BUSINESS 101

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The London Institute of Banking & Finance

BUSINESS 101

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INTRODUCTION

WELCOME

SIGNPOSTS THROUGHOUT THE COURSE BOOK

This course book contains the core content for this course. Additional learning materials can be found on the learning platform, but this course book should form the basis for your learning.

The content of this course book is divided into units, which are divided further into sections. Each section contains only one new key concept to allow you to quickly and efficiently add new learning material to your existing knowledge.

At the end of each section of the digital course book, you will find self-check questions. These questions are designed to help you check whether you have understood the concepts in each section.

For all modules with a final exam, you must complete the knowledge tests on the learning platform. You will pass the knowledge test for each unit when you answer at least 80% of the questions correctly.

When you have passed the knowledge tests for all the units, the course is considered finished and you will be able to register for the final assessment. Please ensure that you complete the evaluation prior to registering for the assessment.

Good luck!

LEARNING OBJECTIVES

The course **Business 101** will enhance your understanding of introductory business concepts. These concepts, theories, and definitions are the foundational building blocks for organizational success and strengthening your own management knowledge and skills.

You will learn about businesses and their environments, as well as types of organizational structures, what companies require to properly function, and what companies consider best practices. Globally, there is an array of different models related to business administration. This course will help you understand the most widely used management methods and practices. It is likely that you have already encountered one or more of these in your own working environment, whether a small or mid-sized enterprise, a multinational corporation, or a not-for-profit firm or public institution.

Furthermore, you will gain insights into the complexities associated with the decision-making process and allocation of scarce resources, which, in turn, leads to our strategic exploration of how goods and services are produced and marketed to the public. Lastly, you will become familiar with the international business environment's demand for management and labor and the fundamental principles of finance, without which making money would not be possible. By the end of this course, you should have a strong foundational understanding of the basic business concepts, theories, and definitions outlined in this book, thereby helping you prepare for future learning and career opportunities.

UNIT 1

BUSINESSES AND THEIR ENVIRONMENT

STUDY GOALS

Upon completion of this unit, you will have learned…

- to explain the nature, purpose, and goals of a business.
- to compare the characteristics of different economic systems.
- to understand the impacts of today's business environment on managing a business organization.

1. BUSINESSES AND THEIR ENVIRONMENT

Case Study

Figure 1: SpaceX Launch

Source: Free-Photos, 2016.

Space Exploration Technologies Corporation (traded as SpaceX) is an aerospace manufacturer and space transportation services firm. The American firm is in Hawthorne, California, and was founded in 2002 by Elon Musk with the goal of reducing costs associated with space transportation to enable the colonization of Mars. SpaceX has many notable achievements, beginning in 2006 with the initial flight of the Falcon 1 rocket (which did not successfully reach orbit until the fourth attempt almost 18 months later) (SpaceX, n.d.).

Becoming the world's first commercial spacecraft would be no easy task. In order to accomplish this extraordinary feat, it was crucial for SpaceX to have the right plan for success. This meant understanding how the external business environment functions and effectively planning the allocation of scare resources, such as money, people, places, things, time, and space. Following the launch of Falcon 1, NASA granted SpaceX an initial $278 million dollar investment (Junod, 2012).

Fast-forward approximately six years later to the Spring of 2012, and SpaceX was preparing to launch the Falcon 9 rocket at Cape Canaveral Air Force Station in Florida, USA. The goal was to deliver cargo to the International Space Station (ISS) and prove to NASA that commercialized space transportation was worth the investment (National Aeronautics and Space Administration & SpaceX, 2015). The mission was a success! In fact, Falcon 9's success helped SpaceX achieve many more successes since then. Most recently, on May 30th, 2020, SpaceX became the first private firm to send humans into space (SpaceX, n.d.).

SpaceX's winning nature can be attributed to a strong understanding and implementation of business concepts. They began with a dream, or as we call it in business, **vision**, from which, the company's **mission** was created. To fulfill their vision and mission, SpaceX needed a plan that established objectives, strategies, and tactics in the form of a road map to success (Corporate Finance Institute, n.d.-a, n.d.-b). Visit the official SpaceX website. Can you identify the company's vision and mission? What do you attribute to the success of SpaceX?

Vision statement
A vision statement describes what a company desires to achieve in the long-run, generally in a time frame of five to ten years.

Mission statement
A mission statement defines what line of business a company is in, why it exists, and what purpose it serves.

1.1 Concepts of Business

Think about the various organizations we interact with on a typical day. From the time we get up in the morning to the time we go to bed, we are engaging in commerce. Imagine if your phone and Wi-Fi only worked on weekends. How would you survive the other five days without digital access to friends, families, shopping, and banking? The good news is that everyone would, indeed, survive! The global business environment, like mother-nature, is a strong and adaptive force. Successful organizations are adaptable, agile, and can change with their environment. Successful firms adapt by introducing a new product or improving upon an existing one.

A large component of daily life is transactional in nature; therefore, we do not always think about the fact that we are engaging in an array of business principles and concepts discussed throughout this course. Every day, we interact with people and typically conduct **commerce** to exchange goods and services. Goods are tangible products that can be seen, touched, felt, or consumed, for example, electronics, medication, and food. Services, such as education, health insurance, and 5G networks, are inanimate in nature.

Commerce
This is the exchange of goods or services between one or multiple parties. This includes legal, economic, social, cultural, and technological ecosystems.

Education, healthcare, and the internet have tangible sub-components. For example, the knowledge you learn from this course book cannot be physically seen or touched. However, it can be tested, measured, and graded as you will receive a degree (tangible), which indicates that you have successfully completed your undergraduate studies. This enables you to show others your credentials in the form of a physical diploma and official recorded transcript.

Over time, as people's needs have changed, so has the interpretation and definition of the term "business". In the past, a business's goal was simply to generate profit through multiple forms of commerce, yielding profitable returns. Today, business is defined as a unified set of tasks and assets that can be managed with the intent of creating products or services for clients, investment income generation (dividends and interest, for example), and income generation from other typical tasks (Carroll, 2019).

To further understand the definition of business in the twenty-first century, let us look at the following concept, called the 3Ps, designed to stimulate thought about the future of capitalism:

1. People. An organization has an impact (both positive and negative) on its most important assets, the stakeholders. A stakeholder is anyone with a personal stake in the organization. This includes internal stakeholders, such as managers and employees, as well as external stakeholders, such as customers, suppliers, shareholders, investors, and the government.
2. Planet. Organizations affect the economic environment and our natural environment. It is an organization's responsibility to use resources effectively and reduce their carbon footprint.
3. Profit. An organization has an impact (both positive and negative) on the microeconomic and macroeconomic economy. This includes job creation, innovation, wealth creation, and tax generation (Kraaijenbrink, 2019).

Therefore, we can say that organizations of all shapes and sizes have an obligation to people, the planet, and profit. Because organizations have a responsibility to the planet, people, and themselves, we could also say that an organization's **corporate social responsibility** (CSR) may affect people's quality of life and standard of living. These terms are defined as follows:

Corporate social responsibility (CSR)
Also known as corporate citizenship, CSR is a business model used to assist companies with social accountability to themselves and the public (Fernando, 2020a).

1. Quality of life is an index that generalizes varying levels of personal happiness with the intention of measuring intangibles. Some examples are health and wellness, resources, such as education, freedoms, and healthcare.
2. Standard of living refers to the level and quality of products and services (tangibles) available within a given population. Factors included may be income levels, job opportunities, healthcare, and gross domestic product (GDP) (Fontinelle, 2019).

Let us examine the way standards of living and quality of life are linked. The United States has one of the highest standards of living in the world. Although countries such as Germany have higher wages than the US on average, their standard of living is not higher. This is because the prices of goods are significantly higher (OECD, n.d.). As a result, the same amount of money will not go as far. For example, if Elon Musk buys all of his SpaceX employees an extra value meal from McDonald's in Cape Canaveral, Florida, after a successful satellite launch, it will cost less than $5.00 per employee. When Mr. Musk goes to Berlin for the opening of his new Tesla giga-factory and decides to buy his employees that same extra value meal, it will cost about $10.00 per employee (Numbeo, n.d.-a).

Although a certain geography's (country or city) standard of living is high, that does not necessarily mean that they have a higher quality of life. Creating a high quality of life is a collaborative effort of governments, businesses, and **not-for-profit organizations** (Kenton, 2020b). Through mid-2020, Denmark and Switzerland ranked highest in quality of life, followed by Finland and Australia. It may come as a surprise that the United States is not in the top 10, in fact, as of July 2020 the US is ranked fifteenth (Numbeo, 2020). Even more interesting is the fact that the US fell one spot, from fourteenth, within the first six months of 2020. Fluctuations like these can be attributed to many factors, such as the economic

Not-for-profit organizations
These organizations do not earn profits for their owners. All of the money earned by or donated to a not-for-profit organization is used to pursue the organization's objectives and keep it running.

state of a nation, political stability, and access to education and healthcare. At the opposite end of the spectrum, countries such as Kenya, Bangladesh, and Nigeria ranked lowest in quality of life (Numbeo, n.d.-b).

It is no easy task for people, organizations, and governments to create a superior quality of life and standard of living. There are many moving pieces and parts that take careful consideration, planning, and risk. The easiest way to think about **risk** is with the following formula: risk = a potential reward or loss.

Risk
In financial terms, risk is the chance that an outcome or an investment's actual gains will differ from an expected outcome or return. Risk includes the possibility of losing some or all of an original investment.

Pretend the year is 2002, you are preparing for the business pitch of your life! Your goal is to convince a group of investors of the following ideas:

1. Colonizing Mars is possible and profitable.
2. You are the visionary that can make it happen.

Imagine how Elon Musk felt putting together a business plan that outlined his intention to launch humans further into space than anyone before. Now, put yourself in the place of the investors that are hearing this for the first time. You think to yourself that this guy is reaching for the moon (no pun intended) if he thinks he can pull this off. Then, you think about all of his successes and one of his first most recognizable firms, PayPal. This man knows what he is doing. You have to make a choice between the following options:

1. Invest in this new company called SpaceX with a big dream, but a big price tag.
   - If you fail, you will not get that money back.
   - If you succeed, the **return on investment (ROI)** was worth it (Fernando, 2020b).
2. Do not invest in a brand-new company that will cost millions of dollars up-front, and decide to spend your money elsewhere.
   - If you do not spend money, it is not a loss.
   - Regret your decision for life not to invest in SpaceX as the ROI would have been worth it.

Return on investment (ROI)
This is a performance measure used to evaluate the efficiency of an investment or compare the efficiency of a number of different investments. ROI tries to directly measure the amount of return on a particular investment, relative to the investment's cost.

Risk comes down to making choices (good choices to mitigate the risk). A best practice in business is to examine all of the facts and decide on the upside of the investment and the losses associated with it. Funds that an organization receives by selling goods or supplying a service to customers is called revenue. Expenses for rent, salaries, supplies, coordination, etc., that a firm incurs from creating and selling goods and services are considered cost. For example, some of the costs incurred by SpaceX when developing Falcon 1 included expenses for salaries, facilities, and materials. If SpaceX has money left over after it pays for all costs, it has a profit. A company with greater costs than revenues makes a loss (Boyte-White, 2020).

When a firm, such as SpaceX, uses resources intelligently, they can often increase sales, earn a profit, and reduce costs; however, not all companies earn profits, thus the risk of being in business. Publicly traded companies, such as Apple and Tesla, face the risk of falling short of shareholder obligations. All institutional entities (government, public, or organization) have stakeholders. Both shareholders and stakeholders have a personal stake in the organizations success as they are a part of its ecosystem. The major difference between the two is that a shareholder has a monetary interest in the form of dividends, whereas a stakeholder could be an employee that relies on a paycheck, or a customer that has purchased a trip aboard a commercial spacecraft (Banton, 2020b).

1.2 A System of Economic Relationships

Economic system
This is a system of production, resource allocation, and distribution of goods and services within a society or a given geographic area.

Economics
This is a social science concerned with the production, distribution, and consumption of goods and services.

Organizational success (in part) is dependent on the location and its economic systems. A country's **economic system** is made up of laws, policies, and procedures that have been set up by the local government. Their purpose is to set up guidelines about how goods and services are produced and distributed.

The study of how society uses global resources to manufacture and distribute goods and services is called **economics**. Governmental, commercial, and personal resources are limited in nature, thus, governments, organizations, and people choose from a portfolio of available resources. All economies are concerned with the types of goods and services that are produced, the amounts, how they should be manufactured, and for whom. These decisions are generated by the marketplace, the government, or both. In the United States, the free-market system and the government guide the economy in tandem.

It's likely that you are more familiar with economics than you know. Every day, a plethora of news stories dealing with economic issues cascades through the world: $9 billion in pay raises for healthcare workers in France, Wall Street has a record day, the Federal Reserve Board (FEDS) lowers interest rates, etc. (Kennedy & Durie, 2020). In today's world, major economic systems fall into two broad categories: free market (or capitalism), and planned economies, which include communism and socialism. All EU member states, alongside other countries, use a mixed system, incorporating elements from various economic systems (Gitman et al., 2018). The biggest difference among economic systems is what the individual or the government decide when considering the following aspects:

- How is the allocation of resources conducted from production factors to societal customer satisfaction?
- Which goods and services are to be produced, and in what quantities?
- How will goods and services be manufactured, and by whom?
- How are goods and services distributed among customers?

Multinational enterprise (MNE)
A multinational enterprise produces goods or delivers services in more than one country.

It is important for business leaders to understand and adapt to the economic systems in which the businesses are run. Firms that conduct business internationally, often referred to as **multinational enterprises (MNEs)**, may quickly discover that they must work in a new economic system and make changes that align with a specific country's laws, processes, and procedures. They may have to make alterations to production, human resources, processes, and methodologies to accommodate a country's particular economic system (Eurostat, 2019).

Let us look again at Elon Musk's company, Tesla. By the end of 2021, Tesla will have four giga-factories worldwide. The figure below depicts the production capacity and the stage of development of the factories as of July 2020. Currently, Tesla has functional operations in the US and China. They are expected to open their first European facility in Berlin-Brandenburg, Germany in 2021 (Kane, 2020).

Table 1: Installed Annual Capacity

Installed annual capacity		Current	Status
Fremont	Model S / Model X	90,000	Production
	Model 3 / Model Y	400,000	Production
Shanghai	Model 3	150,000	Production
	Model Y	—	Construction
Berlin	Model 3	—	In development
	Model Y	—	In development
North America	Tesla Semi	—	In development
	Roadster	—	In development
	Cybertruck	—	In development

Source: Kane, 2020, p. 18.

The economic systems in the US, Germany, and China are quite different from one another. This means that Tesla must adapt to the economic systems of each country if they want to conduct business there. However, before we look at the major economic systems of the world, let us simplify this Tesla example and look specifically at several legal differences between the US and Germany.

United States of America

- Employees in the private sector typically have no contracts.
  - Since contracts are limited, it is easy for the workforce to start a job and find another if they are not happy. The legal notice period is two weeks, which also makes it easier for companies to end their relationship with employees (Raines, 2019).
- All 50 states have at-will employment systems.
  - The term at-will employment is a legal term used in the United States. This term means that an employer can fire an employee for any legal reason without warning. Examples of illegal reasons for firing someone are because of their gender, race, or religion (UpCounsel, n.d.).
- Benefits are important when making career choices.
  - Benefits include salary, retirement plan, vacation time (two weeks is the legal minimum), medical benefits, education, career advancement, and an array of other options (U.S. Department of Labor, n.d.).

- Part-time employees typically do not have benefits, such as healthcare or a retirement plan. The legal guidelines for minimum wage are $7.25 per hour (U.S. Department of Labor, n.d.).

Germany

- Regardless of the business sector, employees are given contracts with a duration. Typical durations are six months, one to three years, and unlimited.
- Germany has a different outlook on benefits.
  - Benefits include salary, retirement plan, such as profit sharing or pension plan, vacation time (five weeks is the minimum legal amount), medical benefits (Germany has both public and private healthcare systems, so it is not typically a concern), education (higher education is free for the most part, although there are exceptions), and career advancement. Depending on the firm, more benefits may be offered (Statistisches Bundesamt, n.d.-b).
- Part-time employees are often offered many of the same benefits as full-time workers. The legal guidelines for minimum wage are $10.79 per hour (Statistisches Bundesamt, n.d.-a).

Based on the fact that one goal of capitalistic and mixed economies is to grow, there is a global "war for talent". Keeping the word talent in mind, let us think about Tesla's success. In 2004, Elon Musk served as chairperson of the company and contributed 30 million dollars in funding as a co-founder. Fast-forward to the summer of 2020, Musk is still CEO, the company appears to be rocketing-skyward, and it is one of the most talked about stocks on Wall Street (Schreiber & Gregerson, 2018).

Let us tie the concept of "the war for talent", back to the definition of economic systems to see relevance. Organizations like Space X and Tesla do not get to where they are by accident. They know the secret to success and are exceptionally skilled workforces with satisfied employees that yield results.

No single person would be able to send a commercial spacecraft into orbit or create an innovative and profitable organization like Tesla all by themselves. Part of Elon Musk's success can be attributed to his leadership and the leadership of his executive teams. From what we can see, both companies' successes can be attributed to the fact that SpaceX and Tesla team members work in tandem with colleagues and leadership to achieve the organizations missions and visions.

Major Economic Systems of the World

As previously stated, MNEs are typically headquartered in their home countries and abide by its economic systems. SpaceX and Tesla are headquartered in the United States, thus, Elon Musk's firms operate within the scope of the American legal system (SpaceX, n.d.). So, what exactly does that mean for Tesla in terms of differences when opening a giga factory in the United States versus in Germany?

Non-contract system (US)

The following list describes the main features of a non-contract system and how they affect the way Tesla does business in the US:

- California, the home and headquarters of Tesla, Inc., has greater employee protection than its state counterparts, but it is still not at the same level as Germany. The automotive industry happens to be one of the few business segments with these protections; however, Tesla happens to be the only major car manufacturer in the US without a **labor union**. While this may not be ideal for employees, it does help the organization in terms of time and money.
- Tesla can make their own decisions about employee salaries, benefits, and whom they choose to hire and fire, as long as their decisions fall within the scope of US law (U.S. Department of Labor, n.d.).
- Although the previous points may seem unfair to employees, it does come with advantages to business owners. Thus, the law of human capital kicks in. It is expensive to onboard an employee, and it costs the company money if they leave, so hiring the right talent is key. Within the capitalistic system, a company like Tesla has figured out the recipe for success, which includes obtaining and keeping the best talent.

Labor union
A labor union, also called a trade union or worker's union, is an organization that represents the collective interests of employees (Staff Author, 2020).

Due to the flexible system in the US, organizations can adapt and invest in their most costly and asset: people! Helping team members achieve professional and personal goals that contribute to the organization's success gives employees purpose and instills loyalty (Boldt, 2017).

Contract system (Germany)

Berlin-Brandenburg, future home of Tesla's European giga factory in Germany, requires employee protections in the form of formalized contracts. German contracts can be broken down into the following four segments, all of which Tesla must adhere to:

- minimum requirements. These requirements contain ten minimum provisions, including collective bargaining agreements, something Elon Musk has not yet had to work with.
- fixed term and open ended contracts. Generally, employment contracts in Germany are unlimited. Fixed-terms contracts also exist; however, terms of the agreement must be in writing prior to the employee start date. Essentially, this means it is much more difficult to part ways with an employee than in the US.
- trial period. An agreement of a trial period may be reached by both the employer and employee; this is limited to a six-month period. Within a trial period, the notice period is two weeks (Pusch Wahlig Workplace Law, n.d.).
- notice period. The length of a notice period can vary from four to seven months depending on an employee's seniority (Pusch Wahlig Workplace Law, n.d.).

Although similarities between Germany and the US exist in terms of negotiable pay structures and safe working conditions for employees, the overall cost of having a production facility in Germany may be higher due to employment law and other regulatory factors related to business standards. It is unlikely that all international firms are subject matter experts on the economic and legal systems of every country in which they operate; many MNEs typically partner with a consulting or integration firm because the partner firm understands local cultural systems and norms. Many times, the partner firm will handle all legalities, which include everything from human resources to operational guidelines, thus, alleviating legal recourse and smoothly integrating into Germany's economic system. Now, let us dig deeper into the major economic systems of the world. The table below summarizes the key factors of the world's economic systems.

Table 2: The Basic Economic Systems of the World

	Capitalism	Communism	Socialism	Mixed economy
Ownership of business	Businesses are privately owned with minimal government ownership or interference.	The government owns all or most enterprises.	Basic industries, such as railroads and utilities, are owned by the government. There is very high taxation as the government redistributes income from successful private businesses and entrepreneurs.	There is private ownership of land and businesses, but the government controls some enterprises. The private sector is typically large.
Control of markets	There is complete freedom of trade and no or little government control.	There is complete government control of markets.	Some markets are controlled, and some are free. There is significant central-government planning. State enterprises are managed by bureaucrats. These enterprises are rarely profitable.	Some markets, such as nuclear energy and the post office, are controlled or highly regulated.
Worker incentives	Workers have strong incentive to work and innovate because profits are retained by owners.	There is no incentive to work hard or produce quality products.	Private-sector incentives are the same as capitalism, and public sector incentives are the same as in a planned economy.	Private-sector incentives are the same as capitalism. There are limited incentives in the public sector.

	Capitalism	Communism	Socialism	Mixed economy
Management of enterprises	Companies can operate under private ownership and control most of their means of production, but within government regulations. There is a large degree of flexibility in decision-making at the factory level.	There is centralized management by the government bureaucracy. There is little or no flexibility in decision-making at the factory level.	There is significant government planning and regulation. Bureaucrats run government enterprises.	Private-sector management is similar to capitalism. The public sector is similar to socialism.
Forecast for 2020	Continued steady growth	No growth and perhaps disappearance	Stable with probable slight growth	Continued growth
Examples	United States	Cuba, North Korea	Finland, India, Israel	Great Britain, France, Sweden, Canada

Source: Wade, n.d., p. 13.

Capitalism

Over the past several decades, more countries in the world have shifted their economic focus away from planned economies and towards free-market economic systems. For example, East Germany transitioned to capitalism after the fall of the Berlin Wall on November 9, 1989. Russia, Germany's neighbor to the east, moved to a free-market system after the fall of the Soviet Union in 1991 (Maier, 2009).

A private enterprise system (another term for capitalism or a free market) is based on the premise of competition within the marketplace. In a competitive economic system, large numbers of people and businesses buy and sell products. In pure capitalism, all production factors are privately owned and the companies set the prices and coordinates the market's activities (Trading Economics, n.d.).

Capitalistic systems guarantee the following economic rights:

- the right to make free choices
- the right to compete
- the right to own property

The core incentive of this system is profit. The system encourages entrepreneurship and innovation. The freedom to choose is a foundation principle of capitalism, so people can choose to become an entrepreneur or work for an organization. There are many professional directions people can take based on their personal interests, education, and career aspirations (Wade, n.d.).

The government does not define job quotas for each industry or figure out areas of the economy in which people must work. Competition is considered the main driver for businesses and customers. It leads to better and more diverse products, keeps prices stable, and increases production efficiencies. Companies try to produce goods and services at the lowest possible cost and sell them at the highest possible price. When profits are increasing, competition enters the market with the intent to take a share of those profits. This results in greater competition, which typically lowers prices. As competition increases, smart businesses continually evolve in order to differentiate themselves from the competition while still being relevant to consumers.

Communism

On the opposite end of the economic system's spectrum, there is communism. This economic system is centralized and is predominantly run by the government. Typically, they own most resources and control the market. This includes controlling measures within the marketplace, such as types of goods and services that will be produced, where production will occur, and where the goods will be sold. In essence, a communistic system is predominantly controlled by the government and mandates tight control over businesses and the lives of people.

Early in the twentieth century, both China and the former Soviet Union chose communism. They believed it would help increase their country's standard of living. However, tight control over major aspects of life can demotivate people. Without the freedom of choice, workers had no reason to work hard or produce quality goods because there were no rewards for success. This led to errors in planning, incorrect allocation of resources, and consistent shortages of food and other products (Wade, n.d.). These factors were among the reasons for the collapse of the Soviet Union in 1991. Since that time, various reforms in China, Russia, and most countries in Eastern Europe have moved their economic systems to a free-market approach that is closer to capitalism (Wade, n.d.).

Socialism

Within this economic system, basic industries are owned by the government or the private sector under strict government control. A social state controls what they consider to be large-scale industry, such as utilities, transportation, and communication. Small businesses considered less critical, for example, clothing and apparel, may be owned privately. To varying degrees, the state still decides the goals of the business, the price and selection of goods, the selection of goods, and the workers' rights.

Socialist countries often provide their citizens with elevated levels of service in terms of healthcare, education, and unemployment benefits, most of which capitalistic countries do not provide. As a result, taxes and unemployment may also be higher in a socialized economic system that has greater benefits for its citizens (Wade, n.d.). For example, in 2020 the top individual tax rate in France was 45 percent, compared to 39.6 percent in the US. Several countries, such as the United Kingdom, Israel, India, and Denmark have socalist systems; however, each country has its own economic system and approach. For example, two-thirds of the population in Denmark are sustained by governmental and social programs, yet most businesses are privately owned and operated (Josephson, 2020).

Mixed Economic Systems

On the spectrum of real-world economic systems, the majority fall somewhere in between the extremes of pure capitalism and communism. The United States leans toward a pure economic system; however, they have governmental policies intended to keep economic stability, stimulate growth, and appropriately distribute funds. Ideally, these funds are reinvested back into the economy where it is needed. For example, allocation of taxpayer money to social programs such as unemployment benefits, the poor, and healthcare for the elderly.

American capitalism has produced some powerful organizations, such as Amazon and Facebook. In order to protect small businesses that account for 99.9 percent of the 30+ million US firms, legislation requires giants to compete fairly against weaker competition and mandates government entities to buy a certain minimum amount from small businesses when obtaining goods or services (U.S. Department of Labor, n.d.).

Germany, the United Kingdom, and Canada are examples of the world's mixed economies. In Canada, the government owns the utility, communication, transportation, healthcare industry, and portions of the national resources. Canada also supplies universal healthcare for its citizens. However, the remaining industries are run by the private sector, much like in the US (Lauckner, 2020).

The UK is a good example of an economic system in transition. As of January 2021, the UK will officially gain its sovereignty. As of mid-2020, the UK and EU have yet to reach a free-trade agreement. The convergence of Brexit and COVID-19 can be referred to as a **black swan**, which is a large-scale catastrophic and unforeseen event that affects the economy. All of these factors will play a part in how the United Kingdom's economic system evolves (Investopedia Staff, 2020a).

Black swan
A black swan is an unpredictable event that has potentially severe consequences.

Macroeconomics and Microeconomics

The state of the economy affects people and businesses. How we choose to spend, save, and invest our money is a personal economic choice. Your decision to attend school, whether you work part-time, and what groceries you buy are examples of your own personal economic system.

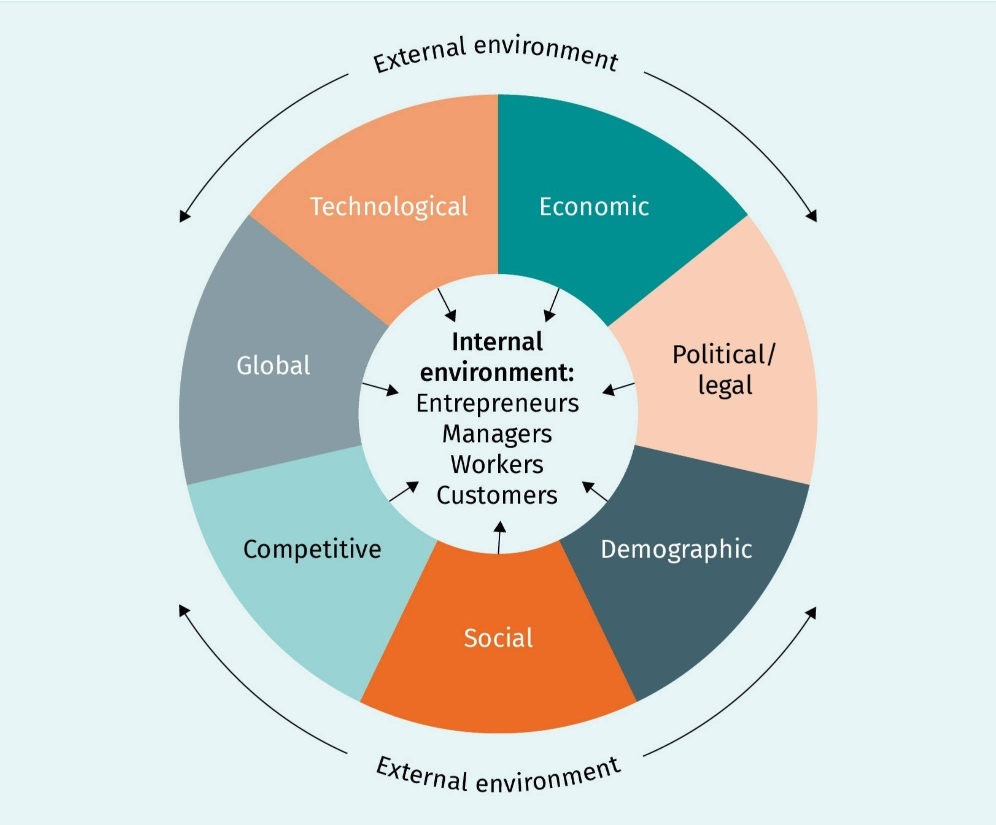
Businesses decide what products and services to produce and how to price them based on economic expectations. The economic outlook, or forecast, also helps businesses figure out how many people to employ, the pay structure, and how much to expand. Economics focuses on two main sub-areas: macro- and microeconomics. Macroeconomics is the economic study of the marketplace, and it uses aggregate data for large groups of people, businesses, companies, and products. Microeconomics is the economic study of households and firms.

Both macro- and microeconomics supply valuable insights about economic outlook, and, as an example, Tesla may utilize both when deciding whether to introduce a new line of vehicles. Tesla would consider macroeconomic factors, such as the national aggregated level of personal income, unemployment data, interest rates, fuel costs, and the national level of sales within the automotive industry (Rodrigo, 2020). From a microeconomic viewpoint, Tesla would analyze customer demand for new vehicles versus the existing supply, competing brands, material availability, and labor costs. They would also examine current prices and sales incentives.

1.3 Business Environment

Businesses do not operate within a vacuum, but rather within a dynamic global environment. The ever-changing dynamics of today's global economic systems directly affect how businesses choose to operate and achieve their goals. The external business environment is made up of many organizations, factors, and forces that can be grouped into seven subenvironments as illustrated below.

Figure 2: The Dynamic Business Environment



Source: Wade, n.d., p. 9.

Each of these sectors creates unique challenges and opportunities for organizations. When it comes to day-to-day decision making, business owners and managers have a large degree of control over their internal business environment. They can choose what products to sell, where to sell them, what supplies to purchase, from who, and which employees they hire. Leaders also utilize their skills and resources to meet existing and prospective customer wants and needs. Externally, the environmental conditions that affect organizations are constantly changing beyond the control of management. Therefore, in order to compete successfully in the open market, business leaders must continually analyze their environment and adapt to its changes (Wade, n.d.).

External forces, such as natural disasters and pandemics, can also have a significant impact on commerce. In 2005, Hurricane Katrina devastated the US Gulf Coast, and three years later, the 2008 Global Financial Crisis occurred, followed by the Gulf Coast Deepwater Horizon (an oil rig explosion) disaster in 2010. The explosion killed eleven workers and distributed over three million oil barrels into the Gulf of Mexico (Dupont, 2014). The event played out for three months and critically wounded the environment, businesses, tourism, and people's livelihood. The global oil conglomerate, British Petroleum, handled the disaster and spent upwards of $60 billion (about twice the value of the gross domestic product (GDP) of Jamaica) in cleanup. A decade later, businesses and tourism were almost fully recovered when COVID-19 began to spread, reaching the same Gulf Coast region previously affected by disaster. This region, which includes the states of Florida, Alabama, Louisiana, Mississippi, and Texas has been drastically affected by the pandemic (OECD, 2020).

Environmental Influences

It is not possible for one business to be large and powerful enough to create extreme change in the external environment. Therefore, managers are agile and adaptive rather than change-agents as global competition is an externally uncontrollable issue. However, organizations can be strategically influential, for example, the five largest companies on the S&P Index (Google, Facebook, Amazon, Microsoft, and Apple) have spent upwards of $50 million on lobbying activities in Washington, D.C. to help policy makers understand the importance of digital innovation and an "open" internet. Let us now take a brief look at the seven varied environmental influences.

Economic influences

Assessing levels of economic fluctuations that affect people and businesses in a variety of ways is crucial in business, for example, when the economy is growing unemployment rates decrease and income levels typically rise. Interest rates and inflation also change according to economic activities, as policies set about taxes and interest rates are a government's way of stimulating or curtailing economic activity. Additionally, the forces of supply and demand decide price fluctuations within a free market.

Political and legal influences

A country's political climate is another critical factor for leaders to consider in daily operations. How much government activity and oversight occurs is a component that contributes to a political environment. For example, an MNE such as Tesla will evaluate the political climate before entering a foreign market, by asking questions. For example, is the government stable, or might there be too much uncertainty? How restrictive are the regulations for foreign businesses, including foreign ownership of business property and taxation? Import tariffs, quotas, and export restrictions also must be considered (Wade, n.d.).

In the US, laws passed by Congress and the many regulatory agencies cover competition, minimum wages, environmental protection, worker safety, copyrights, and patents. For example, in 1996 when Congress passed the Telecommunications Act to deregulate the industry, the result was increased competition and new opportunities. Today's accelerated growth in mobile technology has changed the focus of the telecommunications industry. Their challenges are now associated with broadband access and speed, streaming content, and improvements in infrastructure to tackle the continual increase of data transmissions (Wiggington, 2017).

Government agencies play a crucial role in business operations. When a large pharmaceutical company wants to bring a new medication to market, they must follow procedures set by the Food and Drug Administration (FDA) for testing and clinical trials, and secure FDA approval (Healy, 2017). Before issuing stock as a publicly traded company, the company would need to register with the Securities and Exchange Commission. Otherwise, The Federal Trade Commission would legally penalize the company if its advertisements promoting the drug's benefits were misleading. These are only some of the ways the political and legal climate impact organizational decisions (U.S. Securities and Exchange Commission, 2019).

Demographic factors

Demographic factors are uncontrollable variables in the business environment that are extremely important to leaders. The study of people's vital statistics, such as their age, gender, race, and ethnicity, and location, is known as demography. Demographics help organizations to define which markets are best for their products and decide the size and composition of the workforce. Demographics are at the center of many business decisions (Wade, n.d.).

Organizations in today's world deal with the unique shopping preferences of varying generations. For example, more than 75 million members of the millennial generation in the US were born between the years 1981 and 1997, making them America's largest generation (Lutz, 2016). The marketing impact of millennials continues to be immense. Typically, this generation is technologically savvy, and, although millennials have not yet reached their peak income and spending years, they tend to buy quite freely (Lutz, 2016). Other generations, such as Generation X (born between the years of 1965 and 1980), along with the baby boomers (born between the years 1946 and 1964), have their own types of consumer behavior. Many baby boomers are nearing retirement and have money that they are willing to spend on their health, comforts, leisure pursuits, and cars (Wade, n.d.).

As the population ages, businesses have started to offer more products appealing to middle-aged and senior members of the population. Additionally, minorities represent almost 40 percent of Americans, with immigration bringing millions of new residents to the country over the past several decades (Fry, 2020). In years to come, minorities are likely to make up more and more of the population, and organizations recognize the value of hiring a diverse labor force that reflects our society. Buying power has increased significantly for minorities, and companies are continually developing new goods and marketing campaigns that target minority groups.

Social factors

In essence, social factors are our attitudes, values, ethics, and lifestyles. These factors influence what, how, where, and when consumers spend their money; however, they are challenging to predict, define, and measure as they can be extremely subjective. Social factors also change as people move through stages of their life, and people of all ages have varying interests that defy traditional consumer behavioral patterns.

Changing roles has also increased the number of women in the workforce. This development heightens family incomes, which increases demand for time-saving products and services. This new demand has changed family purchasing patterns. A renewed emphasis on ethical behavior within organizations at all levels of the business encourages managers and employees to search for the right approach when it comes to gender inequality, sexual harassment, and other social behaviors that affect the potential for success (Wade, n.d.).

Technological factors

The application of science and engineering skills and knowledge to solve production and organizational problems is defined as technology, and the application of technology can stimulate growth. The amount of goods and services one worker can produce is known as productivity. New equipment and software, which increase productivity while reducing costs, can be among a businesses most valuable assets.

A country's ability to keep and build wealth largely depends on the speed and effectiveness with which technology is used to innovate and adapt. Many businesses, both big and small, utilize technology to create change, improve efficiencies, and streamline operational processes. Advances in cloud computing have provided companies with the ability to store and access data without having to use a physical computer or server (Rock, 2016). Such programs and applications can now be accessed through the internet. Additionally, mobile technology helps companies communicate with employees, customers, and suppliers with the swipe of a finger on a tablet or smartphone. Automation and artificial intelligence (AI) help businesses to complete repetitive tasks, therefore freeing up workers to focus on more tasks critical to operations (Wade, n.d.).

SUMMARY

Businesses try to make profits by providing products and services that consumers either want or need. Not-for-profit organizations, though not striving for profits, still deliver many necessary services for our society. Our standard of living is measured by the output of goods and services, thus, businesses and not-for-profit organizations help create our standard of living. Our quality of life is not simply the number of goods and services available for consumers, but rather the society's general level of happiness.

The study of how individuals, businesses, and governments use scarce resources to produce and distribute goods and services is called economics. Today, there is a global trend toward capitalism, which is based on marketplace competition and private ownership of the factors of production. Competition leads to more products and services offered, stabilizes prices, and pushes businesses to become more efficient.

In a communistic economy, the government owns almost everything, and all resources and economic decision-making are conducted by the government. Socialism is also a centralized economic system in which the basic industries are owned by the government or by the private sector under strong government control. Today, most economies are a combination of capitalism and socialism. There are two major areas in economics: macro- and microeconomics.

The external business environment includes seven subcategories: economic, political, and legal, demographic, social, competitive, global, and technological segments.

UNIT 2

TYPES OF BUSINESS ORGANIZATIONS

STUDY GOALS

Upon completion of this unit, you will have learned…

- to explain the main characteristics of organizations in the production and service sector of an economy.
- to classify the different types of organizations in an economy.
- to understand the importance of small and mid-sized companies as the backbone of an economy.

2. TYPES OF BUSINESS ORGANIZATIONS

Case Study

Figure 3: Successful Businesswoman

Source: FotografieLink, 2013.

One morning, you wake up with an idea and decide to start a business. However, prior to starting, you realize it would be an innovative idea to ask yourself a series of questions. The reason: to aid your decision about what type of organization best suits your expected wants and needs. Do you like to work alone? A sole proprietorship may be the right structure for you in this case. Or would you prefer others share your challenges and rewards? In this instance, a partnership is the best choice. Would a corporation or the flexibility of a **limited liability company (LLC)** be most logical? There are also other questions you need to consider: Do you need financing now or will you in the future? How easy would it be to obtain financing?

Limited liability company (LLC)
An LLC is a hybrid legal entity that has the characteristics of both a corporation and a partnership.

When people hear the term “business owner”, they typically think about a certain level of prominence and power. This has led to the stereotype of rich, career-driven business owners, often leaving little room in our minds to think about the fact that most small business owners in the world are just trying to make a living, trying to make the world a better place then they left it, and enjoy life! However, Alex Wolfson, a small business owner who works as consultant with a primary focus on corporate and business strategy would be quick to say that, as with many stereotypes, that is only one side of the story.

Alex was on their way to becoming a successful business executive in corporate America. However, they realized that money did not buy happiness and that it was time to make a change. For a decade, following completion of their Bachelor of Business Administration (BBA), they worked for a Fortune 500 firm within the industrial distribution and wholesale segment of the American market. After ten years of climbing the corporate ladder, Alex decided to walk, or rather, fly away to try something new. They packed their bags, boarded a plane, and moved to Berlin, Germany. They had three goals that they wanted to complete within three years:

1. Start their own business
2. Complete their MBA
3. Enjoy life more

Prior to leaving the US, they set up a sole proprietorship because they are simple to form and designed for individuals that want to work alone, prefer close control of the organization, and want flexibility to open and close as they so choose. In Germany, Alex was able to work as a freelancer and filed taxes in both countries. For them, it was the best choice because they did not want responsibility for, or to, anyone else. They could easily dissolve the business if they found that it was not going to plan. While completing their Master of Business Administration (MBA), they turned their sights toward academia with a greater focus on researching human and social dimensions of science and technology. With their newfound interest in research, Alex made two important decisions: to pursue their PhD and to move the focus of their consulting company toward academia.

By owning a sole proprietorship, Alex was quickly able to change the focus of their consulting firm to help them learn and gain further experience within the higher education market. Alex had yet to decide where to pursue their PhD but wanted to do it in the US, the UK, or Germany. As they transitioned to academia, Alex said that they would end up in the public or government sector if they pursue their research at a public university.

Alex enjoyed the rewards of working in corporate America for over a decade, and they are soon planning to move to the public or government sector as they pursue a doctorate degree. It is evident that Alex’s life-needs changed over time; as their personal needs changed, so did the type of business organization they worked for.

Visit your country, region, or state department or ministry of commerce website. Can you find your country’s equivalent to a sole proprietorship and corporation? What are two things you think attribute to an individual’s decision to work for different organizational structures during their career? What does the term “business owner” mean to you (think in business terms)?

2.1 Companies in Production and Service

There is an array of ways to classify companies. For the purposes of this unit, we will focus on the classification of firms according to their legal structure. We can distinguish three models: sole proprietorship, partnerships, and corporations. Each model has both advantages and disadvantages, which we will explore in more detail. An overview is available in the table below.

Table 3: Classification of Companies According to their Legal Structure

Sole proprietorship	Partnership	Corporation
Business owned by only one person	Business owned by two or more people	Business organization with a separate legal personality from its shareholders
Entire profit for the sole proprietor	Profit sharing among business partners	Profit sharing among shareholders
Unlimited liability by sole proprietor	Unlimited liability by all business partners	Limited liability of shareholders

Source: Created on behalf of IU (2020).

Sole Proprietorship

A sole proprietorship is the most common business structure and is chosen by many individuals when starting a business. Sole proprietorships are unincorporated business entities run by one owner, with no distinction between the firm and the individual (owner). Owners are entitled to profits and are responsible for all business debts and liabilities (U.S. Small Business Association, n.d.).

In many developed countries, no formal action is required to start a sole proprietorship. If you are the only owner, this status automatically comes from your firm's activities. For example, if you are a freelance writer, then you are a sole proprietor, and, like all businesses, licenses and permits must be obtained. Regulations vary by country, industry, state, and locality (U.S. Small Business Association, n.d.).

Advantages of sole proprietorships

Sole proprietorships have several advantages that make them popular:

- They are not expensive and are easy to form. Sole proprietorships have few legal requirements (local license) and are inexpensive to form, making them the business system of choice for many small companies and start-ups (U.S. Small Business Association, n.d.).
- All profits go directly to the owner. Sole proprietorships actively work to get all start-up investments associated with the business, however, they receive all profits earned. The amount of profits earned depends on a firm's ability to work effectively and operate efficiently.
- They enable business control. Organizational choices are made by the owner without having to ask anyone else.
- They have regulatory freedom. A sole proprietorship has more freedoms than other types of organizational systems with respect to the regulatory environment. Sole proprietorships do not pay corporate taxes or franchise fees. Taxed as personal income, profits are reported by the business owner on their tax return.
- They are simple to dissolve. Without partners or colleagues, the business owner can close their doors or sell the business at any time. The flexibility of this business organization is an ideal way to test out innovative ideas.

Disadvantages of sole proprietorships

Sole proprietorships also have several disadvantages:

- They have unlimited liability. Legally, a sole proprietor and the organization are the same, meaning there is not a legal distinction between the two. This makes the business owner personally liable for all debts incurred, even if the debts exceed the value of the business. As a result, it is possible that the owner might need to sell private property, such as their car, home, or other investments, in order to satisfy claims against the business.
- They have difficulty raising capital. Due to assets being unprotected against personal liabilities, financial institutions typically view sole proprietorships as higher risk. Expanding can be affected by a lack of ability to raise additional funds (U.S. Small Business Association, n.d.).
- They lead to limited experience as a business leader or manager. The success of a sole proprietorship rests upon the skills and competencies of the owner, who must make 100 percent of the decisions. It is difficult for business owners to be equally skilled in all areas of business operations. For example, an amazing artist might also be a terrific interior designer but have no clue how to accurately keep account records, how to manage a production plant, or even how to market themselves in the digital age.
- It is challenging to find qualified talent. Sole proprietorships usually cannot match the pay or benefits packages that big companies can offer. This makes working for a sole proprietorship less appealing to individuals who want more opportunities.
- They take up a lot of time. Deciding to become a business owner takes more time and sacrifices than people realize. The business is often the dominant part of a sole proprietor's life.
- They are not always stable. Predicting all business lifespans can be difficult. Sole proprietorships are even more unpredictable because everything is dependent on the owner. Therefore, all issues can directly affect the success of the business.
- The owner is responsible for all losses. Sole proprietorships handle all losses; however, tax law allows losses to be deducted from personal income.

Sole proprietorships could be a good decision for an individual just starting out because someone can start with no employees and minimal risk. However, for many sole proprietors, this is a temporary decision; as business increases, the owner may be unable to operate with limited financial and managerial resources. At this point, the owner may decide to take in one or more partners to ensure that the business continues to thrive (U.S. Small Business Association, n.d.).

Partnerships

Partnerships are defined as the association of two or more individuals who form an agreement to operate a business together and split profits and liability. However, could partnerships endanger a company's health? Let us assume partners Ahmed and Rachael own a spa. After several years running the company, they find that both of their end goals for the company have changed. Ahmed feels good about current business levels, but Rachael aspires to grow the business by finding investors and opening new spa resorts. How can Ahmed and Rachael resolve their differences? They must ask themselves tough questions and be honest. Whose view of the future is more realistic? Does the firm have potential to expand and earn a profit like Rachael thinks it can? Where can Rachael find angel investors that can help turn her dream into reality? Is Rachael okay with dissolving the partnership and beginning a new venture alone? Who holds the legal rights to their current customer base?

Rachael has an epiphany; growing the company in a way that aligns with her dreams may have great financial risk, and her partnership with Ahmed gives her advantages that Rachael would miss in a sole proprietorship. After careful consideration, she chooses to leave the business in status quo condition. A partnership may be a desirable choice for those individuals that do not want to “go it alone”. Overall, it is easy to create and offer shared ownership. This is a popular organizational choice for professional-service firms like attorneys, architects, bankers, and real estate brokers.

In a business partnership, the individuals agree to share the profits and losses of a joint enterprise. This can be done in writing or orally and prevents conflicts later down the road; however, it is recommended to have formal agreements in writing. These agreements usually include the business name and what each partner will bring to the table (money, network, talent, etc.). These agreements also outline the compensation structure (salary, profit sharing, etc.) and the responsibilities of both owners. Agreements should contain addendums for additional business partners, the sale of a partner’s part of the business, conflict-resolution planning, and how to dissolve the business and distribute assets accordingly.

Advantages of partnerships

Partnerships have several advantages:

- An agreement is easily drafted after partners agree on how they wish to conduct business together. Overall, partnerships are not overly complex to create and are flexible in nature.
- Two revenue streams are typically better than one. In a partnership, both people contribute financial resources and have the choice to find investors. Combined financial strength can be a good sign to investors, which can increase a partnerships ability to fundraise.
- Partners share the responsibilities of running a firm. Combining skillsets and goal setting can help lead the business to overcome obstacles and increase the partnership’s chances for success.
- They are flexible. Typically, partners are hands-on when overseeing daily operations and can respond quickly to changes in the environment.
- They are relatively free from government regulation. Except for state and local laws, the federal government has minimal control over partnership activities.

Disadvantages of partnerships

Partnerships also have several disadvantages:

- They have unlimited liability. All general partners handle the firm’s debts. In fact, any partner could be personally liable for all partnership debts and legal judgments, such as **malpractice** lawsuits, regardless of who caused them. Sole proprietorships are the same in the essence that business failure may result in the losses of personal assets for general partner. To avoid such losses, a limited liability partnership (LLP) can be formed. An LLP individually protects business partners from responsibility of negative acts conducted by another partner, thereby mitigating the harm their actions may have caused.
- There is the potential for partnership conflicts. It is likely that partners will have different ideas about how to operate and organize the firm, who to hire, how to structure various roles, and when to expand. Conflicts tend to arise when communication does not travel freely. Usually, this breakdown in communication occurs due to different work styles or personality types.
- Profits must be shared. Profit division is not an overly complex task, assuming all partners contribute equal amounts of time, competencies, and monetary funds. However, if one partner puts in more money and the others more time, agreeing to a fair profit-sharing formula can be difficult.
- Dividing or exiting may not be straightforward. In essence, it is simple to create a partnership; however, they can be difficult to dissolve or leave. If a partner decides to exit the firm, a valuation of their shares needs to be calculated. Who will buy the shares? Is the replacement a good fit with other partners? In the case that a partner, who owns a more than 50 percent of a business leaves, becomes unable to work or dies, the partnership has no choice but to restructure or dissolve. Such issues can be avoided by implementing a partnership agreement. Just like a marital contract, buying and selling contracts should include clauses related to living partners and their ability to buy the former partner’s company shares. Like a marriage, or good friendship, choosing the correct partner is an important ingredient for success. Should you decide to form a partnership, give yourself time to consider the potential partner’s personality, areas of expertise, life objectives, and work style prior to agreeing to move forward in a formal partnership (Legal Dictionary, n.d.-c).

Malpractice
This refers to misconduct or negligence conducted by a business professional in the areas of law and medicine (Legal Dictionary, n.d.-b).

Corporations

Typically, when people think about corporations, they think of large and well-known companies, such as Amazon, Apple, Boeing, and Tesla. However, corporations differ in size from large multi-national enterprises (MNEs) with thousands of employees and billions of dollars in sales. Corporations are legal entities that are subject to the national and local laws where the corporation was formed.

Corporations have the power to own property, enter legal contracts, sue, be sued, and engage in commercial operations set in the terms of its charter. Unlike sole proprietorships and partnerships, corporations are taxable entities that exist separately from their owners. In a corporation, the owner or owners are not personally liable for its debts. When launching their company, Growing Edge Property Management Services, Inc., 35-year-old Jamie realized they would need liability protection for their business organization. Jamie’s firm focused on supplying a customized property management service to senior level business executives on extended work assignments away from home, often for six months to three years. Taking care of properties worth millions of dollars was not a small responsibility, so, it was crucial for Jamie to protect the business by setting it up as a corporate business structure and creating extensive contract agreements outlining company obligations. This provided the business with the necessary liability protection, not to mention peace of mind (which, as a business owner, is priceless) to focus on running the business. Note that an LLC does not supply unlimited protection; you can still get in trouble for things such as mixing personal and business funds (Legal Dictionary, n.d.-a).

The Corporate Structure

Corporations have a unique organizational structure encompassing three main components: shareholders, the directors, and officers. Shareholders (or stockholders) own the corporation because they hold stock, which gives them unique rights. These rights could include a part of the profits or **dividends**. This gives shareholders the ability to transfer or sell their piece of the business whenever they choose to do so. Shareholders may attend conferences or vote on issues affecting the business, as long as they act in accordance with the organizational charter and its by-laws (Chen, 2020).

Dividend
This is the disbursement of a portion of the firm's earnings to their shareholders, as decided by an organization's board of directors.

Typically, one stock share carries the weight of one vote. Shareholders elect their directorial board to lead the corporation and the directors create strategic goals, policies, and procedures. They oversee hiring the corporate officers and lead company operations, which includes accounting. Small to medium-sized businesses may have as little as two directors, while big businesses may have as many as 20. The board of directors (BOD) in large corporations typically includes executives and directors (from outside the organization) picked because of their experience.

Directors from outside the organization can bring new viewpoints when the company needs them because they are independent of the business and therefore more neutral. The officers of the corporation are hired by the BOD and include the president, CEO, vice presidents, and other executive level leaders with responsibility to the BOD. Officers can also be shareholders and members of the board.

Corporate advantages

A corporate system gives businesses the following competitive advantages:

- Liability is limited. Corporations are unique in that they are separate legal entities that exist apart from their owners (shareholders). Liability is limited to the number of shares a person owns. If a corporation goes bankrupt, creditors can only look to corporate assets for payment.
- Shares are transferable. Shareholders of publicly traded companies may sell shares as they like without affecting the status of the firm.
- For a corporation, life is unlimited; however, corporate charters specify rules and regulations. Since corporations are entities separate from their owners, the absence or death of an owner will not affect its existence.
- They are tax deductible. Certain liberties are given to corporations, such as these in the form of taxable deductions. For example, expenses related to operating reduce taxable income.

- They are attractive for investors. Corporations can raise funds by selling new stock. They could also choose to divide ownership, increasing the affordability for more investors who are able to buy one or several thousand shares. Immense size and stable climates make corporations appealing to banks for financing. These funds allow corporations to invest in facilities and human resources in order to grow.

Corporate disadvantages

Although corporations have their benefits, they also have disadvantages:

- Profits are doubly taxed. Corporations are legally bound to pay federal and state income taxes on all profits. Additionally, profits (or dividends) paid to stockholders are taxed as personal income; however, this is done at a semi-reduced rate.
- Business formation is complex and costly. Formation of a corporate structure has significantly more steps than other business types. It can also be expensive and require millions of dollars in foreseen and unforeseen costs.
- Regulations are stricter. Corporations must abide by a plethora of legal regulations and requirements. They must register in every state within the US where they conduct business. Additionally, corporations must register with the Securities and Exchange Commission (SEC) prior to selling stock. Publicly traded firms, by law, publish financial reports on a yearly cadence. They must also follow protocols dictated by the SEC and all other regulating state agencies (Internal Revenue Service, 2020).

Differences in Products and Services

Now that you have been introduced to various ways to legally structure a company, let us take look at the organizational differences between production and service firms. The following main differences exist:

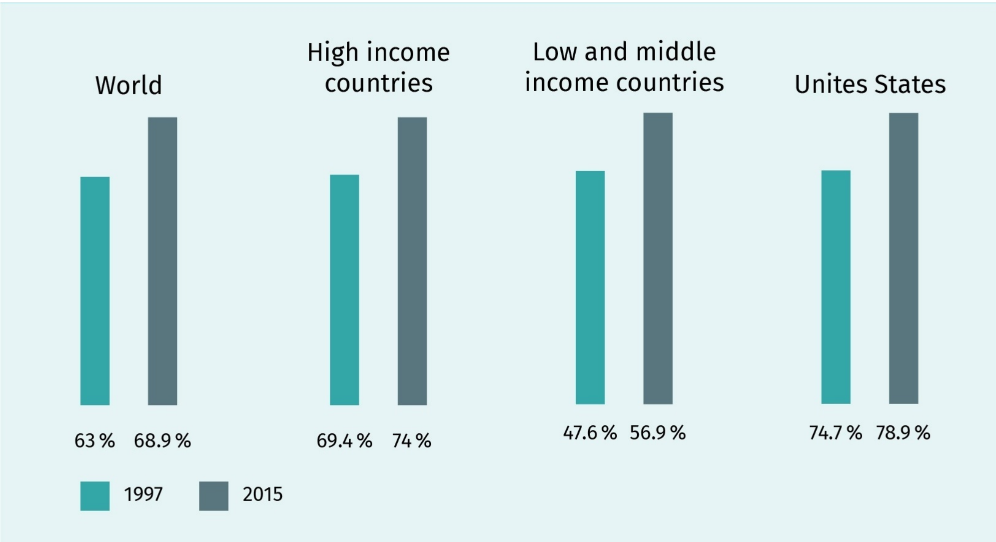
1. Output tangibility. The simplest way to think about the distinction between a production or manufacturing firm and a services firm is output tangibility. Production facilities produce goods that consumers can physically touch, whereas service firms do not. Examples, such as education, consulting, and facility maintenance, fall into the services side of business.
2. Product demand. Production and manufacturing facilities keep inventory on the premises while service firms do not. Manufacturing facilities try to accurately predict customer demand and use the just-in-time method in relation to inventory levels. Services are created based on customer needs and requests (Banton, 2020a).
3. Production specificity (customer specific needs). It is possible for production facilities to manufacture products without forecasting customer demand; however, it is not a recommended strategy. Services are produced by firms on an as needed basis and are less costly. Companies in the service industry typically create a service tailored to customer specific needs; for example, an interior design firm may create a customized solution including ten hours of consultancy, ten hours of design, and ten hours of implementation and installation.
4. Labor and automation. Many processes and procedures within manufacturing and production can be automated in order to reduce the need for excess labor. This tends to be more difficult to carry out within the service industry. Organizations rooted in

the service sector must recruit employees with specific skillsets and areas of knowledge that are relevant to their product portfolio offering. The service industry is more labor intensive than the manufacturing sector.

5. Location. Due to the nature of manufacturing and production, it is a requirement that these businesses have a physical presence (anywhere in the supply chain) in order to operate. The opposite holds true for service firms, for example, consultancies, as they do not require a physical location to perform operations. The people delivering the service or product can be located anywhere. These large international firms use global communications and the cloud network to access relevant knowledge systems worldwide (Linton, 2019).

Companies in production and service are relevant to segments in business because many advanced economies generate 70 percent or more of their total GDP via services (The World Bank, n.d.). The figure below provides an overview of the share of services based on total GDP worldwide, as well as in high-income and low- to middle- income countries. For example, more than 70 percent of Germany's GDP is currently made up of services, almost 30 percent comes from manufacturing and production, while only 1.5 percent comes from agriculture (Pelcher, 2020).

Figure 4: Share of Services According to Total GDP



Source: Created on behalf of IU, based on Buckley & Majumdar, 2018.

2.2 Divisions of Companies

Prior to exploring divisions (sizes) of companies according to global standards, it is important to familiarize ourselves with The Organization for Economic Cooperation and Development (OECD). The OECD is an organizational forum, used for the collaboration of world governments in order to work towards a brighter future. It consists of 36 member states and 70 non-member states. Topics range from sustainability to the economic impact of

COVID-19 on small and medium sized businesses. OECD member countries make up a whopping 63 percent of the global GDP and 75 percent of trade. Over 50 percent of global energy use is consumed by OECD members who make up 18 percent of the global population. Also, 95 percent of global development aid (financial) goes to these countries. The OECD divides organizational structures into the following four categories (OECD, n.d.):

1. Micro enterprises (10 employees or fewer)
2. Small enterprises (10—49 employees)
3. Medium enterprises (50—249 employees)
4. Large enterprises (250 employees or more)

Small and Medium-Sized Enterprises (SMEs)

After reading the above statistics about OECD member countries, it is time to talk about what each of these economies has in common: their central engine of growth originates from small and medium sized businesses. In the Euro zone, SMEs account for 99 percent of all businesses. It is important to note the precise definition of a small or medium sized business because SMEs receive access to financial support programs focused solely on helping these businesses succeed (European Commission, n.d.). The following factors should be considered when deciding whether a business is an SME:

1. Number of employees
2. Turnover, or the total listed on the balance sheet

The table below is only representative of individual businesses. A business that is part of a larger company may also have to include employee headcount, turnover, and the balance sheet data for the company.

Table 4: Categorization of Small- and Mid-Sized Enterprises (SMEs)

Company category	Staff headcount	Turnover	or	Balance sheet total
Medium-sized	< 250	≤ € 50 m		≤ € 43 m
Small	< 50	≤ € 10 m		≤ € 10 m
Micro	< 10	≤ € 2 m		≤ € 2 m

Source: European Commission, n.d.

Small and medium-sized businesses are the economic engine of growth for most countries of the world. Worldwide (not just OECD countries), SMEs account for approximately 50 percent of the global working population and represent more than 90 percent of businesses worldwide. Within emerging markets, SMEs contribute upwards of 40 percent of national income (GDP). According to World Bank estimates, 600 million new jobs will be needed by the year 2030, which makes SMEs a top priority for governments around the world. In emerging markets, it is estimated that seven out of ten new jobs come from small to medium sized businesses (The World Bank, n.d.).

As you can see, SMEs are the backbone of both emerging and advanced markets. Let us look at Germany, where *Mittelstand* (small and medium-sized) businesses are truly the backbone of the fourth largest economy in the world. *Deutsche Qualität*, better known as “Made in Germany”, has almost become its own brand and is synonymous with the promise of quality.

In 2018, a list of “Hidden Champions” was published. These are small and medium-sized firms which, in most cases, have been found as the number one or number two company in their field of ability. For Germany the list includes 455 firms which, according to Prof. Dr. Christoph Müller of University of St. Gallen, who closely follows Hidden Champions, have characteristics that make them able to be owner-operated with sales activities on a minimum of three continents and generate at least 40 percent of total sales in international markets (Freitag et al., 2019).

SUMMARY

In this unit, you learned about sole proprietorships, partnerships, and corporations. We explored the three major types of global businesses, which deliver either a good or service to customers using various legal structures that range in complexity. Sole proprietorships are the simplest business entities to create and dissolve, but all three have advantages and disadvantages worth considering. Lastly, we learned about business divisions and what makes them different from a subsidiary in terms of structure and complexity.

We also explored the meaning of business divisions in terms of size and scale. We broached the topic of small and medium sized businesses, which make up approximately 50 percent of the global workforce. We also discovered that the World Bank believe that over 600 million new jobs will be needed by 2030 in order to meet workforce demand within SMEs. Lastly, we learned that 70 percent of jobs come from these organizations (The World Bank, n.d.).

UNIT 3

MANAGEMENT AND STRUCTURE OF BUSINESS

STUDY GOALS

Upon completion of this unit, you will have learned…

- to explain the main characteristics of management.
- to determine the functions of organizations, managers, and control.
- to assess the relevance of decision-making in business.

3. MANAGEMENT AND STRUCTURE OF BUSINESS

Case Study

Figure 5: Ferrari 458 Spider

Source: Parsons, 2014.

Ferrari is well-known as the Italian luxury sports car manufacturer, engaged in competition in the streets and on the racetrack. Throughout its history, the enterprise has been renowned for innovation and belief as a trend-setting organization. Ferrari's origins and current history are inextricably linked to its founder's life story. Enzo Ferrari's ambition was to manufacture race cars and create streetcars that were exclusive and had the ability to finance his racing activities. Those high-performance vehicles, so innovative and elegant, were initially bought by racecar drivers, followed by an increasing demand from his clientele (Ferrari, n.d.).

Initial public offering
This is a firm's initial sale of stock to the public.

When companies are growing and businesses are improving, actions must be taken to achieve economies of scale. One of the most common decisions is to take the company public in order to add more value to its stakeholders and accumulate new investors. The aim of an **initial public offering (IPO)** is to raise capital quickly and obtain financing outside of the banking system, while reducing debt and risk. Along with an obligation to shareholders comes the prestige of being listed on a major stock exchange (NASDAQ, 2018).

In October 2014, Fiat Chrysler made their intentions known to separate Fiat Chrysler Automobiles (FCA) and Ferrari. FCA owned 90 percent of Ferrari when they made the announcement. In January 2016, both companies officially announced completion of their separation, giving Ferrari the autonomy to be a supercar manufacturer and a luxury goods business. This gave Ferrari the independence to keep their uniqueness, and the brand equity to realize its full potential. It was unlikely that they would grow the firm through acquisitions as it could minimize the brand (Ferrari, 2018).

Fast forward to 2019, Ferrari's strong sales and the new superfast Ferrari 812 model enabled the Italian luxury car manufacturer to raise its yearly revenues for the calendar year with a brand-new strategy that promises progressive growth moving into 2020 and beyond. Ferrari shares saw a 7.4 percent surge after **quarter** three (Q3) earnings were released, lifting the stock to a record high of 155.15 euros and signaling a strong year ahead. This showed Ferrari's ability to effectively navigate complex management structures, which are attributed to Ferrari's international presence and success (Ferrari, n.d.). Visit the official Ferrari website. Can you find the company's corporate social responsibility? What do you attribute to the success of Ferrari?

Quarter
A quarter is a three-month period on a company's financial calendar that acts as a basis for periodic financial reports and the payment of dividends.

3.1 Basics of Business Management

Guiding development, maintenance, and allocation of resources to reach organizational goals is called management. Managers handle continuous development, improvement, and the execution of the management processes. Management is not static, but dynamic by nature. To meet the needs and constraints in the company's internal and external environments, managers must be agile and flexible. In a global environment that is rapidly increasing in size and complexity, flexibility and adaptability are crucial to the success of the managerial process. This process is based on the following four key functional areas of the organization:

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

These activities create a tightly integrated cycle of ideas and actionable items. Interdependent on one another, managers usually perform more than one of them at a time and each of them many times over the course of normal operations. Looking at it from this perspective, the managerial process can be described as

- anticipating potential obstacles or opportunities and producing plans to deal with them.
- coordinating and allocating scarce resources needed to execute plans.
- guiding team members through change processes.
- reviewing results and making any necessary changes.

It is a manager's job to remove organizational barriers and improve the efficiency and effectiveness of corporate processes. Managers need to be both efficient and effective in order to achieve organizational goals (Insight Squared, n.d.).

To illustrate these two skills, let us look at Delta Airlines. In 2016, Delta was considered one of the most efficient network US airline firms. Operating revenue was $12.15 cents per seat-mile, that is, the revenue the airline makes on a seat per one mile. No other airline came that close, except for Southwest who flew seats at $12.51 cents a mile, the best performance of any US airline (Klein, 2017). There is a multitude of ways airlines can produce higher revenues per seat-mile. Examples include raising ticket prices, filling more seats, operating greener and more fuel-efficient planes, and negotiating salaries with their employees. Airlines must also take customer satisfaction into account (Klein, 2017).

This was, of course, prior to COVID-19. Let us fast-forward to July 28, 2020 when Southwest's CEO said his company was in intensive care. Gary Kelly, the airline's chairperson and CEO told employees via a letter on the company's website that revenue was down approximately 70 percent and the company had lost almost $1.6 billion USD (Palma, 2020). "That amount of losses for only one quarter almost wipes out our profits for an entire year", he wrote (Palma, 2020, para. 2). Kelly emphasised the losses that they are facing, he wrote "we're losing roughly $20 million USD a day, and this massive and unprecedented amount of fresh cash is crucial to fund these losses. Without it, we run out of cash, and shut down" (Palma, 2020, para. 4). According to Kelly, the Dallas-based airline tried to cut spending and raise funds since the coronavirus pandemic started. They did this by cutting capital projects, shareholder returns, and operating costs amounting to $7 billion USD, selling Southwest common stock to investors for $2.2 billion USD in cash, borrowing $12.2 billion USD in cash from lenders, through aircraft sales and leasebacks, and securing $3.2 billion USD from the US government under the CARES Act (Palma, 2020).

This example goes to show why organizations, managers, and employees must be efficient and effective. It is possible to go from running effectively and efficiently to a disaster faster than we ever thought possible. The COVID-19 pandemic proved to the world that life can completely change overnight and that, when dealing with an external factor where leadership has no control, there may be no way to prepare, only adapt.

3.2 Functions of Organizations, Managers, and Control

Planning

It is the job of leadership to formulate plans to solve complex and current issues. Planning starts with predicting opportunities and possible risks the firm could experience. They work on preventing future obstacles, while understanding possible competitive advantages. In simple terms, planning is choosing what needs to be carried out in order to achieve business goals. Solid and effective planning requires substantial amounts of data about the external business climate in which the business competes. Planning can be broken down into four different types:

- Strategic plans involve formulating long-term goals and objectives for the company (one to three years). External environmental evaluations of external forces, such as technology, societal needs, and economic factors, are important when successfully producing and executing a plan. Such plans are typically made by the c-suite (top-level) (Alvernia University, 2017).
- Tactical plans are short, and help to implement the strategic plans. They have a condensed timeframe of one year or less that aid in the success of strategic goals (Alvernia University, 2017).
- Operational plans encompass the creation of specified standards, methods, policies, and procedures used in specific functional business segments. Operational objectives are current, narrow, and focused on resources. They guide and control the implementation of the tactical plans (Alvernia University, 2017).
- Contingency plans find alternative courses of action for unexpected events and crises. They usually outline the chain of command, standard operating procedures, and communication channels the organization uses during an emergency (Alvernia University, 2017).

Most of us use these different types of planning in our own daily lives. Some plans are long and broad (more strategic in nature), such as Ferrari's plan to take the company public. Others plans may be more specific and short term (more operational or task based in nature), such as planning to spend a few hours studying for this Business 101 course. Your short-term plans should support the long-term plans. If you study now, you have a better chance of achieving future goals, such as getting a job. Like you, businesses formulate their plans to meet evolving requirements of future situations or events.

Organizing

The secondkey role of managers is to organize, which is the act of distributing company resources and coordinating activities to carry out plans. This means developing structural systems for team members, jobs, departments, and various activities inside the firm. Managers can arrange foundational elements of a business in order to maximize the flow of information and work processes. This is carried out by executing the following three activities:

- division of labor (dividing up tasks)
- departmentalization (grouping jobs and employees)
- delegation (assigning roles and responsibilities)

The following figure depicts this hierarchy. As you can see, the lowest number of managers can be found at the top of the pyramid. They are the top management, a small group of people at the head of the organization (such as the CEO, president, and vice president). Executive management develop plans that tackle long-range challenges, such as where to compete, how to capture market share, and what should be done with the money. These leads not only design and approve basic policies and procedures, but are, in fact, the face of the firm. They represent the organization to different companies. They also have a hand in defining what values, ethics, and other social protocols should be followed.

Figure 6: Management Hierarchy Structure

Source: Created on behalf of IU, based on Williams & Lumen Learning, 2012.

The former CEO of General Electric, Jack Welch, was a good role model to his leadership team. Many have said that he had the wonderful ability of inspiring hundreds of thousands of individuals around the globe. General Electric's executives turned in impressive results, much of which can be attributed to Jack Welch's leadership. During his time with the company, General Electric's average annual shareholder return was 25 percent (Garten, 2001).

Level 2 of the hierarchy is referred to as middle management, and level 3 is supervisory (first-line) management. Typically, middle management would be division heads, department leaders, and regional managers. They design and implement tactical plans in specific areas of the company in order to achieve their strategic plans and overall organizational goals. They are leaders of leaders, meaning they oversee supervisory managers (level 3 and frontline) throughout the business. Supervisory managers make up the largest number of a company's leadership team. They design and execute daily operational planning activities of the business. Most managers' time is spent guiding and motivating their team (Paper Tyari, 2019).

Leadership

Leadership is the process of motivating and guiding other team members to achieve corporate goals. Leaders can be anyone, the position does not matter. Whether you are a formal leader (manager level) or an informal leader (colleagues look to you for guidance), leaders must be able to influence others to follow your example.

In an organizational structure, senior managers use leadership skills to set a direction and share how everyone will achieve the goal. This helps them to gain support and get everyone onboard to carry out company objectives. This has been proven by top-level leadership, such as Jeff Bezos, who has many of the same traits and characteristics as Jack Welch during his time at General Electric. Both of their leadership styles have led to studies of their leadership approaches. Businesses need a strong and effective leadership team at all organizational levels. The ability to influence others is called "power". Effective leaders must be able to influence others' behaviors, or in other words, good leaders need to be influential. There are five types of primary power (Expert Program Management, n.d.):

1. Legitimate power comes from a person's official position in the business.
2. Reward power comes from a person's control over rewards or incentives.
3. Coercive power stems from someone's ability to threaten negative outcomes.
4. Expert power comes from an individual's extensive knowledge in one or more areas.
5. Referent power is derived from an individual's charisma and the respect and admiration the individual inspires.

Usually, leaders try to use a combination of these sources of power to push individuals toward goal achievement. Take the executive chairperson of Procter & Gamble, A. G. Lafley, who received legitimate power from his role in the company. Lafley's reward power stemmed from the firm's revival, increasing their stock value, and raises and bonuses for leaders that met assigned goals (Lafley, 2009).

Lafley often used his coercive power. He cut thousands of jobs, sold off brands that did not perform as expected, and killed product lines that did not sell. Lafely had approximately 50 years of service to Procter & Gamble, which gave him a unique authority when it came to product and market excellence. The company's sales doubled during his time as CEO, and its portfolio of brands increased from 10 to 23 (Lafley, 2009). He oversaw major acquisitions such as AG, Clairol, and IAMS, and his experience resulted in a large amount of power. Lafley is widely respected as a leader, not only by his employees, but by the general business community (Expert Program Management, n.d.).

Styles of Leadership

When it comes to the way leaders try to influence others, they are typically consistent in how they try and do so. This behavioral pattern is referred to as leadership style. Business leadership itself has three distinct styles:

1. Autocratic. These leaders have a very direct approach, allowing for little input or feedback from others. They make decisions and solve problems by themselves and expect their employees to implement and execute their solutions according to specific and detailed instructions. Information from this leadership style typically flows in one direction: upstream to downstream, or from manager to subordinate. By necessity, militaries are typically autocratic (Cherry, 2020).
2. Participative. These types of leaders share decision-making power with other members of the group and encourage collaboration. They use a consultative and democratic approach to accomplishing goals and foreseeable challenges (Cherry, 2020).
3. Free rein. These leaders turn over all responsibility and authority to the group. After being presented with a task, members of the group are free to carry out it how they see fit. This type of approach only works if the leader has an experienced, educated, and highly motivated team that they trust (Cherry, 2020).

There is not one specific leadership style that is always effective. Impactful leaders understand that their team members need to grow, and it is important to use a situational leadership approach. This means picking a specific style of coaching or leadership based on a subordinate's competencies. New hires typically respond well to a more directive or authoritative approach until they have a firm grasp on the job requirements and can show that they can handle routine decision-making. However, once they have proven themselves competent at a specific skill set, a leader may change their approach to a more consultative, supportive, or free rein style. Using situational leadership empowers employees because it is specific to them, and they feel invested.

The Control Processes

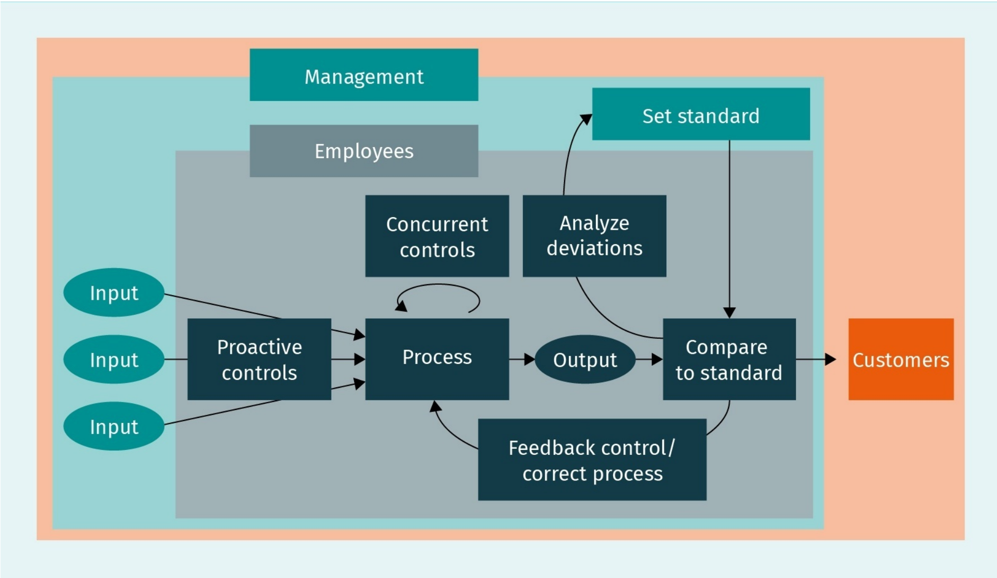
It is critical to the success of firms that they properly manage performance. Once plans have been implemented, the leadership team will execute the operational tactics of a plan to ensure it is accurately completed. The five steps in the basic control process can be used for most applications:

1. Standards of performance. It is a manager's role to put plans into action. Usually, performance standards are in a goal format, such as revenue targets or daily fill rate. To simplify things, standards should be simple and in SMART (specific, measurable, attainable, realistic, and timely) format.
2. Actual performance measurement. It is not possible to figure out if standards have been achieved if performance has not been measured.
3. Performance versus goal achievement. This involves making the choice to either accept or reject end results.
4. Deviation analysis. It is a manager's duty to set up minimum expectations and discuss why standards were not met. During this step of the process, managers figure out whether more or less control is necessary and whether standards should change or stay the same.
5. Corrective action. Once managers have determined the rationale for poor results, they develop solutions to overcome obstacles (Carrol & Lumen Learning, n.d.).

Imagine a fictional firm by the name of Xi Holdings Group, or XHG for short, is based in Beijing. XHG has suffered significant revenue losses from its luxury clothing line due to what they believe is employee theft. The question is, how does the XHG's executive team effectively reduce theft? Let us say XHG has set a goal of no thefts for a two-month period, which is step one. Every month the firm is losing $5,000. To correct the behavior, XHG installed cameras in the warehouse and put new locks on lockers where expensive items are stored. Two months later, XHG managers reach out to the accounting department to get sales and inventory numbers for the past two-month period, which is step two. The managers compare figures of the last period while considering other variables, that is step three. The accounting department found that XHG lost $500 the first month and $600 the second month due to theft. While it is an improvement, it is still short of their goal. To reach that goal, managers then start to adjust the control system, which is step four.

The XHG executive team approves the suggestion of instituting a zero-tolerance rule for employee theft. Now, if evidence is clear that an employee has stolen something, the team member will be terminated from the organization. The new employee handbook is updated to represent the change, and XHG senior leaders meet with warehousing to communicate the changes in policy and procedure, which is step five.

Figure 7: The Control Process



Source: Carroll & Lumen Learning, 2019.

3.3 The Decision-Making Process

No matter the managerial level, strong decision-making skills are necessary in order to effectively navigate unforeseen challenges by developing plans to move forward and become more a more effective team. At the end of the day, the key goal is to consistently drive ongoing organizational initiatives and directives in a positive manner that yields results. Managers often see decision-making as a single event in time, rather than an ongoing process. Looking at it from this vantage point can lead to situations where managers can overestimate their ability to influence outcomes. If a manager aspires to become a leader, it is imperative that they strengthen their business acumen (judgment) and knowledge, especially when it comes to making decisions that influence revenue outcomes.

Steps in the Decision-Making Process

There are many business models with variations of the decision-making process, for example, one model may show five steps in the process while another shows eight. These steps can be used to become a better leader and further contribute to the organization. For the purposes of this unit, we will divide the process into the following eight steps:

1. Decision-making framework. The first step is to find the issue. After the issue has been found, analyzed, and agreed upon, define outcomes about the problem that needs to be solved. One of the most challenging pieces of the decision-making process is finding the root cause of the issue. This is because an incorrect question could result in a decision-making process that does not achieve the desired outcome. For managers to start thinking about the problem early, they must also start thinking about how to shape questions that are focused in nature and try to address the decision that needs to be made (Gavin, 2020).
2. Team structure. Leaders must pick the best talent to help navigate complex decision-making. A leader will want to ask themselves, who is going be involved in helping you make decisions on the central issue the company faces? To build a collaborative and diverse team, you must look at external technical, political, and cultural factors that bring an array of different thoughts and ideas to the table to aid the production of practical solutions to complex problems. It is important to promote talent from within, but you should also hire newcomers from outside the organization who have a different viewpoint and perspective about issues your organization or team may be dealing with. Without having the right people to make the right decisions for the business, the results could be devastating (Gavin, 2020).
3. Timeframe considerations. Typically, it is not possible for managers to carry out all tasks given to them by first and second-tier leadership. That is why prioritization of activities is important. Complex issues with significant financial implications need a longer timeframe in which to make decisions. On the flipside, other challenges may call for an accelerated timeframe depending on the circumstances. Shaping the decision-making process is a skill that managers need to master (Gavin, 2020).
4. The approach. It is critical to determine the rules in the first stages of decision-making along with assignment of roles and responsibilities to each of the team members. This ensures that everyone is on the same page and speaking the same language. This way, everyone can agree on an approach to ultimately solve problems in a collaborative fashion. Clarity up front is key because team members will know what to expect when they hear and interpret a clear message about how decisions will be made and what processes to follow.
5. Encourage ideas, discussions, and spirited debates. Sometimes, leaders encounter teams who default to consensus with peers. The problem with this is that it can shut down promising ideas that others may have not thought of, in turn mitigating the support to solve complex problems. It is okay to poke holes in other people's ideas and thoughts as it helps everyone think more critically. Being creative challenges us to consider innovative ideas and perspectives, which is the beauty in diversity of thought and background. It is important to set boundaries that the group agrees on, which allows everyone to feel safe and communicate in an open environment, and enables more robust decision-making outcomes. These boundaries should be set up front and reinforced (Gavin, 2020).
6. Dynamic group navigation. Not only should it be a leader's obligation to create an open and safe working space, the best ones create environments where debate and honesty are encouraged and valued. Naturally, there are other challenges managers must navigate with their teams throughout the decision-making process. It is important for managers to ensure they have the right number of employees so that they can effectively and efficiently navigate workflows. In today's environment, it is important

to note the processes that can be completed without being face-to-face. No matter how you look at it, at the end of the day, the decision-making process requires a high level of human interaction (Gavin, 2020).

7. Ensuring the puzzle pieces are in place and ready for implementation. A leader should always lead by example and facilitate the discussion and processes in order to help team members arrive at a consensus. Some things to keep in mind when trying to solve the puzzle are as follows:
   - Present shared goals up front and reinforce the goals throughout.
   - Other thoughts that have been examined, analyzed, and vetted should be given fair consideration.
   - Methodical practices should be used to examine the pitfalls of various choices.

   As trivial as it may seem, all three of these bullet points have a profound impact on the substance of the solution that is found (Gavin, 2020).

8. Agreeing on a way forward. In order to reach closure, a sufficient solution should be found that the group agrees to. As in every phase of the decision-making process, clear and brief communication is key. This way, a manager can check to see if the team bought in to the plan and committed (Gavin, 2020).

It is a valuable for managers to have a firm understanding of the decision-making process. Regardless of whether you are a new leader, an aspiring leader wanting to move up the corporate ladder, or a tenured executive wanting to increase performance results, these tools can help your leadership approach in the future.

3.4 Organizational Structures of Business

The key role of a manger is to plan, organize, lead, and control. This section focuses on the coordination of efforts to distribute a firm's resources to execute their plans for achieving business goals, otherwise known as organizing. This is carried out by

- deciding work needs and how to divide the labor (division of labor).
- segmenting or grouping employees and their jobs (departmentalization).
- assignment of responsibilities and authority (delegation).

The result is a formal organizational process. The purpose of organizing is to help ease relationships within the business. It is two or more individuals working together toward a company purpose. Formally structured businesses typically have well defined organizational hierarchy to relay information. Informational resources, finances, materials, and human capital are deliberately connected in order to form the business organization. Connections can vary in terms of length of time. For example, coworkers in different departments typically have long-lasting connections due to the amount of cross-collaboration that takes place. Other connections are more flexible and can be changed at any time. All businesses contain some type of underlying structure, and this part of the unit will introduce you to traditional and contemporary structures.

Dividing work into individual jobs and tasks while delegating the work is called division of labor. In an organization like Alibaba or Amazon, for example, some employees will fill customer orders, others will obtain novel items from vendors to keep stocking levels, and others will maintain and clean equipment while one supervises (Crossman, 2019). In a mobile phone assembly plant like Samsung or Huawei, some workers may control precision machinery that implants micro-processing chips into mobile devices, while others may transport pallets of glass screens used in production from one section of the facility to the other. A smaller task or job that requires great skill is called a specialization. Individuals who perform highly specialized activities within a production facility tend to have a smaller number of tasks due to the complexity of the task itself. Unfortunately, high degrees of specialization may result in employee disengagement due to lack of challenges and pure boredom.

Traditional Structures

Once an organization has agreed on what needs to be done and the work has been divided into specific jobs, it is then typically grouped together according to similarity. This helps to mitigate redundancies by placing team members, jobs, and tasks into organizational units by segment. After a firm has segmented the work into specific jobs that need to be completed, its leaders group the jobs together. Jobs are grouped together according to the tasks and actives that need to be performed. This method of grouping is known as departmentalization, and it eases the processes of planning, leading, and control. Within this structure, organizations have five types of departmentalization that are typically used. They are as follows:

1. Functional. The basis of functional departmentalization is that it is based in the foundation of duties performed within a business unit (human resources, finance, research and development, production, etc.). Wuliangye Yibin Company (WYC) Limited is an alcoholic beverage distributor and China's fourteenth largest company (Strauss, 2019). It is also a successful international food and beverage manufacturer with eight wholly owned subsidiaries. Within most of the food and beverage manufacturers, such as WYC, they departmentalize into functions including finance, operations, quality assurance, sales, and marketing.
2. Product. This concept is based on the premise that goods and services are produced by one department (department A) and sold by another (department B). For example, ITT is a large manufacturer with a diverse business portfolio. They manufacture electrical components and an array of customized technologies to market segments such as coordination, manufacturing, and natural resources. ITT is divided into four product divisions (not wholly owned subsidiaries). They are (ITT Inc., n.d.):
   - industrial process (e.g., wastewater treatment equipment, pumps, and valves),
   - control technologies (e.g., motion control and products for vibration isolation),
   - motion technologies (e.g., including friction products and hydraulics), and
   - interconnect solutions (e.g., specializing in connectors in several markets).
3. Process. The basis of this structure is in the production process needed for each organizational unit. For example, let us look to Russia. Gazprom Neft, an oil company, carries out specific activities associated with extracting oil and making it into a final

and useable product for end users (Gazprom Neft, n.d.). Oil extraction is not an easy task, so is divided as such: research and exploratory methods, production process, modification, marketing, and distribution.

4. Customer. This form of departmentalization is based on consumer-target markets (retail, wholesale, franchise, etc.). The banking industry is a good example. The PNC Financial Services Group has a large breadth of products to offer. PNC is divided into the following departments (PNC Financial, n.d.):
   - retail banking (for individuals and families)
   - asset management (focused on large businesses, government entities, unions, and specific people)
   - corporate and institutional (small and medium sized businesses)
5. Geographic. In this model, employees are assigned to departments or business units along geographic locations. Another plausible reason is joint responsibility for customers, markets, and products. How an organization decides to departmentalize affects the entire business. Many large companies use this approach. Proctor & Gamble (P&G) uses this structure and integrates four assorted styles and refers to this as the “four pillars” (Galbraith, 2010):
   - Global Business Units (GBUs) divide P&G into product categories (medical, beauty, feminine, baby care, etc.).
   - Each product category then creates regionalized departments around the world to market goods and services.
   - Global Business Services unit (GBS) uses the geographic method. GBS supplies the data, processes, procedures, and technology that allow the GBUs and selling and marketing operations (SMOs) to gain a deeper understanding of the business and how to serve customers more effectively.
   - The corporate functions pillar supplies stability to the other three pillars. Each division has functional ability in each area such as sales and marketing, public relations, research and development, and legal.

The final type of traditional organizational structure we will discuss is called line and staff. This organization is created with clear and direct boundaries in terms of authority and flow of communication, which goes from executive management down to front line employees. In this model, all tasks are the responsibility of managers, who have direct control and authority. If you were to see an organizational chart with this structure, you would see an invisible line that starts at the highest senior position in the company and goes to the lowest. This system is typically well suited for small businesses or entrepreneurial firms.

As a business grows larger and more complex, the organization can choose to either restructure, or enhance the design. Naturally, as the business grows, the firm must add new positions. These roles supply guidance and support leaders within the line and staff organization. Typically, line positions are in finance, production, and marketing. Staff positions, on the other hand, are in areas such as resource management, public relations (PR), human resources (HR), and legal counsel. Usually, line positions are found in areas such as production, manufacturing, sales, marketing, and accounting. Other institutions where line positions can be found are legal, business consulting, HR management, and public relations (Knotts & Droege, n.d.).

Contemporary Structures

Many companies around the globe still use traditional forms of departmentalization; however, the emergence of COVID-19 rapidly started to change organizational transformation at the end of Q1 of 2020. The pandemic forced organizations to restructure the way that they conducted business. Let us look at two different structures: matrix and committee (Hayes, 2020).

The matrix structure is approached from a project management perspective and, at times, used simultaneously with the traditional line and staff approach. The matrix approach combines the functional and product approaches as they complement one another in terms of advantages and disadvantages. Organizations that use a matrix structure bring team members together from different functional departments in the firm (sales, digital, finance, and operations) to work on a potential project or pilot program. Employees have two supervisors in this model (the project lead and their line manager from their business function). As you can imagine, having two bosses presents challenges for both the leaders and their direct reports. Let us look at the advantages and disadvantages of the matrix structure.

Matrix structure advantages

The matrix structure has the following advantages:

- collaboration. Teamwork is an invaluable asset, with which organizations can increase creation, innovation, and employee engagement, thereby giving themselves the ability to tackle and complete complex tasks.
- resource efficiency. Instead of wasting time building large groups of costly employees, project managers use subject matter experts (SMEs) to carry out the job.
- agility. This structure is adaptive to the environment; groups can be created and dissolved quickly and easily.
- prioritization. Customers want quality goods at fair and consistent prices. The private sector wants profits in order to develop and grow. Overcoming obstacles and conflict resolution are daily challenges in the business world. This model allows for activity direction and implementation in order to overcome challenges (sales and marketing advocate for the customer, finance wants higher profits, and engineers can influence technological advances).
- increased performance outcomes. When team members are given stretch assignments, such as working on a special project or with other high performing team members, engagement increases. They take ownership and have increased feelings of motivation.
- differential investment opportunities. The matrix structure enables team members to grow and develop hard skills (technical ability) and soft skills (influence without authority).

Matrix structure disadvantages

The matrix structure has the following disadvantages:

- alignment. With two leaders comes different thought processes, unique styles of leadership, and possibly different goals.
- employee confusion. With two leaders comes two communication styles, and job responsibilities may become unclear.
- lack of unity. Just like in life, not all partnerships are a good fit. Employees from different business segments may find it challenging to communicate and work as a team (Sherman, 2019).

Committee Structure

In a committee structure, power, authority, and responsibility are handled by a group of leaders. This structure is typically part of a bigger line and staff organization. Committees act as a type of advisory council only, but in rare instances, the committee may have power to make and execute decisions. Committees can simplify the coordination of activities and increase speed. The Swiss pharmaceutical company Novartis uses a committee structure that reports directly to the board of directors. Novartis' leadership committee takes responsibility for business operations of child companies, which consists of the executive leadership team, general legal counsel, CEOs, and major heads of child companies, such as Sandoz and Alcon (Novartis, 2020).

An advantage of committees is diversity of thought, or looking at challenges and opportunities from different vantage points; however, the committee model also has downsides. Like the matrix structure, more than one person is making the final decision, and reaching a consensus can be a challenging task. Accountability is another pitfall as holding one individual accountable is not possible (Francis, 2012).

Divisions versus Wholly Owned Subsidiaries

A division of the business (business sector or business unit segment) is how organizations are divided. Divisions play specific and vital roles within a large business structure. The easiest way to think about a division is that they are part of the same organization and that the business handles all obligations (including debts) of each division. If divisions are part of the same organization, the company handles all obligations and debts of the divisions. However, in large companies, portions of the company may be led by a different subsidiary. A subsidiary is a separate legal entity, owned by another subsidiary or the parent firm itself. Often, divisions run under separate names and are equivalent to corporations and limited liability counterparts. Typically, companies set up business units to run in divisions prior to the legal formation of a subsidiary (Taylor, 2019). If a company decides to manufacture multiple products or services, they will usually separate into divisions with the intent of working toward one vision, but with a separate goal. For example, a business in the office maintenance industry may have one division that focuses on electrical, while another division works specifically with plumbing.

Wholly Owned Subsidiaries

A wholly owned subsidiary is a business entity that is separate from the parent business. The subsidiary business is technically separate from the larger business; however, owners of the core business keep full control over this smaller business, giving them the ability to guide the subsidiary's operations. Since a wholly owned subsidiary is a separate firm, employees work for, and get paid directly by, the subsidiary.

Advantages and Disadvantages

Advantages of a subsidiary

Firms will usually create a wholly owned subsidiary for tax purposes, as there are added benefits involved. Since the subsidiary is technically a smaller firm, it could also be eligible for various tax breaks that are meant specifically for small to medium sized businesses.

Advantages of a division

Division creation is simpler and faster than developing a wholly owned subsidiary. Since divisions are internal segments of an organization, not separate entities, business owners can form and disband divisions as needed. Since team members in separate divisions are employed by the same firm, modification of staffing needs is simpler.

Disadvantages of a subsidiary

If an organization chose to form a subsidiary, they could find it challenging to control the subsidiary directly. Business owners of the parent firm technically control the subsidiary. However, it is not likely that they play a significant role in the day-to-day decision-making, which is what makes it challenging to oversee.

Disadvantages of a division

If an organization chooses to implement divisions, as opposed to subsidiaries, it is possible they could experience challenges that are related to developing an effective and efficient business structure. It can be challenging for employees to figure out who they report to as boundaries may not be clearly defined (Schreiner, n.d.).

Four Types of Team

Over time, the concept of a team environment has significantly evolved. The following are four basic types of team you should be familiar with:

1. Problem-solving teams. These teams tend to consist of team members at the same hierarchy level in the same department, or subject matter experts on a particular topic. They collaborate consistently to send information and discuss how to improve processes and procedures. Typically, these teams make recommendations and predict future obstacles based on their ability. Problem-solving teams generate ideas and

alternatives and may recommend a specific course of action, but they typically do not make final decisions, distribute resources, or implement change. On rare occasions, they could have decision-making power.

2. Self-managed teams. In today’s Fortune 1000 world, around 80 percent of organizations use a style of self-managed teams, in part due to the success of problem-solving teams (MacDonald, 2019). These teams are extremely autonomous and take responsibility for goal setting, planning, team member performance, and overall outcomes.
3. Cross-functional teams. These are another evolutionary adaption from problem-solving and self-managed teams. Unlike self-managed teams, cross-functional teams usually come from varying levels of organizational hierarchy and different business units in the organization (operations, finance, IT, etc.). It is common for this type of team to only collaborate until the problem is fixed, or the team members may be given a special assignment with a fixed timeframe. This structure pulls together an array of diverse thoughts and ideas from all levels and layers of the company.
4. Virtual teams. Since the emergence of the COVID-19, virtual team environments have become a necessity for organizational survival. Since virtual teams have limited physical interaction, it can be challenging in terms of building trust, cohesion, and engagement. Due to the environment, these teams tend to be task-oriented, and the exchange of crucial information can get lost (Freedom Learning Group, n.d.).

SUMMARY

In this unit, we examined various forms of traditional and contemporary organizational structures and management concepts. In a global market environment that is rapidly increasing in size and complexity, flexibility and adaptability are critical success factors. This process is based in four key functional areas of the organization.

You learned that planning begins by predicting possible obstacles and opportunities the firm may encounter. “Strategy managers” design strategies to solve current and complex issues. They work on preventing future problems or taking advantage of potential upsides. The second key function of managers is organizing, which is the process of coordinating and distributing companies’ resources to carry out its plans. Organizing includes developing a structural system for people, positions, departments, and activities within the business. The third key management function is leadership, which is the process of motivating and guiding others to achieve a common goal. Leaders can be anyone in an organization, regardless of position. Whether you are a formal leader (manager level) or an informal leader (colleagues look to you for guidance), leaders must be able to influence others to follow them of their own volition.

It is critical to success for firms to have proper performance management for team members. This is called control. Once plans have been implemented, the leadership team will execute the operational tactics of a plan to ensure it is accurately completed. In addition to learning about various organizational structures and their importance, we discussed the various meanings of leadership and power, including why picking the right organizational structure and team are all integral parts of the decision-making process. Hopefully, this paints a clearer picture of why the decision-making process is not static and has many layers and variables.

UNIT 4

PRODUCTION OF GOODS AND SERVICES

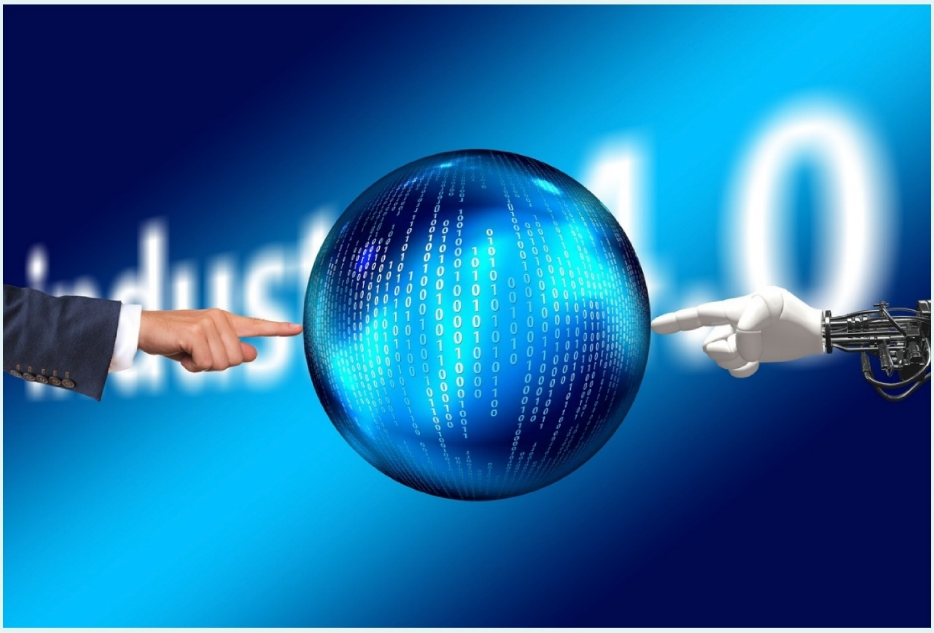
STUDY GOALS

Upon completion of this unit, you will have learned…

- to describe the relevance of production and operations management in both manufacturing and service companies.
- to explain the production processes applied by manufacturing and service companies.
- to determine the relationship between resource planning, inventory management, supplier relationship management, and the production process.

Case Study

Figure 8: Industry 4.0 and Internet of Things



Source: Denischenko, 2020.

Today, when we think about global leaders in production and manufacturing, two countries typically come to mind: the US and China. Globally, they hold the top two spots. However, there is one country that should not be overlooked. That country is India, China's neighbor to the south. With a population of over one billion people and a thriving business sector in production and automation, India is on the way to becoming a global leader with the potential to compete directly with the US and China.

Bosch, headquartered in Stuttgart, Germany, has over 440 business entities in many types of organizational forms. Bosch operates in over 60 countries with an extraordinarily large business portfolio of both products and services. Bosch India is an innovative leader in the areas of energy, mobility solutions, and next wave technologies. They are the largest development center located outside of Germany for front to back technological solutions. Software engineering uses the terms front-end and back-end in reference to a separation of concerns, meaning a distinct boundary between presentation (front-end) and access to data (back-end) for software or physical hardware within the infrastructure. If we are talking about a client-service model, the customer would be considered front end and the server would be the back end. Usually, an end-to end solution is used with vendors offering comprehensive system solutions. The intention of these solutions is to adapt to the rapidly changing business world. End-to-end suppliers typically handle all system requirements, which include software and hardware. Installation, implementation, and maintenance are a part of the service (Kenton, 2020a).

In India, Bosch operates through 13 companies which include seven development centers and 18 manufacturing facilities. In 2019, Bosch India employed over 31,000 people and had revenues of approximately three billion dollars (Bosch Limited, n.d.). Bosch in India was one of the early adopters of **Internet of Things (IoT)** and **Industry 4.0** to focus on green and sustainable solutions. In 2015, Bosch restructured globally to a matrix style organization, giving team members access to free-flowing channels of information worldwide and the ability to collaborate and work cross-functionally on key issues.

Internet of Things (IoT)
This refers to inter-related devices, digital and mechanical machines, and people that can transfer data over a network without requiring human-to-human or human-to-computer interaction (Rouse et al., n.d.).

Industry 4.0
This refers to the fourth industrial revolution and the automation and digitization of manufacturing and production.

Bosch India has worked diligently to turn itself into a globally renowned innovation hub. They have done so by developing solutions based in block chain, automation, and AI with the purpose of building technologies of the future that generate cross-industry sustainable ecosystems (Bosch Limited, n.d.). The majority of Bosch India's business comes from the automotive sector and makes up almost 84 percent of revenues. The remaining part is split between energy, consumer retail goods, energy, and tools. Since Bosch India is a successful wholly owned subsidiary, they are also traded on the Indian stock exchange with a market capitalization of over 12 billion dollars.

Bosch chose to accelerate the digital transformation of their enterprises earlier than many multi-national enterprises. They continue to create solutions designed for the usability and affordability needs of Indian customers. Their consultancy division uses something Bosch calls "3S", sensors, software, and services. 3S assists Bosch with the continuous improvement (CI) of products, processes, and procedures across industry domains to remain an industry leader. Bosch operates in a unique manner, using the LEAD user method as a core belief and strategy. Bosh enhances products by initially running them at their own facilities, then with business partners and customers to help gain feedback in order to further enhance products and processes.

Collaboration and synergies are used with internal and external business partners by Bosch in India (as well as globally). Since 2016, the Indian firm has worked diligently to predict future needs and wants of customers. Their forward-thinking process involving IoT and Industry 4.0 has helped them become a leader in automation and digitalization (Bosch Limited, 2018). Visit Bosch in India's website. Can you find their corporate social responsibility? What do you think attributes to the success of Bosch India's forward-thinking mentality and early push towards digitalization?

4.1 Origin and Development of the Production Process

Inputs
These are resources, such as energy, people, and information, that are systematically placed to create the desired output.

Outputs
These come from the initial inputs and are the end result in the form of goods and services.

A core function of every organization is production, which is the creation of goods and services. Production takes **inputs** such as oil, gas, water, capital, and human resources, and turns them into **outputs**.

A vital part of production and operations is customer satisfaction. It was not long ago that production was focused inwardly, meaning that production teams had little to no contact with customers. As you can imagine, without direct access to end users, it was difficult to understand customer needs and wants. That is not the case and, in most advanced economies, regardless of organizational size, quality is a central piece of the production decision-making process.

Factors of Production

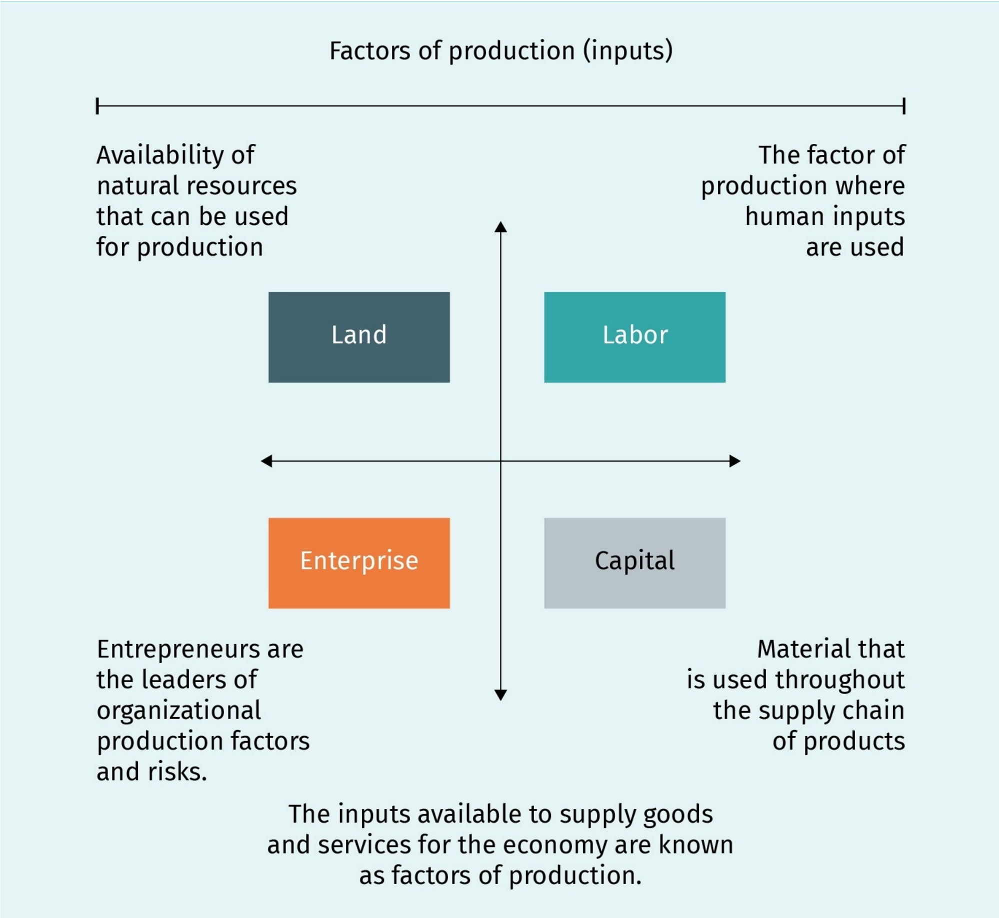
Both private and public organizations require inputs to supply outputs in the form of products and services. Traditionally, there are four common factors of production organizations require, and they are as follows (Wade, n.d.):

The Paris Accord
This aims to strengthen the global response to climate change by keeping global temperatures less than two degrees Celsius above pre-industrial levels.

1. Natural resources. These are inputs in their raw state, including agricultural land, woodlands, gas, oil, and water. Businesses use natural resources in a variety of ways, depending on the product or service being provided. Today, population growth, pollution, and limited resources are an important topic of debate. Around the world, businesses and governments are proposing and implementing legislation (such as **The Paris Accord**) with the aim of becoming more sustainable and green (United Nations, 2015).
2. Human resources (labor). This input category includes competencies and talents that are performed. The number of inputs can vary depending on the job, for example, a neurosurgeon performing a brain surgery performs many tasks in order to produce effective results (in this case health).
3. Capital. This factor includes physical goods needed to produce outputs, such as property, machinery, and any other equipment needed. At times, capital also refers to the money used to buy any of the physical goods needed for production. However, money is unable to produce an output, so it is not considered one of the basic inputs as it is solely used to buy inputs. Therefore, the term “capital” does not include money.
4. Entrepreneurship. Entrepreneurs are the decision-makers of the business who determine the firm’s direction. They combine inputs of natural resources, labor, and capital to make a product or service. The intention is to make a profit (private firms) or reach a goal (not-for-profit organizations).

In the era of Industry 4.0, most experts also accept that knowledge plays a key role in organizational success. When all four factors of production are used effectively and efficiently, businesses can produce more goods and services while using the same amount of resources.

Figure 9: Production Process for Products and Services



Source: Created on behalf of IU, based on Riley, n.d.

The Production Decision-Making Process

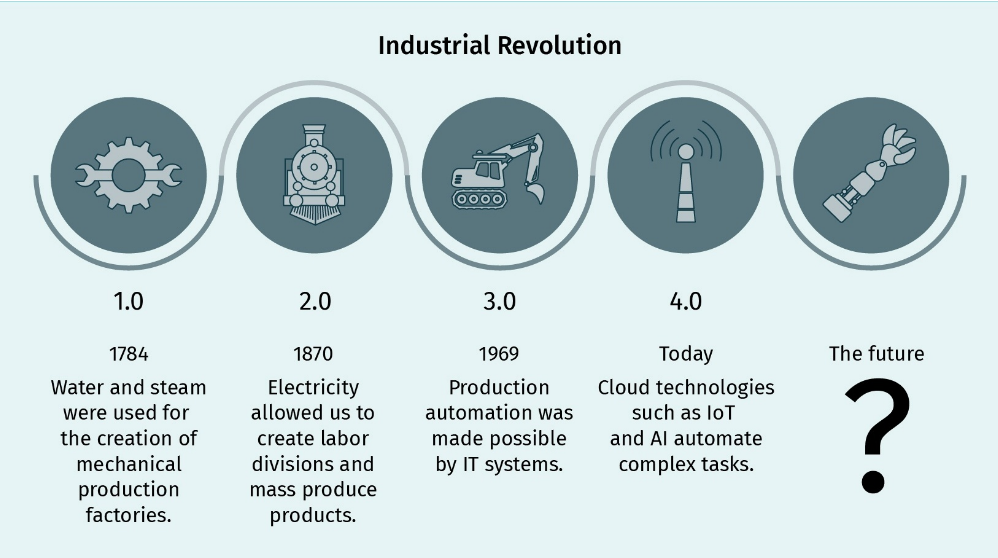
The operational management of production is a continuous process that can typically be broken down into three categories of planning. They enable a firm to analyze the external environment and their own strategic goals in order to find the most effective and efficient production methods. Production planning requires prioritization and balance of organizational goals, which can often be challenging, for example, maintaining a balance in order to supply a high-quality product or service and keep low operating costs.

Production planning can be broken down into three phases, the first of which is long-term planning over a three to five year period. The focus of long-term planning is what to produce, how many to produce, and in which location production should take place. The second phase is medium-term planning, which spans two years. It is focused on the layout of production facilities and where to obtain needed resources, including labor. Lastly, short-term planning is one year or less. This stage turns the organizational goals and aims into specific and executable plans.

The first decision in production planning is what process to use. That means deciding how a good or service will be produced. This decision must align with organizational goals and customer demands. The following are the three types of production:

1. Mass production. Like the name suggests, this type of manufacturing produces substantial amounts of a single good, all at once. This type of production became popular during the industrial revolution in the eighteenth century. Every finished product was totally identical. Typical modern examples include kitchen appliance products, canned goods, medication, and cosmetics, which are typically all mass produced (Jeppesen, 2015).
   This method is used to keep the cost of production low by manufacturing identical goods using a standard-repetitive system or process. Like all goods, the more complicated the production of a finished good becomes, the greater the cost per good. In today's world, mass production of automobiles has also become more complex. New car designs can be overly sophisticated, and, as a result, more assembly stations had to be created in order to implement the added processes and complete the production process of the automobile.
2. Mass customization. This method uses the same mass-production techniques, up to a certain-point. After basic manufacture, the good is custom-tailored to specifications. Sticking with the example of automobiles, once the base has been completed, many cars are designed with certain unique luxuries, such as a sound system or heated seats.
3. Customization. This system manufactures products to meet specific customer requirements. A 3D print-shop serves as a good example. A 3D print-shop could take on clients and create an item to meet a need, such as a large one-time quantity of medical devices. A 3D printer can quickly move onto the next project and next customer (Gitman et al., 2018).

Figure 10: Industrial Revolution Timeline



Source: Created on behalf of IU, based on Jeppesen, 2015.

4.2 Industrial Strategy of Business

A strategy is a general direction the company will take in order to meet the demands of their future desired state. The strategy answers questions, such as how to use and distribute scarce resources. A business strategy should act as a blueprint for decision-making and goal achievement. It should also outline the type of organization it wants to be and the contribution it wants to make to customers, shareholders, and society (Juneja, n.d.).

An industrial strategy can be defined as purposeful decision-making. These policies relate to the production ability within the economy, and the business environment for production and financial investments. Therefore, we can say that the policies cover an array of topics such as research and development, taxation, localized development, import and export promotion, competitive landscape, and sustainability. However, industrial strategy is more than the mere sum of all governmental policies. It is direct coordination, aiming for a clear set of goals or objectives.

Five Points of Success

Let us take the United Kingdom as an example for an industrial strategy. The five points of success are as follows:

1. Structural change. Developed investment patterns and production cycles weakened the UK economy for almost 30 years (Jacobs et al., 2017). To overcome these obstacles many "how" questions needed to be asked, such as:
   - How do we increase productivity in an array of firms in varying sectors and regions, which lag behind other industrialized nations in order to create higher earnings?
   - How do we diversify UK exports and increase import substitution to help with the UK's trade balance?
   - How do we foster the diversification of research and development throughout the country in order to create a digital tech brand for the UK?
   - How do we stimulate economic growth by rebalancing economic activity away from the South East and London?
2. Supply side improvement and demand stimulation. This is the idea that a government should pursue an "investment-led growth strategy", whereby a government invests considerable amounts in innovation and infrastructure. Some examples are as follows:
   - Public investment amounts are set up in line with GDP. For example, the UK's GDP in 2019 was 2.21 trillion British pounds (Clark, 2020), thus, one percent, or 2.21 billion British pounds should be distributed toward an industrial strategy. An internal investment of 2.21 billion emphasizes and focuses on domestic value chains, which can supply enough to match the demand created through effective economic policies.
   - The UK's estimated public sector procurement is 287 billion British pounds per year. Business segments, such as energy, healthcare, and coordination, are a main source of demand (Davies et al., 2018).
   - Overarching goals and objectives that align with innovation and growth should be found and policies should put in place to address the key challenges. For example, "sustainability" and a goal to reduce the country's carbon footprint by 2040 to lev-

els that are in line with other first world changes, or the governments' responsiveness to demographic changes that are in line with a goal to make the UK the healthiest country by 2040 (Jacobs et al., 2017). Lastly, an example could be legislation, such as new policies and procedures drafted specifically for an "Industrial Strategy Act". Such legislation would help streamline and clarify the UK's rules of engagement and structure in a post Brexit and COVID-19 world.

3. Productivity increases. An industrial strategy's scope and scale should involve the "everyday economy" and be concerned with how to increase productivity within these firms. To increase productivity within sectors, such as education, healthcare, and coordination, an industrial strategy should be focused on accelerating innovation and learning. For example, the UK found three weaknesses: low quality management, digital adoption, and low use of skills. Some possible solutions for this are as follows (Jacobs et al., 2017):
   - rethinking how jobs are designed and the types of study programs needed to help those in the public sector
   - the definition of job-standards to help set up goals and guidelines
   - reimbursements or subsidies for people or organizations to help with ongoing training and education for employees
4. Innovation policy. The aim of this policy is to diversify base of global-leading businesses. Depending on the economy and government, where a government chooses to invest and in which sectors could vary. The UK's industrial strategy prior to digitalization was focused on deepening the existing innovation sectors. Now, the UK's predominant goal to reduce trade deficit and increase research and development is to transform the UK into a regionally distinctive and diversified nation by doing the following:
   - increase spending for universities to promote innovation hubs
   - slowly phase out current tax structures to make room for new policies that drive and reward innovation
   - use a mix of taxpayer funding as equity in addition to grants and loans
5. Rebalancing geographies. To effectively rebalance a geography, strong regional institutions must be in place. Over the past 30 years, deficiencies in the UK economy became clear when government spending skewed towards London, leaving out many other regions of the United Kingdom. Experience in other countries suggests balanced growth requires strong subnational institutions with financial freedom and investment powers to oversee a region autonomously (Government Business, 2020).

SUMMARY

In this unit, we learned about the production of goods and services, starting with its origin and development. We learned about inputs and outputs, along with five factors in the production process, such as the importance of the decision-making process and deciding on a production method that is best tailored toward the nature of each individual firm.

Whether it is mass production, mass customization, or customization, production must adapt to the time and place, meaning that an awareness and action plan should be present in order to build a sustainable tomorrow while using resources differently to drive regional and purposeful economic growth. This requires having the right strategy for success in place at a microeconomic level, meaning the firm and its people, and at a macroeconomic level, where policies, systems, and procedures can be put in place.

UNIT 5

MARKETING OF GOODS AND SERVICES

STUDY GOALS

Upon completion of this unit, you will have learned…

- to define the goals and functions of marketing in an organization.
- to tell the difference between different types of marketing.
- to apply the concept of a marketing-mix to your own examples.

5. MARKETING OF GOODS AND SERVICES

Case Study

Figure 11: Raindrops

Source: sourabhkrishna806, 2017.

In the spring of 2008, Stefani Joanne Angelina Germanotta (aka Lady Gaga) released her first single, “Just Dance”, an upbeat electronic pop song that was destined for greatness. Since the song’s release, “Just Dance” has sold over 10 million copies and still is one of the most successful singles of all time. According to Forbes, Stefani Germanotta averages around $40 million (about half the cost of a high-end private jet) per year, and her estimated net worth is $275 million. Fast-forward 12 years, and Lady Gaga continues to produce and deliver chart topping hits. In fact, she has not only exceled as a recording artist, but has diversified her résumé and product offering. Her business portfolio now includes movies, television, endorsements, philanthropies, social activism, and physical merchandise (Biography.com Editors, 2020).

Operationally, the entertainment business has dramatically altered their sales approach. Over a decade ago, when Lady Gaga released her first album, people bought music, movies, and television in the form of CDs, DVDs, and conventional television services. In the age of digitalization and sustainability, we buy fewer physical goods, opting to stream media via an application for smart devices. Like all businesses going into the fourth industrial revolution, the entertainment industry was forced to adapt.

In 2008, Facebook was not even four years old and Instagram did not exist. Although social media had been around since 1997, it had yet to become mainstream (Alamri, 2018). When Lady Gaga released her first studio album *The Fame*, it was branded and marketed in the traditional sense, using conventional platforms such as television, radio, billboards, etc. From the start of Stefani Germanotta's career, she was determined to differentiate herself from the competition. For 12 years, fans have seen and experienced the personal and professional evolution of Lady Gaga. She knew that, to be successful, being authentically talented was not enough and that her business needed to be agile and change to meet the demands of her fan base. In doing so, Ms. Germanotta believed that the following things could be done:

- Customer retention. Lady Gaga understood that any product could not merely be "good," just one time. She knew about the ingredients that could make or break the success of her specific products and services: quality, consistency, agility, and flexibility. These are necessary because the needs of her customers and fans can change as quickly as the external business environment.
- Attract new customers. Stefani Germanotta wanted her brand and business grow. To achieve that, she decided to diversify her product offering by moving into film, television, country music, cosmetics, and business ownership. In 2012, she launched the Born This Way Foundation, a not-for-profit organization, focused on the emotional wellness of the world's youth (Biography.com Editors, 2020).

While working on her second album in 2009, Lady Gaga's inspiration for the album came from monsters (Biography.com Editors, 2020). At a concert later that year, she began calling her fans "Little Monsters." Stefani Germanotta understood the concept of marketing and how to innovatively use it. Before the start of 2010, Lady Gaga created her official Facebook page and started documenting her new album and pieces of her personal life. Notably, Lady Gaga would use social media to promote herself and influence her "Little Monsters." Today, Lady GaGa has close to 100 million followers between Facebook and Instagram.

Lady Gaga has spent more than a decade redefining her work and herself. For Lady Gaga, change and evolution were not just inevitabilities, they were opportunities. Most types of change require demanding work and a thorough understanding of internal and external environmental factors. As an artist and businessperson, Lady Gaga continuously evolves to fit the wants and needs of her customers. Typically, Ms. Germanotta's timing is impeccable. She understands that the right time and the right place are critical success factors that contribute to goal achievement (Biography.com Editors, 2020).

No one will forget the year 2020. The COVID-19 pandemic affected many aspects of life. It accentuated both positive and negative traits at macroeconomic and microeconomic levels. Governments shifted power, institutions were forced to restructure, and people changed their consumer buying patterns overnight. Worldwide, movie theatres closed their doors, and live shows and festivals were canceled, while new and existing projects were either put on pause or smashed out of existence completely. The entertainment industry was handed a blow!

Globally, the music industry alone is worth over 50 billion dollars (about $150 per person in the US) and can be divided into two major income streams (Hall, 2020):

- live music. Over fifty percent of total revenue comes from ticket sales of live performances.
- recorded music. This covers joint revenues of physical sales, downloads, streaming, and licensing rights or royalties. 50 percent or $12.5 million comes from streaming platforms, such as Apple Music, Spotify, and YouTube (Hall, 2020).

Due to an unprecedented decrease in music sales at start of the pandemic, many artists, including Lady Gaga, decided to postpone releasing their work in hopes of "properly" marketing their music later. As mentioned earlier, Stefani Germanotta is known as a passionate social activist and philanthropist. On April 6, 2020 she announced her new partnership with the World Health Organization (WHO) with the goal of raising funds for global personal protective equipment (PPE), supplies, testing kits, and other operational necessities (Beaumont-Thomas, 2020).

To raise the money, Lady Gaga spearheaded the production of an eight-hour digitally streamed music festival called *One World Together at Home*. The stream featured an impressive lineup of entertainers and respected public figures, and raised an impressive $127 million. The WHO's COVID-19 Solidarity Response Fund received $55.1 million (about twice the budget of a modest motion picture). The remaining $72.8 million was given to charities, such as food banks, low-income housing providers, and other public service initiatives (Beaumont-Thomas, 2020).

Like most things in life, timing is everything. The right product, at the right time, effectively marketed to the right audience, typically yields positive results. On April 22 (four days after the *One World Together at Home* broadcast), Lady Gaga took to the social media universe to inform 100 million Little Monsters that her sixth studio album, *Chromatica* would be available at the end of May. That same day, "Rain On Me," was announced as the album's second single, a duet with Ariana Grande. A month later, the song was released in conjunction with a colorful music video. One week later, "Rain On Me" had been streamed 32 million times, downloaded by 73,000 fans, and played over the radio more than 11 million times. The song was certified platinum and became Stefani Germanotta's fifth number one single in the US and Ariana Grande's fourth (Trust, 2020).

Guerilla marketing
This is any unconventional or unique marketing technique intended to produce maximal results while utilizing minimal resources.

The evolution of Lady Gaga, to Stefani Germanotta, and back to Gaga again, serves as an example of Industry 4.0 and the shift to digitalization. In terms of strategy, the emergence of COVID-19 forced Lady Gaga to adapt her business plan. Her experience as a business owner, coupled with her passion and advocacy of social issues, drove the album's decision-making process. By using unconventional **guerilla marketing** techniques, such as volunteering her time and effort to organize a digital concert, further built brand equity. Supporting the WHO, while simultaneously giving people around the globe the gift of entertainment is no easy task, but the WHO partnership was the right choice at the right time. It allowed Lady Gaga to market herself, her values, and her work to a massive audience, increasing her brand-worth and visibility. After 12 years in the public eye, Lady Gaga continues to create, innovate, and effectively deliver goods and services that audiences want. Her ability to use multi-faceted creative marketing strategies that resonate with her target market is a core ingredient of her success (Trust, 2020). From a marketing perspective, what do you believe attributes to Lady Gaga's continued success for over a decade? Visit the official website of your favorite entertainer. What type of marketing can you find? Do you think it is effective? Why or why not?

5.1 Goals and Types of Marketing

Our planet is rapidly changing in a multitude of ways. New technological advancements have forced the business community and scholars alike to reevaluate many business definitions and concepts. For this reason, the definitions of marketing and marketing research are examined and changed every three years. This is done by the American Marketing Association, which includes a panel of five global scholars and researchers. As it stands, marketing is the activity of an institution or institutions to create communication processes that deliver and exchange the flow of information, specifically, products that hold value for clients, customers, partners, and society (American Marketing Association, 2017).

Prior to implementing a sales strategy, research should be conducted. The purpose of marketing research is to analyze data that link the customer to the marketer. The data are used to find and define opportunities, while expecting challenges. Research is continually generated and refined to

- analyze and evaluate marketing performance.
- improve understanding and effectiveness of current marketing process.
- make alterations where necessary based on data.

Marketing is used to help organizations define their brand. According to **International Organization for Standardization (ISO)** standards, a brand is an intangible asset used to create unique and distinctive thoughts and associations. These brand associations can be in the form of a design, name, term, or other feature that readily finds a specific company, good, or service to be distinct from others (International Organization for Standardization, n.d.).

ISO (International Organization of Standardization)
The ISO is a non-government institution headquartered in Switzerland. They define rules and standards for all goods and services, assist with quality control, and define stress tests for product quality.

Goals of Marketing

Goals supply clear direction and purpose to carry out a specific desired result. Both professional and personal goals guide success. When a goal is achieved, it proves that a positive impact was made. For the purposes of this course, we will look at five important goals of marketing management. They are as follows:

1. Increased brand awareness. Every brand is unique, created by people with knowledge of a specific subject matter, and shaped by the marketing platforms that are used. Once a goal is set, a strategy should be created to meet that goal. Today, it is important for businesses to use social media as it enables a platform of engagement for a company's target audience. Social media also makes brands feel friendly and

approachable. When customers feel positive about a specific product or interaction, they will advocate for that brand by sharing content with family, friends, and colleagues.

2. Lead generation. Sales are dependent on a consistent pipeline or stream of leads to nurture the target audience into new clients. Combinations of conventional and progressive methods can be used to generate leads, for example, AI (in the form of chatbots) plays a key role in gathering information to analyze lead data.
3. Grow and keep thought leadership. Regardless of business type, being recognized as an industry expert in your field is a foundation for supplying prominent levels of credibility and knowledge. Research according to Edelman-LinkedIn, suggests 60 percent of decision-makers are convinced to buy goods or services they may not have previously considered due to thought leadership (Price, 2018). There are a variety of ways to grow, develop, and support thought leadership; for example, sharing content that resonates with an audience shows you care enough to address their pain points. Leveraging personal and professional networks to reach larger audiences is another approach.
4. Increase customer value. Today, business generation is typically not an organization's only goal. Customer retention depends on keeping current clients happy and satisfied. Customers that feel delighted do not just buy again, but, in a sense, become a brand ambassador, referring other people. Educating customers about valuable opportunities that resonate with them can be a valuable marketing technique.
5. Colleague empowerment. Around the globe, marketing teams have been taking on more responsibilities for internal communications and team member education. Helping employees understand how to effectively use tools and resources at their disposal that can help simplify their jobs and reach their goals, can create feelings of confidence, collaboration, and loyalty (Higa, 2020).

Types of Marketing

Marketing is a discipline that is constantly evolving, thus, the definitions associated with the concept are updated every three years. Fresh marketing concepts often appear as a result of technological innovation and marketing research. Traditional marketing theories and concepts that were widely accepted several decades ago are no longer applicable in today's digital environment.

The consumer is king; thus, modern marketing revolves around customer needs. These needs are shaped by societal norms, culture, family, friends, work, school, and other group clusters. External changes in consumer surroundings affect the needs and consumption patterns. The emergence of COVID-19 shifted consumer behavior overnight, changing what we bought and how we bought it. Industries, such as retail, travel, and tourism, have suffered greatly and have been forced to adapt or close. Let us examine some of the most popular types: social, service, green, direct, and holistic.

In the 1970's, social marketing began as a formal principle to achieve social good. It was observed that marketing principles used to sell goods and services could also be used to sell ideas, attitudes, and behaviors. Social marketing's goal is to bring about positive change in a person's behavior by analyzing data in order to understand customer wants, needs, and motivations, thus positively shifting a behavior. Typically, target groups are divided into subcategories to increase effectiveness. For example, a campaign aiming to eradicate polio in children would target parents with young children (Giana et al., 2019).

Social marketing reaches an audience through communication methods ranging from mass media, such as television and billboards, to social media networks. Direct collaboration with customers and other stakeholders when building a social marketing strategy also helps with audience engagement and campaign effectiveness (Giana et al., 2019).

Services are an intangible activity that meets customer needs. They can be purely intangible, or they can be associated with a tangible product. They also have varying degrees of subtlety. Teaching has almost no tangible components, while medical services, custom-clothing design, and food delivery are all associated with a physical product. Most services are customized to the individual; for example, a math teacher may adopt different teaching techniques for their students. How a teacher approaches teaching students that excel in mathematics will be different than the technique used to instruct students who need extra help (Giana et al., 2019).

As the name suggests, green marketing aims to market products in a sustainable fashion. Green marketing combines customer wants and needs with the conservation and protection of the environment. World-wide, consumer awareness and appreciation of an organization's sustainability efforts continues to increase. Thus, the sustainable solutions market is rising, and institutions are adopting green measures of all kinds.

Green marketing solutions combine the five elements (product, price, place, promotion, and people) of the traditional marketing mix in an environmentally friendly way that appeals to consumers concerned with ecological issues. Successful green marketing balances profitability, social responsibility, and environmental sustainability. Effective and impactful green marketing is a mechanism that can help lead to long-term success. The process itself helps reduce waste, conserve energy, and effectively use limited resources. Increased operational efficiency, coupled with greater customer satisfaction, benefits the environment and the organization for years to come (Giana et al., 2019).

Contemporary marketing techniques consider marketing to be a comprehensive process, encompassing the economy and society. Holistic marketing allows organizations to view its marketing efforts in their entirety. The firm does not consider itself as a single entity, but as a member of the overall business universe, and multiple viewpoints of the organization's commercial activities are analyzed (Giana, 2019).

The integrated approach recognizes that all variables matter and considers the whole business system when creating a marketing strategy. Each part of the strategy is designed as a piece of the overall unified marketing strategy, and implementation and execution of marketing actives are conducted in a synchronized method. All tasks and actives are coordinated in order to achieve cooperation and deliver the best possible value to consumers.

This is the method of communicating information and selling products directly to the consumer, in turn, helping with the relationship building process. The idea is to build loyalty among existing customers while also attracting new ones. Direct marketing is more effective than other forms of mass marketing because it enables an organization to reach a specific group. Although mass media, such as television advertisements, potentially reach more people, it is likely that the majority of the audience has no interest in the product and it is therefore not relevant to them.

Direct marketing only targets the audience that would want or need the product. Efficiency is increased due to marketing efforts that are solely directed at the target audience. Direct marketing allows for flexibility of marketing methods and is easier to change than other methods. A variety of marketing channels can be used, including the following: Direct mail, email, display advertisements, social media sites, SEO (search engine optimization), mobile marketing, short message service (SMS), multimedia message service (MMS), mobile banner advertisements, mobile applications, LBS (location-based services), telemarketing, direct selling, mail order and catalog marketing, and direct response television (Giana et al., 2019).

5.2 Marketing Mix

Developing an effective marketing strategy depends on the desired goal. To meet that goal, organizations use a variety of marketing tools. Formulating a successful strategy requires a road map of how to get there. This means that various tasks must be defined, along with the action steps necessary to get there. Developing a marketing strategy requires four different components known as the four Ps or the marketing mix. The four Ps are as follows (Twin, 2020):

1. Product. This is anything that can be offered that requires marketing activities. Products can be physical goods, services, solutions, and ideas. Every product has aspects that are both tangible and intangible.
2. Price. This is something that is given in exchange for a good, service, solution or idea. Price does not have to be monetary; for example, you are spending time reading about the four Ps, so its price is time spent.
3. Place. This is how a product gets from creator to customer. This requires many important tasks, such as coordination, location, inventory, supply chain management, digital presence, and atmospherics (how a physical or digital space looks and feels).
4. Promotion. This is how consumers can be informed and influenced to buy something. There are several components of promotion, including traditional marketing, promotions, community relations, digital platforms, and personal selling. Often, promotion is mistaken for marketing because it is typically the most visual part of marketing.

Understanding the external environment in all aspects helps marketers create effective campaigns (plans) in the current market and for future markets, so firms assemble marketing departments with distinctive roles. For example, analysts will continually collect data using a process called environmental scanning. Gathering environmental data helps to find current and future market trends, opportunities, and threats. For example, smart phone manufacturers understand the importance of environmental scanning to check customer buying trends.

As technology has evolved, televisions, computers, and cell phones have become almost indistinguishable from one another. The consolidation of this technology presents unique opportunities for an array of products and services. At the start of the digital revolution, Apple was the clear winner at this as they made their iOS computer platform simple to use and fashionable in nature, and the operating system allowed customers to feel like experts. Naturally, Apple capitalized on its success through the convergence of its technologies, meaning that all Apple technologies (computers, iPads, iPhones, and Apple watches) use the same iOS platform (Toppr, n.d.).

There are six categories of environmental data that shape marketing decisions. They are as follows (Claessens, 2015):

- Cultural and social forces. This includes factors, such as buying patterns of specific cultures and sub-cultures, value systems of potential prospects, changing family dynamics and other societal trends (e.g., working remotely).
- Demographic forces. These are factors, such as generational preferences (baby boomers, Gen X, millennials, and Gen Z), birth rates, death rates, and locations of various target groups.
- Economic forces. These are factors related to the economy, for example, changes in employment rates, income levels, inflation, and **recessions** (Investopedia Staff, 2020b).
- Technological forces. These are any factors associated with technological advances such as AI, Internet of Things (IoT), automation, and digitalization.
- Political and legal forces. The legal and regulatory environment where organizations operate, along with any political movement, would be factors associated with political and legal forces.
- Competitive forces. This includes any factors associated with competition, both domestic and internationally.

Recession
This is a macroeconomic term that defines a significant decline in economic activity within a specific area. Recessions are characterized by two consecutive quarters of economic decline as reflected by GDP, employment levels, and other indicators.

Other global players have caught up to Apple over the years. Since 2015, both Samsung and Huawei have more than doubled their efforts to produce offerings that could strongly compete with Apple and, in 2019, Huawei sold more smartphones than Apple. Approximately 240 million smartphones were sold by Huawei, while Apple sold 197 million units, making Huawei the second-largest smartphone manufacturer in the world. The leading firm, globally, was Samsung, with almost 300 million smartphones sold. This example illustrates the importance of environmental scanning and the power of data analytics (Villas-Boas, 2020).

SUMMARY

In this unit, we discussed basic concepts, definitions, ideas, and applications of marketing. Lady Gaga taught us the importance of creativity, innovation, and adapting to changing customer wants and needs, which led us to learn about the various goals and types of marketing.

Goals supply clear direction and purpose. We looked at five specific goals of marketing: increased brand awareness, lead generation, growth and maintenance of thought leadership, increased customer value, and team member empowerment. We explored several types of marketing in today's world and discovered that definitions and concepts are updated on a consistent basis (every three years) due to the speed of technological advancements. As it stands today, the top five marketing types are social marketing, services marketing, green marketing, holistic marketing, and direct marketing.

Developing effective marketing strategies depends on the desired goals. To meet those goals, organizations use a variety of marketing tools including the four Ps (product, price, place, and promotion), otherwise known as the marketing mix. We learned the definition and importance of environmental scanning in order to meet the changing needs of the environment. Finally, we examined the six components related to decision-making: cultural and social forces, demographic forces, economic forces, technological forces, and competitive forces.

UNIT 6

MANAGEMENT OF LABOR

STUDY GOALS

Upon completion of this unit, you will have learned…

- to evaluate the role of human resource management as an important business function of a company.
- to use the relevant tasks of human resource management to secure the long-term success of a company.
- to define the variables for the demand of labor and its relevance to the marketplace.

6. MANAGEMENT OF LABOR

Case Study

Figure 12: Employee Engagement

Source: marekuliasz, n.d.

During her time in college, Ming Liu was a business administration major and psychology minor. Initially, Ming minored in psychology because she found it interesting. At the time, Ming could not have known just how applicable her training would become. Today, Ming works as an Executive Level HR Human Resource (HR) Manager. Her background in psychology gave her the ability to understand human behavior and empathize with others, by putting herself in their position.

Ming Liu began in the HR department of a well-known consulting firm as an administrative assistant. Over the past 15 years of Ming's career, she has taken on many roles within people operations. As Ming's career progressed, she decided she wanted to become a leader. As a team member experience (human resources) manager, she learned critical competencies for success, such as how to evaluate and keep talented employees. Following that, she became a training manager, sharpening her skills in talent development, coordination, and employee training. In time, Ming became a director of human resources for the firm's Asia-Pacific region. Ming worked her way up the organizational ladder for the following reasons:

- Ming enjoyed the fast-paced environment of consulting, and the knowledge she learned along the way.
- Making a meaningful impact on the firm's team-member experience and engagement brought her joy.

Her leadership skills, coupled with her authentic passion for the work she did, were evident to her team members and the company's executive leadership team. As time passed, the firm continued to invest in Ming's future, even giving her a two-year hiatus to pursue her MSc in Major Program Management at Oxford University in the United Kingdom.

Upon her return to Beijing, Ming was promoted to Head of Global Talent Acquisitions. Ming has been with the same firm since she graduated college 15 years ago. This firm understood the importance of employee satisfaction and that monetary rewards are not the only factor that keep talented employees from leaving companies. Ming's commitment, loyalty, and growth with the company can be attributed to the fact that she felt valued as her firm made differential investments in her, both personally and professionally, which, in turn, flowed downstream to the team members she worked with and led. What would you consider to be the top three most important things in human relations based on what you currently know? Why do you believe Ming Liu was engaged with her firm and stayed with them for such an extended period?

6.1 Process of Management of Labor

The process of recruitment, onboarding, development, motivation, and employee evaluations used to achieve organizational goals is called human resource (HR) management (INC. Editorial, INC. Staff, 2020). Foundational decision making in HR depends on the firm's overall strategies, goals, and business model. The goal of HR is to use employees as a key element of their competitive advantage in the marketplace. HR management (the process itself) has the following sequential tasks and activities:

- job analysis and structure design
- scenario planning and forecasting
- employee recruitment and choice
- onboarding, training, and development
- performance management and evaluation
- compensation and benefits

The process is sequential in nature, as team members cannot be onboarded or paid until they have been selected and placed into a specific role. This process is preceded by HR planning, job analysis, and design. Solid HR habits used within this sequence nurture performance improvement, competency, skills development, and employee retention.

Job Analysis, Structure Design, Planning, and Forecasting

Figuring out employee needs and deciding what type of roles need to be filled are two important aspects of human resource management. When a firm decides to release a new product line, they must decide how the product is sold, if more sales representatives are necessary, or if there is a new role that requires a different skillset, such as a sales operations manager who would aid with sales planning and method. Essentially, **human resource planning** is having the right number of people with the right job and the right training to carry out an organizational goal (Juneja, n.d.).

Human resource planning
This identifies current and future human resources needs for an institution to achieve their goals. Human resource planning should be a link between human resource management and the overall strategic plan of an organization.

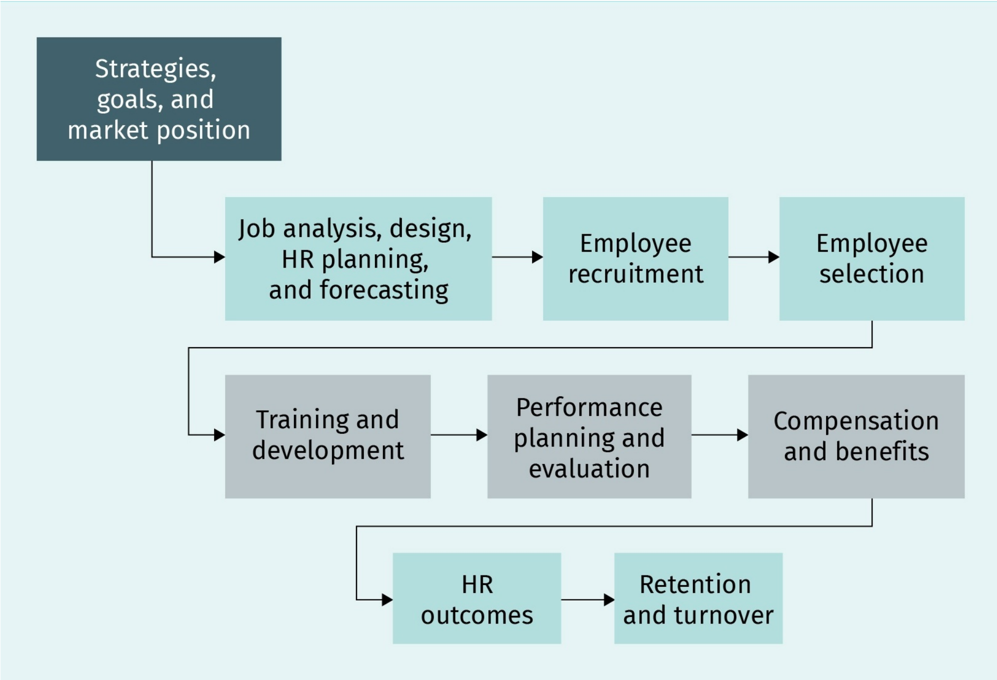
An individual involved in the planning of human resource activities is known as a human resource planner. Human resource planners must know the various qualifications that different jobs require. Deciding upon various job requirements starts with a job analysis. The data are then used to specify skills and competencies required to effectively fulfill a job's requirements.

As Head of Global Talent and Acquisitions, Ming Liu and her team were forced to work digitally like all their colleagues and examined various data analytics about organizational performance and activity. It was clear that many current roles needed adjustments to the role expectations and requirements. The process of **forecasting** a firm's human resource needs is known as the HR demand forecast. Forecasting is a critical part of HR planning, involving the following forecast factors:

Forecasting
This is an activity that utilizes numbers, inputs, and various other forms of data to make informed business decisions. Forecasting helps determine the trajectory of various trends.

- determination of people needed within a future period (five people needed one year from now, for example)
- estimation of the current number of team members with the ability to fill various organizational roles in the future, an internal supply forecast

Figure 13: Human Resource Management Process



Source: Gitman et. al., 2018.

Employee Recruitment Selection

When an organization needs to replace a vacant position or create a new one, the company begins looking for individuals that meet specific job requirements. There are two sources used to fill employee vacancies. They are as follows:

1. Internal labor market. Generally speaking, valuable information can be stored in HR information systems that contain an employee database. For example, relevant work experience, education, certifications, skills, and competencies. Typically, such a system has performance evaluations, attendance records, and career preferences.
2. External labor market. When positions are unable to be filled internally by qualified applicants, a process known as recruitment takes place. A variety of HR management tactics can be used to attract applicants. Some of these methods include, print, radio, TV advertisements, and the internet. Another customary practice is the use of job fairs, which are especially effective for college recruiting efforts (Gitman et al., 2018). Since the emergence of COVID-19, online recruitment efforts have increased. According to the Society of Human Resource Management (SHRM), the following three key findings stand out (Mulvey et al., 2016):
   - One-third of companies use mobile recruiting, which targets smartphone users.
   - Social media recruiting has grown exponentially, with 85 percent of firms using it as a hiring mechanism.
   - Over 80 percent of organizations use social media for the recruitment of passive job candidates.

Once a company has enough qualified applicants, the selection process begins. The selection process finds candidates from the applicant pool that have the skillsets and qualifications required to succeed in the role. There are many different types of hiring approaches, depending on company and culture. A commonly used approach among corporations and government agencies is called a multiple hurdle system (Smith & Angie, 2011). The steps in the selection process are as follows:

1. Initial qualification screening. This involves analyzing candidate data in order to see which individuals meet basic qualifications and have the skills necessary to do the job. There are hundreds of thousands of jobs in the world, requiring many different skillsets.
2. Employment testing. Following the first screening, certain roles may require cognitive, motivational, and aptitude tests, other positions may use physical abilities testing, and some unique positions may require all of them. For example, the global intelligence and security communities have extensive requirements for entrance that measure all points (Department of Homeland Security, n.d.).
3. Interview selection. The mechanism most often used to make hiring decisions is an in-depth discussion about their experience, education, skillsets, and professional interests. Typically, the more senior the position, the more interviews that occur. Interviewers range from executive level leaders to possible future colleagues (teammates). This ensures that the candidate in question is the right choice in terms of skillsets and institutional culture.
4. Background check. This includes checking the applicant's references. Many firms examine a candidate's background through reference checks and other databases that vary from institution to institution, and country to country. Factors examined could be legal, behavioral, financial, or even health related.
5. Physical examinations and drug testing. An institution may require a medical diagnosis of physical health stating that they can physically perform tasks related to the job. Drug tests are common in industries such as transportation, healthcare, and public safety.
6. The decision and offer. After candidates have successfully fulfilled all the requirements, and leadership is confident in the potential employee's ability to perform the job, the hiring decision is made. However, it is contingent upon the candidate accepting the offer and passing the institution's background requirements (Gitman et al., 2018).

Onboarding, Training, and Development

A manager's goal is to produce positive results through their direct reports. Therefore, employee investments in the form of training and development, for both new and experienced team members, are important. HR management oversees the onboarding process for new hires and continuous development of current employees. The goals are to improve performance, reduce errors, and show team members that their organization believes in them and wants them to be successful. Training comes in many forms and can be done on, or off the job. When a new employee is being onboarded, they are typically given an orientation. On the job training is related to the tasks their own job requires, and this type of training tends to be specific in nature. Guidance is given by experienced trainers, managers, or colleagues.

Other forms of on the job training are apprenticeships and mentoring. Apprenticeships typically use a combination of on the job instructional training with classroom exercises. Individuals within specific trade industries, such as electrical work or carpentry, may be in a partnership for years. Mentors can be formal (a manager) or informal (tenured team members that are individual contributors) leaders. Mentorship is inexpensive and new hires can be provided with instantaneous feedback. For example, a mentee on Ming Liu's team, whose second language is Mandarin, may need some extra help with the language. In this instance, a mentor may be provided to help with consistent verbal communication and drafting email messages (Gitman et al., 2018).

Technology is often used to replace traditional off the job training methods due to COVID-19 and cost efficiencies. Major organizations worldwide use programmed instruction online, much like this course. This instruction is highly structured and presents learners with terms, concepts, and problems using a modular system. Simulations are another example of web-based training that can help employees understand the functionality of AI or an automated piece of machinery in a vehicle manufacturing process. It is also common for airlines to use flight simulators for pilots as this helps them become accustomed to possible hazardous conditions they may encounter in a safe environment where no one can get injured (Gitman et al., 2018).

Performance Management and Evaluation

The strategic method of creating and sustaining improved employee performance, leading to increased effectiveness and results is known as performance management. An increased focus on team members' development, in alignment with company, team, and individual goals, can help managers create a work culture of increased collaboration, employee engagement, and business results. The application of performance management means that leaders must be consistently working to develop, coach, and set up clear goals with employees. This contemporary method is used and preferred most often due to the rapidly changing business environment, as it yields better outcomes (Valamis Group, n.d.).

A more traditional approach that is still used to decide salary increases is a yearly performance appraisal. This is a formalized structure with specific goals, agreed upon by leadership at the beginning of each business calendar year. In recent years, it has been proven that annual performance appraisal systems do not increase employee engagement, do not consistently meet organizational goals, and do not help employees self-reflect or understand their own performance (Valamis Group, n.d.).

Compensation and Benefits

The definition of compensation includes both pay and benefits, and is usually connected to a team member's annual performance review. Several factors could influence the pay scale of an employee:

1. Salary structure and internal influences. A compensation package consists of salaries, wages, and diverse benefits that are based on an individual's experience, skillset, and position. Executive level positions, such as president, chief executive officer, and chief

information officer, are compensated at the highest wage levels. Likewise, different jobs of equal importance to an organization are compensated similarly. The higher level of employment means a greater degree of responsibility. For example, if a UX designer and web developer are considered equal in terms of importance, they may both be paid the same amount.

2. Wage level and external factors. When deciding on compensation packages, a key factor for firms to consider is the external competitive environment. If competitors have a better compensation program, firms could lose top talent. Compensation is regularly evaluated by HR professionals according to geographies, job positions, competitors, and in line with the marketplace (Gitman et al., 2018).

6.2 Demand for Labor

The term “demand for labor” is an economic principle, meaning that the demand for labor depends primarily on the customers’ demand for a product or service. For example, if the market experienced increased demand (frequency) for visiting coffee shops, it would lead to an increased demand for baristas. Labor demand is also dependent on labor productivity, product pricing, and overall profitability.

Around the globe, labor markets have had difficulty keeping pace with rapid shifts in the economy and the COVID-19 pandemic highlighted inefficiencies within every system. Millions of individuals are unable to find work, yet segments such as healthcare and IT cannot find the “right people” to fill these jobs (Andrew, 2020). Many workers feel underutilized and overqualified in their roles. Online platforms such as LinkedIn have helped to decrease some dysfunctions by connecting people with job opportunities; however, these platforms only touch a minute portion of the global workforce. They do, however, create benefits for both individuals and economies alike (Manyika et al., 2015).

In different countries around the planet, somewhere between 30 and 45 percent of the working-age population are part-time, inactive, or unemployed. Between China, the US, the UK, Germany, Brazil, India, and Japan, this amounts to 850 million people. LinkedIn and other online job platforms can help inject speed and momentum into various markets. McKinsey & Company calculated that online platforms could inject up to $2.7 trillion into global GDP by 2025, equaling an increase of 72 million full-time positions (Manyika et al., 2015).

Economies with consistently high unemployment rates and low work force participation can benefit the most from digitalization and expanded network capabilities. Examples of these countries are Greece, Spain, and South Africa, though an advanced economy can also benefit due to the fluidity of its market structure. On the opposite side of the spectrum, countries such as China and Japan would benefit the least due to low unemployment rates and certain barriers that limit the adoption of digitalization. Digital talent platforms create a level of transparency around the demand for various skills and competencies, which helps people to make better informed decisions. This type of transparency can help create opportunities for tertiary educational spending in countries such as China, Brazil, India, Japan, Germany, the US, and the UK (Manyika et al., 2015).

Rapidly changing environments present opportunities for emerging occupations and labor market growth. The “green economy” is a good example where newer technologies are forcing economies to adopt digitalization at faster speeds, increasing the demand for skillsets in science, technology, engineering, and mathematics (STEM). Furthermore, analytical and strategic problem-solving skills have been pushed to the forefront in terms of demand within the labor market (Kochhar, 2020).

6.3 Human Relations in Organizations

The relationships that exist between employees and management have a substantial amount of value within every workplace. As previously noted, human relations are the process of employee onboarding, training, addressing employee needs and concerns, fostering a business culture, and resolving conflicts that arise between employees and management.

Employee Collaboration and Workplace Culture

Human relations are key to making a business work and play a significant role in the workplace. Communication and collaboration are important tools for working. Frequently, team members must work together on special projects and communicate with one another across various platforms. HR supports and stimulates the free flow of ideas and supplies motivation to ensure that organizational goals are met. When a business environment is not stable, challenges often arise. These challenges can be operational in nature or related to employee management. Organizations with an engaged workforce and skilled employees are more likely to obtain and keep top talent while fostering loyalty with customers and meeting the changing needs of the marketplace.

Employee Retention

Employee retention is dependent on workplace relations and is crucial to reducing turnover. Turnover is very costly to organizations; new employees need investments of money, time, and energy. Additionally, employees leaving can be challenging, especially if the situation is not amicable. Organizations become more financially sound when existing employees stay engaged and interested. HR teams must be patient, compassionate, and show flexibility in most circumstances.

Productivity and Motivation

Relationships in the workplace improve employee motivation and productivity. Team members that are interested in the work being done and in the well-being of their colleagues are usually more productive than those who are not. Productivity shows itself in the form of financial dividends to the firm because it can get more tasks done in less time and lower costs. Recognizing an employee’s contributions and values to the company, while showing concern for them as individuals goes a long way in relationship building and making employees feel wanted and needed by the firm.

Fostering Creativity

The contemporary and modern workplace typically rewards organizations that can develop products quickly in order to meet customer demand. Some industries (IT and MedTech, for example) allow employees to produce innovative ideas. Innovation and creativity can decide whether a company is successful or not. Communication is a key element of creativity as speaking with one other allows us to share ideas and gain feedback. Without workplace relationships, team members are much less likely to develop innovative ideas and solutions that will help businesses survive (Petryni, 2019).

SUMMARY

In this unit, we discussed human relations management in the workplace. We learned that foundational decision-making in HR depends on the firm's overall strategies, goals, and business model, and the goal of HR is to use employees as a key element of their competitive advantage in the marketplace. HR management (the process itself) has the following sequential tasks and activities: job analysis and structure design, scenario planning and forecasting, employee recruitment and choice, onboarding, training and development, performance management and evaluation, compensation, and benefits.

We learned about the demand for labor and used coffee shops as an illustration. Demand is also dependent on labor productivity, product pricing, and overall profitability. Lastly, we discussed the importance of relationships that exist between employees and management as they have a substantial amount of value within every workplace. As previously noted, human relations encompass the processes of employee onboarding, training, addressing employee needs and concerns, fostering a business culture, and resolving conflicts that arise between employees and management.

UNIT 7

ACCOUNTING IN BUSINESS

STUDY GOALS

Upon completion of this unit, you will have learned…

- to define the term “accounting” and its role in business.
- to determine the key responsibilities of accounting for a company.
- to illustrate the various spheres and principles of accounting.

7. ACCOUNTING IN BUSINESS

Case Study

Figure 14: Starting a Business

Source: Thanyakij, n.d.

Mohamed Dsouza always knew that he wanted to be an entrepreneur, he was just not sure what direction life would take him. In 2019, after a decade of employment as a digital graphics designer for video games, Mohamed cofounded ELIXER, an IT firm specializing in innovative video game design and linguistics to allow for a seamless global product distribution.

It is likely that Mohamed would say he is a creative person, but not great with numbers and other organizational details; however, financial statements, cash flow, and other business details are key to any institution's success. Mohamed Dsouza knew he needed a business partner with a skillset that would complement his, such as financial planning and organization. He found an appropriate partner in a recent MBA graduate named Keisha Harris, who has an affinity for entrepreneurship, videogames, and financial accounting, making the two a good match.

Intuit is a market leader in IT accounting and has helped many small and medium-sized business revolutionize accounting systems with a product portfolio offering programs such as TurboTax and QuickBooks, which have helped small businesses become better at managing their finances. Their digital platform offers online support and advice to help with businesses that want more information about how business accounting functions are tracked (Intuit, n.d.).

Using a cloud-based program has helped both Mohamed and Keisha gain control over the firm's finances. It also helps supply valuable insights into profit and loss, cost of goods sold (COGS), and labor. A key feature that helped QuickBooks' become embedded with ELIXER was their ability to function with other applications that helped Keisha manage sales efficiently. Keisha used HubSpot as her preferred customer relationship management system, which integrates with Intuit products (HubSpot, n.d.).

It is important to closely monitor an organization's financial information. Regardless of whether a business is a conglomerate or a startup, it is a crucial piece of a businesses operating process. The Industry 4.0 tech revolutions have changed bookkeeping activities and allowed them to be conducted more efficiently and effectively, therefore helping business owners, particularly small and medium sized businesses, such as ELIXER, by giving them more time to expand their business and adhere to their corporate social responsibilities. Why do you believe accounting in business is so important? Do you think good and correct accounting equals business success? Why or why not?

7.1 Functions and Goals of Accounting

The role of **accounting** is to supply data in the form of reports, outlining an organizations financial condition. Every institution, regardless of whether it is a public agency or private firm, uses accounting. Financial data supplies a foundation for looking at earlier performance, financial health, and probable future outcomes. Accounting framework is also used as a framework to compare the financial performances and positions of competitive firms in the external environment. An ability to prepare and interpret financial reports aids one's evaluation skills when it comes to any decision-making process.

Accounting
This is the process of recording, analyzing, and summarizing business and financial transactions (Gitman et al., 2018).

Figure 15: The Accounting System

Source: Gitman et al., 2018.

The figure above shows how the accounting system takes numerical data from financial transactions (revenues, bills, payments, purchases, etc.) and converts it into a readable format to be used as an evaluation tool for firms. These reports tell the story of a business' financial position at a specific point in time and its financial performance during a specific time. Financial reporting includes finance statements, such as balance sheets, income statements, special reporting, sales, and expenses breakdowns by segment line. (Gitman et al., 2018).

A customary practice is for financial teams to set goals and objectives across the accounting department. This sets a baseline for the department within a given timeframe and acts as a guideline to ensure best practices are performed at any given time. Usually, these goals should be in alignment with the institution's goals and objectives, however, there are instances where goals may differ from each given company goal. For example, every country's regulatory environment is different. As such, some of the legal and ethical practices they must uphold may not be in complete alignment with corporate level objectives (Gitman et al., 2018).

Payroll Management

It is the responsibility of the accounting department to manage and update all payroll information for new and existing employees in an organization. Employee wages must be tax-deducted and delivered in a consistent and prompt manner, even if there are other important projects in the pipeline. This is a very important task as all employees rely on being paid.

Record Keeping

Accounts receivable analyzes data for accounts who own the firm money. Consumers purchasing goods and companies buying services from a given firm fall into this segment. One common aim shared by all accounts is to follow up on outstanding accounts receivable, in other words, reaching out to the buyers to learn when payments will be made. An account statement is issued at the point of sale; however, busy firms or individuals may need additional notice. The common goal of accounting is to ensure their institution's finances are balanced.

Budgetary Responsibilities

Budgeting starts at the executive level. It is an ongoing and necessary operational activity. Typically, discussions between the accounting team and leadership revolve around operational tasks related to increasing revenues and improving operating efficiencies (monetarily). The finance department plays a significant role in budgetary meetings, addresses questions related to numbers, and gives input and advice to help with the decision-making process. A key goal of budgetary responsibilities is offering strategic solutions to management that keep an organization's net worth balanced, while ensuring the budget has positive profits monthly despite any changes that are made.

Financial Reporting

It is the responsibility of the accounting department to keep updated entries of incoming and outgoing monetary transactions. This helps the finance team to supply information for daily, monthly, quarterly, and yearly reporting to necessary business partners. These entries are very important when working out these reports; every accounting department should have accurate figures.

Customer Service

Typically, account managers and customer sales representatives communicate with accounts receivable to work toward the common goal of collecting payments and providing customer service. Examples of common department goals may include answering email inquiries within a designated timeframe and paying invoices to the firm within ten days of receipt. Customer retention is a key component of revenue generation. Keeping customers satisfied and coming back (instead of purchasing from the competition) helps firms grow while assisting with predictability and forecasting of future revenues (Bragg, 2020).

7.2 Spheres of Accounting

The finance world has four major spheres (or segments). They are: public accounting, management accounting, government accounting, and internal auditing.

Public Accounting

This form of accounting covers an array of services. It can include preparing and issuing public financial reports, offering financial planning and consulting services, and preparing tax returns. Public accounting encompasses the following different types of accounting (AccountingEdu.org, n.d.):

- Financial accounting involves the preparation of an organization's financial statements.
- Tax accounting involves business and individual taxes, with the intent to mitigate as much tax obligation as possible.
- External auditing involves reviewing financial statements to decide if they were accurately prepared.
- Forensic accounting involves the examination of financial records to uncover fraud and other illegal activities, or missing financial records reconstruction.

Management Accounting

The term management accounting is also known as managerial, corporate, industrial, cost, or private accounting. The primary function of management accountants is to support business managers and help them make good business choices. Typically, they prepare detailed financial reports and forecasts for leadership inside the firm. The reports they prepare are not usually meant for public use.

It is the job of management accountants to track and analyze financial data by constructing, implementing, and managing a firm's internal fiscal management systems. They aid performance management, strategic planning, and risk mitigation. Management accounting has various approaches to its methods; for instance, project-based accounting (job cost accounting) tracks finances through each individual project and prepares reporting related specifically to that project. An innovative approach developed in Germany in 2000 is called resource consumption accounting. It is principle-based and not tied to a specific method, according to the Resource Consumption Accounting Institute (AccountingEdu.org, n.d.).

Government Accounting

Government accounting is an umbrella term, referring to any type of accounting used to keep and examine accounting records of government institutions and to audit private firms and people that engage in activities that are subject to government taxation and regulation. Therefore, governmental accounting could encompass metrologies from tax accounting, financial accounting, and other accounting systems. Sometimes, government agencies use fund accounting. This type of structure allows separation or resources according to category in order to track the use of funds and their source. Fund accounting is used to show transparency between government agencies. For this reason, it is also commonly used by not-for-profit organizations (AccountingEdu.org, n.d.).

Internal Auditing

The function of internal auditing is to supply independent and objective viewpoints to an organization's finances. Typically, internal auditors handle the mismanagement of financials, fraud, and identity theft to reduce waste and improve operational efficiency. In the US, publicly traded firms are subject to the regulatory environment of the Securities and Exchange Commission (SEC). Investors use the data revealed in audits to decide which securities are worth making investments in (AccountingEdu.org, n.d.).

7.3 Fundamental Principles of Accounting

Gaining a consistent approach to accounting is no easy task, especially on a global level. Worldwide, several major governing bodies exist to define standards in accounting. The International Financial Reporting Standards (IFRS) is a not-for-profit international organization, responsible for developing a single set of high-quality global accounting standards, known as IFRS Standards. The organization's aim is to develop consistent accounting standards that allow for transparent, efficiency, and accountability to global financial markets. IFRS Standards are required in over 144 jurisdictions, with many others allowing their use (IFRS, n.d.).

The United States uses Generally Accepted Accounting Principles (GAAP), which are set forth by the Financial Accounting Standards Boards (FASB). GAAP governs the states according to general rules and regulations. Their aim is the same as IFRS: to standardize and regulate definitions, assumptions and methodologies used across all industries of accounting (Tuovila, 2020). The following are the eight most common accounting principles (globally):

1. Principle of business entity. It is the accountant's responsibility to keep business transactions of a business entity and their owner's separate. For example, a sole proprietorship and its owner are legally considered a single entity. However, for accounting purposes, they should be considered as two separate entities. As such, assets and liabilities of the business should only be used for business expenses. The reason for this being that if transactions get mixed up, the correct image of the business would not be clear (Das, n.d.).
2. Principle of money management. Accounting measurements of business transactions can only be expressed financially and in a specific currency, such as pounds, euros, or dollars. Whichever monetary system is expressed should be recorded in the same currency. Since accounting can only express monetary units of measurement, any other transactions should be dealt with separately (Das, n.d.).
3. Dual aspect principle. This is the center of the whole accounting process. For each debit, there should be a credit. The principle works so that a transaction is only to be completed when terms and conditions have been fully completed. This principle helps to determine the source of funds, which is where money goes and comes from (Das, n.d.).
4. Matching principle. This principle requires organizations to utilize the accrual basis of accounting. The matching principle requires all revenues and expenses to be matched; for example, an account managers commission expense should be reported within the time period of when the revenue was made (not reported when commissions are paid). Employee wages are reported as an expense during the week the employee worked, not when they were paid. If an employee is given one percent of its firm's 2020 earnings as a bonus on January 15, 2021, the business should report the expense in 2020 (an unpaid liability), not in 2021 (expense occurs as the sale occurs). Since we are unable to measure future economic benefit of an investment, such as marketing (thereby we are unable to match the marketing expertise with related future revenues), an accountant would charge the marketing cost to expenses in the time period that the advertisement runs (Averkamp, n.d.).
5. Accounting year principle. Every organization chooses a time period to complete their accounting cycle. It can be a fiscal year or a calendar year. The majority of companies in India follow a fiscal year, while most American firms follow calendar years. Total income and expenses are calculated based on the accounting year and can be identified on financial statements. Time periods range from six months to one year; however, some firms issue quarterly and semi-annual statements, called interim statements (Das, n.d.).
6. Profit realization principle. Revenue is recognized under accrual-based accounting (instead of the cash basis of accounting). It is recognized the moment a product is sold or a service has been performed, regardless of when payment is received. If using this accounting principle, a firm could report $50,000 of revenue in month one of operations but does not receive any cash that month. Let us say that ELIXER completes agreed upon services at a price of $10,000; ELIXER can recognize that as revenue when the work is finished. It does not matter whether the customer pays the amount immediately or over a given period (Averkamp, n.d.).

7. Principle of going concern. It is assumed that an organization will exist long enough to achieve its goals and commitments and that they will not liquidate in the foreseeable future. If the firm enters a precarious situation, and the accountant believes the firm will be unable to continue, the accountant must show their assessment. The going concern principle allows organizations to defer prepaid expanses until a specific period in the future (Averkamp, n.d.).
8. Consistency principle. Once a business has decided on an accounting methodology, this principle states that the firm must continue to follow the same method on all transactions. They are only allowed to alter the approach if there is a concrete business reason to do so. Consistent changes in policy could be a red flag, and investors also see consistency as an important aspect of the decision-making process (Das, n.d.).

Figure 16: Accounting Principles Every Businessperson Should Know

Business entity principle 1

The business entity and business owner (or owners) are treated as two separate identities. Business transactions and personal spending are to be kept separate.

Money measurement principle 2

Accounting can only record monetary transactions. Transactions in other formats are to be kept elsewhere.

Dual aspect principle 3

Any time a debit occurs, there is a credit. The transaction is complete when the transaction is zeroed out.

Matching principle 4

For each revenue entry, there should be an equal expense recorded for correctly matching the profits and losses within a certain period of time.

Accounting year principle 5

Every organization may choose a discrete-time period for completing an accounting process cycle. Typically, the time period is 12 months long.

Profit realization principle 6

Profit is not realized until it is earned, because profit can only be counted once all of the risk and reward related to the transaction have been transferred.

Going concern principle 7

It is assumed the business will survive for a long period of time and can fulfill its commitments. This also assumes that the firm will not be forced to halt operations and liquidate assets.

Consistency principle 8

Once a business has decided on a method of accounting and record keeping, they should follow that same method for all other transactions unless they have a sound reason to make changes.

Source: Created on behalf of IU, based onDas (n.d.)

SUMMARY

In this unit, we discussed the process of accounting in business. This is the collecting, recording, classifying, summarizing, reporting, and analyzing of financial activities. We learned that the role of accounting is to supply data in the form of reports, outlining an organizations financial condition. Every institution, regardless of whether it is a public agency or private firm, uses accounting because financial data supplies a foundation for looking at earlier performance, financial health, and probable future outcomes.

We learned about the functions and goals of accounting prior to learning the various spheres of accounting and nuances of each when we discussed four specific spheres and their functions. Lastly, we examined eight out of the ten main accounting principles and guidelines that are known as Generally Accepted Accounting Principles (GAAP). GAAP governs the global accounting world according to general rules and regulations, attempting to standardize and regulate definitions, assumptions, and methodologies used across all industries of accounting.

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