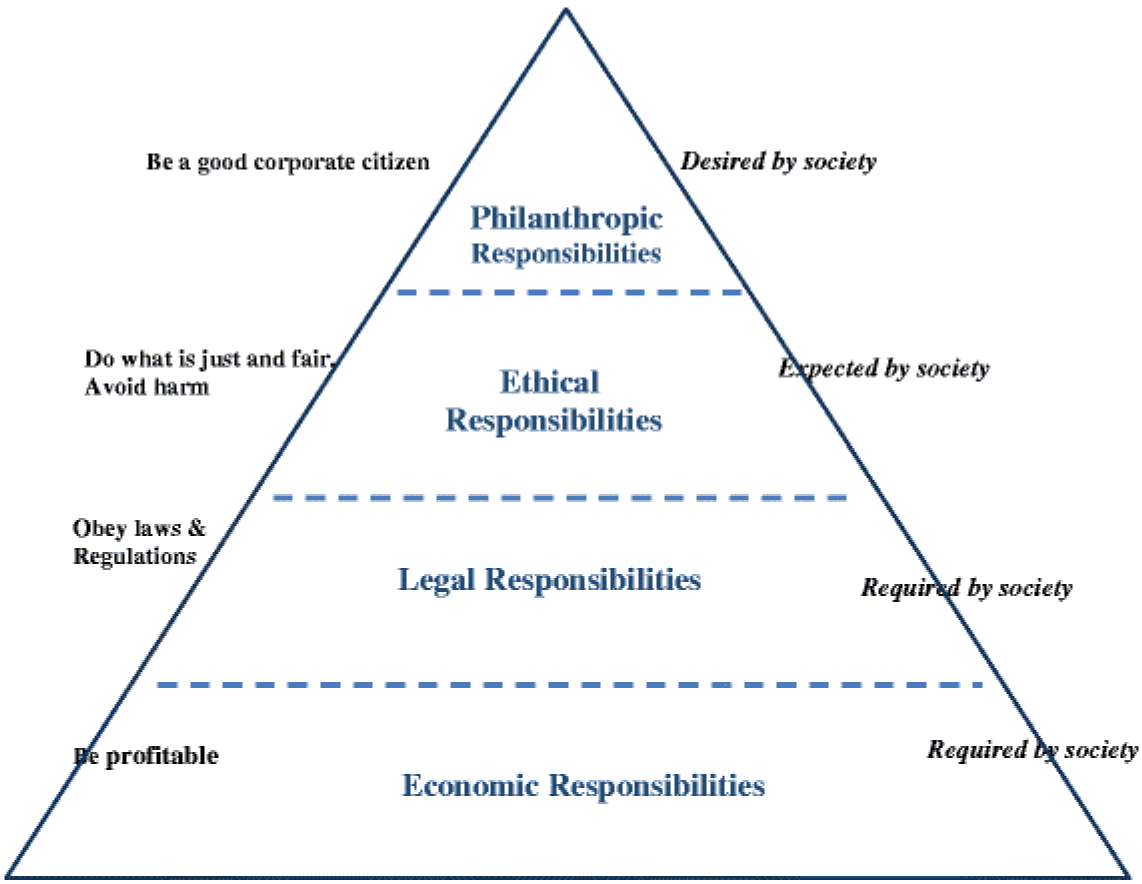
In summary, the four part CSR definition forms a conceptual framework that includes the economic, legal, ethical, and philanthropic or discretionary expectations that society places on businesses at a given point in time. And, in terms of understanding each type of responsibility, it could be said that 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. The pyramid is an integrated, unified whole.



Carroll's Pyramid of Corporate Social Responsibility. Archie B. Carroll, which is licensed under a CC BY 4.0 licence.

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.

Text Attributions

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Chapter 6 - The External Environment's Influence

Learning Objectives

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

1. identify and describe common external forces on organization and various levels of influence, such as local, regional, provincial, national, and/or global;
2. identify and explain the opportunities and threats that arise from the influence of common external environmental influences;
3. explain how uncertainty and complexity influence a business's ability to navigate its external environmental influence;
4. describe how businesses design themselves in order to thrive as an organization within their external environment; and
5. explain **key terms** in the chapter.

Show What You Know

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The External Environment's Effect – It's Different and It's Not

When we think of an organization's external environment and how it influences a company's day-to-day actions, it is clear that each company will face unique opportunities and challenges as they respond to their external environment.

Figure 6.1 "Local = Good" by Tciriello is licensed under CC BY-NC-ND 2.0

For example, the needs of a mom 'n' pop shop selling regional goods in rural Northern British Columbia vary greatly with the needs of Lululemon, operating in hundreds of locations internationally.

Despite their differences, if we zoom out and look at the bigger picture, we will see that actually there are some common trends for these two companies. As discussed in Chapter 1, all companies need to be aware of how the company is affected by its customers, its competitors, its suppliers, socio-cultural influences, the environmental/natural needs and effects, the political context, legal factors, technological needs and trends, and the economy. All companies need to be aware of these influences and ready to adapt as needed.

For the mom 'n' pop shop selling regional wares in Northern British Columbia, the customers, competitors, and suppliers will be easier to identify, and it will be simpler to understand how they influence what the company should do compared to what Lululemon would need to know and understand about its customers, competitors, and suppliers. So, while they share needs in similar areas, the level of **complexity** and **uncertainty** that they face in each of these things differs. In this chapter, we will take a deeper dive into the common external forces influencing companies, discuss how to find opportunities and recognize threats from the external environment, unpack how complexity and uncertainty influence business, and analyze how all of the above can impact the way a company should be designed and operate.

Figure 6.2 Lululemon – Raysonho @ Open Grid Scheduler / Grid Engine.

Common External Forces

In Chapter 1, we built an understanding of the business's:

- **Participants** – the people who participate in conducting the work of the business.
- **Stakeholders** – those affected by the business's operations and its decisions.
- **External Environmental Influences** – external environmental factors that influence what the company does and how it does it.

As illustrated in Figure 6.3, there is an overlap between these three groups. As an example, existing suppliers can be stakeholders and participants. What's more, because they act independently from the organization, suppliers can also be external environmental influences. Before you move on, take a moment to review Figure 6.1. Specifically, test yourself by:

- defining each key term;
- identifying each term as a participant, stakeholder, function, or external influence (remember some can be more than one); and
- providing an example of why each term is important to a business.

Figure 6.3 The Organization's Landscape

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What We Need to Know About External Environmental Factors

As we explore the business's external environmental factors, it is important that we understand the levels at which these factors can be considered and common ways that these factors influence businesses.

Levels of Factors

When considering the external environmental factors impacting a business, it is important to note that there are levels at which these influences occur:

- **local** – the community level;
- **regional** – the level that is the combination of communities;
- **provincial** – the provincial/state level which includes multiple regions;
- **national** – the federal level;
- **regional (global)** – the combination of multiple nations; and
- **global** – the worldwide level.

To get an understanding of how the levels affect each company differently, let us use our example companies from the introduction to illustrate the levels of influences that impact them the most. Table 6.1 shares a brief example of each influence. This table just highlights quick examples, but going deeper could reveal many more. As you look at these, bear in mind that the external environmental factors are entirely outside the control of the business.

Table 6.1 How the External Local Environment Can Affect Different Companies

Local Environment	**Mom 'n' Pop Shop (in rural area)**	**Lululemon (multinational company)**
Political	Local political leanings affect taxes.	Local political leanings affect taxes.
Economic	Local economy affects spending patterns of customers, directly impacting the **majority** of sales.	Local economy affects spending patterns of customers, impacting **local** sales.
Social and Cultural	Directly impacts customer preferences in terms of which items they will/will not buy.	Somewhat impacts customer preferences, but usually does not directly impact the local level.
Legal	The local laws govern the zoning, policies, and other requirements of the business as a whole.	The local laws governs the zoning, policies, and other requirements and differ in each of the company's locations.
Technological	Customers could have a common pattern for how they use technology to pay for things.	Usually an indirect impact because they focus on trends at higher levels.
Environmental/ Natural	The weather affects the customer's desire to go shopping, impacting the number of sales the store has and the items the store wants.	The weather affects what items that customer's want to buy in each of the local areas in which it operates.

Table 6.2 How the Regional Environment Can Affect Different Companies

Regional Environment	**Mom 'n' Pop Shop (in rural area)**	**Lululemon (multinational company)**
Political	Regional politics affect how stable the political situation is locally, regionally, and provincially.	Regional politics affect the company differently in each region in which it operates.
Economic	Regional economy affects spending patterns of customer, directly impacting a large portion of sales.	Regional economy affects spending patterns of customer, impacting the sales in each region in which it operates.
Social and Cultural	Directly impacts customer preferences in terms of which items they will/will not buy.	Somewhat impacts customer preferences in terms of what items are wanted and therefore developed by the company for that region's stores.
Legal	Regional policies are usually less impactful, but can impact the company if there is a strong regional influence.	Regional policies are usually less impactful, but can impact the company if there is a strong regional influence in the region in which it operates.
Technological	Customers could have a common pattern for how they use technology to pay for things.	Usually an indirect impact because they focus on trends at higher levels.
Environmental/ Natural	The weather affects the customer's desire to go shopping, impacting the number of sales the store has and the items the store wants.	The weather affects the items customers want to buy in each of the regions in which it operates.

Table 6.3 How the Provincial Environment Can Affect Different Companies

Provincial Environment	Mom 'n' Pop Shop (in rural area)	Lululemon (multinational company)
Political	Provincial politics affect how stable the political situation is provincially, which in turn affects tax rates, minimum wage, and other important factors.	Provincial politics affect how stable the political situation is in each region in which it operates, which in turn affects tax rates, minimum wage, and other important factors.
Economic	Provincial economy affects spending patterns of customers and the cost and availability of supplies.	Provincial economy affects spending patterns, impacting the regions of sales in each region it serves.
Social and Cultural	Generally impacts customer preferences in terms of which items they will/will not buy.	Somewhat impacts customer preferences in what items are wanted and therefore developed by the company.
Legal	Provincial laws affect tax, minimum wage, and other important factors; these have a direct impact on the company's expenses.	Provincial laws affects tax, minimum wage, and other important factors; these have a direct impact on the company's expenses in that province.
Technological	Customers could exhibit a pattern of how they use technology to pay for things.	Usually an indirect impact because they focus on trends at higher levels.
Environmental/ Natural	The environment does not directly impact the company at this level, but could indirectly impact customer preferences.	The environment does not directly impact the company at this level.

Table 6.4 How the National Environment Can Affect Different Companies

National Environment	Mom 'n' Pop Shop (in rural area)	Lululemon (multinational company)
Political	National politics affect how stable the political situation is, which in turn affects changes to federal tax rates and other important factors.	National politics affect how stable the political situation is in each region in which it operates, which in turn affects federal tax rates and other important factors.
Economic	National economy affects the cost and availability of suppliers and can also affect spending patterns of customers.	Each national economy in which the company operates affects the cost of supplies, availability of suppliers, and spending patterns of that nation's customers.
Social and Cultural	Can have an indirect impact on what customers' preferences are for products.	Somewhat impacts customer preferences for what items are wanted and therefore developed by the company.
Legal	National laws affect tax rates and other important factors; these have a direct impact on the company's expenses.	National laws affect tax rates, minimum wage, and other important factors; these have a direct impact on the company's expenses in the country.
Technological	National privacy laws affect what the stores needs to do with customer data.	Each country has unique privacy laws, which affect what the stores need to do with customer data in each country.
Environmental/ Natural	The environment does not directly impact the company at this level, but could indirectly impact customer preferences. If there is a natural disaster though, it could affect the transportation of supplies, which could impact what the shop can sell.	The environment does not impact the company at this level, except if the natural environment causes a disruption in supplies. For example, if there is natural disaster that wipes out key supply routes, then it would mean less access to supplies to make their products and/or a harder time shipping their products.

Table 6.5 How the Regional (Global) Environment Can Affect Different Companies

Regional (Global) Environment	Mom 'n' Pop Shop (in rural area)	Lululemon (multinational company)
Political	The political climate has an indirect impact as it can change the leaning of the governments in power, which in turn can change laws and policies. The business owner should be aware of this aspect but not overly concerned.	This can be very important to the multinational company, especially if its focus is within a particular region (like North America). Most of Lululemon's stores are in North America, so regional politics (be they smooth or challenging) can have an impact on trade, which directly affects the price points of goods sold.
Economic	Similar to the political environment, being aware of this is helpful as it can affect trade, which in turn affects supplies and price points.	In regions such as North America, in which the economics are closely linked, the economy of one country can have a large impact on the another. Thus, it is very important to pay attention to the economy and its effects.
Social and Cultural	This is indirectly relevant to the small rural business as they do not need to focus much energy on trends beyond the provincial level.	This is highly important for a company working within or across global regions, especially in retail. Paying attention to the social and cultural trends can help Lululemon to create products that will be popular across all of their stories.
Legal	This has little direct impact on the smaller stores when compared to larger changes. However, smaller stores should be aware of the big changes.	Legal requirements for import/export and immigration within a region can greatly impact the ease with which a company such as Lululemon can transport its goods across borders; they also affect employee mobility.
Technological	This is less important for the smaller business, except that tech trends within a global region can affect available software and hardware.	The tech trends in a region affect a multinational company because, for efficiency sake, they will want to try to have the same type of systems in their stores. Thus, finding large regional trends will help them choose systems that work across all of their stores, not just in specific areas.
Environmental/ Natural	This doesn't have a direct effect on a small business unless the environmental/natural context impacts the supply. For example: if there is a flood that disrupts a key type of supply, they may not have as much access to that product for a particular period of time.	The environment does not directly impact the company at this level, except if the natural environment causes a disruption in the regional supply chain. For example, if supplies come from the Pacific Northwest in the US and that area is hit by a Tsunami that causes damage to facilities and trade routes, then fewer supplies will be available.

Table 6.6 How the Global Environment Can Affect Different Companies

Global Environment	Mom 'n' Pop Shop (in rural area)	Lululemon (multinational company)
Political	The political climate has an indirect impact, as it can change the leaning of the governments in power, which in turn can change laws and policies. The business owner should be aware of these, but not overly concerned.	This can be very important to the multinational company, especially if its focus is on different trade perspectives by various political groups. Most Lululemon stores are in North America; however, most retail stores depend on supplies from East Asia. Thus, if trade relations are unstable, it can affect the supply availability and cost.
Economic	Similar to the political climate, being aware of this is helpful as it can affect trade, which in turn affects supplies and price points.	With the global linkages of economy, it is very important to pay attention to the economy and its effects for multinational companies, especially global regions related to customers and suppliers.
Social and Cultural	This is indirectly relevant to the small rural business as they do not need to focus much energy on trends beyond the provincial level.	This is highly important for a company working within or across global regions, especially in retail. Paying attention to the social and cultural trends can help Lululemon to create products that will be popular across all of their stores.
Legal	This has little direct impact on the smaller stores when compared to larger changes. However, smaller stores should be aware of the big changes.	Legal requirements for import/export and immigration globally can impact the ease with which a company such as Lululemon can transport its goods across borders; they also affect employee mobility.
Technological	This is less important for a small business, except tech trends within a global region can affect available software and hardware.	Global tech trends are less important for a company like Lululemon that focuses its efforts in North America. However, it is critical to be aware of these trends to anticipate what will dominate the tech landscape in North America.
Environmental/ Natural	This doesn't have a direct effect on a small business unless the environmental/natural context impacts the supply. For example: if there is a flood that disrupts a key type of supply, they may not have as much access to that product for a particular period of time.	The environment does not directly impact the company at this level, except if the natural environment causes a disruption in the regional supply chain, For example, if China experiences a devasting earthquake in a manufacturing city, supplies that come from China may be in short supply.

As evident in the comparison in **Table 6.6**, a company's focus depends on how it operates. Namely, a large multinational corporation will have to focus on many local, regional, provincial, and even national considerations, while keeping its eye on its global region and the overall global trends. On the other hand, the local Mom 'n' Pop shop needs to focus deeply on one local area and region most of the time and be aware of national, global region, and global trends. The demands of the company differ, but the factors remain the same – political, economic, social and cultural, legal, technological, and natural/environmental.

Common Influences of the Environmental Factors

When looking at the political, economic, social and cultural, legal, technological, and natural/environmental factors, common influences emerge. This, in turn, makes it easier for the business owner to understand how to pay attention to these factors and understand their impact on their business.

Finding Opportunities and Recognizing Threats

Because external environmental factors cannot be controlled by the business, it is common for the business to focus on the negative impact that a company experiences as the result of a change in its external environment. However, each external environmental factor produces both opportunities and threats. Common **opportunities** and **threats** are identified in Table 6.2 below.

Figure 6.4 Common Opportunities and Threats from the External Environment

(move the slider left to right to compare the opportunities and threats)

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Now, it is time to apply these concepts. For the two companies that we have discussed so far, sort between the opportunities and threats.

Exercise 6.1 Put to the Test – Opportunity or Threat?

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If **Exercise 6.1** was challenging, it might be time to review Table **6.7** and/or use the hints in **Exercise 6.1**.

Understanding the Role of Uncertainty and Complexity

In this section, we will discuss the role of **complexity** and **uncertainty** . Specifically, we will try to answer the following questions.

1. What is complexity and how does it influence the business's approach to the external environment?
2. What is uncertainty and how does it influence the business's approach to the external environment?
3. Why do companies need to be aware of uncertainty and complexity?

Complexity

In considering complexity, it is perhaps easier to compare again our two sample companies – the Mom 'n' Pop Shop and Lululemon. Through this comparison, the two sides of the complexity spectrum become clearer.

Table 6.7 Comparing the Complexity of Two Companies

National Environment	Mom 'n' Pop Shop (in rural area)	Lululemon (multinational company)
Political	Requires the general knowledge of the political factors that affect small businesses.	Requires coherent knowledge of the impacts of all the political contexts in which it operates – local, regional, provincial, national, regional (global), and global.
Economic	Needs to understand how the local, regional and perhaps the provincial economy affects their customers' buying behaviors.	Requires coherent knowledge of the impacts of all the economic contexts in which it operates – local, regional, provincial, national, regional (global), and global.
Social and Cultural	Requires a clear understanding of the social and cultural trends that affect their business.	Requires coherent knowledge of the impacts of all the social trends and cultural expectations in which it operates – local, regional, provincial, national, regional (global), and global.
Legal	Requires a clear knowledge of the legal factors that affect small businesses.	Requires a coherent knowledge of the impacts of all the legal requirements in which it operates – local, regional, provincial, national, regional (global), and global.
Technological	Requires an understanding of the technology required to conduct their business.	Requires a clear and operational understanding of the impact of technology requirements and trends in all the levels in which it operates: local, regional, provincial, national, regional (global), and global.
Environmental/ Natural	Requires knowledge of existing and environmental impacts at the local, regional and provincial level (and if suppliers are affected, sometimes at the national and global levels).	Requires a clear and operational understanding of the impact of emerging and existing environmental situations and expectations at all levels in which it operates: local, regional, provincial, national, regional (global), and global.
	Conclusion = Simple	**Conclusion = Complex**

As illustrated in **Table 6.7**, companies in a simple environment require only a basic to general understanding of most factors, whereas companies in a complex environment require specialized knowledge, often in multiple areas and at multiple levels.

Uncertainty

When there is uncertainty in its environment, a company has factors that change frequently, and often unpredictably. As the focus moves to uncertainty, we can again rely on our two companies to clarify what companies look like in stable versus unstable environments.

Table 6.8 Comparing the Uncertainty of Two Companies

National Environment	Mom 'n' Pop Shop (in rural area)	Lululemon (multinational company)
Political	The political climate stays the same in the local and regional area; big changes that affect the business only happen occasionally at the provincial or national levels – those are usually predictable.	The political climate at multiple levels (local to global) changes moderately to very often, trends at one or more levels are unpredictable.
Economic	The economic factors that change do so in a manner that is predictable; if big changes come they all affect all businesses.	Economic changes across the levels (local to global) change and require the company to adapt its operations and offering of goods to maintain sustainable income.
Social and Cultural	Trends of what customers want from the shop are fairly stable. Big changes come every 2-3 years.	Trends changes often. The importance of social media means that trends can change dramatically in a short span of time.
Legal	The legal changes, like the political climate, are fairly steady. Big changes usually happen only at the provincial and federal levels and in predictable ways.	Balancing the needs of multiple levels can be challenging, since multiple levels are inconsistent. Without a single approach that can work, the company must pay attention and adapt to all.
Technological	These trends usually don't affect the business. They can continue to use the same tech until it becomes obsolete. They have a fair amount of warning before that happens.	The tech trends can change fairly often in terms of the hardware and software they use in their managerial roles as well as in the fabrication of their products. They must be aware of trends in all areas.
Environmental/ Natural	The environmental impacts are all indirect, unless a disaster hits (a rare occurrence). So, all in all, this is fairly stable.	The environmental changes that can affect supply and transport of their products are ever changing and require quick adaptation.
	Conclusion = Stable (low uncertainty)	**Conclusion = Unstable (high uncertainty)**

What Is the Impact of Complexity and Uncertainty?

The impact of complexity and uncertainty, while illustrated in Tables 6.2 and 6.3, is more than just what the business needs to focus on. It is also about the capabilities that the business needs to develop. Some of the best-known businesses, including Airbnb, Uber, and Groupon, began as startups during the Great Recession in the mid-2000s. Their success demonstrates that it's possible for startups to achieve incredible growth, even during uncertain times.

- **In complex and uncertain environments,** organizations need to be astute to see what is happening and understand the trends, as well as nimble enough to change with the ebb and flow of the environment.
- **In simple and stable environments,** organizations need to build best practices to increase efficiency, but also be aware of major changes on the horizon. They need to get information and use it quickly to stay ahead of the competition that usually has access to the same information.
- **In moderately complex and moderately stable environments,** organizations are constantly balancing efficiency with adaptability in order to build practices that allow for cost savings, but that can be changed as trends change.

These differing needs lead us to the conclusion that one size does *not* fit all. In fact, each organization needs a design that is uniquely suited to meet the needs of its environment. We will pick this idea up again in Chapter 10 – Structuring Organizations. Until then, the three examples above should help with the main archetypes.

Comprehension Check

1. Define the following terms:
   - participants;
   - stakeholders;
   - external environmental factors;
   - complexity;
   - uncertainty;
   - opportunities; and
   - threats.
2. List and define the levels of the external environment.
3. List and define the key factors in the external environment.
4. Give three examples of common opportunities and three threat examples that arise in the external environment.
5. Explain how uncertainty and complexity affect organizations.
6. Describe what an organization should focus on in a:
   - complex and uncertain environment;
   - simple and stable environment; and a
   - moderately complex and moderately uncertain environment.

Key Takeaways

Important terms and concepts:

1. The common external environment factors that businesses should consider are political, economic, social and cultural, legal, technological, and environmental/natural.
2. The external environmental factors affect the organization at multiple levels: local, regional, provincial, federal, regional (global), and global.
3. Even though companies differ greatly, there are common opportunities for all businesses. For example, most businesses prefer conservative political climates and the laws passed by conservative governments. Weak economies are favorable for companies that provide low cost options, but challenging for other companies because customers spend less if the economy is weak. If a company can connect with social and cultural trends and expectations, they tend to do better. Companies prefer technological developments and natural climate conditions that make buying easier.
4. External environmental uncertainty makes it harder to predict what the business needs to do to respond to the changes in its environment, and also means the business needs to be able to adapt quickly to changes. On the other hand, stable (low uncertainty) external environments allow the company to refine

its practices and look for efficiencies to get a competitive advantage.

5. Complexity in the external environment makes it harder for a business to understand the factors affecting it, and often requires specialized knowledge in multiple areas to understand it. Conversely, simple external environments have easily discernible information that is easily accessible to both the business and its competitors; however this can create a challenge by increasing competition.
6. In complex and uncertain environments, organizations need to be astute to see what is happening and understand the trends, as well as nimble enough to change with the ebbs and flows of the environment.
7. In simple and stable environments, organizations need to build best practices to increase efficiency, but also be aware of major changes on the horizon. They need to get information and use it quickly to stay ahead of the competition that usually has access to the same information.
8. In moderately complex and moderately stable environments, organizations are constantly balancing efficiency with adaptability in order to build practices that allow for cost savings but can be changed as trends change.

Chapter 7 - 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; and
8. explain **key terms** in the chapter.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=66#h5p-13 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=66#h5p-13)

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.

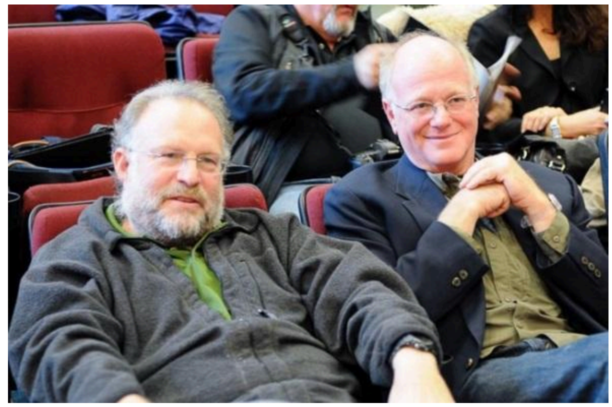

Figure 7.1 Ben Cohen and Jerry Greenfield from https://commons.wikimedia.org licensed CC BY SA

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, he still didn't like it.

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 a 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.

1. Lager, F. C. (1994). *Ben & Jerry's: The Inside Scoop*. New York: Crown Publishers.

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

According to Statistics Canada, as of December 2019, there were 1.23 million employer businesses in Canada (Table 1). Of these, 1.2 million (97.9 percent) were small businesses, 22,905 (1.9 percent) were medium-sized businesses and 2,978 (0.2 percent) were large businesses.

More than half of Canada's small employer businesses are concentrated in Ontario and Quebec (440,306 and 249,685, respectively). Western Canada has a large number of small businesses, led by British Columbia, which had 187,252 small businesses as of December 2019. In the Atlantic region, Nova Scotia has the most small businesses at 29,876.

Table 7.1: Total number of employer businesses by business size and number of SMEs per 1,000 provincial population, December 2019[2]

Region	Small businesses (1-99 employees)	Medium businesses (100-499 employees)	Large businesses (500+ employees)	Total	Number of businesses per 1,000 individuals (18 +years)
Newfoundland and Labrador	16,633 (98.1%)	294 (1.7%)	25 (0.1%)	16,952	39.0
Prince Edward Island	6,348 (98.2%)	107 (1.7.%)	8 (0.1%)	6,463	50.8
Nova Scotia	29,876 (98.0%)	542 (1.8%)	68 (0.2%)	30,486	37.8
New Brunswick	25,063 (98.0%)	459 (1.8%)	51 (0.2%)	25,573	39.9
Quebec	249,685 (97.8%)	4,960 (1.9%)	702 (0.33%)	255,347	37.0
Ontario	440,306 (97.7%)	9,092 (2.0%)	1,238 (0.3%)	450,636	38.2
Manitoba	39,370 (97.6%)	836 (2.1%)	122 (0.3%)	40,328	38.0
Saskatchewan	41,008 (98.3%)	647 (1.6%)	77 (0.2%)	41,732	46.3
Alberta	160,920 (98.0%)	2,936 (1.8%)	332 (0.2%)	164,188	48.3
British Columbia	187,252 (98.3%)	2,947 (1.5%)	347 (0.2%)	190,546	45.3
Territories	4,110 (97.8%)	85 (2.0%)	8 (0.2%)	4,203	46.0
Canada	1,200,571 (97.9.%)	**22,905 (1.9%)**	**2,978 (0.2%)**	**1,226,454**	**40.4**

Factors to Consider

If you are 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 us address some of the questions that you would probably ask yourself in choosing the appropriate legal form for your business.

2. Sources: Statistics Canada, Table 33-10-0222-01 (https://www.ic.gc.ca/eic/site/061.nsf/eng/h_03126.html#table1) Canadian Business Counts, with employees, December 2019, Table 17-10-0005-01 — Population estimates on July 1st, by age and sex; and ISED calculations.

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 will 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

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[3] 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 is 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 (https://www.google.com/url?q=https://canadabusiness.ca/&sa=D&ust=1524513262667000) (@canadabusiness #SMEPME) is a collaborative arrangement among federal departments and agencies, provincial and territorial governments and not-for-profit entities.

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It offers webinars and other learning events across the country. For example, Ontario's Small Business Access (https://www.google.com/url?q=https://www.ontario.ca/page/small-business-access&sa=D&ust=1524513262667000), offers workshops, a help line, funding, and 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; and
- 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

3. IRS. (2015). *SOI Bulletin Historical Table 12: Number of Business Income Tax Returns, by Size of Business for Income Years 1990-2013*. https://www.irs.gov/uac/soi-tax-stats-historical-table-12

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 is the really bad news: if the business does not 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 is 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.[4] Additionally, corporations are subject to levels of regulation and governmental oversight that can place a burden on small businesses. Finally, corporations are subject to what's generally called "double taxation." Corporations are taxed by the federal and 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

4. AllBusiness. (2016). What Are the Costs of Forming a Corporation? AllBusiness. https://www.allbusiness.com/costs-of-forming-a-corporation-502-1.html

lower tax rate is one of the key advantages to incorporating a business. However, accountants make the distinction that the taxes are not being saved, but instead deferred. That is 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".[5] He wanted the company to be owned by those who lined up in the gas station to buy cones. The stock was so popular that one in every hundred Vermont families bought stock in the company.[6] Eventually, as the company continued to expand, the stock was sold on a national level.

Other Types of Business Ownership

In addition to the three commonly adopted forms of business organization—sole proprietorships, partnerships, 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;

5. Lager, F. C. (1994). *Ben & Jerry's: The Inside Scoop*. New York: Crown Publishers.
6. Lager, F. C. (1994). *Ben & Jerry's: The Inside Scoop*. New York: Crown Publishers.

- cooperatives; and
- 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; or
- does not treat the company as a separate legal entity, for example, uses company assets for personal uses.

Cooperatives

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

Figure 7.2 MEC in Ottawa. 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:

- There are 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?

7. Ocean Spray Cooperative. (2016). *Our History*. http://www.oceanspray.com/Who-We-Are/Heritage/Our-History.aspx
8. Southern States Cooperative. (2016). *Southern States Heritage*. https://www.southernstates.com/sscinfo/our-heritage/index.aspx

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 H5P element has been excluded from this version of the text. You can view it online here:
https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=66#h5p-16 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=66#h5p-16)

The headline read, “Wanted: More than 2,000 in Google hiring spree”.[9] 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 would 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 are synonymous, the terms merger and acquisition mean slightly different things. A **merger** occurs when two companies combine to form a new company — the arrangement to consolidate the two firms is more collaboratively. An **acquisition** is the purchase of one company by another. When companies in the same industry merge, it is called a **horizontal merger**. When one of the companies in the merger is a supplier or customer to the other, it is called a **vertical merger**.

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

9. Oreskovic, A. (2010). *Wanted: More than 2,000 in Google Hiring Spree*. Reuters. http://www.reuters.com/article/us-google-idUSTRE6AI05820101119

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 (https://www.google.com/url?q=http://www.cbc.ca/news/business/loblaw-to-buy-shoppers-drug-mart-for-12-4b-1.1342108&sa=D&ust=1524513262677000)). Contrast this merger with an acquisition in that same year. Sobey's 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.[10] 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's.
- Loblaw's is able to add Shoppers health care products to its shelves.
- Sobey's 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 outlets are already located, bringing a wider variety of products to customers in densely populated areas.

10. Howard, T. (2005). *Adidas, Reebok Lace up for a Run Against Nike*. USAToday. http://usatoday30.usatoday.com/money/industries/manufacturing/2005-08-02-adidas-usat_x.htm

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 percent, 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 does not want to be acquired? The outcome could be a **hostile takeover** — an act of assuming control that is resisted by the targeted company's management and its board of directors. Ben Cohen and Jerry Greenfield, the Ice Cream Men 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.[11] Despite fears that the company's social mission would end, it did not 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.

Comprehensive Check

1. What type of business would you open if you were considering starting your own business? Why?
2. Which industries are easiest for a small business to enter? Which are hardest? Why?
3. Would you prefer to buy an existing business or start from scratch? Why?

This is just a fun game!

11. CNN Money. (2000). *Ben and Jerry's Scooped Up*. http://money.cnn.com/2000/04/12/deals/benandjerrys/

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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 a C-corporation, but it has fewer rules and restrictions than a 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.

Chapter 8 - 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; and
8. explain **key terms** in the chapter.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=69#h5p-17
(https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=69#h5p-17)

Arts and Crafts for Adults: Collective Beer

Canadian Business often profiles innovative entrepreneurs and gathered 15 of its finest profiles online (https://www.google.com/url?q=http://www.canadianbusiness.com/innovation/canadian-entrepreneur-success-stories/&sa=D&ust=1524528381538000). 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 tipple 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.

Figure 8.1 Collective Arts Brewery retrieved from http://ontariobev.net

Things were better back in September 2013, when the 41-year-old launched his company, (https://www.google.com/url?q=http://collectiveartsbrewing.com/&sa=D&ust=1524528381539000)Collective Arts Brewing (https://www.google.com/url?q=http://collectiveartsbrewing.com/&sa=D&ust=1524528381540000), 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 (https://www.google.com/url?q=https://blippar.com/&sa=D&ust=1524528381540000)Blippar (https://www.google.com/url?q=https://blippar.com/&sa=D&ust=1524528381540000) (no ugly QR code here), and you'll see a music video or artist's bio.

Since inception, more than 350 labels have been carefully culled from thousands of submissions; featured artists have included Canadian band (https://www.google.com/url?q=http://www.thestrumbellas.ca/&sa=D&ust=1524528381541000)The Strumbellas (https://www.google.com/url?q=http://www.thestrumbellas.ca/&sa=D&ust=1524528381541000), Spanish illustrator (https://www.google.com/url?q=http://www.bertoneeduardo.com/&sa=D&ust=1524528381542000)Eduardo Bertone (https://www.google.com/url?q=http://www.bertoneeduardo.com/&sa=D&ust=1524528381542000) and U.S. painter (https://www.google.com/url?q=http://www.lolafineart.com/&sa=D&ust=1524528381542000)Lola Gil (https://www.google.com/url?q=http://www.lolafineart.com/&sa=D&ust=1524528381543000). "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

1. Dollinger, M. J. (2003). *Entrepreneurship: Strategies and Resources (3rd ed.)*. Upper Saddle River, NJ: Prentice Hall.

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 commit yourself to managing it.

To jumpstart your thinking around entrepreneurship, take this short quiz (https://www.qzzr.com/c/quiz/68438/ce06e251-4753-49ea-9f25-9889a7fa667a) 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 intended to prompt your thinking.

A Few Things to Know About Going into Business for Yourself

Mark Zuckerberg founded Facebook while he was a student at Harvard. By age 27 he had 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:

2. Encyclopedia of World Biography. (2006). *Marcia Kilgore: Entrepreneur and spa founder*. http://www.notablebiographies.com/newsmakers2/2006-Ei-La/Kilgore-Marcia.html
3. Bruder, J. (2010, August 12). *The Rise Of The Serial Entrepreneur*. Forbes. http://www.forbes.com/2010/08/12/serial-entrepreneur-start-up-business-forbes-woman-entrepreneurs-management.html
4. Bruder, J. (2010, August 12). *The Rise Of The Serial Entrepreneur*. Forbes. http://www.forbes.com/2010/08/12/serial-entrepreneur-start-up-business-forbes-woman-entrepreneurs-management.html

- 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 distinguish 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; and
- 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 do 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

5. U.S. Small Business Administration. (2023). *10 steps to start your business*. https://www.sba.gov/business-guide/10-steps-start-your-business
6. Waters, S. (2016). *Top Four Reasons People Don't Start a Business*. Liveaboutdotcom. http://retail.about.com/od/startingaretailbusiness/tp/overcome_fears.htm

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 (https://www.google.com/url?q=https://www.kickstarter.com&sa=D&ust=1524528381558000)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.

Apart from financial resources, entrepreneurs acquire resources needed to make the venture a reality by bootstrapping, which means "doing more for less." The term bootstrapping refers to financing techniques whereby entrepreneurs make do with less and use other people's resources wherever they can. It also refers to the acquisition of other types of resources, such as people, space, equipment, or materials loaned or provided free by customers, suppliers, or other sources.

The federal and provincial governments have a wide range of financial assistance programs such as low-interest loans, loan guarantees, interest-free loans and wage subsidies. Other resources, information and assistance include services provided by the Business Development Bank of Canada, business incubators (provide new businesses with support to help nurture them into a successful future), the internet, and crowdfunding vehicles.

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; and
- provide opportunities for many people, including women and minorities, to achieve financial success and independence.

7. Allen, K. (2001). *Entrepreneurship for Dummies*. New York: Wiley.

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 100 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]

8. Headd, B. (2010). *An Analysis of Small Business and Jobs*. U.S. Small Business Administration, Office of Advocacy. https://www.sba.gov/sites/default/files/files/an%20analysis%20of%20small%20business%20and%20jobs(1).pdf
9. Breitzman, A., & Hicks, D. (2008). *An Analysis of Small Business Patents by Industry and Firm Size*. Faculty Scholarship for the College of Science & Mathematics. https://rdw.rowan.edu/cgi/viewcontent.cgi?referer=&httpsredir=1&article=1011&context=csm_facpub
10. Baumol, W. J. (2005). *Small Firms: Why Market-Driven Innovation Can't Get Along without Them*. U.S. Small Business Administration, Office of Advocacy.

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's 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.

Figure 8.2 Amazon Store Front. 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. They encourage fast decision making, 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 included 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."

11. Yahoo Finance. (2016). *Amazon.com Income Statement*. http://finance.yahoo.com/q/is?s=AMZN+Income+Statement&annual
12. Baumol, W. J. (2005). *Small Firms: Why Market-Driven Innovation Can't Get Along without Them*. U.S. Small Business Administration, Office of Advocacy.

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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]

13. U.S. Census Bureau. (2012). *Estimates of Business Ownership by Gender, Ethnicity, Race, and Veteran Status*: 2012. http://www.census.gov/library/publications/2012/econ/2012-sbo.html#par_reference_25
14. Central Intelligence Agency. (2016). World Factbook. https://www.cia.gov/the-world-factbook/about/cover-gallery/2016-cover/

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

15. Ecoscraps. (2016). Our Story. http://ecoscraps.com/pages/our-story
16. Isidro, I. (2003). *How to Succeed Online with a Niche Business: Case of RedWagons.com.* PowerHomeBiz. http://www.powerhomebiz.com/online-business/success-online-business/succeed-online-niche-business-case-redwagons-com.htm

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 H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=69#h5p-19 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=69#h5p-19)*

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 H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=69#h5p-20 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=69#h5p-20)*

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

17. Isidro, I. (2001). *Geese Police: A Real-Life Home Business Success Story*. PowerHomeBiz. http://www.powerhomebiz.com/working-from-home/success/geese-police-real-life-home-business-success-story.htm
18. Illinois Small Business Development Center at SIU. (2016). *Frequently Asked Questions: What are the Pros and Cons of Owning a Business*? http://sbdc.siu.edu/frequently-asked-questions/index.html

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.

19. Chun, J. (1997). *Type E Personality: What makes entrepreneurs tick*? Entrepreneur. https://www.entrepreneur.com/article/13764
20. Allen, K. (2001). *Getting Started in Entrepreneurship. Entrepreneurship for Dummies*. New York: Wiley.

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 ideas and also increases your chances of success. Take Sam Walton, the late founder of Walmart. 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 Walmart 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, by buying an existing one, or by 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

21. Thurm, S., & Lublin, J. S. (2005, November 14). *Peter Drucker's Legacy Includes Simple Advice: It's All about the People*. The Wall Street Journal. http://www.wsj.com/articles/SB113192826302796041
22. Krass, P. (1997). *Sam Walton: Running a Successful Business: Ten Rules that Worked for Me*. In The Book of Business Wisdom: Classic Writings by the Legends of Commerce and Industry (Pp. 225-230). New York: Wiley.
23. Schultz, H., & Yang, D. J. (1997). *Pour Your Heart into It*. New York: Hyperion.

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. Table 8.1 lists the top ten franchises according to *Entrepreneur* magazine for 2024. Franchises apply to be on the list and are then assessed using *Entrepreneur's* five pillars (https://www.google.com/url?q=https://www.entrepreneur.com/franchise500/2018&sa=D&ust=1524528381592000).

24. Steiner, C. (2010). *Meet the Fastest Growing Company Ever*. Forbes. http://www.forbes.com/forbes/2010/0830/entrepreneurs-groupon-facebook-twitter-next-web-phenom.html
25. The Week. (2011). Groupon's 'Startling' Reversal of Fortune. https://theweek.com/articles/482479/groupons-startling-reversal-fortune

Table 8.1 Top ten franchises according to *Entrepreneur* magazine for 2024

Ranking	Franchise Name	Description
1	Taco Bell	Mexican-inspired food
2	Jersey Mike's Subs	Subs and Philly cheesesteaks
3	Popeyes Louisiana Kitchen	Fried chicken, seafood, biscuits
4	The UPS Store	Shipping, packing, package management, mailboxes, printing, faxing, shredding, notary services
5	Ace Hardware	Hardware and home improvement stores.
6	Dunkin'	Coffee, doughnuts, baked goods
7	Culver's	Frozen custard, specialty burgers
8	Hampton by Hilton	Upper midscale hotels
9	Arby's	Sandwiches, fries, shakes
10	Kumon	Supplemental education

2024 Franchise ranking shines a light on the unique challenges and changes that have shaped the franchise industry over the last year – and how franchisors have adapted and evolved to meet them. From the 2024 ranking franchises such as McDonalds, Subway, KFC are not in the 10 ranking. Why do you think this is the case?

In Canada, 1 out of every 14 workers are 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 (https://www.canadafranchiseopportunities.ca/investment/)[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]

26. Peterson, H. (2014). *Here's How Much It Costs To Open Different Fast Food Franchises In The US*. BusinessInsider. http://www.businessinsider.com/cost-of-fast-food-franchise-2014-11
27. Seid, M., & Ainsley, K. M. (2002). "*Franchise Fee*" *Made Simple*. Entrepreneur. https://www.entrepreneur.com/article/51174

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

Common Reasons for Businesses Failing

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 (https://www.google.com/url?q=https://www.ic.gc.ca/eic/site/061.nsf/eng/h_03018.html%23point2-3&sa=D&ust=1524528381619000). 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;

28. Farrell, M. (2007). *The 10 Riskiest Businesses to Start*. Forbes. https://www.forbes.com/2007/01/18/fairisaac-nordstrom-verizon-ent-fin-cx_mf_0118risky.html?sh=5988321d3370

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.

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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.
5. There are two broad types of industries, or sectors: the goods-producing sector and the service-producing sector.
6. 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.

PART C - UNDERSTANDING THE BUSINESS OF MANAGING

This third section discusses the elements, processes, procedures and issues in managing the business organization from different perspectives — employers, employees, consumers and investors. This part focuses on the role of the managers, the structure and organization of large and small businesses, the management of human resources, the motivation of employees, operations management, and marketing processes and consumer behavior. The section also discusses elements and processes of financial information and systems. It also discusses the role of financial institutions, financial planning, and managing risk with diversification, stock market, mutual funds and securities.

Chapter 9 - The Role of Managers

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; and
7. explain **key terms** in the chapter.

Show What You Know

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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

Chart 9.1 Circular management process: planning to organizing to leading to controlling

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 Walmart: his new chain of stores would exist to offer customers the lowest prices with the best possible service.[1]

The purpose of strategic planning is to set the overall goals for the business and to develop a plan to achieve them. It involves stepping back from the day-to-day operations and asking where your business is headed and what are the priorities.

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

- Write a vision statement that support the strategic plan. The vision statement outlines the organization's overall goals and states the purpose of the organization's existence.
- 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.

1. Walmart. (2016). *Our Story*. http://corporate.walmart.com/our-story/our-history

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

Vision Statement or Purpose

The vision statement indicates why an organization exists and what kind of organization it wants to be. It distills the organization's vision for the future in a way that outlines its long-term goals. For example, Disney's vision statement is "to be one of the world's leading producers and providers of entertainment and information". The statement is concise, and adopts ambitious worldwide goals, extending their product reach beyond entertainment — which is what they're known for — into information.

Mission Statement

The mission statement describes the reason for an organization's 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

2. Mary Kay. (2016). *Corporate Careers: Discover what you love about Mary Kay*. http://www.marykay.com/en-US/About-Mary-Kay/EmploymentMaryKay
3. Harley Davidson. (2016). *About Harley Davidson*. http://www.harley-davidson.com/content/h-d/en_US/company.html
4. Volvo Group. (2016). *Volvo Group Global: Our Values*. http://www.volvogroup.com/group/global/en-gb/volvo group/ourvalues/Pages/volvovalues.aspx

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 upon 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 Starbucks SWOT Analysis video (https://www.youtube.com/watch?v=mR9eICQJLXA) explains the ins and outs of a SWOT analysis.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=74#oembed-1 (#oembed-1)

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 it's 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

5. Coca Cola Company. (2016). *Our Company: Vision, Mission, and Values*. http://www.coca-colacompany.com/our-company/mission-vision-values

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:

Chart 9.2 SMART acronym used for setting and developing goals.

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.

6. Safranski, S. and Kwon, I. (1991). *Strategic Planning for the Growing Business*. U.S. Small Business Administration.
7. Bison, F. (2003). *McDonald's Announces Plans to Revitalize Its Worldwide Business and Sets New Financial Targets*. Franchisebison.

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 (https://www.google.com/url?q=https://www.youtube.com/watch?v=AfCiV6ysngU&sa=D&ust=1524536570163000)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 (https://www.google.com/url?q=https://www.harpersbazaar.com/celebrity/latest/news/a21830/kendall-jenner-pepsi-commercial-twitter-reactions/&sa=D&ust=1524536570163000).

Figure 9.1 Twitter screen capture responding to Pepsi ad featuring Kendall Jenner

8. Richtel, M. (2005, April 29). *Wendy's Gets a Break, But Still Has Work Ahead of it*. The New York Times. http://www.nytimes.com/2005/04/29/business/media/wendys-gets-a-break-but-still-has-work-ahead-of-it.html?_r=0

Leading

The third management function is leading — providing focus and direction to others and motivating them to achieve organizational goals. [Yes, ORGANIZING was skipped, since it will be covered 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 or a team captain; or think of a leader on the larger stage, e.g., politics, sports, or 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 H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=74#h5p-23 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=74#h5p-23)

7 Leadership Qualities and Attributes of Great Leaders – An infographic by the team at Brian Tracy International (//www.briantracy.com/)

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

9. Reh, F. J. (2018). *Management Basic and the Manager Job Role*. Liveaboutdotcom. http://management.about.com/cs/generalmanagement/a/Management101.htm

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.

Situational Leadership

Situational leadership means adapting your management style to each unique situation or task to meet the needs of the team or team members. Ken Blanchard and Paul Hersey developed the Situational Leadership Theory in 1969. They believe that there is no "one size fits all" leadership style. Situational leaders are flexible to enhance their leadership skills to the changing condition of the work environment. They are also insightful and trustworthy. This character trait is exhibited in their management skills of easily modifying to new conditions and establishing trust with the participants through constant communication, close supervision and engagement.

Transformational and Transactional

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

10. Burke, S., & Collins, K. M. (2001). Gender differences in leadership styles and management skills. *Women in Management Review*, 16(5), 244–257. https://doi.org/10.1108/09649420110395728

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 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 that 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.

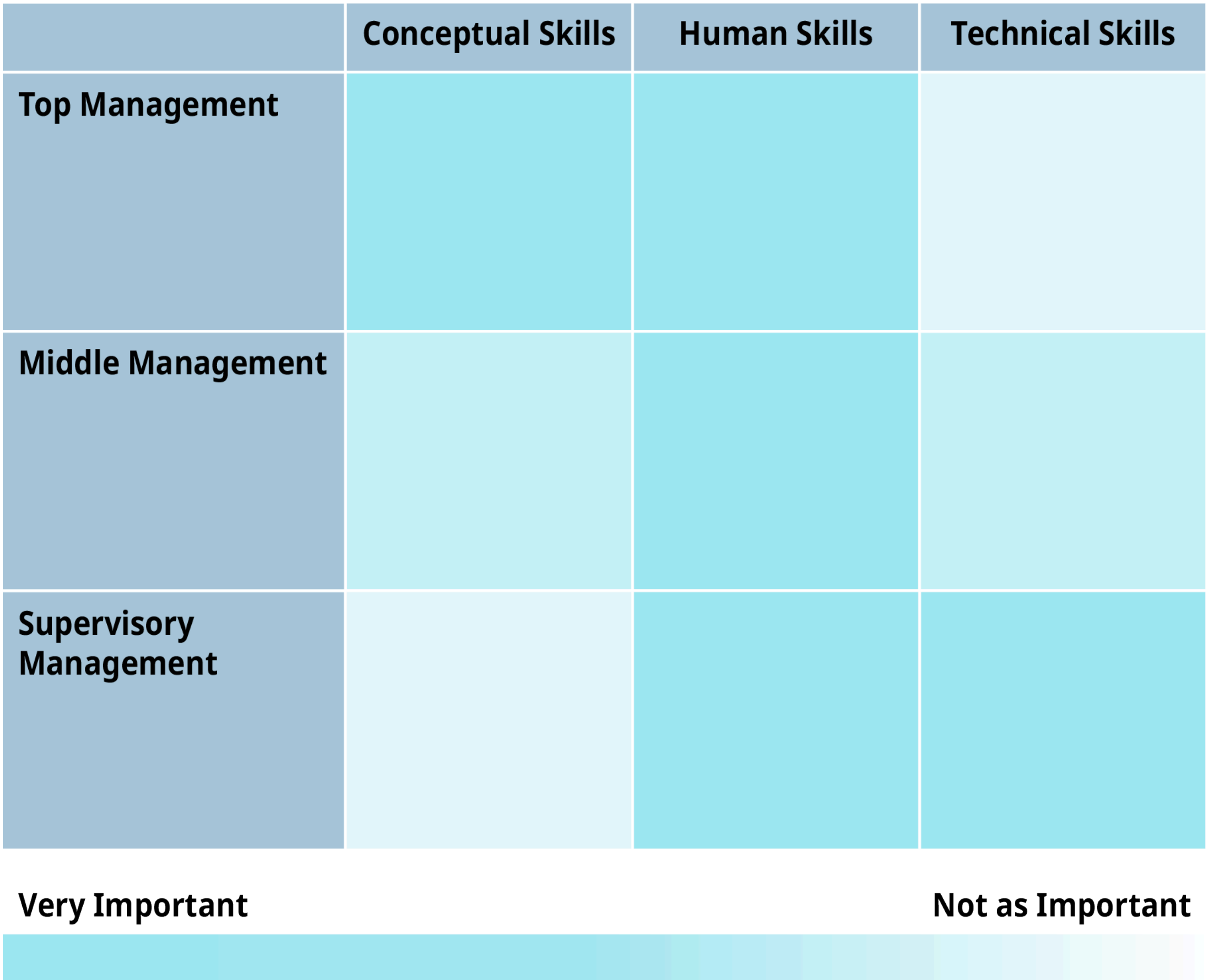
Interpersonal Skills

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. The chart below underlines the importance of human or people skills (interpersonal) at all levels of management.

11. Perkins, B. (2000). *Defining Crisis Management*. Wharton Magazine.



The Importance of Managerial Skills at Different Management Levels (Attribution: Copyright Rice Univers

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]

12. Davis, B. L., et al. (1992). *Successful Manager's Handbook: Development Suggestions for Today's Managers*. Minneapolis: Personnel Decisions Inc.

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 H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=74#h5p-24 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=74#h5p-24)

13. Davis, B. L., et al. (1992). *Successful Manager's Handbook: Development Suggestions for Today's Managers*. Minneapolis: Personnel Decisions Inc.

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:

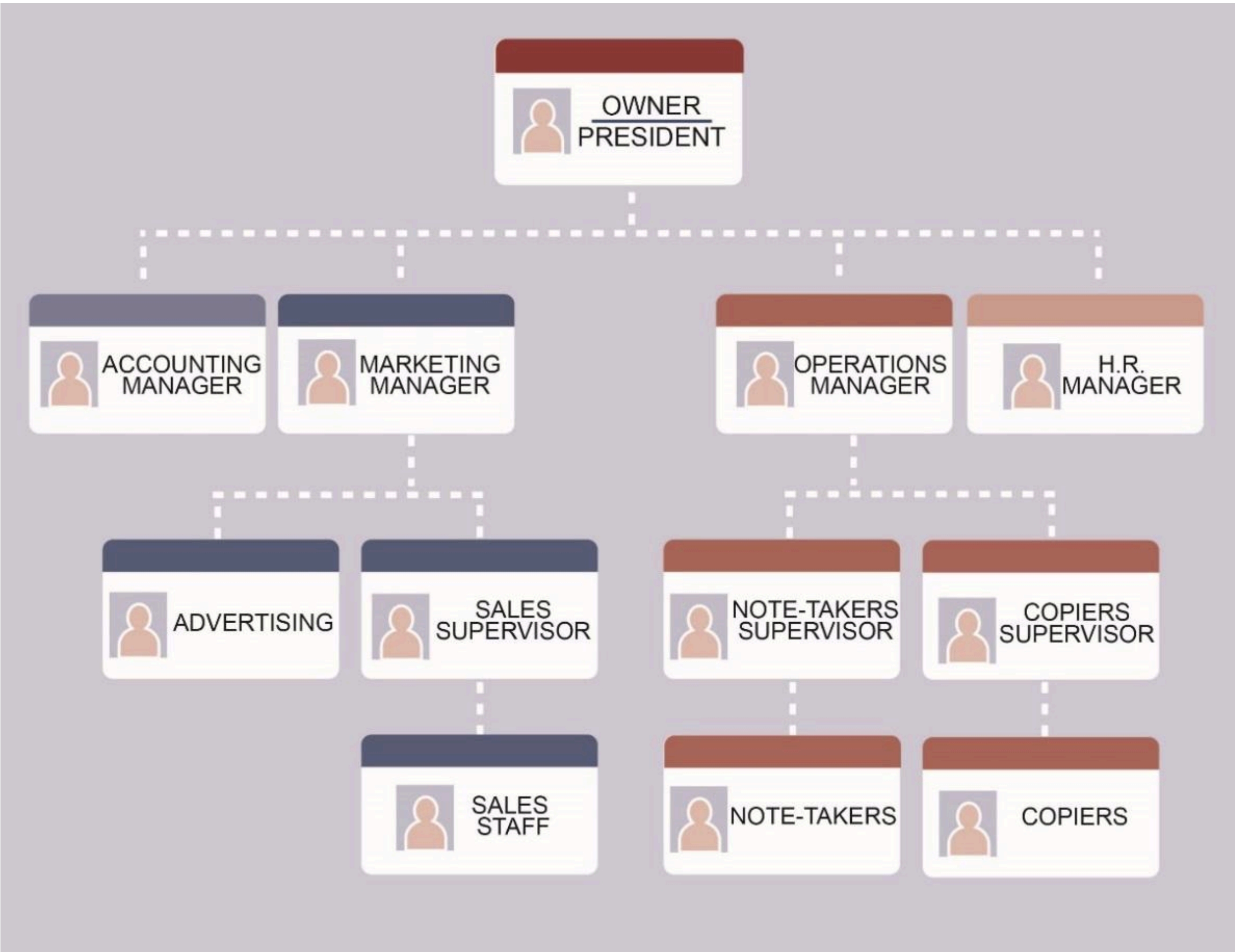


Chart 9.3 Potential organization chart for the Note-4-You company

Comprehensive Check

1. Describe four skills needed to be a successful manager.

2. Explain which of the four management functions (planning, organizing, leading, and controlling) is the most critical for business success. Provide an example to demonstrate your opinion.

3. Explain the process of developing and implementing a strategic plan.

4. Why is it important for businesses to develop contingency plans? Discuss your experiences in contingency planning or crisis management.

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; 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.

Chapter 10 - 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; and
6. explain **key terms** in the chapter.

Show What You Know

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Organizing

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.

Figure 10.1 Levels of Management

Figure 10.1 Levels of Management. Pyramid with first line managers on the bottom; middle managers in the middle; and top managers on top including their duties.

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.

> In 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 hypothes.is 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 organizational, which positions report to which, and how an organization will departmentalize its work. Take note than 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 all 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]

1. Associated Press (2010). *General Motors Rebuilds with 4 Divisions*. http://chronicle.augusta.com/life/autos/2010-10-07/general-motors-rebuilds-4-divisions#
2. Johnson and Johnson (2023). *Company Structure*. Organimi. https://www.organimi.com/organizational-structures/johnsonjohnson/

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]

(https://www.adidas-group.com/en/group/headquarters/)
Figure 10.2 Adidas Geographical Locations. 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.

Project Organization

Project organization is an organization that uses teams of specialists to complete specific projects. In organizations using the project organization structure, the project team optimizes resources, provides clear communication about roles and responsibilities and reduces potential roadblocks. To maintain a strong project organization, the team needs proper direction and training. Every company may have its own approach to project organization, depending on how many employees they have and what the project complexity.

3. Lakehead University Faculty of Natural Resources Management (2016). *From the Forest to the Office and Home: Bowater—A Case Study in Newsprint and Kraft Pulp Production*. http://www.borealforest.org/paper/index.htm
4. Adidas Group (2015). *Adidas Group Annual Report 2015*. http://www.adidas-group.com/en/investors/financial-reports/#/2015/

Matrix Structure

A matrix organization is a company structure where teams report to multiple leaders. In a matrix structure, individuals work across teams and projects as well as within their own department or function. For example, a project or task team established to develop a new product might include engineers and design specialists as well as those with marketing, financial, personnel and production skills. The matrix design keeps open communication between teams and can help companies create more innovative products and services. Using the matrix structure prevents teams from needing to realign every time a new project begins.

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. **Chart 10.1** provides an example of this type of organization chart:

Chart 10.1 Potential Organization Chart for the Note-4-You Company

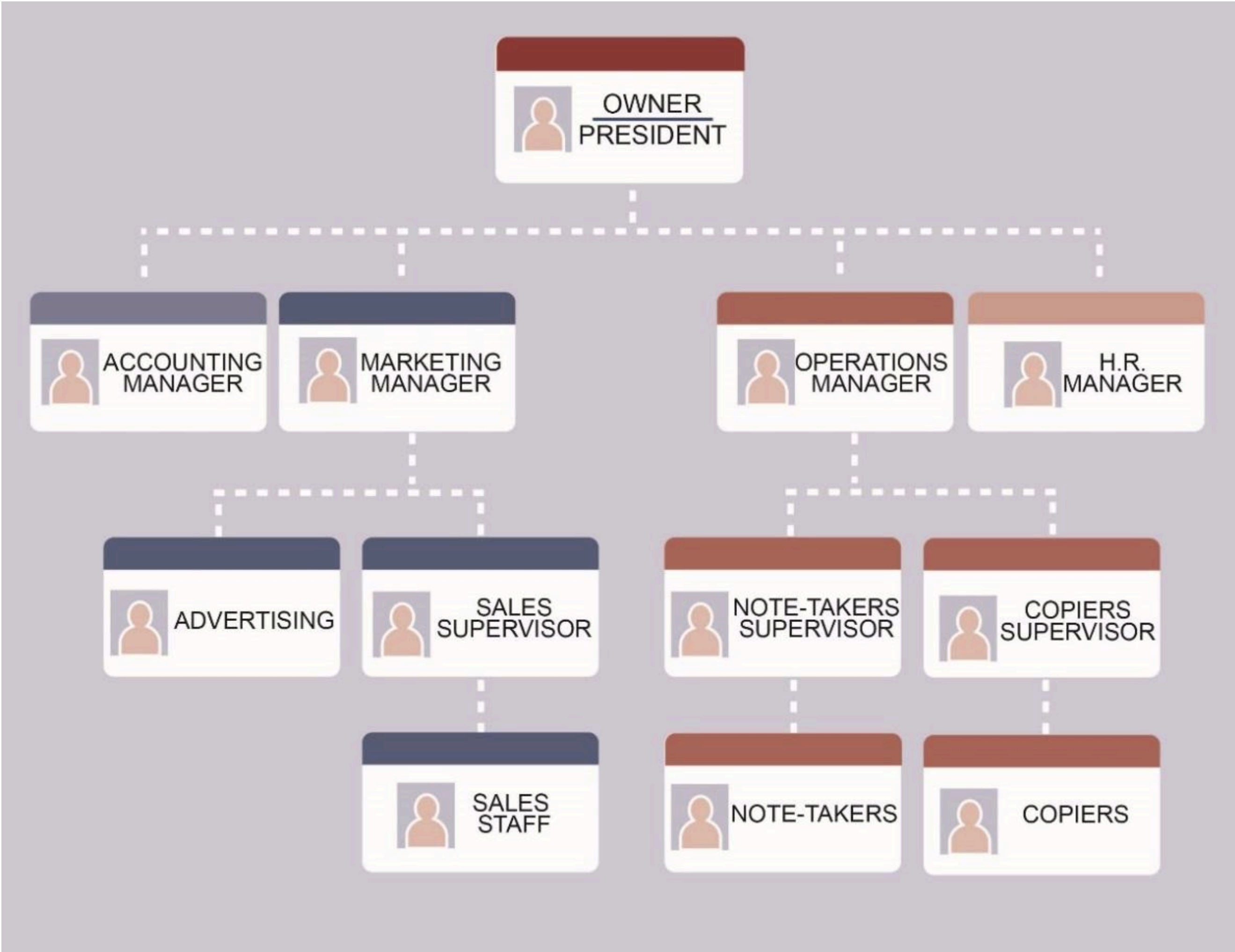

Chart 10.1 Potential organization chart for the Note-4-You company

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, service, or customer base. Educational institutions reflect a mix of those divisional structure options.

Chart 10.2 Organization Chart – Divisional Structure – Educational Institutions

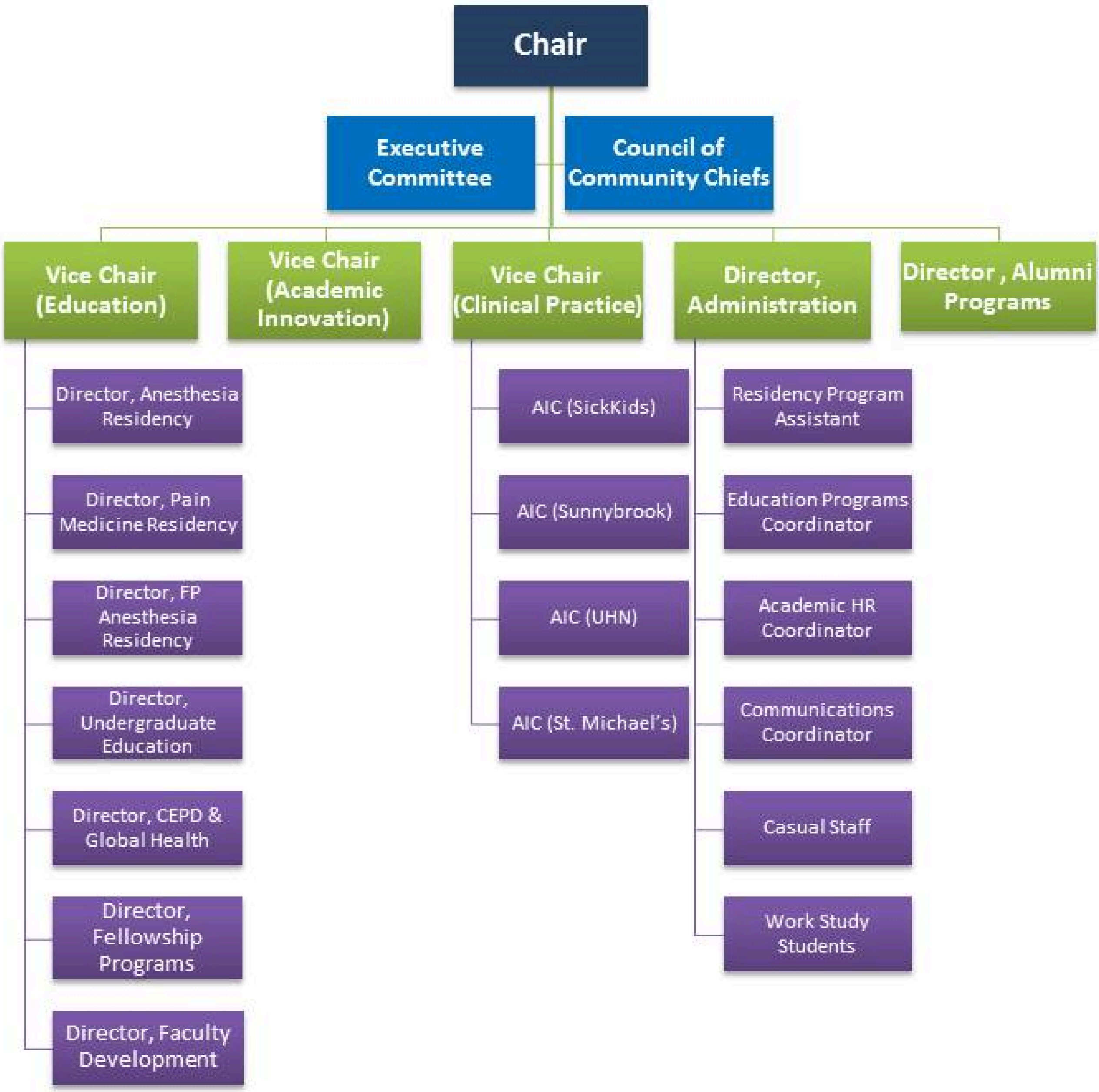

Chart 10.2 Educational institutions reflect a mix of those divisional structure options. Four tiered hierarchy detailing the levels of one department at a large university. Chair is at the top, with two reports, followed by another 5 people reporting up. Three of the five in the third level have stacked reports.

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 **Chart 10.3** Geographic Divisional Structure.

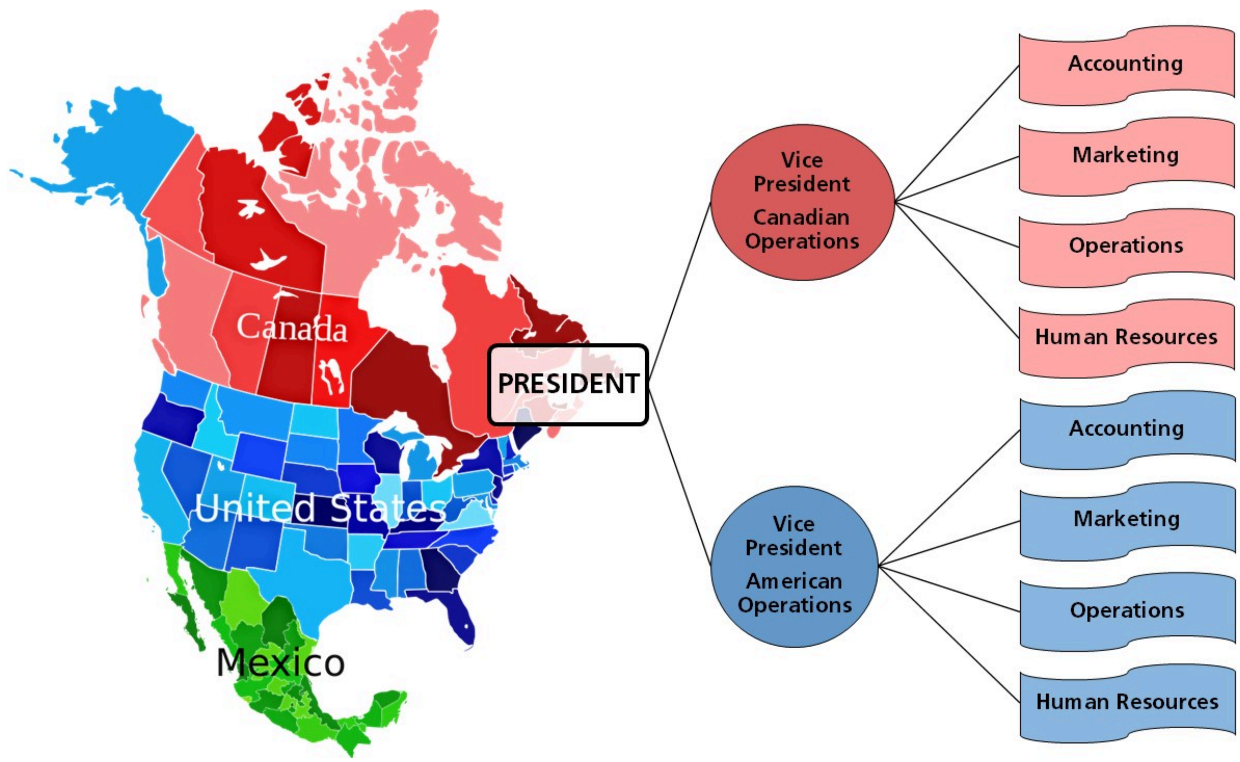

Chart 10.3 Geographic divisional Organizational Structure

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. **Chart 10.4** is a Matrix Organization Chart as follows:

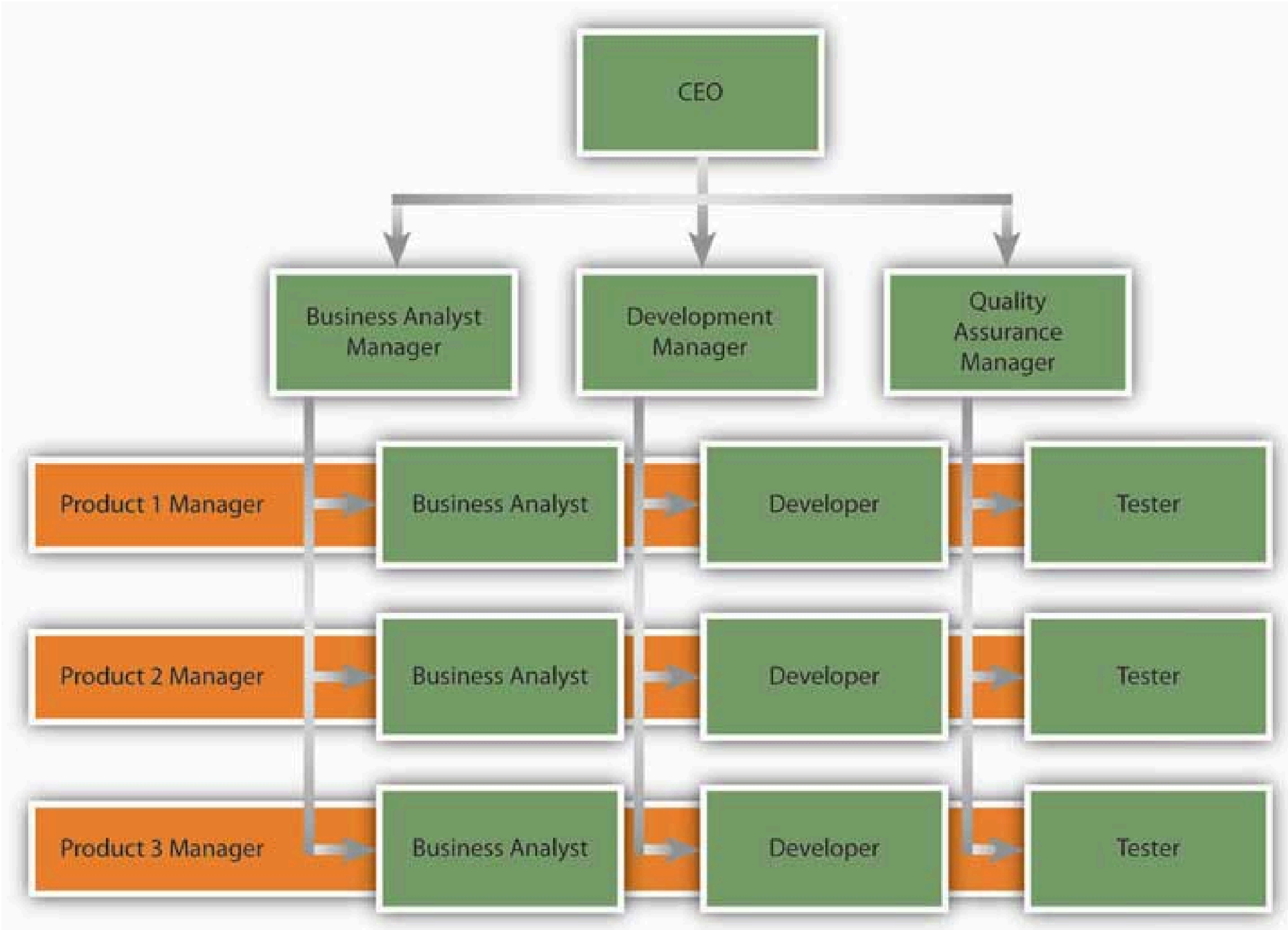

Chart 10.4 is a Matrix Organization Chart

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.

7. 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.

Chapter 11 - Managing Human Resources and Union Relations

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;
5. explain why workers unionize and how unions are structured, and describe the collective-bargaining process;
6. discuss key terms associated with union/management issues, such as mediation and arbitration;
7. identify the tactics used by each side to support its negotiating position: strikes, picketing, boycotting, and lockouts; and
8. explain **key terms** in the chapter.

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(https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=100#h5p-43)

The Grounds of a Great Work Environment

Howard Schultz (https://www.google.com/url?q=https://en.wikipedia.org/wiki/Howard_Schultz&sa=D&ust=1524776479522000)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.

Figure 11.1 Starbucks Founder Howard Schultz by Gage Skidmore/flickr (CC BY 2.0).

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]

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]

1. Schultz, H. & Yang, D., J. (1997). *Pour Your Heart into It: How Starbucks Built a Company One Cup at a Time*. New York, NY: Hyperion. p. 3–8.
2. Schultz, H. & Yang, D., J. (1997). *Pour Your Heart into It: How Starbucks Built a Company One Cup at a Time*. New York, NY: Hyperion. p. 138.
3. Schultz, H. & Yang, D., J. (1997). *Pour Your Heart into It: How Starbucks Built a Company One Cup at a Time*. New York, NY: Hyperion. p. 6-7.
4. Starbucks (2016). *Working at Starbucks*. http://www.starbucks.com/careers/working-at-starbucks
5. Starbucks (2016). *Working at Starbucks*. http://www.starbucks.com/careers/working-at-starbucks

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.

6. Schultz, H. & Yang, D., J. (1997). *Pour Your Heart into It: How Starbucks Built a Company One Cup at a Time*. New York, NY: Hyperion. p. 125.

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; and
- 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.

7. Starbucks (2016). *Working at Starbucks*. http://www.starbucks.com/careers/working-at-starbucks
8. Fortune (2007). 100 *Top MBA Employers*. http://archive.fortune.com/magazines/fortune/mba100/2007/full_list/index.html
9. Cruise International (n.d.). *The Norwegian Dawn*. http://www.cruise-international.com/cruise-search/ShpDetailsQuery?nShp=290&nLine=18&nOperator=Norwegian+Cruise+Line

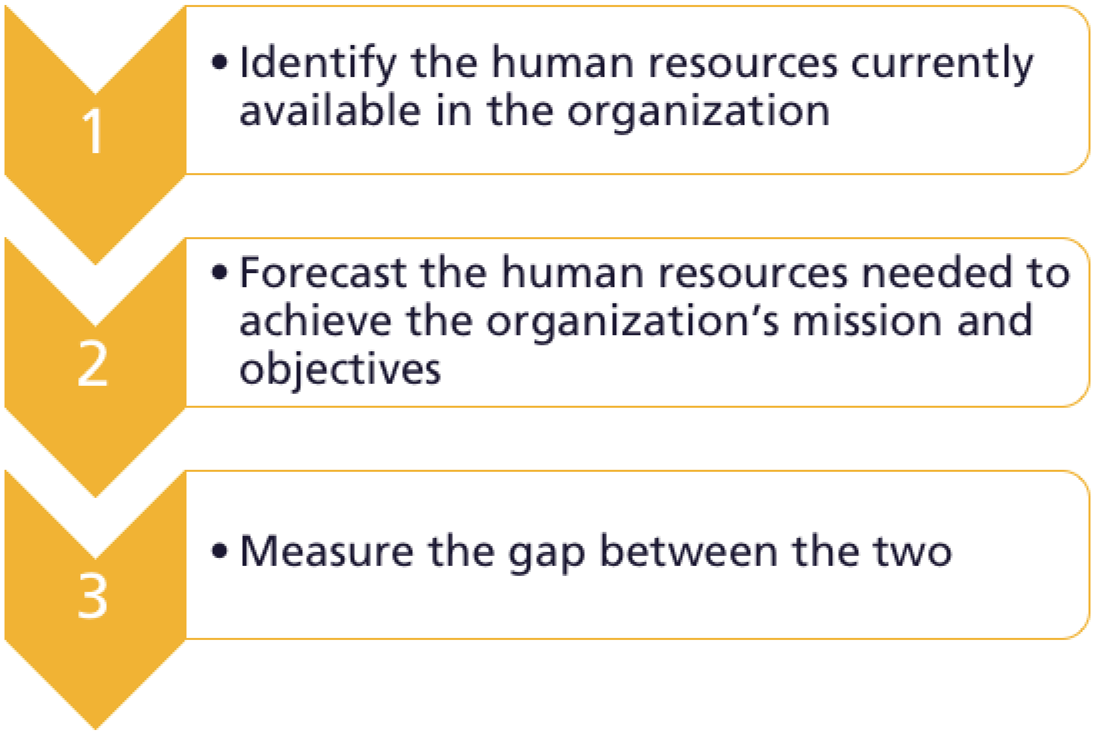

Chart 11.1 How to Forecast Hiring (and Firing) Needs.

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 (https://www.google.com/url?q=http://laws-lois.justice.gc.ca/eng/acts/h-6/FullText.html&sa=D&ust=1524776479525000), 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 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, that 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 experience. 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:


Figure 11.2 College job fair

- 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 (https://www.google.com/url?q=https://www.linkedin.com/&sa=D&ust=1524776479527000), Workopolis (https://www.google.com/url?q=https://www.workopolis.com/&sa=D&ust=1524776479527000), Indeed (https://www.google.com/url?q=https://www.indeed.com/&sa=D&ust=1524776479527000), LeapOut (https://www.google.com/url?q=https://www.leapout.com/&sa=D&ust=1524776479527000), JobBank (https://www.google.com/url?q=https://www.jobbank.gc.ca/home&sa=D&ust=1524776479527000), Eluta; (https://www.google.com/url?q=https://www.eluta.ca/&sa=D&ust=1524776479528000)
- social media;
- local job fairs;
- in-store recruiting posters; and
- informative "business cards" for distribution to customers.[10]

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.

10. Carolyn B. Thompson (n.d.). *In Focus: Target Your Recruitment Market.*
11. Lee, D. (2006). *Your First Task* As A *Recruiter: Recruit Senior Management Onto Your Team.* https://web.archive.org/web/20130529204750/http://www.humannatureatwork.com/Recruiting-Employees.htm

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 H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=100#h5p-44 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=100#h5p-44)

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.

Take 10 minutes to learn more about the likely future of work; watch "The gig economy: when algorithms decide your pay". During the pandemic the gig economy grew, where workers are paid by tech platforms like Uber and Lyft. How is the new platform-driven economy affecting the people who do the jobs?

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=100#oembed-1 (#oembed-1)

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

12. Canadian Security Intelligence Service. (n.d.). *Job Requirements – Canada.ca*. https://www.canada.ca/en/security-intelligence-service/corporate/csis-jobs/job-requirements.html

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 within a company, 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; and
- 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; and
- 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,

13. Price, A. (2004). Human Resource Management in a Business Context. Hampshire, U.K.: Cengage EMEA. Retrieved from: http://www.bestbooks.biz/learning/induction.html
14. Toronto Jobs. (n.d.). *Articles*: *10 ways to turn off new employees*. https://www.torontojobs.ca/news/131/10-ways-to-turn-off-new-employees.html

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. Training, mentoring and coaching can benefit everyone in the work environment. Mentoring means having a more experienced manager sponsor and teach a lesser manager. Reverse mentoring is a term used to describe a system where new employees (usually much younger) can help train more experienced workers in areas such as social media and technology applications.

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 (https://www.google.com/url?q=https://www.theglobeandmail.com/report-on-business/careers/top-employers/diversity-and-inclusion-give-these-firms-a-competitive-advantage/article38217315/&sa=D&ust=1524776479531000).[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 (entitled 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.

15. Jermyn, D., (2018). *Diversity and inclusion give these firms a competitive advantage*. Globe and Mail. https://www.theglobeandmail.com/report-on-business/careers/top-employers/diversity-and-inclusion-give-these-firms-a-competitive-advantage/article38217315/
16. Golfarb, Z. A. (2007). *Where Technocrats Play With Toys of Tomorrow*. The Washington Post. http://www.washingtonpost.com/wp-dyn/content/article/2007/12/23/AR2007122301574.html
17. Locascio, B. (2004). *Working at Starbucks: More Than Just Pouring Coffee*. Tea and Coffee Trade Online. http://www.teaandcoffee.net/0104/coffee.htm
18. Schultz, H. & Yang, D., J. (1997). *Pour Your Heart into It: How Starbucks Built a Company One Cup at a Time*. New York, NY: Hyperion. p. 250-251.

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

Chart 11.2 Employment by Gender Group. Source: Usalcas, J. & Kinack, M. (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.

19. Usalcas, J. & Kinack, M. (2017). *History of the Canadian Labour Force Survey, 1945 to 2016*. Statistics Canada. https://www150.statcan.gc.ca/n1/en/pub/75-005-m/75-005-m2016001-eng.pdf?st=VUjdeAww
20. Usalcas, J. & Kinack, M. (2017). *History of the Canadian Labour Force Survey, 1945 to 2016*. Statistics Canada. https://www150.statcan.gc.ca/n1/en/pub/75-005-m/75-005-m2016001-eng.pdf?st=VUjdeAww
21. Minister of Justice (n.d.). *Canadian Human Rights Act*. Canadian Human Rights Tribunal. https://www.chrt-tcdp.gc.ca/index-en.html

Addressing Myths About Hiring People with Disabilities

Although there are many well-educated, skilled people with disabilities in Canada and in other countries around the world, they continue to be unemployed, or underemployed at a rate more than twice that of the general adult population. In fact according to Human Resources and Skills Development Canada, more than 50% of people with disabilities have high school diplomas, and over one third of these have completed a post-secondary program.

In Ontario, the unemployment rate for people with disabilities is about 8% higher than the general population, as reported by the Ontario Chamber of Commerce (OCC). According to the OCC, this is in part due to systemic and cultural discrimination based on misperceptions of people with disabilities. People with disabilities are often perceived as less productive, more likely to take time off, too costly to accommodate, and more likely to be a burden on employees who do not have disabilities. In fact the opposite is true for all these points. Because people with disabilities have more difficulty finding work, they are likely to value employment more than typical fully abled workers.

The Ontario Chamber of Commerce has put together a list of eight myths about hiring people with disabilities, and the OCC challenges those myths with facts. Take a few moments to read through "8 Myths About Hiring People with Disabilities" (http://quintewestchamber.ca/8-myths-about-hiring-people-with-disabilities/).

What Makes a Great Place to Work?

Every year, Great Place to Work Canada (https://www.google.com/url?q=https://www.greatplacetowork.ca/en/&sa=D&ust=1524776479533000) 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:

1. Google (https://www.google.com/url?q=https://www.forbes.com/companies/google/&sa=D&ust=1524776479535000)
2. Kruger Products (https://www.google.com/url?q=https://www.forbes.com/companies/kruger-products/&sa=D&ust=1524776479536000)
3. Hydro-Québec (https://www.google.com/url?q=https://www.forbes.com/companies/hydro-quebec/&sa=D&ust=1524776479536000)
4. SAP (https://www.google.com/url?q=https://www.forbes.com/companies/sap/&sa=D&ust=1524776479537000)
5. Vitalité Health Network (https://www.google.com/url?q=https://www.forbes.com/companies/vitalite-health-network/&sa=D&ust=1524776479537000)
6. Queen's University (https://www.google.com/url?q=https://www.forbes.com/companies/queens-

22. Great Place to Work Institute® (2018). *The Definition of* A *Great Workplace*. https://www.greatplacetowork.ca/en/about-us/trust-model
23. Wilhelmsen, T. R. (2019, April 23). 15 *Practice Areas Critical to Achieving a Great Workplace*. Great Place to Work Institute®. http://www.greatplacetowork.com/events-and-insights/blogs-and-news/3040-15-practice-areas-critical-to-achieving-a-great-workplace

university/&sa=D&ust=1524776479538000)

7. Concordia University (https://www.google.com/url?q=https://www.forbes.com/companies/concordia-university/&sa=D&ust=1524776479539000)
8. Siemens (https://www.google.com/url?q=https://www.forbes.com/companies/siemens/&sa=D&ust=1524776479539000)
9. SaskTel (https://www.google.com/url?q=https://www.forbes.com/companies/sasktel/&sa=D&ust=1524776479540000)
10. Ottawa-Carleton District School Board (https://www.google.com/url?q=https://www.forbes.com/companies/ottawa-carleton-district-school-board/&sa=D&ust=1524776479541000)

Job Redesign

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 has consistently made the list of "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.

24. Kerka, S. (1995). *The Changing Role of Support Staff: Trends and Issues Alerts*. ERIC Clearinghouse on Adult, Career, and Vocational Education. https://eric.ed.gov/?id=ED378351
25. Greenhaus, J., Collins, K., & Shaw, J. (2003). *The Relationship between Work-Family Balance and Quality of Life*. Journal of Vocational Behavior 63(3). p. 510–31.
26. Employers, C. T. 100. (n.d.). *Canada's Top Family-Friendly Employers* (2021). https://www.canadastop100.com/family/
27. Mediacorp Canada Inc. (2022, November 17). *KPMG LLP*. Canada's Top 100. https://reviews.canadastop100.com/top-employer-kpmg

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 exemplary companies, they offer the following benefits.[30]

28. WFC Resources Inc. (n.d.). *The Business Case for Telecommuting*. Career/Life Alliances Services Inc.
29. Statistics Canada (2016). *Working from home: an update*. https://www.statcan.gc.ca/pub/11-402-x/2012000/chap/information/information02-eng.htm
30. Mediacorp Canada Inc. (2022, November 17). *BASF Canada INC*. Canada's Top 100. https://reviews.canadastop100.com/top-employer-basf-canada

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 (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. The 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 have 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

31. Mediacorp Canada Inc. (2022, November 17). *KPMG LLP*. Canada's Top 100. https://reviews.canadastop100.com/top-employer-kpmg
32. Collins, K., & Hoover, E. (1995). Addressing the Needs of the Single Person in Public Accounting. *Pennsylvania CPA Journal*. 16.

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.

33. Collins, K., & Killough, L. (1989). Managing Stress in Public Accounting. *Journal of Accountancy*, 167 (5), 92.
34. Withiam, G. (1993). American concierges set Service Standards. *Cornell Hotel and Restaurant Administration Quarterly*, 34(4), 26. https://doi.org/10.1177/001088049303400407
35. Great Place To Work®. (n.d.). *Fortune 100 Best Companies to Work For®* 2016. Great Place to Work®. https://www.greatplacetowork.com/best-workplaces/100-best/2016

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

36. Cisco. (2023, January 18). *Benefits and Perks | Cisco Careers*. https://www.cisco.com/c/en/us/about/careers/we-are-cisco/benefits-and-perks.html
37. Nature's Path Foods (n.d.). *Working at Nature's Path*. https://www.naturespath.com/en-ca/careers/
38. Canadian Tire Corporation Limited. (n.d.). *Investors – Investor Resources* – FAQs. https://corp.canadiantire.ca/English/investors/investor-resources/faqs/default.aspx

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, and 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 their website.[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); and
- 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

39. Bruineman, M. (2016). *How Canadian Tire connects retirement to profits*. Benefits Canada. https://www.benefitscanada.com/news/how-canadian-tire-connects-retirement-to-profits/
40. Starbucks, Inc. (2016). *About bean stock*. http://starbucksbeanstock.com/en-us/welcome-en-us/about-bean-stock-en-us/
41. Stewart, N. (2015). *Benefits benchmarking* 2015. http://www.conferenceboard.ca/e-library/abstract.aspx?did=7364
42. Stewart, N. (2015). *Benefits benchmarking* 2015. http://www.conferenceboard.ca/e-library/abstract.aspx?did=7364

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, and 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.

43. Starbucks Coffee Company. (n.d.). *Culture and Values*. Starbucks. https://www.starbucks.com/careers/working-at-starbucks/culture-and-values/
44. Heathfield, S. M. (2019, October 10). *Why Employee Performance Appraisal Just Doesn't Work*. LiveAbout. https://www.liveabout.com/performance-appraisals-dont-work-1918846

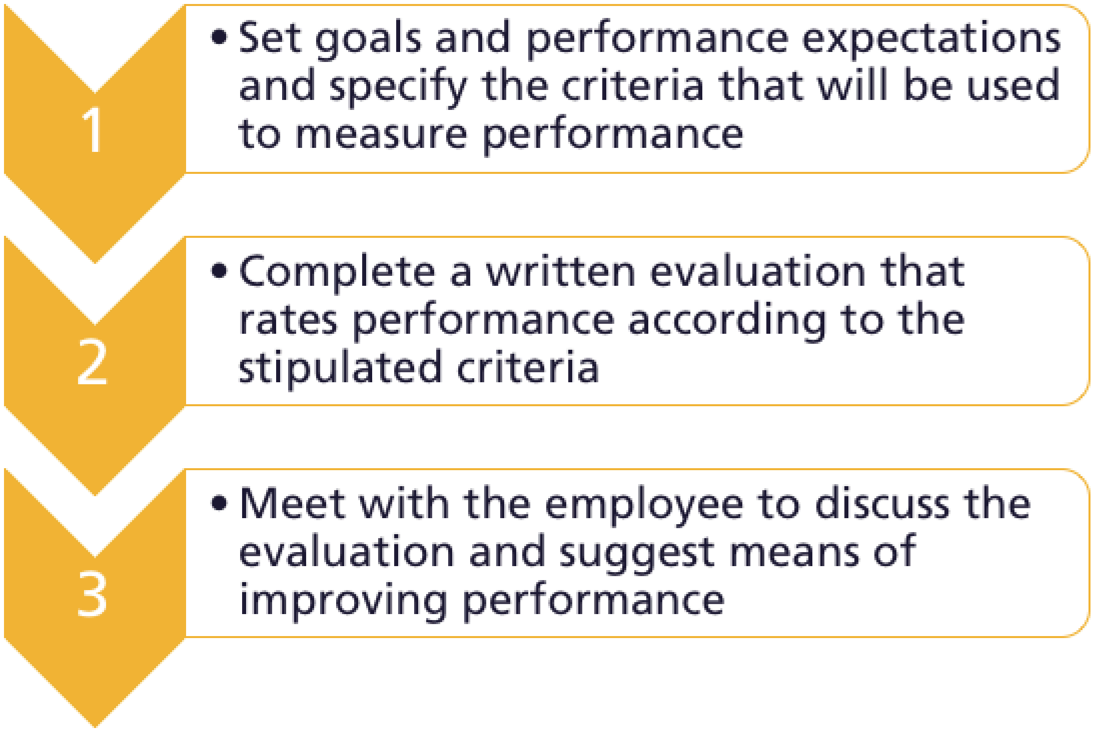

Chart 11.3 The Performance Appraisal Process

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]

45. Nelson B., & Economy, P. (2003). *Managing for Dummies (2nd ed.)*. New York, NY: Wiley. p. 140.
46. Archer North & Associates. (n.d.). *Performance Appraisal: Reward Issues*. http://www.performance-appraisal.com/rewards.htm

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 providing training and development, and 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, and registered 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, as well as an increase in job applications and Telus stock price.[49] Take a few moments and watch the RSA Shorts "Drive" video (https://www.youtube.com/

47. Dell, Inc. (2011). *2011 Corporate Responsibility Report: Listening, Inspiring, Sharing: Tell Dell*, 37. http://i.dell.com/sites/content/corporate/corp-comm/en/Documents/dell-fy11-cr-report.pdf
48. Smith, G. (2020, July 20). 5 *Tips to Attract, Keep and Motivate Your Employees*. ZenBusiness Inc. https://www.zenbusiness.com/blog/attract-workforce/
49. Lindzon, J. (2014). *How employee engagement can boost the bottom line*. The Globe and Mail. https://www.theglobeandmail.com/report-on-business/careers/career-advice/life-at-work/how-employee-engagement-can-boost-the-bottom-line/article21875491/

watch?v=u6XAPnuFjJc) from Daniel Pink, which summarizes recent research on motivation and comes to some interesting conclusions.

> *One or more interactive elements has been excluded from this version of the text. You can view them online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=100#oembed-2 (#oembed-2)*

The Employee-Friendly Workplace

What sorts 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 a very low (3 percent) turnover rate.

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 ha.ve formal programs for identifying and rewarding good performers. The U.S.-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

50. Leung, R. (2003). *Working The Good Life*. CBS News. http://www.cbsnews.com/news/working-the-good-life/
51. McGarvey, R. (2004). A *Tidal Wave of Turnover*. American Way. 32–36.
52. The Container Store (2013). *What We Stand For: Organization with Heart—My 20-Year Trip*. http://standfor.containerstore.com/my-20-year-trip-2
53. The Container Store (2016). *What We Stand For: Organization with Heart—17 Years on FORTUNE's "100 Best" List*. http://standfor.containerstore.com/17-years-on-fortunes-100-best-list

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; and
- 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, it is 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 — cutting costs by eliminating jobs. Sometimes a particular job is being phased out, and sometimes an employee has simply failed to meet performance requirements.

54. Turner, F. (2002). *An effective employee suggestion program has a multiplier effect*. MBA Depot. https://www.mbadepot.com/an-effective-employee-suggestion-program-has-a-multiplier-effect/
55. Daft, R. L. & Marcic, D. (2006). *Understanding Management* (*6th Ed.*). Florence, KY: Cengage Learning. 219.
56. Smith, G. P. (2019, December 4). *Top Ten Reasons Why People Quit Their Jobs*. ZenBusiness Inc. https://www.zenbusiness.com/blog/top-reasons-people-quit/

Employment at Will

Is it possible for you to get fired even if you are doing a good job and there is 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.

57. Muhl, C. J. (2001, January 1). *The employment-at-will doctrine: three major exceptions: Monthly Labor Review*. U.S. Bureau of Labor Statistics. https://www.bls.gov/opub/mlr/2001/article/employment-at-will-doctrine-three-major-exceptions.htm

The ‘Great Resignation’? It’s not happening in Canada

According to the Globe and Mail Nov 2, 2021, the economic recovery from COVID-19 has produced many tales of people quitting jobs or switching careers as part of a broader re-evaluation of work and what’s truly important amid a deadly pandemic.

Stories abound of workers who have simply had enough — say, the stressed-out waiter who turned a passion project into a small business, or the overworked lawyer who quit to recharge, indulge in hobbies and spend time with family. Some commentators have dubbed it the “Great Resignation,” (https://www.theglobeandmail.com/investing/personal-finance/young-money/article-gen-z-millennials-playing-a-significant-part-in-the-great-resignation/) a collective rush for the workplace exits.

But those anecdotes, while true, don’t add up to much of a trend in Canada — at least, not yet. There is little evidence to suggest that people here are resigning en masse. Instead, it appears that Canadians are exercising some caution as the economy recovers from the worst shock in generations.

https://www.theglobeandmail.com/business/article-the-great-resignation-its-not-happening-in-canada/

Unions

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 (https://www.google.com/url?q=https://en.wikipedia.org/wiki/Trade_union&sa=D&ust=1525097706654000) — an organized group of workers that bargains with employers to improve its members’ pay, job security, and working conditions.

According to statistics Canada there has been an overall decrease in the percentage of workers in Canada who are union members from 1981 to 2022. The trend is not true for women in the workforce, where the participation rate has been fairly steady over that same period. The overall decrease is due to a number of factors including the shift away from traditional manufacturing industries, mining, forestry 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.

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. 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.[58]

Figure 11.3 Ontario College Faculty picketing during a strike in October 2017.

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 Figure11.3). The purpose of picketing is informative — to tell people that a workforce is on strike or to publicize some 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.

On November 15, 2024 more than 55,000 Canada Post workers represented by the Canadian Union of Postal Workers (CUPW) went on strike according to the union. Canada Post says there will be no mail or parcel delivery during the strike and some post offices will be closed. The CUPW issued a 72-hour strike notice earlier in the week, saying it's been asking for fair wages, safer working conditions and other improvements over nearly a year of bargaining. At first, many citizen supported this right, but some of the most noticeable effects of the nationwide strike was a significant and immediate impact on millions of Canadians, small businesses and charities who count on Canada Post during the busy holiday season. Further, services to remote and Northern regions that rely on Canada Post was shut down.[59]

58. Karim, A., & Bush, D. (2017, November 10). *Striking York University Food Service Workers Win $15 and Fairness*. Socialist Project. https://socialistproject.ca/2017/03/b1381/
59. https://vancouver.citynews.ca/2024/11/14/canada-post-workers-strike-union/nter your footnote content here.

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=100#oembed-3 (#oembed-3)

Listen to The Decibel – December 4, 2024, The Globe and Mail's daily news podcast from Vanmala Subramaniam, The Globe's Future of Work reporter, on how the Canada Post strike fits with other essential services taking work action and how governments intervene in work stoppages.

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 (https://www.google.com/url?q=http://www.ufcw.ca/index.php?option%3Dcom_content%26view%3Darticle%26id%3D646%26Itemid%3D6%26lang%3Den&sa=D&ust=1525097706659000) 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.[60]

60. CNN Wire Staff. (2011, July 25). *Players, owners sign deal to end NFL lockout*. CNN. http://edition.cnn.com/2011/SPORT/07/25/nfl.deal/

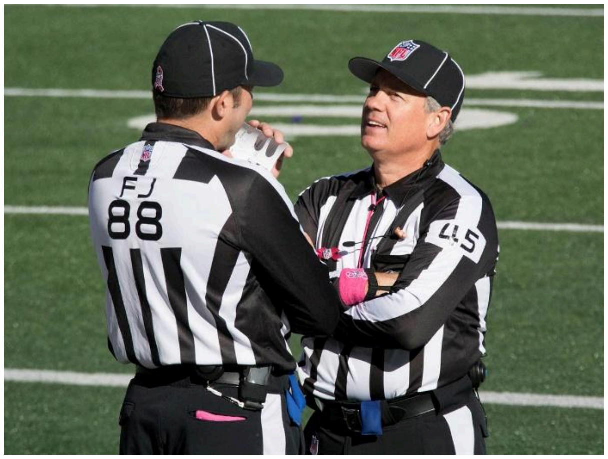

Figure 11.4 Two football referees conversing/flickr CC-BY 2.0

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.[61]

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 poorly 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 (http://www.cbc.ca/news/canada/highlights-in-canadian-labour-history*-1.850282), 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.

61. Pearson, M. (2012, October 1). *Sorry about that, NFL chief says of replacements*. CNN. https://edition.cnn.com/2012/09/27/sport/nfl-referees-deal/

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 H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=100#h5p-31 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=100#h5p-31)

The Future of Unions

Union membership in Canada and the United States has 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.[62]

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.

Comprehension Check

Use the Internet to research a company that has an excellent reward and incentive system. Identify some of this company's main financial and non-financial benefits.

62. Statistics Canada. (n.d.). *Unionization rates falling*. https://www150.statcan.gc.ca/n1/pub/11-630-x/11-630-x2015005-eng.htm

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. 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.
6. Employees are motivated to perform well when they're challenged, respected, treated fairly, and appreciated. 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.
7. 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).
8. 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.
9. In addition, employees may receive year-end bonuses, participate in profit-sharing plans, or receive stock options. Managers conduct performance appraisals to evaluate work performance.
10. 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.
11. Labour unions are organized groups of workers that bargain with employers to improve members' pay, job security, and working conditions.
12. When there's a discrepancy between what unionized 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.
13. 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).

14. 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.
15. 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); or
    - arrange for boycotting (in which workers and other consumers are urged to refrain from buying an employer's products).
16. 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).

Chapter 12 - 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; and
    - Equity theory.
4. Identify strategies for enhancing motivation; and
5. Explain **key terms** in the chapter.

Show What You Know

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(https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=94#h5p-27)

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.

(https://ecampusontario.pressbooks.pub/app/uploads/sites/168/2018/04/image5-2.png)
Chart 12.1 Extrinsic and Intrinsic Motivation.

Hierarchy of Needs Theory

Psychologist Abraham Maslow's hierarchy of needs theory (https://www.google.com/url?q=https://www.youtube.com/watch?v%3DUgp3hm2JIqM&sa=D&ust=1524676422507000) 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 (life-sustaining needs, such 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.

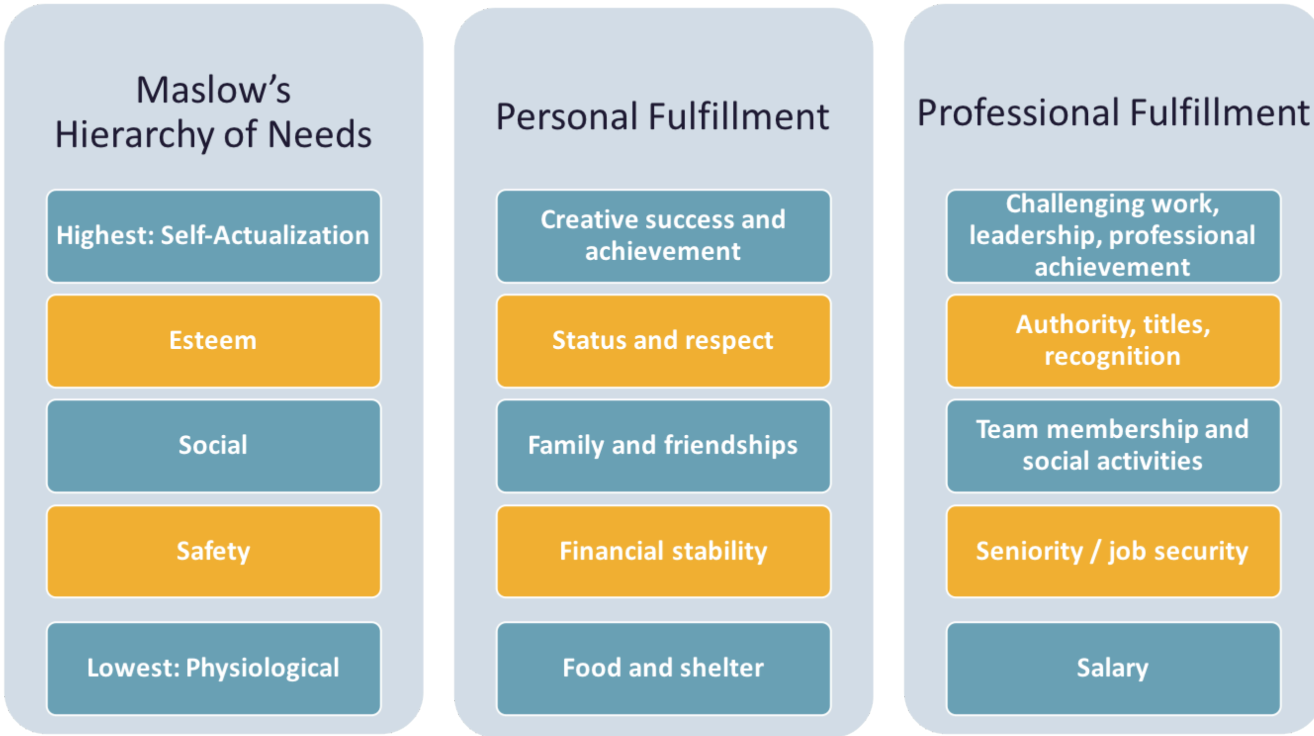

Chart 12.2 Hierarchy of Needs Theory

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.

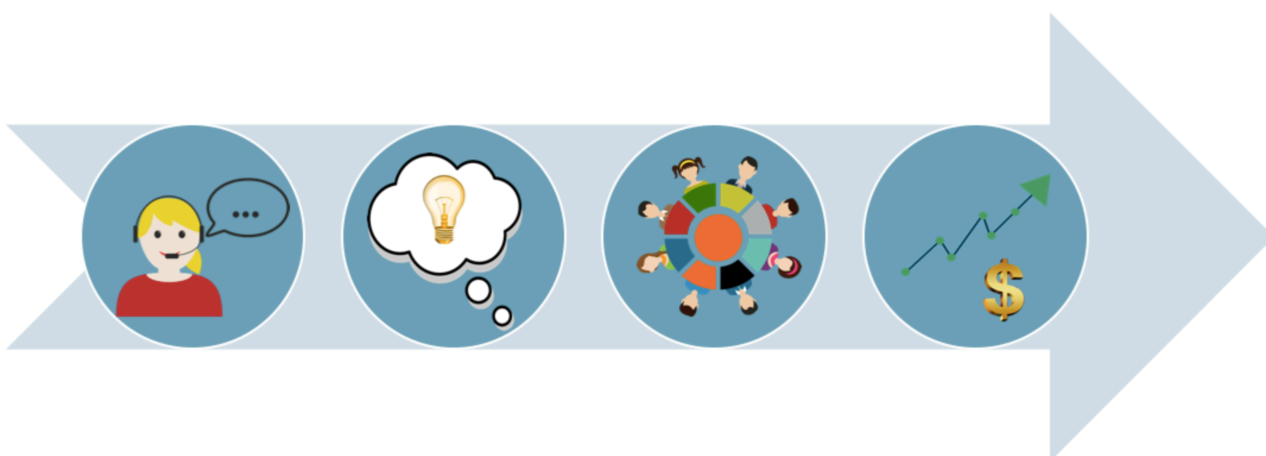

Chart 12.3 Herzberg's Two-Factor theory: Poor hygiene factors will increase job dissatisfaction, while good motivators will increase satisfaction.

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; and
3. values the reward.

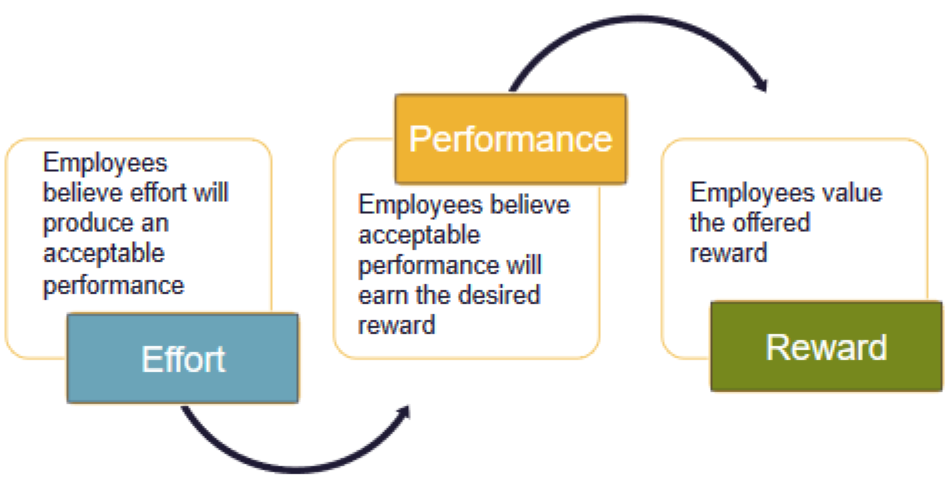

Chart 12.4 Expectancy Theory

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 (https://www.google.com/url?q=https://www.businessballs.com/improve-workplace-performance/adams-equity-theory-on-job-motivation-4045/&sa=D&ust=1524676422515000), 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); or
- oneself at another point in time.

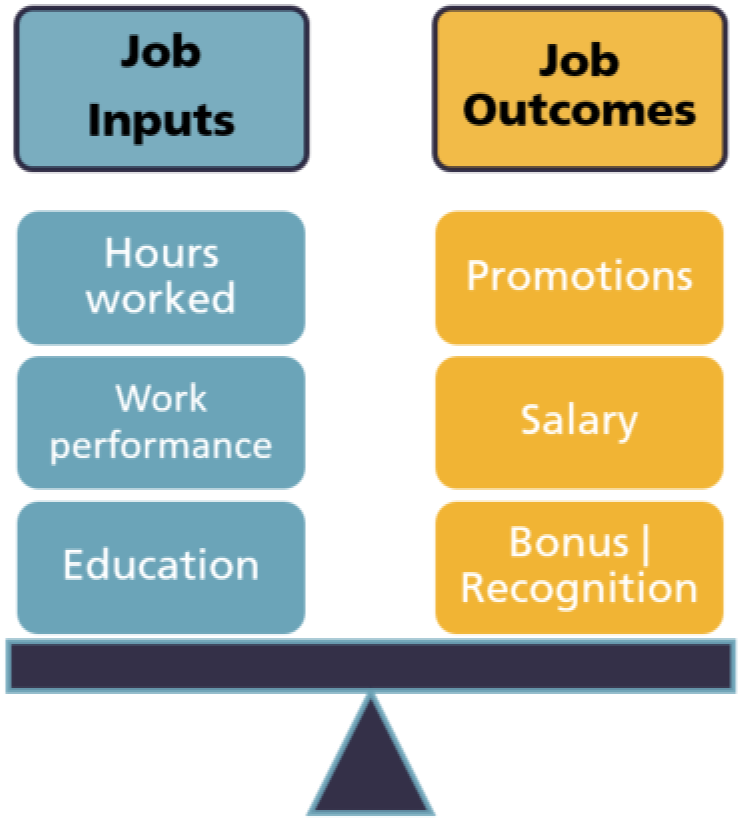

Chart 5 Equity Theory

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., decide 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.

Strategies for Enhancing Motivation

People are different and what inspires one person may not motivate another. For some it may be money, while others want rewards or recognition. Others find all the motivation they need within themselves and just get on and perform, therefore no one-size-fits-all method for motivating employees, boosting performance levels, and creating a happy, thriving work environment.   Companies have therefore used many different programs to increase motivation levels of their employees.

Below are some examples of motivation strategies utilized to help keep employees happy and focused on doing their best.

Reinforcement and Behavior Modification

Reinforcement is controlling and modifying employee behavior through the use of systematic rewards and punishments for specific behavior. Managers define specific behaviors that they want employee to exhibit (working hard, being customer service focus, stressing the importance of quality, etc.) and behaviors they want to eliminate (wasting time and resources, being disrespectful to customers, ignoring quality, etc.). Managers therefore use positive reinforcements (apply positive consequences when employees exhibits desired behaviors) or negative reinforcements (apply when when employee exhibit undesirable behaviors) to shape behavior.

Empowerment

Empowerment is a method of increasing job satisfaction by giving employees authority and responsibility in the management of their jobs and the company. This encourages employees to be self-motivated and to make suggestions for improvements. Some organizations have a flat organization structure without the usual hierarchy and empower their workers by giving them a lot of autonomy.

Setting SMART Goals

SMART Goals stands or Specific, Measurable, Achievable, Realistic or Results-Oriented and Timely. Employees perform best when they have specific goals to achieve. By breaking larger objectives down into smaller ones, employees are motivated and focused; with smaller goals, team members get to clearly see that they have made progress and that their hard work has tangible meaning. One important method of setting performance goals is Management by Objectives (MBO). This involves managers and their subordinates collaboratively setting goals and evaluating progress.

Promoting Teamwork and Collaboration

Teamwork is one of the greatest motivators. There are a variety of teams such as problem-solving teams, self-managed teams, etc. Creating an environment for teams to work collaboratively and communicate can motivate employees.

Job Enrichment and Redesign

Job enrichment is a method of increasing employees' job satisfaction by extending or adding motivating factors such as responsibility or growth. It may include combining tasks, forming quality circles (where employees are grouped into smaller teams that define, analyze, and solve quality and other problems within an area) or other work groups, or allowing employees to interact with customers or clients. Job enrichment is accomplished by job redesign to achieve a more satisfactory person-job fit, which motivates individuals who aspire to growth or achievement.

Modified Work Schedules

Modified work schedules include flextime, compressed work week, telecommuting, and workshare programs.

Flextime Work Schedule

A flextime work schedule allows people to choose their working hours. It is an alternative work schedule for employees who normally work the eight-hour, five-day workweek, usually from 8 a.m. to 5 p.m. Flextime scheduling permits employees to select a work schedule that may assist with individual needs, especially commuting and family needs. Flextime work schedules are available at many organizations in Canada and around the world; this is a method of increasing employees' job satisfaction by allowing employees some choice in the hours they work.

Compressed Work Week

A compressed work week is defined as an alternative work schedule that compresses the standard weekly hours into fewer than five standard working days over a given period. The most popular compressed workweek is four days, 10 hours per day, which is used in many companies.

Telecommuting

Telecommuting is the ability for an employee to complete work assignments from outside the traditional workplace by using telecommunications tools such as email, phone, chat, and video apps.

Workshare Programs

Workshare or job share programs are methods of increasing employee job satisfaction by allowing two people to share one job.

Comprehensive Check

1. There are many different theories of motivation. If you believe that Maslow's needs hierarchy best explains motivation in the workplace, how will you motivate your employees to work harder?
2. Assuming that you have a new business venture employing 5 people, how would you use the Herzberg's two-factor theory to support your new business venture?
3. How is the job enrichment/job redesign approach to motivation different from the modified work schedules approach to motivation? Are there similarities between the two approaches?

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.
3. Employees use many different strategies to improve job satisfaction and employee motivation.

Chapter 13 - 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; and
9. explain **key terms** in the chapter.

Show What You Know

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The Challenge: Producing Quality Jetboards

Figure 13.1 The Powerski jetboard in action! Source: PowerSki.com

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.

1. Time. (2001, November 19). *Best Inventions of 2001.* https://content.time.com/time/specials/packages/article/0,28804,1936165_1936240_1936351,00.html
2. Hydroforce Group LLC (2012). *Powerski Jetboards.* http://www.powerski.com/content/psi_index

- 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 would 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 set of 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.

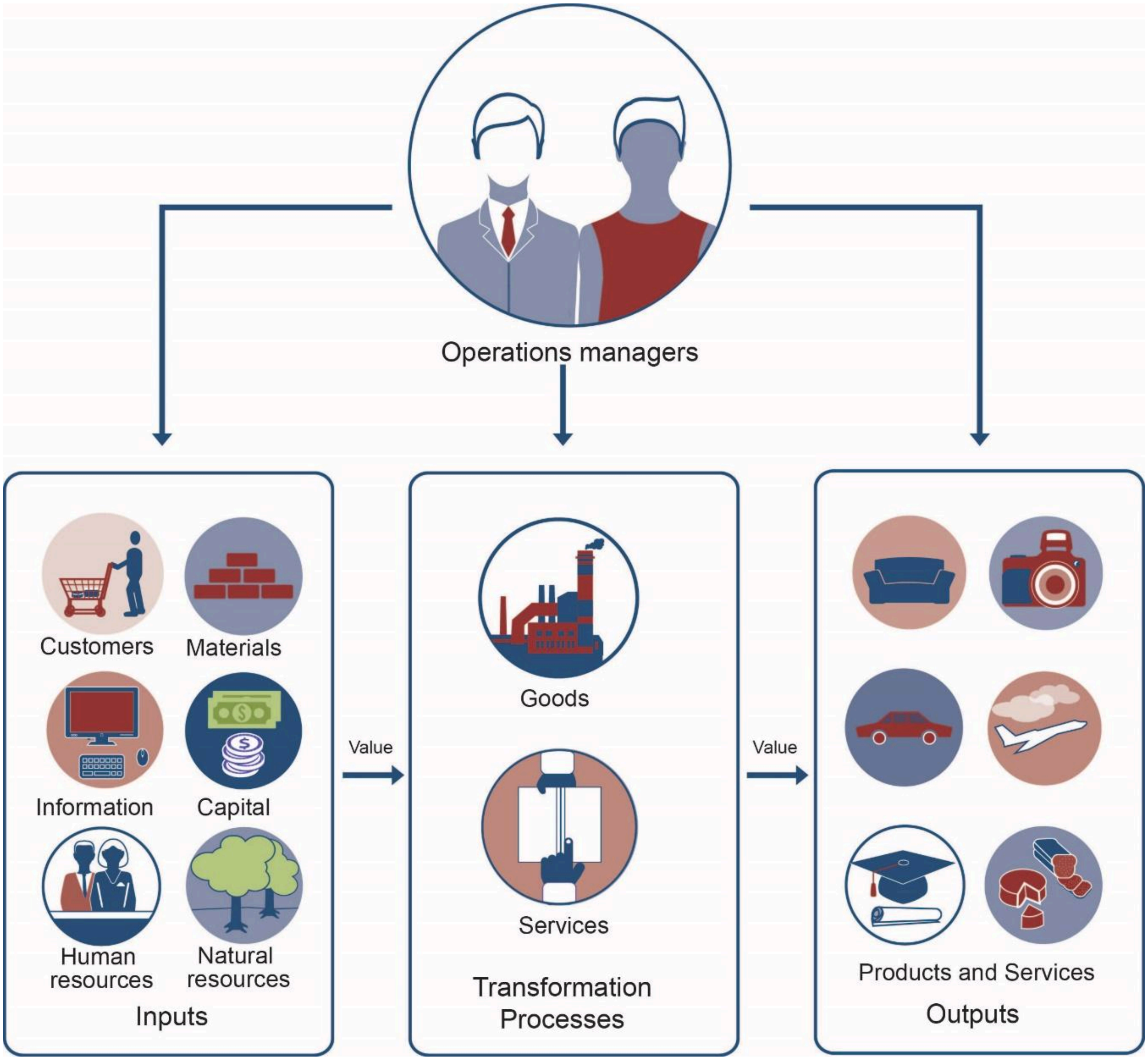

Chart 13.1 Transformation Process

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, hold down the costs of materials and labour, and 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 the ways in which 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 the costs of operational activities represent a proportion of the final sale price of the good or service.

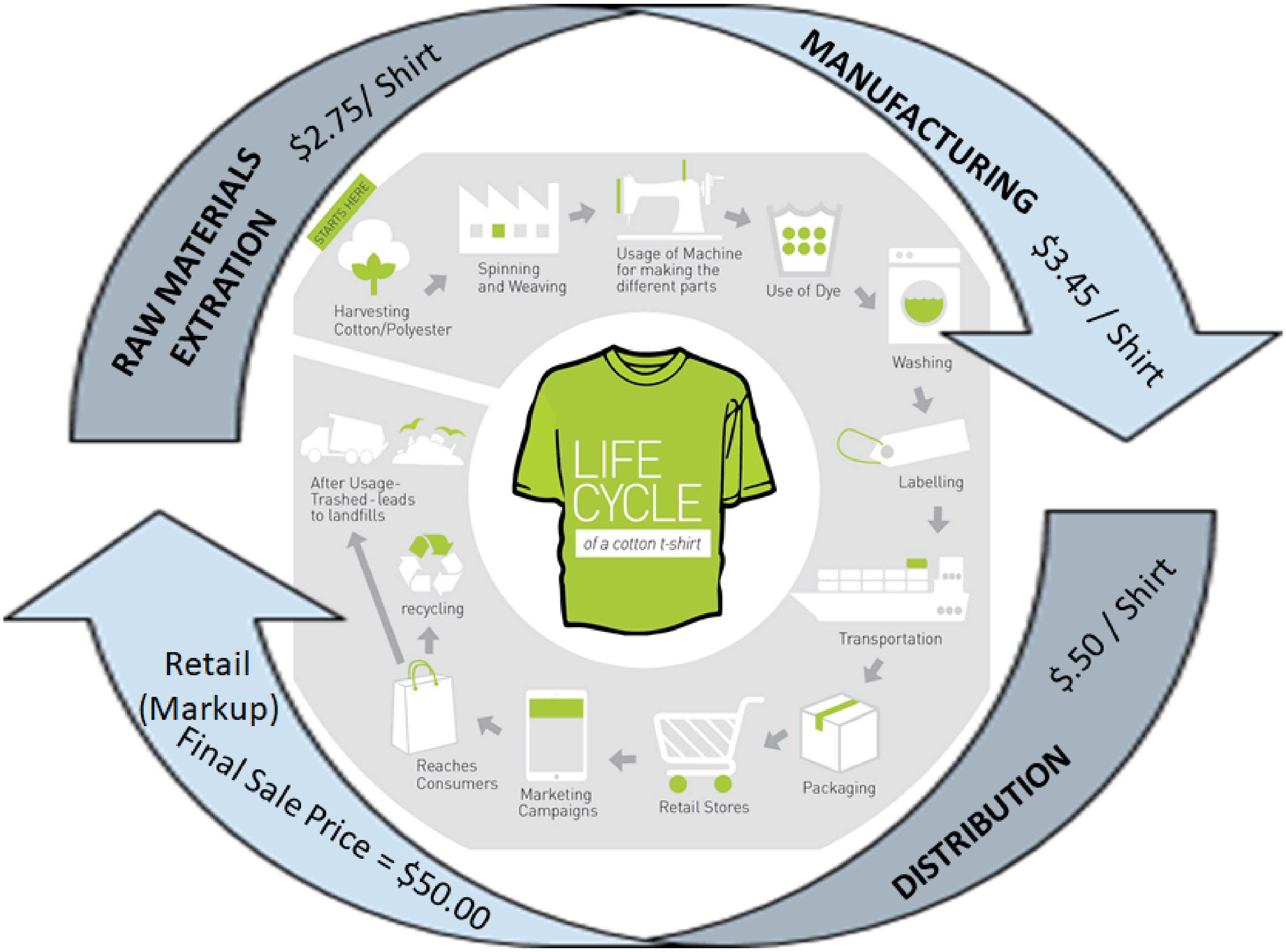

Chart 13.2 Lifecycle of a cotton shirt.

Another job of operations managers is making the decisions involved in the effort to attain this level of operational organization and achieve 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.

Figure 13.2 Personalized M&Ms: 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 BCcampus in British Columbia is harnessing this efficiency. You can order a low cost, high-quality print version of our textbooks thanks to our partnership with the Simon Fraser University 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.

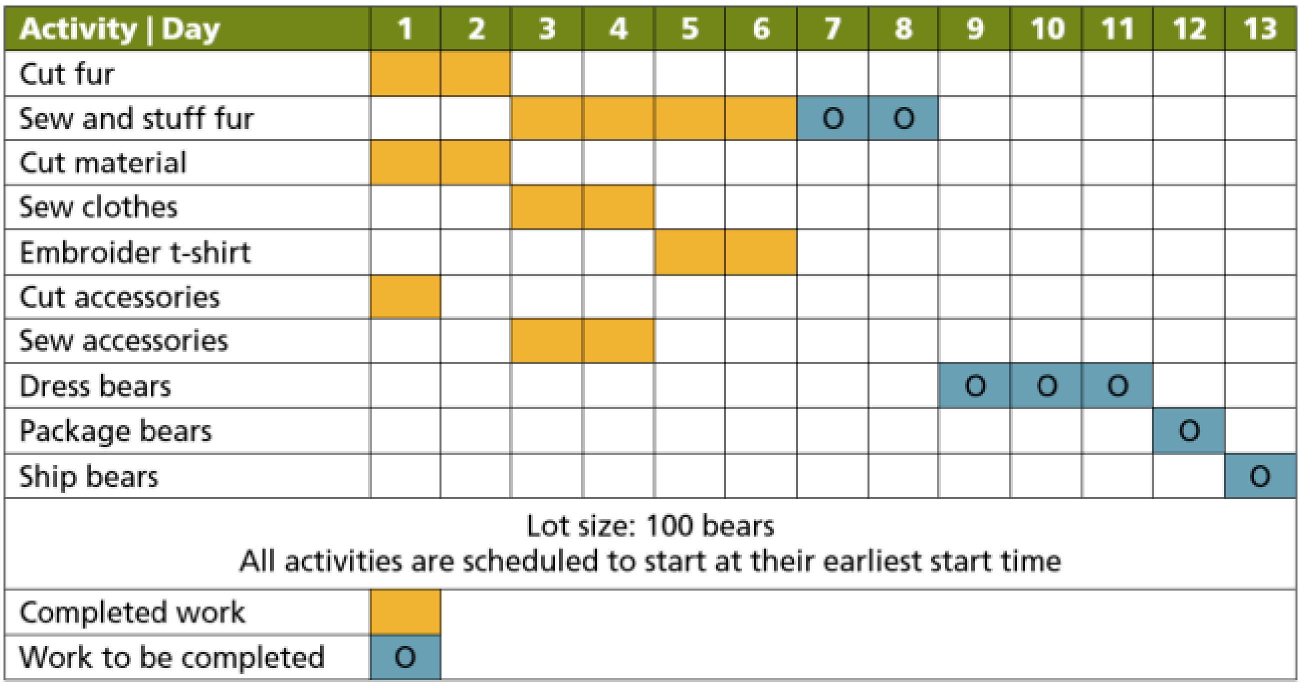

Chart 13.3 Gantt chart for producing Toronto teddy bears.

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.

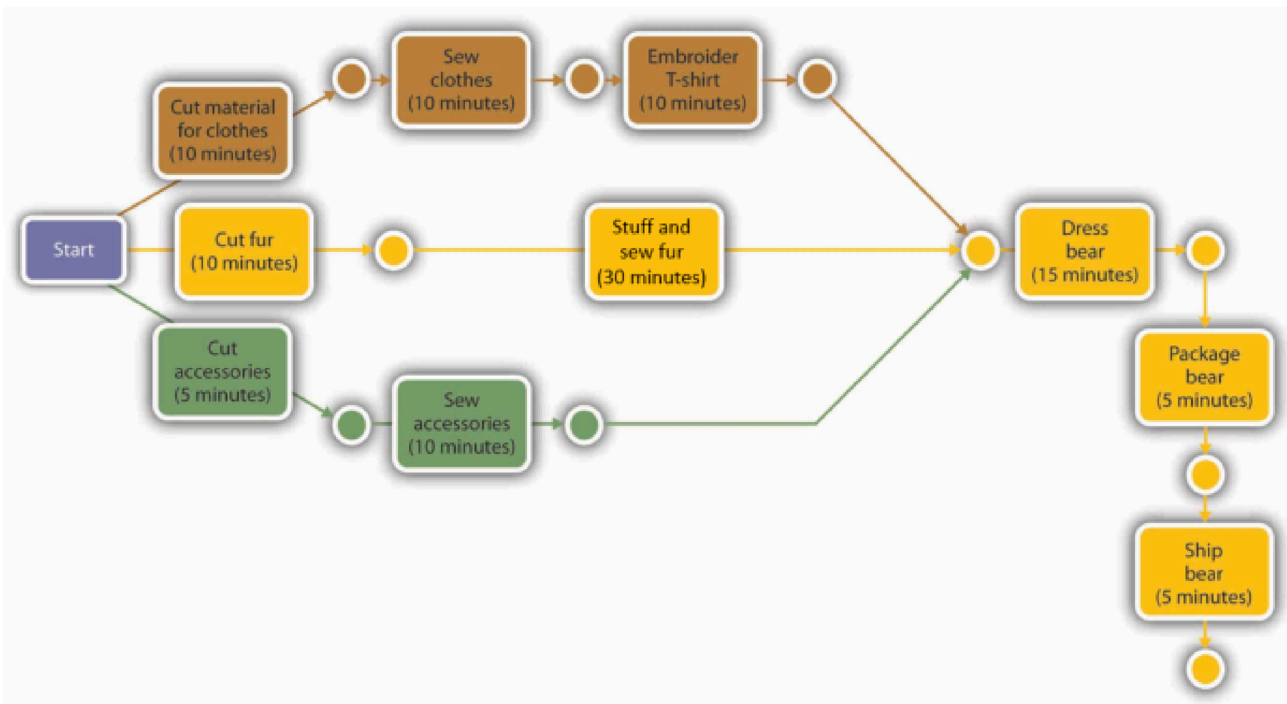

Chart 13.4 PERT chart for Toronto teddy bears

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 robot — 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,

3. Janzen, N. (2017). *The Decline in Manufacturing's Share of Total Canadian Output – A Source of*

which accounts for approximately 80 percent of Canadian jobs.[4] In 2013, Walmart 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 Oshawa in Ontario 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.

(https://commons.wikimedia.org/wiki/File:Burger_King_in_London.jpg)

Figure 13.3 Exterior of Burger King restaurant. Source Wikimedia

Today, there are BK company-owned 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

Concern? RBC Economics. http://www.rbc.com/economics/economic-reports/pdf/other-reports/Manufacturing%20Trends-Feb2017.pdf

4. Statistics Canada. *Table 14-10-0023-01 Labour force characteristics by industry, annual* (x 1,000). https://doi.org/10.25318/1410002301-eng
5. Hess, A. E. M. (2013, August 22). *The 10 largest employers in America*. USA Today. https://eu.usatoday.com/story/money/business/2013/08/22/ten-largest-employers/2680249/
6. Restaurant Brands International Limited Partnership (2016). *2015 SEC Form 10-K Annual Report*. https://s26.q4cdn.com/317237604/files/doc_financials/2016/ar/Restaurant-Brands-International-Limited-Partnership-2015-SEC-Form-10-K-An.pdf
7. Burger King. (n.d.). *About Us*. https://www.bk.com/about-bk

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

8. Information on Burger King was obtained from an interview with David Sell, former vice president of Central, Eastern, and Northern Europe divisions and president of Burger King France and Germany.
9. NPD (2012). *Drive-Thru Windows Still Put the Fast in Fast Food Restaurants*. Reports NPD. https://planning.lacity.org/eir/8150Sunset/References/4.E.%20Greenhouse%20Gas%20Emissions/GHG.41_NPD%20Fast%20Food.pdf

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. For example, it must 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 balance scorecard. The balance scorecard model utilizes 360 degree feedback, a process of collecting feedback from all of a business’s stakeholders, in order to improve operational efficiency.

In his book entitled *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 resolving a maintenance problem 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's 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" (https://www.google.com/url?q=https://www.youtube.com/watch?v%3D2v0RhvZ3lvY&sa=D&ust=1524627998000000).

The video "Every life has a story" shows different segments of our population and their stories. It shows that employees as well as customers are people with their own life stories, and that it is important for us all to be kind, respectful and compassionate.

> *One or more interactive elements has been excluded from this version of the text. You can view them online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=88#oembed-1 (#oembed-1)*

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

10. Carlzon, J. (1987). *Moments of Truth*. Cambridge, MA: Ballinger Publishing Company.
11. The Ritz-Carlton. (n.d.). *Gold Standards*. https://www.ritzcarlton.com/en/about/gold-standards
12. Kelso, A. (2020, July 11). *Business lessons from the late founder of Chick-fil-A*. QSRweb. https://www.qsrweb.com/articles/business-lessons-from-the-late-founder-of-chick-fil-a/
13. Sheridan, M. (2021, February 5). *8 Reasons Why Chick-fil-A has the Best Business Model in America*. Impact. https://www.impactplus.com/blog/reasons-chick-fil-best-business-model

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; and
3. continuous improvement.

Let's take a closer look at these three principles.

1. Customer Satisfaction

Companies that are committed to TQM understand that the purpose of a business is to generate a profit through

14. American Society for Quality. (n.d.). *Six Sigma Forum – Community Home*. myASQ. https://my.asq.org/communities/home/35/

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 even have 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.

15. Powerski (2005). *About Powerski International*. http://www.powerski.com/aboutpsi.htm
16. RGIS. (n.d.). *Retail*. https://www.rgis.com/retail

Comprehensive Check

1. Describe the role of an operations manager in a manufacturing company and provide three key tasks for which they are responsible.
2. Describe the decisions and activities of the operations manager in the production process.
3. What is the meaning of the term production (or operations)?
4. What are the characteristics that distinguish service operations from goods production, and what are the main differences in the service focus?
5. Explain the connection between productivity and quality.
6. Explain the concept of total quality management and describe some tools that companies can use to achieve it.
7. Explain how technology has improved cost-efficiency in the production process. Use an example to demonstrate your understanding.
8. Detail how a service operation differs from a manufacturing operation.

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; and
    - 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 favorable community for workers and their families, offer resources at low cost, and have a favorable 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.
   Gantt and PERT charts are two common tools used by operations managers.
6. A Gantt chart helps operations managers determine the status of projects.
7. 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 labor, located domestically or abroad.

Chapter 14 - Marketing Processes and Consumer Behaviour

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; and
9. explain **key terms** in the chapter.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here:
https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#h5p-32
(https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#h5p-32)

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.

Figure 14.1 M. Tilden and his creation, Robosapien. Source Wikipedia

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]

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 do not 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]

1. WowWee Toys (n.d.) *Robosapien: A Fusion of Technology and Personality*. http://wowwee.com/robosapien-x
2. Taylor, M. (2004). *Innovative toy packs a punch*. South China Morning Post. http://www.scmp.com/article/478240/innovative-toy-packs-punch
3. WowWee Toys (n.d.). *Our Story*. http://wowwee.com/about/company-history
4. American Marketing Association (2013). *Definitions of Marketing*. https://www.ama.org/AboutAMA/Pages/Definition-of-Marketing.aspx

In other words, marketing is not 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; and
- managing relationships with customers after it has been delivered.

Think about a typical business — a local movie theater, for example. It is 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.

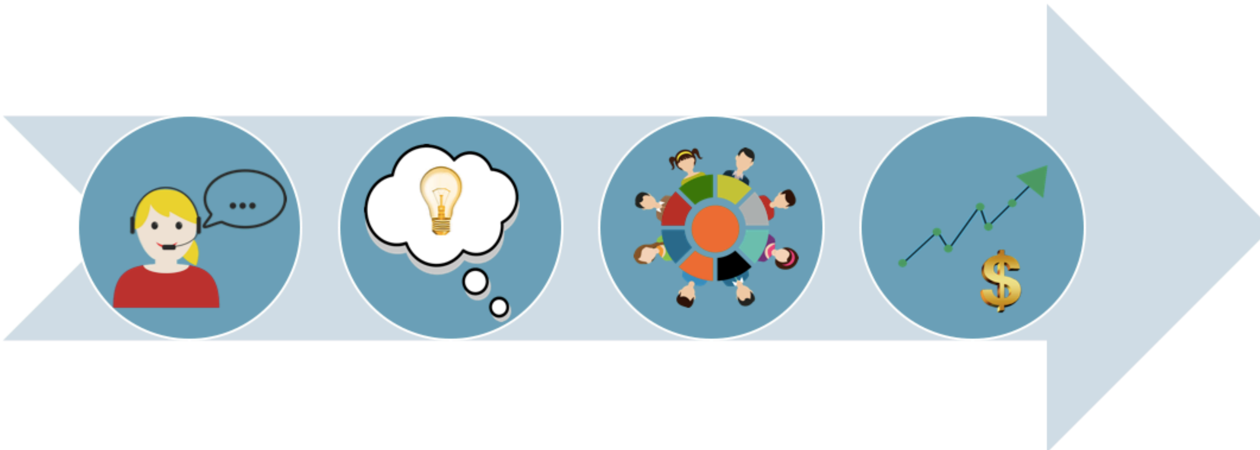

Chart 14.1 The Marketing Concept Leads to Company Profit. Source: The Noun project.

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 (https://www.google.com/url?q=http://www.medtronic.com/ca-en/index.html&sa=D&ust=1525113928342000), 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]

Putting the customer first is a strategy which involves relationship marketing, which entails forging long-term relationships with customers, and can lead to repeat sales, reduced costs, and stable relationships.

Selecting a Target Market

Businesses earn profits by selling goods or providing services. It would be nice if everybody in the marketplace was

5. Funding Universe (n.d.). *Medtronic Inc. History*. http://www.fundinguniverse.com/company-histories/medtronic-inc-history/
6. Arndt, M. (2004). *High Tech — and Handcrafted*. Bloomberg. http://www.bloomberg.com/news/articles/2004-07-04/high-tech-and-handcrafted

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; and
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 us look at some of the most useful categories in **market segmentation** in detail.

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#h5p-34 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#h5p-34)

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, 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 4Ps 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; and
4. **promoting** the product — informing potential buyers about it.

Chart 14.2 The Marketing Mix

In recent years, with the explosive use of technology, it is recommended that the 7Ps of the marketing mix should be considered when reviewing competitive strategies. The 7Ps helps companies to review and define key issues that affect the marketing of its products and services and is often referred to as the 7Ps framework for the digital marketing mix. The 7Ps is made up of the original 4Ps plus: People, Process and Physical Evidence.

Developing a Product

The development of Robosapien was a bit unusual for a company that was already active in its market.[7] 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 (https://www.google.com/url?q=https://www.statcan.gc.ca/&sa=D&ust=1525113928353000), for example, posts

7. Information in this section was obtained through an interview with the director of marketing at Wow Wee Toys Ltd. conducted on July 15, 2004.

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 whom 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 year's supply of the chips, as well as the limited availability of a dozen 'ketchup roses' during Valentine's season.[8]

(https://flic.kr/p/jr4V2K)
Figure 14.2 "Limited Time Only" Ketchup Doritos (Canada) | the impulsivebuy | flickr CC-BY 2.0 license

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 (https://www.google.com/url?q=http://www.ic.gc.ca/eic/site/cipointernet-internetopic.nsf/eng/h_wr00002.html&sa=D&ust=1525113928356000). 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

8. Horn, J. (2017, January 12). *Marketers of the Year: Christine Kalvenes snacks on a new market*. Strategy. https://strategyonline.ca/2017/01/10/marketers-of-the-year-christine-kalvenes-snacks-on-a-new-market/

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.

(https://flic.kr/p/bBRLcy)

Figure 14.3 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.[9]

9. Marriott. (2022, November 15). *Autograph Collection Hotels | Premium Marriott Hotels*. Autograph Hotels. https://autograph-hotels.marriott.com/

Table 14.1 Major Hotel Chains and Their Hotels

Type of Hotel	Marriott	Hilton	Hyatt
Luxury	Ritz Carltonm JW Marriott	Waldorf Astoria, Conrad	Park Hyatt, Andaz
Independent	Autograph Collection	Curio Collection	Unbound Collection
Full service	Marriot, Renaissance, Gaylord	Hilton, Canopy, Doubletree	Hyatt
Select service	Courtyard by Marriott, AC Hotels	Hilton Garden Inn, Hampton Inn	Hyatt Place
Extended stay	Residence Inn	Homewood Suites	Hyatt House

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., that 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 (https://www.google.com/url?q=http://interbrand.com/best-brands/best-global-brands/2017/ranking/%23?listFormat%3Dls&sa=D&ust=1525113928360000)Best Global Brands (https://www.google.com/url?q=http://interbrand.com/best-brands/best-global-brands/2017/ranking/%23?listFormat%3Dls&sa=D&ust=1525113928360000) 2017 ranking (https://www.google.com/url?q=http://interbrand.com/best-brands/best-global-brands/2017/ranking/%23?listFormat%3Dls&sa=D&ust=1525113928361000) 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.[10]

10. Interbrand. (n.d.). *Best Global Brands* | 2017. Ranking the Brands. https://www.rankingthebrands.com/The-Brand-Rankings.aspx?rankingID=37

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.

Figure 14.4 Robosapian in its package. No known copyright restrictions

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 are 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. Distribution channels are a series of marketing entities through which goods and services pass on their way from producers to end users.

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.

Table 14.2 Types of Retailers

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	offers a range of merchandise organized into departments, but generally seen as lower quality and at a much lower price	Walmart, Dollarama
Specialty Store	offers goods typically confined to a narrow category, with a 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 is 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 are both hotel chains that have been quite successful in the hospitality industry, but they project very different images to appeal to different clientele bases. The differences are evident in their promotions. The Ritz-Carlton website (https://www.google.com/url?q=http://www.ritzcarlton.com/&sa=D&ust=1525113928378000) describes itself as the "gold standard" and promises that the chain provides “the finest personal service and facilities throughout the world”.[11] Motel 6, by contrast, characterizes its facilities as “no frills ” and assures you that you will pay “the lowest price”.[12]

Promotional Tools

We will now examine each of the elements that can go into the promotion mix — advertising, personal selling, sales promotion, and publicity. Then we will see how Wow Wee incorporated them into a promotional 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).[13] 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[14] 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.’[15] Advertising is still the most prevalent form of promotion.

11. The Ritz-Carlton. (n.d.). *Gold Standards*. https://www.ritzcarlton.com/en/about/gold-standards
12. G6 Hospitality (2015). *About Us*. Motel 6. https://www.motel6.com/en/faq.html
13. Johnson, C. (2007, February 1). *Cutting Through Advertising Clutter*. CBS News. https://www.cbsnews.com/news/cutting-through-advertising-clutter/
14. Story, L. (2007, January 15). *Anywhere the Eye Can See, It’s Likely to See an Ad*. The New York Times. https://www.nytimes.com/2007/01/15/business/media/15everywhere.html?pagewanted=all
15. Sullivan, E. (2022, May 24). *Everything You Need To Know About Social Media Product Feeds*. Tinuiti. https://tinuiti.com/blog/paid-social/everything-you-need-to-know-about-social-media-product-feeds/

(https://flic.kr/p/98RsdY)
Figure 14.5 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.

In current times marketers are using extended reality to make consumer experiences much more accessible to a wider audience. **Extended reality** (XR) is an umbrella term referring to all real and virtual combined environments and interactions generated by computer technology. It includes augmented reality (AR) and virtual reality (VR). Augmented reality is an interactive 3D experience that combines a view of the real world with computer-generated elements, usually overlaid on top of the real world view. Since audiences want dynamic, engaging experiences, marketers need to move beyond static text-based messages and provide more immersive experiences.

In contrast to virtual reality (VR) experiences, AR experiences can offer an immersive experience with little additional hardware required — often just a mobile device. This makes these experiences much more accessible to a wider audience. These immersive experiences all require significant upfront investments in time and money. Here is an example of a 360 VR marketing video of Amsterdam (https://youtu.be/FzrkpXlRP1M?si=UsV4SDNr4Ub8cVhQ&t=6).

Personal Selling


Figure 14.6 Personal selling at Best Buy

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.[16] 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.[17]

16. Clancy, K. J. (2001). *Sleuthing, Not Slashing, for Growth*. Across the Board, 38(5). 9.
17. Howland, D. (2016, May 25). *Best Buy CEO: Customer service key to battling Amazon*. Retail Dive. https://www.retaildive.com/news/best-buy-ceo-customer-service-key-to-battling-amazon/419812/

Sales Promotion

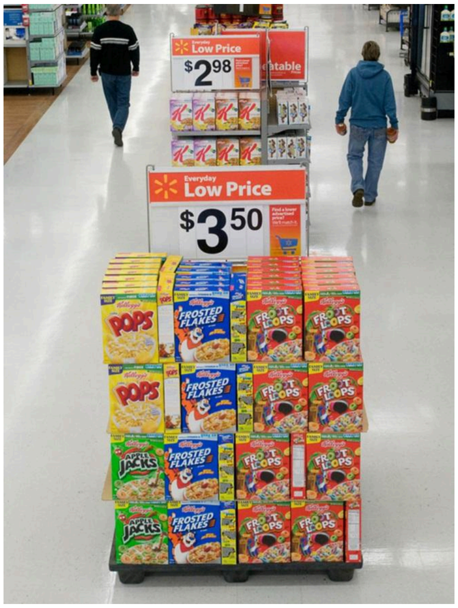

Figure 14.7 Sales promotion at Walmart

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 (https://en.wikipedia.org/wiki/Loss_leader)

Publicity and Public Relations

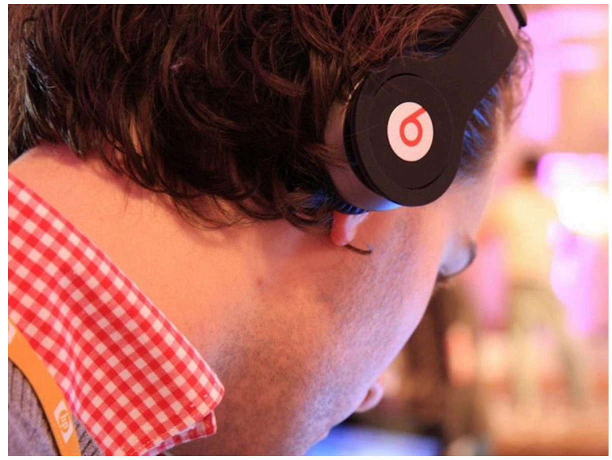
Figure 14.8 Beats headphones by Dr. Dre

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".[18] It wasn't long before the pricey headphones became a must-have fashion accessory for everyone from celebrities to high school students.

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 publishes annually as Fortune magazine's "World's Most Admired Companies®".[19] Topping the list in 2016 are Apple, Alphabet (Google), Amazon, Berkshire Hathaway, and Starbucks.[20]

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

18. Helm, B. (2014). *How Dr. Dre's Headphones Company Became a Billion-Dollar Business*. Inc. https://www.inc.com/audacious-companies/burt-helm/beats.html
19. Korn Ferry. (2022, February 2). *FORTUNE World's Most Admired Companies* 2022. https://www.kornferry.com/insights/this-week-in-leadership/fortune-worlds-most-admired-companies-2022
20. Korn Ferry. (2018). *World's Most Admired Companies* 2018. https://www.kornferry.com/institute/fortune-worlds-most-admired-companies-2018

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 Robosapiens. 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 H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#h5p-33 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#h5p-33)

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#h5p-35 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#h5p-35)

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 sell to an existing one.[21] 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.[22]

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.[23]

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.

Digital Marketing

Digital marketing is the use of the internet and other digital communication to promote brands and connect with potential customers and it includes social media marketing, email marketing, web-based advertising, text and multimedia messages, search engine marketing (SEM) and content marketing.

In the last several years, the popularity of social media marketing has exploded. You already know what social media is: Facebook, X, Instagram LinkedIn, YouTube, TikTok 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.

21. Lawrence, A. (2012). Five Customer Retention Tips for Entrepreneurs. Forbes. http://www.forbes.com/sites/alexlawrence/2012/11/01/five-customer-retention-tips-for-entrepreneurs/#56de8ec717b0
22. Fitch, S. (2004). *Stacking the Deck*. Forbes. http://www.forbes.com/forbes/2004/0705/132.html
23. Hotel News Resource (2004). *Sheraton Hotels Lure Travelers with the Promise of a Good Night's Sleep in New $12 Million Television and Print Ad Campaign*. http://www.hotelnewsresource.com/article10706.html

Why do businesses use digital 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 the Tim Hortons market?

For companies like Tim Hortons, 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 Hortons 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:[24]

- 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".[25] The ALS Association raised $115 million in six weeks (their usual annual budget was only $20 million).[26] 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:

One or more interactive elements has been excluded from this version of the text. You can view them online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=118#oembed-1 (#oembed-1)

24. Godin, S. (1999). *Permission Marketing: Turning Strangers into Friends, and Friends into Customers.* New York: NY. Simon & Schuster. 40-52.
25. ALS Association. (n.d.). *ALS Ice Bucket Challenge Commitments.* https://www.als.org/IBC
26. ALS Association. (n.d.). *ALS Ice Bucket Challenge Commitments.* https://www.als.org/IBC

Mountain Dew (PepsiCo)

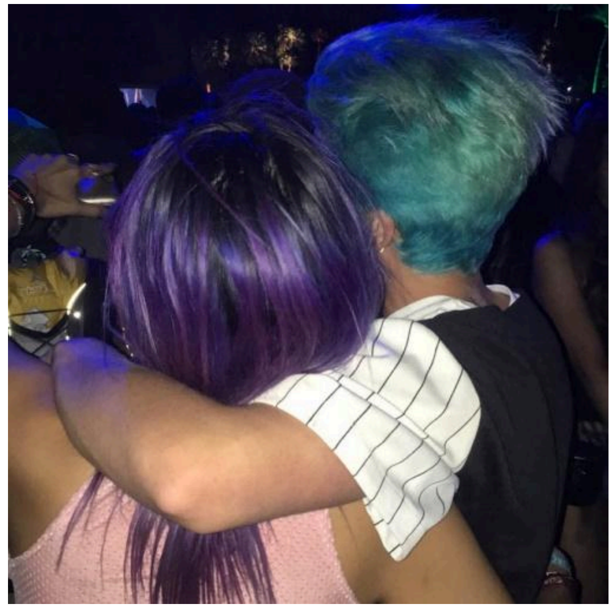

Figure 14.9 Dye Dews. Mountain Dew wiki

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.[27] 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.[28] 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 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.'"[29]

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.[30]

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

27. Betancourt, L. (2010, January 28). Social Media Marketing: How Pepsi Got It Right. Mashable. http://mashable.com/2010/01/28/social-media-marketing-pepsi/#PH_2T_7ZKEq7
28. Mountain Dew Wiki. (n.d.). *DEWcision 2016*. https://mountaindew.fandom.com/wiki/DEWcision_2016
29. Betancourt, L. (2010, January 28). Social Media Marketing: How Pepsi Got It Right. Mashable. http://mashable.com/2010/01/28/social-media-marketing-pepsi/#PH_2T_7ZKEq7
30. Sniderman, Z. (2010, September 14). 5 *Winning Social Media Campaigns to Learn From*. Mashable. http://mashable.com/2010/09/14/social-media-campaigns/#R7bMibHpKaq7

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 ins" 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 the Starbucks nationwide mayor rewards program because it brought attention to the marketing possibilities of the location-sharing app.[31]

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.[32] 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.[33] Keeping with Twitter's 140 characters per tweet rule, the Starbucks 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.[34]

Free Pastry Day (Promoted through Twitter and Facebook)

Starbucks's "free pastry day" was promoted on Facebook and Twitter.[35] 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 stores around the country in search of free food.[36]

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".[37] This is not surprising given that Starbucks is the most popular brand on Facebook and has over 36 million "likes" in 2016.[38]

31. Grove, J. V. (2010, May 17). *Mayors of Starbucks Now Get Discounts Nationwide with Foursquare*. Mashable. http://mashable.com/2010/05/17/starbucks-foursquare-mayor-specials/#1E9sN9cxPiqk
32. Grove, J. V. (2010, April 15). *Celebrate Tax Day with Free Stuff*. Mashable. http://mashable.com/2010/04/15/tax-day-2010-freebies/#bkRuURIJKmq2
33. Efrati, A. (2011, July 28). *How Twitter's Ads Work*. WSJ. https://www.wsj.com/articles/BL-DGB-22873
34. Dilworth, D. (2010, April 20). *Twitter kicks off Promoted Tweets*. DMNews. https://www.dmnews.com/twitter-kicks-off-promoted-tweets/
35. Bustillos, P. (2009, July 21). *Starbucks Free Pastry Day*. Facebook. https://www.facebook.com/patsy.bustillos/posts/103702604431
36. Grove, J. V. (2010, June 8). Starbucks Used Social Media to Get One Million to Stores in One Day. Mashable. http://mashable.com/2010/06/08/starbucks-mashable-summit/#bkRuURIJKmq2
37. Ostrow, A. (2009, July 21). *Starbucks Free Pastry Day: A Social Media Triple Shot*. Mashable. http://mashable.com/2009/07/21/starbucks-free-pastry-day/#DytKqtxcPqqp
38. Starbucks (2016). *Starbucks*. Facebook. https://www.facebook.com/Starbucks/

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".[39]

Digital Marketing Challenges

The main challenge of digital marketing and in articular 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.[40] Even large companies can find the management of media marketing initiates challenging. 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.[41] This is not surprising given that in 2017, Facebook had more than 2.1 billion active users[42] and five hundred million tweets are sent each day.[43] 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".[44] 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: it is clear 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".[45]

39. Walsh, M. (2010, July 14). *Starbucks Tops 10 Million Facebook Fans*. Media Post. http://www.mediapost.com/publications/article/132008/
40. Ward, S. (2020, September 21). *What is Social Media Marketing*. LiveAbout. http://sbinfocanada.about.com/od/socialmedia/g/socmedmarketing.htm
41. Prodhan, G. (2011). *Marketers struggle to harness social media – survey*. Reuters. http://www.reuters.com/article/socialmedia-ibm-idUSL5E7LA3JO20111011
42. Statista (2016). *Number of monthly active Facebook users worldwide*. http://www.statista.com/statistics/264810/number-of-monthly-active-facebook-users-worldwide/
43. Internet Live Stats (2016). *Twitter Usage Statistics*. http://www.internetlivestats.com/twitter-statistics/
44. Prodhan, G. (2011). *Marketers struggle to harness social media – survey*. Reuters. http://www.reuters.com/article/socialmedia-ibm-idUSL5E7LA3JO20111011
45. Ronnestam, J. (n.d.). *Simon Pestridge from Nike makes future advertising sound simple*. Ronnestam. http://www.ronnestam.com/simon-pestridge-from-nike-make-future-advertising-sound-simple/

A New Marketing Model

The 4Ps 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.[46] The authors advocate replacing the 4Ps with SAVE as companies define their offerings. The essence of the SAVE framework is as follows:

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46. Ettenson, R., Conrado, E., & Knowles, J. (2013). Rethinking the 4 P's. *Harvard business review*, 91(1), 26-27.

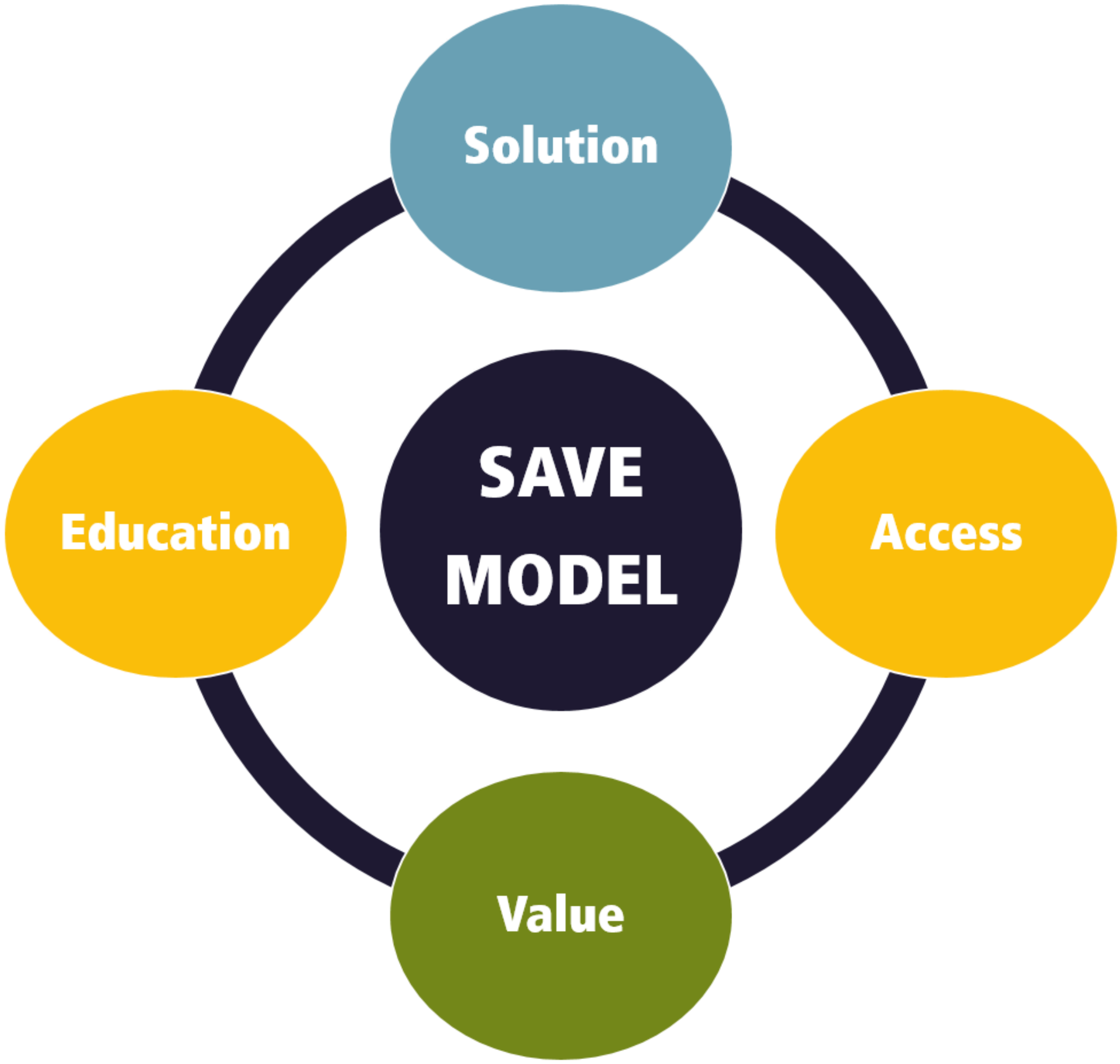

Chart 14.3 SAVE model. S.A.V.E framework brings customer needs to the forefront, fostering deeper, trust-based relationships essential in B2B.

The SAVE framework appears to be gaining traction, and it may eventually replace Marketing's 4Ps altogether.

Comprehensive Check

1. What is meant by the marketing mix?
2. What are the components of the marketing mix?
3. How can marketing techniques help not-for-profit organizations?

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.

Chapter 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; and
10. explain **key terms** in the chapter.

Show What You Know

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Most Valuable Player

Figure 15.1 Apple Headquarters in Cupertino, California. (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

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, 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 of how the valuation process works.

1. Yahoo Finance (2018). *Apple Inc.* (AAPL). https://finance.yahoo.com/quote/AAPL/
2. Yahoo Finance (2018, April 30). *Alphabet Inc.* (GOOG). https://finance.yahoo.com/quote/GOOG/

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 should not 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 are 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.

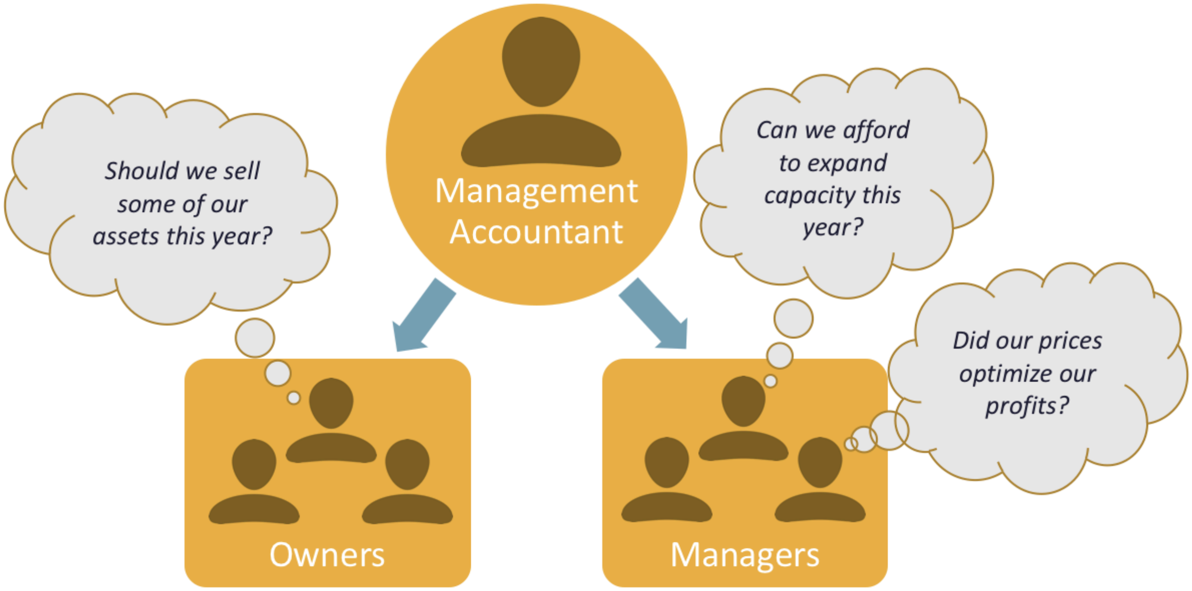

Chart 15.1 Role of Managerial Accounting. (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

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 are 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 (https://www.google.com/url?q=http://www.rbi.com/Annual-Reports&sa=D&ust=1525192811214000)

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 much more 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.

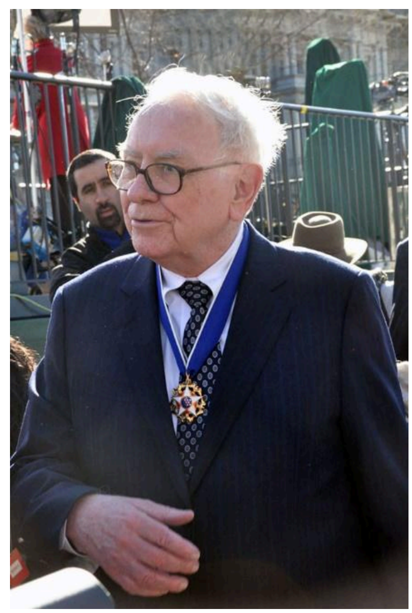

Figure 15.2 Warren Buffet, Presidential Medal of Freedom recipient in 2011. Pixabay

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

3. Forbes (2016). *Warren Buffett*. http://www.forbes.com/profile/warren-buffett/

the truth with respect to their financial positions. Companies must also provide financial information to the Canadian Revenue Agency (CRA).

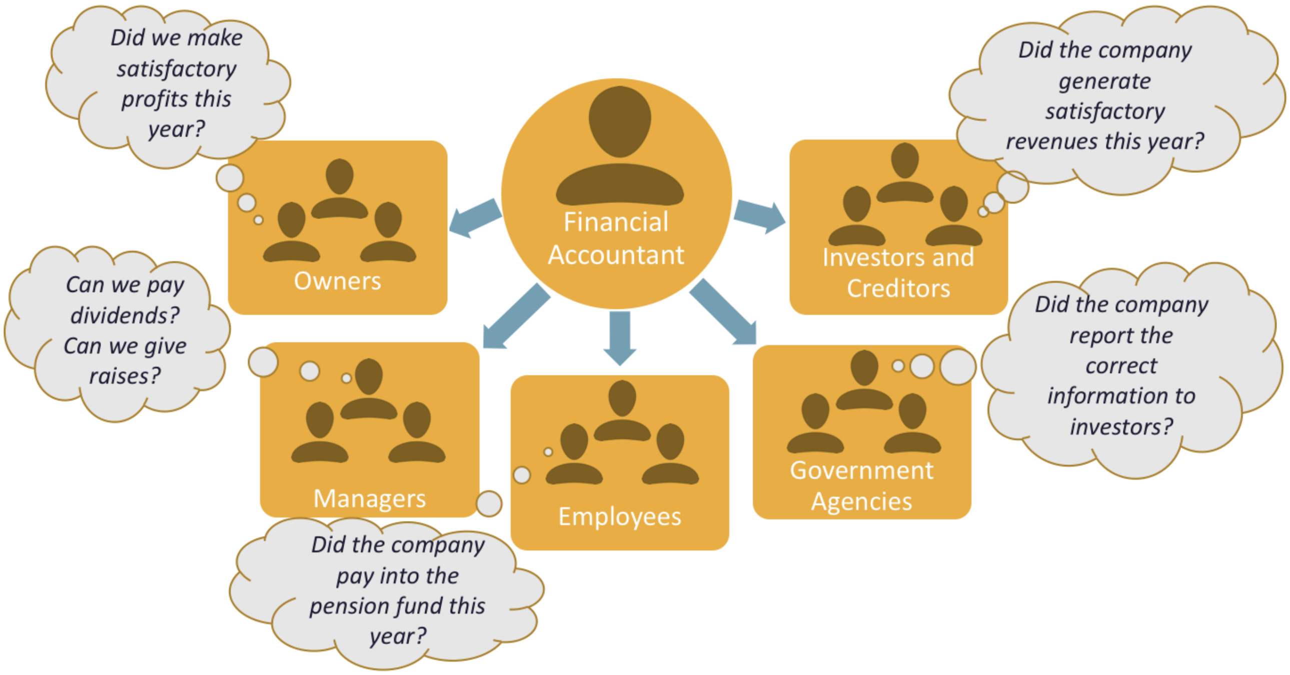

Chart 15.2 The Role of Financial Accounting. (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

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 are 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 is 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 — shows assets and liabilities, the amount invested in the business.

Statement of Cash Flow — shows how much cash is coming in and going out.

Even from this basic overview, match which financial statement answers each of Connor's questions.

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Since this book is for an introductory course, its emphasis 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 us 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. 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 chequing 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 are 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 is what you have in mind: you will 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 is 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 will 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 × 4 days × 4 weeks = 32 hours × $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 us 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 have sold; and
- Operating expenses: the costs of operating your business except for the costs of things that you have 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 × $10.00) $1,000
- **Less cost of goods sold** (100 × $6) $600
- **Gross profit** (100 × ($10 − $6)) $400
- **Less operating expenses**

- Salaries $240
- Advertising $40
- Table rental $20
- Total $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; and
- 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**:

Assets = Liabilities + 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 us 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 us 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 us 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 will 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 will 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 × $10.00) $750
- **Less cost of goods sold** (75 × $6) $450
- **Gross profit** ($75 × ($10 – $6)) $300
- **Less operating expenses**
  - Salaries $240
  - Advertising $40
  - Table rental $20
  - Total $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; and
- cash from financing.

Now let's prepare the statement of cash flow for the 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 after deducting the month's expenses from the month's revenues, and 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 earning 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 (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

Table 15. 1Apple 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 percentage 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 percentage of a larger figure (i.e., net income as a percent of sales, or cash as a percentage 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 is 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	143,810	128,645
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	$ 406,794	$ 375,319
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	115,788	100,814
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	266,595	241,272
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	140,199	134,047
Total liabilities and shareholders' equity	$ 406,794	$ 375,319

Table 15.2 Apple Inc.: Consolidated Balance Sheets.

Here is 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 outstanding number of shares of stock. 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.

Key profitability ratios include:

- return on sale = net income/sales revenue;
- return on equity = net income/total owner's equity; and
- earnings per share (EPS) = net income/number of shares of stock.

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.

Apple's current ratio = $68.5 Billion / $63.5 Billion = 1.08 (greater than >) 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.

Liquidity ratio = current assets/current liabilities.

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 whom 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.

Debt ratio = funds acquired from creditors (debt)/funds invested by owners (equity).

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 will leave the rest for another day.

Ethics in Accounting

Accountants are responsible for making sure that businesses report their finances clearly and according to recognized standards. This often puts them in situations impacting them ethically or even legally. These may include:

- pressure to manipulate the figures;
- conflicts of interest;
- access to information and confidential issues; and
- blowing the whistle.

The accounting profession over the years has evolved. In 2017, The American Institute of Certified Public Accountants (CPA) – Vision Project created a comprehensive and integrated vision of the profession's future, including identifying emerging competencies for success in accounting, summarized below.

Table 15.3 Competencies for Success in Accounting

Competency	Description
Skills in Strategic Thinking and Critical Problem Solving	The accountant can combine data with professional knowledge and reasoning to help solve critical problems.
Communication, Interpersonal Skills and Effective Leadership	The accountant can communicate effectively in various business situations that provide interpersonal effectiveness and leadership.
Dedication to Meeting Customer Needs	The accountant understands each client's unique needs in meeting those needs and visualizing client's future needs.
Ability to Integrate Diverse Information	The accountant can combine financial and other kinds of information to gain new meaning that provides clients with new and useful insights and understanding for solving problems.
Proficiency with Information Technology	The accountant can use information technology in performing services and can identify appropriate IT applications the client can adopt to add value.

Comprehensive Check

1. What is the role of accountants?
2. What is the accounting equation? How is it used?
3. What are three basic financial statements? Show how they reflect the activity and financial condition of a business.
4. What are the key standards and principles for reporting financial statements?
5. Explain how computing financial ratios can help in analyzing the financial strengths of a business.
6. What is the role of ethics in accounting?

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: assets – liabilities = 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.

Chapter 16 - Money and Banking

Learning Objectives

1. identify the functions of money and the different forms it takes in Canada;
2. describe how government measures the money supply;
3. distinguish among different types of financial institutions in the Canadian financial system;
4. discuss the services that financial institutions provide in Canada;
5. classify money supply into M-1 and M-2;
6. identify the functions of the Bank of Canada and explain how it uses monetary policy to control the money supply and influence interest rates;
7. discuss some of the institutions and activities in international banking and finance; and
8. Explain **key terms** in the chapter.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here:

https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=445#h5p-54 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=445#h5p-54)

Functions of Money

Finance is about money. So our first question is, what is **money**?

If you happen to have one on you, take a look at a $5 bill. Though this piece of paper — indeed, money itself — has no intrinsic value, it is certainly in demand. Why? Because money serves three basic functions:

1. a medium of exchange;
2. a measure of value; and
3. a store of value.

To get a better idea of the role of money in a modern economy, let us imagine a system in which there is no money. In this system, goods and services are *bartered* — traded directly for one another. Now, if you are living and trading under such a system, for each barter exchange that you make, you will have to have something that another trader wants. For example, say you are a farmer who needs help clearing his fields. Because you have plenty of food, you might enter into a barter transaction with a laborer who has time to clear fields but not enough food: he'll clear your fields in return for three square meals a day. This system will work as long as two people have exchangeable assets, but needless to say, it can be inefficient. If we identify the functions of money, we will see how it improves the exchange for all the parties in our hypothetical set of transactions.

Figure 16.1 Canadian money from Flickr.

Money is anything that is acceptable as payment for goods and services. It affects our lives in many ways. We earn it, spend it, save it, invest it — and often wish we had more of it. Businesses and government use money in similar ways. Both require money to finance their operations. By controlling the amount of money in circulation, the federal government can promote economic growth and stability. For this reason, money has been called the lubricant of the machinery that drives our economic system. Our banking system was developed to ease the handling of money.

Medium of Exchange

Money serves as a medium of exchange because people will accept it in exchange for goods and services. Because people can use money to buy the goods and services that they want, everyone's willing to trade something for money. The laborer will take money for clearing your fields because he can use it to buy food. You'll take money as payment for his food because you can use it not only to pay him but also to buy something else you need (perhaps seeds for planting crops).

For money to be used in this way, it must possess a few crucial properties:

1. It must be *divisible* — easily divided into usable quantities or fractions. A $5 bill, for example, is equal to five $1 bills. If something costs $3, you don't have to rip up a $5 bill; you can pay with three $1 bills.
2. It must be *portable* — easy to carry; it can't be too heavy or bulky.
3. It must be *durable*. It must be strong enough to resist tearing and the print can't wash off if it winds up in the washing machine.
4. It must be *difficult to counterfeit*; it won't have much value if people can make their own.

Measure of Value

Money simplifies exchanges because it serves as a measure of value. We state the price of a good or service in monetary units so that potential exchange partners know exactly how much value we want in return for it. This practice is a lot better than bartering because it's much more precise than an ad hoc agreement that a day's work in the field has the same value as three meals.

Store of Value

Money serves as a store of value. Because people are confident that money keeps its value over time, they're willing to save it for future exchanges. Under a bartering arrangement, the laborer earned three meals a day in exchange for his work. But what if, on a given day, he skipped a meal? Could he "save" that meal for another day? Maybe, but if he were paid in money, he could decide whether to spend it on food each day or save some of it for the future. If he wanted to collect on his unpaid meal two or three days later, the farmer might not be able to pay it; unlike money, food could go bad.

The Money Supply

Now that we know what money does, let us tackle another question: how much money is there? How would you go about "counting" all the money held by individuals, businesses, and government agencies in this country? You could start by counting the money that's held to pay for things on a daily basis. This category includes *cash* (paper bills and coins) and funds held in demand deposits — chequing accounts, which pay given sums to "payees" when they demand them.

Then, you might count the money that is being "saved" for future use. This category includes *interest-bearing accounts*, *time deposits* (such as *certificates of deposit*, which pay interest after a designated period of time), and money market mutual funds, which pay interest to investors who pool funds to make short-term loans to businesses and the government.

M-1, M-2 and M3

Counting all this money would be a daunting task (in fact, it would be impossible). Fortunately, there's an easier way — namely, by examining two measures that the government compiles for the purpose of tracking the money supply: M-1 and M-2.

- M-1 is the narrowest measure, and it includes the most *liquid* forms of money — the forms, such as cash and chequing account funds, that are spent immediately.
- M-2 includes everything in M-1 plus *near-cash items* invested for the short term — savings accounts, time deposits and money market mutual funds.
- Canada Money Supply M3 includes M2 plus long-term time deposits in banks.

How much money *is* out there? Statistics Canada reports that as of April 2018, M-1, totalled $877 billion in Canada and M-2 totalled $1596 in Canada.[1] Also, Money Supply M2 in Canada increased to 2289771 CAD Million in October from 2286467 CAD Million in September of 2021.[2]

What, Exactly, Is "Plastic Money"?

Are credit cards a form of money? If not, why do we call them plastic money? Actually, when you buy something with a credit card, you are not spending money. The principle of the credit card is buy-now-pay-later. In other words, when you use plastic, you are taking out a loan that you intend to pay off when you get your bill. And the loan itself is not money. Why not? Basically, because the credit card company cannot use the asset to buy anything. The loan is merely a promise of repayment. The asset does not become money until the bill is paid (with interest). That is why credit cards are not included in the calculation of M-1 and M-2.

Financial Institutions

For financial transactions to happen, money must change hands. How do such exchanges occur? At any given point in time, some individuals, businesses, and government agencies have more money than they need for current activities; some have less than they need. Thus, we need a mechanism to match savers (those with surplus money that they are willing to lend out) with borrowers (those with deficits who want to borrow money). We could just let borrowers search out savers and negotiate loans, but the system would be both inefficient and risky. Even if you had a few extra dollars, would you lend money to a total stranger? If you needed money, would you want to walk around town looking for someone with a little to spare?

Now you know why we have financial institutions: they act as intermediaries between savers and borrowers and they

1. Statistics Canada. (2018, March 14). *Currency composition of Canada's international investment position*. https://www150.statcan.gc.ca/n1/pub/13-605-x/2018001/article/54916-eng.htm
2. Trading Economics. (n.d.). *Canada Money Supply* M2. https://tradingeconomics.com/canada/money-supply-m2

direct the flow of funds between them. With funds deposited by savers in chequing, savings, and money market accounts, they make loans to individual and commercial borrowers. We will discuss the most common types of depository institutions (banks that accept deposits) and several non-depository institutions (which provide financial services but do not accept deposits), including finance companies, insurance companies, brokerage firms, and pension funds. The financial services industry in Canada continues to evolve, so some of the differences between institutions are disappearing. Also deregulation in the financial industry, advancement in technology and the changes in consumer demands, have enabled Canadian banks to diversify to provide more financial products and services to their customers and clients.

Chartered (Commercial) Banks

Chartered banks are the most common financial institutions in Canada, with total financial assets of about $2.39 trillion in February 2018.[3] They generate profit not only by charging borrowers higher interest rates than they pay to savers but also by providing such services as cheque processing, trust- and retirement-account management, and electronic banking. The country's chartered banks range in size from very large (Royal Bank of Canada, Toronto Dominion Bank) to very small (such as Versa Bank). Because of mergers and financial problems, the number of banks has declined significantly in recent years, but by the same token, surviving banks have grown quite large. Banking is a competitive business, so chartered banks do not just provide short- and long-term loans or create money, but many other products and services, such as the following.

Electronic Funds Transfer: **Electronic funds transfer (EFT)** is the electronic transfer of money from one bank account to another, either within a single financial institution or across multiple institutions, via computer-based systems and telephones, without the direct intervention of bank staff. Transfers can take place between individuals or businesses, locally, nationally or internationally, and use various currencies. Formats include PayPal, Alipay and other electronic payments. EFT systems enable customers to use their debit cards and mobile devices to enjoy speed and convenience at checkouts instead of writing cheques. EFTs enable automatic payroll deposits, ATM transactions, bill payments, automatic funds transfer, etc. EFT has changed the way businesses and people interact online, and fosteredd e-commerce. Other examples include:

- automated banking machines (ABM) and automated teller machines (ATM);
- direct deposits and withdrawals;
- transfer initiated by telephones;
- debit cards;
- blink credit cards (contactless payment system);
- smart cards;
- mobile digital wallets; and
- wire transfer by Society for Worldwide Interbank Financial Telecommunication (SWIFT).

Pension services: Most banks assist customers in establishing retirement savings plans. Banks serve as financial intermediaries by receiving funds and investing them as directed by the customers and discussing investment options with customers.

3. Statistics Canada. (n.d.). *Table 10-10-0109-01 Chartered banks, assets and liabilities, month-end, Bank of Canada* (x 1,000,000). https://doi.org/10.25318/1010010901-eng

Trust services: Banks manage funds left in a bank's trust. For a fee they manage investment portfolio and estates of deceased persons.

Financial advice: Banks advise their customers about investment opportunities and options. Banks stress their role as financial advisors.

International services: International services that banks provide include: currency exchange, letters of credit and bankers' acceptances.

You can appreciate the diversity of the services offered by chartered banks by visiting their Web sites. For example, Royal Bank of Canada (RBC) promotes services to four categories of customers: individuals, small businesses, corporate and institutional clients, and affluent clients seeking wealth management. In addition to traditional chequing and savings accounts, the bank offers automated teller machine (ATM) services, credit cards, and debit cards. It lends money for homes, cars, college, and other personal and business needs. It provides financial advice and sells securities and other financial products, including Registered Retirement Savings Plans (RRSPs), by which investors can save money that is tax free until they retire. RBC even offers life, auto, disability, and homeowners' insurance. It also provides electronic banking for customers who want to check balances, transfer funds, and pay bills online.[4]

How Banks Expand the Money Supply

When you deposit money, your bank does not set aside a special pile of cash with your name on it. It merely records the fact that you made a deposit and increases the balance in your account. Depending on the type of account, you can withdraw your share whenever you want, but until then, it is added to all the other money held by the bank. Because the bank can be pretty sure that all its depositors would not withdraw their money at the same time, it holds onto only a fraction of the money that it takes in — its *reserves*. It lends out the rest to individuals, businesses, and the government, earning interest income and expanding the money supply.

The Role of the Bank of Canada

The Bank of Canada is the nation's central bank. Its principal role is "to promote the economic and financial welfare of Canada," as defined in the Bank of Canada Act. The Bank of Canada is a special type of Crown corporation that is owned by the federal government, but has considerable independence to carry out its responsibilities and therefore operates separately from the political process.

The Bank's four main areas of responsibility are:[5]

- Monetary policy: The Bank influences the supply of money circulating in the economy, using its monetary policy framework to keep inflation low and stable.
- Financial systems: The Bank promotes safe, sound and efficient financial systems, within Canada and internationally, and conducts transactions in financial markets in support of these objectives.

4. Royal Bank of Canada. (n.d.). *Our Company*. https://www.rbc.com/our-company/index.html
5. Bank of Canada. (n.d.). *About Us*. https://www.bankofcanada.ca/about/

- Currency: The Bank designs, issues and distributes Canada's bank notes.
- Funds management: The Bank is the fiscal agent for the Government of Canada, managing its public debt programs and foreign exchange reserves.

The Bank of Canada is led by the Governing Council, the policy-making body of the Bank, which is responsible for:

- conducting monetary policy; and
- promoting a safe and efficient financial system.

The Governing Council is made up of the Governor, the Senior Deputy Governor and the Deputy Governors. The Governing Council's main tool for conducting monetary policy is the target for the overnight rate (also known as the key policy rate). This rate is normally set on eight fixed announcement dates per year. The Council reaches its decisions about the rate by consensus, rather than by individual votes, as is the case at some other central banks.

The Bank of Canada's Role in Managing the Money Supply.

The Bank of Canada plays a vital role in managing the money supply in Canada. If the Bank of Canada wants to increase the money supply, it can buy government securities. The individuals and investors who sell these bonds then deposit the proceeds in their banks. These deposits increase banks' reserves and their willingness to make loans. The Bank of Canada can also lower the bank rate; this action will cause increased demand for loans from businesses and households because these customers borrow more money when interest rates drop.

If the Bank of Canada wants to decrease the money supply, it can sell government securities. Individuals and investors spend money to buy bonds, and these withdrawals bring down banks' reserves and reduce their willingness to make loans. The Bank of Canada can also raise the bank rate; this action will decrease the demand for loans from businesses and households because these customers borrow less money when interest rates rise.

Exhibit 2: Illustrations of Bank of Canada monetary policy actions.

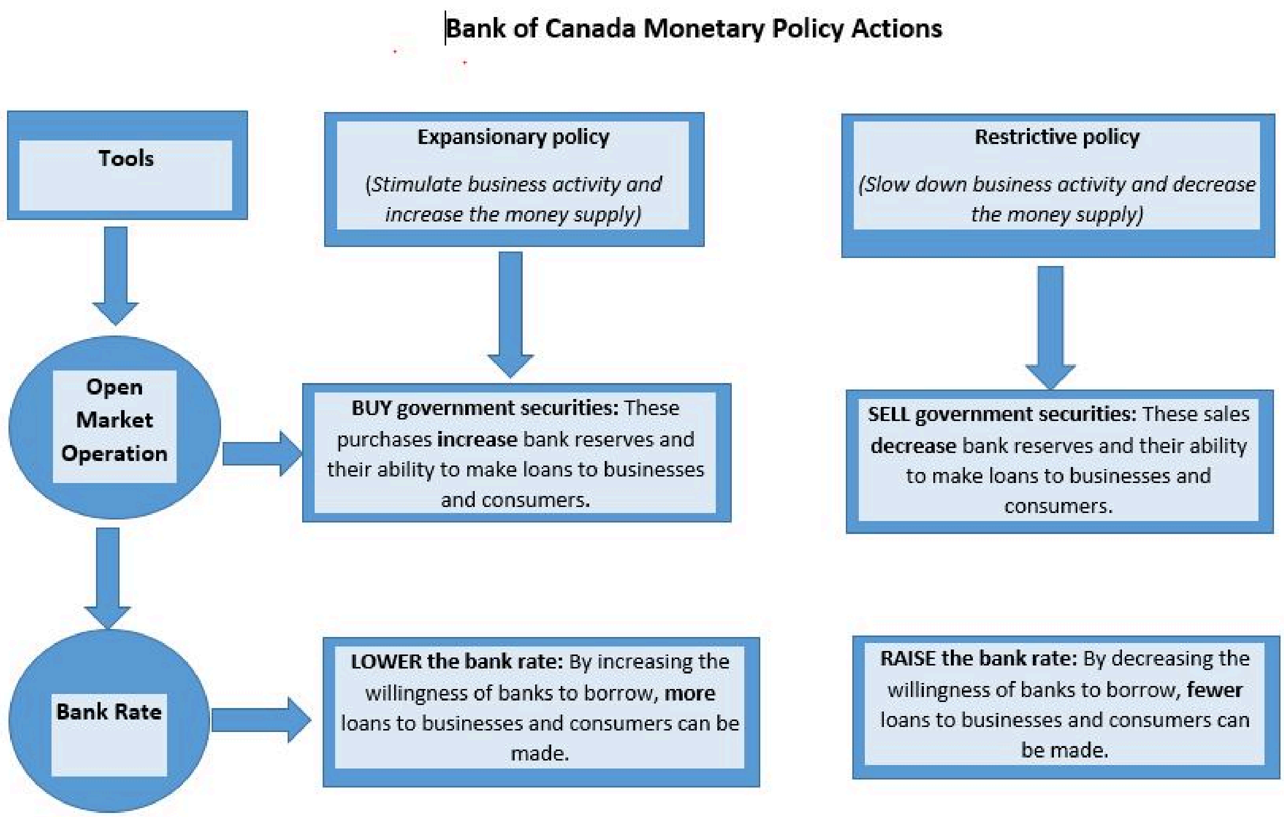

Chart 16.1 Bank of Canada Monetary Policy Actions

Alternate Banks

The big banks — Chartered Banks — in Canada, including BMO, CIBC, RBC, Scotiabank, and TD, offer a large variety of banking products. Alternate banks are Credit Unions, Trust companies and Online Banks that specialize and tend to offer better rates and lower fees.

Credit Unions

Credit unions are cooperative savings, owned by their members with common interest, who receive shares of their profits. They offer almost anything that a chartered bank offers — savings account and loans, chequing accounts, home and car loans, credit cards, and even some commercial loans.

Trust Companies

A trust company safeguards property — funds and estates — entrusted to it. It may serve as a trustee, transfer agent, and registrar for corporations, and provide other services as well. In recent years trust companies have declined in importance.

Online Banks

Due to the global pandemic over the past year and a half, we have seen just how little we rely on in-person services from brick-and-mortar banks, with most people avoiding their local branch and opting to use online products offered by their traditional banks instead.

The online banking industry in Canada got its start around 1996, and although people were somewhat skeptical at first, the industry has grown to proportions today that rival the traditional banking industry.

Online banks have significant advantages over their traditional counterparts. They have developed a business model that provides customers with the best of both worlds: low — and even no — monthly fees, along with accessible customer service administered remotely. Examples in Canada include: Tangerine, EQ Bank, Neo Financial, Simplii Financial and Manulife Bank.

Specialized Lending and Savings Intermediaries

Finance Companies or Financial Corporation

Finance companies are non-deposit institutions because they do not accept deposits from individuals or provide traditional banking services, such as chequing accounts. They do, however, make loans to individuals and businesses, using funds acquired by selling securities or borrowed from chartered banks. Those that lend money to businesses, such as General Electric Capital Corporation, are *commercial finance companies*, and those that make loans to individuals or issue credit cards, such a PCFinancial are *consumer finance companies*. Some, such as General Motors Acceptance Corporation, provide loans to both consumers (car buyers) and businesses (GM dealers).

Insurance Companies

Insurance companies sell protection against losses incurred by illness, disability, death, and property damage. To finance claims payments, they collect premiums from policyholders, which they invest in stocks, bonds, and other assets. They also use a portion of their funds to make loans to individuals, businesses, and government agencies. Manulife is the leading Canadian life insurance company, and it has an international presence.

Brokerage Firms or Factoring Companies

Companies like Commercial Capital LLC, who buy and sell stocks, bonds, and other investments for clients, are brokerage firms (also called *securities investment dealers*). A mutual fund invests money from a pool of investors in stocks, bonds, and other securities. Investors become part owners of the fund. Mutual funds reduce risk by diversifying investment; because assets are invested in dozens of companies in a variety of industries, poor performance by some firms is usually offset by good performance by others. Mutual funds may be stock funds, bond funds, and money market funds, which invest in safe, highly liquid securities.

Finally, pension funds, which manage contributions made by participating employees and employers and provide members with retirement income, are also non-deposit institutions.

Venture Capital Firms

Venture Capital Firms provide private equity financing or funds to start-ups, early-stage, and emerging companies that have been deemed to have high growth potential or that have demonstrated high growth. Venture capital generally comes from wealthy investors, investment banks, and any other financial institutions. However, it does not always take a monetary form; it can also be provided in the form of technical or managerial expertise. Financing new and untested venture can be risky for investors who put up funds, however, the potential for above-average returns is an attractive payoff.

Pension Funds

A pension fund is any plan, fund, or scheme that provides retirement income in the future to subscribers. Pension funds typically have large amounts of money to invest and are the major investors in listed and private companies.

Other Sources of Funds

Government Financial Institutions and Granting Agencies

The Canadian government provides government funding support to businesses across the country. This funding support comes in the form of government grants, government loans, tax breaks, tax credits and other types of financial contributions. A number of provincial agencies also provide funding to developing business firms in the hope that they will provide jobs in the province. There are both federal and provincial programs supporting the agriculture industry and providing grants to business operations.

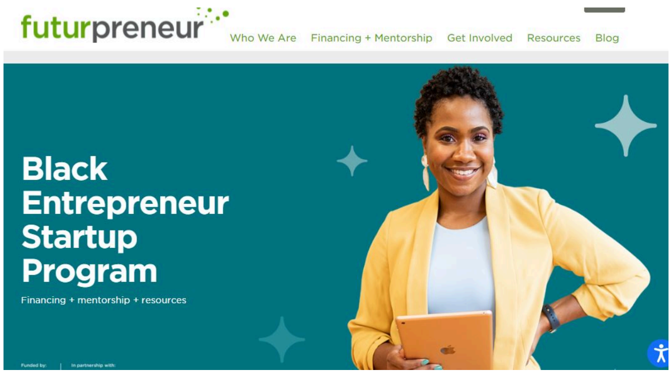

Figure 16.2 Black Entrepreneur Startup Program brochure picture

Some examples of federal agencies include:

- *The Business Development Bank of Canada* (BDC) makes term loans, primarily to smaller firms judged to have growth potential but unable to secure funds at reasonable terms from traditional sources. They also provide counselling services to support their clients.
- The federal government's *Export Development Corporation* (EDC) finances and insures export sales for Canadian companies.
- *The Canada Mortgage and Housing Corporation*(CMHC) is involved in providing and guaranteeing mortgages. The CMHC is important to the construction industry.
- *Crown-Indigenous Relations and Northern Affairs Canada* (CIRNAC) *and Indigenous Services Canada* (ISC) provide

numerous services to First Nations or Indigenous peoples.
- *Futurpreneur Canada* is a non-profit organization helping Canadians aged 18-39 become business owners with loan financing, mentoring and business resources.

International Banking and Finance

Foreign sources of funds have been important throughout the economic development of Canada. The Canadian capital market is one part of the international capital market. Canadian provinces borrow in foreign markets such as London and New York. Future projections of Canadian capital requirements indicate that organizations will continue to need these funds.

What roles do Canadian banks play in the international marketplace?

The financial marketplace spans the globe, with money routinely flowing across international borders. Canadian banks play an important role in global business by providing loans to foreign governments and businesses. Multinational corporations need many special banking services, such as foreign currency exchange and funding for overseas investments. Canadian banks also offer trade-related services, such as global cash management, that help firms manage their cash flow, improve their payment efficiency, and reduce their exposure to operational risks. Sometimes consumers in other nations have a need for banking services that banks in their own countries do not provide. Therefore, large banks often look beyond their national borders for profitable banking opportunities.

Some Canadian banks have expanded into overseas markets by opening offices in Europe, Latin America, and Asia. They often provide better customer service than local banks and have access to more sources of funding.

For Canadian banks, expanding internationally can be difficult. Banks in other nations are often subject to fewer regulations than Canadian banks, making it easier for them to undercut Canadian banks on the pricing of loans and services. Some governments also protect their banks against foreign competition. For example, the Chinese government imposes high fees and limits the amount of deposits that foreign banks can accept from customers. It also controls foreign bank deposits and loan interest rates, limiting the ability of foreign banks to compete with government-owned Chinese banks. Despite the banking restrictions for foreign banks in China, some Canadian banking institutions continue to do business there.[6]

International banks operating within Canada have a substantial impact on the economy through job creation — they employ thousands of people in Canada, and most workers are Canadian citizens — operating and capital expenditures, taxes, and other contributions.

Political and economic uncertainty in other countries can make international banking a high-risk venture. European and Asian banks were not immune to the financial crisis of 2007–2009. In fact, several countries, including Greece, Portugal, Spain, and Ireland, continue to rebound slowly from the near-collapse of their economic and financial

6. Bank of Montreal Canada. (n.d.). *About BMO ChinaCo*. https://www.bmo.com/asia/about_BMO_China.html

systems that they experienced a decade ago. Financial bailouts spearheaded by the European Union and the International Monetary Fund have helped stabilize the European and global economy.

Currency Values and Exchange Rates

Currencies are traded in the foreign exchange market. Like any other market, when something is exchanged there is a price. In the foreign exchange market, a currency is being bought and sold, and the price of that currency is given in some other currency. That price is expressed as an exchange rate.

When an exchange rate changes, the value of one currency will go up while the value of the other currency will go down. When the value of a currency increases, it is said to have *appreciated*. On the other hand, when the value of a currency decreases, it is said to have *depreciated*.

The Canadian dollar fluctuates against the American dollar between 65-70 per cent range. On November 2007, the CAD dollar was stronger than the US dollar, at US $1.09. After a few years of parity, the Canadian dollar retreated to approximately US $0.76 in June 2018.[7] These fluctuations have an impact on businesses.

International Payment Process

International financial settlements between buyers and sellers are different in many countries. Canadian banks provide services to buyers and sellers to support their clients during global financial transactions. Country-to-country transactions rely on an international payment process that moves money between buyers and sellers in different countries. For example, payment from a Canadian buyer start at a local bank that converts funds from dollars into the seller's currency, say British pounds sterling, to be sent to a seller in England. At the same time, payments and currency conversions from separate transactions are also flowing between British businesses and Canadian sellers in the other direction. A balance trade between the two countries implies that money inflows and outflows are equal for both countries. If inflows and outflows are not in balance at the Canadian bank or the British bank, then a flow of money — either to England or Canada — is made to cover the difference.

International Banking Structure – World Bank and International Monetary Fund

Policymaking and regulatory powers are different in every nation; local standards and laws also vary greatly, which means that banking systems vary greatly. These two United Nation agencies — The World Bank and International Monetary Fund — assist in financing international trade.

7. Xe. (n.d.). *US Dollar to Canadian Dollar Exchange Rate Chart*. https://www.xe.com/currencycharts/?from=USD&to=CAD

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 the United Kingdom), the World Bank provides loans, grants, and guarantees to some of the world's poorest nations. Loans are made to help countries improve the lives of the poor through community support programs designed to provide health, nutrition, education, infrastructure, and other social services.

The International Monetary Fund

The International Monetary Fund (IMF) consists of 189 nations who, as a group, combine their resources to:

- encourage the development of a system for international payments;
- promote the stability of exchange rates;
- provide temporary, short term loans to member countries; and
- encourage members to cooperate on international monetary issues.

The 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.

Some nations have declined IMF funds rather than accept the economic changes that the IMF demands. In 2021, according to the IMF website, the IMF had about $1 trillion available for loans. Despite the fact that the U.S. has been instrumental in promoting global free trade for decades in 2018, it was rumoured that under Trump's administration the U.S. would withdraw from the World Trade Organization (WTO). This did not happen but the instability caused by such news was damaging to the WTO.

Digital Currencies

Digital currencies are currencies that are only accessible with computers or mobile phones because they only exist in electronic form. Digital money is not physically tangible like a dollar bill or a coin. It is accounted for and transferred using online systems. The difference between digital currencies and cryptocurrencies is that digital currencies are centralized, meaning that transaction within the network is regulated in a centralized location, like a bank. Cryptocurrencies are mostly decentralized, and the regulations inside the network are governed by the majority of the community.

The Bank of Canada revealed in 2016 that it was developing the CAD-coin as a digital version of the Canadian dollar, a move in response to the rise in popularity of bitcoin and other blockchain-based digital currencies. The initiative will involve issuing, transferring and settling the central bank's monetary assets by way of a computerized ledger rather than by way of printed dollars. Research and experiments have been ongoing since 2016. Some major banks in Canada are participating in this new initiative, including Royal Bank of Canada, CIBC and TD Bank Group, and institutional partners such as Payments Canada and TMX Group.

Despite their claim of being the money of the future, current private digital currencies, like bitcoin, do not work well for making payments or saving for the future. Because of their fluctuating values and slow clearing times, very few merchants accept them. It is possible that in the future digital currencies could at least partially solve these problems, leading to greater adoption. But widespread adoption of private digital currencies would carry important risks to both the economy and the financial system. The issuer could go out of business or fall victim to cybertheft; either situation could cause a loss of confidence in the payment system.

Exploring the idea of a central bank digital currency makes sense. In theory, it could provide the safety of cash, with the convenience of modern electronic payments. It could take many forms, but two broad approaches are:

- value-based — people transfer money from their bank account to a card or a phone app; or
- account-based — people or businesses open accounts at the central bank.

Either way, payments made using a central bank digital currency could allow payments to remain private to the parties involved, just like cash but

Central bank digital currencies could give consumers more choice while maintaining competition among financial service providers like banks, the way cash does now. Depending on their design, they could even act as a backup if other payment methods become temporarily unavailable.

Basically, central bank digital cash would act like current electronic payment methods, the only difference being that it would not be tied to a commercial bank the way bank accounts and debit cards are.[8]

Comprehensive Check

1. Define the following terms:
    - money;
    - M1 and M2 money supply;
    - electronic funds transfer (EFT); and
    - digital currency.
2. What are the crucial properties of money?
3. What services do financial institutions provide in Canada?
4. List the functions of the Bank of Canada.
5. Explain the balance of trade between two nations.

8. Bank of Canada. (n.d.). *The Road to Digital Money*. https://www.bankofcanada.ca/2019/04/the-road-to-digital-money/

Key Takeaways

1. Money serves three basic functions:
    - *Medium of exchange*: because you can use it to buy the goods and services you want, everyone's willing to trade things for money.
    - *Measure of value*: it simplifies the exchange process because it's a means of indicating how much something costs.
    - *Store of value*: people are willing to hold onto it because they're confident that it will keep its value over time.
2. The government uses two measures to track the money supply: **M-1** includes the most liquid forms of money, such as cash and chequing account funds. **M-2** includes everything in M-1 plus near-cash items, such as savings accounts and term deposits below $100,000.
3. Financial institutions serve as financial intermediaries between savers and borrowers and direct the flow of funds between the two groups.
4. Those that accept deposits from customers — depository institutions (chartered banks) — include commercial banks, savings banks, and credit unions; those that do not — non-depository institutions — include finance companies, insurance companies, and brokerage firms (investment dealers).
5. Financial institutions offer a wide range of services, including checking and savings accounts, ATM services, and credit and debit cards. They also sell securities and provide financial advice.
6. A bank holds onto only a fraction of the money that it takes in — an amount called its reserves — and lends the rest out to individuals, businesses, and governments. In turn, borrowers put some of these funds back into the banking system, where they become available to other borrowers. The money multiplier effect ensures that the cycle expands the money supply.
7. Currency — paper money (bills) and coins issued by the Canadian government.
8. Credit card — immediately transfers money from the credit card company's chequing account to the seller, and at the end of the month the user owes the money to the credit card company; a credit card is a short-term loan.
9. Debit card — like a cheque, is an instruction to the bank to transfer money directly and immediately from the user's bank account to the seller.
10. Demand deposit — chequable deposit in banks that is available by making a cash withdrawal or writing a cheque.
11. M1 money supply — a narrow definition of the money supply that includes currency and chequing accounts in banks, and to a lesser degree, traveler's cheques.
12. M2 money supply — a definition of the money supply that includes everything in M1, but also adds savings deposits, money market funds, and certificates of deposit.
13. Money market mutual funds — the deposits of many investors are pooled together and invested in a safe way, like short-term government bonds and other low-risk financial securities.
14. Savings deposit — bank account from which the user cannot withdraw money by writing a cheque, but

can withdraw the money at a bank — or can transfer it easily to a chequing account.

15. Smart card — stores a certain value of money on a card with which the user can make purchases.
16. Time deposit — an account that the depositor has committed to leaving in the bank for a certain period of time, in exchange for a higher rate of interest; also called certificate of deposit. Requires prior notice of withdrawal and cannot be transferred by cheque.
17. International Banking and Finance — changes in currency values and exchange rates reflect global supply and demand for various currencies. Central Banks' policies on money supplies and interest rates influence the value of currencies in the foreign currency/exchange markets.
18. The World Bank and International Monetary fund provide stability to encourage international trade.
19. Digital currency (digital money, electronic money or electronic currency) is primarily managed, stored or exchanged on digital computer systems, especially over the internet.

Attributions

Chapter 17 - Financial Decisions and Risk Management

Learning Objectives

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

1. explain how financial decisions affect the overall business strategy;
2. discuss the role and responsibilities of the financial manager;
3. distinguish between short-term (operating) and long-term (capital) expenditures;
4. explain the ways in which a new business gets start-up cash;
5. identify approaches used by existing companies to finance operations and growth;
6. identify sources of short-term and long-term financing for business;
7. distinguish between equity and debt financing;
8. explain the process by which securities are bought and sold and describe the secondary market for each type of security;
9. describe the investment opportunities offered by mutual funds, exchange traded funds, hedge funds, and commodities;
10. explain how risk affects business operations and identify the five steps in the risk management process; and
11. explain **key terms** in the chapter.

Show What You Know

An interactive H5P element has been excluded from this version of the text. You can view it online here: https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=447#h5p-55 (https://pressbooks.bccampus.ca/fundamentalsbusiness/?p=447#h5p-55)

How Do Finance and the Financial Manager affect the Business's Overall Strategy?

Any company, whether it is a small town bakery or Tim Hortons, needs money to operate. To make money, it must first spend money — on inventory and supplies, equipment and facilities, and employee wages and salaries. Therefore, finance is critical to the success of all companies. It may not be as visible as marketing or production, but management of a firm's finances is just as key to the firm's success.

Financial management — the art and science of managing a firm's money so that it can meet its goals — is not just the responsibility of the finance department. All business decisions have financial consequences. Managers in all departments must work closely with financial personnel. If you are a sales representative, for example, the company's credit and collection policies will affect your ability to make sales. The head of the IT department will need to justify any requests for new computer systems or employee laptops.

Revenue from sales of the firm's products should be the chief source of funding. But money from sales does not always come in when it is needed to pay the bills. Financial managers must track how money is flowing into and out of the firm (see Exhibit 17.1). They work with the firm's other department managers to determine how available funds will be used and how much money is needed. Then they choose the best sources to obtain the required funding.

For example, a financial manager will track day-to-day operational data such as cash collections and disbursements to ensure that the company has enough cash to meet its obligations. Over a longer time horizon, the manager will thoroughly study whether and when the company should open a new manufacturing facility. The manager will also suggest the most appropriate way to finance the project, raise the funds, and then monitor the project's implementation and operation.

Financial management is closely related to accounting. In most firms, both areas are the responsibility of the vice president of finance or CFO. But the accountant's main function is to collect and present financial data. Financial managers use financial statements and other information prepared by accountants to make financial decisions. Financial managers focus on cash flows, the inflows and outflows of cash. They plan and monitor the firm's cash flows to ensure that cash is available when needed.

The Financial Manager's Responsibilities and Activities

Financial managers have a complex and challenging job. They analyze financial data prepared by accountants, monitor the firm's financial status, and prepare and implement financial plans. One day they may be developing a better way to automate cash collections, and the next they may be analyzing a proposed acquisition. The key activities of the financial manager are:[1]

- *Financial planning*: preparing the financial plan, which projects revenues, expenditures, and financing needs over a given period;
- *Investment (spending money)*: investing the firm's funds in projects and securities that provide high returns in relation to their risks;
- *Financing (raising money)*: obtaining funding for the firm's operations and investments and seeking the best balance between debt (borrowed funds) and equity (funds raised through the sale of ownership in the business); and
- Financial Control: checking performance against strategic plans.

The Goal of the Financial Manager

How can financial managers make wise planning, investment, and financing decisions? The main goal of the financial manager is to maximize the value of the firm to its owners. The value of a publicly owned corporation is measured by the share price of its stock. A private company's value is the price at which it could be sold.

To maximize the firm's value, the financial manager has to consider both short- and long-term consequences of the firm's actions. Maximizing profits is one approach, but it should not be the only one. Such an approach favors making short-term gains over achieving long-term goals. What if a firm in a highly technical and competitive industry did no research and development? In the short run, profits would be high because research and development is very expensive. But in the long run, the firm might lose its ability to compete because of its lack of new products.

1. What challenges do today's financial managers face? CFO magazine at http://www.cfo.com

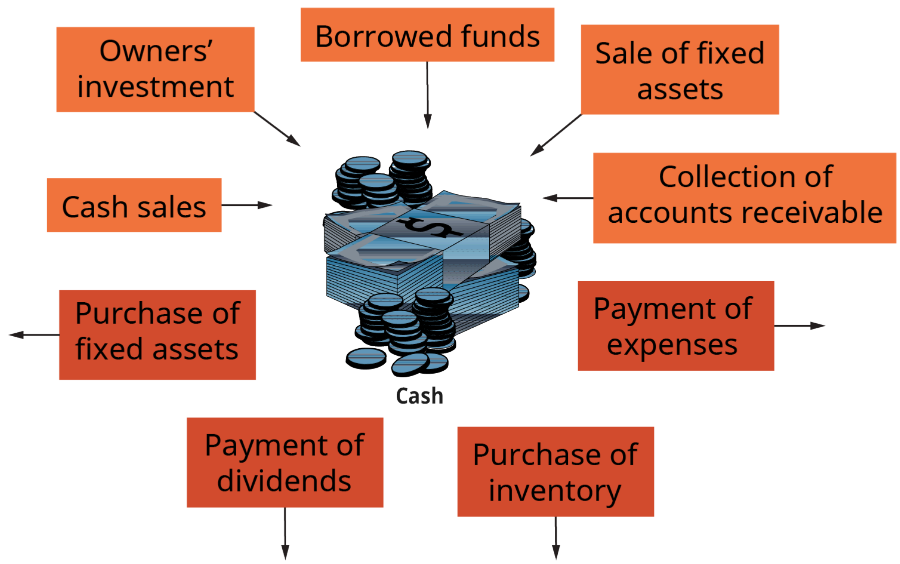

Chart 17.1 How Cash Flows through a Business (Attribution: Copyright Rice University, OpenStax, under CC BY 4.0 license.)

In finance, the opportunity for profit is called return; the potential for loss, or the chance that an investment will not achieve the expected level of return, is risk. A basic principle in finance is that the higher the risk, the greater the return that is required. This widely accepted concept is called the **risk-return trade-off**. Financial managers consider many risk and return factors when making investment and financing decisions. Among them are changing patterns of market demand, interest rates, general economic conditions, market conditions, and social issues (such as environmental effects and equal employment opportunity policies).

What Types of Short-term and Long-term Expenditures does a Firm make?

To grow and prosper, a firm must keep investing money in its operations. The financial manager decides how best to use the firm's money. Short-term expenses support the firm's day-to-day activities. For instance, athletic apparel maker lululemon Athletica regularly spends money to buy such raw materials as leather and fabric, and to pay employee salaries. Long-term expenses are typically for fixed assets. For lululemon, these would include outlays to build a new factory, buy automated manufacturing equipment, or acquire a small manufacturer of sports apparel.

Short-Term Expenses

Short-term expenses, often called operating expenses, are outlays used to support current production and selling activities. They typically result in **current assets**, which include cash and any other assets (accounts receivable and inventory) that can be converted to cash within a year. The financial manager's goal is to manage current assets so the firm has enough cash to pay its bills and to support its accounts receivable and inventory.

Cash Management: Assuring Liquidity

Cash is the lifeblood of business. Without it, a firm could not operate. An important duty of the financial manager is **cash management**, or making sure that enough cash is on hand to pay bills as they come due and to meet unexpected expenses.

Businesses estimate their cash requirements for a specific period. Many companies keep a minimum cash balance to cover unexpected expenses or changes in projected **cash flows**. The financial manager arranges loans to cover any shortfalls. If the size and timing of cash inflows closely match the size and timing of cash outflows, the company needs to keep only a small amount of cash on hand. A company whose sales and receipts are fairly predictable and regular throughout the year needs less cash than a company with a seasonal pattern of sales and receipts. A toy company, for instance, whose sales are concentrated in the fall, spends a great deal of cash during the spring and summer to build inventory. It has excess cash during the winter and early spring, when it collects on sales from its peak selling season.

Because cash held in checking accounts earns little, if any, interest, the financial manager tries to keep cash balances low and to invest the surplus cash. Surpluses are invested temporarily in **marketable securities**, short-term investments that are easily converted into cash. The financial manager looks for low-risk investments that offer high returns. Four of the most popular marketable securities are Treasury bills, certificates of deposit, **commercial paper**, and banker's acceptances. (Commercial paper is unsecured short-term debt — an IOU — issued by a financially strong corporation.)

A banker's acceptance (BA) is a type of commercial paper; an unsecured short-term debt issued by a lesser financially strong corporation that is guaranteed by a bank for a fee. The bank guarantee makes the BA a secured note for the buyer.

Today's financial managers have new tools to help them find the best short-term investments, such as online trading platforms that save time and provide access to more types of investments. These have been especially useful for smaller companies who don't have large finance staffs.[2]

Companies with overseas operations face even greater cash management challenges. Developing the systems for international cash management may sound simple in theory, but in practice it's extremely complex. In addition to dealing with multiple foreign currencies, treasurers must understand and follow banking practices and regulatory and tax requirements in each country. Regulations may impede their ability to move funds freely across borders. Also, issuing a standard set of procedures for every office may not work because local business practices differ from country to country. In addition, local managers may resist the shift to a centralized structure because they don't want to give up control of cash generated by their units. Corporate financial managers must be sensitive to and aware of local customs and adapt the centralization strategy accordingly.

In addition to seeking the right balance between cash and marketable securities, the financial manager tries to shorten the time between the purchase of inventory or services (cash outflows) and the collection of cash from sales (cash inflows). The three key strategies are to collect money owed to the firm (accounts receivable) as quickly as possible, to pay money owed to others (accounts payable) as late as possible without damaging the firm's credit reputation, and to minimize the funds tied up in inventory.

2. Royal Bank of Canada. (n.d.). *Cash Management & Payment Solutions*. http://www.rbcroyalbank.com/caribbean/bb/business/cash-management-payment-solutions/home.html

Managing Accounts Receivable

Accounts receivable represent sales for which the firm has not yet been paid. Because the product has been sold but cash has not yet been received, an account receivable amounts to a use of funds. For the average manufacturing firm, accounts receivable represent about 15 to 20 percent of total assets.

The financial manager's goal is to collect money owed to the firm as quickly as possible, while offering customers credit terms attractive enough to increase sales. Accounts receivable management involves setting credit policies, guidelines on offering credit, credit terms, and specific repayment conditions, including how long customers have to pay their bills and whether a cash discount is given for quicker payment. Another aspect of accounts receivable management is deciding on collection policies, the procedures for collecting overdue accounts.

Setting up credit and collection policies is a balancing act for financial managers. On the one hand, easier credit policies or generous credit terms (a longer repayment period or larger cash discount) result in increased sales. On the other hand, the firm has to finance more accounts receivable. The risk of uncollectible accounts receivable also rises. Businesses consider the impact on sales, timing of cash flow, experience with bad debt, customer profiles, and industry standards when developing their credit and collection policies.

Companies that want to speed up collections actively manage their accounts receivable, rather than passively letting customers pay when they want to. Many businesses experience late payments from customers, and some companies write off a percentage of their bad debt, which can be expensive.

Technology plays a big role in helping companies improve their credit and collections performance. For example, many companies use some type of automated decision making, whether that comes in the form of an Enterprise Relational Planning (ERP) system or a combination of software programs and supplemental modules that help companies make informed decisions when it comes to credit and collection processes.[3]

Other companies choose to outsource financial and accounting business processes to specialists rather than develop their own systems. The availability of cutting-edge technology and specialized electronic platforms that would be difficult and expensive to develop in-house is winning over firms of all sizes. Giving up control of finance to a third party has not been easy for CFOs. The risks are high when financial and other sensitive corporate data are transferred to an outside computer system: data could be compromised or lost, or rivals could steal corporate data. It's also harder to monitor an outside provider than your own employees. One outsourcing area that has attracted many clients is international trade, which has regulations that differ from country to country and requires huge amounts of documentation. With specialized IT systems, providers can track not only the physical location of goods, but also all the paperwork associated with shipments. Processing costs for goods purchased overseas are about twice those of domestic goods, so more efficient systems pay off.[4]

3. Kelly, S. (2017, March 20). *Credit Management Technology Plays Catch-Up*. Treasury & Risk. https://www.treasuryandrisk.com/2017/03/20/credit-management-technology-plays-catch-up/?slreturn=20230024165817
4. Bramwell, J. (2013, December 16). *CFOs More Likely to Outsource Accounting and Finance Projects*. Accounting Web. Retrieved October 10, 2017, from https://www.accountingweb.com/practice/team/cfos-more-likely-to-outsource-accounting-and-finance-projects

Inventory

Another use of funds is to buy inventory needed by the firm. In a typical manufacturing firm, inventory comprises nearly 20 percent of total assets. The cost of inventory includes not only its purchase price, but also ordering, handling, storage, interest, and insurance costs.

Production, marketing, and finance managers usually have differing views about inventory. Production managers want lots of raw materials on hand to avoid production delays. Marketing managers want lots of finished goods on hand so customer orders can be filled quickly. But financial managers want the least inventory possible without harming production efficiency or sales. Financial managers must work closely with production and marketing to balance these conflicting goals. Techniques for reducing the investment in inventory are inventory management, the just-in-time (JIT) system, and materials requirement planning.

For retail firms, inventory management is a critical area for financial managers, who closely monitor inventory turnover ratios. This ratio shows how quickly inventory moves through the firm and is turned into sales. If the inventory number is too high, it will typically affect the amount of working capital a company has on hand, forcing the company to borrow money to cover the excess inventory. If the turnover ratio number is too high, it means the company does not have enough inventory of products on hand to satisfy customer needs, which means they could take their business elsewhere.

Long-Term Expenditures

A firm also invests funds in physical assets such as land, buildings, machinery, equipment, and information systems. These are called **capital expenditures**. Unlike operating expenses, which produce benefits within a year, the benefits from capital expenditures extend beyond one year. For instance, a printer's purchase of a new printing press with a usable life of seven years is a capital expenditure and appears as a fixed asset on the firm's balance sheet. Paper, ink, and other supplies, however, are expenses. Mergers and acquisitions are also considered capital expenditures.

Firms make capital expenditures for many reasons. The most common are to expand, to replace or renew fixed assets, and to develop new products. Most manufacturing firms have a big investment in long-term assets. Boeing Company, for instance, puts billions of dollars a year into airplane manufacturing facilities. Because capital expenditures tend to be costly and have a major effect on the firm's future, the financial manager uses a process called **capital budgeting** to analyze long-term projects and select those that offer the best returns while maximizing the firm's value. Decisions involving new products or the acquisition of another business are especially important. Managers look at project costs and forecast the future benefits the project will bring to calculate the firm's estimated return on the investment.

Sources and Costs of Secured and Unsecured Short-term Financing?

How do firms raise the funding they need? They borrow money (debt), sell ownership shares (equity), and retain earnings (profits). The financial manager must assess all these sources and choose the one most likely to help maximize the firm's value.

Like expenses, borrowed funds can be divided into short- and long-term loans. A short-term loan comes due within one year; a long-term loan has a maturity greater than one year. Short-term financing is shown as a current liability on the balance sheet and is used to finance current assets and support operations. Short-term loans can be unsecured or secured.

Unsecured Short-Term Loans

Unsecured loans are made on the basis of the firm's creditworthiness and the lender's previous experience with the firm. An unsecured borrower does not have to pledge specific assets as security. The four main types of unsecured short-term loans are trade credit, bank loans, banker's acceptances (BA's) and commercial paper.

Trade Credit: Accounts Payable

When Goodyear sells tires to General Motors Canada (GMC), GMC does not have to pay cash on delivery. Instead, Goodyear regularly bills GMC for its tire purchases, and GMC pays at a later date. This is an example of trade credit: the seller extends credit to the buyer between the time the buyer receives the goods or services and when it pays for them. **Trade credit** is a major source of short-term business financing. The buyer enters the credit on its books as an **account payable**. In effect, the credit is a short-term loan from the seller to the buyer of the goods and services. Until GMC pays Goodyear, Goodyear has an account receivable from GMC, and GMC has an account payable to Goodyear.

Bank Loans

Unsecured bank loans are another source of short-term business financing. Companies often use these loans to finance seasonal (cyclical) businesses. Unsecured bank loans include lines of credit and revolving credit agreements. A line of credit specifies the maximum amount of unsecured short-term borrowing the bank will allow the firm over a given period, typically one year. The firm either pays a fee or keeps a certain percentage of the loan amount (generally 10 to 20 percent) in a checking account at the bank. Another bank loan, the revolving credit agreement, is basically a guaranteed line of credit that carries an extra fee in addition to interest. Revolving credit agreements are often arranged for a period of two to five years.

Commercial Paper Bankers Acceptances

As noted earlier, commercial paper is an unsecured short-term debt — an IOU — issued by a financially strong corporation. Thus, it is both a short-term investment and a financing option for major corporations. Corporations issue commercial paper in multiples of $100,000 for periods ranging from 3 to 270 days. Many big companies use commercial paper instead of short-term bank loans because the interest rate on commercial paper is usually 1 to 3 percent below bank rates.

Secured Short-Term Loans

Secured loans require the borrower to pledge specific assets as collateral, or security. The secured lender can legally take the collateral if the borrower doesn't repay the loan. Commercial banks and commercial finance companies are the main sources of secured short-term loans to business. Borrowers whose credit is not strong enough to qualify for unsecured loans use these loans. Typically, the collateral for secured short-term loans is accounts receivable or inventory. Because accounts receivable are normally quite liquid (easily converted to cash), they are an attractive form of collateral. The appeal of inventory — raw materials or finished goods — as collateral depends on how easily it can be sold at a fair price. Note the collateral is checked regularly to ensure it exists. If it has been sold without the lender's knowledge it is an illegal activity referred to as "fraudulent conversion."

Another form of short-term financing using accounts receivable is **factoring**. A firm sells its accounts receivable outright to a factor, a financial institution (often a commercial bank or commercial finance company) that buys accounts receivable at a discount. Factoring is widely used in the clothing, furniture, and appliance industries. Factoring is more expensive than a bank loan, however, because the factor buys the receivables at a discount from their actual value.

For businesses with steady orders but a lack of cash to make payroll or other immediate payments, factoring is a popular way to obtain financing. In factoring, a company sells its invoices to a third-party funding source for cash. The factor purchasing the invoices then collects on the due payments over time. Trucking companies with voluminous accounts receivable in the form of freight bills are good candidates for the use of short-term financing such as factoring.

Key Differences between Debt and Equity

A basic principle of finance is to match the term of the financing to the period over which benefits are expected to be received from the associated outlay. Short-term items should be financed with short-term funds, and long-term items should be financed with long-term funds. Long-term financing sources include both debt (borrowing) and equity (ownership). Equity financing comes either from selling new ownership interests or from retaining earnings. Financial managers try to select the mix of long-term debt and equity that results in the best balance between cost and risk.

Debt versus Equity Financing

Say that Bombardier Inc. plans to spend $2 billion over the next four years to build and equip new factories to make jet aircraft. Bombardier Inc.'s top management will assess the pros and cons of both debt and equity and then consider several possible sources of the desired form of long-term financing.

The major advantage of debt financing is the deductibility of interest expense for income tax purposes, which lowers its overall cost. In addition, there is no loss of ownership. The major drawback is **financial risk**: the chance that the firm will be unable to make scheduled interest and principal payments. The lender can force a borrower that fails to make scheduled debt payments into bankruptcy. Most loan agreements have restrictions to ensure that the borrower operates efficiently.

Equity, on the other hand, is a form of permanent financing that places few restrictions on the firm. The firm is not required to pay dividends or repay the investment. However, equity financing gives common stockholders voting rights that provide them with a voice in management. Equity is more costly than debt. Unlike the interest on debt, dividends to owners are not tax-deductible expenses. **Table 17.1** summarizes the major differences between debt and equity financing.

Debt Financing

Long-term debt is used to finance long-term (capital) expenditures. The initial maturities of long-term debt typically range between 5 and 20 years. Three important forms of long-term debt are term loans, bonds, and mortgage loans.

Table 17.1 Major Differences between Debt and Equity Financing

	Debt Financing	**Equity Financing**
Have a say in management	Creditors typically have none, unless the borrower defaults on payments. Creditors may be able to place restraints on management in event of default.	Common stockholders have voting rights.
Have a right to income and assets	Debt holders rank ahead of equity holders. Payment of interest and principal is a contractual obligation of the firm.	Equity owners have a residual claim on income (dividends are paid only after paying interest and any scheduled principal) and no obligation to pay dividends.
Maturity (date when debt needs to be paid back)	Debt has a stated maturity and requires repayment of principal by a specified date.	The company is not required to repay equity, which has no maturity date.
Tax treatment	Interest is a tax-deductible expense.	Dividends are not tax-deductible and are paid from after-tax income.

A **term loan** is a business loan with a maturity of more than one year. Term loans generally have maturities of 5 to 12 years and can be unsecured or secured. They are available from commercial banks, insurance companies, pension funds, commercial finance companies, and manufacturers' financing subsidiaries. A contract between the borrower and the lender spells out the amount and maturity of the loan, the interest rate, payment dates, the purpose of the loan, and other provisions such as operating and financial restrictions on the borrower to control the risk of default. The payments include both interest and principal, so the loan balance declines over time. Borrowers try to arrange a repayment schedule that matches the forecast cash flow from the project being financed.

Bonds are long-term debt obligations (liabilities) of corporations and governments. A bond certificate is issued as proof of the obligation. The issuer of a bond must pay the buyer a fixed amount of money — called interest, stated as the *coupon rate* — on a regular schedule, typically every six months. The issuer must also pay the bondholder the amount borrowed — called the **principal**, or *par value* — at the bond's maturity date (due date). Bonds are usually issued in units of $1,000 — for instance, $1,000, $5,000, or $10,000 — and have initial maturities of 10 to 30 years. They are secured with specific collateral. If unsecured (no collateral) they are called debentures. Bonds and debentures may include special provisions for early retirement, or be convertible to common stock.

A **mortgage loan** is a long-term loan made against real estate as collateral. The lender takes a mortgage on the property, which lets the lender seize the property, sell it, and use the proceeds to pay off the loan if the borrower fails to make the scheduled payments. Long-term mortgage loans are often used to finance office buildings, factories, and warehouses. Life insurance companies are an important source of these loans. They make billions of dollars' worth of mortgage loans to businesses each year.

Equity Financing and the Cost

Equity refers to the owners' investment in the business. In corporations, the preferred and common stockholders are the owners. A firm obtains equity financing by selling new ownership shares (external financing) and by retaining earnings (internal financing). Small and growing, typically high-tech, companies, raise capital through venture capital firms (external financing) by giving up some ownership (i.e. selling shares).

Selling New Issues of Common Stock

Common stock is a security that represents an ownership interest in a corporation. A company's first sale of stock to the public is called an *initial public offering* (IPO). An IPO often enables existing stockholders, usually employees, family, and friends who bought the stock privately, to earn big profits on their investment. (Companies that are already public can issue and sell additional shares of common stock to raise equity funds.)

But going public has some drawbacks. For one thing, there is no guarantee an IPO will sell. It is also expensive. Big fees must be paid to investment bankers, brokers, attorneys, accountants, and printers. Once the company is public, it is closely watched by regulators, stockholders, and securities analysts. The firm must reveal such information as operating and financial data, product details, financing plans, and operating strategies. Providing this information is often costly.

Going public is the dream of many small company founders and early investors, who hope to recoup their investments and become instant millionaires. Google went public in 2004 at $85 a share and soared to $475 in early 2006 before settling back to trade in the high-300 range in August 2006. More than a decade later, in October 2017, Google continues to be a successful IPO, trading at more than $990 per share.[5]

In recent years, the number of IPOs has dropped sharply, as start-ups think long and hard about going public, despite the promise of millions of dollars for investors and entrepreneurs. For example, in 2017, Blue Apron, a meal-kit delivery service, went public with an opening stock price of $10 per share. Several months later, the share price dropped more than 40 percent. Some analysts believe that Amazon's possible entry into the meal-kit delivery sector has hurt Blue Apron's value, as well as the company's high marketing costs to attract and retain monthly subscribers.[6]

Some companies choose to remain private. Maple Leaf Sports & Entertainment, Mars Canada, London Drugs, Giant Tiger, Gateway Casinos, Harry Rosen Inc., Joe Fresh, and McCain Foods are among the largest Canadian private companies.

Spotify, the Swedish music streaming company went public on the New York Stock Exchange in April 2018. Instead of an initial public offering, Spotify opted for a direct listing, meaning rather than issue new shares, the company started trading by letting existing shareholders sell their shares directly on the public market. In doing so, Spotify pioneered the direct listing. It's grown to 71 million paying subscribers and 159 million monthly active users. In the U.S., Spotify

5. McKay, P. (2017, October 6). *Why Going Public Doesn't Make Sense Right Now*. Fortune. https://fortune.com/2017/09/13/going-public-snap-blue-apron-ipo-stock-price/
6. Kochkodin, B. (2017, August 10). Blue Apron is the IPO Bust of the Decade. Bloomberg. https://www.bloomberg.com/news/articles/2017-08-10/blue-apron-down-44-is-the-ipo-bust-of-the-decade-chart

claims 41% of the U.S. market share, outpacing the reach of rival music services from Apple, Amazon, Pandora, Soundcloud and Tidal.[7]

Dividends and Retained Earnings

Dividends are payments to stockholders from a corporation's profits. Dividends can be paid in cash or in stock. **Stock dividends** are payments in the form of more stock. Stock dividends may replace or supplement cash dividends. After a stock dividend has been paid, more shares have a claim on the same company, so the value of each share often declines. A company does not have to pay dividends to stockholders. But if investors buy the stock expecting to get dividends and the firm does not pay them, the investors may sell their stocks.

At their quarterly meetings, the company's board of directors (typically with the advice of its CFO) decides how much of the profits to distribute as dividends and how much to reinvest. A firm's basic approach to paying dividends can greatly affect its share price. A stable history of dividend payments indicates good financial health.

For example, the CIBC has increased its dividend more than 85% ($0.87 to $1.61) percent over the past ten years, giving shareholders a healthy return on their investment.[8]

If a firm that has been making regular dividend payments cuts or skips a dividend, investors start thinking it has serious financial problems. The increased uncertainty often results in lower stock prices. Thus, most firms set dividends at a level they can keep paying. They start with a relatively low dividend payout ratio so that they can maintain a steady or slightly increasing dividend over time.

Retained earnings, profits that have been reinvested in the firm, have a big advantage over other sources of equity capital: they do not incur underwriting costs. Financial managers strive to balance dividends and retained earnings to maximize the value of the firm. Often the balance reflects the nature of the firm and its industry. Well-established and stable firms and those that expect only modest growth, such as public utilities, financial services companies, and large industrial corporations, typically pay out much of their earnings in dividends.

Most high-growth companies, such as those in technology-related fields, finance much of their growth through retained earnings and pay little or no dividends to stockholders. As they mature, many decide to begin paying dividends, as Apple decided to do in 2012, after 17 years of paying no annual dividends to shareholders.[9]

7. Snider, M. (2018, April 4). *Spotify goes public: What you need to know about the music streamer and its* IPO. USA TODAY. https://eu.usatoday.com/story/tech/talkingtech/2018/04/03/spotify-goes-public-what-you-need-know-music-streamer-and-its-ipo/480318002/
8. CIBC Investor Relations. (n.d.). *CIBC Common Dividends*. https://www.cibc.com/en/about-cibc/investor-relations/share-information/common-share-information/common-dividends.html
9. Vascellaro, J. E. (2012, March 21). *Apple to Pay Dividend, Plans $10 Billion Buyback*. WSJ. Retrieved October 10, 2017, from https://www.wsj.com/articles/SB10001424052702304724404577291071289857802

Preferred Stock

Another form of equity is **preferred stock**. Unlike common stock, preferred stock usually has a dividend amount that is set at the time the stock is issued. These dividends must be paid before the company can pay any dividends to common stockholders. Also, if the firm goes bankrupt and sells its assets, preferred stockholders get their money back before common stockholders do.

Like debt, preferred stock increases the firm's financial risk because it obligates the firm to make a fixed payment. But preferred stock is more flexible. The firm can miss a dividend payment without suffering the serious results of failing to pay back a debt.

Preferred stock is more expensive than debt financing, however, because preferred dividends are not tax-deductible. Also, because the claims of preferred stockholders on income and assets are second to those of debtholders, preferred stockholders require higher returns to compensate for the greater risk.

Venture Capital

Venture capital is another source of equity capital. It is most often used by small and growing firms that aren't big enough to sell securities to the public. This type of financing is especially popular among high-tech companies that need large sums of money.

Venture capitalists invest in new businesses in return for part of the ownership, sometimes as much as 60 percent. They look for new businesses with high growth potential, and they expect a high investment return within 5 to 10 years. By getting in on the ground floor, venture capitalists buy stock at a very low price. They earn profits by selling the stock at a much higher price when the company goes public. Venture capitalists generally get a voice in management through seats on the board of directors. Getting venture capital is difficult, even though there are hundreds of private venture-capital firms in this country. Most venture capitalists finance only about 1 to 5 percent of the companies that apply. Venture-capital investors, many of whom experienced losses during recent years from their investments in failed dot-coms, are currently less willing to take risks on very early stage companies with unproven technology. As a result, other sources of venture capital, including private foundations, states, and wealthy individuals (called *angel investors*), are helping start-up firms find equity capital. These private investors are motivated by the potential to earn a high return on their investment.

What Securities Trade in the Capital Markets?

Stocks, bonds, and other securities trade in securities markets. These markets streamline the purchase and sales activities of investors by allowing transactions to be made quickly and at a fair price. Securities are investment certificates that represent either *equity* (ownership in the issuing organization) or *debt* (a loan to the issuer). Corporations and governments raise capital to finance operations and expansion by selling securities to investors, who in turn take on a certain amount of risk with the hope of receiving a profit from their investment.

Securities markets are busy places. On an average day, individual and institutional investors trade billions of shares of stock in more than 10,000 companies through securities markets. *Individual investors* invest their own money to achieve their personal financial goals. **Institutional investors** are investment professionals who are paid to manage other people's money. Most of these professional money managers work for financial institutions, such as banks, mutual funds, insurance companies, and pension funds. Institutional investors control very large sums of money, often buying stock in 10,000-share blocks. They aim to meet the investment goals of their clients. Institutional investors are a major force in the securities markets, accounting for about half of the dollar volume of equities traded.

Types of Markets

Securities markets can be divided into primary and secondary markets. The **primary market** is where *new* securities are sold to the public, usually with the help of investment bankers. In the primary market, the issuer of the security gets the proceeds from the transaction. A security is sold in the primary market just once — when the corporation or government first issues it. The Google Blue IPO is an example of a primary market offering.

Later transactions take place in the **secondary market**, where *old* (already issued) securities are bought and sold, or traded, among investors. The issuers generally are not involved in these transactions. The vast majority of securities transactions take place in secondary markets, which include broker markets, dealer markets, the over-the-counter market, and the commodities exchanges. You will see *tombstones*, announcements of both primary and secondary stock and bond offerings, in the Globe and Mail; and other newspapers.

The Role of Investment Bankers and Stockbrokers

Two types of investment specialists play key roles in the functioning of the securities markets. **Investment bankers** help companies raise long-term financing. These firms act as intermediaries, buying securities from corporations and governments and reselling them to the public. This process, called **underwriting**, is the main activity of the investment banker, which acquires the security for an agreed-upon price and hopes to be able to resell it at a higher price to make a profit. Investment bankers advise clients on the pricing and structure of new securities offerings, as well as on mergers, acquisitions, and other types of financing. Well-known investment banking firms include Goldman Sachs, Morgan Stanley, and (Canada) BMO Nesbitt Burns, Inc., RBC Capital Markets LLC, and Canaccord Genuity Corp.

A **stockbroker** is a person who is licensed to buy and sell securities on behalf of clients. Also called *account executives*, these investment professionals work for brokerage firms and execute the orders customers place for stocks, bonds, mutual funds, and other securities. Investors are wise to seek a broker who understands their investment goals and can help them pursue their objectives.

Brokerage firms are paid commissions for executing clients' transactions. Although brokers can charge whatever they want, most firms have fixed commission schedules for small transactions. These commissions usually depend on the value of the transaction and the number of shares involved.

Online Investing

Improvements in internet technology have made it possible for investors to research, analyze, and trade securities online. Today almost all brokerage firms offer online trading capabilities. Online brokerages are popular with "do-it-yourself" investors who choose their own stocks and don't want to pay a full-service broker for these services. Lower transaction costs are a major benefit. Fees at online brokerages range from about $4.95 to $8.00, depending on the number of trades a client makes and the size of a client's account. Although there are many online brokerage firms, the four largest — Charles Schwab, Fidelity, TD Ameritrade, and E*Trade — account for more than 80 percent of all trading volume and trillions in assets in customer accounts.[10]

In Canada the highest ranking include: Questrade, Interactive Brokers, TD Direct Investing, and CIBC Investor's Edge. The internet also offers investors access to a wealth of investment information, for example, Qtrade Investor, rated (2021) best for Research.

Investing in Bonds

The terms "bonds" and "fixed income" are often used interchangeably, but in fact, bonds are only one type of fixed income investment in a family (asset class) which includes guaranteed investment certificates (GICs), and money market securities. Typically, these products generate a predictable stream of interest income and/or promise of a future lump sum payment and can be a great way to achieve diversification in your portfolio.

When many people think of financial markets, they picture the equity markets. However, the bond markets are huge. According to Bloomberg News Canada July 16, 2021 (https://www.bnnbloomberg.ca/canadian-companies-are-issuing-new-bonds-at-a-record-pace-1.1629944),[11] Canadian companies are issuing new bonds at a record-breaking pace. In 2021, Canadian companies took advantage of low rates to refinance and fund post-pandemic investments, putting them on-track to exceed the record of $111 billion sold in 2020.

Bonds can be bought and sold in the securities markets. However, the price of a bond changes over its life as market interest rates fluctuate. When the market interest rate drops below the fixed interest rate on a bond, it becomes more valuable, and the price rises. If interest rates rise, the bond's price will fall. *Corporate bonds*, as the name implies, are issued by corporations. They usually have a par value of $1,000. They may be secured or unsecured (called *debentures*), include special provisions for early retirement, or be convertible to common stock. Corporations can also issue *mortgage bonds*, bonds secured by property such as land, buildings, or equipment.

In addition to regular corporate debt issues, investors can buy *high-yield*, or *junk, bonds* — high-risk, high-return bonds often used by companies whose credit characteristics would not otherwise allow them access to the debt markets. They generally earn 3 percent or more above the returns on high-quality corporate bonds. Corporate bonds may also be issued with an option for the bondholder to convert them into common stock. These *convertible bonds* generally allow the bondholder to exchange each bond for a specified number of shares of common stock. Elon Musk and his electric car company, Tesla, issued high-yield junk bonds in August 2017 and raised nearly $1.8 billion to help

10. Woolley, S. (2017, February 27). *TD Ameritrade Jumps into Price War with Fidelity and Schwab*. Bloomberg. https://www.bloomberg.com/news/articles/2017-02-28/fidelity-slashes-commissions-in-the-latest-salvo-in-the-fee-wars#xj4y7vzkg
11. Duarte, E. (2021, July 16). *Canadian companies are issuing new bonds at a record pace*. BNN Bloomberg. https://www.bnnbloomberg.ca/canadian-companies-are-issuing-new-bonds-at-a-record-pace-1.1629944

finance the production and launch of Tesla's new Model 3. Tesla has spent billions of dollars in its efforts to develop electric cars in the past few years.[12]

Canadian Government, Provincial and Municipal Bonds and Securities

Federal, provincial and municipal governments issue bonds to fund deficits or to raise capital for program spending. Generally, maturity terms range from over two to 30 years and interest is payable on a semi-annual basis. The most highly-traded bond issues have terms of five, 10, and 30 years. As discussed earlier, corporate bonds are debts issued by companies to raise capital to finance operations and projects. Corporate bonds are riskier than government bonds and have a higher risk of default. However, the increased risk generally comes with higher returns than safer government bonds. Liquidity varies depending on the issuer. See below Summary of Government of Canada (GOC) Bonds, Provincial Bonds and Municipal Bonds from RBC – Understanding Fixed Income.[13] (https://www6.royalbank.com/en/di/reference/article/fixed-income-types/j7cypocm)

Table 17.2 Types of Bonds

	Government of Canada (GOC) Bonds	**Provincial Bonds**	**Municipal Bonds**
Rating	AAA rating	Vary in credit rating depending on the province's power of taxation and the creditworthiness of the debt	Vary in credit rating depending on the municipality's power of taxation and the creditworthiness of the debt.
Yield	Highest credit quality and most conservative bond available in Canada	Have higher yields than GOC bonds	May have higher or lower yields than provincial issues of the same quality, depending on specific issues and liquidity.
Guaranteed?	Guaranteed by the federal government	Guaranteed by issuing province	Not automatically guaranteed by the provinces in which they operate

Strip Coupons and Residual Bonds

Coupons are created from federal, provincial, or municipal bonds whose two basic components — the semi-annual interest payments (coupons) and the principal amount (the residual) — are separated and sold as individual securities. These instruments are purchased at a discount and mature at par (100% or $100). Generally, the longer the term to maturity, the greater the discount. Coupons and residuals pay no interest until maturity and entitle the holder to the security's full face value at maturity. The interest compounds annually at the yield to maturity at the time of purchase. For example, a Canadian strip coupon maturing in five years with a yield of 6% would be priced at $74.72 and mature at $100. Although no money is paid out until maturity, the interest on the bond accrues each year and must be included as income on income tax records annually. Compared with conventional bonds, strip coupons eliminate reinvestment risk over the term of the investment by paying no cash flows until maturity. Coupons may offer higher yields than bonds but its price will fluctuate more than a bond of similar term and credit quality. Coupons offer investors safety (most are

12. Sifma. (2016). 2016 *Year in Review*. Retrieved October 10, 2017, from https://www.sifma.org/wp-content/uploads/2017/05/2016-year-in-review.pdf
13. Royal Bank of Canada. (n.d.). Types of Fixed Income. https://www6.royalbank.com/en/di/reference/article/fixed-income-types/j7cypocm

government or high-quality corporate-backed), and an attractive guaranteed yield if held to maturity. Strip coupons remain a popular choice for tax-sheltered accounts such as RRSPs and RRIFs.

Bond Ratings

Bonds vary in quality, depending on the financial strength of the issuer. Because the claims of bondholders come before those of stockholders, bonds are generally considered less risky than stocks. However, some bonds are in fact quite risky. Companies can default — fail to make scheduled interest or principal payments — on their bonds. Investors can use **bond ratings**, letter grades assigned to bond issues to indicate their quality or level of risk. Ratings for corporate bonds are easy to find. The two largest and best-known rating agencies are Moody's and Standard & Poor's (S&P), whose publications are in most libraries and in stock brokerages. **Table 17.3 (https://openstax.org/books/introduction-business/pages/16-6-securities-markets#fs-idm405100656)** lists the letter grades assigned by Moody's and S&P. A bond's rating may change if a company's (or country's) financial condition changes.

Table 17.3 Moody's and Standard & Poor's Bond Ratings

Moody's Ratings	S & P Ratings	Description
Aaa	AAA	**Prime-quality investment bonds:** Highest rating assigned; indicates extremely strong capacity to pay.
Aa, A	AA, A	**High-grade investment bonds:** Also considered very safe bonds, although not quite as safe as Aaa/AAA issues; Aa/AA bonds are safer (have less risk of default) than single As.
Baa	BBB	**Medium-grade investment bonds:** Lowest of investment-grade issues; seen as lacking protection against adverse economic conditions.
Ba B	BB B	**Junk bonds:** Provide little protection against default; viewed as highly speculative.
Caa Ca C	CCC CC C D	**Poor-quality bonds:** Either in default or very close to it.

Money Market Products

Treasury Bills

Money market products such as treasury bills (T-bills), commercial paper and banker's acceptances are short-term fixed income products that are sold at a discount and mature at par (face value). The difference between your purchase price and par value is your return. T-Bills are short-term debt instruments issued by federal and provincial governments. Fully backed by the applicable government issuer, a high level of security makes T-Bills a popular investment for individual, institutional, and corporate investors. T-bills are considered very safe because they are fully guaranteed by the issuing government; however, they offer considerably lower potential returns than most other securities. The difference between your purchase price and par value is your return and it is considered interest income.

Banker's Acceptances (BAs)

BAs are short-term credit investments created by a borrower for payment on a specified future date. BAs are "accepted" or guaranteed at maturity by banks and offer a high degree of safety for short-term investors.

Commercial Paper (CP)

CP investments are unsecured promissory notes issued by corporations. Companies issue CP to finance seasonal cash flow and working capital needs at lower rates than conventional bank loans.

Crown Corporate Paper

Crown corporations are state-owned enterprises owned by the Sovereign of Canada. Short-term promissory notes are issued by crown corporations such as the Canadian Mortgage and Housing Corporation, Federal Business Development Bank, Export Development Corporation or Canadian Wheat Board. Many crown corporations issue commercial paper denominated in both Canadian and U.S. dollars.

Other Popular Securities

In addition to stocks and bonds, investors can buy Guaranteed Investment Certificates (GICs), mutual funds, or exchange-traded funds (ETFs). Futures contracts and options are more complex investments for experienced investors.

Guaranteed Investment Certificates

A Guaranteed Investment Certificate (GIC) is a deposit investment issued by financial institutions such as chartered banks, trust companies and mortgage and loan companies. GICs offer a specified rate of return for a set period.

Many GICs are guaranteed by the Canada Deposit Insurance Corporation (CDIC) for up to $100,000 (this includes both principal and interest), provided that certain criteria are met. Each individual issuer can provide full CDIC coverage, which means that you could invest, for example, $400,000 with four different issuers — all completely CDIC insured and in one account. In addition, the CDIC coverage applies to each registration. For example, with one issuer you could have $100,000 in each of a GIC, an RRSP, a RRIF and a TFSA and they would all be covered.

Mutual Funds

Suppose that you have $1,000 to invest but don't know which stocks or bonds to buy, when to buy them, or when to sell them. By investing in a mutual fund, you can buy shares in a large, professionally managed portfolio, or group, of stocks and bonds. A **mutual fund** is a financial service company that pools its investors' funds to buy a selection of securities — marketable securities, stocks, bonds, or a combination of securities — that meet its stated investment goals. Each mutual fund focuses on one of a wide variety of possible investment goals, such as growth or income. Many large financial service companies, such as BMO Investments Inc., CIBC Securities Inc., and Manulife Securities Investments

Services Inc., sell a wide variety of mutual funds, each with a different investment goal. Investors can pick and choose funds that match their particular interests. Some specialized funds invest in a particular type of company or asset: in one industry such as health care or technology, in a geographical region such as Asia, or in an asset such as precious metals.

Mutual funds are one of the most popular investments for individuals today; they can choose from about 9,500 different funds. Investments in mutual funds amount to more than $40 trillion worldwide, of which U.S. mutual funds hold more than $19 trillion. Mutual funds appeal to investors for three main reasons:

- They are a good way to hold a diversified, and thus less risky, portfolio. Investors with only $500 or $1,000 to invest cannot diversify much on their own. Buying shares in a mutual fund lets them own part of a portfolio that may contain 100 or more securities.
- Mutual funds are professionally managed.
- Mutual funds may offer higher returns than individual investors could achieve on their own.

Exchange-Traded Funds

Another type of investment, the exchange-traded fund (ETF), has become very popular with investors. ETFs are similar to mutual funds because they hold a broad basket of stocks with a common theme, giving investors instant diversification. ETFs trade on stock exchanges (most trade on the American Stock Exchange, AMEX), so their prices change throughout the day, whereas mutual fund share prices, called net asset values (NAVs), are calculated once a day, at the end of trading. Investors can choose from more than 1,700 ETFs that track almost any market sector and industry sectors such as health care or energy, and geographical areas such as a particular country (Japan) or region (Latin America). In Canada there are over 700 ETFs listed on the TSX (Toronto Stock Exchange). ETFs have very low expense ratios. However, because they trade as stocks, investors pay commissions to buy and sell these shares.

Futures Contracts and Options

Futures contracts are legally binding obligations to buy or sell specified quantities of commodities (agricultural or mining products) or financial instruments (securities or currencies) at an agreed-on price at a future date. An investor can buy commodity futures contracts in cattle, pork bellies (large slabs of uncured bacon), eggs, coffee, flour, gasoline, fuel oil, lumber, wheat, gold, and silver. Financial futures include Treasury securities and foreign currencies, such as the British pound or Japanese yen. Futures contracts do not pay interest or dividends. The return depends solely on favorable price changes. These are very risky investments because the prices can vary a great deal and are considered speculative for retail investors.

Options are contracts that entitle holders to buy or sell specified quantities of common stocks or other financial instruments at a set price during a specified time. As with futures contracts, investors must correctly guess future price movements in the underlying financial instrument to earn a positive return. Unlike futures contracts, options do not legally obligate the holder to buy or sell, and the price paid for an option is the maximum amount that can be lost. However, options have very short maturities, so it is easy to quickly lose a lot of money with them.

Where can Investors Buy and Sell Securities, and How are Securities Markets Regulated?

When we think of stock markets, we are typically referring to secondary markets, which handle most of the securities trading activity. The two segments of the secondary markets are broker markets and dealer markets. The primary difference between broker and dealer markets is the way each executes securities trades. Securities trades can also take place in alternative market systems and on non-U.S. securities exchanges.

The securities markets both in Canada and around the world are in flux and undergoing tremendous changes. We present the basics of securities exchanges in this section and discuss the latest trends in the global securities markets later in the chapter.

Broker Markets

The broker market consists of national and regional securities exchanges that bring buyers and sellers together through brokers on a centralized trading floor. In the broker market, the buyer purchases the securities directly from the seller through the broker. Broker markets account for about 60 percent of the total dollar volume of all shares traded in the U.S. securities markets.

Canadian Stock Exchange

TMX Group is an integrated, multi-asset class exchange group. TMX Group's key subsidiaries operate cash and derivative markets and clearinghouses for multiple asset classes including equities, fixed income and energy. The TMX owns and operates *Toronto Stock Exchange* (TSX) which is Canada's senior equities market, providing issuers with a venue for raising capital and providing domestic and international investors with the opportunity to invest in and trade those issuers' securities.

- TMX also owns the *TSX Venture Exchange*. TSX Venture Exchange is Canada's premier junior listings market, providing companies at the early stages of growth with the opportunity to raise capital and providing investors with the opportunity to invest in and trade those issuers' securities.
- *TSX Trust*: TSX Trust is a provider of corporate trust, securities transfer and registrar, and employee plan administration services for issuers.
- *Montréal Exchange*: Montréal Exchange is Canada's standardized financial derivatives exchange. Headquartered in Montréal, MX offers trading in interest rate, index and equity derivatives.
- *TSX Alpha Exchange*: TSX Alpha Exchange is an exchange that provides equities trading for TSX and TSXV listed securities.
- *Shorcan*: Shorcan is Canada's first inter-dealer broker (IDB), providing facilities for matching orders for Canadian federal, provincial, corporate and mortgage bonds and treasury bills and derivatives for anonymous or name-give-up buyers and sellers in the secondary market.
- *Canadian Derivatives Clearing Corporation*(CDCC) offers clearing and settlement services for all MX transactions and certain over-the-counter (OTC) derivatives, including fixed income repurchase and reverse repurchase agreement (REPO) transactions.
- *Canadian Depository for Securities*(CDS) is Canada's national securities depository, clearing and settlement hub.

CDS supports Canada's equity, fixed income and money markets and is accountable for the safe custody and movement of securities, the processing of post-trade transactions, and the collection and distribution of entitlements relating to securities deposited by participants.
- *TMX Insights* delivers financial content, tools and applications, as well as analytics to drive better markets and investment decisions.
- *Trayport* is a leading provider of energy trading solutions to traders, brokers and exchanges worldwide.
- *TMX Money* provides investors with powerful investment tools and resources. It is the trusted Canadian source for current market data, index, and company information for the Canadian and US markets.

Dealer Markets

Unlike broker markets, do not operate on centralized trading floors but instead use sophisticated telecommunications networks that link dealers throughout Canada. Buyers and sellers do not trade securities directly, as they do in broker markets. They work through securities dealers called *market makers*, who make markets in one or more securities and offer to buy or sell securities at stated prices. A security transaction in the dealer market has two parts: the selling investor sells his or her securities to one dealer, and the buyer purchases the securities from another dealer (or in some cases, the same dealer).

The Over-the-Counter Market

The over-the-counter (OTC) markets refer to those other than the organized exchanges. There are two OTC markets: the *Over-the-Counter Bulletin Board* (OTCBB) and the *Pink Sheets*. These markets generally list small companies and have no listing or maintenance standards, making them attractive to young companies looking for funding. OTC market has no trading floor. It consists of many people in different locations who hold an inventory of securities that are not listed on any of the major exchanges. The OTC market consists of independent dealers who own the securities that they buy and sell at their own risk. Investing in OTC companies is highly risky and should be for experienced investors only.

NASDAQ

The largest dealer market is the National Association of Securities Dealers Automated Quotation system, commonly referred to as NASDAQ. The first electronic-based stock market, the NASDAQ is a sophisticated telecommunications network that links dealers throughout the world. Its sophisticated electronic communication system provides faster transaction speeds than traditional floor markets and is the main reason for the popularity and growth of the OTC market. The NASDAQ lists more companies than the NYSE, but the NYSE still leads in total market capitalization. Many newer firms are listed there when their stocks first become available in the secondary market. Highly traded listings include Apple, Microsoft, Intel, and Netflix.

Watch How to read a stock quote from RBC (http://https://www.youtube.com/watch?v=MMwHzkywe4o&t=148s).

Alternative Trading Systems

In addition to broker and dealer markets, alternative trading systems such as electronic communications networks (ECNs) make securities transactions. ECNs are private trading networks that allow institutional traders and some individuals to make direct transactions in what is called the *fourth market*. ECNs bypass brokers and dealers to automatically match electronic buy and sell orders. They are most effective for high-volume, actively traded stocks. Money managers and institutions such as pension funds and mutual funds with large amounts of money to invest like ECNs because they cost far less than other trading venues.

Global Trading and Foreign Exchanges

Improved communications and the elimination of many legal barriers are helping the securities markets go global. The number of securities listed on exchanges in more than one country is growing. Foreign securities are now traded in the United States. Likewise, foreign investors can easily buy U.S. securities.

Stock markets also exist in foreign countries; more than 60 countries operate their own securities exchanges. NASDAQ ranks second to the NYSE, followed by the London Stock Exchange (LSE) and the Tokyo Stock Exchange. Other important foreign stock exchanges include Euronext (which merged with the NYSE but operates separately) and those in Toronto, Frankfurt, Hong Kong, Zurich, Australia, Paris, India and Taiwan. Why should U.S. investors pay attention to international stock markets? Because the world's economies are increasingly interdependent, businesses must look beyond their own national borders to find materials to make their goods and markets for foreign goods and services. The same is true for investors, who may find that they can earn higher returns in international markets.

Regulation of Securities Markets

In Canada, the regulation of securities markets is a provincial responsibility. Canada has a number of provincial securities commissions, such as the British Columbia Securities Commission, the Québec Securities Commission (Québec Autorité des marchés financiers), and the New Brunswick Financial and Consumer Services Commission. These commissions oversee the securities industry and the capital markets across Canada and administer and enforce provincial securities legislation, such as the *Securities Act*.

Regulators protect investors by making and enforcing rules for the securities industry in Canada. In Canada, we have two main bodies protecting investors: Provincial and Territorial Securities Regulators and Industry Self-Regulatory Organizations and Groups (SROs).

1. Provincial and Territorial Securities Commissions

Provincial securities commissions are mandated to protect investors from unfair, improper, or fraudulent practices and to foster fair and efficient capital markets. They do this by:

1. registering and supervising those in the business of advising on or trading in securities;
2. supporting self-regulation of the securities markets and overseeing the self-regulatory organizations;
3. ensuring that investors have access to the information they need to make informed investment decisions; and

4. conducting investigations and bringing enforcement actions for serious infractions of securities law.

In Canada, provincial and territorial securities commissions, such as the BC Securities Commission or Ontario Securities Commission (OSC), administer and enforce rules around how securities are issued, bought and sold, and set minimum entry standards for market intermediaries who deal with investors. Anyone who sells securities or gives advice about securities must be registered with their provincial commission. Different types of registration can be held by an investment representative or the sponsoring firm. Individuals or firms that are registered are called "registrants." The type of registration determines what kinds of investment products the registrants are licensed to sell or the types of services they can provide.

Securities regulators also regulate marketplaces and clearing agencies, oversee the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA), approve individuals and firms for regulation based on proficiency and educational requirements, and discipline firms and individuals. Securities regulators work together through the Canadian Securities Administrators (CSA).

2. Self-Regulatory Organizations (SROs)

The investment community also regulates itself, developing and enforcing ethical standards to reduce the potential for abuses in the financial marketplace. In Canada, SROs regulate their members' standards of practice and business conduct in order to promote investor protection. Canada has two main SROs:

1. IIROC sets and enforces rules for investment dealers and for equity marketplaces like the Toronto Stock Exchange and TSX Venture Exchange. It also monitors trading on those marketplaces, approves training courses and disciplines member firms and individuals.
2. The MFDA sets and enforces rules for mutual fund dealers and disciplines member firms and individuals.

In Quebec, the Montréal Exchange is also considered an SRO. MX is the only financial derivatives exchange in Canada, and currently lists equity options, options on ETFs, currency options, index derivatives, and interest rate derivatives.

Securities Legislation

Canada does not have comprehensive federal securities legislation or federal regulatory body. Government regulation is primarily provincial and emphasizes self-regulation though the various provincial securities exchanges.

The meaning of *insider* was expanded beyond a company's directors, employees, and their relatives to include anyone who gets private information about a company. The B.C. *Securities Act*, *Securities Regulation*, and *Securities Rules*, as well as national, multi-lateral, and B.C. instruments regulate trading in securities and derivatives in the province of British Columbia.

Risk Management

Canadian financial institutions face an increasingly complex regulatory web as regulators in Canada and globally are imposing greater pressures to assess, monitor and mitigate regulatory and operational risks. Also, today's financial institutions need to keep up with new regulations, deal with new issues, including those created by remote work and emerging technologies, and manage the human resources and technological requirements to get the job done. The speed of change is rapid and the demands are increasing.

Risk is defined as the uncertainty about future events; various risks originate due to the uncertainty arising out of various factors that influence an investment or a situation. Businesses face two basic types of risk: speculative risks, such as financial investments, including the possibility of a gain or loss, and pure risk, which includes all the possibility of loss or no loss. Managing these risks is important for companies to survive and prosper.

Risk management in the financial world is the process of identification, analysis, and acceptance or mitigation of uncertainty in investment decisions. Essentially, risk management occurs when an investor or fund manager analyzes and attempts to quantify the potential for losses in an investment. There are five steps to Risk Management:

1. Identify Risks and Potential Losses.
2. Measure the Frequency and Impact.
3. Evaluate Alternatives and Respond; respond options include:
    - **Avoidance** — refuse to participate in ventures that carry any risk:
    - **Control** — techniques to prevent, minimize, or reduce losses or consequences of losses;
    - **Retention** — covering unavoidable losses with its own funds; and
    - **Transfer** — transfer of risk to another individual or firm by contract.
4. Implement Choice of Risk Response.
5. Monitor Results.

Comprehensive Check

1. What is the main goal of the financial manager? How does the risk-return trade-off relate to the financial manager's main goal?
2. Distinguish between short- and long-term expenses.
3. Describe a firm's main motives in making capital expenditures.
4. Why might firms choose factoring instead of loans?
5. Distinguish between unsecured and secured short-term loans.
6. Briefly describe the three main types of unsecured short-term loans.
7. Distinguish between debt and equity.
8. Briefly describe these sources of equity: retained earnings, preferred stock, and venture capital.
9. Why do mutual funds and exchange-traded funds appeal to investors?

Key Takeaways

1. The key activities of the financial manager are:
    - *financial planning;*
    - *investment; and*
    - *financing.*
2. Financial management — the art and science of managing a firm's money so that it can meet its goals — is not just the responsibility of the finance department. All business decisions have financial consequences. Managers in all departments must work closely with financial personnel.
3. Risk-return trade-off is a concept in finance that explains the principle that the higher the risk, the greater the return that is required.
4. Short-term expenses support the firm's day-to-day activities, and long-term expenses are typically for fixed assets.
5. Financial managers must choose the best mix of debt and equity for their firm. The main advantage of debt financing is the tax-deductibility of interest. But debt involves financial risk because it requires the payment of interest and principal on specified dates. Equity — common and preferred stock — is considered a permanent form of financing on which the firm may or may not pay dividends. Dividends are not tax-deductible.
6. The main types of long-term debt are term loans, bonds, and mortgage loans.
7. The main sources of equity financing are common stock, retained earnings, and preferred stock.
8. Securities markets allow stocks, bonds, and other securities to be bought and sold quickly and at a fair price. New issues are sold in the primary market. After that, securities are traded in the secondary market. Investment bankers specialize in issuing and selling new security issues. Stockbrokers are licensed professionals who buy and sell securities on behalf of their clients.
9. Competition among the world's major securities exchanges has changed the composition of the financial marketplace.

Attributions

CASE STUDIES

Case Study 1: Empowering Women in Business

Nicole McClaren - An inspirational story of a Canadian Indigenous Entrepreneur

VANESSA COOK

By Vanessa Cook – Douglas College Student (Feb 2022)

As a mother, an immigrant, a Canadian, and a woman in business, I have followed many different women entrepreneurs, as a source of inspiration, and Nicole McClaren (https://ravenreads.org/pages/about-us#story) is definitely an entrepreneur to celebrate.

The Truth and Reconciliation Commission (TRC) of Canada (https://www.rcaanc-cirnac.gc.ca/eng/1450124405592/1529106060525)was created to bring awareness and provide people affected by the legacy of the Indian Residential Schools system an opportunity to have a voice. At a time where Canada needed to come together and celebrate our diversity, Nicole, an indigenous Canadian and member of the Metis Nation of BC started a business to bring awareness to the power of inclusion through reading.

When Raven Reads (https://ravenreads.org/pages/about-us#about) was first formed, it was a book club to share stories written by indigenous people. Since then, Nicole, who is the Founder & CEO has evolved the book club into an Indigenous Subscription Box Service, shipping their elegantly packaged products to customers of all ages. With an emphasis on indigenous writers and creators, Raven Reads has created a platform that services customers globally, leveraging the power of technology with their website and ecommerce capabilities. Their product portfolio includes beautifully crafted boxes decorated with Indigenous art, with each box including:

- a book written/illustrated by an Indigenous author;
- a letter;
- Indigenous culture teachings from around the world; and
- giftware items from Indigenous entrepreneurs.

Raven Reads also has a line of age-appropriate boxes developed specifically for children, as well as for companies looking for gifts (Corporate Gift Boxes).

Customers in Canada pay no shipping fees and all customers can subscribe seasonally, bi-annually, or annually. Their business model provides the option to cancel at any time, making it easy for people to experience their products without being tied into a contract.

Raven Reads was featured in BC Business (https://www.bcbusiness.ca/Inventory-These-BC-subscription-boxes-make-opening-the-mail-more-fun)[1] and Best Health Magazine (https://www.besthealthmag.ca/list/holiday-gift-baskets-sets-canada/), and Nicole was awarded the Entrepreneurial Spirit Award (https://www.powwowpitch.org/nicole-mclaren-wins-the-entrepreneur-spirit-award/) at the Indigenous Entrepreneurship Awards in November 2021. To learn more about these awards, and other Canadian Indigenous Entrepreneurs, please watch the video listed here (https://www.youtube.com/watch?v=HO7Au7xod4E&t=28s). You will be moved and inspired by the music, the

1. Hirose, A. (2021) BC *Business* 49 (5), 89. https://www.bcbusiness.ca/industries/retail/Inventory-These-BC-subscription-boxes-make-opening-the-mail-more-fun/

language, the majestic landscape of our vast and diverse country and the power of the words of the song, Remember Me.

"I want to show Indigenous girls and women that they can scale multi-million dollar businesses with big impact," said Nicole McLaren. "Winning this award is a recognition for the blood (cardboard cuts), sweat, and tears I have invested in this entrepreneurial journey and is an important occasion to celebrate how far we have come." (McClaren, 2021)

In a Canada Export article (https://www.tradecommissioner.gc.ca/canadexport/0006041.aspx?lang=eng&utm_campaign=gac-amc-tcs-canadexport-21-22&utm_source=canadexport&utm_medium=newsletter&utm_content=2021-06-10-en) as part of the Trade Commissioner Service through the Government of Canada, Raven Reads is looking to expand globally, and Nicole has leveraged the Trade Accelerator Program to help develop an export plan.

To illustrate the global stigma for woman in business, this TED Talk[2] brings awareness of the challenges but also the opportunities that exist, when women are empowered. In addition to running Raven Reads, Nicole founded the Indigenous Women's Business Network (https://www.indigenouswomenbc.com/), a non-profit organization to empower indigenous women in BC to be successful in business.

The Inclusive Futures Indigenous Engagement in Canada's Workforce (https://ppforum.ca/wp-content/uploads/2020/03/AC-Inclusive-Futures-Indigenous-ENG-WEB.pdf)[3] white paper highlights the value that Indigenous people bring to Canada's overall Economic Development being the fastest-growing and youngest demographic in Canada.

There is much more work to be done to ensure Canada recognizes and embraces a fully inclusive and diverse culture and with Canada's aging population (https://www.canada.ca/en/employment-social-development/programs/seniors-action-report.html), women and indigenous people need empowerment to start new businesses to aid in the overall economic development of Canada. Nicole McClaren is a powerful role- model, and her success story needs to be shared with all indigenous peoples, and more broadly, all girls, women, and entrepreneurs globally.

"What makes entrepreneurs special is that they see opportunities where everyone else sees obstacles. Entrepreneurs are problem-solvers, so they're often undaunted — and even excited — by problems." *Arlene Dickenson* (Dickenson, 2021).

2. Tzemach Lemmon, G. (2011, December). Women entrepreneurs, example not exception [Video]. TED. https://www.ted.com/talks/gayle_tzemach_lemmon_women_entrepreneurs_example_not_exception
3. Davey, J., Giang, V., McCale, A., (2020) Inclusive Futures, Indigenous Engagement in Canada's Workforce https://ppforum.ca/wp-content/uploads/2020/03/AC-Inclusive-Futures-Indigenous-ENG-WEB.pdf

Glossary

absolute advantage

A country has an absolute advantage in producing a good over another country if it uses fewer resources to produce that good. Absolute advantage can be the result of a country's natural endowment.

account payable

Purchases for which a buyer has not yet paid the seller.

accounting

Accounting is the organizational function that is focused on recording, keeping, analyzing and communicating financial information.

accounting equation

Accounting equation is the principle that the book value of a company's assets must equal the finance that has purchased those assets. Accounting Equation is expressed as:
Assets = Liabilities + Owner's Equity

Accounts receivable

Sales for which a firm has not yet been paid.

acquisition

Acquisition is a term used when one company purchases another company.

balance of payments

The balance of payments (BOP) is 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.

balance of trade

Balance of trade (BOT) is the difference between the value of a country's exports and the value of a country's imports for a given period.

balance sheet

Balance sheet is a statement of an organization's assets, liabilities and the owner's equity at a specific point in time.

bond ratings

Letter grades assigned to bond issues to indicate their quality or level of risk; assigned by rating agencies such as Moody's and Standard & Poor's (S&P).

Bonds

Bonds are long-term debt obligations (liabilities) of corporations and governments. A bond certificate is issued as proof of the obligation.

branding

Branding is about establishing an identity for a company's product that distinguishes it from the competition. Successful branding adds value to a product and can ensure brand loyalty.

breakeven

Breakeven is the point where total sales revenue equals expenses that is the point with no profit or loss.

business

A business is an organization that produces or sells goods and/or services for a profit. Other organizations, such as non-profits, may provide goods or services, but do not do so for a profit.

business cycle

The business cycle is the regular economic pattern of upturns and downturns in demand and output within the economy that tend to repeat themselves every three to five years or may last much longer.

Business ethics

Business ethics is the study of how a business should act when faced with ethical dilemmas and controversial situations in a business context.
Business ethics is important because it enables a business to work within the boundaries of the law, and ensures that the the business is not committing crimes against its employees, customers, consumers and other stakeholders and interested parties.

business participants

Business participants are the people who participate in conducting the work of the business. These always include the employees and managers, but often include suppliers, customers, and shareholders.

capital budgeting

The process of analyzing long-term projects and selecting those that offer the best returns while maximizing the firm's value.

capital expenditures

Investments in long-lived assets, such as land, buildings, machinery, equipment, and information services, that are expected to provide benefits over a period longer than one year.

Cash Flow Statement

The Cash Flow Statement reports cash inflows and outflows and 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).

cash flows.

The inflow and outflow of cash for a business.

cash management

The process of making sure that a firm has enough cash on hand to pay bills as they come due and to meet unexpected expenses.

coincident indicators

Coincident indicators show the state of the economy today.

commercial paper

Commercial paper is unsecured short-term debt—an IOU—issued by a financially strong corporation.

comparative advantage

A country has a comparative advantage when a good can be produced at a lower cost in terms of other goods. The idea is that countries can benefit from specializing in the production of goods at which they are relatively more efficient. This implies that consumers in each country gain the maximum benefit from international trade.

competitor

Competitors are other organizations that compete in one or more areas of business. Competitors play an important role in the business's success. In fact, suppliers can be participants, stakeholders, and an external environmental influence.

complexity

Complexity in the external environment is related to the extent to which the business requires specialized and differing knowledge in order to understand the influences of the environment and how to operate the business.

Consumer price index (CPI)

The Consumer Price Index (CPI) represents changes in prices as experienced by Canadian consumers. It measures price change by comparing, through time, the cost of a fixed basket of goods and services.

cooperative

A cooperative is a business owned and controlled by those who use its services - producers, customers or consumers..

corporation

A corporation is a legal entity that is entirely separate from the parties who own it. Once businesses reach a substantial size, it is advantageous to organize as a corporation so that its owners can limit their liability.

cross-functional team

Cross-functional teams are teams where team members come from different organizational functional areas.

current assets

Current assets, include cash and any other assets (accounts receivable and inventory) that can be converted to cash within a year.

customer

Customers buy the products and/or services from the business. Customers are extremely important to the business. In fact, they are participants, stakeholders, and an external environmental influence.

Debt ratios

The debt ratio is defined as the ratio of total debt to total assets. It measures the extent of a company's leverage.

deflation

Deflation is downward pressure upon the level of economic activity. It is a period of falling demand and prices. It is usually accompanied by reduce output and rising unemployment.

demand

Demand is the quantity of a product that buyers are willing to purchase at various prices.

Dividends

Payments to stockholders from a corporation's profits.

dumping

Dumping describes the selling of a good in another country at less than its cost price.

economic indicator

An economic indicators are the monthly statistics that provide information on the country's economic performance. There are different types of indicators which are all subject to considerable error, so it is unwise to draw any conclusions from just one month's data.

Economics

Economics is concerned with the production, distribution, and consumption of goods and services. It studies how individuals, businesses, governments, and nations make choices about how to allocate resources.

economy

Economy is a region's or country's system for selling, trading, and consuming goods and services (1 (https://www.investopedia.com/terms/e/economy.asp)). The economy is an external environment influence on the business. It affects the money available to the customers and to the business. Factors, such as interest rates, inflation, and deflation, greatly influence the buying behaviours of customers and how the businesses should adapt their offerings.

Efficiency ratios

Efficiency ratios measures a company's ability to use its assets to generate income.

Electronic funds transfer (EFT)

Electronic funds transfer (EFT) is the electronic transfer of money from one bank account to another, either within a single financial institution or across multiple institutions, via computer-based systems, telephones without the direct intervention of bank staff.

employees

Employees are the people who work for an organization. Sometimes, when talking about organizations, managers' roles are differentiated from other workers' roles because their responsibilities are different. Nonetheless, managers and workers are all employees of the organization.

ethics

The term ethics is used to describe moral principles that governs a person's behavior or conduct during an activity.

exporting

Exporting refers to the sales of products and services in foreign countries that are sourced or made in the home country.

Extended reality

Extended reality (XR) is an umbrella term referring to all real-and-virtual combined environments and interactions generated by computer technology. It includes augmented reality (AR) and virtual reality (VR).

external factors

External environmental factors are the factors outside the organization that influence the business. These often include the social and cultural, natural environment, political, legal, technological, and economic factors.

factoring

Factoring is a form of short-term financing in which a firm sells its accounts receivable outright at a discount to a factor.

finance

Finance is the organization function that is about planning what financial resources are needed, procuring the necessary financial resources, and then maintaining financial health for the business.

Financial accounting

Financial accounting is concerned with the production and reporting of the financial accounts according to the requirements of the International Financial Reporting Standards (IFRS) so that users of the accounts have an accurate view of the company's financial position.

Financial management

Financial Management is the art and science of managing a firm's money so that it can meet its goals.

financial risk

Financial risk is the chance that the firm will be unable to make scheduled interest and principal payments.

Fiscal policy

Fiscal policy is a government towards its raising of revenue and its level of public spending.

Foreign direct investment

Foreign direct investment refers to the buying or establishing tangible assets in another country.

franchises

Franchise is a business based upon the name, logo and trading method of an existing successful business (franchisor). To obtain a franchise requires the payment of an initial fee and the signing of a contract that imposes constraints and restrictions on the franchisee.

free market system

Free market system is defined as an economy operating by free competition.

full employment

The term full employment describes the level of employment which provides jobs for all those who wish to work.

functional areas of business

When we look at the functional area of business, we are organizing the work in terms of the type of work. The most common function areas are marketing, information technology, human resources, finance, operations, and accounting.

These are functions that important are for the business to do. In small businesses, the owner may do the finance, accounting, and human resource functions along with overseeing the operations. In large businesses, these functions are often broken down into departments that have large groups of people working within each function.

Global

The highest level of influence; in our globalized society, this can have an impact on all external factors.

governmental agencies

Governmental agencies are made up of the agencies, policy makers, and other actors within the government. These agencies are stakeholders impacted by the business and its decisions. For example, the government can benefit from the business's innovations that help improve the government's work. A major impact for governmental agencies is from the taxes that come from the business's profits.

gross domestic product (GDP)

Gross domestic product (GDP) is defined as the market value of all goods and services produced by the economy in a given year.

Gross national product (GNP)

Gross national product is the value of all products and services produced by citizens of a country both domestically and internationally minus income earned by foreign residents.

group

A group is a collection of individuals who coordinate their individual efforts.

Group Cohesiveness

Group cohesiveness is the tendency for a *group* to be in unity while working towards a goal.

groupthink

Groupthink is the tendency to conform to group pressure in making decisions, while failing to think critically or to consider outside influences.

horizontal merger

Horizontal merger is when companies in the same industry merge.

hostile takeover

Hostile takeover is an act of assuming control that is resisted by the targeted company's management and its board of directors.

human resources

The human resources is an organizational function that is about searching for, selecting, training, and maintaining workers.

Importing

Importing refers to buying goods and services from foreign sources and bringing them back into the home country. Importing is also known as global sourcing.

income statement

Income statement shows revenues, or sales, and expenses—the costs of doing business.

inflation

Inflation is a sustained rise in the average prices of goods within an economy. It can also be explained as the fall in the purchasing power of money, since it is usual for wages to move ahead at least as fast as the price level.

information technology

Information technology is the organizational function that aims to understand the information and data needs of the company in terms of obtaining, analyzing, and protecting information.

Inputs

Inputs are the elements which goes into producing a good or service such as labor, raw materials, capital, land, entrepreneurship etc.

Institutional investors

Investment professionals who are paid to manage other people's money.

International Monetary Fund

International Monetary Fund (IMF) is the banker to the world's central banks. If a country requires to borrow money it can apply for a loan from the IMF. There will be conditions tied to the loan.

Investment bankers

Firms that act as intermediaries, buying securities from corporations and governments and reselling them to the public.

joint ventures

Joint ventures is where one or two companies set up a business division that will be operated jointly.

lagging indicators

Lagging indicators show the health of the economy in the recent past.

leading indicators

Leading indicators give a prediction of future events.

legal factors

Legal factors are the laws, policies, and legal systems. For businesses, legal factors are a type of external environmental influence on the business. Here are some examples:

-The legal system affects how laws are passed.
-The legal system affects how civil proceedings, such as lawsuits, are conducted.
-The legal system also impacts the workers' and business owner's rights and responsibilities.

licensing agreement

Licensing agreements allows firms to choose foreign individuals or organizations to manufacture or market their products in another country.

limited liability company

Limited liability company is where the owners or shareholders are financially only responsible for the amount they have invested in the company rather than their personal wealth. The importance of limiting the amount of a shareholder's liability is that it encourages people to invest with relatively little risk.

limited partnership

A limited partnership (LP) exists when two or more partners go into business together, but the limited partners are only liable up to the amount of their investment. A limited partnership have limited partners and a general partner with unlimited liability.

Liquidity ratios

Liquidity ratios is the measurement of a company's ability to meet its short-term debts.

Local

The local area in which a company operates, such as Vancouver, Burnaby, Richmond, or Surrey in British Columbia, can affect all areas of the external environment.

macro environment

The macro environment is the external forces (economic, demographic, technological, social and cultural, legal and political) which influence a firm's decision making and have an impact upon its performance.

Management accounting

Management accounting is the production and use of accounting information for internal managerial purposes of analysis, planning, review and control rather than for historical financial records.

manager-led team

Manager-led team is where the manager is the team leader and is in charge of setting team goals, assigning tasks, and monitoring the team's performance.

managers

Managers are the people who "plan, organize, lead, and control" (1 (https://www.aiuniv.edu/degrees/business/articles/functions-of-management)) the activities and work of the people in the organization.

market segmentation

Market segmentation is finding specific subsets of the overall target market that have common characteristics that influence buying decisions.

marketable securities

Market securities are short-term investments that are easily converted into cash.

marketing

Marketing is the organizational function that aims to promote and sell the goods and/or services of the business.

marketing concept

The marketing concept involves identifying consumer needs and wants and then producing products (which can be goods, services, or ideas) that will satisfy them while making a profit.

marketing mix

Marketing mix refers to the set of actions, tools or tactics, that a company uses to promote its brand or product in the market. The 4Ps make up a typical marketing mix - Price, Product, Promotion and Place. In recent years commentators refer to the 7 Ps which includes People, Process and Physical Evidence.

merger

A merger is a term used to describe an agreement between the management and shareholders of two companies of approximately equal size to bring both companies together under a common board of directors.

mixed market

A mixed market economy is defined as an economic system blending elements of a market economy with elements of a planned economy, markets with state interventionism, or private enterprise with public enterprise.

Monetary policy

Monetary policy is concerned with the money supply, rates of interest, exchange rates and the amount of credit available in order to control the level of spending within the economy.

money

Money is a medium of exchange, serves as a measure of value and a store of value.

monopolistic competition

Monopolistic competition occurs when an industry has many firms offering products that are similar but not identical. Unlike a monopoly, these firms have little power to curtail supply or raise prices to increase profits.

monopoly

A monopoly is a market structure characterized by a single seller, selling a unique product in the market. In a monopoly market, the seller faces no competition, as he is the sole seller of goods with no close substitute.

mortgage loan

Mortgage loan is a long-term loan made against real estate as collateral.

multinational corporation

Multinational corporation is a company that operates - design, produces and market products in many countries.

mutual fund

A financial-service company that pools investors' funds to buy a selection of securities that meet its stated investment goals.

National

The country's influence on the company's operations; for most companies, this level has a broad reaching impact on most to all areas of the external environment, especially companies that are in more than one province or global.

national debt

National debt is the liabilities of the government sector. Historically, government deficits have occurred much more often than surpluses since government typically spends more than it takes in.

oligopoly

Oligopoly means few sellers. In such an oligopolistic market, each seller supplies a large portion of all the products sold in the marketplace.

operations

Operations is the organizational function that is focused on producing the goods and/or services of the business.

opportunities

In business, we look at opportunities as positive options for the business that arise from the external environment.

opportunity cost

Opportunity cost measures cost in terms of the next best or highest-valued alternative foregone. Opportunity cost may be measured in money terms or not.

Outputs

Output is the finished product coming from a production process.

outsourcing

Outsourcing is a business practice in which a company hires a third-party in a foreign country to perform tasks, handle operations or provide services for the company.

participants

Business participants are the people who participate in conducting the work of the business. These always include the employees and managers, but often include suppliers, customers, and shareholders.

partnership

A partnership is a business owned jointly by two or more people. Partnership have unlimited liability where each partner is liable for the debts of the other partners, including their tax liability.

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.

planned system

Planned system is an economic system in which the elements of an economy (such as labor, capital, and natural resources) are subject to government control and regulation designed to achieve the objectives of a comprehensive plan of economic development.

political factors

Political factors are political climate, systems, and other factors in a political environment that affect organizations. For businesses, political factors are a type of external environmental influence for the business. Here are some examples of the impacts:

-Political climate (left-, center-, or right-leaning) affects the amount of taxation, regulation, and incentives business have.
-Political systems (communist, socialist, etc.) can impact the type of ownership and how the market in an area is managed.
-Political factors are also closely linked with legal systems as political climate and systems affect the laws and policies that impact a business.
-Political factors also influence the trade relationships between countries when can affect the supply of products.

preferred stock

An equity security for which the dividend amount is set at the time the stock is issued and the dividend must be paid before the company can pay dividends to common stockholders.

price stability

Price stability is the stable level of prices in the economy, which avoids long periods of inflation or deflation and sustains the value of money over time.

primary market

The securities market where new securities are sold to the public.

principal

Principal is the amount borrowed.

Profitability ratios

Profitability ratios measures profit in proportion to a yardstick such as net assets (return on investments) or sales revenue.

Provincial

The province in which the company operates, sometimes referred to as "State" in countries that have states instead of provinces; this level impacts all areas of the external environment.

quota

Quota is a form of import protection that limits the sales of foreign goods to a specified quantity or market share.

Regional

The region in which the local community belongs, such as MetroVancouver, Fraser Valley, or Cariboo Chilcotin, often affects many to allareas of the external environment.

Regional (global)

The influence of the nation's region, such as North America, often has a clear influence on the legal, political, cultural, social, and economic factors as well as others.

Retained earnings

Profits that have been reinvested in a firm.

Risk

Risk is the uncertainty about future events. It is the potential for loss or the chance that an investment will not achieve the expected level of return.

risk-return trade-off

Risk-return trade off Is a concept which explains the basic principle in finance that the higher the risk, the greater the return that is required.

secondary market

The securities market where old (already issued) securities are bought and sold, or traded, among investors; includes broker markets, dealer markets, the over-the-counter market, and the commodities exchanges.

Self-managing teams

A self-managed team is a small group of employees who take full responsibility for delivering a service or product through peer collaboration without a manager's guidance. This team often works together long-term to make decisions about a particular process.

social audits

A social audit is an official evaluation of an organization's involvement in social responsibility projects or endeavors.

sole proprietorship

Sole proprietorship is an individual who may or may not employ other people but owns and operates the business.

stakeholders

Stakeholders are those affected by the business's operations and its decisions. Examples of stakeholders include shareholders, investors, the community, customers, competitors, and governmental agencies.

Stock dividend

Payments to stockholders in the form of more stock; may replace or supplement cash dividends.

stockbroker

A person who is licensed to buy and sell securities on behalf of clients.

strategic alliance

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.

suppliers

Suppliers provide the materials needed for the business to create the products and/or services the business sells for profit. Suppliers are essential to the business's success. In fact, suppliers are participants, stakeholders, and an external environmental influence.

supply

Supply is the quantity of a product that sellers are willing to sell at various prices.

target market

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.

Tariffs

Tariff is a tax imposed on an imported good. This is likely to reduce the demand and make any domestic competitor more attractive to consumers.

team

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

Team contract

A team contract is an agreement between you and your teammates about how your team will operate. The team focusses on issues that the team considers most important. All team members must sign the contract indicating their agreement.

term loan

Term loan is a business loan with a maturity of more than one year. Term loans generally have maturities of 5 to 12 years and can be unsecured or secured.

The Equilibrium Price

The Equilibrium Price is the price point at which the demand and supply curves intersect.

threats

In business, we look at threats as positive impacts for the business that arise from changes in the external environment.

trade controls

Trade Controls are restrictions imposed on the transfer of items from one country to another by any individual, company, government or public body.

Trade credit

The extension of credit by the seller to the buyer between the time the buyer receives the goods or services and when it pays for them.

uncertainty

The level of uncertainty a company faces is related to the extent to which the factors in the environment change in a predictable manner. If the changes are steady and change predictable, then there is low uncertainty. If they change often and in unpredictable ways, there is high uncertainty.

underwriting

The process of buying securities from corporations and governments and reselling them to the public; the main activity of investment bankers.

unemployment rate

The unemployment rate is the percentage of the labour force that is unemployed and actively seeking work.

Unsecured loans

Loans for which the borrower does not have to pledge specific assets as security.

vertical merger

Vertical merger is when one of the companies in the merger is a supplier or customer to the other.

virtual team

Virtual team is where geographically dispersed members interact electronically in the process of pursuing a common goal.

virtual teams

A virtual team usually refers to a group of individuals who work together from different geographic locations and rely on communication technology such as email, instant messaging, and video or voice conferencing services in order to collaborate to achieve a common goal.

World Bank

World Bank provide aid to developing countries in the form of loans and technical assistance.

World Trade Organization

The World Trade Organization is an international free trade club, where member countries commit themselves to work towards the elimination of barriers to imports and thereby encourage free and fair trade.