CPA

Certified Public Accountant Examination

Stage: Foundation 1

Subject Title: F1.4 Business Management Ethics and Entrepreneurship

Study Manual

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Foundation F1

F1.4 BUSINESS MANAGEMENT, ETHICS & ENTREPRENEURSHIP

First Edition 2012

This study manual has been fully revised and updated
in accordance with the current syllabus.
It has been developed in consultation with experienced lecturers.

CONTENTS

INTRODUCTION TO THE COURSE

Stage: Foundation 1

Subject Title: F1.4 Business Management, Ethics and Entrepreneurship

Aim

The aim of this subject is to ensure that students have an understanding of key principles and concepts in business management and also a full understanding of the importance of business and professional ethics in their conduct and actions. They should also be aware of the skills required to be a successful entrepreneur and the importance and techniques of effective communication.

Business Management, Ethics and Entrepreneurship as an Integral Part of the Syllabus

The principles and concepts learnt in this subject are relevant to students throughout their professional accounting studies.

Although there are connections with many subjects throughout the syllabus, knowledge gained from this subject will also be particularly relevant in the further study of *Auditing, Audit Practice and Assurance Services, Financial Accounting, Introduction to Law, Management Accounting* and *Strategy and Leadership.* There is a connection between communications subjects and the *Information Systems* paper.

Learning Outcomes

On successful completion of this subject students should be able to show:

- An understanding of the core Business functions of Management and marketing
- An understanding of the attributes of an effective entrepreneur.
- An understanding of how these functions affect the running of a modern business.
- An understanding of the key concepts and fundamental principles of Ethics and the practical application of them in the context of business and commercial activities.
- Enhanced communication skills, verbal and written, that allow candidates to disseminate information and messages clearly to a range of audiences.

Syllabus:

1. Foundations of Business Management

- The nature of management and its role in business
- Common business analysis techniques such as SWOT and PEST
- The challenges that arise in the contemporary business environment and its dynamic nature

2. Management

- The fundamental principles and theories on which business management is based
- The contributions of management within a modern business organisation
- The challenges involved in effective business management
- Functions of Management
- The role of Human Resource management within the organisation and the associated challenges that may arise

3. Marketing

- The role of marketing and sales within the organisation
- The importance of customer relations, market research and marketing communications
- The use of the internet in marketing
- Marketing ethics
- The different elements of the marketing mix and the role of services marketing

4. Governance

- The main elements of governance that apply to both large and small companies

5. Ethics

- The concepts and principles of the ICPAR Code of Ethics and the IFAC Code of Ethics
- Disciplinary procedures of ICPAR and the consequences of a breach of the regulations
- The ethical obligations upon a person dealing with financial information, products and services
- The ethical obligations of company directors
- The ethical obligations of auditors

6. Entrepreneurship and self-employment

- The definition of entrepreneurs and entrepreneurship
- Factors to be reviewed when considering self-employment
- The economic importance of self-employment
- Entrepreneurship and innovation
- Entrepreneurial characteristics
- The role and challenges of an entrepreneur

7. Entrepreneurial opportunities

- Generation and sources of business ideas
- Business incubation
- Qualities of a good business opportunity
- Assessing and selecting a suitable market
- Matching skills and resources to changing technology
- The protection of business ideas and business security issues
- Networking

8. Enterprise development

- Factors and trends that influence the growth of business enterprises
- Business life cycles, stages and challenges faced by an entrepreneur at each stage
- Strategies for managing growth and transition
- Factors for success at each stage of development
- Statutory policies on enterprise development

9. Entrepreneurial awareness and motivation

- Procedures involved in starting a business
- Sources of business finance, for example micro-finance
- Legal forms of business ownership
- Legal aspects in business: licenses, labour laws, health and safety rules
- Business contracts and tendering procedures
- Business amalgamations for example mergers, acquisitions, franchise, take-overs, integrations
- Motivational theories of entrepreneurship
- Incentives for aspiring entrepreneurs

10. Business plan development

- The definition and importance of a business plan
- The components of a business plan: business description, owners, products/services, marketing plan, organisation and management plan, operational/production plan, personal financial statement, financial plan, executive summary, appendices.

11. Current issues in entrepreneurship

- Taxation, trade exhibitions, e-commerce, globalisation, outsourcing
- Entrepreneurship Education & Training
- Social Entrepreneurship (NFP- Not for Profit)

12. Essential communication skills

- Communication processes and barriers
- Channels of communication
- Types of verbal and non-verbal communication
- The importance of listening skills, critical thinking and problem solving

13. Business communication

- Meetings and interviews
- Business correspondences: letters, memos, circulars
- Report writing, types, structure and uses of reports
- Postal and courier services
- Presentations: planning, organising/delivering business presentations

14. Technology and communication

- Telephone, fax
- Email
- Internet
- Electronic postal services and money transfers
- Other modern communication technologies

15. Emerging trends in communication

- Diversity in physical infrastructure & Higher Speed broadband networks
- Network Management Technologies e.g. E-Security
- Web based services and the emerging "social web" – social networking sites (SNS), Mobile Web, Internet TV, Cloud Computing, Virtual Identities, Semantic Web

SECTION 1: INTRODUCTION TO MANAGEMENT

Study Unit 1

Nature and Role of Management

Contents

A. MANAGEMENT - DEFINITION

Management is the process of achieving organisational objectives by working with and through others in an ever-changing environment.

Fayol (1916) wrote that all managers perform five main management functions:

1. **Planning:** Planning is an activity which involves making decision about ends.
2. **Organising:** This is concerned with dividing and coordinating tasks.
3. **Commanding:** This refers to the importance of leadership in organisations.
4. **Controlling:** Controlling involves measuring actual performance against agreed standards and taking corrective action if necessary.
5. **Co-ordinating:** This involves ensuring that all activities and groups are brought together to achieve the overall objectives.

Today these functions have been condensed down to the following four:

1. Planning
2. Organising
3. Leading
4. Controlling

1. Planning

Planning is concerned with where the organisation wants to be in the future and how it is going to get there. The planning function includes defining an organisation's goals, establishing an overall strategy for achieving those goals and developing a hierarchy of plans to co-ordinate all activities. Planning can be long term or short term and takes place at all levels in the organisation.

2. Organising

Organising generally follows planning and it refers to deciding on an organisational structure, staffing it adequately and making sure the organisation is running efficiently. Managers develop a framework of necessary tasks and available resources called an organisational structure. This structure sets out the groupings of staff organisation. In simple terms organising includes determining how tasks are to be done, who is to do them, how the tasks are to be grouped, who reports to whom and where decisions are to be made.

3. Leading

Leadership involves motivating employees to achieve organisational goals. Leading entails creating a vision, communicating that vision and goals, and influencing others to achieve high levels of performance. It also involves directing the activities of others and resolving conflicts among employees.

4. Controlling

Activities within an organisation don't always go as smoothly as planned. Controlling involves monitoring employee activities to determine whether or not they are achieving targets. It involves comparing actual performance against predetermined goals and taking corrective action if necessary.

B. ROLE OF MANAGEMENT

Mintzberg (1973) suggested that rather than looking at the functions of managers, we should instead look at the roles they perform. Mintzberg identified ten roles that all managers perform and grouped these roles into three categories as shown in Figure 1.1.

Category	Role
Interpersonal Role	Figurehead
	Leader
	Liaison
Information Role	Monitor
	Disseminator
	Spokesperson
Decisional Role	Entrepreneur
	Disturbance Handler
	Resource Allocator
	Negotiator

Figure 1.1: The role of management

Interpersonal Role

A key aspect of a manager's job involves interacting with other people. In the role of **figurehead** the manager represents the organisation by performing ceremonial and symbolic activities. In the role of **leader** a manager will attempt to motivate, communicate with and influence people. As a **liaison** a manager develops relations with groups both inside and outside the organisation. These groups could include customers, trade unions and government departments.

Information Role

Information is a very important resource of any organisation. The **monitor** role refers to the acquiring of information from internal and external resources. The **disseminator** role refers to the transmitting of information to those who require it. As a **spokesman** a manager conveys information to groups outside the organisation such as the media.

Decisional Role

The **entrepreneur** role involves the manger seeking out new ways to deal with problems and find opportunities for the organisation. The **disturbance handler** role involves resolving conflicts between individuals and teams. In the **resource allocator** role the manager must make decisions on how to allocate resources such as money, people, materials and time, to best achieve the objectives of the organisation. In the **negotiator** role a manager will negotiate with various interest groups such as customers, suppliers and other managers.

C. LEVELS OF MANAGEMENT

The following are the three main levels of management:

1. Senior Management
2. Middle Management
3. Front Line Management

Senior Management

Senior management are concerned with strategic issues such as the mission and direction they will take into the future. They must make and implement strategic decisions and communicate these decisions to relevant parties such as the shareholders and customers.

Senior managers include the Chairperson, Chief Executive, Directors and members of the Board.

Middle Management

Middle management operates at a tactical level, translating strategic direction and organisational goals into tangible achievable objectives for their division. Middle management acts as a link between the strategic level and the operational levels. Examples of middle managers include Plant and Operations managers.

Front Line Management

This level of management, which is also referred to as "Supervisory Management" and “Operations Management”, is responsible for directly managing and supervising employees involved in the day-to-day operations of the organisation. Front line managers operate between middle management and the operational personnel.

Team Leaders

In the traditional management hierarchy there are three levels of management as shown in Figure 1.2. In these traditional structures the line managers are responsible for the performance of non-managerial employees and have the authority to hire and fire workers, make job assignments and control resources. Williams, C. (2007) identifies a fourth kind of manager – the team leader. This new kind of management job has developed as companies have shifted to self-managed teams. Team leaders are responsible for facilitating team performance. Team leaders help their team members plan and schedule work, learn to solve problems and work effectively with each other. Team leaders act as a bridge between their own teams and other teams. Team leaders are also responsible for internal team relationships.

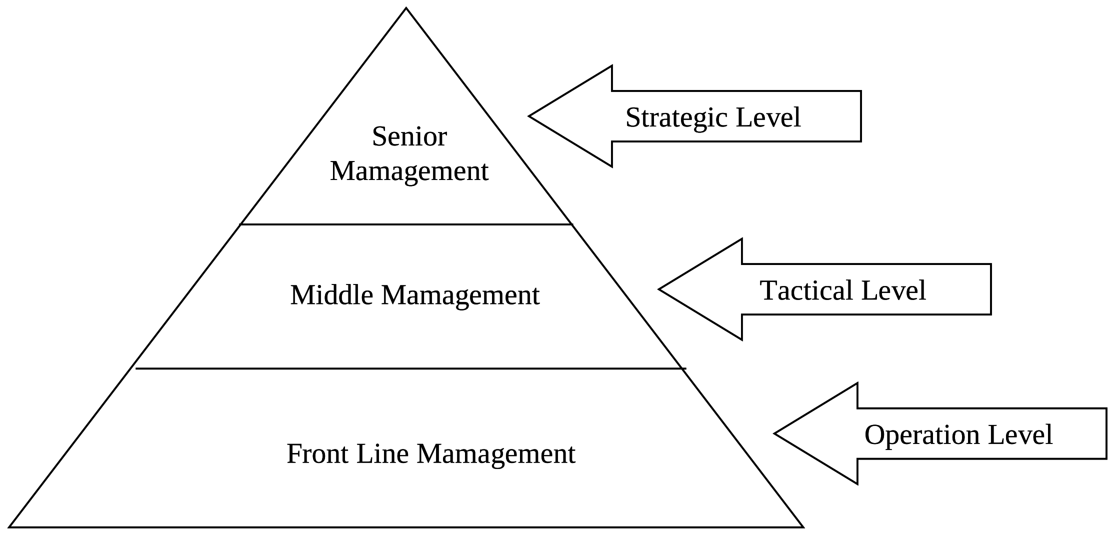


Figure 1.2: The different levels of Management

Planning Horizon

A key task of managers at all levels is planning. However the planning timeframe is different for each level. Senior managers plan for the long term, between 3-5 years. Middle managers focus on a mid-term timeframe, normally for up to three years. Front-line managers plan for the short term normally in term of weeks and months.

Horizontal levels of Management

The three levels of management discussed above are called vertical levels. Different types of management also occur horizontally across the organisation. Functional departments such as marketing, operations, finance and human resources have their own functional managers who are responsible for activities within their department. The various management functions are discussed in Section 3 of this course manual.

D. MANAGEMENT SKILLS

A manager should posses a range of skills in order to be successful. The skills required can be grouped into three categories (Katz, R. 1973):

- Technical Skills
- Human Skills
- Conceptual Skills

Technical Skills

Technical skills relate to the performance of specific tasks. It relates to expertise in specific organisational functions such as finance, operations etc. Technical skills could also include specialised knowledge and competencies with particular tools and techniques. Technical skills are more important at lower levels of management.

Human Skills

Human skills are often referred to as interpersonal skills and include the ability to work with other people and work effectively in group situations. Human skills are concerned with a manager's ability to motivate, lead, communicate and resolve conflict. Human skills are important at all levels of management.

Conceptual Skills

Conceptual skills refer to the ability to think strategically, to take a long-term, broad view of the organisation in its entirety and the relationship between each part.

Managers at all levels in the organisation require conceptual skills but they are of greater importance at the senior levels.

In addition to these three categories of skills managers must be effective in a range of other skills such as verbal and written skills.

E. EFFECTIVE MANAGERS

According to research by John Kotter (1999), Effective Managers spend significant time establishing personal agendas and goals; both short and long-term. Effective managers spend a great deal of time building an interpersonal network composed of people at virtually all levels of the organisation. Managers use their networks to execute personal agendas and accomplish their own goals.

To be an effective manager a person must have the necessary skills required to manage.

Characteristics of Effective Managers

Bateman and Zeithamal (1993) proposed the following three characteristics of effective managers or leaders:

1. Active Leadership
2. Ability to Motivate Others
3. Opportunity of High Performance

Active Leadership

Active leaders are those who take a hands-on role. They make an active contribution to the team effort.

Ability to Motivate Others

Effective managers are able to motivate others to achieve the organisation’s goals. They communicate to workers the importance of these goals and the performance required to achieve the goals.

Provide Opportunity of High Performance

To be able to achieve a high level of performance; managers must have autonomy and control over their area of work. Having control over resource and decision-making is crucial to the effectiveness of managers.

F. MISTAKES MANAGERS MAKE

Another way to understand what it takes to be a manager is to look at the mistakes managers make. Based on studies of US and British managers, Williams, C. (2007) identifies the following top ten mistakes that managers make:

1. Insensitive to others; abrasive, intimidating; bullying style
2. Cold aloof, arrogant
3. Overly ambitious: thinking of the next job, playing politics
4. Specific performance problems with the business
5. Over-managing; inability to delegate
6. Unable to staff effectively
7. Unable to think strategically
8. Unable to adapt to a boss with a different style
9. Over-dependent on advocate or mentor

G. BUSINESS ETHICS AND SOCIAL RESPONSIBILITY

Business ethics concerns the moral conduct of an organisation. It concerns the moral judgements that managers have to make, taking into account their own belief and the organisation's belief of what is right and what is wrong. There are three categories that govern human behaviour (Daft, 2010). The first relates to the law and what is legal, while the third is the area of free choice where the individual (or firm) is free to choose how to behave. In between the two extremes is the second category which is the area of ethics choice. While the law does not govern actions in these areas, there are moral standard, values and expectations that are shared by society and should guide individual and corporate behaviour. For example is it ethical for a profitable company to cut employee’s wages so it can make even greater profits? Ethics presents dilemmas for business as a decision made on an ethical basis may reject the most profitable option in favour of one that is of greater benefit to society.

Ethical Decision Making

To aid organisations that want to pursue an ethical direction in their activities, they can apply one of the following ethical decision making approaches:

- Utilitarian Model
- Moral Rights Model
- Justice Model

Utilitarian Model

Under a utilitarian model an ethical decision is one that produces the greatest good for the greatest number of stakeholders. Therefore a manager would consider the impact of a decision on each stakeholder group and attempt to choose a course of action that would maximise the benefits and minimise the costs overall. Therefore this represents a logical/benefits analysis approach that appeals to managers. However the difficulty is trying to appreciate the value of the decision to each stakeholder group.

Note: Stakeholders would typically include:

- Owners and Senior Managers
- Employees
- Customers
- Suppliers
- Local Community
- Government

Moral Rights Model

This approach proposes that certain rights should be protected, such as freedom of choice, privacy, health and safety, freedom of speech etc. Therefore any decision that violates these rights is considered to be unethical. The difficulty with this approach is deciding the importance of stakeholder's rights, whose rights takes priority – the right of the individual or the rights of the business.

Justice Model

This approach rests on equity, fairness and impartiality. Therefore, an ethical decision is one which shares the costs and benefits of a decision amongst stakeholders groups, in a fair manner. However, equity does not imply equality, consequently when distributing pay rises it may seem equitable to reward those performing at a higher level. This may be seen as fair but not equal.

Corporate Social Responsibility

Corporate social responsibility is management's obligation to make choices and take actions that will contribute to the welfare and interests of society as well as to the welfare and interests of the organisation (Daft, 2010). A business has economic responsibilities to produce goods and services that society wants and to generate profits for shareholders. Organisations have legal responsibilities to operate within the law. A business also has an ethical responsibility that may go beyond areas covered by the law to treat individuals fairly and equally, and to respect the rights of the individual and society as a whole. The company can also exercise discretionary responsibilities, which drive voluntary acts that make a contribution to society, for which no economic gain is expected.

Corporate Governance

Corporate governance is concerned with the structures and systems of control by which managers are held accountable to the stakeholders in an organisation (Jacoby, S. 2005). In simple terms corporate governance refers to the system by which companies are directed and controlled. It can include internal elements defined by the company officers, shareholders or the constitution of a company, as well as external elements such as government regulations. The aim of corporate governance is to increase transparency and accountability in the manner in which companies are governed.

Corporate governance deals with how management conduct their affairs and how the board of directors supervise the running of the organisation. Corporate governance is the response to the need for ways of ensuring that an organisation is pursuing its proper ends, typically by keeping directors and managers accountable to the shareholders.

Better, more ethical corporate governance has come to be seen as the answer to the public perception of corporate wrongdoing. People often point to practices such as high dividend payouts to shareholders, high executive compensation and the 'short-termism' of many business enterprises, which focus exclusively on immediate profits, as evidence that new codes of conduct are needed.

In response to a series of high profile corporate failures and evidence of corporate wrongdoing in the United States in early 2002 (Enron, WorldCom etc.), many countries enacted laws and put codes of practice in place to improve corporate governance. In the US the 2002 Sarbanes-Oxley Act was put in place to protect shareholders and the general public from accounting errors and fraudulent practices in business.

Whistleblowing

Whistleblowing occurs when an employee informs the public of inappropriate activities going on in the organisation. The whistleblower may be motivated by moral reasons or may have been passed over for promotion or suffered some other injustice in the workplace. The consequences of whistleblowing are often extreme: loss of job and/or home, ostracism by peers, loss of family relationships, personal isolation and effects on physical health. Employers look on whistleblowers as disloyal and unworthy of trust, while their peers may regard them as weak or unbalanced. Legislation has been passed in many countries to protect the whistleblower, because if these individuals do not come forward, many cases of wrongdoing would never be exposed.

The arguments for Ethics and Social Responsibility

Daft, (2010) put forward a number of reasons why it makes good business sense to be concerned about ethics and social responsibility:

- Paying attention to ethics and social responsibility is as important as profits and costs
- Ethical and social actions impact financial performance
- Companies are beginning to measure non-financial factors that create value
- Customers pay attention to a company’s ethics and social responsibility

Study Unit 2

Evolution of Management Theory

Contents

A. INTRODUCTION TO HISTORY OF MANAGEMENT

Management may only have been a field of study for the last 100 years, but management principles have guided how work has been done for over 5,000 years.

From the ancient Egyptians, Greeks, Chinese and Romans to modern times, leaders have used planning, organising, leading and controlling to accomplish all types of tasks, from the daily duties to large civil engineering projects.

Work has shifted from families and self-organised groups of skilled labourers, to large factories employing thousands of individuals that use large standardised mass production. As these organisations developed, managers were needed to enforce order and structure, to motivate and direct large groups of workers, and to plan and make decisions that optimised overall performance (Williams, C. 2007).

There are a number of key phases in the development of management theory over the last 100 years. Some of the key approaches are shown Figure 2.1.

Classical Approaches		**Date when approach began**
	Scientific Management	1898
	Bureaucracy Management	1916
	Administrative Management	1920s
	Human Relations Management	1927
Modern Approaches		
	System theory	1950s
	Contingency theory	1960s
	Total quality Management	1970s
	Organisational Culture	1980s

Figure 2.1: The evolution of Management thought (Tiernan, Morley & Foley, 2001).

B. CLASSICAL MANAGEMENT THEORIES

The study of management theory began around the start of the twentieth century. Mass production and the development of large industries gave rise to demand for a way to manage these organisations and increase labour productivity.

The key elements of the classical management approach are:

1. Scientific Management
2. Bureaucracy Management
3. Administrative Management
4. Human Relations Management

Scientific Management

Fredrick Taylor (1865-1915) is credited as one of the founders of scientific management. In his book "The Principles of Scientific Management" in 1911, he emphasised the need to take a more scientific and systematic approach to management.

The main elements of Taylor's approach were:

- A "work study" or systematic analysis of the production process followed by the breaking of jobs into a number of key tasks with each task to be performed separately.
- All planning was taken over by management, leading to workers losing control over how their work was done.
- Workers were issued with work instructions that set out:
    - What needed to be done
    - How it should be done
    - How long it should take
- Select workers that were most suitable for the job and train them.
- Provide workers with financial incentives by results based payments - a piece rate system.

Scientific Management led to increased labour productivity from workers who specialised in one simple repetitive task. Replacing skilled workers with non-skilled workers could also reduce labour costs.

Scientific management could also lead to deskilling of workers that may result in dissatisfaction among workers and low levels of motivation, which could adversely affect productivity.

This approach was also accused of dehumanising of workers – treating them as if they were machines.

Scientific Management after Taylor

Three followers of scientific management were Frank and Lillian Gilbreth and Henry Gantt.

The Gilbreth's followed on from Taylor's work on work-study by analysing bricklayer's movements. From their work on task or method study they were able to reduce the movements of a bricklayer. Flow charts were devised by the Gilbreths to enable whole processes or operations to be analysed.

Henry Gantt a contemporary of Taylor felt that the individual worker was not given enough consideration. Gantt introduced a payment system where performance below that described on a workers instruction card still qualified that person for the day rate but performance of all work on the instruction card qualified the individual for a bonus. The Gantt chart was initially used to graphically represent tasks achieved. See Chapter 7 for a description of a Gantt chart.

Overall the most important outcome of scientific management was that it stimulated ideas for improving the systematic analysis of work at the workplace. The disadvantage of scientific management is that it subordinated the worker to the work system.

Bureaucratic Management

Max Weber (1864-1920), a German theorist put forward the idea of the Bureaucratic organisation with its pyramid structure and chain of command with the senior manager at the top. Weber felt that bureaucracy was indispensable for the needs of large-scale organisations and that this form of organisation exists to a greater or lesser extent in practically every business and public enterprise.

The six main elements of Weber's approach were:

1. **Division of Labour**: The division of labour allowed specialisation, responsibility and authority to be defined, which led to increased efficiency.
2. **Hierarchy**: Authority was centralised at the top of the organisation and positions were organised in a hierarchy structure. The degree of one’s authority depended on the position you occupied in the hierarchy.
3. **Selection**: Weber believed that jobs should be filled according to technical skill and expertise of the individual rather than through favouritism.
4. **Career Orientation**: Management was considered a professional career that did not necessarily involve future ownership in the company.
5. **Formalisation**: Roles and procedures were developed to guide the way things are done, rather than ad-hoc decision-making.
6. **Impersonality**: Rules and procedures applied to all employees regardless of their position in the hierarchy.

Today the term bureaucracy has tended to take on a negative meaning, as it is often associated with excessive administration, overstaffing, inefficiency, rigid rules and procedures.

Administrative Management

Administrative management focused on the whole organisation rather than solely on the employees. Henry Fayol (1841-1925) was one of the pioneers of administrative management.

In contrast to Taylor who focused on the bottom of the organisation, Fayol’s focus was on management. The main task of the organisation head, according to Fayol, was forecasting and planning. Fayol believed that all activities in a business could be split into the following six groups:

- **Technical** (Production)
- **Commercial** (Buying and selling)
- **Financial** (Accessing and using capital)
- **Security** (Guarding property)
- **Accounting** (Costing and stock-taking)
- **Managerial** (Planning, organising, controlling, commanding and coordinating)

Fayol believed that all six groups of activities were dependent on each other, and that they all needed to be run effectively for the business to prosper.

During his career Fayol developed the following fourteen principles of management, which he believed could be applied to any organisation:

Division of Work: Specialisation leads to efficiency as workers develop practice and familiarity.

Authority and Responsibility: The right to give orders should not be considered without reference to responsibility.

Unity of command: Employees should only receive orders from one superior or a manager.

Discipline: Clear defined rules and procedures to ensure order and proper behaviour.

Unity of direction: One head and one plan for group activities.

Subordination: Subordination of the individual interest to group interest.

Remuneration: Pay should be fair and satisfactory to both the employee and the firm.

Centralisation: May be present depending upon the quality of management and size of the organisation.

Scalar chain: This is the line of authority from the top of the organisation to the bottom.

Order: A place for everything and everything in its place.

Equity: A combination of kindness and justice to employees.

Stability of tenure: Employees need time to settle into their jobs and feel secure.

Initiative: All levels of the organisation's staff should be encouraged to show initiative.

Espirit de corps: Teamwork and team spirit should be encouraged.

Human Relations Theory

While the classical theorists were principally concerned with the structure and mechanics of the organisation, the theorists of the humanistic school were interested in the human factor.

The human relations movement emphasised the necessity to satisfy employees' basic needs in order for employee productivity to be increased. They believed that if workers are happy they will work harder.

The turning point in the development of the human relations movement came with the famous Hawthorne experiments at the Western Electric Company's Hawthorn plant in Illinois (1924-32). Elton Mayo and Fritz Roethlisberger carried out these experiments.

There were four main phases to the Hawthorne experiments:

1. The illumination experiment,
2. The relay assembly test room experiment,
3. The interviewing programme,
4. The bank wiring observation room experiment.

The illumination experiment divided the workers into two groups, an experimental and control group. Lighting levels fluctuated with one of the groups whilst the lighting with the other group remained constant.

The results of the tests were inconclusive as production in the experimental group varied without any relationship to the level of lighting, but actually increased when conditions were worse. They concluded that there was no simple cause and effect relationship between illumination and productivity and the increase in output was due to the workers being observed. This phenomenon was called the Hawthorne Effect, where workers were influenced more by psychological and social factors (observation) than by physical and logical factors (illumination).

In the relay assembly test room the work was boring and repetitive. Six women were transferred from another department to the assembly room where a number of tests were carried out including altering hours, rest periods and the provision of refreshments. The observer consulted regularly with the women, listened to their complaints, and kept them informed.

All of the changes to their conditions except one yielded an increase in production and so the conclusion drawn was that the attention paid to the workers was the main reason for the increased productivity.

The interviewing programme was conducted using prepared questions regarding workers feelings towards supervisors and their general work conditions. The result of the programme has given impetus to present day personnel management, counselling interviews and the need for management to listen to the workers.

The bank wiring observation room was centred around a group of fourteen men. It noted that the men formed their own informal organisation with sub groups or cliques. Despite financial incentive the group decided on a level of output below the level they were capable of producing; group pressures were stronger than financial incentives.

The main finding of the Hawthorn experiments is that workers increased their productivity simply because their needs were being catered for as part of the experiment. They were consulted about their part in the work and made to feel special.

Human relations writers demonstrated that people go to work to satisfy a complexity of needs and not simply for monetary reward.

Two other key contributors to the human relations approach were Abraham Maslow (1908-1970) and Douglas McGregor (1906- 1964).

Maslow proposed that people seek to satisfy a series of needs that range from basic needs such as food and shelter, to high level needs such as "self actualisation". Maslow's theory is covered in detail in Chapter 4.

McGregor questioned the assumptions made about workers in the past such as they disliked work and had to be directed and controlled. McGregor believed that organisations should harness the imagination and intellect of workers. His Theory X-Y is covered in detail in Chapter 4.

Other Contributors to the Classical Approach to the Study of Management

Two other important contributions to the study of management were:

- **Mary Parker Follett's** theories of constructive conflict and coordination.
- **Chester Barnard's** theories of cooperation and acceptance of authority.

CONSTRUCTIVE CONFLICT AND COORDINATION: MARY PARKER FOLLETT

Mary Parker Follett is often called the "mother of management". Her many contributions to modern management include the ideas of negotiation, conflict resolution and power sharing.

She believed that conflict could be a good thing and that it should be embraced and not avoided. She said that conflict is "the appearance of difference, difference of opinion and of interests". She identified three ways of dealing with conflict:

- **Domination**: An approach to dealing with conflict in which one party deals with the conflict by satisfying its own desires and objectives at the expense of the other party's desires and objectives.
- **Compromise**: An approach to dealing with conflict in which both parties deal with the conflict by giving up some of what they want in order to reach agreement on a plan by reducing or settling the conflict.
- **Integrative conflict resolution**: An approach to dealing with conflict in which both parties deal with the conflict by indicating their preferences and then working together to find an alternative that meets the needs of both parties.

Follett believed that integrative conflict resolution was superior to the other methods used because it focused on developing creative methods for meeting conflicting parties' needs.

Follett used four principles to emphasise the importance of coordination where leaders and workers at different levels and in different parts of the organisation directly coordinate their efforts to solve problems and produce the best overall outcomes in an integrative way.

These principles are:

- **Coordination in relation to all factors in a situation:** Because most things that occur in an organisation are related, managers at different levels and at different parts of the organisation must coordinate their efforts to solve problems and produce the best overall outcome.
- **Coordination by direct contact with the people concerned:** Working with those involved or affected by the organisation problem or issue will produce more effective solutions.
- **Coordination in the early stages:** The direct contact should be early in the process before people's views have become crystallised – they can still modify one another's views.

- **Coordination as a continuous process:** The need for coordination is never ending. The very process of solving a problem is likely to result in the generation of new problems to solve.

Follett's work significantly contributed to modern understandings of the human, social and psychological sides of management.

COOPERATION AND ACCEPTANCE OF AUTHORITY: CHESTER BARNARD

The former president of the New Jersey Bell Telephone Company, Chester Barnard, emphasised the critical importance of willing cooperation in organisations and said that managers could gain workers' willing cooperation through three executive functions:

- Securing essential services from individuals (through material, nonmaterial and associational incentives).
- Unifying members of the organisation by clearly formulating the organisation's purpose and objectives.
- Providing a system of communication.

Barnard's definition of an organisation relies heavily on his comprehensive theory of cooperation. He defined an organisation as "a system of consciously coordinated activities or forces created by two or more people".

Finally, most managerial requests or directives will be accepted because they fall within the zone of indifference, in which acceptance of managerial decisions are automatic. In general people will be indifferent to managerial directives or orders if they:

- are understood
- are consistent with the purpose of the organisation
- are compatible with the people's personal interests
- can actually be carried out by those people

Rather than threatening workers to force cooperation, Barnard maintained that it is more effective to induce cooperation through incentives, clearly formulating organisational objectives, and effective communication throughout the organisation. Ultimately, he believes that workers grant managers their authority, not the other way around.

C. CONTEMPORARY MANAGEMENT THEORIES

Since the 1950s, modern approaches to the study of management have tried to build on and integrate many of the elements of the classical approaches to provide a framework for managing modern organisations. This section concentrates on the following four important approaches:

- System Theory
- Contingency Theory
- Total Quality Management
- Organisational Culture

System Theory

System theory focuses on the analysis of organisations as systems with a number of interrelated sub systems and also an external environment that affects organisational performance (See Figure 2.2).

One of the key elements of system theory is that the organisation should be viewed as an **open system** with a range of inter-dependencies and both an internal and external environment. In contrast a closed system is one which focuses only on the internal environment of the organisation. Because organisations are open systems, they need to understand and anticipate the external environment if they are to survive.

Organisations also need to consider the subsystems within the business as **synergies** that can be achieved when all systems are working together (the whole being greater than the sum of its parts). Another aspect of system theory is called **entropy**; this refers to the tendency of systems to collapse and die if they don't receive new impetus from the external environment.

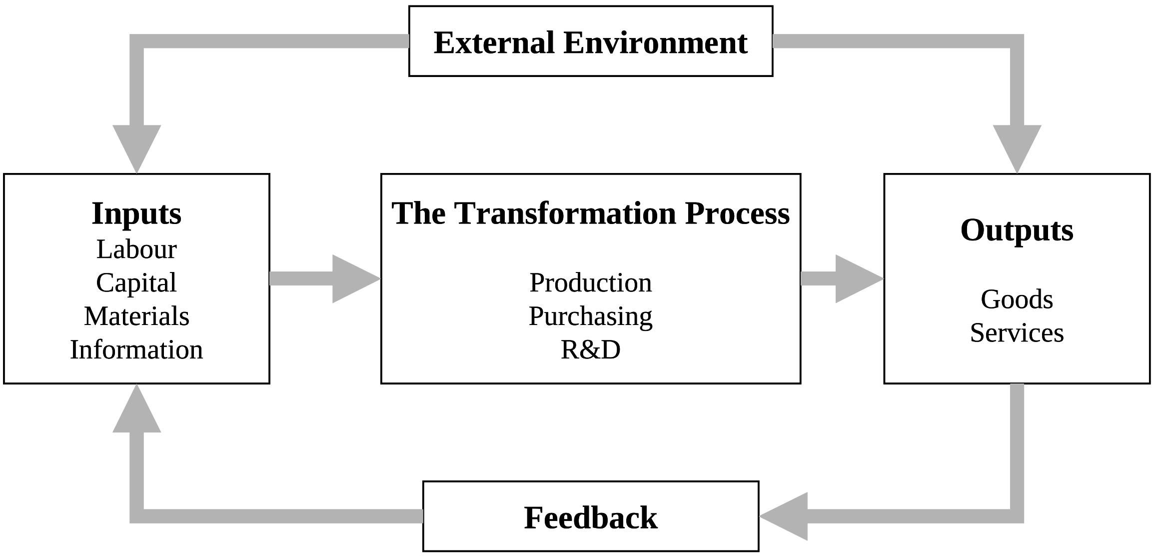


Figure 2.2: The System view of organisations

Contingency Theory

One of the limitations of many traditional management theories was that it was assumed that they apply to all situations. The contingency theory suggests that there is no single way to organise or manage. So when managers try to answer the questions outlined below, the contingency approach to management assumes there is no universal answer because organisations, people and the external environment vary widely and are constantly changing.

- Should we have a functional or divisional structure?
- Should we have narrow or wide spans of control?
- Should we have centralised or decentralised decision making?
- Should we have an organic or mechanistic structure?
- Should we have a simple versus complex control systems?

- Should we pursue a task focused or people focused style of leadership?

The contingency approach proposes the view that there are contingencies and variables that exist in most business situations and an analysis of these contingencies will assist managers in selecting the best course of action in a particular situation. The main factors or contingencies, which a manager should consider are:

- Production technology
- Size of the organisation
- Organisation structure
- Economic environment; in particular market competition and technological change

For example, according to the contingency view a stable external environment would suggest a centralised structure with an emphasis on standardised rules and procedures in order to achieve efficiency and consistency. On the other hand, an unstable environment suggests a decentralised structure to achieve flexibility and adaptability.

The most appropriate structure and systems of management are dependent upon the contingencies of the situation for each particular organisation.

Total Quality Management (TQM)

The quality movement is associated with the Japanese economic renaissance after World War II. TQM is an approach based on the use of quality concepts developed in Japan. The aim of TQM is to minimise waste and reworking by achieving zero defects in the production process.

Two of the best-known writers on the TQM approach are Deming and Juran.

Deming identified a number of points that were essential ingredients for achieving quality within the organisation. These include:

- Organisations should cease to rely on inspection to ensure quality.
- Quality should be built into every stage of the production process.
- The cause of inefficiency and poor quality lay with the systems used and not with the people using them.
- It was management's responsibility to correct the systems in order to achieve high quality.
- Deming also stressed the importance of reducing deviations from standards.

Juran believed that quality revolved around three areas:

1. Quality planning to identify the key processes capable of achieving standards.
2. Quality control to highlight when corrective action is necessary.
3. Quality improvement to identify ways of doing things better.

The TQM approach involves a number of steps:

1. Find out what the customer wants,
2. Design products /services that meets/exceeds customer requirements,

3. Design quality into the work processes so that tasks are done correctly,
4. Monitor performance,
5. Expand the approach to suppliers and distributors.

Organisational Culture

An organisational culture is the shared values, beliefs and assumptions held by members of the organisation and are commonly communicated through symbolic means. Schiein (1985) defines organisational culture as:

"The pattern of basic assumptions that a given group has invented, discovered or developed in learning to cope with its problems of external adaptation and internal integration".

Organisational culture can be described as consisting of four layers:

- **Values:** These may be easy to identify in an organisation as they are often written down as statements about the organisation's mission, objectives or strategy. However they often tend to be vague such as "service to the community".
- **Beliefs:** These tend to be more specific but again there are issues, which people in the organisation can bring to the surface and talk about. They might include the belief that the company should not trade with a particular country.
- **Behaviours:** These are the day-to-day ways in which an organisation operates and can be seen by people both inside and outside the organisation. This includes the work routines, and how the organisation is structured and controlled.
- **Taken for granted Assumptions (paradigm):** These are the core of an organisation's culture. They are the aspects of organisational life which people find difficult to identify and explain. For an organisation to operate effectively there has to be a generally accepted set of assumptions. These assumptions can underpin successful strategies and constrain the development of new strategies.

The culture of an organisation develops over time from a number of interdependent influences:

- Firstly it is developed by the prevailing **national culture** which influences attitudes to work, authority, equality and a number of other important factors that differ from one location to another. These values will change over time, and may even vary between different regions in larger countries. Organisations that operate internationally have the added problem of having to deal with many different national cultures.
- The second major influence is the **nature of the industry**, which acts as a determinant of an organisation's culture. Specific industries contain cultural characteristics which become manifested in an organisation's culture. Gordon (1991) argues that organisational culture is shaped by the competitive environment and the degree to which the organisation is in a monopoly situation or faced by many competitors. Similarly customer requirements in the form of reliability versus novelty shape an organisation's culture. Finally society holds certain expectations about particular industries, which influence the values adopted.

- The final element shaping an organisation’s culture is **the role of the founder** of the organisation. Founder members shape organisational culture by their own cultural values, which they use to develop assumptions and theories in establishing organisations.

Organisational culture is therefore developed from three interdependent sources all of which influence the beliefs, values and assumptions of the organisation.

A number of books published in the early 1980s sought to explain why some organisations were more successful than others and pointed at aspects of culture, which they argue, contributed to organisational performance.

Peters and Waterman (1982) focused on the relationship between organisation culture and performance. They chose a sample of highly successful organisations and tried to describe the management practices that led these organisations to be successful. They identified eight cultural values that led to successful management practices, which they called excellent values.

The characteristics of the excellent organisation suggested by Peters and Waterman are:

1. **Bias for action:** Managers are expected to make decisions even if all the facts are not available.
2. **Stay close to the customer:** Customers should be highly valued.
3. **Encourage autonomy and entrepreneurship:** The organisation is broken into small, more manageable parts and these are encouraged to be independent, creative and risk-taking.
4. **Encourage productivity through people:** People are the organisation's most important asset and the organisation must let them flourish.
5. **Hands-on management:** Managers stay in touch with business activities by wandering around the organisation and not managing from behind closed doors
6. **Stick to the knitting:** These organisations are reluctant to engage in business activities outside of the organisation's core expertise – i.e. what it is good at.
7. **Simple form, lean staff:** Few administrative and hierarchical layers, and small corporate staff.
8. **Simultaneously loosely and tightly organised:** Tightly organised in that all organisational members understand and believe in the organisation's values. At the same time, loosely organised in that the organisation has fewer administrative overheads, fewer staff members and fewer rules and procedures.

In summary, the organisational culture perspective argued that successful management resulted from the development of key cultural values rather than any innovations in structure and systems.

SECTION 2: MANAGEMENT

Study Unit 3

Planning and Control

Contents

A. ROLE OF PLANNING

In Chapter 1, the four basic functions of management process were identified as planning, organising, leading and controlling. It could be argued that planning is the most important of these functions as everything else flows from it. Planning takes place in all organisations either formally or informally. It is important that organisations know where their future lies and that they have planned for it. Planning is future oriented and involves selecting from a number of possible courses of actions. The rapid rate of change that faces all firms makes planning more difficult but also more important.

Definitions

A **plan** is a statement of action to be undertaken by the organisation aimed at helping achieve its objectives.

Planning is defined as "The establishment of objectives, and the formulation, evaluation and selection of policies, strategies, tactics and action required to achieve them" (Foulks & Lynch, 1999).

Planning and control are closely linked, as a plan is effectively a road map that tells everyone in the organisation where they are going and control ensures that they get there.

B. LEVELS OF PLANNING

In general there are three levels of planning within organisations as shown in Figure 3.1.

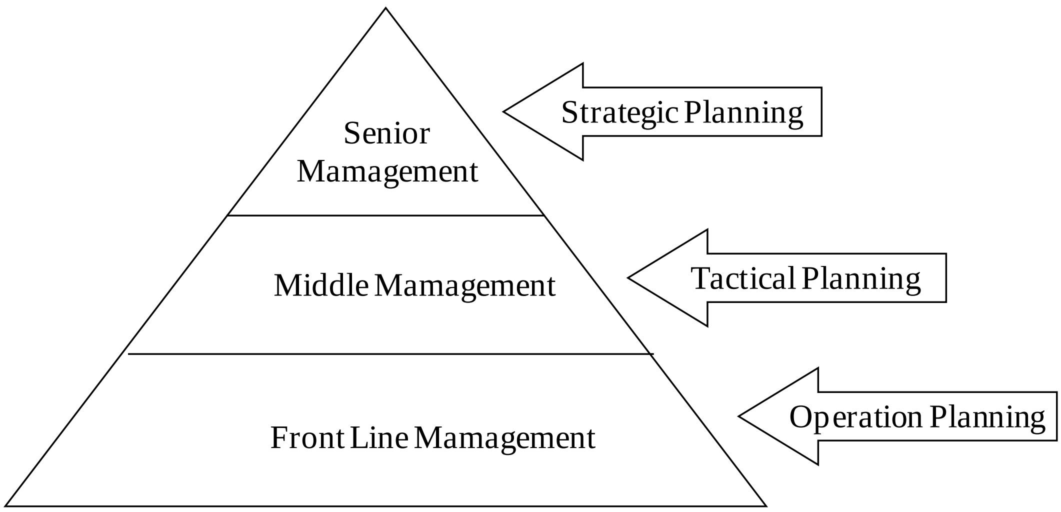


Figure 3.1: Levels of Planning

Strategic Planning

Strategic planning is concerned with determining the major goals and mission of an organisation and crafting a strategy to achieve them. Strategic planning is normally carried out at the senior management level. A strategic plan is a long-term plan that will stretch from three to five years.

All other planning in an organisation is derived from the strategic plans.

Tactical Planning

Tactical planning takes place at the middle management level and is concerned with the various component parts of the organisation. A tactical plan is normally a medium term plan covering a period of up to 1 year. Tactical plans will be focused on achieving the overall objectives of the organisation.

Operational Planning

Operational planning is concerned with the short-term, day-to-day functions of the organisation. It is concerned with achieving the operational targets set out in the tactical plans. Operational planning is normally undertaken by front line managers and supervisors within the different functions of the business including sales, production, human resources and finance.

C. HIERARCHY OF PLANNING

Organisations typically use a wide variety of plans to assist in their planning process. Weihrich and Koontz (1993) state that there are eight different types of plans, which form a hierarchy as shown in Figure 7.2.

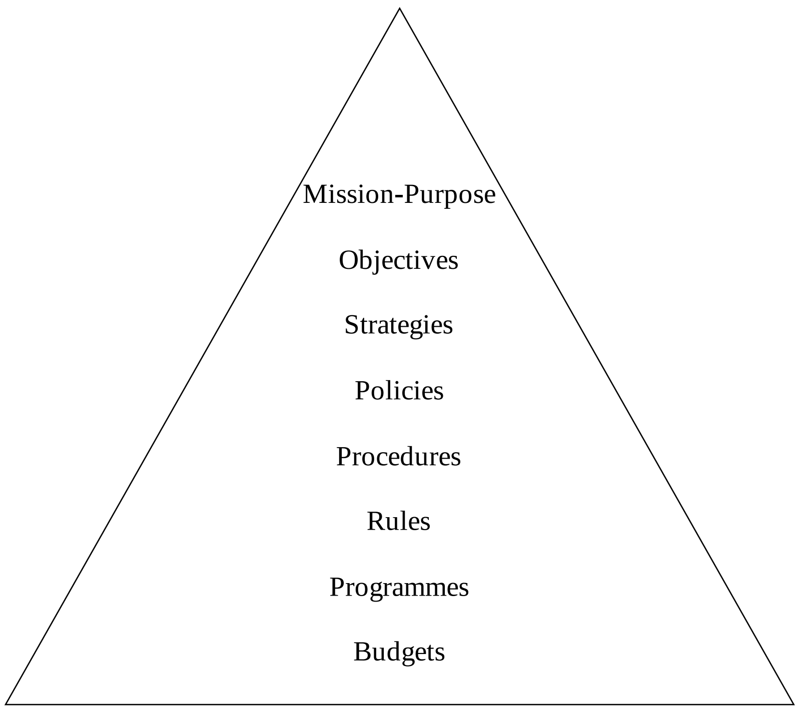


Figure 3.2 Hierarchy of Planning

Mission or Purpose

The mission or purpose is set out in a mission statement that is used to communicate the strategic vision through the organisation. A mission statement will set out how to make the firm distinctive in the eyes of its employees, customers and suppliers. A mission statement will generally include a description of the company's basic product or service and its target market.

Goals and Objectives

Organisational goals set out the long-term targets that have to be achieved if the hopes in the mission statement are to be attained. Objectives set out in the medium-term outline how these goals are to be achieved. Sample goals and objectives might include:

> **Goal:** To become Africa's number one low cost airline with five years.
>
> **Objectives:** To become market leader on Kenyan and Ugandan routes within two years, to increase market share on Kenyan to Ugandan routes by 10% per year, to open 6 new routes per year and to increase seat occupancy by 3% per year.

It is possible for objectives/goals to be in direct conflict with each other. For example, the organisation might have set a goal to reduce costs and at the same time improve product/service quality. The basic conflict in this example is that improving product or service quality can lead to increased costs and reducing costs can have a negative effect on quality. The organisation in this example must strike a balance between the two or drop one.

Strategies

The fundamental plans that an organisation devises in order to achieve its goals and objectives are called strategies. Strategies are the set of activities identified to achieve goals and objectives. Strategies should take account of the company's strengths and weaknesses and the opportunities and threats that exist in the external market.

A company's strategy represents the management's answer to such issues as whether to concentrate on a single business or build a diversified group of businesses, whether to cater for a broad range of customers or concentrate on a niche market, whether to develop a narrow or broad product line and whether to pursue competitive advantage through low cost or product superiority.

Policies

Policies provide a framework to assist managers in their decision-making. Policies tend to limit an area within which a decision can be made and ensure that the decision will be consistent with and contribute to the overall organisational objectives.

Policies can be in two forms, namely express or implied. An express policy is a written or verbal statement, which guides managers in their decision-making. For example personnel may state an organisation is an equal opportunities employer. An implied policy is inferred from looking at the organisation's behaviour and actions. Sometimes an organisation's expressed and implied policies may conflict or contradict each other, with the organisation pursuing an expressed policy openly yet privately applying an implied policy.

Procedures

Procedures are used to standardise activities ensuring consistency. They provide a framework to assist management in decision-making. Procedures are set out for the different functions. For example there might be purchasing procedures, hiring procedures, procedures to handle bad debts, customer complaints procedures etc.

Procedures exist at all levels in the organisation but tend to proliferate at lower levels often as a means of control. Weihrich and Koontz (1993) argue that one of the reasons for the widespread use of procedures at lower levels is that routine jobs can often be completed more efficiently when management details the best way to carry them out.

Well-established procedures are commonly termed ‘standard operating procedures’. These are procedures that the organisation uses in a routine manner.

Rules

Rules are statements that either prohibit or prescribe certain actions by clearly specifying what employees can and cannot do. Examples of rules would include "No Smoking", “Safety helmets must be worn on the building site" and "No cheques accepted without cheque card".

Unlike procedures rules allow no discretion in their application.

Programmes

Programmes provide a link between strategy and execution. Programmes are a method by which middle management can translate organisational strategy into activities to meet its goals and objectives. For example an IT manager may develop a computer replacement program to reduce maintenance costs of obsolete equipment. The introduction of a program within an organisation may lead to the development of a number of supporting programmes.

Budgets

A budget is a numerical expression of a plan, which deals with future allocation and utilisation of resources over a given period of time. Budgets are normally expressed in financial terms, person hours, productivity or any other measurable unit.

Budgeting is an important planning tool in many businesses. Financial budgets are developed in conjunction with a programme and they set out the financial resources available to achieve the programme's objectives.

A budget also serves as an important control mechanism. One of the advantages of a budget is that it forces people to plan in a precise way.

D. THE PROCESS OF PLANNING

To gain an understanding of the planning process we will look at one type of planning (Strategic planning) and describe the steps involved.

Strategic planning involves the following stages:

1. Developing a mission statement
2. Setting objectives
3. Analysing the company’s internal and external environment
4. Developing plans
5. Implementation of plans
6. Evaluating performance

Developing a Mission Statement

This stage involves an analysis of the organisation's current position and an investigation of the external environment, in order to establish where the company is and where it is headed. It also involves identifying gaps in human (skills) and materials resources that need to be filled. The purpose is to provide a long-term direction on what the company is trying to become.

Setting Objectives

This stage involves translating the strategic vision or mission into specific performance targets to be achieved. Objectives should be **S**pecific, **M**easurable, **A**chievable, **R**ealistic and **T**ime-bound (S.M.A.R.T)

Analyse the Company's Internal and External Environment

Before preparing a strategy, an organisation needs to carry out an analysis of both its internal and external environment. The business environment is made up of a number of different layers as shown in Figure 3.1. These layers include the macro-environment and the industry or sector in which it operates.

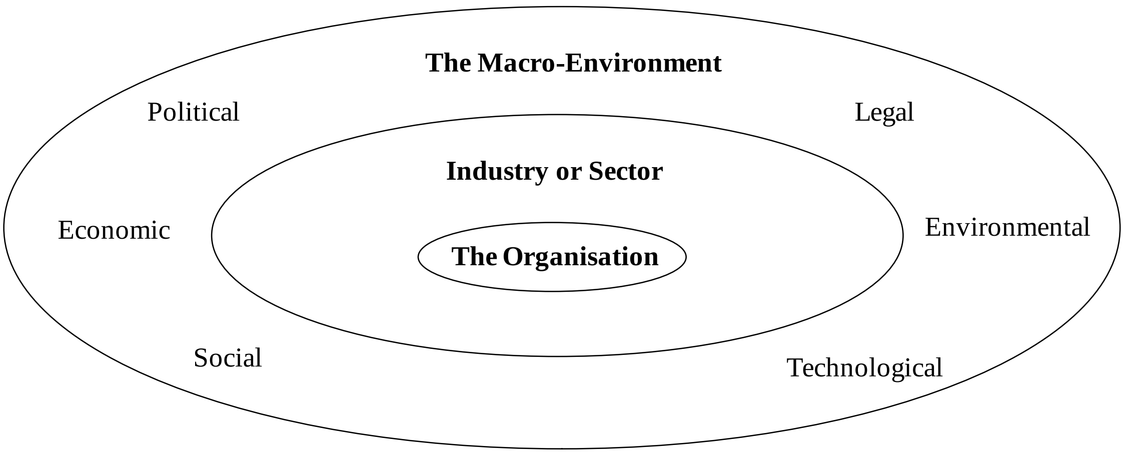


Figure 3.1: The Business Environment (Adapted from Johnson and Scholes, 2008).

Macro-Environment

The Macro-Environment: This "general" layer consists of broad environmental factors that impact almost all organisations. It is important to build up an understanding of how changes in the macro-environment are likely to impact on individual organisations. While the firm may have little control over these factors it must be in a position to deal with these effects whether they represent a threat or an opportunity for the firm. The PESTEL framework can be used to identify how future trends in the political, economic, social, technological, environmental and legal environments might impact on organisations.

PESTEL ANALYSIS

- **Political Factors:** The political and legal factors are shaped by the activities of governments at both national and international levels. On a national level, a government can affect business through its policies in relation to industrial development, and in particular by the tax incentives, capital grants and expansion schemes made available. On an international level, the political environment influences business through policies in relation to international trade and deregulation.

- **Economic Factors:** The economic environment affects the purchasing power of a given market and therefore will affect the level of demand for a firm's products and services.
- **Societal Factors:** The culture of a society in terms of basic beliefs, values and norms within which a firm operates can affect the type of products the society needs and wants. Demographic factors relate to the nature and structure of the population from which the firm's customer base is chosen. Factors such as population increase or decrease, movement of population, age of the population and education level will all have to be considered when preparing the organisations strategy. Organisations will need to establish what the current and emerging trends are in fashion and lifestyle, what demographic changes are occurring and what the likely impact on the firm's markets is.
- **Technological Factors:** The pace of technological change can affect the product service offering available in the marketplace, the methods of production used and the channels of distribution used. Organisations need to determine which emerging technological trends are likely to affect the industry in which they are operating.
- **Environmental Factors:** The cost-effectiveness of raw materials and energy, and the need for a cleaner environment have a major impact on the type of product and service offerings available and the way in which they are produced. Organisations need to be aware of their environmental responsibilities.
- **Legal Factors**: There is a wide range of laws that can impact an organisation which include the following:
    - Competition law: Unfair competition, below cost selling, regulated industries.
    - Employment law: Unfair dismissal, minimum wage, holiday pay, redundancy etc.
    - Health and safety: All employers are required by law to protect the safety, health and welfare of their employees.
    - Product safety: Laws to protect the consumer.

Industry or Sector:

This is the next layer within the broad general environment. The industry or sector is a group of organisations producing the same products or services. The **five forces framework** can be useful in understanding how the competitive dynamics within and around an industry are changing.

Porter's Five Forces Framework

Porter identified five competitive forces that can be used to analyse the intensity of competition within an industry, and the attractiveness and profitability of an industry. By understanding these forces management can develop effective strategies.

Porter's framework states that competition in an industry is a composite of five competitive forces (see Figure 3.3):

1. The threat of new entrants
2. The bargaining power of supplier
3. The bargaining power of buyers
4. The threat of substitute products
5. The intensity of rivalry

Each of these forces is now discussed in detail.

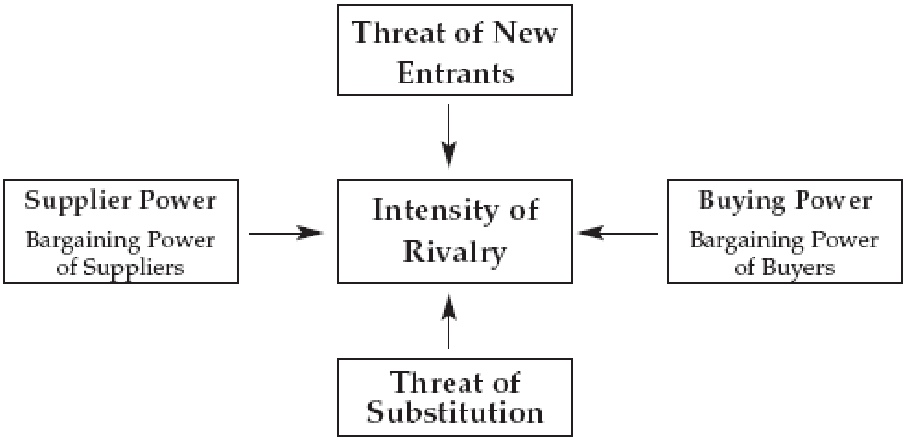


Figure 3.3: Porter's Five Forces

THREAT OF NEW ENTRANTS

The threat of new entrants will depend on the extent to which there are barriers to entry. Barriers to entry are factors that need to be overcome by new entrants if they are to compete successfully. Typical barriers include; capital cost of building and equipment, economies of scale, access to supply or distribution channels, customer loyalty, experience, government regulations and differentiation.

BARGAINING POWER OF SUPPLIERS

Whether the suppliers to an industry are a weak or strong competitive force depends on market conditions in the supplier industry and the importance of the item they supply. Supplier-related competitive pressures tend to be minimal whenever the item supplied is a standard commodity available on the open market from a large number of suppliers with ample capacity. Suppliers also tend to have less leverage to bargain over price and other terms of sale when the firm they are supplying is a major customer. Supplier's power is likely to be high when there are only a few main suppliers of the product or service, or when the costs of switching from one supplier to another are high. Supplier power is also strong if there is the possibility of the supplier competing directly with their buyers (forward integration).

BARGAINING POWER OF BUYERS

The bargaining power of the buyer is strong when some of the following conditions exist:

- Where there are a few dominant buyers and a large number of small suppliers

- Where the number of buyers is small
- If the costs of switching to a competing product or substitute are relatively low
- If the buyer poses a credible threat of backward integration into the business of the supplier

THREAT OF SUBSTITUTES

Firms in one industry are quiet often in close competition with firms in another industry because their products are good substitutes. Substitution reduces demand for a particular class of products as customers switch to the alternatives.

INTENSITY OF RIVALRY

This is normally the strongest of the five competitive forces. In some industries rivalry is centred around price competition, which sometimes results in lowered prices. In other industries rivalry is focused on factors such as performance features, new product innovation, quality, warranties, after-sale service and brand image.

Rivalry intensifies as the number of competitors increase and as competitors become more equal in size. Also rivalry is usually stronger when demand for a product is growing slowly or shrinking.

SWOT Analysis

SWOT is a Strategic planning tool used to assess the Strengths, Weaknesses, Opportunities and Threats of a business. Strengths and weaknesses are internal to the organisation while opportunities and threats are external to the organisation**.**

STRENGTHS

Strengths are what a company is good at doing or a feature of its operation that gives it a competitive advantage. Strengths can be the skills of the workforce, patented technology, organisational resources, quality products, strong brand names or low manufacturing costs.

WEAKNESSES

Weaknesses are those features of its operations that have a negative impact on its performance and profitability. Weaknesses put companies at a disadvantage and if they are not corrected can make them vulnerable. Weaknesses might include high cost of production, low skilled workforce, outdated products, poor brand image etc.

OPPORTUNITIES

Industry **opportunities** are an important element in determining a company's strategy. Industry opportunities relevant to a company are those that provide the best ways of achieving growth in sales and profitability by taking into account the company's skills and resources.

THREATS

These are factors that have ability to impact negatively on the company. T**hreats** can come from substitute products, increased power of suppliers and buyers, new entrants to the market, increased rivalry within the industry and new competitor products. Threats might also come from new government legalisation, slowdown in economic growth, changes in customer's tastes or rapid technology change.

Opportunities and threats highlight the need for strategic action. A SWOT analysis can be used to complete a detailed evaluation of a company's strengths, weaknesses, opportunities and threats, in order to highlight the need for change and to build this into the organisation's strategy.

Develop Plans

This stage involves developing the plan to achieve the desired objectives. The objectives are the ends and the strategy is the means. The strategic plan will consist of a number of planned actions to address such issues as: how to satisfy customer needs, how to overcome rivals, how to respond to changing market conditions and how to develop specific organisational capabilities. Two important steps in strategic planning are SWOT Analysis and evaluating alternative strategies.

EVALUATING ALTERNATIVE STRATEGIES

The organisation will develop a list of strategic options that will help it achieve its strategic objectives. Options could include expanding into new markets with existing products or launching new products on the existing market of even acquiring a competitor. The company will need to evaluate each of the alternatives and choose the most viable one(s).

Implementation of Plans

This stage involves implementing the strategic plan. The task on management includes such actions as assessing what needs to be done to put the strategy in place, executing it proficiently and achieving good results. Implementing strategy involves developing the capabilities of the organisation, creating a suitable culture and motivating the people to pursue the target objectives. It also involves developing and controlling a budget towards the resources critical to the strategic plan.

Evaluating Performance

This stage involves evaluating performance and initiating corrective adjustments in the direction, objectives, or implementation in light of changing conditions or new opportunities that may arise.

E. MANAGEMENT BY OBJECTIVES

Management by Objectives (MBO) is an approach which encourages managers and employees to set their own goals within a framework set out by senior management. It is based on the idea that when employees are set specific and challenging goals, accompanied by feedback, they are more likely to be motivated to give their best.

The specific stages of the MBO process are:

- Senior management set long-term goals for the organisation
- Each department within the organisation is assigned specific targets.

- Lower level manager's objectives and targets are set and agreed with the managers and employees involved.
- Progress towards achieving objectives is constantly monitored and corrective action is taken where necessary.

The management writer Peter Drucker argued in his book "The Process of Management" that MBO was the ideal way of delegating authority in a large organisation.

Benefits of MBO

- It encourages managers to employ a result focus to their planning.
- It can help identify deficiencies in the organisational structure as MBO forces managers to clarify organisational roles and structure.
- Can lead to improved moral and motivation among the managers and employees involved as they have input into the goals that are set.
- Can increase employee commitment to achieving the goals set for them.
- Supports the development of management control and performance measurement.

Weaknesses of MBO

- MBO relies on commitment of all management to succeed and it will fail without top management commitment.
- It can be difficult to set goals for all managers in all circumstances
- Management can become disillusioned if unrealistic and unachievable targets are set for them.
- It can encourage individual achievement at the expense of a team focus.

F. MANAGEMENT DECISION MAKING

Decision-making is defined as choosing one alternative from several. This definition could be extended to include an identification phase, where problems and opportunities are identified that require decisions to be made. Decision-making is a key task of management, in particular in the context of planning.

Types of Decisions

There are basically two types of decisions:

1. **Programmed Decision**: This is a decision or problem that recurs regularly enough for a decision rule to be developed. The decision rule tells the manager which alternative to select.
2. **Non-programmed Decision**: This is a decision or problem not encountered before where the decision maker cannot rely on previously defined decision rules.

The Decision Making Process

Despite the fact that decisions will be made in different organisational contexts, it is possible to create a model that can be applied to most situations. A six-step model called the Rational Model (Moorhead and Griffin, 1995) is one that can be applied to a variety of decision-making situations. The six steps are as follows:

1. **Stating the goal**: The first step is to establish the goal or desired end state against which solution will be measured.
2. **Identifying the problem**: The problem is in effect the difference between the current and the desired or goal state.
3. **Determining the decision type**: The type of decision must be determined. If the decision is a programmed decision, then there should already be policies or rules that can be used. If a non-programmed decision is involved, the decision makers will have to generate solutions as well as evaluate them.
4. **Choosing an alternative**: The alternative chosen will be the one with the highest possible benefits while taking into account the risks involved.
5. **Implementation**: In this phase the chosen alternative will be implemented. The implementation phase will involve planning and communication to ensure that all those affected are aware of the decision and what is required of them.
6. **Measurement and control**: Measurements should be taken to establish the success or otherwise of the implementation. Corrective action should be taken where required.

The Administrative Model of Decision Making

The administrative model describes how decisions are made in difficult situations of uncertainty and ambiguity.

Three important aspects of this model are:

- **Bounded rationality –** means people have limits or bounds on how rational they can be. Organisations are very complex and have time only to process limited amounts of information to make decisions. Therefore they choose the first solution that satisfies the minimal decision criteria.
- **Intuition –** entails a quick apprehension of a decision situation based on past experience but without conscious thought. Intuitive decision making is not arbitrary or irrational because it is based on past experience.
- **Coalition building -** entails forming an informal alliance among managers who support a specific goal. Managers gain support through discussion, negotiation and bargaining.

The administrative model is more realistic than the rational model as it focuses on organisational factors that influence individual decisions.

Group Decision Making

Group decision-making can be a very powerful tool if utilised successfully as it can bring a wide range of knowledge, skills and experiences to a particular problem or situation. However, the disadvantage is that too many strongly held viewpoints can make it difficult to reach consensus. A number of different formats/techniques have been developed to facilitate group-decision making.

1. **Interactive Groups**: A group is brought together face to face with a specific agenda. The discussion group will generate ideas and all ideas will be discussed. A vote is taken to reach consensus on a chosen solution.
2. **Brainstorming**: This is a creative process used to generate ideas involving a group of people who are encouraged to contribute ideas. All ideas are written down without evaluation and are examined in more detail once the brainstorming process is completed.
3. **Nominal Groups**: Group members assess the problem and ideas are generated by the individuals. These ideas are then presented and discussed as a group. Group members then rate ideas individually and the idea with the highest score is chosen.
4. **Delphi technique**: This is a decision making process that was designed to avoid conflict between participants and to prevent any one participant having undue influence on the decision making. A chairman or facilitator asks each participant to fill in a questionnaire. The chairman summarises the replies and sends the summary to each participant for their opinion. The process continues until consensus is reached. The main disadvantage of this technique is its slowness.

Individual versus Group Decision Making

Benefits of Individual Decision Making

The benefits associated with individual decision-making are:

- Speed
- Clear Accountability
- Consistency

Benefits of Group Decision Making

The benefits associated with group decision-making are:

- Wider range of skills and experience used in the decision making process
- Higher quality decisions
- Greater acceptance of the decision made

G. ORGANISATIONAL CONTROL

Organisational control can be defined as the process through which managers regulate organisational activities to make them consistent with present performance standards.

Management control is designed to provide information on progress against present performance targets. Control is crucial to managers as it enables them to:

- Prevent problems for growing and becoming crises
- Standardise output in terms of quality and quantity
- Carry out performance assessment of employees
- Update plans - actual progress against planned progress
- Protect assets by preventing inefficiency and waste

H. THE PROCESS THEORY OF CONTROL

The careful design of a management control system can ensure that all employees, work teams and functional departments meet the objectives and targets of the organisation with minimum deviation. The basic activities involved in a control process are:

- **Setting Performance Standards**
- **Performance Measurement**
- **Corrective Action**

Setting Performance Standards

Standards set out what must be achieved in terms of quantity or quality to meet the organisation's objectives. Performance standards are set at a specific point in an implementation program and will assist managers in gauging the actual performance against the planned performance objectives. Setting performance standards is a key aspect of the planning process at all levels in the organisation. To be effective standards must be measurable so that they can be recorded and monitored.

Performance Measurement

This stage involves measuring or evaluating actual performance against standards. There are various reasons why performance could fall below the standards set out at the planning stage:

- Standards may have been inappropriately set
- Lack of effort by employees or managers in meeting the standards
- Failure to use the resources efficiently

When examining performance results it is normal for management to concentrate on deviations that lie outside the upper and lower limits set.

Corrective Action

The final stage in the control process involves taking action to correct deviations from the standards. In some situations the standards may have to be revised especially if they are based on historical data that is no longer appropriate.

I. CATEGORIES OF CONTROL SYSTEMS

There are three general categories of control systems:

1. **Feedforward**: These types of controls are implemented before the plan becomes operative and attempt to prevent problems from occurring. It analyses the inputs (e.g. human, materials and financial) to establish if they are adequate in terms of quantity and quality.
2. **Concurrent**: These types of control monitor the process of transformation of inputs to outputs and enable adjustments to be made during the operation of the process. It is normal with these types of controls to have guidelines for dealing with contingencies that may arise.
3. **Feedback**: This type of control monitors the quality and/or quantity of output after the transformation of input has occurred. This enables managers to decide whether to instigate new plans or continue with existing ones. A customer satisfaction survey is an example of this type of control.

The category of control to be used will depend on the stage of operation in which it is to be applied. Feedforward controls would be appropriate before the process commences while concurrent controls would be used during operation and feedback controls after operation.

J. CHARACTERISTICS OF EFFECTIVE CONTROL SYSTEMS

For an organisational control system to be effective it must be linked to the organisational strategy and be accepted by employees. The information it produces must be accurate and timely. Effective controls display the following characteristics:

- Appropriateness
- Cost Effectiveness
- Acceptability
- Focus on Critical Points and Exceptions
- Flexibility
- Reliability and Validity
- Accessibility and Comprehensibility

Appropriateness

The type of control to be used depends on factors such as the size of the organisation, the area or function to which they are being applied, and the management level that they are designed for. Controls should be aligned with the organisational structure when assigning responsibility for implementing plans and for correcting any deviations. Controls should be geared to provide relevant information only and avoid generating redundant data.

Cost Effectiveness

Control mechanisms should be designed to work in a cost effective way. They control system should save more money than it costs to implement.

Acceptability

Controls should be designed in a way that avoids causing antagonism between management and staff.

Focus on Critical Points and Exceptions

Controls should focus on significant variations and on those points that are important to the overall objectives of the organisation. A small deviation on one point could be more significant than a larger deviation at a different point.

Flexibility

The control mechanism should ideally be flexible to cater for changed circumstances. A budget would be an example of an inflexible control mechanism because of its inability to cater for changed circumstance.

Reliability and Validity

The information supplied by the control mechanism must be dependable and must measure what it claims to measure.

Accessibility and Comprehensibility

Employees should have access to feedback on their performance and should understand how the control process operates. This will make them more likely to get involved in the corrective actions suggested by the control mechanism.

K. FINANCIAL METHODS OF CONTROL

Financial methods of control include:

- Financial Statements
- Budgetary Control
- Financial Analysis

Financial Statements:

Financial statements are summaries of an organisation's accounting records and are concerned with three key areas of financial performance: namely liquidity, profitability and general financial health. Financial statements are prepared based on past information and can provide managers with useful information about trends. The main financial statements are:

- Balance Sheets
- Income Statements
- Cash Flow Statements

Budgetary Control

Budgets are the most widely used means of planning and controlling activities at every level of an organisation. Budgets are widely used as they provide a clear standard of performance within a specified time. At regular intervals during the time period addressed by the budget, actual results are compared with budget figures and this allows deviations to be detected and corrected.

In general, budgets are drawn up by middle managers in response to guidelines set by senior management and are then submitted to higher management for approval.

Note: Budgets are discussed in more detail in Chapter 11

Financial Analysis

Analysis of a firm’s performance can be undertaken using a number of different forms of financial analysis which include:

- Ratio Analysis
- Break Even Analysis

Ratio Analysis

Ratio analysis can be used by managers and others to evaluate a firm’s past and current performance. Ratio analysis is a useful method of comparing a company's financial performance against competing firms in the industry (benchmarking). Financial ratios are calculated from information contained in the financial statements.

The four key categories of financial ratios used by companies are:

1. **Profitability Ratios**: These measure the efficiency of a firm in generating profit which is achieved by comparing its sales performance to the assets of the firm.
2. **Liquidity Ratios**: This measures a firm's ability to pay back its short-term debt.
3. **Leverage Ratios**: These identify the source of an organisations capital.
4. **Activity Ratios**: These measure the efficiency of a firm in using the resources it deploys.

Break Even Analysis

Break-even analysis seeks to identify the point (break even point) at which revenue generated from a given volume of output matches total costs (fixed costs + variable) of that output (See Figure 3.4). Break-even analysis can be used to calculate the output volume necessary to break even or to make a specific level of profit.

Break-even analysis is widely used both in decision-making and control situations as it is reasonable easy to use.

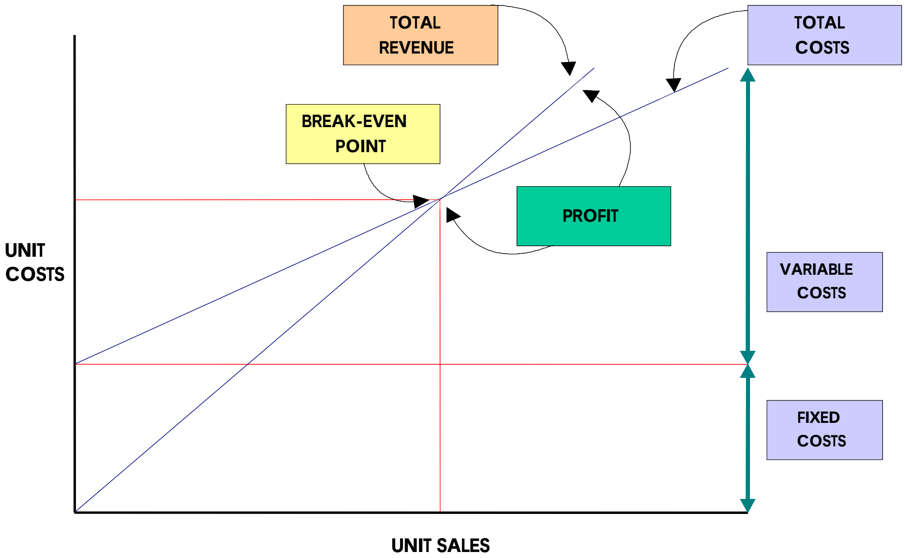


Figure 3.4: Break-Even Point

L. NON-FINANCIAL METHODS OF CONTROL

The main non-financial control methods are:

- Functional Audits
- Quality Control
- Inventory Control
- Production Control

Functional Audits

Functional Audits evaluate the accuracy of accounting and related records. These audits should be comprehensive, systematic, independent and periodic. The audits can be internal or external. Internal audits concentrate the financial health of the company - sales, resources, production etc. Audits may be conducted in each of the functional areas of the business, namely production, marketing, finance and human resource.

External audits, which relies on information that has been made public about competitor firms has the objective of analysing the performance of individual competitors or the industry as a whole.

Quality Control Systems

Quality control relates to the activities employed by a firm to achieve and maintain a certain level of quality for a product, a process or a service. Traditionally quality control was a monitoring activity but is increasingly concerned with identifying and eliminating the root causes of poor quality.

Japanese organisations introduced the concept of quality circles, which involved groups of employees getting together to solve problems in the workplace related to quality.

ISO Standardisation

ISO is an internationally recognised set of quality standards related to design, manufacture supply and servicing of products. Before a company can obtain ISO certification, they must re-examine their operations, document procedures and put a quality systems in place.

Inventory Control

The goal of inventory control is to reduce the cost of handling and storing inventory. The aim is to have adequate inventory at hand but no more than is required. To achieve this aim an inventory control system is used to indicate how much inventory should be bought and at what point it should be reordered. Factors that have to be taken into account include the lead-time involved and the amount of safety stock kept in reserve in case of problems with suppliers. The inventory control system must also decide on the Economic Order Quantity. The Economic Order Quantity is the point where the cost of ordering the goods is not greater than the cost of holding the goods. The task of inventory control has been simplified by the widespread availability of information technology.

Production Control

Production control systems are used to determine where and when a task is to be performed so that an order can be delivered at the appropriated time. These systems also support monitoring of the production process to enable early detection of problems. The type of production control system being used will depend on the organisations production methods. An assembly plant will use a flow control system to reduce bottlenecks. A specialist firm making one off products may use an order control system to track the order from design through to delivery.

Study Unit 4

Organisation and Structure

Contents

A. NATURE OF ORGANISING

The organisation of a firm is closely linked to the planning process; it creates the structure in which the firm fits its strategy. The organisational structure is one of the tools that management uses to get work done.

Core Features of Organising

Organisational Structure

Organisational structure refers to the framework in which the organisation sets out how tasks are divided, resources are deployed and departments are coordinated. The main features of organisational structure are:

- The set of tasks assigned to individuals and departments.
- The formal reporting relationship, including lines of authority, decision responsibility, number of levels and the span of a manager control.
- The systems that ensure effective coordination across departments.

The characteristics of the vertical structure of an organisation are represented in the organisational chart.

Work specialisation

Work specialisation, which is also called division of labour, is the degree to which organisational tasks are subdivided into separate jobs. This is done because in many work situations it is more efficient if employees are allowed to specialise on a particular task.

Chain of Command

The chain of command is the unbroken line of authority that links all persons in an organisation - it effectively shows who reports to whom. A closely linked principal is called **Unity of Command**, which means that each employee is held accountable to only one supervisor.

Authority, Responsibility, Accountability and Delegation

Authority is defined as the right to make decisions and take action.

Responsibility is the obligation of a person to complete a given task.

Accountability is the requirement that managers and workers accept the consequences of their actions and report those actions to their immediate supervisor.

Delegation is the process that merges authority, responsibility and accountability. Senior management may delegate authority and responsibility to lower level management but they are still accountable for the outcome.

Span of Control

Span of control defines the number of subordinates a manager supervises. Wider spans of control give employees greater freedom while a narrow span of control involves close supervision of subordinates. The breath of the span of control is a function of the complexity of the organisational structure and task complexity coupled with the amount of time required.

The exact number will depend on a variety of factors such as:

1. **The geographic proximity of the personnel**: The more concentrated the work area is the greater span of control that is possible.
2. **The functional similarity of operations**: A manager can exercise a broad span of control if the majority of staff performs similar tasks.
3. **Functional complexity of the organisation**: Organisations with complex functions require narrow spans of control.
4. **The need of the employees for supervision**: The greater the need for supervision the narrower the span of control.
5. **The clarity and complexity of plans**: Well defined and straight forward plans support a broad span of control.
6. **The level of managerial support available**: The span of control can be extended if there is support from higher-level managers.
7. **The need for coordination within functions**: A narrow span of control will be necessary in organisations where there is a need to coordinate between functions.

Centralisation versus Decentralisation

The extent to which authority is delegated depends on the extent of centralisation or decentralisation. A decentralised organisation is one in which the authority to make decisions and to commit money and materials is widely delegated throughout every level of the organisation. A centralised organisation is one where little authority is exercised outside the key group of senior managers.

ADVANTAGES OF DECENTRALISATION

The advantages of decentralisation are as follows:

1. Top management are free to concentrate on their strategic responsibilities.
2. It speeds up operational decisions as they can be made nearer to where they apply.
3. It allows local management to be flexible.
4. It can contribute to staff motivation.
5. It encourages responsibility among junior managers.

DISADVANTAGES OF DECENTRALISATION

The main disadvantages of decentralisation are,

1. Control and co-ordination by management (top management in particular) is more difficult to accomplish.
2. Communication is more difficult but also more important.
3. It can encourage people to focus on their own individual goals rather than the organisation’s goals.

4. It requires well-trained, capable and motivated managers.

Overall, the advantages of decentralisation outweigh the disadvantages because of the pressure on modern organisations to be flexible and respond quickly to the business environment.

Tall versus Flat Organisational Structures

Flat organisations	**Tall organisations**
Decentralised authority	Centralised authority
Few levels of management	Many levels of management
Wide span of control	Narrow spans of control

Table 4.1: Tall versus Flat Organisational Structures

A flat structure would generally apply to smaller organisations of 500 employees or less; however control can become unmanageable for some managers and supervisors. In flat organisations managers are more likely to delegate responsibilities.

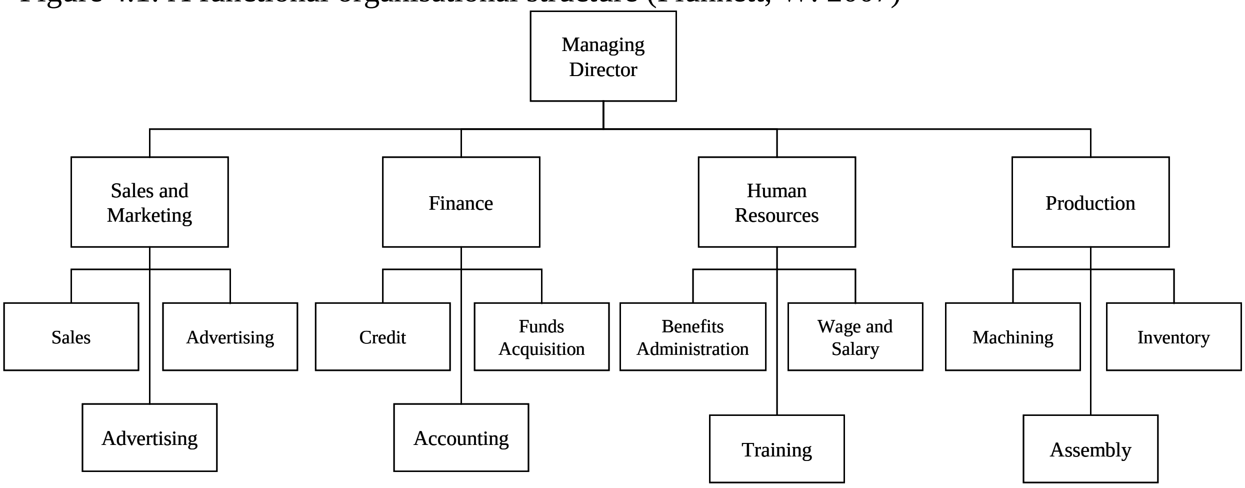
The advantage of tall organisations is they can maintain a very high degree of specialisation of functions and roles. However, tall organisations tend to be very formalised with standardisation of procedures that usually discourages initiative and risk taking.

B. APPROACHES TO STRUCTURING ORGANISATIONS

Functional Approach

In this type of organisational structure tasks are linked based on common function (Figure 4.1). For example, all tasks associated with production are grouped in a single function and all sales activities are grouped together. Figure 4.1 is an organisational chart of a functional organisation.

Figure 4.1: A functional organisational structure (Plunkett, W. 2007)



There is a high degree of division of labour and specialisation in this approach, which can yield economies of scale. However the high degree of coordination required between departments may result in delays in adapting to changes in the external environment.

Divisional Approach

In this approach, departments are grouped together into separate self-contained divisions based on a common product or a geographical region (Figure 4.2). The divisional approach has the advantage that reporting lines and chain of command are in line with the main activities of the organisation. This provides a clear framework for channelling strategic efforts to achieve the strategic aims of the organisation.

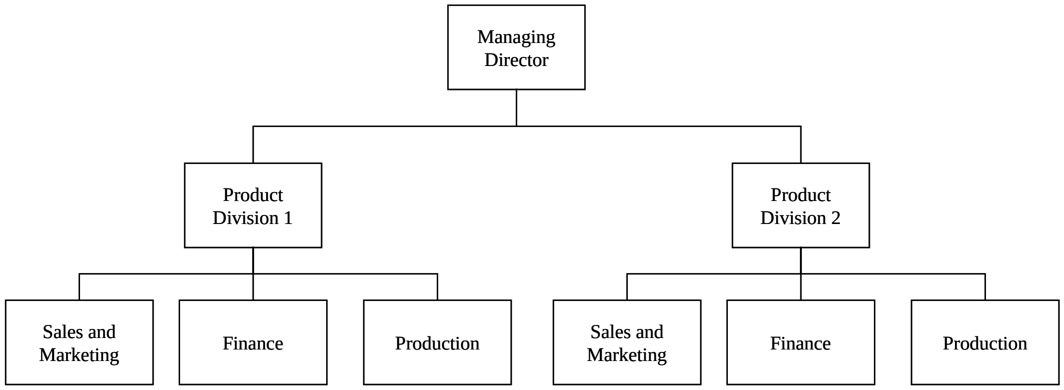


Figure 4.2: A Divisional Organisational Structure

The main disadvantage of this type of organisation is that divisions can become compartmentalised and focused on divisional interest to the detriment of the overall organisation. Divisions may also become isolated and unaware of what the other sections of the business are doing.

Matrix Approach

In the matrix approach, both functional and divisional chains of command are implemented simultaneously and overlap with one another in the same departments. Two chains of command exist and employees report to two bosses.

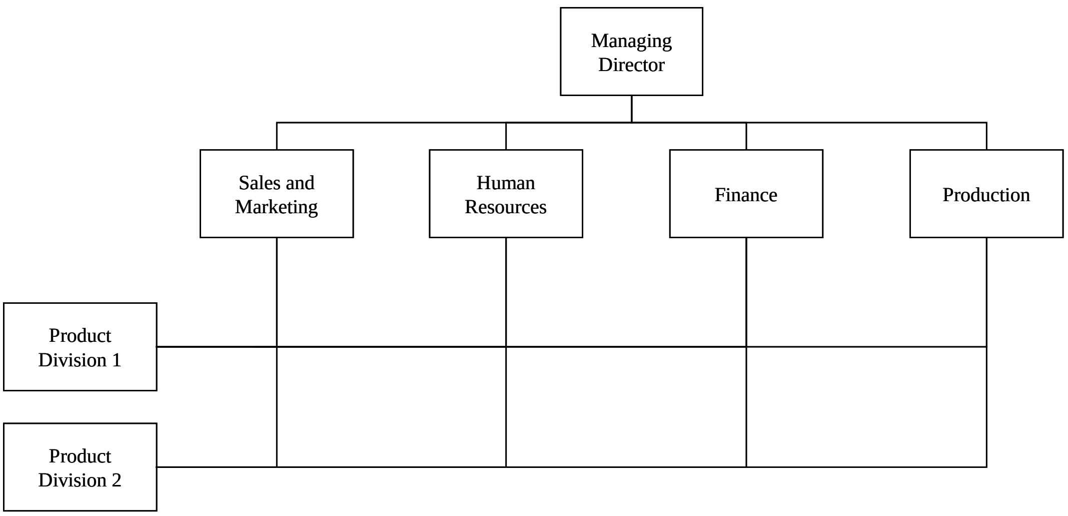


Figure 4.3: A Matrix Organisational Structure

This approach tries to bring the best of both worlds - functional specialisation and expertise with a product focus. The main disadvantage is that individuals may experience divided loyalties between individual bosses.

C. FACTORS AFFECTING ORGANISATION STRUCTURE (LYNCH AND ROCHE, 1999)

In general, the structure of an organisation depends on a variety of contingency factors. Different organisations require different types of structure. The factors involved in the choice of structure include:

- Strategy
- The Business Environment
- Size and Life Cycle
- Manufacturing and Service Technologies
- Department Interdependences

Strategy

In general, an organisation's structure follows the strategy being pursued. For example, a start-up company operating in a domestic market may be able to centralise decision making to a greater extent than an export led company. A company pursuing a differentiation strategy might require a more flexible structure than a company pursuing a low cost strategy.

The Business Environment

Firms operating in a dynamic environment need a more flexible structure. Firms operating in a stable environment need a rigid structure, whereas firms operating in an intermediate environment need a hybrid structure.

Size and Life Cycle

One of the major determinants of organisational structure is the size of the organisation. Larger firms that have greater access to capital can attract better management, greater market share and superior market information than smaller firms. As an organisation grows in size, so too must its structure, as more levels or layers of management are needed to co-ordinate operations. The problems for large firms are how to manage layers of managers, how to delegate to all their employees, and how to obtain commitment and employee satisfaction, while at the same time achieving the organisation's objectives.

Manufacturing and Service Technologies

There is a direct relationship between the level of technology involved and the required structure of the organisation. In general the use of IT within organisations is reducing management layers and increasing spans of control. Also, very high levels of customer service requirements suggest the need for locally responsive decentralised types of structure. Furthermore, a company utilising high levels of mass production to produce standard products might employ a formal structure as workers are required to carry out repetitive tasks.

Department Interdependences

This refers to the level of dependence between departments' vis-à-vis resources and supplies in accomplishing tasks and has an influence on the required organisational structure. Where interdependence is low, there is little need for a structure, which facilitates interaction, information sharing and coordination.

D. RECENT DEVELOPMENTS IN ORGANISATIONAL STRUCTURE

The challenge facing organisations is the need to become more flexible and responsive to changes in the external environment. There has been a shift from bureaucratic hierarchical forms of organisation to flatter, more adaptable ones. The changes in organisational practices can be grouped under the following headings:

- **Flatter hierarchies**: Many organisations are de-layering their management structure in an effort to speed up decision-making and communications. The widespread use of information technology has facilitated a reduction in layers of clerical management in particular. Overall, in many companies the number of managers and in particular middle management is being reduced.
- **Emphasis on teamwork**: The use of different teams from project teams to product development teams and sales teams has become a common feature in many organisations, particularly in the technology sector. The use of the team approach is an effort to improve employee commitment and motivation, thereby increasing productivity and profitability. The subject of teamwork is covered in more detail in Chapter 5.
- **More distributed responsibility and decision-making authority**: Flatter organisations have facilitated a move to delegate authority down to lower levels in the organisation than was previously possible. The emergence of teamwork has enabled decision making to be moved closer to the front line.

E. NEW APPROACHES TO DESIGNING AND STRUCTURING ORGANISATIONS

Organisational thinking has continued to evolve in the last 100 years and with it the structure of organisation continues to change. Two of the new organisational structures that have developed are:

1. The Network Organisation
2. The High Performance Organisation

The Network Organisation

The network organisation extends the trend of decentralisation further by granting more authority to departments and functions. Instead of the traditional hierarchical model of authority within the organisation, control and responsibility is assigned to effectively independent units. The aim of this structure is to enable different parts of the organisation to work together. The networking approach can be taken a step further where the network involves external suppliers and customers. Alliances with competitors can be formed where the relationship can be mutually beneficial. In the airline industry airlines that are in competition on some routes often form alliances that allow passengers to switch between airlines on different segments of long haul routes. Another form of the network approach is where an organisation can outsource a part of its operation from other companies. The main company becomes a small central broker electronically connected to other companies that perform vital functions. Department are independent, contracting services to the broker for a profit (See Figure 4.4).

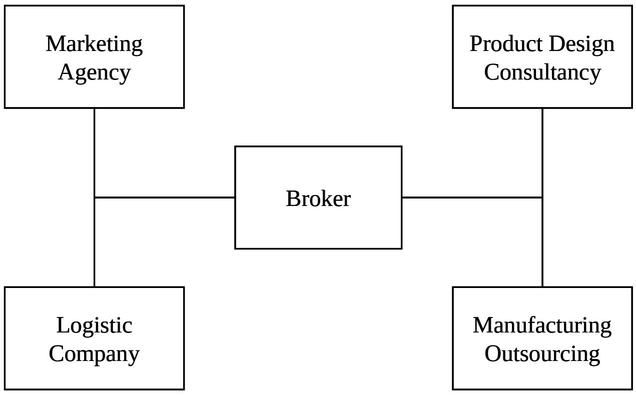


Figure 4.4: A Network Organisational Structure

A similar approach to networking is called the ***modular approach***; an example of this approach is where a manufacturing company uses outside suppliers to provide entire chunks of a product, which are then assembled by a handful of workers.

Another example is when Apple developed its iPod digital music player; it outsourced the audio chip design and manufactures a company in the US and the final assembly to a Taiwanese company. Doing this not only reduced cost and sped up production but also allowed Apple to concentrate on what it does best – design innovative products with easy to use software.

Advantages of the network approach include:

- Can draw on expertise worldwide
- Highly flexible and responsive
- Reduced overhead costs

Disadvantages of the network approach include:

- Loss of control when key business activities are outsourced
- Loss of competitive advantage when core business activities are mistakenly outsourced
- Greater demand on managers
- Employee loyalty is weakened

The High Performance Organisation

High performance organisations are structured to encourage and enable employees to deliver a high performance. Key aspects of this approach are the development of self- managed teams, decentralisation and a focus on products, services and customers. Employees are encouraged to take responsibility and also deal directly with customers and suppliers. These types of structures tend to be common in the technology sector where innovation and flexibility are needed to be able to deal with a rapidly changing environment.

F. THE MINTZBERG FRAMEWORK - FIVE TYPES OF STRUCTURE

According to Mintzberg (1979), the choice of an appropriate structure depends on the productive combination of an organisation's strategy (given its size and market position), and its internal culture (what type of decision making and co-ordination does it employ, and how does its division of labour function). Mintzberg lists five types of organisation:

- **Simple Structure**: This suits small organisations in a competitive environment, such as family-owned shops. Direct supervision of employees is possible in these organisations, and is necessary as they are required to react quickly to changes in the environment.
- **Machine Bureaucracy:** This is found in many large organisations that operate in a stable environment such as the civil service or large production organisations. Its main features are standardisation of work processes and centralised decision-making.
- **Professional Bureaucracy:** This is appropriate for organisations such as hospitals, which operate in a stable but complex environment. Decision-making is relatively decentralised, and co-ordination of activities is reliant on the standardisation of employee skills.
- **Divisionalised Structure:** These operate in organisations where decision-making is split between headquarters and various divisions operating in distinct markets. Machine bureaucracies can develop in each of the divisions, so that the output of each is standardised to the satisfaction of headquarters.
- **Adhocracy:** This is usually found in young organisations producing technical products, where organisational flexibility and dynamism is key. Decision-making is spread throughout the organisation and specialist project teams are set up as required.

	Simple Structure	**Machine Bureaucracy**	**Professional Bureaucracy**	**Divisionalised Structure**	**Adhocracy**
Age & Type	Small, new	Large, mature	Professional organisations	Old and large	Young, fast growing technology based
Co-operative External Environment	Simple but dynamic	Simple and stable	Stable but complex	Simple and stable	Complex and dynamic
Examples	Small Local business	Civil Service	Universities and hospitals		Fast moving consumer goods
Coordination Mechanism	Direct supervision	Standardisation of work processes	Standardisation of employee skills	Standardisation of output	Mutual adjustment - informal communication
Structure	Organic, little specialisation or formalisation	Bureaucratic tall management hierarchy	Relatively flat management hierarchy	Usually tall management hierarchy	Matrix and project team based
Decision Making	Centralised in owner-manager	Centralised	Decentralised in the basis of expertise	Split	Spread throughout the organisation
Division of Labour	Minimal	Strong and inflexible	Based on professional expertise with little formalisation	Similar to machine bureaucracy but dependent on degree of autonomy of divisions	Specialist based, and innovation based

Figure 4.5: The Mintzberg Framework

Study Unit 5

Leadership

Contents

Leadership

A key role of management is to direct and motivate employees to work productively, in order to achieve the organisational objectives that have been set for them. While organisations traditionally focused on directing employees in a top down hierarchical fashion the current focus in on leading and motivating.

A. LEADERSHIP

Leadership can be defined as the capacity to achieve the objectives of the organisation, by showing what needs to be done and by showing how to do it. Therefore, leadership is a management process of getting results through people and other resources and involves:

- Creating a vision for others to follow
- Establishing values
- Transforming the efficiency and effectiveness of the organisation
- Organising and motivating employees by means of workgroups, teams and departments
- Organising resources in the most effective manner
- Resolving conflicts that may arise

Difference between Leadership and Management

Leadership and management are different, but compatible qualities that are both important to the organisation. While management is concerned with organising, planning, directing, and controlling through formal authority, leadership is concerned with creating a vision for the future and developing a strategy to make the vision a reality.

Qualities

Though leadership and management qualities may overlap within the same individual, there are distinct differences. Leadership qualities tend to be visionary, passionate, creative, flexible, inspiring, innovative, courageous and imaginative. On the other hand management qualities tend to be rational, consulting, persistent, problem solving, analytical and tough mindedness. While a person may possess more of one set of qualities than the other, a manager should have a balance between both leadership and managerial qualities.

Source of Power

One of the main differences between management and leadership relates to the source of their power. Power is important in an organisational context as it linked with the ability to influence the behaviour of others. The types of power associated with leadership and management are personal power and positional power, respectively.

PERSONAL POWER

Personal power comes from the leaders themselves - their interest, values and goals. Personal power promotes vision, creativity and change within the organisation.

POSITIONAL POWER

Positional power is associated with management and it comes for the organisational structure. It promotes stability, order and problem solving within the structure.

The differences between leadership and management are summarised in Figure 5.1:

	Leadership	**Management**
Concerns	Creating a vision for the future	Organising, planning, directing
	Developing a strategy to realise the vision	Controlling through formal authority
	Focus on bringing about change	Operation of current procedures
	Inspiring people towards higher levels of performance	Achieving goals
Qualities	Visionary, passionate, creative	Rational, consulting, persistent
	Flexible, inspiring, innovative	Problem solving, analytical
	Courageous and imaginative	Tough minded
Source of Power	Personal power	Positional power

Figure 5.1: Differences between leadership and management

B. LEADERSHIP STYLES

The fundamental difference between leadership styles has to do with where decision making rests. It is possible to identify the following five generic leadership styles as shown in Figure 5.2.

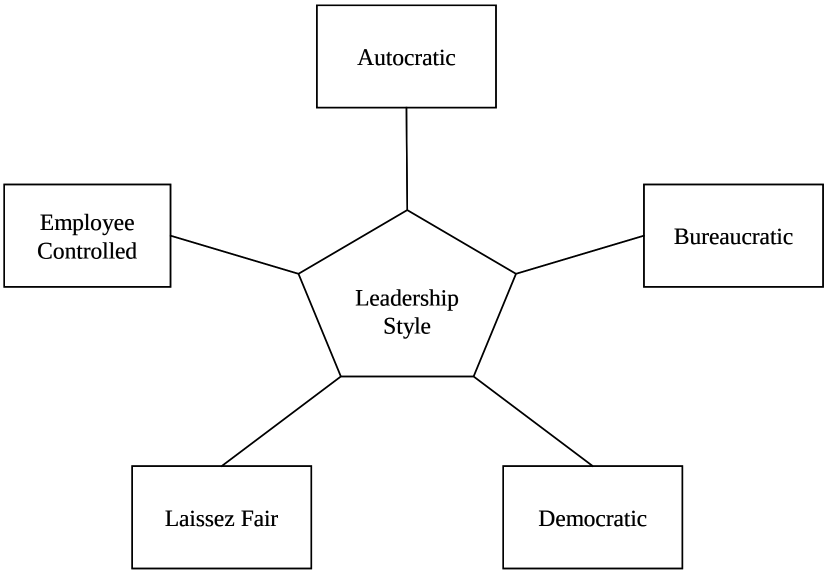


Figure 5.2: Leadership Styles

Autocratic Leadership

This style of leadership involves making decision without consultation. Management retain high levels of power over subordinates through the issuing of orders. The dominant characteristics of an autocratic leader include:

- Decisiveness
- Dominance
- Aggressiveness
- Self-assurance
- Initiative

Autocratic leadership is most prevalent in the military and is most effective in emergency situations where absolute trust in the leaderships is required. Motivation will often be the result of fear and intimidation.

Bureaucratic Leadership

This style of leadership involves centralised managerial decision-making and is supported by rules, regulations and policies, which employees must follow. Because of the absence of flexibility, organisations using bureaucratic leadership will often find it difficult to cope with changes in the market place. The dominant characteristics of this type of leadership include:

- Stability
- Strength of conviction
- Deliberateness
- Persistence.

This style of leadership is most prevalent in large organisations and in the civil service.

Democratic Leadership

Democratic leadership involves wider participation in the decision-making process - it would involve employees having input in management decision making. The management characteristics associated with democratic leadership include:

- Flexibility
- Good communication skills
- Co-operation
- Openness

Organisations that rely on rigorous and consistent procedures for their success would have limited scope for democratic leadership.

Laissez Fair Leadership

This style involves management setting goals and objectives, and allowing employees a free reign to accomplish these as they see fit. It is most commonly seen in high tech industries; engineering, research and development and professions such as architecture, management consultancy and medicine. The managerial characteristics required for this style of leadership include:

- Understanding
- Good judgement
- Trust

Employee Controlled Leadership

In these types of organisations employees set goals and make decisions, while management deal with the administrative aspects of these decisions. An example of where this style of leadership would be used is in universities. Dominant management characteristics include:

- Responsiveness
- Tact
- Adaptability
- Flexibility

C. LEADERSHIP THEORIES

This section provides a summary on four main schools of thought on leadership, namely:

- The trait approach
- The behaviour approach
- The contingency approach
- The charismatic approach

Trait Theories

The earliest theories of leadership focused on traits. The basis of these theories was that it was possible to identify a set of underlying characteristics that make all great leaders great. The trait theories argue that leaders are born with particular traits such as personality traits, and physical traits that mark them out to be leaders.

Research into the universal traits possessed by leaders has produced little by way of compelling evidence. The view that leaders are born and not made is not as strongly held today.

The following is a summary of trait theories:

- Traits and skills can be identified that set leaders apart from non-leaders.
- The traits identified mainly concern personality, including such characteristics as dependability, intelligence, shows initiative, lateral thinker, need for achievement, visionary etc.
- These traits and skills can be used to select leaders - such an approach is used in personal specifications for selection.
- This approach has re-emerged as management competencies.

Behaviour and Style Theories

Results from two research groups at the Ohio State University (Stogdill and Coons, 1957) and at the University of Michigan (Likert, 1961) are described as follows:

Ohio State University Studies

These studies sought to identify and classify the various dimensions of leadership behaviour. Two categories were identified that accounted for the majority of the leadership behaviour. These two categories were called:

- **Initiating Structure style** (Task-oriented behaviour): This style reflects the extent to which the leader defines his/her role and the role of their followers in achieving established goals.
- **Considerate style** (People-oriented behaviour): This style reflects the extent to which the leader focuses on establishing trust, mutual respect and rapport between themselves and their followers and among the group of followers.

This research demonstrated that leaders that show behaviour with high levels of initiating structure style and high levels of considerate style were generally more likely to achieve higher performance among their followers.

University of Michigan Studies

These studies sought to examine the nature of the relationship between behavioural characteristics of leaders and performance effectiveness. The research produces a two-way classification of leadership; **employee-oriented** and **production-oriented** styles. Employee-oriented leaders emphasise interpersonal relations in the workplace while production-oriented leaders focus on the technical aspects of work.

The results of the study showed that the employee-oriented leaders achieved higher productivity and job satisfaction among their workers than production-oriented leaders. However, the study also found that the employee-oriented and production-oriented approaches needed to be balanced.

The results of the two studies could be summarised as follows:

- They suggest that the behaviour of the leader, rather than a personality trait, determines leadership effectiveness.
- There are two dimensions of leader behaviour; **production-oriented** versus **employee-centred** leaders.
- Employee-centred leadership is favoured over task-centred leadership.
- The most effective leaders emphasise concern for their employees.
- There are some situations where task-centred leadership is more appropriate.

Contingency Leadership Theory

These theories are based on the premise that predicting leadership success and effectiveness is more complex than simply isolating traits or behaviour. Situational factors, such as the characteristics of the employees, experience of the leader and the nature of the task being done also have an effect on the leader's effectiveness.

FIELDER'S THEORY

Fielder Theory (1970s) was an attempt to combine leadership style and organisational situation. The idea was to match the leader's style with the most favourable situation.

According to Fielder effective leadership is a function of four factors:

- Leader's preferred style
- Leader-member relations
- Task structure
- Leader's position power

Situational Factors

Leadership Style

Fielder identified two main leadership styles:

- **Relationship-motivated leaders:** These obtain satisfaction from having good relationships with others. They usually encourage participation and involvement and are concerned about what the other team members think of them.
- **Task-motivated leaders:** These are strongly focused on the task and emphasise procedures and task completion.

Fielder's view was that both these styles could be useful and effective in appropriate situations.

Leadership style was measured with a questionnaire known as the least preferred co-worker (LPC) scale. The LPC scale has an 18 adjectives pairs (each adjective in a pair oppose one another) along an 8 point scale.

Examples of the adjectives are as follows:

open	1	2	3	4	5	6	7	8	guarded
quarrelsome	8	7	6	5	4	3	2	1	harmonious
efficient	1	2	3	4	5	6	7	8	inefficient
self-assured	1	2	3	4	5	6	7	8	hesitant
gloomy	8	7	6	5	4	3	2	1	cheerful

The manager (leader) is asked to describe the person they worked least well with- in the past (least preferred co-worker) on a scale 1-8. If the leader describes the least preferred co-worker using positive concepts, he or she is considered relationship-oriented – a leader who cares about and is sensitive to others feelings. On the other hand, if a leader uses negative concepts to describe the least preferred co-worker, he or she is considered task oriented – a leader who places greater value on tasks than on people.

Situation

Leadership situations can be analysed in terms of three elements which can be favourable or unfavourable for the leader:

- **Leader-member relations**: This refers to group atmosphere, and members' attitude towards and acceptance of the leader.
- **Task structure**: This refers to the extent to which tasks performed by the group are defined, have specific procedures and have clear explicit goals.
- **Leader's position power**: This refers to the extent to which the leader has formal authority over subordinates.

When he examined the relationship between leadership style and situational factors, and the link with performance Fielder found the following:

- When all three elements are favourable, the task oriented leader excelled because everyone got on well together, the task is clear and the leader has power – all that is needed is for someone to provide direction.
- When the situation is unfavourable to the leader, a great deal of structure and task direction is needed so a task-oriented leader will do best.
- When the situation is intermediately favourable the relationship-oriented leader will do best because human relations skills are important in achieving high group performance.

SITUATIONAL THEORY - HERSEY AND BLANCHARD

This theory focuses on the characteristics of the employee in determining appropriate leadership behaviour. According to Hersey and Blanchard, subordinates vary in their readiness level. People who are low in task readiness, because of little ability or training, or insecurity, need a different leadership style than those who are high in readiness and have good ability, skills, confidence and willingness to work.

According to the situational theory a leader can adopt one of four leadership styles based on a combination of relationship (concern for people) and task (concern for production) behaviour. The four styles are as follows:

1. **Telling Style**: This style reflects a high concern for task and a low concern for people and relationships. It involves giving explicit instructions on how a task should be accomplished. A telling style is appropriate when followers are at a low readiness level because of poor ability and skills, little experience, insecurity or unwillingness to take responsibility for their own task behaviour.
2. **Selling style**: This style is based on a high concern for both people and tasks. The selling style involves giving direction but also includes seeking input and clarifying the task rather than simply giving instructions. A selling style is appropriate with moderate levels of readiness. These subordinates might lack some education, experience and skills, but they demonstrate high confidence, ability, interest and willingness to learn.
3. **Participation Style**: The style is based on a combination of high concern for people and low concern for production tasks. The leader shares ideas with subordinates, gives them a chance to participate and facilitates decision making. A participating style is appropriate with high levels of readiness. These subordinates might have the necessary education, experience and skills, but might be insecure in their abilities and need some guidance

4. **Delegation Style**: This style reflects a low concern for both relationships and tasks. This leader style provides little direction and little support because the leader turns over responsibility for decisions and their implementation to subordinates. When followers have a very high level of education, experience and readiness to take responsibility for their own task behaviour, the delegating style can be used effectively.

Charismatic Leadership Theories

Studies have focused on the behaviours that distinguish charismatic leaders from non-charismatic leaders. House (1977) suggests that charismatic leaders are exceptionally self-confident, are strongly motivated to attain and assert influence, and have strong conviction in the moral rightness of their beliefs.

Studies have focused on the behaviours that distinguish charismatic leaders from non-charismatic leaders.

Competencies displayed by charismatic leaders include the following:

- Compelling vision or purpose
- The ability to communicate the vision to others
- Demonstrate consistency and focus in pursuit of vision
- Know their own strengths and capitalise on them.

Transactional -Transformational Leadership

Burns (1978) looked at management differences between successful and unsuccessful companies and concluded that the key factor contributing to success was "transformational leadership". In his research he identified two types of leadership; transactional and transformational. These leadership types are summarised as follows:

Transactional leadership:

- Leaders motivate their followers in the direction of established goals by clarifying role and task requirements.
- Leaders allocate work, make routine decisions and monitor performance.
- Works best in stable situations with routine tasks.

Transformational leadership:

- Leaders have skills to recognise the need for change and identify action.
- Associated with vision, inspiration and charisma.
- Focus on high performance.
- Works best in uncertainty and change.

Study Unit 6
Motivation
Contents

Introduction

Motivation can be described as the forces acting on or within an individual, which determine the direction as well as the strength of their behaviours. This definition implies that there are four elements to the motivational process:

- **Internal forces**: These are forces within the individual such as the need to belong.
- **External Forces**: These are forces from outside the individual such as the need to obtain financial resources.
- **Direction**: Individuals are directed towards achieving particular goals such as being promoted.
- **Strength**: This refers to the amount of effort an individual expends to achieve a particular goal.

The Link between Performance and Motivation

If an organisation is to be successful in meeting goals and objectives, managers and employees must be in a position to perform their jobs competently. An individual's performance in any job is a function of three variables:

- **Ability**: This refers to the abilities and skills an individual possesses.
- **Motivation**: This refers to an individual's desire to use their abilities and skills to perform a particular task.
- **Environment**: This refers to issues external to the individual such as the availability of financial or information resources.

Beyond a certain point lack of ability cannot be compensated for by high motivation. Also if an employee is not motivated, high level of ability will not suffice.

To meet goals/objectives managers must understand the needs, perceptions and expectations of employees that underlie their behaviour.

A. THEORIES OF MOTIVATION

There are many theories of motivation and various ways of classifying them. In this chapter we will looks at two broad categories of theories referred to as:

- Content Theories
- Process Theories

Content Theories

Content theories, which are sometimes referred to as needs theories, try to explain motivation in terms of the needs experienced by employees. The main theories are:

- Maslow's Hierarchy of Needs
- Alderfer's ERG Motivation Theory
- McClelland's Achievement Theory
- Herzberg Two Factor Theory

Maslow's Hierarchy of Needs

Maslow's Hierarchy of Needs theory states that human motivation is dependent on the desire to satisfy various levels of needs. According to this theory, human needs are classified into five categories and grouped in a hierarchy with the most basic needs (those essential for survival) located at the bottom (see Figure 6.1).

The basic assumptions of this theory are:

- Only unsatisfied needs are motivators.
- Higher level needs will not emerge until lower level needs have been satisfied.

Lower level needs are called deficiency needs and higher level needs are called growth needs.

DEFICIENCY NEEDS

- **Physiological Needs**: These needs relate to basic survival needs, which allow for continued existence and include food, water, warmth and freedom from pain.
- **Safety Needs**: These needs relate to physical and psychological safety from external threats to our well- being, such as the need for security and protection. These needs take effect when physiological needs have been met.
- **Social Needs**: This level of needs relate to the requirement for company and companionship, and for a sense of personal belonging. These needs for personal contact and interaction with other people are triggered once physiological and safety needs have been met.

GROWTH NEEDS

- **Esteem Needs**: These relate to the need for self-esteem and a feeling of personal self-worth. These needs become active once all the deficiency needs have been satisfied
- **Self-Actualisation Needs**: These refer to an individual's need for self-fulfilment, personal development and realising ones potential. This need level is different from others in that such needs can rarely be fully satisfied or fulfilled. The more they are satisfied the stronger they become. Maslow believed that managers should strive to create the climate necessary to develop employees' potential to their fullest.

Although research findings on the validity of Maslow's hierarchy have not always been positive it remains useful as an introduction to needs theory.

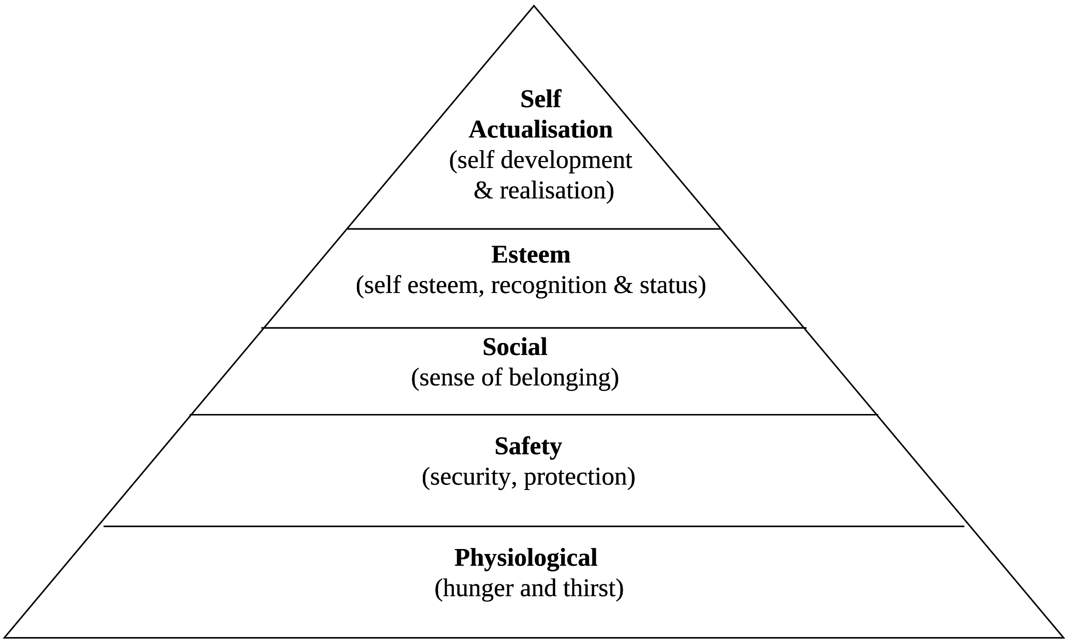


Figure 6.1: Maslow's Hierarchy of Needs

Alderfer's ERG Motivation Theory

Alderfer's (1969) ERG (Existence, Relatedness and Growth) Theory specifies that individuals have three basic needs:

- **Existence**: The need for food, water, air etc.
- **Relatedness**: The need for interpersonal relations.
- **Growth**: The need for personal development.

Building upon the work of Maslow, ERG theory avoids some of the criticism of Maslow's work. The ERG model suggests that more than one set of needs can be active at the same time. Individuals can move from one category of needs to another and lack of fulfilment in one category can affect needs in another. For example, if an individual fails in a task that would satisfy a growth need that person might then regress back to a relatedness need.

McClelland's Achievement Theory

McClelland (1960) concentrated on developing and identifying motivational differences between individuals. He proposed that people have three key sets of needs:

- The need for **achievement**, which is a desire for challenging tasks and a good deal of responsibility.
- The need for **affiliation**, which refers to the need for developing social and personal relations.
- The need for **power**, which refers to the need for dominance.

The needs identified by McClelland can be useful in helping managers to recognise the differences in people at work. McClelland suggested that people posses an extremely wide variety of different types of needs and these needs are not arranged in any particular hierarchy. He believed that needs are learned through life rather than inherited and suggested that they may be activated by events in the external environment. McClelland argued that the main factor in willingness to perform is the intensity of an individual's actual need for achievement.

Other needs he identified include autonomy, aggression, endurance, impulsiveness, nurturance and understanding. From a managerial viewpoint, this research suggests that it is important for managers to assess the strengths of various needs in their employees and to design motivational strategies that enable employees to satisfy the needs that are strongest in the individual.

Herzberg Two Factor Theory

According to Herzberg's two factor theory (1962), there are two sets of factors affecting employees. One set of factors can cause extreme satisfaction and the second set can cause extreme dissatisfaction. The factors that cause satisfaction are called **motivators** and the factors that cause dissatisfaction are called **hygiene factors**.

MOTIVATORS

These factors, which can lead to extreme satisfaction, are related to job content issues such as the nature of the work itself, achievement, responsibility, recognition, advancement possibilities and self-growth potential. According to Herzberg, employees can be motivated by maximising satisfaction in terms of these factors.

HYGIENE FACTORS

These factors, which can lead to extreme dissatisfaction, are issues related to the job context such as company policy, supervision, pay, status, security and relationships with superiors, peers and subordinates. Although these factors do not explicitly motivate people, if an organisation were to perform poorly with regard to them, extreme dissatisfaction would occur. Thus, if these factors are good dissatisfaction is removed, but satisfaction does not occur. Hertzberg's findings indicate that satisfaction and dissatisfaction are not at opposite ends of the same spectrum. Rather they are on two separate spectra. The opposite of satisfaction is not dissatisfaction but no satisfaction. Similarly the opposite of dissatisfaction is no dissatisfaction. Thus, pleasant or good working conditions do not actually produce motivation – as hygiene factors they simply prevent dissatisfaction.

Process Theories

Process theories attempt to explain motivation in terms of people's thoughts, feelings and perceptions regarding their job and the organisation in which they work. The process theories are concerned with determining how individual behaviour is initiated, directed and maintained. The major process theories of motivation are expectancy theory, equity theory, goal-setting theory and reinforcement theory. The following process theories are discussed:

- McGregor's XY Theory
- Vroom's Expectancy Theory
- Equity Theory
- Reinforcement Theory
- Goal Setting Theory

McGregor's XY Theory

McGregor focused on the assumptions that managers hold in relation to employees and on how this affects managerial behaviour in terms of motivating them. He suggested two sets of managerial assumptions about employees called Theory X and Theory Y.

THEORY X

In Theory X, managers see employees as inherently lazy, doing as little work as possible and therefore they need to be corrected, controlled and directed to ensure that they do enough work

THEORY Y

In Theory Y, managers see employees as liking work and needing challenges. The implication of this theory is that if the work and organisational environment are appropriate, employees will embrace the tasks set for them without any need for control or coercion.

McGregor believed that all workers are naturally Theory Y, but may become Theory X as a result of how they are treated in organisations. Therefore organisational structures, systems and practices should allow for employee participation in the decision making process, and job enrichment and flexibility should be allowed and even encouraged.

Vroom's Expectancy Theory

This theory was developed by Victor Vroom in 1964 and is sometimes called the Expectancy-Valence theory. This theory identifies important expectations that the individual brings to the workplace and focuses on the relationship between the efforts put into completion of a particular activity by the individual and the expectations concerning the actual reward that will accrue as a result of expending the effort. This theory argues that individuals base decisions about their behaviour on the expectation that one behaviour or another is more likely to lead to needed or desired outcomes. The relationship between one's behaviour and particular desired outcomes is affected by individual factors such as personality, perception, motives, skills, abilities etc, and by organisational factors such as culture, structure, managerial style, etc. This theory argues that a worker's motivation is dependent on how the employee perceives the relationship between effort, performance and outcome.

Motivation = Expectancy x Instrumentality x Valence

Expectancy: This is the probability assigned by the individual that work level will be followed by a given level of achieved task performance.

Instrumentality: This is the probability assigned by the individual that a given level of achieved task performance will lead to various work outcomes (rewards).

Valence: This is the value attached by the individual to various work outcomes.

Therefore the level of motivation associated with a given task or job is drastically reduced whenever one or more of the factors approaches the value zero. Vroom's theory suggests that effort (motivation) is not simply a function of rewards - the individual must feel that they have the ability to perform the task (expectancy), that this performance will impact on the reward and that this reward is actually valued.

IMPLICATION OF EXPECTANCY THEORY

Vroom (1964) suggests that managers must seek to understand individual employee goals and motives; ensure these are clearly and positively linked to desired performance levels, which in turn are achievable from the employee's perspectives.

Equity Theory

This theory was developed by Adams (1965) and focuses on people's feelings on how fairly they have been treated in comparison to how others are treated. It is based on the comparison between two variables, inputs and outcomes. Inputs refer to what employees bring to his or her job and include effort, experience and skills. Outcomes from a job are what the person receives in return for his or her inputs and include pay, recognition, benefits, promotion etc.

The input output ratio may be compared to that of another employee. A state of equity exists when the input outcome ratio is perceived to be equal to that of another person or the group average. Inequity occurs when the input to outcome ratio is perceived to be out of balance when compared to others.

The most common way of reducing perceived inequity is to:

- Change their input – may reduce their level of effort
- Try to change outcomes– for example by looking for a pay increase
- Leave the job – if they feel they are under paid

The implications for managers are that employees evaluate the equity of their rewards compared to others and will not be motivated if they feel they are not being treated equally.

Reinforcement Theory

The emphasis of reinforcement theory is that the behaviour of a person in a situation is influenced by the rewards or penalties that a person experienced in a similar situation in the past.

Reinforcement theory introduces an important point about motivation; that a large amount of motivated behaviour is learned behaviour.

There are four main types of reinforcement behaviours available to managers:

- **Positive reinforcement** (for example; pay raise, promotion) is provided after desired behaviour occurs, with the intention of increasing the probability that the desired behaviour will be repeated.
- **Avoidance** is an attempt to increase the probability that the desired behaviour will be repeated. When the manager uses avoidance, the employee is shown what the consequences of improper behaviour will be, but is allowed to avoid those consequences by displaying good behaviour. This is sometimes referred to as negative reinforcement.
- **Extinction** is basically ignoring the behaviour of subordinates. It is an attempt to weaken behaviour by giving the employee neither positive nor negative reinforcement. This approach can be used when the behaviour is seen by the supervisor as temporary, non-typical, and not serious in its negative consequences.

- **Punishment** (threats, docking pay and suspension) is an attempt to decrease the likelihood of a behaviour recurring by applying negative consequences.

Reinforcement theory has a number of implications for management:

- Motivated behaviour is influenced by learning what is acceptable to the organisation.
- If managers are working with the employees to develop motivated behaviour, they should:
    - Tell the employee what they are doing wrong.
    - Be careful not to reward all individuals at the same time.
    - Tell individuals what they can do to get positive reinforcement.
    - Be sure to administer the reinforcement as closely as possible to the occurrence of the behaviour.
    - Recognise that failure to reward can also modify behaviour

Goal-Setting Theory

A goal is a target, objective or result that someone tries to accomplish. Goals tell an employee what needs to be done and how much effort will be expanded. Goal setting focuses on the conscious choices a person has to make.

Goal-setting theory states that people will be motivated to the extent to which they accept specific, challenging goals and receive feedback that indicates their progress towards goal achievement.

There can be two approaches to goal setting:

- Management sets goals for the employees.
- The employees and managers mutually develop goals with each other.

The goal-setting theory has implications for management:

- Managers need to work with employees in goal setting to provide targets for motivation.
- The goals established should be specific rather than general in nature.
- Goal setting requires that the manager provide feedback on performance

B. Structuring of work

Organisations can also use job design to improve motivation by making task more interesting to the employees. The following are the main approaches:

- Job Enlargement
- Job Enrichment
- Job Rotation

Job Enlargement

Job enlargement involves increasing the scope of the job by extending the range of duties and responsibilities involved. Job enlargement is a reversal of the process of division of labour.

Job Enrichment

Job enrichment was developed for the advancement of the Hertzberg's 'two factor' theory of work motivation discussed earlier in the chapter. The job enrichment approach suggests that employees gain most satisfaction from the work itself and it was the intrinsic outcomes arising from the work that motivated employees to perform well in their job. Herzberg (1966) established the concept of **vertical loading.** Vertical loading involves the addition of more challenging dimensions to the job; including increasing the authority, responsibility and accountability associated with the job and at the same time reducing some controls.

On a similar line Hackman and Oldham (1980) suggested that three basic conditions necessary for promoting job satisfaction and employee motivation:

- Work should be **meaningful** for the doer.
- Doers should have **responsibility** for the results.
- Doers should get **feedback** on the results.

Hackman and Oldham identified five core job characteristics, which needed to be incorporated into job design to increase meaningfulness and feedback:

- **Skill variety**: the extent to which a job requires a variety of skills from an employee.
- **Task identity**: the degree to which a task is perceived as a unified one with a clear outcome visible from the start.
- **Task significance**: the degree to which the task has an impact on others in the organisation.
- **Autonomy**: the degree of discretion the employee has in scheduling work and determining procedure.
- **Feedback:** the amount and kind of information that is received about job performance.

Job Rotation

This approach involves moving workers from one job to another, in order to increase interest, satisfaction and motivation.

Study Unit 7

Teamwork

Contents

Teamwork

A team, in an organisational context, can be defined as a unit of two or more people who interact and co-ordinate actively to meet a particular organisational objective.

A team is more than just a collection of skilled individuals. They must share a collective vision and work together to achieve a common objective. Finally the team's objectives and goals must be in line with the organisations.

A. IMPORTANCE OF TEAMWORK IN MODERN ORGANISATIONS

The importance of teams and teamwork stems from the need for organisations to be flexible and responsive to customer requirements in an increasingly competitive market, while at the same time ensuring that management and staff work together to meet these changing business needs.

The benefits that can be gained through teamwork include:

- **Increased Performance**: Teams tend to produce more than if each person were to work alone. Teams develop a synergy where the whole is greater than the sum of the parts.
- **Increased Responsiveness**: Because of the range of skills available in a team, they are better able and quicker to respond to changes.
- **Increased Innovation**: While an individual can produce the initial idea, a range of skills will be required to develop and implement the idea.
- **Increased Motivation**: Generally speaking people experience a stronger sense of satisfaction and motivation from working in a successful team than working on their own. However a poorly managed and performing team can be de-motivating.

B. TYPES OF TEAMS

Different types of teams exist within organisations to perform a variety of activities. There are two main categories of teams:

- Formal Teams
- Self Directed Teams

Formal Teams

Formal teams are created by the organisation as part of the formal organisational structure. The four most common types of formal teams are:

- Vertical Teams
- Horizontal Teams
- Special Purpose Teams
- Committee

Vertical Teams

A vertical team usually refers to a manager and their direct reports (subordinated) in an organisation's formal structure. A vertical team can also be referred to as a functional team.

Horizontal Teams

This type of team is composed of employees of a similar hierarchical level but from different functions or departments. This is also called a cross-functional team or task force.

Special Purpose Teams

A special purpose team is one that is created from outside the normal organisational structure to undertake a special project. This type of team will normally disband after the project is complete.

Committee

This type of team deals with activities that occur on a regular basis and would generally be a permanent team. An example would be a health and safety committee.

Self Directed Teams

Self directed teams are part of a modern approach to organising work that tries to involve employees in the decision making process. It is felt that the increased involvement of front line staff in the decision making process will lead to improved performance.

Self directed teams usually involve 5 to 20 multi skilled workers who have responsibility for a range of task such as scheduling of work, planning, decision-making and the control of budgets.

To enable self directed teams to be effective they should:

- Be given autonomy, authority and responsibility.
- Have sufficient knowledge, training and experience.
- Should be free from interference from outside the group.
- Be given reasonably complex and challenging activities.

Two forms of self directed teams are:

- Problem Solving Teams
- Network/Virtual Team

Problem Solving Teams

A problem solving team usually consists of 5 to 12 employees from the same functional area who meet to find ways of improving quality, efficiency and effectiveness of their work.

Network/Virtual Teams

The network or virtual team is a team that uses computer technology such electronic conferencing facilities, email and collaboration systems to enable them to work together on projects. The members of a network/virtual team are normally geographically dispersed.

C. CHARACTERISTICS OF EFFECTIVE TEAMS OR GROUPS

The characteristics of an effective team are not easy to identify. Mullins (2007, p311) suggests that the underlying feature of effective teams is a spirit of co-operation in which members work well together as a united team, with harmonious and supportive relationships. This is shown when teams exhibit the following:

- A belief in shared aims and objectives
- A sense of belonging to the group
- Acceptance of group values and norms
- A feeling of mutual trust and dependency
- Full participation by all members and decision making by consensus
- A free flow of information and communication
- Open expression of feelings and disagreements
- Conflict resolution by the members themselves
- Low levels of staff turnover, absenteeism, accidents, errors and complaints

Enhancing Work Team Effectiveness

Managing Teams is a challenging process. According to Williams (2007) companies can increase the likelihood that teams will succeed by carefully managing the **setting of team goals and priorities, how team members are selected**, **trained** and **compensated.**

SETTING TEAM GOALS AND PRIORITIES

Teams need to have four main characteristics in order to be properly motivated to achieve challenging goals:

- A high degree of autonomy or control to make decisions and to carry out their own plans.
- Empowerment to control resources such as budgets, workspaces, computers or whatever is needed to do their jobs.
- Structural accommodation: the ability to change organisational structures, policies and practices.
- Bureaucratic immunity: the ability to make changes without first getting approval from managers or other parts of an organisation.

SELECTING PEOPLE FOR TEAMWORK

A focus on teamwork, team level and team diversity can help companies choose the right team.

- **Team members must show a preference for teamwork**, which can be assessed by each member's degree of individualism versus collectivism.

  Individualists generally prefer independent tasks in which they work alone and would not necessarily make great team members.

  Collectivists prefer interdependent tasks in which they work with others. The latter would make better team members because they put the interests of the group ahead of themselves.

- **Team level:** the average level of ability, experience, personality or any other factor in a team. A high level of team experience means that a team has experienced team members.
- **Team diversity**: the variances or differences in ability, experience, personality or any other factor in a team. Teams with strong diversity in job experience would have a mix of team members, ranging from seasoned veterans, to people with three or four years of experience, to rookies with little or no experience.

TEAM TRAINING

Teams need training to be successful. Many companies underestimate the amount of training that team members need. There are four types of team training:

- **Training in interpersonal skills**: Interpersonal skills: these include skills such as listening, communicating, questioning and providing feedback, that enable people to have effective working relationships with others.
- **Training in decision-making and problem-solving**; this is sometimes taught in conjunction with **conflict-resolution skills**.
- **Technical training** needed to do their jobs.
- **Training for team leaders**.

TEAM COMPENSATION AND RECOGNITION

Compensating teams can be very difficult. However, companies can compensate employees for team participation in three different ways:

- **Skill-based pay**: a compensation system that pays employees for learning additional skills or knowledge.
- **Gainsharing**: a compensation system in which companies share the financial value of performance gains, such as productivity, cost savings, or quality, with their workers.
- **Non-financial rewards** such as vacations, plaques or inexpensive gifts.

D. TEAM SIZE AND ROLES

Two important characteristics of a team that will affect the overall performance of the organisation are the **size** of the team and the **roles** that members perform within the team.

Team Size

The ideal size of a manageable work team is believed to be 7, although teams of 5 to 12 can be used effectively depending on the issue involved.

Small Teams: These teams, which have 2 to 4 members, will normally work better together. They tend to be more informal, exchange more opinions, get into more discussions and generally make fewer demands on team leaders.

Large Teams: These teams, which have 12 or more members, tend to suffer from many problems. They tend to be less friendly and have more disagreements. Conflict levels are higher and subgroups often form. Demands on the team leader are greater because of centralised decision making and less member participation. Turnover and absenteeism levels are higher in large teams especially for operatives and support staff.

Team Roles

A team role refers to the part someone plays in the team. Dr R. M. Belbin suggested that for a team to be effective it needs to have a number of participants who play very different roles within the team structure. Belbin's research indicated that it was possible to identify and distinguish nine distinct management styles, which he labelled team roles.

Belbin's Nine Team Roles

1. **Plant**: Advances proposals and makes criticisms that lead to counter suggestions. Can offer new insights into old ways.
2. **Resource Investigator**: Introduces new ideas from external origins and engages in negotiation type activities. Makes contact with others.
3. **Coordinator/Chairperson**: Clarifies goals, objectives and selects problems on which decisions have to be made. Helps to establish roles, responsibilities and work boundaries. Sums up the achievements and feelings of the group.
4. **Shaper**: Pushes the group towards agreement. Shapes roles and responsibilities, tasks and objectives.
5. **Monitor /Evaluator**: Analyses problems and situations. Can interpret complex information and clarify obscurities, assesses the contribution of others.
6. **Team-worker**: Gives personal support to others and builds on another member’s ideas. A team-worker will normally take steps to avert or overcome disruption.
7. **Company Worker/Implementer**: Transforms talk and ideas into practical steps.
8. **Completer**: Emphasises the need for task completion, identifies errors and omissions, and galvanises others into action.
9. **Specialist**: Brings knowledge and expertise to the team.

Effective teams have members who recognise the roles they play best and who attempt to enhance the strengths of that role.

E. STAGES OF TEAM DEVELOPMENT

Managers and team leaders need to understand the stages a team goes through and the dynamics that need to be managed at each stage in the process. B. W. Tuckman proposes a 5-stage model to describe the stages a team goes through. These stages are illustrated in Figure 5.1.

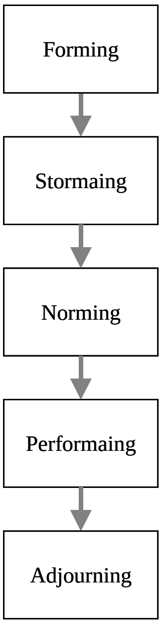


Figure 5.1: Stages of Team Development

Forming

The team is formally introduced and given its tasks or goals. At this stage members will be uncertain about their own role, the role of others and what it is that they have to achieve. This stage is likely to involve some members "jockeying for position" within the team. The team leader should focus on facilitating social interaction within the team and making everyone aware of the team objectives, and individual roles and requirements.

Storming

This is the stage of team development in which individual personalities and roles emerge. The potential for conflict and misunderstanding of individual roles becomes an issue here.

At this stage the team may break into factions, which if not addressed, will have a serious impact on the overall cohesiveness of the group.

The challenge of the team leader or manager is to ensure healthy participation by all members, and that disagreements are minimised and conflicts are dealt with.

Norming

This stage is characterised by team harmony and unity starting to emerge. The conflicts developed during the storming stage are now resolved and the members of the group start to develop their own norms of acceptable behaviour. The team leader should focus on the team rather than the individual performance and assist in clarifying team roles and values.

Performing

At this stage, the team is highly motivated and focused on their individual roles. The team moves towards problem solving and the accomplishment of the task at hand. During this stage, the role of the team leader is one of facilitator of high performance.

Adjourning

At this stage in team development, the team members prepare for the team's disbandment. This may be because they team has achieved their goal or it could be because of changes in the organisation. Members may be anxious and uncertain about their future. The role of the team leader will be to ensure task completion and to reward members where appropriate.

F. TEAM COHESIVENESS AND TEAM NORMS

Team Cohesiveness

Team cohesiveness can be defined as the extent to which team members are attracted to the team and are motivated to remain in it to accomplish required tasks.

Benefits of Team Cohesiveness

The benefits of team cohesiveness are:

- **Improved Performance**: Improved performance levels generally result from team cohesiveness, but is often dependent upon the relationship between management and employees. Where industrial relations are strained, team cohesiveness can have a negative effect on productivity. Team cohesiveness can often lead to a standardisation of performance rather than its optimisation.
- **Improved Morale**: A high level of team morale is evidence of a cohesive team. This is due to greater levels of communications, information sharing between team members, and high levels of loyalty, participation and involvement within the team.

Factors Affecting Team Cohesiveness

A number of factors can influence team cohesiveness. The factors include the following:

- **Interactions within the team**: The level of workplace and social interactions between members of the team has a direct effect on cohesiveness.
- **Shared Goals**: If the team members agree on the purpose and goals of the team it is likely to be more cohesive.
- **Personal values**: The level of team cohesiveness is affected by shared values, attitudes and motivations within a team.
- **Competition**: The level of cohesiveness with a team is affected by competition with other internal teams.
- **Feedback**: Positive feedback from the organisation for achievements will increase the cohesiveness of the team.

Team Norms

Team norms are defined as informal standards of conduct shared by team members, which control and guide their behaviour. Team members generally conform to team norms, as they want to be accepted within the team. Team norms can help reduce conflict and achieve a consistent way of doing things.

Team norms can have both positive and negative effects. Depending on the relationship between employees and management, team norms can evolve to embrace an organisational change or create a resistance to the specific change.

Development of Team Norm

There are a number of factors that can influence the development of team norms, which include the following:

- **Initial Behaviour**: The initial behaviour of a team can develop into team norms and a precedent for future expectations. Therefore the forming stage of team development needs to be carefully managed (start as you mean to continue).
- **Inherited Behaviour**: Members will often bring with them experiences and behaviour from other teams or work culture.
- **Explicit Directions**: Explicit statements or directions from management or team leaders are an effective way of developing positive team norms or re-directing established team norms.
- **Critical events**: Team norms can develop from a critical event which the team experiences.

G. TEAM CONFLICT

Team conflict is defined as the antagonistic interaction in which one party attempts to block the intentions or goals of another. Team conflict can have a detrimental effect on team performance and morale and therefore needs to be carefully managed.

Causes of Conflict Within and Among Teams

- **Personality Differences**: Differences in personalities among team members can result in conflict. The job of team leader will be to diffuse any situations that may occur and to minimise interactions between the individuals at critical decision-making points.
- **Power and Status Differences**: When a team comes together from various departments and from different levels in the organisations, some individuals may feel they have to be perceived to exert power over other members of the team. This can result in conflict within the team.
- **Goal Differences**: Goal differences can be a source of conflict among teams that comprise individuals from different departments (e.g. a cross functional project team). This can occur if the goals of the team are at odds with the goals of the various functions.
- **Communications Breakdown**: When there is a communications breakdown, the goals or objectives of the group can get misunderstood due to poor communication and conflict can arise.

- **Unclear Boundaries or Responsibilities**: When job boundaries are unclear, tensions can arise between group members. This can become a problem during times of change within the organisation.
- **Scarce Resources**: As financial and human resources are always scarce in organisations, conflicts can arise in cross-functional teams who have an inherent loyalty to their own groups.

Managing Conflicts

A variety of approaches are available to managers and team leaders for handling conflict situations. The approach taken will depend on the situation at hand. In general, managers will choose an assertive approach or a co-operative approach. The following five styles, which have varying levels of assertion/co-operation, are available for managers to follow when dealing with conflict:

1. **Competing**: This style is most effective during crises or when decisive action is required. It requires a very high level of assertiveness. This is an appropriate style when:
   - Time is short and a rapid decision must be made.
   - The other party may take advantage of you, if you adopt a non-competitive style.
   - Your survival is at stake.
   - You have to implement an unpopular decision regarding an important issue.
2. **Avoiding**: This is a neutral style which is most appropriate when the conflict is not priority, where there is not adequate information available or when there is no hope of an immediate resolution of the problem. This is an appropriate style when:
   - There is no need to reach an immediate solution.
   - It is useful to buy time in order to let feelings simmer down.
   - Time is needed to gain more information about the issue.
   - There is little chance of winning on the issue.
   - The issue is not important or there are more important issues.
   - The possibility of disruption is high but the likely benefits of a solution are low.
3. **Compromising**: This involves a degree of both assertiveness and co-cooperativeness. It requires each party to be prepared to give up something of value to reach an agreement. This is appropriate when:
   - Both sides have valid arguments, equal power and incompatible goals.
   - A problem has to be split down into manageable parts.
   - A temporary agreement is needed over an issue.
   - Neither competition nor collaboration are practical approaches.
   - Time is short and a solution must be found quickly.
4. **Accommodating**: This is a highly co-operative style where group harmony is vital and where one side realises their arguments are weak or invalid. This style is appropriate when**:**
   - You think the outcome is more important for the other party than for you.

- You need to cut your losses.
- You find you are wrong over the issue.
- You feel it would be useful to build up some credit for the future.
- It is important to maintain harmony and avoid the potentially disruptive effects of conflict.

5. **Collaborating**: This is when both parties are willing to work together and they are genuinely concerned about seeking a conclusion where the concerns of both sides are satisfied. This is often referred to as a win-win situation. This style is appropriate when;

- Reaching commitment and consensus is paramount.
- Both parties feel it is worthwhile to commit resources to developing a collaborative solution.
- The goal for both parties is to learn from each other.

H. DEVELOPING INTERPERSONAL SKILLS

Normally team members receive training on interpersonal skills. Interpersonal skills, such as listening, communicating, questioning and providing feedback, enable people to have effective working relationships with others. Also, because managers ultimately get things done through others, competencies in leadership, communication and other interpersonal skills are prerequisites to managerial effectiveness.

The following provides a brief summary of some of the main interpersonal skills:

Listening

Listening requires paying attention to what is being said.

Effective listening is active rather than passive. You need to get inside the speaker's mind so that you can understand the meaning of the communication from his or her point of view.

Active listening requires:

- Listening attentively (intensely) to the speaker.
- Developing empathy for what the speaker is saying.
- Accepting by listening without judging content.

  Taking responsibility for completeness in getting the full meaning from the speaker's communication.

Feedback

Skills in feedback and evaluation are essential to improving learning, team communication and the quality of products, processes and relationships. Receiving feedback can help team members to get a more rounded view of their performance and helps the reviewer to recognise their strengths and development needs. For those giving feedback there are a number of points to consider:

Positive feedback:

- Is more readily and accurately perceived than negative feedback.

- Is almost always accepted, whereas negative feedback often meets resistance.

Negative feedback:

- Is most likely to be accepted when it comes from a credible source or if it is objective.
- Carries weight only when it comes from a person with high status and credibility.

The following are some suggestions for making feedback more effective:

- Focus on specific behaviour
- Keep feedback impersonal
- Keep feedback goal oriented
- Make feedback well-timed
- Ensure understanding
- Direct negative feedback towards behaviour that the receiver can control

Empowerment Skills - Delegation

Delegation is defined as: "The assignment of authority to another person to carry out specific activities while retaining the ultimate responsibility for the activities".

Proper delegation requires:

- Clarifying the exact job to be done
- Setting the range of the employee's discretion
- Defining the expected level of performance
- Setting the time frame for the task to be completed
- Allowing employees to participate
- Establishing feedback controls

Effective delegation pushes authority down vertically through the ranks of an organisation. A number of contingency factors that can influence delegation include:

- The size of the organisation
- The importance of the duty or decision
- Organisational culture
- Task complexity
- Qualities of the employees

Managing Conflict

The topic "Managing Conflicts" is discussed in detail in Section 7.7.2 of this chapter.

Negotiation

This is a process in which two or more parties who have different preferences must make a joint decision and come to an agreement. To achieve this goal, both parties typically use a bargaining strategy. The following are two types of bargaining strategies:

- **Distributive Bargaining**: Negotiation under zero-sum conditions, in which the gains by one party involve losses by the other party. An example of distributive bargaining is in traditional labour-management negotiations over wages and benefits. Each party has a resistance point that marks the lowest outcome that's acceptable. The area between their resistance points is the settlement range and as long as there is some overlap in their aspiration ranges, there exists a settlement area in which each party's aspiration can be met.
- **Integrative Bargaining**: Negotiation in which there is at least one settlement that involves no loss to either party. In general, integrative bargaining is preferable to distributive bargaining because it builds long-term relationships and facilitates working together in the future.

DEVELOPING EFFECTIVE NEGOTIATION SKILLS

- Research the individual with whom you'll be negotiating.
- Begin with a positive overture.
- Address problems, not personalities.
- Pay little attention to initial offers.
- Emphasise win-win solutions.
- Create an open and trusting climate.
- If needed, be open to accepting third-party assistance.

Effective Presentations

The ability to deliver effective presentations is an important skill. The following are some guidelines when making presentations:

- Prepare for the presentation.
- Make your opening comments.
- Make your points.
- End the presentation.
- Answer questions
- Be natural in your presentation, but address what's important to the listener.
- If your audience is interested in what you have to say they will listen.

Source: Fundamentals of Management by S. Robbins & D DeCenzo (2005). Publisher: Prentice Hall

Study Unit 8

Communicating in Organisations

Contents

Communicating in Organisations

Communication can be defined as the process by which ideas, information, opinions, attitudes, etc. are conveyed from one person to another.

Organisational communication is about sharing information with others, listening to and receiving information from all levels of the organisation.

A. IMPORTANCE OF COMMUNICATIONS IN ORGANISATIONS

For organisations to function effectively, information must be exchanged efficiently, meaning that the information received must have the same meaning as the information sent.

The primary purpose of communications in organisations is to achieve coordinated action, information and decision-making.

B. THE COMMUNICATIONS PROCESS

The communications process is made up of a number of elements or stages through which every form of communication must pass (Figure 6.1):

1. **Sender**: The entire process starts when the sender decides that he or she wants to send a message to another person. For example, the sender may want to inform his/her manager about a systems problem.
2. **Encoding the message**: Before a message can be sent, it must be encoded in a suitable language. This language or sign could be any of the following; a gesture or non-verbal communication, written word, spoken word, picture or illustration.
3. **Medium**: Once the sender has encoded the message the next decision is to choose which medium to use to transmit the message. Different types of medium include: email, memo, briefing, meeting, videoconference and telephone. The choice of medium will depend on a number of factors such as; is the message bad news, what is the speed of transmission of the message or a report.
4. **Decoding process**: The receiver must decode the message and understand it before acting on the message. The use of unfamiliar language will impact the understanding of the message.
5. **Receiver**: Finally once the receiver has decoded and understood the message, the receiver then becomes the sender in the process. The receiver then sends feedback to the original sender to indicate that the message has been received and understood. The receiver also acts on the contents of the message if a direct action is required.

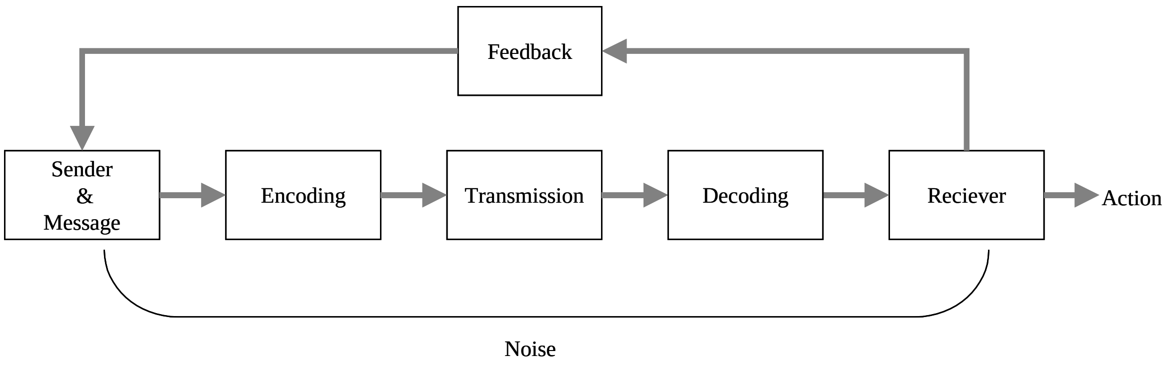


Figure 6.1: Model of the communication process

Two important elements of the communications process are **feedback** and **noise.**

Feedback: It is importance that the sender of the message gets feedback from the recipient to indicate that the message has been received and understood correctly. Feedback enables corrective action to be taken if there is a breakdown in the communications process.

Noise: Is used to denote anything that inhibits the success of the communications process. Noise can refer to actual noise in the room or the reader's state of mind. It is the job of the communicator to ensure that noise does not interfere with the successful communication of the message.

Methods of Communication

The primary methods of communication are written, oral and non-verbal.

Written Communication: This allows a permanent method of communication, for example memos, reports and e-mails.

Oral (verbal) Communication: This is the most prevalent form of organisational communication and also the most powerful because in addition to words it can contain other information conveyed by the speaker's change of tone, volume and pitch.

Non-verbal Communication: This includes personal and environmental information such as body language, handshake, facial expression, eye movement or contact. Environmental factors include the layout or space. For example a large office may place more status on the inhabitant.

C. ORGANISATIONAL COMMUNICATIONS

There are two forms of organisational communications:

- Formal Communications
- Informal Communications

Formal Communications

Formal communications are those that flow within the chain of command defined by the organisation. There are three distinct types of formal communications:

- Downward Communications

- Upward Communications
- Horizontal Communications

Downward Communications

This is the most common form of communication in an organisation and usually involves messages and information from top management flowing down through the organisation.

The most common media used for downward communications are speeches, e-mail, published reports, newsletters and increasingly the company's Intranet site.

The topics covered in downward communications include:

- The vision, goals and objectives of the organisation
- Procedures and policies
- Specific job instruction
- Feedback on performance and attainment of objectives

The main problems associated with downward communications are that the message will not filter down to all levels and it can get misinterpreted through numerous reiterations.

Upward Communications

Upward communication is the process of encouraging employees to share feelings and ideas with managers and employees at a higher level in the organisation.

Upward communication is becoming increasingly important as employees are demanding and receiving more involvement in decision-making.

The following are some methods that can be used to establish and improve upward communications:

- Formal grievance procedure
- Opinion surveys
- Open door policy
- Informal meetings
- Task forces
- Team meetings

Horizontal Communications

Horizontal communication involves the lateral exchange of information among employees at the same level within an organisation, or between different departments in the organisation.

Horizontal communication falls into three main categories:

- Intra-departmental Communication - Within a department
- Inter-departmental Communication - Between departments
- Manager/Supervisor Communication - Between a Manager and their Supervisor(s)

Poor horizontal communications can result in lack of coordination between departments and rivalry between departments. These factors will have a negative impact on organisation effectiveness.

Informal Communications

Informal communications can also exist within an organisation and they can have both negative and positive impacts on communication effectiveness. The main informal communication system is referred to as the grapevine.

Chester Bernard identified four functions of informal communications:

- To communicate intangible facts, opinions, suggestions and suspicions.
- To minimise excessive cliques within an organisation arising from too great a divergence of interests and views.
- To promote self- discipline of the group.
- To promote important personal influence in the organisation.

Some of the reasons for the development of informal communication systems are the lack of an effective formal communications system, or a lack of openness in the organisation.

Informal organisations can present management with formidable challenges. It can stall and slow down their plans, it can act as a covert third force. However it would be incorrect to presume this is always negative. In some instances the informal organisation may be presenting a picture of "lived experience” that is worthy of greater managerial attention.

D. BARRIERS TO ORGANISATIONAL COMMUNICATIONS

Improving organisational communications depends on identifying barriers to effective communication, which may include the following:

- **Poorly defined Channels of Communications**: The organisational structure may hinder good communications. Managers and employees may not be aware of the information needs of other sections of the organisation.
- **Organisational Culture**: The culture of the organisation may not allow for sufficient opportunities for communication to take place. Meetings may be arranged infrequently and even then they are not conducive to free speech and openness.
- **Personality Clashes**: Personality differences between individuals or rivalry between departments can stifle communications.
- **Inappropriate Choice of Medium or Presentation**: Information can be either too detailed or too generalised or the information may not be expressed clearly. A medium such as written communication is more suitable for detailed communication while verbal communication in more appropriate when persuasion and clarification are necessary.
- **Frame of Reference**: Depending on past experience, individuals may interpret communications differently. This is a common cause of breakdown in communications.

- **Jargon**: Using technical language may make communication incomplete or incomprehensible to those unfamiliar with it.
- **Communication Overload or Underload**: Too much or too little information being communicated, directly affects receiver comprehension. Too little generates a feeling of mistrust, while too much information may produce mental overload or stress.
- **Communicator Credibility**: The level of credibility a receiver assigns to a sender will affect how the receiver will react to the ideas suggested by the sender.
- **Selective Listening**: Individuals tend to selectively perceive information which reaffirms their beliefs and filter out conflicting information.
- **Withholding Information and Filtering**: The sender may withhold or manipulate information for to create a more favourable appearance. The communication may become distorted and meaningless if information is omitted.

E. IMPROVING ORGANISATIONAL COMMUNICATIONS

The following can enhance effective communications in an organisational context:

- Effective Listening
- Effective Writing
- Effective Meetings.

Effective Listening

For listening to be effective it needs to be active. Active listening is more than simply listening to what is being said, it is also confirming to the speaker that their points are being understood in the way that they were intended to be. In turn, they will be more open and participative in their work. Active listening skills can be verbal and non-verbal. Verbal listening skills include:

- Summarising what the person is saying.
- Clarifying that what was said is understood, such as facts, opinions etc.
- Paraphrasing – repeating back to the speakers a little of what was said either in their own words or similar words.
- Explaining – giving an interpretation of previous statements.
- Open-ended questions to encourage further disclosure.
- Encouraging – thanking the person for their contribution.
- Silence – to encourage the speaker to continue.
- Linking – linking various statements and comments.

Non-verbal listening skills are rarely used alone and work in conjunction with and enhance verbal skills. They include facial expression, eye contact, body language, gestures, personal space and timing. There are cultural variations in how non-verbal language is used and in the meaning attached to them.

Active listening skills are very valuable but there are a number of pitfalls, which should be avoided. These include over-analysing, parroting, over-expansion, omitting, exaggerating and rushing. It is also important that the person chooses the right environment for the meeting and avoids a judgmental attitude. If the listener is trying to find a solution, they may be concentrating on what they are going to say, and not on what is being said. Good listening skills are a very important part of management. To improve on their listening skills a person needs to be aware of their present level of skills in this area, recognise the areas that need improvement and then actively work on those areas.

Writing

With the wide spread use of e-mail and other forms of electronic communication, writing remains an important method of communication. It is a particularly important skill for managers whose job will involve writing reports, memos, etc. The following points should bourn in mind when writing any document.

- Keeping the words as simple as possible will make the document more understandable.
- Avoid unnecessary formality but adapt your style to the purpose of the communication.
- Be concise and specific, otherwise accuracy and clarity may be lost.

Writing is covered in detail later in this chapter.

Effective Meetings

Meetings are an important means of sharing information and making decisions and those who chair them must ensure that people's time and talent are used effectively. The following are some guidelines for effective meetings:

- Make sure that the meeting is necessary and cannot be achieved by a memo or phone call.
- Set out an agenda; including items to be covered and what is expected of participants.
- Invite only those who need to attend.
- Prepare for the meeting, including a strategy on how to stimulate discussion on areas you need the meeting to focus on. Reserve your own opinion until near the end to avoid unduly influencing others.
- Give the meeting your undivided attention and avoid possible interruptions.
- Encourage participants to contribute, but keep to the agenda and avoid discussions of unrelated topics.
- Conclude the meeting by summarising the discussion, and confirm any action to be taken and by whom. As soon as possible after the meeting make out a set of minutes and distribute to participants.

F. ELECTRONIC FORMS OF COMMUNICATION

The widespread use of Information Technology has introduced new methods of communication. These include the use of:

E-mail

E-mail is becoming one of the most widespread means of communication within organisation. It is very fast and efficient and supports one-to-one and one-to-many communications. Another advantage is that there is a written record of the communication. Some points to bear in mind when using e-mail are:

- Do not assume privacy, as the receiver can forward your message to another person without the knowledge or permission of the sender.
- Keep message to the point but not overly short as this may annoy the recipients.
- Respond to e-mails in a timely manner.

CREATING EFFECTIVE E-MAIL MESSAGES

The following are some guidelines for creating effective emails:

- Be sure to recognise the differences between business e-mail and personal e-mail.
- The consequences of poor judgment in the use of e-mail can be quite serious in business.
- Electronic documents have the same legal weight as printed documents.
- Be sure to clarify if your company has an e-mail policy and follow it.
- Be careful what you write: 25% of companies monitor internal e-mail; 50% of companies monitor incoming and outgoing e-mail.
- Planning effective e-mail messages involves:
    - Sending only those messages that are essential
    - Paying attention to e-mail etiquette
    - Making sure every e-mail you send is necessary
    - Using the “cc” function carefully
    - Being specific
    - Respecting the chain of command
- When writing most e-mail messages, you don’t need to compose perfect works of literature, but you do need to be careful and sensitive to your audience’s needs.
- Subject lines are one of the most important parts of e-mail messages; they help the reader decide whether or not to open the message.
    - Make sure your subject line is informative and compelling.
    - Do more than just describe or classify message content—build interest with key words, quotations, directions, or questions.

    - When exchanging multiple e-mails with someone on the same topic, modify the subject line to reflect the revised message content.
- Keep your emotions under control:
    - Never allow yourself to send a highly emotional e-mail
    - Ask yourself if you would say this to your audience face-to-face and if you are happy with the idea of this message potentially being read by anybody in the organisation.
- Like other messages, e-mail requires revision, production and proofing.
- Use your e-mail system's ability to include a signature.
- Pause to verify what you're doing before you click "Send."

Videoconferencing

Videoconferencing is a live video (television) exchange between people in different locations. The main benefits of Videoconferencing are the time and costs saved by not having to travel to meetings. Videoconferencing is still quite expensive and this has tended to limit its use.

Teleconferencing

Teleconferencing is cheaper to set up and use than videoconferencing. Teleconferencing is used widely to enable groups of graphically dispersed people to communicate. It can be useful for briefing staff at short notice and also for project teams to monitor the progress of a project. It is limited in its use in group decision-making situations, unless the issues are clearly understood and there is unlikely to be conflicting views within the group.

Blogs

Blogs, which represent the earliest form of social media, are special types of websites that usually display date stamped entries in reverse chronological order. They are the social media equivalent of personal web pages and can come in a multitude of different variations; from personal diaries describing the author's life to summaries of all relevant information in one specific content area. Blogs are usually managed by one person only, but provide the possibility of interaction with others through the addition of comments. Due to their historical roots, text-based blogs are still by far the most common.

Social Networks

Social networks such as Facebook are being used to complement other communication channels such as the telephone and email. Social networks also provide the opportunity to interact and engage with customers and the wider community.

Many companies have Facebook pages to communicate new products and offers with the public. Social networks are a very cost effective way of communicating with customers and getting their feedback on products and services. Social networks have opened up another dimension of advertising to the wider community. Two of the most popular social networking service are Facebook and Twitter.

Twitter is an online social networking and micro-blogging service that enables its users to send and read text-based posts of up to 140 characters. Twitter can provide businesses a means of fast, free, up-to-date communication of products/services/offers with twitter users. Social networks and blogs are of great importance for communication in businesses involved in media such as newspapers and magazines.

LinkedIn is a business orientated social networking service that can be used by businesses to communicate with potential further employees.

Web Conferencing (Webinars)

Web conferencing services enable conferences to be shared with remote locations. The web conference utilises Internet technologies, to allow the sender to communicate in real-time with many receivers using computers. This is referred to as a multicast communication. The Web conference enable information in text, audio, graphics and video formats to shared over large geographic regions. Web conferencing can be utilised for meetings, presentations, lectures and training.

Web conferences are also referred to as Webinars (short for Web seminars). Webinars are generally interactive; that is as well as allowing the audience to receive information, they can also interact with the teacher/speaker to discuss and provide feedback.

Wikis

Wikis are a type of Web site that allows users to edit Web pages or create new Web pages directly from the browser without any need use Web development tools or programming languages. Wikis can be utilised by organisations to create and store knowledge as they cost much less than formal knowledge management systems and they are more flexible and dynamic.

G. Construction of Effective Business Correspondence

Business Letters

The following is the most widely used format for business letters:

Letter head including senders address telephone number and e-mail address	**AMM Ltd** PO Box 1234 Kigali, Rwanda Tel: (078) 1112222 Fax: (078) 1112233 Email: info@ammltd.fr
Reference (Initials of writer/typist and sometimes a filing reference	AB/CD
Date (day, month, year)	10 October 2011
Inside address (name, title, company, full address)	Mr Paul Orr Sales Manager The Print Company PO Box 777 Kigali Rwand
Salutation	Dear Mr Orr,
Heading (indication of the contents of the letter	Delivery of New Laptop Computer
Body of letter (one line space between paragraphs)	This layout has been established as the most popular way of setting out letters, fax, messages and memos – in fact most business correspondence. Consistency is important in layout and spacing of all documents. It is usual to leave just one clear line space between each section
Complementary close	Yours Sincerely
Signature (*leave room for*)	*John Sarr*
Name of sender	John Sarr Sales Executive
	Enc
	Copy

Sender's designation or department	
Enc (if anything is enclosed)	
Copy (if appropriate)	

Writing Reports

Many different types of reports are used in business – some are formal and quite long, while others are short and informal. The main purpose of a report is to provide information that is ultimately used to aid in decision-making.

Some reports contain little more than the recordings of an event, providing some facts on the event and possible actions to be taken. Other more detailed reports contain comprehensive explanations of facts, with conclusions and possibly recommendations for actions.

The more detailed reports will require an amount of research, which may involve interviews, questionnaires, observations and investigation. The information in a report may be presented in written, tabular or graphical form.

A Guide to Writing Reports (Taylor, S. 2003)

The main stages in writing a report are:

- **Defining a Purpose**: The author should be clear about:
    - Why they are writing the report
    - What to include
    - What to leave out
    - Who the readers are
- **Investigating the Topic**: This depends on the topic and purpose of the report. You may need to read, interview, experiment and observe.
- **Organising the report into sections**: Reports can be set out in eight parts but not all parts are always necessary.
    - **Title or title page**: A short report will not need a titles page, only a title.
    - **Contents list**: This is normally only needed for long reports.
    - **Abstract**: This is only needed for formal reports such as scientific research. The abstract is a summary of the report that appears in library files and journals. It is usually between 150 to 300 words.
    - **Introduction**: The introduction should be brief and answer questions such as: What is the topic? What was the method used? What is the background? What were the sources?

- **Discussion**: This is the main body of the report. It will generally be the longest part of the report containing all the details of the work organised under headings and sub headings.
- **Summary and conclusions**: This section describes the purpose of the report, the conclusions and how they were reached. This section is sometimes placed before the discussion section
- **Recommendations**: The section details what future actions are required to improve the situation.
- **Appendix**: This contains material which readers only need if they are studying the report in depth.

Note: Writers often put the summary conclusions and recommendations together and circulate them as a separate document. This is often called an executive summary

- **Order of presentation**: The following is the recommended order of presentation. However all the sections would not be required for every report, especially those shown in brackets

  Long Report

  - Title or title page
  - Contents list
  - (Abstract)
  - Introduction
  - Discussion
  - Summary and conclusions
  - Recommendations
  - (Appendix)
  - (Bibliography): Long reports might include research and thus a bibliography or reference page may be required.

  Short Report

  - Title
  - Introduction
  - Discussion
  - Summary and conclusions
  - Recommendations
  - (Appendix)

- **Order of Writing**: The order of writing doesn't have to follow the order of presentation. The following approach is useful as each section helps to write the next:
  - Introduction
  - Discussion

    - Summary and conclusions
    - Recommendations
    - (Abstract)
    - Title or title page
    - Contents list
    - (Appendix)
- **Numbering of sections and paragraphs**: Sections and paragraphs should be numbered and labelled.
- **Planning the writing**: Before writing a report you will normally have to collect a large volume of information. To save time and to produce a better organised report you should make a plan for each of the main sections of your report.
- **Revision**: You should always critically read what you have written. You may have to change your structure and rewrite parts of the report so that it is clear and concise.

H. A THREE STEP PROCESS FOR WRITING MESSAGES

In their book "Excellence in Business Communication", Thrill and Bovee propose a three-step process for writing messages:

The writing process may be viewed as three simple steps:

Step 1. Planning business messages

- **Analysing the situation:** A successful message starts with a clear purpose that connects the sender's needs with the audience's needs. All business messages have both a general purpose (to inform, to persuade or to collaborate) and a specific purpose (such as placing an order). Develop an audience profile by identifying the primary audience, determining audience size and composition, evaluating the level of knowledge, and gauging the probable reaction.
- **Gathering information**: For many kinds of business messages, you can informally gather information to satisfy your audience's needs by:
    - Considering other viewpoints
    - Reading reports and other company documents
    - Talking with supervisors, colleagues or customers
    - Asking your audience for input
- **Selecting the right medium**: The choice of media include:
    - Oral - face-to-face conversation, speeches, presentations and meetings
    - Written - notes, letters, memos, reports and proposals
    - Visual - charts, graphs and diagrams
    - Electronic Media – includes telephone calls, teleconferencing, voice-mail messages and audio recordings such as compact discs and podcasts, e-mail, instant messages, blogs, websites, text messaging, electronic presentations, computer animation and video.

- **Organising the information**: The four steps for organising messages are:
    - Define the main idea
    - Limit the scope of the message
    - Group the points in an outline
    - Choose a direct or an indirect approach, depending on anticipated audience reaction, message length and message type (routine, negative or persuasive).

Step 2. Writing business messages

- Adapting to your audience:
    - Being sensitive to your audience's needs
    - Building strong relationships with your audience
    - Controlling your style and tone
- Composing your message:
    - Choosing strong words
    - Creating effective sentences
    - Craft coherent paragraphs

Step 3. Complete business messages by:

- Revising:

  Reviewing content and organisation

  Reviewing readability

  Editing and rewriting to make the message concise and clear
- Producing:

  Designing your document to suit your purpose

  Being careful with font selection, use of white space and so on
- Proofreading:

  Reviewing for typos

  Looking for errors in spelling and mechanics

  Spotting alignment problems

  Detecting poor print quality
- Distributing:

  Balancing cost, convenience, time, security and privacy

The three steps are summarised in Figure 6.2.

<table>
<tr><th colspan="3">The Three Step Writing Process</th></tr>
<tr><th>Planning</th><th>Writing</th><th>Completing</th></tr>
<tr><td>Analyse Situation</td><td rowspan="2">Adapt to the Audience</td><td>Revise</td></tr>
<tr><td>Gather Information</td><td>Produce</td></tr>
<tr><td>Select Medium</td><td rowspan="2">Compose Message</td><td>Proofread</td></tr>
<tr><td>Get Organised</td><td>Distribute</td></tr>
</table>

Figure 6.2: The three step writing process (Thrill and Bovee, 2007).

I. WRITING STYLES

In this section we look at three different writing styles:

- Writing routine informative messages
- Writing persuasive messages
- Writing negative messages

The Informative Style Message

For a typical employee, most day-to-day business communication concerns fairly routine matters. A request is routine or informative when it is part of the normal course of business and the audience is likely to comply. Because your readers will be interested or neutral, you can use the direct approach for most routine messages. The following approach is suggested by Bovee & Thill (2007):

Planning your message

Planning routine messages may take only a few moments.

- Begin planning by **analysing your situation** to make sure that your purpose is clear and you know enough about your audience to craft a successful message.
- Continue planning by **gathering all information** your audience needs to know so as to save time for yourself and your audience, and avoid the trouble writing of additional messages to fill the gaps.
- Continue planning by **selecting the medium** most appropriate for your message and audience.
- Finish planning by **organising your information** effectively:
    - Defining your main idea (usually well defined for routine business messages).
    - Limiting your scope.

- Selecting a direct or indirect approach (usually direct for routine, positive messages).
- Outlining your content.

Writing the Message

With some practice, you'll be able to write most routine messages quickly. Be sensitive to your audience's needs by being polite and emphasising the positive. Use a conversational tone, plain English and the active voice.

Complete the routine messages by revising, producing, proofreading and distributing. It is important to balance cost, convenience, time, security and privacy.

Type of Routine Messages:

Routine messages can be divided into two groups; routine requests and routine replies.

1. MAKING ROUTINE REQUESTS

You are making a request whenever you ask for something such as information, action, products or adjustments.

Routine requests have three parts:

- **Opening**: Where you clearly state your main request.
- **Body**: Where you give details and justify your request.
- **Close**: Where you request specific action.

2. SENDING ROUTINE REPLIES AND POSITIVE MESSAGES

When sending routine replies and positive messages, you have several goals:

- To communicate the information or good news.
- To answer all questions.
- To provide all required details.
- To leave your reader with a good impression of both you and your firm.

Routine replies and positive messages usually have three parts:

- They open with the main idea (the positive reply or the good news) stated clearly and concisely.
- They provide all the relevant details in the middle.
- They close cordially, perhaps highlighting a benefit to your reader.

Most routine and positive messages fall into six main categories:

- Answers to requests for information and action.
- Grants of claims and requests for adjustment.
- Recommendations.
- Informative messages.

- Good-news announcements.
- Goodwill messages.

Some Guidelines when Writing Routine or Informative Messages:

- When asking a series of questions in a request, the writer should (1) ask the most important questions first, (2) ask only relevant questions, and (3) deal with no more than one topic per question.
- Explaining how responding to your request may benefit your audience, is one aspect of the "you" attitude. Doing so accommodates the reader's need to understand why he or she should make your request a priority, and increases the likelihood that you will receive a desirable response.
- It's usually best to avoid an outright apology. However, you can't avoid taking responsibility for a mistake that has been made. Word your response carefully, emphasising the good news about what you are doing to provide compensation and to improve circumstances. Be sure to balance your humility over the mistake with your responsible handling of the claim and your fairness in making the adjustment.

The Persuasive Style Message

Persuasion is the attempt to influence the attitudes, beliefs, or actions of members of your audience. Persuasion is not about trickery or getting people to make choices that aren't in their best interest; persuasion gives your audience a choice and helps them choose to agree with you.

Bovee & Thill, (2007) suggest that successful persuasive messages demand careful attention to all four tasks in the planning step:

- Analysing your situation
- Gathering information
- Selecting the right medium
- Organising your information

DEVELOPING YOUR MESSAGE

The goals of your persuasive business messages are to convince your readers that your request or idea is reasonable and that it will benefit your readers in some way.

STRUCTURING YOUR ARGUMENTS

When structuring a persuasive argument, you can use the AIDA plan:

Attention: Your opening does more than simply introduce your topic; it grabs audience attention and encourages them to hear more about your main idea.

Interest: Your explanation does more than present reasons; it stimulates the interest of your audience.

Desire: Your continued explanation does more than present benefits; it changes your audience's attitude.

Action: Your close does more than end on a positive note; it emphasises reader benefits and motivates the reader to take specific action.

This is a suitable structure for persuasive messages because the main idea - what you want the audience to do is presented at the end, after all the reasons and attention-getting material is laid out. By the time the readers reach the action stage of the message, they are not only paying attention but are also more interested in the information and motivated to follow through by taking the proposed action.

General Guidelines

When writing persuasive requests for action, you want to:

- Choose either a direct or an indirect approach (depending on whether your audience anticipates your request).
- Begin with an attention-getting device (showing readers you know something of their concerns).
- Give facts, explain benefits, and enhance your appeal in the interest and desire sections.
- Gain credibility for you and your request.
- Make your readers believe that helping you will help solve a significant problem.
- Close with a request for some specific action.

Some Guidelines when Writing Persuasive Messages:

- Unless your request is routine, opening your persuasive message with an immediate call to action will often lead the audience to say "no." Most audiences are initially resistant to act, and unless you give yourself a chance to explain why they should comply, they will make up their minds before hearing all that you have to say.
- If an emotional appeal is used to manipulate an audience's decision, and especially if the communicator appeals to some negative emotion such as fear, that appeal must be considered unethical. Subtle appeals to an audience's emotions that evoke positive feelings of comfort, happiness, safety, self-esteem and so on would usually be considered ethical.
- The best way to deal with audience resistance to your persuasive message is to anticipate and address as many objections as you can in your initial message. If you wait until people raise the concern after reading your message, chances are they already will have gravitated towards a firm "no" before you have a chance to address their concerns.
- In persuasive messages, an aggressive "hard sell" approach is likely to put audiences on guard and on the defensive, reducing their willingness to agree with you and/or to do what you ask of them.
- You present both sides to show that you have thoroughly studied the alternatives. By second-guessing your audience's concerns, you can provide compelling reasons in your persuasive message that show why other alternatives won't work. If you don't do this, your audience will focus on other possible alternatives instead of your proposed solution. Until you can satisfy their concerns, they won't accept your proposal.

- Unlike routine requests, persuasive messages require you to motivate others to act, and they are not about ordinary, day-to-day matters. Because persuasive messages are supposed to convince or motivate readers, they often include more detail than routine requests. They also require more strategic planning to achieve credibility, to choose the right appeal, and to use semantics and other reinforcement tools effectively.

The Negative Style Message

When you send negative messages, you have five main goals:

- To convey the bad news
- To gain acceptance for the bad news
- To maintain as much goodwill as possible with your audience
- To maintain a good image for your organisation
- To reduce or eliminate the need for future correspondence on the matter.

According to Bovee & Thill (2007), when developing negative messages there are two approaches:

The Direct Approach

- Open with a clear statement of the bad news,
- Provide reasons and additional information,
- Close with a positive forward-looking statement that is helpful and friendly.

One advantage of using the direct approach to deliver the negative news at the beginning of a message is that doing so makes the message shorter. Another advantage is that the audience gets to the main idea in less time. The direct approach makes sense when the audience is known to prefer reading the negative news first and when readers are unlikely to react very negatively to the news.

The Indirect Approach

- Open with a buffer - a neutral, non-controversial statement related to the point of the message,
- Provide reasons and additional information,
- Continue with a clear statement of the bad news,
- Close with a positive forward-looking statement that is both helpful and friendly.

Some Guidelines when Writing Negative Messages

- Some critics believe that buffers are unethical and see them as being manipulative and dishonest. However, buffers that are sincere are neither manipulative nor dishonest and are perfectly ethical.
- When using an indirect approach to announce a negative decision, presenting your reasons before explaining the decision is a way to convince the audience that your decision is justified, fair and logical.

- Three techniques for de-emphasising negative news are (1) minimising the space or time devoted to the negative news, (2) subordinating the negative news, and (3) embedding the negative news in the middle of a paragraph or in parentheses.
- When you de-emphasise the negative news, your intentions are kind, not manipulative. You still present the facts and deliver the negative news. However, you are trying to get readers to focus on the positive, or you are helping them become more willing to understand the reasons for the negative news.
- Suggesting an alternative to readers is often a good idea if the suggestion is genuinely useful. Offering constructive advice encourages readers to think of you in a positive way.
- When giving a negative review to an employee, follow these five steps: (1) confront the problem right away, (2) plan your message, (3) convey the message in private, (4) focus on the problem without attacking the person, and (5) ask the employee to make a commitment to improve.
- The last thing your audience will remember is the close of your message. A positive close can help create an upswing from a potentially damaging situation. No one likes negative news, and your upbeat close can overcome lingering feelings that could interfere in future business relationships.

The Principles of Effective Communications

1. Think carefully about your objective before communicating. Do you want to inform, persuade, advise or consult?
2. Choose the correct medium, or combination of media; speech, visual etc.
3. Organise your ideas and express them carefully.
4. Time the message to its best advantage.
5. Check for feedback.
6. As the receiver, give messages your full attention and respond in an appropriate way.

Study Unit 9

Change Management

Contents

Change Management

Organisational change is defined as the adoption of a new idea or behaviours by an organisation (Daft, 2010).

The management of change has become a top priority for all managers irrespective of the organisation. Change is now occurring at a far greater pace than ever before.

Hussey (1995), argues that dealing with change is one of the most critical aspects of effective management and that the turbulent business environment in which most organisations operate means that not only is change becoming more frequent, but that the nature of change is becoming more complex and the impact of change is often more extensive.

A. NATURE OF CHANGE IN BUSINESS

Forces for Change

Forces for change exist in both the external and internal environment. External forces originate in all environmental sectors including customers, competitors, technology, demographic changes, economic and international events. Internal forces for change arise from internal activities and decisions such as demands by employees, labour unions, and production inefficiencies. These internal factors can all generate a force to which management must respond to with change. Rapidly increasing competition in all areas is driving the need for change and innovation (Daft, 2010). Some important drivers of change are now discussed:

Globalisation

Domestic markets are now open to foreign competitors, which provide intense competition. Businesses are forced to change in response to new, cheaper and/or higher quality products. The trend toward globalisation has resulted from the emergence and development of a number of important industrial economies which have provided intense competition in established markets, especially that of high technology:

- The emergence of newly industrialised countries including South Korea, Taiwan, Hong Kong and Singapore.
- The emergence of the single European Market.
- The move to more open-market-based economies in Eastern Europe, and the former Soviet Union.
- Development in the Asia Pacific region.
- The opening up of China to foreign investment.

Technology Developments

Some of the most dramatic changes have occurred in the area of technology. New automated technology allows manufacturing to operate more efficiently with a reduced work force. Information technology allows companies to operate more effectively and efficiently. The emergence of e-business and the use of the Internet for business purposes has probably been the most significant change to the conduct of business in the last decade. Organisations now have electronic links to suppliers and customers, connecting manufacturing and inventory functions to aid re-ordering. Business-Business (B2B) transactions allow organisation to purchase supplies over the Internet. Business-Consumer (B2C) transactions allow organisations to deal directly with customers through online facilities. Customers wishing to purchase goods online simply login to the organisations website and can purchase goods with a credit card.

Changes in the Nature of the Labour Force

The world labour force is changing significantly both in terms of composition, values and expectation. Organisations in the developed world have an ageing workforce, which are more costly than organisations in developing countries with a young work force. Unless these costs are met with higher productivity, developed countries will become less competitive.

A Move Away from Labour Intensive Industry

In recent years there has been a move away from traditional labour intensive industries e.g. iron, steel, coal and mining, to knowledge-based industries and services.

Traditional industries required large numbers of people at cheap rates and were heavily supervised. The move towards knowledge-based industries and organisations means that different people and different forms of organisation are required. Organisations will contract or outsource work to agencies while retaining a core group of talented workers.

Rapidly Increasing Competition

Competition is increasing in all industries and sectors, which drives the need for companies to continually develop new improved quality products and services.

Customer Expectations

Organisations need to be able to adapt to changing customer expectations. Customers are becoming more demanding in terms of product quality, lower prices, product features and after sales services etc. This is in part driven by the greater availability of information facilitated by the internet. Customers can search for information regarding products and increasingly purchase products and services online.

Other drivers of change include; changes in law and regulation at both a national and international level, changing customer tastes, emerging social issues, increased focus on environmental issues, growth in outsourcing, economic downturns, organisations focus on increasing profits and increased efficiency etc.

B. IMPORTANCE OF MANAGING CHANGE

In today's dynamic environment, managing change is critically important as organisations must embrace many different types of change. Organisational change requires companies to adopt new ideas and behaviours.

A change program that is poorly managed will at best not reach its goals, but is more likely to have a detrimental impact on the performance of the section being changed and at worst could impact the whole organisation.

A poorly managed change program can result in:

- Slow pace of change within the organisation.
- Employees reverting back to old behaviours if they don't buy into the change.
- Individuals can become focused on their own interests and as a result teamwork and co-operation can suffer.
- The performance of the company in the marketplace suffers if it losses competitiveness.
- Employees may oppose change programs in the future if they feel that a previous change initiative was not a success.

A number of models and approaches have been proposed for managing change. Some of these are now discussed.

C. MODELS OF CHANGE MANAGEMENT

Kotter's Eight Stage Change Process

In response to research which indicated the 70% of all major change efforts in organisations fail, Dr. John Kotter developed an 8-step process that can be used to bring about change in an organisation. Why do change efforts fail? Perhaps because organizations often do not take the holistic approach required to see the change through.

Kotter's model can be divided into three distinct stages:

Stage 1: Creating a climate for change:

1. **Increase urgency –** explain the need to change – remove fear and complacency.

   Establishing a sense of urgency is necessary to gain the cooperation required to drive a significant change effort.

2. **Create a guiding team –** Assemble a group with enough power to lead the change effort and encourage the group to work as a team.
   No one person, no matter how competent, is capable of single handedly developing and making the change happen on their own.

3. **Get the vision right –** Create a vision for the future to help direct the change effort, and develop strategies for achieving that vision.

   A clear vision serves three important purposes. It simplifies hundreds or thousands of more detailed decisions needed, it motivates people to take action in the right direction and it helps to coordinate the actions of the different people involved.

Step 2: Engaging and enabling the organisation (involve the stakeholders**):**

4. **Communications (vision) for buy-in –** Use every vehicle possible to communicate the new vision and strategies, and teach new behaviours.

   Gaining understanding and commitment to a new direction is a difficult task, especially in the case of complex organisations.

5. **Enable action** - Remove obstacles to change, change systems or structures that seriously undermine the vision, and encourage risk-taking and non-traditional ideas, activities and actions.
6. **Generate short-term wins –** Plan for visible performance improvements, create those improvements, recognise and reward employees involved in the improvements.

   This demonstrates to everyone involved that progress is occurring.

Step 3: Implementing and sustaining the change (leading the change**):**

7. **Don't let-up –** You must persist with the change; monitoring & measuring progress and reinvigorating the process with new projects regularly.

   The consequences of letting up can be very serious - critical momentum can be lost and regression may soon follow.
8. **Incorporating the Changes into the culture –** leaders must recognise, reward and embed the change into the company culture.

   New practices must grow deep roots in order to remain firmly planted in the culture.

Adapted from http://www.kotterinternational.com/kotterprinciples/changesteps/step-8

The Three Step Model of Change

Lewin (1958), argued that change towards a higher level of group performance is often short lived - after an initial improvement; group behaviour soon reverts back to its previous level. According to Lewin a successful change program should involve three stages:

1. Unfreezing
2. Moving
3. Refreezing

Unfreezing

Unfreezing involves reducing the forces maintaining the organisation's behaviour at its present level. Rubin (1967) argues that it requires some form of confrontation or re-education for those involved. This re-education could take the form of team building or management development training. This stage involves convincing the relevant parties of the need to change. This could involve presenting data to show that serious problems exist with the current situation.

Moving

Having analysed the current situation, identified alternatives and selected the most appropriate strategy, action is then needed to move to the new state. This requires developing new behaviours, values and attitudes through changes in organisational structure and processes so that those involved do not revert back to the old way of doing things.

Refreezing

Refreezing seeks to stabilise the organisation at the new state, in order to ensure that there is no regression from the new ways of working. Support mechanisms including organisation culture, policies and practices are used to reinforce the new way of working.

Force Field Analysis

Force Field Analysis is a technique based on the idea that change was a result of the competition between **driving forces** (forces in favour of change) and **restraining forces** (forces resisting change). When a change is introduced, some forces drive change and other forces resist it. To implement a change, management should analyse the change forces and by selectively removing forces that restrain change, the driving forces will be strong enough to enable implementation. Figure 8.1 shows some examples of driving and resisting forces.

Change is a difficult process for organisations to carry out. When considering change, it is often helpful to construct a force field. This is a diagrammatic representation showing the various forces acting for and against, the proposed change. The force field was originally developed by Lewin, who recognised that a stable social situation is the result of a balance of opposing forces. One set of forces will be attempting to implement the change; these are the driving or facilitating forces. The opposing forces act against change and wish for the status quo to remain; these are the resisting or restraining forces. Both sets of forces work to try and shift the equilibrium point. See Figure 10.1

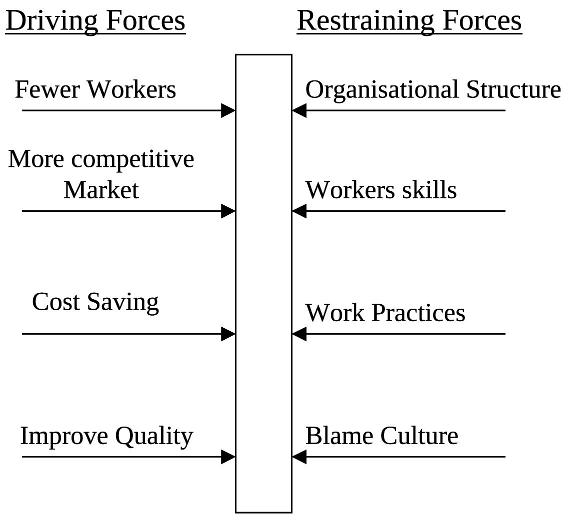


Figure 10.1: Force Field Analysis

D. DEALING WITH RESISTANCE TO CHANGE

Resistance to change can come from the individuals or from the organisation itself.

Individual Sources of Resistance

Nadler (1983) and Stanislao/Stanislao (1983) have identified several individual sources of resistance to change which include:

- Habit/Security

- Selective perception
- Economic factors
- Security
- Social factors
- Lack of understanding

Habit/Security

As people do their jobs they develop habits in the way they work. They also develop routines that help get them through the week. They develop a sense of security in their job and also in their lives. If there are any changes in their work they can become insecure. Pressure to change habits and routines can lead to resistance particularly if the individual does not see any advantage in changing. One method of overcoming this resistance is to offer rewards linked to the change

Selective Perception

Individuals tend to selectively perceive or view issues and events in a way that matches their understanding of their work environment and the world. In resisting change the individual will often filter and misunderstand things they do not agree with. Communication is one way of addressing this type of change.

Economic Factors

Changes in work practices that affect skills learned over a number of years could affect the income of the individual in the long term or the short-term while they learn the new skills.

Security

Individuals like to feel comfortable and secure in completing things in the same way. In doing so, they gain a degree of security in their jobs and in their lives. When the status quo is threatened by change, employees feel their security is at risk, and consequently they resist such change. Confronting any form of the unknown makes the individual anxious and insecure. Insecurity arises not only from the change itself but also from the prospective outcomes of such change; for example, employees may turn down a promotion due to insecurity and fear of the unknown.

Social Factors

Individuals are affected by group pressure or group norms. An individual may wish to embrace change but could resist it because of group pressure. Conversely they may accept change because the group accept it even though as an individual they are inclined to resist it.

Lack of Understanding

If an individual does not fully understand the reason the change is necessary, he or she may resist the change. Therefore communication is an important element of any change program.

Organisational Sources of Resistance

Katz and Kahn (1978) identified the following organisational sources of resistance to change:

- Organisational structures
- Narrow focus of change
- Group inertia
- Threatened expertise
- Threatened power and influence
- Threatened resources

Organisational Structures

Organisational structures such as roles, policies, rules and procedures are designed to maintain stability and continuity. However, these same structures can by their nature act as a form of "structural inertia" (Hannon and Freeman, 1984) that will slow the progress of change.

Narrow Focus of Change

Change programs that have too narrow a focus may fail to take account of the interdependencies between elements in an organisation. In this situation segments of an organisation may resist the change.

Group Inertia

Group inertia occurs when a group refuses to change its behaviour patterns because of a desire to maintain the status quo.

Threatened Expertise

If the expertise of an individual or group is threatened by the introduction of new technology or job re-designs, resistance to change is likely. This is common in traditional industries such as manufacturing.

Threatened Power and Influence

The introduction of change within organisations often involves loss of power for some individual. The loss of power increases resistance to change.

Threatened Resources

The loss of power associated with change can often be accompanied with the loss of resources such as personnel, money and information. Individuals or groups who currently enjoy favourable allocations of resources will resist change to the status quo.

Overcoming Resistance to Change

Several methods can be employed to overcome resistance change. These include:

- **Data collection**: Identifying the source of the resistance.

- **Coalition building**: Providing advice and support from powerful individuals in the organisation to those who may pose resistance.
- **Negotiation and agreement**: Using bargaining and tradeoffs, including financial bargaining.
- **Articulation of a shared vision**: Communicating a vision of the future can overcome a fear of the unknown.
- **Education, communication and training**: Through effective communication, information and re-skilling, resistance can be lowered.
- **Participation and involvement**: Identifying potential resistors and involving them in the change process in positives roles.
- **Rewards and incentives**: Increasing motivation using money and other incentives.

E. IMPLEMENTING CHANGE MANAGEMENT PROGRAMMES

Radical and Incremental Change

There are two basic types of change projects:

- **Radical change**: Radical change operates at the organisational level and attempts to transform the entire organisation. This type of change is strategy driven and involves changing structures, practices and procedures, people and systems.
- **Incremental change**: This is small-scale change that is aimed at a small part of the organisation.

Peters and Waterman (1982) suggested that strategic change should be broken down into a series of small but interrelated chunks. In other words, radical change that is broken down into a number of related incremental changes.

Change Management Approach

There are numerous models available for implementing change management programs. Regardless of the model used the following factors need to be addressed:

- **Strategy:** Any change program must be considered in light of the organisation's objectives and priorities.
- **Phased approach:** The majority of the approaches to change management suggest a phased approach. The following stages are important:
  - Create recognition of the need to change
  - Make the actual change
  - Evaluate and consolidate.
- **Involvement:** Those who are directly involved in the change should be involved in planning and executing the change. Involvement helps gain commitment and buy-in from workers.
- **Communication:** Communication helps reduce resistance to change.

- **Behavioural change:** The success of a change program depends on individuals and groups changing their behaviour.
- **Culture change:** Where the changes being undertaken are at odds with the current organisational culture, the change project may involve changing the culture of the organisation. This would be radical change rather than incremental change.

Management Styles and Change

Management styles are the techniques used by managers or Change Agents in introducing change. The change agent is the person responsible for managing the change effort. The various management styles are designed to overcome resistance to change, and the style used will depend on the extent and nature of resistance to change in any given situation. According to Kotter and Schlesinger (1979) there are six main styles of management associated with introducing change:

- **Education and communication** are appropriate where problems and resistance are caused by insufficient information or misinformation. Such a style requires an atmosphere of trust between the sides involved. Education and communication are generally more effective if they take place before the change is implemented. However, this style is costly and time-consuming as it involves mass briefings. Organisations dealing with large numbers of employees can use small group briefings to ensure effective communication.
- **Participation** is appropriate where the commitment and participation of employees is vital to the success of the change programme. It is an effective way of overcoming resistance based on lack of awareness or a narrow focus of change. Employees who are involved in the change process are also more likely to accept changes. Participation usually involves project teams or task forces who generate ideas and give advice on implementing change. Once again, this style is time-consuming and costly.
- **Support and facilitation** are appropriate management styles when employees are experiencing difficulty in coming to terms with the new changes. Support and facilitation help to overcome resistance arising from a fear of the unknown and the need for security. Schneider *et al*. (1996) have argued that creating the correct climate and culture for change determines whether change will be successful. This style of management involves providing support mechanisms for employees to help them cope with change. Most frequently organisations provide additional training or extra emotional support while employees get used to the changes. A problem associated with this style is that while it may help people through the change process, it does not necessarily win their commitment and support. It is also time-consuming and can fail.
- **Negotiation and agreement** is a useful management style when groups or key individuals are negatively affected by the change, and have sufficient power to resist and interrupt the introduction of change. A good example is a Trade Union whose primary concern is to protect the welfare of its members. Trade unions resist any change that negatively affects their members. By engaging in negotiation before implementation, the organisation may find the change process runs more smoothly. If any other problems arise during the course of implementation, then both sides can refer to the written agreement to sort out these problems. This method is most appropriate for overcoming resistance to change arising from threatened expertise, power, resources and group factors. The

possibility of rewards, such as increased wages or perks, can also be examined to reinforce the direction of change (Nadler, 1981).

- **Manipulation** of the situation by the agent can make it easier to introduce change. For example, it has been established that crisis situations are more likely to motivate people to change. So organisations can attempt to exaggerate the extent of the situation facing the organisation, to make it appear as if the organisation is in a crisis. This style is often used when resistance is caused by habit, re allocation, economic and group factors.
- **Coercion** involves the explicit use of power by issuing directives to employees about the changes being implemented. Managers or the change agent resort to coercion if all other methods have failed to reduce resistance to change. It is generally recognised as the least successful method of introducing change. Even when coercion is applied, and employees accept change, it can have long-term negative effects on employee attitudes and behaviour.

Each of the management styles described above is appropriate for particular situations. Education and communication are most effective for incremental change or where transformational change is being introduced over a long period of time. Manipulation and coercion are effective if there is a crisis or a need for rapid transformational change. Participation and negotiation are intermediate styles whereby transformational change can be achieved with less risk, but they are also effective in incremental change (Nutt, 1989).

Successful Change Programs

Following a clearly defined model of change is not sufficient to ensure success. Research by the Harvard Business School, which investigated the effect on performance of change initiatives, found that only 30% of these change initiatives produced an improvement in bottom line results. However, some organisations introduced change programmes that were very successful. So what factors contributed to the success of a change program? Pettigrew and Whipp (1991) conducted research in the UK in a number of industries from publishing to automobiles. They identified organisations, which had introduced strategic change programmes and pinpointed aspects of their successful programmes. Based on their research, they argue that successful strategic change depends on five interrelated elements:

- **Environmental assessment:** Organisations, which introduce successful change programmes, assessed their external environment very carefully, went beyond acquiring and processing data and became open learning systems. External developments within the business environment were effectively communicated to employees and championed by a change agent.
- **Leading change:** Pettigrew and Whipp (1991) found that success depended on the ability of the change agent to establish and develop a context for change both in cultural terms and in the capabilities of the organisation. Styles of management were used which were tailored to the context, and the change agent altered the approach where necessary.
- **Strategic human resource management**: Successful organisations integrated their human resource management (HRM) policies with their strategic changes. Training and development, employee relations and rewards were all designed to facilitate the introduction of the desired changes.

- **Linking strategic and operational change**: Organisations, which have successfully managed strategic change, have effectively linked strategic change with operational change. In other words, there has been a clear connection and consistency between strategic, tactical and operations plan.
- **Coherence:** The most complex factor arises from the demands of the previous four. Pettigrew and Whipp (1991) found that success depended on coherence across all aspects of the organisation as follows:
  - Consistency between intended strategy, strategic objectives, operational plans and the behaviour of the change agent.
  - Consistency between the direction of strategic change and the environmental changes.
  - A feasible strategy in terms of the resources required, organisational structure and the changes required to the organisational culture.
  - A strategic direction that is clearly related to achieving competitive advantage.

SECTION 3: FUNCTIONS OF BUSINESS MANAGEMENT

Study Unit 10

Sales and Marketing

Contents

A. THE CONCEPT OF MARKETING AND ITS ROLE IN BUSINESS

Marketing has been defined as:

"The process of studying the wants and need of others and then satisfying those wants and needs with quality goods and services (i.e. products) at a competitive price" (Nickels, McHugh, McHugh 1991).

Therefore marketing involves the entire process of providing products to consumers and isn’t solely concerned with a firms advertising or promotional activities.

The job of the marketer revolves around the following:

- Understanding the needs of consumers.
- Determining and creating wants - desires for specific satisfaction of deeper needs.
- Satisfying and managing demand - wants for specific products that are backed up by an ability and willingness to buy them.

Evolution of the Marketing Concept

Marketing has been an important part of business for many years though its focus has changed over the years. Part of this change involved adopting different concepts, from the **Production concept**, to the **Product Concept,** to the **Selling Concept,** to **the Marketing Concept** and to the **Societal Marketing Concept**

Production Concept: Companies pursuing this strategy believe consumers prefer products that are widely available and inexpensive. Their focus involves exploiting economies of scale.

Product Concept: This holds that consumers will favour those products that offer the most quality or performance.

Selling Concept: This holds that if consumers are left alone they will not ordinarily buy enough of the organisations products. These companies see their task as persuading customers to purchase their products through promotion and personal selling

The Marketing Concept: The Marketing Concept holds that the key to organisational success lies in determining the needs and wants of the target market and delivering products that meet these needs more effectively and efficiently than competitors**.** The Marketing Concept comprises the following four main pillars:

1. Market Forces
2. Customer Orientation
3. Co-ordinated Marketing
4. Profitability

The Societal Marketing Concept

The societal marketing concept is concerned with ethical and sustainable marketing. The aim is to satisfy market demand but do so in a way that maintains or improves societies well-being. Marketers need to balance three considerations in setting their marketing policies: company profits, customer wants and society's interests.

B. THE ELEMENTS OF THE MARKETING MIX

Any product you purchase today is made available to you through a marketing process that included 4 vital ingredients, and is based on a quality and customer focused foundation. The producer designs a **Product** that satisfies customers needs, sets a competitive **Price**, has the product in a **Place** that is convenient for the consumers to buy (or consume) and **Promotes** it. These four factors are known as the **Marketing Mix** or 4 Ps. See Figure 10.1.

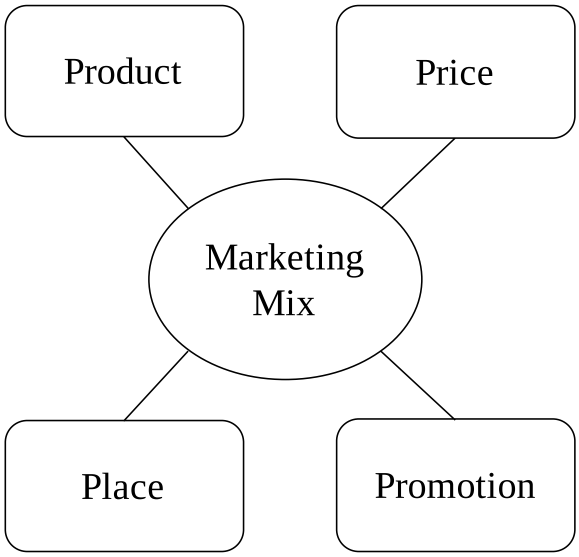


Figure 10.1: The Marketing Mix

Product

Designing products of a high quality and high perceived value-added is a vital part of any business. Marketers must communicate with consumers and constantly adapt the products to meet changing market demands.

Product Mix, Lines and Offers

Businesses will normally have a range of products to satisfy different segments of the market. A **Product Mix** is the combination of products offered by a business.

A **Product Line** is a group of products that are physically similar or are intended for a similar market

A **Product Offer** consists of all the tangible and intangible benefits consumers evaluate when deciding whether or not to buy a product. In addition to the product itself, this evaluation may also include the products price, packaging, shop surroundings, the image created by advertising, the reputation of the producer, the brand name and the level of customer service.

Product Differentiation

Product Differentiation is an attempt to create the impression in the mind of the consumer that a given product is distinctive from others.

Consumers will perceive the importance of various products and services according to their needs. It is important therefore that a business is careful when selecting the target audience for its marketing efforts.

Consumer Goods and Services

The strategy that a marketer will adopt will vary according to the type of end market. Generally there are two types of end market, namely Consumer Markets and Industrial Markets.

Within consumers markets there are three categories of goods and services based on purchase habits and buyer preferences:

1. **Convenience Goods and Services:** These relate to products that a consumer wants to purchase regularly and with a minimum of effort. Location, brand awareness and image are very important. Examples include confectionery, newspapers and cigarettes.
2. **Shopping Goods and Services:** These relate to products that the consumer buys only after comparing value and price from a variety of goods. Marketers emphasise price and quality differences. Examples include clothing, footwear, electrical appliances and Personal Computers.
3. **Speciality Goods and Services:** These relate to products that have a special attraction to consumers, who are willing to go out of their way to obtain them. Examples include cars, sports and leisure facilities, jewellery and holidays.

Industrial Goods and Services

Industrial goods and services are products that are used as inputs to other products. Within industrial markets there are generally three categories:

1. **Materials and Parts:** These relate to finished products that are used as inputs in the production process of other products. Examples include engines in cars and hard disks in computers.
2. **Capital Equipment:** This relates to products required to produce or manage the production of other products. Equipment includes manufacturing equipment, delivery vans etc.
3. **Supplies and Services:** These relate to products that are used to support the production of finished goods. Examples include office stationary, insurance and accounting services.

The Product Life Cycle

Every product has a life cycle, from introduction to growth to maturity and finally decline (figure 10.2). The length of a product life cycle varies from product to product. The concept of the Product Life Cycle can be used to assist managers to develop appropriate strategies for managing products depending on the stage that the product is at in its development. As the product moves through its cycle, the strategies relating to competition, promotion, place/distribution, pricing and market information must be periodically evaluated and possibly changed.

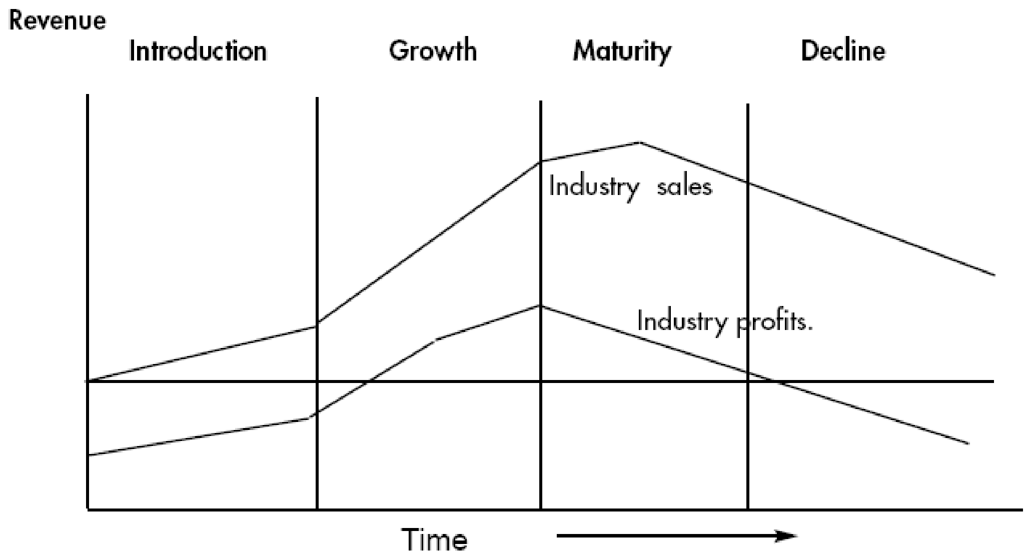


Figure 10.2: The four stages of the Product Life Cycle

INTRODUCTION

The introduction stage is the most risky and costly. The public must be informed about the product through a promotional campaign, and perhaps given incentives to buy the product. Costs during this phase include research and development, market research, and product launch costs. The level of competition would generally be low at this stage.

GROWTH

As the product becomes known, sales will increase and consequently profits. Competition may emerge as competitors are attracted by the growth of sales. This is a critical stage for the product's survival because competition will increase greatly and will affect the product's life expectancy. Aggressive promotional pricing, including price cuts is typical at this stage. The goal is to establish the products position and to strengthen it by encouraging brand loyalty. During this stage, the product offerings may have to be expanded, and segmentation may be used to achieve greater penetration. Gaps in the marketing channels should be filled during the growth stage, and the company may move from an exclusive to a more intensive distribution. Later on, advertising expenditure may be lowered slightly from the high levels of the introductory stage, but still needs to be substantial.

Maturity

Maturity sees the sales curve peak and should level off before it starts to decline. For those products with a large market share this is generally they most profitable stage. There will be severe competition, with many brands in the market. Competitors emphasise improvements and differences in their product. Many of the weaker competitors are likely to be squeezed out at this point. For those remaining, they must make fresh promotional and distribution efforts to ensure brand visibility is maintained. It will often require modification to the product and marketing mix. Product modification covers quality, enhanced functionality and modifications to the appearance and style of the product.

Decline

Demand falls as the product becomes obsolete. The choices for the company are to phase out the product or drop it immediately. If the company has continued to develop products there will be a new product ready to replace it.

The produce life cycle has implications for all firms. No business can afford to stand still even if its position is the market is strong at present. Unless a company continues to improve upon its existing products and plans for their replacement, that company will eventually be overtaken by its competitors. Consequently, companies should have many different products at various stages of the life cycle, thus ensuring the continued growth of the company.

Branding

A **brand** is defined as a name, symbol or design that identifies the goods or services of one seller and distinguishes them from those of competitors.

A **brand name** is defined as the part of the brand consisting of a word, letter, or group of words and letters comprising a name that differentiates the goods or services of a seller from those of competitors. Brand names of goods become known to consumers through advertising. Some well-known brands names include Apple, Coco Cola, and Microsoft.

The main advantages of branding are:

- Helps product identification
- It can be used to communicate benefits to the consumers
- It gives the consumer reassurance that they know what they are buying
- Helps create loyalty, defends against competition,
- It can help positioning a product in the marketplace
- IT can enable premium pricing and can increases power over retailer
- Facilitates advertising and promotion

A **trademark** is a brand that has been given exclusive legal protection for both the brand name and graphic design.

Packaging

An important aspect of the brand image of a product is the packaging that is used. The three functions of packaging are:

- Protection of the product,
- The promotional opportunities that the packaging itself offers,
- The opportunities for innovation and product improvements/ modification.

Price

The main issues around price include how price can be used as a **competitive tool**, what are the **determinants of price** and what **pricing methods** can be used.

Price as a Competitive Tool

Price is a critical element of the marketing mix as it is the only element that produces revenue. Many firms base their pricing policies on cost factors alone and neglect to take account of dynamics of the market place where a product might be successful at a particular price but not at another. Also firms that base their prices on the cost of manufacture often neglect the cost of things such as after sale service. Price can be used as a competitive tool in the context of an overall market strategy

Determinants of Price

The price of a product is influenced by both external and internal factors.

INTERNAL FACTORS

- **The Cost of Production:** The costs of producing a product or service set the floor price for a product or service. An organisation must recover the costs if it wants to stay in business in the long term.
- **The Organisation's Objectives:** The objectives of the organisation will also influence the price charged. For example the organisation may charge a high price to maximise profits, or they may decide to charge a low price initially to gain market share.
- **Positioning Strategy:** The Company may be pursuing a low price strategy or a differentiation strategy where it will charge a high price for perceived quality such as BMW and Rolex.

EXTERNAL FACTORS

- **The Customer:** The customer effectively determines the highest price that can be charged for the product. Companies should carry out market research to establish the disposable income of target customers and how much they are willing to pay for a particular product or service
- **Competition:** The level of competition in the market place will impact the level of prices. In a highly competitive market place, prices will tend to be lower but in a market with few competitors an organisation can charge a higher price.
- **Economic conditions**: If the economy of a country is booming, then prices will tend to be higher while in a recession prices will generally fall.
- **Government Regulations and Control:** Governments actions can affect prices in a number of ways. In some countries the prices charges for utilities such as electricity and public transport are subject to government regulations. Governments can also affect the prices charged for products and services by increasing taxes and duties.

Pricing Methods

Depending on the firms marketing objectives there are several different pricing strategies that can be adopted including:

- **Cost plus pricing:** This is the most common approach to pricing and is based on product cost plus a variable mark up.

- **Price Skimming:** This involves setting a higher price at the early stages of the product life cycle.
- **Price Penetration:** This involves setting the prices at a very competitive level to increase market share.
- **Price Bundling:** This involves grouping together two or more products and offering them at a price less than the sum of their individual prices. This may be used to stimulate sales in a product that is selling poorly.
- **Target pricing:** The price of a product is determined on the basis of a target profit margin.
- **Perceived values pricing:** This involves pricing the product based on the value or performance it offers the buyer and may involve a premium on the price.
- **Competition oriented pricing:** There the price of the product is determined with reference to what the competition is charging.

Promotion

The third P in the marketing mix is Promotion, which relates to all communications with markets and consumers, including promotional activities, selling and sales, and market research. There are a number of different methods of promotion which include:

- Advertising
- Sales Promotion
- Public Relations
- Personal Selling
- Direct Marketing

Advertising

This may be defined as the communication of information about a product or service to a particular audience. The main aims of advertising include:

- To increase the sales of a firm's products and therefore increase its profits
- To provide information about products and their uses, including technical information
- To keep the brand name in the minds of consumers. In some advertisements no particular product is advertised, just the brand name is mentioned
- To project a good image of the firm to the public. Some advertisements by banks insurance companies etc. often have this aim in mind.

CHOICE OF MEDIA

The advertising media selected by a firm will depend mainly on the following factors:

- The type of product or service to be advertised
- The target market for the product
- The amount of money that is available for advertising
- The method of presentation needed.
- The competitors choice of media

- Geographic coverage

The media available to the organisation for advertising purposes include:

- Television
- Radio
- Magazines
- Newspapers
- Internet

TELEVISION

This is a very effective medium of advertising goods and services that have a broad market appeal.

The advantages of television as an advertising medium include:

- It can reach a large audience with a low cost per contact
- It offers creative opportunity
- It enables segmentation of the market – for example a company selling sports gear could run their adds during a sports program

The disadvantages of television as an advertising medium include:

- There are too many adds and is very easy for consumers to change channel
- The amount of time is very short so recall by consumers can be low
- Both the production and broadcast costs are very high

RADIO

Radio is a very widely used medium for advertising and can be effective, particularly in the morning an during the earlier parts of the day when it is not competing directly with television

The advantages of radio as an advertising medium include:

- The cost is lower than TV – also the cost of production is lower
- Radio supports high levels of segmentation,

The disadvantages of radio as an advertising medium include:

- Short exposure time, as advertisements generally have a very short duration
- Low attention span of most listeners

NEWSPAPERS

Although newspaper readership has declined in recent years, newspapers are still an important advertising medium.

The advantages of newspaper as an advertising medium include:

- Possible to advertise locally (local paper) and can also include coupons and leaflets

- Newspapers are a low cost medium and will generally have high credibility particularly if the ads appear in a reputable paper.

The disadvantages of newspaper as an advertising medium include:

- Major clutter as there are so many papers – also the life span of a newspaper is usually only a single day
- Newspapers are normally printed on low-grade paper which results in poor quality colour pictures
- As the numbers buying papers is declining the audience for newspaper advertisements is declining

MAGAZINES

Magazine advertisements are usually targeted at a particular market - the particular grouping who read the magazines. For example the advertisements in a farmers magazine would generally be targeted at farmers, whereas the advertisements in a computer magazine would be geared toward computer users.

The advantages of magazines as an advertising medium include:

- Magazines offer segmentation possibilities – if you are advertising computer hard disks then you should advertise in a computer magazine
- Magazines have a longer life span and are generally printed on higher quality paper than newspapers

The disadvantages of magazines as an advertising medium include:

- They are higher cost than newspaper but also suffer from high clutter and like newspapers magazine sales are dropping

THE INTERNET

The internet is the fastest growing advertising medium. The different methods of internet advertising include:

- Corporate websites
- Banner ads
- Ad-words
- Social networking sites
- Email

The advantages of the internet as an advertising medium include:

- Very high reach – in fact it is global reach
- Segmentation and targeting are possible, particularly when using adwords
- It is possible to evaluate the effectiveness of a add (measuring how many people click on it
- The internet offers interactivity in that the consumer can click on the advert and it automatically links to the firm’s website. The consumer can choose to view pictures

of the product, read specification details or watch a video of the product. They can also enter their email address to receive additional communications

- It is generally lower cost that other media

The disadvantages of the internet as an advertising medium include:

- A very high level of clutter with billions of web pages
- The internet excludes some people who don't have access. This makes it hard to target some groups, in particular older people.
- There are security issues associated with the internet

Sales Promotion

Sales promotions are short term methods used by organisations to increase sales of a product.

The main sale promotion methods uses are as follows:

- **Price Reductions** – such 10% of or 20% extra free
- **Competitions and Draws – customers** can fill out a form on the packaging to enter a draw
- **Free Samples –** for example offering a free sample of hair conditioner with a purchase of shampoo
- **Bundling of Products -** where two products are bundled and sold together
- **Vouchers and coupons –** these can be used to purchase more of the product at a lower price.

Publicity and Public Relations

Publicity is non personal communication about an organisation and its products and services that is generally not paid for. Public Relations (PR) is the management of internal and external communication of an organisation to create and maintain a positive image for the company.

Publicity events include:

- Press releases which are aimed at generating interest in the press
- Publicity 'stunts'
- Photo opportunities
- Speeches and personal appearances by senior management
- Giving interview on radio and television
- Writing newspaper articles and books
- Blogs and social media – these enable the organisation to engage in two way communications

The main objective of public relations is to create and maintain a good impression of the company and its products in the minds of the public.

Personal Selling

Personal Selling involves informing customers and persuading them to purchase products through personal communications in an exchange situation. It also involves promotion of products, plus searching out prospects and providing follow-up services.

Personal selling has advantages and limitations when compared to advertising. Advertising is generally communications aimed at a relatively large target audience, whereas personal selling offers more specific communication aimed at one person or several people. Reaching one person through personal selling costs considerably more than doing so through advertising, but personal selling often has a greater impact on customers. Personal selling also provides immediate feedback, which allows the marketers to adjust the message to improve communication.

Direct Marketing

This involves selling directly to the end-customer. Direct marketing enable a marketer to deal directly with target customers. Methods of direct marketing include: catalogues, mailings, telemarketing, the Internet, TV shopping, etc. Dell, Ryanair and Amazon are examples of companies that employ direct marketing.

Sales Department

The sales department has responsibility for selling the company's products and services. It receives support from all the other departments involved in marketing. The sales departments will work closely with the other departments such as production, and finance and with other groups with the sales and marketing department such as marketing and market research. The head of the sales department is normally the sales manager.

SALES MANAGER

The main duties of the sales manager are the following:

- Implementing company policy in the sales department
- Organising the sales force and setting sales targets
- Preparing sales forecasts and budgets
- Leading and motivating the sales staff
- The sales manager is responsible for evaluation and control of the sales force

Market Research

Market research is used by marketers to improve the effectiveness of all other marketing efforts. It normally involves direct communication with markets and consumers. Market research is defined as the systematic gathering, recording and analysis of data about problems relating to the marketing of goods and services. The two main sources of data are primary data and secondary data. Primary data is information resulting from original research concerning a specific problem. Secondary data is already published research information from journals, trade associations, government bodies, libraries etc, which was collected for a separate purpose.

Place

A key aspect of the marketing process is the ability to physically get the product from where it is produced to a place where the consumer can view, purchase or consume it most conveniently. This involves setting up the appropriate distribution channels. There are a number of distribution functions; transportation, storage, buying selling etc... The key issues in distribution from a marketing mix perspective are as follows:

- Utility and Marketing Intermediaries
- Physical Distribution and Logistics
- Channels of Distribution

Utility and Marketing Intermediaries

Utility refers to the value of want satisfying ability that is added to goods or services by organisation through making them more useful or accessible to consumers.

Form utility is value added to a product mainly by the producer to make it more useful. Other types of utility are added by the Marketing Intermediaries.

Marketing Intermediaries are organisations that assist in the movement of goods and services from producers to consumer.

Time utility is value added to products by retailers who make them available as they are needed.

Place utility is value added to products by intermediaries who distribute them to where they are wanted.

Possession utility is the value that intermediaries add to products by enabling the transfer of ownership from one party to another.

Information utility is the value added to products by opening two-way flow of information between marketing participants

Physical Distribution and Logistics

Physical Distribution refers to the movement and storage of goods and services from producers to consumer. A business has to handle both inward and outward distribution.

No physical distribution service can simultaneously maximise customer service and minimise distribution cost. The task of the distribution manager is to balance the cost of physical distribution with the provision of a quality service.

The criteria when choosing a mode of transport include speed, frequency, dependability, capacity and availability. Shippers are increasingly combining two or more modes of transportation thanks to containerisation.

Channels of Distribution

Channels of distribution refer to the Marketing Intermediaries such as wholesalers, retailers and agents who together transport and store goods in the path (channel) from producer to consumer.

Wholesalers are marketing intermediaries that sell to organisations and individuals for resale and not to final consumers.

Retailers are marketing intermediaries that sell to consumers and include department stores, supermarkets and convenience stores.

The three normal channels of distribution are shown in figure 10.3.

- **Channel 1:** This is referred to as Direct Marketing and Non Store Retailing. It is a fast growing channel of distribution and includes telemarketing, Internet marketing, direct mail marketing, vending machines, door to door sales, mail order retailing, and home shopping networks.
- **Channel 2:** This is the longest and most indirect distribution channel. It is used with most consumer goods. The manufacturer sells the goods to the wholesaler, who in turn sells to the retailer. The consumer purchases the goods from the retailer.
- **Channel 3:** This is an indirect channel of distribution. For example a large hardware store who buys timber directly from the sawmill and sells directly to the consumer or a large supermarket chain who buy directly from the manufacturer.

Channel 1	Channel 2	Channel 3
Manufacturer	Manufacturer	Manufacturer
	Wholesaler	
	Retailer	Retailer
Consumer	Consumer	Consumer

Figure 10.3: Channels of Distribution

C. THE MARKETING OF SERVICES

Difference between Service Industries and Manufacturing Industries

Service industries differ from manufacturing industries in both the types of processes they engage in to produce the services and in the types of relationship they engage in with their customers. The following are the main characteristics that make the management of service organisations different from that of goods producing organisations:

- **Intangibility:** Services are difficult to describe, demonstrate, and communicate to the buying public. As a result an organisation's reputation is very important in service marketing.
- **Perishability:** Services are only immediate or single use: Most services are purchased and consumed simultaneously (normally in the presence of the consumer), which means

they cannot be held in stock. If there are fluctuations in demand, service firms may have problems matching supply and demand. This aspect of service can be addressed by good demand management

- **Heterogeneity/Variability:** Services produce diverse output. There can be a great deal of variability in the output of a service firm or even a single employee, which makes it difficult to establish standards and ensure standards are met.
- **Inseparability:** Service is produced and consumed simultaneously. The consumer interacts with and participates in the service delivery system.

The Seven Ps of Service Management Strategy

Earlier in this chapter the four Ps of the marketing mix (product, price, place and promotion) were discussed. However when it comes to marketing services these four parameters were found to be insufficient. As a result three additional "Ps" were added, namely **Physical Evidence**, **Process** and **Participants**. The combined 7 Ps called the **extended marketing mix** or **service mix** are as follows:

- Product
- Price
- Place
- Promotion
- Physical Evidence
- Process
- Participants

Product

The product in a service environment is referred to as a Consumer Benefits Package (CBP), which normally consists of a bundle of products and services. The service marketers must communicate with consumers and adapt the CBP to changing market demands.

Many factors have to be considered at the service level including:

- The range of services required to satisfy the different segments of the market
- The intangibles as well as the tangibles consumers evaluate when buying a service
- Differentiation - how to promote the distinguishing characteristics of the service that the organisation provides
- Difference between consumer and industrial markets
- Branding the bundles of benefits provided

Price

As in a manufacturing environment, many service firms base their pricing policies on cost factors alone without accounting for the dynamics of the market place and the pricing behaviour of competitors. It is important that service firms develop a flexible pricing strategy based on the purchasing power of the target market and the pricing behaviour of competitors.

A service may be successful at a certain price but not at another. The main factors that determine the price of a service include:

- Market structure
- Economic conditions
- Competitive conditions
- Types of customers and their disposable income bracket
- Strategic objectives of the firm
- Legal issues
- Distribution channels

Place

Distribution and location are very important for many firms, in particular retailing, restaurants and financial services. For example the multinational retail giants will generally locate in the high street or may become anchor tenants in new shopping centres. Online shopping and Tele-shopping have become important distribution channels for service providers in recent years as it allows retailers to reach a much larger market without the expense of retail outlets.

Promotion

From a service perspective the advertising and communications strategy is vital in positioning the product/service bundle. In many instances the product/service bundle is purchased and consumed simultaneously which increases the opportunity for personal and direct selling at the point of contact. The key issues to be addressed within promotion include:

- Promotion and promotional mix
- Marketing communication
- Market research

Promotion is defined as an attempt by marketers to persuade others to participate in an exchange with them. The promotional mix is the combination of tools marketers use to promote their services and is made up of the following:

- Personal selling
- Publicity
- Public relations
- Sales promotion
- Advertising

These topics were discussed earlier in this chapter.

Physical Evidence

The physical evidence relates to how the facilities are designed and managed. The key management activities in this instance are as follows:

- The interior /exterior facility layout with regard to theme, décor, lights, signage. Service encounter, cleanliness, etc.

- Employee appearance and hygiene.
- Equipment/automation convenience reliability, ease of use, attractiveness etc.
- Adequate exterior capacity such as parking facilities etc.
- Visible professional credibility e.g. licences etc.

Process

Process refers to the efficiency and effectiveness of the service process involved in delivering the product/service mix. The specific management activities from a process perspective are as follows:

- The drawing up of detailed operating procedures, manuals and job descriptions.
- Specifying procedures for customer problem resolution.
- Training on technical and procedural aspects of the job.
- Establishing standards of performance for the facility, the process, the equipment, and the jobs that deliver the Consumer Benefit Package.
- Facility design and layout to enhance customer/item movement through the process.

Participants (People)

The final P in the service environment is the Participants, which refer to the people who actually deliver the service at the point of customer contact. In essence the other 6 Ps play only a support role in a service environment. Whether it is a one-to-one basis, over the phone or via the Internet, the professionalism, politeness and credibility of the Participants are critical. The key issues to be considered here are the following:

- The use of employee reward system as a motivational tool.
- Training on human interaction skills and customer problem resolution.
- Personal Selling procedures and techniques.
- Self-service/group participation procedures and norms of behaviour.
- Simultaneous execution of technical and human interaction skills at points of customer contact.

D. MARKET SEGMENTATION, TARGETING AND POSITIONING

Markets consist of buyers and buyers differ in one or more ways. They may differ in their wants, resources, locations, buying attitudes, and buying practices. Through market segmentation, companies divide large, variable markets into smaller segments that can be reached more efficiently and effectively with product and services that match their unique needs. Market research gives an organisation a better idea of the options it can pursue within the market place.

Selecting the market to which it is most suited is often seen as a three-stage process:

1. **Market Segmentation:** This involves dividing a market into smaller groups of buyers with distinct needs, characteristics, or behaviours who might require separate products or marketing mixes. Segmentation is essentially the identification of subsets of buyers

within a market who share similar needs and who demonstrate similar buyer behaviour. It involves developing measures of segment.

2. **Market Targeting:** This involves evaluating each market segment's attractiveness and selecting one or more of the market segments to enter.
3. **Market Positioning:** This involves setting the competitive positioning for a product and creating a detailed marketing mix.

Market Segmentation

Market Segmentation consists of breaking the total market into segments that share common properties such as:

- Common wants of consumers
- Purchasing power
- Geographical location
- Buying attitudes or practices

The ultimate degree of market segmentation is customised marketing where sellers design a separate product for individual buyers. Airline manufactures such as Boeing customise airplane for different buyers. However for smaller businesses it isn't profitable in most cases to customise products at the individual level, so manufactures identify classes of buyers who differ in their broad requirements. By focusing on a segment of the market the organisation is able to get a better understanding of those customers specific needs and as a result can develop products that meets those needs better. Market segmentation can be carried out at several different levels:

- **Mass Marketing** (No segmentation or undifferentiated marketing): This is where the firm decides to ignore market segment difference and targets the whole market with one offer. This mass market strategy focuses on what is common in the needs of consumers rather than on what is different. Coca Cola use this strategy.
- **Segmented marketing** (or differentiated marketing): This is a strategy where a firm decides to target several market segments and designs separate offers (product or services) for each. Most of the major car manufactures would adopt this approach.
- **Niche marketing**: Instead of going after a small share of a large market the firm concentrates on a few smaller segments or niches and tries to gain a large share of the niche market. This is an attractive strategy when company resources are limited.
- **Micro marketing (**customised products): This strategy involves customising or tailoring products/services and marketing programs to suit the tastes of specific individuals and locations.

Companies developing their strategy for segmentation can choose one of several variables or bases from a wide range of choices, which include the following:

- **Demographics:** This method uses characteristics of peoples such as age, gender, family lifecycle (single, married, married no children, married young children, retired, etc.) social class, etc.
- **Geographic:** This uses, country, region, area (urban or rural), etc

- **Buyer Behaviour:** Occasions (are they regular, occasional buyers); Benefits sought (quality, convenience, speed etc); User rates (light, medium or heavy users); Loyalty status (none, strong, medium); Attitude to product (positive, negative, indifferent).
- **Personality, Motives and Lifestyle:** (referred to as psychographic)

Market Targeting

The second step in market selection calls for market targeting. The company now has to evaluate the various segments and decide how many and which ones to serve.

In evaluating market segments, a marketer must look at a number of factors:

1. **Segment size and growth**: Companies must collect and analyse data on current sales, projected sales growth rates, and expected profit margins for the various segments. The company will be interested in segments that have the "right" size and growth characteristics. The largest, fastest-growing segments are not always the most attractive ones for every company. The company must consider competition and whether their company resources are sufficient to pursue the opportunity.
2. **Segment structural attractiveness**: The Company must assess several major structural factors that affect long-run segment attractiveness. Areas to consider include:
   - Current and potential competitors.
   - The threat of substitute products.
   - Relative power of buyers.
   - Relative power of suppliers.
3. **Firm's objectives, strategies and resources:** The company needs to examine its own objectives and resources. The opportunity should provide a good fit. The environmental hazards of pursuing the opportunity must also be considered. "Can the company succeed in gaining this segment?"

Targeting Strategies

The company must also decide on the type of marketing strategy to adopt**:**

1. **Undifferentiated Marketing**: This is where a firm decides to ignore individual market segment difference and targets the whole market with one product or service offer.
2. **Differentiated Marketing**: This is where a firm decides to target a number of market segments & designs a separate marketing mix for each.
3. **Concentrated Marketing**: This is where a firm targets one or more niche market segments.

Market Positioning

A product's position is the way the product is defined by consumers on important attributes; i.e. the place the product occupies in consumer's minds relative to competing products. Because consumers cannot re-evaluate products every time they make a buying decision, they "position" products, services, and companies in their minds. The marketer seeks to position a product so that it is perceived to posse key variables considered important by consumers. The objective is to create and obtain a distinctive place in a market for a company and/or its products. Marketers must therefore:

- Plan positions to give their products the greatest advantage in selected target markets.
- Design marketing mixes to create those planned positions.

Positioning Strategy

The following steps should be taken to position a product or service in the market place to gain the best advantage:

Step 1:

Identify possible competitive advantages.

- The key to winning and keeping market share is to understand customers' needs and buying processes better than competitors and deliver more value.
- Competitive advantage over competitors is gained by offering consumers greater value, either through lower prices or by providing more benefits that justify competitive advantage.
- Competitive advantage can be achieved by differentiating ones products from those of competitors. Differentiation can be based on product features, performance, style and design, or attributes. The whole marketing mix can be used to differentiate a product.

Step 2:

Select the right competitive advantage – criteria for determining which differences to promote.

- Find USP (unique selling proposition) if possible. Ideally the advantage should be important, distinctive, superior, communicable, pre-emptive, affordable and profitable.

Step 3: Communicate and deliver the chosen position

- Take strong actions to deliver and communicate the desired position to target consumers.
- The marketing mix must support the positioning strategy
- The positioning strategy must be monitored and adapted over time to match changes in consumer needs and competitors strategies

Market Planning

Marketing planning is a systematic process that involves assessing marketing opportunities and resources, determining marketing objectives and developing a plan for implementation and control. The objective is to create a marketing plan. The marketing planning cycle indicates that marketing planning is a circular process.

Marketing plans vary in duration: Short-range plans cover one year or less. Medium-range plans encompass two to five years. Long-range plans extend beyond five years.

Marketing plans should do the following:

- Specify expected results so that the organisation can anticipate what its situation will be at the end of the current planning period.
- Identify the resources needed to carry out the planned activities so that a budget can be developed.

- Describe in sufficient detail the activities to take place so that responsibilities for implementation can be assigned.
- Provide for the monitoring of activities and results so that control can be exerted.
- Lead to the implementation of the organisation's marketing strategy.

The three core steps of marketing planning are **analysis**, **strategy** and **implementation**.

Elements of the Marketing Plan

The output of the planning phase is the marketing plan. The plan outlines the process involved in analysing the marketplace, the decisions made by marketers and senior managers in terms of marketing mix and marketing strategy, and the action plans required to implement strategy.

The seven key elements in a marketing plan are as follows:

- **Situational Analysis:** This provides background information on the marketing environment, the market itself, competitors and the 4 Ps.
- **SWOT Statement:** This identifies the main opportunities and threats that face the firm of the product in question and the strengths and weaknesses of the firm.
- **Marketing Objectives:** The objectives of the plan are identified, which include a forecast of sales volume and value, the desired market share and profit objectives.
- **Marketing Strategy:** This is the key part of the plan, which details the marketing mix to be employed.
- **Action Plan and Programmes:** These identify how the strategy will be implemented in terms of what is going to be done, who is going to do it, what is the time frame involved and how much is it going to cost.
- **Financial Details:** The expected financial returns in terms of a Cash Flow statement, a Profit and Loss statement and a Balance Sheet, is put forward.

Product Market Strategy (Ansoff's Matrix)

An important planning task is to decide the best approach to positioning a product in the marketplace. Igor Ansoff identified that the basis for strategic advantage lay in the options that arose from combining the product and market mix. He identified the following options:

1. **Market Penetration:** The objective is to gain market share for the current mix of products and markets by undertaking activities such as improving quality, productivity or increased marketing, and generally involves the organisation in being more aggressive in marketing.
2. **Product Development:** This strategy involves building on the organisation's current knowledge and skills to develop new products within the existing market. Drivers for such a strategy include changing customer needs. High risks are involved in terms of pioneering costs and demand uncertainty.
3. **Market Development:** This approach is based on venturing into new markets with the current product or service. This could include entering new segments as well as increasing the geographical scope, including exporting.

4. **Diversification:** This involves developing new products for new markets. There are two types of diversification**:**
    a. **Related Diversification:** This involves moving into a new area of business, but within the existing industry that is served. Advantage is gained through the benefits the relationship to the current business.
    b. **Unrelated Diversification:** Involves development beyond the present industry into areas where there is no apparent relationship to current business.

The various product market strategies, also known as Ansoff's competitive strategies or Ansoff's matrix or grid is shown in figure 10.5.

		Product	
		Existing	New
Market	Existing	Market Penetration	Product Development
	New	Market Development	Differentiation - related - unrelated

Figure 10.5: Product Market Strategies - Ansoff’s Matrix

The Marketing Mix in Market Planning

Taking account of the product market strategy that has been chosen, the marketer must integrate the other elements of the marketing mix into a coherent marketing strategy. The marketing mix will evolve to meet market requirements over the planning period and may also differ according to the market being targeted.

E. CUSTOMER CARE AND RELATIONSHIP MANAGEMENT

Customer Relationship Management (CRM) is one of the most important concepts of modern marketing. It is the overall process of building and maintaining profitable customer relationships by delivering superior customer value and satisfaction.

Companies are targeting fewer, more profitable customers. They are beginning to assess carefully the value of customers to the firm. Called selective relationship management, many companies now use customer profitability analysis to target their best customers.

Today’s companies are using customer relationship management to retain current customers and build profitable, long-term relationships with them. On average, it costs five to 10 times as much to attract a new customer as it does to keep a current customer satisfied.

Companies are also connecting more directly with customers. Direct marketing is booming.

Growing Share of Customer

Customer relationship management can help marketers to increase their share of customer customer’s purchases. To increase the share of customer, firms can leverage customer relationships by offering greater variety to current customers. Or they can train employees to cross-sell (related products) and up-sell (higher value products and services) in order to market more products and services to existing customers.

Satisfying the Customer Needs

According to Peppers and Rogers there are four basic steps in CRM:

1. Identify your customers in as much detail as possible, including demographics, psychographics (Interests, Attitudes, and Opinions), habits, and preferences.
2. Differentiate among them (for example, most and least profitable).
3. Interact with your customers (make this interaction more cost effective through automation whenever possible).
4. Customise your offerings to fit each customer’s needs through mass customisation or individual tailoring

Through these four stages, a company is better able to learn and understand its customers and provide more relevant and customised offerings.
Building learning relationships may be easier for companies in some industries than others. Travel agencies know their customers and their preferences. Most large retailers do not—unless they provide their customers with something of value in order to collect customer information, such as supermarket ID cards. In return for completing an application form and letting the supermarket record your purchases against your demographic data, the shopper will often get discounts on items. Once a company learns about its customers, it must be able to tailor its products, services, or promotions to cash in on the learning relationship. Hotels can record guests’ preferences (rooms, newspapers, restaurants, time of servicing the room, promotional specials etc.) and deliver these customised preferences upon check-in or throughout the stay. Other retailers would have a harder time supplying such customer customisation.

F. INFORMATION SYSTEMS IN THE SALES AND MARKETING FUNCTION

Sales Order Processing Systems

The sales area is concerned with selling products to customers. Sales order processing systems are used to capture and process customer orders and produce data needed for sales analysis and inventory control.

Before an order is accepted from a customer the Sales area must check with Stores that the goods requested are in stock and with finance that the customer has a good credit status. If both checks are positive the order is taken and confirmation is sent to the customer

Sales order processing systems can also be used to track the status of customer orders until they are delivered. Computer-based sales order processing systems provide a fast, accurate and efficient method of recording and processing customer orders and sales transactions. They also provide inventory control systems with information on accepted orders so they can be filled as quickly as possible.

Staff using a computerised sale order processing system can also access to information held by other functions. Sales staff can check stock levels and customer account information from their computer screen. Sales order processing systems enable the status of an order to be checked and also enable reporting to be carried out.

Point of Sales Systems (POS)

Electronic point of sale terminal incorporates a cash register and a terminal connected to a computer. As well as performing the normal functions of a cash register, the point of sales terminal collects data relevant to each sale and sends this data to the shops computer system where it can be used for sales analysis and stock control.

Most point of sale terminals also incorporate a scanning device to read the bar codes of the grocery items. As well as improving the efficiency of the checkout operation, the data collected by the bar code reader enable a detailed receipt to be printed for each customer and sales and management information to be collected.

Most retail POS systems do much more than just "point of sale" tasks. Many POS systems can include fully integrated accounting, inventory management, forecasting and customer relation management (CRM),

Point of sale systems are used in supermarkets, restaurants, and hotels, as well as most types of retail establishment.

Sales Force Automation

Increasingly computers and the internet are providing the basis for sales force automation. In many companies the sales force are being supplied with notebook computers, WEB browsers and sales contact management software that connects them to marketing websites on the Internet and their company's intranet. This not only increases the productivity of the salespeople, but dramatically speeds up the capture and analysis of sales data from the field to marketing managers at the company headquarters. It allows marketing and sales management to improve the delivery of information and support to their sales people.

For example, sales people can use their PCs to record sales data as they make their calls on customers and prospects during the day. Then each evening the sales representative in the field can connect their computer remotely through the internet to the company's network. They can then upload information on sales orders, sales calls, and other sales statistics, as well as send e-mail messages and access sales support information. In return the network can down load product data, prospect lists on good sales prospects, and e-mail messages.

Marketing Databases

Many organisations maintain files or databases specifically for information generation purposes. For example an organisation may conduct or commission market research in order to create a marketing database containing information on existing customers and prospective customers.

Data Warehousing

A data warehouse can be defined as any centralised data repository, which can be queried for business benefit.

A data warehouse is a database that stores current and historical data of potential interest to managers throughout the company. This data originates in many core operational systems and external sources each with different data models. The data from the different applications are copied into the warehouse database as often as needed – hourly, daily, weekly, and monthly. The data are standardised into a common data model(s) and consolidated so that they can be used across the enterprise for management analysis and decision-making. The data are available for anyone to access as needed but cannot be altered. Data warehouses are specifically designed to allow the warehouse user to:

- Extract archived operational data
- Overcome inconsistencies between different legacy data formats
- Integrate data from throughout an enterprise, regardless of location, format, or communication requirements
- Incorporate additional or expert information

The data warehouse concept is shown in the figure 10.6 above. Companies can build enterprise-wide warehouses where a central data warehouse serves the entire organisation, or they can create smaller, decentralised warehouses called **data marts**.

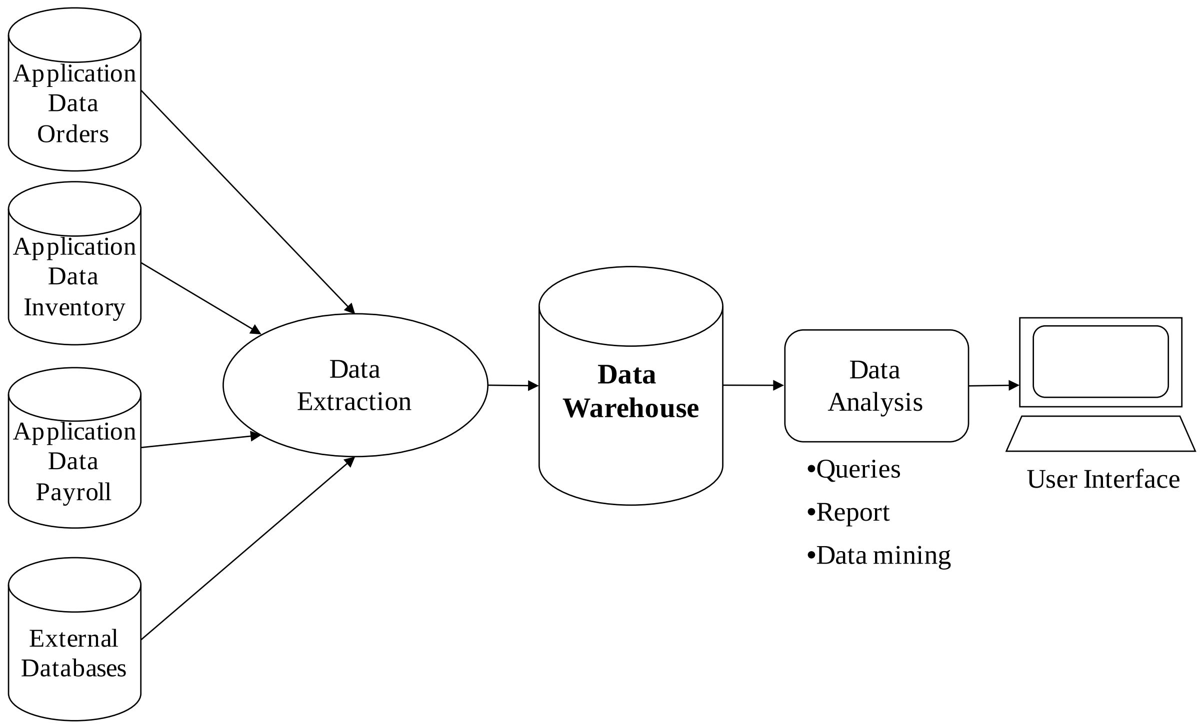


Figure 10.6: Components of a Data Warehouse

Data Mining

Data mining is the analysis of data for relationships that have not previously been discovered.

Data mining results include:

- Associations, or when one event can be correlated to another event (those who purchase a shirt may also buy a tie a certain percentage of the time)
- Sequences, or one event leading to another later event (a purchase of a camera followed by a purchase of a camera case)
- Classification, or the recognition of patterns and a resulting new organisation of data (for example, profiles of customers who make purchases)
- Clustering, or finding and visualising groups of facts not previously known
- Forecasting, or simply discovering patterns in the data that can lead to predictions about the future

Customer Relationship Management (CRM) Systems

CRM systems attempt to integrate customer-serving processes in the Marketing, Sales and Service functions. The main CRM components include contact and account management, sales order handling and fulfilment, customer service and support, and customer retention and loyalty programmes.

CRM systems are aimed at helping organisations to acquire and retain as well as sell to profitable customers. Traditionally organisations had different departments dealing with customers in isolation, which created difficulties for the customers and the organisation. For example if the customer wanted to place an order they had to contact function A while if they wanted to request service they were required to contact function B. CRM systems try to co-ordinate the efforts of Marketing, Sales and Service staff by ensuring all relevant customer activities, and transactions are recorded in a commonly accessible manner

Business Value of Customer Relationship Management Systems

Companies with effective customer relationship management systems can realise many benefits, including increased customer satisfaction, reduced direct marketing costs, more effective marketing, and lower costs for customer acquisition and retention. Information from CRM systems can be used to increase sales revenue by identifying the most profitable customers and segments for focused marketing, cross-selling, and up-selling.

G. IMPACT OF E-COMMERCE

The Business Value of the Internet

Most companies are building commercial sites on the Web to achieve business value. The business value of the internet includes:

- Generate new revenue from online sales.
- Reduce costs through online sales and customer support.
- Attract new customers via Web marketing and advertising, and online sales.
- Increase the loyalty of existing customers via improved Web-based customer service and support.
- Develop new Web-based markets and distribution channels for existing products.
- Develop new information-based products that can be accessed over the Web.

Electronic Commerce (e-commerce)

Electronic commerce is more than just buying and selling products online. Instead, it encompasses the entire online process of developing, marketing, selling, delivering, servicing, and paying for products and services purchased over the internet by customers.

Electronic commerce can include:

- Interactive marketing, ordering, payment, and customer support processes at e-commerce sites on the Web
- Access to inventory databases by customers and suppliers
- Access to customer relationship management systems by sales and customer service representatives

Companies involved in e-commerce as either buyers or sellers rely on Internet-based technologies and e-commerce applications and services to accomplish marketing, discovery, transaction processing, and product and customer service processes.

The Internet and other networks provide vital electronic links between the components of a business and its customers, suppliers, and other business partners. This allows companies to engage in three main categories of electronic commerce applications:

1. Business-to-Consumer (B2C) e-Commerce
2. Business-to-Business (B2B) e-Commerce
3. Consumer-to-Consumer (C2C) e-Commerce

Business-to-Consumer (B2C) e-Commerce

B2C e-commerce involves retailing products and services to individual shoppers. In this form of e-commerce the sellers are organisations and the buyers are individual consumers. The Internet provides companies with new channels of communications and interaction with customers that can be more cost-effective than traditional retailing. Companies can offer:

1. E-commerce Web sites that provide virtual storefronts and multimedia catalogues
2. Interactive order processing
3. Secure electronic payment systems
4. Online customer support

Some examples of successful business to consumer e-commerce Web sites are Dell.com who sell computer equipment directly to consumers and Amazon.com who sell books, eBooks, DVDs, cameras, computers, and a vast range of other items.

Business-to-Business (B2B) e-Commerce

Business-to-business electronic commerce is the wholesale and supply side of the commercial process, where businesses buy and sell goods and services with other businesses.

Many businesses are integrating their Web-based e-commerce systems with supply chain management, customer relationship management, and other information systems. This ensures that all electronic commerce activities are integrated with their business processes.

Consumer-to-Consumer (C2C) e-Commerce

In this category of e-commerce, consumers sell directly to other consumers. For example, e-Bay the giant online auctions site enables consumers to sell to other consumers by the auctioning off of items to the highest bidder.

Benefits and Limitations of E-Commerce

Benefits of E-Commerce

Both organisations and consumers can benefit from e-commerce.

Benefits to Organisations

The benefits to the organisation include:

- Global reach
- Being able to source cheaper supplies
- Reduced Cost of doing business

- Speeds up the flow of goods
- Improved customer service
- Enable small businesses compete against large companies

BENEFITS TO CONSUMERS

The benefits to the consumer include:

- Providing less expensive products and services by allowing customers to do quick online comparisons
- Enabling customers to shop or make other transactions 24 hours a day
- Giving customers more choices in terms of products and suppliers
- Delivering relevant and detailed information quickly
- Enabling consumers to get customised products such as PCs

Limitations of E-Commerce

The limitations of e-commerce include:

- Lack of universally accepted standards for quality, security and reliability
- Difficulty in integrating e-commerce software with some existing applications
- Unresolved legal issues related to fraud and buyer and seller protection
- Customer resistance to changing from real to virtual stores
- Perception that e-Commerce is expensive and unsecured
- Increasing incidence of internet fraud and other crimes

E-CRM

Electronic customer relationship management (eCRM) is an electronic communications approach used by companies to establish, develop, and manage relationships with customers. It helps a company communicate effectively with customers through the Internet. Communications through eCRM range from sales and customer service to electronic customer satisfaction surveys. These communications usually occur through the company's Web site.

Although CRM and eCRM share the same goals and focus, they have some basic differences. eCRM is essentially an online version of CRM. It provides a company with an additional channel to communicate with their customers. Although eCRM needs more advanced technology than traditional CRM systems, the opportunities presented to customers during one visit to the company's Web site far outweigh the opportunities they experience through telephone, fax, or mail.

A company can succeed at managing customer relationships most effectively by incorporating a combination of eCRM and CRM strategies throughout the organisation.

H. ENTREPRENEURSHIP

Enterprise in general relates to generating an idea, identifying the resources required to get the idea up and running as a business venture, and making the venture a commercial reality (Lynch and Roche 1999). The classical definition of **entrepreneurship** limits itself to individuals who start up new business, large or small. The non-classical definition refers to any activity which creatively develops an organisation, whether from scratch or as part of an ongoing process.

Characteristics of Entrepreneurs

Much research has been undertaken to identify the basic characteristics and personality traits common to entrepreneurs. However, entrepreneurs generally come from all walks of life; they can be teachers, engineers, business students, farmers, accountants, lawyers etc. There are usually self-confident, sure of their goals and of how to achieve them. They are self-nurturing, and capable of overcoming disappointments. They are usually action-oriented, with high energy levels and with a capacity to work with uncertain situations. Timmons (1994) identified the key traits of the entrepreneur, based on an analysis of 50 research studies. These traits include:

- Total commitment, determination and perseverance
- A drive to achieve and grow
- Opportunity and growth orientation
- Willingness to take initiative and personal responsibility
- Persistence when problem solving
- Low need for status and power
- Calculatedly risk taking and risk seeking

O'Farrell (1986) identified the following types of new firm founders:

- **The Graduate Entrepreneur:** Typically a graduate of engineering or business, she/he is usually involved in high-value-added technology-based goods with export or import substitution potential.
- **The Opportunist Entrepreneur:** Usually of a middle class background, this person has typically held a variety of jobs and may have a family background in small business. They tend to have nursed an ambition to found his/her own business for a long time.
- **The Craftsman Entrepreneur:** Generally a semi-skilled or skilled background with a technical education or apprenticeship. They will often start a business on a part-time basis with little capital. They will have little business or management experience and is more likely to be limited to one or two products or services.

Entrepreneurs are changing all the time. In the future it is most likely that they will be more educated and younger than previously as more potential new products than ever will be technology based or will rely on the use of technology to produce.

The availability of entrepreneurs and entrepreneurship skill is influenced in part by the economic environment. The provision of low cost enterprise assistance in terms of resources and training by state agencies are mechanisms that have been shown to encourage entrepreneurship. The increased use of outsourcing by organisations has meant that more people have in recent years started to go out on their own, seeking an opportunity to fill a niche in the market.

Stages in the Enterprise Process

The enterprise sets out the staged involved in moving from the initial idea to a commercial venture. The enterprise process discussed here is adapted for one proposed by Lynch and Roche (1999) and consists of the following six key phases:

1. Generating the Idea
2. Testing and Validating the Venture Idea
3. Writing the Business Plan
4. Assembling Resource and Market Entry
5. Growing the Business
6. Expanding or Exiting the Business

Generating the Idea

Business ideas can come from a wide variety of sources. Vesper (1990) identified a number of sources of venture ideas including the following:

- **Prior Employment:** Many new venture ideas come from the experience gained in former jobs. Some employees start their own business to fill a gap they found in the market that in now being served by the industry.
- **Obtaining Rights:** Acquiring a licence to produce and sell a product or service developed by others is another way of developing a new business venture.
- **Collaboration or Invention:** An inventor or creator of an idea who lacks some necessary skill sales, finance, production etc may be willing to let an appropriate person collaborate with them a new venture.
- **Hobbies:** These can be a source of new venture ideas. For example an avid part-time gardener may decide to open their own garden centre.
- **Social and Business Networks Encounter:** Social and Business networks play an important role in the commercialisation of new venture ideas.
- **Chance Observation:** Sometimes the inspiration for a new product or service will come simply from seeing a need in ones daily life.

Deliberate Search: This approach involves the entrepreneur searching for ideas. The internet is a growing source of ideas with its extensive search capabilities.

Testing and Validating the Venture Idea

Once the new venture idea has been generated, it must be tested and validated to establish its business potential. Before a business plan can be written, market research is undertaken and a feasibility study is carried out.

Testing the Venture Idea

The testing phase will attempt to answer the following questions:

- Will people want the product? Will they buy it? Will it make a profit?

- What are the setup costs and the opportunity costs? What are the risks?
- Will the venture generate wealth for the entrepreneur?

VALIDATING THE VENTURE IDEA

If the results of the testing are favourable then additional validation is carried out. The validation will look at the competitive advantages of the venture, the production, marketing, human resource and capital requirements of the venture to establish if it is a viable commercial business opportunity.

The next decision to be made is how to get the product to market. The following are some common routes to market:

- **Develop the new business from scratch.**
- **Subcontracting out production** - the entrepreneur focuses on marketing and sales
- **Franchising -** The entrepreneur may decide to franchise an existing operation
- **Acquisition –** this is where the entrepreneur buys an existing company.

THE FEASIBILITY STUDY

A feasibility study should be undertaken before preparing a business plan. Its purpose is to determine the feasibility of the business venture.

MARKET RESEARCH

Market research enables the entrepreneur to determine whether there are people willing to buy their product or service. Essentially market research should cover the following areas:

- **Determine the market:** Who are the customers? How many are there? Where are they located? What price are they prepared to pay? Is the number of customers increasing or declining?
- **Analyse the competition:** What are the strengths and weaknesses of the competition? What products do they offer? For how much? Where do they sell?
- **Assess the environment:** How will the economy affect your business? Are there any trends in society that may influence your product e.g. green issues etc?
- **Evaluate the resources required:** How much capital will be required? How much working capital will be needed?

Writing the Business Plan

The purpose of writing a business plan is to show how the business is to be setup and managed. It sets targets for each phase of the development of the business, it clearly outlines the financial requirements of the business, and in addition it details the marketing strategy to be adopted.

It is often written with potential investors in mind as well as for the benefit of the entrepreneur. In general a business plan should include the following:

- An executive summary
- A description of the products or services to be offered

- An analysis of the market
- A detailed marketing plan
- A comprehensive human resource plan
- An operations plan and financial plan, including sales forecasts, financial projections, resource requirements etc.
- A capitalisation plan stating how much money the owner is putting into the business and what other finance is required.
- Details of the experience and expertise of the owner and/or management team.

In essence the business plan should show that:

- The venture is financially viable
- There is a market for the product or service
- The entrepreneur is able to manage the business

Assembling Resource and Market Entry

When funding has been arranged it is then possible to move the venture forward. It is critical that a realistic timeframes is established for market entry plans. The timeframe for starting the business will depend on the assembly of a number of resources. Factors, which need to be addressed, include:

- Finding funding sources
- Finding suppliers and distributors
- Finding suitable premises
- Recruiting and organising staff
- Acquiring machinery and technology
- Marketing and Venture launch
- Winning customers

Two key aspects for any start-up business are cashflow and credit control. If the money does not come in, there will not be any working capital to fund the next phase of production and marketing.

SOURCES OF FINANCE

The two main sources of finance for an enterprise are debt financing which involves obtaining a bank loan and equity financing where others are given a stake in the business in return for providing capital. Also Government funding in the form of grants are available. The various sources of finance are discussed in details in chapter 11.

MARKET STRATEGY

An important consideration is the market strategy to adopt. The main options (Porters generic strategies) include:

- **A low cost strategy:** By adopting a low cost strategy a company may be able to under-cut the competition and gain market share. However the competition can also reduce price and may have the resources to sustain lower prices for a long period of time.
- **A focused or niche market strategy:** This is where a company focuses on a segment of the market that has some special needs. This may be a good strategy for a small company. A key consideration here is whether the niche is large enough to support the business.
- **A broad mass-market strategy:** This strategy is where the company tries to appeal to the broad mass of customers in the market. The down side of this approach is amount of competition in the market but if a firm is successful they will be able to achieve economies of scale and will have good growth opportunities

Business Incubation

Business incubators are programs designed to support the successful development of entrepreneurial companies through and array of business support resources and services, developed and arranged by incubator management and offered both to the incubator and through its network of contacts.

E.g. of Incubation Services

- Marketing Services
- Help with Business Basics
- Technology Assistance
- Help with Presentation Skills
- Help with Accounting/Financial Management

Business Opportunities

Characteristics of good business opportunities, e.g.

- Something you are passionate about
- Find a niche market
- Low start- up costs
- Low fixed costs
- Recurring Sales
- Clear, distinct position in the marketplace
- Maximise the unique talents of you and your team
- Create intellectual property

Challenges Entrepreneurs Face

- Internal & External Factors – The way an entrepreneur conducts his/her business. Competitors entering the market , especially if you are within a niche market
- Negative Mindset – our own fears, excuses
- Overwhelming feelings – being the captain of your own ship can be difficult when you have to look after all aspects of the business
- Feelings of wanting to give up – e.g. when you are not seeing results
- Perfectionism – wanting to make perfect every aspect of the business at once

- Forgetfulness – so many things that need to be done to the extent that some of the things that need to be accomplished are forgotten

Social Entrepreneurship

Social entrepreneurs play the role of change agents in the social sector, by:

- Adopting a mission to create and sustain social value (not just private value),
- Recognizing and relentlessly pursuing new opportunities to serve that mission,
- Engaging in a process of continuous origination, modification, and learning,
- Acting boldly without being limited by resources currently in hand, and
- Exhibiting a heightened sense of accountability to the populations served and for the outcomes created.

Entrepreneurship Education & Training

- Entrepreneurship Education and Training is about the development of personal skills and qualities so that people of all ages gain knowledge and understanding of the way in which the economy works and reacts to market forces.

  This involves approaches to the development of:-
  - Creativity
  - Problem Solving
  - Team working
  - Taking calculated risks
  - Communication Skills
  - Leadership
  - Decision Making
  - Time management

Entrepreneurship Education and Training identifies the role of the entrepreneur in society. Entrepreneurship education fosters entrepreneurship, which in turn results in positive outcomes on individuals, firms and society. The growing interest in entrepreneurship education is witnessed by the vast array of publications in books and journals.

Some jurisdictions offer tax incentives to start up enterprises, it is strongly recommended to check with your accountant, revenue authorities about such incentives.

Growing the Business

Once the business is up and running and the initial problems have been resolved, the business needs to consider the next phase of growth and how to achieve it. Options include consolidation in core market, market development, product development and diversification. These growth strategies are discussed in chapter 10.

Expanding or Exiting the Business

Once a company is successful and the value of the company has increased, there are three basic options open to the owners of the company if they want to realise a profit. The three options include:

1. **Flotation:** a flotation can help raise cheap capital via the equity market. The company can finance acquisitions by issuing shares, which would enable it to grow more quickly than if it relied on its own resources or bank borrowings.
2. **Trade Sale:** A trade sale involves the sale of all the company's equity, the managers retaining no stake. The owner-manager may only want to realise part of their investment so as to allow the refinancing of the company.
3. **Sale to Management:** This involves the owner selling the business and its assets as a going concern to the existing management team

BANKRUPTCY

Bankruptcy occurs when an enterprise cannot meet its financial obligations - when it cannot pay its debts. Bankruptcy can be either voluntary or involuntary. In voluntary bankruptcy cases, the debtor applies for bankruptcy while in the case of involuntary bankruptcy cases, the creditors start legal proceedings against the debtors.

Different Forms of Business Organisation

There are many ways in which an enterprise can get up and running. The section looks at the five main types of commercial enterprise (as suggested by Lynch and Roche 1999), which are as follows:

- Sole trader
- Partnerships
- Limited Liability Companies (Private and Public)
- Franchises

Sole-Trader

Sole traders include farmers, tradesmen shopkeepers, and individuals who trade under their own name. As these businesses grow they can become difficult to manage and they may also find it difficult to raise finance. The characteristics of this form of business include:

- **Unlimited Liability** - owner is personally responsible for all the debts of the business
- Taxation at a Personal Level – and general public does not have access to the accounts of the business

Partnerships

A partnership is defined as an association of persons, not exceeding 20 (10 in the case of banking partnership), formed in order to realise profit through a business venture. Partnerships are particularly common in profession such as Law and Accountancy,

Limited Liability Companies (Private and Public)

A company is a business organisation in which ownership is transferable through the buying and selling of shares. A limited liability company is one in which shareholders and investors are liable only for debts equalling the sum invested. This is the most common form of business enterprise for medium and large sized firms. The main advantage of limited liability companies is the capacity to attract sums of capital from various sources. Other advantages include taxation of limited companies at a specific corporation tax rate usually lower than the rate of personal income tax.

The main disadvantages are that profits are paid out as dividends, and the owners may lose control of the company.

Franchises

A franchise is an arrangement whereby a franchisee is permitted by the franchiser to sell or distribute trademarked goods or services. Example McDonalds (fast food). Franchises are often seen as the simplest way of getting into business, as the entrepreneur or franchisee can draw on the expertise, support and financial assistance of the existing business. Strict rules for every aspect of the business are written into the franchise agreement to ensure the products or services offered remain recognisably those of the franchiser. There is therefore little room for manoeuvre in terms of making the business distinctive. In addition, the cost of securing a well-known franchise can be very high, and royalty payments based on sales can be challenging.

Study Unit 11

Finance and Accounting

Contents

Finance and Accounting

This chapter provides an overview of the Finance and Accounting function. The main activities involved in finance and accounting function include:

- Financial Management.
- Financial Reporting
- Management Accounts

The aim of the chapter is to

- Provide an introduction to financial management
- Describe financial planning
- Describe the main sources of finance available to an organisation
- Explain financial analysis and reporting
- Provide an overview of management accounting
- Identify the different information systems found in finance and accounting
- Discuss the impact of e-commerce on Finance and accounting

A. INTRODUCTION TO FINANCIAL MANAGEMENT

Financial management has been defined (Kennedy, MacCormac & Teeling 1995) as "Assisting in the achievement of overall objectives of the firm through:

- Provision of finance when and where required in a manner and at a cost which represents an acceptable level of risk to a business
- The investigation and evaluation of investment opportunities open to the business."

The primary functions of the financial manager or financial management team include:

- Advising on the best investments that the firm should make to meet overall objectives.
- Sourcing the appropriate finance to fund these investments.
- Analysing, recording and reporting on the activities and financial well- being of the firm.

In summary financial management is primarily concerned with matching the sources of finance (**Investment Decisions**) to the uses of finance (**Financial Decisions**) and the final task involves compiling detailed accounts.

Investment Decisions

These decisions result from the analysis and appraisal of the various capital project opportunities open to the company. Investment decisions include:

- Long term strategic investment decisions such as Capital Expenditure - for example, the purchase of equipment
- Short term or tactical decisions such as Working Capital management - for example, the payment of staff and suppliers

Financing Decisions

These decisions relate to identifying how best to finance the proposed investments given the existing financial environment, and how best to reward the shareholders for taking the financial risk. Financial decisions can be broken down into short-term finance, long-term finance, equity financing, and dividend policy (the amount paid to shareholders).

B. FINANCIAL PLANNING

Financial planning involves the construction of financial forecasts and the appraisal of investment opportunities and is an aid to the development of a strategic plan. Financial planning enables an integrated approach across all functions.

Rational for Financial Planning

Financial planning is useful for organisations for the following reasons:

- It indicates to management the funding requirements of operations, projects and programmes.
- Financial planning ascertains when and for how long funding will be required.
- It also demonstrates what financial outcomes will result if certain paths are followed.
- It provides a method of control whereby deviations from expected performance are highlighted allowing management to take corrective action in time.
- It can be used as a readily available criterion for decision-making.
- It can be uses in analysing the risk associated with proposed projects or policies.
- It can also be used as a motivational device for the organisations employees.

There are two key types of financial planning - short **term planning** or forecasting and **long term financial planning** or forecasting.

Short Term Planning or Forecasting

A number of methods are used in identifying the short-term financial requirements of a company. These include cash flow forecasting, projected profit and loss account and balance sheets and budgets.

Cash Flow Forecasting

The cash flow forecast outlines the expected cash receipts and payments over a period of time, providing information on the projected cash position for the period under examination.

The following three elements are involved in the preparation of a cash flow forecast:

- **Preparing the cash inflow forecast:** The accuracy will depend on the reliability of the sales estimates and the expected credit terms taken by customers.
- **Preparing the cash outflow forecast:** This takes all cash payments into account, including wages, supplies, interest, etc.
- **Comparison:** The two forecasts are compared to determine whether there will be a surplus or a deficit of cash during each period. If there is a prolonged deficit, it will have to be financed through an overdraft or through some form of loan.

Projected Profit and Loss Account and Balance Sheet

A projected profit and loss account will show whether the business will record a profit or loss for the next trading period. This allows a comparison between future and current profit and losses. Action can be taken to improve the position if required. The projected Balance Sheet is based on information from the cash flow forecast. The projected Balance Sheet gives a broad picture of the firm's expected short term position, including the use and sources of finance, the debtors and creditors level, the amount of cash at hand or in the bank and the stock levels. This information is important for assessing the liquidity of the firm on a short-term basis.

Budgets

Budgets provide a detailed statement of the financial objectives for the coming year. Each department will prepare its own budgets which are combined into a master budget for the company. Once a budget is prepared it provides a forecast of activity for each area. Budgets also help facilitate management control.

Long Term Planning or Forecasting

Techniques that are used in long term financial planning are called capital budgeting.

Capital Budgeting

Capital Budgeting which is sometimes referred to as investment appraisal is the planning process used to determine whether an organisation's long term investments such as new plant machinery, or other capital projects are worth pursuing. The amount of capital available to an organisation at any given time for new projects is limited so management use capital budgeting methods to determine which projects will give the most return over a specific period of time.

Popular methods of assessing capital investment projects include net present value (NPV), internal rate of return (IRR), and payback period.

Payback Period: This method measures the time required to pay back the initial investment in the project. Those investment projects that repay the investment the quickest are often seen as the most attractive.

Net Present Value method: Net present value is the amount of money an investment is worth, taking into account its cost, earnings and the time value of money. The investment with the highest net present value amount is normally considered the most attractive

Accounting Rate of Return: The accounting rate of return on investment calculates the return from an investment by adjusting the project inflows produced by the investment for depreciation. The investment project that provides the greatest accounting rate of return is considered the most attractive.

C. Sources of Finance

C. SOURCES OF FINANCE

The key to raising finance for organisational activities is having the right type of finance available, in the right place and at the right time. Most organisations use a variety of financial sources. The main sources of finance available to a firm are:

- Short term sources of finance
- Medium term sources of finance
- Long term sources of finance

Short Term Sources of Finance

Short-term sources of finance relate to those sources that have to be repaid within one year. This type of finance is best suited to investment in current assets such as stock as these assets liquidate themselves in time to repay the funds raised. The objective of raising short-term finance is to minimise financial risk at the very lowest cost.

The most commonly utilised sources of short-term finance include the following:

- Bank Overdraft
- Trade Credit Taken
- Factoring of Debtors

Bank Overdraft

Commercial banks will generally provide short-term facility mainly in the form of an overdraft. Banks have the right to cancel overdraft facilities at short notice. If used properly a bank overdraft facility can be a flexible source of finance. The security required by the bank might include a personal guarantee or a fixed charge on some assets of the company.

Bank overdraft can be a reasonably cheap and flexible source of finance in that interest is only charged on the outstanding amount.

One of the disadvantages of bank overdrafts as a source of finance is that the interest rate charged by the bank can go increase during the period in which the monies are owed.

Trade Credit Taken

When a company buys goods from another company, they are usually given credit for a period of time – usually 1 to 2 months. An option for companies which has difficulty with bank-borrowings is to take greater credit by delaying payments to suppliers for goods or services bought.

While this may seem like an attractive source of finance there are a number of downsides. Company will miss out on discounts for prompt settlement of invoices, which could be as much as 1% per month (12% per year). This would make it expensive finance in times of low interest rates. If a company continued to delay payments, suppliers might refuse to supply goods or services to that company in the future.

Factoring of Debtors

Factoring of debtors is a source of finance where companies acquire money on the strength of their debtors' balances at a date earlier than when the debt is due to be paid. There a two main types factoring:

1. Confidential Invoice Factoring
2. Sales Ledger Factoring

Confidential Invoice Factoring

The factorer advances money to the company on the strength of the company's invoices. The company itself must still collect the debt and then pay back the factorer. The buyer of goods who owes the debt remains unaware of any third party involvement. This can be an important source of finance for companies with large amount of credit sales. The cost of factoring would generally be much higher than bank interest rates.

Sales Ledger Factoring

With this method the factorer becomes responsible for credit control and debt collection. For an additional premium, the factorer will accept the risks associated with potential debt default. This method of factoring can work out expensive.

Medium Term Sources of Finance

Medium Term sources of finance are best suited to finance investments, which are neither short-term (current assets) nor long-term (e.g. a manufacturing plant). They are investments that are intermediate in nature, having a lifespan of less than 7 years and would include machinery, computer systems and hardware and office equipment.

The main forms of medium term financing are as follows:

- Hire Purchase
- Leasing

Hire Purchase

Hire purchase is a widely used for the purchase of plant and equipment. The hire purchase company buys the asset and hires it to the intended purchaser. After a period of time making regular payments the intended purchaser acquires legal possession of the asset.

The advantage of this source of finance is that the hirer gets immediate use of the equipment without incurring a large capital cost. This can help cash flow for the company and they can claim capital allowances on cost of plant, and can claim tax relief on the interest paid to the hire purchase company.

The main disadvantage hire purchase is that it is relatively expensive form of finance.

Leasing

Leasing is normally a cheaper source of financing than hire purchase. This is because at the end of the leasing period the asset is still owned by the leasing firm.

There are a number of advantages associated with leasing which include:

- Capital is not tied up in assets and is therefore free to be used for other purposes
- The rental charges can be claimed against tax
- Leasing does not affect a company's borrowing ability as assets are not tied up as security – no security used

Long Term Sources Finance and Equity

The most commonly used sources of long-term finance are

- Ordinary Shares or Equity
- Preference Shares
- Debentures
- Long term loans **-** Mortgages

Ordinary Shares or Equity

Ordinary shareholders own a share of the company and share in profits. They also have voting rights at general meetings. Equity is a good source of long-term finance as a company is not required to pay-back the equity capital during its life-time of the company so; it is effectively a permanent source of capital.

ADVANTAGES OF EQUITY AS A SOURCE OF FINANCE:

- It provides finance for business ventures to develop – important when bank finance may not be available due to the risk associated with the venture
- No fixed repayment or interest has to be paid
- Dividends need not be paid when profits are low or if the directors decide not to pay a dividend

DISADVANTAGE OF EQUITY AS A SOURCE OF FINANCE:

- Equity is considered a more expensive source of finance than loan finance because dividends to shareholders are not tax deductible
- Issuing new shares has the potential to dilute the control of existing shareholders

Preference Shares

Preference shares have an entitlement to a fixed percentage dividend before any dividend is paid to the ordinary shareholders. As with ordinary shares a preference dividend can only be paid if sufficient distributable profits are available. Although with **cumulative** preference shares the right to an unpaid dividend is carried forward to later years. The arrears of dividend on cumulative preference shares must be paid before any dividend is paid to the ordinary shareholders. With non-cumulative preference shares any non- paid dividend is not carried forward. If business is wound up the preference shareholders will have priority to get their money back.

ADVANTAGES

- The issue of preference shares does not restrict the company's borrowing, in that preference share capital is not secured against assets in the business.
- As with ordinary shares, dividends do not have to be paid in a year in which profits are poor unlike interest on loans

DISADVANTAGES

- Dividend payments on preference shares are not tax deductible in the way that interest payments on debts are

Debentures

A debenture is a long-term debt instrument used by large companies to borrow money. The debenture itself is a document that acknowledges debt by a company. So in effect a debenture is like a certificate of loan or a loan bond acknowledging the fact that the company is liable to pay a specified amount with interest. Interest is normally paid at a fixed rate. A person having the debentures is called debenture holder

Debentures are not part of the share capital of a company so debenture holders do not have the right to vote in the company's general meetings of shareholders. In some countries such as the United States, debenture refers specifically to an unsecured corporate bond while in the United Kingdom a debenture is usually secured.

There are different types of debentures:

- **Convertible debentures** can be converted into equity shares of the issuing company after a predetermined period of time.
- **Non-convertible debentures** cannot be converted into equity shares – as a result these carry a higher interest rate

ADVANTAGES OF DEBENTURES:

- Interest paid is allowable for tax purposes
- Debenture holders have no rights to interfere in the running of the company - they have no voting rights

DISADVANTAGES OF DEBENTURES:

- Interest on debentures must be paid in all circumstances, whether there is profit or loss
- The company issuing the debenture will normally be required to pledge some assets as security (in some countries)
- Debentures may restrict the company's future borrowing position if assets are pledged as security

THE DEBENTURE TRUST DEED

This is a formal legal document/contract that outlines the terms of the debenture issue between issuer and holders. Included in this document will be details of the maturity date, interest rate, interest payment, provisions related to any security pledges and any other terms & conditions between issuer & holders.

Long-term loans – Mortgages

A company can raise long-term finance by mortgaging its property. Mortgages are normally granted for a fixed term period, while the interest rate will vary during the loan period.

ADVANTAGES

- An advantage of a mortgage is that the company has the option to repay the mortgage early if it has the finance.
- Any increase in the value of the asset during the loan period will accrue to the company.
- The low after tax cost due to the tax deductibility of the interest on long-term finance
- Long-term loan finances does not involve giving up voting or share control of the firm as would be the case with equity finance

DISADVANTAGES

- One of the main disadvantages of debt is the fixed burden on the organisations financial resources created by the interest payments and repayments schedule.
- Also the lender may impose restrictions on the management's freedom to act independently as part of the overall loan agreement.

D. FINANCIAL ANALYSIS AND REPORTING

This section looks at the role of accounting in business management. This role involves the analysis, recording and reporting on the activities and financial well-being of the organisation. Financial control over its activities is vital for any organisation.

Financial Analysis

The financial well- being of a firm can be assessed by answering the following questions:

- How liquid is the firm – can it pay its bills when they are due?
- How does the firm finance its investments and or capital expenditure?
- Are the common stockholders receiving sufficient return on their investment?

Financial Statements

Financial statements are necessary to show both the owners of a business and the lenders how the capital has been used and to assist suppliers to set credit limits. Financial statements describe in monetary terms the flow of goods and services into, around and out of an organisation. They are summaries of the firms accounting records and are concerned with three key areas of financial performance, namely liquidity, general financial health and profitability. Financial statements are prepared on the basis of past information and as such their usefulness as a short-term control mechanism is limited. However they do provide management with information about trends, and quarterly or monthly statements can enable managers to take corrective actions.

Financial statements are the primary source of data used by outsiders to assess an organisation performance.

The key forms of financial statements are as follows:

- The Balance Sheet
- The Profit and Loss Account (Income Statement)
- The Cash Flow Statement

Balance Sheet

The balance sheet describes the financial position of an organisation at a particular point in time, in terms of assets, liabilities, and the net worth of the owners. Assets are classified according to whether they are current, fixed or intangible. Liabilities are classified in terms of whether they are current or long-term. Net worth is the residual value after total liabilities have been deducted from total assets.

Income Statements

Income Statements show a company's financial performance over a period of time. All costs including taxes are deducted from gross income, which gives you the net income. This amount is then available for paying dividends to stockholders or for reinvesting in the business.

Cashflow Statements

Cashflow statements, also known as sources and uses of funds statements, show where funds came from (operations, loans, reduction in debtors, etc), and where the funds went (capital investment, dividends, reduction of creditors etc).

External Users of Financial Reports

Financial reports such as the profit and loss account and the balance sheet of a company are used by various stakeholders to establish the financial positions of the company. These include:

Investors: These will be interested in analysing the information in reports to decide whether or not to invest in the company.

The State: They use the financial information to decide how much tax the company must pay.

Suppliers: These may analyse a company's financial reports to determine the risk of giving credit to the company

Business customers: These may want to assess the risk of placing an order with the company

Competitors: These may wish to compare the financial performance of the company with themselves.

Ratio Analysis

Ratio analysis is used by managers and outsiders (such as investors and bankers) in evaluating a firm's performance. The financial health of an organisation can be examined using ratio analysis to compare performance to the firm's past achievements or the performance of competing firms in the industry or sector.

Financial ratios are calculated from information contained in financial statements and they express the relationship between items in the form of percentages or fractions.

Three of the most commonly used ratios are:

- **Return on Investment:** This is usually given as an annual percentage return on assets employed, and is therefore used to measure productivity of assets.
- **Current Ratio:** This is the ratio of current assets to current liabilities and measures the short-term solvency of the firm.
- **Debt to Equity Ratio:** This is the ratio of total debts to total assets and shows the leverage of the organisation or the relative amount of internal or external funding.

The following are five categories of financial ratios which are summarised in table 11.1-11.5:

(The ratios tables are adapted from Lynch and Roche (1999)

- **Profitability:** Profitability ratios measure the efficiency of the firm in generating profit and are measured through sales performance relative to the assets of the firm.
- **Liquidity:** Liquidity ratios measure a firm's ability to pay its short-term liabilities.
- **Leverage (**also called Gearing)**:** Leverage ratios identify the sources of an organisation's capital. Leverage is the increased rate of return on stockholders' equity when an investment earns a return larger than the interest paid for debt financing.
- **Activity:** Activity ratios measure the efficiency of a firm in using the resources it deploys.
- **Investment**: Investment ratios provide information for investors on the return on investment

RATIO	FORMULA	EXPLANATION
Gross Margin*	$\frac{\text{Sales-Cost of Goods Sold}}{\text{Sales}}$	Indicates the total margin available to cover operating expenses and yield a profit.
Operating Margin (Return on Sales)	$\frac{\text{Profit before Interest \& Tax}}{\text{Sales}}$	Indicates the firm's profitability from current operations not taking into account interest charges accruing from the capital structure.
Net Margin (Net return on sales)	$\frac{\text{Profit after taxes}}{\text{Sales}}$	Indicates after tax profits according to sales. Below benchmark margins indicate costs too high or sales price too low.
Return on Total Assets	$\frac{\text{Profit after Taxes}}{\text{Total Assets}}$ or $\frac{\text{Profit after Taxes \& Interest}}{\text{Total Assets}}$	A measure of the return on total investment
Net Worth (Return on stockholder's equity).	$\frac{\text{Profit after Taxes}}{\text{Total Stockholders' equity}}$	A measure of the rate of return on stockholders on stockholders' investments in the enterprise.
Return on Common Equity	$\frac{\text{Profit after taxes less Preferred Stock Dividends}}{\text{Total stockholders' equity less par value of preferred stock}}$	A measure of the rate of return on investment of common stock owners in the firm.
Earnings per share	$\frac{\text{Profit after taxes less Preferred Stock Dividends}}{\text{Number of common share stocks outstanding}}$	The earnings available to the owners of each share of common stock.
Return on Capital Employed*	$\frac{\text{Profit before interest and tax}}{\text{Total long-term capital}}$	Return on Capital Employed (ROCE) is a measure of Profitability that is used to indicate how efficient and effectively a company has used its assets during a given period

Table 13.1: Profitability Ratios

RATIO	FORMULA	EXPLANATION
Current Ratio*	Current Assets / Current Liabilities	The extent to which the claims of short-term creditors are covered by asset that are expected to be converted to cash in a period roughly corresponding to the maturity of liabilities
Acid Test Ratio (Quick Ratio)*	Current Assets less Inventory / Current Liabilities	A measure of the firm's ability to pay off short-term obligations without relying on the sale of its stock or inventories
Inventory to net working capital	Inventory / Current Assets less Current Liabilities	A measure of the extent to which the firm's working capital is tied up in inventory

Table 11.2: Liquidity Ratios

RATIO	FORMULA	EXPLANATION
Debt to Assets Ratio.	Total Debt / Total Assets	The extent to which borrowed funds have been used to finance the firms operations.
Debt to Equity Ratio	Total Debt / Total Assets	Measures the funds provided by creditors versus the funds provided by owners.
Long Term Debt to Equity Ratio	Long Term Debt / Total Stockholders' Equity	A measure of the balance between debt and equity in the firm's long term capital structure.
Coverage Ratio (Times-interest earned)	Profit before Interest & Tax / Total Interest Charges	A measure of the extent to which earnings can decline without the firm becoming unable to meet its annual interest costs.
Fixed Charge Coverage	Profit before Interest, Tax & Leases / Total Interest charges plus Leases	A clearer indication of the firm's ability to meet all of its fixed charge obligations.

Table 11.3: Leverage (also called Gearing) Ratios

RATIO	FORMULA	EXPLANATION
Inventory Turnover	Sales / Inventory of finished goods	An indication of whether a firm has excessive or inadequate finished goods inventory, when compared with industry or sector benchmarks.
Fixed Assets turnover	Sales / Fixed Assets	A measure of sales productivity and utilisation of plant & equipment.
Total Assets turnover	Sales / Total Assets	A measure of the utilisation of all the firm's assets and the level of sales volume generated, compared to industry and sector benchmarks
Accounts receivable turnover	Annual credit Sales / Accounts receivable	The average length of time it takes the firm to collect the sales made on credit
Average collection period	Accounts receivable / Total sales / 365 Or Accounts receivable / Average daily sales	The average length of time the firm must wait after making a sale before it receives payment.

Table 11.4: Activity Ratios

RATIO	FORMULA	EXPLANATION
Earnings per Share (EPS)	Net Profit after interest and tax and preference shares / Number of ordinary shares issued	This ratio measures the profit earned by each ordinary share.
Price/Earning Ratio (PE Ratio)	Market price per share / Earnings per share	This ratio indicates how many years it will take to get back the investment per share
Dividend Yield	Dividend per share / Market price per share	This ratio is a measure of the rate of return on investment
Dividend Cover	Profit after corporation tax and preference dividends / Annual ordinary dividend	This ratio gives an indication of whether the company will be maintain future dividends

Table 11.5: Investment Ratios

E. MANAGEMENT ACCOUNTING

Management Accounting is largely concerned with control. Control is the process of monitoring business operations to ensure that planned objectives are achieved.

Control involves the following activities:

- Establishing a plan (budget) for a specific time period
- Establishing the actual position at different points during the planning period
- Comparing actual performance with planned performance
- Taking effective action to correct adverse trends or taking advantage of any favourable trends that occur

The following are important aspects of the control process:

- Responsibility must be allocated for the control of particular aspects of the business
- Those responsible must know what is required of them
- The activities of the business need to be coordinated

The information provided by financial accounts (balance sheet and the profit and loss account) is useful to management in the control of their operations. However, it does suffer from two main defects. First, the information is not always readily available, as the final accounts are not normally drawn up until the end of the financial year. While some firms do produce these statements half-yearly and quarter-yearly, information for control purposes is needed much more frequently. Secondly the information presented in the final accounts is of limited use at the operational level of the business. Management needs information for product pricing, to ensure departments do not over spend, and to control the labour and material used in production.

Management Accounting seeks to fill this gap by providing managers with the information they need to manage effectively. Management Accounting can be divided between Control Accounting and Decision Accounting.

Control Accounting

The primary areas of control accounting relate to Standard Costing Systems and Budgetary Control.

Standard Costing Systems

According to CIMA (London), "a standard costing is a control technique which compares standard costs and revenues with actual results to obtain variances which are used to stimulate improved performance". A standard cost is the estimated cost for a single unit of a production. Standard cost provides a basis of comparison with actual cost so that variances can be calculated and the causes corrected.

The main uses of standard costs are to provide a basis for performance measurement, cost control, valuating stock and establishing selling prices.

Standard costing relates specifically to the cost of a single unit and is usually associated with production. The aim of standard costing is to improve efficient utilisation of materials, labour and overheads. Budgets are prepared for all functions; sales human resources, production and finance. Budgetary control systems set down monetary limits that should not be exceeded.

Budgetary Control

Budgetary control refers to the analysis, recording and reporting on the activities and financial well- being of the organisation. It involves management forecasting likely outcomes of plans in an attempt to control the future of the organisation. It is an important activity for the financial team, in that it ensures effective monitoring of current activities, and gives valuable information about performance in relation to plans.

Financial control of activities is vital to all organisations. Many smaller firms, for a variety of reasons such as lack of expertise, opt for informal systems of control. This can be disastrous for a small firm as the true performance or profitability cannot be gauged.

Budgetary control requires that realistic profit and loss and Cashflow forecast are prepared at the beginning of the period and that they be updated normally on a quarterly basis as the year progresses. Great care is required in interpreting variances from a budget to ensure managers are held accountable only for those matters that fall within their sphere of control.

Budgets

Budgets are one of the most widely used means of planning and controlling activities at every level of an organisation. Budgets provide a clear standard of performance within a specified time. At regular intervals during the time period addressed by the budget actual results are compared with budget figures and this allows deviations to be detected and corrected.

The widely used timeframe for budgets is one year. An annual budget set targets for the year for all parts of the business. The annual budget is normally broken down into monthly budgets which set out monthly targets.

In general budgets are drawn up by middle managers in response to guidelines set by senior management and are then submitted to higher management for approval.

BENEFITS OF BUDGETS

Atrill and McLaney (2009) suggest the following benefits of budgeting:

- Budgets tend to promote forward thinking and the possible identification of short-term problems
- Budgets can be used to help co-ordination between various sections of the business
- Budgets can motivate managers to better performance
- Budgets can provide a basis for a system of control
- Budgets can provide a system of authorisation for managers to spend up to a particular limit

THE BUDGET SETTING PROCESS

The setting of budgets generally follows a formal process with a number of distinct stages. The following are the typical steps involved (Atrill and McLaney, 2009):

1. **Communicate the budget guidelines to managers**: It is important that those preparing plans are aware of what the strategic objectives of the organisations are how the upcoming budgeting period will work towards them.
2. **Determine the key limiting factor**: The limiting factor will determine the overall level of activity in the business. For many organisations this would be the level of sales expected.
3. **Prepare the budget for the area with the limiting factor**: This would usually be the sales budget since the level of sales will determine the level of activity in other areas such as production, purchasing, staffing etc.
4. **Prepare draft budgets for the other areas of the organisation**: There are two broad approaches to setting individual budgets. The top down approach involves senior managers in each area setting budget targets for that area, maybe in discussion with lower level managers. With the bottom-up approach target are fed up from lower levels in the particular area. They are then incorporated into the budget
5. **Review and co-ordinate budgets**: A review is carried out by the budget committee of the various budgets to ensure they complement each other. Some negotiation and alterations to budgets may be required.
6. **Prepare the master budgets**: The master budgets are the budgeted income statements, the budgeted statement of financial position (balance sheet) and generally a summarised cash budget.
7. **Communicate the budgets to all parties**: The formally agreed budgets are given to individual managers who will be responsible for their implementation
8. **Monitor performance relative to the targets set in the budgets**: One of the main purposes of budgets is that it enables each manager’s actual performance to be compared to planned targets which are set out in the various budgets. Corrective actions can be undertaken to address any variances. Where a budget is proving to be totally un-realistic it may need to be revised, although revision of a budget is a rare occurrence.

INCREMENTAL AND ZERO-BASED BUDGETING

Incremental budgeting involves using last year’s budget as the basis for preparing the forthcoming budgets and making adjustment to factors that are expected to change such as an increase in sales, and increase in raw material costs etc.

Zero-based budgeting is based on the idea that all spending needs to be justified rather than doing the same as last year. It involves starting from scratch and carefully analysing what activities need to be carried out in the coming year and being able to justify the spend involved in terms of value for money. The main problem with Zero-based budgeting is that it is time consuming and expensive to undertake.

Decision Accounting

Key techniques associated with decision accounting are break-even analysis and investment appraisal.

Break-even analysis

Break-even analysis is a widely used decision making technique. It allows managers to determine the effect of changes in the variable such as, price, costs and output on overall profit. Break-even analysis takes account of the fact that some costs are fixed and some are variable. Fixed costs are independent of the volume of production, e.g. insurance on buildings. However the level of variable costs is directly related to level of output.

Break-even analysis seeks to identify the point (break-even point) at which revenue generated from a given volume of output matches total costs (fixed costs + variable) of that output. Break-even analysis can be used to calculate the output volume necessary to break even, or to make a specific level of profit.

Break-even analysis is widely used both in decision-making and control situations.

Investment appraisal

Investment decisions related to long-term proposals are very important for an organisation for a number of reasons. Firstly, the amount of long-term finance available is limited and secondly, once funds have been committed to a particular investment project it is very difficult to remove them.

The aim of investment appraisal is to ensure that available finances are allocated to provide best return on capital invested.

F. INFORMATION SYSTEMS IN FINANCE AND ACCOUNTING

This section looks at the main information systems used in the Financial and Accounting function. There are a number of systems that deal with financial transactions of the company. These systems generate the information for the financial records and statements of the company and include:

- Accounts Receivable
- Accounts Payable
- Financial Reporting Systems
- Integrated Accounting Systems
- Budgetary Control Systems

Note: Many of the systems uses in the Finance and Accounting area are Transactions Processing Systems (TPS). These systems perform and record the daily routine transactions necessary to conduct business.

Accounts Receivable

The Accounts Receivable system is concerned with the collection and recording of moneys owed to the company. The system keeps records of amounts owed by customers from data generated by customer purchases and payments.

The main transactions are:

- Invoices and Credit Notes issued to customers
- Payments received from customers.

This information is stored in the Debtors Ledger. Transactions posted to the Debtors Ledger are reflected in the Nominal Ledger, which is the basis for producing the financial statements of the company.

Accounts receivable systems stimulate prompt customer payments by preparing accurate and timely invoices and monthly statements to credit customers.

Accounts Payable

The accounts payable system keeps track of data concerning purchases from and payments to suppliers. The system is centred on the maintenance of the Creditors Ledger, which contains data on financial dealing with Suppliers.

The main transactions are:

- Invoices and Credit Notes received from Suppliers
- Payments made to Suppliers.

Computer based accounts payable system prepare cheques in payment of outstanding invoices and produce management reports. The system helps ensure prompt and accurate payment of suppliers to maintain good relationships and ensure good credit standing and secure any discounts offered for prompt payment.

Financial Reporting Systems

The financial reporting system accesses information mainly from the Nominal (General) Ledger. The other systems which supply financial information such as Accounts Payable, Accounts Receivable and Payroll, which are sources of financial transactions, supply data to the Nominal Ledger. The Nominal Ledger also supports the production of the key financial statements - balance sheet (statement of financial position) and profit and loss (income) statements.

Integrated Accounting Systems

Most accounting software packages offer an integrated approach where the system consists of a number of modules that deal with the various accounting activities. The standard modules offered in most integrated accounting systems include:

- Accounts Receivable
- Accounts Payable
- Stock Control

- Financial Reporting

Some well-known packages are SAGE, PEGASUS, QUICKBOOKS, TAKE 5, and TAS BOOKS.

The more advanced Accounting packages offer additional modules such as Sales and Purchase Order Processing, Cashbook and Bank Reconciliation, Job Costing, Bill of Materials, and Fixed Asset Register.

One of the key advantages of an Integrated Accounting System is that transaction data needs to be input only once, saving time and effort and reducing errors.

Budgetary Control Systems

These are systems that support the preparation and control of financial budgets. This includes support for budget requests, approvals, and updates. For current budgets the system enables actual income and expenses to be compared with target or budgeted figures and any variances to be highlighted. The budgetary control systems usually support monitoring on a periodic basis such as monthly quarterly or year to date.

The **capital budgeting** process involves evaluating the profitability and financial impact of proposed capital expenditures. This application makes use of models that incorporate present value analysis of expected cash flows and probability analysis of risk to determine the optimum mix of capital projects for a business.

For smaller companies a spreadsheet application such as Excel could be utilised as a simple budgetary control system.

G. IMPACT OF E-COMMERCE

Payment for the products and services purchased is an important set of e-commerce transactions.

Most business to consumer (B2C) e-commerce depends on credit card payment systems. Many B2B e-commerce systems rely on more complex payments method related to the use of purchase orders

Electronic Funds transfer (EFT) systems are a major form of electronic payments systems used in banking and retailing industries. EFT systems capture and process money and credit transfers between banks and businesses and their customers.

Security

When you make an online purchase on the Internet, your credit card information is vulnerable to interception. Some basic security measures are being used to solve this security problem: (1) encrypt (code) the data passing between the customer and the retailer, (2) encrypt the data passing between the customer and the company authorising the credit card transaction, or (3) take the sensitive information off-line.

Many companies use Secure Socket Layer (SSL) security method that automatically encrypts data passing between the computer's Web Browser and a retailer's computer.

Digital wallets make paying for purchases over the Web more efficient by eliminating the need for shoppers to enter their address and credit card information repeatedly each time they buy something. A digital wallet securely stores credit card and owner identification information and provides that information at an electronic commerce site's “checkout counter”.

Access to Financial and Economic Reports

Investments decisions require managers to evaluate economic reports and news provided by various government agencies, universities, research intuitions, financial services companies, and corporations. There are hundreds of Internet sources of these reports, mostly free but some require a subscription.

Managers may also wish to use Internet resources to research the financial performance of competitors, and potential suppliers and business customers. (Turban et al. 2003)

Study Unit 12

Human Resource Management

Contents

Human Resource Management

Managing human resources is one of the key elements in the co-ordination and management of an organisation. An organisational workforce represents one of its most valuable resources. However, human resources are also potentially the most difficult to manage, principally because of individual difference. It is said that the extent to which the workforce is managed effectively may be a critical factor in improving and sustaining organisational effectiveness and efficiency.

Human Resource Management is defined as the process of evaluating the human resources needs of the organisation, finding suitable people to fill these needs, and optimising these resources through incentives and job enrichment, in line with the objectives of the organisation.

A. THE MAIN ELEMENTS OF HUMAN RESOURCE MANAGEMENT

Human resource management is concerned with all personnel matters including planning for human resource requirements, recruitment, selection and induction, training and development, performance appraisal, compensation, scheduling, administration and Trade Union negotiations and industrial relations.

- Human Resource Planning,
- Recruitment, Selection and Induction,
- Training and development,
- Performance appraisal,
- Compensation,
- Scheduling,
- Management Training and Promotion
- Administration
- Industrial Relations.

B. HUMAN RESOURCE PLANNING

Human Resource planning is linked to management planning. It is very important when expanding a business that the HR planning is properly executed. Human Resource planning is derived from the organisational strategy, which requires that the work and job specifications entailed by the strategic objectives are translated into the number of people required, a list of the skills to be acquired or developed and a timetable to have the required people in place.

Bowey (1974) defines human resource planning as:

"An effort to anticipate future business and environmental demands upon an organisation and to provide the personnel to fulfil that business and satisfy those demands".

The main objectives of HR planning are:

- To ensure that the organisation finds and retains the quantity and quality of human resources that it requires.

- To ensure that the organisation makes the best possible use of human resources.
- To ensure that the organisation can manage the human resource implications of employee surpluses or deficits.

Human resources planning is not just about the numbers of people but also about the quality of personnel and how they can be best deployed throughout the organisation in order to ensure optimum organisation effectiveness and efficiency. It should therefore be clearly linked to an integrated with the organisations. It is a process, which affects every aspect of human resource management (recruitment, selection, performance appraisal, training and development, industrial relations etc), and one, which must be aligned with the corporate objectives/mission and strategic, plans of the organisation.

Tyson and York (1992) suggest that sound HR planning needs to be based on the following six principles:

1. The plan has to be fully integrated with the other areas of the organisation's strategy and planning.
2. Senior management must give a lead in stressing its importance throughout the organisation.
3. In larger organisations a central HR planning unit responsible to senior management needs to be established, the objective of which is to co-ordinate and reconcile the demands for human resources from different departments.
4. The time span to be covered by the plan needs to be defined.
5. The scope and details of the plan have to be determined.
6. The plan must be based on the most comprehensive and accurate information that is available.

There are four main stages in the human resource planning process as follows:

Stage 1: Demand analysis

This stage of the process is concerned with estimating the quantity and quality of human resources required to meet the objectives of the organisation. It is based upon a thorough understanding of the organisations strategy and its implication for the workforce, planned technology change, a detailed inventory of employee characteristics (age, skill level, qualifications, performance level, etc.).

Stage 2: Supply analysis

This is concerned with estimating the quantity and quality of manpower that is likely to be available to the organisation. There are two major sources to be examined, namely, the internal labour market (existing employees) and the external labour market (the potential supply of manpower that is available outside the organisation).

Stage 3: Estimating deficit/surpluses

As a result of conducting both a demand and supply analysis, it is now possible to compare the results of the first two stages to determine whether the supply of labour available matches the demand for labour. Equally it is possible that the supply of labour exceeds or falls short of the estimates required. Depending on the results achieved at this stage of the process, the action plan will be prepared.

Stage 4: Developing action plans.

This last stage is based on the information that the preceding stages have yielded. The purpose of the action plan is to ensure that the day-to-day human resource needs of the organisation are satisfied. Plans emanating from the process will cover what the organisation must do, and how it will manage recruitment, selection, training and development, promotions etc.

C. EMPLOYEE RECRUITMENT SELECTION AND INDUCTION

Employee Recruitment is the process of obtaining the right people at the right time to best meet the need of the organisation. It involves finding, hiring and holding on to people who can satisfy the technical, educational and social needs of the organisation. Recruitment relies on a number of sources including promotions, advertising, employment agencies, management consultants etc.

The process of Recruitment and Selection involves a number of stages:

Recruitment

- **Manpower planning/Needs Analysis:** As part of manpower planning, a needs analysis can be used to identify staff requirements.
- **Job Description:** The vacancy is discussed with the department manager and a job description is drawn up. The job description is a detailed description of the job, which is to be carried out by the new employee, who exactly they report to, and their place in the organisational structure.
- **Attributes/Aptitudes Required:** The necessary attributes/aptitudes required of the candidate would include skill, knowledge, experience etc.
- **Establishing Conditions:** The conditions of employment, which include the type of contract, hours of work and rate of pay, are laid down.
- **Job Advertisement Drawn up**: The job advertisement is drawn up which invites interested applicants to write in for an application form or to send in a Curriculum Vita with a cover letter.
- **Advertised Internally:** A vacancy that is filled internally will usually mean promotion for the successful employee.
- **Advertised Externally:** The Company may avail of the services of an employment agency at this stage.

Selection

The purpose of selection is to select from those applicants coming forward at the recruitment stage, the one who appears most suitable for the position. Selection involves:

- **Short-listing:** Using pre-determined selection criteria a number of the original applicants are short-listed and invited to attend an interview.
- **Interview and other selection procedures**: Interviews are held to select the best person for the vacant position. The interview may be supplemented with various selection tests.
- **Offers are made**: The successful candidate is offered the position and if it is accepted the unsuccessful candidates are notified.
- **Induction and Training:** New employees will need to be inducted into the organisation and trained.

Short-listing

A variety of factors influence the recruitment decision. Before any criteria may be set, those involved need to have a clear understanding of the nature and purpose of the position to be filled. This entails developing answers to the following questions, what has to be done in this job? How is it done? What background, knowledge, attitudes and skills are required for a job of this nature?

In short-listing or ranking applications (CV's) for a particular position, the following could be used:

1. **Professional and academic qualifications**: Ideally the candidate should have qualifications appropriate to the role.
2. **Previous Experience**: Preferable candidates have a proven track record in a comparable environment (e.g. direct experience in the areas in question in the same industry or the potential to progress quickly).
3. **Fit**. Ideally there should be an appropriate match or fit between the candidates and the job. (e.g. the candidate is not over qualified for the post or currently earning a substantially higher salary etc).
4. **Achievement:** Ideally the candidate has demonstrated achievement in work and other areas (e.g. has demonstrated evidence that he/she is a self- starter, shown initiative, is a good finisher etc.)
5. **Personality traits**: Ideally the candidate should have the appropriate personal and managerial characteristics. However this would be difficult to assess from a CV. Some organisations hold screening interviews typically over the phone before the final shortlist is decided.

Interviews

The most commonly used selection technique is the interview. Interviews can be one on one or involve a panel of experienced interviewers. The interview should ideally be a two way process - the interviewer(s) will require certain information about the candidate, and the interviewee will require information about the firm. The key to success in interviews is preparation by both the interviewer(s) and the interviewee.

The Rodger's Seven Point Plan specifies the following criteria that can be used to judge candidates during an interview:

1. Physical make up
2. Attainments
3. Intelligence
4. Special aptitudes
5. Interests
6. Disposition
7. Circumstances

Though widely used by all organisations, interviews do not always allow the interviewer to assess specific skills or proficiencies, and for that reason and also to avoid interview bias, many organisations supplement interviews with selection tests. The most popular selection tests include the following:

- **Intelligence Tests:** These are designed to measure thinking abilities.
- **Aptitude Tests:** These are tests of skills such as verbal, numerical, as mechanical ability.
- **Personality Tests:** These try to determine if the candidate's personality is suitable for the particular vacancy.
- **Proficiency Tests:** These measure the depth of knowledge or grasp of skills that have been learned in the past, for example typing skills.

Induction

After selection a period of induction will normally take place.

The new employees told about the firm in general, the numbers employed, products produced, markets, etc.

Information will be given on hours of work, rates of pay, overtime, holidays, pension provisions, safety, and discipline and grievance procedures.

Many organisations work from an induction checklist or form to ensure that important information regarding procedures, policies and rules are not omitted during the induction period.

D. EMPLOYEE TRAINING AND DEVELOPMENT

As business and technology is changing rapidly the organisation needs to develop new skills to keep a pace. It is not always possible or practical to take on new staff to address the skill shortages. Therefore these skills need to be developed internally as part of a Learning Organisation approach.

Training and development is the process of improving employee performance through learning. All training and development programmes undertaken should be linked to the organisation's long-term strategy. As well as the task related skills required to implement the strategy, the focus should be on developing employees and manager to make them more productive. Training and development can sometimes be linked with the reward structure, which further reinforces desired behaviour.

The main forms of employee training and development are as follows:

- **Employee Orientation Programmes:** Process of introducing employees to the organisation and its mission, to work colleagues, to supervisors, and to the various policies, practices and objectives of the organisation.
- **On the Job Training:** The employee learns by doing or watching others directly within the workplace. On the job training also includes coaching job rotation temporary promotions, job rotations etc. Many commentators argue that the future workplace will be a place of continuous learning not simply in the employee's initial period with the organisation.
- **Off the Job Training**: This includes internal and external training programmes to develop a variety of skills, and foster personal development, away from the immediate workplace environment. Many colleges, university and other institutions offer part time courses for those in employment
- **Apprentice Programmes:** This involves a new worker working alongside a master technician or experienced professional to learn the appropriate skills or procedures.

Evaluating the Success of a Training Program

The cost of training represents a major investment for an organisation and management will want to evaluate the effectiveness of the training. The following methods proposed by Kirkpatrick can be used to evaluate the success of a training program:

- **Training-Cantered Evaluation:** Here the focus is on evaluating if the correct training methods are being used.
- **Reaction-Centred Evaluation:** This method seeks to evaluate the reaction of the trainees to the training. This is the most widely used evaluation strategy.
- **Learning-Centred Evaluation:** This seeks to measure the level of learning that has been achieved. It involves testing trainees after the training.
- **Job-Related Evaluation:** This method focuses on evaluating the degree of behaviour change on the job after the training. It measures the learning, which has been applied in the workplace.
- **Cost-Benefit Evaluation:** This method compares the benefits that have accrued from the training with the costs incurred. For example has the training resulted in increases in sales, improved customer service, or reduction in costs?

E. EMPLOYEE APPRAISAL

Performance Appraisal can be defined as: "A procedure and process which assists in the collection, checking, sharing, and use of information collected from and about people at work for the evaluation of their performance and potential for such purposes as staff development and the improvement of that work performance" (McMahon and Gunnigle, 1994).

Performance appraisal is a formal assessment of how well employees are doing their jobs, and it is a key function of human resource management. Its purpose is to achieve and sustain high performance standards in an attempt to ensure organisational survival. Tyson and York (1992) identify six major objectives of the performance appraisal process:

- To determine how far people are meeting the requirements of their jobs and whether any changes or action are required for the future.
- To determine developmental needs in terms of work experience and training.
- To identify people who have potential to take on wider responsibilities.
- To provide a basis for assessing and allocating pay increments and similar rewards.
- To improve communication between managers and their staff.
- To develop motivation and commitment by providing regular and scheduled opportunities for feedback on performance and discussion of work, problems, suggestions for improvement, prospects, etc.

The organisation must be clear on the purpose of the appraisal system and all employees must understand this purpose. The evaluation must be fair and non-discriminatory and measure performance on important job elements and not traits that are irrelevant to job performance.

As with all control systems, the first step is the establishment of performance standards. This can be a difficult process as valid performance measures are difficult to establish. Next the employee's performance must be measured and compared with the standards expected. Then decisions can be made in regard to that performance – is training required, or are rewards to be allocated.

Research by McMahon and Gunnigle (1994) suggest that performance/objective or results-orientated appraisal methods are the most widely used. However, many organisations use key elements of different appraisal schemes in evaluating employees, with self-appraisal techniques becoming quite popular.

Appraisal Methods

Trait Rating Scale (also called Graphic Rating Scale)

In this method of performance appraisal the traits or characteristics related to the workers job are set out and the rater assesses the extent to which the worker demonstrated these traits. The traits might include job related features such as knowledge and skills and personality qualities such as initiative, intelligence, reliability etc. A scale is developed for each trait and employees are assessed and given a rating. For example if the scale was 1-5; a rating of 1 would indicate poor performance, while a rating of 5 would indicate exceptional performance. Trait rating scales do not always provide an accurate measure of performance as it can be difficult to relate traits to actual job performance. Also managers have found it difficult to judge the level of particular traits in employees.

Another approach that is used to measure performance is called behavior observation scale (BOS)

Behavior Observation Scale

This approach focuses on what the individual actually does, rather than on their capabilities and other qualities. The employee is rated on how frequently they perform specific behaviours associated with particular dimensions of the job. These would be behaviours that are critical to the success of the particular job. For example an important dimension of a salesperson's job would be customer service. So a sales person would typically be assessed on behavior that showed excellence in customer service. They would also be assessed on other dimensions of their job.

Self Appraisal

Appraisal might be more useful to the appraisee, and lead in the longer term to greater improvement if it is conducted either by the employee themselves or by a colleague of equal occupational status (Hannagan, 2005). Self-appraisal may enable a more critical analysis of one's strengths and weaknesses as the possible career consequence of admitting mistakes is removed. However there are problems with self appraisal as people will tend to overstate their successes and ignore their failings where an appraisal may form the basis for future career development.

360 Degree Appraisal (also called 360 Degree Feedback)

In this appraisal method feedback is collected from a variety of sources in addition to the manager, including peers, customers, suppliers and senior and junior staff. If a balanced view is taken, the resulting appraisal will be more informed than feedback from a single source.

The feedback process needs to be carefully managed. Special training is required for those involved in managing the process so that information collected can be used to improve the overall work and behaviour.

The disadvantage of the 360-degree appraisal is that it is expensive, time-consuming and requires high level of resources

Improving the Performance Appraisal Process

Performance appraisals or reviews should be part of a continuous overall performance management process that involves:

- Identifying performance of individuals and teams
- Measuring performance of individuals and teams
- Developing performance of individuals and teams
- Aligning performance with the strategic goals of the organisation

The Performance Management Process has a number of components, which include:

1. **Prerequisites**: Involves gaining a knowledge of the organisation's mission and strategic goals and a knowledge of the job in question
2. **Performance Planning**: This should set out the areas of a job for which the employee is responsible for producing result, the specific objectives to be achieved and performance standards to be used to evaluate how well employees have achieved each objective.
3. **Performance Execution**: The employee responsibilities include a commitment to achieving goals, and collecting and sharing performance data and communication with supervisor. Manager's responsibilities include observation of performance and providing feedback and resources.

4. **Performance Assessment**: Could involve management assessment, self-assessment and other sources including peers, customers etc. Multiple assessments are necessary to increase employee ownership of process, increase commitment to system and provide information to be discussed at the review.

5. **Performance Review**: This is discussed in the next section

6. **Performance Renewal**: The performance management cycle begins again, using insights and information from previous phases

These topics are covered in detail elsewhere in the manual. In the next section we will look briefly at performance review and improvement

Performance Review

Overview of Appraisal Meeting

During the review (appraisal) meeting three aspects of performance are addressed:

- Past: The employees behaviours and results are reviewed against objectives and standards
- Present: The level of compensation to be received as a result of the review is discussed
- Future: A set of new goals for the future are agreed and development plans are drawn up

Six Steps for Conducting Productive Performance Reviews

- Identify what the employee has done well and poorly
- Solicit feedback
- Discuss the implications of changing behaviours
- Explain how skills used in past achievements can help overcome any performance problems
- Agree on an action plan
- Set a follow-up meeting and agree on behaviours, actions, and attitudes to be evaluated

Improving Performance

The following are some guidelines that could be used to improve performance:

- Performance feedback/coaching
- Identification of individual strengths and weaknesses
- Identify causes of performance deficiencies
- Tailor development of individual career path

Source: Performance Management by Herman Aguinis (2005) Publisher: Prentice Hall

F. EMPLOYEE COMPENSATION

The basis of good Industrial relations in an organisation is the assurance that good work is rewarded with good pay and benefits. In order to hold on to good staff an organisation must ensure that they are being adequately compensated. The choice of a payment system is an important consideration for organisations. The money that a person receives for carrying out work can be a major source of motivation and therefore it is imperative that an organisation maintains an appropriate and equitable payment system. The particular package offered will be determined by a variety of factors, not least among them the organisation's ability to pay, labour market conditions, comparable rates/levels elsewhere and possibly the bargaining strength of the Trade Union.

Employee compensation can come in the form of various pay schemes including:

- **Salary systems:** These are fixed and are based on weekly, biweekly or monthly pay periods.
- **Hourly wage or day work:** This is used for blue collar and clerical workers.
- **Piecework:** With this method employees are paid according to the number of items they produce hourly or daily.
- **Commission plans:** These are based on a percentage of sales achieved by the employee.
- **Bonus plans:** These are normally applicable to executives and salespeople and are used as an incentive for them to accomplish or surpass certain objectives.
- **Profit sharing plans:** These give employees a share of the profits on top of their normal pay.
- **Fringe Benefits:** Compensation may also come in the form of Fringe Benefits, which may include such features as sick pay, holiday pay, pension plans and health plans.

Determining Rates of Pay

The HR department will have a policy on determining rates of pay. Such a policy is necessary in order to attract top calibre staff and to motivate current employees. In order to determine the rate of pay for a specific job a job evaluation will be carried out. Currie (2007) highlights the following methods of job evaluation:

- **Ranking System:** The approach involves comparing jobs with one another without a detailed analysis of the jobs. Jobs are then ranked according to size. Pay is determined based on a jobs position in the rank. A criticism of this approach is that it tends to be subjective in the absence of a standard for assessing job sizes.
- **Job Classification:** In this approach a set of grouping or pay grades are set out in advance. Then a general job description is produced for each for the jobs in each group. Each job is compared with the general job descriptions and placed in the appropriate group which determines the pay grade for that job.
- **Points Rating Method:** With this method each job is analysed on the basis of factors such as qualifications and skills required, level of responsibility, job complexity, etc. Each factor or element carries a number of points. By assessing the degree to which a particular element is present in a job, a number of points are allocated to the job. The

overall number of points allocated to a job determines the level of pay. This is probably the most commonly used method of job evaluation.

G. OTHER ASPECT OF HR

Scheduling Employment

For a variety of reasons everyone cannot work from 9 to 5. Many manufacturing firms run 24 hours in three shift schedules and financial firms and stockbrokers now deal 24 hours a day. These factors added to the problem of traffic congestion means that it is not logical for everyone to start work at the same time. The scheduling of employees involves the search for the ideal balance between the needs of individuals and those of the organisation. Apart from conventional 9 to 5 scheduling other forms of scheduling include:

- **Flexible Plans:** These allow an employee some say in the hours they work, as long as they work the required number of hours. Flexible plans normally require an employee to be at work during a core time such as between 2pm and 4pm. Some work types such as assembly line processes are unsuitable for this form of working.
- **Job Sharing Plans:** In this arrangement two part-time employees share one full-time job.
- **Compressed Workweeks:** An example of this is where an employee works four 10-hour days and has three days off.
- **Teleworking:** This form of working, which involves people working remotely, usually from home, is developing rapidly as new telecommunications technologies are developed.

Management Training and Promotion

In a constantly changing business environment the need for the retraining and development of managers becomes increasingly important. Also to hold onto good managers the firm must show that there is a rewarding career path for them at the firm.

Internal management training programmes include the following elements:

- **On the Job Coaching:** This is where a senior manager teaches a lower-level manager new skills and provides direction.
- **Understudy Positions:** This involves young managers working as assistants to established managers and even taking over when they are away.
- **Job Rotation:** This enables mangers to see the operation of different department or units of the organisation.
- **Off the job Courses and Training:** Management development programmes have become widespread, especially in universities and management development firms and large organisations may have in-house development programmes.

It is difficult to develop a company policy in relation to promotion but where such a policy is developed it should be linked to the long-term strategy of the organisation. People with potential can be actively sought within the organisation, given the opportunity to obtain varied experience and skills and developed as a pool of candidates for promotion.

The long-term success of firms depends on the ability to continuously formulate and implement good strategy. Good strategists must pay attention to their own succession and promotions and transfers to top management should be strategically controlled.

Human Resource Administration

The administration of personnel involves, work controls (time cards), pay administration, tax returns, holidays and sickness calculations etc. This work is quite time consuming for organisations and it is therefore worth considering the computerisation of as much of the work as possible.

Trade Union Negotiations and Industrial Relations

Industrial relations are a key element of the overall HR environment for any organisation. Industrial relations would typically address such issues as pay and conditions. Strategies aimed at coping with the business environment can be rendered ineffective by internal strife. Successful strategy implementation should therefore take account of employee relations by creating a climate of enhanced cooperation.

H. TRENDS IN HUMAN RESOURCE MANAGEMENT

The following is a summary of the main trends that will impact human resource management:

- Skill requirements will increase in response to technological change
- Future workforces will be significantly more educated and more diverse
- Advances in technology will change the way training is delivered
- Organisational emphasis on human performance management will accelerate
- Low skilled jobs are increasingly moving to countries with lower costs
- Individuals will be required to assume more personal responsibility for their own educational, development and training throughout their working life
- The workforce increasingly needs to be flexible to respond to change Part-time contracts and temporary work is increasing
- Employees are changing jobs more frequently
- Closer alignment of pay with achieving organisational objectives
- Employees will be expected to take on more job responsibility

I. INFORMATION SYSTEMS IN HUMAN RESOURCE FUNCTIONS

Payroll System

Payroll systems capture employee data such a timesheets (hours worked) and records wages paid to employees. Computer based payroll systems help businesses make prompt and accurate payments to their employees as well as reports to management, employees and government agencies concerning earnings, taxes, and other deductions. They may also provide management with reports analysing labour costs and productivity.

Employee Records System

Information Systems are used to maintain employee records, which include basic employee data such as name, address, educational qualifications, salary, job title, date of hiring, positions held and dates. These systems may also be used to record details of performance appraisals. These systems can provide a range of management reports.

Training Related Systems

Employee training and retraining is an important task of the HR function. Information systems are used to deliver training and record training records. Two examples of the use of computer systems to deliver training are:

- Computer-based training (CBT)
- Web Based Training (WBT)

Computer-based training (CBT) services are where a student learns by executing special training programs on a computer. CBT is especially suitable for training people to use computer applications because the CBT program can be integrated with the applications so that students can practice using the application as they learn.

Some of the advantages of computer-based training include:

- It is possible to integrate multiple forms of media like text, audio, video, and animation. This provides variety and gives learners a way to use the visual, auditory, and kinaesthetic learning
- Many CBT systems and programs allow the learner to access the content in any order instead of following one set, linear path like audio and videotape
- They can provides access to huge pools of information
- The learner can access the training material from their desk
- Training can be paced to the learner's speed and ability
- Learners can start class anytime of the day or night
- It is a cost effective way to delivery training to staff without major disruption to normal business as staff do not have to leave their desk

A disadvantage of CBT for some students is the lack of face-to-face interaction with instructors and other learners.

Web Based Training (WBT) is similar to Computer Based Training (CBT) except that it delivers the content over the Internet or an organisation's intranet via a computer with access to the Web. Usually, learners will need to be signed up for the training to receive a password and gain access to the website.

Like Computer Based Training, WBT can use a wide variety of media, including text, graphics, sound, video, and animation. If you have the right equipment and access to the training, you can use it at any time, in any place in the world. Companies with employees in different locations can save on travel costs by offering training over the Web. Learners have the advantage of attending "class" without leaving the desk, office, or home. Because Web Based Training is easy to update, the content can be kept more current. Ongoing improvements to computer technology will allow Web Based Training to get even better, faster, and more interactive with improved graphics and sound. (Source: Steinbach, R, 2000)

J. IMPACT OF E-COMMERCE

Recruitment

Companies are using the Internet in a number of different ways to recruit employees. These include the following:

Posting job Vacancies on the Company Web Site

Organisations will often advertise Job vacancies on their own Web site. This is a very cost effective way of advertising vacancies and is used by many larger companies. A disadvantage of this approach particularly for smaller companies is that it may not attract sufficient numbers of appropriately qualified or experiences candidates.

Jobsites Operated by Recruitment Companies

Organisations can use Jobsites to assist in the recruitment of employees by either posting vacancies on these websites or searching through resource databases of CVs posted by Jobseekers

Many Recruitment sites are operated by “virtual” recruitment companies. These do not have a high street presence, as would be the case with a traditional recruitment firm.

Some Jobsites are operated by traditional Recruitments companies, which can offer additional services to the jobseeker and the employer. These services might include career planning and pre-screening of employees before sending them to the employer for interview.

Communicating with Job Applicants via E-mail

E-Mail provides a quick and efficient way of communication with job applicants. It can help speed up the recruitment process by allowing documents such as CVs and Application forms to be sent in electronic format and reduces the need to handle paper documents.

Limitations with E-Recruitment

While online recruitment sites have grown in size and visits, there are many competing ways to find a job and only about 25% of those who post a job resume even get an interview. Most jobs are local jobs, and personal networks remain the most common way people find jobs along with local newspaper classifieds and just calling employers. One can conclude from this that online job sites have their limitations

Other issues include worries about confidentiality where jobseekers are sending personal details over the Internet, and employers may be inundated with CVs from unsuitable candidates.

SECTION 4: BUSINESS INTEGRATION AND INFORMATION SYSTEMS

Study Unit 13

Business Integration

Contents

Business Integration

Integration is a process of combining various parts or elements into a more harmonious, effective, and productive unit, and by this process, somehow make the whole greater than the sum of its parts. An integrated team, whether in sport or business, usually performs its tasks, whether winning games or launching a new product, more efficiently and effectively than one that is weighed down by conflict and disunity (Salacuse, J. 2004).

This chapter looks at the issue of integration in a business context. Integration between business functions is discussed, as are the benefits of integrations and mechanisms for achieving integration. The topic of external integration is briefly outlined. The final section of the chapter describes how information systems can be used to facilitate integration

A. INTER-RELATIONSHIP BETWEEN BUSINESS FUNCTIONS

Integration describes "the quality of the state of collaboration that exists among departments that are required to achieve unity of effort by demands of the environment". It is the degree of co-ordination and co-operation between different departments with independent tasks.

Problems associated with Functional Structures

When an organisation is structured around functions, each function tends to view itself as an autonomous unit and to ignore or even compete with other units for resources and influence. They also tend not to understand the goals and concerns of the other units, and they blame each other when problems occur. Examples of the problems associated with poor integration are where marketing does not understand why production cannot deliver enough products and sales promises new innovative features that R&D cannot deliver.

Benefits of Integration

The benefits of integration include:

- Reduced costs through more efficient and effective operations
- Improved productivity
- Reduced time to market with new products
- Improved quality of products and services
- Improved customer service
- Reduced cost of inventory
- Greater flexibility
- Improved access to information for operational staff and management

Mechanisms for achieving better Integration

How to achieve greater levels of integration is a major strategic issue facing most organisations today; whether internal integration of business processes and functions or external integration with suppliers and business customers.

The mechanisms used to achieve integration depend on the amount of integration required and the difficulty in achieving it. The following are some methods that can be used:

- **Encouraging direct contact between functions**: Regular meetings between managers of the different functions can encourage a sharing of ideas and information and can lead to collaboration between functions.
- **Policies, rules and procedures**: Firms also integrate their business functions by formalising the ways in which functional activities are performed across functions and business units. This integrating approach relies on standardised work procedures, rules, policies, and manuals.
- **Move People between functions**: The moving of people from one functional area or one business to another can help broaden their skills. Such movement does not guarantee integration, but it does mean that many people in one functional area or business will have a good understanding of other areas, which improves their potential for cooperative effort when needed.
- **Teamwork**: Integration may be attempted through teamwork and mutual co-operation
- **Product teams**: One now widely used and successful method of integrating functions is the use of product teams. All relevant functions are represented on the team, and they coordinate their activities from the outset so that the functions mesh. For example, engineering and manufacturing will cooperate in the design of the product to ensure low cost and high product quality. Both will cooperate with marketing to ensure customer acceptance and satisfaction. This approach is particularly suited to manufacturing organisations.
- **Project teams**: As the requirements for the amount of integration increases additional methods may be adopted such as formal lateral (horizontal or cross functional) relations, committees and project teams. Project teams can be used successfully in both manufacturing and service organisations.
- **Integrators**: The use of "integrators" may be useful in organisations where there is a high level of differentiation between departments. Because they are not dominated by any particular perspective, these integrators can help resolve problems of co-ordination and work programming between different departments.
- **Organisational structure**: Structuring is perhaps the most obvious method of integration. A matrix organisational structure can be used to achieve integration between functions. The matrix structure is described in chapter 3.3.
- **Integrating Business Processes**: Operating in a global environment requires an organisation to focus on the efficient execution of its processes, customer service, and speed to market. To accomplish these goals, the organisation must exchange valuable information across different functions, levels, and business units. By integrating its processes, the organisation can more efficiently exchange information among its functional areas, business units, suppliers, and customers.
- **Information systems**: The use of information systems provides another method for integrating business functions. The key information systems that can be used to integrate business are discussed in section 13.3 of this chapter.

It is important to achieve the right balance of integration. Too high a level of integration may involve costs that are likely to exceed possible benefits. Too low a level of integration is likely to result in departments "doing their own thing", poorer quality decisions and a failure to make the best use of resources.

Sources: Mullins, L, 2004 and Locke, E, 2002

B. OTHER TYPES OF INTEGRATION

Integration of Business Units within a Corporation

Corporations are large organisations that are composed of many different business units often located in different countries. Corporations strive to integrate these business units to gain synergies such as sharing logistics, purchasing or sales functions.

A recurring issue with corporations involves the number of business units a company will have. The problem with too many units is that they cannot be understood as a whole and thus cannot be coordinated. For example, when Jack Welch took over General Electrical in 1981, it consisted of 350 separate businesses and a much greater number of product lines. After selling off the weak product lines, he combined the remaining units into 15 business units. This made the task of integrating the business units more manageable.

Integration of New Acquisitions or Merged Businesses

When an organisation acquires or mergers with another organisation they will often struggle to integrate the two businesses and the success of the acquired or merged business will often depend on how well it can be integrated with the existing business.

Collaboration with Other Businesses

The trend in many industries is for companies to work closely with small numbers of preferred suppliers and customers. The relationship between these businesses has become one of partnership and collaboration.

The main pressures on companies are reduced delivery times, prices, costs, stocks, and product lifecycles and increased customisation and flexibility. To respond to these pressures companies have integrated their supply chains leading to greater information and cost sharing, coordination, joint forecasting and planning. Also by sharing information organisations and their suppliers can react more quickly to changes in demand.

C. INFORMATION SYSTEMS FACILITATING INTEGRATION

For many organisations, the key to improved productivity and decision-making is the expanded use of information systems. Such systems can help to improve the integration of business functions and processes.

Systems Integration

The use of functional systems can impact negatively on the effectiveness of today's organisations. Functional systems may prevent different departments communicating efficiently with each other. For example, account numbers in information systems developed along department lines may not be logically related and so cannot be used for crossreferencing a customer's accounts. It can also be difficult to integrate the information needed for decision-making. In some cases crucial sales, inventory, and production data often have to be painstakingly entered manually into separate systems every time they need to be processed together. In many cases employees simply do not get the information they need, or they get it too late. For optimal use of information, integration should cross not only department boundaries, but also organisational ones, reaching suppliers and customers. The following are some of the benefits of system integration:

- **Tangible Benefits:** Inventory reduction, personnel reduction, productivity improvements, order management improvements, IT cost reduction, cash management improvements, revenue/profit improvements, reduction in transport and logistics cost, maintenance reduction and on-time delivery improvements.
- **Intangible Benefits:** Information visibility, new and improved processes, improved customer responsiveness, standardisation and flexibility. (Source: Turban, Rainer & Potter: 2003)

Two approaches to integration systems are:

- Integrate functional systems
- Cross functional systems

Integrated Functional Systems

Functional systems such as Sales Order Processing, Payroll, Accounts Payable and Inventory systems were traditionally stand-alone systems with no interface between them. If information needed to be transferred between systems it had to be printed on one system and typed into the other system.

One approach to integrating these functional systems is to build interfaces between them allowing data to transfer electronically from one system to the others. This is a complex process as the systems are generally developed by different companies and have different data structures.

A second approach is where software vendors develop integrated software packages. Examples of these integrated packages are **Integrated Accounting Packages** and **Computer Integrated Manufacturing (CIM) Systems.**

While these types of systems are more efficient than stand alone systems, they are limited by the fact that they tend to focus on one particular functional area.

Cross Functional Systems

Many organisations are using information technology to develop integrated cross-functional enterprise systems that cross the boundaries of the traditional business functions. These systems can be used to share information and improve the efficiency and effectiveness of business processes and to develop strategic relationship with customers, suppliers and business partners. The main cross-functional enterprise systems are:

- Customer Relationship Management (CRM) Systems
- Supply Chain Management (SCM) Systems

- Enterprise Resource Planning (ERP) Systems

Customer Relationship Management (CRM) systems

Customer relationship management involves the use of information systems to coordinate all of the business processes surrounding the firm's interaction with its customers in sales, marketing, and service.

CRM systems are designed to provide information and tools to deliver superior customer experience and to maximise customer lifetime value to the business. CRM systems integrate customer data from all over the organisation to provide a single enterprise view of the customer that can be used for improving both sales and customer service. CRM systems can also provide customers with a single view of the company.

See Chapter 10 for more details on Customer Relationship Management and CRM Systems.

Supply Chain Management (SCM)

A supply chain refers to the flow of material, information, payments, and services from suppliers through factories & warehouses to end customers A supply chain also includes the organisation and its processes. The function of Supply Chain Management is to plan, organise, coordinate & control supply chain tasks. SCM uses Information technology to support & manage the links between a company's key business processes & those of suppliers, customers, & business partners

SCM systems are cross-functional computer systems that attempt to integrate the processes involved in Procurement, Logistics and Manufacturing in order to ensure that customers are supplied with goods and services in a timely and efficient manner. SCM systems seek to overcome traditional problems caused by demarcation lines and lack of communication between business functions that need to collaborate to ensure satisfactory fulfilment of customer orders.

SCM seeks to simplify and accelerate operations that deal with how customer orders are processed through the system and filled. The goal of SCM is to create a fast, efficient, and low-cost network of business relationships, or supply chains.

The benefits of SCM include:

- Faster, more accurate order processing
- Reductions in inventory levels and quicker time to market
- Lower transaction and materials costs
- Companies that are more flexible & responsive to customer demands

Note: Both CRM and SCM systems can be difficult to implement because of the complexity of the systems and the need for buy-in by the different departments and functions.

Enterprise Resource Planning (ERP) Systems (ERPS)

Enterprise Resource Planning (ERP) is a process of managing all resources and their use in the entire enterprise in a co-ordinated manner. The main objective of ERP is to integrate all departments and functions across a company onto a single information system that can serve all of the enterprise's needs. For example improved order entry allows immediate access to inventory, product data, customer credit history, and prior order information. This availability of information raises productivity, quality, and profitability, and increases customer satisfaction. The implementation of ERP is done by commercial software available from companies such as SAP and Oracle.

Main Features of ERP Systems (ERPS)

The Main features of a typical ERP system are:

- They attempt to provide a total solution to an organisation's information systems needs
- An ERP System consist of a core module and a number of integrated modules which cover the common business functions such as Marketing, Sales, Production, Accounting, HR etc. (figure 13.1)
- They adopt an integrated approach within functions and between functions.
- The modules can be configured to suit individual needs of particular organisations
- They are very expensive to purchase and implement, and therefore tended to be used by only the larger organisations that could afford them.

Some companies are now offering less expensive ERP systems that are tailored to the needs of smaller organisations.

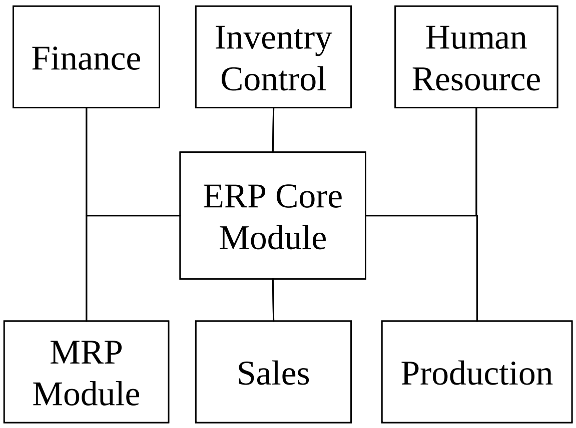


Figure 13.1: ERP Modules

Group Interworking

Groupware is an information system that enables groups to work together electronically. Groupware provides capabilities for supporting organisation-wide communication and collaborative work. Individuals, teams, and workgroups at different locations in the organisation can use groupware for the following activities:

- Writing and commenting on group projects

- Sharing ideas and documents
- Conducting electronic meetings
- Tracking the status of tasks and projects
- Scheduling meetings and activities
- Sending e-mails.

Any group member can review the ideas of other group members at any time and add to them, or individuals can post a document for others to comment or edit. Many Groupware systems have been enhanced to integrate with the Internet or private intranets (Loudon and Loudon, 2004).

Lotus Notes and Microsoft Exchange are examples of Groupware Systems

Study Unit 14

Information Systems

Contents

Information Systems

A. INTRODUCTION

In the previous 4 chapters we have looked at how information systems are supporting various business functions such as sales and marketing, finance and accounting and human resources. We also looked at how information systems are helping businesses achieve greater integration. We explored the growing impact of e-commerce on the different functions.

In this chapter the following topics are discussed:

- Acquiring information systems
- System development
- Security and control

B. ACQUIRING INFORMATION SYSTEMS

Organisations acquire information systems mainly to enable them to improve the efficiency of the operations, to provide management information to improve decision making organisation. This section examines the two main sources of information systems, which are:

1. Purchase ready-made application software packages.
2. Development of custom built systems (also referred to as bespoke systems).

Ready-Made Software Packages

The type of application required by a company depends on the nature of the business involved. Some application packages are specific to a particular business sector, while other packages are more general and are used by many different types of business. These two categories of application are called Horizontal and Vertical Applications.

- **Horizontal Applications:** These are applications such as Sales Order Processing, Inventory and Payroll systems that are applicable across a range of industrial sectors.
- **Vertical Applications:** These are applications that are specific to a particular business sector such as, Hospital Administration, Banking and Insurance applications.

If the business sector is large then it is likely that there will be a large choice of suitable packages available. However when a particular business sector is limited in size to a relatively small number of companies then the number of ready-made packages available may be small or in some case there may be no suitable package available.

Ready-made or Application packages are generally only feasible where the application required is of a standard variety, the kind of system that is likely to be required by a large number of companies

Advantages of Using Application Packages

Application packages purchased offer a number of advantages over custom-built systems. These advantages include the following:

- Packages are available for use straight away, while custom-built systems can take months to develop.
- Packages are normally in use for some time and will generally be free of errors unlike custom built systems...
- Packages are normally supplied with good documentation.
- Packages are normally upgraded at regular intervals and these upgrades can be purchased by the users...
- Packages are generally cheaper than developing custom built systems.
- The package supplier will normally provide training and support

Disadvantages of Using Application Packages

Application package will not generally be the optimal solution to an organisation's requirement. The following are the main disadvantages:

- Software packages may not meet all the company's- needs.
- The software may be difficult if not impossible to modify and may require extensive business process change during implementation
- Purchased software may be difficult to integrate with existing systems
- The software vendor who created the package may cease supporting the application or go out of business
- Support and software licences may work out expensive for the organisation

Custom Built (Bespoke) Systems

For some companies, standard of –the shelf application packages do not provide a solution to their business needs. The companies will need to acquire custom-built systems that have been designed and built to meet their specific needs. Companies, who require custom built systems which are also referred to a bespoke or tailor made systems, normally have two options:

- Develop the system in-house
- Outsource development

In-House Development

This involves system development within the company itself. The work is normally done by Systems Analysts and Programmers employed within the company's IT department.

Outsourced Development

This approach involves contracting out the development work to a specialist software development company. The software development company will build the system to agreed client specification. This approach can be expensive as any changed (even small) outside the agreed specification can involve substantial additional charges.

Advantages of Custom Built (Bespoke) Systems

The following are the main advantages of custom-built packages:

- They provide the optimal solution to an organisation's requirement.
- The custom-built system can be designed to interface with existing systems
- Can provide tailored support for desired business processes.
- Minor changes to the system can be implemented at minimal cost (where internally developed).

Disadvantages of Custom Built (Bespoke) Systems

The following are the main advantages associated with custom-built packages:

- It can take a long time to produce a working system.
- Highly skilled systems analyst and programmers are required to develop custom-built systems.
- Custom-built systems are expensive to develop
- Extensive testing of systems are required
- Custom-built packages often experience teething problems when first implemented
- The subsequent maintenance of custom-built systems can be hindered by lack of documentation of the original design. This can be a serious problem where the original programmer has left the company

Evaluating Alternative Software Packages

Rainer, Turban et al 2007 set out the following six step process for selecting a software vendor and an application package.

Vendor and Software Selection Process

STEP 1: IDENTIFY POTENTIAL VENDORS

A company can identify software application vendors through a number of sources including, technical and trade journals, consultants with experience in the particular area, other companies in the industry and Web searches.

Step 2: Determine the Evaluation Criteria

The company will require a detailed set of evaluation criteria which include the following areas:

- Characteristics of the vendor
- Functional requirements of the system
- Quality of the documentation to be provides
- Vendor support of the package

The criteria should be set out in a **request for proposa**l (RFP) document which is sent to potential vendors. They specify that the vendor should supply a list of current users of the system and require a demonstration of the system.

STEP 3: EVALUATE VENDORS AND PACKAGES

The responses to the RFP will be evaluated using the criteria established earlier. Some criteria will have a higher weighting than others. A short list will be prepared of those vendors who achieved the highest overall score.

STEP 4: CHOOSE THE VENDOR AND PACKAGE

Once the short list is ready the company will begin negotiation with these vendors. The following is a list of software selection criteria that could be used to select the application package:

- **Fit for Requirements**: Does the software meet the essential requirements?
- **Cost and financial terms**: How much is the purchase cost? Are there additional licences costs and how much?
- **Technical Compatibility:** Is the application compatible with the existing operating environment?
- **Level of Usage:** How many other companies are using the package and for how long?
- **Upgrade and costs**
- **Vendors reputation**
- **Application flexibility and scalability**
- **Availability of documentation**
- **Level and cost of training provided**
- **System security**: How secure is the application? What access controls are included?
- **System interface and ease of use**:

STEP 5: NEGOTIATE THE CONTRACT

The contract price of the software and the amount of support provided. If the system needs to be modified to company's requirement then detailed specifications must be included in the contract. Details of the acceptance testing to be carried out would also be included.

STEP 6: ESTABLISH A SERVICE LEVEL AGREEMENT

These specify how work is divided between the company and the vendor. SLAs would typically include details such as performance, availability, backup and recovery, upgrades, the level of support to be provided (9-5 or 24-7) and response times to faults on the system.

C. THE SYSTEM DEVELOPMENT LIFE CYCLE (SDLC)

The system development life cycle (SDLC) is a structured framework that consists of a set of sequential processes that are used to develop information systems. The following are the stages that would be found in a typical SDLC:

- System Investigation (including feasibility study)
- Systems analysis and design
- Programming
- Testing
- Implementation (including conversion or changeover)
- Operation and Maintenance.

The following sections provide an overview of these stages.

System Investigation

The system investigation stage examines the feasibility of the proposed system solution.

Feasibility Criteria

The feasibility may be considered under the following three headings:

- Technical Feasibility
- Operational Feasibility
- Financial Feasibility

TECHNICAL FEASIBILITY

This focuses on the reliabilities/capabilities of the hardware and software to meet the needs of the proposed system, and whether they can be acquired or developed in the required time. The technical feasibility will involve an outline quantification of the data volumes, frequencies, cycle of activities etc and a provisional assessment of the hardware and software needed to service this workload.

OPERATIONAL FEASIBILITY

The operational feasibility focuses on the organisational implications of the proposed computerised system(s). It involves as examination of the potential impact of the system on organisational structure, group relationships and jobs. The costs associated with possible redundancies, redeployment and retraining need to be assessed. The general acceptability of alternative computer systems from a management and employee perspective is considered.

FINANCIAL FEASIBILITY

This focuses on whether expected cost savings, increased revenue, increased profits, and reductions in required investment, and other types of benefits will exceed the costs of developing and operating a proposed system. A **cost-benefit analysis** may be used to assess the financial feasibility of the proposed system(s). The findings of the feasibility study are presented to management in the form of a **feasibility report**.

Systems Analysis and Design

The systems analysis stage involves examining the problem that the organisation is trying to solve with an information system. This stage involves defining the problem in more detail, identifying its causes, specifying solutions, and identifying the information requirements that must be satisfied by a system solution.

The purpose of the systems design phase is to show how the system will fulfil the information requirements specified in the system analysis phase. The system designer draws up specifications that will deliver the functionality identified during the systems analysis phase.

Both the analysis and design activities are the job of the systems analysts.

SYSTEMS ANALYSTS

The main tasks of the Systems Analyst are:

- Analysing the business processes to identify the requirements for a computerised system.
- Engagement with business users to establish their information system requirements
- Designing the information (computer based) system.
- Drawing up detailed specifications of the programs that need to be written which are supplied to the programmers.
- Organising the implementation of the new and improved systems and their subsequent maintenance

Programming

Programming translates the design specification into software (program code) that provides instructions for the computer. The program code is written by the programmers.

PROGRAMMERS

The main duties of the programmers include:

- Analysing the program specification supplied by the Systems Analyst
- Designing the structure of each program
- Writing the program(s) in a specific program language (e.g. C, Visual Basic, Java etc.)
- Testing the programs to ensure they work correctly and in accordance with the program specification

Testing

Testing is carried out to ensure the system produces the desired result and to detect any errors in the code. The following three categories of testing are normally carried out on a custom built system:

- Program or Unit Testing – this is done by the programmers
- System Testing **–** this is normally done by the Systems Analysts
- User Acceptance Testing - this is done by the system users

Program or Unit Testing

Each individual program is tested by the programmer to identify and correct errors in the program code.

System Testing

This is carried out on completed system to establish that the system meets its specified requirements.

User Acceptance Testing

Acceptance testing is normally carried out by the end users of the system to ensure that the system meets their requirements. This is the final stage of testing before the system goes live and it involves putting data through the system to see that it performs correctly. The data used will be similar to real business data. Any defect found will be reported to the developers and when corrected will be retested.

Implementation

The implementation phase is used whether the system is built or purchased as a package. The level of problems experienced during the implementation phase is likely to vary depending on whether the system is a custom built or purchased package.

The implementation phase involves a number of tasks that must be planned, organised and controlled. The main tasks required are:

1. Software Installation
2. User Training
3. System Conversion or Changeover

Software Installation

The software installation will normally be done by the organisation's IT personnel or in the case of packaged software; it may be done by the external software supplier

User Training

As systems become more complex the need for training becomes more important. If the benefits expected from the installation of a computerised based system are to be achieved it is essential that the users know how to use the system and understand why the system is being introduced.

The typical components of the user-training program involve:

- **Selection**
  The manager of the particular department or area affected by the introduction of the new system will select the people that need to be trained.
- **Identify Training Requirements**
  The training requirements will be identified based on the changes that result from the new system introduction

- **Planning Training Sessions**
  The aim of the training sessions is to give users the specific skills to use the new system effectively. Training sessions should be primarily practical activity involving users performing tasks on the systems. This is because people learn better by doing than by listening and watching.
- **Delivering the Training**
  If the system is developed in-house by the IT Department then they are most likely to deliver the training. The training could also be delivered by one of the users who are first trained themselves. If an external supplier provides the new system, the supplier will usually provide the training for a fee.
- **Computer Based Training (CBT)**
  The use of computer-based training is a lower cost option than instructor led training. It also allows users to learn at their own pace.

System Conversion or Changeover

A critical part of the implementation stage is the system conversion or changeover. System conversion or changeover is the process involved in changing from the old system to the new system. There are four main approaches to conversion: parallel running, direct cutover, pilot conversion and phased conversion.

PARALLEL RUNNING

Parallel running involves operating the old and new systems simultaneously for a period of time, until it is established that the new system working correctly. Both systems process the same data and the outputs are compared. The main advantage of this approach is that if a problem is discovered in the new systems users can revert to the old system until the problem is solved. The main disadvantages with this approach relate to difficulty and cost in both time and money of having to update two systems and danger of data input error. In many situations this is not a viable approach

DIRECT CHANGEOVER

This method involves a complete replacement of the old system with the new system at a particular point in time. The direct changeover method is probably the most straightforward and least expensive method. It is also the most risky approach because there is no fallback if the new system doesn’t work as planned.

PILOT CONVERSION

A pilot conversion involves implementing the system in one part of the organisation such as in one functional area. The system is assessed during the pilot and if working successfully it is implemented in other parts of the organisation.

PHASED CONVERSION

Phased conversion involves introducing parts of the systems in stage which could be one module at a time. Each module is assessed and if working correctly then more modules are introduced.

Operation and Maintenance

Once the new system is implemented it will **operate** for a period of time until it is upgraded or replaced. During this period the system will be assessed to establish if it is operating correctly and if it needs to be changed.

The term system **maintenance** is generally used to describe all changes made to a computer system after initial implementation.

There are three main types of maintenance:

1. **Corrective Maintenance:** This is to fix **e**rrors or omissions may have been discovered in the system after it has gone into production
2. **Adaptive Maintenance:** The business environment is dynamic and subject to constant change and these changes need to be incorporated into the systems if they are to remain useful
3. **Enhancement Maintenance:** Experience of using the system will often show that improvements and enhancements to the system are needed.

Over its lifetime a system will normally go through many maintenance phases.

D. SECURITY AND CONTROL

This section describes the major risks to computer security and the main control measures that can be taken to protect against those threats. Disaster recovery planning is also briefly discussed

Risks and Threats to Information Systems

The data stored in organisation's files and databases is a critical asset to the business, and must be protected from a range of risks and threats.

Causes of Vulnerability

A number of factors related to the nature of an organisation’s computerised environment make it especially vulnerable to risks and threats. Laudon and Laudon highlight the following contributing factors:

- Data are stored in electronic format and are therefore are not visible or easily auditable.
- Data are concentrated in electronic files and databases. A disaster such as a hardware or software fault, power failure or fire could destroy organisation’s entire records
- There may not be a visible trail to indicate what occurred for every computer process so errors entered in data can be very difficult to detect.
- Computer programs are also vulnerable as errors can be accidentally introduced when updates to the programs are installed.
- Many information systems can be accessed through telecommunications, and telecommunications can produce errors in data transmission.

- Data in files or databases can be accessed and manipulated directly in online systems. The data can be stolen, corrupted or damaged by hackers and computer viruses.
- Hardware equipment such as mobile computing devices can be stolen

Types of Risk and Threats

The main threats to an organisation's information systems include the following:

- Malicious software
- Hackers
- Threats from employee
- Software errors

Malicious Software

Malicious software, also referred to as **malware,** is any program or file that is harmful to a computer user. Malware includes computer viruses, computer worms, Trojan horses, spyware and keyloggers.

Virus: A computers virus is a small program or programming code that replicates itself by being copied or initiating its copying from one file to another.

Worms: A computer worm is a self-replicating virus that resides in active memory and duplicates itself but does not alter files.

Trojan horse: A Trojan horse is a program in which malicious or harmful code is contained inside what appears to be harmless programming or data in such a way that it can get control and execute some form of damage to the computer system. A Trojan can also give a hacker remote access to a targeted computer system.

Like a virus and worms, a Trojans can also harm a computer system's data or performance.

Spyware: These are programmes that are resident in computers and gather information about a computer user without their knowledge.

Keyloggers: These record keystrokes made on a computer by the person using the keyboard to discover login names and passwords, bank account numbers etc...

Hackers

A hacker is an individual who intends to gain unauthorised access to a computer system. Hackers gain access to the systems by finding weaknesses in the security protections employed by Web sites or information systems. Hackers can steal information, deface, disrupt or damage a Website or information system.

DENIAL OF SERVICE (DOS) ATTACK

This is where hackers flood a network or Web server with thousands of false requests for service in order to crash the network of server

Spoofing and Sniffing

Spoofing involves hiding of a hacker's identity or email addresses, or redirecting a Web link to a different web site setup up by the hacker. The aim of spoofing is to trick users to provide information such as login names and passwords and account information to the outsider.

A **sniffer** is an eavesdropping program that monitors network information and can enable hackers to steal information transmitting over the network.

Threats from Employee

Some of the largest threats to businesses come from employees. These can include disruptions to service, errors in data entry, accidental deletion if data and diversion of customer credit data and personal information.

Many employees forget their passwords to access computer systems or allow other members of staff to use them, which can compromise the system. Employees can introduce errors by entering faulty data or by not following instructions for processing data and using computer equipment.

Software Errors

Software errors pose a constant threat to information systems as they can cause the system to crash, or slow down operation and can lead to large losses in productivity and in some cases cause losses of data. Software can contain hidden bugs in the program code which in addition to impacting performance can open system to hackers.

To protect against these various threats an organisation will typically implement a range of control measures implement. These are discussed in the next section.

Controls

The purpose of controls is to prevent accident damage, deter deliberate act and intrusion, detect problems and enhance recovery. There are two broad categories of controls:

- General Controls
- Application Controls

The controls associated with these categories are summarised in table 14.1

General Control
Physical controls
Access controls
Data Security controls
Administrative Control
Firewalls
Antivirus controls
Intruder detection
Authentication and authorisation
Application Controls
Input controls
Processing controls
Output controls

Figure 14.1: Types of control (Adapted from Rainer, Turban. Et al 2007)

General Controls

General controls protect the overall system environment within an organisation regardless of application. The major categories of general controls include: physical controls, access controls, data security controls, administrative control, firewalls, antivirus controls, intruder detection and authentication and authorisation

PHYSICAL CONTROLS

Physical controls are used to prevent unauthorised physical access to a company's computer facilities. A typical physical control would the use of swipe cards to gain access to locked computer rooms.

ACCESS CONTROLS

These are used to prevent unauthorised users from accessing an information system. A username and password would be an example of an access control.

DATA SECURITY CONTROLS

Data security controls prevent unauthorised changes, deletion or access to data while the data is in use or in storage. Data security software can be configured to restrict access to individual files, data fields or groups of records

ADMINISTRATIVE CONTROL

These are formalised standards, rules, procedures and control disciplines to ensure the organisations general and application controls are properly executed and enforced.

FIREWALLS

A firewall consists of hardware and software and its purpose is to prevent unauthorised traffic from entering a private or company network from an external network such as the internet. The firewall normally sits between the company's internal network and an external network and monitors outgoing and incoming messages. It blocks any message that doesn't conform to specific security criteria that have been programmed into the firewall.

ANTIVIRUS CONTROLS

Viruses are software programmes that infect a computer system, causing loss or damage to software and data. Viruses can enter a computer network in a number of ways:

- On portable memory devices
- From the Internet
- In email attachments

Antivirus programs protect against viruses by either preventing their installation or detecting and removing viruses already installed on a computer system

INTRUDER DETECTION

Intrusion detection systems detect unauthorised intruders trying to access a network. The detection system can be configured to close part of the network if an intrusion is detected.

AUTHENTICATION AND AUTHORISATION

To gain access a user must be authorised and authenticated. **Authentication refers** to the ability to know that a person is who they claim to be. Authentication is often established by using passwords to log on to a computer system and also by using passwords to access particular systems and files that they have been authorised to access.

APPLICATION CONTROLS

Application controls are designed to protect a specific application. Application controls include input, processing and output controls.

INPUT CONTROLS

Input controls are procedures to check data for accuracy and completeness when they enter the system.

PROCESSING CONTROLS

Processing controls are the routines for establishing that data are complete and accurate during updating. Common controls include control totals, computer matching and run control totals.

OUTPUT CONTROLS

Output controls are measures to ensure that the outputs after processing are accurate, complete and distributed to the correct recipients.

Disaster Recovery Planning

Disaster recovery planning involves specifying plans for the restoration of computing and communications services after they have been disrupted by a natural event such as an earthquake, flood, or some human activity. Disaster recovery plans focuses on getting the systems up and running. It means having data backups available and the maintenance of backup computer systems and having backup telecommunications links in place.

With the increasing importance of information technology for the continuation of business critical functions, it is importance to protect an organisations data and IT infrastructure in the event of a disruption.

E. TRENDS IN INFORMATION SYSTEMS

This section looks at some recent development in information systems and the internet.

Mobile Computing

Increasingly we are using wireless devices such as smartphones, wireless handheld devices, and laptops with wireless network connections to communicate and to obtain information and data.

Mobile phones are no longer just for voice communications; they are now an important platform for delivering digital data, such as downloading video and music, internet access and e-mail. There are increasingly being used by remote staff such as field sales and service staff to access applications and email. Businesses are using wireless networks and applications to increases productivity and worker output by providing communication and access to information from almost anywhere.

Mobile technology provides more flexible arrangements for organising work as field staff can access details of jobs on their mobile device without having to return to the office for instructions.

Cloud Computing

Cloud computing is a model of computing that provides access to a pool of shared computing resources over a network (usually the internet). These resources include computers, storage, applications and services. These resources are made available to the users based on their needs and independent of the location of the users themselves.

According to Laudon and Laudon (2012) there are basically three types of cloud computing services:

- Software as a Service (SaaS): Customers can use software applications hosted on a service provider's infrastructure. A wide range of applications can be delivered through a SaaS model, such as customer relationship management, and email. Users are charged a subscription fee on the level of services offered and the numbers of user logins required. An example of a company offering SaaS is Salesforce.com which leases CRM software over the internet.

- Cloud infrastructure as a service: Customers use computer processing, storage, networking and resources from the cloud service provider. For example Amazon sell infrastructure services including storage service for storing customer's data. Users only pay for the storage capacity used.
- Cloud platform services: Customers use software tools and infrastructure hosted by the service provider to develop their own applications that are then hosted on the servers belonging to the service provider.

The benefits of cloud computing to the business are:

- Large investment in IT infrastructure is not required
- Services are available on-demand
- Charges are based on amount of resources used
- Ability to scale up or down resources as required

Semantic Web

The Semantic Web is an initiative led by the World Wide Web Consortium (W3C) that promotes common formats for data on the World Wide Web. The Semantic Web aims to move for the current situation where the Web is composed of basically unstructured documents into a "web of data". According to the W3C the Semantic Web is about two things:

- It is about common formats for integration and combination of data drawn from diverse sources, where on the original Web mainly concentrated on the interchange of documents.
- It is also about language for recording how the data relates to real world objects.

The Semantic Web was initially conceived by Tim Berners-Lee, the inventor of the World Wide Web who defines the Semantic Web as "a web of data that can be processed directly and indirectly by machines."

Virtual Identities

A virtual identity is created when someone logs on to a digital platform or system such as virtual communities, social media and gaming sites. Platforms such as Second Life offer a virtual community where people act through their virtual identity.

Businesses need to understand the impactions of a large section of population (40% who contribute content online do so using user names and pseudonyms) including customers and worker that are using virtual identities to interact with each other, and with businesses.

Study Unit 15
Ethics
Contents

A. INTRODUCTION –INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC)

The IFAC Board has established the International Ethics Standards Board for Accountants (IESBA) to develop and issue, under its own authority, high quality ethical standards and other pronouncements for professional accountants for use around the world.

The *Code of Ethics for Professional Accountants* (IESBA Code) establishes ethical requirements for professional accountants. A member body of IFAC or firm shall not apply less stringent standards than those stated in this Code.

A professional accountant in acting in the public interest shall observe and comply with this Code**. The code contains 3 parts**:-

Part A – establishes the **fundamental principles** of professional ethics for professional accountants.

Parts B & C – provide a conceptual framework that professional accountants shall apply to:

- Identify **Threats**
- Evaluate **Threats**
- Apply **Safeguards**

Part B – applies to professional accountants in *public practice*
Part C – applies to professional accountants in *business*

ICPAR code of ethics is based on the principles of the IFAC code of ethics as are other professional accountancy bodies around the globe.

B. FUNDAMENTAL PRINCIPLES

A professional accountant shall comply with the following fundamental principles:-

- **Integrity –** To be straightforward and honest in all professional and business relationships.
- **Objectivity –** To not allow bias, conflict of interest or undue influence of others to override professional or business judgments.
- **Professional Competence and Due Care –** to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.
- **Confidentiality –** To respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.
- **Professional Behaviour –** To comply with relevant laws and regulations and avoid any action that discredits the profession.

Synopsis of Fundamental Principles

Integrity
Integrity implies fair dealing and truthfulness.
A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:-

- Contains a materially false or misleading statement
- Contains statements or information furnished recklessly
- Omits or obscures information required to be included where such omission or obscurity would be misleading

When a professional accountant becomes aware that the accountant has been associated with such information, the accountant shall take steps to be disassociated from that information.

Objectivity
A professional accountant may be exposed to situations that may impair objectivity.
A professional accountant shall not perform a professional service if a circumstance or relationship biases or unduly influences the accountant's professional judgment with respect of that service.

Professional Competence & Due Care
Competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of such service. There are 2 phases of professional competence:-

1. *Attainment* of professional competence
2. *Maintenance* of professional competence

The maintenance of professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments.

The professional accountant should act in accordance with the requirements of an assignment, *carefully, thoroughly and on a timely basis*. The professional accountant shall take steps to ensure that those working under the professional accountant's authority in a professional capacity have *appropriate training and supervision*.

Where appropriate the professional accountant shall make clients, employers, or other users of the accountant's professional services *aware of the limitations inherent in the services.*

Confidentiality
The professional accountant shall maintain confidentiality, including in a social environment.
A professional accountant shall take reasonable steps to ensure that staff under the professional accountant's control and persons from whom advice and assistance is obtained respect the professional accountant's duty of confidentiality.
The need to comply with the principle of confidentiality continues even after the end of relationships between a professional accountant and a client or employer.

Circumstances where disclosure of confidential information is appropriate:-

- Disclosure permitted by law and is authorized by the client or employer
- Evidence in legal proceedings

- Public authorities of infringements of the law
- Quality review of a member body or professional body
- Respond to an inquiry or investigation by a member body or regulatory body
- To protect the professional interests of a professional accountant in legal proceedings
- To comply with technical standards and ethical requirements

Factors to consider in deciding whether to disclose confidential information:-

- Whether the interests of all parties, including third parties whose interests may be affected, could be harmed if the client or employer consents to the disclosure of information by the professional accountant.
- When a situation involves unsubstantiated facts, incomplete information or unsubstantiated conclusions, professional judgment shall be used in determining the type of disclosure to be made.
- The type of communication that is expected and to whom it is addressed
- Whether the parties to whom the communication is addressed are appropriate recipients.

Professional Behaviour
In marketing and promoting themselves and their work, professional accountants shall not bring the profession to disrepute. Professional accountants shall be honest and truthful and not:-

1. Make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained
2. Make disparaging references or unsubstantiated comparisons to the work of others

C. PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

A professional accountant in public practice shall not knowingly engage in any business, occupation, or activity that impairs or might impair *integrity, objectivity or the good reputation of the profession.*

Threats & Safeguards
When a relationship or circumstance creates a threat, such a threat could compromise, or could be perceived to compromise, a professional accountant's compliance with the fundamental principles. A circumstance or relationship may create more than one threat, and a threat may affect compliance with more than one fundamental principle. Threats fall into the following categories:-

- **Self – Interest Threat –** The threat that a financial or other interest will inappropriately influence the professional accountant's judgment or behaviour.
    - *E.g.: the improper use of corporate assets or where an accountancy firm has an undue dependence on one particular client's fees or enters into a joint venture.*

- **Self – Review Threat –** The threat that a professional accountant will not appropriately evaluate the results of a previous judgment made or service performed by the professional accountant, or by another individual within the professional accountant's firm or employing organization, on which the accountant will rely when forming a judgment as part of providing a current service.
    - o *E.g.: providing a service for a client that relies on previous results that the individual, firm or another professional carried out – if this situation arises such results should be double checked before proceeding.*

- **Advocacy Threat –** The threat that a professional accountant will promote a client's or employer's position to the point that the professional accountant's objectivity is compromised.
    - o *E.g.: When a professional accountant promotes an organisations position with misleading and factually incorrect statements, or where you inappropriately promote shares of a client that you are auditing.*

- **Familiarity Threat –** The threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work.
    - o *E.g. becoming too sympathetic to the client's needs and losing <u>objectivity.</u>*

- **Intimidation Threat –** The threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the professional accountant.
    - o *E.g... Where an individual or firm is placed under pressure to act in a certain way or feels threatened by a client, employer or third party if they do not produce the results they expect.*

- **Safeguards**
  Safeguards are actions or other measures that may eliminate threats or reduce them to an acceptable level. They fall into two broad categories:-
    - *Safeguards created by the profession, legislation or regulation*
    - *Safeguards in the work environment*

  E.g. Safeguards created by the profession, legislation or regulation include:
    - Educational, training and experience requirements for entry into the profession
    - Continuing professional development requirements
    - Corporate Governance regulations
    - Professional Standards
    - Professional or regulatory monitoring and disciplinary procedures
    - External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.

  E.g. Safeguards in the work environment
    - Leadership of the firm that stresses the importance of compliance with the fundamental principles
    - Policies and procedures to implement and monitor quality control of engagements

- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client.
- Designating a member of senior management to be responsible for overseeing the adequate functioning of the firm's quality control system.
- Having a professional accountant who was not involved with the non-assurance service review the non-assurance work performed or otherwise advise as necessary.
- Having a professional accountant who was not a member of the assurance team review the assurance work performed or otherwise advise as necessary.
- Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- Discussing ethical issues with those charged with governance of the client.
- Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged
- Rotating senior assurance team personnel.

Professional Appointment

A professional accountant in public practice before accepting a specific client engagement shall determine whether acceptance would create any threats to compliance with the *fundamental principles*.
E.g. Professional Competence & Due Care – the engagement team does not possess the competencies necessary to properly carry out the engagement.

The professional accountant shall evaluate the significance of threats and apply safeguards, to eliminate them or reduce them to an acceptable level.

Possible safeguards:-

- Acquiring an appropriate understanding of the nature of the client's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed
- Acquiring knowledge of relevant industries or subject matters
- Possessing or obtaining experience with relevant regulatory or reporting requirements
- Assigning sufficient staff with the necessary competencies
- Using experts where necessary – consider: reputation, expertise, professional and ethical standards
- Agreeing a realistic timeframe for the performance of the engagement
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

The professional accountant should decline the engagement is threats cannot be eliminated or reduced to an acceptable level through the application of safeguards.

Conflicts of Interest

A professional accountant before accepting or continuing a client relationship or specific engagement, the professional accountant in public practice shall evaluate the significance of any threats created by business interests or relationships with the client or third party.

Possible Safeguards:
- The use of separate engagement teams
- Procedures to prevent access to information – e.g. secure data filing
- Clear guidelines to members of the engagement team on issues of security and confidentiality
- Confidentiality agreements by employees and partners of the firm
- Regular review of the application of safeguards by a senior individual not involved with relevant client engagements

In circumstances where a threat cannot be eliminated or reduced to an acceptable level through the application of safeguards, the professional accountant in public practice should not accept the engagement or resign.

Fees and Other Types of Remuneration

A professional accountant in public practice may quote whatever fee is deemed appropriate. There may be threats to compliance with the fundamental principles arising from the level of fees quoted.

Possible Safeguards:
- Making client aware of the terms of the engagement, basis on which fees are charged and which services are covered by the quoted fee. *(e.g. Engagement letter)*
- Assigning appropriate time and qualified staff to the task
- Quality control policies and procedures
- Review by an independent third party of the work performed by the professional accountant in public practice.

Marketing Professional Services

A professional accountant in public practice, who solicits new work through advertising or other forms of marketing, may be creating a threat to compliance with the *fundamental principles.*

Recommendation:
If the professional accountant in public practice is in doubt about whether a proposed form of advertising or marketing is appropriate, the professional accountant in public practice should consider consulting with the relevant professional body.

Gifts and Hospitality

An offer of a gift or hospitality from a client to a professional accountant may create threats to compliance with the *fundamental principles*.
The significance of the threat will depend on the nature, value, and intent of the offer. If the gift or hospitality is considered trivial and inconsequential, the professional accountant may conclude that the offer was made in the normal course of business without the specific intent to influence decision making or to obtain information.

If threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in public practice should not accept such an offer.

Custody of Client Assets

A professional accountant in public should not assume custody of client monies or other assets unless permitted to do so by law, and, if so, in compliance with any additional legal duties imposed on a professional accountant in public practice holding such assets.
The holding of client assets creates threats to compliance with the *fundamental principles*.
The professional accountant in public practice entrusted with money (other assets) should:-

- Keep such assets separately from personal or firm assets
- Use such assets only for the purpose for which they are intended
- At all times be ready to account for those assets
- Comply with relevant laws and regulations

The professional accountant should make appropriate enquiries about the source of such assets, e.g. the assets could be derived from illegal activities, such as money laundering. In this situation the professional accountant should seek legal advice.

Objectivity – All Services

A professional accountant in public practice should determine when providing any professional service whether there are threats to compliance with the *fundamental principle of objectivity* results from having interests in, or relationships with, a client or its directors, officers or employees.

The threat to objectivity will depend on the nature of the work that the professional accountant in public practice is performing.

Possible Safeguards:

- Withdrawing from the engagement team
- Supervisory measures
- Ceasing the financial or business relationship
- Discussing the issue with higher levels of management within the firm
- Discussing the issue with those charged with governance of the client

If safeguards cannot eliminate or reduce the threat to an acceptable level, the professional accountant should decline or terminate the engagement.

Independence – Audit & Review Engagements

Independence is required in audit engagements where a professional accountant in public practice expresses a conclusion on financial statements. Audit engagements are in the public interest, and therefore members of audit teams, firms and network firms shall be independent of audit clients.

Networks & Network Firms
If a firm is deemed to be a network firm, the firm shall be independent of the audit clients of the other firms within the network.

Public Interest Entities:

- all listed entities
- Any entity defined by regulation as a public interest entity

Related Entities
When the audit team knows or has reason to believe that a relationship or circumstance involving another related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team must include that related entity when identifying and evaluating threats to independence and applying appropriate safeguards.

Those Charged with Governance
Regular communication is expected between the firm and those charged with governance of the audit client regarding relationships and other matters that might in the firm's opinion, have a bearing on independence.

Documentation
The professional accountant should document conclusions regarding compliance with independence requirements:-

- Document nature of threat, and appropriate safeguard

Independence from the audit client is required both during the engagement period and the period covered by the financial statements.

Engagement Period
Engagement starts – when audit team begins to perform the audit
Engagement ends – when audit report is issued

Mergers & Acquisitions
As a result of a merger or acquisition, an entity becomes a related entity of an audit client, the firm shall identify and evaluate previous and current interests and relationships with the related entity, taking into account available safeguards, could affect its independence and therefore its ability to continue the audit engagement after the effective date of the merger or acquisition.

Other Considerations
In situations where an inadvertent violation occurs, it generally will be deemed not to compromise independence provided the firm has appropriate quality control policies and procedures in place.

Independence Applications

Financial Interests
Holding a financial interest in an audit client may create a self-interest threat. The significance depends upon;

- The role of the person holding the financial interest
- Whether the financial interest is direct or indirect
- Materiality of the financial interest

Loans and Guarantees
If an audit client approaches a member of the audit team, member of the audit teams immediate family, or the firm offering a loan or guarantee that is not under normal lending procedures, terms and conditions, a self- interest threat would be created that would be so significant that no safeguards could reduce the threat to an acceptable level.
The member of the audit team, member of the audit teams immediate family or firm should not accept such a loan or guarantee.

Business Relationships
Close business relationships between a firm and the audit client as a result of a commercial relationship or common financial interest, may create self-interest or intimidation threats.
E.g... Financial interest in a joint venture
Unless the financial interest is immaterial and the business relationship is insignificant, the business relationship should not be entered into, be reduced to an insignificant level or terminated.

Family & Personal Relationships
Family and personal relationships between a member of the audit team and the audit client may create self-interest, familiarity or intimidation threats. The existence and significance of threats will depend on:-

- Individuals responsibilities on the audit team
- Role of the family member or other individual within the client and the closeness of the relationship

Possible Safeguards:

- Remove the individual form the audit team
- Re-structuring the responsibilities of the audit team

Employment with an Audit Client
Familiarity or intimidation threats may be created if a director or officer of the audit client, or an employee in a position to exert significant influence over the preparation of the client’s accounting records or the financial statements on which the firm will express an opinion, has been a member of the audit team or partner of the firm.

Possible Safeguards

- Modifying audit plan

- Having professional accountant review the work of the former member of the audit team

Temporary Staff Assignments
The lending of staff by a firm to an audit client may create a self-review threat. The firm's personnel should only give assistance for a short period of time should not be involved in non- assurance services or assume management responsibilities.
The audit client should be responsible for directing and supervising the activities of the loaned staff.

Possible Safeguards

- Double checking work performed by the loaned staff
- Not giving the loaned staff audit responsibility
- Not including the loaned staff as a member of the audit team

Recent Service with an Audit Client
Self-interest, self-review or familiarity threats may be created if a member of the audit team has recently served as a director, officer, or employee of the audit client.
E.g... A member of the audit team has to evaluate elements of the financial statements for which the member of the audit team had prepared the accounting records while with the client.

Possible Safeguard

- Double checking/reviewing the work performed by the individual as a member of the audit team.

Serving as a Director or Officer of an Audit Client
If a partner or employee of the firm serves as a director or officer of an audit client, the self-review and self-interest threats created would be so significant that no safeguards could reduce the threats to an acceptable level, therefore, no partner or employee should serve as a director or officer of an audit client.

Long Association of Senior Personnel with an Audit Client
Familiarity and self-interest threats are created by using the same senior personnel on an audit engagement over a long period of time.

Possible Safeguards

- Rotating senior personnel
- Professional accountant who is not a member of the audit team review the work of the senior personnel
- Regular independent internal and external quality reviews of the engagement

Fees
When the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the dependence on that client and concern about losing the client creates a self-interest or intimidation threat.

Possible Safeguards

- Reducing the dependency on the client

- External quality control reviews
- Consulting a third party, such as a professional regulatory body or a professional accountant.

Overdue Fees
A self-interest threat may be created if fees due from an audit client remain unpaid for a long time, especially if a large part is not paid before the issue of the audit report for the following year. If fees remain unpaid after the report has been issued, the existence and significance of any threat should be evaluated and safeguards applied.

Possible Safeguards
- Have an additional professional accountant who did not take part in the audit engagement provide advice or review the work performed.

Contingent Fees
Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm.

It is strongly advised that firms do not enter contingent fee arrangements.

Compensation and Evaluation Policies
A self-interest threat is created when a member of the audit team is evaluated on or compensated for selling non-assurance services to an audit client.

Possible Safeguards
- Removal of the member from the audit team
- Have a professional accountant review the work of the member of the audit team

Actual or Threatened Litigation
When litigation takes place between a firm or a member of the audit team and the audit client, self-interest and intimidation threats are created. The significance of the threats will depend on factors such as:-
- Materiality of litigation
- Whether litigation relates to a prior audit engagement

Possible Safeguards
- If litigation involves a member of the audit team, remove that individual from the team
- Having a professional accountant review the work performed

Provision of Non-assurance Services to Audit Clients
Self-review, self-interest and advocacy threats create threats to the independence of the firm by providing non-assurance services.

Management Responsibilities
Management of an entity performs many activities in managing the entity in the best interests of stakeholders. Management responsibilities involves leading, directing an entity, making

significant decisions regarding the acquisition, deployment and control of human, financial, physical and intangible resources.

E.g.

- Strategic decisions
- Being responsible for the actions of the entity's employees
- Authorizing transactions
- Taking responsibility for the preparation and fair presentation of the financial statements in accordance with applicable financial reporting framework
- Taking responsibility for designing, implementing and maintaining internal control

Preparing Accounting Records and Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.

E.g.

- Originating or changing journal entries, determining account classifications of transactions
- Preparing originating data

The client may request technical assistance from the firm on matters such as resolving accounting reconciliation problems, or analysing or accumulating information for regulatory reporting. *Such services do not, generally, create threats to independence provided the firm does <u>not assume a management responsibility for the client.</u>*

Valuation Services

A valuation comprises the making of assumptions with regard to future developments, the application of appropriate methodologies and techniques and the combination of both to compute a certain value, range of values, for an asset, a liability or for a business as a whole.

A firm performing valuation services for an audit client may create a self-review threat.

Possible Safeguards

- Have a professional who is not involved in providing the valuation review the audit or valuation of work performed
- Ensure personnel providing such services do not participate in the audit engagement

Taxation Services

When a firm performs certain tax services a self-review and advocacy threat is created.

E.g. of taxation Services

- Tax return preparation
- Tax calculations for the purpose of preparing the accounting entries
- Tax planning
- Tax advisory
- Tax disputes

Possible Safeguards

- Using professional who are not members of the audit team to perform the service
- Senior partner/senior staff member to review tax calculations
- Obtain advice from an external tax professional
- Advice from tax authorities

Internal Audit Services
The provision of internal audit services to an audit client creates a self-review threat to independence if the firm uses the internal audit work in the course of a subsequent external audit. If a firm's personnel assume a management responsibility when providing internal audit services to an audit client, the threat created would be so significant that no safeguards could reduce the threat to an acceptable level therefore a firm's personnel should not assume a management responsibility when providing internal audit services to an audit client.

IT Systems Services
Providing systems services may create a self-review threat depending on the nature of the services and the IT systems.

It is important that the firm's personnel do not assume a management responsibility otherwise there may to a threat to independence.

Litigation Support Services
Self-review or advocacy threats may be created in litigation support services such as:-

- Acting as an expert witness
- Calculating estimated damages
- Document management and retrieval.

Legal Services
Legal services that support an audit client in executing a transaction (for example, contract support, legal advice, legal due diligence and restructuring) may create self-review threats. The existence of any threat will depend on factors such as:-

- The nature of the service
- Whether the services is provided by a member of the audit team
- The materiality of any matter in relation to the client's financial statements

Acting as an advocacy role for the audit client in resolving a dispute of litigation when the amounts involved are not material to the financial statement on which the firm will express an opinion, the firm should evaluate the significance of any advocacy threats and apply safeguards.

Possible Safeguards

- Using professional who are not members of the audit team to perform the service
- Having a professional who was not involved in providing the legal services provide advice to the audit team on the service and review any financial statement treatment.

Acting in an advocacy role resolving a dispute or litigation when the amounts involved are material, the firm shall not perform this type of service for an audit client.

Recruiting Services
Providing recruiting services to an audit client may create self-interest, familiarity or intimidation threats. In all cases, the firm should not assume management responsibilities,

including acting as a negotiator on the client's behalf, and the hiring decision should be left to the client.

Corporate Finance Services
Providing corporate finance services such as:-

- Assisting an audit client in developing corporate strategies
- Assisting finance raising transactions may create advocacy and self-review threats.

Possible Safeguards

- Using professionals who are not members of the audit team to provide the services
- Have a professional who was not involved in providing the corporate finance service advise the audit team on the service and review the accounting treatment and any financial statement treatment.

Independence – Other Assurance Engagements

This section addresses independence requirements for assurance engagements that are not audit or review engagements.

Compliance with the fundamental principle of objectivity requires being independent of assurance clients.

Assurance Engagements
The professional accountant in public practice in an assurance engagement expresses a conclusion designed to enhance the degree of confidence of the intended users about the outcome of the evaluation or measurement of a subject matter.

"Subject Matter Information" is used to mean the outcome of the evaluation or measurement of a subject matter.

Assurance engagements may be **direct reporting <u>or</u> assertion based**. It involves three separate parties:-

1. Professional Accountant in Public Practice
2. Responsible Party
3. Intended users

Direct Reporting
Within direct reporting assurance engagements the professional accountant in public practice directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report. The firm should be independent of the assurance client (the party responsible for the subject matter). An evaluation should be made of any threats the firm has reason to believe are created by network firm interests and relationships.

Assertion-based Assurance Engagements
Assertion based assurance engagement is the evaluation or measurement of the subject matter performed by the *responsible party* and is made available to intended users.

The members of the assurance team and the firm should be independent of the assurance client (the party responsible for the subject matter information). Such independence requirements prohibit certain relationships between members of the assurance team and

- Directors or officers
- Individuals at the client in a position to exert significant influence over the subject matter information

Reports that Include a Restriction on Use and Distribution
The firm should communicate with the intended users regarding the independence requirements that are to be applied with respect to the provision of the assurance engagement, ***(for example – Engagement Letter).***

Multiple Responsible Parties
In some assurance engagements, whether assertion-based or direct reporting, there may be several responsible parties. The firm should consider factors with regard to independence such as:-

- Materiality of the subject matter for which the responsible party is responsible
- Degree of Public Interest associated with the engagement

Documentation
The professional accountant should document conclusions regarding compliance with independence requirements. The professional should document:-

- Nature of threat
- Safeguard applied
- Rationale for conclusions

Engagement Period
The engagement period starts when the assurance team begins to perform assurance services. The engagement period ends when the assurance report is issued.
Other Considerations
There may be situations where an unintended violation occurs it generally will not compromise independence provided the firm has appropriate quality control policies and procedures.

Independence Applications

There may be circumstances that may create threats to independence. Such threats can be eliminated or reduced to an acceptable level by implementing appropriate safeguards.

Financial Interest
Assurance client may create a self-interest threat. The significance depends on:-

- The role of the person holding the financial interest
- Whether financial interest is direct or indirect

- Materiality of the financial interest

Possible Safeguards

- Removing the individual from the assurance team
- Have a professional accountant review the work of the member of the assurance team
- Excluding the member of the assurance team from any important decisions concerning the assurance engagement

Loans & Guarantees

A self-interest threat is created if a loan or guarantee is not made under the normal lending procedures, terms and conditions. No safeguards could be applied in this situation, therefore neither the member of the assurance team, a member of that individual's immediate family, or a firm should accept such a loan or guarantee.

Business Relationships

Close business relationships may create self-interest or intimidation threats. *E.g. having a financial interest in a joint venture with either the client or a controlling owner, director or officer or other individual who performs senior managerial activities for that client.*

Unless the financial interest is immaterial, the business relationship should not be entered into, should be reduced to an acceptable level or terminated.

Possible Safeguards

- Eliminating or reducing the magnitude of the transaction
- Removing the individual from the assurance team

Family & Personal Relationships

Self-interest, familiarity or intimidation threats may be created as a result of family and personal relationships between a member of the assurance team and a director or officer or certain employees.

Possible Safeguards

- Removing the individual or professional from the assurance team
- Structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the immediate family member
- Structuring the partner's or employee's responsibilities to reduce any potential influence over the assurance engagement
- Have a professional accountant review all relevant assurance work performed

Employment with Assurance Clients

Familiarity or intimidation threats may be created if a director or officer of the assurance client, or an employee who is in a position to exert significant influence over the subject matter information of the assurance engagement, has been a member of the assurance team or partner of the firm.

Possible Safeguards

- Making arrangements such that the individual is not entitled to any benefits or payments from the firm, unless made in accordance with fixed pre-determined arrangements
- Making arrangements such that any amount owed to the individual is not material to the firm
- Modifying the plan for the assurance engagement
- Assigning individuals to the assurance team who have sufficient experience in relation to the individual who has joined the client
- Have a professional accountant review the work of the former member of the assurance team
- Removing the individual from the engagement team

Self-review threats are created when a member of the assurance team participates in the assurance engagement while knowing that the member of the assurance team will, or may, join the client sometime in the future.

Possible Safeguards

- Removing the individual from the assurance team
- A review of significant judgments made by the individual while on the team

Recent Service with an Assurance Client

Self-interest, self-review or familiarity threats may be created if a member of the assurance team has recently served as a director, officer or employee of the assurance client.

Possible Safeguard

- Review the work performed by the individual as part of the assurance team

Serving as a Director or Officer of an Assurance Client

If a partner or employee of the firm serves as director or officer of an assurance client, the self-review and self-interest threats would be so significant that no safeguards could reduce the threats to an acceptable level. Accordingly, no partner or employee should serve as a director or officer of an assurance client.

Long Association of Senior Personnel with Assurance Clients

Familiarity and self-interest threats are created by using the same senior personnel on an assurance engagement over a long period of time.

Possible Safeguards

- Rotation of senior personnel
- Professional accountant who is not a member of the assurance team review the work of the senior personnel
- Regular independent internal and external quality reviews

Provision of Non-assurance Services to Assurance Clients
Self-review, self-interest and advocacy threats are created when firms provide their assurance clients with a range of non-assurance services that are consistent with their skills and expertise.

If threats cannot be reduced to an acceptable level by the application of safeguards the non-assurance service should not be provided.

Management Responsibilities
Management duties involve managing the entity in the best interests of stakeholders of the entity. Management responsibilities involve leading, directing, decision making, deployment and control of human, financial, physical and intangible resources.

A firm should not assume a management responsibility as part of the assurance service, the threats created would be so significant that no safeguards could reduce the threats to an acceptable level.

Other Considerations
Self-review threats are created if the firm develops and prepares prospective financial information and subsequently provides assurance on this information. The firm should evaluate the significance of this self-review threat created by the provision of such services and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level.

Fees
Self-interest or intimidation threats are created when the total fees from an assurance client represent a large proportion of the total fees of the firm.

Possible Safeguards
- Reducing dependency on the client
- External quality control reviews
- Consulting a third party, such as a professional regulatory body or a professional accountant, on key assurance judgments
- Professional accountant who is not a member of the assurance team review the work or otherwise advise as necessary

Overdue Fees
A self-review threat may be created if fees due from an assurance client remain unpaid for a long time.

Possible Safeguard
- Professional accountant who did not take part in the assurance engagement provide advice or review the work performed

It is important to note that overdue fees could be considered as a loan especially if the amount is significant.

Contingent Fees
Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm.

A self-interest threat is created if a contingent fee is charged directly or indirectly through an intermediary, by a firm in respect of a non-assurance service provided to an assurance client. No safeguards could reduce the threat to an acceptable level the firm should not accept such arrangements.

For other contingent fee arrangements charged by a firm for a non -assurance service to an assurance client, factors to consider:-

- Possible fee amounts
- Whether an appropriate authority determines the outcome of the matter upon which the contingent fee will be determined
- The nature of the service
- The effect of the event or transaction on the subject matter information

Possible Safeguards

- Have a professional accountant review the relevant assurance work or otherwise advise as necessary
- Using professionals who are not members of the assurance team to perform the non-assurance service

Gifts & Hospitality

Self-interest and familiarity threats are created when accepting gifts or hospitality from an assurance client. If a firm or a member of the assurance team accepts gifts or hospitality unless the value is trivial and inconsequential, the threats created would be so significant that no safeguards could reduce the threats to an acceptable level. The firm should not accept such gifts or hospitality.

Actual or Threatened Litigation

Self-interest and intimidation threats are created when litigation or threatened litigation takes place between the firm or a member of the assurance team.

Possible Safeguards

- If litigation involves a member of the assurance team, removing that individual from the assurance team
- Have a professional review the work performed

If such safeguards do not reduce the threats to an acceptable level, the only suitable action is to withdraw from, or decline the assurance engagement.

D. PROFESSIONAL ACCOUNTANTS IN BUSINESS

A professional accountant in business may be a salaried employee, a partner, director, owner manager, a volunteer or another working for one or more employing organization. Professional accountants in business may be solely or jointly responsible for the preparation and reporting of financial and other information, which both their employing organizations and third parties may rely on. Investors, creditors, employers, and other sectors of the business community, as well as governments and the public at large, all may rely on the work of professional accountants in business.

Potential Conflicts
Intimidation threats arise when a professional accountant in business may face pressure for example in the following circumstances:-

- Act contrary to law and regulation
- Lie or intentionally mislead – Auditors or Regulators
- Issue or be associated with financial or non-financial reports that materially misrepresents the facts

Possible Safeguards

- Obtaining advice, from within the employing organization, an independent advisor, or a relevant professional body
- Seeking legal advice
- Using a formal dispute resolution process within the employing organization

Preparation & Reporting of Information
A professional accountant in business may be involved with such information as:-

- Forecasts and budgets
- Financial Statements
- Management discussions and analysis
- Management letter of Representation – provided to auditors

Threats to compliance with the *fundamental principles,* e.g. self-interest or intimidation threats to objectivity or professional competence and due care, are created where a professional accountant in business is pressured to become associated with misleading information or to become associated with misleading information through the actions of others.

Possible Safeguards

- Consultation with superiors within the employing organization
- Consultation with audit committee or those charged with governance
- Consultation with relevant professional body

Where it is not possible to reduce the threat to an acceptable level, the professional accountant should refuse to be or remain associated with information he/she determines misleading, and it may be advisable to consider legal advice or resign.

Acting with Sufficient Expertise
The professional accountant in business may encounter threats in performing his/her duties within the *fundamental principle* of professional competence and due care, e.g. include:-

- Insufficient time for properly performing or completing the relevant duties
- Incomplete, restricted or otherwise inadequate information for performing the duties properly
- Insufficient experience, training and/or education
- Inadequate resources for the proper performance of the duties

Possible Safeguards

- Obtaining additional advice or training
- Ensuring there is adequate time available for performing relevant duties
- Obtaining assistance from someone with necessary expertise
- Consulting where appropriate with – Superiors, Independent experts, professional body

Financial Interests

Circumstances that may create self-interest threats for the professional accountant in business or an immediate close family member:-

- Holds a direct or indirect financial interest in the employing organisation and the value of that financial interest could be directly affected by decisions made by the professional accountant in business
- Profit related bonuses
- Holds directly or indirectly share options

Possible Safeguards

- Consultation with superiors within the employing organisation
- Consultation with those charged with governance
- Consultation with relevant professional body
- Up to date education on ethical issues and on the legal restrictions and other regulations around potential insider trading

Inducements *(receiving offers)*

Offers of inducements may create threats to compliance with the *fundamental principles*. Self-interest threats to objectivity or confidentiality are created when an inducement is made in an attempt to unduly influence actions or decisions encourage illegal or dishonest behaviour or obtain confidential information. Intimidation threats to objectivity or confidentiality are created if such an inducement is accepted and it is followed by threats to make that offer public and damage the reputation of either the professional accountant in business or an immediate or close family member.

E. DISCIPLINARY PROCEDURES

Introduction

Regulatory professional bodies take complaints seriously and will deal with them fully. You may find that you need advice about particular circumstances, or you may not be sure if you have sufficient grounds on which to complain. You should telephone, write to the Secretary. You will be given advice.

All complaints should be made in writing. The complaint should detail the pertinent issues as comprehensively as possible and where possible important copy documentation should be provided.

Types of Complaint

Complaints can be made where for example or member of a regulatory professional body has been guilty of a breach of professional conduct i.e. a breach of the *Fundamental Principles.*

Investigation & Discipline

An Investigation Committee will use evidence (such as statements, letters, documentation and accounts) to form a view. Investigations are detailed and are designed to get to the core of the matter. Investigations will frequently involve meetings with several parties and in-depth reviews of documentation. The volume and complexity of the evidence have a direct bearing on the length of time required to properly investigate a complaint.

The Investigation Committee discusses all the evidence and communicates its opinion, both to the complainer and member has been guilty of misconduct or of bringing himself or herself, the Institute, or the accountancy profession into disrepute. It the complaint is *not made out*, the complaint will be dismissed the complainer and the member will be informed in writing.

Where the complaint *is made out*, the Investigation Committee will decide if the conduct of the member was disgraceful to such an extent that disciplinary action is required against the member. The Committee may decide that disciplinary action is unnecessary if, in all the circumstances, the case is not serious, or if there is some other compelling reason. In the remainder of cases it will take action by prosecuting a formal complaint.

Prior to Investigation Committee's complaint being upheld, the Disciplinary Committee must be satisfied that the member is guilty of the conduct complained of. If it finds the complaint proven, it will impose a sanction against the member which, according to the seriousness of the breach of professional conduct, will range from ***reprimand*** to ***exclusion from membership*** and ***may include a fine***.

Liability of Member Firms to Disciplinary Action

A member firm will be liable to disciplinary action in circumstances as follows:-

- Member firm has been guilty of misconduct whilst discharging its professional duties or otherwise
- Member firm has performed its professional duties or conducted its practice inefficiently or incompetently to such an extent that as to bring discredit to itself, the Institute or the accountancy profession
- Member firm has failed or neglected to respond adequately or at all to correspondence or other communication from an officer, the Secretary or an employee of the Institute or any person acting on behalf of any committee of the Institute or failed to co-operate fully with an enquiry or investigation being conducted by or on behalf of the Institute
- Member firm has failed to satisfy a judgment debt in any jurisdiction
- Member firm has before a Court pleaded guilty or has been found guilty of any offence involving violence or indecency, drug trafficking, money laundering, tax evasion, breach of companies legislation or complicity of any such offences or has in any criminal proceedings been found to have acted fraudulently or dishonesty, it should be presumed, unless to the contrary that such conviction or finding constitutes proof of misconduct.

Duties of the Secretary in Disciplinary Proceedings

The secretary should ensure that:-

- A copy of the Complaint is sent to the Member, Audit Affiliate, Student or Member Firm concerned with a request for a response within a two week period.
- Receipt of the Complaint is acknowledged to the Complainant where applicable. He has been advised that a copy of the Complaint has been sent to the Member, Audit Affiliate, Student or Member Firm and that a copy of a response from the Member, Audit Affiliate, Student or Member Firm will be forwarded to him when received.
- When a response is received, a copy of it is sent to the Complainant. The Complainant may be requested, or he may wish, to respond to the response of the Member, Audit Affiliate, Student or Member Firm.

PRECEDENT BOOK

The *Institute* should establish and maintain a Precedent Book. The *Institute* should appoint a person who is an employee of the *Institute* to establish and maintain the Precedent Book.

The Precedent Book should record all *Investigation Committee*, *Disciplinary Tribunal* and *Appeal Tribunal* decisions and sanctions imposed.

The Precedent Book may be used by members of all *Investigation Committee*s, *Disciplinary Tribunal*s and *Appeal Tribunal*s as a reference when dealing with *Complaint*s, *Formal Complaints* or *Appeal*s.

GENERAL

In situations where there are disciplinary proceedings (e.g. Disciplinary Tribunal) the *Respondent* should submit to the Secretary all relevant certificates, licenses and authorisations affected by the Order.

CONFIDENTIALITY

The *Secretary, Special Investigator, Independent Reviewer, Investigation Committee, Disciplinary Committee, Disciplinary Tribunal* have the absolute authority not to provide certain information and/or documentation (including written responses from a *Respondent*) to a *Complainant* if he or it deems it appropriate.

RESIGNATION DURING THE DISCIPLINARY PROCESS

In the event of a *Member, Firm, Affiliated Partner or Student* resigning during the course of any disciplinary process or prior to the commencement of any disciplinary process but where a ***Complaint*** has been made then the Institute may publish a statement that such a resignation has taken place together with a statement as to the existence of the complaint and/or a statement of fact that the disciplinary process was on-going prior to the resignation. In any such statement the *Member, Firm, Affiliate Partner or Student* should be named. In the event of such a resignation details will also be recorded in the registrar of findings naming the *Member, Firm, Affiliated Partner or Student.*

F. ETHICAL OBLIGATIONS OF COMPANY DIRECTORS

Directors duties

Company directors' responsibilities are wide and diverse. Their duties arise primarily from:-

- Statute Legislation
- Company Law

Directors duties include:-

- Exercising their powers in good faith and in the interests of the company as a whole
- Not allowed to make an undisclosed profit from their position as directors
- Carrying out their functions with due care, skill and diligence
- Maintaining proper books of account
- Preparing annual accounts
- Maintaining certain registrars and other documents
- Filing certain documents with the Office of the Registrar General (ORG)
- Disclosure of certain personal information
- Convening at general meetings of the company
- Transactions with the company

Auditor's duties

Auditors duties include:-

- **Duty to provide an Audit Report –** report to the members of the company on the financial statements examined by them. The auditors' report must be read at the general meeting and should be made available to every member of the company.
- **Duty to report failure to maintain proper books of account –** where auditors form the opinion that the company being audited is disobeying, or has disobeyed its obligations to maintain proper books of account, they are obliged to serve notice on the company informing it of that opinion. The auditors may report this to the Office of the Registrar General (ORG)
- **Duty to exercise Professional Integrity –** Auditor is under a duty to carry out the audit with professional integrity. In preparing their report, they must exercise skill, car and caution of a reasonably competent, careful and cautious auditor.