PREFACE

The Examinations of ICAP are a demanding test of student’s ability to master the wide range of knowledge and skills required of the modern professionals. Subject of “Business Management” is one of the efforts made by ICAP in this context for enhancing student’s knowledge about detailed overview of effective management of businesses.

The best and recommended book for this subject is “Study Text by PBP” that covers each and every area of syllabus in extraordinary detail. The basic problems faced by the students in going through PBP are its size and the language used in that book. Students who are new to this subject have to spend most of their precious time in understanding the theme conveyed in any chapter.

For these reasons there arise needs to have some short and easy notes for this subject. For this purpose after much surfing on the internet, I found the site www.tutor2u.com that contains business studies material in very short and understandable form. So I compile the notes relevant to our module E syllabus of BM and present to you in a booklet form. Hope it would be helpful to you.

How To use:

This booklet does not cover 100 % of our BM syllabus, nor is supposed to be the alternative of PBP. The basic purpose of these notes is to have maximum content of BM in short and understandable form.

Just follow these steps for effective outcome from this booklet.

- Select a portion / chapter of PBP to be read for the first time.
- Find that portion / chapter in this booklet (if available).
- Simply read it with fresh mind.
- After you have read it, you have acquired the necessary concepts discussed in that portion in relatively less time. And an overview of main points related to that portion is now clear in your mind.
- Now go through that specific portion in PBP.
- You would INSHAALLAH find it relatively easy for you as you have the theme of maximum content in your mind.
- This booklet is also very good for speedy revision of Business Management.

I would recommend that you start from Marketing portion and do Strategy portion in last of all, going through following preference for your preparation (from any source.)

1. Marketing Very interesting and easy to learn portion
2. HR Detailed procedures about HRM
4. Strategy Relatively boring portion

May ALLAH bless you with success in every exam of both lives.
Thanks

Syed Atif Hassan Abidi
June 13, 2007
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Introduction to Strategy

Overall Definition:

Johnson and Scholes (Exploring Corporate Strategy) defines strategy as follows:

"Strategy is the direction and scope of an organisation over the long-term: which achieves advantage for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfil stakeholder expectations".

In other words, strategy is about:

* Where is the business trying to get to in the long-term (direction)
* Which markets should a business compete in and what kind of activities are involved in such markets? (markets; scope)
* How can the business perform better than the competition in those markets? (advantage)?
* What resources (skills, assets, finance, relationships, technical competence, facilities) are required in order to be able to compete? (resources)?
* What external, environmental factors affect the businesses’ ability to compete? (environment)?
* What are the values and expectations of those who have power in and around the business? (stakeholders)

Strategy at Different Levels of a Business

Strategies exist at several levels in any organisation - ranging from the overall business (or group of businesses) through to individuals working in it.

**Corporate Strategy** - is concerned with the overall purpose and scope of the business to meet stakeholder expectations. This is a crucial level since it is heavily influenced by investors in the business and acts to guide strategic decision-making throughout the business. Corporate strategy is often stated explicitly in a "mission statement".

**Business Unit Strategy** - is concerned more with how a business competes successfully in a particular market. It concerns strategic decisions about choice of products, meeting needs of customers, gaining advantage over competitors, exploiting or creating new opportunities etc.

**Operational Strategy** - is concerned with how each part of the business is organised to deliver the corporate and business-unit level strategic direction. Operational strategy therefore focuses on issues of resources, processes, people etc.

How Strategy is Managed - Strategic Management

In its broadest sense, strategic management is about taking "strategic decisions" - decisions that answer the questions above.

In practice, a thorough strategic management process has three main components, shown in the figure below:
Strategic Analysis

This is all about the analysing the strength of businesses’ position and understanding the important external factors that may influence that position. The process of Strategic Analysis can be assisted by a number of tools, including:

**PEST Analysis** - a technique for understanding the "environment" in which a business operates

**Scenario Planning** - a technique that builds various plausible views of possible futures for a business

**Five Forces Analysis** - a technique for identifying the forces which affect the level of competition in an industry

**Market Segmentation** - a technique which seeks to identify similarities and differences between groups of customers or users

**Directional Policy Matrix** - a technique which summarises the competitive strength of a businesses operations in specific markets

**Competitor Analysis** - a wide range of techniques and analysis that seeks to summarise a businesses' overall competitive position

**Critical Success Factor Analysis** - a technique to identify those areas in which a business must outperform the competition in order to succeed

**SWOT Analysis** - a useful summary technique for summarising the key issues arising from an assessment of a businesses "internal" position and "external" environmental influences.

Strategic Choice

This process involves understanding the nature of stakeholder expectations (the "ground rules"), identifying strategic options, and then evaluating and selecting strategic options.

Strategy Implementation

Often the hardest part. When a strategy has been analysed and selected, the task is then to translate it into organisational action.
**Mission**

A strategic plan starts with a clearly defined business mission. Mintzberg defines a mission as follows:

“A mission describes the organisation’s basic function in society, in terms of the products and services it produces for its customers”.

A clear business mission should have each of the following elements:

1. **A Purpose**
   - Why does the business exist? Is it to create wealth for shareholders? Does it exist to satisfy the needs of all stakeholders (including employees, and society at large?)

2. **A Strategy and Strategic Scope**
   - A mission statement provides the commercial logic for the business and so defines two things:
     - The products or services it offers (and therefore its competitive position)
     - The competences through which it tries to succeed and its method of competing

   A business’ strategic scope defines the boundaries of its operations. These are set by management. For example, these boundaries may be set in terms of geography, market, business method, product etc. The decisions management make about strategic scope define the nature of the business.

3. **Policies and Standards of Behaviour**
   - A mission needs to be translated into everyday actions. For example, if the business mission includes delivering “outstanding customer service”, then policies and standards should be created and monitored that test delivery.

   These might include monitoring the speed with which telephone calls are answered in the sales call centre, the number of complaints received from customers, or the extent of positive customer feedback via questionnaires.

4. **Values and Culture**
   - The values of a business are the basic, often un-stated, beliefs of the people who work in the business.

   These would include:
   1. Business principles (e.g. social policy, commitments to customers)
   2. Loyalty and commitment (e.g. are employees inspired to sacrifice their personal goals for the good of the business as a whole? And does the business demonstrate a high level of commitment and loyalty to its staff?)
   3. Guidance on expected behaviour – a strong sense of mission helps create a work environment.
where there is a common purpose

What role does the mission statement play in marketing planning?
In practice, a strong mission statement can help in three main ways:
- It provides an outline of how the marketing plan should seek to fulfil the mission
- It provides a means of evaluating and screening the marketing plan; are marketing decisions consistent with the mission?
- It provides an incentive to implement the marketing plan

Values And Vision

Values form the foundation of a business’ management style. Values provide the justification of behaviour and, therefore, exert significant influence on marketing decisions.

Consider the following examples of a well-known business – BT Group - defining its values:

BT's activities are underpinned by a set of values that all BT people are asked to respect:
- We put customers first
- We are professional
- We respect each other
- We work as one team
- We are committed to continuous improvement.

These are supported by our vision of a communications-rich world - a world in which everyone can benefit from the power of communication skills and technology.
A society in which individuals, organisations and communities have unlimited access to one another and to a world of knowledge, via a multiplicity of communications technologies including voice, data, mobile, internet - regardless of nationality, culture, class or education.
Our job is to facilitate effective communication, irrespective of geography, distance, time or complexity.
Source: BT Group plc web site

Why are values important?

Many Japanese businesses have used the value system to provide the motivation to make them global market leaders. They have created an obsession about winning that is communicated at all levels of the business that has enabled them to take market share from competitors that appeared to be unassailable.

For example, at the start of the 1970’s Komatsu was less than one third the size of the market leader – Caterpillar – and relied on just one line of smaller bulldozers for most of its revenues. By the late 1980’s it had passed Caterpillar as the world leader in earth-moving equipment. It had also adopted an aggressive diversification strategy that led it into markets such as industrial robots and semiconductors.

If “values” shape the behaviour of a business, what is meant by “vision”?

To succeed in the long term, businesses need a vision of how they will change and improve in the future. The vision of the business gives it energy. It helps motivate employees. It helps set the direction of corporate and marketing strategy.

What are the components of an effective business vision?

Davidson identifies six requirements for success:
- Provides future direction
- Expresses a consumer benefit
- Is realistic
- Is motivating
- Must be fully communicated
- Consistently followed and measured

Strategic Planning - The Link With Marketing
Businesses that succeed do so by creating and keeping customers. They do this by providing better value for the customer than the competition.

Marketing management constantly have to assess which customers they are trying to reach and how they can design products and services that provide better value (“competitive advantage”).

The main problem with this process is that the “environment” in which businesses operate is constantly changing. So a business must adapt to reflect changes in the environment and make decisions about how to change the marketing mix in order to succeed. This process of adapting and decision-making is known as marketing planning.

Where does marketing planning fit in with the overall strategic planning of a business?

Strategic planning is concerned about the overall direction of the business. It is concerned with marketing, of course. But it also involves decision-making about production and operations, finance, human resource management and other business issues.

The objective of a strategic plan is to set the direction of a business and create its shape so that the products and services it provides meet the overall business objectives.

Marketing has a key role to play in strategic planning, because it is the job of marketing management to understand and manage the links between the business and the “environment”.

Sometimes this is quite a straightforward task. For example, in many small businesses there is only one geographical market and a limited number of products (perhaps only one product!).

However, consider the challenge faced by marketing management in a multinational business, with hundreds of business units located around the globe, producing a wide range of products. How can such management keep control of marketing decision-making in such a complex situation? This calls for well-organised marketing planning.

What are the key issues that should be addressed in strategic and marketing planning?

The following questions lie at the heart of any marketing and strategic planning process:

• Where are we now?
• How did we get there?
• Where are we heading?
• Where would we like to be?
• How do we get there?
• Are we on course?

Why is marketing planning essential?

Businesses operate in hostile and increasingly complex environment. The ability of a business to achieve profitable sales is impacted by dozens of environmental factors, many of which are inter-connected. It makes sense to try to bring some order to this chaos by understanding the commercial environment and bringing some strategic sense to the process of marketing products and services.

A marketing plan is useful to many people in a business. It can help to:

• Identify sources of competitive advantage
• Gain commitment to a strategy
• Get resources needed to invest in and build the business
• Inform stakeholders in the business
• Set objectives and strategies
• Measure performance
**PEST Analysis**

PEST analysis is concerned with the environmental influences on a business.

The acronym stands for the Political, Economic, Social and Technological issues that could affect the strategic development of a business.

Identifying PEST influences is a useful way of summarising the external environment in which a business operates. However, it must be followed up by consideration of how a business should respond to these influences.

The table below lists some possible factors that could indicate important environmental influences for a business under the PEST headings:

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<th>Economic</th>
<th>Social</th>
<th>Technological</th>
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<tr>
<td>- Environmental regulation and protection</td>
<td>- Economic growth (overall; by industry sector)</td>
<td>- Income distribution (change in distribution of disposable income;</td>
<td>- Government spending on research</td>
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<td>- Taxation (corporate; consumer)</td>
<td>- Monetary policy (interest rates)</td>
<td>- Demographics (age structure of the population; gender; family size and composition; changing nature of occupations)</td>
<td>- Government and industry focus on technological effort</td>
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<tr>
<td>- International trade regulation</td>
<td>- Government spending (overall level; specific spending priorities)</td>
<td>- Labour / social mobility</td>
<td>- New discoveries and development</td>
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<tr>
<td>- Consumer protection</td>
<td>- Policy towards unemployment (minimum wage, unemployment benefits, grants)</td>
<td>- Lifestyle changes (e.g. Home working, single households)</td>
<td>- Speed of technology transfer</td>
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<tr>
<td>- Employment law</td>
<td>- Taxation (impact on consumer disposable income, incentives to invest in capital equipment, corporation tax rates)</td>
<td>- Attitudes to work and leisure</td>
<td>- Rates of technological obsolescence</td>
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<tr>
<td>- Government organisation / attitude</td>
<td>- Exchange rates (effects on demand by overseas customers; effect on cost of imported components)</td>
<td>- Education</td>
<td>- Energy use and costs</td>
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<tr>
<td>- Competition regulation</td>
<td>- Inflation (effect on costs and selling prices)</td>
<td>- Fashions and fads</td>
<td>- Changes in material sciences</td>
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<tr>
<td>- Stage of the business cycle (effect on short-term business performance)</td>
<td>- Health &amp; welfare</td>
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<td>- Impact of changes in Information technology</td>
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<tr>
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<td>- Living conditions (housing, amenities, pollution)</td>
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<td>- Internet!</td>
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**Analysing Competitive Industry Structure [Porter’s Five Forces Model]**

**Defining an Industry**

An industry is a group of firms that market products which are close substitutes for each other (e.g. the car industry, the travel industry).

Some industries are more profitable than others. Why? The answer lies in understanding the dynamics of competitive structure in an industry.

The most influential analytical model for assessing the nature of competition in an industry is Michael Porter’s Five Forces Model, which is described below:

Porter explains that there are five forces that determine industry attractiveness and long-run industry profitability. These five "competitive forces" are:

- The threat of entry of new competitors (new entrants)
- The threat of substitutes
- The bargaining power of buyers
- The bargaining power of suppliers
- The degree of rivalry between existing competitors

**1. Threat of New Entrants**

New entrants to an industry can raise the level of competition, thereby reducing its attractiveness. The threat of new entrants largely depends on the barriers to entry. High entry barriers exist in some industries (e.g. shipbuilding) whereas other industries are very easy to enter (e.g. estate agency, restaurants). Key barriers to entry include:

- Economies of scale
- Capital / investment requirements
- Customer switching costs
- Access to industry distribution channels
- The likelihood of retaliation from existing industry players.

**2. Threat of Substitutes**

The presence of substitute products can lower industry attractiveness and profitability because they limit price levels. The threat of substitute products depends on:
- Buyers' willingness to substitute
- The relative price and performance of substitutes
- The costs of switching to substitutes

3. Bargaining Power of Suppliers

Suppliers are the businesses that supply materials & other products into the industry. The cost of items bought from suppliers (e.g. raw materials, components) can have a significant impact on a company's profitability. If suppliers have high bargaining power over a company, then in theory the company's industry is less attractive. The bargaining power of suppliers will be high when:

- There are many buyers and few dominant suppliers
- There are undifferentiated, highly valued products
- Suppliers threaten to integrate forward into the industry (e.g. brand manufacturers threatening to set up their own retail outlets)
- Buyers do not threaten to integrate backwards into supply
- The industry is not a key customer group to the suppliers

4. Bargaining Power of Buyers

Buyers are the people / organisations who create demand in an industry. The bargaining power of buyers is greater when:

- There are few dominant buyers and many sellers in the industry
- Products are standardised
- Buyers threaten to integrate backward into the industry
- Suppliers do not threaten to integrate forward into the buyer's industry
- The industry is not a key supplying group for buyers

5. Intensity of Rivalry

The intensity of rivalry between competitors in an industry will depend on:

- The structure of competition - for example, rivalry is more intense where there are many small or equally sized competitors; rivalry is less when an industry has a clear market leader

- The structure of industry costs - for example, industries with high fixed costs encourage competitors to fill unused capacity by price cutting

- Degree of differentiation - industries where products are commodities (e.g. steel, coal) have greater rivalry; industries where competitors can differentiate their products have less rivalry

- Switching costs - rivalry is reduced where buyers have high switching costs - i.e. there is a significant cost associated with the decision to buy a product from an alternative supplier

- Strategic objectives - when competitors are pursuing aggressive growth strategies, rivalry is more intense. Where competitors are "milking" profits in a mature industry, the degree of rivalry is less

- Exit barriers - when barriers to leaving an industry are high (e.g. the cost of closing down factories) - then competitors tend to exhibit greater rivalry.

BCG Matrix: Covered in Marketing section

Portfolio Analysis Covered in same notes under the Chapter of Strategic Audit

Segmentation: Covered in Marketing section

Competitor's Analysis Covered in same notes under the Chapter of Competitors Analysis
The Strategic Audit

In our introduction to business strategy we emphasised the role of the "business environment" in shaping strategic thinking and decision-making.

The external environment in which a business operates can create opportunities which a business can exploit, as well as threats which could damage a business. However, to be in a position to exploit opportunities or respond to threats, a business needs to have the right resources and capabilities in place.

An important part of business strategy is concerned with ensuring that these resources and competencies are understood and evaluated - a process that is often known as a "Strategic Audit". The process of conducting a strategic audit can be summarised into the following stages:

(1) Resource Audit:
The resource audit identifies the resources available to a business. Some of these can be owned (e.g. plant and machinery, trademarks, retail outlets) whereas other resources can be obtained through partnerships, joint ventures or simply supplier arrangements with other businesses.

(2) Value Chain Analysis:
Value Chain Analysis describes the activities that take place in a business and relates them to an analysis of the competitive strength of the business. Influential work by Michael Porter suggested that the activities of a business could be grouped under two headings: (1) Primary Activities - those that are directly concerned with creating and delivering a product (e.g. component assembly); and (2) Support Activities, which whilst they are not directly involved in production, may increase effectiveness or efficiency (e.g. human resource management). It is rare for a business to undertake all primary and support activities. Value Chain Analysis is one way of identifying which activities are best undertaken by a business and which are best provided by others ("outsourced").

(3) Core Competence Analysis:
Core competencies are those capabilities that are critical to a business achieving competitive advantage. The starting point for analysing core competencies is recognising that competition between businesses is as much a race for competence mastery as it is for market position and market power. Senior management cannot focus on all activities of a business and the competencies required undertaking them. So the goal is for management to focus attention on competencies that really affect.

(4) Performance Analysis
The resource audit, value chain analysis and core competence analysis help to define the strategic capabilities of a business. After completing such analysis, questions that can be asked that evaluate the overall performance of the business. These questions include:
- How have the resources deployed in the business changed over time; this is "historical analysis"
- How do the resources and capabilities of the business compare with others in the industry - "industry norm analysis"
- How do the resources and capabilities of the business compare with "best-in-class" - wherever that is to be found "Benchmarking"
- How has the financial performance of the business changed over time and how does it compare with key competitors and the industry as a whole? – "Ratio Analysis"

(5) Portfolio Analysis:
Portfolio Analysis analyses the overall balance of the strategic business units of a business. Most large businesses have operations in more than one market segment, and often in different geographical markets. Larger, diversified groups often have several divisions (each containing many business units) operating in quite distinct industries.
An important objective of a strategic audit is to ensure that the business portfolio is strong and that business units requiring investment and management attention are highlighted. This is important - a business should always consider which markets are most attractive and which business units have the potential to achieve advantage in the most attractive markets.
Traditionally, two analytical models have been widely used to undertake portfolio analysis:
- BCG Matrix (the "Boston Box") and McKinsey/General Electric Growth Share Matrix

(6) SWOT Analysis:
SWOT is an abbreviation for Strengths, Weaknesses, Opportunities and Threats. SWOT analysis is an important tool for auditing the overall strategic position of a business and its environment.
In our introduction we used Johnson & Scholes' definition stating that

"Strategy is the direction and scope of an organisation over the long-term: which achieves advantage for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfil stakeholder expectations".

So, what are these "resources" that a business needs to put in place to pursue its chosen strategy?

Business resources can usefully be grouped under several categories:

**Financial Resources**

Financial resources concern the ability of the business to "finance" its chosen strategy. For example, a strategy that requires significant investment in new products, distribution channels, production capacity and working capital will place great strain on the business finances. Such a strategy needs to be very carefully managed from a finance point-of-view. An audit of financial resources would include assessment of the following factors:

**Existing finance funds**
- Cash balances
  - Bank overdraft
  - Bank and other loans
  - Shareholders' capital
  - Working capital (e.g. stocks, debtors) already invested in the business
  - Creditors (suppliers, government)

**Ability to raise new funds**
- Strength and reputation of the management team and the overall business
  - Strength of relationships with existing investors and lenders
  - Attractiveness of the market in which the business operates (i.e. is it a market that is attracting investment generally?)
  - Listing on a quoted Stock Exchange? If not, is this a realistic possibility?

**Human Resources**

The heart of the issue with Human Resources is the skills-base of the business. What skills does the business already possess? Are they sufficient to meet the needs of the chosen strategy? Could the skills-base be flexed / stretched to meet the new requirements? An audit of human resources would include assessment of the following factors:

**Existing staffing resources**
- Numbers of staff by function, location, grade, experience, qualification, remuneration
  - Existing rate of staff loss ("natural wastage")
  - Overall standard of training and specific training standards in key roles
  - Assessment of key "intangibles" - e.g. morale, business culture

**Changes required to resources**
- What changes to the organisation of the business are included in the strategy (e.g. change of location, new locations, new products)?
  - What incremental human resources are required?
  - How should they be sourced? (alternatives include employment, outsourcing, joint ventures etc.)
Physical Resources

The category of physical resources covers wide range of operational resources concerned with the physical capability to deliver a strategy. These include:

**Production facilities**
- Location of existing production facilities; capacity; investment and maintenance requirements
- Current production processes - quality; method & organisation
- Extent to which production requirements of the strategy can be delivered by existing facilities

**Marketing facilities**
- Marketing management process
- Distribution channels

**Information technology**
- IT systems
- Integration with customers and suppliers

Intangible Resources

It is easy to ignore the intangible resources of a business when assessing how to deliver a strategy - but they can be crucial. Intangibles include:

**Goodwill**
- The difference between the value of the tangible assets of the business and the actual value of the business (what someone would be prepared to pay for it)

**Reputation**
- Does the business have a track record of delivering on its strategic objectives? If so, this could help gather the necessary support from employees and suppliers

**Brands**
- Strong brands are often the key factor in whether a growth strategy is a success or failure

**Intellectual Property**
- Key commercial rights protected by patents and trademarks may be an important factor in the strategy.

**Strategy - Value Chain Analysis**

Value Chain Analysis describes the activities that take place in a business and relates them to an analysis of the competitive strength of the business. Influential work by Michael Porter suggested that the activities of a business could be grouped under two headings:

1. **Primary Activities** - those that are directly concerned with creating and delivering a product (e.g. component assembly); and

2. **Support Activities**, which whilst they are not directly involved in production, may increase effectiveness or efficiency (e.g. human resource management). It is rare for a business to undertake all primary and support activities.

Value Chain Analysis is one way of identifying which activities are best undertaken by a business and which are best provided by others ("out sourced").

**Linking Value Chain Analysis to Competitive Advantage**
What activities a business undertakes is directly linked to achieving competitive advantage. For example, a business which wishes to outperform its competitors through differentiating itself through higher quality will have to perform its value chain activities better than the opposition. By contrast, a strategy based on seeking cost leadership will require a reduction in the costs associated with the value chain activities, or a reduction in the total amount of resources used.

**Primary Activities**

Primary value chain activities include:

<table>
<thead>
<tr>
<th>Primary Activity</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Inbound logistics</strong></td>
<td>All those activities concerned with receiving and storing externally sourced materials</td>
</tr>
<tr>
<td><strong>Operations</strong></td>
<td>The manufacture of products and services - the way in which resource inputs (e.g. materials) are converted to outputs (e.g. products)</td>
</tr>
<tr>
<td><strong>Outbound logistics</strong></td>
<td>All those activities associated with getting finished goods and services to buyers</td>
</tr>
<tr>
<td><strong>Marketing and sales</strong></td>
<td>Essentially an information activity - informing buyers and consumers about products and services (benefits, use, price etc.)</td>
</tr>
<tr>
<td><strong>Service</strong></td>
<td>All those activities associated with maintaining product performance after the product has been sold</td>
</tr>
</tbody>
</table>

**Support Activities**

Support activities include:

<table>
<thead>
<tr>
<th>Secondary Activity</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Procurement</strong></td>
<td>This concerns how resources are acquired for a business (e.g. sourcing and negotiating with materials suppliers)</td>
</tr>
<tr>
<td><strong>Human Resource Management</strong></td>
<td>Those activities concerned with recruiting, developing, motivating and rewarding the workforce of a business</td>
</tr>
<tr>
<td><strong>Technology Development</strong></td>
<td>Activities concerned with managing information processing and the development and protection of &quot;knowledge&quot; in a business</td>
</tr>
<tr>
<td><strong>Infrastructure</strong></td>
<td>Concerned with a wide range of support systems and functions such as finance, planning, quality control and general senior management</td>
</tr>
</tbody>
</table>

**Steps in Value Chain Analysis**

Value chain analysis can be broken down into a three sequential steps:

1. Break down a market/organisation into its key activities under each of the major headings in the model;

2. Assess the potential for adding value via cost advantage or differentiation, or identify current activities where a business appears to be at a competitive disadvantage;

3. Determine strategies built around focusing on activities where competitive advantage can be sustained
(3). Competition

**Competitive Advantage**

A competitive advantage is an advantage over competitors gained by offering consumers greater value, either by means of lower prices or by providing greater benefits and service that justifies higher prices.

**Competitive Strategies**

Following on from his work analysing the competitive forces in an industry, Michael Porter suggested four "generic" business strategies that could be adopted in order to gain competitive advantage. The four strategies relate to the extent to which the scope of a businesses' activities are narrow versus broad and the extent to which a business seeks to differentiate its products.

The four strategies are summarised in the figure below:

The differentiation and cost leadership strategies seek competitive advantage in a broad range of market or industry segments. By contrast, the differentiation focus and cost focus strategies are adopted in a narrow market or industry.

**Strategy - Differentiation**

This strategy involves selecting one or more criteria used by buyers in a market - and then positioning the business uniquely to meet those criteria. This strategy is usually associated with charging a premium price for the product - often to reflect the higher production costs and extra value-added features provided for the consumer. Differentiation is about charging a **premium price** that more than covers the additional production costs, and about giving customers clear reasons to prefer the product over other, less differentiated products.

Examples of Differentiation Strategy: Mercedes cars; Bang & Olufsen

**Strategy - Cost Leadership**

With this strategy, the objective is to become the lowest-cost producer in the industry. Many (perhaps all) market segments in the industry are supplied with the emphasis placed minimising costs. If the achieved selling price can at least equal (or near) the average for the market, then the lowest-cost producer will (in theory) enjoy the best profits. This strategy is usually associated with large-scale businesses offering "standard" products with relatively little differentiation that are perfectly acceptable to the majority of customers. Occasionally, a low-cost leader will also discount its product to maximise sales, particularly if it has a significant cost advantage over the competition and, in doing so, it can further increase its market share.

Examples of Cost Leadership: Tesco, Dell Computers, Nissan

**Strategy - Differentiation Focus**

In the differentiation focus strategy, a business aims to differentiate within just one or a small number of target market segments. The special customer needs of the segment mean that there are opportunities to provide products that are clearly different from competitors who may be targeting a broader group of customers. The important issue for any business adopting this strategy is to ensure that customers really do have different needs and wants - in other words that there is a **valid basis for differentiation** - and that existing competitor products are not meeting those needs and wants.
Examples of Differentiation Focus: any successful niche retailers; (e.g. The Perfume Shop); or specialist holiday operator (e.g. Carrier)

**Strategy - Cost Focus**

Here a business seeks a lower-cost advantage in just on or a small number of market segments. The product will be basic - perhaps a similar product to the higher-priced and featured market leader, but acceptable to sufficient consumers. Such products are often called “me-too's”.

Examples of Cost Focus: Many smaller retailers featuring own-label or discounted label products.

**Competitor Analysis**

Competitor Analysis is an important part of the strategic planning process. This revision note outlines the main role of, and steps in, competitor analysis

**Why bother to analyse competitors?**

Some businesses think it is best to get on with their own plans and ignore the competition. Others become obsessed with tracking the actions of competitors (often using underhand or illegal methods). Many businesses are happy simply to track the competition, copying their moves and reacting to changes.

Competitor analysis has several important roles in strategic planning:

- To help management understand their competitive advantages/disadvantages relative to competitors
- To generate understanding of competitors’ past, present (and most importantly) future strategies
- To provide an informed basis to develop strategies to achieve competitive advantage in the future
- To help forecast the returns that may be made from future investments (e.g. how will competitors respond to a new product or pricing strategy?)

**Questions to ask**

What questions should be asked when undertaking competitor analysis? The following is a useful list to bear in mind:

- Who are our competitors? (see the section on identifying competitors further below)
- What threats do they pose?
- What is the profile of our competitors?
- What are the objectives of our competitors?
- What strategies are our competitors pursuing and how successful are these strategies?
- What are the strengths and weaknesses of our competitors?
- How are our competitors likely to respond to any changes to the way we do business?

**Sources of information for competitor analysis**

Davidson (1997) describes how the sources of competitor information can be neatly grouped into three categories:

- **Recorded data**: this is easily available in published form either internally or externally. Good examples include competitor annual reports and product brochures;
- **Observable data**: this has to be actively sought and often assembled from several sources. A good example is competitor pricing;
- **Opportunistic data**: to get hold of this kind of data requires a lot of planning and organisation. Much of it is “anecdotal”, coming from discussions with suppliers, customers and, perhaps, previous management of competitors.

The table below lists possible sources of competitor data using Davidson’s categorisation:

<table>
<thead>
<tr>
<th>Recorded Data</th>
<th>Observable Data</th>
<th>Opportunistic Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual report &amp; accounts</td>
<td>Pricing / price lists</td>
<td>Meetings with suppliers</td>
</tr>
<tr>
<td>Press releases</td>
<td>Advertising campaigns</td>
<td>Trade shows</td>
</tr>
<tr>
<td>Newspaper articles</td>
<td>Promotions</td>
<td>Sales force meetings</td>
</tr>
<tr>
<td>Analysts reports</td>
<td>Tenders</td>
<td>Seminars / conferences</td>
</tr>
<tr>
<td>Regulatory reports</td>
<td>Patent applications</td>
<td>Recruiting ex-employees</td>
</tr>
<tr>
<td>Government reports</td>
<td></td>
<td>Discussion with shared distributors</td>
</tr>
<tr>
<td>Presentations / speeches</td>
<td></td>
<td>Social contacts with competitors</td>
</tr>
</tbody>
</table>
In his excellent book [Even More Offensive Marketing], Davidson likens the process of gathering competitive data to a jigsaw puzzle. Each individual piece of data does not have much value. The important skill is to collect as many of the pieces as possible and to assemble them into an overall picture of the competitor. This enables you to identify any missing pieces and to take the necessary steps to collect them.

What businesses need to know about their competitors
The tables below lists the kinds of competitor information that would help businesses complete some good quality competitor analysis.
You can probably think of many more pieces of information about a competitor that would be useful. However, an important challenge in competitor analysis is working out how to obtain competitor information that is reliable, up-to-date and available legally(!).

<table>
<thead>
<tr>
<th>What businesses probably already know their competitors</th>
<th>What businesses would really like to know about competitors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall sales and profits</td>
<td>Sales and profits by product</td>
</tr>
<tr>
<td>Sales and profits by market</td>
<td>Relative costs</td>
</tr>
<tr>
<td>Sales by main brand</td>
<td>Customer satisfaction and service levels</td>
</tr>
<tr>
<td>Cost structure</td>
<td>Customer retention levels</td>
</tr>
<tr>
<td>Market shares (revenues and volumes)</td>
<td>Distribution costs</td>
</tr>
<tr>
<td>Organisation structure</td>
<td>New product strategies</td>
</tr>
<tr>
<td>Distribution system</td>
<td>Size and quality of customer databases</td>
</tr>
<tr>
<td>Identity / profile of senior management</td>
<td>Advertising effectiveness</td>
</tr>
<tr>
<td>Advertising strategy and spending</td>
<td>Future investment strategy</td>
</tr>
<tr>
<td>Customer / consumer profile &amp; attitudes</td>
<td>Contractual terms with key suppliers</td>
</tr>
<tr>
<td>Customer retention levels</td>
<td>Terms of strategic partnerships</td>
</tr>
</tbody>
</table>

Core Competencies

Core competencies are those capabilities that are critical to a business achieving competitive advantage. The starting point for analysing core competencies is recognising that competition between businesses is as much a race for competence mastery as it is for market position and market power.

Senior management cannot focus on all activities of a business and the competencies required to undertake them. So the goal is for management to focus attention on competencies that really affect competitive advantage.

The Work of Hamel and Prahalad

The main ideas about Core Competencies where developed by C K Prahalad and G Hamel through a series of articles in the Harvard Business Review followed by a best-selling book - Competing for the Future. Their central idea is that over time companies may develop key areas of expertise which are distinctive to that company and critical to the company's long term growth.

In the 1990s managers will be judged on their ability to identify, cultivate, and exploit the core competencies that make growth possible - indeed, they'll have to rethink the concept of the corporation itself. C K Prahalad and G Hamel 1990

These areas of expertise may be in any area but are most likely to develop in the critical, central areas of the company where the most value is added to its products.

For example, for a manufacturer of electronic equipment, key areas of expertise could be in the design of the electronic components and circuits. For a ceramics manufacturer, they could be the routines and processes at the heart of the production process. For a software company the key skills may be in the overall simplicity and utility of the program for users or alternatively in the high quality of software code.
writing they have achieved.

Core Competencies are not seen as being fixed. Core Competencies should change in response to changes in the company's environment. They are flexible and evolve over time. As a business evolves and adapts to new circumstances and opportunities, so its Core Competencies will have to adapt and change.

Identifying Core Competencies
Prahalad and Hamel suggest three factors to help identify core competencies in any business:

<table>
<thead>
<tr>
<th>What does the Core Competence Achieve?</th>
<th>Comments / Examples</th>
</tr>
</thead>
</table>
| Provides potential access to a wide variety of markets | The key core competencies here are those that enable the creation of new products and services. Example: Why has Saga established such a strong leadership in supplying financial services (e.g. insurance) and holidays to the older generation? Core Competencies that enable Saga to enter apparently different markets:
- Clear distinctive brand proposition that focuses solely on a closely-defined customer group
- Leading direct marketing skills - database management; direct-mailing campaigns; call centre sales conversion
- Skills in customer relationship management |

| Makes a significant contribution to the perceived customer benefits of the end product | Core competencies are the skills that enable a business to deliver a fundamental customer benefit - in other words: what is it that causes customers to choose one product over another? To identify core competencies in a particular market, ask questions such as "why is the customer willing to pay more or less for one product or service than another?" "What is a customer actually paying for? Example: Why have Tesco been so successful in capturing leadership of the market for online grocery shopping? Core competencies that mean customers value the Tesco.com experience so highly:
- Designing and implementing supply systems that effectively link existing shops with the Tesco.com web site
- Ability to design and deliver a "customer interface" that personalises online shopping and makes it more efficient
- Reliable and efficient delivery infrastructure (product picking, distribution, customer satisfaction handling) |

| Difficult for competitors to imitate | A core competence should be "competitively unique": In many industries, most skills can be considered a prerequisite for participation and do not provide any significant competitor differentiation. To qualify as "core", a competence should be something that other competitors wish they had within their own business. Example: Why does Dell have such a strong position in the personal computer market? Core competencies that are difficult for the competition to imitate:
- Online customer "bespoking" of each computer built
- Minimisation of working capital in the production process
- High manufacturing and distribution quality - reliable products at competitive prices |

A competence which is central to the business's operations but which is not exceptional in some way should not be considered as a core competence, as it will not differentiate the business from any other similar businesses. For example, a process which uses common computer components and is staffed by people with only basic training cannot be regarded as a core competence. Such a process is highly unlikely to generate a differentiated advantage over rival businesses. However it is possible to develop such a process into a core competence with suitable investment in equipment and training. It follows from the concept of Core Competencies that resources that are standardised or easily available will not enable a business to achieve a competitive advantage over rivals.
### Portfolio Analysis

The **business portfolio** is the collection of businesses and products that make up the company. The best business portfolio is one that fits the company’s strengths and helps exploit the most attractive opportunities.

The company must:
1. Analyse its current business portfolio and decide which businesses should receive more or less investment, and
2. Develop growth strategies for adding new products and businesses to the portfolio, whilst at the same time deciding when products and businesses should no longer be retained.

The two best-known portfolio planning methods are the “Boston Consulting Group Portfolio Matrix” (discussed in this Marketing Section) and the “McKinsey / General Electric Matrix”. In both methods, the first step is to identify the various Strategic Business Units (“SBUs”) in a company portfolio. An SBU is a unit of the company that has a separate mission and objectives and that can be planned independently from the other businesses. An SBU can be a company division, a product line or even individual brands - it all depends on how the company is organized.

### The McKinsey / General Electric Matrix

The McKinsey/GE Matrix overcomes a number of the disadvantages of the BCG Box. Firstly, **market attractiveness** replaces **market growth** as the dimension of industry attractiveness, and includes a broader range of factors other than just the market growth rate. Secondly, **competitive strength** replaces **market share** as the dimension by which the competitive position of each SBU is assessed.

The diagram below illustrates some of the possible elements that determine market attractiveness and competitive strength by applying the McKinsey/GE Matrix to the UK retailing market:

<table>
<thead>
<tr>
<th>Market Attractiveness</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Factors that Affect Market Attractiveness

While any assessment of market attractiveness is necessarily subjective, there are several factors which can help determine attractiveness. These are listed below:

- Market Size
- Market growth
- Market profitability
- Pricing trends
- Competitive intensity / rivalry
- Overall risk of returns in the industry
- Opportunity to differentiate products and services
- Segmentation
- Distribution structure (e.g. retail, direct, wholesale)

Factors that Affect Competitive Strength
Factors to consider include:
- Strength of assets and competencies
- Relative brand strength
- Market share
- Customer loyalty
- Relative cost position (cost structure compared with competitors)
- Distribution strength
- Record of technological or other innovation
- Access to financial and other investment resources

**McKinsey Growth Pyramid**

This model is similar in some respects to the well-established Ansoff Model. However, it looks at growth strategy from a slightly different perspective.

The McKinsey model argues that businesses should develop their growth strategies based on:

- Operational skills
- Privileged assets
- Growth skills
- Special relationships

Growth can be achieved by looking at business opportunities along several dimensions, summarised in the diagram below:

- Operational skills are the “core competences” that a business has which can provide the foundation for a growth strategy. For example, the business may have strong competencies in customer service; distribution, technology.
- Privileged assets are those assets held by the business that are hard to replicate by competitors. For
example, in a direct marketing-based business these assets might include a particularly large customer database, or a well-established brand.

• Growth skills are the skills that businesses need if they are to successfully “manage” a growth strategy. These include the skills of new product development, or negotiating and integrating acquisitions.

• Special relationships are those that can open up new options. For example, the business may have specially strong relationships with trade bodies in the industry that can make the process of growing in export markets easier than for the competition.

The model outlines seven ways of achieving growth, which are summarised below:

**Existing products to existing customers**

The lowest-risk option; try to increase sales to the existing customer base; this is about increasing the frequency of purchase and maintaining customer loyalty

**Existing products to new customers**

Taking the existing customer base, the objective is to find entirely new products that these customers might buy, or start to provide products that existing customers currently buy from competitors

**New products and services**

A combination of Ansoff’s market development & diversification strategy – taking a risk by developing and marketing new products. Some of these can be sold to existing customers – who may trust the business (and its brands) to deliver; entirely new customers may need more persuasion

**New delivery approaches**

This option focuses on the use of distribution channels as a possible source of growth. Are there ways in which existing products and services can be sold via new or emerging channels which might boost sales?

**New geographies**

With this method, businesses are encouraged to consider new geographic areas into which to sell their products. Geographical expansion is one of the most powerful options for growth – but also one of the most difficult.

**New industry structure**

This option considers the possibility of acquiring troubled competitors or consolidating the industry through a general acquisition programme

**New competitive arenas**

This option requires a business to think about opportunities to integrate vertically or consider whether the skills of the business could be used in other industries.
(6) SWOT Analysis

SWOT is an abbreviation for **Strengths, Weaknesses, Opportunities and Threats**

SWOT analysis is an important tool for auditing the overall strategic position of a business and its environment.

Once key strategic issues have been identified, they feed into business objectives, particularly marketing objectives. SWOT analysis can be used in conjunction with other tools for audit and analysis, such as PEST analysis and Porter’s Five-Forces analysis. It is also a very popular tool with business and marketing students because it is quick and easy to learn.

The Key Distinction - Internal and External Issues

**Strengths and weaknesses are Internal factors.** For example, a strength could be your specialist marketing expertise. A weakness could be the lack of a new product.

**Opportunities and threats are external factors.** For example, an opportunity could be a developing distribution channel such as the Internet, or changing consumer lifestyles that potentially increase demand for a company's products. A threat could be a new competitor in an important existing market or a technological change that makes existing products potentially obsolete.

It is worth pointing out that SWOT analysis can be very subjective - two people rarely come-up with the same version of a SWOT analysis even when given the same information about the same business and its environment. Accordingly, SWOT analysis is best used as a guide and not a prescription. Adding and weighting criteria to each factor increases the validity of the analysis.

Areas to Consider

Some of the key areas to consider when identifying and evaluating Strengths, Weaknesses, Opportunities and Threats are listed in the example SWOT analysis below:
Seasonality refers to fluctuations in output and sales related to the seasonal of the year.

For many (or even most products) there will be seasonal peaks and troughs in production and/or sales. In some cases there will be fluctuations over the week or even within the working day but the time based fluctuation that produces the greatest problem concerns fluctuations related to seasons of the year.

**Demand or supply?**

We should distinguish between seasonality of demand and seasonality of supply. Products whose production is affected by the weather and the cycle of the year can be subject to seasonality in supply. The main examples of seasonality in supply relate to agricultural, horticulture and related activities. If production takes places in the open then seasonal changes will have an impact. But manufactured products and services are produced indoors and supply is not affected by the seasons and the weather.

**Seasonal demand**

Supply of manufactured goods and services is little affected by seasonal factors. But demand for these goods is subject to seasonal fluctuation. In some cases it can be explained in terms of culture and customs e.g. religious festivals. In other cases the seasonality can be explained in terms of the weather.

**Obvious examples** of products with highly seasonal demand include:

- Christmas cards
- Valentine cards
- Easter eggs
- Fireworks
- Sun lotion
- Overcoats
- Swimwear
- College textbooks
- Holidays
- Winter clothes
- Summer clothes
- Back to school clothes

**Less obvious examples** of products with seasonal demand include:

- Demand for slippers peaks in the run up to Christmas
- Demand for strawberries peaks in the period around the Wimbledon fortnight
- Demand for plants at garden centres is linked to the planting season
- There is high demand for decorating materials before the Easter weekend
- Demand for electricity and gas rises in the winter
- High street retailers such as M&S rely heavily on the Christmas period. Up to 25% of sales occur around Christmas
- Many theatres take a similar proportion of their income during the Christmas pantomime season – hence the desire to sign up UK and Australian soap stars

**Example of induced seasonality**

- Car registration induced a distinct seasonal pattern to sales of new cars
- Each year, from 1st August onwards, new cars were given a new registration suffix
- The purpose was to introduce some transparency to the market so that the age of the car was clear to all concerned. But it produced an unfortunate effect
- Sales of new cars slumped in the spring and early summer and a high proportion of sales were concentrated in August
- This was an example of seasonal fluctuation as an unintended by-product of a bureaucratic decision
- As it distorted the market in new cars the practice was abandoned
## Balanced Scorecard - Four Perspectives

### The background

- No single measures can give a broad picture of the organisation’s health.
- So instead of a single measure why not use a composite scorecard involving a number of different measures.
- Kaplan and Norton devised a framework based on four perspectives – financial, customer, internal and learning and growth.
- The organisation should select critical measures for each of these perspectives.

### Origins of the balanced scorecard


- “Kaplan and Norton suggested that organisations should focus their efforts on a limited number of specific, critical performance measures which reflect stakeholders key success factors” (Strategic Management, J. Thompson with F. Martin)

### What is the balanced scorecard?

- A system of corporate appraisal which looks at financial and non-financial elements from a variety of perspectives.
- An approach to the provision of information to management to assist strategic policy formation and achievement.
- It provides the user with a set of information which addresses all relevant areas of performance in an objective and unbiased fashion.
- A set of measures that gives top managers a fast but comprehensive view of the business.

### The balanced scorecard...

- Allows managers to look at the business from four important perspectives.
- Provides a balanced picture of overall performance highlighting activities that need to be improved.
- Combines both qualitative and quantitative measures.
- Relates assessment of performance to the choice of strategy.
- Includes measures of efficiency and effectiveness.
- Assists business in clarifying their vision and strategies and provides a means to translate these into action.

### In what way is the scorecard a balance?

The scorecard produces a balance between:

- Four key business perspectives: financial, customer, internal processes and innovation.
- How the organisation sees itself and how others see it.
- The short run and the long run
- The situation at a moment in time and change over time

### Main benefits of using the balanced scorecard

- Helps companies focus on what has to be done in order to create a breakthrough performance
- Acts as an integrating device for a variety of corporate programmes
- Makes strategy operational by translating it into performance measures and targets
- Helps break down corporate level measures so that local managers and employees can see what they need to do well if they want to improve organisational effectiveness
- Provides a comprehensive view that overturns the traditional idea of the organisation as a collection of isolated, independent functions and departments
The four perspectives are

- **Financial perspective** - how does the firm look to shareholders?
- **Customer perspective** - how do customers see the firm?
- **Internal perspective** - how well does it manage its operational processes?
- **Innovation and learning perspective** - can the firm continue to improve and create value? This perspective also examines how an organisation learns and grows.

For each of four perspectives it is necessary to identify indicators to measure the performance of the organisations.

1. **Financial perspective**

This is concerned with the shareholders view of performance. Shareholders are concerned with many aspects of financial performance: Amongst the measures of success are:

- Market share
- Revenue growth
- Profit ratio
- Return on investment
- Economic value added
- Return on capital employed
- Operating cost management
- Operating ratios and loss ratios
- Corporate goals
- Survival
- Profitability
- Growth
- Process cost savings
- Increased return on assets
- Profit growth
- Measures
- Cash flow
- Net profitability ratio
- Sales revenue
- Growth in sales revenue
- Cost reduction
- ROCE
- Share price
- Return on shareholder funds

2. **Customer perspective**

How do customers perceive the firm?

This focuses on the analysis of different types of customers, their degree of satisfaction and the processes used to deliver products and services to customers.

Particular areas of focus would include:

- Customer service
- New products
- New markets
- Customer retention
- Customer satisfaction
- What does the organisation need to do to remain that customer’s valued supplier?

Potential goals for the customer perspective could include:
• Customer satisfaction
• New customer acquisition
• Customer retention
• Customer loyalty
• Fast response
• Responsiveness
• Efficiency
• Reliability
• Image

The following metrics could be used to measure success in relation to the customer perspective:

• Customer satisfaction index
• Repeat purchases
• Market share
• On time deliveries
• Number of complaints
• Average time to process orders
• Returned orders
• Response time
• Reliability
• New customer acquisitions
• Perceived value for money

3. Internal perspective

This seeks to identify:

• How well the business is performing.
• Whether the products and services offered meet customer expectations.
• The critical processes for satisfying both customers and shareholders.
• Activities in which the firm excels?
• And in what must it excel in the future?
• The internal processes that the company must be improved if it is to achieve its objectives.

This perspective is concerned with assessing the quality of people and processes.

Potential goals for the internal perspective include:

• Improve core competencies
• Improvements in technology
• Streamline processes
• Manufacturing excellence
• Quality performance
• Inventory management
• Quality
• Motivated workforce

The following metrics could be used to measure success in relation to the internal perspective:

• Efficiency improvements
• Reduction in unit costs
• Reduced waste
• Improvements in morale
• Increase in capacity utilisation
• Increased productivity
• % defective output
• Amount of recycled waste
4. Innovation and learning perspective

This perspective is concerned with issues such as:

- Can we continue to improve and create value?
- In which areas must the organisation improve?
- How can the company continue to improve and create value in the future?
- What should it be doing to make this happen?

Potential goals for the innovation and learning perspective include:

- New product development
- Continuous improvement
- Technological leadership
- HR development
- Product diversification

The following metrics could be used to measure success in relation to the innovation and learning perspective:

- Number of new products
- % sales from new products
- Amount of training
- Number of strategic skills learned.
- Value of new product in sales
- R&D as % of sales
- Number of employee suggestions.
- Extent of employee empowerment
Some definitions of a stakeholder:

- An individual or group with an interest in an organisation.
- Any individual or group who can affect or are affected by the achievement of a firm’s objective.
- Groups/individuals that have an interest in the well being of the company and/or are affected by the goals, operations, activities of the organisation.

Stakeholders can be classified as:

- Internal stakeholders (e.g. employees, managers)
- Connected stakeholders (e.g. shareholders, customers, suppliers, financiers)
- External (e.g. government, the community, pressure groups)

The main stakeholders in any business are:

- Shareholders
- Employees
- Customers
- Suppliers
- Creditors
- Society
- The government
- Competitor

**Shareholders** look for:

- High profits
- High dividend
- Long term growth
- Prospect of capital gain
- A say in the business
- A positive corporate image
- Preferential treatment as customers

**Employees** look for:

- High pay
- Job security
- Good working conditions
- Fair treatment
- Fringe benefits
- Health and safety
- Promotion prospects
- Training opportunities

**Customers** look for:

- Low prices
- Value for money
- High quality products
- Good service
- Innovation
- Certain and regular supply
- Choice of goods i.e. variety
- Clear and accurate information

**Suppliers** look for:

- A long term relationship with the firm
• Large size and high value of contracts
• Frequent and regular orders
• Prompt payment
• Fair prices
• Growth of the firm leading to more orders

Creditors look for:
• Prompt payment
• Payment of interest on outstanding debt
• Repayment at agreed date
• Credit worthiness of the organisation
• Sufficient positive cash flow to meet obligations

The community looks for:
• Employment prospects
• Safeguarding the environment
• Acceptance of social responsibility
• Ethical behaviour

Government looks for:
• Compliance with laws and regulations
• Efficient use of resources
• Employment
• Contribution to the national economy
• Payment of taxes

Interests And Power

Common and conflicting interests of stakeholders

The different stakeholder groups have different interests some in common with other stakeholders and some in conflict.

Examples of common interests:
- Shareholders and employees have a common interest in the success of the organisation.
- High profits which not only lead to high dividends but also job security.
- Suppliers have an interest in the growth and prosperity of the firm.

Examples of conflicting interests
- Wage rises might be at the expense of dividend.
- Managers have an interest in organisational growth but this might be at the expense of short term profits.
- Growth of the organisation might be at the expense of the local community and the environment.

Thinking about stakeholder power

The study of stakeholders should not be limited to a description of the way in which the organisation impacts upon the stakeholders. In the context of strategy, what is more important is the power and influence that a stakeholder has over the organisation and its objectives.

Stakeholder influence:

Current and future strategies of the organisation are affected by:
- **External pressure** from the market place, including competitors, customers, suppliers, shareholders, pressure groups threatening a boycott, the government (through taxation and spending).
- **Internal pressures** from existing commitments, managers, employees and their trade unions.
- The personal **ethical and moral** perspectives of senior managers.
The importance of profit maximization

Traditional economic theory is based on the assumption that firms seek to maximise profits. It must be appreciated that this does not mean "any old level of profits" or even a certain target level of profits but it means squeezing the last penny of profits out of the firm’s operations.

This assumption was based on the circumstances of 19th century business where owners acted as managers and could ignore the interests of stakeholders such as the employees and the community.

Stakeholder theory

The profit maximising theory of the firm that characterised Neo-Classical Economics has to be modified to taken into account the power and influence of stakeholders.

Various writers have put forward theories based on an alternative to the profit maximising aim:

- Baumol (1959) put forward a theory based on a sales maximising objective.
- Williamson (1964) offered a theory based on managers setting the objectives to maximise their personal satisfaction.
- Marris (1964) offered theory based on growth as the key concern.

In all three cases:

- The objective the result of managerial power over decision making.
- Reflected the interests of managers rather than shareholders.
- There was a limiting factor- these objectives are pursued subject to producing a satisfactory level of profits.

Behavioural theory

In “A Behavioural theory of the Firm” (1963) Cyert and March argued the goals of an organisation are a compromise between members of a coalition made up of the stakeholders. The outcome of decision making is a compromise or “trade off” between the interests of the various stakeholder groups.

In the process leading to compromise much will depend on the relative power of the different stakeholder groups.

Satisficing

The Cyert and March theory of decisions being a compromise between the different stakeholders has certain features in common with the idea of satisficing behaviour which is associated with Herbert Simon. Simon argued that decisions are taken in conditions of uncertainty and ignorance. Rather than an exhaustive search for the best or ideal solution, decision makers seek an acceptable or satisfactory outcome.

This is chosen because of the internal and external constraints such as time pressure, lack of information and the influence of powerful stakeholder.

Shareholders influence

In small private firms shareholders are in direct contact with managers and in, many cases, are directors of the company. They have the ability to influence the objectives and directions of the organisation.

But the individual shareholder in a large public company has very little influence. In theory they can exert influence through voting at the annual shareholders meeting but unless individuals group together their votes will have little impact.

In any case they are likely to be outvoted by the big institutional investors (e.g. pension funds) who own large blocks of shares.

However, shareholders can exert influence through threatening to “vote with their feet” by selling shares. As a result, managers and directors must at least keep shareholders satisfied.

Determinants of stakeholder power

For stakeholders to have power and influence the desire to exert influence must be coupled with the means to exert leverage on the company. How much power the stakeholder can exert will reflect the extent to which:
• The stakeholder can disrupt the organisation's plans.
• The stakeholder causes uncertainty in the plans.
• The organisation needs and relies on the stakeholder.

**Levers operated by internal stakeholders**
Internal stakeholders have their own interests which they might pursue - e.g. managers might seek organisational growth over profits, employees seek high wages and favourable working conditions. Managers make decisions and therefore have extensive power.

**Internal stakeholders**
• Have negative power to impede the implementation of strategy.
• Can threaten industrial action
• Can threaten to resign
• Might refuse to relocate.

**Levers operated by connected stakeholders**
• Shareholders have voting rights and can sell shares thus making the company vulnerable to take over.
• Creditors can refuse credit, charge high interest rates, take legal action for non-payment and, in extreme cases, initiate moves to liquidate the company.
• Suppliers can refuse future credit.
• Customers can seek to buy goods/services elsewhere and enjoy consumer protection rights.

**Levers operated by government & pressure groups**
The government can exert influence through taxation, government spending, legal action, regulation and threatened changes in the law. Community and pressure groups can exert influence by:
• Publicising business activities they regard as unacceptable.
• Political pressure for changes in the law
• Refusing to buy goods/services from named firms
• Illegal actions such as sabotage

**Stakeholder analysis**

“All animals are equal but some are more equal than others” [George Orwell, Animal Farm]

**Inequality of influence:**
It is naïve to believe that the stakeholders have equality in terms of power and influence. Managers have more influence than environmental activists. At the same time the institutional investor with 25% of shares will have a greater influence that the small shareholder. Banks have a considerable impact on firms facing cash flow problems but can be ignored by a cash rich firm.

**Primary and secondary stakeholders.**

**Primary stakeholders;**
• Those most vital to the organisation.
• A group without whose continuing participation the company cannot survive as a going concern.
• e.g. customers, suppliers.

**Secondary stakeholders:**
Those without whose continuing participation the company can still exist. e.g. the community.

**Active and passive stakeholders** This is an alternative categorisation of stakeholders.

**Active stakeholders**
Seek to participate in the organisation’s activities. e.g. managers, employees, pressure groups.

**Passive stakeholders**
Do not normally seek to participate in an organisation’s policy making. e.g. most shareholders, government, local communities.
### Crises Management

#### Defining and categorising crises

A crisis is defined as:

- An unexpected event that threatens the wellbeing of a company, or
- A significant disruption to the company and its normal operations which impacts on its customers, employees, investors and other publics

Crisis can be categorised as:

- Fairly predictable and quantifiable crises, or
- Totally unexpected crises

#### Types of crises

**Natural disaster (so called acts of God)**

- Physical destruction due to natural disaster e.g. flood
- Environmental disaster

**Industrial accident**

- Construction collapse
- Fire
- Toxic release

**Product or service failure**

- Product recall
- Communications failure
- Systems failure
- Machine failure causes massive reduction in capacity
- Faulty or dangerous goods
- Health scare related to the product of industry

**Public relations**

- Pressure group or unwelcome media attention.
- Adverse publicity in the media.
- Removal/loss of CEO or other key management

**Business and management**

- Hostile takeover
- Sudden strike by workforce or that of a key supplier
- Major customer withdraws its support
- Competitor launches new product
- Sudden shortfall in demand

**Legal**

- Product liability
- Health scare
- Employee or other fraud
Examples of crises

- Asian tsunami - crisis for the countries concerned and for the tourist industry
- Three Mile Island - US nuclear industry crisis in the 1980s
- Sudan 1 dyestuff in processed food
- Coca Cola’s Dansani purified water – contained a carcogen and as a result the European launch was abandoned
- Hurricane Katrina

Case study - Exxon Valdez

- This oil tanker which got into trouble in Prince William Sound off Alaska caused an oil spillage amounting to 30m US gallons
- In addition to the loss of product and a major asset:
  - The clean up took three years and cost Exxon $2.2 billion
  - Legal settlement with the state and federal government amounted to $1 billion

Case study - Buntsfield (2005)

In 2005 the oil storage depot at Buntsfield, Hemel Hempstead suffered major explosion and fire

The result was:

- Loss of product
- Significant loss of capacity
- Disruption to supplies
- Loss of business
- Physical damage to neighbouring houses and commercial premises
- Possible environmental damage
- Damage to reputation
- Claims for compensation
- Legal action

Case study - a different type of disaster

- In 1991 Gerald Ratner, head of the chain of high street jewellers that bore his name, explained why his products were so inexpensive
- He said that a decanter sold in his shop was cheap because it was “total crap”
- He “sold a pair of earrings for under £1, which was cheaper than a prawn sandwich from M&S, but probably wouldn’t last as last as long”
- The result: share values fell substantially, Mr Ratner left the company and it was sold

Dealing With Risk

<table>
<thead>
<tr>
<th>Risk management</th>
<th>The identification and acceptance or offsetting of the risks threatening the profitability, or even the existence, of an organisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contingency planning</td>
<td>A plan for back up procedures, emergency response and post disaster recovery</td>
</tr>
<tr>
<td>Crisis management</td>
<td>The process of responding to an event that might threaten the operations, staff, customers, reputation or the legal and financial status of an organisation. The aim is to minimise the damage</td>
</tr>
</tbody>
</table>
Risk
Risk is:

- The possibility of incurring misfortune or loss
- A threat that an event, action or failure to act will adversely affect an organisation’s ability to achieve its business objectives and execute its strategies effectively
- The chance of something happening that will have an impact on objectives

How risk differs from uncertainty

- Risk is defined as the chance or probability of danger, loss, injury or other adverse consequence
- Uncertainty is “not knowing (or not known), unreliable, changeable or erratic”. The result could be adverse

The difference is that:

- In the case of risk, a measure of probability can be attached to the various outcomes
- In the case of uncertainty, the probabilities of an event happening are too vague to quantify

Options for dealing with risk

- Ignore it - adopt a wait and see approach
- Avoid or reduce risk - reduce probability of risk
- Reduce or limit the consequences
- Share or deflect the risk e.g. by insurance
- Make contingency plans - prepare for it
- Adapt in order to maintain performance
- Treat it as an opportunity- if it affects competitors, then flexibility leads to competitive advantage
- Move to another environment

[adapted from D. Waters, Operations Strategy]

Risk management

Risk management involves:

- The identification of where and how things can and might go wrong
- Appreciating the extent of any downside if things go wrong
- Devising plans to cope with the threats
- Putting in place strategies to deal with the risks either before or after their occurrence

Key elements of risk management

- An on-going process for identifying, evaluating and managing significant risk
- Annual process for reviewing the effectiveness of the system of internal control
- A process to deal with the internal control aspects of any significant problems
- An embedded system in all the activities of the organisation and forms part of its culture
- A system for responding quickly to evolving risks
- Procedures for reporting any significant control failings to appropriate levels of management

Probability-impact matrix
<table>
<thead>
<tr>
<th>High likely impact</th>
<th>High probability of occurrence</th>
<th>Low probability of occurrence</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>High priority</td>
<td>Serious concern</td>
</tr>
<tr>
<td>Contingency plans</td>
<td></td>
<td>Adapt strategy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Limit likely consequences</td>
</tr>
<tr>
<td>Low</td>
<td>Little concern</td>
<td>Some concern</td>
</tr>
<tr>
<td>Can be ignored</td>
<td></td>
<td>Reduce, limit or defer risk</td>
</tr>
</tbody>
</table>

Risk-performance trade off

<table>
<thead>
<tr>
<th>High organisational performance</th>
<th>Unawareness of risk</th>
<th>Managing the risk</th>
<th>Obsessed with risk</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Managing risk</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Contributes to high performance</td>
<td></td>
</tr>
<tr>
<td>Low organisational performance</td>
<td>Important leads to Exposure and low performance when things go wrong</td>
<td>Over-control stifles initiative = low performance</td>
<td></td>
</tr>
</tbody>
</table>

Minimising the risk

<table>
<thead>
<tr>
<th>Financial risks</th>
<th>Avoid low liquidity and high gearing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Careful cash flow forecasting and control</td>
</tr>
<tr>
<td>Trading and transactional risks</td>
<td>Avoid over reliance or single or small number of products, markets, suppliers, distributors</td>
</tr>
<tr>
<td></td>
<td>Buy forward to minimise problem of rising prices</td>
</tr>
<tr>
<td>Production risks</td>
<td>Plan for some surplus capacity</td>
</tr>
<tr>
<td></td>
<td>Planned maintenance of equipment</td>
</tr>
<tr>
<td></td>
<td>Total quality management</td>
</tr>
<tr>
<td>Crisis</td>
<td>Contingency planning to prepare for a crisis</td>
</tr>
</tbody>
</table>

Planning and Action

Contingency planning
Organisations prepare contingency plans in recognition of the fact that things do go wrong from time to time.

Contingency planning involves:

- Preparing for predictable and quantifiable crises
- Preparing for unexpected and unwelcome events

The aim is to minimise the impact of a foreseeable event and to plan for how the organisation will resume normal operations after the crisis.

The contingency plan:

- Identifies alternative courses of action that can be taken if circumstances change with time
- Details standby procedures to enable the continuation of essential activities and services during the period of the emergency
- Includes programmes for improving the business in the longer term once the immediate situation has been resolved

Steps in drawing up a contingency plan

- Recognise the need for contingency planning
- Identify possible contingencies - all the possible adverse and crisis scenarios
- Specify the likely consequences
- Assess of the degree of risk to each eventuality
- Determine risk strategy to prevent a crisis & to deal with a crisis should one occur
- Draft the plan and identify responsibilities
- Simulate crises and the operate of each plan

Dealing with the “what if” question

Scenario analysis:

- This involves constructing multiple but equally plausible views of the future
- The scenario consists of a “story” from which managers can plan

Sensitivity analysis

- Involves testing the effect of a plan on alternative values of key variables
- e.g. the effect of a 50% loss of capacity

Crisis management

- Crisis management involves:
- Identifying a crisis
- Planning a response
- Responding to a sudden event that poses a significant threat to the firm
- Limiting the damage
- Selecting an individual and team to deal with the crisis
- Resolving a crisis

Stages of a crisis
Pre-crisis | Prior to the event
---|---
Warning | Indications that there is or may be or could be an event liable to cause a significant impact on the organization
Crisis point | When the event begins to cause significant impact on the organization
Recovery | The acute stage of crisis has passed and the organisation is able to focus on a return to normal operations
Post crisis | Evaluation of the effects
| Repair to the organisation

Role of the crisis manager

- Crisis assessment
- Event tracking
- Managing human considerations
- Damage assessment
- Assessment or resources and options
- Development of contingencies
- Managing communications
- Co-ordination with external bodies
- Controlling information
- Controlling expectations
- Managing legal requirements

Advice on handling a crisis

- Appoint a crisis manager
- Recognise that the crisis manager is likely to adopt a more authoritarian style than is normal
- Do an objective assessment of the cause(s) of the crisis
- Determine whether the cause(s) will have a long term effect or whether it will be a short term phenomenon
- Project the most likely cause of events
- Focus on activities that will mitigate or eliminate the problem
- “Look for the silver lining”- opportunities in the aftermath
- Act to guard cash flow

Dealing with the financial aspects of a crisis

- Accelerate accounts receivable (payment by debtor)- by offering a discount if necessary.
- Slow up payment to creditors where possible.
- Increase short term, sales
- Reduces expenses - especially “non mission critical” expenses
- Outsource non mission critical operations.
- Re-schedule loans

Dealing with the “people” aspects of a crisis

- Form a crisis team
- Designate one person only to speak about the crisis to the outside world
- Act to prevent or counter the spread of negative information
- Make use of the media to provide a counter argument
- Do not tell untruths - trying to manipulate or distort the information will backfire
**Business Ethics**

**Business Ethics** is a relatively new, but increasingly important, part of Business Studies. The question, or problem, is this:

A business is expected to achieve its objectives, usually to make a decent profit for the owners/shareholders. In doing so, it may need to overlook the wishes of others.

For example, it could lie about the benefits of its products in order to get more revenue. It could skip important safety checks to save costs. What should the business do?

To some extent, this is an area already covered by Business Law. When society largely agrees, a law can be passed to stop behaviour the society disapproves of. For example, discrimination against women is illegal (it wasn’t always so).

**What Business Ethics Covers**

Business Ethics looks at areas that are too new, or too controversial, for society to agree on. For example, the medical business is increasingly controversial. The pharmaceutical businesses concentrate their (very expensive) research on illnesses that afflict rich people, because rich people (or the government of a rich country) can afford to buy these new treatments when they are launched on the market. This means too little research is done into illnesses (like malaria) that primarily affect poor people and poor governments. Is this right?

So, we can have profit-maximising businesses that don’t worry too much about who gets in their way; or we can have ethical businesses that are very careful with people get in their way, but which don’t make very much profit. This is the contrast, the trade-off that we are faced with.

Or is it? Increasingly, there is thought about a middle way. Consumers in developed countries are increasingly aware of ethical issues, and some are prepared to pay for it.

For example, BodyShop was one of the first businesses to build on this trend, and made their market niche largely out of the fact that their products are kinder to the world than are competing products. Why buy from BodyShop? Because their products aren’t tested on animals. So, the ethical nature of the product becomes part of the unique selling point ("USP") of the product and central to the Marketing of that product. In other words, there is no conflict between ethics and profit, because an ethical stance is part of the profit-making process.

Since then, many businesses in all sorts of markets have followed this line. Washing powders, for example. BP is trying to portray the oil business as environmentally friendly. Other businesses have been pushed in this direction by adverse publicity. Triumph, a Swiss makers of bras, was forced to abandon an investment in Myanmar (Burma ) because of widespread opposition to a dictatorial and unpleasant government. And Nike (and others) have been widely criticised for using cheap labour in developing countries, which is what you would expect from a profit-maximising business.

One difficult question is ‘what sort of things count as ethical question?’ There is no agreement on this, hence the difficulty. Take the example above. Some people might say well-done to Nike for creating jobs in a very poor part of the world where jobs are desperately needed. But other people have said that it is unethical to exploit very poor people, and to make them work in poor conditions for low wages, especially when the business could afford to pay them more.

**Do Businesses Behave Ethically?**

**Introduction**

The word ‘ethics’ means standards of right and wrong behaviour. Another word often used is ‘morality’.

This revision note is about whether or not businesses behave in an ethical way. There is a popular
image of the cruel and wicked Victorian mill owner. But in the 19th Century everybody in the UK more or less accepted the Christian code of ethical behaviour, and businesses were expected to follow. Some businesses, especially those owned by Quakers such as the Fry and Rowntree families, set very high standards indeed.

The Modern Business Environment

Today, things have got more complicated:-

1. There is no longer one agreed moral code. Most people have a weak sense of religion or none at all. So their morals must come from somewhere else.

2. There are competing religious and social moral codes, especially for multinational companies ("MNCs") operating in different parts of the world and employing people from different cultures.

3. The pursuit of profit has become a goal in its own right, and this puts pressures on people to compromise their standards, not just ethically, but in less important areas also. For example, a very rude manager might be tolerated because he (it usually is a he) makes large profits. So when good behaviour and good profits come into conflict, businesses find it difficult to resist the profits.

4. Businesses are only the people who work there; businesses don’t decide anything – it’s the people who make decisions. But businesses have group cultures with their own norms and standards. Individuals have a strong need to fit in and be accepted, so it is very difficult for any individual to stand up against attitudes and decisions they disagree with.

5. Greater wealth in the western economies means people have less tolerance for ethically dubious behaviour. We are no longer so desperate for growth and employment at any cost. People are also better educated and better informed. People are less deferential ie they are less accepting of what people in authority say. So there are higher expectations of how businesses should behave.

6. Businesses have to sell to consumers and employ workers who have their own standards and opinions. They are not going to buy from or work for a business they disapprove of. So there is a competitive pressure for better behaviour from businesses.

7. Many managers and owners have ambitions of social acceptance and recognition eg knighthoods, and so are not going to get caught behaving unethically.

8. Modern technology creates ethical dilemmas which never existed until quite recently. Medical products, and gene technologies, are a good example of this. Should parents be allowed to alter the genes of their unborn children, and should businesses sell the products to do this?

You can see that these factors all pull in different directions. It has all got a lot more difficult and a lot more complicated. Some businesses set up special committees to discuss and decide ethical problems, and they may even employ a professional philosopher to help them.

The Growth of Corporate Responsibility

‘Corporate responsibility’ is the phrase used to describe businesses which have decide to behave in a deliberately socially responsible manner.

Obeying the strict letter of the law doesn’t always solve these problems, although it does keep the business out of trouble with the authorities. Laws are general, and don’t always act as a good guide to decisions in any one individual case. Laws have to interpreted by courts, and it is not always obvious what is illegal until the case goes to court. Laws don’t cover all the areas that people consider important in ethical behaviour. For example, it may be perfectly legal to dump waste at sea, but many people would consider this to be unacceptable behaviour.

In many cases different ethical principles pull in opposite directions. For example, closing a polluting factory may be good for the environment, but it is not going to help the local community who need the jobs and the incomes. What should the business do? Whatever it does, it is going to upset one group of people or another, because society at large cannot clearly answer these questions, and there is no
clear guide to the business how to behave.

Businesses which get caught acting unethically suffer much more damage than used to be the case. The press is much more active in investigating and publicising such cases. The population at large takes more interest, has their own views, and is more willing to let their displeasure be known. Pressure groups opposed to some activities of business are much better organised, better financed and better able to attack such businesses. Huntingdon Life Sciences has been an extreme example, because the Animal Liberation Movement is prepared to use extreme (and ethically dubious) methods. Not only have employees been threatened, but the employees of shareholders and banks, so the business nearly went bust through lack of finance. This shows that the opponents of business understand business and its weak points very well.

The internet now allows very rapid sharing of information across the world (and MNCs operate across the world). There are many web sites devoted to publicising and discussing the behaviour of businesses. Whistle-blowing is more acceptable, and even protected by law in some countries, so access to secret information is now better.

**Increasing Consumer Activism**

Consumer campaigns can be very effective. If enough consumers stop buying from a business revenues will fall until the business is forced to change or go bust. Managers don't like the negative publicity, and are sometimes embarrassed by their own decisions anyway; they know they are dubious decisions. Suppliers may want to switch away from such a business because there is guilt by association.

In extremes there may be an investors strike where large numbers of people refuse to buy the shares of such a business and the business cannot raise finance. A large number of US pension funds (especially in the public sector) used to refuse to invest in US businesses involved in apartheid South Africa. Businesses may also have trouble recruiting enough good employees.

**Benefits of Ethical Behaviour**

The main benefits for a business of behaving ethically are:

1. Avoidance of expensive and embarrassing PR disasters.
2. Better image with consumers and better sales.
4. Better employee motivation because employees are proud of their jobs.

**Effects of Ethical Behaviour**

1. Increased costs as businesses try to do what is expected eg not pay bottom wages, or dump pollution cheaply at sea.
2. Conflict between profit and ethical standards.
3. Business practice and organisational culture will have to be changed.
4. Changes in relations with suppliers. This may mean passing the same standards down the supply chain, and severing relations with suppliers not prepared to meet the same standards. Alternative suppliers may be more expensive. For example, the export of Brazilian mahogany is illegal for reasons of conservation, but it is very difficult (and expensive) to buy mahogany that is absolutely guaranteed to come from an officially recognised sustainable source.

**Should Businesses Be Expected to Behave Ethically?**

One argument is that businesses are products of the society in which they operate, in which they sell...
their products, and in which they hire their employees. So businesses should be expected to reflect the ethical standards of the surrounding society. One problem with this view is that society doesn’t always have clear ethical standards to which businesses can stick. For example, some people care passionately about animal experiments, and argue it is deeply unethical, whereas many other people say such experiments are justified if real people benefit medically from the research. What is a business supposed to do?

The opposite argument is that businesses are supposed to make a profit for their owners, to create jobs for employees, and to create wealth for society as a whole. Anything else is at best an irrelevance and at worst simply gets in the way of profitable business. See What's Wrong with Ethical Corporate Behaviour for a counter-argument.

The middle argument is that businesses in the real world (or most of them, at least) would like to do both, if possible. But there will always be conflicts. What then happens? Does the business stick with the ethical behaviour? Usually the business will go for the profits and it is this which upsets many people, although perhaps people sometimes expect too much and haven’t really thought through the consequences of their own opinions.

Are Businesses Behaving More Ethically?

Research suggests middle and junior managers care quite a lot about ethical behaviour, but that senior managers still care mainly about profit. To the extent that it is senior managers that make the decisions, then little has changed, but middle managers can gradually shift the climate of opinion in a business.

Well-publicised cases such as Shell and the Brent Spar suggest businesses have become more sensitive to public opinion about ethical behaviour and have begun to behave more ethically (as opposed to just saying that they do). Cynics argue this is not because of a change of heart, but merely yet another changed response to changed market conditions in the eternal pursuit of profit.
Corporate Social Responsibility

Definitions of social responsibility

Corporate social responsibility (CSR) is:

- An obligation, beyond that required by the law and economics, for a firm to pursue long term goals that are good for society
- The continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as that of the local community and society at large
- About how a company manages its business process to produce an overall positive impact on society

Corporate social responsibility means:

- Conducting business in an ethical way and in the interests of the wider community
- Responding positively to emerging societal priorities and expectations
- A willingness to act ahead of regulatory confrontation
- Balancing shareholder interests against the interests of the wider community
- Being a good citizen in the community

Is CSR the same as business ethics?

- There is clearly an overlap between CSR and business ethics
- Both concepts concern values, objectives and decision based on something than the pursuit of profits
- And socially responsible firms must act ethically

The difference is that ethics concern individual actions which can be assessed as right or wrong by reference to moral principles.

CSR is about the organisation’s obligations to all stakeholders – and not just shareholders.

There are four dimensions of corporate responsibility

- Economic - responsibility to earn profit for owners
- Legal - responsibility to comply with the law (society’s codification of right and wrong)
- Ethical - not acting just for profit but doing what is right, just and fair
- Voluntary and philanthropic - promoting human welfare and goodwill
- Being a good corporate citizen contributing to the community and the quality of life

The debate on social responsibility

Not all business organisations behave in a socially responsible manner

And there are people who would argue that it is not the job of business organisations to be concerned about social issues and problems

There are two schools of thought on this issue:

- In the free market view, the job of business is to create wealth with the interests of the shareholders as the guiding principle
- The corporate social responsibility view is that business organisation should be concerned with social issues
Free market view - a summary

- The role of business is to create wealth by providing goods and services
- “There is one and only one social responsibility of business-to use its resources and engage in activities designed to increase its profit so long as it stays will the rules of the game, which is to say, engages in open and free competition, without deception or fraud.” [Milton Friedman, American economist]
- Giving money away is like a self imposed tax
- Managers who have been put in charge of a business have no right to give away the money of the owners
- Managers are employed to generate wealth for the shareholders - not give it away
- Free markets and capitalism have been at the centre of economic and social development
- Improvements in health and longevity have been made possible by economies driven by the free market
- To attract quality workers it is necessary to offer better pay and conditions and this leads to a rise in standards of living and wealth creation
- Free markets contribute to the effective management of scarce resources
- It is true that at times the market fails and therefore some regulation is necessary to redress the balance
- But the correcting of market failures is a matter for government - not business
- Regulation should be kept to a minimum since regulation stifles initiative and creates barrier to market entry

The free market case against corporate social responsibility

- The only social responsibility of business is to create shareholder wealth
- The efficient use of resources will be reduced if businesses are restricted in how they can produce
- The pursuit of social goals dilutes businesses’ primary purpose
- Corporate management cannot decide what is in the social interest
- Costs will be passed on to consumers
- It reduces economic efficiency and profit
- Directors have a legal obligation to manage the company in the interest of shareholders – and not for other stakeholders
- CSR behaviour imposes additional costs which reduce competitiveness
- CSR places unwelcome responsibilities on businesses rather than on government or individuals

The corporate responsibility view

- Businesses do not have an unquestioned right to operate in society
- Those managing business should recognise that they depend on society
- Business relies on inputs from society and on socially created institutions
- There is a social contract between business and society involving mutual obligations that society and business recognise that they have to each other

Stakeholder theory.

The basic premise is that business organisations have responsibility to various groups in society (the internal and external stakeholders) and not just the owners/ shareholders

The responsibility includes a responsibility for the natural environment

Decisions should be taken in the wider interest and not just the narrow shareholder interest

Arguments for socially-responsible behaviour

- It is the ethical thing to do
- It improves the firm’s public image
- It is necessary in order to avoid excessive regulation
• Socially responsible actions can be profitable
• Improved social environment will be beneficial to the firm
• It will be attractive to some investors
• It can increase employee motivation
• It helps to corrects social problems caused by business

Enlightened self interest

This is the practice of acting in a way that is costly and/or inconvenient at present but which is believed to be in one’s best long term interests

There is a long history of philanthropy based on enlightened self interests e.g. Robert Owen’s New Lanark Mills, Titus Salt’s Saltaire as well the work of the Quaker chocolate makers such as Cadbury at Bournville and Rowntree in York.

Enlightened self interest is summed up in this quotation from Anita Roddick (founder of the Body Shop): “Being good is good for business”

CSR behaviour can benefit the firm in several ways

• It aids the attraction and retention of staff
• It attracts green and ethical investment
• It attracts ethically conscious customers
• It can lead to a reduction in costs through re-cycling
• It differentiates the firm from its competitor and can be a source of competitive advantage
• It can lead to increased profitability in the long run

Business In The Community

BITC is an independent charity set up by leading business organisations to inspire, engage, support and challenge continually improve the impact they have on society

It defines CSR as “a company’s positive impact on society and the environment, through its operations, products or services and through its interaction with key stakeholders” (www.bitc.org.uk)

The BITC index

Each year BITC conducts a self assessment survey on how companies are managing, measuring and reporting their social and environmental impacts

For each of community, environment, market place and workplace assessment is made in terms of:

• Community issues
• Environmental issues
• Market place issues
• Workplace issues

Scores are given and a BITC index is produced

How the BITC measures CSR:

• Commitment to CSR is evaluated in terms of the extent to which:
• Responsibilities have been clearly defined at all levels
• Policies are in place to ensure responsible business behaviour
• Objectives and targets have been set to create improvement
• There are effective communications systems to share knowledge
• Training is provided to ensure competency and delivery of objectives
• A process is in place for stakeholder consultation and engagement
• There are monitoring systems in place to assess and report progress
• Key issues, targets and performance are reported quickly.

BITC Index 2006: the top 20

• Co-operative Bank.
• BAA.
• Barclays
• BT
• National Grid
• PriceWaterhouseCoopers
• CE Electric UK
• Scottish and Southern Energy
• Veolia Water UK
• Boots
• Co-operative Insurance
• HBOS
• Lloyds TSB
• John Lewis Partnership
• RWE Npower
• Tesco
• Reckitt Benckiser
• Rolls Royce
• United Utilities
• And joint 20th- BBC,M&S, Scottish Power, Severn Trent Water.

(Source :Sunday Times 7/5/06)

Case study in CSR – Tesco

Tesco went on the offensive against criticism that it is an uncaring retail giant by unveiling a plan in turn it into a “better neighbour”

In addition to the investing in sustainable environmental technology such as wind turbine to light its stores, Tesco announced a 10 point action plan

Was this a genuine measure or corporate responsibility or an attempt to defect criticism of the power of the supermarket giants?

Tesco’s Ten Point Action Plan:

• Halve average energy used in Tesco buildings by 2010 compared with 2000
• Double the amount that customers recycle at stores by 2008
• Make all carrier bags degradable
• Put nutritional labeling on all own brand products by 2007
• Help educate parents about healthier food for their children
• Get 2m people running, cycling or walking in sponsored events leading up to the 2012 Olympics
• Be a quieter neighbour by cutting the number of deliveries to Express convenience stores
• More consultation before building new stores from 2007
• Make it easier for small suppliers to gain access to Tesco
• Sell more local product than other retailers and introduce regional counters into stores
1. The listed companies shall encourage effective representation of independent non-executive directors including directors representing minority interest on the BOD, so that, the board as a group includes core competence relevant to each listed company.

2. Executive directors are working whole time director and non-executive director, on the other hand include independent person who give outside view point to the BOD of the company and do not devote their whole working time to the company.

3. The guiding factor in distinguishing between executive and non-executive director is the extent of their involvement in the management of the company.

4. An executive director can not be categorically defined as a “paid director” and a non executive director as who is “not paid director”

5. The payment of remuneration to directors is at the discretion of the company.

6. Independent director means a director who is not connected with the listed company or its promoters or directors on the basis of family relation, for other relations and connection with the associated company and related party. Test of independence is taken from the fact whether a person can be reasonably perceived to exercise independent business judgment without being subservient and undue influence.

7. Minority share holders as a class or facilitated to contest election of directors by obtaining proxies. The company shall annex to the notice of general meeting at which director election are to be held, a statement by the candidate from the minority share holders who seeks to contest election of the BOD. This statement shall include the profile of that candidate.

8. The directors of the listed company shall also include atleast one independent director representing institutional equity interest of a banking company, BFI, NBFI, modarabas, leasing companies, investment bank, mutual funds or insurance company. No minimum investment has been prescribed in the board. No action can be taken for the time being in case an institutional investor fails to nominate a director on the board of Investee Company.

9. Executive director i.e. whole time working director shall not be more than 75% of the elected directors including chief executive, provided that this provision shall not be applicable to banking company which is required by prudential regulations not to have more than 25% directors as paid executive directors.

10. The directors of listed company at the time of filing of their consent shall give a declaration that they are aware of their duties and powers under the relevant clause of Memorandum & Articles of Association and listing regulations.

11. A company shall not have a person a director who is a director of ten other listed companies. The director shall be the registered tax payer.

12. The director shall not be convicted as a defaulter of any bank.

13. The listed company shall endeavor that no person is elected as a director if he or his spouse is engaged in business of stock brokerage unless specifically permitted by the SECP.

14. The tenure of the director shall be three years any casual vacancy in the board of directors shall be filed by the directors within 30 days.

15. Every listed company shall ensure that a “statement of ethics and business practices” is prepared and circulated annually by the directors to establish a standard of conduct for the director and employee. This statement shall be signed by each director and employees in acknowledgment of their understanding and acceptance of the code of conduct. The director shall adopt of vision and mission statement and overall corporate strategy for the company and also formulate significant policies, which may include risk management, human resource management, procurement of goods and services, marketing, determination of terms of credit and discount to customers, right off bad debts, acquisition and disposal of fixed assets, investments, borrowings, donations and charities, delegation of financial powers, transactions with associated companies and related parties, health safety and environment.

16. A complete record of the significant policies alongwith dates on which they were approved or amended by the directors shall be maintained.
17. The directors shall establish a system of sound internal control which is effectively implemented.

18. The following powers shall be exercised by the BOD documented by a resolution passed at a meeting of the board:
   - Investment and dis-investment of funds, where, maturity period is 6 months or more
   - Determination of nature of loans and advances
   - Right off of bad debts
   - Right off of inventories and other assets

19. Appointment remuneration and terms and conditions of the employment of chief executive officer and other executive directors of the company shall be determined and approved by the BOD.

20. The chairman of the listed company shall preferably be elected from the non-executive directors. The BOD shall clearly define roles and responsibilities of chairman and chief executive, whether or not these offices be held by separate individual or same individual.

21. The chairman will ensure that the minutes of meeting of the board are properly recorded and circulated to the directors and officers who entitled to attend meeting within 14 days of the meeting.

22. In case the director of the company is of the view that his decending notes have not been appropriately recorded in the minutes he may refer to the company secretary to require him to append his decending notes with minutes of meeting. If company secretary fails to do so he may file an objection with the SECP.

The following matters and significant issues shall be placed for information consideration and approval by the BOD:

- Annual business plan
- Cash flow projections and other forecasts
- Budgets alongwith variance analysis
- Quarterly operating activities
- Internal audit report, including cases of fraud and irregularity
- Management letter issued by external auditor
- Details of joint ventures and agreements with distributors and agents
- Promulgation or amendment of any law rules regulations accounting standard which may affect the listed company
- Status and implication of law suits by and against the company
- Any showcause notice demands etc. from revenue regulatory authorities
- Default in payment of loans
- Failure to recover material amounts
- Significant accident, dangerous occurrence and instances of pollution involved in the listed company
- Dispute with the labour
- Payment of goodwill or brand

**Chief Financial Officer and Company Secretary**

**Appointment**

The appointment and remuneration and terms and conditions of the employment of the CFO and CS and the head of internal audit shall be determined by CEO with the approval of the board. They shall
not be removed except by the CEO with the approval of the board.

Qualification

CFO

- Member of recognized body of professional accountant OR
- Graduate from recognized university having at least 5 years experience of financial and corporate affairs of a listed company or a bank or a financial institution.

Company Secretary

- Member of recognized body of professional accountants
- Member of recognized body of corporate chartered secretary
- MBA, M.COM, LLB having at least two years of relevant experience

Attendance in the Board Meeting

- The CFO and company secretary shall attend the meeting of BOD and would not be deemed to be directors and cast vote at the meeting

Responsibility of Financial Reporting and Corporate Compliance

- No listed company can circulate its financial unless the CFO and CEO present the financial statement duly endorsed by their signature for consideration and approval of the directors. The directors after consideration and approval shall authorize the signing of financial statement for circulation and issuance.
- The company secretary shall furnish a secretariat compliance certificate in a prescribed form as part of annual return file with the registrar of company to satisfy that secretariat and corporate requirement of the Companies Ordinance 1984 has been complied with.

CORPORATE AND FINANCIAL REPORTING FRAMEWORK

Director’s Report (Sec-236)

1. The director shall include their statement to the following effect in the director’s report prepared under section 236 of the Companies Ordinance, 1984

   - The financial statement prepared by the management of the listed company, present fairly its state of affairs the results of operations, cash flow and changes in equity.
   - Proper books of account have been maintained here.
   - Appropriate accounting policies have been consistently applied in preparation of financial statement and accounting estimates are based on reasonable and prudent judgment.
   - International accounting standard as applicable in Pakistan have been followed in preparation of financial statement and any departure there from have been adequately disclosed.
   - Internal control is sound and effectively implemented.
   - There is no significantly doubt on the ability of company to continue or going concern.
   - There is no material departure from the best practices of the corporate
governance.

2. The following matters shall be disclosed in the director’s report:

- If the company is not considered to be going concern the reason shall be disclosed.
- Significant deviation from last year operating results along with reasons.
- Keep operating and financial data of last six years in summarized form.
- If the company has no declared dividend or issue bonus shares, the reason shall be given.
- Where any statutory payments (Taxes & Duties) are outstanding the reason shall be disclosed.
- Significant plans and decisions like corporate restructuring, business expansion and discontinuance of operations shall be given along with future prospects risks and uncertainty.
- Statement on the value of investment of provident fund, gratuity and pension fund shall be disclosed.
- Number of board’s meeting held during the year and attendance by each director shall be disclosed.
- The pattern of share holding shall contain the aggregate no. of shares (name wise detail) held by:
  - Associated companies and related parties (name wise)
  - NIT and ICP
  - Directors and their spouse
  - Chief executive
  - Public sector company (Government owned)
  - Banks, DIFI, NBFI, insurance companies, modarabas and mutual funds
  - Share holders holding 10% or more voting rights
- All trades in the shares of the listed company by the directors, CFO, CEO, company secretary and their spouses and minor children.

Audit Committee

Composition

1. The director shall establish an audit committee which shall comprise not less than three members.
2. Majority of members shall be from Non-Executive directors (NED).
3. Chairman of the committee shall be preferably from NED.
4. The names of the members of audit committee shall be given in the annual report.

Frequency of Meetings

1. The audit committee shall meet atleast once every quarter of the financial year.
2. These meetings shall be held prior to approval of interim results of the company and before and after the completion of external audit.
3. A meeting of the audit committee shall also be held if requested by external auditor or the head of internal audit.

Attendance at Meetings
1. The CFO and the head of internal audit and a representative of external audit shall attend meetings of the audit committee at which issues relating to the accounts and audit are discussed.

2. Provided, that at least once a year the audit committee shall meet the external auditor without presence of CFO and head of internal audit.

3. Provided further, that at least once a year the audit committee shall meet the head of internal audit without presence of CFO and external auditor.

Terms of Reference of Audit Committee

1. The BOD of the company shall determine the terms of reference of audit committee which shall inter alia be responsible for recommending to the BOD, the appointment of external auditor and shall consider any question of resignation or removal of external auditor, audit fee and other services.

2. The terms of reference also includes the following:

3. Determination of appropriate measures to safeguard company’s assets

4. Review of preliminary announcement of results prior to publication

5. Review of quarterly and annual financial statement prior to approval of BOD, focusing on:
   - Major judgment areas
   - Significant adjustment resulting from the audit
   - Going concern assumption
   - Changes in accounting policies
   - Application of accounting standards
   - Other statutory requirement

6. Facilitating the external auditor and discussion with internal auditor on their observation

7. Review of management letter issued by external auditor and management response

8. Ensuring coordination between internal and external auditor

9. Review of internal audit function

10. Consideration of major finding of the internal investigation

11. Ascertaining that the internal control system including financial and operational controls and accounting system and reporting structure are adequate and effective

12. Monitoring compliance with the best practices of the code of corporate governance

13. Any other matter as may be assigned by the BOD

14. Audit committee shall appoint a secretary, who shall circulate minutes of the meetings of audit committee to all the members of committee, directors and CFO with fortnight

Reporting Procedure

Audit committee shall appoint a secretary who shall circulate the minutes of the meeting to the members of committee, directors and CFO within the fortnight.

External Auditor

1) No listed company shall appoint as external auditor who is not been given satisfactory dating under the QCR program under ICAP.

2) The external auditor shall be compliant with IFAC guidelines on code of ethics as adopted by ICAP.

3) The board of directors of listed company shall recommend the appointment of external auditors for one year as suggested by audit committee. The recommendations shall be included in the director report.
4) No listed company shall appoint auditor to provide services in addition to audit except in accordance with the IFAC guidelines.

5) All listed company in the financial sector shall change their external auditor every five years. Financial sector include Banks, NBFC, Modarbas and Insurance companies.

6) All listed companies other than these financial sector companies shall at minimum rotate the engagement partners every 5 years.

7) No listed company shall appoint as CEO, CPO, Internal auditor or director who was the partner of the firm of external auditor (or an employee who is involved in the audit of the company) at any time during the preceding 2 years or the close of relation of such partner or employee.

8) The company shall acquire the external auditor to furnish the management letter to its board of directors not later than 30 days of audit report.

9) Every listed company require a partner of the firm of auditor to attend the AGM.

Compliance with the Codes

The listed company shall publish in the annual reports status of compliance with the best practice of the code of corporate governance. This statement shall be reviewed by the external auditors.

Transfer Pricing

1. No listed company used a price other than arm’s length price except in rare circumstances where subject to approval of the board of directors and to with the reasons to be recorded in writing, it is in the trust of the company to do so.

2. The directors shall approve transfer pricing policies for related party’s transactions.

3. For each related party, the company shall prepare a statement to record the methods for determining transfer price of various transactions with such party

4. The company shall maintain the record of related party transactions as follows;
   - Name of related party
   - Nature of transaction
   - Amount of transaction
   - Terms and conditions of transaction
   - Basis, methods, assumptions and underlying the computation of transfer price
   - A statement whether in management opinion the consideration is an arm’s length price.

5. The record of all related party shall be placed before audit committee and also before the board of directors. The transaction which has not been executed as arm’s length transaction shall be separately placed.

6. The record of related party transaction shall also be presented to statutory auditor.

7. The company shall publish in the annual report status of compliance with the best practice of transfer pricing. This statement shall be reviewed by the statutory auditor.
Human Resource Management ("HRM") is a way of management that links people-related activities to the strategy of a business or organisation. HRM is often referred to as "strategic HRM". It has several goals:

- To meet the needs of the business and management (rather than just serve the interests of employees);
- To link human resource strategies / policies to the business goals and objectives;
- To find ways for human resources to "add value" to a business;
- To help a business gain the commitment of employees to its values, goals and objectives

The link between Human Resources and Business Strategy

All elements of the business strategy have implications for human resources, as illustrated in the table below. The challenge for management is to identify and respond to these HR challenges:

<table>
<thead>
<tr>
<th>Examples of Key Strategy Issues</th>
<th>Possible Human Resource Implications</th>
</tr>
</thead>
<tbody>
<tr>
<td>What markets should the business compete in?</td>
<td>What expertise is required in these markets? Do existing management and employees have the right experience and skills</td>
</tr>
<tr>
<td>Where should the business be located to compete optimally?</td>
<td>Where do we need our people? How many do we need?</td>
</tr>
<tr>
<td>How can we achieve improvements in our unit production costs to remain competitive?</td>
<td>How productive is the workforce currently? How does this compare with competitors? What investment in the workforce (e.g. training, recruitment) and their equipment is required to achieve the desired improvement in productivity?</td>
</tr>
<tr>
<td>How can the business effect cultural change?</td>
<td>What are the current values of the workforce. How can the prevailing culture be influenced/changed to help implement a change programme?</td>
</tr>
<tr>
<td>How can the business respond to rapid technological change in its markets?</td>
<td>What technological skills does the business currently possess? What additional skills are needed to respond to technological change? Can these skills be acquired through training or do they need to be recruited?</td>
</tr>
</tbody>
</table>

An important part of HRM is the Human Resources Plan. The purpose of this plan is to analyse the strategic requirements of the business in terms of manpower - and then to find a way of meeting the required demand for labour. This is the subject of a separate revision note.

Succession Planning

Succession planning is seen as an important process by most large businesses - but what does it mean? Some of the confusion surrounding succession planning is due to people using the term in many different ways. Succession planning is best described as a process where one or more "successors" are identified for key jobs, and career moves and/or employee development activities are planned for these successors. Successors may be fairly ready to do the job (short-term successors) or seen as having longer-term potential (long-term successors).

Objectives of Succession Planning

The main objectives (and advantages) of succession planning are:
- Improved job filling for key positions through broader candidate search, and faster decision-making
- Active development of longer-term successors through ensuring their careers progress, and by making sure they get the range of work experiences they need for the future
- Encouraging a culture of “progression” through developing employees who are seen as a ‘business resource’ and who share key skills, experiences and values seen as important to the future of the business

Of the above objectives, it is the active development of a strong ‘talent pool’ for the future which is often viewed as the most important. Increasingly, this is also seen as vital to the attraction and retention of the ‘best’ people (particularly in service businesses like the accountancy and legal professions).

**How are succession and development plans produced?**

Succession plans normally cover both short- and longer-term successors for key jobs, and development plans for these successors.

Where a number of jobs are of similar type and need similar skills, it is preferable to identify a ‘pool’ of successors for this collection of posts.

Typical activities covered by succession planning include:
- Identifying possible successors
- Challenging and reviewing succession plans through discussion of people and posts
- Agreeing job (or job group) successors and development plans for individuals
- Analysis of the gaps or surpluses revealed by the planning process
- Review, i.e. checking the actual pattern of job filling and whether planned individual development has taken place.
Workforce planning is one of the most important activities in a business. It starts with analysis of the strategic position of the business. The results of this analysis then feed into a forecast of the required demand for labor by the business and how this is likely to be supplied. The final stage involves the creation and implementation of a human resources plan which aims to deliver the right number of the right people for the business.

How strategy feeds into the workforce plan

The strategic position and needs of the business have the most important influence on workforce planning: for example:

- Labour environment: what is happening to the size of the labour force? What key population and employment trends (e.g. the increasing number of women seeking part-time work; increasing numbers of people working on temporary or short-term contracts) affect the ability of the business to recruit staff? What provision needs to be made for employee pensions (particularly in the light of falling stock market values); what employment legislation
- Business objectives and scope of activities: what are the objectives of each business unit? What products are to be sold, in which markets; using what kind of distribution?
- Business location - where is the business located? How are the various business units, divisions, functions distributed across the various locations? What specialist skills are essential in each location? What are the workforce implications of decisions on business location?
- Timetables - to what extent do the strategic needs of the business require short-term changes in the workforce - or can change be achieved over a longer period. For example, are new retailing or distribution locations to be opened in the next 12 months that require staff?

Forecasting Workforce Demand

Putting a good Human Resources plan together requires a business to make a reasonably accurate forecast of workforce size. Key factors to consider in this forecast are:

- Demand for existing and new products
- Business disposals and product closures
- Introduction of new technology (e.g. new production equipment)
- Cost reduction programmes (most usually involve a reduction in staff numbers somewhere within the business)
- Changes to the business organisational structure
- Business acquisitions, joint ventures, strategic partnerships

Forecasting Workforce Supply

The starting point for estimating supply is the existing workforce: a business should take account of:

- Scheduled changes to the composition of the existing workforce (e.g. promotions; job rotation)
- Normal loss of workforce - e.g. through retirement, "normal" labour turnover
- Potential exceptional factors - e.g. actions of competitors that create problems of staff retention

By comparing the forecast workforce demand and supply - it is possible to compile a forecast of net workforce size. This then needs to be compared with the strategic requirements for the business. The result is the "workforce gap" (which be a forecast of too few or too many workers). The role of HRM is to close the gap!

HRM - Policies to Close the Workforce Gap

The key HRM activities to manage the workforce gap comprise:
- Recruitment plans (how many people, where, what type, how)
- Training plans
- Redundancy plans
- Staff Retention Plans (how the business intends to keep the staff it wants to retain)

Flexible Working Hours
A system of flexible working hours gives employees some choice over the actual times they work their contracted hours. Such a system can be a good way of recruiting and retaining staff - since it provides an opportunity for employees to work hours consistent with their other commitments (e.g. child care).

Most flexible working hours schemes have a period during the day when employees must be present. This is known as "core time". A typical core time would be 10:00 a.m. to 4:00 p.m. Other than the core time, employees may choose when they start and finish work within flexible bands at the beginning and end of each day. These bands are typically 08:00–10:00 and 16:00–18:00. However, there is wide scope for variation depending on the core time, the hours the work place is open and the nature of the business.

Some schemes also have a flexible band during the middle of the day so that employees have some choice over the time they take their lunch break. Contracted hours (the total hours an employee must work according to their employment contract) are achieved by employees working the core time plus hours of their choice during the flexible bands over an agreed period. This period is known as the accounting period and is typically four weeks long. Some schemes allow for an excess or deficit (within set limits) to be carried over to the next accounting period. Hours are credited for absences such as sickness or holidays.

**How to introduce a flexible working hours scheme**

The introduction of a flexible working hours scheme requires care and needs to be carefully planned by all those likely to be affected. Experience suggests that a joint "working party" comprising representatives of management and employees is usually the best approach and any recognised trade union should be fully involved. The working party should consider:

- Whether the scheme is to be voluntary or compulsory
- What type of recording system should be used (e.g. manual, clocking or computerised)
- How flexibility should be built into the bands
- How sickness, absence and late attendance should be treated
- Arrangements for managing and monitoring the scheme (e.g. monitoring the effect on production or customer service levels)

When the details have been agreed there should be a trial period of, perhaps, three months to help identify and eliminate any problems.

**Advantages of flexible working hours**

- Employees have greater freedom
- Can make traveling easier (e.g. avoiding commuting during the normal rush-hour)
- Improved morale and reducing absence and lateness
- Reduction in overtime and less lost time since long lunch breaks or late arrivals are not recorded as time worked

**Disadvantages of flexible working hours**

- Costs involved in administering the scheme
- If the premises are open longer, there may be increased costs for lighting and heating
- Employees will not be in work at certain times and therefore it may not be suitable for organisations where continuous cover is necessary.

**Labour Turnover**

**What is "labour turnover"?**

Labour turnover refers to the movement of employees in and out of a business. However, the term is commonly used to refer only to ‘wastage’ or the number of employees leaving. High labour turnover causes problems for business. It is costly, lowers productivity and morale and tends to get worse if not dealt with.

**Measuring labour turnover**

The simplest measure involves calculating the number of leavers in a period (usually a year) as a
percentage of the number employed during the same period. This is known as the "separation rate" or "crude wastage rate" and is calculated as follows:
Number of leavers / average no employed x 100

For example, if a business has 150 leavers during the year and, on average, it employed 2,000 people during the year, the labour turnover figure would be 7.5%.

An alternative calculation of labour turnover is known as the "Stability Index". This illustrates the extent to which the experienced workforce is being retained and is calculated as follows:
Number of employees with one or more years' service now / Number employed one year ago x 100

Labour turnover will vary between different groups of employees and measurement is more useful if broken down by department or section or according to such factors as length of service, age or occupation.

Patterns of labour turnover
The highest rate of labour turnover tends to be among those who have recently joined an business. Longer-serving employees are more likely to stay, mainly because they become used to the work and the business and have an established relationship with those around them.

Causes of labour turnover
A high level of labour turnover could be caused by many factors:
- Inadequate wage levels leading to employees moving to competitors
- Poor morale and low levels of motivation within the workforce
- Recruiting and selecting the wrong employees in the first place, meaning they leave to seek more suitable employment
- A buoyant local labour market offering more (and perhaps more attractive) opportunities to employees

Costs of labour turnover
High rates of labour turnover are expensive in terms of:
- Additional recruitment costs
- Lost production costs
- Increased costs of training replacement employees
- Loss of know-how and customer goodwill
- Potential loss of sales (e.g. if there is high turnover amongst the sales force)
- Damage that may be done to morale and productivity (an intangible cost)

Benefits of labour turnover
Labour turnover does not just create costs. Some level of labour turnover is important to bring new ideas, skills and enthusiasm to the labour force. A "natural" level of labour turnover can be a way in which a business can slowly reduce its workforce without having to resort to redundancies (this is often referred to as "natural wastage").

**Job Sharing**

Job sharing involves dividing a single full-time job between two people who share the responsibility, pay and benefits.

Jobs can be shared between two people on a:
- Daily basis, with one sharer working mornings and the other afternoons
- Weekly basis, with sharers working half a week each

Another method is for sharers to work alternate weeks. When deciding how to split a job, several factors should be considered:
- The flexibility of the job sharers
- The need for any overlap (e.g. an hour to "hand-over" the current issues of the job)
Travel costs (for example, if these are significant, the use alternate week sharing may reduce costs through the purchase of weekly tickets)

**Advantages of job sharing**

- Job sharing allows businesses to recruit skilled, experienced workers who may not be available for or willing to do full-time work
- It allows one position to be filled by two people with different but complementary experience
- It provides some continuity if one sharer leaves or is absent

**Disadvantages of job sharing**

- Job sharing involves some additional administrative and training costs and extra time spent on supervision and communication
- Where job sharers have managerial responsibilities staff may find it difficult or confusing to work for two people
- Some job sharers may feel that they are achieving proportionately more than a full-time employee and that they are being inadequately paid.
Recruitment is an important part of a business' human resource planning. In all businesses, people are a vital resource - and they need to be managed as such. The overall aim of the recruitment and selection process is to obtain the number and quality of employees that are required in order for the business to achieve its objectives.

There are three main stages in recruitment:

1. **Identify and define** the requirements. This involves the preparation of job descriptions, job specifications and person specifications
2. **Attract potential employees** - there are various methods for doing this - which are described in a separate revision note
3. **Select and employ** the appropriate people from the job applicants

It is important to appreciate that recruitment is a continuous process - because of:
- Staff departures (e.g. retirements, sackings, resignations)
- Changes in business requirements (e.g. new products, markets, expanded operations)
- Changes in business location (a relocation often triggers the need for substantial recruitment)
- Promotions

Recruitment is becoming more and more important in business. In particular, this reflects the increasing need for a well-motivated and flexible workforce that requires less management supervision

**Recruitment Planning**

There are a number of possible reasons as to why a business may have to recruit more employees:

- Business is expanding due to:
  - Increasing sales of existing products
  - Developing new products
  - Entering new markets
- Existing employees leaving to work with competitors or other local employers
- Existing employees leaving due to factors such as retirement, sick leave, maternity leave
- Business needs employees with new skills
- Business is relocating – and not all the existing workforce wants to move to the new location
In each of these circumstances a business will normally carry out Workforce Planning to find out how many workers and what types of workers are required. The workforce plan will establish what vacancies exist and managers then need to draw up a job description and job specification for each post.

**Job Analysis**

The management of a business need to determine what work needs to be done. Job analysis is a key part of this need. Job analysis concentrates on what job holders are expected to do. It provides the basis for a job description, which in turn influences decisions taken on recruitment, training, performance appraisal and reward systems.

**What is contained in a job analysis?**

A job analysis would typically contain:

- **Job purpose**: What is the job meant to do - and how does this related to other parts of the business?
- **Job content**: Duties and responsibilities
- **Accountabilities**: What results / outputs is the job holder responsible for?
- **Performance criteria**: How will the job holder's performance be measured?
- **Resource requirements**: E.g. equipment, location

**How is a job analysis carried out?**

Several techniques should be used to complete an effective job analysis:
- Research business documents - e.g. procedures manuals
- Ask relevant managers about the requirements and purpose of the job; what are the key activities; what relationships does the job have with other posts. Develop a comprehensive profile through these discussions
- Interview the existing job holder (if the job already exists) - e.g. ask store managers in retail stores and build a profile from asking those who actually do the job
- Observe the job holders to see what they really do

The key information that needs to be collected includes:
- Job title
- Main duties and tasks
- Targets and performance standards that the job holder is required to achieve
- The amount of supervision that is normally given / freedom of decision-making in the job
- Skills and/or qualifications needed for the job (including personal skills)

**Job Description**

A job description sets out the purpose of a job, where the job fits into the organisation structure, the main accountabilities and responsibilities of the job and the key tasks to be performed.

A job description has four main uses:
- **Organisation**: defines where the job is positioned in the organisation structure. Who reports to who
- **Recruitment**: it provides essential information to potential recruits (and the recruiting team) so that they can determine the right kind of person to do the job (see person specification)
- **Legal**: the job description forms an important part of the legally-binding contract of employment
- **Appraisal of performance**: individual objectives can be set based on the job description

**Contents of a Job Description**

The main contents of a job description are:
- **Job Title**: this indicates the role/function that the job plays within an organisation, and the level of job within that function (e.g. Finance Director would be a more senior position than Financial Accountant - although both jobs are in the “finance department”)
Internal vacancies are usually advertised within the business via a variety of media:
- Staff notice boards
- Intranets
- In-house magazines / newsletters (for example, Emap, a major publishing business) have a weekly staff magazine devoted solely to advertising jobs within the organisation!
- Staff meetings

Advantages
- Gives existing employees greater opportunity to advance their careers in the business
- May help to retain staff who might otherwise leave
- Requires a short induction training period
- Employer should know more about the internal candidate’s abilities (= a reduced risk of selecting an inappropriate candidate)
- Usually quicker and less expensive than recruiting from outside

Disadvantages of internal recruitment
- Limits the number of potential applicants for a job
- External candidates might be better suited / qualified for the job

Person Specification
A person specification describes the requirements a job holder needs to be able to perform the job satisfactorily. These are likely to include:
- Education and qualifications
- Training and experience
- Personal attributes / qualities

Difference between person specification and a job description?
A job description describes the job; a person specification describes the person needed to do the job, therefore, form the basis for the selection of the most suitable person to fill the job.

How should a person specification be created?
The most common approach now used by recruiters is to use what are known as "competencies" to design the person specification. These are then classified as "essential" or "desired" to determine which are most important.
Competencies might include some or all of the following:
- Physical attributes (e.g. state of health, aged, speech)
- Attainments (e.g. highest level of education completed, relevant market experience, ability to supervise/manage)
- Aptitudes (e.g. verbal reasoning; numerical aptitude)
- Interests (social activities; sporting activities)
- Personal circumstances (e.g. ability to work shifts; full or part time)
- Person specifications have to be prepared and used with great care. In particular, it is important to ensure that the list of essential or desired competencies does not lead to unlawful discrimination against potential employees.

Internal Recruitment
This refers to the filling of job vacancies from within the business - where existing employees are selected rather than employing someone from outside.
A business might decide that it already has the right people with the right skills to do the job, particularly if its training and development programme has been effective.

Internal vacancies are usually advertised within the business via a variety of media:
Another vacancy will be created that has to be filled
Existing staff may feel they have the automatic right to be promoted, whether or not they are competent
Business may become resistant to change; by recruiting from outside, new perspectives and attitudes are brought in

External Recruitment

This refers to the filling of job vacancies from outside the business (contrast with internal recruitment). Most businesses engage in external recruitment fairly frequently, particularly those that are growing strongly, or that operate in industries with high staff turnover.

There are several ways of looking for staff outside the business:

1. Employment / recruitment agencies
   These businesses specialise in recruitment and selection. They often specialise in recruitment for specific sectors (e.g., finance, travel, secretarial). They usually provide a shortlist of candidates based on the people registered with the agency. They also supply temporary or interim employees.
   The main advantages with using an agency are the specialist skills they bring and the speed with which they normally provide candidates. They also reduce the administrative burden of recruitment. The cost is the high agency fees charged - often up to 30% of the first year wages of anyone employed.

2. Headhunters / Recruitment Consultancies
   "Upmarket" recruitment agents who provide a more specialised approach to the recruitment of key employees and/or senior management. They tend to "approach" individuals with a good reputation rather than rely on long lists of registered applicants - often using privileged industry contacts to draw up a short list. The cost of using a headhunter or recruitment consultant is high.

3. Job centres
   Government run agency - good for identifying local candidates for relatively straightforward jobs. The job centre service is free to employers and is most useful for advertising semi-skilled, clerical and manual jobs.

4. Government Funded Training Schemes
   There is a variety of government funded schemes that provide potential recruits, including the New Deal and Modern Apprenticeships. The advantage of these schemes is that government funding lowers the cost of employment and the business can get to know the employee before committing for the long-term. However, relatively few employment requirements are covered by these schemes.

5. Advertising
   Probably the most common method. Advertising allows the employer to reach a wider audience. The choice of advertising media (e.g. national newspaper, internet, specialist magazine etc) depends on the requirement for the advert to reach a particular audience and, crucially, the advertising budget.

Advantages
Mainly opposite of the disadvantages of internal recruitment. The main one being that a wider audience can be reached which increases the chance that the business will be able to recruit the skills it needs.

Job Advertisements

The objectives of recruitment advertising are to:
- Attract suitable candidates, and
- Deter unsuitable candidates

What makes a good job advert?
Whilst there are no hard and fast rules about the contents of a job advert, the following features are likely to be in an effective advertisement:
- **Accurate** - describes the job and its requirements accurately
- **Short** - not too long-winded; covers just the important ground
- **Honest** - does not make claims about the job or the business that will later prove false to
applicants

Positive - gives the potential applicant a positive feel about joining the business

Relevant - provides details that prospective applicants need to know at the application stage
(e.g. is shift-working required; are there any qualifications required)

Content of a job advert
Most job adverts contain:

- Details of the business/organisation (name, brand, location, type of business)
- Outline details of the job (title, main duties)
- Conditions (special factors affecting the job)
- Experience / qualifications required (e.g. minimum qualifications, amount of experience)
- Rewards (financial and non-financial; the financial rewards may be grouped together under a total valued "package", e.g. total package circa £50,000)
- Application process (how should applicants apply, how to; deadlines)

Choice of medium
What kind of advertising medium should be chosen? The following factors are relevant:

- **Type of job**: senior management jobs merit adverts in the national newspapers and/or specialist management magazines (e.g. the Economist, BusinessWeek). Many semi-skilled jobs need only be advertised locally to attract sufficient good quality candidates
- **Cost of advertising**: National newspapers and television cost significantly more than local newspapers etc
- **Readership and circulation**: how many relevant people does the medium reach? How frequently (e.g. weekly, monthly, annually!). Is the target audience actually only a small fraction of the total readership or Viewer ship?
- **Frequency**: how often does the business want to advertise the post?

Interviews

An interview is the most common form of selection as it is relatively cheap to undertake and is the chance for an employer to meet the applicant face to face and so obtain much more information on what the person is like and how suitable they are for the job. Examples of information that can only be learnt from interview and not on paper from a CV or application form are:

- Conversational ability- often known as people skills
- Natural enthusiasm or manner of the applicant
- See how applicant reacts under pressure
- Queries on comments or details missing from CV or application form

Interviewers should also follow-up a candidate’s references, which can act as the final check that all the information given by the candidate is correct. An honest reference from an independent source can also reveal good or bad incidences from the candidate’s past or particular traits that may have been missed.

There are though other forms of selection tests that can be used in addition to an interview to help select the best applicant. The basic interview can be unreliable as applicants can perform well at interview but not have the qualities or skills needed for the job. Other selection tests can increase the chances of choosing the best applicant and so minimise the high costs of recruiting the wrong people. Examples of these tests are aptitude tests, intelligence tests and psychometric tests (to reveal the personality of a candidate).

Managers selecting candidates for a high level post in an organisation may even send applicants to an assessment centre. In such centres candidates undergo a variety of tests, role-plays and simulations for a number of days.

Once the best candidate has been selected and agreed to take up the post, the new employee must be given an employment contract. This is an important legal document that describes the obligations of the employee and employer to each other (terms and conditions) as well as the initial remuneration...
package and a number of other important details.

**Dealing With Job Applications**

For many jobs, a business will ask applicants to provide a *curriculum vitae (CV)*. This is a document (often on one or two sides of A4) that the applicant designs providing the details summarised below.

<table>
<thead>
<tr>
<th><strong>Personal details</strong></th>
<th>Name, address, date of birth, nationality</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Educational history</strong></td>
<td>Including examination results, schools/universities attended, professional qualifications</td>
</tr>
<tr>
<td><strong>Previous employment history</strong></td>
<td>Names of employers, position held, main achievements, remuneration package, reasons for leaving</td>
</tr>
<tr>
<td><strong>Suitability and reasons for applying for the job</strong></td>
<td>A chance for applicants to ‘sell themselves’</td>
</tr>
<tr>
<td><strong>Names of referees</strong></td>
<td>Often recent employer or people who know applicant well and are ideally independent</td>
</tr>
</tbody>
</table>

In some circumstances however an applicant may be asked to fill in a firm’s own *application form*. This is different from a CV in that the employer designs it and sends it to applicants, but it will still ask for much of the same information. It has the benefit over a CV in that a business is able to tailor it to their exact needs and ask specific questions.

Once a business has received all the applications, they need to be analysed and the most appropriate form of selection decided upon. When analysing applications, a business will normally sieve the applications into three categories.

Those to **reject** - Candidates may be rejected because they may not meet the standards set out in the job specification such as wrong qualifications or insufficient experience or they may not have completed the application form to a satisfactory standard.

Those to place on a **short list**. Often comprises 3-10 of the best candidates who are asked to interview.

Those to place on a **long list** - A business will not normally reject all other candidates immediately but keep some on a long list in case those on the short list drop out or do not appear suitable during interview. The business would not want to incur costs putting them through the selection process, such as interviews, unless they have to.
**Communication**

**Communication** is the process by which a message or information is exchanged from a sender to a receiver. For example a production manager (sender) may send a message to a sales manager (receiver) asking for sales forecasts for the next 6 months so they can plan production levels. The sales manager would then reply (feedback) to the production manager with the appropriate figures.

This is an example of **internal communication**, i.e. when communications occur between employees of a business. Communication therefore links together all the different activities involved in a business and ensures all employees are working towards the same goal and know exactly what they should be doing and by when. Effective communication is therefore fundamental to the success of a business.

A business will of course need to communicate with people or organisations outside of the business. This is known as **external communication**. For example a marketing manager will need to tell customers of a new special pricing offers or the finance director may need to ask banks for a loan.

<table>
<thead>
<tr>
<th>Receivers of Messages</th>
<th>Internal</th>
<th>External</th>
</tr>
</thead>
<tbody>
<tr>
<td>Workers</td>
<td></td>
<td>Customers</td>
</tr>
<tr>
<td>Directors</td>
<td></td>
<td>Local community</td>
</tr>
<tr>
<td>Managers</td>
<td></td>
<td>Suppliers</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Shareholders</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Government</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Banks</td>
</tr>
</tbody>
</table>

**Examples of communication**

To illustrate the all-pervasive nature of communication, consider the following list of communication examples:

- Exchanging ideas
- Announcing investment plans
- Producing a report with the monthly management accounts comparing actual results against budget
- Giving instructions to the production and purchasing departments about the new product plans for next year
- Delivering a presentation to the marketing department following the results of some quantitative, primary market research
- Announcing the annual trading results and future strategy to company investors and analysts

**The importance of good communication**

Good communication has many advantages for a business: strong communication:

- **Motivates employees** – helps them feel part of the business (see below)
- **Easier to control and coordinate business activity** – prevents different parts of the business going in opposite directions
- **Makes successful decision making easier for managers** – decisions are based on more complete and accurate information
- **Better communication with customers** will increase sales
- **Improve relationships with suppliers** and possibly lead to more reliable delivery
- **Improves chances of obtaining finance** – e.g. keeping the bank up-to-date about how the business is doing

**Effectiveness**

There are several factors that will determine what the best or most appropriate method of communication:
The advancement of information technology has altered the way that many businesses communicate. For example, fax was a popular form of communication for businesses in the 1980’s. Whilst it still has its uses, people now largely use e-mail instead. The internet is a key tool for many firms now to communicate with many different groups, such as advertising to customers and finding suppliers. Investing in the new technology is costly however and potentially it can become outdated within a few years. There is also the need to train many staff on how to use the technology effectively and even then some employees may be reluctant to change from their traditional methods.

**Formal communication** occurs when channels of communication are used which have been established by the firm. This may be when workers communicate with managers via works councils or trade union representatives. **Informal communication** is often known as communication through the grapevine and it can be useful for a manager as they can hear some useful and interesting information which they would not from official channels. This can often be akin to gossiping and it can transmit information quickly but not always accurately (just think how rumours and gossip spread through a school!).

Businesses need to have in place appropriate structures or technology in order to aid communication (e.g. e-mail facilities for all employees) but on an every day level it is down to individual managers and employees to ensure that they communicate their messages or information effectively. Not all managers for instance will naturally have good communication skills and there is an obvious need for training in this case to ensure they are able to choose the most appropriate communication method to get their message across clearly.

To be effective the message must be clearly understood by the receivers and also the receivers should be able to supply some feedback. When feedback occurs it is known as **two-way communication** and is seen as the most effective form of communication. The best example of this is direct face-to-face communication as the sender can get an immediate reaction in terms of the oral reply and also importantly from the receivers body language.

**One-way communication** occurs when there is no feedback given on a message, for example putting a notice on a notice board. This is suitable in some circumstances, if for instance someone is announcing a change of time for a meeting and little feedback is required, but generally employees should try to maximise methods that encourage two-way communication and feedback.

**Two-way feedback** is becoming relevant in firms for two main reasons.

Many firms are introducing new techniques and initiatives, such as kaizen or total quality management, which rely on employee participation and feedback. In addition two-way communication is a pre-requisite for a democratic management style, which is becoming increasingly popular in businesses.

For many firms one of their main objectives is to grow in size (gaining market share or entering new markets) as this is seen as the way to boost profits. As a firm expands one of the major problems they will face will be to continue to communicate effectively with their increasing workforce and so maintain motivation levels

**Directions of communication in a business**

Communication flows in three main directions in a business:

**1) Vertical Communication**

E.g. from managers to sub-ordinates; from shop floor workers to supervisors; from the Chief Executive to all other management and employees.
Vertical communication flows are mainly used for reporting information (e.g. results, plans) and obtaining feedback (e.g. an employee survey summarised for the Board of Directors)

(2) Horizontal Communication

This is between people of the same "level" in a business - usually in the same department, but sometimes communication between departments. This is sometimes known as "peer communication". It is normally used to co-ordinate work. E.g. sales managers for different regions circulate details of potential customers to each other and allocate based on the customer location; or accounting staff in different departments share information to help prepare the annual budget on a consistent basis.

(3) Diagonal Communication

Less common; this involves interdepartmental communication by people at different levels. A good example would be a project team drawn from different grades and departments.
What makes a good leader or manager? For many it is someone who can inspire and get the most from their staff.

There are many qualities that are needed to be a good leader or manager.

- Be able to think creatively to provide a vision for the company and solve problems
- Be calm under pressure and make clear decisions
- Possess excellent two-way communication skills
- Have the desire to achieve great things
- Be well informed and knowledgeable about matters relating to the business
- Possess an air of authority

Do you have to be born with the correct qualities or can you be taught to be a good leader? It is most likely that well-known leaders or managers (Winston Churchill, Richard Branson or Alex Ferguson?) are successful due to a combination of personal characteristics and good training.

Managers deal with their employees in different ways. Some are strict with their staff and like to be in complete control, whilst others are more relaxed and allow workers the freedom to run their own working lives (just like the different approaches you may see in teachers!). Whatever approach is predominately used it will be vital to the success of the business. “An organisation is only as good as the person running it”.

There are three main categories of leadership styles: autocratic, paternalistic and democratic.

**Autocratic** (or authoritarian) managers like to make all the important decisions and closely supervise and control workers. Managers do not trust workers and simply give orders (one-way communication) that they expect to be obeyed. This approach derives from the views of Taylor as to how to motivate workers and relates to McGregor’s theory X view of workers. This approach has limitations (as highlighted by other motivational theorists such as Mayo and Herzberg) but it can be effective in certain situations. For example:

When quick decisions are needed in a company (e.g. in a time of crises)

When controlling large numbers of low skilled workers.

**Paternalistic** managers give more attention to the social needs and views of their workers. Managers are interested in how happy workers feel and in many ways they act as a father figure (pater means father in Latin). They consult employees over issues and listen to their feedback or opinions. The manager will however make the actual decisions (in the best interests of the workers) as they believe the staff still need direction and in this way it is still somewhat of an autocratic approach. The style is closely linked with Mayo’s Human Relation view of motivation and also the social needs of Maslow.

**A democratic** style of management will put trust in employees and encourage them to make decisions. They will delegate to them the authority to do this (empowerment) and listen to their advice. This requires good two-way communication and often involves democratic discussion groups, which can offer useful suggestions and ideas. Managers must be willing to encourage leadership skills in subordinates.

The ultimate democratic system occurs when decisions are made based on the majority view of all workers. However, this is not feasible for the majority of decisions taken by a business- indeed one of the criticisms of this style is that it can take longer to reach a decision. This style has close links with Herzberg’s motivators and Maslow’s higher order skills and also applies to McGregor’s theory Y view of workers.

**Summary of management styles**
<table>
<thead>
<tr>
<th>Style</th>
<th>Description</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Autocratic</td>
<td>Senior managers take all the important decisions with no involvement from workers</td>
<td>Quick decision making</td>
<td>No two-way communication so can be de-motivating</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Effective when employing many low skilled workers.</td>
<td>Creates “them and us” attitude between managers and workers</td>
</tr>
<tr>
<td>Paternalistic</td>
<td>Managers make decisions in best interests of workers after consultation</td>
<td>More two-way communication so motivating</td>
<td>Slows down decision making</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Workers feel their social needs are being met</td>
<td>Still quite a dictatorial or autocratic style of management</td>
</tr>
<tr>
<td>Democratic</td>
<td>Workers allowed to make own decisions. Some businesses run on the basis of majority decisions</td>
<td>Authority is delegated to workers which is motivating</td>
<td>Mistakes or errors can be made if workers are not skilled or experienced enough</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Useful when complex decisions are required that need specialist skills</td>
<td></td>
</tr>
</tbody>
</table>
What is Motivation?

Buchanan defines motivation as follows: "Motivation is a decision-making process, through which the individual chooses the desired outcomes and sets in motion the behaviour appropriate to them".

How does motivation differ from "motives"
Buchanan defines motives as: "learned influences on human behaviour that lead us to pursue particular goals because they are valued".

Motivation can therefore be thought of as the degree to which an individual wants AND chooses to engage in certain behaviours.

For example: are you motivated to study? The answer lies in whether you
1) Want to study - what are the reasons, if so?
2) Choose to study? - Why are you reading these revision notes? What factors mean that you have taken the decision to study? How much effort do you put in?

Individual behaviour is at the heart of human motivation
Why is individual behaviour so important in trying to understand and then influence motivation?
- Every individual has a set of needs and a different set of goals
- Individuals behave in a way as to satisfy their needs and fulfil their goals
- Therefore, individuals behave differently!
- Businesses, as organisations, are in a position to offer some of the satisfactions that individuals seek:

  E.g. - Relationships; sense of belonging; intellectual stimulation; mental & physical challenge; self-development

Why is motivation important for businesses?
It is often said that the best businesses have the best motivated workers. Why might this be important?

A well-motivated workforce can provide the following advantages:
- **Better productivity** (amount produced per employee). This can lead to lower unit costs of production and so enable a firm to sell its product at a lower price
- **Lower levels of absenteeism** as the employees are content with their working lives
- **Lower levels of staff turnover** (the number of employees leaving the business). This can lead to lower training and recruitment costs
- **Improved industrial relations** with trade unions
- **Contented workers give the firm a good reputation** as an employer so making it easier to recruit the best workers
- **Motivated employees are likely to improve product quality** or the customer service associated with a product

Motivation Theories

1. *Herzberg two factor theory*

Introduction
Herzberg’s Two Factor Theory is a "content theory" of motivation"

Herzberg analysed the job attitudes of 200 accountants and engineers who were asked to recall when they had felt positive or negative at work and the reasons why. From this research, Herzberg suggested a two-step approach to understanding employee motivation
Hygiene factors are based on the need to for a business to avoid unpleasantness at work. If these factors are considered inadequate by employees, then they can cause dissatisfaction with work. Hygiene factors include:

- Company policy and administration
- Wages, salaries and other financial remuneration
- Quality of supervision
- Quality of inter-personal relations
- Working conditions
- Feelings of job security

Motivator factors are based on an individual's need for personal growth. When they exist, motivator factors actively create job satisfaction. If they are effective, then they can motivate an individual to achieve above-average performance and effort. Motivator factors include:

- Status
- Opportunity for advancement
- Gaining recognition
- Responsibility
- Challenging / stimulating work
- Sense of personal achievement & personal growth in a job

There is some similarity between Herzberg's and Maslow's models. They both suggest that needs have to be satisfied for the employee to be motivated. However, Herzberg argues that only the higher levels of the Maslow Hierarchy (e.g. self-actualisation, esteem needs) act as a motivator. The remaining needs can only cause dissatisfaction if not addressed.

**Applying Herzberg's model to de-motivated workers**
What might the evidence of de-motivated employees be in a business?
- Low productivity
- Poor production or service quality
- Strikes / industrial disputes / breakdowns in employee communication and relationships
- Complaints about pay and working conditions

According to Herzberg, management should focus on rearranging work so that motivator factors can take effect. He suggested three ways in which this could be done:

- Job enlargement
- Job rotation
2. Maslow's Hierarchy of Needs

Introduction
Maslow's Hierarchy of Needs is a "content theory" of motivation (the other main one is Herzberg's Two Factor Theory).

Maslow's theory consisted of two parts:
1) The classification of human needs, and
2) Consideration of how the classes are related to each other.

The classes of needs were summarised by Maslow as follows:

- **Physiological Needs**
  - Hunger
  - Thirst

- **Safety Needs**
  - Security
  - Protection

- **Social Needs**
  - Sense of belonging
  - Love

- **Esteem Needs**
  - Self-esteem
  - Recognition
  - Status

- **Self-actualisation**

How does the Hierarchy Work?
- A person starts at the bottom of the hierarchy (pyramid) and will initially seek to satisfy basic needs (e.g. food, shelter)
- Once these physiological needs have been satisfied, they are no longer a motivator. The individual moves up to the next level
- Safety needs at work could include physical safety (e.g. protective clothing) as well as protection against unemployment, loss of income through sickness etc
- Social needs recognise that most people want to belong to a group. These would include the need for love and belonging (e.g. working with colleague who support you at work, teamwork, communication)
- Esteem needs are about being given recognition for a job well done. They reflect the fact that many people seek the esteem and respect of others. A promotion at work might achieve this
- Self-actualisation is about how people think about themselves - this is often measured by the extent of success and/or challenge at work
- Maslow's model has great potential appeal in the business world. The message is clear - if management can find out which level each employee has reached, then they can decide on suitable rewards.

Problems with the Maslow Model
There are several problems with the Maslow model when real-life working practice is considered:
- Individual behaviour seems to respond to several needs - not just one
- The same need (e.g. the need to interact socially at work) may cause quite different behaviour in different individuals
- There is a problem in deciding when a level has actually been "satisfied"
- The model ignores the often-observed behaviour of individuals who tolerate low-pay for the promise of future benefits
- There is little empirical evidence to support the model. Some critics suggest that Maslow's model is only really relevant to understanding the behaviour of middle-class workers in the UK and the USA
3. **Taylor - Scientific Management**

**Introduction**
Taylor developed his theory of "scientific management" as he worked his way up from a labourer to a works manager in a US steelworks. From his observations, Taylor made three key assumptions about human behaviour at work:

1. Man is a rational economic animal concerned with maximising his economic gain;
2. People respond as individuals, not as groups
3. People can be treated in a standardised fashion, like machines

Taylor had a simple view about what motivated people at work - money. He felt that workers should get a fair day's pay for a fair day's work, and that pay should be linked to the amount produced (e.g. **piece-rates**). Workers who did not deliver a fair day's work would be paid less (or nothing). Workers who did more than a fair day's work (e.g. exceeded the target) would be paid more.

The implications of Taylor's theory for managing behaviour at work were:
- The main form of motivation is high wages, linked to output
- A manager's job is to tell employees what to do
- A worker's job is to do what they are told and get paid accordingly

**Weaknesses in Taylor's Approach**
The most obvious weakness in Taylor's approach is that it ignores the many differences between people. There is no guarantee that a "best way" will suit everyone. Secondly, whilst money is an important motivation at work for many people, it isn't for everyone. Taylor overlooked the fact that people work for reasons other than financial reward.

4. **McGregor - Theory X and theory Y**

**Introduction**
McGregor developed two theories of human behaviour at work: Theory and X and Theory Y. He did not imply that workers would be one type or the other. Rather, he saw the two theories as two extremes - with a whole spectrum of possible behaviours in between.

**Theory X workers could be described as follows:**
- Individuals who dislike work and avoid it where possible
- Individuals who lack ambition, dislike responsibility and prefer to be led
- Individuals who desire security

The management implications for Theory X workers were that, to achieve organisational objectives, a business would need to impose a management system of coercion, control and punishment.

**Theory Y workers were characterised by McGregor as:**
- Consider effort at work as just like rest or play
- Ordinary people who do not dislike work. Depending on the working conditions, work could be considered a source of satisfaction or punishment
- Individuals who seek responsibility (if they are motivated)

The management implications for Theory Y workers are that, to achieve organisational objectives, rewards of varying kinds are likely to be the most popular motivator. The challenge for management with Theory Y workers is to create a working environment (or culture) where workers can show and develop their creativity.

5. **Mayo**

Elton Mayo (1880 – 1949) believed that workers are not just concerned with money but could be better motivated by having their social needs met whilst at work (something that Taylor ignored). He introduced the Human Relation School of thought, which focused on managers taking more of an interest in the workers, treating them as people who have worthwhile opinions and realising that workers enjoy interacting together.

Mayo conducted a series of experiments at the Hawthorne factory of the Western Electric Company in
Chicago

He isolated two groups of women workers and studied the effect on their productivity levels of changing factors such as lighting and working conditions.

He expected to see productivity levels decline as lighting or other conditions became progressively worse.

What he actually discovered surprised him: whatever the change in lighting or working conditions, the productivity levels of the workers improved or remained the same.

From this Mayo concluded that workers are best motivated by:

**Better communication** between managers and workers (Hawthorne workers were consulted over the experiments and also had the opportunity to give feedback).

**Greater manager involvement** in employees working lives (Hawthorne workers responded to the increased level of attention they were receiving).

**Working in groups or teams.** (Hawthorne workers did not previously regularly work in teams).

In practice therefore businesses should re-organise production to encourage greater use of team working and introduce personnel departments to encourage greater manager involvement in looking after employees’ interests. His theory most closely fits in with a paternalistic style of management.

*Motivating employees - financial rewards*

In reality, despite the views of Herzberg that monetary methods of motivation have little value, firms still use money as a major incentive. There are a variety of payment systems that a business could use to motivate its employees.

**Wages and Salaries**

Wages are normally paid per hour worked and workers receive money at the end of the week. Overtime is paid for any additional hours worked during the week. However salaries are annual (based on a year’s work) and are paid at the end of each month.

<table>
<thead>
<tr>
<th>Advantage</th>
<th>Disadvantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Simple and easy to use for businesses</td>
<td>Workers may resent being paid the same as a colleague who they feel is not so productive</td>
</tr>
</tbody>
</table>

**Piece-rate**

Piece-rate is paying a worker per item they produce in a certain period of time. It was recommended by the motivation theorist Taylor and had close links with working on production lines.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increases speed of work and therefore productivity</td>
<td>Workers do not concentrate on quality of work as emphasis on speed of work</td>
</tr>
<tr>
<td>Often workers not entitled to sick pay or holiday pay which reduces cost</td>
<td>Workers may ignore company rules, such as Health and safety issues, in they try to speed up output</td>
</tr>
</tbody>
</table>

**Fringe Benefits**
These are often known as ‘perks’ and are items an employee receives in addition to their normal wage or salary e.g. company car, private health insurance, free meals.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Encourages loyalty to a company so employees may stay for longer</td>
<td>Widespread use to a majority of employees will increase costs sharply</td>
</tr>
<tr>
<td>Helps meet a workers human and social needs</td>
<td></td>
</tr>
</tbody>
</table>

**Performance-related pay**

This is paid to those employees who meet certain targets. The targets are often evaluated and reviewed in regular appraisals with managers. It is system that is being increasingly used in businesses in the UK.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Easier for managers to monitor and control their staff</td>
<td>It can be difficult to measure the performance of employees in service based industries</td>
</tr>
<tr>
<td>Reduces the amount of time spent on industrial relations (negotiations with trade unions)</td>
<td>It does not promote teamwork and can lead to workers feeling they are treated unfairly if colleagues are awarded more</td>
</tr>
</tbody>
</table>

**Profit sharing**

This is a system whereby employees receive a proportion of the company’s profits. This means staff are in the same position as shareholders.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Should improve loyalty to the company and break down the “them and us” barrier if all staff given same amount</td>
<td>The share given to employees is often too small to provide a worthwhile incentive</td>
</tr>
<tr>
<td>Workers are more likely to accept changes to their working practices if they can see that it may decrease costs and so increase profit</td>
<td>Workers may feel that however hard they work it will not have a noticeable effect on the company’s profit level, so therefore no incentive</td>
</tr>
</tbody>
</table>

**Share ownership**

This is a common incentive for senior managers who are given shares in the company rather than a straightforward bonus or membership of a profit sharing scheme. It means that some staff are also shareholders.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employees will work harder as they have a stake in the company, just like a shareholder has</td>
<td>Often only available to senior managers so can cause resentment among other staff.</td>
</tr>
<tr>
<td>Workers are less likely to leave the firm</td>
<td></td>
</tr>
</tbody>
</table>

**Motivating employees - non financial rewards**

**1. Job enrichment**

Job enrichment is connected to the concept of job enlargement.

Job enrichment is the process of “improving work processes and environments so they are more
satisfying for employees”.

Many jobs are monotonous and unrewarding - particularly in the primary and secondary production industries. Workers can feel dissatisfied in their position due to a lack of a challenge, repetitive procedures, or an over-controlled authority structure.

Job enrichment tries to eliminate these problems, and bring better performance to the workplace.

There are three key parts to the process of job enrichment

a. Turn employees’ effort into performance:

- Ensuring that objectives are well-defined and understood by everyone. The overall corporate mission statement should be communicated to all. Individual's goals should also be clear. Each employee should know exactly how she fits into the overall process and be aware of how important her contributions are to the organization and its customers.
- Providing adequate resources for each employee to perform well. This includes support functions like information technology, communication technology, and personnel training and development.
- Creating a supportive corporate culture. This includes peer support networks, supportive management, and removing elements that foster mistrust and politicking.
- Free flow of information. Eliminate secrecy.
- Provide enough freedom to facilitate job excellence. Encourage and reward employee initiative. Flextime or compressed hours could be offered.
- Provide adequate recognition, appreciation, and other motivators.
- Provide skill improvement opportunities. This could include paid education at universities or on the job training.
- Provide job variety. This can be done by job sharing or job rotation programmes.
- It may be necessary to re-engineer the job process. This could involve redesigning the physical facility, redesign processes, change technologies, simplification of procedures, elimination of repetitiveness, redesigning authority structures.

b. Link employees performance directly to reward:

- Clear definition of the reward is a must
- Explanation of the link between performance and reward is important
- Make sure the employee gets the right reward if performs well
- If reward is not given, explanation is needed

c. Make sure the employee wants the reward. How to find out?

- Ask them
- Use surveys( checklist, listing, questions)

2. Job enlargement

Job enlargement means simply giving workers more tasks to do of a similar nature or complexity. This will reduce the monotony or repetition involved in a persons work but over time this will not increase a person’s satisfaction or sense of achievement.

Job rotation is a part of this and involves having a wider variety of tasks to do, perhaps rotating jobs with other members in your team, but not increasing the challenge of the job.

3. Job Rotation

Job rotation involves the movement of employees through a range of jobs in order to increase interest and motivation.
Job rotation can improve “multi-skilling” but also involves the need for greater training.

In a sense, job rotation is similar to job enlargement. This approach widens the activities of a worker by switching him or her around a range of work.

For example, an administrative employee might spend part of the week looking after the reception area of a business, dealing with customers and enquiries. Some time might then be spent manning the company telephone switchboard and then inputting data onto a database.

Job rotation may offer the advantage of making it easier to cover for absent colleagues, but it may also reduce productivity as workers are initially unfamiliar with a new task.

Why is Job Rotation Important?

Job rotation is seen as a possible solution to two significant challenges faced by business:

(1) Skills shortages and skills gaps, and

(2) Employee motivation

Skills shortages occur when there is a lack of skilled individuals in the workforce.

Skills gaps occur when there is a lack of skills in a company’s existing workforce which may still be found in the labour force as a whole.

According to the Treasury and DfES, both skills shortages and gaps are major problems acting as major barriers to economic growth and the reduction in long-term unemployment in the UK.

4. Teamworking

Teamworking is where employees work in groups or teams. This can meet a worker’s social needs as a person can more easily build friendships and feel a sense of belonging to a unit or group and hopefully to the business as a whole. This applies in much the same way as being a member of a sports team or any other team representing a school or college.

A business can create a number of different types of team; examples include production teams (often known as cells), quality circles and management teams.

Teamworking has other advantages to a firm over and above improving motivation. It can lead to greater flexibility of production, as employees are likely to be multi-skilled (able to do more than one persons job) as they have learnt from other team members or undertaken formal job rotation. This means they can cover any absences and can quickly adapt to a new production technique.

4. Empowerment

Empowerment is like delegation. It is when power or authority is given to employees so they can make their own decisions regarding their working life. For instance workers have control over how to use their time and deciding the priority of tasks that need to be done. They are encouraged to consider problems they face and come up with some solutions.

For empowerment to be successful, workers must have adequate training and/or good skill levels in order to be trusted to make the correct decisions. If they do not, then expensive mistakes can be made that could affect the whole business. It is the manager’s job to judge whether a subordinate can cope with more authority and decision-making power. It should be noted however, that even if managers pass down authority to their subordinates, they are still responsible for the work that is done by them.
Introduction

Training and personal development is an important method for a business to improve the performance of employees.

Training starts with a strategy

It is important that a business provides training that is consistent with the business strategy. The main steps in developing a training strategy are to:

- Identify the skills and abilities needed by employees;
- Draw up an action plan to show how investment in training and development will help meet business goals and objectives;
- Implement the plan, monitoring progress and training effectiveness.

Benefits of training to a business

The main benefits to a business of a well-trained workforce are:

- Better productivity (and, therefore, lower production / operating costs)
- Higher quality
- More flexibility - training helps employees develop a variety of skills. Multi-skilling is only possible if the workforce is well trained
- Less supervision - lower supervision and management costs if employees can get on with their jobs. This might also improve motivation - through greater empowerment
- More successful recruitment and employee retention - businesses with a good reputation for training are likely to find it easier to attract good quality staff - and then keep them
- Help in achieving change - businesses with strong training systems and culture find it easier to implement change programmes

What training cannot solve

It is tempting to think that training is the solution to many if not all business problems. However, there are some things that training can rarely solve: these include:

- Poor management (although management training might help!)
- Poor job design
- Ineffective or inefficient equipment, production organisation
- Recruitment

If training is so important, why do some businesses invest so little in it?

Ideally training should be seen as an investment in the future of the business. It takes time for the effects of training to impact business performance. Some businesses are reluctant to spend on training because:

- They fear employees will be poached by competitors (who will then benefit from the training)
- A desire to minimise short-term costs
- They cannot make a justifiable investment case

On the Job Training

As the name implies, on the job training involves employees training at their place or work. The most common methods of on the job training are:

- Demonstration / instruction; showing the trainee how to do the job
- Coaching - a more intensive method of training that involves a close working relationship between an experienced employee and the trainee
- Job rotation - where the trainee is given several jobs in succession, to gain experience of a wide range of activities (e.g. a graduate management trainee might spend periods in several different departments)
- Projects - employees join a project team - which gives them exposure to other parts of the
business and allow them to take part in new activities. Most successful project teams are "multi-disciplinary"

**Advantages of on the job training**

- Generally more cost effective
- Less disruptive to the business - i.e. employees are not away from work
- Training an employee in their own working environment, with equipment they are familiar with and people they know can help they gain direct experience to a standard approved by the employer
- Employees may find that they have more confidence if they are supervised and guided as they feel they are doing the job right
- Employees may feel more at ease being taught or supervised by people they know rather than complete strangers at an external training course
- Managers or supervisors can assess improvement and progress over a period of time and this makes it easier to identify a problem intervene and resolve problems quickly
- On the job training is also productive, as the employee is still working as they are learning
- As training progresses and the employee begins to feel more confident, this confidence would allow them to work at a higher standard and ultimately be more productive
- Training "on-the-job" provides an opportunity to get to know staff they might not normally talk to

**Disadvantages of on the job training**

- Teaching or coaching is a specialist skill in itself; unless the trainer has the skills and knowledge to train, this would mean that the training will not be done to a sufficient standard
- The trainer may not be given the time to spend with the employee to teach them properly, which would mean substandard training has been achieved and learning has only been half done
- The trainer may posses bad habits and pass these on to the trainee

**Training - off the job**

Off the job training involves employees taking training courses away from their place of work. This is often also referred to as "formal training". Off the job training courses might be run by the business' training department or by external providers.

The main types of off the job training courses are:

- Day release (where the employee takes time out from normal working hours to attend a local college or training centre)
- Distance learning / evening classes
- Revision courses (e.g. in the accountancy profession, student employees are given blocks of around 5-6 weeks off on pre-exam courses)
- Block release courses - which may involve several weeks at a local college
- Sandwich courses - where the employee spends a longer period of time at college (e.g. six months) before returning to work
- Sponsored courses in higher education
- Self-study, computer-based training (an increasingly popular option - given that attendance at external courses can involve heavy cost)

**Advantages of off-the-job training:**

- Use of specialist trainers and accommodation
- Employee can focus on the training - and not be distracted by work
- Opportunity to mix with employees from other businesses

**Disadvantages of off-the-job training:**

- Employee needs to be motivated to learn
- May not be directly relevant to the employee’s job
- Costs (transport, course fees, examination fees, materials, accommodation)

**Training induction**

Induction training is training given to new employees.
The purpose of the induction period (which may be a few hours or a few days) is to help a new employee settle down quickly into the job by becoming familiar with the people, the surroundings, the job and the business.

It is important to give a new employee a good impression on the first day of work. However, the induction programme should not end there. It is also important to have a systematic induction programme, spread out over several days, to cover all the ground in the shortest effective time.

Devising an effective induction training programme

The induction programme should be drawn up in consultation with all those involved. Depending on the size and complexity of the business this may include:

- Senior management (including directors)
- Supervisors or line managers
- Personnel officers
- Health and Safety managers
- Employee or trade union representatives

What induction training involves

Usually induction involves the new employee meeting and listening to different people talk about aspects of the business. Other methods include written information, audio visual aids and group discussion.

The following items should be covered in an effective induction programme:

- Introduction to the business/department and its personnel/management structure
- Layout of the buildings (factory / offices)
- Terms and conditions of employment (explaining the contract of employment)
- Relevant personnel policies, such as training, promotion and health and safety
- Business rules and procedures
- Arrangements for employee involvement and communication
- Welfare and employee benefits or facilities
### Employee Appraisal

#### 360 Degree Appraisal

In the revision note on appraisal and performance review we concentrated on the assessment of employees by managers. But how should management be assessed? After all, key management have a vital impact on the performance of a business – and they too will have development and training needs.

One increasingly popular method of managerial assessment is 360-degree feedback.

360-degree feedback is an assessment process used to improve managerial effectiveness by providing the manager with a more complete assessment of their effectiveness, and their performance and development needs.

The process involves obtaining feedback from the manager’s key contacts. These would normally include:

- The manager him/herself
- Subordinates (employees who work for the manager)
- Peers (fellow managers)
- Manager (senior management)
- Customers
- Suppliers

**Feedback** is normally obtained by using a questionnaire which asks participants to rate the individual according to observed behaviours - usually managerial or business-specific competencies.

The 360-degree process will not suit all companies. You should assess how well it would fit with your current culture before launching a scheme and a pilot scheme is worth building into your programme.

Communicating the scheme, it’s purpose and benefits to all those involved will be a key factor in reducing the participants’ fears and gaining their commitment to any new scheme.

Presenting the results of the appraisal to managers in a constructive way is critical to the success of the process. All feedback, positive and critical, should be presented, with the aim of highlighting and acting on areas for development.

Results can be aggregated to give you some feedback on organisational strengths and weaknesses in relation to your business objectives and training strategy.
Change Management

What is change management?
Change management is an aspect of management focusing on ensuring that the firm responds to the environment in which it operates.

Four key features of change management:

- Change is the result of dissatisfaction with the present strategies
- It is essential to develop a vision for a better alternative
- It is necessary to develop strategies to implement change
- There will be resistance to the proposals at some stage

Change often arises from:

- The development of new products
- The entry of new competition
- Changes in consumer tastes & preferences
- Changes in the cultural, political, economic, legal and social framework
- Changes in technology leading to technological obsolescence or new product opportunities

Change affects all aspect of people management. HRM is directly affected by change in:

- Organisational structure
- Personnel of teams
- Process
- Location
- Work load
- Work role
- Work practices
- Supervision
- Work teams

There are many forces for change in business:

- Internal forces
- Desire to increase profitability
- Reorganisation to increase efficiency
- Conflict between departments
- To change organisational culture
- External forces
- Customer demand
- Competition
- Cost of inputs
- Legislation
- Tax changes
- New technology
- Political
- Ethics
- Technological obsolescence

Force Field Analysis & Lewin's Change Model
There are forces driving change and forces restraining it
Where there is equilibrium between the two sets of forces there will be no change
In order for change to occur the driving force must exceed the restraining force

The analysis can be used to:

- Investigate the balance of power involved in an issue
- Identify the key stakeholders on the issue
- Identify opponents and allies
- Identify how to influence the target groups

**Lewin’s change model**

This model defines three stages in the process of change:
- Unfreezing
- Change
- Refreezing

It assists organisation change by:

- Allowing the process to be understood
- Providing milestones for evaluating progress towards the change

**Unfreezing**

This is the shake up phase perhaps triggered by declining sales or profits. The result is an acceptance that the existing structures and ways are not working. To get people ready for change it is necessary to develop an awareness of the:

- Necessity of change
- Nature of change needed
- Methods planned to achieve the change
- Needs of those affected
- Ways that progress will be planned and monitored

**Changing**

This is the process of devising and implementing the change:

- Define the problem
- Identify solutions
- Devise appropriate strategy to implement change
- Implement solutions
Refreezing
This is the process of maintaining the momentum of change:

- Locking in the changes
- Stabilising the situation
- Building relationships
- Consolidating the system
- Evaluation and support
- Preventing any going back to the old ways

Refreezing is complete when the new patterns are accepted and followed willingly

Resistance And Barriers To Change

Resistance to change
A degree of resistance is normal since change is:

- Disruptive
- Stressful

Moreover a degree of scepticism can be healthy especially where there are weaknesses in the proposed changes. However resistance will also impede the achievement of organisational objectives

Four basic reasons why change is resisted.
Kotter and Schlesinger identified basic causes of resistance to change:

(1) Parochial self interest
- Individuals are more concerned with the implications for themselves

(2) Misunderstanding
- Communications problems
- Inadequate information

(3) Low tolerance of change
- Sense of insecurity
- Different assessment of the situation

(4) Disagreement over the need for change
- Disagreement over the advantages and disadvantages

Some negative comments often received on proposed changes:
- "My needs are already being met"
- "There is no justification for change"
- "I don’t like the way they propose to do it"
- "The risks outweigh the benefits"
- "It will now be harder for me to meet my own needs"

Organisational barriers to change

- Structural inertia
- Existing power structures
- Resistance from work groups
- Failure of previous change initiatives

Individual barriers to change

- Tradition and set ways:
• Loyalty to existing relationships
• Failure to accept the need for change
• Insecurity
• Preference for the existing arrangements
• Break up of work groups
• Different person ambitions
• Fear of:
  - Loss of power
  - Loss of skills
  - Loss of income
  - The unknown

• Redundancy
• Inability to perform as well in the new situation

Inappropriate change management

• Change is often resisted because of failures in the way it is introduced
• Failure to explain the need for change
• Failure to provide information
• Failure to consult, negotiate and offer support and training
• Lack of involvement in the process
• Failure to build trust and sense of security
• Poor employee relations

Why change should be welcomed

• Change can produce positive benefits for the individual:
  - Opportunities for personal change and development
  - Provides a new challenge
  - Reduces the boredom of work
  - Opportunity to participate and shape the outcome

Implementation

1. Managing the change

Preparation for change

• Environmental analysis.
• Set out the strengths and weaknesses of the organisation
  - Current provisions
  - Resources
  - Roles and responsibilities

• Identify the change required
• Determine the major issues
• Identify and assess the key stakeholders
• Win the support of key individuals
• Identify the obstacles
• Determine the degree of risk and the cost of change
• Understand why change is resisted
• Recognize the need for change, identify current position, devise a suitable method

Building the vision

• Develop a clear vision
• Make it people clear about what a change involves and how they are involved in it
• What is involved
• What is the proposed change
• Why should we do it
• What the major effects will be
• How we can manage the change

2. Plan the change

- Devise appropriate strategies to introduce change
- Design the change
- Identify the significant steps in the change process
- Discuss the need for change and the full details of what is involved
- Allow people to participate in planning change
- Communicate the plan to all concerned
- Produce a policy statement
- Devise a sensible time scale
- Produce action plans for monitoring the change
- Allow people to participate in planning change
- Get all parties involved in and committed to the change
- Inspire confidence by forestalling problems and communicating regularly
- Devise a sensible time scale for implementation of change
- Anticipate the problems of implementation
- Understand why change is resisted

3. Implementing the change

- Check on and record progress
- Make sure that change is permanent
- Evaluate the change
- Improve on any weak areas
- Overcome resistance
- Involve all personnel affected
- Keep everyone informed
- Devise an appropriate reward system
- Be willing to compromise on detail
- Ensure that strategies are adaptable
- Select people to champion change
- Provide support and training
- Monitor and review

Two types of change

(1) Step change

- Dramatic or radical change in one fell swoop
- Radical alternation in the organisation
- Gets it over with quickly
- May require some coercion

(2) Incremental change

- Ongoing piecemeal change which takes place as part of an organisation’s evolution and development
- Tends to more inclusive

Step v incremental change
Advantages of using a change agent:

- Teams building across units
- Internal communication
- Negotiation
- Action planning
- Change agents or champions of change
- And a certain amount of compulsion manipulation and coercion

Techniques to help implement change

- Make controversial change as gradually as possible
- Be firm but flexible
- Facilitation and support

Change agents

Managers should be able to act as change agents:

- To identify need for change
- Be open to good ideas for change
- To able to successfully implement change

Advantages of using a change agent:

- Forces through change
- Becomes the personification of the process
- Responsibility for change is delegated thus freeing up senior managers to focus on future strategy

Helping people to accept change

- Consider how they will be affected
- Involve them in the change
- Consult and inform frequently
- Be firm but flexible
- Make controversial change as gradually as possible
- Monitor the change
- Develop a change philosophy

Six ways of overcoming resistance to change

- (1) Education and communication - if people understand the needs for change and what is involved they are more likely to co-operate.
- (2) Participation and involvement - to encourage people to feel ownership of the change.
- (3) Facilitation and support - listening to the real concerns of people affected.
- (4) Negotiation and agreement - agreement and compromise if necessary.
- (5) Manipulation - e.g. “buying off” leaders of resistance.
- (6) Explicit and implicit coercion - threats where necessary but this is a high risk strategy.

Monitor and review

- Adapt as necessary
- Recording and monitor the changes
- Measure progress against targets
• Have the desired results been achieved?
• Has the process been successful?
• How do those affected feel about the new situation?
• What might have been done differently?
• How can those not responding well to the change be helped?
• Sustain the change.- prevent any back sliding

Kotter’s change phases model

• Establish a sense of urgency
• Create a coalition
• Develop a clear vision
• Share the vision
• Empower people to clear obstacles
• Secure short term wins
• Consolidate and keep moving
• Anchor the change

Change management failures

What not to do
Ways to increase resistance to change:

Managers can increase resistance by:
• Failing to specific about a change
• Failing to explain why change is needed
• Not consulting
• Keeping people in the dark
• Creating excess work pressure
• Expecting immediate results
• Not dealing with fears and anxieties
• Ignoring resistance

Reasons why change can fail

• Employees do not understand the purpose or even the need for change
• Lack of planning and preparation
• Poor communication
• Employees lack the necessary skills and/or there is insufficient training and development offered
• Lack of necessary resources
• Inadequate/inappropriate rewards

Eight common reasons for failure of change management:

• Allowing too much complexity
• Failing to build a substantial coalition
• Failing to understand the need for a clear vision
• Failure to clearly communicate that vision
• Permitting roadblocks against that vision
• Not planning for short term results and not realising them
• Declaring victory too soon
• Failure to anchor changes in corporate culture

(John Kotter)
WHAT IS MARKETING?

There are many different definitions of marketing. Consider some of the following alternative definitions:

“*The all-embracing function that links the business with customer needs and wants in order to get the right product to the right place at the right time*”

“The achievement of corporate goals through meeting and exceeding customer needs better than the competition”

“The management process that identifies, anticipates and supplies customer requirements efficiently and profitably”

“Marketing may be defined as a set of human activities directed at facilitating and consummating exchanges”

In short all definitions try to embody the essence of marketing:

- Marketing is about meeting the **needs and wants** of customers;
- Marketing is a business-wide function – it is not something that operates alone from other business activities;
- Marketing is about **understanding customers** and finding ways to provide products or services which customers demand

To help put things into context, you may find it helpful to often refer to the following diagram which summarises the key elements of marketing and their relationships:
**Customers or Consumers?**

A common question that arises when studying marketing is the following:

**What is the difference between a customer and a consumer?**

The following distinction should help:

- **A customer** – purchases and pays for a product or service
- **A consumer** – is the ultimate user of the product or service; the consumer may not have paid for the product or service

Consider the following example:

- **A food manufacturing business** makes own-label, Italian ready meals for the major supermarkets.
- So far as the business is concerned, the **customer** is the supermarket to whom it supplies meals
- The **consumer** is the individual who eats the meal

In terms of its marketing effort, who should the business above target?

- In reality – it needs to understand the needs and wants of both the customer and the consumer.
- It needs to develop a strong understanding of the needs of the supermarkets in terms of their requirements for ready meals (e.g. packaging, recipes, price & delivery).
- It also needs to understand (perhaps with the help of the supermarkets) the needs and wants of the consumer. How are tastes changing? Are consumers happy with the standard / taste of the product?

**Marketing Concept and Orientation**

It is a fundamental idea of marketing that organisations survive and prosper through **meeting the needs and wants of customers.** This important perspective is commonly known as the **marketing concept.**

The marketing concept is about **matching a company’s capabilities with customer wants.** This matching process takes place in what is called the **marketing environment.**

Businesses do not undertake marketing activities alone. They face **threats** from competitors, and changes in the political, economic, social and technological environment. All these factors have to be taken into account as a business tries to match its capabilities with the needs and wants of its target customers.

An organisation that adopts the marketing concept accepts the needs of potential customers as the basis for its operations. Success is dependent on satisfying customer needs.

**What are customer needs and wants?**

A **need** is a basic requirement that an individual wishes to satisfy.

People have basic needs for food, shelter, affection, esteem and self-development. Many of these needs are created from human biology and the nature of social relationships. Customer needs are, therefore, very broad.

Whilst customer needs are broad, customer wants are usually quite narrow.

A **want** is a desire for a specific product or service to satisfy the underlying need.

**example:**

Consumers **need** to eat when they are hungry. What they **want** to eat and in what kind of environment will vary enormously. For some, eating at McDonalds satisfies the need to meet hunger. For others a microwaved ready-meal meets the need. Some consumers are never satisfied unless their food comes served with a bottle of fine Chardonnay.

Consumer wants are shaped by social and cultural forces, the media and marketing activities of businesses.

This leads onto another important concept - that of **customer demand:**

Consumer demand is a **want** for a **specific product** supported by an **ability and willingness to pay** for it.

For example, many consumers around the globe want a Mercedes. But relatively few are able and willing to buy one.

Businesses therefore have not only to make products that consumers want, but they also have to make
them affordable to a sufficient number to create profitable demand. Businesses do not create customer needs or the social status in which customer needs are influenced. It is not McDonalds that makes people hungry. However, businesses do try to influence demand by designing products and services that are
- Attractive
- Work well
- Are affordable
- Are available

Businesses also try to communicate the relevant features of their products through advertising and other marketing promotion.

Which leads us finally to an important summary point.

**A marketing orientated business is one that which has adopted the marketing concept**

**Structural Characteristics of Marketing-Orientated Business**

A business that has a marketing orientation sees the needs of customers and consumers as vital. As it develops and markets products to meet those demands, certain structural characteristics become apparent in the business. These are summarised in the table below: [You should expect to see all the above activities well-established in a business that is marketing-orientated.]

<table>
<thead>
<tr>
<th>Business Function</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identifying customer/consumer needs and wants</td>
<td>Marketing research</td>
</tr>
<tr>
<td>Developing products to meet customer/consumer needs and wants</td>
<td>Research and development</td>
</tr>
<tr>
<td>Deciding on the value of the product to customers</td>
<td>Pricing (sales and marketing department)</td>
</tr>
<tr>
<td>Making the product available to customers at the right time and place</td>
<td>Distribution</td>
</tr>
<tr>
<td>Informing customers/consumers of the existence of the product and persuading them to buy it</td>
<td>Promotion</td>
</tr>
</tbody>
</table>

**Alternatives to a Marketing Orientation**

Whilst marketing text books usually suggest that successful business will be "marketing orientated", it is the case in the real world not all businesses subscribe to the marketing concept. The implications of believing in the marketing concept become clearer when the alternatives are examined:

There are three main alternatives to adopting a marketing orientation. These are:

1. **Sales orientation**

   Some businesses see their main problem as selling more of the product or services which they already have available. They may therefore be expected to make full use of selling, pricing, promotion and distribution skills (just like a marketing-orientated business). The difference is that a sale-orientated business pays little attention to customer needs and wants, and does not try particularly hard to create suitable products or services.

2. **Production orientation**

   A production-orientated business is said to be mainly concerned with making as many units as possible. By concentrating on producing maximum volumes, such a business aims to maximise profitability by exploiting economies of scale. In a production orientated business, the needs of customers are secondary compared with the need to increase output. Such an approach is probably most effective when a business operates in very high growth markets or where the potential for economies of scale is significant.
3. Product orientation
This is subtly different from a production orientation. Consider a business that is “obsessed” with its own products – perhaps even arrogant about how good they are. Their products may start out as fully up-to-date and technical leaders. However, by failing to consider changing technological developments or subtle changes in consumer tastes, a product-orientated business may find that its products start to lose ground to competitors.

**Marketing Management in a Customer-Orientated Business**

The process of marketing management is about attracting and retaining customers by offering them desirable products that satisfy needs and meet wants. Marketing management in a customer-orientated business consists of five key tasks summarised in the table below:

<table>
<thead>
<tr>
<th>Marketing Task</th>
<th>Commentary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Identify target markets</td>
<td>Management have to identify those customers with whom they want to trade. The choice of target markets will be influenced by the wealth consumers hold and the business’ ability to serve them</td>
</tr>
<tr>
<td>Market research</td>
<td>Management have to collect information on the current and potential needs of customers in the markets they have chosen to supply. Areas to research include how customers buy (which marketing channels are used) and what competitors are offering</td>
</tr>
<tr>
<td>Product development</td>
<td>Businesses must develop products and services that meet needs and wants sufficiently to attract target customers to wish and buy</td>
</tr>
<tr>
<td>Marketing mix</td>
<td>Having identified the target markets and developed relevant products, management must then determine the price, promotion and distribution for the product. The marketing mix is tailored to offer value to customers, to communicate the offer and to make it accessible and convenient</td>
</tr>
<tr>
<td>Market monitoring</td>
<td>The objective in marketing is to first attract customers - and then (most importantly) retain them by building a relationship. In order to do this effectively, they need feedback on customer satisfaction. They also need to feed this back into product design and marketing mix as customer needs and the competitive environment changes</td>
</tr>
</tbody>
</table>
**PLANNING**

**Introduction**

A plan is a way of achieving something. Your revision plan is a way of helping to achieve success in business studies exams. In business, it is no different. If a business wants to achieve something, it is more likely to do so with a well-constructed and realistic plan.

**Planning involves:**

- **Setting objectives**, quantifying targets for achievement, and communicating these targets to people responsible for achieving them.
- **Selecting strategies**, tactics, programmes etc for achieving the objectives.

The whole topic of planning brings with it some important terminology that it is worth spending time getting to know well. You will come across these terms many times in your study of marketing (and business studies in general):

**Strategy**

Strategy is the method chosen to achieve goals and objectives

*Example:* Our strategy is to grow sales and profits of our existing products and to broaden our business by introducing new products to our existing markets

**Tactics**

Tactics are the resources that are used in the agreed strategy

*Example:* We will use our widespread distribution via UK supermarkets to increase sales and existing products and introduce new products

**Goals**

Goals concern what you are trying to achieve. Goals provide the “intention” that influence the chosen actions

*Example:* Our goal is to achieve market leadership in our existing markets

**Objectives**

Objectives are goals that can be quantified

*Examples:*

- We aim to achieve a market share of 20% in our existing markets.
- We aim to penetrate new markets by achieving a market share of at least 5% within 3 years.
- We aim to achieve sales of growth of 15% per annum with our existing products

**Aims**

Aims are goals that cannot be measured in a reliable way. However, they remain important as a means of providing direction and focus.

Examples: We aim to delight our customers.

*Strategic Marketing Process*

Macdonald (1995) suggests that several stages have to be completed in order to arrive at a strategic marketing plan. These are summarised in the diagram on next page:

The extent to which each part of the process (diagram on next page) needs to be carried out depends on the size and complexity of the business.

In an un diversified business, where senior management have a strong knowledge and detailed understanding of the overall business, it may not be necessary to formalise the marketing planning process.

By contrast, in a highly diversified business, top level management will not have knowledge and expertise that matches subordinate management. In this situation, it makes sense to put formal marketing planning procedures in place throughout the organisation.
Setting Marketing Objectives

Objectives set out what the business is trying to achieve. Objectives can be set at two levels:

(1) Corporate level
These are objectives that concern the business or organisation as a whole.
Examples of “corporate objectives” might include:
- We aim for a return on investment of at least 15%.
- We aim to achieve an operating profit of over £10 million on sales of at least £100 million.
- We aim to increase earnings per share by at least 10% every year for the foreseeable future.

(2) Functional level
E.g. specific objectives for marketing activities
Examples of functional marketing objectives might include:
- We aim to build customer database of at least 250,000 households within the next 12 months.
- We aim to achieve a market share of 10%.
- We aim to achieve 75% customer awareness of our brand in our target markets.

SMART
Both corporate and functional objectives need to conform to the commonly used SMART criteria. The SMART criteria (an important concept which you should try to remember and apply in exams) are summarised below:

- **Specific**
  The objective should state exactly what is to be achieved.
- **Measurable**
  An objective should be capable of measurement – so that it is possible to determine whether (or how far) it has been achieved.
- **Achievable**
  The objective should be realistic given the circumstances in which it is set and the resources available to the business.
- **Relevant**
  Objectives should be relevant to the people responsible for achieving them.
- **Time Bound**
  Objectives should be set with a time frame in mind. These deadlines also need to be realistic.
The Link of Marketing With Strategic Planning

Businesses that succeed do so by creating and keeping customers. They do this by providing better value for the customer than the competition. Marketing management constantly have to assess which customers they are trying to reach and how they can design products and services that provide better value (“competitive advantage”). The main problem with this process is that the “environment” in which businesses operate is constantly changing. So a business must adapt to reflect changes in the environment and make decisions about how to change the marketing mix in order to succeed. This process of adapting and decision-making is known as marketing planning.

Where does marketing planning fit in with the overall strategic planning of a business?

Strategic planning is concerned about the overall direction of the business. It is concerned with marketing, of course. But it also involves decision-making about production and operations, finance, human resource management and other business issues.

The objective of a strategic plan is to set the direction of a business and create its shape so that the products and services it provides meet the overall business objectives.

Marketing has a key role to play in strategic planning, because it is the job of marketing management to understand and manage the links between the business and the “environment”.

Sometimes this is quite a straightforward task. For example, in many small businesses there is only one geographical market and a limited number of products (perhaps only one product!).

However, consider the challenge faced by marketing management in a multinational business, with hundreds of business units located around the globe, producing a wide range of products. How can such management keep control of marketing decision-making in such a complex situation? This calls for well-organised marketing planning.

What are the key issues that should be addressed in marketing planning?

The following questions lie at the heart of any marketing (or indeed strategic) planning process:

• Where are we now?
• How did we get there?
• Where are we heading?
• Where would we like to be?
• How do we get there?
• Are we on course?

Why is marketing planning essential?

Businesses operate in hostile and increasingly complex environment. The ability of a business to achieve profitable sales is impacted by dozens of environmental factors, many of which are inter-connected. It makes sense to try to bring some order to this chaos by understanding the commercial environment and bringing some strategic sense to the process of marketing products and services.

A marketing plan is useful to many people in a business. It can help to:

❖ Identify sources of competitive advantage
❖ Gain commitment to a strategy
❖ Get resources needed to invest in and build the business
❖ Inform stakeholders in the business
❖ Set objectives and strategies
❖ Measure performance

Values and Vision

Introduction to Values and Vision

Values form the foundation of a business’ management style. Values provide the justification of behaviour and, therefore, exert significant influence on marketing decisions.

Consider the following examples of a well-known business – BT Group - defining its values:

BT’s activities are underpinned by a set of values that all BT people are asked to respect:

• We put customers first
• We are professional
Marketing [www.tutor2u.com/revision_notes]

Planning

- We respect each other
- We work as one team
- We are committed to continuous improvement.

These are supported by our vision of a communications-rich world - a world in which everyone can benefit from the power of communication skills and technology. A society in which individuals, organisations and communities have unlimited access to one another and to a world of knowledge, via a multiplicity of communications technologies including voice, data, mobile, internet - regardless of nationality, culture, class or education. Our job is to facilitate effective communication, irrespective of geography, distance, time or complexity.

Why are values important in marketing?
Many Japanese businesses have used the value system to provide the motivation to make them global market leaders. They have created an obsession about winning that is communicated at all levels of the business that has enabled them to take market share from competitors that appeared to be unassailable.

Example
At the start of the 1970’s Komatsu was less than one third the size of the market leader – Caterpillar – and relied on just one line of smaller bulldozers for most of its revenues. By the late 1980’s it had passed Caterpillar as the world leader in earth-moving equipment. It had also adopted an aggressive diversification strategy that led it into markets such as industrial robots and semiconductors. If “values” shape the behaviour of a business, what is meant by “vision” and how does it relate to marketing planning?

To succeed in the long term, businesses need a vision of how they will change and improve in the future. The vision of the business gives it energy. It helps motivate employees. It helps set the direction of corporate and marketing strategy.

components of an effective business vision?
Davidson identifies six requirements for success:

1. Provides future direction
2. Expresses a consumer benefit
3. Is realistic
4. Is motivating
5. Must be fully communicated
6. Consistently followed and measured
An important part of the marketing process is to understand why a customer or buyer makes a purchase. Without such an understanding, businesses find it hard to respond to the customer’s needs and wants.

Marketing theory traditionally splits analysis of buyer or customer behaviour into two broad groups for analysis – Consumer Buyers and Industrial Buyers.

**Consumer buyers** are those who purchase items for their personal consumption.

**Industrial buyers** are those who purchase items on behalf of their business or organisation.

Businesses now spend considerable sums trying to learn about what makes “customers tick”. The questions they try to understand are:

- Who buys?
- How do they buy?
- When do they buy?
- Where do they buy?
- Why do they buy?

For a marketing manager, the challenge is to understand how customers might respond to the different elements of the marketing mix that are presented to them. If management can understand these customer responses better than the competition, then it is a potentially significant source of competitive advantage.

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**Decision-Making Process**

**How do customers buy?**

Research suggests that customers go through a five-stage decision-making process in any purchase.

1. **Need Recognition & Problem Awareness**
2. **Information Search**
3. **Evaluation of Alternatives**
4. **Purchase**
5. **Post-Purchase Evaluation**

This model is important for anyone making marketing decisions. It forces the marketer to consider the whole buying process rather than just the purchase decision (when it may be too late for a business to influence the choice!)

The model implies that customers pass through all stages in every purchase. However, in more routine purchases, customers often skip or reverse some of the stages.

For example, a student buying a favourite hamburger would recognise the need (hunger) and go right to the purchase decision, skipping information search and evaluation. However, the model is very useful when it comes to understanding any purchase that requires some thought and deliberation.

The buying process starts with need recognition. At this stage, the buyer recognises a problem or need...
Buyers Behavior

(e.g. I am hungry, we need a new sofa, I have a headache) or responds to a marketing stimulus (e.g. you pass Starbucks and are attracted by the aroma of coffee and chocolate muffins).

An “aroused” customer then needs to decide how much information (if any) is required. If the need is strong and there is a product or service that meets the need close to hand, then a purchase decision is likely to be made there and then. If not, then the process of information search begins.

A customer can obtain information from several sources:

- Personal sources: family, friends, neighbours etc
- Commercial sources: advertising; salespeople; retailers; dealers; packaging; point-of-sale displays
- Public sources: newspapers, radio, television, consumer organisations; specialist magazines
- Experiential sources: handling, examining, using the product

The usefulness and influence of these sources of information will vary by product and by customer. Research suggests that customers value and respect personal sources more than commercial sources (the influence of “word of mouth”). The challenge for the marketing team is to identify which information sources are most influential in their target markets.

In the evaluation stage, the customer must choose between the alternative brands, products and services.

How does the customer use the information obtained?

An important determinant of the extent of evaluation is whether the customer feels “involved” in the product. By involvement, we mean the degree of perceived relevance and personal importance that accompanies the choice.

Where a purchase is “highly involving”, the customer is likely to carry out extensive evaluation.

High-involvement purchases include those involving high expenditure or personal risk – for example buying a house, a car or making investments.

Low involvement purchases (e.g. buying a soft drink, choosing some breakfast cereals in the supermarket) have very simple evaluation processes.

Why should a marketer need to understand the customer evaluation process?

The answer lies in the kind of information that the marketing team needs to provide customers in different buying situations.

In high-involvement decisions, the marketer needs to provide a good deal of information about the positive consequences of buying. The sales force may need to stress the important attributes of the product, the advantages compared with the competition; and maybe even encourage “trial” or “sampling” of the product in the hope of securing the sale.

Post-purchase evaluation - Cognitive Dissonance

The final stage is the post-purchase evaluation of the decision. It is common for customers to experience concerns after making a purchase decision. This arises from a concept that is known as “cognitive dissonance”. The customer, having bought a product, may feel that an alternative would have been preferable. In these circumstances that customer will not repurchase immediately, but is likely to switch brands next time.

To manage the post-purchase stage, it is the job of the marketing team to persuade the potential customer that the product will satisfy his or her needs. Then after having made a purchase, the customer should be encouraged that he or she has made the right decision.

Cultural Factors

Cultural factors have a significant impact on customer behaviour. Culture is the most basic cause of a person’s wants and behaviour. Growing up, children learn basic values, perception and wants from the family and other important groups.

Marketing are always trying to spot “cultural shifts” which might point to new products that might be wanted by customers or to increased demand. For example, the cultural shift towards greater concern about health and fitness has created opportunities (and now industries) servicing customers who wish to buy:
Low calorie foods
Health club memberships
Exercise equipment
Activity or health-related holidays etc.

Similarly the increased desire for “leisure time” has resulted in increased demand for convenience products and services such as microwave ovens, ready meals and direct marketing service businesses such as telephone banking and insurance.

Each culture contains “sub-cultures” – groups of people with share values. Sub-cultures can include nationalities, religions, racial groups, or groups of people sharing the same geographical location. Sometimes a sub-culture will create a substantial and distinctive market segment of its own.

For example, the “youth culture” or “club culture” has quite distinct values and buying characteristics from the much older “gray generation”

Similarly, differences in social class can create customer groups. In fact, the official six social classes in the UK are widely used to profile and predict different customer behaviour. In the UK’s socioeconomic classification scheme, social class is not just determined by income. It is measured as a combination of occupation, income, education, wealth and other variables:

<table>
<thead>
<tr>
<th>Class name</th>
<th>Social Status</th>
<th>Occupational Head of Household</th>
<th>% of UK Population</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Upper middle</td>
<td>Higher managerial, administrative or professional</td>
<td>3</td>
</tr>
<tr>
<td>B</td>
<td>Middle</td>
<td>Intermediate managerial, administrative or professional</td>
<td>14</td>
</tr>
<tr>
<td>C1</td>
<td>Lower middle</td>
<td>Superiors or clerical, junior managerial, administrative or professional</td>
<td>27</td>
</tr>
<tr>
<td>C2</td>
<td>Skilled working</td>
<td>Skilled manual workers</td>
<td>25</td>
</tr>
<tr>
<td>D</td>
<td>Working</td>
<td>Semi-skilled and un-skilled manual workers</td>
<td>19</td>
</tr>
<tr>
<td>E</td>
<td>Those at lowest level of subsistence</td>
<td>State pensioners or widows, casual or lower-grade workers</td>
<td>12</td>
</tr>
</tbody>
</table>

**New Products**

**Customer buying process for new products**

How do customers approach the process of buying a new product? How does this differ from the process for buying a product which the customer has bought before? What is meant by a “new product”?

A new product can be defined as:

“A good, service or idea that is “perceived” by some potential customers as new. It may have been available for some time, but many potential customers have not yet adopted the product nor decided to become a regular user of the product”

Research suggests that customers go through five stages in the process of adopting a new product or service: these are summarised below:

1. **Awareness** - the customer becomes aware of the new product, but lacks information about it
2. **Interest** - the customer seeks information about the new product
3. **Evaluation** - the customer considers whether trying the new product makes sense
4. **Trial** - the customer tries the new product on a limited or small scale to assess the value of the product
5. **Adoption** - the customer decides to make full and/or regular use of the new product

**What is the role of marketing in the process of new-product adoption?**

A marketing team looking to successfully introduce a new product or service should think about how to
help customers move through the five stages. For example, what kind of advertising or other promotional campaign can be employed to build customer awareness? If customers show a desire to trial or sample a product, how can this be arranged effectively?

Research also suggests that customers can be divided into groups according to the speed with which they adopt new products. Rogers, in his influential work on the diffusion of innovations, suggested the following classification:

![Consumer Adoption Model for New Products]

The “innovators” (those who adopt new products first) are usually relatively young, lively, intelligent, socially and geographically mobile. They are often of a high socioeconomic group (“AB’s”). Conversely, the “laggards” (those who adopt last, if at all) tend to be older, less intelligent, less well-off and lower on the socioeconomic scale.

It follows from the above model that when a business launches a new product or service, the customers who buy first are likely to be significantly different from those who buy the product much later. This needs to be borne in mind when developing the marketing mix.

**Social Factors**

A customer’s buying behaviour is also influenced by social factors, such as the groups to which the customer belongs and social status.

In a group, several individuals may interact to influence the purchase decision. The typical roles in such a group decision can be summarised as follows:

- **Initiator** The person who first suggests or thinks of the idea of buying a particular product or service
- **Influencer** A person whose view or advice influences the buying decision
- **Decider** The individual with the power and/or financial authority to make the ultimate choice regarding which product to buy
- **Buyer** The person who concludes the transaction
- **User** The person (or persons) who actually uses the product or service

The family unit is usually considered to be the most important “buying” organisation in society. It has been researched extensively. Marketers are particularly interested in the roles and relative influence of the husband, wife and children on the purchase of a large variety of products and services.

There is evidence that the traditional husband-wife buying roles are changing. Almost everywhere in the world, the wife is traditionally the main buyer for the family, especially in the areas of food, household products and clothing. However, with increasing numbers of women in full-time work and many men becoming “home workers” (or “telecommuting”) the traditional roles are reversing.

The challenge for a marketer is to understand how this might affect demand for products and services and how the promotional mix needs to be changed to attract male rather than female buyers.
Stimulus-Response Model

Introduction
A well-developed and tested model of buyer behaviour is known as the stimulus-response model, which is summarised in the diagram below:

In the above model, marketing and other stimuli enter the customers “black box” and produce certain responses. Marketing management must try to work out what goes on in the mind of the customer – the “black box”.

The Buyer’s characteristics influence how he or she perceives the stimuli; the decision-making process determines what buying behaviour is undertaken.

Characteristics that affect customer behaviour
The first stage of understanding buyer behaviour is to focus on the factors that determine he “buyer characteristics” in the “black box”. These can be summarised as follows:

Each of these factors is discussed in more detail in our other revision notes on buyer behaviour.
All businesses operate in “markets”. But what is a market? And how can it be defined?

It is important to be careful about how a market is defined. The following key marketing processes rely on a relevant market definition:

- Measuring market share
- Measuring market size and growth
- Specifying target customers
- Identifying relevant competitors
- Formulating a marketing strategy

A market can be defined as follows:

**A market is the set of all actual and potential buyers of a product or service.**

This definition suggests that a market is the total value and/or volume of products that satisfy the same customer need.

For example, if the customer need is “eat breakfast”, then the relevant market could be defined as the “Breakfast Food Market”. Many products would be relevant to measuring and analysing such a market:

- Breakfast Cereals
- Nutrition Bars
- Porridge / Oats
- Speciality Breads (e.g. croissants)
- Fast-food Outlets serving breakfast

In defining a market, it is important not to focus only on products/services that currently meet the customer need. For example, the button manufacturer who believed that their market was the “button market” would have made some poor marketing decisions unless he had seen the arrival of products such as Velcro and zips – which also satisfy the same need – “to fasten clothes”.

Thinking about customer needs first – and then identifying the products that meet those needs – is the best way to define a market.

However, it is also important not to define a market too broadly. For example, it is not particularly helpful for a marketing manager to define his or her market as the “food market” or the “transport market”. The purpose of market definition is to provide a meaningful framework for analysis and decision-making.

For example; consider the “entertainment market”. The customer need is to be “entertained”. There are many products and services that can claim to meet that need in different ways:

**At home:**
- Television
- Radio
- Video
- DVD
- Games Consoles

**Outside the Home:**
- Cinema
- Theatre
- Theme Parks
- Opera
- Sporting Events

It is important to avoid too broad a definition of a market. For example, it will be more manageable for marketing managers in the sporting events market to further refine their market definition into more detailed classes or segments.

To help with calculating market share, the following definitions are helpful:

**Product class** – e.g. computers, televisions, holidays

**Product subclass** – e.g. laptops, digital televisions, long-haul holidays

**Product brands** – e.g. Dell, Panasonic, Kuoni

Kuoni as a brand, for the purposes of measuring market share, is only concerned with the aggregate of all other travel brands that satisfy the same group of customers. However, Kuoni also needs to be aware of the trends in long haul holidays and the holiday market in general.
Importance of Market Share

An important piece of research in the 1960's provided the basis for understanding the importance of market share - and emphasised the implications for marketing and business strategy. The Profit Impact of Market Strategy ("PIMS") analysis was developed at General Electric in the 1960's and is now maintained by the Strategic Planning Institute. The PIMS database provides evidence of the impact of various marketing strategies on business success.

The most important factor to emerge from the PIMS data is the link between profitability and relative market share. PIMS found (and continues to find) a link between market share and the return a business makes on its investment. The higher the market share - the higher the return on investment. This is probably as a result of economies of scale. Economies of scale due to increasing market share are particularly evident in purchasing and the utilisation of fixed assets.

Case Study on Market Share - Dixons

Dixons is widely regarded as the dominant electrical retailer in the UK. What does dominant mean? It refers to the fact that Dixons (which is the market leader) has a very high relative market share. In other words, it is substantially bigger than the next largest competitor. This can be illustrated by the chart below which lists the leading UK electrical retailers in 2000.

How might Dixon's market dominance enable it to further increase its market share? Many retail analysts believe that the electrical retailing market provides advantages to larger businesses. In recent years, Dixons, along with the number two Comet, has been able to thrive while other retailers have suffered. The reasons for the advantages of size include:

**Buying advantage:** An ability to use size to source product more cheaply is a clear advantage in an industry that faces rapidly declining consumer prices

**Volume advantage:** As a low-margin business, retailers that can sell in high volumes are in the best position to gain market share

**Access to new products:** The largest retailers typically have first-mover advantage in stocking new "in demand" products that have just been released

**Advertising scale:** As a price-led business, access to national advertising provides the ability to keep customers regularly informed of the latest product deals. This helps to reinforce customer perception of value, in addition to strengthening the Dixons Group brands

**Access to retail property:** With the continuing trend towards out-of-town, larger destination stores that offer a broader range of choice, and with restrictive planning laws limiting opportunities, the larger electrical retailers have both the financial and operational capacity to secure such important new sites. The UK electrical retail market has many examples of businesses with a small market share that have fallen victim to the intense competition in the market. In the UK, Tiny Computers and US brand Gateway both folded. In the electrical appliance sector, well-known market casualties include Tandy (which was acquired by Carphone Warehouse who subsequently closed 110 of Tandy's shops and reformatted the remaining 160 into its own format) and Scottish Power's consumer appliance chain. These are summarised in the table below:
## Introduction to Market Share

Market share can be defined as the percentage of all sales within a market that is held by one brand/product or company. Market share can be measured in several ways. However, the two most important measures are by:

- Sales revenue
- Sales volume (the number of units sold)

### Examples of market share

Market share information on the UK clothing retail market is summarised below:

<table>
<thead>
<tr>
<th>Position</th>
<th>Brand</th>
<th>Sales (£'m)</th>
<th>Market Share (%)</th>
<th>Number of Outlets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Marks &amp; Spencer</td>
<td>2,743</td>
<td>10.2</td>
<td>315</td>
</tr>
<tr>
<td>2</td>
<td>Next</td>
<td>1,708</td>
<td>6.3</td>
<td>333</td>
</tr>
<tr>
<td>3</td>
<td>Arcadia</td>
<td>1,609</td>
<td>5.9</td>
<td>1,603</td>
</tr>
<tr>
<td>4</td>
<td>Debenhams</td>
<td>1,076</td>
<td>4.0</td>
<td>97</td>
</tr>
<tr>
<td>5</td>
<td>Asda</td>
<td>963</td>
<td>3.6</td>
<td>215</td>
</tr>
<tr>
<td>6</td>
<td>Matalan</td>
<td>776</td>
<td>2.9</td>
<td>137</td>
</tr>
<tr>
<td>7</td>
<td>Tesco</td>
<td>710</td>
<td>2.6</td>
<td>588</td>
</tr>
<tr>
<td>8</td>
<td>Bhs</td>
<td>631</td>
<td>2.3</td>
<td>163</td>
</tr>
<tr>
<td>9</td>
<td>New Look</td>
<td>552</td>
<td>2.1</td>
<td>573</td>
</tr>
<tr>
<td>10</td>
<td>John Lewis</td>
<td>482</td>
<td>1.8</td>
<td>25</td>
</tr>
</tbody>
</table>

Total of Top 10: 11,250  UK Market: 26,911

Source: Deutsche Bank 2002

The UK clothing market, as defined by Deutsche Bank in their recent report, is valued at £26.9 billion. It is one of the most concentrated retail markets in Europe, with the top ten retailers accounting for some 42% of the market.

What is market concentration? It is the proportion of market value that is owned by the leading brands/products/companies in the market. Where the market leaders own a large part of the overall market, the market is said to be highly concentrated. By contrast, where the market leader has a relatively small market share and there are many other competitors, a market is said to be “fragmented”

There has been little change in the concentration of the UK clothing retail market in recent years. The top 10 retailers accounted for 39% of the market in 1995. However, as the table below illustrates, the composition of the top 10 has changed quite considerably, with only six of the top ten in 1995 remaining in the top league in 2002:

<table>
<thead>
<tr>
<th>Position</th>
<th>1995</th>
<th>1997</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>M&amp;S</td>
<td>M&amp;S</td>
<td>M&amp;S</td>
</tr>
<tr>
<td>2</td>
<td>Arcadia</td>
<td>Arcadia</td>
<td>Next</td>
</tr>
<tr>
<td>3</td>
<td>Debenhams</td>
<td>Debenhams</td>
<td>Debenhams</td>
</tr>
<tr>
<td>4</td>
<td>C&amp;A</td>
<td>Next</td>
<td>Asda</td>
</tr>
<tr>
<td>5</td>
<td>Next</td>
<td>C&amp;A</td>
<td>Matalan</td>
</tr>
<tr>
<td>6</td>
<td>Sears</td>
<td>Sears/Adams</td>
<td>Tesco</td>
</tr>
<tr>
<td>7</td>
<td>Bhs</td>
<td>Bhs</td>
<td>Bhs</td>
</tr>
<tr>
<td>8</td>
<td>Littlewoods</td>
<td>Asda</td>
<td>New Look</td>
</tr>
<tr>
<td>9</td>
<td>John Lewis</td>
<td>Littlewoods</td>
<td>John Lewis</td>
</tr>
<tr>
<td>10</td>
<td>House of Fraser</td>
<td>House of Fraser</td>
<td>House of Fraser</td>
</tr>
</tbody>
</table>

Source: Deutsche Bank
The table above masks the change in the format of retail businesses that have evolved in the UK over recent years. Five years ago, the value or "discount" retailers had a relatively small share of the clothing market, accounting for only 18% total market share. Today the market is very different. The value or discount retailers now have over a quarter of the market. Foreign clothing retailers have also penetrated the market (e.g. the Gap, H&M and Zara) although their total market share is still less than 5%

**Measuring Market Share**

An accurate measure of market share is dependent on several factors:
- A satisfactory definition of the market. This would answering questions such as which products to include, which geographical areas, which means of distribution?
- The availability of reliable, up-to-date information
- Agreement on which measures of share are most relevant. For example, should market share be calculated on the basis of sales revenues, profits, units produced or some other measure that competitors in the market generally recognise as valid.

In reality, market shares are calculated in a myriad of ways. However, most tend to be based on one or both of the following:
- Sale revenues
- Sales volumes (units)

**Worked Example of Market Shares based on Sales Volumes**

In this example, we take figures for the global sale of personal digital assistants ("PDA@s") in 2001. According to research by Dataquest, global sales of PDA's totaled 13.1 million units, a 18% increase from sales in 2000

The breakdown of these 13.1 million units by major PDA manufacturer is shown in the table below:

<table>
<thead>
<tr>
<th>Company (Operating System)</th>
<th>2001 Sales Units</th>
<th>2001 Market Share %</th>
<th>2000 Sales Units</th>
<th>2000 Market Share %</th>
<th>Sales Growth %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Palm (Palm)</td>
<td>5,056</td>
<td>38.6</td>
<td>5,588</td>
<td>50.4</td>
<td>-9.5</td>
</tr>
<tr>
<td>Handspring (Palm)</td>
<td>1,648</td>
<td>12.6</td>
<td>1,369</td>
<td>12.4</td>
<td>20.4</td>
</tr>
<tr>
<td>Compaq (Microsoft)</td>
<td>1,283</td>
<td>9.8</td>
<td>466</td>
<td>4.2</td>
<td>175.4</td>
</tr>
<tr>
<td>Hewlett-Packard (Microsoft)</td>
<td>711</td>
<td>5.4</td>
<td>442</td>
<td>4.0</td>
<td>60.9</td>
</tr>
<tr>
<td>Casio (Microsoft)</td>
<td>529</td>
<td>4.0</td>
<td>440</td>
<td>4.0</td>
<td>20.4</td>
</tr>
<tr>
<td>Others</td>
<td>3,884</td>
<td>29.6</td>
<td>2,777</td>
<td>25.1</td>
<td>39.9</td>
</tr>
<tr>
<td>Total Market</td>
<td>13,111</td>
<td>100.0</td>
<td>11,083</td>
<td>100.0</td>
<td>18.3</td>
</tr>
</tbody>
</table>

Source: Gartner Dataquest February 2002

As can be seen from the table, Palm continues to lead the PDA market with a market share of 38.6%. However, in just one year, its market share fell by 11.8 percentage points from 50.4% in 2000 reflecting the aggressive marketing of new and strong players in the market such as Compaq and Hewlett-Packard.

In 2000, Palm was four times the size of the next largest competitor (Handsprint). By 2001, Palm was just three times the size of Handsprint, implying a reduction in its relative market strength.

**Worked Example of Market Share Based on Sales Revenues**

In this example, we look at the retail sales figures of the major UK grocery chains. This analysis is based upon data collected by the leading market research company Taylor Nelson Sofres ("TNS"). The TNS data is sourced via a continuous interview of 15,000 households in the UK. It measures the relative sales performance of the major grocery chains using what it calls the "Till Roll" measure.

The Till Roll measures by retailer the total amount spent by each household in the grocery store as captured by the total printed on the till receipt. This is then adjusted to exclude items such as petrol purchases, kiosk sales and amounts spent in the coffee shop or restaurant.

Based on the Till Roll measure, the monthly market shares of the leading grocery chains in August 2002 were as follows:
Before delving too deep into the study of marketing, it is worth pausing to consider the different types of market that exist.

Markets can be analysed via the **product** itself, or **end-consumer**, or both. The most common distinction is between *consumer* and *industrial* markets.

**Consumer Markets**

Consumer markets are the markets for products and services bought by individuals for their own or family use. Goods bought in consumer markets can be categorised in several ways:

- **Fast-moving consumer goods** ("FMCG’s")
  These are high volume, low unit value, fast repurchase
  Examples include: Ready meals; Baked Beans; Newspapers

- **Consumer durables**
  These have low volume but high unit value. Consumer durables are often further divided into:
  - **White goods** (e.g. fridge-freezers; cookers; dishwashers; microwaves)
  - **Brown goods** (e.g. DVD players; games consoles; personal computers)

- **Soft goods**
  Soft goods are similar to consumer durables, except that they wear out more quickly and therefore have a shorter replacement cycle
  Examples include clothes, shoes

- **Services** (e.g. hairdressing, dentists, childcare)

**Industrial Markets**

Industrial markets involve the sale of goods between businesses. These are goods that are not aimed directly at consumers. Industrial markets include

- **Selling finished goods**
  – Examples include office furniture, computer systems

- **Selling raw materials or components**
  – Examples include steel, coal, gas, timber

- **Selling services to businesses**
  – Examples include waste disposal, security, accounting & legal services

Industrial markets often require a slightly different marketing strategy and mix. In particular, a business may have to focus on a relatively small number of potential buyers (e.g. the IT Director responsible for ordering computer equipment in a multinational group). Whereas consumer marketing tends to be aimed at the mass market (in some cases, many millions of potential customers), industrial marketing tends to be focused.
To undertake marketing effectively, businesses need information. Information about customer wants, market demand, competitors, distribution channels etc. Marketers often complain that they lack enough marketing information or the right kind, or have too much of the wrong kind. The solution is an effective marketing information system.

The information needed by marketing managers comes from three main sources:

1. **Internal company information**
   E.g. sales, orders, customer profiles, stocks, customer service reports etc.

2. **Marketing intelligence**
   This can be information gathered from many sources, including suppliers, customers, distributors. Marketing intelligence is a catch-all term to include all the everyday information about developments in the market that helps a business prepare and adjust its marketing plans. It is possible to buy intelligence information from outside suppliers (e.g. Mintel, Dun & Bradstreet, Mori) who set up data gathering systems to support commercial intelligence products that can be profitably sold to all players in a market.

3. **Market research**
   Management cannot always wait for information to arrive in bits and pieces from internal sources. Also, sources of market intelligence cannot always be relied upon to provide relevant or up-to-date information (particularly for smaller or niche market segments). In such circumstances, businesses often need to undertake specific studies to support their marketing strategy - this is market research.

### Conducting Market Research

Depending on the situation facing a business, particularly the resources allocated to marketing research, there are four main ways of carrying out market research:

1. **Do it yourself - personally**
   This is often the case in smaller businesses. Here, marketing staff do the research themselves. Sample sizes tend to be small - which may be appropriate if there are a relatively small number of customers.

2. **Do it yourself - using a marketing research department**
   By employing a marketing research manager, a business may benefit from specialist research skills.

3. **Do it yourself - using a fieldwork agency**
   Often the design of a piece of market research can be completed using internal resources - particularly if the business employs a marketing specialist with knowledge of research techniques. However, the scope of the research (for example, interviewing a large sample of consumers in various locations) may be beyond the resources of a business. In this case, the fieldwork can be carried out by a marketing research agency.

4. **Use the full services of a marketing research agency**
   Where resources permit a business can invest in the full range of skills offered by marketing research agencies. There are thousands of market research agencies in the UK alone who provide such services. A complete service would include:
   - Preparation of the market research proposal (survey design, costs, timetable, method of feedback)
   - Conduct exploratory research
   - Design the research questionnaire
   - Select the sample
   - Choose the survey method (e.g. telephone, postal, face-to-face)
   - Conduct the interviewing
   - Analyse and interpret the results
   - Prepare a report
   - Make a presentation

In terms of data capture and analysis there are two main types of market research:

**Qualitative Research and Quantitative Research**
Qualitative Research

Qualitative Research is about investigating the features of a market through in-depth research that explores the background and context for decision making.

There are two main qualitative methods - depth interviews and focus groups. However qualitative research can also include techniques such as usability testing, brainstorming sessions and "vox pop" surveys.

Depth Interviewing

Depth interviews are the main form of qualitative research in most business markets. Here an interviewer spends time in a one-on-one interview finding out about the customer's particular circumstances and their individual opinions.

The majority of business depth interviews take place in person, which has the added benefit that the researcher visits the respondent's place of work and gains a sense of the culture of the business. However, for multi-national studies, telephone depth interviews, or even on-line depth interviews may be more appropriate.

Feedback is through a presentation that draws together findings across a number of depth interviews. In some circumstances, such as segmentation studies, identifying differences between respondents may be as important as the views that customers share.

The main alternative to depth interviews - focus group discussions - are typically too difficult or expensive to arrange with busy executives. However, on-line techniques increasing get over this problem.

Group Discussions

Focus groups are the mainstay of consumer research. Here several customers are brought together to take part in a discussion led by a researcher (or "moderator"). These groups are a good way of exploring a topic in some depth or to encourage creative ideas from participants.

Group discussions are rare in business markets, unless the customers are small businesses. In technology markets where the end user may be a consumer, or part of a team evaluating technology, group discussions can be an effective way of understanding what customers are looking for, particularly at more creative stages of research.

Quantitative Research

Quantitative research is about measuring a market and quantifying that measurement with data. Most often the data required relates to market size, market share, penetration, installed base and market growth rates.

However, quantitative research can also be used to measure customer attitudes, satisfaction, commitment and a range of other useful market data that can tracked over time.

Quantitative research can also be used to measure customer awareness and attitudes to different manufacturers and to understand overall customer behaviour in a market by taking a statistical sample of customers to understand the market as a whole. Such techniques are extremely powerful when combined with techniques such segmentation analysis and mean that key audiences can be targeted and monitored over time to ensure the optimal use of the marketing budget.

At the heart of all quantitative research is the statistical sample. Great care has to be taken in selecting the sample and also in the design of the sample questionnaire and the quality of the analysis of data collected.

Market research involves the collection of data to obtain insight and knowledge into the needs and wants of customers and the structure and dynamics of a market. In nearly all cases, it would be very costly and time-consuming to collect data from the entire population of a market. Accordingly, in market research, extensive use is made of sampling from which, through careful design and analysis, Marketers can draw information about the market.
Sampling

Market research involves the **collection of data** to obtain insight and knowledge into the **needs and wants** of customers and the structure and dynamics of a market. In nearly all cases, it would be very costly and time-consuming to collect data from the entire **population** of a market. Accordingly, in market research, extensive use is made of **sampling** from which, through careful design and analysis, Marketers can draw information about the market.

Sample Design
Sample design covers the method of selection, the sample structure and plans for analysing and interpreting the results. Sample designs can vary from simple to complex and depend on the type of information required and the way the sample is selected.

Sample design affects the size of the sample and the way in which analysis is carried out. In simple terms the more precision the market researcher requires, the more complex will be the design and the larger the sample size.

The sample design may make use of the characteristics of the overall market population, but it does not have to be **proportionally representative**. It may be necessary to draw a larger sample than would be expected from some parts of the population; for example, to select more from a minority grouping to ensure that sufficient data is obtained for analysis on such groups.

Many sample designs are built around the concept of **random selection**. This permits justifiable inference from the sample to the population, at quantified levels of precision. Random selection also helps guard against sample bias in a way that selecting by judgement or convenience cannot.

Defining the Population
The first step in good sample design is to ensure that the specification of the target population is as clear and complete as possible to ensure that all elements within the population are represented. The target population is sampled using a **sampling frame**. Often the units in the population can be identified by existing information; for example, pay-rolls, company lists, government registers etc. A sampling frame could also be geographical; for example postcodes have become a well-used means of selecting a sample.

Sample Size
For any sample design deciding upon the appropriate sample size will depend on several key factors

1. **No estimate taken from a sample is expected to be exact**: Any assumptions about the overall population based on the results of a sample will have an attached **margin of error**.
2. **To lower the margin of error usually requires a larger sample size**: The amount of variability in the population (i.e. the range of values or opinions) will also affect accuracy and therefore the size of sample.
3. **The confidence level is the likelihood that the results obtained from the sample lie within a required precision**: The higher the confidence level, that is the more certain you wish to be that the results are not atypical. Statisticians often use a **95 per cent confidence level** to provide strong conclusions.
4. **Population size does not normally affect sample size**: In fact the larger the population size the lower the proportion of that population that needs to be sampled to be representative. It is only when the proposed sample size is more than 5 per cent of the population that the population size becomes part of the formulae to calculate the sample size.

Types of Sampling
There are many different types of sampling technique. We have summarised the most popular below:

<table>
<thead>
<tr>
<th>Sampling Method</th>
<th>Definition</th>
<th>Uses</th>
<th>Limitations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cluster Sampling</td>
<td>Units in the population can often be found in certain geographic groups or &quot;clusters&quot; (e.g. primary school children in Derbyshire). A random sample of clusters is taken, then all units within the cluster are examined</td>
<td>Quick &amp; easy; does not require complete population information; good for face-to-face surveys</td>
<td>Expensive if the clusters are large; greater risk of sampling error</td>
</tr>
<tr>
<td>Convenience Sampling</td>
<td>Uses those who are willing to volunteer</td>
<td>Readily available; large amount of information can be gathered quickly</td>
<td>Cannot extrapolate from sample to infer about the population; prone to</td>
</tr>
</tbody>
</table>
### Volunteer Bias
Volunteer bias is a type of selection bias where the sample is chosen by allowing participants to self-select into the study. This means that the sample might not be representative of the general population. It is often used in non-randomized studies, such as surveys where participants opt to participate. This can lead to significant biases in the results, as the volunteers may not be representative of the general population. For example, if a survey is conducted online, it might attract a higher response rate from people with internet access, which might not reflect the views of those without internet access.

### Quota Sampling
Quota sampling is a non-probability sampling method where the researcher selects participants to ensure that the sample is representative of the population in terms of key characteristics. The researcher defines the quotas or the proportions of the sample that should have specific characteristics, such as age, gender, or income level. The researcher then selects participants to fill those quotas. This method is often used in market research to ensure that the sample reflects the demographics of the target population. However, it can still be prone to bias, especially if the quotas are not set up properly or if the population is not well defined.

### Simply Random Sampling
Simply random sampling is a probability sampling method where every member of the population has an equal chance of being selected. This is done using a random selection process, such as a random number generator. Simply random sampling ensures that the sample is representative of the population and can be used to make generalizable inferences about the population. However, it can be costly and time-consuming if the sample requires lots of small visits all over the country.

### Systematic Sampling
Systematic sampling is a probability sampling method where the researcher selects a starting point from the population and then selects every nth unit. The starting point is selected randomly, and then every nth unit is selected, where n equals the population size divided by the sample size. This method is easier to extract the sample than via simple random sampling and ensures that the sample is spread across the population. However, the choice of starting point can affect the representativeness of the sample, so it is important to choose a random starting point.

### Types Of Market Research
The main distinction between the different types of market research is between "ad-hoc" and "continuous" research:

**Ad-hoc Market Research**
- Ad-hoc research studies focus on specific marketing problems. They collect data at one point in time from one sample of respondents. Good examples of ad-hoc studies include:
  - Product usage survey
  - New product concept tests (where consumers are asked to trial new brands, product prototypes etc)
  - Advertising development (how does the sample of consumers respond to a specific advertising campaign? Most TV adverts are researched in this way)
  - Corporate image surveys (often quite enlightening)
  - Customer satisfaction surveys (these can often turn into continuous research)

**Continuous Research**
Continuous studies interview the same sample of people, repeatedly. The major types of continuous research are:

**Consumer panels**
Consumer panels are formed by recruiting large numbers of households who provide information on their buying over time. Research agency AC Nielsen has one of the largest consumer panels in the world, continuously interviewing 125,000 households in 18 countries. The main competitor for AC Nielsen is TNS which runs panels in 20 countries.

**Retail Audits**
By gaining the cooperation of retail outlets, sales of brands can be measured (using bar coded sales data) to track changes in brand loyalty, market share and effectiveness of different retail formats.
Television Viewership / Radio Listening Panels

These panels aim to measure viewership or listening minute by minute. This data is critical information for broadcasters to determine their programme strategy (what kinds of programmes to produce and when to broadcast them) as well as for advertisers (who is watching, listening, and when?). In the UK, the main source of such data is produced by the Broadcasters' Audience Research Board ("BARB").

Uses

A wide variety of information used to support marketing decisions can be obtained from market research. A selection of such uses are summarised below:

Information about the market

- Analysis of the market potential for existing products (e.g. market size, growth, changing sales trends)
- Forecasting future demand for existing products
- Assessing the potential for new products
- Study of market trends
- Analysis of competitor behaviour and performance
- Analysis of market shares

Information about Products

- Likely customer acceptance (or rejection) of new products
- Comparison of existing products in the market (e.g. price, features, costs, distribution)
- Forecasting new uses for existing products
- Technologies that may threaten existing products
- New product development

Information about Pricing in the Market

- Estimates and testing of price elasticity
- Analysis of revenues, margins and profits
- Customer perceptions of "just or fair" pricing
- Competitor pricing strategies

Information about Promotion in the Market

- Effectiveness of advertising
- Effectiveness of sales force (personal selling)
- Extent and effectiveness of sales promotional activities
- Competitor promotional strategies

Information about Distribution in the Market

- Use and effectiveness of distribution channels
- Opportunities to sell direct
- Cost of transporting and warehousing products
- Level and quality of after-sales service

Sales Forecasting

Sales forecasting is a difficult area of management. Most managers believe they are good at forecasting. However, forecasts made usually turn out to be wrong! Marketers argue about whether sales forecasting is a science or an art. The short answer is that it is a bit of both.

Reasons for undertaking sales forecasts
Businesses are forced to look well ahead in order to plan their investments, launch new products, decide when to close or withdraw products and so on. The sales forecasting process is a critical one for most businesses. Key decisions that are derived from a sales forecast include:

- Employment levels required
- Promotional mix
- Investment in production capacity

Types of forecasting

There are two major types of forecasting, which can be broadly described as **macro** and **micro**:

**Macro forecasting** is concerned with forecasting markets in total. This is about determining the existing level of Market Demand and considering what will happen to market demand in the future.

**Micro forecasting** is concerned with detailed unit sales forecasts. This is about determining a product’s market share in a particular industry and considering what will happen to that market share in the future.

The selection of which type of forecasting to use depends on several factors:

1. **The degree of accuracy required** – if the decisions that are to be made on the basis of the sales forecast have high risks attached to them, then it stands to reason that the forecast should be prepared as accurately as possible. However, this involves more cost.
2. **The availability of data and information** - in some markets there is a wealth of available sales information (e.g. clothing retail, food retailing, holidays); in others it is hard to find reliable, up-to-date information.
3. **The time horizon that the sales forecast is intended to cover**. For example, are we forecasting next weeks’ sales, or are we trying to forecast what will happen to the overall size of the market in the next five years?
4. **The position of the products in its life cycle**. For example, for products at the “introductory” stage of the product life cycle, less sales data and information may be available than for products at the “maturity” stage when time series can be a useful forecasting method.

Creating the Sales Forecast for a Product

1st Stage in creating the sales forecast is to estimate Market Demand.

**Definition:**

*Market Demand for a product is the total volume that would be bought by a defined customer group, in a defined geographical area, in a defined time period, in a given marketing environment. This is sometimes referred to as the Market Demand Curve.*

For example, consider the UK Overseas Mass Market Package Holiday Industry. What is Market Demand?

Using the definition above, market demand can be defined as:

- **Defined Customer Group**: Customers Who Buy an Air-Inclusive Package Holiday
- **Defined Geographical Area**: Customers in the UK
- **Defined Time Period**: A calendar year
- **Defined Marketing Environment**: Strong consumer spending in the UK but overseas holidays affected by concerns over international terrorism

Recent data for the UK Overseas Mass Market Package Holiday market suggests that market demand can be calculated as follows:

- **Number of Customers in the UK**: 17.5 million per calendar year
- **Average Selling Price per Holiday**: £450
- **Estimate of market demand**: £7.9 billion (customers x average price)

2nd Stage in the forecast is to estimate Company Demand

Company demand is the company’s share of market demand. This can be expressed as a formula:

*Company Demand = Market Demand v Company’s Market Share*
For example, taking our package holiday market example; the company demand for First Choice Holidays in this market can be calculated as follows:

First Choice Holidays Demand = £7.9 billion x 15% Market Share = £1.2 billion

A company’s share of market demand depends on how its products, services, prices, brands and so on are perceived relative to the competitors. All other things being equal, the company’s market share will depend on the size and effectiveness of its marketing spending relative to competitors.

3rd stage is then to develop the Sales Forecast

The Sales Forecast is the expected level of company sales based on a chosen marketing plan and an assumed marketing environment.

Note that the Sales Forecast is not necessarily the same as a “sales target” or a “sales budget”.

A sales target (or goal) is set for the sales force as a way of defining and encouraging sales effort. Sales targets are often set some way higher than estimated sales to “stretch” the efforts of the sales force.

A sales budget is a more conservative estimate of the expected volume of sales. It is primarily used for making current purchasing, production and cash-flow decisions. Sales budgets need to take into account the risks involved in sales forecasting. They are, therefore, generally set lower than the sales forecast.

Obtaining information on existing market demand

As a starting point for estimating market demand, a company needs to know the actual industry sales taking place in the market. This involves identifying its competitors and estimating their sales.

An industry trade association will often collect and publish (sometime only to members) total industry sales, although rarely listing individual company sales separately. By using this information, each company can evaluate its performance against the whole market.

This is an important piece of analysis. Say, for example, that Company A has sales that are rising at 10% per year. However, it finds out that overall industry sales are rising by 15% per year. This must mean that Company A is losing market share – its relative standing in the industry.

Another way to estimate sales is to buy reports from a marketing research firm such as AC Neilsen, Mintel etc. These are usually good sources of information for consumer markets – where retail sales can be tracked in great detail at the point of sale. Such sources are less useful in industrial markets which usually rely on distributors.

Estimating Future Demand

So far we have identified how a company can determine the current position:

Current Company Demand = Current Market Demand x Current Market Share

How can future market demand and company demand be forecast?

Very few products or services lend themselves to easy forecasting. These tend to involve a product whose absolute level or trend of sales is fairly constant and where competition is either non-existent (e.g. monopolies such as public utilities) or stable (pure oligopolies). In most markets, total demand and company demand are not stable – which makes good sales forecasting a critical success factor.

A common method of preparing a sales forecast has three stages:

1. Prepare a macroeconomic forecast – what will happen to overall economic activity in the relevant economies in which a product is to be sold.
2. Prepare an industry sales forecast – what will happen to overall sales in an industry based on the issues that influence the macroeconomic forecast;
3. Prepare a company sales forecast – based on what management expect to happen to the company’s market share

Sales forecasts can be based on three types of information:

1. What customers say about their intentions to continue buying products in the industry
2. What customers are actually doing in the market
3. What customers have done in the past in the market
There are many market research businesses that undertake surveys of customer intentions – and sell this information to businesses that need the data for sales forecasting purposes. The value of a customer intention survey increases when there are a relatively small number of customers, the cost of reaching them is small, and they have clear intentions. An alternative way of measuring customer intentions is to sample the opinions of the sales force or to consult industry experts.

**Time Series Analysis**

Many businesses prepare their sales forecast on the basis of past sales. Time series analysis involves breaking past sales down into four components:

1. **The trend**: are sales growing, “flat-lining” or in decline?
2. **Seasonal or cyclical factors**: Sales are affected by swings in general economic activity (e.g. increases in the disposable income of consumers may lead to increase in sales for products in a particular industry). Seasonal and cyclical factors occur in a regular pattern;
3. **Erratic events**: these include strikes, fashion fads, war scares and other disturbances to the market which need to be isolated from past sales data in order to be able to identify the more normal pattern of sales;
4. **Responses**: the results of particular measures that have been taken to increase sales (e.g. a major new advertising campaign)

Using time series analysis to prepare an effective sales forecast requires management to:

- Smooth out the erratic factors (e.g. by using a moving average)
- Adjust for seasonal variation
- Identify and estimate the effect of specific marketing responses
Segmentation

**Better matching of customer needs**
Customer needs differ. Creating separate offers for each segment makes sense and provides customers with a better solution.

**Enhanced profits for business**
Customers have different disposable income. They are, therefore, different in how sensitive they are to price. By segmenting markets, businesses can raise average prices and subsequently enhance profits.

**Better opportunities for growth**
Market segmentation can build sales. For example, customers can be encouraged to "trade-up" after being introduced to a particular product with an introductory, lower-priced product.

**Retain more customers**
Customer circumstances change, for example they grow older, form families, change jobs or get promoted, change their buying patterns. By marketing products that appeal to customers at different stages of their life ("life-cycle"), a business can retain customers who might otherwise switch to competing products and brands.

**Target marketing communications**
Businesses need to deliver their marketing message to a relevant customer audience. If the target market is too broad, there is a strong risk that (1) the key customers are missed and (2) the cost of communicating to customers becomes too high / unprofitable. By segmenting markets, the target customer can be reached more often and at lower cost.

**Gain share of the market segment**
Unless a business has a strong or leading share of a market, it is unlikely to be maximising its profitability. Minor brands suffer from lack of scale economies in production and marketing, pressures from distributors and limited space on the shelves. Through careful segmentation and targeting, businesses can often achieve competitive production and marketing costs and become the preferred choice of customers and distributors. In other words, segmentation offers the opportunity for smaller firms to compete with bigger ones.

**Bases Of Segmentation**

It is widely thought in marketing that than segmentation is an art, not a science. The key task is to find the variable, or variables that split the market into actionable segments.

There are two types of **segmentation variables:**

1. **Needs**
2. **Profilers**

The basic criteria for segmenting a market are **customer needs**. To find the needs of customers in a market, it is necessary to undertake **market research**.

Profilers are the descriptive, measurable customer characteristics (such as location, age, nationality, gender, income) that can be used to inform a segmentation exercise.

The most common profilers used in customer segmentation include the following:

- **Geographic**
  - Region of the country
  - Urban or rural
- **Demographic**
  - Age, sex, family size
  - Income, occupation, education
  - Religion, race, nationality
- **Psychographic**
  - Social class
  - Lifestyle type
  - Personality type
- **Behavioural**
  - Product usage - e.g. light, medium, heavy users
  - Brand loyalty: none, medium, high
Type of user (e.g. with meals, special occasions)

**Behavioural Segmentation**

Behavioural segmentation divides customers into groups based on the way they respond to, use or know of a product. Behavioural segments can group consumers in terms of:

*Occasions*

When a product is consumed or purchased. For example, cereals have traditionally been marketed as a breakfast-related product. Kelloggs have always encouraged consumers to eat breakfast cereals on the "occasion" of getting up. More recently, they have tried to extend the consumption of cereals by promoting the product as an ideal, anytime snack food.

*Usage*

Some markets can be segmented into light, medium and heavy user groups

*Loyalty*

Loyal consumers - those who buy one brand all or most of the time - are valuable customers. Many companies try to segment their markets into those where loyal customers can be found and retained compared with segments where customers rarely display any product loyalty. The holiday market is an excellent example of this. The "mass-market" overseas tour operators such as Thomson, Airtours, JMC and First Choice have very low levels of customer loyalty - which means that customers need to be recruited again every year. Compare this with specialist, niche operators such as Laskarina which has customers who have traveled with the brand in each of the last 15-20 years.

*Benefits Sought*

An important form of behavioural segmentation. Benefit segmentation requires Marketers to understand and find the main benefits customers look for in a product. An excellent example is the toothpaste market where research has found four main "benefit segments" - economic; medicinal, cosmetic and taste.

**Geographic Segmentation**

Geographic segmentation tries to divide markets into different geographical units: these units include:

- **Regions**: e.g. in the UK these might be England, Scotland, Wales Northern Ireland or (at a more detailed level) counties or major metropolitan areas
- **Countries**: perhaps categorised by size, development or membership of geographic region
- **City / Town size**: e.g. population within ranges or above a certain level
- **Population density**: e.g. urban, suburban, rural, semi-rural
- **Climate**: e.g. Northern, Southern

Geographic segmentation is an important process - particularly for multi-national and global businesses and brands. Many such companies have regional and national marketing programmes which alter their products, advertising and promotion to meet the individual needs of geographic units.

**Demographic Segmentation**

Demographic segmentation consists of dividing the market into groups based on variables such as age, gender family size, income, occupation, education, religion, race and nationality.

As you might expect, demographic segmentation variables are amongst the most popular bases for
segmenting customer groups.

This is partly because customer wants are closely linked to variables such as income and age. Also, for practical reasons, there is often much more data available to help with the demographic segmentation process.

The main demographic segmentation variables are summarised below:

**Age**

Consumer needs and wants change with age although they may still wish to consumer the same types of product. So Marketers design, package and promote products differently to meet the wants of different age groups. Good examples include the marketing of toothpaste (contrast the branding of toothpaste for children and adults) and toys (with many age-based segments).

**Life-cycle stage**

A consumer stage in the life-cycle is an important variable - particularly in markets such as leisure and tourism. For example, contrast the product and promotional approach of Club 18-30 holidays with the slightly more refined and sedate approach adopted by Saga Holidays.

**Gender**

Gender segmentation is widely used in consumer marketing. The best examples include clothing, hairdressing, magazines and toiletries and cosmetics.

**Income**

Another popular basis for segmentation. Many companies target affluent consumers with luxury goods and convenience services. Good examples include Coutts bank; Moet & Chandon champagne and Elegant Resorts - an up-market travel company. By contrast, many companies focus on marketing products that appeal directly to consumers with relatively low incomes. Examples include Aldi (a discount food retailer), Airtours holidays, and discount clothing retailers such as TK Maxx.

**Social class**

Many Marketers believe that a consumers "perceived" social class influences their preferences for cars, clothes, home furnishings, leisure activities and other products & services. There is a clear link here with income-based segmentation.

**Lifestyle**

Marketers are increasingly interested in the effect of consumer "lifestyles" on demand. Unfortunately, there are many different lifestyle categorisation systems, many of them designed by advertising and marketing agencies as a way of winning new marketing clients and campaigns!
Competitor Analysis

Why bother to analyse competitors?
Some businesses think it is best to get on with their own plans and ignore the competition. Others become obsessed with tracking the actions of competitors (often using underhand or illegal methods). Many businesses are happy simply to track the competition, copying their moves and reacting to changes.

Competitor analysis has several important roles in marketing:

- To help management understand their competitive advantages/disadvantages relative to competitors
- To generate understanding of competitors’ past, present (and most importantly) future strategies
- To provide an informed basis to develop strategies to achieve competitive advantage in the future
- To help forecast the returns that may be made from future investments (e.g. how will competitors respond to a new product or pricing strategy?)

What questions should be asked when undertaking competitor analysis? The following is a useful list to bear in mind:

a) Who are our competitors? (see the section on identifying competitors further below)
b) What threats do they post?
c) What is the profile of our competitors?
d) What are the objectives of our competitors?
e) What strategies are our competitors pursuing and how successful are these strategies?
f) What are the strengths and weaknesses of our competitors?
g) How are our competitors likely to respond to any changes to the way we do business?

Sources of Information

Davidson (1997) describes how the sources of competitor information can be neatly grouped into three categories:

- **Recorded data**: this is easily available in published form either internally or externally. Good examples include competitor annual reports and product brochures;

- **Observable data**: this has to be actively sought and often assembled from several sources. A good example is competitor pricing;

- **Opportunistic data**: to get hold of this kind of data requires a lot of planning and organisation. Much of it is “anecdotal”, coming from discussions with suppliers, customers and, perhaps, previous management of competitors.

The table below lists possible sources of competitor data using Davidson’s categorisation:

<table>
<thead>
<tr>
<th>Recorded Data</th>
<th>Observable Data</th>
<th>Opportunistic Data</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual report &amp; accounts</td>
<td>Pricing / price lists</td>
<td>Meetings with suppliers</td>
</tr>
<tr>
<td>Press releases</td>
<td>Advertising campaigns</td>
<td>Trade shows</td>
</tr>
<tr>
<td>Newspaper articles</td>
<td>Promotions</td>
<td>Sales force meetings</td>
</tr>
<tr>
<td>Analysts reports</td>
<td>Tenders</td>
<td>Seminars / conferences</td>
</tr>
<tr>
<td>Regulatory reports</td>
<td>Patent applications</td>
<td>Recruiting ex-employees</td>
</tr>
<tr>
<td>Government reports</td>
<td></td>
<td>Discussion with shared distributors</td>
</tr>
<tr>
<td>Presentations / speeches</td>
<td></td>
<td>Social contacts with competitors</td>
</tr>
</tbody>
</table>

In his excellent book [Even More Offensive Marketing], Davidson likens the process of gathering competitive data to a jigsaw puzzle. Each individual piece of data does not have much value. The important skill is to collect as many of the pieces as possible and to assemble them into an overall picture of the competitor. This enables you to identify any missing pieces and to take the necessary steps to collect them.
Kinds of Information

The tables below lists the kinds of competitor information that would help businesses complete some good quality competitor analysis.

You can probably think of many more pieces of information about a competitor that would be useful. However, an important challenge in competitor analysis is working out how to obtain competitor information that is reliable, up-to-date and available legally(!).

<table>
<thead>
<tr>
<th>What businesses probably already know about their competitors</th>
<th>What businesses would really like to know about competitors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall sales and profits</td>
<td>Sales and profits by product</td>
</tr>
<tr>
<td>Sales and profits by market</td>
<td>Relative costs</td>
</tr>
<tr>
<td>Sales by main brand</td>
<td>Customer satisfaction and service levels</td>
</tr>
<tr>
<td>Cost structure</td>
<td>Customer retention levels</td>
</tr>
<tr>
<td>Market shares (revenues and volumes)</td>
<td>Distribution costs</td>
</tr>
<tr>
<td>Organisation structure</td>
<td>New product strategies</td>
</tr>
<tr>
<td>Distribution system</td>
<td>Size and quality of customer databases</td>
</tr>
<tr>
<td>Identity / profile of senior management</td>
<td>Advertising effectiveness</td>
</tr>
<tr>
<td>Advertising strategy and spending</td>
<td>Future investment strategy</td>
</tr>
<tr>
<td>Customer / consumer profile &amp; attitudes</td>
<td>Contractual terms with key suppliers</td>
</tr>
<tr>
<td>Customer retention levels</td>
<td>Terms of strategic partnerships</td>
</tr>
</tbody>
</table>

Competitor Analysis And Competitive Advantage

Marketing-orientated businesses need to do more than just meet customer needs. To succeed and prosper, a business also needs to meet customer needs and wants better than the competition. In other words - the business needs to seek competitive advantage.

A competitive advantage is a clear performance differential over the competition on factors that are important to customers.

Competitor actions have a direct effect on the profitability of a business. These may include:

1. Price cuts
2. Launching a rival product
3. Aggressive expansion of production to increase market share
4. Inclusion of significant (possibly costly) modifications to a product which other competitors must also undertake

The diagram below shows the impact of varying levels of competitor action on the profits of a business:
A product is defined as: "Anything that is capable of satisfying customer needs"

This definition includes both physical products (e.g. cars, washing machines, DVD players) as well as services (e.g. insurance, banking, private health care). The process by which companies distinguish their product offerings from the competition is called branding.

For most companies, brands are not developed in isolation - they are part of a product group. A product group (or product line) is a group of brands that are closely related in terms of their functions and the benefits they provide (e.g. Dell’s range of personal computers or Sony’s range of televisions).

There are two main types of product brand:

1. **Manufacturer brands**
   Manufacturer brands are created by producers and use their chosen brand name. The producer has the responsibility for marketing the brand, by building distribution and gaining customer brand loyalty. Good examples include Microsoft, Panasonic and Mercedes.

2. **Own-label brands**
   Own-label brands are created and owned by distributors. Good examples include Tesco and Sainsbury’s.

The main importance of branding is that, done well, it permits a business to differentiate its products, adding extra value for consumers who value the brand, and improving profitability for the company.

Businesses should manage their products carefully over time to ensure that they deliver products that continue to meet customer wants. The process of managing groups of brands and product lines is called portfolio planning.

Two models of product portfolio planning are widely known and used in business:
- The Boston Group Growth-Share Matrix, and
- GE Market Attractiveness model

Businesses need to regularly look for new products and markets for future growth. A useful way of looking at growth opportunities is the Ansoff Growth matrix which suggests that there are four main ways in which growth can be achieved through a product strategy:

1. **Market penetration** - Increase sales of an existing product in an existing market
2. **Product development** - Improve present products and/or develop new products for the current market
3. **Market development** - Sell existing products into new markets (e.g. developing export sales)
4. **Diversification** - Develop new products for new markets

The stages through which individual products develop over time is called commonly known as the "Product Life Cycle".

The classic product life cycle has four stages (illustrated in the diagram below): introduction; growth; maturity and decline.
Introduction Stage
At the Introduction (or development) Stage market size and growth is slight, it is possible that substantial research and development costs have been incurred in getting the product to this stage. In addition, marketing costs may be high in order to test the market, undergo launch promotion and set up distribution channels. It is highly unlikely that companies will make profits on products at the Introduction Stage. Products at this stage have to be carefully monitored to ensure that they start to grow. Otherwise, the best option may be to withdraw or end the product.

Growth Stage
The Growth Stage is characterised by rapid growth in sales and profits. Profits arise due to an increase in output (economies of scale) and possibly better prices. At this stage, it is cheaper for businesses to invest in increasing their market share as well as enjoying the overall growth of the market. Accordingly, significant promotional resources are traditionally invested in products that are firmly in the Growth Stage.

Maturity Stage
The Maturity Stage is, perhaps, the most common stage for all markets. it is in this stage that competition is most intense as companies fight to maintain their market share. Here, both marketing and finance become key activities. Marketing spend has to be monitored carefully, since any significant moves are likely to be copied by competitors. The Maturity Stage is the time when most profit is earned by the market as a whole. Any expenditure on research and development is likely to be restricted to product modification and improvement and perhaps to improve production efficiency and quality.

Decline Stage
In the Decline Stage, the market is shrinking, reducing the overall amount of profit that can be shared amongst the remaining competitors. At this stage, great care has to be taken to manage the product carefully. It may be possible to take out some production cost, to transfer production to a cheaper facility, sell the product into other, cheaper markets. Care should be taken to control the amount of stocks of the product. Ultimately, depending on whether the product remains profitable, a company may decide to end the product.

Examples
Set out below are some suggested examples of products that are currently at different stages of the product life-cycle:

<table>
<thead>
<tr>
<th>INTRODUCTION</th>
<th>GROWTH</th>
<th>MATURITY</th>
<th>DECLINE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Third generation mobile phones</td>
<td>Portable DVD Players</td>
<td>Personal Computers</td>
<td>Typewriters</td>
</tr>
<tr>
<td>E-conferencing</td>
<td>Email</td>
<td>Faxes</td>
<td>Handwritten letters</td>
</tr>
<tr>
<td>All-in-one racing skin-suits</td>
<td>Breathable synthetic fabrics</td>
<td>Cotton t-shirts</td>
<td>Shell Suits</td>
</tr>
<tr>
<td>iris-based personal identity cards</td>
<td>Smart cards</td>
<td>Credit cards</td>
<td>Cheque books</td>
</tr>
</tbody>
</table>

Ansoff’s Product / Market Matrix

The Ansoff Growth matrix is a tool that helps businesses decide their product and market growth strategy.
Ansoff’s product/market growth matrix suggests that a business’ attempts to grow depend on whether it markets new or existing products in new or existing markets.

The output from the Ansoff product/market matrix is a series of suggested growth strategies that set the direction for the business strategy. These are described below:

### Market penetration

Market penetration is the name given to a growth strategy where the business focuses on selling existing products into existing markets.

Market penetration seeks to achieve four main objectives:

- **Maintain or increase the market share of current products** – this can be achieved by a combination of competitive pricing strategies, advertising, sales promotion and perhaps more resources dedicated to personal selling
- **Secure dominance of growth markets**
- **Restructure a mature market by driving out competitors**; this would require a much more aggressive promotional campaign, supported by a pricing strategy designed to make the market unattractive for competitors
- **Increase usage by existing customers** – for example by introducing loyalty schemes

A market penetration marketing strategy is very much about “business as usual”. The business is focusing on markets and products it knows well. It is likely to have good information on competitors and on customer needs. It is unlikely, therefore, that this strategy will require much investment in new market research.

### Market development

Market development is the name given to a growth strategy where the business seeks to sell its existing products into new markets.

There are many possible ways of approaching this strategy, including:

- New geographical markets; for example exporting the product to a new country
- New product dimensions or packaging: for example
- New distribution channels
- Different pricing policies to attract different customers or create new market segments

### Product development

Product development is the name given to a growth strategy where a business aims to introduce new products into existing markets. This strategy may require the development of new competencies and requires the business to develop modified products which can appeal to existing markets.

### Diversification

Diversification is the name given to the growth strategy where a business markets new products in new markets.

This is an inherently more risk strategy because the business is moving into markets in which it has little or no experience.

For a business to adopt a diversification strategy, therefore, it must have a clear idea about what it expects to gain from the strategy and an honest assessment of the risks.

### The Boston Consulting Group Box (BCG Box)

The business portfolio is the collection of businesses and products that make up the company. The best business portfolio is one that fits the company’s strengths and helps exploit the most attractive opportunities.
The company must:
- Analyse its current business portfolio and decide which businesses should receive more or less investment, and
- Develop growth strategies for adding new products and businesses to the portfolio, whilst at the same time deciding when products and businesses should no longer be retained.

Methods of Portfolio Planning
The two best-known portfolio planning methods are from the Boston Consulting Group (the subject of this revision note) and by General Electric/Shell. In each method, the first step is to identify the various Strategic Business Units ("SBUs") in a company portfolio. An SBU is a unit of the company that has a separate mission and objectives and that can be planned independently from the other businesses. An SBU can be a company division, a product line or even individual brands - it all depends on how the company is organised.

Using the BCG Box a company classifies all its SBUs according to two dimensions:

**On the horizontal axis**: relative market share - this serves as a measure of SBU strength in the market
**On the vertical axis**: market growth rate - this provides a measure of market attractiveness

By dividing the matrix into four areas, four types of SBU can be distinguished:

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**Stars** - Stars are high growth businesses or products competing in markets where they are relatively strong compared with the competition. Often they need heavy investment to sustain their growth. Eventually their growth will slow and, assuming they maintain their relative market share, will become cash cows.

**Cash Cows** - Cash cows are low-growth businesses or products with a relatively high market share. These are mature, successful businesses with relatively little need for investment. They need to be managed for continued profit - so that they continue to generate the strong cash flows that the company needs for its Stars.

**Question marks** - Question marks are businesses or products with low market share but which operate in higher growth markets. This suggests that they have potential, but may require substantial investment in order to grow market share at the expense of more powerful competitors. Management have to think hard about "question marks" - which ones should they invest in? Which ones should they allow to fail or shrink?

**Dogs** - Unsurprisingly, the term "dogs" refers to businesses or products that have low relative share in unattractive, low-growth markets. Dogs may generate enough cash to break-even, but they are rarely, if ever, worth investing in.

Using the BCG Box to determine strategy
Once a company has classified its SBUs, it must decide what to do with them. In the diagram above, the company has one large cash cow (the size of the circle is proportional to the SBU’s sales), a large dog and two, smaller stars and question marks.

Conventional strategic thinking suggests there are four possible strategies for each SBU:

1. **Build Share**: here the company can invest to increase market share (for example turning a "question mark" into a star)

2. **Hold**: here the company invests just enough to keep the SBU in its present position

3. **Harvest**: here the company reduces the amount of investment in order to maximise the short-term cash flows and profits from the SBU. This may have the effect of turning Stars into Cash Cows.

4. **Divest**: the company can divest the SBU by phasing it out or selling it - in order to use the resources elsewhere (e.g. investing in the more promising "question marks").
Brands

Take a look at the list below that shows the world’s top 10 brands in 2002 (as measured by value): Rank Brand & Value ($ billions))

1. Coca-Cola ($69.6)
2. Microsoft ($64.1)
3. IBM ($51.2)
4. GE ($41.3)
5. Intel ($30.9)
6. Nokia ($30.0)
7. Disney ($29.3)
8. McDonalds ($26.4)
9. Marlboro ($24.2)
10. Mercedes ($21.0)

[Source: Interbrand; JP Morgan Chase, 2002]

Why do companies such as Coca-Cola, Microsoft, IBM and Disney seem to achieve global marketing success so easily? Why does it seem such an effort for others? Why do we, as consumers, feel loyal to such brands that the mere sight of their logo has us reaching into our pockets to buy their products?

The meaning of brands

Brands are a means of differentiating a company’s products and services from those of its competitors.

There is plenty of evidence to prove that customers will pay a substantial price premium for a good brand and remain loyal to that brand. It is important, therefore, to understand what brands are and why they are important.

Macdonald sums this up nicely in the following quote emphasising the importance of brands:

“...it is not factories that make profits, but relationships with customers, and it is company and brand names which secure those relationships”

Businesses that invest in and sustain leading brands prosper whereas those that fail are left to fight for the lower profits available in commodity markets.

What is a brand?

One definition of a brand is as follows:

“A name, term, sign, symbol or design, or a combination of these, that is intended to identify the goods and services of one business or group of businesses and to differentiate them from
those of competitors”.

Interbrand - a leading branding consultancy - define a brand in this way:
“A mixture of tangible and intangible attributes symbolised in a trademark, which, if properly managed, creates influence and generates value”.

Three other important terms relating to brands should be defined at this stage:

**Brand equity**

‘Brand equity’ refers to the value of a brand. Brand equity is based on the extent to which the brand has high brand loyalty, name awareness, perceived quality and strong product associations. Brand equity also includes other “intangible” assets such as patents, trademarks and channel relationships.

**Brand image**

‘Brand image’ refers to the set of beliefs that customers hold about a particular brand. These are important to develop well since a negative brand image can be very difficult to shake off.

**Brand extension**

‘Brand extension” refers to the use of a successful brand name to launch a new or modified product in a new market. Virgin is perhaps the best example of how brand extension can be applied into quite diverse and distinct markets.

**Brands and products**

Brands are rarely developed in isolation. They normally fall within a business’ product line or product group.

A **product line** is a group of brands that are closely related in terms of their functions and the benefits they provide. A good example would be the range of desktop and laptop computers manufactured by Dell.

A **product mix** relates to the total set of brands marketed by a business. A product mix could, therefore, contain several or many product lines. The width of the product mix can be measured by the number of product lines that a business offers.

For a good example, visit the web site of Hewlett-Packard (“HP”). HP has a broad product mix that covers many segments of the personal and business computing market. How many separate product lines can you spot from their web site?

Managing brands is a key part of the product strategy of any business, particularly those operating in highly competitive consumer markets.

**Names**

How should brand names be chosen? Is the name important?

Marketing theory suggests that there are three main types of brand name:

1. **Family brand names:**

A family brand name is used for all products. By building customer trust and loyalty to the family brand name, all products that use the brand can benefit.

Good examples include brands in the food industry, including Kellogg’s, Heinz and Del Monte. Of course, the use of a family brand can also create problems if one of the products gets bad publicity or is a failure in a market. This can damage the reputation of a whole range of brands.

2. **Individual brand names:**

An individual brand name does not identify a brand with a particular company.

For example, take the case of Heinz. Heinz is a leading global food manufacturer with a very strong family brand. However, it also operates many well-known individual brand names. Examples include Farleys (baby food), Linda MacCartney Foods (vegetarian meals) and Weight Watcher’s Foods (diet/slimming meals and supplements).

Why does Heinz use individual brand names when it has such a strong family brand name? There are several reasons why a brand needs a separate identity – unrelated to the family brand name:
• The product may be competing in a new market segment where failure could harm the main family brand name.
• The family brand name may be positioned inappropriately for the target market segment. For example, the family brand name might be positioned as an upmarket brand for affluent consumers.
• The brand may have been acquired; in other words it has already established itself as a leading brand in the market segment. The fact that it has been acquired by a company with a strong family brand name does not mean that the acquired brand has to be changed.

(3) Combination brand names:
A combination brand name brings together a family brand name and an individual brand name. The idea here is to provide some association for the product with a strong family brand name but maintaining some distinctiveness so that customers know what they are getting.
Examples of combination brand names include Microsoft XP and Microsoft Office in personal computing software and Heinz Tomato Ketchup and Heinz Pet Foods.

What are the features of a good brand name?
Brand names should be chosen carefully since the name conveys a lot of information to a customer. The following list contains considerations that should be made before making a final choice of brand name: A good brand name should:
- Evoke positive associations
- Be easy to pronounce and remember
- Suggest product benefits
- Be distinctive
- Use numerals when emphasizing technological features
- Not infringe existing registered brand names

Building a brand

What factors are important in building brand value?
Professor David Jobber identifies seven main factors in building successful brands as illustrated

1. Quality
   - Quality is a vital ingredient of a good brand. Remember the “core benefits” – the things consumers expect. These must be delivered well, consistently. The branded washing machine that leaks, or the training shoe that often falls apart when wet will never develop brand equity.
   - Research confirms that, statistically, higher quality brands achieve a higher market share and higher profitability that their inferior competitors.

2. Positioning
   - Positioning is about the position a brand occupies in a market in the minds of consumers. Strong brands have a clear, often unique position in the target market.
   - Positioning can be achieved through several means, including brand name, image, service standards, product guarantees, packaging and the way in which it is delivered. In fact, successful positioning usually requires a combination of these things.

3. Repositioning
   - Repositioning occurs when a brand tries to change its market position to reflect a change in consumer’s tastes. This is often required when a brand has become tired, perhaps because its original market has matured or has gone into decline.
   - The repositioning of the Lucozade brand from a sweet drink for children to a leading sports drink is one example. Another would be the changing styles of entertainers with above-average longevity such as Kylie Minogue and Cliff Richard.

4. Communications
   - Communications also play a key role in building a successful brand. We suggested that brand positioning is essentially about customer perceptions – with the objective to build a clearly defined position in the minds of the target audience.
   - All elements of the promotional mix need to be used to develop and sustain customer perceptions. Initially, the challenge is to build awareness, then to develop the brand personality and reinforce the perception.
5. First-mover advantage
   - Business strategists often talk about first-mover advantage. In terms of brand development, by “first-mover” they mean that it is possible for the first successful brand in a market to create a clear positioning in the minds of target customers before the competition enters the market. There is plenty of evidence to support this.
   - Think of some leading consumer product brands like Gillette, Coca Cola and Sellotape that, in many ways, defined the markets they operate in and continue to lead. However, being first into a market does not necessarily guarantee long-term success. Competitors – drawn to the high growth and profit potential demonstrated by the “market-mover” – will enter the market and copy the best elements of the leader’s brand (a good example is the way that Body Shop developed the “ethical” personal care market but were soon facing stiff competition from the major high street cosmetics retailers.

6. Long-term perspective
   - This leads onto another important factor in brand-building: the need to invest in the brand over the long-term. Building customer awareness, communicating the brand’s message and creating customer loyalty takes time. This means that management must “invest” in a brand, perhaps at the expense of short-term profitability.

7. Internal marketing
   - Finally, management should ensure that the brand is marketed “internally” as well as externally. By this we mean that the whole business should understand the brand values and positioning. This is particularly important in service businesses where a critical part of the brand value is the type and quality of service that a customer receives.
   - Think of the brands that you value in the restaurant, hotel and retail sectors. It is likely that your favourite brands invest heavily in staff training so that the face-to-face contact that you have with the brand helps secure your loyalty.

**Brand Extension And Stretching**

Marketers have long recognised that strong brand names that deliver higher sales and profits (i.e. those that have brand equity) have the potential to work their magic on other products.

The two options for doing this are usually called “brand extension” and “brand stretching”.

**Brand extension**

Brand extension refers to the use of a successful brand name to launch a new or modified product in a same broad market.

A successful brand helps a company enter new product categories more easily.

For example, Fairy (owned by Unilever) was extended from a washing up liquid brand to become a washing powder brand too.

The Lucozade brand has undergone a very successful brand extension from children’s health drink to an energy drink and sports drink.

**Brand stretching**

Brand stretching refers to the use of an established brand name for products in unrelated markets.

For example the move by Yamaha (originally a Japanese manufacturer of motorbikes) into branded hi-fi equipment, pianos and sports equipment.

When done successfully, brand extension can have several advantages:
- Distributors may perceive there is less risk with a new product if it carries a familiar brand name. If a new food product carries the Heinz brand, it is likely that customers will buy it.
- Customers will associate the quality of the established brand name with the new product. They will be more likely to trust the new product.
- The new product will attract quicker customer awareness and willingness to trial or sample the product.
- Promotional launch costs (particularly advertising) are likely to be substantially lower.

**Brand Positioning**
As we have argued in our other revision notes on branding, it is the “added value” or augmented elements that determine a brand’s positioning in the market place.

Positioning can be defined as follows:

**Positioning is how a product appears in relation to other products in the market**

Brands can be positioned against competing brands on a perceptual map.

A perceptual map defines the market in terms of the way buyers perceive key characteristics of competing products.

The basic perceptual map that buyers use maps products in terms of their price and quality, as illustrated below:

<table>
<thead>
<tr>
<th>Low Price</th>
<th>High Quality</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Economy Brands</strong></td>
<td><strong>Bargain Brands</strong></td>
</tr>
<tr>
<td><strong>Cowboy Brands</strong></td>
<td><strong>Premium Brands</strong></td>
</tr>
</tbody>
</table>

**Types**

There are two main types of brand – manufacturer brands and own-label brands.

**Manufacturer brands**

Manufacturer brands are created by producers and bear their chosen brand name. The producer is responsible for marketing the brand. The brand is owned by the producer. By building their brand names, manufacturers can gain widespread distribution (for example by retailers who want to sell the brand) and build customer loyalty (think about the manufacturer brands that you feel “loyal” to).

**Own label brands**

Own-label brands are created and owned by businesses that operate in the distribution channel – often referred to as “distributors”. Often these distributors are retailers, but not exclusively. Sometimes the retailer’s entire product range will be own-label. However, more often, the distributor will mix own-label and manufacturers brands. The major supermarkets (e.g. Tesco, Asda, Sainsbury’s) are excellent examples of this. Own-label branding – if well carried out – can often offer the consumer excellent value for money and provide the distributor with additional bargaining power when it comes to negotiating prices and terms with manufacturer brands.

**Why should businesses try to build their brands?**

- Higher prices
- Higher profit margins
- Better distribution
- Customer loyalty

Businesses that operate successful brands are also much more likely to enjoy higher profits. A brand is created by augmenting a core product with distinctive values that distinguish it from the competition. This is the process of creating brand value.

All products have a series of “core benefits” [benefits that are delivered to all consumers]. For example:
- Watches tell the time
• CD-players play CD's
• Toothpaste helps prevent tooth decay
• Garages dispense petrol.

Consumers are rarely prepared to pay a premium for products or services that simply deliver core benefits – they are the expected elements of that justify a core price.

Successful brands are those that deliver added value in addition to the core benefits. These added values enable the brand to differentiate itself from the competition. When done well, the customer recognises the added value in an augmented product and chooses that brand in preference.

For example, a consumer may be looking for reassurance or a guarantee of quality in a situation where he or she is unsure about what to buy. A brand like Mercedes, Sony or Microsoft can offer this reassurance or guarantee.

Alternatively, the consumer may be looking for the brand to add meaning to his or her life in terms of lifestyle or personal image. Brands such as Nike, Porsche or Timberland do this.

A brand can usefully be represented in the classic “fried-egg” format shown below, where the brand is shown to have core features that are surrounded (or “augmented”) by less tangible features.
Setting the right price is an important part of effective marketing. It is the only part of the marketing mix that generates revenue (product, promotion and place are all about marketing costs).

Price is also the marketing variable that can be changed most quickly, perhaps in response to a competitor price change.

Put simply, price is the amount of money or goods for which a thing is bought or sold.

The price of a product may be seen as a financial expression of the value of that product. For a consumer, price is the monetary expression of the value to be enjoyed/benefits of purchasing a product, as compared with other available items.

The concept of value can therefore be expressed as:

\[
\text{(perceived) VALUE} = \text{(perceived) BENEFITS} - \text{(perceived) COSTS}
\]

A customer’s motivation to purchase a product comes firstly from a need and a want: e.g.
- Need: “I need to eat
- Want: I would like to go out for a meal tonight”

The second motivation comes from a perception of the value of a product in satisfying that need/want (e.g. “I really fancy a McDonalds”).

The perception of the value of a product varies from customer to customer, because perceptions of benefits and costs vary.

Perceived benefits are often largely dependent on personal taste (e.g. spicy versus sweet, or green versus blue). In order to obtain the maximum possible value from the available market, businesses try to ‘segment’ the market – that is to divide up the market into groups of consumers whose preferences are broadly similar – and to adapt their products to attract these customers.

In general, a product’s perceived value may be increased in one of two ways – either by:
1. Increasing the benefits that the product will deliver, or,
2. Reducing the cost.

For consumers, the PRICE of a product is the most obvious indicator of cost - hence the need to get product pricing right.

Factors affecting demand

A): Within the control of a business and

- Price (assuming an imperfect market – i.e. not perfect competition)
- Product research and development
- Advertising & sales promotion
- Training and organisation of the sales force
- Effectiveness of distribution (e.g. access to retail outlets; trained distributor agents)
- Quality of after-sales service (e.g. which affects demand from repeat-business)

B): Outside the control of business include:

- The price of substitute goods and services
- The price of complementary goods and services
- Consumers’ disposable income
- Consumer tastes and fashions

Price is, therefore, a critically important element of the choices available to businesses in trying to attract demand for their products.

Link Between Price And Business Objectives
Pricing objectives of businesses are generally related to satisfying 1 of 5 common strategic objectives:

**Objective 1: To Maximise Profits**
Although the ‘maximisation of profits’ can have negative connotations for ‘the public’, in economic theory, one function of ‘profit’ is to attract new entrants to the market and the additional suppliers keep prices at a reasonable level. By seeking to differentiate their product from those of other suppliers, new entrants also expand the choice to consumers, and may vary prices as niche markets develop.

**Objective 2: To Meet a Specific Target Return on Investment (or on net sales)**
Assuming a standard volume operation (i.e. production and sales) target pricing is concerned with determining the necessary mark-up (on cost) per unit sold, to achieve the overall target profit goal. Target return pricing is effective as an overall performance measure of the entire product line, but for individual items within the line, certain strategic pricing considerations may require the raising or lowering of the standard price.

**Objective 3: To Achieve a Target Sales Level**
Many businesses measure their success in terms of overall revenues. This is often a proxy for market share. Pricing strategies with this objective in mind usually focus on setting price that maximises the volumes sold.

**Objective 4: To Maintain or Enhance Market Share**
As an organisational goal, the achievement of a desired share of the market is generally linked to increased profitability. An offensive market share strategy involves attaining increased market share, by lowering prices in the short term. This can lead to increased sales, which in the longer term can lead to lower costs (through benefits of scale and experience) and ultimately to higher prices due to increased volume-market share.

**Objective 5: To Meet or Prevent Competition**
Prices are set at a level that reflects the average industry price, with small adjustments made for unique features of the company’s specific product(s). Firms that adopt this objective must work ‘backwards’ from price and tailor costs to enable the desired margin to be delivered.

**Influences On Pricing Policy**

Factors that businesses must consider in determining pricing policy can be summarised in four categories:

(1) **Costs**
In order to make a profit, a business should ensure that its products are priced above their total average cost. In the short-term, it may be acceptable to price below total cost if this price exceeds the marginal cost of production – so that the sale still produces a positive contribution to fixed costs.

(2) **Competitors**
If the business is a monopolist, then it can set any price. At the other extreme, if a firm operates under conditions of perfect competition, it has no choice and must accept the market price. The reality is usually somewhere in between. In such cases the chosen price needs to be very carefully considered relative to those of close competitors.

(3) **Customers**
Consideration of customer expectations about price must be addressed. Ideally, a business should attempt to quantify its demand curve to estimate what volume of sales will be achieved at given prices.

(4) **Business Objectives**
Possible pricing objectives include:
- To maximise profits
- To achieve a target return on investment
- To achieve a target sales figure
- To achieve a target market share
- To match the competition, rather than lead the market
Full Cost Plus Pricing

Full cost plus pricing seeks to set a price that takes into account all relevant costs of production. This could be calculated as follows:

Total budgeted factory cost + selling / distribution costs + other overheads + MARK UP ON COST
Budgeted sales volumes

An illustration of applying this method is set out below:
Consider a business with the following costs and volumes for a single product:

<table>
<thead>
<tr>
<th>Fixed costs:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Factory production costs</td>
<td>£750,000</td>
</tr>
<tr>
<td>Research and development</td>
<td>£250,000</td>
</tr>
<tr>
<td>Fixed selling costs</td>
<td>£550,000</td>
</tr>
<tr>
<td>Administration and other overheads</td>
<td>£325,000</td>
</tr>
<tr>
<td>Total fixed costs</td>
<td>£1,625,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Variable costs</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable cost per unit</td>
<td>£8.00</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Mark-Up</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Mark-up % required</td>
<td>35%</td>
</tr>
<tr>
<td>Budgeted sale volumes (units)</td>
<td>500,000</td>
</tr>
</tbody>
</table>

What should the selling price be on a full cost plus basis?

The total costs of production can be calculated as follows:

| Total fixed costs       | £1,625,000 |
| Total variable costs (£8.00 x 500,000 units) | £4,000,000 |
| Total costs             | £5,625,000 |
| Mark up required on cost (£5,625,000 x 35%) | £1,968,750 |
| Total costs (including mark up) | £7,593,750 |
| Divided by budgeted production (500,000 units) |       |

= Selling price per unit £15.19

advantages of using cost plus pricing are:
- Easy to calculate
- Price increases can be justified when costs rise
- Price stability may arise if competitors take the same approach (and if they have similar costs)
- Pricing decisions can be made at a relatively junior level in a business based on formulas

The main disadvantages of cost plus pricing are often considered to be:
- This method ignores the concept of price elasticity of demand - it may be possible for the business to charge a higher (or lower) price to maximise profits depending on the responsiveness of customers to a change in price
- The business has less incentive to cut or control costs - if costs increase, then selling prices increase. However, this might be making an "inefficient" business uncompetitive relative to competitor pricing;
- It requires an estimate and apportionment of business overheads. For example, total factory overheads need to be calculated and then allocated in some way against individual products. This allocation is always arbitrary.
- If applied strictly, a full cost plus pricing method may leave a business in a vicious circle. For example, if budgeted costs are over-estimated, selling prices may be set too high. This in turn may lead to lower demand (if the price is set above the level that customers will accept), higher costs (e.g. surplus stock) and lower profits. When the pricing decision is made for the next year, the problem may be exacerbated and repeated.

Amongst the factors that influence the choice of the mark-up percentage are as follows:
- **Nature of the market** - a mark-up should reflect the degree of competition in the market (what do the close competitors do?)
- **Bulk discounts** - should volume orders attract a lower mark-up than a single order?
- **Pricing strategy** - e.g. skimming, penetration (see more on pricing strategies further below)
  - **Stage of the product in its life cycle**: products at the earlier stages of the life cycle may need
a lower mark-up percentage to help establish demand.

**Return On Investment Method**

The "return on investment" pricing method determines the price of a product based on the target return on the **amount invested** in a product:

The calculation is as follows:

<table>
<thead>
<tr>
<th>Unit Price</th>
<th>Total costs (fixed and variable) + (% return x Investment)</th>
<th>Budgeted sales volume</th>
</tr>
</thead>
</table>

This calculation can be illustrated using the following example:

Willowbrook Limited has developed a new product called the "Eternal Flame" - a methane-powered heater for use in industrial buildings. Willowbrook requires a return on invested capital of 25% per annum. The sales price for the Eternal Flame should be set using a target return on investment method. The following additional information has been provided:

- **Budgeted sales volume**: 25,000 units
- **Variable production cost per unit**: £45
- **Fixed production cost per unit**: £25
- **Other annual fixed costs (overheads etc.)**: £550,000
- **Investment in new machinery to produce the Eternal Flame**: £350,000
- **Period over which investment in new machinery to be written off**: 4 years
- **Research and development costs for the Eternal Flame**: £225,000

The total investment in the Eternal Flame is (New machinery + R&D costs) £575,000. The required annual profit = £575,000 x 25% = £143,750.

Total annual costs can be calculated as follows:

- **Production costs per unit (£45 + £25) x 25,000 units**: £1,750,000
- **Annual depreciation on new machinery (£350,000 / 4)**: £87,500
- **Other annual fixed costs**: £550,000
- **Total annual costs**: £2,387,500

Total required annual revenue = total annual costs + required annual profit = £2,531,250. Unit price (total required revenue / budgeted sales volume) = £101.25.

The use of a targeted return on investment to determine price has the following **advantages**:
- Consistent with other performance measures - e.g. Return on Investment
- A suitable method for market leaders which are able to set a price which competitors follow
- A relevant pricing method for new products - particularly those which have a substantial investment.

The method does, however, have some **disadvantages**:
- With new products, there is an inherent uncertainty about what the achieved sales volume will be - which in turn will be influenced by the price chosen
- Some investment may be common to several products or product groups (e.g. an extension to a factory; investment in new development facilities). This raises the question of how to apportion investment amongst products.

**Expansionistic Pricing**

Expansionistic pricing is a more exaggerated form of penetration pricing and involves setting very low prices aimed at establishing mass markets, possibly at the expense of other suppliers.

Under this strategy, the product enjoys a high price elasticity of demand so that the adoption of a low price leads to significant increases in sales volumes.
Expansionistic pricing strategies may be used by companies attempting to enter new or international markets for their products. Lower-cost version of a product may be offered at a very low price to gain recognition and acceptance by consumers. Once acceptance has been achieved more expensive versions or models of the offering can be made available at higher prices.

The extreme case of expansionistic pricing, where offerings are made available to the (overseas) market at a price that is actually less than the cost of production is known as dumping. This practice is closely scrutinised by governments since it can force domestic producers out of business and many countries have enacted anti-dumping legislation.

Markets that might benefit from expansionistic pricing strategies include those of magazine and newspaper publishers. Where low prices (annual subscription rates) attract a large number of subscribers, publishers can benefit from the higher rates that they are able to charge advertisers for their advertising ‘space’. Book and CD ‘clubs’ also use expansionistic to attract new members.

Other Pricing Strategies

Prestige pricing
Prestige pricing refers to the practice of setting a high price for a product, throughout its entire life cycle – as opposed to the short term ‘opportunistic’, high price of price ‘skimming’. This is done in order to evoke perceptions of quality and prestige with the product or service.

For products for which prestige pricing may apply, the high price is itself an important motivation for consumers. As incomes rise and consumers become less price sensitive, the concepts of ‘quality’ and ‘prestige’ can often assume greater importance as purchasing motivators. Thus advertisements and promotional strategies focus attention on these aspects of a product, and, not only can a ‘prestige’ price be sustained, it also becomes self-sustaining.

Pre-emptive pricing
Pre-emptive pricing is a strategy which involves setting low prices in order to discourage or deter potential new entrants to the suppliers market, and is especially suited to markets in which the supplier does not hold a patent, or other market privilege and entry to the market is relatively straightforward.

By deterring other entrants to the market, a supplier has time to
Refine/develop the product
Gain market share
Reduce costs of production (through sales/ experience effects)
Acquire name/brand recognition, as the ‘original’ supplier

Extinction pricing
Extinction pricing has the overall objective of eliminating competition, and involves setting very low prices in the short term in order to ‘under-cut’ competition, or alternatively repel potential new entrants.

The extinction price may, in the short term, be set at a level lower even than the suppliers own cost of production, but once competition has been extinguished, prices are raised to profitable levels. Only firms dominant in the market, and in a strong financial position will be able survive the short-term losses associated with extinction pricing strategies, and benefit in the longer term.

The strategy of extinction pricing can be used selectively by firms who can apply it either to limited geographical markets (making up any losses by increasing prices in other geographical markets), or to certain product ‘lines’. In the latter case, the low price of a product at one end of the product range might attract new purchasers to the product line, and sales of different, more profitable items might increase.

Penetration Pricing

Penetration pricing involves the setting of lower, rather than higher prices in order to achieve a large, if not dominant market share.
This strategy is most often used businesses wishing to enter a new market or build on a relatively small market share.
This will only be possible where demand for the product is believed to be highly elastic, i.e. demand is
price-sensitive and either new buyers will be attracted, or existing buyers will buy more of the product as a result of a low price.

A successful penetration pricing strategy may lead to large sales volumes/market shares and therefore lower costs per unit. The effects of economies of both scale and experience lead to lower production costs, which justify the use of penetration pricing strategies to gain market share. Penetration strategies are often used by businesses that need to use up spare resources (e.g. factory capacity). A penetration pricing strategy may also promote complimentary and captive products. The main product may be priced with a low mark-up to attract sales (it may even be a loss-leader). Customers are then sold accessories (which often only fit the manufacturer’s main product) which are sold at higher mark-ups.

Before implementing a penetration pricing strategy, a supplier must be certain that it has the production and distribution capabilities to meet the anticipated increase in demand. The most obvious potential disadvantage of implementing a penetration pricing strategy is the likelihood of competing suppliers following suit by reducing their prices also, thus nullifying any advantage of the reduced price (if prices are sufficiently differentiated the impact of this disadvantage may be diminished).

A second potential disadvantage is the impact of the reduced price on the image of the offering, particularly where buyers associate price with quality.

**Skimming**

The practice of ‘price skimming’ involves charging a relatively high price for a short time where a new, innovative, or much-improved product is launched onto a market. The objective with skimming is to “skim” off customers who are willing to pay more to have the product sooner; prices are lowered later when demand from the “early adopters” falls.

The success of a price-skimming strategy is largely dependent on the inelasticity of demand for the product either by the market as a whole, or by certain market segments. High prices can be enjoyed in the short term where demand is relatively inelastic. In the short term the supplier benefits from ‘monopoly profits’, but as profitability increases, competing suppliers are likely to be attracted to the market (depending on the barriers to entry in the market) and the price will fall as competition increases.

The main objective of employing a price-skimming strategy is, therefore, to benefit from high short-term profits (due to the newness of the product) and from effective market segmentation.

There are several advantages of price skimming

- Where a highly innovative product is launched, research and development costs are likely to be high, as are the costs of introducing the product to the market via promotion, advertising etc. In such cases, the practice of price-skimming allows for some return on the set-up costs
- By charging high prices initially, a company can build a high-quality image for its product. Charging initial high prices allows the firm the luxury of reducing them when the threat of competition arrives. By contrast, a lower initial price would be difficult to increase without risking the loss of sales volume
- Skimming can be an effective strategy in segmenting the market. A firm can divide the market into a number of segments and reduce the price at different stages in each, thus acquiring maximum profit from each segment
- Where a product is distributed via dealers, the practice of price-skimming is very popular, since high prices for the supplier are translated into high mark-ups for the dealer
- For ‘conspicuous’ or ‘prestige goods’, the practice of price skimming can be particularly successful, since the buyer tends to be more ‘prestige’ conscious than price conscious. Similarly, where the quality differences between competing brands is perceived to be large, or for offerings where such differences are not easily judged, the skimming strategy can work well. An example of the latter would be for the manufacturers of ‘designer-label’ clothing.

**Variable Or Marginal Cost Pricing**

With variable (or marginal cost) pricing, a price is set in relation to the variable costs of production (i.e. ignoring fixed costs and overheads). The objective is to achieve a desired “contribution” towards fixed costs and profit.
Contribution per unit can be defined as: SELLING PRICE less VARIABLE COSTS

Total contribution can be calculated as follows:

Contribution per unit v Sales Volume
The resulting profit in a business is, therefore:

Total Contribution less Total Fixed Costs
The break even level of sales can be calculated using this information as follows:

Break even volume = Total Fixed Costs / Contribution per Unit

Consider a business with the following costs and volumes for a single product:

<table>
<thead>
<tr>
<th>Fixed costs:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Factory production costs</td>
<td>£750,000</td>
</tr>
<tr>
<td>Research and development</td>
<td>£250,000</td>
</tr>
<tr>
<td>Fixed selling costs</td>
<td>£550,000</td>
</tr>
<tr>
<td>Administration and other overheads</td>
<td>£325,000</td>
</tr>
<tr>
<td>Total fixed costs</td>
<td>£1,625,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Variable costs</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable cost per unit</td>
<td>£8.00</td>
</tr>
</tbody>
</table>

Mark-Up

| Mark-up % required | 35% |

| Budgeted sale volumes (units)      | 500,000 |

Prices are set using variable costing by determining a target contribution per unit. This reflects:
• Variable costs per unit
• Total fixed costs
• The desired level of target profit (i.e. contribution less fixed costs)

The variable/marginal costing method can be illustrated using the same data used further above:

- Assume that the selling price per unit is £12
- Variable costs per unit are £8
- The contribution per unit is, therefore, £4 (£12 less £8)

What is the break even volume for the business?

- Total fixed costs are £1,625,000
- To achieve break-even, therefore, the business needs to sell at least 406,250 units (each of which produces a contribution of £4)

Looked at another way, what would be the required sales volume to generate a profit of £250,000?

- Total contribution required = total fixed costs + required profit
- Total contribution = £1,625,000 + £250,000 = £1,875,000
- Contribution per unit = £4
- Sales volume required therefore = 468,750 (£1,875,000 / £4)

The advantages of using a variable/marginal costing method for pricing include the following:

- Good for short-term decision-making;
- Avoids having to make an arbitrary allocation of fixed costs and overheads;
- Focuses the business on what is required to achieve break-even

However, there are some potential disadvantages of using this method:

- There is a risk that the price set will not recover total fixed costs in the long term. Ultimately businesses must price their products that reflects the total costs of the business;
- It may be difficult to raise prices if the contribution per unit is set too low
Promotion

It is not enough to have good products sold at attractive prices. To generate sales and profits, the benefits of products have to be communicated to customers.

Promotion is, therefore, about companies communicating with customers.

A business' total marketing communications programme is called the promotional mix and consists of a blend of:

- Advertising
- Direct marketing
- Personal selling
- Sales promotion
- Public relations tools

Promotion has several possible objectives and many pieces of marketing promotion aim to achieve several of the following objectives at the same time:

**Inform**
Management may need to make their audience aware that their product exists, and to explain exactly what it does. This is a particularly important objective for new products.

**Persuade**
An important stage in creating favourable attitudes towards the business and its brands. Through persuasive promotion, management will seek to persuade customers and the trade that their brand has benefits that are superior to competitors.

**Image creation**
Sometimes, promoting a brand image is the only way to create differentiation in the mind of the consumer (e.g. lager advertising).

**Reassurance**
Much promotion (particularly advertising) is about reassuring customers that they have made the right choice and encouraging them to stay loyal to a brand.
There are a large and growing number of promotional methods that businesses can use. The main instruments - advertising, direct response mailing, sales promotion, public relations and direct selling, are often mixed together as part of the promotional mix. Each has different strengths. What is important is that the promotional mix is carefully planned and the results monitored to ensure that the total promotional cost is controlled.

**Introduction to the promotional mix**

It is not enough for a business to have good products sold at attractive prices. To generate sales and profits, the benefits of products have to be communicated to customers. In marketing, this is commonly known as "promotion".

Promotion is all about companies communicating with customers.

A business' total marketing communications programme is called the "promotional mix" and consists of a blend of advertising, personal selling, sales promotion and public relations tools. In this revision note, we describe the four key elements of the promotional mix in more detail.

It is helpful to define the four main elements of the promotional mix before considering their strengths and limitations.

**1) Advertising**
Any paid form of non-personal communication of ideas or products in the "prime media": i.e. television, newspapers, magazines, billboard posters, radio, cinema etc. Advertising is intended to persuade and to inform. The two basic aspects of advertising are the message (what you want your communication to say) and the medium (how you get your message across).
(2) **Personal Selling**  
Oral communication with potential buyers of a product with the intention of making a sale. The personal selling may focus initially on developing a relationship with the potential buyer, but will always ultimately end with an attempt to “close the sale”.

(3) **Sales Promotion**  
Providing incentives to customers or to the distribution channel to stimulate demand for a product.

(4) **Publicity**  
The communication of a product, brand or business by placing information about it in the media without paying for the time or media space directly, otherwise known as “public relations” or PR.

**Advantages and Disadvantages of Each Element of the Promotional Mix**

<table>
<thead>
<tr>
<th>Mix Element</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td>Good for building awareness</td>
<td>Impersonal - cannot answer all a customer's questions</td>
</tr>
<tr>
<td></td>
<td>Effective at reaching a wide audience</td>
<td>Not good at getting customers to make a final purchasing decision</td>
</tr>
<tr>
<td></td>
<td>Reposition of main brand and product positioning helps build customer trust</td>
<td></td>
</tr>
<tr>
<td>Personal Selling</td>
<td>Highly interactive - lots of communication between the buyer and seller</td>
<td>Costly - employing a sales force has many hidden costs in addition to wages</td>
</tr>
<tr>
<td></td>
<td>Excellent for communicating complex / detailed product information and features</td>
<td>Not suitable if there are thousands of important buyers</td>
</tr>
<tr>
<td></td>
<td>Relationships can be built up - important if closing the sale make take a long time</td>
<td></td>
</tr>
<tr>
<td>Sales Promotion</td>
<td>Can stimulate quick increases in sales by targeting promotional incentives on particular products</td>
<td>If used over the long-term, customers may get used to the effect</td>
</tr>
<tr>
<td></td>
<td>Good short term tactical tool</td>
<td>Too much promotion may damage the brand image</td>
</tr>
<tr>
<td>Public Relations</td>
<td>Often seen as more &quot;credible&quot; - since the message seems to be coming from a third party (e.g. magazine, newspaper)</td>
<td>Risk of losing control - cannot always control what other people write or say about your product</td>
</tr>
<tr>
<td></td>
<td>Cheap way of reaching many customers - if the publicity is achieved through the right media</td>
<td></td>
</tr>
</tbody>
</table>

**Factors that determine the type of promotional tools used**

Each of the above components of the promotional mix has strengths and weaknesses. There are several factors that should be taken into account in deciding which, and how much of each tool to use in a promotional marketing campaign:

(1) **Resource availability and the cost of each promotional tool**  
Advertising (particularly on television and in the national newspapers can be very expensive). The overall resource budget for the promotional campaign will often determine which tools the business can afford to use.

(2) **Market size and concentration**  
If a market size is small and the number of potential buyers is small, then personal selling may be the most cost-effective promotional tool. A good example of this would be businesses selling software systems designed for supermarket retailers. On the other hand, where markets are geographically disperse or, where there are substantial numbers of potential customers, advertising is usually the most effective.

(3) **Customer information needs**  
Some potential customers need to be provided with detailed, complex information to help them evaluate a purchase (e.g. buyers of equipment for nuclear power stations, or health service managers investing in the latest medical technology). In this situation, personal selling is almost always required - often using selling teams rather than just one individual. By contrast, few consumers need much information about products such as baked beans or bread.
Promotional tools such as brand advertising and sales promotion are much more effective in this case.

**Advertising**

The Institute of Practitioners in Advertising (IPA), the body which represents advertising agencies, defines advertising as:

"The means of providing the most persuasive possible selling message to the right prospects at the lowest possible cost".

Kotler and Armstrong provide an alternative definition:
"Advertising is any paid form of non-personal presentation and promotion of ideas, goods and services through mass media such as newspapers, magazines, television or radio by an identified sponsor".

There are five main stages in a well-managed advertising campaign:

**Stage 1: Set Advertising Objectives**
An advertising objective is a specific communication task to be achieved with a specific target audience during a specified period of time. Advertising objectives fall into three main categories:
(a) To inform - e.g. tell customers about a new product
(b) To persuade - e.g. encourage customers to switch to a different brand
(c) To remind - e.g. remind buyers where to find a product

**Stage 2: Set the Advertising Budget**
Marketers should remember that the role of advertising is to create demand for a product. The amount spent on advertising should be relevant to the potential sales impact of the campaign. This, in turn will reflect the characteristics of the product being advertised.
For example, new products tend to need a larger advertising budget to help build awareness and to encourage consumers to trial the product. A product that is highly differentiated may also need more advertising to help set it apart from the competition - emphasising the points of difference.
Setting the advertising budget is not easy - how can a business predict the right amount to spend. Which parts of the advertising campaign will work best and which will have relatively little effect? Often businesses use "rules-of-thumb" (e.g. advertising/sales ratio) as a guide to set the budget.

**Stage 3: Determine the key Advertising Messages**
Spending a lot on advertising does not guarantee success (witness the infamous John Cleese campaign for Sainsbury). Research suggests that the clarity of the advertising message is often more important than the amount spent. The advertising message must be carefully targeted to impact the target customer audience. A successful advertising message should have the following characteristics:
(a) Meaningful - customers should find the message relevant
(b) Distinctive - capture the customer's attention
(c) Believable - a difficult task, since research suggests most consumers doubt the truth of advertising in general

**Stage 4: Decide which Advertising Media to Use**
There are a variety of advertising media from which to choose. A campaign may use one or more of the media alternatives. The key factors in choosing the right media include:
(a) Reach - what proportion of the target customers will be exposed to the advertising?
(b) Frequency - how many times will the target customer be exposed to the advertising message?
(c) Media Impact - where, if the target customer sees the message - will it have most impact? For example does an advert promoting holidays for elderly people have more impact on Television (if so, when and which channels) or in a national newspaper or perhaps a magazine focused on this segment of the population?
Another key decision in relation to advertising media relates to the timing of the campaign. Some products are particularly suited to seasonal campaigns on television (e.g. Christmas hampers) whereas for other products, a regular advertising campaign throughout the year in media such as newspapers and specialist magazines (e.g. cottage holidays in the Lake District) is more appropriate.

**Stage 5: Evaluate the results of the Advertising Campaign**
The evaluation of an advertising campaign should focus on two key areas:
(1) The Communication Effects - is the intended message being communicated effectively and to the intended audience?
(2) The Sales Effects - has the campaign generated the intended sales growth. This second area is much more difficult to measure.

Setting The Advertising Budget

A famous comment usually attributed to Lord Leverhulme goes:

“I know that half of my advertising budget is wasted, but I’m not sure which half”

It is notoriously difficult to measure the effect of advertising on a business’ sales. Advertising is just one of the variables that might affect sales in a particular period. These include:

- Consumer and business confidence
- Levels of disposable income
- Availability of product (e.g. does the retailer actually have stock to sell?)
- Availability of competing products
- The weather (often blamed by retailers for poor sales!)

How can a business know whether a specific advertising campaign was effective?

As a percentage of sales, advertising expenditure varies enormously from business to business, from market to market. For example, the leading pharmaceutical companies spend around 20% of sales on advertising, whilst business such as Ford and Toyota spend less than 1%. An average for fast-moving consumer goods markets (“FMCG”) is around 8-10% of sales.

In practice, the following approaches are used for setting the advertising budget:

Method (1) Fixed percentage of sales

In markets with a stable, predictable sales pattern, some companies set their advertising spend consistently at a fixed percentage of sales. This policy has the advantage of avoiding an “advertising war” which could be bad news for profits.

However, there are some disadvantages with this approach. This approach assumes that sales are directly related to advertising. Clearly this will not entirely be the case, since other elements of the promotional mix will also affect sales. If the rule is applied when sales are declining, the result will be a reduction in advertising just when greater sales promotion is required!

Method (2) Same level as competitors

This approach has widespread use when products are well-established with predictable sales patterns. It is based on the assumption that there is an “industry average” spend that works well for all major players in a market.

A major problem with this approach (in addition to the disadvantages set out for the example above) is that it encourages businesses to ignore the effectiveness of their advertising spend – it makes them “lazy”. It could also prevent a business with competitive advantages from increasing market share by spending more than average.

Method (3) Task

The task approach involves setting marketing objectives based on the “tasks” that the advertising has to complete. These tasks could be financial in nature (e.g. achieve a certain increase in sales, profits) or related to the marketing activity that is generated by the campaigns. For example:

- Numbers of enquiries received quoting the source code on the advertisement
- Increase in customer recognition / awareness of the product or brand (which can be measured)
- Number of viewers, listeners or readers reached by the campaign

Method (4) Residual

The residual approach, which is perhaps the worst of all, is to base the advertising budget on what the business can afford – after all other expenditure. There is no attempt to associate marketing objectives with levels of advertising. In a good year large amounts of money could be wasted; in a bad year, the low advertising budget could guarantee a further low year for sales.
Effectiveness?

Judging the effectiveness of advertising

How can the effectiveness of an advert be judged?
The answer depends on what objectives or tasks were set for the advert.

The table below sets out some possible objectives/tasks and how the effectiveness of the advert might be measured:

<table>
<thead>
<tr>
<th>Advertising objective</th>
<th>How success can be measured</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stimulate an increase in sales</td>
<td>- Number of enquiries from advert</td>
</tr>
<tr>
<td></td>
<td>- Number of enquiries converted into sales</td>
</tr>
<tr>
<td>Remind customers of the existence of a product</td>
<td>- Test customer awareness both before and after the advertising campaign</td>
</tr>
<tr>
<td></td>
<td>- Number of enquiries</td>
</tr>
<tr>
<td>Inform customers</td>
<td>- Test customer awareness</td>
</tr>
<tr>
<td></td>
<td>- Number of requests for further information</td>
</tr>
<tr>
<td>Build a brand image</td>
<td>- Sales</td>
</tr>
<tr>
<td></td>
<td>- Test customer awareness of brand recognition and perceived values</td>
</tr>
<tr>
<td>Build customer loyalty and relationship</td>
<td>- Levels of repeat purchase</td>
</tr>
<tr>
<td></td>
<td>- Levels of customer retention</td>
</tr>
<tr>
<td>Change customer attitudes</td>
<td>- Measure demographic profile of purchases</td>
</tr>
<tr>
<td></td>
<td>- Measure type of goods ordered by new purchasers</td>
</tr>
<tr>
<td></td>
<td>- Compare with previous data</td>
</tr>
</tbody>
</table>

Media

There is a huge variety of media available through which a business can conduct an advertising campaign. What are the main types of media and what considerations should a business make in choosing between them?

The starting point in the selection of appropriate advertising media is a “media analysis”. This can be defined as:

"An investigation into the relative effectiveness and the relative costs of using the various advertising media in an advertising campaign"

Before committing an advertising budget it is necessary to carry out marketing research on:
- Potential customers
- Their reading habits, television-watching habits
- How many times the advertisers wish the potential customers to see an advertisement
- How great a percentage of the market they wish to reach, etc.

These elements all need to be considered and balanced to plan a campaign that will effectively reach its target audience at a reasonable cost.

A useful distinction can be made between “published media” and “visual/aural media”.

Published media include:
1. National daily newspapers
2. Sunday newspapers
3. Local and regional newspapers
4. Consumer magazines
5. Specialist magazines
6. Trade and professional press
7. Internet

Visual and aural media include:
1. Television (terrestrial and digital)
2. Radio  
3. Cinema  
4. Billboards  
5. Transport  
6. Direct mailing

**Why And What?**

Before undertaking an advertising campaign, marketers should be able to answer two key questions:
(1) Why are we advertising?  
(2) What are we advertising?

On the face of it these seem like two fairly obvious questions. But they are significant. Advertising can be a very expensive promotional tool. It is widely believed that much advertising spend is wasted. So careful consideration about “Why” and “What” can pay dividends.

**Why advertise?**
The following may be good reasons why a business is advertising:
- To create awareness, customer interest or desire  
- To boost sales (moving the demand curve to the right)  
- To build brand loyalty (or to maintain it at the existing level)  
- To launch a new product  
- To change customer attitudes – perhaps trying to move a product more “upmarket” or to dispel some widely held perceptions about the product  
- To support the activities of the distribution channel (e.g. supporting a “pull” strategy)  
- To build the company or brand image  
- To remind and reassure customers  
- To offset competitor advertising – businesses may defend market share by responding to competitors’ campaigns with their own advertising  
- To boost public standing: companies can boost their public standing with advertisements that link them with generally approved campaigns such as care for the environment  
- To support the sales force – advertising can make the job of the sales force easier and more effective by attracting leads from potential customers and perhaps motivate them by boosting the profile of the business

Take a look through any magazine and select a sample of adverts. Which of the above reasons do you think are behind the adverts you choose? Don’t forget that some adverts aim to achieve multiple objectives.

**What to advertise?**
Factors that help answer the “what are we advertising”? focus on what the advertising message should be. In general, there are really only two kinds of effective advertising message:
Firstly, does the business/product have a **Unique Selling Proposition (“USP”)**

* A unique selling proposition is a customer benefit that no other product can claim

In reality these are rare, although that does not stop marketers from claiming them for their products. Secondly, does the thing that is being advertised “add value” and if so, how?
For example, advertising for washing powders will focus on the “added value” created by whitening agents or the fact that a particular formulation will last longer than the competition (take a look at the Fairy web site to see if you can spot the other “added value” features claimed for its products)

Whatever is advertised, it is important that the message is:
- a) Seen  
- b) Read  
- c) Believed  
- d) Remembered  
- e) Action upon by target customers
Direct Marketing

Direct marketing is concerned with establishing an individual relationship between the business offering a product or service and the final customer. Direct marketing has been defined by the Institute of Direct Marketing as:

The planned recording, analysis and tracking of customer behaviour to develop a relational marketing strategies

The process of direct marketing covers a wide range of promotional activities you may be familiar with. These include:

- Direct-response adverts on television and radio
- Mail order catalogues
- E-commerce (you bought this marketing companion following tutor2u’s direct marketing campaign!)
- Magazine inserts
- Direct mail (sometimes also referred to as “junk mail”)
- Telemarketing

Direct mail

Of the above direct marketing techniques, the one in most widespread use is direct mail. Direct mail is widely thought of as the most effective medium to achieve a customer sales response. Why?

- The advertiser can target a promotional message down to an individual level, and where possible personalise the message. There are a large number of mailing databases available that allow businesses to send direct mailing to potential customers based on household income, interests, occupation and other variables
- Businesses can first test the responsiveness of direct mailing (by sending out a test mailing to a small, representative sample) before committing to the more significant cost of a larger campaign
- Direct mailing campaigns are less visible to competitors – it is therefore possible to be more creative, for longer

However, direct mail has several weaknesses:

- A piece of direct mail is less “interactive” than a television or radio advert, although creative packaging can still stimulate customer response
- Lead times to produce direct mailing campaigns can be quite long
- There is increasing customer concern with “junk mail” – the receipt of unsolicited mail which often suggests that the right to individual privacy has been breached.

The Direct marketing database

Direct mailing is based on the “mailing list” – a critical part in the direct marketing process. The mailing list is a database which collects together details of past, current and potential customers. A properly managed mailing database enables a business to:

- Focus on the best prospective customers
- Cross-sell related products
- Launch new products to existing customers

How is the mailing database compiled?

The starting point is the existing information the business keeps on its customers. All forms of communication between a customer and the business need to be recorded so that a detailed, up-to-date profile can be maintained.

It is also possible to “buy” mailing lists from elsewhere. There are numerous mailing list owners and brokers who sell lists of names. The Internet, directories, associations and other sources are good sources.

Personal Selling
Personal selling can be defined as follows: **Personal selling is oral communication with potential buyers of a product with the intention of making a sale. The personal selling may focus initially on developing a relationship with the potential buyer, but will always ultimately end with an attempt to "close the sale"**

Personal selling is one of the oldest forms of promotion. It involves the use of a **sales force** to support a **push strategy** (encouraging intermediaries to buy the product) or a **pull strategy** (where the role of the sales force may be limited to supporting retailers and providing after-sales service).

**What are the main roles of the sales force?**

Kotler describes six main activities of a sales force:

1. **Prospecting** - trying to find new customers
2. **Communicating** - with existing and potential customers about the product range
3. **Selling** - contact with the customer, answering questions and trying to close the sale
4. **Servicing** - providing support and service to the customer in the period up to delivery and also post-sale
5. **Information gathering** - obtaining information about the market to feedback into the marketing planning process
6. **Allocating** - in times of product shortage, the sales force may have the power to decide how available stocks are allocated

**What are the advantages of using personal selling as a means of promotion?**

- Personal selling is a face-to-face activity; customers therefore obtain a relatively high degree of personal attention
- The sales message can be customised to meet the needs of the customer
- The two-way nature of the sales process allows the sales team to respond directly and promptly to customer questions and concerns
- Personal selling is a good way of getting across large amounts of technical or other complex product information
- The face-to-face sales meeting gives the sales force chance to demonstrate the product
- Frequent meetings between sales force and customer provide an opportunity to build good long-term relationships

Given that there are many advantages to personal selling, why do more businesses not maintain a direct sales force?

**Main disadvantages of using personal selling**

The main disadvantage of personal selling is the cost of employing a sales force. Sales people are expensive. In addition to the basic pay package, a business needs to provide incentives to achieve sales (typically this is based on commission and/or bonus arrangements) and the equipment to make sales calls (car, travel and subsistence costs, mobile phone etc).

In addition, a sales person can only call on one customer at a time. This is not a cost-effective way of reaching a large audience.

**Public Relations**

The Institute of Public Relations defines public relations as follows: **“The planned and sustained effort to establish and maintain goodwill and mutual understanding between an organisation and its publics”**

What is meant by the term “publics” in the above definition?
A business may have many “publics” with which it needs to maintain good relations and build goodwill.

Example: consider the relevant “publics” for a publicly-quoted business engaged in medical research:

- Employees
- Shareholders
- Trade unions
- Members of the “general public”
- Customers (past and present)
Pressure groups
The medical profession
Charities funding medical research
Professional research bodies and policy-forming organizations
The media
Government and politicians

The role of public relations is to:
- Identify the relevant publics
- Influence the opinions of those publics by:
  a) Reinforcing favourable opinions
  b) Transforming perhaps neutral opinions into positive ones
  c) Changing or neutralising hostile opinions

Public relations techniques
There are many techniques available to influence public opinion, some of which are more appropriate in certain circumstances than others:

Consumer communication
Customer press releases
Trade press releases
Promotional videos
Consumer exhibitions
Competitions and prizes
Product launch events
Celebrity endorsements
Web sites

Business communication
Corporate identity design
Company and product videos
Direct mailings
Web site
Trade exhibitions

Internal / employee communication
In-house newsletters and magazines
Intranet
Notice boards
Employee conferences
Email

External corporate communication
Company literature (brochures, videos etc.)
Community involvement programmes
Trade, local, national and international media relations

Financial communication
Financial media relations
Annual report and accounts
Meetings with stock market analysts, fund managers etc
Shareholder meetings (including the annual general meeting)

Given the wide range of techniques used in public relations, how is it possible to measure the effectiveness of public relations?

It is actually quite difficult to measure whether the key messages have been communicated to the target public. In any event, this could be quite costly since it would involve a large amount of regular research. Instead, the main measures of effectiveness concentrate on the process of public relations and include:

- Monitoring the amount of media coverage obtained (press cuttings agencies play a role in keeping businesses informed of this)
- Measuring attendance at meetings, conferences
- Measuring the number of enquiries or orders received in response to specific public relations efforts.
Push And Pull Strategies

Marketing theory distinguishes between two main kinds of promotional strategy - "push" and "pull".

Push

A “push” promotional strategy makes use of a company's sales force and trade promotion activities to create consumer demand for a product. The producer promotes the product to wholesalers, the wholesalers promote it to retailers, and the retailers promote it to consumers.

A good example of “push” selling is mobile phones, where the major handset manufacturers such as Nokia promote their products via retailers such as Carphone Warehouse. Personal selling and trade promotions are often the most effective promotional tools for companies such as Nokia, for example offering subsidies on the handsets to encourage retailers to sell higher volumes.

A “push” strategy tries to sell directly to the consumer, bypassing other distribution channels (e.g. selling insurance or holidays directly). With this type of strategy, consumer promotions and advertising are the most likely promotional tools.

Pull

A “pull” selling strategy is one that requires high spending on advertising and consumer promotion to build up consumer demand for a product. If the strategy is successful, consumers will ask their retailers for the product, the retailers will ask the wholesalers, and the wholesalers will ask the producers.

A good example of a pull is the heavy advertising and promotion of children's' toys – mainly on television. Consider the recent BBC promotional campaign for its new pre-school programme – the Fimbles. Aimed at two to four-year-olds, 130 episodes of Fimbles have been made and are featured everyday on digital children's channel CBeebies and BBC2.

As part of the promotional campaign, the BBC has agreed a deal with toy maker Fisher-Price to market products based on the show, which it hopes will emulate the popularity of the Tweenies. Under the terms of the deal, Fisher-Price will develop, manufacture and distribute a range of Fimbles products including soft, plastic and electronic learning toys for the UK and Ireland.

In 2001, BBC Worldwide (the commercial division of the BBC) achieved sales of £90m from its children's brands and properties last year. The demand created from broadcasting of the Fimbles and a major advertising campaign is likely to “pull” demand from children and encourage retailers to stock Fimbles toys in the stores for Christmas 2002.

Sales Promotion

“An activity designed to boost the sales of a product or service. It may include an advertising campaign, increased PR activity, a free-sample campaign, offering free gifts or trading stamps, arranging demonstrations or exhibitions, setting up competitions with attractive prizes, temporary price reductions, door-to-door calling, telemarketing, personal letters on other methods”.

More than any other element of the promotional mix, sales promotion is about “action”. It is about stimulating customers to buy a product. It is not designed to be informative – a role which advertising is much better suited to. Sales promotion is commonly referred to as “Below the Line” promotion.

Sales promotion can be directed at:
- The ultimate consumer (a “pull strategy” encouraging purchase)
- The distribution channel (a “push strategy” encouraging the channels to stock the product). This is usually known as “selling into the trade”

Methods of sales promotion
Price promotions
Price promotions are also commonly known as “price discounting.” These offer either (1) a discount to the normal selling price of a product, or (2) more of the product at the normal price. Increased sales gained from price promotions are at the expense of a loss in profit — so these promotions must be used with care. A producer must also guard against the possible negative effect of discounting on a brand’s reputation.

Coupons
Coupons are another, very versatile, way of offering a discount. Consider the following examples:
- On a pack to encourage repeat purchase
- In coupon books sent out in newspapers allowing customers to redeem the coupon at a retailer
- A cut-out coupon as part of an advert
- On the back of till receipts

The key objective with a coupon promotion is to maximise the redemption rate — this is the proportion of customers actually using the coupon.

One problem with coupons is that they may simply encourage customers to buy what they would have bought anyway. Another problem occurs when retailers do not hold sufficient stocks of the promoted product — causing customer disappointment.

Use of coupon promotions is, therefore, often best for new products or perhaps to encourage sales of existing products that are slowing down.

Gift with purchase
The “gift with purchase” is a very common promotional technique. It is also known as a “premium promotion” in that the customer gets something in addition to the main purchase. This type of promotion is widely used for:
- Subscription-based products (e.g. magazines)
- Consumer luxuries (e.g. perfumes)

Competitions and prizes
Another popular promotion tool with many variants. Most competition and prize promotions are subject to legal restrictions.

Money refunds
Here, a customer receives a money refund after submitting a proof of purchase to the manufacturer. These schemes are often viewed with some suspicion by customers — particularly if the method of obtaining a refund looks unusual or onerous.

Frequent user / loyalty incentives
Repeat purchases may be stimulated by frequent user incentives. Perhaps the best examples of this are the many frequent flyer or user schemes used by airlines, train companies, car hire companies etc.

Point-of-sale displays
Research into customer buying behaviour in retail stores suggests that a significant proportion of purchases results from promotions that customers see in the store. Attractive, informative and well-positioned point-of-sale displays are, therefore, very important part of the sales promotional activity in retail outlets.

Sponsorship
An increasingly common form of promotional activity is sponsorship. What is sponsorship?

Sponsorship can be defined as follows:
Supporting an event, activity or organisation by providing money or other resources that is of value to the sponsored event. This is usually in return for advertising space at the event or as part of the publicity for the event.

There are many kinds of sponsorship:

Television and radio programme sponsorship (e.g. Cadbury’s sponsor broadcasts of Coronation Street). The increasing fragmentation of television in the UK through new digital channels is providing...
many more opportunities for sponsorship of this kind

**Sports sponsorship:** major sporting events have the advantage of being attended and (more importantly) watched by large numbers of people. They also attract significant media coverage.

**Arts sponsorship:** arts events or organisations are not as well attended as sports events but are often regarded as more “worthy” and more in keeping with the image of certain businesses and brands.

**Educational sponsorship:** this can take several forms from the sponsoring of individual students at college through to the provision of books and computers nationwide using the redemption of product or store-related vouchers (e.g. Tesco’s Computers for Schools)

**What is involved in developing a sponsorship promotion?**

Smith suggests a six-stage process to decide what and how to sponsor:

1. Analyse the current situation: look at which other businesses are sponsoring in the target area. Are competitors already doing this and is it providing them with an advantage?
2. Define the sponsorship objectives: e.g. raise awareness of the brand; build an image; promote a new product
3. Agree the strategy: how does the sponsorship fit in with any other promotional activity?
4. Develop the tactics: agree the details of what to sponsor, price, timing etc
5. Define the target audience
6. Consider what resources are needed to make the sponsorship a success.
Distribution (or “Place”) is the fourth traditional element of the marketing mix. The other three are Product, Price and Promotion.

The Nature of Distribution Channels
Most businesses use third parties or intermediaries to bring their products to market. They try to forge a “distribution channel” which can be defined as “all the organisations through which a product must pass between its point of production and consumption”.

Why does a business give the job of selling its products to intermediaries? After all, using intermediaries means giving up some control over how products are sold and who they are sold to. The answer lies in efficiency of distribution costs. Intermediaries are specialists in selling. They have the contacts, experience and scale of operation which means that greater sales can be achieved than if the producing business tried run a sales operation itself.

Functions of a Distribution Channel
The main function of a distribution channel is to provide a link between production and consumption. Organisations that form any particular distribution channel perform many key functions:

<table>
<thead>
<tr>
<th>Function</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Information</td>
<td>Gathering and distributing market research and intelligence - important for marketing planning</td>
</tr>
<tr>
<td>Promotion</td>
<td>Developing and spreading communications about offers</td>
</tr>
<tr>
<td>Contact</td>
<td>Finding and communicating with prospective buyers</td>
</tr>
<tr>
<td>Matching</td>
<td>Adjusting the offer to fit a buyer’s needs, including grading, assembling and packaging</td>
</tr>
<tr>
<td>Negotiation</td>
<td>Reaching agreement on price and other terms of the offer</td>
</tr>
<tr>
<td>Physical distribution</td>
<td>Transporting and storing goods</td>
</tr>
<tr>
<td>Financing</td>
<td>Acquiring and using funds to cover the costs of the distribution channel</td>
</tr>
<tr>
<td>Risk taking</td>
<td>Assuming some commercial risks by operating the channel (e.g. holding stock)</td>
</tr>
</tbody>
</table>

All of the above functions need to be undertaken in any market. The question is - who performs them and how many levels there need to be in the distribution channel in order to make it cost effective.

Numbers of Distribution Channel Levels
Each layer of marketing intermediaries that performs some work in bringing the product to its final buyer is a "channel level". Some examples of Distribution channel are given

1. Manufacturer - Consumer
2. Manufacturer – Retailer - Consumer
3. Manufacturer – Wholeseller – Retailer - Consumer

In the figure above, Channel 1 is called a "direct-marketing" channel, since it has no intermediary levels. In this case the manufacturer sells directly to customers. An example of a direct marketing channel would be a factory outlet store. Many holiday companies also market direct to consumers, bypassing a traditional retail intermediary - the travel agent.

The remaining channels are "indirect-marketing channels".

Channel 2 contains one intermediary. In consumer markets, this is typically a retailer. The consumer electrical goods market in the UK is typical of this arrangement whereby producers such as Sony, Panasonic, Canon etc. sell their goods directly to large retailers such as Comet, Dixons and Currys which then sell the goods to the final consumers.

Channel 3 contains two intermediary levels - a wholesaler and a retailer. A wholesaler typically buys and stores large quantities of several producers goods and then breaks into the bulk deliveries to supply retailers with smaller quantities. For small retailers with limited order quantities, the use of wholesalers makes economic sense. This arrangement tends to work best where the retail channel is fragmented - i.e. not dominated by a small number of large, powerful retailers who have an incentive to cut out the wholesaler. A good example of this channel arrangement in the UK is the distribution of drugs.
Channel Strategy

The following table describes the factors that influence the choice of distribution channel by a business:

<table>
<thead>
<tr>
<th>Influence</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market factors</td>
<td>An important market factor is &quot;buyer behaviour&quot;; how do buyer’s want to purchase the product? Do they prefer to buy from retailers, locally, via mail order or perhaps over the Internet? Another important factor is buyer needs for product information, installation and servicing. Which channels are best served to provide the customer with the information they need before buying? Does the product need specific technical assistance either to install or service a product? Intermediaries are often best placed to provide servicing rather than the original producer - for example in the case of motor cars. The willingness of channel intermediaries to market product is also a factor. Retailers in particular invest heavily in properties, shop fitting etc. They may decide not to support a particular product if it requires too much investment (e.g. training, display equipment, warehousing). Another important factor is intermediary cost. Intermediaries typically charge a &quot;mark-up&quot; or &quot;commission&quot; for participating in the channel. This might be deemed unacceptably high for the ultimate producer business.</td>
</tr>
<tr>
<td>Producer factors</td>
<td>A key question is whether the producer have the resources to perform the functions of the channel? For example a producer may not have the resources to recruit, train and equip a sales team. If so, the only option may be to use agents and/or other distributors. Producers may also feel that they do not possess the customer-based skills to distribute their products. Many channel intermediaries focus heavily on the customer interface as a way of creating competitive advantage and cementing the relationship with their supplying producers. Another factor is the extent to which producers want to maintain control over how, to whom and at what price a product is sold. If a manufacturer sells via a retailer, they effective lose control over the final consumer price, since the retailer sets the price and any relevant discounts or promotional offers. Similarly, there is no guarantee for a producer that their product/(s) are actually been stocked by the retailer. Direct distribution gives a producer much more control over these issues.</td>
</tr>
<tr>
<td>Product factors</td>
<td>Large complex products are often supplied direct to customers (e.g. complex medical equipment sold to hospitals). By contrast perishable products (such as frozen food, meat, bread) require relatively short distribution channels - ideally suited to using intermediaries such as retailers.</td>
</tr>
</tbody>
</table>

Distribution Intensity

There are three broad options - intensive, selective and exclusive distribution:

**Intensive distribution** aims to provide saturation coverage of the market by using all available outlets. For many products, total sales are directly linked to the number of outlets used (e.g. cigarettes, beer). Intensive distribution is usually required where customers have a range of acceptable brands to chose from. In other words, if one brand is not available, a customer will simply choose another.

**Selective distribution** involves a producer using a limited number of outlets in a geographical area to sell products. An advantage of this approach is that the producer can choose the most appropriate or best-performing outlets and focus effort (e.g. training) on them. Selective distribution works best when consumers are prepared to "shop around" - in other words - they have a preference for a particular brand or price and will search out the outlets that supply.

**Exclusive distribution** is an extreme form of selective distribution in which only one wholesaler, retailer or distributor is used in a specific geographical area.

Types of Distribution Intermediary

There is a variety of intermediaries that may get involved before a product gets from the original
producer to the final user. These are described briefly below:

**Retailers**
Retailers operate outlets that trade directly with household customers. Retailers can be classified in several ways:
- Type of goods being sold (e.g. clothes, grocery, furniture)
- Type of service (e.g. self-service, counter-service)
- Size (e.g. corner shop; superstore)
- Ownership (e.g. privately-owned independent; public-quouted retail group)
- Location (e.g. rural, city-centre, out-of-town)
- Brand (e.g. nationwide retail brands; local one-shop name)

**Wholesalers**
Wholesalers stock a range of products from several producers. The role of the wholesaler is to sell onto retailers. Wholesalers usually specialise in particular products.

**Distributors and dealers**
Distributors or dealers have a similar role to wholesalers – that of taking products from producers and selling them on. However, they often sell onto the end customer rather than a retailer. They also usually have a much narrower product range. Distributors and dealers are often involved in providing after-sales service.

**Franchises**
Franchises are independent businesses that operate a branded product (usually a service) in exchange for a licence fee and a share of sales.

**Agents**
Agents sell the products and services of producers in return for a commission (a percentage of the sales revenues)
Introduction to international business

International business is not new – businesses and nations have conducted trade across national boundaries for centuries.

Lured by the prospects of large markets and/or sources of raw materials, businesses have traded with other parts of the world.

But as we will see later global business and global industry is different.

Overseas trade and Ansoff’s matrix

<table>
<thead>
<tr>
<th>Existing products</th>
<th>New products</th>
</tr>
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<tbody>
<tr>
<td>Existing markets</td>
<td>Market penetration</td>
</tr>
<tr>
<td>New markets</td>
<td>Market development</td>
</tr>
</tbody>
</table>

Thinking about international business in the context of Ansoff’s matrix:

- Entry into overseas markets represents market development.
- Existing products are sold in new markets.
- It is appealing because:

  a. market penetration is difficult in saturated markets
  b. product development is costly
  c. Diversification is risky

Why enter overseas markets?

Push factors

- Saturation in domestic markets
- Economic difficulty in domestic markets
- Near the end of the product life cycle at home
- Excess capacity
- Risk diversification

Pull factors

- The attraction of overseas markets
- Increase sales
- Enjoy greater economies of scale
- Extend the product life cycle
- Exploit a competitive advantage
- Personal ambition

Factors in the choice of which overseas market(s) to enter:

- Size of the market (population, income)
- Economic factors (state of the economy)
- Cultural linguistic factors (e.g. preference for countries with similar cultural background)
- Political stability (there is usually a preference for stable areas)
- Technological factors (these affect demand and the ease of trading)

**Constraints and difficulties in entering overseas markets:**

- Resources
- Time
- Market uncertainty
- Marketing costs
- Cultural differences
- Linguistic differences
- Trade barriers
- Regulations and administrative procedures
- Political uncertainties
- Exchange rates (transactions costs & risks)
- Problems of financing
- Working capital problems
- Cost of insurance
- Distribution networks

**Exporting is only one method of doing business internationally**

- We normally think of overseas trade in terms of exporting and importing goods and services
- This involves transporting goods and selling them across national boundaries.
- Direct exporting implies that the domestic firm is actively involved in selling the goods abroad
- Indirect exporting means that the marketing of goods is delegated to export agents and the UK manufacturer concentrates on production
- But exporting involving the movement of goods is only one method of engaging in international business

**Other methods of market entry**

- Overseas product an/or assembly (producing goods abroad)
- International alliances and joint ventures (working with foreign companies)
- International M&A (mergers and acquisitions across frontiers)

International franchising and licensing allowing foreign based firms to produce, market and distribute goods in specified areas abroad
Richard Bowett describes the key features of international competition from a business studies perspective.

Trade Barriers

The world is full of trade barriers which make exports and imports more difficult and more expensive. There are considerably fewer trade barriers than there used to be. This reduction is mainly due to the work of the WTO, and this organisation is working to further reduce trade barriers. At the same time, there has been a growth in the number of regional trading blocs. The EU is perhaps the best known of these, but there are others such as NAFTA, the Andes Pact in the east of S America, Mercosur in the west of S America and ASEAN. These blocs promote trade within the bloc, but often erect further barriers between blocs.

Costs of Production

Competing in a market depends on having as low or preferably lower costs of production than competitors. This is not as simple as having access to cheap raw material and other factor inputs (the factors of production used by businesses). It also depends how efficiently these factors are used. What counts is productivity ie the amount of output produced from a given amount of input.

Example:

Suppose two farmers use land to produce crops. In Country A a farm costs £5000 and in Country B a farm costs £10 000. We might think land is cheaper in country A so their farmers have lower costs and a competitive advantage. But it also depends on how much is produced. Suppose Country B also has superior knowledge and technology in farming, and produces 150 tons of crop instead of 50 tons of crop in Country A. The unit cost of each ton is £100 per ton in Country A and £66.67 per ton in Country B. So it is in fact Country B that has the competitive advantage. We than have to think about what gives low per unit costs, and the answer to that is efficiency and productivity, productivity of all the factors of production (land, labour, capital and enterprise) and productivity most of all of labour because the UK and most of its competitors are high-wage economies.

The Behaviour of Businesses

Low costs are a good place to start a new business from, but you still have to sell the product. To do this you must offer customers (industrial and consumers) a product which meets their needs in the fullest way possible, needs for a good price, needs for quality, needs for reliability and so on.

Some businesses still do not behave as if their customers are the most important things to business success. A change in business behaviour is often needed to ensure that the customers are the prime focus of business activity, that their needs are fully met (including adapting as these needs change – innovation) and that the low and efficient costs are used as a platform for successful fulfilment of those needs.

However, there is a possible problem in that it is more difficult to understand the needs of export customers who may have different values and priorities than domestic customers; successful export businesses make the effort to understand these differences properly.

International Organisations and Groupings of Developed Economies [Main Groupings only]

1. The European Union (see other tutor2u revision notes)
2. The World Trade organisation ("WTO"). This used to be called GATT (General Agreement on Tariffs and Trade). It has worked hard since 1945 to reduce international barriers to trade with considerable success, despite some very hard-fought battles. Almost all countries are members. The most recent new member is China, which had fought hard for many years to gain acceptance. The advantage of membership is that the same rules then apply to all members (MFN – Most Favoured Nation Status – which means your access to a country’s market is as good as the ‘most favoured nation’) and your exports can’t be kept out for any reason, economic or political. Breaches of the rules
are referred to a kind of ‘court’ and the WTO can fine countries large sums of money for breaking the rules, as the US is alleged to have done with its recent import duties on steel.

Every few years the WTO arranges a new ‘round’ of talks with the aim of getting all the members to agree to some new reduction in barriers to trade. Because the interests of different members are so different (eg developed countries v. developing countries) this can be a very difficult job. Lower barriers to trade mean lower costs and more efficiency. More efficiency means more growth. The work of the WTO since 1945 has led to a dramatic increase in world trade, and has arguably contributed to the growth of all economies during that time.

3. G-7. This a ‘club’ of the 7 biggest economies in the world; the USA, Japan, Germany, the UK, France, Italy and Canada. They meet to discuss the world economy, the interests of themselves, and possible economic co-operation such as exchange rate co-ordination. Russia has observer status in order to make it feel better about itself.

4. The OECD (Organisation of Economic Co-operation and Development). This is a much bigger club of all the developed countries, and nearly-developed countries, in the world. It was originally set up in 1945 to co-ordinate the economic recovery of the war-damaged countries of Europe, but it has a much bigger and wider role of discussion and co-operation between countries now. Its HQ in Paris publishes very well-respected economic analyses and forecasts.

Eastern Europe

One of the most significant political changes of the last century was the collapse of the Soviet empire in 1989. This has allowed freedom to a number of Eastern European countries. They have gradually, and with difficulty, converted their centrally-run command economies to market economies. This has opened up new opportunities for EU businesses including UK businesses:

1. A large number of new consumers, although most of them still have fairly low incomes.

2. There are opportunities for joint ventures, where EU technology and management skills can be combined with cheaper labour and land.

3. On the other hand, any Eastern European business that manages to update itself can use its lower cost base to become a competitive threat to EU & UK businesses.

4. Eastern Europe is nearer Germany, and has historical and linguistic ties with Germany. Many Eastern Europeans speak German as a second language as opposed to English. This puts UK businesses at a disadvantage, and German businesses have already been very active in forming trading links.

The Eastern European economies have many problems for business associated with their Communist past, and the fact that the changeover to a market economy is far from complete. The main problems are as follows:

1. Bureaucracy. Many things eg permissions are still controlled by the government and the process of gaining these permissions can be very complex and time-consuming. In Russia this is dealt with by bribery. Protection money is also demanded by organised crime (the ‘Russian Mafia’).

2. Low incomes. Many E European consumers simply have very little spare money to spend.

3. Political instability. The democratic political systems are still new and haven’t in all cases reliably settled down. Bulgaria and Rumania are problem cases.

4. Infrastructure is still very poor. This is not merely a matter of roads, railways and electricity supplies, but also the financial infrastructure to borrow money or raise finance by selling shares. The legal infrastructure to enforce contracts is also poor.

5. Economic conditions are still fragile because they are so new after so many years of the command economy system. Inflation has been a problem in some countries, especially Russia where it reached 1000% at one stage. There is a possibility of sudden economic collapse.
6. Some countries, such as the Ukraine, Byelorussia, and Russia itself, have made limited progress towards a market economy, and are very risky places to do business.

**Developing Economies**

This is a very broad area, and it is easy to over-generalise. Mostly, these countries are in ‘the South’ and have low to very low incomes. They are also in earlier stages of economic development; many are still primarily based around raw materials and industrialisation is very limited. A smaller group has broken away and has developed more quickly. Because they are now well into the industrial stage of development they are often called NICs (newly industrialised countries).

Poor infrastructure is a common and major problem. Health and education are both limited, with high mortality rates. Financial infrastructure is also very limited. Political instability can be a major problem, and coups and even revolutions may occur. The political system is usually non-democratic and corruption and bribery may be rife. These are basic preconditions for doing business which we take for granted in the UK; indeed, very few people stop to think about them. But the absence of trust and the legal enforcement of contracts can make business impossible, especially for outsiders. So business opportunities can be very limited.

There are a few Western businesses that operate in these markets, but they have years of experience of the local scene and know how it works. The risk, however, is that they get sucked into the corruption and lower their ethical standards. Most developed countries have had to pass laws against bribery by western businesses operating in developing countries. Some western businesses, such as Nike, have had problems with pressure groups due to their behaviour in developing countries.

**The Newly Industrialised NICs**

The exact definition of a NIC is not always easy to give. Some ‘NICs’ eg South Korea and Singapore are now effectively developed economies, just as Japan became several decades ago. China is a NIC, but only parts of it; it is a huge country and much of it is still very backward. Thailand, Malaysia and Indonesia are all examples of NICs although they are all at different stages of development with different levels of growth, employment and income. Some of these NICs operate as cheap bases for foreign investment. Japanese businesses, for example, are very active in Thailand. Some of these NICs have their own very effective businesses eg Taiwan (arguably no longer a NIC).

Either way, these countries can offer very effective competition to business in developed economies. Local businesses have low costs, and where this is combined with educated management (often holding MBAs from the best US universities) they have become MNCs able to compete with the best MNCs from developed countries. Their low costs attract investment, especially manufacturing investment from western businesses who ‘export’ jobs.

This means previous production plants in developed countries close down, and jobs are lost. This is a very contentious area. Some people argue these jobs are lost due to ‘unfair’ competition from countries where not only wages are lower, but also the other employment costs of health and safety, paid holidays, sickness benefit and all the protection provided to workers in developed economies. The MNCs are accused of ‘exploiting’ the workers of these countries (no-one actually bothers to ask these workers what they want, to which the answer is probably a reasonably reliable job). There is pressure to ban imports from these countries unless the producers have met the same standards usual in developed economies. This, of course, is absurd because these countries are much poorer and can’t afford all these ‘perks’ just as the UK couldn’t 100 years ago.

Another way of looking at the same issue is that a developed economy develops by replacing lower-wage jobs with higher-wage jobs. This is associated with rising productivity. So, it is actually a benefit if a developed economy loses relatively simple and unproductive manufacturing jobs provided it replaces these with other and better jobs. That way UK workers get better off, and so do the workers in the developing country who previously had either an agricultural job or no job at all.

Development is a huge and complex topic which is widely misunderstood. It is best to leave it at this point, but to leave you with the thought that businesses need to be very careful what they do or don’t do in the developing world; it can be very risky.
Competitiveness

International competitiveness

This refers to the ability of a country (or firm) to provide goods and services which provide better value than their overseas rivals. This is competitive advantage but on an international scale.

As there is constant threat from foreign competition it is essential for business to strive to improve competitiveness.

Although there is a tendency to look to government to play a role in maintaining the competitiveness of UK business, in the final analysis it is a matter for individual firms.

Some determinants of International competitiveness

- Price relative to competitors
- Productivity - output per worker
- Unit costs
- State of technology
- Investment in capital equipment
- Technology
- Quality
- Reliability
- Lead time
- Entrepreneurship
- Exchange rate
- Relative inflation
- Tax rates
- Interest rates

Increasing competitiveness

Firms can increase their international competitiveness by:

- Rationalisation output to get rid of high cost plants
- Relocating to places where labour costs are lower
- Process innovation
- Product innovation
- Incorporating the latest technology into investment
- Sourcing from abroad where appropriate
- Seeking out new market opportunities
- Improving relationships with suppliers and customer

Government’s role to improve international competitiveness

- Encourage R&D spending (e.g. through tax breaks)
- Improve the skills base
- Improve the economic infrastructure
- Promote competition between firms
- Operate macro-economic policies favourable to business expansion
- Reduce interest rates to stimulate investment
- Reduce tax rates to stimulate enterprise, effort and investment
- Deregulation to promote competition
- Reduce bureaucracy
- Encourage sharing of ideas and best practice
- Reduce protectionist barriers to stimulate competition
- Encourage investment in human capital
Global Strategy

A global industry

A global industry can be defined as:

- An industry in which firms must compete in all world markets of that product in order to survive
- An industry in which a firm’s competitive advantage depends on economies of scale and economies of scope gained across markets

Global markets are international markets where products are largely standardised.

Michael Porter argued that industries are either multi-domestic or global.

**Global industries**: competition is global. The same firms compete with each other everywhere.

**Multi-domestic industries**: firms compete in each national market independently of other national markets.

In general businesses adopt a global strategy in global markets and a multi-local strategy in multi-domestic markets.

Global strategy

Companies such as Sony and Panasonic pursue a global strategy which involves:

- Competing everywhere
- Appreciating that success demands a presence in almost every part of the world in order to compete effectively
- Making the product the same for each market
- Centralised control
- Taking advantage of customer needs and wants across international borders
- Locating their value adding activities where they can achieve the greatest competitive advantage
- Integrating and co-ordinating activities across borders
- A global strategy is effective when differences between countries are small and competition is global. It has advantages in terms of
  - Economies of scale
  - Lower costs
  - Co-ordination of activities
  - Faster product development

However, many regret the growing standardisation across the world.

Multi domestic strategy

- A multi-domestic strategy involves products tailored to individual countries
- Innovation comes from local R&D
- There is decentralisation of decision making within the organisation
- One result of decentralisation is local sourcing
- Responding to local needs is desirable but there are disadvantages: for example high costs due to tailored products and duplication across countries

Comparison of the two strategies

Four drivers determine the extent and nature of globalisation in an industry:
<table>
<thead>
<tr>
<th>Market drivers</th>
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</thead>
<tbody>
<tr>
<td>• Degree of homogeneity of customer needs</td>
</tr>
<tr>
<td>• Existence global distribution networks</td>
</tr>
<tr>
<td>• Transferable marketing</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Potential for economies of scale</td>
</tr>
<tr>
<td>• Transportation cost</td>
</tr>
<tr>
<td>• Product development costs</td>
</tr>
<tr>
<td>• Economies of scope</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Government drivers</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Favour trade policies e.g. market liberalisation</td>
</tr>
<tr>
<td>• Compatible technical standards and common marketing regulations</td>
</tr>
<tr>
<td>• Privatisation</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Competitive drivers</th>
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</thead>
<tbody>
<tr>
<td>The greater the strength of the competitive drivers the greater the tendency for an industry to globalize</td>
</tr>
</tbody>
</table>
Globalisation

Background

During the last decades of the 20th century many barriers to international trade fell and a wave of firms began pursing global strategies to gain competitive advantage.

Rather than thinking in terms of national markets and national economies, leaders of business thought in terms of global markets.

Let us first consider why there has been such a rapid expansion of overseas trade in recent decades.

Causes of rapid expansion of trade

- Rising real living standards
- Trade liberalisation (World Trade Organisation, expansion and deepening of the European Union)
- Transition to market systems in Eastern Europe
- Rapid growth in the Asian Tigers and more recently in China and India
- Privatisation in and liberalisation of domestic markets
- Deregulation of international capital markets
- Fall in transport costs
- Improvement in global communications

What is globalisation?

Globalisation is a business philosophy based on the belief that the world is becoming more homogeneous - national distinctions are fading and will eventually disappear.

Globalisation is an increase in interconnectedness and interdependence of economic activity and social relations.

If the world is homogeneous then companies need to think globally and standardise their strategy across national boundaries.

Globalisation concerns:

- Trade in goods and services
- Investment
- Labour force movement
- Products
- Production
- Technology
- Research and development
- Exchange of ideas and knowledge
- Intellectual property

Key features of globalisation

- Rapid expansion of international trade
- Internationalisation of products and services by large firms
- Growing importance of multinational corporations
- Increase in capital transfers across national borders
- Globalisation of technology
- Shifts in production from country to country
- Increased freedom and capacity and firms to undertake economic transactions across national boundaries
- Fusing of national markets
- Economic integration
- Global economic interdependence

**Growth of multinational enterprise:**

- The search for growth markets
- Globalisation of markets
- Desire to reduce production costs
- Desire to shift production to countries with lower unit labour costs
- Desire to avoid transportation costs
- Desire to avoid tariff and non tariff barriers
- Forward vertical integration
- Extension of product life cycles
- Deregulation of capital markets
Globalisation And Business - Introduction

What is Globalisation?

‘Globalisation’ means ‘the reduction of the difference between one economy and another’ so that trade within and between different countries is increasingly similar all over the world. Globalisation has become a big buzz word in the last 10/15 years, but it has been going on for centuries, and especially since 1945. What has changed is the pace of this trend; it used to be quite a slow process and in recent years it has become much faster.

Background

In the 17th Century new ship design allowed Europeans to start trading with the rest of the world in a much bigger way, although trade was still a tiny part of the economy compared to agriculture.

Later developments in transport, steam ships, the railways and now aircraft, have all contributed to the development of trade. Aircraft also move people around quickly, so the sense of the size and distances of the world ‘shrinks’ making us feel that far-away places are no longer so strange. The internet now allows international communication in a way that was not possible before; your favourite site could just as easily be in New Zealand as in London.

The WTO has, since 1945, made major reductions to the barriers to trade, and this has led to an enormous increase in international trade compared with domestic trade. Because world trade has consistently grown much faster than world GDP, the proportions of domestic versus international business have changed; much more of all countries’ business is now done overseas than used to be the case.

Increasing Economic Integration

A second important idea is that of ‘integration’. In the past, an economy was largely self-contained, and imports and exports were something that happened almost co-incidentally. Now, economies depend closely on each other for inputs eg raw material and for markets for outputs.

A recession in one economy (especially a large economy like Japan or the US) affects many other economies. Consumer markets are the most important in any economy. There has been a rapid convergence of consumer tastes and buying habits, so the purchases of consumers all over the world have an increasing amount in common (although there are still many important differences); a business can sell much the same product in many different markets. A global brand like ‘Coca-Cola’ is very good examples of this.

Multinational companies (“MNCs”) have existed for many years, but today there are many more of them and their importance to all economies has become much greater. Their example, and their success, has led many businesses to change their strategic objectives and their management thinking so ‘thinking globally but acting locally’ is now much more common; many businesses used to almost ignore what went on elsewhere.

Factors Affecting Globalisation

The following main factors have fuelled the pace of globalisation:

1. **Technological change, especially in communications technology.** For example, UK businesses and data by satellite to India (taking advantage of the difference in time zones) where skilled but cheaper data handlers input the data and return it by satellite for the start of the UK working day.

2. **Transport is much cheaper and faster.** This is not just aircraft, but also ships. The development of containerisation in the 1950s was a major breakthrough in goods handling, and there have been continuing improvements to shipping technology since then.

3. **Deregulation.** From the 1980s onwards (starting in the UK) many rules and regulations in business were removed, especially rules regarding foreign ownership. Privatisation also took place, and large
areas of business were now open to purchase and/or take-over. This allowed businesses in one country to buy those in another. For example, many UK utilities, once government businesses, are owned by French and US businesses.

4. **Removal of capital exchange controls.** The movement of money from one country to another was also controlled, and these controls were lifted over the same period. This allowed businesses to move money from one country to another in search for better business returns; if investment in one’s own country looked unattractive, a business could buy businesses in another country. During the 1990s huge sums of money, mainly from the US, have come into the UK economy. See, for example, this news story: [http://news.bbc.co.uk/1/hi/business/2250903.stm](http://news.bbc.co.uk/1/hi/business/2250903.stm)

5. **Free Trade.** Many barriers to trade have been removed. Some of this has been done by regional groupings of countries such as the EU. Most of it has been done by the WTO. This makes trade cheaper and therefore more attractive to business.

6. **Consumer tastes have changed, and consumers are more willing to try foreign products.** The arrival of global satellite television, for example, has exposed consumers to global advertising. Consumers are more aware of what is available in other countries, and are keen to give it a try.

7. **Emerging markets in developing countries,** especially the ‘Tigers’ of SE Asia eg Thailand. There has been high growth of incomes in these countries, which makes large consumer markets with money to spend. Indonesia, for example, whilst still not particularly rich, has some 350 myn consumers. Both India and China are very poor countries, but there are small middle classes who are doing very well and have money to spend. Although these groups are small in the context of the country, the overall populations are so huge (over 1 byn) that a small middle class adds up to many millions of consumers.
**Effects On Business**

### The Effects of Globalisation on Business

The effects vary a lot from one part of the world to another, and from one area of business to another. Communications infrastructure is important to modern businesses, but not all countries have got one. There is also the ‘non-traded’ sector ie goods and services which are not traded internationally. Domestic services, for example, have to be provided where the house is; you can’t export a clean house.

**Competition**

- Foreign businesses buy into domestic markets.
- Deregulation opens up markets to competition.
- Deregulation encourages innovation in new products and markets which challenges traditional market leaders.

**Meeting consumer expectations and tastes**
- Generally, consumers all over the world are better informed, have higher incomes and therefore higher and more exacting expectations. This forces businesses to meet higher standards.

**Economies of scale**
- Selling into a global market allows for enormous economies of scale, although not all industries benefit from these.

**Choice of location**
- Businesses are now much freer to choose where they operate from, and can move to a cheaper and more efficient location. In the last decade the UK has been seen by many businesses as an attractive business location, especially in financial services, and many businesses have located in the UK which has boosted the UK economy but also provided increased competition for UK businesses. This increased movement of businesses and jobs has, to some extent, forced governments to compete with each other in providing an attractive and low-cost location. Ireland, for example, offers ‘tax holidays’ to businesses relocating there. Manufacturing businesses are increasingly relocating to low-wage countries such as Indonesia. Inputs vary in price across the world, and businesses now have more freedom of movement in moving to get hold of those cheaper inputs eg labour in developing countries, or financial advice in the City of London. One limitation on this is that managers won’t always move to some countries if living conditions are unpleasant or even dangerous.

**Multi-national and multi-cultural management**
- This is a major challenge to businesses and their managers. A multi-national business environment is more complex with more variables, and so is more difficult to manage. A multi-cultural employment policy leads to employees of many different nationalities, languages, religions and cultures in different offices across the globe. These employees react in quite different ways to incentives, to motivation and it is very difficult to find managers who are sensitive to all these different factors. It is very easy to inadvertently give offence and demotivate workers. For example, the Japanese were initially very disappointed with their Thai employees who didn’t respond well to Japanese methods of building up corporate loyalty and motivation. Once they turned production targets into a game, the Thais worked extremely well.

**Globalisation of markets**
- National borders are becoming less and less important. Markets stretch across borders and MNCs are well-placed to take advantage of this. The same issues of language and culture and so on arise. Consumers are more alike, but by no means the same. Many businesses have made expensive mistakes by not taking local variation sufficiently into account. Marketing, in particular, is a minefield because of its dependence on language. The marketing books are full of stories, often very amusing, of how businesses got it wrong. For example, the GM Nova failed in Spain because ‘NoVa’ means ‘doesn’t go’ in Spanish. See, for example, [http://news.bbc.co.uk/1/hi/business/1592295.stm](http://news.bbc.co.uk/1/hi/business/1592295.stm)
Globalisation And Business - Multinationals

The Influence of Multi-Nationals

Multinational Companies ("MNCs") have become very large and very powerful. Some, for example, are worth more than the entire GDP of many countries. So MNCs can have an enormous effect, for good and for ill, on the countries they do business in, especially if those countries are small and/or poor. This revision note examines the main areas of influence:

The Balance of Payments

MNCs import large amounts of capital in order to pay for their new business investments; factories, offices or whatever. This surplus on the capital account creates a deficit on the current account ie the country is importing more goods and services than it is exporting. This lifts local standards of living until the import of capital stops for whatever reason and then standards fall again.

If the new business is for import substitution (ie producing locally what had been imported) then imports fall and the current account improves. If the new business is developing local raw materials for export (eg oil exploration) then the exports of raw material also improve the current account.

But, the MNC may need to import large amounts of technical equipment not available locally, and this will worsen the current account. If the MNC re-invests its profits then there is no effect on the Balance of Payments, but if it repatriates its profits, the current account worsens. Further, the exchange market of a small country may not be well-developed, so the attempt by a business to buy or to sell large amounts of foreign exchange will send the price of that currency sharply up or down unless things are managed very carefully

Employment

Generally, MNCs set up new businesses which need new workers and so employment is improved; jobs are created. However, it depends on the skills match between the new jobs and the local employment market. The business may set up a factory specifically designed to suit the local employment market. But in the Middle East oil states, for example, there are many factories producing for the local consumer markets. Sometimes the jobs are too demanding for the locals, and sometimes the jobs are too demeaning. Either way, the result is huge numbers of expatriate workers from India, Bangladesh, the Philippines and so on and at the same time large local unemployment.

But, MNCs can sometimes provide devastating competition for local businesses which may end up closing which creates unemployment. MNCs usually employ fewer workers; that is part of their greater efficiency. The MNC may then relocate again after a period of years.

Technology transfer

An MNC invariably operates to a higher standard of managerial and technical expertise than the local economy. Local employees can learn about these things and the local economy can benefit from this new expertise. Even the UK can benefit, so we are not simply talking about developing countries where technology transfer is enormously important. This will depend on how willing the MNC is to employ and train local workers.

Social responsibility

Standards and regulations are another kind of business cost, and MNCs are always looking for lower costs. So there is an advantage to locating in countries with few regulations. Some poor countries are prey to corruption and bribery which means their few regulations are ineffective. India, for example, has excellent environmental protection laws, on paper. In practice, the inspectors are so badly paid it only costs a matter of dollars to get them to look the other way. This opens the way for a slippage of standards below the levels considered acceptable in the MNCs home country.

One of the most scandalous cases was in the 1980s where the US chemical business Union Carbide tolerated very poor safety standards at a factory in Bhopal, India.. The result was an explosion which
released clouds of toxic gas and killed thousands. Many more thousands are still alive and very ill because of this. What was particularly irresponsible was the long years it took to force Union Carbide to accept responsibility and pay compensation. This whole area is a large and important area which it is impossible to cover completely. It is, for example, one important reason why some western pressure groups are so hostile to MNCs

**Government control**

It is quite difficult for some governments to exercise effective control over MNCs because they are so large and powerful. One MNC may be the dominant force in the local economy. Even large and wealthy countries such as the UK can’t always control MNCs effectively. They have a wide repertoire of tricks to minimise government control, especially taxes.

One favourite trick (technically illegal) is **transfer pricing**. MNCs often buy and sell between different national offices of the same business, because each is a separate profit centre. For example, the Paris office makes the product, and the Berlin office sells it. So the Paris office has to sell to the Berlin office. There is then the question of at what price the sale takes place. Officially, the selling price must be the market price on the day, but some markets don’t have prices every day, and governments have a difficulty in proving what is going on.

If, for example, German company taxes are higher than French company taxes, then the Berlin office will pay too much for the product and make a loss. The Paris office makes a very large profit and pays tax on this profit at the lower rate. When different governments have completely different tax systems, with thousands of detailed rules of how tax is paid, and deductions for this, and allowances for that, the opportunities for MNCs to employ a few clever tax accountants and ‘cook the books’ are enormous.