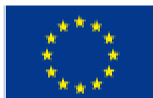
evropský
sociální
fond v ČR

EVROPSKÁ UNIE

MINISTERSTVO ŠKOLSTVÍ,
MLÁDEŽE A TĚLOVÝCHOVY

OP Vzdělávání
pro konkurenceschopnost

Slezská univerzita v Opavě

INVESTICE DO ROZVOJE VZDĚLÁVÁNÍ

Silesian University in Opava
School of Business Administration in Karviné

MANAGEMENT ECONOMICS

SELECTED ASPECTS OF THE BUSINESS

Pavel Adámek, Žaneta Rylková

Karviná 2014

OP VK No. CZ.1.07/2.2.00/28.0017 Project „Innovation of study programes at Silesian university in Opava, School of Business Administration in Karvina“

Subject: Organization and Management.

Annotation: The business management economics is designed for students who are interested in business or management with a foundation in economics and a selection of applied fields related to business management. The study material helps students to understand choosen parts from business economics, especially focused on definition, nature, scope and cocenpts of business economics with an emphasis on principles of entrepreneurship; creation of business enterprise and basic elelement of every business concretely human ressource management. From financial aspect of the business there are introduced the complementary part focused on cost volume profit analysis and business performance measurement with tratitioanal, modern and comprehensive approaches. The aspects of business strategy complement the other parts of the business such as enterpreneurship issues and factors affecting business environment. Finally, investment decision-making act is introduced in last chaper forcefully on investment process and investment evaluation methods.

Key words: Business, entrepreneurship, economics, management, business environment.

Author: **Ing. Pavel Adámek, Ph.D.,**
Ing. Žaneta Rylková, Ph.D.

Recenzenti: doc. Anna Čepelová, PhD., Ing. Jiří Franěk

ISBN **978-80-7248-991-6**

CONTENT

INTRODUCTION **5**

1 BUSINESS ECONOMICS: DEFINITON, NATURE, SCOPE AND CONCEPTS . **7**

1.1 DEFINITION 7
1.2 NATURE OF BUSINESS ECONOMICS 8
1.3 SCOPE OF BUSINESS ECONOMICS AND INTERNAL ORGANISATION 10
1.4 THE ORIGINS OF ENTERPRISE 13

1.4.1 ORGANIZATION THEORY 14
1.4.2 BASIC ORGANIZATIONAL CHARACTERISTICS 18
1.4.3 SELECTED EXAMPLES OF ORGANIZATIONAL THEORY 19
1.4.4 BASIC ORGANIZATIONAL STRUCTURES 22

2 PRINCIPLES OF ENTREPRENEURSHIP 31

2.1 WHAT BUSINESS DO 31

2.1.1 EXTERNAL FACTORS AFFECTING BUSINESS ENVIRONMENT 32
2.1.2 BUSINESS FUNCTIONS 37

2.2 AN ENTREPRENEUR 37

2.2.1 BECOME AN ENTREPRENEUR 38
2.2.2 DECISIONS AND DOWNFALLS 39
2.2.3 CHOOSING A PRODUCT AND A MARKET 40
2.2.4 ENTRY STRATEGIES FOR NEW VENTURES 40
2.2.5 CHOOSING A FORM OF BUSINESS 41
2.2.6 INTELLECTUAL PROPERTY: A VALUABLE BUSINESS ASSET 42

3 A BUSINESS ENTERPRISE IS BORN 44

3.1 CAPITALISM AND RISK 45
3.2 FINANCING THE ENTERPRISE 46

3.2.1 SOURCES OF FINANCING 48

3.3 CORPORATE GOVERNANCE 49
3.4 CAPITAL STRUCTURE 50

3.4.1 IS THERE AN OPTIMAL DEBT-EQUITY RELATIONSHIP? 51
3.4.2 CAPITAL RATIONS AND INDICATORS 51

3.5 TO MAKE OR TO BUY 52

4 HUMAN RESOURCE MANAGEMENT 53

4.1 ACTIVITIES FOR MANAGING HUMAN RESOURCES 55
4.2 HUMAN RESOURCE STRATEGY 56
4.3 ROLE OF HRM ON ORGANISATIONAL CULTURE 59

5 COST VOLUME PROFIT ANALYSIS 61

5.1 PRODUCT COSTS 63
5.2 COSTS IN RELATION TO PRODUCT VOLUME 65
5.3 COST FUNCTION AND RELEVANT RANGE 66

6 BREAK-EVEN ANALYSIS 69

6.1 BREAK-EVEN POINT THROUGH LINEAR COST 72

6.1.1 IMPORTANCE OF BREAK-EVEN ANALYSIS 74
6.1.2 LIMITATIONS OF BREAK-EVEN ANALYSIS 74

7 BUSINESS STRATEGY ... 76
7.1 THE STRATEGY PROCESS ... 78
7.1.1 STRATEGY IMPLEMENTATION ... 83
7.1.2 STRATEGY EVALUATION AND CONTROL ... 83
7.2 THE OBJECTIVES OF MULTINATIONAL BUSINESS STRATEGIES ... 84
8 INVESTMENT ... 86
8.1 INVESTMENT DECISION-MAKING ACT ... 87
8.2 INVESTMENT PROCESS ... 88
8.3 INVESTMENT APPRAISAL ... 88
8.3.1 DETERMINING THE CASH FLOWS ... 89
8.3.2 INVESTMENT EVALUATION METHODS ... 90
8.3.3 RISK MANAGEMENT ... 96
9 BUSINESS PERFORMANCE ... 98
9.1 TRADITIONAL APPROACHES TO PERFORMANCE MEASUREMENT ... 99
9.1.1 PROFITABILITY ... 99
9.1.2 RETURN ON INVESTMENT ... 100
9.2 MODERN APPROACHES TO PERFORMANCE MEASUREMENT ... 101
9.2.1 EVA ... 101
9.3 COMPREHENSIVE APPROACHES TO PERFORMANCE MEASUREMENT ... 102
9.3.1 BALANCED SCORECARD ... 102
9.3.2 EFQM ... 107
SUMMARY ... 110
THE LIST OF LITERATURE ... 111

INTRODUCTION

The business management economics is focused for students who are interested in business or management with a foundation in economics and selection of applied fields related to business management. This study material prepares students for entrance into the business world in selected part of all business economics subjects, because we have competitive environment and managers must make increasingly complex business decisions that will determine whether the firm will prosper or even survive.

Management Economics is the application of economic theory and methodology to business. In this study material we have selected some parts from the complexity of problematic of business economics and managerial economics. All types of this approaches are focused on decision making process. The question of choice arises because the basic resources such as capital, land, labour and management are limited and can be employed in alternative uses. The decision-making function thus becomes one of making choice and taking decisions that will provide the most efficient means of attaining a desired end, say, profit maximation.

What is Economics and Management? Economics is the study of how consumers, firms and governments make decisions that together determine how resources are allocated. An appreciation of economics and the general workings of the economy has become increasingly necessary to make sense of government policy-making, the conduct of businesses and the enormous changes in economic systems which are occurring throughout the world.

Management is concerned with the effective use and coordination of materials and labour within organisations in the pursuit of the organisation's defined objectives. It considers the interrelationship and interactions between distinct parts of an organisation, and between the organisation and its environment. Management students look at theories, models and frameworks in order to understand how managers behave and consider their role in the process of decision-making.

The study material "*Management Economics*" helps students to understand chosen parts from business economics, especially focused on definition, nature, scope and concepts of business economics (part 1) with an emphasis on origins of enterprise, short overview of organisational theory with basic organizational characteristics and selected examples. In the first part are introduce the basic forms of organizational structures and types of enterprise.

Second part consists of principles of entrepreneurship divided into component parts such as „what business do" in which are introduced relation between outputs, resources, costs, revenues and business profits. In this part are also included external factors affecting business environment consisting of economic forces (income, inflation, recession, interest rate, Exchange rate), technological factors (technologies for nations, technologies for product and services, technologies for business models), socio-cultural factors (values, time-starved customers, multiple lifestyles, changing structures of families); demographic factors (such as adolescents, youth and people with different age stages); political legal environment and natural environment. The second part is extended into basic business functions and definition of the entrepreneur profiles with condition for becoming an entrepreneur. Also part of decisions and downfalls of entrepreneurship and choosing a product and a market is not neglected. This part presents entry strategies for new ventures with criteria for choosing a form of business and role of the intellectual property.

Third part of study support introduces creation of business enterprise with focused on capitalism and risk, financing the enterprise and possibilities of business financing existing in business environment. Short overview of corporate governance is included in this part.

Particular focus is appropriately amended by aspects of capital structure and optimal debt-equity relationship with capital rations and indicators. Final part of this chapter go in to decision whether to use „in-house“ production or to outsource.

Human resource management (HRM) was chosen as a basic element of every business units. This short outline the importance of human resource as the HRM framework, managing of HRM in the context of external and organizational environments with impact on the key HRM variables. The fundamental aspects of activities of managing human resources are introduced. This part follows by definition on human resource strategy with outcomes in cycle of resource-based HRM model. Chapter is concluded by defining a role of HRM on organisational culture with the addition of factors influencing this culture.

Fifth part brings us to the issue of cost volume profit analysis with definition of the different kinds of cost (e.g. manufacturing, administrative, total, direct, overhead, fixed, variable, lifecycle costs etc.). Problematic of costs is extended to managerial aspects of costs such as sunk costs and opportunity costs. Chapter follows with description of product costs structure which is critical for comprehending the process of estimating – direct and indirect costs. Next part of the chapter uses the definition of costs in relation to product volume with cost volume behaviour patterns and cost function and relevant range which is using within a short-term planning horizon. Issues of total revenue function are presented by the total revenue line for the accountant and the economist. Chapter is finished by profitability analysis based on detecting the contribution to profit of changes in volume of products and services sold in a period of time.

Sixth chapter is addressed to break-even analysis which is very important indicator when revenues of product sales equal the total costs associated with the sale of product. Analysis is considerable factor of acounting tool to help plan and control the business operations. The chapter is enriched by break-even point through linear cost and also there is graphically indication of the relationship between profit and loss at different levels of sales volume achieved. The issues of break-even point are completed by importance and limitations of this break-even analysis.

Seventh chapter contains definition and practical aspects of business strategy with specifications in the global markets, competition, innovation and organization. In this chapter is described and defined the hierarchy of strategy and the strategy process divided into partial steps. This definition is further extended by strategy implementation, evaluation and control. The objectives of multinational business strategies are the last part of this chapter.

During each business there are, used various activities, among one of the most important is the investment activity included in the eight chapter. Investment decision-making act is introduce in four principal factors follows by definition of investment process and investment appraisal. In this chapter are contained investment evaluation methods and risk management approach within an investment project management methodology.

Business performance is devoted in ninth chapter and highlights the possibility of measurement of business performance (e.g. non-financial measures). Chapter is divided into three parts; first part introduces the traditional approaches to performance measurement such as absolute indicators, differential indicators, ratios, pyramidal decomposition and aggregates. Second part uses the modern approaches to performance measurement such as economic value added, market value added and return on investment on the basis of cash flows. Third part of the chapter use another point of view, such as comprehensive approaches to performance measurement with focused on balance scorecard and model of excellence.

1 BUSINESS ECONOMICS: DEFINITON, NATURE, SCOPE AND CONCEPTS

Business economics is the application of economic principles and methods to business management practices. It deals with the business organisation and decision making process of the firm. It helps firms in business administration; decision making and business planning. Decision making involves the process of choosing the best (optimum) choice(s) or course of action(s) from the many alternatives available to the decision makers of the firm. Forward planning involves the establishment of future plans.

Profit is the ultimate aim of almost all business firms. Hence, forward planning and decision making will generally be targeted towards the maximisation of the firm's profit. Some argue that business economics is essentially about the firms and it deals mainly with the factors which help to influence the firm's decisions regarding the process of production and distribution of commodities to satisfy human wants and needs. The focus is shifted to objectives of the firms other than profit, like sales, size of firms market share, competition, etc. (Sivagnanam and Srinivasan, 2010, p. 18).

Whatsoever may be the short term objective of a firm, the ultimate one could be nothing but profit. Given such a goal, the nature of most business problems is basically economic, i.e. getting more from the given resources, and the nature of competition. The productive resources of the firms are limited in general. Acquiring more such productive resources, transforming them into goods and services and selling them for maximum profit involve innumerable plans, decisions and strategies;, and the bottom-line of all such issues is getting more from them. The limited resources have to be used efficiently in such a way as to attain maximum profit. Here comes the relevance of economics. The economic theories and methods help business managers to make efficient choices that give optimum results in business problems using techniques such as profit maximisation, demand forecasting, optimum price determination, cost minimisation, revenue forecasting and revenue maximisation.

1.1 DEFINITION

Attempting to define any subject matter concisely and adequately is a bit difficult venture with an associated risk of limiting the boundaries of the subject. Like economics, it is also difficult to have the most accurate definition of business economics which is concise as well as comprehensive. Many scholars have attempted to define business or managerial economics by emphasising its various aspects. However, the focus of this section is to summarise them to know what business economics is all about rather than deliberating about the accuracy or otherwise of any one definition.

Business economics deals with the application of economic principles and methods for business and managerial decision making of firms. The following are some of the attempt to define business or managerial economics.

"*Managerial economics deals with the integration of economic theory with business practice for the purpose of facilitating decision making and forward planning by the management*". (Spencer and Sigelman)

"*Managerial economics is concerned with the application of economic principles and methodologies to the decision making process within the firm or organisation under conditions of uncertainty. It seeks to establish rules and principles to facilitate the attainment of the desired economic goals of the management. These economic goals relate to costs, revenues and profits and are important within both the business and the non business institutions*". (Prof. Evans J. Douglas)

"*Managerial economics is concerned with application of economic concepts and economic analyses to the problems of formulating material managerial decisions*". (E. Mansfield)

The various definitions listed above are almost same in form and content with minor shift here and there. These definitions clearly show that economic principles are useful in decision making, forward planning and to arrive at rational business and managerial solutions towards efficient outcomes. The essence of these definitions can be summarised as follows.

Business economics may be viewed as the study of economic principles and methods which are relevant or useful for business and managerial decision making of firms. (Sivagnanam and Srinivasan, 2010, p. 19).

1.2 NATURE OF BUSINESS ECONOMICS

In business economics, economic principles are applied to solving at the level of the firm. The problems, of course, relate to choices and application of resources in the process of production and consumption of commodities which are basically economic in nature. Business economics bridges economic theory and economics in practice. The bottom-line that runs through most of business economics is the attempt to optimise business decisions, given the firm's objectives and given the resource constraints (including time) imposed by the society.

Decision makers of firms are confronted with many issues of decision, having to choose from among a number of possible alternatives. They must choose a specific course of action by which the firm's given resources must efficiently be used for achieving the ultimate goal, profit. This is, thus, essentially a problem of choice. Had there been no alternatives available, their would have been no decision making exercise at all. Managerial economics helps in analysing alternatives and selecting the one which would achieve the optimal result, within the limited resources and other constraints. It helps to identify alternative means of achieving objectives and then to select the alternative that accomplishes the objectives efficiently.

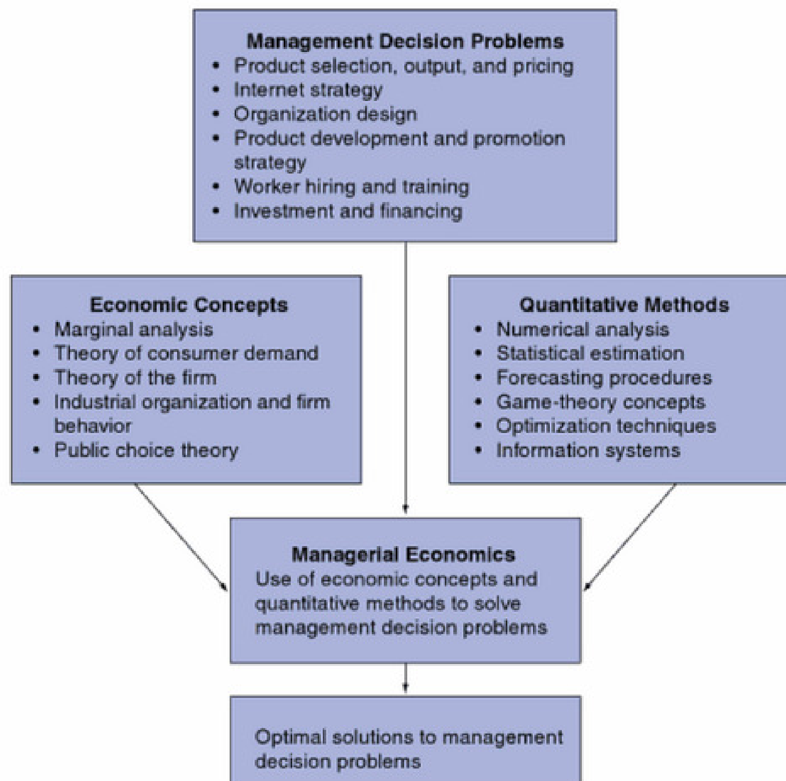
Traditional economic theory has developed along two lines: normative and positive. Normative focuses on prescriptive statements, and help establish rules aimed at attaining the specified goals of business. Positive, on the other hand, focuses on description it aims at describing the manner in which the economic system operates without staffing how they should operate. The emphasis in business economics is on normative theory. Business economic seeks to establish rules which help business firms attain their goals, which indeed is also the essence of the word normative. However, if the firms are to establish valid decision rules, they must thoroughly understand their environment. This requires the study of positive or descriptive theory. Thus, business economics combines the essentials of the normative and positive economic theory, the emphasis being more on the former than the latter.

Further, there are many forces and institutions that affect the business outcomes in the real world. They include government structure, policies, climate, socio-and political issues, NGOs, media, international agreements and trade blocks, ets. However, economic forces are

the most critical among them. Business economics also studies mostly such forces, both at the micro and macro level, that affect the business firms and their profit. Thus, business economics is broadly an approach to decision making about business problems using economics (Sivagnanam and Srinivasan, 2010, p. 20).

Managerial economics helps managers recognize how economic forces affect organizations and describes the economic consequences of managerial behaviour. It also linkd economic concept and quantitative methods to develop vital tools for managerial decision making. This process is illustrated in Figure 1.

Figure 1 Managerial Economics is a Tool for Improving Management Decision Making



Source: Hirschey, M. 2009, p. 4

Managerial economics identifies ways to achieve goals efficiently. For example, suppose a small business seeks rapid growth to reach a size that permits efficient use of national media advertising, managerial economics can be used to identify pricing and production strategies to helps meet this short-run objective quickly and effectively. Similarly, managerial economics provides production and marketing rules that permit the company to maximize net profits once it has achieved growth or market share objectives.

Managerial economics has applications in both profit and not-for-profit sectors. For example, an administrator of a non-profit hospital strives to provide the best medical care possible given limited medical staff, equipment, and related resources. Using the tools and concepts of managerial economics, the administrator can determine the optimal allocation of these limited resources. In short, managerial economics helps managers arrive at a set of operating rules that aid in the efficient use of scarce human and capital resources. By following these rules, businesses, non-profit organizations, and government agencies are able to meet objectives efficiently (Hirschey, 2009, p. 5).

1.3 SCOPE OF BUSINESS ECONOMICS AND INTERNAL ORGANISATION

As regards the scope of business economics, no uniformity of views exists among various authors. However, the following aspects are said to generally fall under business economics.

1. Demand Analysis and Forecasting
2. Cost and production Analysis.
3. Pricing Decisions, policies and practices.
4. Profit Management.
5. Capital Management.

These various aspects are also considered to be comprising the subject matter of business economic.

1. Demand Analysis and Forecasting

A business firm is an economic organisation which transform productive resources into goods to be sold in the market. A major part of business decision making depends on accurate estimates of demand. A demand forecast can serve as a guide to management for maintaining and strengthening market position and enlarging profits. Demands analysis helps identify the various factors influencing the product demand and thus provides guidelines for manipulating demand. Demand analysis and forecasting provided the essential basis for business planning and occupies a strategic place in managerial economic. The main topics covered are: Demand Determinants, Demand Distinctions and Demand Forecast.

2. Cost and Production Analysis

A study of economic costs, combined with the data drawn from the firm's accounting records, can yield significant cost estimates which are useful for management decisions. An element of cost uncertainty exists because all the factors determining costs are not known and controllable. Discovering economic costs and the ability to measure them are the necessary steps for more effective profit planning, cost control and sound pricing practices. Production analysis is narrower, in scope than cost analysis. Production analysis frequently proceeds in physical terms while cost analysis proceeds in monetary terms. The main topics covered under cost and production analysis are: Cost concepts and classification, Cost-output Relationships, Economics and Diseconomies of scale, Production function and Cost control.

3. Pricing Decisions, Policies and Practices

Pricing is an important area of business economic. In fact, price is the genesis of a firms revenue and as such its success largely depends on how correctly the pricing decisions are taken. The important aspects dealt with under pricing include. Price Determination in Various Market Forms, Pricing Method, Differential Pricing, Product-line Pricing and Price Forecasting.

4. Profit Management

Business firms are generally organised for purpose of making profits and in the long run profits earned are taken as an important measure of the firms success. If knowledge about the future were perfect, profit analysis would have been a very easy task. However, in a world of uncertainty, expectations are not always realised so that profit planning and measurement constitute a difficult area of business economic. The important aspects covered under this area are: Nature and Measurement of profit, Profit policies and Technique of Profit Planning like Break-Even Analysis.

5. Capital Management

Among the various types business problems, the most complex and troublesome for the business manager are those relating to a firm's capital investments. Relatively large sums are involved and the problems are so complex that their solution requires considerable time and labour. Often the decision involving capital management are taken by the top management. Briefly Capital management implies planning and control of capital expenditure. The main topics dealt with are: Cost of capital Rate of Return and Selection of Projects.

Significance of Business Economics

The significance of business economics can be discussed as under :

1. Business economic is concerned with those aspects of traditional economics which are relevant for business decision making in real life. These are adapted or modified with a view to enable the manager take better decisions. Thus, business economic accomplishes the objective of building a suitable tool kit from traditional economics.
2. It also incorporates useful ideas from other disciplines such as psychology, sociology, etc. If they are found relevant to decision making. In fact, business economics takes the help of other disciplines having a bearing on the business decisions in relation various explicit and implicit constraints subject to which resource allocation is to be optimized.
3. Business economics helps in reaching a variety of business decisions in a complicated environment. Certain examples are:

- What products and services should be produced?
- What input and production technique should be used?
- How much output should be produced and at what prices it should
- be sold?
- What are the best sizes and locations of new plants?
- When should equipment be replaced?
- How should the available capital be allocated?

4. Business economics makes a manager a more competent model builder. It helps him appreciate the essential relationship Characterising a given situation.
5. At the level of the firm. Where its operations are conducted though known focus functional areas, such as finance, marketing, personnel and production, business economics serves as an integrating agent by coordinating the activities in these different areas.
6. Business economics takes cognizance of the interaction between the firm and society, and accomplishes the key role of an agent in achieving the its social and economic welfare goals. It has come to be realised that a business, apart from its obligations to shareholders, has certain social obligations. Business economics focuses attention on these social obligations as constraints subject to which business decisions are taken. It serves as an instrument in furthering the economic welfare of the society through socially oriented business decisions.

Summary

The various aspects outlined above represent major uncertainties which a business firm has to reckon with viz., demand uncertainty, cost uncertainty, price uncertainty, profit uncertainty and capital uncertainty. We can therefore, conclude that the subject matter of business economic consists of applying economic principles and concepts to dea1 with various uncertainties faced by a business firm.

The usefulness of business economics lies in borrowing and adopting the toolkit from economic theory, incorporating relevant ideas from other disciplines to take better business decisions, serving as a catalytic agent in the process of decision making by different functional departments at the firm's level, and finally accomplishing a social purpose by orienting business decisions towards social obligations.

Internal organisation

The internal organisation of a business is the way in which it is structured to carry out its various activities. A lot of attention needs to be given to structure. The structure needs to be determined by the organisation's objectives and the communications networks that need to be built up both internally and externally. For example, a customer focused organisation may need a structure which is based on meeting the needs of different categories of customers. A manufacturing company, may need a structure based on different production lines. The main ways of structuring an organisation are by: 1. Function; 2. Product; 3. Process; 4. Geographical area; 5. Type of customer.

1. By function - this is the most common way of grouping employees, particularly in manufacturing companies. Functional organisation meant that a company is divided into broad sectors each with its own particular specialism or function, for example, marketing, accounts or human resources. Every company will have its own way of structuring its functions. Traditionally, functional organisation is hierarchical, with some form of line management, e.g. in a factory.

2. By product - when a large organisation produces a range of different products, it might find it convenient to create an organisational structure based on product lines. For example, a firm in the publishing industry might have a newspaper division, a magazine and periodicals division and a book publishing division. Each division will then contain a mixture of all the specialist ingredients required to enable it to work independently. A great advantage of this form of structure is that divisions can concentrate on their own market areas. It also becomes possible to assess the profitability and effectiveness of each sector. At the same time it is still possible to share expertise between divisions and to share combined services such as a combined transport fleet. By identifying the various parts of a business organisation it becomes possible to cut out loss making divisions and to amalgams divisions by merging them with similar divisions in other companies.

3. Grouping by process - where a product requires a series of processes, departments will be set up to perform each process. To take the example of the publishing company, within each of the divisions departments are responsible for carrying out the various stages for example the editing of copy, page layout and design, buying of print, etc. The illustration below shows the way in which process departments might take the responsibility for each stage. The advantages of organising on a process basis are that:

- it is possible to set up teams of similar minded specialists
- it becomes easy to identify points in the production process at which things go well or badly
- it is easy to introduce new technology at a given stage of production (i.e. a given process).

4. Grouping by geographical area - many companies will have branches spread throughout the country and sometimes overseas. Multiple retailing companies are a good example. A company like Marks and Spencer will have shops on most High Streets in the United Kingdom, groups of shops will be organised into a regional division which will have

overall supervision of such features as training of staff and distribution policy. The illustration below shows a company with five domestic divisions and two overseas divisions: There are a number of advantages of organising on a geographical basis:

- Setting up distinct regional divisions makes it possible to respond quickly to local needs, issues and problems. The organisation thus becomes more sensitive to customers, employees and other groups. At the same time it might be able to cut through a lot of red tape if the regional groups are allowed to make their own decisions.
- Setting up national and regional divisions makes it possible to tailor the operation of an organisation to local conditions. Differences would include those of language, law and custom. Local knowledge is best gained by hiring local specialists.

5. Grouping by type of customer - organisations will often set up different structures to deal with different sets of customers. This is because they will often give some groups more time and attention than others. An obvious example would be in a hospital where casualty patients would require a different type of attention to those requiring a routine X-ray. In a department store the restaurant department will operate in a different way and have different procedures to a department selling underwear. The furniture department will need to set out a process of documentation and make arrangements for delivery to customers which contrast with purchase procedures for toys. In a bank, new customers opening accounts will be dealt with separately from existing customers, etc. Many businesses will have different procedures for dealing with large and small customers. Separate departments might handle these accounts, using different types of paperwork, offering different rates of discount, and treat customers in different ways. The advantages of organising in a pattern based on having different sets of customers are:

- Different types of customers can be dealt with by separate departments.
- Customers will be more inclined to deal with a business with departments concentrating on their particular needs.
- It is easier to check on the performance of individual products.

A matrix structure - many organisations today employ what is known as a matrix structure where individual employees may report to two or more line managers at the same time. This is common when organisations are made up of teams, drawing on individuals from a range of specialism. BIC is a good example, of an organisation employing a matrix structure - an individual employee may be part of their French (geographical) division, and the razors manufacturing division at the same time[1].

1.4 THE ORIGINS OF ENTERPRISE

Firms start when entrepreneurs organise resources and take risks in the expectation of earning a profit. More specifically, enterprises tend to be set up for one or more of the following reasons:

1. To solve a problem - some firms originate to solve a problem faced by consumers, by other firms, or by government. For example, internet comparison websites solve the problem faced by consumers of having limited time to research the whole market for the best current deals.
2. To exploit an idea - many firms start in order to exploit an original idea or an invention. If the invention can be turned into a good or service which adds value, it can command a price, and earn a profit.

[1] Business Case Studies. [online]. [cit. 2013-10-02]. Available from: http://businesscasestudies.co.uk/business-theory/strategy/internal-organisation.html#axzz2kNQuP7r5

3. To fill a gap - some firms start because the entrepreneur identifies a gap in an existing or emerging market, such as online delivery businesses, like Amazon.
4. Because it can produce at lower cost – many firms enter a market because to produce an existing product more cheaply, or more effectively, than existing firms in the market. For example, Tesco plc started in 1919 when co-founder Jack Cohen sold cheap groceries from a single stall in London's East End.
5. To exploit knowledge - many firms exploit information that is not readily available, such as estate agents and travel agents.

In all cases, entrepreneurs anticipate that they will be successful and earn themselves a profit for their personal risk-taking and entrepreneurial skill. Private firms can only survive if they satisfy consumer demand effectively.

A business enterprise is any type of operation that is involved in providing goods or services with the anticipated outcome of earning a profit. Its broad nature allows the term to be applied to any type of company or firm that is geared toward generating revenue by selling products of any type. The terms *company*, *firm*, and *business enterprise* are often used interchangeably.

While some think of a business enterprise as being a large corporation or conglomerate, any type of for-profit operation that involves sales to consumers can be rightly referred to using this word. A child who engages in the task of setting up a roadside lemonade stand, and has the goal of earning a profit from that endeavor, can be said to be operating an enterprise. So too can an individual who opens a small bookshop with the plan of selling books to generate profit.

Along with the sale of goods, a business can also be involved in the sale of various types of services. Companies that offer telecommunications services are part of this category. Local businesses that offer outsourcing services, such as accounting or janitorial support, are also considered to be business or commercial enterprises. Courier services also qualify as an enterprise of this type[2].

1.4.1 ORGANIZATION THEORY

It means study of organizational designs and organizational structures, relationship of organizations with their external environment, and the behaviour of managers and technocrats within organizations. It suggest ways in which an organization can cope with rapid change[3].

Organization theory is subject to shared, although revisable, methodological procedures through which reasoned judgements of competing interpretative frames and explanatory theories are negotiated and debated. The interaction and contestation of rival intellectual traditions imply the existence of negotiated, historicized, and contextualized understandings that make rational argumentation possible. It complements the studies of organizational behaviour and human resource studies (Clegg and Hardy, 1999, p. 27).

An organization, by its most basic definition, is an assembly of people working together to achieve common objectives through a division of labour. An organization provides a means of using individual strengths within a group to achieve more than can be accomplished by the aggregate efforts of group members working individually. Business organizations are formed to deliver goods or services to consumers in such a manner that they can realize a profit at the conclusion of the transaction. Over the years, business analysts, economists, and academic

[2] Wisegeek. [online]. [cit. 2013-09-03]. Available from http://www.wisegeek.org/what-is-a-business-enterprise.htm#

[3] Business dictionary. [online]. [cit. 2013-10-25]. Available from http://www.businessdictionary.com/definition/organization-theory.html

researchers have pondered several theories that attempt to explain the dynamics of business organizations, including the ways in which they make decisions, distribute power and control, resolve conflict, and promote or resist organizational change. As Jeffrey Pfeffer summarized in *New Directions for Organization Theory*, organizational theory studies provide "an interdisciplinary focus on a) the effect of social organizations on the behaviour and attitudes of individuals within them, b) the effects of individual characteristics and action on organization, c) the performance, success, and survival of organizations, d) the mutual effects of environments, including resource and task, political, and cultural environments on organizations and vice versa, and e) concerns with both the epistemology and methodology that undergird research on each of these topics." (Pfeffer, 1997)

Of the various organizational theories that have been studied in this realm, the open-systems theory has emerged as perhaps the most widely known, but others have their proponents as well. Indeed, some researchers into organizational theory propound a blending of various theories, arguing that an enterprise will embrace different organizational strategies in reaction to changes in its competitive circumstances, structural design, and experiences.

Modern organization theory is rooted in concepts developed during the beginnings of the Industrial Revolution in the late 1800s and early 1900s. Of considerable import during that period was the research done by of German sociologist Max Weber (1864 - 1920). Weber believed that bureaucracies, staffed by bureaucrats, represented the ideal organizational form. Weber based his model bureaucracy on legal and absolute authority, logic, and order. In Weber's idealized organizational structure, responsibilities for workers are clearly defined and behaviour is tightly controlled by rules, policies, and procedures.

Weber's theories of organizations, like others of the period, reflected an impersonal attitude toward the people in the organization. Indeed, the work force, with its personal frailties and imperfections, was regarded as a potential detriment to the efficiency of any system. Although his theories are now considered mechanistic and outdated, Weber's views on bureaucracy provided important insight into the era's conceptions of process efficiency, division of labour, and authority.

Another important contributor to organization theory in the early 1900s was Henri Fayol. He is credited with identifying strategic planning, staff recruitment, employee motivation, and employee guidance (via policies and procedures) as important management functions in creating and nourishing a successful organization.

Weber's and Fayol's theories found broad application in the early and mid-1900s, in part because of the influence of Frederick W. Taylor (1856-1915). In a 1911 book entitled *Principles of Scientific Management*, Taylor outlined his theories and eventually implemented them on American factory floors. He is credited with helping to define the role of training, wage incentives, employee selection, and work standards in organizational performance.

Researchers began to adopt a less mechanical view of organizations and to pay more attention to human influences in the 1930s. This development was motivated by several studies that shed light on the function of human fulfilment in organizations. The best known of these was probably the so-called Hawthorn Studies. These studies, conducted primarily under the direction of Harvard University researcher Elton Mayo, were conducted in the mid-1920s and 1930s at a Western Electric Company plant known as the Hawthorn Works. The company wanted to determine the degree to which working conditions affected output.

Surprisingly, the studies failed to show any significant positive correlation between workplace conditions and productivity. In one study, for example, worker productivity escalated when lighting was increased, but it also increased when illumination was decreased. The results of the studies demonstrated that innate forces of human behaviour may have a greater influence on organizations than do mechanistic incentive systems. The legacy of the Hawthorn studies and other organizational research efforts of that period was an emphasis on

the importance of individual and group interaction, humanistic management skills, and social relationships in the workplace.

The focus on human influences in organizations was reflected most noticeably by the integration of Abraham Maslow's "hierarchy of human needs" into organization theory. Maslow's theories introduced two important implications into organization theory. The first was that people have different needs and therefore need to be motivated by different incentives to achieve organizational objectives. The second of Maslow's theories held that people's needs change over time, meaning that as the needs of people lower in the hierarchy are met, new needs arise. These assumptions led to the recognition, for example, that assembly-line workers could be more productive if more of their personal needs were met, whereas past theories suggested that monetary rewards were the sole, or primary, motivators.

Figure 2 Maslow´s Hierarchy of Needs

Source: Management Study. [online]. [cit. 2013-10-09]. Available from: http://www.managementstudyhq.com/maslows-need-hierarchy-theory.html

Douglas McGregor contrasted the organization theory that emerged during the mid-1900s to previous views. In the 1950s, McGregor offered his renowned Theory X and Theory Y to explain the differences. Theory X encompassed the old view of workers, which held that employees preferred to be directed, wanted to avoid responsibility, and cherished financial security above all else.

McGregor believed that organizations that embraced Theory Y were generally more productive. This theory held that humans can learn to accept and seek responsibility; most people possess a high degree of imaginative and problem-solving ability; employees are capable of effective self-direction; and that self-actualization is among the most important rewards that organizations can provide their workers[4].

[4] INC. [online]. [cit. 2013-10-02]. Available from: http://www.inc.com/encyclopedia/organization-theory.html/2

Open-system theory

Traditional theories regarded organizations as closed systems that were autonomous and isolated from the outside world. In the 1960s, however, more holistic and humanistic ideologies emerged. Recognizing that traditional theory had failed to take into account many environmental influences that impacted the efficiency of organizations, most theorists and researchers embraced an open-systems view of organizations.

The term "open systems" reflected the newfound belief that all organizations are unique in part because of the unique environment in which they operate—and that they should be structured to accommodate unique problems and opportunities. For example, research during the 1960s indicated that traditional bureaucratic organizations generally failed to succeed in environments where technologies or markets were rapidly changing. They also failed to realize the importance of regional cultural influences in motivating workers (Wagner, Sigmund, 2003).

Environmental influences that affect open systems can be described as either specific or general. The specific environment refers to the network of suppliers, distributors, government agencies, and competitors with which a business enterprise interacts. The general environment encompasses four influences that emanate from the geographic area in which the organization operates. These are:

- Cultural values, which shape views about ethics and determine the relative importance of various issues.
- Economic conditions, which include economic upswings, recessions, regional unemployment, and many other regional factors that affect a company's ability to grow and prosper. Economic influences may also partially dictate an organization's role in the economy.
- Legal/political environment, which effectively helps to allocate power within a society and to enforce laws. The legal and political systems in which an open system operates can play a key role in determining the long-term stability and security of the organization's future. These systems are responsible for creating a fertile environment for the business community, but they are also responsible for ensuring—via regulations pertaining to operation and taxation—that the needs of the larger community are addressed.
- Quality of education, which is an important factor in high technology and other industries that require an educated work force. Businesses will be better able to fill such positions if they operate in geographic regions that feature a strong education system.

The open-systems theory also assumes that all large organizations are comprised of multiple subsystems, each of which receives inputs from other subsystems and turns them into outputs for use by other subsystems. The subsystems are not necessarily represented by departments in an organization, but might instead resemble patterns of activity.

An important distinction between open-systems theory and more traditional organization theories is that the former assumes a subsystem hierarchy, meaning that not all of the subsystems are equally essential. Furthermore, a failure in one subsystem will not necessarily thwart the entire system. By contrast, traditional mechanistic theories implied that a malfunction in any part of a system would have an equally debilitating impact (Pfeffer, Jeffrey, 1997).

1.4.2 BASIC ORGANIZATIONAL CHARACTERISTICS

Organizations differ greatly in size, function, and makeup. Nevertheless, the operations of nearly all organizations - from the multinational corporation to a newly opened delicatessen - are based on a division of labour; a decision-making structure; and rules and policies. The degree of formality with which these aspects of business are approached vary tremendously within the business world, but these characteristics are inherent in any business enterprise that utilizes the talents of more than one person.

Organizations practice division of labour both vertically and horizontally. Vertical division includes three basic levels-top, middle, and bottom. The chief function of top managers, or executives, typically is to plan long-term strategy and oversee middle managers. Middle managers generally guide the day-to-day activities of the organization and administer top-level strategy. Low-level managers and labourers put strategy into action and perform the specific tasks necessary to keep the organization operating.

Organizations also divide labour horizontally by defining task groups, or departments, and assigning workers with applicable skills to those groups. Line units perform the basic functions of the business, while staff units support line units with expertise and services. In general, line units focus on supply, production, and distribution, while staff units deal mostly with internal operations and controls or public relations efforts.

Decision-making structures, the second basic organizational characteristic, are used to organize authority. These structures vary from operation to operation in their degree of centralization and decentralization. Centralized decision structures are referred to as "tall" organizations because important decisions usually emanate from a high level and are passed down through several channels until they reach the lower end of the hierarchy. Conversely, flat organizations, which have decentralized decision-making structures, employ only a few hierarchical levels. Such organizations are typically guided by a management philosophy that is favourably disposed toward some form of employee empowerment and individual autonomy.

A formalized system of rules and policies is the third standard organizational characteristic. Rules, policies, and procedures serve as templates of managerial guidance in all sectors of organizational production and behaviour. They may document the most efficient means of accomplishing a task or provide standards for rewarding workers. Formalized rules provide managers with more time to spend on other problems and opportunities and help ensure that an organization's various subsystems are working in concert. Ill-conceived or poorly implemented rules, of course, can actually have a negative impact on business efforts to produce goods or services in a profitable or satisfactory manner.

Thus, organizations can be categorized as informal or formal, depending on the degree of formalization of rules within their structures. In formal organizations, say researchers, management has determined that a comparatively impersonal relationship between individuals and the company for which they work is viewed as the best environment for achieving organizational goals. Subordinates have less influence over the process in which they participate, with their duties more clearly defined.

Informal organizations, on the other hand, are less likely to adopt or adhere to a significant code of written rules or policies. Instead, individuals are more likely to adopt patterns of behaviour that are influenced by a number of social and personal factors. Changes in the organization are less often the result of authoritative dictate and more often an outcome of collective agreement by members. Informal organizations tend to be more flexible and more reactive to outside influences. But some critics contend that such arrangements may also diminish the ability of top managers to effect rapid change (Wagner, Sigmund, 2003).

1.4.3 SELECTED EXAMPLES OF ORGANIZATIONAL THEORY

Since time immemorial, people have socially come together to undertake various activities, often out of sheer necessity because there are so many things we cannot do alone without the help of other people. We are, if we are anything, social beings who are usually reliant on other members of our species for survival. To put it bluntly, we are mutually interdependent because we rely on one another and this may be both a strength and a weakness. Imagine if you had to survive alone for a long period of time without the support of the various organizations that provide you with everything from food and clothing to water, fuel, shelter, health care, education, transport and so on.

Indeed, many activities in any society usually require people to socially interact in various ways and, to a degree, cooperate and coordinate their efforts with some sense of purpose. This seems to be the case whether we are referring to hunter–gatherer communities that use a relatively simple technology or to today's vast, technologically complex, industrial and post-industrial communities. In other words, organizing ourselves is at the heart of much of what we are and what we do as human beings. Our organizations are largely the outcomes of this collective behaviour as well as being significant influences on that behaviour. However, although these human creations may well be crucial to enabling so many aspects of our lives, through their development they might come to dominate our lives and remove much of what we do from our own control. For instance, when we go to work or attend school or university as students, we inevitably give up some of our freedom of choice over what we can do and how we do it. We lose some of our autonomy, and our behaviour becomes channelled in particular directions by the requirements and expectations of the other people involved in those organizations.

The result is that in our contemporary world, organizations are a central and all-pervasive phenomena that impact upon all of us, all our lives, from maternity hospital to funeral parlour. Indeed, there may be no escape from living in an organized manner and the discipline or control over our behaviour that comes with it that often remains unnoticed because it is so mundane and appears normal. Just think about queuing for a bus to arrive. In many, but not all, countries, this is such ordinary organizational behaviour that we barely notice doing it; we often just automatically form an orderly queue and wait our turn. It is often when the subtle and fairly informal self-organizing rules that we routinely follow and expect to be obeyed by others are broken by a 'queue jumper' or when they do not apply in a country we are visiting that we become aware of, and get rather concerned about, what is going on.

Just about everything we do is tacitly organized in some respects. Moreover, organizations themselves, in a formal manner, do so many different things for us – and to us – by enabling, transforming, yet also constraining the things we can do in numerous different ways. Although it is obvious to say that organizations organize most aspects of what we do and how we do it, this also raises issues around who decides what should be done and how it should be done, as well as raising questions about the effects of some of these social processes upon people. Therefore, studying organizations is also about trying to grapple with what sort of world we have created and what alternatives we might desire. Indeed, these complex social institutions have come to epitomise and constitute many aspects of our lives by influencing how we see ourselves and others. In other words, these institutions influence our sense of identity, whether we are students, university lecturers, managers, coal miners and so on. Through these processes, organizations are and will remain a pervasive influence on most kinds of human activity. Therefore, studying organizations entails investigating many aspects of our own lives, which is why organization theory is so interesting and will remain

important for the foreseeable future. Because organizations impact on so many aspects of our lives, organization theory is important in two key respects. Firstly, organization theory helps us to reflect upon and understand who we are and why we are who we are. Secondly, organization theory is about us and how we interact with others during our encounters in a

vast array of different, often deceptively ordinary and mundane, social contexts that we take for granted because we cannot see or imagine any alternative to how things appear to be. Organizational theory could be divided in different point of view. For our purpose we used the following type of organizational theories.

1. Classical Organization Theory

Classical organization theory evolved during the first half of this century. It represents the merger of scientific management, bureaucratic theory, and administrative theory. Frederick Taylor (1917) developed scientific management theory (often called "Taylorism") at the beginning of this century. His theory had four basic principles: 1) find the one "best way" to perform each task, 2) carefully match each worker to each task, 3) closely supervise workers, and use reward and punishment as motivators, and 4) the task of management is planning and control.

Initially, Taylor was very successful at improving production. His methods involved getting the best equipment and people, and then carefully scrutinizing each component of the production process. By analyzing each task individually, Taylor was able to find the right combinations of factors that yielded large increases in production.

While Taylor's scientific management theory proved successful in the simple industrialized companies at the turn of the century, it has not faired well in modern companies. The philosophy of "production first, people second" has left a legacy of declining production and quality, dissatisfaction with work, loss of pride in workmanship, and a near complete loss of organizational pride.

Max Weber expanded on Taylor's theories, and stressed the need to reduce diversity and ambiguity in organizations. The focus was on establishing clear lines of authority and control. Weber's bureaucratic theory emphasized the need for a hierarchical structure of power. It recognized the importance of division of labour and specialization. A formal set of rules was bound into the hierarchy structure to insure stability and uniformity. Weber also put forth the notion that organizational behaviour is a network of human interactions, where all behaviour could be understood by looking at cause and effect.

Classical management theory was rigid and mechanistic. The shortcomings of classical organization theory quickly became apparent. Its major deficiency was that it attempted to explain peoples' motivation to work strictly as a function of economic reward.

2. Neoclassical Organization Theory

The human relations movement evolved as a reaction to the tough, authoritarian structure of classical theory. It addressed many of the problems inherent in classical theory. The most serious objections to classical theory are that it created over conformity and rigidity, thus squelching creativity, individual growth, and motivation. Neoclassical theory displayed genuine concern for human needs.

One of the first experiments that challenged the classical view was conducted by Mayo and Roethlisberger in the late 1920's at the Western Electric plant in Hawthorne, Illinois. While manipulating conditions in the work environment (e.g., intensity of lighting), they found that any change had a positive impact on productivity. The act of paying attention to employees in a friendly and nonthreatening way was sufficient by itself to increase output. Taylor, Weber, Barnard, Mayo, Roethlisberger, and Simon shared the belief that the goal of management was to maintain equilibrium. The emphasis was on being able to control and manipulate workers and their environment (Walonick, 1993).

3. Systems Theory

Systems theory was originally proposed by Hungarian biologist Ludwig von Bertalanffy in 1928, although it has not been applied to organizations until recently. The foundation of systems theory is that all the components of an organization are interrelated, and that changing one variable might impact many others. Organizations are viewed as open systems, continually interacting with their environment. They are in a state of dynamic equilibrium as they adapt to environmental changes. Senge (1990) describes systems thinking as: understanding how our actions shape our reality. If I believe that my current state was created by somebody else, or by forces outside my control, why should I hold a vision? The central premise behind holding a vision is that somehow I can shape my future, Systems thinking helps us see how our own actions have shaped our current reality, thereby giving us confidence that we can create a different reality in the future.

4. Organizational Structure Theory

Until recently, nearly all organizations followed Weber's concept of bureaucratic structures. The increased complexity of multinational organizations created the necessity of a new structure that Drucker called (1974) "federal decentralization". In federal decentralization, a company is organized so that there are a number of independent units operating simultaneously. "Each unit has its own management which, in effect, runs its own autonomous business." (p. 572) This structure has resulted in large conglomerates which have diversified into many different fields in order to minimize risk.

The project management organizational structure has been used effectively in highly dynamic and technological environments. The project manager becomes the focal point for information and activities related to a specific project. The goal is to provide effective integration of an organization's resources towards the completion of a specific project. Implementing a project management approach often involves dramatic changes in the relationships of authority and responsibility.

The matrix organizational structure evolved from the project management form. It represents a compromise between the traditional bureaucratic approach and the autonomous project management approach. A matrix organization has permanently established departments that provide integration for project management. The matrix form is superimposed on the hierarchical structure, resulting in dual authority and responsibilities. Permanent functionality departments allocate resources to be shared among departments and managers.

Systems theory views organizational structure as the established pattern of relationships among the parts of the organization. Of particular importance are the patterns in relationships and duties. These include themes of 1) integration (the way activities are coordinated), 2) differentiation (the way tasks are divided), 3) the structure of the hierarchical relationships (authority systems), and 4) the formalized policies, procedures, and controls that guide the organization (administrative systems).

The relationship between the environment and organizational structure is especially important. Organizations are open systems and depend on their environment for support. Generally, more complex environments lead to greater differentiation. The trend in organizations is currently away from stable (mechanistic) structures to more adaptive (organic) structures. The advantage is that organizations become more dynamic and flexible. The disadvantage is that integration and coordination of activities require more time and effort.

The relationship between an organization and its environment is characterized by a two-way flow of information and energy. Most organizations attempt to influence their environment. Advertising campaigns and lobbying efforts are two examples. Some theorists believe that environments are largely invented by organizations themselves. Organizations

select their environments from ranges of alternatives, then they subjectively perceive the environments they inhabit. Strategic decisions regarding product lines and distribution channels contribute to the selection of the organizational structure and the environment.

It is a commonly held tenant that people are less satisfied with their work in highly structured organizations. Many research studies have been conducted to examine the relationship between organizational structure and employee behaviour (e.g., satisfaction, performance, and turnover). However, the results of these studies are contradictory. Structural deficiencies can result in low motivation and morale, decisions lacking in timeliness or quality, lack of coordination and conflict, inefficient use of resources, and an inability to respond effectively to changes in the environment.

5. The learning organization

Peter Senge (1990) defines learning as enhancing ones capacity to take action. "So learning organizations are organizations that are continually enhancing their capacity to create." One of the most serious disabilities is when people form a strong identification with their position. What they do becomes a function of their position. They see themselves in specific roles, and are unable to view their jobs as part of a larger system. This often leads to animosity towards others in the organization, especially when things go wrong. Another disability is that we are slow to recognize gradual changes and threats.

According to us, there are five disciplines important to the learning organization. The first discipline is "building a shared vision". "Building" involves an ongoing process, and "shared" implies that the vision is held in common by individuals. A second discipline of "personal mastery" demonstrates a commitment to the vision. A third discipline involves the idea of mental models, where we construct internal representations of reality. An important element of using mental models is the need to balance inquiry and advocacy. A fourth discipline in that only shared mental models are important for organizational learning. The fifth discipline is a commitment to a systems approach.

1.4.4 BASIC ORGANIZATIONAL STRUCTURES

All businesses are organised into groups of people. This is so the employees can be organised and controlled to make sure the necessary work is one efficiently. These groups have managers responsible for them.

There are different ways of organising the business into groups, and each way has its advantages and disadvantages. There are additional benefits of organising people into groups, such as making it clearer how communications should be organised. The development of team-spirit also usually improves motivation and productivity.

In addition to the root characteristics of business organizations, there are two main types of structures: functional and divisional. Most companies represent an amalgam of both, and many variations exist. In following part will be introduce chosen type of organizational structures.

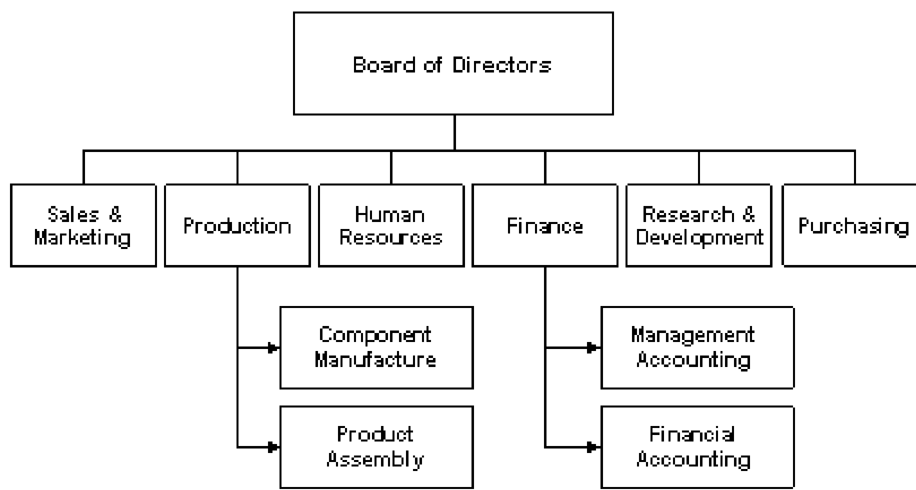
1. Functional structure

Functional organizational structures are more traditional. They departmentalize the company based on key functions. For example, activities related to production, marketing, and finance might be grouped into three respective departments. Within each, moreover, activities would be departmentalized into sub departments. Within the marketing department, for example, might be the sales, advertising, and promotions departments.

The advantage of functionally structured organizations is that they typically achieve an efficient specialization of labour because people with specific skills can follow a career path within their department. In addition, this type of structure is relatively easy for employees to comprehend. Therefore, they are more likely to identify with their group and enjoy a sense of accomplishment through the gains of the department. Finally, functional structures reduce duplication of work because responsibilities are clearly defined.

On the other hand, functional structures are often divisive, causing departments to become adversarial and employees to engage in behaviour that benefits their department at the expense of the overall organization.

Figure 3 Organisation by function



Source: Bowett, 2009

Furthermore, employees in departments often become myopic, losing sight of the goals of the entire organization. In addition, functional structures typically fail to make full use of the talents of workers and they are often less reactive to environmental influences (Burton, Borge, 1998). Concluding comments on this method of organisation:

- Specialisation by function is more efficient. Employees get experienced in and competent at one particular job.
- Accountability is clear ie whose responsibility is it to do what.
- Clarity is improved ie it is clear who does what.
- Communication is weakened by a lack of communication across and between functions. HRM may be doing things Marketing need to know about.
- Inertia may set in where departments become over-focussed on their own agendas and lose sight of the overall business objectives. In extreme case the team-spirit may degenerate into tribalism where departments are ‘at war’ with each other and are more concerned with ‘winning’ this war than attending to the overall business objectives.
- This system can become overly bureaucratic where flexibility is lost because things have to be done ‘by the book’.
- This system may not be suitable for large businesses with many different markets and/or products.

2. Line organization

Line organization is the simplest form of organization and is most common among small companies. The authority is embedded in the hierarchical structure and it flows in a direct line from the top of the managerial hierarchy down to different levels of managers and subordinates and further down to the operative levels of workers. It clearly identifies authority, responsibility and accountability at each level.

These relationships in the hierarchy connect the position and tasks of each level with those above and below it. There is clear unity of command so that the person at each level is reasonably independent of any other person at the same level and is responsible only to the person above him. The line personnel are directly involved in achieving the objectives of the company.

Because of the small size of the company, the line structure is simple and the authority and responsibility are clear-cut, easily assignable and traceable. It is easy to develop a sense of belonging to the organization, communication is fast and easy and feedback from the employees can be acted upon faster.

The discipline among employees can be maintained easily and effective control can be easily exercised. If the president and other superiors are benevolent in nature, then the employees tend to consider the organization as a family and tend to be closer to each other that is highly beneficial to the organization.

On the other hand, it is a rigid form of organization and there is a tendency for line authority to become dictatorial that may be resented by the employees. Also, there is no provision for specialists and specialization that is essential for growth and optimization and hence for growing companies, pure line type of structure becomes ineffective.

The line organization can be a pure line type or departmental line type. In the pure line type set-up, all similar activities are performed at any one level. Each group of activities is self contained and is independent of other units and is able to perform the assigned duties without the assistance of others. In a departmental line type of organization, also known as functional structure, the respective workers and supervisors are grouped on a functional basis such as finance, production and marketing, and so on[5].

3. Divisional structure

Companies that employ a more divisional structure break the organization down into semiautonomous units and profit centres based on activities related to products, customers, or geography. Regardless of the activity group used to segment the company, each unit operates as a separate business. For example, a company might be broken down into southern, western, and eastern divisions. Or, it might create separate divisions for consumer, industrial, and institutional products. Again, within each division are subdivisions.

One benefit of a divisional structure is that it facilitates expansion because the company can easily add a new division to focus on a new profit opportunity without having to significantly alter exiting systems. In addition, accountability is increased because divisional performance can be measured more easily. Furthermore, divisional structures permit decentralized decision making, which allows managers with specific expertise to make key decisions in their area.

[5] Management study. [online]. [cit. 2013-09-03]. Available from: http://www.managementstudyhq.com/types-of-organizational structures.html#sthash.FAxSmCrk.dpuf

The potential drawbacks to divisional structures include duplication of efforts and a lack of communication. For example, separate consumer and industrial divisions of the same air-conditioner company may both be trying to develop a better compressor. In addition, divisional organizations, like functionally structured companies, may have trouble keeping all departments focused on an overall company goal. A corollary is that top management sometimes loses touch with the goals and inner-workings of each division. This division and concentration of related activities into integrated units is categorized on the following basis:

- ***Departmentalization by Product.*** In this case, the units are formed according to the type of product and it is more useful in multi-line corporations where product expansion and diversification, and manufacturing and marketing characteristics of the product are of primary concern. The general policies are decided upon by the top management within the philosophical guidelines of the organization.
- ***Departmentalization by Customers.*** This type of departmentalization is used by those organizations that deal differently with different types of customers. Thus, the customers are the key to the way the activities are grouped. Many banks have priority services for customers who deposit a given amount of money with the bank for a given period of time. Similarly, business customers get better attention in the banks than other individuals.
- ***Departmentalization by Area.*** If an organization serves different geographical areas, the division may be based upon geographical basis. Such divisions are specially useful for large scale enterprises that are geographically spread out such as banking, insurance, chain department stores or a product that is nationally distributed.
- ***Departmentalization by Time.*** Hospitals and other public utility companies such as telephone company that work around the clock are generally departmentalized on the basis of time shifts. For example, the telephone company may have a day shift, on evening shift and a night shift, and for each shift a different department may exist, even though they are all alike in terms of objectives.

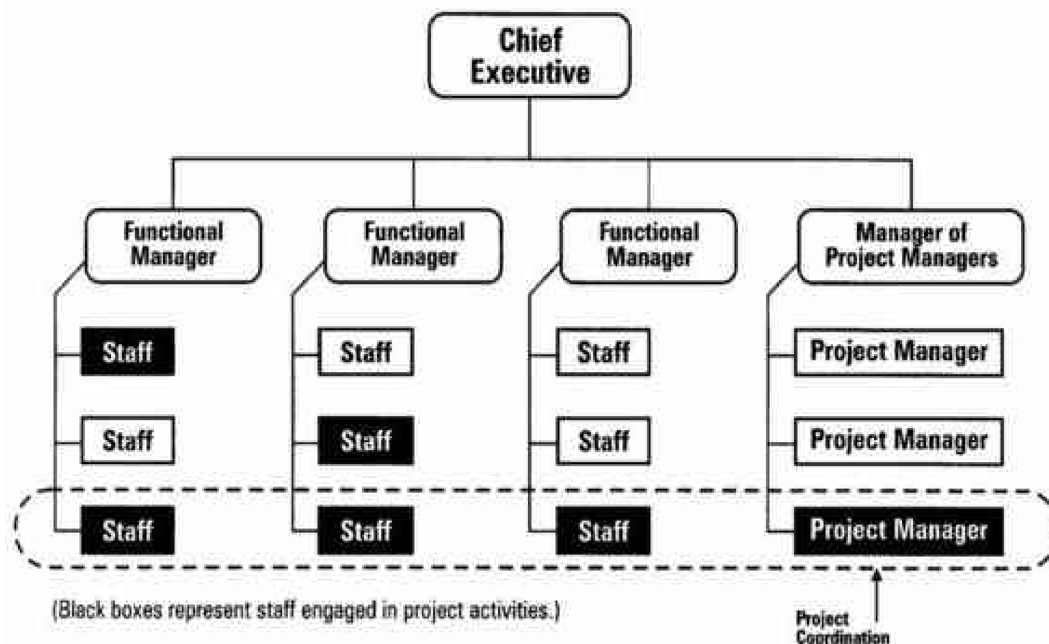
4. Sectoral structure

A variation on the divisional structure is known as the sector structure. This is employed typically by very large and diversified companies. One of the best known examples is General Electric Co., which pioneered the format in the mid-1970s. Sectors are usually broad market-defined operating areas and they may combine several conventional divisions that produce related goods or services. For instance, some of GE's sectors include aircraft engines, lighting, and capital services. The logic behind the sector structure is to strike a medium between extreme centralization and extreme decentralization. If a company has dozens of divisions it might be impractical to have all the division heads report directly to the CEO. On the other hand, because the company is so large, it may not be possible or desirable to merge divisions and centralize it more. By grouping similar divisions into coherent sectors, the sector approach attempts to make large organizations more focused and manageable (Daft, 1997).

5. Matrix structure

A less traditional (and less common) approach is the matrix structure, which emphasizes collaborative relationships between different parts of an organization. Under a matrix structure, individuals or departments have multiple reporting relationships, or at least multiple consulting relationships. This is particularly useful on large projects that require inputs from many different functional areas of the organization.

Figure 4 Matrix organization



Source: Management study. [online]. [cit. 2013-09-03]. Available from: http://www.managementstudyhq.com/types-of-organizational structures.html#sthash.FAxSmCrk.dpuf

The key features of a matrix structure are that the functional and project lines of authority are super-imposed with each other and are shared by both functional and project managers. The project managers are generally responsible for overall direction and integration of activities and resources related to the project. They are responsible for accomplishing work on schedule and within the prescribed budget. They are also responsible for integrating the efforts of all functional managers to accomplish the project and directing and evaluating project activity. The functional managers are concerned with the operational aspects of the project. The functional structure is primarily responsible for:

1. Providing technical guidance for the project.
2. Providing functional staffs that are highly skilled and specialized.
3. Completing the project within prescribed technical specifications.

Greiner sees matrix organization, in which cross-functional teams are used, as a response to growing complexity associated with the organizational growth. These complexities, both internal (size, technology) as well as external (markets, competitors), create problems of information processing and communication that are best dealt by matrix type of organization. Matrix organizational design is most useful when there is pressure for shared resources. For example, a company may need eight product groups, yet have the

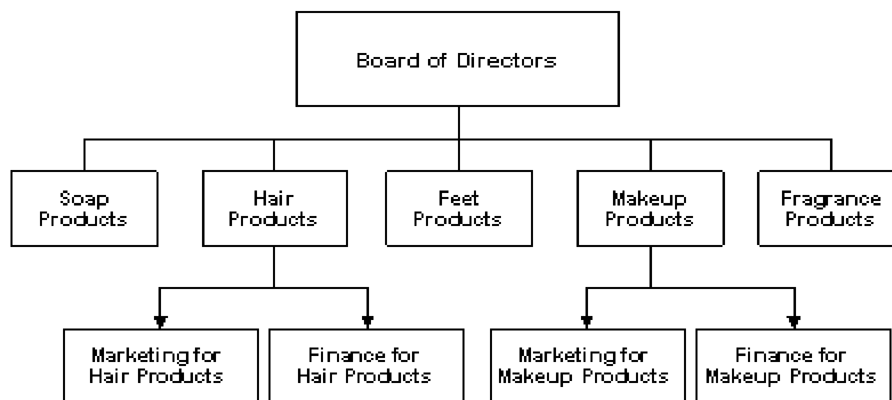
resources only to hire four marketing specialists. The matrix provides a convenient way for the eight groups to share the skills of the four specialists. Each matrix contains three unique sets of role relationships: (1) the top manager or Chief Executive Officer who is the head and balances the dual chains of command; (2) the managers of functional and project (or product) departments who share subordinates; and (3) the specialists who report to both the respective functional manager and project manager.

An important aspect of the matrix structure is that each person working on the project has two supervisors – the project manager and the functional manager. For example, a company may have a product manager for each of its product lines, and these individuals may work both with marketing staff and with production staff in order to fulfil their role. In addition, each may collaborate periodically with other product managers in order to maintain a unified product strategy. If drawn on paper, this structure would appear as a grid with reporting or consulting lines connecting the product managers to the marketing department, the manufacturing or production department, and each other[6].

6. Organisation by product

This structure gives focus on individual products, which may be especially appropriate if different products have different problems and concerns. The issue of focus is important because it determines the priorities people will have, and the way they think about those priorities.

Figure 5 Organisation by product



Source: Bowett, 2009

Comments on this method of organisation: each group can be run as a separate profit centre. This way, healthy competition and rivalry can develop between ‘teams’ which can help motivation and productivity. It is also flexible in that poorly performing groups can be closed down without too much disruption to the rest of the organisation.

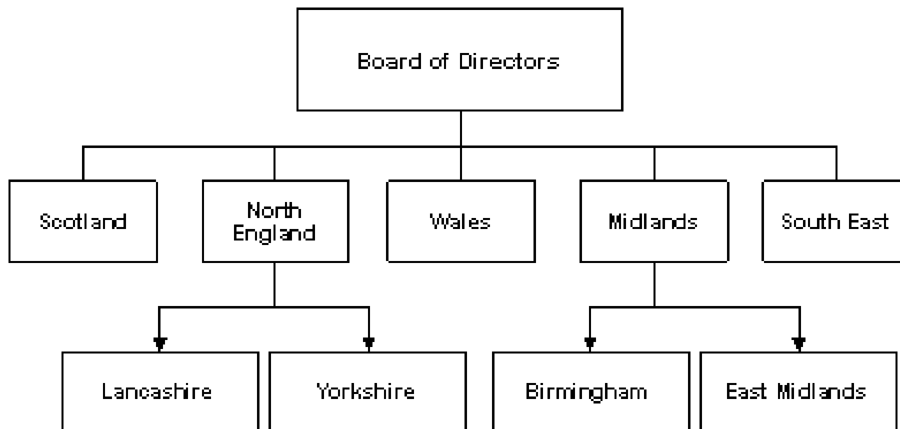
Co-operation between teams will improve where it is in the interests of both teams to do so. There is a danger of duplication of resource use if each team has a Marketing department, a Finance department and so on. Rivalry can get out of hand and become destructive. Individual teams can get out of overall management control, especially if headed by a very ambitious person.

[6] Reference for Business – Encyclopedia of Business, 2nd ed. [online]. [cit. 2013-08-13]. Available from: http://www.referenceforbusiness.com/encyclopedia/Oli-Per/Organization-Theory.html#ixzz2kkaCuvxW

7. Organisation by Area/Region

For this type of organisation is typical better response to and focus on local customer Leeds and better communication within the locally-based department. Rivalry between departments. Duplication of resource use. Conflict and lack of co-operation between departments.

Figure 6 Organisation by area

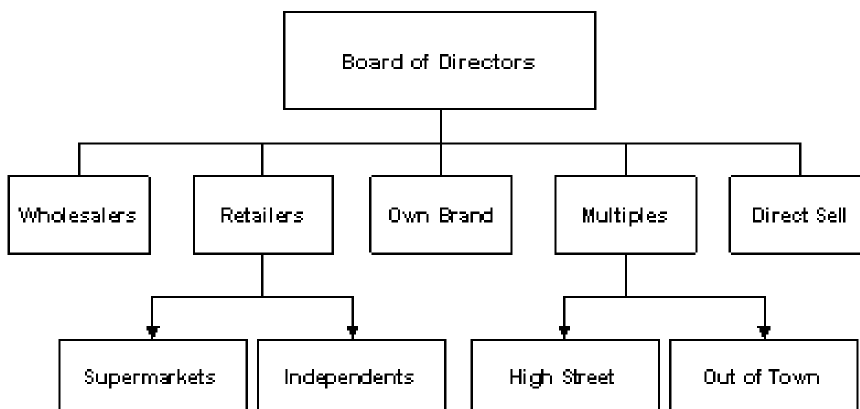


Source: Bowett, 2009

8. Organisation by customer/customer type

This method of organisation promotes focus on customers and their different individual needs. This is a major advantage and helps a business to become market oriented as opposed to the previous product oriented structure. Departments can be organised by market segment which adds to the focus on customer need. It is sometimes difficult to define exactly which group a particular customer belongs to. Some customer groups may be small and so individual departments may be inefficient and there will be duplication of resources. Individual departments may escape from proper overall management control.

Figure 7 Organisation by customer/customer type



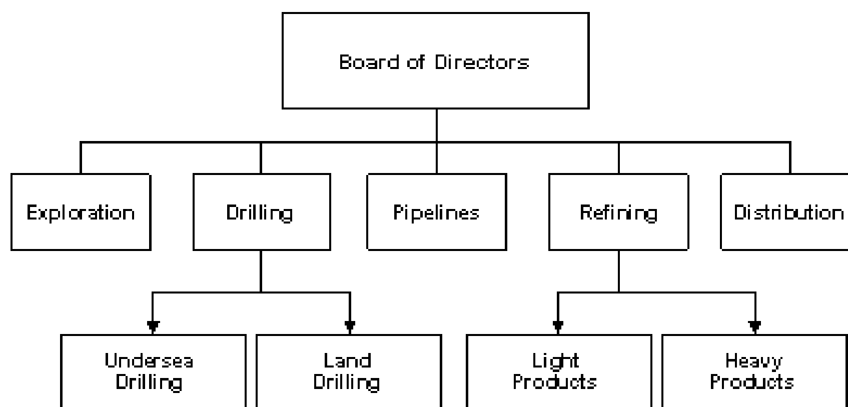
Source: Bowett, 2009

9. Organisation by process

Process organization involves the design of work processes. It involves organizing the way work is broken down in terms of content and space as well as the order in which it is carried out in time and the use of funds and materials. This process design is the foremost task in modern organizational development because it is essentially here that the outcome of the work process is determined.

Changing processes in the form, for example, of Business Process Reengineering has been vital in administrative modernization. The changed work organization not only produces gains in efficiency for the organization, but it can also have negative consequences for staff. It may result in “redundancies” or in extension of the range of duties without a concomitant extension in authority. This is frequently associated with a feeling of overload, as new routines for action have to be developed parallel to the work process. Negative effects are mostly felt especially at clerical level, where many women work (Hildegard, 2004).

Figure 8 Organisation by process



Source: Bowett, 2009

Process optimization often results in the creation of jobs with low scope for independent action (support division) which are then mostly allocated to women. These jobs offer little scope for further qualification and promotion. Women may furthermore, because of gender stereotyping, not be adequately involved in the development of new information technology networks. This results in hardening of gender-specific discrimination and insufficient consideration in knowledge management of the informal knowledge existing in functional areas in which predominantly women are employed.

Organizational development geared to gender equality is aware of these dangers and systematically integrates gender aspects into its process organization. Balanced consideration of all relevant differences results on the one hand in staff being addressed as individuals, so that disappointments and the resulting loss of motivation can be avoided; and on the other hand, the organization thus has all available knowledge resources for process optimization at its disposal. Moreover, it is a good idea to link the implementation of Gender Mainstreaming strategically with the reorganization of processes. For successful implementation, corresponding knowledge and information management is vital. Gender-sensitive process organization thus aims at a work organization that enables individual needs such as family responsibilities and the organization’s operational requirements to be harmonized in a much more balanced way than hitherto (Margit and Sigrid, 2004).

10. Project Organisation

These are temporary organizational structures formed for specific projects for a specific period of time and once the goal is achieved, these are dismantled. For example, the goal of an organization may be to develop a new automobile. For this project, the specialists from different functional departments will be drawn to work together. These functional departments are production, engineering, quality control marketing research, etc. When the project is completed, these specialists go back to their respective duties. These specialists are basically selected on the basis of task related skills and technical expertise rather than decision-making experience or planning ability. These structures are very useful when:

1. The project is clearly defined in terms of objectives to be achieved and the target date for the completion of the project is set. An example would be the project of building a new airport.
2. The project is separate and unique and not a part of the daily work routine of the organization.
3. There must be different types of activities that require skills and specialization and these must be coordinated to achieve the desired goal.
4. The project must be temporary in nature and not extend into other related projects.

Conclusions on organisational structures

All these structures have strengths and weaknesses which a business has to think about before choosing which one to use. Changing that decision, and re-structuring, is very disruptive and very expensive, so it is better to get it right the first time. Communications and control are key issues.

The question of focus is also very important, because the structure affects the way employees think about themselves and their own personal objectives eg 'I am an accountant' or 'I am a soap-team member' or 'I am a driller'. It is natural for humans to identify with a group of people (a 'team') and this can be turned to the business' advantage by acting as a motivator and helping to raise productivity. But it is also an important limiting factor. People become very defensive and territorial about the interests of 'their' team and this can get in the way of objective problem-solving. In the extreme, a business can disintegrate into a bunch of warring tribes where 'revenge' on 'that lot' overrides the business' objectives. We can summarise the aspects into key elements for proper organisational structure:

- **Work Specialization**: To what degree are articles subdivided into separate jobs?
- **Departmentalization**: On what basis jobs will be grouped?
- **Chain of Command**: To whom will individuals and groups report?
- **Span of Control**: Up to how many individuals can a manager efficiently direct?
- **Centralization vs Decentralization**: Who will be the sole maker of decisions?
- **Formalization**: To what degree will there be rules and regulations to direct employees and managers?

Questions to test your knowledge:

1. *Characterize the range of business economics in basic aspects.*
2. *What is the main importance of managerial economics in business practice?*
3. *What are the main organization theories and what are the pros and cons of these theories?*
4. *Which distinguish the major organizational structures and according to criteria that are appropriate for a particular type of the company?*

2 PRINCIPLES OF ENTREPRENEURSHIP

The concept of entrepreneurship was first established in the 1700s, and the meaning has evolved ever since. Many simply equate it with starting one's own business. Most economists believe it is more than that. To some economists, the entrepreneur is one who is willing to bear the risk of a new venture if there is a significant chance for profit. Others emphasize the entrepreneur's role as an innovator who markets his innovation. Still other economists say that entrepreneurs develop new goods or processes that the market demands and are not currently being supplied.

In the 20th century, economist Joseph Schumpeter (1883-1950) focused on how the entrepreneur's drive for innovation and improvement creates upheaval and change. Schumpeter viewed entrepreneurship as a force of "creative destruction." The entrepreneur carries out "new combinations," thereby helping render old industries obsolete. Established ways of doing business are destroyed by the creation of new and better ways to do them.

Business expert Peter Drucker (1909-2005) took this idea further, describing the entrepreneur as someone who actually searches for change, responds to it, and exploits change as an opportunity. A quick look at changes in communications - from typewriters to personal computers to the Internet - illustrates these ideas.

Most economists today agree that entrepreneurship is a necessary ingredient for stimulating economic growth and employment opportunities in all societies. In the developing world, successful small businesses are the primary engines of job creation, income growth, and poverty reduction. Therefore, government support for entrepreneurship is a crucial strategy for economic development.

As the Business and Industry Advisory Committee to the Organization for Economic Cooperation and Development (OECD) said in 2003, "*Policies to foster entrepreneurship are essential to job creation and economic growth.*" Government officials can provide incentives that encourage entrepreneurs to risk attempting new ventures. Among these are laws to enforce property rights and to encourage a competitive market system.

The culture of a community also may influence how much entrepreneurship there is within it. Different levels of entrepreneurship may stem from cultural differences that make entrepreneurship more or less rewarding personally. A community that accords the highest status to those at the top of hierarchical organizations or those with professional expertise may discourage entrepreneurship. A culture or policy that accords high status to the "self-made" individual is more likely to encourage entrepreneurship.

2.1 WHAT BUSINESS DO

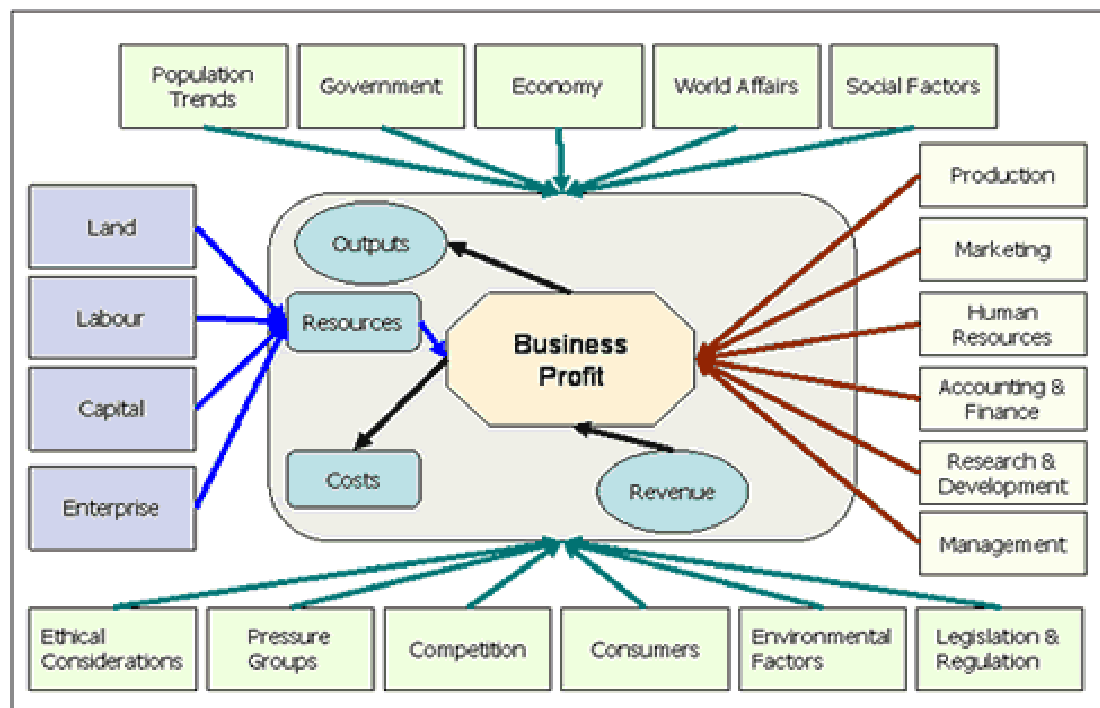
A business uses inputs of resources to make goods and services which it sells. A business pays out money (costs) to use the resources and takes in money (revenue) for its sales. The difference between the two (revenue less costs) is profit/loss. Not all businesses produce consumer goods that we buy in the shops. There is a lot of buying and selling between businesses that we don't see. Types of outputs could be:

1. **Consumer Goods.** This is the normal output of things we buy in the shops.
2. **Consumer Services.** These are things like insurance, holidays and hair-cuts.
3. **Durable Goods.** These are consumer goods which aren't consumed straightaway (like food aka non-durable goods) but last quite a long time, such as washing machines and TVs.
4. **Capital Goods.** This means productive equipment used by other businesses, such as machinery and vehicles.

5. **Raw Materials.** This means the basic starting ingredients of the productive process, such as wheat which ends up as bread or cake.
6. **Semi-Finished Goods.** This means components which one business buys from another and turns into something else eg components that go to make up a finished car.
7. **Finished Goods.** Businesses buy lots of finished goods eg cars for managers or PCs for employees.
8. **Business Services.** Businesses also buy services such as insurance and banking services.

The diagram shows that the full picture is quite complicated. All of the different boxes represent something that affects what businesses do. Each box contains important detail that leads to a full understanding of how businesses work.

Figure 9 What Business Do



Source: Bowett, 2009

2.1.1 EXTERNAL FACTORS AFFECTING BUSINESS ENVIRONMENT

Businesses are surrounded by all sorts of external factors which influence what businesses do and how they do them. Subsequently, we determined list of the most important factors.

Economic Forces

The economic environment can have a major impact on businesses by affecting patterns of demand and supply. Companies need to keep a track of relevant economic indicators and monitor them over time.

- **Income** - indicates a customer's ability to spend on the products sold by the marketer. The rise in the number of dual income families in several parts of the world, including urban world, has led to the rise in the incomes for such families. This has resulted in

higher demand for lifestyle and luxury products. However, marketers should be wary of making generalizations, as customer's propensity to spend depends on cultural factors as well. Such products, such as dishwashers that are considered in necessities in Western markets do not even fall into the consideration set of consumers.

- **Inflation** - refers to an increase in prices without a corresponding increase in wages, resulting in lower purchasing power of consumers. When cost of production of products and services is low, they will be sold at lower prices. Inflation rate is higher when costs of producing products or services go up, or when there is too much money chasing too few supplies, prompting suppliers to raise prices and earn higher profits. High inflation rate decreases real wages, i.e. the customer can buy less goods with his income because the goods have become costlier. Inflation will reduce the demand for several products because the customer will ration his income on goods. In inflationary times, customers stock items to save themselves from further increase in prices and abandon their favourite brands to buy more economical brands. When costs of production go up, companies should try to withhold increasing prices for as long as possible. In the long run, companies will have to look for better methods of production and cheaper inputs so that cost of production can be brought down.

- **Recession** - is a period of economic activity when income, production, and employment tend to fall. Demand of products and services are reduced. During recession, companies should improve existing products and introduce new ones. The idea is to reduce production hours, waste, and the cost of materials so that companies can offer products at lower prices. The most potent way to end a recession cycle is to make it attractive for customers to buy more. In recession, business buyers will postpone the purchase of new equipments and materials because they do not know if there will be demand for their products and services. Sellers should be willing to extend credit to buyers to get over their reluctance to purchase. Sales of replacement parts and other services may become an important source of income. Companies should emphasize their top-of-the-line products and promote product value. Customers with less to spend will look for demonstrated quality, durability, and capability to save time and money. High priced, high value items do well during recession. Companies should understand that though there are specific causes that trigger recession. It is perpetuated because consumers and businesses become uncertain about future and are reluctant and scared to buy. Once consumers start buying, businesses will start buying automatically. Therefore companies selling to consumers should generate confidence in the consumers by offering them high quality products and services at reasonable prices and also extend credit to them.

- **Interest Rate** - if interest rate of an economy is high, businesses will borrow capital at a higher rate and they will set up new businesses only when they are convinced that they can earn at a rate higher than the interest rate they are paying on the capital. Even in existing businesses operating costs would go up as their working capital requirements will attract higher interest rates. Therefore companies will be able to produce products and services at higher costs and will perforce sell them at higher prices. There will be inflationary tendencies if interest rates are higher for long periods. Consumers will have strong tendencies to save because of the prospect of earning higher interest rates from their deposits. High interest rates have detrimental effects on the economy.

- **Exchange Rate** - becomes a very important driver of performance when a company exports its products and when it imports materials and components for making its products. It is more profitable to export when the currency of the exporting country is weaker than the currency of the importing country. But this advantage is nullified if materials and components are imported from a country whose currency is stronger. A company will run its most profitable operations when it exports its product to a country whose currency is stronger, and imports material and components from a country whose currency is weaker[7].

Technological Factors

New technologies can be used very effectively to counter inflation and recession. New machines can reduce production costs. Advances in information technology have made it possible to plan global supply chains, enabling companies to make better products at lesser cost and distribute them economically.

- **Technologies for Nations** - economies which are well off should concentrate more on basic research because they can remain ahead of other economies only by creating new businesses through inventing new technologies. They should be ready to relinquish businesses they are currently excelling in, because other economies will catch up with them and developed economies will not be able to charge premium prices for their products and services.

- **Technologies for Product and Services** - new products and services are possible because of new technologies. These help to increase revenues and profits of companies. At different times in history, technologies have created new businesses like automobile, railways, telephones, computers, etc.

- **Technologies for Business Models** - companies also use new technologies to do business differently and more effectively. For instance, by using the Internet, Dell is able to earn greater profits by serving only the most profitable customers. Companies in fragrance and other business have equipped their customers with design tools so they design their own products and services. Some companies have used the power of the Internet to create virtual design teams. There are a lot of other ways in which technologies like the Internet are impacting businesses.

Socio-Cultural Factors

Social factors influence the products people buy, the prices they are willing to pay, the effectiveness of specific promotions, and how, where, and when people purchase products. But societies are hardly ever static. They change gradually and some changes will be imperceptible if not watched closely. Social change is the most difficult variable for marketing managers to forecast, influence and integrate into marketing plans.

- **Values** – a value is a strongly held and enduring belief. The majority of people living in a society uphold the values of the society. A person's values are key determinants of what is important and not important to him, how he reacts in a particular situation, and how he behaves in social situations. Values affect the goods that a customer buys and the ways he buys them. Organizations ore trying hard to become customer oriented. Nowadays, customers do not tolerate ineffective products and sloppy

[7] Management study. [online]. [cit. 2013-09-16]. Available from: http://www.managementstudyhq.com/external-factors-affect-business-environment.html

behavior of marketers. Customers have become inquisitive, discriminating, and demanding. Companies should learn to expect tough customers.

- **Time-starved Customers** - today, many customers place value on non-material accomplishments, such as having control over their lives, and being able to toke a day off when they want. As work-life gets longer and more stressful, people are spending their leisure time recuperating. People will increasingly place more value on time than money.

- **Multiple Lifestyles** - today, people lead multiple lifestyles. They choose products and services that meet diverse needs and interests rather than conform to traditional stereotypes. In the past, a person's profession defined his lifestyle. Today, a person can be a teacher and also a gourmet, fitness enthusiast, and so many other things. Each of these lifestyles is associated with different products and services and is a potential customer for companies. Multiple lifestyles increase the complexity of consumers' buying habits. A person may go on holidays to exotic holiday locations and may spend a fortune to travel, but may dine in very ordinary restaurants. He may buy fast food for lunch but may wear the most expensive suits.

- **Changing Structures of Families** - multiple lifestyles have evolved because people can choose from a growing number of products and services, and most have the money to exercise more options. The growth of dual-income families has resulted in increased purchasing power. The phenomenon of working women has had greater effect on marketing strategies and initiatives of companies than any other social change. As working women's earnings grow, so do their expertise, experience, and authority.

Demographic Factors

Demography is the study of people in terms of their age, gender, race, ethnicity, and location. Demographics are significant because people constitute markets. Demographic characteristics strongly affect buyer behavior. Fast growth of population accompanied with rising income means expanding markets. A longer life span means a growing market for products and services targeted for the elderly.

- **Adolescents** - the new-age teens are a marketers' delight. They do not earn but they are fond of spending, and most of them have their own budgets. They spend lavishly on clothes, eating out, going out, latest gadgets, and are very keen to keep up with their friends in terms of possessions and lifestyles. They do not feel guilty of spending their parents' money and put real pressure on their parents to shell out money for them. They will put their parents in financial inconvenience but they will have their motorbikes and fanciful mobiles, and will hang out at eating joints, theaters, and malls. They are stylish and fashion conscious, and submit to peer pressure. They will latch on to the next hot item. They feel they need to have a life of their own, and it should not be denied to them just because they are not earning.

- **Youth** - the current youngsters are growing in a more media-influenced, brand-conscious world than their parents. They respond to advertisements differently and prefer to encounter those advertisements in different places. Companies have to take their messages to the places where these youngsters frequent, whether on the Internet, in a cricket stadium, or television. The advertisements may be comical or may be disarmingly direct. But the

advertisements should never suggest that the advertiser knows these youngsters better than they know themselves. These youngsters know what they want from their lives and the products and services they buy. They do not mind information reaching them but they will reserve their right to make their choices. They hate to be persuaded and influenced. Companies would do well to leave them alone to make their decisions.

- **People between 35 to 45** - people in the age group of 35 to 45 years are settled in their professions and have toddlers and growing children at home. They exert themselves in their profession because they realize that their career is likely to take off at this stage. They put in long hours at office and they have to juggle endlessly between their responsibilities as spouses and parents, and growing responsibilities at work. They may also have old parents to look after. Parents may be staying with them or they may be living in different cities.

- **People between 45 and 60** - some people in this age group are at the peak of their careers while some others are struggling to keep their jobs. Children become a major priority for people in this age group. Children are ready to go to colleges and professional schools, and some of these people are willing to make sacrifices in their careers to avoid unsettling their children. People in this age group spend less as they save resources to fund the higher education of their children.

- **People above 60** - people in this age group live on a steady income. Some of them live with their grown-up children and are part of their household. They contribute to the requirement of the joint household and do not spend much on themselves. The family looks after their requirements. Most of their money is spent on buying gifts for their children and grandchildren. But quite a few of these people live alone, and are visited by their children infrequently.

Political Legal Environment

The political-legal environment of a country is influenced by political structures and organizations, political stability, government's intervention, constitutional provisions, government's attitude, foreign policy, etc. The viability of businesses depends upon their ability to understand the laws of the land and to abide by them, while not becoming less innovative in their marketing endeavours due to fear of their infringing some laws.

Natural Environment

Natural environment includes factors such as seasonal variations, climatic differences, soil conditions and natural terrain. In consumer markets, the natural environment affects companies because of the differences in the nature of products bought by consumers due to variations in seasons and climate. For instance, products such as apparel and food get affected due to these factors.

In difficult terrains like hilly areas, it is difficult and expensive to get products to the customers. It becomes more expensive to build distribution channels for companies whose target markets are geographically disperse. This increases the price of the product for the customer. Soil conditions influences the nature of the agricultural produce in a country. This affects the type of agricultural implements that must be manufactured and marketed[8].

[8] Management study. [online]. [cit. 2013-09-16]. Available from: http://www.managementstudyhq.com/external-factors-affect-business-environment.html

2.1.2 BUSINESS FUNCTIONS

Businesses are divided up into specialist units (or departments) which do each of the different jobs needed to run a successful business. In a small business these jobs may be done simultaneously by one or two managers.

1. Marketing. This means trying to bring your product to the attention of buyers and make more people buy it. This makes Revenue and (hopefully) profit.
2. Production. This means making the product you are selling.
3. Purchasing. This means buying all the different inputs the business needs in order to do its work.
4. Human Resources. This means looking after your workers and their needs. The point of this is to improve motivation which improves productivity so more product is made. When this extra product is sold this means Revenue and profit.
5. Finance. This means looking after all the money needed to run the business.
6. Research & Development. This means trying to make existing products better and also trying to come up with new products.
7. Logistics/Transport. This means moving around inputs and outputs from where they are made to where they are needed.
8. Management. This means planning for the future, making decisions about the present, and organising the business in the most efficient manner.
9. Administration. This means looking after the day-to-day needs of the business and making sure everything runs smoothly.

All businesses organise themselves slightly differently from one another, but the list above includes all the departments (functions) that are usual in the typical business. It is important that all these separate functions are properly integrated and co-ordinated so all the separate bits of the business are working together towards the same objectives.

2.2 AN ENTREPRENEUR

There is no one definitive profile. Successful entrepreneurs come in various ages, income levels, gender, and race. They differ in education and experience. But research indicates that most successful entrepreneurs share certain personal attributes, including: creativity, dedication, determination, flexibility, leadership, passion, self-confidence, and "smarts."

- Creativity is the spark that drives the development of new products or services or ways to do business. It is the push for innovation and improvement. It is continuous learning, questioning, and thinking outside of prescribed formulas.
- Dedication is what motivates the entrepreneur to work hard, 12 hours a day or more, even seven days a week, especially in the beginning, to get the endeavor off the ground. Planning and ideas must be joined by hard work to succeed. Dedication makes it happen.
- Determination is the extremely strong desire to achieve success. It includes persistence and the ability to bounce back after rough times. It persuades the entrepreneur to make the 10th phone call, after nine have yielded nothing. For the true entrepreneur, money is not the motivation. Success is the motivator; money is the reward.
- Flexibility is the ability to move quickly in response to changing market needs. It is being true to a dream while also being mindful of market realities. A story is told about an entrepreneur who started a fancy shop selling only French pastries. But customers wanted to buy muffins as well. Rather than risking the loss of these customers, the entrepreneur modified her vision to accommodate these needs.
- Leadership is the ability to create rules and to set goals. It is the capacity to follow through to see that rules are followed and goals are accomplished.

- Passion is what gets entrepreneurs started and keeps them there. It gives entrepreneurs the ability to convince others to believe in their vision. It can't substitute for planning, but it will help them to stay focused and to get others to look at their plans.
- Self-confidence comes from thorough planning, which reduces uncertainty and the level of risk. It also comes from expertise. Self-confidence gives the entrepreneur the ability to listen without being easily swayed or intimidated.
- "Smarts" consists of common sense joined with knowledge or experience in a related business or endeavor. The former gives a person good instincts, the latter, expertise. Many people have smarts they don't recognize. A person who successfully keeps a household on a budget has organizational and financial skills. Employment, education, and life experiences all contribute to smarts.

Every entrepreneur has these qualities in different degrees. But what if a person lacks one or more? Many skills can be learned. Or, someone can be hired who has strengths that the entrepreneur lacks. The most important strategy is to be aware of strengths and to build on them[9].

2.2.1 BECOME AN ENTREPRENEUR

What leads a person to strike out on his own and start a business? Perhaps a person has been laid off once or more. Sometimes a person is frustrated with his or her current job and doesn't see any better career prospects on the horizon. Sometimes a person realizes that his or her job is in jeopardy. A firm may be contemplating cutbacks that could end a job or limit career or salary prospects. Perhaps a person already has been passed over for promotion. Perhaps a person sees no opportunities in existing businesses for someone with his or her interests and skills.

Some people are actually repulsed by the idea of working for someone else. They object to a system where reward is often based on seniority rather than accomplishment, or where they have to conform to a corporate culture. Other people decide to become entrepreneurs because they are disillusioned by the bureaucracy or politics involved in getting ahead in an established business or profession. Some are tired of trying to promote a product, service, or way of doing business that is outside the mainstream operations of a large company. In contrast, some people are attracted to entrepreneurship by the advantages of starting a business. These include:

- Entrepreneurs are their own bosses. They make the decisions. They choose whom to do business with and what work they will do. They decide what hours to work, as well as what to pay and whether to take vacations.
- Entrepreneurship offers a greater possibility of achieving significant financial rewards than working for someone else.
- It provides the ability to be involved in the total operation of the business, from concept to design and creation, from sales to business operations and customer response.
- It offers the prestige of being the person in charge.
- It gives an individual the opportunity to build equity, which can be kept, sold, or passed on to the next generation.
- Entrepreneurship creates an opportunity for a person to make a contribution. Most new entrepreneurs help the local economy. A few - through their innovations - contribute to society as a whole. One example is entrepreneur Steve Jobs, who co-founded Apple in 1976, and the subsequent revolution in desktop computers.

Some people evaluate the possibilities for jobs and careers where they live and make a conscious decision to pursue entrepreneurship. No one reason is more valid than another; none

[9] U.S. Department of State/Bureau of International Information Programs. [online]. [cit. 2013-10-02]. Available from: http://www.ait.org.tw/infousa/zhtw/docs/enterp.pdf

guarantee success. However, a strong desire to start a business, combined with a good idea, careful planning, and hard work, can lead to a very engaging and profitable endeavor[10].

2.2.2 DECISIONS AND DOWNFALLS

Entrepreneurship is an attractive career choice. But many decisions have to be made before launching and managing a new business, no matter its size. Among the questions that need to be answered are:

- Does the individual truly want to be responsible for a business?
- What product or service should be the basis of the business?
- What is the market, and where should it be located?
- Is the potential of the business enough to provide a living wage for its employees and the owner?
- How can a person raise the capital to get started?
- Should an individual work full or part time to start a new business? Should the person start alone or with partners?

Answers to these questions are not empirically right or wrong. Rather, the answers will be based on each entrepreneur's judgment. An entrepreneur gathers as much information and advice as possible before making these and other crucial decisions.

The entrepreneur's challenge is to balance decisiveness with caution -to be a person of action who does not procrastinate before seizing an opportunity - and at the same time, to be ready for an opportunity by having done all the preparatory work possible to reduce the risks of the new endeavor.

Preparatory work includes evaluating the market opportunity, developing the product or service, preparing a good business plan, figuring out how much capital is needed, and making arrangements to obtain that capital.

Through careful analysis of entrepreneurs' successes and failures, economists have identified key factors for up-and-coming business owners to consider closely. Taking them into account can reduce risk. In contrast, paying them no attention can precipitate the downfall of a new enterprise.

- **Motivation:** What is the incentive for starting a business? Is it money alone? True, many entrepreneurs achieve great wealth. However, money is almost always tight in the startup and early phases of a new business. Many entrepreneurs do not even take a salary until they can do so and still leave the firm with a positive cash flow.
- **Strategy:** What is the strategy for distinguishing the product or service? Is the plan to compete solely on the basis of selling price? Price is important, but most economists agree that it is extremely risky to compete on price alone. Large firms that produce huge quantities have the advantage in lowering costs.
- **Realistic Vision:** Is there a realistic vision of the enterprise's potential? Insufficient operating funds are the cause of many failed businesses. Entrepreneurs often underestimate start-up costs and overestimate sales revenues in their business plans. Some analysts advise adding 50 percent to final cost estimates and reducing sales projections. Only then can the entrepreneur examine cash flow projections and decide if he or she is ready to launch a new business[11].

---

[10] U.S. Department of State/Bureau of International Information Programs. [online]. [cit. 2013-10-02]. Available from: http://www.ait.org.tw/infousa/zhtw/docs/enterp.pdf

[11] U.S. Department of State/Bureau of International Information Programs. [online]. [cit. 2013-10-02]. Available from: http://www.ait.org.tw/infousa/zhtw/docs/enterp.pdf

2.2.3 CHOOSING A PRODUCT AND A MARKET

A prospective entrepreneur needs to come up with a good idea. This will serve as the foundation of the new venture. Sometimes an entrepreneur sees a market need and Eureka! - has an idea for a product or service to fill it. Other times an entrepreneur gets an idea for a product or service and tries to find a market for it. A Scottish engineer working at General Electric created putty that bounces but had no use for it. In the hands of a creative entrepreneur, it became a toy, “Silly Putty,” with an enthusiastic market: children.

The idea doesn’t have to be revolutionary. Research, timing, and a little luck transform commonplace ideas into successful businesses. In 1971, Chuck Burkett launched a firm to make an ordinary product, novelty key chains. But when he got a contract with a new venture in Florida - Disney World - he started making Mickey Mouse key chains, and achieved tremendous success.

There are many ways to look for ideas. Read a lot, talk to people, and consider such questions as: What limitations exist in current products and services? What would you like that is not available? Are there other uses for new technology?

What are innovative ways to use or to provide existing products? In Australia in 1996, two entrepreneurs founded Aussie Pet Mobile Inc. to bring pet bathing and grooming to busy people’s homes. It is now a top U.S. franchise business. Is society changing? What groups have unfulfilled needs? What about people’s perceptions? Growing demand for healthy snacks created many business opportunities in the United States, for example.

Business ideas usually fit into one of four categories that were described by H. Igor Ansoff in the Harvard Business Review in 1957:

- An existing good or service for an existing market. This is a difficult approach for a start-up operation. It means winning over consumers through merchandising appeal, advertising, etc. Entry costs are high, and profit is uncertain.
- A new good or service for a new market. This is the riskiest strategy for a new firm because both the product and the market are unknown. It requires the most research and planning. If successful, however, it has the most potential for new business and can be extremely profitable.
- A new good or service for an existing market. (Often this is expanded to include modified goods/services.) For example, entrepreneurial greeting-card makers use edgy humor and types of messages not produced by Hallmark or American Greetings - the major greeting-card makers - to compete in an existing market.
- An existing good or service for a new market. The new market could be a different country, region, or market niche. Entrepreneurs who provide goods/services at customers’ homes or offices, or who sell them on the Internet, are also targeting a new market - people who don’t like shopping or are too busy to do so.

The last two categories have moderate risk, but product and market research can reduce it. They also offer opportunities for utilizing effective start-up strategies - innovation, differentiation, and market specification (Stolze, 1999).

2.2.4 ENTRY STRATEGIES FOR NEW VENTURES

It is easy to be captivated by the promise of entrepreneurship and the lure of becoming one’s own boss. It can be difficult, however, for a prospective entrepreneur to determine what product or service to provide. Many factors need to be considered, including: an idea’s market potential, the competition, financial resources, and one’s skills and interests. Then it is important to ask: Why would a consumer choose to buy goods or services from this new firm?

One important factor is the uniqueness of the idea. By making a venture stand out from its competitors, uniqueness can help facilitate the entry of a new product or service into the market.

It is best to avoid an entry strategy based on low cost alone. New ventures tend to be small. Large firms usually have the advantage of lowering costs by producing large quantities.

Successful entrepreneurs often distinguish their ventures through differentiation, niche specification, and innovation. Differentiation is an attempt to separate the new company's product or service from that of its competitors. When differentiation is successful, the new product or service is relatively less sensitive to price fluctuations because customers value the quality that makes the product unique.

A product can be functionally similar to its competitors' product but have features that improve its operation, for example. It may be smaller, lighter, easier to use or install, etc. In 1982, Compaq Computer began competing with Apple and IBM. Its first product was a single-unit personal computer with a handle. The concept of a portable computer was new and extremely successful.

Niche specification is an attempt to provide a product or service that fulfills the needs of a specific subset of consumers. By focusing on a fairly narrow market sector, a new venture may satisfy customer needs better than larger competitors can. Changes in population characteristics may create opportunities to serve niche markets. One growing market segment in developed countries comprises people over 65 years old. Other niches include groups defined by interests or lifestyle, such as fitness enthusiasts, adventure-travel buffs, and working parents. In fact, some entrepreneurs specialize in making "homemade" dinners for working parents to heat and serve.

Innovation is perhaps the defining characteristic of entrepreneurship. Visionary business expert Peter F. Drucker explained innovation as "change that creates a new dimension of performance." There are two main types of product innovation. Pioneering or radical innovation embodies a technological breakthrough or new-to-the-world product. Incremental innovations are modifications of existing products.

But innovation occurs in all aspects of businesses, from manufacturing processes to pricing policy. Tom Monaghan's decision in the late 1960s to create Domino's Pizza based on home delivery and Jeff Bezos' decision in 1995 to launch Amazon.com as a totally online bookstore are examples of innovative distribution strategies that revolutionized the marketplace.

Entrepreneurs in less-developed countries often innovate by imitating and adapting products created in developed countries. Drucker called this process "creative imitation." Creative imitation takes place whenever the imitators understand how an innovation can be applied, used, or sold in their particular market better than the original creators do. Innovation, differentiation, and/or market specification are effective strategies to help a new venture to attract customers and start making sales (Drucker, 2002).

2.2.5 CHOOSING A FORM OF BUSINESS

In many countries, entrepreneurs must select a form of organization when they start a small business. The basic forms of organization are sole proprietorships, partnerships, and corporations. Each has advantages and disadvantages. Moreover, the laws and regulations that apply to business owners vary from country to country and by local jurisdiction. Entrepreneurs should consult an attorney or other expert to make sure that they have all the necessary licenses and permits, and are aware of all their legal obligations. In many countries, the local Chamber of Commerce or local business council is also a good source of information.

- *Sole Proprietorship*: In a sole proprietorship, the individual entrepreneur owns the business and is fully responsible for all its debts and legal liabilities. Examples include writers and consultants, local restaurants and shops, and home-based businesses. This is

the easiest and least expensive form of business to start. In general, an entrepreneur files all required documents and opens a shop. The disadvantage is that there is unlimited personal liability - all personal and business assets owned by the entrepreneur may be at risk if the business goes into debt.

- *Partnership*: A partnership consists of two or more people who share the assets, liabilities, and profits of a business. The greatest advantage comes from shared responsibilities. Partnerships also benefit by having more investors and a greater range of knowledge and skills. There are two main kinds of partnerships, general partnerships and limited partnerships. In a general partnership, all partners are liable for the acts of all other partners. All also have unlimited personal liability for business debts. In contrast, a limited partnership has at least one general partner who is fully liable plus one or more limited partners who are liable only for the amount of money they invest in the partnership. The largest disadvantage of any partnership is the potential for disagreements, regardless of how well or how long the partners have known each other. Experts agree that a partnership agreement drawn up by an experienced lawyer is essential to a successful partnership. It is often used to:
  - create a mechanism for resolving disagreements;
  - specify each partner's contribution to the partnership;
  - divide up management responsibilities; and
  - specify what happens if a partner leaves or dies.
- *Corporations*: Corporations are recommended for entrepreneurs who plan to conduct a large-scale enterprise. As a legal entity that has a life separate from its owners, a corporation can sue or be sued, acquire and sell property, and lend money. Corporations are divided into shares or stocks, which are owned by one, a few, or many people. Ownership is based on the percentage of stock owned. Shareholders are not responsible for the debts of the corporation, unless they have personally guaranteed them. A shareholder's investment is the limit of her liability. Corporations can more easily obtain investment, raise capital by selling stock, and survive a change of ownership. They provide more protection from liability than other forms of business. Their potential for growth is unlimited. However, corporations are more complex and expensive to set up than other forms of business and are usually subject to a higher level of government regulation[12].

2.2.6 INTELLECTUAL PROPERTY: A VALUABLE BUSINESS ASSET

Intellectual property is a valuable asset for an entrepreneur. It consists of certain intellectual creations by entrepreneurs or their staffs that have commercial value and are given legal property rights. Examples of such creations are a new product and its name, a new method, a new process, a new promotional scheme, and a new design.

A fence or a lock cannot protect these intangible assets. Instead, patents, copyrights, and trademarks are used to prevent competitors from benefiting from an individual's or firm's ideas.

Protecting intellectual property is a practical business decision. The time and money invested in perfecting an idea might be wasted if others could copy it. Competitors could charge a lower price because they did not incur the startup costs. The purpose of intellectual property law is to encourage innovation by giving creators time to profit from their new ideas and to recover development costs.

Intellectual property rights can be bought, sold, licensed, or given away freely. Some businesses have made millions of dollars by licensing or selling their patents or trademarks. Every entrepreneur should be aware of intellectual property rights in order to protect these assets in a world of global markets. An intellectual property lawyer can provide information and advice.

[12] U.S. Department of State/Bureau of International Information Programs. [online]. [cit. 2013-10-02]. Available from: http://www.ait.org.tw/infousa/zhtw/docs/enterp.pdf

The main forms of intellectual property rights are:

- *Patents*: A patent grants an inventor the right to exclude others from making, using, offering for sale, or selling an invention for a fixed period of time - in most countries, for up to 20 years. When the time period ends, the patent goes into the public domain and anyone may use it.
- *Copyright*: Copyrights protect original creative works of authors, composers, and others. In general, a copyright does not protect the idea itself, but only the form in which it appears - from sound recordings to books, computer programs, or architecture. The owner of copyrighted material has the exclusive right to reproduce the work, prepare derivative works, distribute copies of the work, or perform or display the work publicly.
- *Trade Secrets*: Trade secrets consist of knowledge that is kept secret in order to gain an advantage in business. "Customer lists, sources of supply of scarce materials, or sources of supply with faster delivery or lower prices may be trade secrets," explains Joseph S. Iandiorio. Trade secrets are usually protected by contracts and non-disclosure agreements. No other legal form of protection exists. The most famous trade secret is the formula for Coca-Cola, which is more than 100 years old. Trade secrets are valid only if the information has not been revealed. There is no protection against discovery by fair means such as accidental disclosure, reverse engineering, or independent invention.
- *Trademarks*: A trademark protects a symbol, word, or design, used individually or in combination, to indicate the source of goods and to distinguish them from goods produced by others. For example, Apple Computer uses a picture of an apple with a bite out of it and the symbol (®) which means registered trademark. A service mark similarly identifies the source of a service. Trademarks and service marks give a business the right to prevent others from using a confusingly similar mark. In most countries, trademarks must be registered to be enforceable and renewed to remain in force. However, they can be renewed endlessly. Consumers use marks to find a specific firm's goods that they see as particularly desirable - for example, Barbie dolls or Toyota automobiles. Unlike copyrights or patents, which expire, many business's trademarks become more valuable over time.

Summary

Second part consisted of principles of entrepreneurship divided into component parts such as „what busines do“ in which are introduced relation between outputs, resources, costs, revenues and business profits. In this part are also included external factors affecting business environment consisting of economic forces (income, inflation, recession, interest rate, Exchange rate), technological factors (technologies for nations, technologies for product and services, technologies for gbusiness models), socio-cultural factors (values, time-starved customers, multiple lifestyles, changing structures of families); demographic factors (such as adolescents, youth and people with diffrerent age stages); political legal envrironment and natural environment. The second part is extended to basic business functions and definiton of the entrepreneur profiles with condition for becoming an entrepreneur. Also part of dececisions and downfalls of entrepreneurship and choosing a product and a market is not neglected. This part presents entry strategies for new ventures vith criteria for choosing a form of business and role of the intellectual property.

Questions to test your knowledge:

1. *How would you characterize and describe the factors affecting the business environment?*
2. *What criteria are decisive for the choice of form of business?*
3. *Such properties should have an entrepreneur that has successfully operated its business?*
4. *What role does intellectual property in business?*

3 A BUSINESS ENTERPRISE IS BORN

So far, we have looked at the origins of ideas for businesses, the problem of sizing up whether there will be a big enough market for the output of a new business, how the product might be made, how much it might cost to make, what determines the price of the product if it is offered for sale to customers and what determines the long-run prospects for production to be profitable. These are some of the key ingredients of a business plan.

However, even if an entrepreneur is convinced that a product could be profitable in the long run if produced in a particular way and sold for a particular price, this does not guarantee that the entrepreneur will be able to get it produced and sold in the expected quantities at the planned price. In this chapter we consider some further issues that have to be addressed if business plans are to be turned into companies with some hope of surviving in the long run. This chapter's structure is based on a particular view of the nature of a business enterprise:

"***A business enterprise is a pool of resources directed by an entrepreneur and/or by a team of hired managers***" (Earl and Wakeley, 2005).

We focused on four main kinds of resources are vital for bringing a business into being and keeping it out of receivership. In listing them, we emphasize the importance of quality, not merely quantity.

1. ***Financial resources***, including:
   - loans;
   - capital raised by selling shares;
   - working capital gained by success in getting customers to pay their bills faster than suppliers of inputs require their bills to be paid. How useful such resources will be depends on the terms under which they are supplied. For example, an overdraft facility may be much more valuable to some firms, if they operate in an unstable environment, than a fixed-term loan with a fixed repayment plan that has a much lower rate of interest. For a small business, a good working relationship with the firm's bank manager may be a major competitive resource if the firm's rivals have to deal with much more rigid and austere bankers.

2. ***Complementary businesses*** that serve as suppliers of inputs or downstream services such as distribution. These will be more valuable to the enterprise if they are:
   - competent;
   - reliable;
   - trustworthy;
   - flexible;
   - solvent;
   - cost-effective.

Given the importance of non-price factors in buyers' decision processes, it may be unwise for a firm to use the cheapest suppliers. Such suppliers might be cutting corners or be desperate for business. The result could be poor product quality, erratic deliveries or major disruption due to a supplier going out of business altogether.

3. ***Human resources***, ideally including:
   - visionary entrepreneur(s);
   - managers who can lead and motivate as well as take decisions;
   - workers with relevant skills. They will be more valuable if committed to the enterprise, open to change, adaptable, attentive and neither tardy nor prone to absenteeism.
4. ***Customers***, who are more valuable if they:
   - provide repeat business;
   - are willing to provide feedback;
   - are loyal enough to remain customers after making complaints and offering suggestions, and thereby give the business a better chance to improve what it does. A firm whose customers are mostly unsophisticated and undemanding in terms of quality and design and who are prone to choose on the basis of price or sheer size is hardly likely to face the kinds of pressures to be innovative and dynamic experienced by rivals whose clientele are knowledgeable and discerning (Earl and Wakeley, 2005).

As well as needing an ability to assemble a set of resources, the entrepreneur needs to be able to maintain it or be a good judge of people to whom that task may be delegated. As time passes, the set of resources connected together as a particular firm will tend to change: some shareowners, suppliers, workers and customers will sever their links and switch to other firms, or be attracted from them. But the enterprise will retain an identity beyond its legal status insofar as these comings and goings take time and entail similar kinds of players replacing those who leave the scene (Čepelová, 2007).

3.1 CAPITALISM AND RISK

In seeing relationships with suppliers (of finance, goods and services, and skills) and customers as part of the firm's pool of resources we are portraying the firm with three visions in mind:

- The firm as a (sometimes shifting) coalition of groups with different interests.
- The firm as a connective node in the fabric of industrial structure.
- The firm as an evolving institution known, at least to some degree, for doing business in a particular context and manner.

The first of these visions is the most useful to have in mind if one is trying to make sense of the nature of capitalist enterprise. It may seem odd to portray the firm as a coalition of interest groups that includes customers and complementary businesses. Mainstream economists traditionally emphasize the role of natural resources and capital equipment in production processes. To them, complementary businesses and customers are external, legally separate entities with which transactions may be made. Heterodox economics takes a rather different perspective, despite agreeing that access to natural resources and capital equipment play a major role in shaping a firm's costs and hence its viability. The heterodox viewpoint, beginning with the writings of Karl Marx in the nineteenth century and running into modern writing on the 'resource-based view of the firm', sees capitalism with a focus not on the role of physical assets in production processes for making goods and delivering services but on what goes on in the process of making money in terms of systems of relationships.

Capitalism is a mode of business organization in which those who risk their financial capital seek to increase their wealth by extracting the value that is added when workers produce commodities that are then exchanged for money by being sold in the market. Capitalist enterprise is not inherently associated with the buildings and machinery that comprise factories and other production systems in which commodities are produced from commodities via a sequence of inputs of labour, assisted by the physical capital. State-owned

businesses or worker co-operatives entail exactly the same sort of thing in physical terms. Instead, the distinguishing feature of capitalist enterprise is the division of risk-taking roles.

The owners of the firm thus carry the bulk of the risks associated with being left with unsaleable inventories, being let down or held up by slack or devious employees and suppliers, or being mucked around by customers. In return they get to keep the net revenues of the business; in other words, they are the residual claimants. By contrast, in a worker co-operative, the residual claimants are the workers who are members of the co-operative; and with a state-owned enterprise, the residual claimants are, ultimately, voters/taxpayers. To some extent, the owners of a firm can offload their risks to other parties. Examples of this include:

- waiters who receive a large part of their income from tips;
- sales personnel whose pay includes commission;
- the payment of end-of-year bonuses to employees (which are much more
- common in Japanese business than in the West);
- payments based on the number of items the worker makes, or hours worked,
- with no guarantee of a particular output being required;
- managers whose 'remuneration packages' include performance-based pay
- and/or stock options.

When capitalists share the risks and returns with workers, they do not necessarily end up capturing less value added, for those to whom some of the risks have been shifted may now have bigger incentives to perform in a way that increases the total value added by the business. The crucial thing for the capitalists is that those with whom the risks are being shared do not capture all the extra value that they create when responding to the chance to earn more by foregoing certainty in their incomes.

In short, how much money the owners of a business can make depends on the terms of the deals that are done with the workers, customers and other businesses involved in the supply chain, and on what happens as a consequence of these deals being done (Earl and Wakeley, 2005).

3.2 FINANCING THE ENTERPRISE

Many businesses are financed initially from the entrepreneur's own resources, such as a redundancy settlement, a major legacy or by mortgaging the family home. If the business succeeds, the entrepreneur captures all of the residual earnings, but if it fails the entrepreneur may suffer major financial difficulties, even bankruptcy. Self-financing is a high-risk strategy for an inexperienced entrepreneur: even if entrepreneurs are able to generate good ideas, their inexperience in terms of marketing, management or dealing with suppliers and distributors may result in poor sales or unexpectedly high costs.

Sharing the financial risks with others comes, of course, at a price, namely, that the other parties may capture much of the profits. Profit-sharing can be reduced if finance is raised in the form of a loan rather than by letting others take a share in the business. However, a loan is unlikely to be forthcoming unless collateral is offered, and the lender will be at the front of any queue of creditors and able to call in the receiver if interest obligations are not met. Giving others a share in the business in return for their financial input at least gives the entrepreneur scope for keeping the firm going in difficult times by not paying any dividends to the shareholders.

Other shareholders run the risk that the entrepreneur may choose not to act in their best interests. This problem arises with loan finance too, but there the incentive to take care and make the business succeed is enhanced by the prospect of losing a major asset such as the family home that has been used as collateral. With share-based finance, an entrepreneur who has not put much into the business may stand to gain a lot if it is profitable, whereas if it fails, most of the losses are borne by the other shareholders. Entrepreneurs in such situations may

be tempted to take bigger risks than are prudent, or to try to capture profits by paying themselves fat fees for 'management services'. They will be less likely to do this, however, if they are worried about possible damage to their reputation and their ability to raise money for future enterprises. Given this, it is not surprising that hybrid forms of financing business startups are sometimes used. For example, an entrepreneur starting a publishing business that specializes in economics books might get it started as a joint venture with an established publisher in the social science area. The entrepreneur contributes financially by mortgaging the family home, as well as offering creative insight about which books to commission and relationship management expertise to bring them to fruition. The established publisher provides the rest of the finance, along with, say, warehousing and marketing capabilities.

With such an arrangement, the entrepreneur has a major incentive to make the business succeed and is able to begin operations on a much stronger footing. The other publisher may get better utilization of its assets pending growth in its own catalogue of products and the deal may include an option arrangement whereby the entrepreneur can eventually buy this publisher's stake in the firm and then go it alone. Such an entrepreneurial buyout only makes sense if the entrepreneur foresees stronger long-term prospects for the business than the partner firm does, or if the partner firm has an urgent need to put money back into its primary business, either to solve problems or to take advantage of new opportunities to earn higher returns.

There are two main barriers to the greater use of external finance. One is the inability of suppliers of finance to share the entrepreneur's vision of the potential market and ability to implement the project. Too much may depend on a gut instinct in the case of a radical new venture, or there may be disagreements about assumptions underlying the entrepreneur's business plan. The other problem is that in many economies venture capital markets are very poorly developed, both in terms of risk-taking traditions and market institutions that enable entrepreneurs to find suppliers of finance. Venture capital markets in such economies do not operate like that for which Silicon Valley is famous. Its venture capitalists often see past failures as indicators of experience rather than incompetence and focus on the case an entrepreneur is making for his or her latest business. If they do not judge themselves competent to assess the proposal's chances, they will rapidly point the entrepreneur to other venture capitalists who are likely to be better able to make a fair appraisal of it (Earl and Wakeley, 2005).

New businesses rarely show a profit in the early months of operation. Generating sales takes time, and receipts are not usually sufficient to offset start-up costs and monthly expenses. Therefore, entrepreneurs need to estimate how much money they need and then raise that amount to transform their dream into a reality. Entrepreneurs need finance to test, produce, and distribute their products. Finance can be obtained from a number of sources, including:

- The entrepreneur's own funds, called private equity.
- Selling shares in their business, called share capital.
- Borrowing from individuals, banks via loans and mortgages, or from other firms.
- Credit from suppliers, which is similar to a loan in its effect.

It doesn't necessarily take a lot of cash to create a successful business. In the mid-1970s, Steve Jobs and Steve Wozniak started Apple Computer by selling a Volkswagen microbus and a Hewlett-Packard scientific calculator to raise $1,300 - enough for a makeshift production line. In 1997, Bill Martin and Greg Wright used the free Internet connections in their college dorm rooms and $175: $75 for a New Jersey partnership fee, $70 to register their Web domain name, and $30 for a month's hosting fee - to start www.ragingbull.com, which is now a successful financial Web site.

Many entrepreneurs start businesses with $5,000 or less, just enough to establish the business, invest in some inventory, and create some advertising materials. There are many

ways to reduce expenses: for instance, by initially working out of one's home rather than leasing an office or leasing office equipment rather than buying it.

However, all entrepreneurs need to estimate how much cash they need to cover expenses until the business begins to make a profit. For this task, the best financial tools are the income statement and cash flow statement. Cash flow refers to the amount of money actually available to make purchases and pay current bills and obligations. It is the difference between cash receipts (money taken in) and cash disbursements (money spent) over a specific time period.

It is important to attach notes to these forecasts to explain any unusual expenses or assumptions used in the calculations. An *income statement* sets out all of the entrepreneur's projected revenues and expenses (including depreciation and mortgages) to determine a venture's profits per month and year. Depreciation is a method to account for assets whose value is considered to decrease over time.

A *cash flow statement* estimates anticipated cash sales as well as anticipated cash payments of bills. This estimate can be done on a weekly, monthly, or quarterly basis, but experts recommend that it be done at least once every month for the first year or two of a new business. This forecast is used to project the money required to finance the operation annually. By calculating this forecast on a cumulative basis, the entrepreneur can forecast his company's overall capital needs at start up.

The monthly net cash flow shows how much an entrepreneur's cash receipts exceed or fall short of monthly cash expenditures. For most of the first year, the monthly expenditures are likely to exceed the receipts. In many cases, goods are shipped out before payment is received. Meanwhile, the entrepreneur still has to pay his bills. Therefore, the cumulative cash flow, which adds each month's total to that of previous months, will result in a growing negative amount.

A critical point for a new business occurs when monthly sales receipts are enough to cover monthly expenses. At this point, the negative cumulative cash flow will begin to decrease and move toward a positive one. The cumulative cash flow amount reached just before it reverses direction indicates approximately how much capital the new business will need.

Financial projections are inevitably somewhat inaccurate simply because every contingency cannot be predicted. For this reason, experts recommend that entrepreneurs add at least 20 percent to the financial needs calculated in the cash flow statement to create a safety net for unforeseen events. With these estimates, the entrepreneur can seek funding and concentrate more clearly on launching the new business.

3.2.1 SOURCES OF FINANCING

Many entrepreneurs struggle to find the capital to start a new business. There are many sources to consider, so it is important for an entrepreneur to fully explore all financing options. He also should apply for funds from a wide variety of sources.

- ***Personal savings***: Experts agree that the best source of capital for any new business is the entrepreneur's own money. It is easy to use, quick to access, has no payback terms, and requires no transfer of equity (ownership). Also, it demonstrates to potential investors that the entrepreneur is willing to risk his own funds and will persevere during hard times.
- ***Friends and family***: These people believe in the entrepreneur, and they are the second easiest source of funds to access. They do not usually require the paperwork that other lenders require. However, these funds should be documented and treated like loans. Neither part ownership nor a decision-making position should be given to these lenders, unless they have expertise to provide. The main disadvantage of these funds is that, if the business fails and money goes lost, a valuable relationship may be jeopardized.

- ***Credit cards***: The entrepreneur's personal credit cards are an easy source of funds to access, especially for acquiring business equipment such as photocopiers, personal computers, and printers. These items can usually be obtained with little or no money paid up front and with small monthly payments. The main disadvantage is the high rate of interest charged on credit card balances that are not paid off in full each month.
- ***Banks***: Banks are very conservative lenders. As successful entrepreneur Phil Holland explains, "Many prospective business owners are disappointed to learn that banks do not make loans to start-up businesses unless there are outside assets to pledge against borrowing." Many entrepreneurs simply do not have enough assets to get a secured loan from a lending institution. However, if an entrepreneur has money in a bank savings account, she can usually borrow against that money. If an entrepreneur has good credit, it is also relatively easy to get a personal loan from a bank. These loans tend to be short-term and not as large as business loans.
- ***Venture investors***: This is a major source of funding for start-ups that have a strong potential for growth. However, venture investors insist on retaining part ownership in new businesses that they fund.
    - *Formal institutional* venture funds are usually limited partnerships in which passive limited partners, such as retirement funds, supply most of the money. These funds have large amounts of money to invest. However, the process of obtaining venture capital is very slow. Several books, such as Galante's Venture Capital & Private Equity Directory, give detailed information on these funds.
    - *Corporate venture* funds are large corporations with funds for investing in new ventures. These often provide technical and management expertise in addition to large monetary investments. However, these funds are slow to access compared to other sources of funds. Also, they often seek to gain control of new businesses.
    - *Angel investors* tend to be successful entrepreneurs who have capital that they are willing to risk. They often insist on being active advisers to businesses they support. Angel funds are quicker to access than corporate venture funds, and they are more likely to be invested in a start-up operation. But they may make smaller individual investments and have fewer contacts in the banking community.
- ***Government programs***: Many national and regional governments offer programs to encourage small and medium-sized businesses.

3.3 CORPORATE GOVERNANCE

Corporate governance is primarily understood as a set of rules through which corporations are governed. Corporate governance "is the way in which are companies directed and controlled" (source: Cadbury Report, 1992). Over the years, corporate governance has become a much broader issue and includes other aspects of a corporation's management.

Companies must comply with certain rules and regulations and adhere to the directions agreed by the board of directors. They institutionalize and adhere to rules of executive compensation, and are monitored by financial institutions and banks. Company executives and managers on lower levels comply with set rules. This system should ensure that the gap between shareholders and managers is bridged and that managers act in the interest of shareholders.

With broader objectives, corporate governance does not concentrate solely on companies and their owners, but takes into consideration a broader spectrum of stakeholders (for example, shareholders, employees, government, environment, and local community). The objective is that everybody can potentially be better off by using resources accountably and in a reasonable manner. An often-used example in this context can be pollution. If firms took a

broader view on corporate governance, they would change their behavior and produce a socially acceptable level of pollution (Jindřichovská, 2008).

The corporate governance structure of joint stock corporations in a given country is determined by several factors: the legal and regulatory framework outlining the rights and responsibilities of all parties involved in corporate governance; the de facto realities of the corporate environment in the country; and each corporation's articles of association. While corporate governance provisions may differ from corporation to corporation, many de facto and de jure factors affect corporations in a similar way. Therefore, it is possible to outline a "model" of corporate governance for a given country.

In each country, the corporate governance structure has certain characteristics or constituent elements, which distinguish it from structures in other countries. We have identified as an example two models of corporate governance in developed capital markets. These are the Anglo-US model and the German model. Each model identifies the following constituent elements: key players in the corporate environment; the share ownership pattern in the given country; the composition of the board of directors (or boards, in the German model); the regulatory framework; disclosure requirements for publicly-listed stock.

3.4 CAPITAL STRUCTURE

The term capital structure refers to the percentage of capital (money) at work in a business by type. Broadly speaking, there are two forms of capital: equity capital and debt capital. Each has its own benefits and drawbacks and a substantial part of wise corporate stewardship and management is attempting to find the perfect capital structure in terms of risk / reward payoff for shareholders. A mix of a company's long-term debt, specific short-term debt, common equity and preferred equity. The capital structure is how a firm finances its overall operations and growth by using different sources of funds.

Debt comes in the form of bond issues or long-term notes payable, while equity is classified as common stock, preferred stock or retained earnings. Short-term debt such as working capital requirements is also considered to be part of the capital structure or stock investors that favor companies with good fundamentals, a "strong" balance sheet is an important consideration for investing in a company's stock. The strength of a company's balance sheet can be evaluated by three broad categories of investment-quality measurements: working capital adequacy, asset performance and capital structure. In this article, we'll look at evaluating balance sheet strength based on the composition of a company's capital structure.

A company's capitalization (not to be confused with market capitalization) describes the composition of a company's permanent or long-term capital, which consists of a combination of debt and equity. A healthy proportion of equity capital, as opposed to debt capital, in a company's capital structure is an indication of financial fitness[13].

The equity part of the debt-equity relationship is the easiest to define. In a company's capital structure, equity consists of a company's common and preferred stock plus retained earnings, which are summed up in the shareholders' equity account on a balance sheet. This invested capital and debt, generally of the long-term variety, comprises a company's capitalization, i.e. a permanent type of funding to support a company's growth and related assets.

A discussion of debt is less straightforward. Investment literature often equates a company's debt with its liabilities. Investors should understand that there is a difference between operational and debt liabilities - it is the latter that forms the debt component of a company's capitalization - but that's not the end of the debt story. Among financial analysts and investment research services, there is no universal agreement as to what constitutes a debt liability. For many analysts, the debt

[13] Investopedia – Evaluating A Company´s Capital Structure. 2012. [online]. [cit. 2013-08-10]. Available from: http://www.investopedia.com/articles/basics/06/capitalstructure.asp

component in a company's capitalization is simply a balance sheet's long-term debt. This definition is too simplistic. Investors should stick to a stricter interpretation of debt where the debt component of a company's capitalization should consist of the following: short-term borrowings (notes payable), the current portion of long-term debt, long-term debt, two-thirds (rule of thumb) of the principal amount of operating leases and redeemable preferred stock. Using a comprehensive total debt figure is a prudent analytical tool for stock investors.

3.4.1 IS THERE AN OPTIMAL DEBT-EQUITY RELATIONSHIP?

In financial terms, debt is a good example of the proverbial two-edged sword. Astute use of leverage (debt) increases the amount of financial resources available to a company for growth and expansion. The assumption is that management can earn more on borrowed funds than it pays in interest expense and fees on these funds. However, as successful as this formula may seem, it does require that a company maintain a solid record of complying with its various borrowing commitments.

A company considered too highly leveraged (too much debt versus equity) may find its freedom of action restricted by its creditors and/or may have its profitability hurt as a result of paying high interest costs. Of course, the worst-case scenario would be having trouble meeting operating and debt liabilities during periods of adverse economic conditions. Lastly, a company in a highly competitive business, if hobbled by high debt, may find its competitors taking advantage of its problems to grab more market share.

Unfortunately, there is no magic proportion of debt that a company can take on. The debt-equity relationship varies according to industries involved, a company's line of business and its stage of development. However, because investors are better off putting their money into companies with strong balance sheets, common sense tells us that these companies should have, generally speaking, lower debt and higher equity levels[14].

3.4.2 CAPITAL RATIONS AND INDICATORS

In general, analysts use three different ratios to assess the financial strength of a company's capitalization structure. The first two, the so-called debt and debt/equity ratios, are popular measurements; however, it's the capitalization ratio that delivers the key insights to evaluating a company's capital position.

The debt ratio compares total liabilities to total assets. Obviously, more of the former means less equity and, therefore, indicates a more leveraged position. The problem with this measurement is that it is too broad in scope, which, as a consequence, gives equal weight to operational and debt liabilities. The same criticism can be applied to the debt/equity ratio, which compares total liabilities to total shareholders' equity. Current and non-current operational liabilities, particularly the latter, represent obligations that will be with the company forever. Also, unlike debt, there are no fixed payments of principal or interest attached to operational liabilities.

The capitalization ratio (total debt/total capitalization) compares the debt component of a company's capital structure (the sum of obligations categorized as debt + total shareholders' equity) to the equity component. Expressed as a percentage, a low number is indicative of a healthy equity cushion, which is always more desirable than a high percentage of debt[15].

---

[14] Investopedia – Evaluating A Company´s Capital Structure. 2012. [online]. [cit. 2013-08-10]. Available from: http://www.investopedia.com/articles/basics/06/capitalstructure.asp

[15] Investopedia – Evaluating A Company´s Capital Structure. 2012. [online]. [cit. 2013-08-10]. Available from: http://www.investopedia.com/articles/basics/06/capitalstructure.asp

3.5 TO MAKE OR TO BUY

The extent to which a new enterprise will need to grapple with the tasks of raising funds and hiring personnel depends not merely on the number of units of the product that are going to be produced but also on how much of the total value of each unit is to be produced in-house and how much is to be produced by other businesses. In other words, an activity may be internalized, in the sense of being undertaken by the staff hired by the organization in question, or outsourced, in the sense of being undertaken by staff in another organization with the resulting products being purchased through a market contract.

Although we are going to focus mainly on activities, much the same kind of analysis can be applied to the question of whether a firm should own the physical assets that it employs in those activities that it does undertake, or whether it should rent or lease them from other businesses. As with an individual facing the choice between renting a house or renting money (in other words, borrowing) to buy a house, so firms can rent or lease buildings, office equipment, company cars and machinery, rather than raising more money upfront and buying them outright. The range of capital goods that firms can lease is now very wide indeed: for example, many large airlines lease their jets from specialist finance companies, while a boutique brewery may lease its beer kegs.

Similar choices arise in respect of goods that are held in stock by retailers. A retailer may take title to the items that it stocks, or it may sell them for commission on a sale-or-return, consignment basis, shifting back to the supplier the risk that they might not get sold. The theoretical analysis can also be used for analysing different kinds of employment arrangements. Some staff working in a business may be employees on contracts of unspecified duration with particular arrangements for termination, while other employees may be working on contracts for particular periods that offer no guarantee of being rolled over upon expiry.

In some cases, workers may be working on secondment, or under some kind of leasing arrangement with another firm, such as a management consulting business or a business owned by the person in question. In yet more complicated arrangements, people may be working for a succession of firms that pay fees to temporary-employment agencies, and the agencies, in turn, pass the pay on to the workers, less commission charges (Earl and Wakeley, 2005).

Summary

Third part introduced the creation of business enterprise with focused on capitalims and risk, financing the enterprise and possibilities of business financing existing in business environment. Short overview of corporate governance was included in this part. Particular focus was appropriately amended by aspects of capital structure and optimal debt-equity relationship with capital rations and indicators. Final part of this chapter went in to decesion whether to use „in-house“ production or to outsorced.

Questions to test your knowledge:

1. *What are the options for business financing?*
2. *Characterize and determine in which types of companies are required to use corporate governance?*
3. *What is the optimal capital structure and what are the methods or indicators useful for the distribution of capital?*
4. *What is the interaction between the capitalism and risk?*

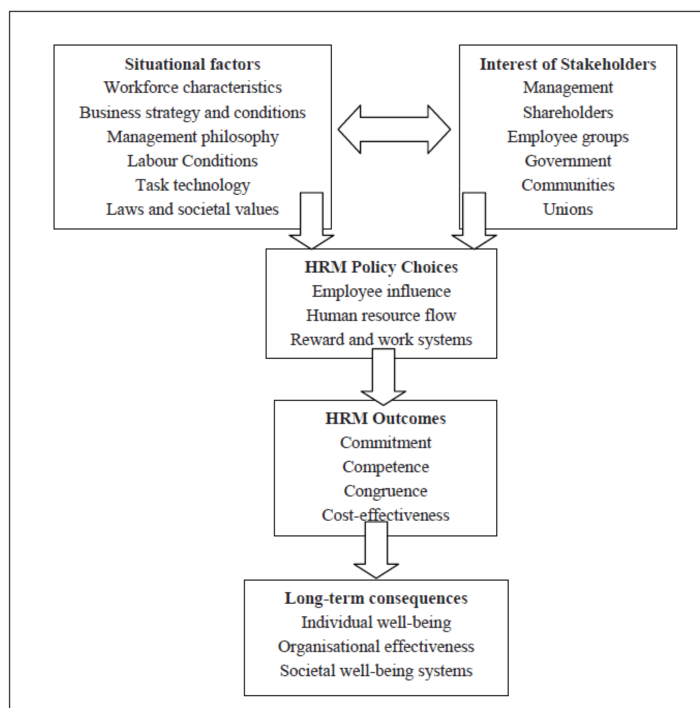
4 HUMAN RESOURCE MANAGEMENT

The importance of human resource management is to organize the process of changes in the structure and quality of human resources in organization. This is one of progressive forms of personnel management, which must comply with the requirements of economic and social surroundings, with its internal performances, goals and requirements (Čepelová, A. a kol., 2006).

Today, managing human resources effectively is more important than ever. Managers in organizations of all sizes describe how vital it is to have highly motivated, competent employees if their companies are to gain a sustainable competitive advantage and serve all of their multiple stakeholders.

Since the mid-1980´s Human Resource Management (HRM) has gained acceptance in commercial circles. HRM is a multidisciplinary organizational function that draws theories and ideas from various fields such as management, psychology, sociology and economics. There are countless definitions of what HRM is or should be and there is not one definition that can define what HRM exactly is. There is no best way to manage people and no manger has formulated how people can be best managed because managing people is not a straightforward thing. People are complex beings that have complex needs. Effective HRM very much depends on the causes and conditions that an organisational setting would provide (Senyucel, 2009).

Figure 10 The HRM framework



Source: Senyucel, 2009

Although there is no consensus on the definition or the characteristics of HRM it can be seen as that HEM is a combination of people-oriented management practices that views employees as assets, not costs, and its main aims is to create and maintain a skilful and committed workforce to gain competitive advantage.

The differences in the interpretation of HRM have created two different schools of thought: soft and hard variants of HRM. Soft and hard HRM are also often defined as two main models of HRM. Soft HRM focuses on employee training, development, commitment and participation. It is used to define HR functions aimed to develop motivation, quality and

commitment of employees, hard HRM, on the other hand, concentrates mostly on strategy where human resources are used to achieve organisational goals. It is also associated with cost control and head count strategies, especially in business processes like downsizing, lowering the wages, shortening comfort breaks, etc. (Senyucel, p. 16, 2009).

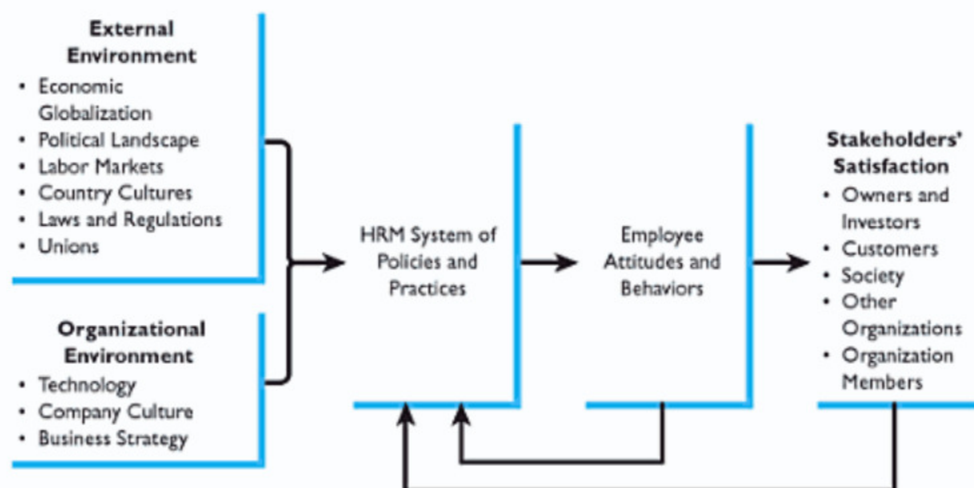
A comprehensive Human Resource Management (HRM) plays a vital role in the achievement of an organisation's overall strategic objectives and visibly illustrates that the human resources function fully understands and supports the direction in which the organisation is moving. A comprehensive HR Strategy will also support other specific strategic objectives undertaken by the marketing, financial, operational and technology departments.

Human Resource Management (HRM) is the function within an organization that focuses on recruitment of, management of, and providing direction for the people who work in the organization. HRM can also be performed by line managers. HRM is the organizational function that deals with issues related to people such as compensation, hiring, performance management, organization development, safety, wellness, benefits, employee motivation, communication, administration, and training.

Human resource managers administer the contract of employment, which is the legal basis of the employment relationship, but within that framework they also administer a psychological contract for performance. To have a viable business the employer obviously requires those who do its work to produce an appropriate and effective performance and the performance may come from employers', but is just as likely to come from non-employees. A business which seeks to be as lean and flexible as it can needs to reduce long-term cost commitments and focus its efforts on the activities which are the basis of its competitive advantage.

The employer needs performance from the employee, but an employee also has a psychological need to perform, to do well and to fulfil personal needs that for many can best be met in the employment context (Torrington, Hall and Taylor, 2008).

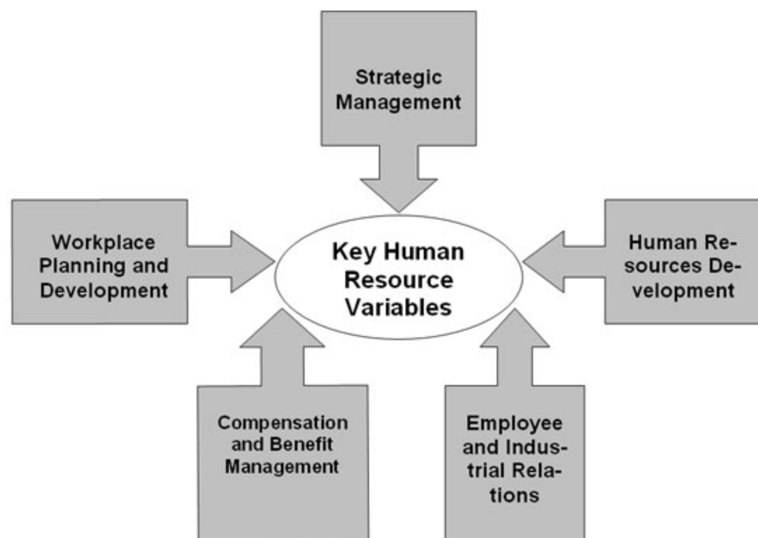
Figure 11 Managing Human Resources in the context of external and organizational environments



Source: Werner, Schuler and Jackson, 2012

Managing human resources effectively requires understanding all of the human resource policies and practices that make up an organization´s human resource management system as well as the interconnections that link the parts of that system together. Because managing people effectively is rather complex, it requires cooperation among human resource professionals, line managers, and all other employees (Werner, Schuler and Jackson, 2012).

Figure 12 The key Human Resource Variables



Source: Major variables impacting on HR management effectiveness. [online]. [cit. 2013-10-02]. Available from: http://www.ilocarib.org.tt/Promalco_tool/productivity-tools/manual11/m11_10.htm

HRM is also a strategic and comprehensive approach to managing people and the workplace culture and environment. Effective HRM enables employees to contribute effectively and productively to the overall company direction and the accomplishment of the organization's goals and objectives. HRM is moving away from traditional personnel, administration, and transactional roles, which are increasingly outsourced. HRM is now expected to add value to the strategic utilization of employees and that employee programs impact the business in measurable ways. The new role of HRM involves strategic direction and HRM metrics and measurements to demonstrate value (Heathfield, 2012).

Human resources management is one of the major elements of business operations. Its impact and effectiveness on the overall business is dependent on the treatment and outcomes of the many variables characterising its activities. This subject therefore seeks to examine the components of each of the major variables – strategic management, workplace planning and employment, human resource development, compensation and benefit management and employee and industrial relations.

4.1 ACTIVITIES FOR MANAGING HUMAN RESOURCES

Every organization, from the smallest to the largest, engages in a variety of HR activities. Human resource activities include the formal HR policies developed by the company as well as the actual ways these policies are implemented in the daily practices of supervisors and managers.

In some organizations, the formal HR policies and daily practices are closely aligned. In many organizations,, however, the formal policies are regarded as statements of expectations and aspirations, but they are not implemented in actual daily practices. That is, the actual practices are not aligned with the formal policies. The more that policies and practices are aligned and the more systematic companies are in creating HR activities to fit the organization

and its environment, the more effective the organization is likely to be. The many HR policies and practices that companies need to understand and create include:

- HR planning for alignment and change.
- Job analysis and competency modeling.
- Recruiting and retaining qualified employees.
- Selecting employees to fit the job and the organization.
- Training and developing a competitive workforce.
- Conducting performance management.
- Developing and approach to total compensation.
- Using performance-based pay to achieve strategic objectives.
- Providing benefits and services.
- Promoting safety, health, and well-being in the workplace.
- Understanding unionization and collective bargaining.

When an organization systematically understands, creates, coordinates, aligns and integrates all of their policies and practices, it creates a human resource management system. In takes many HR policies and practices working together as a system to get the best results (Werner, Schuler and Jackson, 2012).

4.2 HUMAN RESOURCE STRATEGY

In essence, an HR strategy should aim to capture "the people element" of what an organisation is hoping to achieve in the medium to long term, ensuring that:

- it has the right people in place,
- it has the right mix of skills,
- employees display the right attitudes and behaviours, and
- employees are developed in the right way.

A strategy is a plan of actions designed by senior management to achieve a favourable position in the competitive environment. There are existing four main concepts when explaining strategy: mission, objective, vision and policy.

- **Mission**: dominant purpose, or overriding reasons of an organisation´s existence.
- **Objective**: statement of outcomes to be achieved within a time frame.
- **Vision**: a desired future state where the organisation aspires to be.
- **Policy**: guidelines of organisational tasks.

There are four main points that HR managers need to analyze in order to establish a healthy and effective strategic HR function (Senyucel, p. 20, 2009):

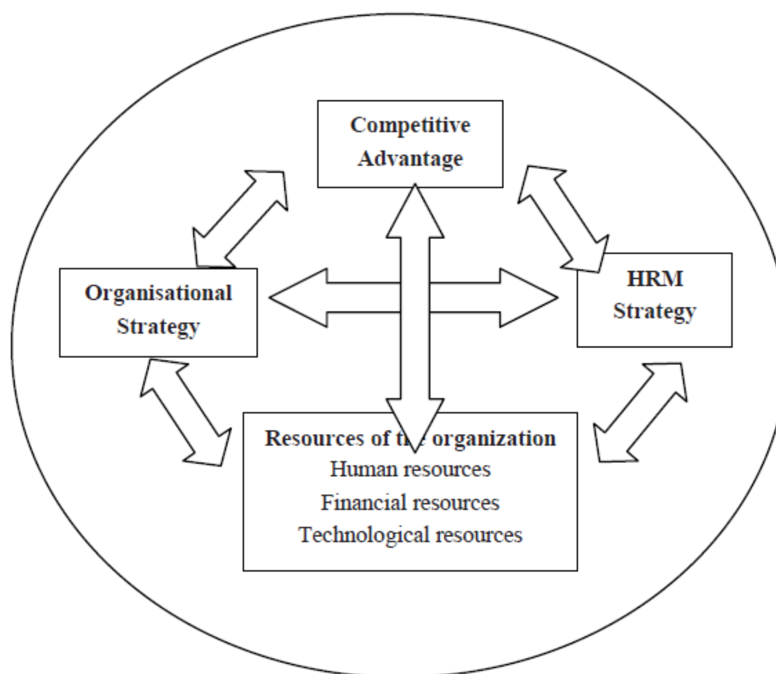
- **Current state of the workforce**: What is the current situation of our workforce? Is our workforce doing what it should be doing in order to achieve our goals?
- **Internal strength and weaknesses**: What are our core capabilities and sources of our workforce for competitive advantage? How can we train, develop and retain our employees? What are the limitations of our workforce?
- **External opportunities and threats**: How can we take advantage of the current situation in the business environment? What plans do we have for our workforce if the current market changes?

- **The path**: How do we know we are on the right part? Are we meeting our deadlines? Are we on schedule?

It is important to have HRM on the strategic level because it provides a broader range of solutions to complex problems generated by the changing nature of work, employee diversity, changing customer needs and globalisation. Effective organisational strategies can only be set if resources such as people, money and technology are taken into account. Organisations need to know their employee's capabilities and their financial and technological capacities before laying down any plans for the future.

Strategic HR function is connected to the idea known as the "resource based view" - competitive advantage can only be achieved through creating and developing core competencies that are getter than the rivals. Organizations gain competitive advantage by adapting faster to changes that occur in their environment. This requires planning long-term organisational flexibility and innovation, which comes from the people who work in that organisation, i.e. its human resources.

Figure 13 Cycle of resource-based HRM model



Source: Senyucel, 2009

If, as is sometimes the case, organisation strategies and plans have been developed without any human resource input, the justification for the HR may be more about teasing out the implicit people factors which are inherent in the plans, rather than simply summarising their explicit "people" content. An HR strategy will add value to the organisation if it:

- articulates more clearly some of the common themes which lie behind the achievement of other plans and strategies, which have not been fully identified before; and
- identifies fundamental underlying issues which must be addressed by any organisation or business if its people are to be motivated, committed and operate effectively.

The first of these areas will entail a careful consideration of existing or developing plans and strategies to identify and draw attention to common themes and implications, which have

not been made explicit previously. The second area should be about identifying which of these plans and strategies are so fundamental that there must be clear plans to address them before the organisation can achieve on any of its goals. These are likely to include:

- workforce planning issues
- succession planning
- workforce skills plans
- employment equity plans
- black economic empowerment initiatives
- motivation and fair treatment issues
- pay levels designed to recruit, retain and motivate people
- the co-ordination of approaches to pay and grading across the organisation to create alignment and potential unequal pay claims
- a grading and remuneration system which is seen as fair and giving proper reward for contributions made
- wider employment issues which impact on staff recruitment, retention, motivation etc.
- a consistent performance management framework which is designed to meet the needs of all sectors of the organisation including its people
- career development frameworks which look at development within the organisation at equipping employees with "employability" so that they can cope with increasingly frequent changes in employer and employment patterns
- policies and frameworks to ensure that people development issues are addressed systematically : competence frameworks, self-managed learning etc.

The HR strategy will need to show that careful planning of the people issues will make it substantially easier for the organisation to achieve its wider strategic and operational goals.

In addition, the HR strategy can add value is by ensuring that, in all its other plans, the organisation takes account of and plans for changes in the wider environment, which are likely to have a major impact on the organisation, such as:

- changes in the overall employment market - demographic or remuneration levels
- cultural changes which will impact on future employment patterns
- changes in the employee relations climate
- changes in the legal framework surrounding employment
- HR and employment practice being developed in other organisations, such as new flexible work practices.

Finding the right opportunity to present a case for developing an HR Strategy is critical to ensuring that there will be support for the initiative, and that its initial value will be recognised by the organisation. Giving a strong practical slant to the proposed strategy may help gain acceptance for the idea, such as focusing on good management practice. It is also important to build "early or quick wins" into any new strategy. Other opportunities may present the ideal moment to encourage the development of an HR Strategy:

- a major new internal initiative could present the right opportunity to push for an accompanying HR strategy, such as a restructuring exercise, a corporate acquisition, joint venture or merger exercise.
- a new externally generated initiative could similarly generate the right climate for a new HR strategy - e.g. Black economic empowerment initiatives.
- In some instances, even negative news may provide the "right moment", for example, recent industrial action or employee dissatisfaction expressed through a climate survey.

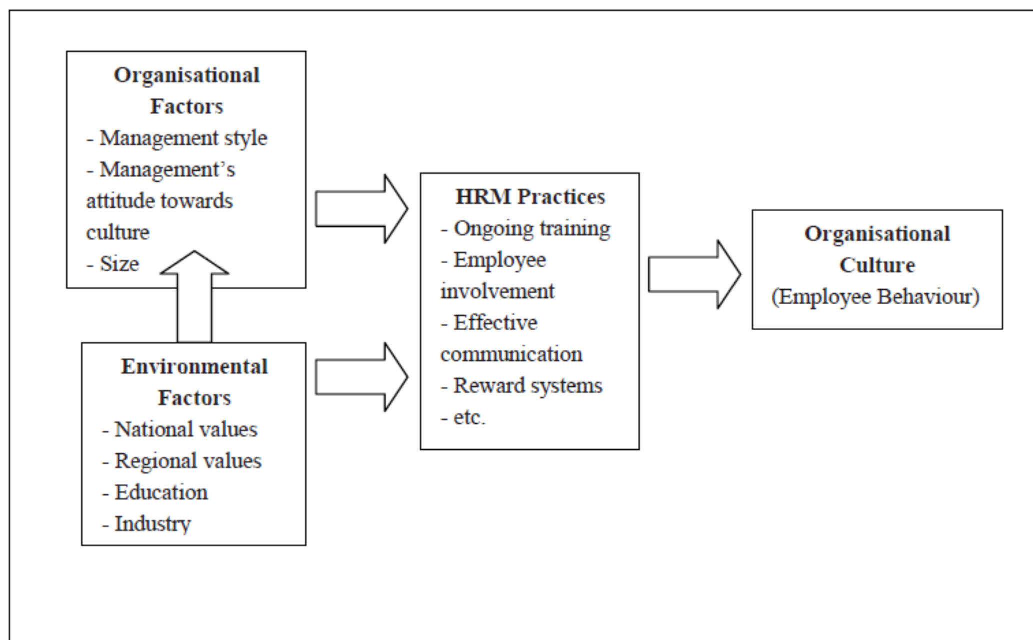
4.3 ROLE OF HRM ON ORGANISATIONAL CULTURE

HRM practices aims to develop strategies that provide fit between the style of management and the overall business strategy while maintaining employee well-being and increased performance at work. Basic HRM practices such as recruitment, selection, training, etc. affect the performance and stability of an organisation. Thus these practices have the ability to influence employee behaviour and create values that develop organisational culture (Gomes, 2004).

Weber (1996) argues that attitude of senior management is crucial for facilitating organisational culture because senior managers play an important part in shaping cultural values. After all, the style of management is likely to reflect on organisational culture. The most effective way this can be done is through key HR practices: on-going training, creating continuous communication channels, involving employees, establishing clear goals, creating a fair reward system, developing employees and flattening the organisational structures (Gomes, 2004).

Size, is also a very important factor. In the case of facilitating organisational culture, size does matter. Large organisations have more complex structures and complex management styles than small ones. As a consequence, large organisations need to ensure equal treatment of employees and clearer borders for management responsibility.

Figure 14 Model of factors influencing organisational culture



Source: Gomez, 2004

Organisational factors are dominated by these national and environmental factors their effects on HRM practices are highly significant. These factors affect the way people define work whether it is a burden, means to an end, responsibility or social contribution. The ways employees see work and behave at work are influence the design and delivery HRM practices at work.

Summary

HRM has a long-term agenda, the focus of which is employee development which includes the management of managers. It is a strategic function where recruitment, selection, the welfare of employees, their training, development and retention is planned and the most

effective ways of putting these ideas into practice are desinged in alignemtn with orgaisation´s strategic goals.

The importance of strategic HRM has been established in the business environment. It is a continuosly evolving field. New challenges to the business environment (e.g. the credit crunch, chaining government legislations for businesses, new organisational forms, etc.) are presenting new opportunities and challenges for HR practitioners on strategic levels. These opportunities and challenges need to be addressed and new strategies need to be formulated to keep up with the growing competition and performance pressures.

Questions to test your knowledge:

1. *Characterize the importance of human resource management in the organization.*
2. *What are the basic key human resource variables?*
3. *Wchich activities are inevitable for managing human resource in the organizations?*
4. *What are the mutual relations in cycle of resource-based HRM model?*

5 COST VOLUME PROFIT ANALYSIS

Objektive of cost volume profit analysis (CVP analysis) is to establish what will happen to the financial results if a specified level of activity or volume fluctuates. This information is vital to management, since one of the most important variables influencing total sales revenue, total costs and profit sis output or volume. For this reason output is given special attention, since knowledge of this relationship will enable management to identify the critical output levels, such as the level at which neither a profit nor a loss will occur (i.e. the break-even point).

In a company, the costs anc the possibilities of reducing the costs can be viewed from a variety of perspectives. From the aspekt of efficient product development, the costs that are of interest here are those incurred by the products. In this regard, a classification of costs is useful.

Manufacturing costs are assigned directly to the manufacturing process. Essentials, these consist of the material and production costs for the product.

Administrative costs are costs that cannot be directly assigned to the product manufacture. They are combined with the manufacturing costs to form the company´s total costs.

The **total costs**, in turn, contribute to the lifecycle costs and are reflected in the product sales price.

There are a number of ways to classify the total costs at the company level, which are signifiant in cost management. There is the fundamental classification according to cost types, for example, material costs, personnel costs, or capital costs.

Cost accounting further breaks down costs into **direct costs and overhead costs**.

Direct costs are costs that can be assigned directly to so-called cost units. By cost units we mean the company´s individual products or service activities. Typice direct costs are production material costs or production wages (direct labor).

In contrast to these, the term overhead costs includes those costs that cannot bet hus assigned. Examples of such costs are administrative costs, officers´salaries, CAD costs, heating costs, etc. which cannot be assigned to a specific cost unit.

The **lifecycle costs** are costs that accrue to the product user, and are the sum of all costs associated with purchase, use, and disposal of the product.

Furthermore, costs may be designated as **fixed or variable**, according to whether they are dependent on the company´s workload or production quantities.

Fixed costs are also called overhead. A firm has to spend for land, some machinery of permanent nature, an effluent treatment plant, etc. All such expenses have to be incurred irrespective of the output level, and they are called total fixed cost. The fixed costs do not change with changes in output, they are independent of output. As these costs must be incurred by a firm in the short run even if there is no production, they are called as fixed cost. The following are some fixed costs: cost of salaries to regular staff, cost of land, buildings, machinery, and capital of fixed nature, cost incurred on instance premium, cost incurred for any other purpose of permanent nature. Fixed costs are ones like rent and administrative payroll that don´t change much from month to month, regardless of how many units you sell.

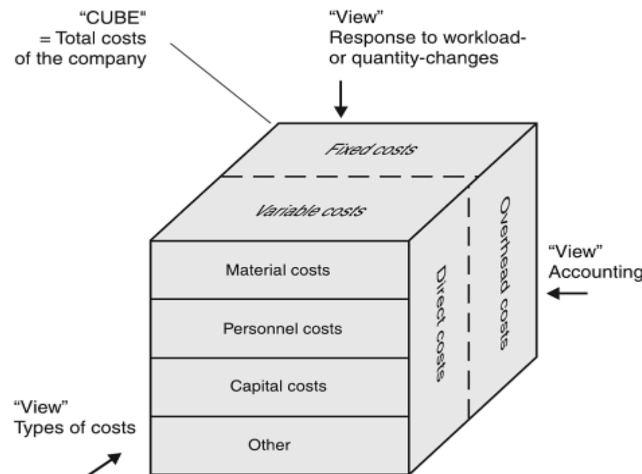
The variable cost „varies“ with production within the limits imposed by the fixed plant capacity. Variable costs are ones like inventory, shipping and sales commissions that rise or fall with your sales volume. The following are some variable costs: cost of raw materials, cost on wages and salaries of temporary labour, cost of depreciation on machina, buildings and

such other capital goods, cost of running any fixed capital, like fuel, elektricity, maintenance, etc. As with fixed costs, talk to trade associations, vendors and even other business owners in your field to come up with the most accurate estimate.

Total cost

The total cost (TC) refers the total cost of production at any level of production. The total cos tis summation of total variable cost (TVC) and total fixed cost (TFC).

Figure 15 Various views of the total costs of a company



Source: Ehrlenspiel, Kiewert, Lindemann, 2007, p.7.

Cost of production, or cost, revers to the expenses incurred in the production o fany amount of a good.

The money spent is mostly payment for services of factor inputs employed for production. Thus, cost of production depends on the quantity of output, the relevant inputs combination and the cost of inputs.

Cost, in economics, basically refers to opportunity cost. It is, used to discuss the efficient allocation of society´s resources. A business firm also needs to adress the issue of allocation its limited resources for the best possible uses. There are also other cost concepts, like opportuinty cost and explicit and implicite costs, sunk costs.

Sunk costs – one of the more confusing aspects of capital budgeting is the treatment of „sunk costs“. The correct approach is to assume that the decision is being taken today, and that any expenditure made prior to the decision is irrelevant. Even if costs have been incurred to research the viability of the project, at this stage they are not relevant to the decision making. The manager´s koncern is not to recover sunk or irreversible costs but to create value from subsequent investments.

Opportunity costs – an opportunity cos tis the return that might be earned should the funds available for the investment being considered be used for another purpose. When a company takes an action (i.e. an investment) the action eliminates other possible actions. The diference between the action taken and the best action is the opportunity cost. The opportunity cost provils an indication of the relative importace of a decision.

5.1 PRODUCT COSTS

Understanding the product cost structure is critical to comprehending the process of estimating. Product costs are of two types – direct costs and indirect costs.

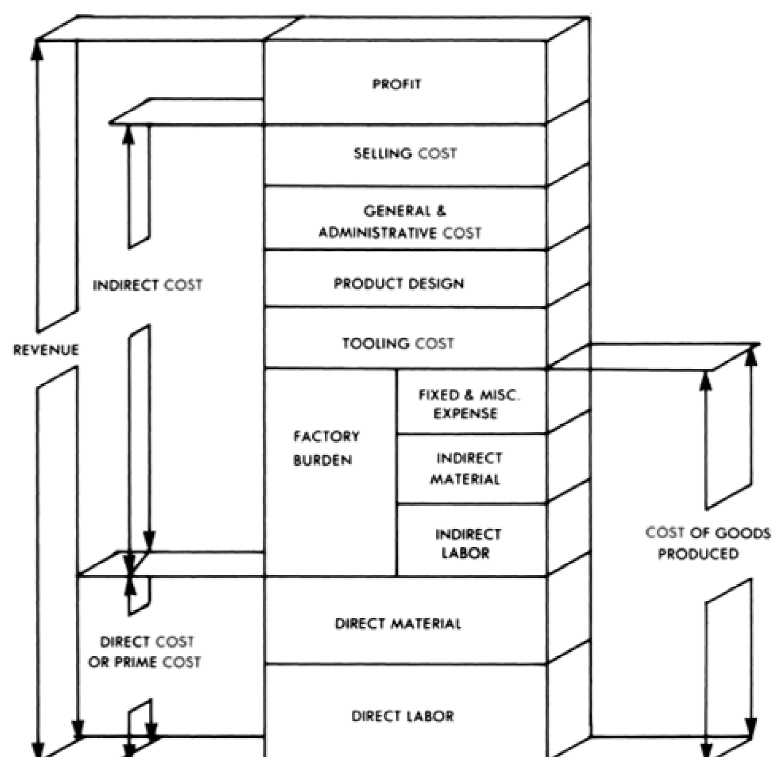
Direct costs are the costs that can be traced to a special products. For many companies, onyl direct labor and direct material are included in this category. These two costs combined are known as prime cost.

Direct labor involves the wages of people that do tasks in the manufacturing process for a specific product. The wages paid to a press operator to form a briket is an example of this. So is money spent to pay for a person to drive a fastener to hold a bracket onto another part.

Direct material is the cost to purchase material or parts that will ultimately be part of a specific product. This is the cost of the metal purchased to form a bracket. Cost for fasteners purchased from a supplier to assemble a bracket would also be in this category.

Figure shows product cost structure.

Figure 16 Product cost structure



Source: Winchell, 1989, p. 5.

For the same manufacturing process, these costs should be directly proportional to the quantity produced. For example, the cost for wages, purchased metal and fasteners to produce and assembler 100 000 brackets should be ten times the cost for 10 000 brackets using the same manufacturing process. Often costs, which may otherwise be proportional, are considered too small to be wortwhile to keep track of as direct cost. An example may bet he minute cost of the cleaning solution to cash a bracket prior to assembly. In this case, it is included as part of the indirect costs. (Winchell, 1989, p. 5)

Indirect costs are costs that are „considered“ as not being traceable to a specific product but are still required to run the company. These costs, unlike direct costs, are also not directly

proportional to the quantity of a specific product produced. The categories comprising indirect costs vary greatly among companies. A representative grouping of categories is faktory burden, tooling, product design, general and administrative costs, and selling costs. The combination of direct costs and faktory burden are known as cost of goods produced. (Winchell, 1989, p. 6)

Factory burden includes all costs associated with the operation of the plant considered not directly related to a specific product. Sub-categories include indirect labor, indirect material, and fixed and miscellaneous expense.

Indirect labor refers to the wages of people that do tasks not considered directly realated to the manufacturing process for a specific product. The costs of janitorial services, forklift operators, maintenance people, inspectors, and machine set-up people are examples. A practice in companies that process barches is to separetely estimate the wages involved in setting-up the tools and equipment to run each batch. This is used to quote a lump-sum set-up charge each time an order is processed.

Indirect material is the cost to purchase material that will not ultimately be part of a specific product. This may include such čems as cutting or grinding fluids.

Fixed or miscellaneous expense is defined as salaries of people, not considered directly related to the manufacturing process for a specific product, such as telefone bills, energy bills, taxes, cost of perishable tools, and depreciation of equipment. This category also includes the salaries of industrial engineers, manufacturing engineers, production supervisit, buyers and material engineers. Unusual expenses sometimes are absorbed by the supplier and charged to this category without an offsetting charge to the buying company. Examples include premium freight, overtime costs, depreciation of new facilities, and launch or debugging costs. There is a growing trend among suppliers to recognize these addend costs in product cost estimates. (Winchell, 1989, p. 6)

Tooling is the cost to design and build new durable tools or revise existing durable tools to process a specific product. Suppliers often provide the projected cost of this in product cost estimates for a lump sum reimbursement by the buying company. In this case, the buying company usually owns the tools, and they cannot be used to process similar parts for another comany. Where the supplier retains ownership of the tools, the cost is usually amortized over the life of the product and is part of the product cost estimate under faktory burden.

Product design is the cost of designing the product for the intended application. It could also include the cost of building and testing prototypes to verify that the design mens performance and durability requirements. Suppliers to larger companies are sometimes asked to handle the design of a product. This enhances the application of the target cost concept. Suppliers may provide the projected cost of this in product cost estimates for a lump sum reimbursement by the buying company. In other cases, the cos tis allocated over the production life of the product and becomes part of the product cost estimate.

General and administrative costs are those costs necessary to keep the company in operation but not directly related to production in the factory. Examples are executive salaries, research costs, and public relations. Some companies are encountering an increasing amount of product warranty cost being demanded by thein customers. This cost is typically charged to this category. The trend among suppliers is to recognize this addend cost in product cost estimates.

Selling costs are costs directly related to selling products. Examples are the cost of salespeople who call on potential customers, and marketing studies. Some suppliers also charge a lump sum amount for preparing a product cost estimate that is paid by the customer when the quote is delivered. (Winchell, 1989, p. 7)

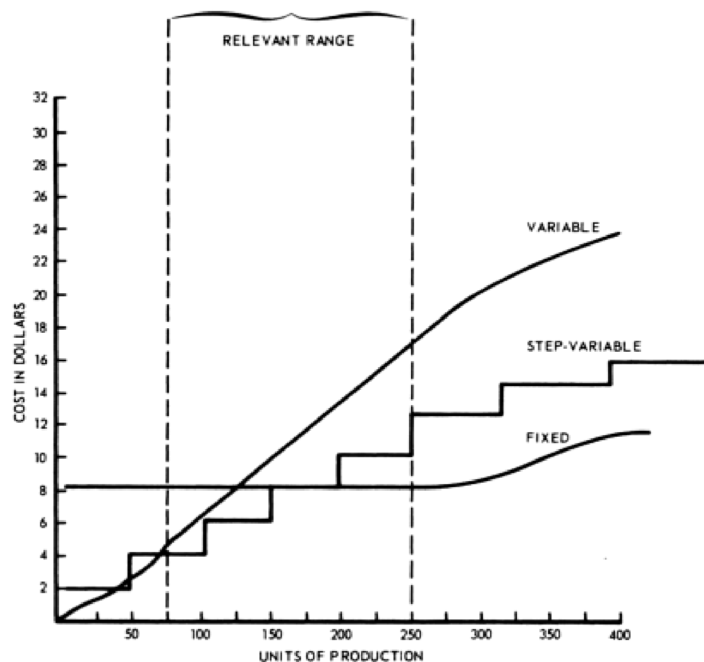
5.2 COSTS IN RELATION TO PRODUCT VOLUME

Costs are also categorized according to thein behavior in relation to product volume. Fixed, variable, and step-variable cost patterns are shown in figure. The definitions of fixed, variable, and step-variable costs assume the existence of upper and lower limits on production quantities. Only within this relevant range do costs behave according to their definitions. Note, the cost behavior patterns below 50 units and above 250 units in figure. Fixed costs remain the same regardless of volume. Specific examples include executive salaries, secretarial services, facilities, durable tooling, and security services. Durable tooling is classified as a fixed cost because a certain level of tooling is required to produce one unit or many units. Adequate plant security probably demands at least one night watchman, regardless of production levels. (Winchell, 1989, p. 7)

Variable costs rise in direct proportion to the number of units produced. Direct costs such as material and labor generally follow a variable curve such as the one depicted in figure. Note that this curve clils less steeeply outside the relevant range. As larger volumes are produced, lower material costs are possible and costs per unit are lowered.

A step-variable cost is one that remains the same over a given number of production units but jumps shuply to new plateaus at certain incremental changes in volume. The cost of a machine capable of producing 50 units, for example, would be the same whether one or 50 units, for example, would bet he same whether one or 50 units were actually produced. Perhaps, at 51 units, however, a new machine would need to be purchased, doubling the cost of machinery.

Figure 17 Cost volume behavior patterns



Source: Winchell, 1989, p. 8.

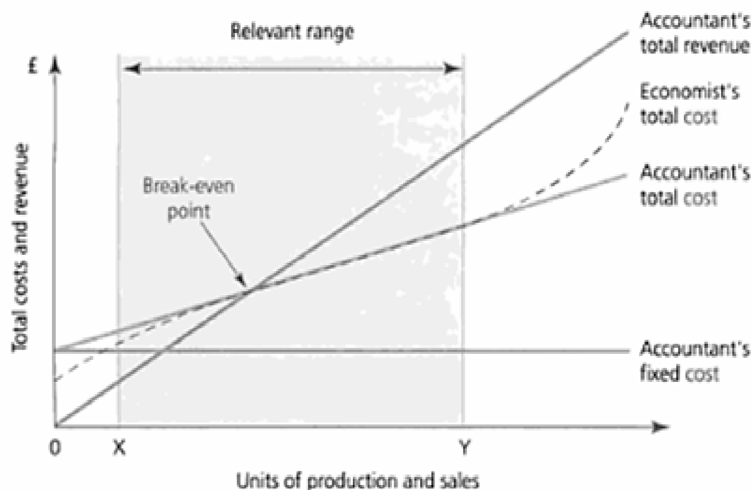
5.3 COST FUNCTION AND RELEVANT RANGE

The term relevant range is used to afer to the output range at which the firm expech to be operating within a short-term planning horizon. This relevant range also bradly represents the output levels which the firm has had experience of operating in the past and for which cost information is available.

You can see from figure 3 that, between points X and Y, the shape of the accountant´s total cost line is very similar to that of the economist´s. this is because the total cost line is only intrended to provide a good approximation within the relevant range. Withnin this range, the accountant assumes that the variable cost per unit is the same throughout the entire range of output, and the total cost line is therefore linear. Note that the cost fiction is approximately linear within this range. It would be unese, however, to maket his assumption for production levels outsider the relevant range. It would be more appropriate if the accountant´s total cost line was presented for the relevant range of output only, and not extended to the vertical axis or to the output levels beyond Y in figure 3.

Note also that the accountant´s fixed cost fiction in figure 3 mens the vertical axis at a different point to that at which the economist´s total cost line mens the vertical axis. The reason for thiw can be explained from figure 4. The fixed cost level of 0A may be applicable to say, activity level Q_2 to Q_3 , but if there were to be a prolonged economic recession then output might fall below Q_1 , and this could result in redundancies and shutdowns. Therefore fixed costs may be reduced to 0B if there is a prolonged and a significant dechne in sales demand. Alternatively, additional fixed costs will be incurred in long-term sales volume is expected to be greater than Q_3. Over a longer-term time horizon, the fixed cost line will consist of a series of step functions ether than the horizontal straight line depicted in figure 3. However, since within its short-term planning horizon the firm expech to be operating between output levels Q_2 and Q_3, it will be committed, in the short term, to fixed costs of 0A; but you should remember that if there was a prolonged economic recession then in the longer term fixed costs may be reduced to 0B.

Figure 18 Accountant´s cost-volume-profit diagram



Source: Drury, 2008, p. 168.

Let´s review the expression of cost as an equation for a straight line from figure 3.

$TC = F + v * Q$

TC = total cost (the dependent variable)

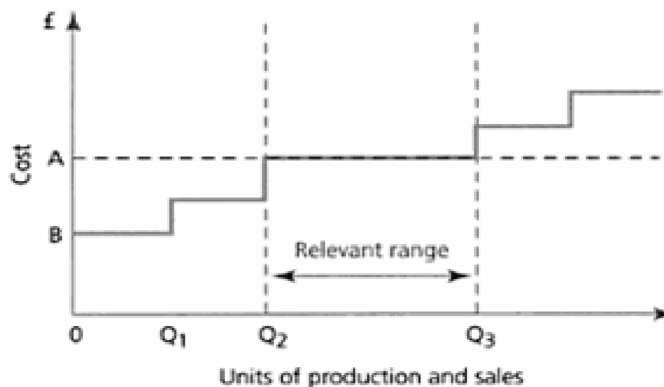
F = fixed cost component (the intercept parameter)

v = variable cost per unit (the slope parameter)

Q = measure of output (the independent variable)

The fixed cost line for output levels below Q_1 (i.e. 0B) represents the cost of providing the basic operating capacity, and this line is the equivalent to the point where the economist´s total cost line mens the vertical axis in figure 3.

Figure 19 Accountant´s fixed costs



Source: Drury, 2008, p. 169.

Because the accountant assumes that it the short term the firm will operate in the relevant range between Q_2 and Q_3, the accountant´s fixed cost line 0A in figure represents the fixed costs for the relevant output range only, which the firm is committed to in the current period and does not represents the fixed costs that would be incurred at the extreme levels of output beyond the shaded area in figure 4.

Total revenue function

Let us now compare the total revenue line for the accountant and the economist. We have seen that the accountant assumes that selling price is constant over the relevant range of output, and therefore the total revenue line is a straight line. The accountant´s assumption about the revenue line is a realistic one in those firms that operate in industries where selling prices tend to be fixed in the short term. A further factor reinforcing the assumption of a fixed selling price is that competition may také the form of non-price rather than price competition. Moreover, beyond the relevant range, increases in output may only be possible by offering substantial reductions in price. As i tis not the intention of firms to operate outsider the relevant range, the accountant makes no attempt to produce accurate revenue functions outsider this range. It might be more meaningful in figure 3 if the total revenue line was presented for output levels X and Y within the relevant range, instead of being extended to the left and right of these points.

Profitability analysis

Profitability analysis is based on detecting the contribution to profit of changes in volume of products and services sold in a period of time. It is widely known that this analysis requires ex ante the definitiv of the time horizon of such an effect. In the so-called short-term, fixed costs are not affected by any decision and action regarding sale volume and, therefore, their effects on profit are measured in terms of contribution margin (diference between changes in revenues and changes in variable costs). As mentioned above, in service organizations, pure variable costs are a small share of total costs and therefore, contribution margin analysis has a limited capability of explaning profitability, given that margins tend to equal revenues. Customer management (selection, acquisition, retention) tends to maximize the value of the customers, and therefore the value creation in general (Kaplan and Norton, 2003) in the long run. These actions require mainly a long-run mind set because they tend to show their effects over time. Even though some action (like selection) might produce some effects in the short run, the firm should focus on long-term value production by selecting customer groups capable of producing value in the long term. All these reasons are suggesting that a data warehouse with detailed information regarding long-term profitability of each individual customer should be put in plac efor supporting decision-making in the marketing area. In order to develop such analysis, a full cost approach is required. Full cost, when carefully done, allows the understanding of the implications of customers´ behaviour on ressource usage in the long run. Of course, when a long-run approach is taken, teh short-term relation between costs (fixed and variable) and volume is neglected and all costs are seen as variable.

Summary

Cost volume profit analysis is base on the relationship between volume and sales revenues, costs and profit in the short run, the short run normally being a period of one year, or less, in which the output of a firm is restricted to that available from the current operating capacity. In the short run, some inputs can be increased, but others cannot. For example, additional supplies of materials and unskilled labour may be obtained at short notice, but it takes time to expand the capacity of plant and machinery.

Thus output is limited in the short run because plant facilities cannot be expanded. It also takes time to reduce capacity, and therefore in the short run a firm must operate on a relativem constant stock of production resources. Furthermore, most of the costs and prices of a firm´s products will have already been determined, and the major area of uncertainty will be sales volume. Short-run profitability will therefore be most sensitive to sales volume. Cost volume profit analysis thus highlights the effects of changes in sales volume on the level of profits in the short run.

Questions to test your knowledge:

1. *Try to describe product cost structure.*
2. *Try to define total cost.*
3. *Describe differences between fixed and variable costs.*

6 BREAK-EVEN ANALYSIS

One of the important indicators of success of the start-up company is the time from starting the business till the moment when revenues of product sales equals the total costs associated with the sale of product – it is also called break-even point. In other words profit = 0. Break-even analysis is accounting tool to help plan and control the business operations.

Depending on the type of business and the frequency with which this type of analysis helps in decision making, the relevant time period can be any common unit such as daily, weekly, monthly, quarterly, or annually. Annual total cost estimates can be broken down on a monthly basis and adjusted for known fluctuations in costs. Just recognize that as the time period increases in length, the presence of other influences on the change in cost and revenue will become greater.

This application of breakeven analysis looks at the business model´s big picture. It represents the overall magnitude of operations. Such an overview can be helpful when only generalized results are needed, and changes to the structure of fixed costs and variable costs are believed to be minimal. This broad-stroke approach can be useful as an initial approximating method when details are not available.

For some business situations, details on costs, revenue, or pricing may be difficult to obtain, such as in the early stages of planning for a new venture. The broad approach taken by this basic formula leaves out consideration of the number of units of the product or service that need to be produced and sold during the time period. It says nothing about the sales mix. Precise estimates of total costs and total revenue for a business operation may be difficult to determine in advance. Differentiating between fixed and variable costs may also be difficult.

Break-even analysis also known as cost-volume-profit (CVP) analysis can help you get the point when the net profit is zero, which means the total renvenues equals to the total expenses. It is quite useful to price a new product when you can forecast your cost and sales. You can also see how fixed costs, price, volume, and other factors affect your net profit.

Break-even point represents the volume of business, where company´s total revenues (money coming into a business) are equal to its total expenses (total costs). In its simplest form, break-even analysis provils insight into whether or not revenue from a product or service has the ability to cover the relevant costs of production of that product or service.

TOTAL REVENUE = TOTAL COSTS

Break-even analysis is based on categorizing production costs between those which are:

- Variable cost that do vary with the number of units produced and sold (raw materials, fuel, direct labor, revenue-related costs), and those that are
- Fixed costs that don´t vary with the number of units produced and sold (salaries, rent and rates, depreciation, marketing costs, administration costs, R&R, instance).

To calculate break-even point it is needed to know following information[16]:

- The price that the company is charging,
- Variable costs (direct costs) of each unit and
- Fixed costs (or indirect costs/overheads).

TR = Total revenue

p = Selling price

Q = Number of units sold

TC = Total costs

F = Fixed costs

v = Variable costs per unit

FC = Total fixed costs

VC = Total variable costs

TR = p * Q

VC = C * Q

TC = FC + VC

TR – TC = profit

Because there is no profit (0 CZK):

TR – TC = 0

p * Q – (F + v * Q) = 0

Q = F * (p – v)

The basic formula for break-even analysis, sometimes abbreviated as BEA, is as follows:

BEQ = FC/(p-v)

Where BEQ = Break-even quantity

FC = Total fixed costs

p = Average price per unit, and

v = Variable costs per unit.

Note: the higher the fixed costs are the higher is the break-even point!

[16] Business Plan Tool. European Commission – Enterprise and Industry. [online]. [cit. 2013-09-03]. Available from: http://www.businessplantool.org/Dokumenti/Break-even%20point%20analysis.pdf

In the formula shown above, BEQ, the quantity, revers to a single unit sold, whatever it might be. It may be a product like a teddy-bear (including its packaging) or something more complicated such a „carpet cleaning job“ (including travel to and from the site). BEQ always revers to the actual entity sold (teddy-bear or carpet cleaning job) rather than something that goes into the entity (e.g., teddy-bear stuffing or vacuum cleaner bags). BEQ is the entity the company puts a price on, „the unit“. Total sales of this unit, divided by number of units sold, yields VC, the cost per unit. Note that fixed cost is not included in VC.

Fixed costs are costs that never change no matter how much or little a company produces: administrative salaries, rent or mortgage payments, instance, interest on borrowed funds, and similar costs sometimes also labeled fixed overhead. Variable costs are directly tied to product manufacturing or service provision: direct labor, raw materials, sales commissions, delivery expenses, and more[17].

Price per unit less variable cost per unit produces a surplus if the price is set correctly. In accounting terminology, this is called the „contribution margin.“ It is the amount the sale of each unit contributes to the ultimate profitability of a corporation. When enough such chunks of contribution have been produced to equal fixed costs, the business has reached its break-even point. It isn´t profitable yet, but all of the overhead has been „absorbed“.

Supposing that fixed costs are 150 000 CZK. Price per unit is 85 CZK and variable cost per unit is 75 CZK. The contribution margin will then be 10 CZK. Fixed cost dividend by 10 CZK results in 15 000 CZK. Therefore this company must sell 15 000 units just to break even. The next unit sold thereafter is the first contribution to profit. This company must sell 15 001 units to make a tiny profit of 10 CZK.

This example illustrates how changes can affect break-even. Fixed costs can be lowered, price can be increased, variable costs can be shaved. Conversely, if variable costs rise and cannot be lowered, contribution margin will sink and break-even will require more sales-unless, for example, price is hiked or the company moves to cheaper space and lowers its rent substantially.

Assumptions of Breakeven Analysis:

- Costs can be reasonably subdivided into fixed and variable components – fixed costs and variable costs can be easily identified in most cases. Semivariable expenses can be problematic, but can nonetheless be separand into fixed and variable components for analysis purposes.
- All cost-volume-profit relationships are linear – assumption holds so long as analysis is confined to reasonable range of operations. If level of operations are doubled, relationship may be different.
- Sales prices will not change with changes in volume – economic theory states that one would normally expect price increase to be accompanied by decrease in sales volume and vice versa.

Four major applications:

1. Pricing decisions – study the effect of changing price and volume relationships on total profits.
2. New product decisions – determine sales volume required for firm (or individual product) to break even, given expected sales and expected costs.

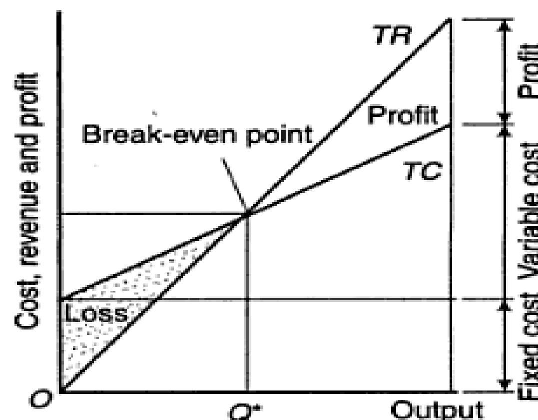
[17] INC – encyclopedia. Brak-Even Analysis: A Basic Calculation. [online]. [cit. 2013-08-25]. Available from: http://www.inc.com/encyclopedia/break-even-analysis.html

3. Modernization or automatik decisions – analyze profit implications of a modernization or automation program. In this case, firm substitutes fixed costs (i.e. capital equipment costs) for variable costs (i.e. direct labor).
4. Expansion decisions – study aggregate effect of general expansion in production and sales. In this case, relationships between total czech crown for all products and total czech crown costs for all products are examined in order to identify potential changes in these relationships.

6.1 BREAK-EVEN POINT THROUGH LINEAR COST

Figure shows the break-even point through linear cost (TC) and revenue functions (TR). The TR is passing through the origin indicating that the price is constant in the perfectly competitive market. And the total cost curve starts from the level of fixed cost and increases as variable cost increase for different levels of output. The firm is breaking even at the level of output Q* where the TR is equal to TC. To the left of Q* the firm faces losos and to the right of Q* it has profit, as TR exceeds total cost. At the point of break-even, TR is exactly equal to TC. At the initial level of production, the loss (shaded area in figure) is greater. It can be minimised only by increasing production. Similarly, from the break-even point, profit can be maximised by increasing production.

Figure 20 Break-Even Point

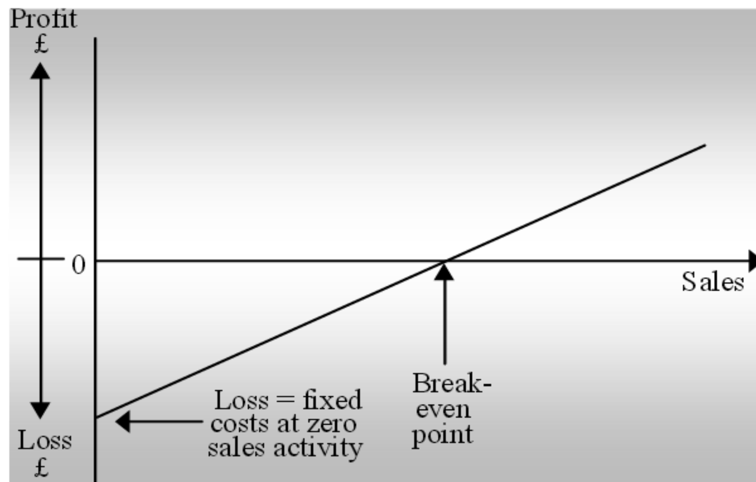


Source: Sivagnanam, Srinivasan, 2010

- Where sales revenue (TR) is greater than total cost it means that profits are being generated.
- Where sales revenue (TR) is less than total cost it means that losses are being incurred.
- Where sales revenue equals total costs (intersection of the sales revenue line and total costs line) it means that no profit or los sis occurring. This is the break-even point.
- Variable costs vary directly with output, as more output is produced then more variable costs are incurred.
- Fixed costs do not vary with output and are constant for a range of output produced. They are incurred even when there is no output at the beginning of production. This is because they are costs that must be incurred to support manufacture such as machinery or a warehouse.
- The total costs line (TC) is a representation of the combined variable and fixed costs. This is way at nil output it has a cost which represents fixed costs, and then as output increases the total cost line varies with it and in parallel with the variable cost line.

A variation of a break-even chart, indicating graphically the relationship between profit and loss at different levels of sales volume achieved.

Figure 21 Profit Volume Chart

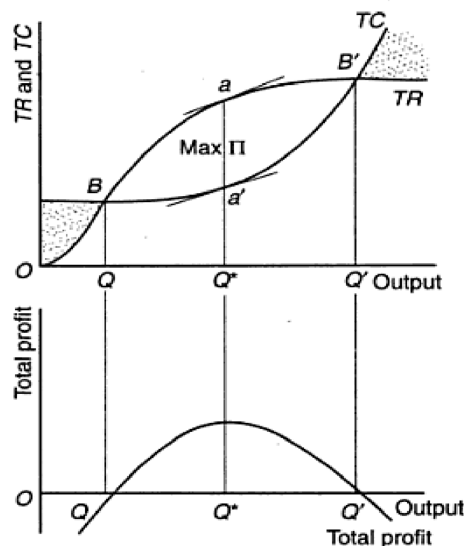


Source: ACORNlive. [online]. [cit. 2013-08-10]. Available from:http://www.acornlive.com/demos/pdf/P2_PM_Chapter_5.pdf

The profit volume chart is a summarisation of the break even chart, whereby the line represents total profit (sales less all costs). When the line rises abov the horizontal axis it means that production is beginning to yield a profit, before this point it means that production is yielding a loss. The break even point where no profit or loss is being made is where this profit line intersected the horizontal axis.

Figure exhibits break-even points through non-linear functions. The total cost fiction is non-linear reflecting the law of variable proportion.

Figure 22 Break-Even Points



Source: Sivagnanam, Srinivasan, 2010

The firm maximises its profit at only one output level, Q*, where the vertical distance between total cost and total revenue is maximum. Below and above the output level Q* the firm earns profit, but it is lesser than at the Q* level. At output levels below Q ant above Q´, the firm suffers losses because, in both cases, TC is more than TR. Hence, points B and B´ are called break-even points because the firm makes neither profit nor loss at B and B´. (Sivagnanam, Srinivasan, 2010).

6.1.1 IMPORTANCE OF BREAK-EVEN ANALYSIS

Why do companies want (and need) to know the break-even point:

- First, in order to even know what volume of operations allows them to operate without loss, or, what is the volume of business in which the loss breaks in the profits.
- Further in order to determine, if they sufficient capacity for this volume of business.
- And ultimatem therefore, to find out if there is sufficient market for such volume of operations.

Break-even analysis has many applications and plays a signifiant role in business decision making. Some of them are:

1. Break-even analysis helps to make decisions about the optimum level of price and output.
2. It helps to adjust the level of output to maximise profit, or at least to minimise loss.
3. It helps to plan for the purchase of raw matarials and other inputs in adequate quantity at appropriate time.
4. It helps to choose the appropriate technology.
5. It is also useful in planning cost cutting strategies in advance.
6. It also helps to plan and adjust selling expenditure.

6.1.2 LIMITATIONS OF BREAK-EVEN ANALYSIS

Through break-even analysis is important for various decision making processes, it suffers from many limitations. Some are listed below:

1. Price and output decisions depem on many other determinants, like competition, business cycles, etc. Hence, break-even analysis may go wrong.
2. Break-even analysis is static in nature. The real business environment is more dynamic and profits depend on various other factors in addition to cost and revenue.
3. Application of break-even analysis is difficult when a firm engages in the production of different products.
4. Estimation of cost fiction is difficult in the long run.
5. Splitting total cost into fixed and variable components i salso difficult.

Summary

The break-even point is the point at which your product stops costing you money to produce and sell, and starts to generace a profit for your company. Break-even analysis can

also be used to solve other management problems, including petting prices, targeting optimal variable/fixed cost combinations, and evaluating the best strategies to follow.

A break-even analysis is also a key part o fany good business plan. It can be helpful even before you decide to write a business plan, when you´re trying to figure out if an idea is worth pursuing. Long after your company is up and running, it can remain helpful as a way to figure out the best pricing structure for your products. Basically, a break-even analysis lets you know how many units of stuff – say, how many sandwiches, iPhone apps, or hours of consulting services – you must sell in order to cover your costs.

Questions to test your knowledge:

1. *Try to describe break-even point.*
2. *To calculate break-even point it is needed to know following information, which one?*
3. *Try to characterise limitations of break-even analysis.*

7 BUSINESS STRATEGY

Business strategy as the twenty-first century dawns is global strategy. Much is made of global markets, but competition, innovation, and organization are equally global. Globalization is a term that is widely used, but with few limits on its possible meanings. We use it in relation to business strategy to describe the increasing integration of national and regional markets and economies and the domination of the world economy by massive multinational firms. (Tallman, 2009)

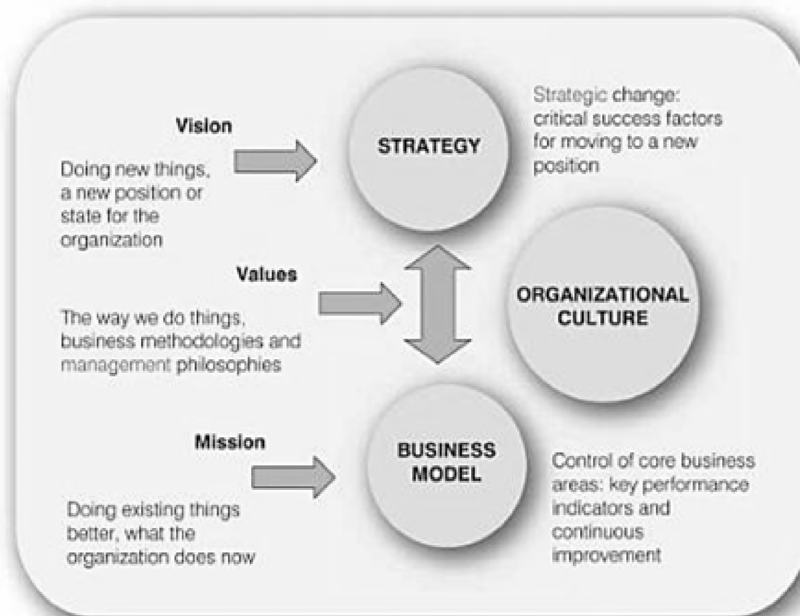
In the simplest sense, business strategy is what businesses do and strategic management is about the planning and execution of activities by which „it“ is done. Stretegy is about market positioning, about responding to the competition, the environment, and the customer. It is about being good at what we do, being efficinet, being unique and innovative, about having better products and processes and more effective managers, about creating detailed plans and responding quickly to changing times.

A small business which does not grow may begin to die. Growth is probably the most important goal for a business because that is what investors and shareholders look for. A business cannot achieve growth through the application of the same strategy over and over again. Today, growth is what distinguishes entrepreneurs from small business owners. Growth can be achieved through several strategies, such as: (Goldman, Nieuwenhuizen, 2006, p. 4)

- Organic business growth by expanding the market or products or both
- Acquiring businesses to expand into other revenue sources
- Franchising
- Expanding globally through internationalisation strategies
- Combination strategies

Values as purpose concenrs the appropriate organizational culture for vision and mission (see figure).

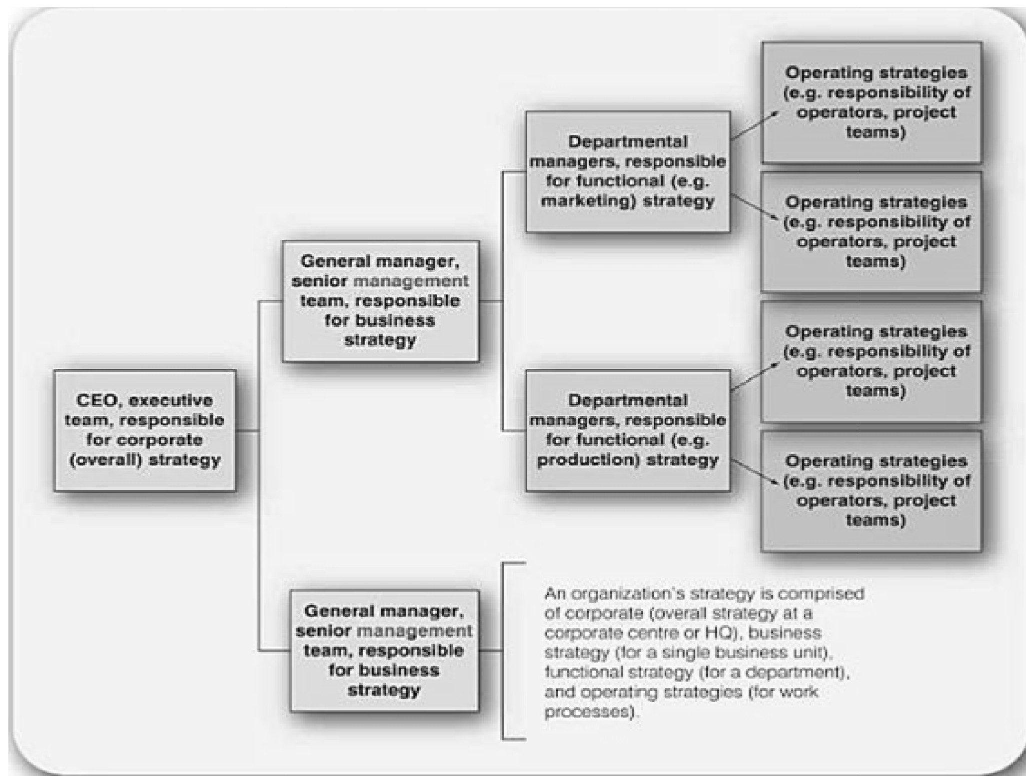
Figure 23 Three roles for purpose in strategic management



Source: Witcher, Chau, 2010, p. 31.

In other words, values should be managed to take into account the required business methodologies and management philosophies, or core competences, that an organization´s people need to achieve vision, while effectively managing the key business areas, ort he core capabilites, of its business model.

Figure 24 Strategy hierarchy



Source: Witcher, Chau, 2010, p. 10.

Strategy is an entrepreneurial issue

While entrepreneurship has to do with recognition or identification of opportunities and finding innovative wals to pursue them, the strategic process is also involved in scanning the environment for new opportunities and creating wals to profit from them. At its core, finding new wals to do things is finding new strategies to improve performance. There are many who believe that the strategy of the futur eis to be entrepreneurial. Looking at the growth of corporate entrepreneurship as a subjekt field, there appeal to be support for the role of entrepreneurship in the growth of small businesses. (Goldman, Nieuwenhuizen, 2006, p. 4)

Strategy is an innovation issue

Innovation hat to do with commercialising opportunities and doing things in different ways. Finding new ways to do things better is about strategy to improve performance. The growth in technical developments, for example, has forced businesses to chase the way they do things. If businesses do not chase, they will not be albe to compete with other small businesses in the same industry that are able to effectively chase. Doing research and spending money on development to find new products, markets, processes and profit model is therefore crucial for survival. Doing so, however, requires new strategies. (Goldman, Nieuwenhuizen, 2006, p. 5)

From the above, it is clear that strategy can be associated with thinking, leadership, change, growth, entrepreneurship and innovation. Essentials, it is desirable and beneficial if management is successful at pursuing the right strategy for the right context.

The question is not if strategic management makes a difference, but rather what is the impact of proper strategic management for the business. There are as many definitions of strategy as there are authors writing about it. In the text box below, there are two definitions developed over years by key management gurus to help us understand what strategy is all about. (Goldman, Nieuwenhuizen, 2006, p. 5)

Strategic management is defined as a set of decisions and actions that reset in formulation and implementation of plans to achieve the company´s objectives. (Pearce and Robinson, 2003)

Strategic management is the analysis, decisions and actions an organisation undertakes in order to create and sustain competitive advantages. (Dess and Lumpkin, 2003)

From these definitions (any many others not mentioned), one could determine the essentials of strategy. The main aim is not to provide a new definition of strategic management but rather to elaboráte on the construct and its related concepts. By definition, strategic management has to do with: (Goldman, Nieuwenhuizen, 2006, p. 6)

- Ensuring long-term survival of the business in a changing environment
- Growing the business as the ultimate business goal.
- An ongoing and sometimes messy process of analysis, evaluation, planning, implementation and reviewing while many of these things happen simultaneously and interactively.
- Choices and decision-making
- Leading and motivating people to pursue the vision by:
  - Allocating resources to support strategic goals
  - Implementing the decisions and executing the choices
  - Changing and adapting to ganges which reset from the decisions

Formal and informal strategy

Research indicates that small businesses that have formal strategic plans perform better than small businesses that have informal strategic plans. However, if someone does not have a formally writen plan, it is not to say that they do not have a strategy. Expecially when talking to entrepreneurs ans small business owners, one often finds that they have clear strategies despite not having them on paper. Thein problems are rather associated with sparing the strategies with staff as well as implementing the plans. (Goldman, Nieuwenhuizen, 2006, p. 7)

Every business owner or manager is not and cannot be an expert in strategic management. Large companies can akord to employ consultants and staff to facilitace their strategic processes, but being so expensive, small entrepreneurs are often left to fend for themselves. Traditionally, strategy formulation is mainly the responsibility of the leadership (top management), while implementation is the responsibility of operational management.

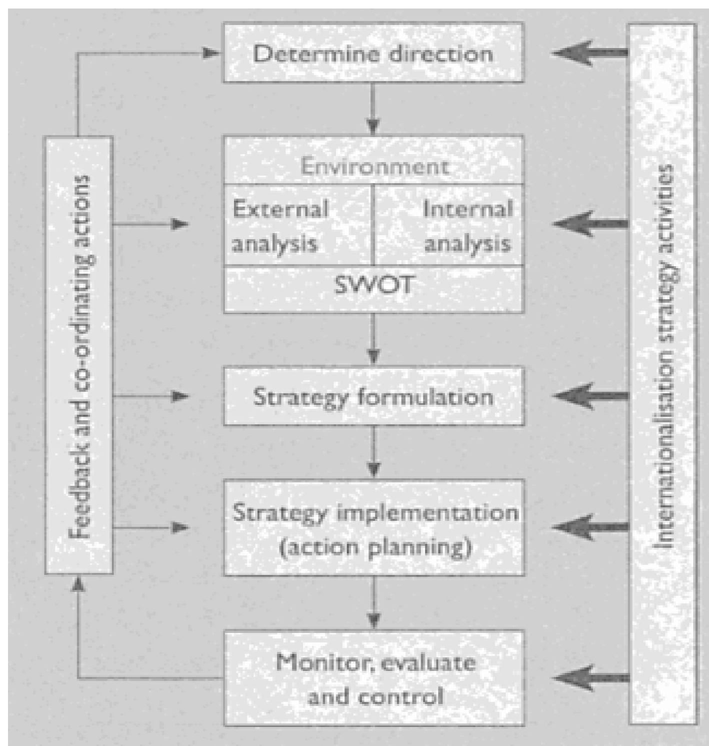
7.1 THE STRATEGY PROCESS

As will be clear in this book, strategic management has to do with main areas, namely:

- Strategy formulation
- Strategy implementation
- Review of implementation (control)

Main areas of strategic management you can see in figure.

Figure 25 Main areas of strategic management



Source: Goldman, Nieuwenhuizen, 2006, p. 11.

The process of developing a business strategy generally follows a familiar sequence, as we see in figure.

Figure 26 The strategy process

Source: Tallman, 2009.

Before one can start formulating a strategy, one has to use strategic thinking in identifying the important events, patterns and trends that will influence the future of the small business as well as the industry in which the small business operates. Awareness of one´s environment is important. One of the key aspects needed to excel at strategic management is to ensure that all people involved must be strategically oriented. This requires that they should converse about strategic issues all the time. Strategic conversation must therefore become part of the culture (the way they do things) of the business. An important part of strategic conversation is to challenge choices and decisions all the time. Asking the right questions is more important than finding the right answers.

One of the reasons for strategic management is to be able to adapt business activities to ensure long-term survival. Long-term survival has to do with the achievement of goals that support the vision. Both vision and goals have to do with choices. The faster the environment ganges, the more important it is to be stronger on strategic management and to set and achieve meaningful goals for the small business. Doing more of the same will not keep the business going forever if the environment is changing.

An organization´s **vision** is a statement of its aspiration and view ot its future. It represents a statement of intent to move to an improved conditon or towards a desired stat of being. Thus it provides everybody with a sense of being. Thus it provides everybody with a sense of purpose in terms of the direction i tis going in, and making things better. A vision statement is typically short and to the point. It should be memorably different from the ordinary, ant for a competitive organization, the difference should be relatively outstanding – ambitious but not overblown. Because a vision provides the basic rationate for change, the reasons for change and the broad implications for action should be made obvils to the organization as a whole. Vision should adequately excite and motivace to encourage people to rethink thein work and to stretch them. It should appeal to everybody as realistic. (Witcher, Chau, 2010, p. 31)

The **mission** of the firm is its larger sense of purpose. From an economic perspective, firms exist to increase the wealth of their owners or shareholders. However, many successful firms have mission statements that are pithier, more emotionally appealing, more motivating, or that offer broker perspective on the role of the firm in society.

Within its broker mission, a business firm must define a **set of goals and objectives**. These are immediate outcomes that management can pursue and against which its performance can be measured. Such goals and objectives should support the mission. From a shareholder perspective, profitability (however measured) and growth (also subject to variety of of measures) tend to be the focus, as ever-increasing profits tend to maximize equity values over time. A currently popular measure that summarizes various measures is the concept of Economic Value Added, which suggests that long-term shareholder value derives from a combination of performance measures. From a stakeholder perspecitve, these economic goals remain important, but other measures such as the triple bottom line, or net performance on economic, social, and environmental measures, are becoming popular. Even firms that may not have a strong initial commitment to noneconomic goals may be forced to consider these other outcomes by activist shareholders, particularly public institutions such as public retirement funds or university portfolio managers. For multinationals, a wider set of goals and objectives to support more social and environmental missions may be strongly encouraged or even required in some countries. In the end, though, if the business firm does not perform well economically, it will be able to do little in other spheres of endeavor.

In general, the approach taken here is that the real objective of business strategy is to generate sustained competitive advantage for the firm. Competitive advantage can be used to create growth in sales, increase market share, expand into new businesses or markets, or to generate greater profits. Different firms may use competitive advantage for different purposes,

and any one firm may switch from growth to profit to social objectives over time, but without a source of competitive advantage, none of these outcomes is possible. Form a microeconomic perspective, competitive advantage is reflected by the idea of producer surplus.

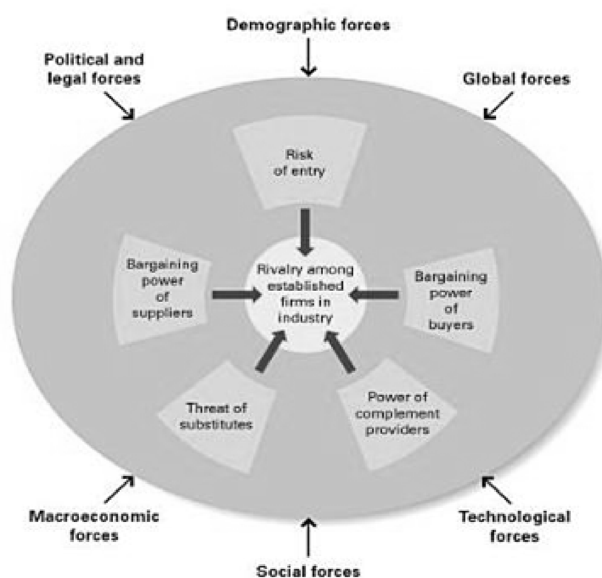
Four factors help a company to build and sustain competitive advantage – superior efficiency, quality, innovation, anc consumer responsiveness. Each of these factors is the product of a company´s distinctive competencies. Figure shows building blocks of competitive advantage.

Figure 27 Building Blocks of Competitive Advantage

Source: Hill, Jones, 2008, p. 95.

The firm that can either sell at a market price wile facing lower costs, or that can produce a unique product that can support a price premium while still attracting adequate demand will generate above-normal profits. From a strategic perspective, competitive advantage occurs when a firm can provide increased value to its customers, whether through low prices or through improved products, and can therefore attain or surpass its competition and its own goals, whether by generating greater than normal profits or by taking customers away from competitors.

Figure 28 The Role of Macroenvironment



Source: Hill, Jones, 2008, p. 73.

Sustained advantage comes from the ability to develop new resources and capabilities and to apply them to new markets as the economic and competitive environment changes, competitors copy successful strategies and resources, innovation changes customer options, and so forth. Only by adapting its internal capabilities and accessing new assets, together with expanding its scope for applying these resources, can a firm keep up with the everevolving environment of business – a condition that is noly exacerbated in the international realm.

In order to pursue its goals and objective in support of its overall mission, the managers of a firm must understand the internal and external enivronments of the firm.

The essential purpose of the external analysis is to identify strategic opportunities and threats within the organization´s operating environment that will affect how it pursues its mission.

Internal analysis focuses on reviewing the resources, capabilities, and competencies of a company. The goal is to identify the strengths and weaknesses of the company.

External and internal analysis is referred to SWOT (Strengths, Weaknesses, Opportunities, and Threats) analysis, this stage of the strategy process requires the identification of the resources and capabilities of the firm as well as the external competitive and contextual environment of the firm. The internal resources of the firm are the key to sustained competitive advantage. Most of the assets and capabilities o fany firm are needed just to take part in an industry, to stay even with other competitors. However, must firms have certain unique, firm-specific assets and capabilities that are not exactly the same as those of other firms. If these resources can be applied to offer unique value, whether lower prices, better qualitiy, higher performance, or some other preferred characteristics, to customers, the firm theoretically can generate economic rents from the resources – and in a strategic sense, can use these resources to generate competitive advantage. If the resources can be renewed and replaced as the world changes, this becomes a sustained competitive advantage. Of course, if management identifies resources that are weaker than those of the competition, it must find a way to reach competitive parity before seeking advantage, so understanding limitations is as important as knowing where the firm is strong. The central purpose is to identify the strategies to exploit external opportunities, counter threats, build on and protect company strengths, and eradicate weaknesses.

Since resources only generate advantage and value when applied in the marketplace, managers must understand their environment. This applies to the larger exogenous context in which the firm operates – the political, economic, legal, social, and cultural environment. Obviously, this aspekt of assessment is critical to multinational enterprises, as the dimensions of the international business environment vary from country to country and are also dependent on relationships between countries. While managers in a domestic environment may be able to largely assume the character of thein home market, managers in the international „opportunities and threats“ faced by the firm and of concern to the strategic Langer. The larger environment gets little of no consideration, because it is treated more or less as the water in which fish swim – ubiquitous and homogenous, therefore not an explicit concern in most situations. For the multinational, though, the macro-environment is essential. The worldwide economy and various national economies are neither constant nor identical – indeed, one important aspect of international strategy is to reduce the negative effects of economic cycles in individual markets through a portfolio approach. (Tallman, 2009)

More generally, the goal of a SWOT analysis is to create, affirm, or fine-tune a company-specific business model that will best align, fit, or match a company´s resources and capabilities to the demands of the environment in which it operates. Managers compare and contrast the various alternative possible strategies against each other and then identify the set

of strategies that will cerate and sustain a competitive advantage. These strategies can be dividend into four main categories: (Hill, Jones, 2008, p. 20)

- Funcitonal-level strategies, directed at improving the effectiveness of operations within a company, such as manufacturing, marketing, materials management, product development, and customer service.
- Business-level strategies, which encompasses the business´s overall competitive theme, the way it positions itself in the marketplace to gain a competitive advantage, and the different positioning strategies that can be used in different industry petting – for example, cost leadership, differentiation, focusing on a particular niche or segment of the industry, or some combination of these.
- Global strategies, which adresses how to expand operations outsider the home country to grow and prosper in a world where competitive advantage is determined at a global level.
- Corporate-level strategies, which anter the primary questions: What business or businesses should we be in to maximize the long-run profitability and profit growth of the organization, and how should we enter and increase our presence in these business to gain a competitive advantage?

The strategies identified through a SWOT analysis should be congruent with each other. Thus, functional-level strategies should be consistent with, or support, the company´s business-level strategy and global strategy. Moreover, corporate-level strategies should support business-level strategies. When combined, the varios strategies pursued by a company should constitute a komplete, viable business model. In essence, a SWOT analysis is a metodology for choosing between competing business models, and for finetuning the business model that managers choosen.

7.1.1 Strategy implementation

Once managers have chosen a set of congruent strategies to achieve a competitive advantage and increase performance, managers must put those strategies into action: strategy has to be implemented. Strategy implementation involves taking actions at the functional, business, and corporate levels to exekute a strategic plan. Implementation can include, for example, putting quality improvement programs into place, changing the way a product is designed, positioning the product differently in the marketplace, segmenting the marketing and offering different versions of the product to different consumer groups, implementing price increases or decreases, expanding through mergers and acquisitions, or downsizing the company by closing down or selling off parts of the company.

Strategy implementation also entails designing the best organization structure and the best culture and kontrol systems to put a chosen strategy into action. In addition, senior managers need to put a governance system in place to make sure that all within the organization act in a manner that is not only consistent with maximizing profitability and profit growth, but also legal and ethical. (Hill, Jones, 2008, p. 20)

7.1.2 Strategy evaluation and control

Once the business owner-manager has crafted and implemented a strategy, it is critically important to control the execution of the strategic management process. Where necessery, alternations may be made. Control involves the measuring and evaluation of performance. (Goldman, Nieu, 2006, p. 26)

Evaluation of strategy includes ongoing assesment of internal strengths and weaknesses and external opportunities and threats. Many organisations lack a formal process for

collecting, assimilating and converting competitive information into knowledge and inteligence that is useful for strategy formulation. Pressures from competitors changing customer needs, and the macro-economy continuosly confront businesses, requiring them to constantly evaluace and change their strategic goals. Generally, businesses adequately audit thein internal environment, but many lack the metodology to properly and accurately assess the external environment.

Unfortunately, many businesses do still have an inward focus when planning for the future and developing strategies.

The balanced scorecard is applied as a framework for strategic control. Through it strategic objectives are viewed from financial, customer, internal business process and growth perspectives. The objectives are translated into critical success factors indicating what must be achieved for the strategy to be successful. Standards and performance indicators are developed to measure objectives and become the drivers of performance. The balanced scorecard determines whta actions should be taken to co-ordinate the strategy amongst the different areas. It is a control technique that moves away from purely financial measurements towards other internal functioning processes.

Four management processes emerge from the balanced scorecard. The first three, namely translating of the vision, communication and linking, and business planning, provide a framework for implementation control. Feedback and leasing, the fourth management process, provides a foundation for strategic control that involves reviewing the content of the strategy. Continuous improvement is essential to sustain competitive advantage. Benchmarking, best practices, total quality management and re-engineering are important methods used in the control stage.

7.2 THE OBJECTIVES OF MULTINATIONAL BUSINESS STRATEGIES

Beyond the essential objective of increased economic value, what forces drive firms to look to international expansit as a strategic move? These forces seem to come from sources both external and internal to the firm. Because the study of multinational firms evolved from the study of international trade, the usual focus has been on driver sof direct investment, though these considerations lie blind international involvements of all sorts. One list of the reasons for international investment, used in whole or part by various scholars over the years, includes the following objectives: (Tallman, 2009)

- To search for new markets to explit existing competencies
- To search for new resources, both natural endowments and those developer by local industry.
- Production-efficiency seeking through economies of scale on regional or global bases.
- Technology seeking in countries or localities that have unique product or process development.
- The search for lower risk, both through portfolio effects and by reducing uncertainties through direct involvement.
- Countering competition form other multinational firms.

From a capabities-oriented strategic perspective, though, these six points collapse into three main objectives: to leverage existing capabilities in new or larger markets, to acquire or build new resources and capabilities in new places, and to reduce uncertainty and risks from a variety of sources.

In deciding how to find, protect, and apply thein unique assets internationally, multinational firms must make two key strategic decisions about the international

marketplace. The first is the scope of their international operations (internationalization), which here refers to the choice of how widely to disperse their activities across international locations. The second is thein desired degree of cross-national integration or consolidation of operations (globalization or regionalization), which is defined here as the choice of how much to consolidate international markets and operations into a single worldwide strategic entity. Some authors feel that as relatively few companies are actually present in worldwide markets, most preferring to invest primarily in thein home regional markets, so consolidation regionally is more relevant to current multinational strategies. Whether regionalization is but a step on the way toward global consolidation or is the end result for most firms, the issue of consolidating and coordinating across various foreign markets remains independent of the drive to spread into new markets. (Tallman, 2009)

Resource strategies and multinational strategies work together to generace competitive advantage. Internationalization and integration offer opportunities to exploit existing resources and capabilities, both those related to generating superior goods or services and those related to managing the organization. Moving into new markets exploits investments in fixed assets such as brands and technology. Superior managerial capabilities are also emphasized through internationalization and globalization, as coordinating more and more widespread operations raises constant challenges, and integrating these operations into a single operation, dispersed but responsive, is tremendously demanding. Just as the skills of Tiger Woods shows to best advantage on difficult golf courses, so the challenges of multiproduct multinational competition bendit the most skilled management more than do less complex settings. (Tallman, 2009)

Likewise, internationalization and consolidation offer opportunities to build new resources and capabilities. Internationalization brings the firm into multiple varied locations where new resources, new ways of operating, new market ideas, and new products can be found and must be tried. Participation in these many markets, particularly through subsidiaries and joint ventures, will give the multinational access not just to new opportunities for exercising its existing capabilities, but to new capabilites that can be internalized, made available to the worldwide firm, and applied in distant local markets, where these new ideas can offer a level of differentiation not available to local competitors. Managing this global organizational learning, as well as directing and coordinating the movement of real goods among subsidiaries aroound the world, offers considerable opportunities for building organizational capabilites at corporate management. Firms can work themselves into difficulties with excessively fast or broad internationalization, but empirical evidence suggests that experience with increasing international scope and experience with increasing global (or regional) integration leads to success in yet further internationalization and globalization and to superior economic performance. (Tallman, 2009)

Conclusion

Strategic management is the management of processes to create, protect, sustain, renew, and exploit unique firm-specific resources and capabilities in the marketplace to gain sustanied competitive advantage. Global strategy is strategy practised by multinational corporations in the rapidly globalizing marketplace of the early twenty-first century. The strategic proces sis designed to offer a systematic, step-by-step method to bring understanding to what often seems a chaotic situation and to offer a reasoned approach to decising on a path to sustained advantage.

Questions to test your knowledge:

1. *Growth can be achieved through several strategies, such as..*
2. *Charecterise strategy implementation.*
3. *Describe the objectives of multinational business strategies.*

8 INVESTMENT

Investments represent financial securities owned by the firm. They are divided into two categories, long-term investments and current investments.

Long-term investments generally comprise of financial securities like equity shares, preference shares, and debentures of other companies, most of which are likely to be associate companies and subsidiary companies. These inestments are made for income and control purposes. Long-term investments are stated at cost less any diminution of value which is regarded as permanent in the opinion of management.

Current investments generally represent short-term holding sof units or shares of mutual fund schemes. These investments are made primarily to generate income from short-term cash surpluses of the firm. Current investments are carried at cost or market (fair) value, whichever is lower.

One may argue that current investments, being short-term in nature, may be classified under the asset category current assets, hans, and advances. Under the format prescribed in the companies act, however, current investments have to be shown under the asset category investments.

Investing activities involve acquiring and disposic fixed assets, buying and selling financial securities, and disbursing and collecting hans. Cash inflows from investic achtivities include receipts from the sale of assets (real as well financial), recovery of hans, and collection of dividend and interest. Cash outflows from investic activities include payments for the purchase of assets (real and financial) and disbursement of loans.

Investment has been defined as „investing money“ and the word incest connotes „lay out money on“. It, therefore, follows that the word“investment“ is an act and the result of the act: the decision to invest and the capital invested.

An act of investment arises when a sacrifice is made of an immediate and certain satisfaction, for a future expectation whose security lies in the capital invested. The word expectation as is ures, is appropriate in the sense that it involves a gamble for a payment in the future, involving the process or the act as a futuristy, as also a risk element against a deprivation of a sure and instant satisfaction.

Let us define: (Bower, 1986, p. 19)

The business planning process in a firm as the process – potentially continuous – by which a firm searches and analyzes its environment and resources to select opportunities defined in terms of markets to be served and products to serve them.

The investment process in a firm as the process by which a firm makes discrete decisions to invest resources in order to achieve strategic objectives.

These two processes as critical in the sense that they provide a direction and a framework within which ether routine activities in the firm take place.

Observable change in a corporation is determined by the nature of the critical processes and the effectiveness of the routine activity. If management of routine change is kompetent, the principal observed change in a firm may be explanied by a sequence of planning and investment decisions.

A business planning system as one that chooses markets and products to sell in markets based on an appraisal of resources and a forecast of market and competitive behavior.

An investment planning system as one that chooses projects for investment of resources in facilities that will generate chosen products for sale in chosen markets. The choice is based on a forecast of future unit sales, volume at a price, operating cost, and facility investment cost.

Decentralization as describing the class of formal organizations in which autority to make decisions and the responsibility for these decisions are delegated to subordinace managers. The specific responsibility delegated varies by company and by situation.

Investment depending on the final motive and usage and these are as indicated:

Expansion outlays: these may be either qualitative (new product) or quantitative (increased volume of product) in nature or both, the outlays may result in the production of a new line of product or add to production of an existing line. This investment presuposes that capital outlay has been initially made and/or modifications are called for requiring fresh capital: both fixed and working.

Replacement and renewal outlays: these comprise expenditure incurred in the replacement of wornout and obsolete equipment and are needed for the continuance of the activity hopefully with improved performance.

Modernisation outlays: these comprise expenditure incurred in improvement of equipment primarily to reduce unit production cost and to improve or maintain quality standards.

Investment in the face on inadequate information: often investments in explorátory or extractive activities have to be made based on inadequate information: drilling, mining and others. Considerable outlay of capital may be invested with little or no sale value.

Strategic outlays: dean considers this category of outlay as essential for the survival of na enterprise so as to provide the enterprise with means for expansion and diversification: R&D investment which may be either defensive and spent for the maintenance of product quality or offensive as expenditure in the development of new products.

8.1 INVESTMENT DECISION-MAKING ACT

In the investment decision-making act are identified four principal factors: (Barat, 1998, p. 4)

1. The subjekt – the investor who decides on investing
2. The object – the capital invested
3. The cost of privation – the price attached to the sacrifice made by the investor, and
4. The value of expectation – the value which the investor expects to derive in the future out ot his act of investment.

It is obvious that the higher the value of expectation attributed to the investment by the investor, the greater will bet he attraction for that investment. However, it should be realised that the attitude of risk propensity and the objectives of the subjekt, i.e., the investor, towards the value imputed to expectation, the cost computation of the privation, and the availability of the object which is the capital to be invested will influence all such decisions.

The nature of investment decision, therefore, involves: (Barat, 1998, p. 4)

- An acceptance of the part of the subjekt to forego immediate satisfaction for future expectations, and
- An availability of resources from either internal or external sources commensurate with investment requirements.

It should be noted that these two factors or criteria are not mutually exklusive and for that matter influence each other to the extent that higher the future expectations and the cost of privation, the greater should bet he availability of resources and vice versa.

The business planning process in a firm as the process – potentially continuous – by which a firm search and analyzes its environment and resources to select opportunities defined in terms of markets to be served and products to serve them.

The investment process in a firm as the process by whig a firm makes discrete decisions to invest resources in order to achieve strategic objectives.

These two processes as critical in the sense that they provide a direction and a framework within which other routine activities in the firm také place.

Observable change in a corporation is determined by the nature of the critical processes and the effectiveness of the routine activity. If management of routine change is kompetent, the practical observed change in a firm may be explained by a semence of planning and investment decisions.

A business planning system as one that chooses markets and products to sell in markets based on an appraisal of resources and a forecast of market and competitive behavior.

An investment planning system as one that chooses projects for investment of resources in facilities that will generate chosen products for sale in chosen markets. The choice is based on a forecast of future unit salses, volume at a price, operating cost, and facility investment cost.

In lagre diversified corporations, individual planning and investment decisions are made by managers at many levels of the firm.

8.2 INVESTMENT PROCESS

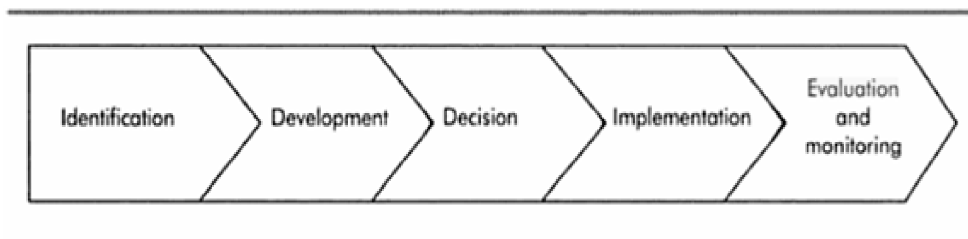
Developing a sophisticated investment solution requires more than a review of historical patterns. Freedom applies forvard-looking assumptions in the construction of its models, placing a premium on those factors that are most likely to add value to your portfolio.

- Capital market assumptions
- Asset allocations
- Portfolio selection and portfolio construction
- Continual monitoring

8.3 INVESTMENT APPRAISAL

While financial managers, analysts and investors evaluace the impact of capital budgeting decisions on the firm´s published report and accounts, decisions regarding projects and investments should be based on an analysis of the project´s impact on the firm´s cash flows.

Figure 29 Investment Appraisal



Source: Geddes, 2002, p. 59.

The process of capital budgeting or investment appraisal differs from company to company, but will almost always constist of the following four elements: (Geddes, 2002, p. 58)

- Idea generation and investment proposals
- Evaluation of project proposals
- Application of acceptance/rejection criteria
- Ongoing evaluation and monitoring

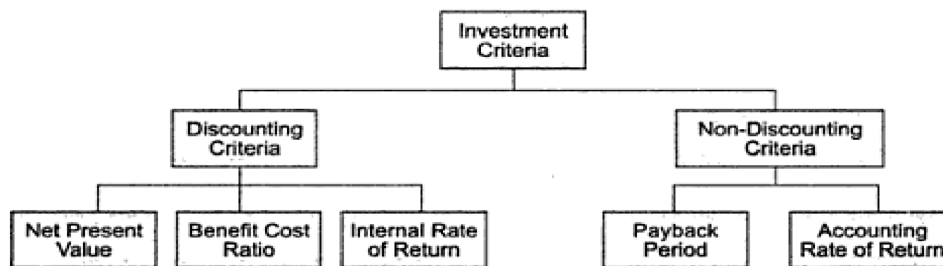
Corporate managers, seeking to increase shareholder wealth (i.e. the value of their firm) have a number of choices with respect to investment decisions. These might include: (Geddes, 2002, p. 59)

- Investment in new equipment (hardware) or technology (software) in order to reduce future operating costs.
- Investment in equipment or plant to enable an expansion of production
- Investment in the development of new products or services to offer to existing or new customers.

Investment criteria

A wide range of criteria has been suggested to judge the wortwhileness of investment projects. The important investment criteria, classified into two broad categories – non-discounting criteria and discounting criteria - are shown in figure.

Figure 30 Investment Criteria



Sources: Chandra, 2008, p. 283.

Additionally, regulatory requirements may cause companies to undertake investments (e.g. laws requiring the installation of pollution control devices).

8.3.1 DETERMINING THE CASH FLOWS

The most important unit of analysis in evaluating capital investments is the project´s anticipated cash flow. Cash flow is the most important measure because a firm´s suppliers of raw materials and services expect to receive cash payment. Equally, suppliers of the firm´s capital (banks, bondholders, and shareholders) expect a cash return – in the form of interest payments for debtholders and dividends for shareholders. A company that cannot meet its financial obligations will face bankruptcy. This can even happen to companies that report net profits in their audited accounts.

The cash flows involved in investment appraisal can be grouped into four categories (listed roughly in the order in which they occur): (Geddes, 2002, p. 61)

- Capital investment
- Working capital
- Operating cash flow
- Taxation

Capital investment – the capital investment normally takes place at the beginning of the evaluation period for the project (i.e. the investment is required for the project to get u pand running). Refurbishment of plant and equipment during the project´s life would also fall under the capital investment category as would any residual value from the sale of assets at the end of the project´s life.

Working capital – working capital is cash made available to finance the initial stocks and debtors at the beginning of the project´s operations. Working capital, which is sometimes called working investment, is defined as Stocks + trade debtors + trade creditors

As the turnover from the project increases, there is and increased demand for working capital. Similarly, if turnover declines, there is usually a reduction in the need for working capital.

Operating cash flow – cash flow from operations is the cash generated from the business of the project. There are two important points to be emphasised:

1. No deducation for interest expense is made. When determining the operating cash flows, the analyst should ignore any financing charges such as interest expense. This is not an oversight – the financing decision (i.e. whether to take on debt and how much) should be made separately from the investment decision.
2. Depreciation is a non-cash expense. However, the depreciation charge is deductible for income tax purposes. Thus cost of sales includes depreciation, thereby reducing operating profit. To ensure that the cash flow is reflected properly, depreciation (a non-cash expense) is addend back to the after-tax operating profit.

Taxation - The tax charge to be deducted in reaching operating income is the corporate tax rate prevailing at the time of the project analysis. In the Czech Republic at the time of publication of this book, the standart corporate tax rate was 19 per cent. (Geddes, 2002, p. 62)

8.3.2 INVESTMENT EVALUATION METHODS

Companies often use a mix of cash flow (economic value) and accruals (accounting value) approaches in capital budgeting. This is not appropriate. Cash flow, or economic analysis, should bet he focus of the analysis and the most appropriate method is to determine the net present value (NPV) of future cash flows generated by the project.

Although the NPV approach is accepted as the „best“ method of project (investment) evaluation, several other methods continue to be used. We will examine these prior to discussing in detail, the discounted cash flow approaches to valuation. The main project evaluation approaches are listed below:

1. Cost-benefit analysis (CBA)
2. Payback
3. Discounted payback
4. Net present value (NPV)
5. Internal rate of return (IRR)
6. Profitability index (cost/benefit ratio)
7. Return on investment

Cost-benefit analysis (CBA)

This is the simplest method, although the determination of benefits is always difficult. CBA involves calculating the costs and benefits related to a specific project and then determining whether or not there is a positive net benefit. When there is, the project should be approved if money is available. The method does not account for absolute cost of a project, nor does it prioritize projects. It also does not account for the time it takes to complete the project and when benefits will start to be accrued.

Payback

Payback is the lenit of time before the net cumulative cash flow of the project becomes positive. Managers who use payback are told to select the project with the shortest or fasted payback. The main benefit of the payback method is that it is well established and therefore easily underwood by both financial and non-financial managers. In some circumstances, using the payback method can guard against accepting projects with low or negative cash flows in the early years followed by very high, but less certain cash flows in future years.

Figure 31 Investment appraisal using playback

Investment **appraisal using payback**					
Project	**Initial investment** CF_0	**Year 1** CF_1	**Year 2** CF_2	**Year 3** CF_3	**Payback (years)**
A	-2000	2000			1.0
B	-2000	1000	1000	4000	2.0

Source: Geddes, 2002, p. 65.

Project A has payback of one year. According to the rule sof payback, it should be selected over Project B, which has payback of two years. Payback has three well-known, and fatal, flaws:

- It ignores all cashflows after the payback period has been achieved.
- It does not take account of the timing of the cash flows during the payback period.
- It does not defferentiate between projects with different risk profiles.

Thus, in the above example, Project A would be recommended, even though the total cash flows for Project B are far greater.

Discounted payback

As noted, the drawbacks of the payback method are that it ignores cashflows beyond the payback period and that it does not take into account the time value of money. The latter can be overcome using discounted payback. Discounted payback makes use of the persent value of each cash flow to be received (i. e. it recognises the time value of money). Discounted payback is the lenit of time before the cumulative present value of the cashflow of the project covers the initial investment.

Net present value (NPV)

The typice capital investment is composed of a string of cash flows, both in and out, that will continue until the investment eventually is liquidated at some point in the future. These

cash flows are comprised of many things: the initial payment for equipment, continuing maintenance cosi, salvage value of the equipment hen i tis eventually sold, tax payments, receipts from product sold, and so on. The trouble is, since the cash flows are coming in and going out over a period of many years, how do we make them comparable for an analysis that is done in the present? We can use discount rate to reduce the value of a future cash flow into what it would be worth right now. By applying the discount rate to each anticipated cash flow, we can reduce and add them together, which yields a single combined figure that represents the current value of the entire capital investment. This is known as its net present value (NPV).

For an example of how NPV works, we have listed in Exhibit the cash flows, both in and out, for a capital investment that is expected to last for five years. The year is listed in the firn column, the amount of the cash flow in the sekond column, and the discount rate in the third column. The final column multiplies the cash flow from the sekond column by the discount rate in the third column to yield the present value of each cash flow. The grand total cash flow is listed in the lower right corner of the table.

Notice that the discount factor in exhibit becomes progressively smaller in later years, because cash flows farther in the future are worth less than those that will be received toner. The discount factor is published in present value tables, which are listed in many accounting and finance textbooks. Theky are also a standard feature in midrange hand-held calculators. Another variation is the use the next formula to compute a present value manually.

Figure 32 Present value of future cash flow

$$\text{Present value of a future cash flow} = \frac{\text{(Future cash flow)}}{(1 + \text{Discount rate})^{\text{(squared by number of discounting periods)}}}$$

Source: Bragg, 2011, p. 134.

Figure 33 Simplified Net Present Value Example

Year	Cash Flow	Discount Factor*	Present Value
0	–$100,000	1.000	–$100,000
1	+25,000	.9259	+23,148
2	+25,000	.8573	+21,433
3	+25,000	.7938	+19,845
4	+30,000	.7350	+22,050
5	+30,000	.6806	+20,418
		Net Present Value	+$6,894

* Discount factor is 8%.

Source: Bragg, 2011, p. 134.

Using this formula, if we expect to recese $ 75,000 in one year, and the discount rate is 15 %, the calculation is:

Figure 34 Present value

$$\text{Present value} = \frac{\$75,000}{(1+.15)^1}$$

$$\text{Present value} = \$65,217.39$$

Source: Bragg, 2011, p, 135.

The example shown in the exhibit was of the simplex possible kind. In reality, there are several additional factors to take into consideration. First, there may be multiple cash inflows and outflows in each period rather than the single lump sum that was shown in the example. If you want to know precisely what the cause of each cash flow is, it is best to add a line to the NPV calculation that clearly identifies the nature of each item and discounts it separately from the other line čems. Another isme is which čems to include in the analysis and which to exclude. The basis rule of thumb is that an item that impacts cash flow must be included, anything that does not impact cash flow is not included. The most common cash flow line items to include in an NPV analysis are listed next.

- Cash inflows from sales
- Cash inflows and outflows from equipment purchases and sales
- Cash inflows and outflows from working capital
- Cash outflows for maintenance
- Cash outflows for taxes
- Cash inflows for the tax effect of depreciation

The NPV approach is the best way to see if a proposed capital investment has a sufficient rate of return to justify the use o fany required funds. Also, because it reveals the amount of cash created in excess of the corporate hurdle rate, it allows management to rank projects by the amount of cash they potentially can spin off, which is a good way to determine which projects to fund if there is not enough cash available to pay for an entire set of proposed investments.

The NPV is similar to cost-benefit analysis except that the time value of money is incorporated into the analysis. It is based on the premise that a CZK held today will be worth more in the future because it accrues interest. For example, for a 10 % interest rate, the CZK is worth CZK 1.10 at the ent of 1 year. Conversely, a CZK earned 1 year from now has a discounted value of about CZK 0,91 today. The 0,91 is discount factor. If costs incurred and benefits obtained are laid out across some future period of time (say, 5 years), then future negative cash flows (costs) and positive cash flows (benefits or revenues) can be discounted to the present to determine the NPV. In general, if the NPV is positive, the project should be considered. However, other factors, which might include intangible benefits, will determine whether the project´s priority is high enough for it to be approved. In addition, for the NPV calculation, a single interest rate is assumed throughtout the life of the project, which is generally not particularly realistic.

Return on investment (ROI)

This is merely the ratio of net benefits (or returns) to costs (investment), where net benefit (or profit) is total benefits less total costs. If the ROI is greater than zero, then the project should be considered. However, this method does not consider the time value of money, nor does it account for the absolute magnitude of the investment or relative magnitude as compared to other projects.

Breakeven

The breakeven is the point at which costs and benefits are equal. It corresponds to the payback period in that the latter designates the time at which the breakeven occurs. In addition, the breakeven is defined as an amount, namely, the project´s breakeven point is CZK 750 000 which occurs in the eighteenth month following initiation of the project.

Internal rate of return (IRR)

The end reset of an NPV calculation is the amount of money that is earned or lost after all related cash flows are discounted at a present hurdle rate. This is a good evaluation method, but what if management wants to know the overall returnt on investment (ROI) of the same stream of cash flows? Also, what if the NPV was negative, but only by a small amount, so that management wants to know how far a project´s rate of return varies from the hurdle rate? Also, what if management wants to rank projects by thein overall rates of return rather than by thein NPVs? All of these questions can be answered by using the internal rate of return (IRR) method.

The IRR method is very simile to the NPV method, because we use the same cash flow layout, itemizing the net inflows and outflows by year. The difference is that, using the IRR method, we alter use a high-low approach to find the discount rate at which the cash flows equal zero. At that point, the discount rate equals the rate of ROI for the entire stream of cash flows associated with the capital investment. To illustrate how the method works, we begin with the standart NPV format that was listed in the last section. This time we have a new set of annual cash flows, as shown in exhibit. The difference between this calculation and the one used for NPV is that we are going to guess at the correct rate of return and enter this amount in the „Internal Rate of Return“ column. We enter the discount rates for each year, using a low-end assumption of a 7 % rate of return.

The end reslut of the calculation is that we have a positive net present value of $ 13,740. Since we are shooting for the IRR percentage at which the net present value is zero, we must increase the IRR. If the net present value had been negative, we would have reduced the IRR percentage instead. We will make a higher guess a tan IRR of 9 %, and run the calculation again, which is shown in exhibit.

Figure 35 Internal Rate of Return Calculation, Low Estimate

Year	Cash Flow	Internal Rate of Return = 7%	Present Value
0	–$250,000	1.000	–$250,000
1	+55,000	.9345	+51,398
2	+60,000	.8734	+52,404
3	+65,000	.8163	+53,060
4	+70,000	.7629	+53,403
5	+75,000	.7130	+53,475
		Net Present Value	+$13,740

Source: Bragg, 2011, p. 136.

Figure 36 Internal Rate Calculation, High Estimate

Year	Cash Flow	Internal Rate of Return = 9%	Present Value
0	–$250,000	1.000	–$250,000
1	+55,000	.9174	+50,457
2	+60,000	.8417	+50,502
3	+65,000	.7722	+50,193
4	+70,000	.7084	+49,588
5	+75,000	.6499	+48,743
		Net Present Value	–$517

Source: Bragg, 2011, p. 137.

The reset of the calculation in exhibit is very close to an NPV of 9 %. If we want to try a few more high-low calculation, we can zero in on the IRR more precisely. In the example, the achal IRR is 8,9 %.

The IRR is best used in conjunction with the NPV calculation, because it can be misleading hen used by itself. One problem is that the IRR favus those capital investments with very high rates of return, even if the total dollar return is rather small. An example is when a potential investment of $ 10,000 has a return of $ 3,000, which equates to a 30 % rate of return, and is ranked higher than a $ 100,000 investment with a return of $ 25,000 (which has a 25 % rate of return). In this case, the smaller project certainly has a greater rate of return, but the larger project will return more cash in total than the smaller one. If there were enough capital available for only one of the two projects, perhaps $ 100,000, and the smaller project were selected because of its higher rate of return, the total return would be less than optimal, because much of the funds are not being invested at all. In this situation, only $ 3,000 is being earned, even though $ 100,000 can be invested, which yields only a 3 % return on the total pool of funds. Thus, if there are too many capital investments chasing too few funds, selecting investments based on nothing but thein IRR may lead to suboptimal decisions.

Another isme is that the IRR calculation assumes that all cash flows thrown off by a project over the course of its life can be reinvested at the same rate of return. This is not always a valid assumption, since the earnings from a special investment that yields a uniquely high rate of return may not be investable at anywhere close to the same rate of return.

Despote its shortcomings, the IRR method is a scientifically valid way to determine the rate of return on a capital investment´s full stream of cash flows. However, because it does not recognize the total amount of cash spun off by an investment, i tis best used in conjunction with the NPV calculation in ordet to yield the most komplete analysis of a capital investment.

The IRR is to NPV as ROI is to CBA. The IRR is the interest rate, calculated from periodic cash flows, which would maket he NPV equal to zero. Because of the nature of the mathematics, there will generally be two solutions to the IRR calculation, where on eis clearly not valid for the purposes. The appropriate IRR is then compared to a minimum return or hurdle rate desired (usually some level above the cost of money to the organization) and projects with IRRs exceeding that rate are viable. Again, priorities are determined based not only on the IRR, but also on the size of the expenditures relative to available fading. Also, there is an implicite assumption that all cash flows are invested at the same IRR rate.

Economic value addend (EVA)

This is a measure based on maximizing shareholder or stakeholder value. The method is associated with New York consulting firm Stern Stewart & Co. This is mentioned in charter.

8.3.3 RISK MANAGEMENT

The far of investment silure has led to risk management emerging as a more virble business skill and discipline. We introdukce risk management within an investment project management metodology.

Risk Types

Risk is the possibility of an event happening. Risk is often associated with negative outcomes, although there are some beneficial possibilities too, people generally connote risk with loss or damage. We normally take instance and everyday life cystom of linking risk automatically with and unpleasant event. It is neceséry to consider to reci on our views of risk within a multi-step process: (Chong, 2004, p. 13)

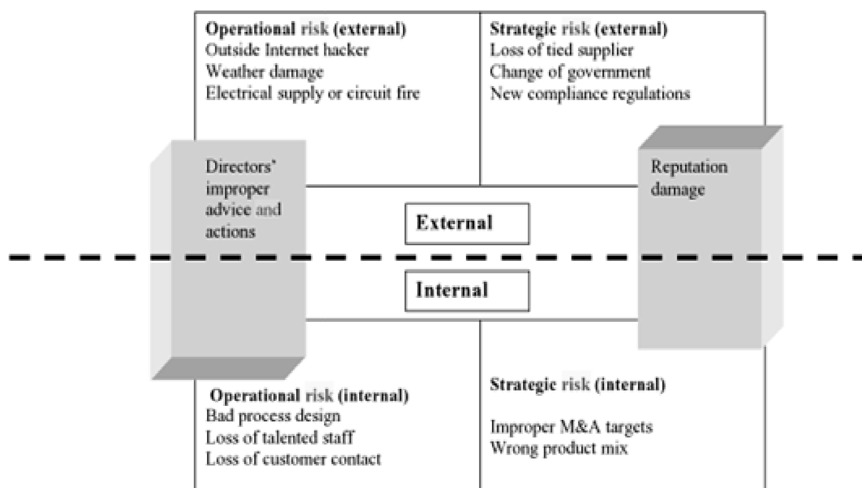
- Hazard – the risk of an outcome or event.
- Danger of risk catalyst that allowed this risk to occur.
- Impact of the event upon your group.
- Risk management – the process in which you can limit or avoid the potential damage.

There are four risk types:

- Reputation risk
- Market risk
- Credit risk
- Operational risk

Reputation risk – the time worn way to avoid risk was the tactic of keeping silent („there is no danger, keep slum"), or hiring a big name with a good reputation to reduce your investment risk.

Figure 37 Risks inside and outside the corporation



Source: Chong, 2004, p. 17

Thus, taking on the services of the top Wall Street London City investment banks, lawyers, accountants and specialists was a sure way or reducing risk because they were „safe" business partners. One of the drawbacks of this method is that we are relying on heuristics that are either unfounded or out of date. The rule of thumb „prestigous reputation = great service".

Conclusion

There are a number of ways in which an investment can be evaluated, such as cost-benefit analysis, net present value, return on investment, internal rate of return, and payback period. Each method has its supportem and detractors. That investment decisions have a characteristics of their own, requiring planning and the use of relevant analytical methods has been identified.

Questions to test your knowledge:

1. *Define investment process.*
2. *Whatn does it mean investment appraisal?*
3. *Characterise investment evaluation methods.*

9 BUSINESS PERFORMANCE

Accounting measures of performance have been the traditional mainstay of quantitative approaches to organizational performance measurement. However, over the past two decades a great deal of attention has been paid to the development and use of non-financial measures of performance that can be used both to motivace and report on the performance of business (and other) organizations. Non-financial performance measures have undergone significant development, to the relative neglect of the development of improved financial measures. However, the recent publicity surrounding the marketing of economic value addend (EVA) as and overall measure of company performance by management consultants Stern Stewart can be seen as a sign of a new emphasis on the financial aspects of performance.

The thtee main functions of financial measures involved are as follows: (Neely et al., 2007, p. 11)

- The use of financial measures of performance as a tool of financial management. Here the focus is on the functional specialit of finance and financial management. This is concerned with the efficient provision and use of financial resources to support the wider aids of the organization, and to manage the effective and efficient operation of the finance function.
- The role of financial performance as a major objektive of a business organization. Here some overarching financial performance measure, such as profit, return on investment (ROI) or EVA, is used to signify the achievement of an important (perhaps the most important) organizational objektive.
- The function of financial performance measures as a mechanism for motivation and control within the organization. Here the financial information provils a window into the organization by which specific operations are managed through the codification of their inputs and outputs in financial terms.

The complementary approaches that have been developer move away from a concentration on accounting measures alone, and add consideration of a wider range of factors that are believed to drive future economic performance. The most populár of these approaches in the 1990s was the balanced scorecard approach, developer at the Harvard Business School (Kaplan and Norton, 1996). Although this will be discussed in some detail in this section, it should be recognized that other similar approaches exist, including the European Foundation for Quality Management (EFQM) scheme, which is in many ways similar to the Harvard approach. Moreover, these approaches are not new. The General Electric Company developed a set of performance measures for its departments in the 1950s that incorporated the following elements: (Neely et al., 2007, p. 27)

- short-term profitability,
- market share
- produktivity,
- product leadership,
- personnel development,
- employee attitudes,
- public responsibility, and
- balance between short-range objektives and long-range goals.

Approaches to measuring business performance can also be dividend into three groups:

1. Traditional approaches to performance measurement
2. Modern approaches to performance measurement
3. Comprehensive approaches to performance measurement

9.1 TRADITIONAL APPROACHES TO PERFORMANCE MEASUREMENT

Traditional approaches to measuring performance are using financial analysis, which is based largely on information from the financial statements of the company. Traditional approach works with indicators, which are ether čems of financial statements and data from other sources, or numbers that are derived from them (Kaplan, Norton, 2006). Indicators can be expressed in monetary terms, in percentage, in units of time, or they can be dimensionless. Among the most common types of indicators to measure financial performance we can involve:

1. Absolute indicators – status indicators based on balance and flow, based on the profit and loss account and cash flow.
2. Differential indicators – net working capital.
3. Ratios – indicators of profitability, activity, liquidity, produktivity, debt and capital market indicators.
4. Pyramidal decomposition – Du Pont analysis.
5. Aggregates – Altman test, Tamary risk index, Fluner indicator, Taffler indicator etc.

The basic problem of evaluating the performance of an enterprise only by financial indicators is the explanatory power. The financial results reflect the decisions made in the past and a basis for corrective action can be done only with great difficulty. These indicators do not cover comprehensiverly the actual dynamics and variability of factors affecting the prosperity of society and its development potential. Traditional financial indicators usually do not include the evaluation of a number of indicators that may be important for business, such as degree of innovation, customer satisfaction, motivation of employees, etc.

9.1.1 PROFITABILITY

If managers are going to be held to profitability goals, someone has to figure out a way to measure profitability. Fortunately, accounting has. How do we measure profitability, and how do we determine standards? Is it enough for managers to report that earnings for the year are some amount such as 500 000 CZK? Earnings are determined by subtracting a company´s business expenses – salaries, interest, the cost of goods sold, for example – from its revenues fpro sales, investment, and other sources.

Suppose that a company income statement is composed of the following: Sales (25 000 000 CZK), expenses (24 500 000 CZK), profit (500 000 CZK). Our company has made half a million CZK. Does this mean that company managers have performed well? Probably not, because for sales activity of 25 000 000 CZK, owners, creditors, and top management would expect a higher profit: 500 000 CZK is only 2 percent of 25 000 000 CZK. Business people expect that profit must be linked to activity if we are going to properly measure the adequacy of a company´s profit or judge the efforts of a company´s management.

Suppose imaginary company instead had the following income statement: sales (3 125 000 CZK), expenses (2 625 000 CZK), profit (500 000 CZK). It looks like the same half a million, but as we look at the relationship between profit and activity, where 500 000

CZK in profit sis generated by sales of 3 125 000 CZK, we can see that in this scenario the profits are 16 percent of sales.

Still, if we are going to draw conclusions about the profitability, we need to know more than the absolute CZK amount of profit 500 000 CZK and the relationship between profit and activity (16 percent in our example). We need to know something about how much money we are earning to our investment.

9.1.2 RETURN ON INVESTMENT

Let´s suppose that the management team for the company represented by our second income statement, with sales of 3 125 000 CZK and profits of 500 000 CZK, runs a company with assets – plant, equipment, inventories, and other čems – worth 20 000 000 CZK. Does this new information change our opinion of the performance of the management team? Of course it does: 500 000 CZK is only 2,5 percent of 20 000 000 CZK. A 2,5 percent return on an investment of 20 000 000 CZK is not acceptable! Owners would be better off with their funds invested in treasury bills (T-bills) or even in a savings account – the return would be better, and there would be no risk. A company must generace a much higher return than T-bills or savings accounts to justify the risk involved in doing business. As our example shows, return on investment, or ROI, is calculated as follows: (Friedlob, Schleifer, Plewa, 2002, p. 3)

ROI = profit/investment

ROI = 500 000/20 000 000 = 0,025 or 2,5 %

Let´s suppose, instead, that the 500 000 CZK profit was earned using only 2 000 000 CZK in assets, rather than 20 000 000 CZK. ROI is now 25 percent. This return is much higher than the ROI one expech from T-bills, government bonds, or a bank savings account, and is thus much more acceptable to owners and creditors. (Friedlob, Schleifer, Plewa, 2002, p.5)

ROI = profit/investment
ROI = 500 000/2 000 000 = 0,25 or 25 %

Thre relationship between profit and the investment that generates the profit i sone of the most widely used measures of company performance. As a quantitative measure of investment and results, ROI provils a company´s management (as well as the owners and creditors) with a simple tool for examining performance. ROI allows management to cut out the guesswork and replace it with mathematical calculation, which cant hen be used to compare alternative use sof invested capital. (Should we increase inventory? Or pay off debt?)

Creditors and owners can always incest in government securities that yield a low rate of return but are essentially risk-free. Rivier investments require higher rates of return (reward) to attract potential investors. ROI relates profits (the rewards) to the size of the investment used to generate it. (Freidlob, Schleifer, Plewa, 2002, p. 4)

9.2 MODERN APPROACHES TO PERFORMANCE MEASUREMENT

The traditional methods are often based solely on profit maximization. The limited view from a position of value creation for the customer or the owner that all leaded to search for additional paths assessment of business performance (Kaplan, Norton, 2006). The result is a modern approach to measuring financial performance in the form of new standrads. We can involve there the indicators:

- Economic value addend (EVA)
- Market value addend (MVA)
- Return on investment on the basis of cash flows – Cash Flow Return on Investment (CFROI)

9.2.1 EVA

The analytical tool called EVA, for Economic Value Added, was commercially developer in 1982 by the corporate advisory team of Joel Stern Bennett Stewart. This financial metric gained early acceptance from the corporate community because of its innovative way of looking at the firm´s real profitability. Unlike traditional measures of profit – such as EBIT, net operating income – EVA looks at the firm´s residual profitability, net of both the direct cost of debt capital and the indirect cost of equity capital. In this way, EVA serves as a modern-day measure of corporate success because it is closely aligned with the shareholder wealth-maximization requirement. (Fabozzi, 2003, p.1)

EVA is defined as the diference between the firm´s net operating profit after tax (NOPAT) and its weighted-average cost of capital.

EVA metric is net of both the direct cost of debt capital and the indirect cost of equity capital – as reflected in the shareholders´ required return on common stock. In this context, EVA can be expressed in general terms as:

$$EVA = EBIT * (1 - t) - C * WACC$$

$$WACC = k_d * (1-t) * D/C + k_e * E/C$$

WACC – weighted average cost of capital,

EBIT – earnings before interest and (income) taxes

t- margine rate of tax applicable

C – capital

k_d – pre-tax cost of debt

k_e- cost of equity capital

E – equity capital

D – debt capital

In practice, EVA changes are likely to impact, ether positively or negatively, the firm´s credit rating, and therefore the valuation of its risky bonds. Discovering these financial happenings before they occur is at the heart of the EVA revolution. When EVA is on average negative, however, the firm´s managers destroy wealth by investic in capital projects having after tax returns that fall short of the weighted average cost of debt and equity capital.

9.3 COMPREHENSIVE APPROACHES TO PERFORMANCE MEASUREMENT

The relatively new approach to performance measurement includes both economic indicators, as well as non-economic indicators (Šulák, Vacík, 2005). This category can include methods:

- Balanced Scorecard (BSC)
- EFQM

Selection of appropriate indicators for measuring the performance of a business is not a simple matter. Currently, this is one of the most debated issues in the area of business management. In addition to financial performance indicators is recommended to consider the non-financial criteria to measure the performance of companies. A suitable alternative seems to be practical use of Balanced Scorecard, which includes both financial and non-financial criteria (Šulák, Vacík, 2005).

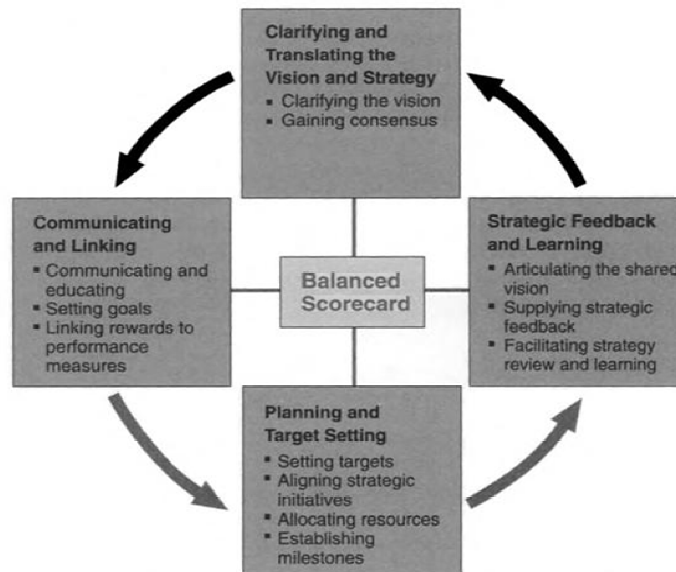
The complexity of today´s business environment requires a robust performance measurement and complex systems, which are sufficient to cover all areas of the company and its surroundings, which is due to the dynamic development constantly changing. These systems are reffered as the measurement systems and performance management. They are seen as balanced dynamic systém to support decision-making processes, acquisition, analysis and processing of informantion. The concept of balance refers to the need to use different areas, which together give a complete view of the organization. Dynamic addition indicates the need to develop a system that continuously monitors the internal and external context and evaluace goals and priorities.

9.3.1 BALANCED SCORECARD

We can describe the Balanced Scorecard as a carefully selected set of quantifiable measures derived from an organization´s strategy. The measures selected for the Scorecard represent a tool for leaders to use in communicating to employees and external stakeholders the outcomes and performance drivers by which the organization will achieve its milion and strategic objectives. A simple definitiv, however, cannot tell us everything about the Balanced Scorecard. (Niven, 2006, p. 13)

Balanced Scorecard (BSC) is a complex system that decomposes an assembly of strategy, objectives and goals to lower levels. It is established on the vision, strategy and interconnects them with financial and nonfinancial performance of business (Čepelová, A. et al., 2010).

Figure 38 The Balanced Scorecard as a Strategic Framework for Action



Source: Kaplan, Norton, 1996, p. 11.

We can see this tool as three things:

- Communication tool
- Measurement system
- Strategic management system

An accurate picture of strategy execution, it must be painted in the full palette of perspectives that comprise it, therefore, when developing a Balanced Scorecard, we consider these four: Financial, Customer, Internal Processes, Employee Learning and Growth.

The Balanced Scorecard is more than a tactical or an operational measurement system. Innovative companies are using the scorecard as a strategic management system, to manage their strategy over their long run.

They are using the measurement focus of the scorecard to accomplish critical managment processes:

1. Clarify and translate vision and strategy
2. Communicate a link strategic objectives and measures
3. Plan, set targets, and align strategic initiatives
4. Enhance strategic feedback and learning

Many people think of measurement as a tool to control behavior and to evaluace past performance. The measures on a Balanced Scorecard should be used in a different way – to articulate the strategy of the business, to communicate the strategy of the business, and to help align individual, organizational, and cross-departmental initiatives to achieve a common goal. Used in this way, the scorecard does not strive to keep individuals and organizational units in compliance with a pre-established plan, the traditional control system objektive. The Balanced Scorecard should be used as a communication, informing, and learning system, not a controlling system.

The four perspectives of the scorecard permit a balance between short-term and long-term objectives, between outcomes desired and the performance drivers ot those outcomes, and between hard objectives measures and softer, more subjective measures. While the

multiplicity of measures on a Balanced Scorecard may seem confusing, properly constructed scorecards, as we will see, contain a unity of purpose since all the measures are directed toward achieving an integrated strategy.

Altogether, the Balanced Scorecard translates vision and strategy into objectives and measures across a balanced set of perspectives. The scorecard includes measures of desired outcomes as well as processes that will drive the desired outcomes for the future.

Financial Perspective

The BSC retains the finacial perspective since financial measures are valuace in summarizing the readily measureble economic consequences of actions already taken. Financial performance measures indicate whether a company´s strategy, implementation, and execution are contributing to bootom-line improvement. Financial objectives typically relate to profitability – measured, for example, by opearating income, return-on-capital-employed, or, more recently, economic value-added. Alternative financial objectives can be rapid sales growth or generation of cash flow. (Kaplan, Norton, 1996, p. 25)

Figure 39 Measuring Strategic Financial Themes

Business Unit Strategy	Strategic Themes		
	Revenue Growth and Mix	Cost Reduction/ Productivity Improvement	Asset Utilization
Growth	Sales growth rate by segment Percentage revenue from new product, services, and customers	Revenue/Employee	Investment (percentage of sales) R&D (percentage of sales)
Sustain	Share of targeted customers and accounts Cross-selling Percentage revenues from new applications Customer and product line profitability	Cost versus competitors' Cost reduction rates Indirect expenses (percentage of sales)	Working capital ratios (cash-to-cash cycle) ROCE by key asset categorie Asset utilization rates
Harvest	Customer and product line profitability Percentage unprofitable customers	Unit costs (per unit of output, per transaction)	Payback Throughput

Source: Kaplan, Norton, 1996, p. 52.

Customer Perspective

In the customer perspective of BSC, managers identify the customer and market segments in which the business unit will compete and the measures of the business unit´s performance in these targeted segments. This perspective typically includes several core or generic measures of the successful outcomes from a well-formulated and implemented strategy. The core outcome measures include customer satisfaction, customer retention, new customer acquisition, customer profitability, and market and account share in targeted segments. But the customer perspective should also include specific measures of the value propositions that the company will deliver to customers in targeted market segments. The segment-specific drivers of core customer outcomes represent those factors that are critical for customers to switch to or remain loyal to their suppliers. For example, customers could value short lead times and on-time delivery. Or a constant stream of innovative products and services. Or a supplier able to anticipace their emerging needs and capable of developing new products and approaches to satiry those needs. The customer perspective enebles business unit managers to articulate the customer and market-based strategy that will deliver superior future financial returns. (Kaplan, Norton, 1996, p. 26)

Internal-Business-Process Perspective

In the internal-business-process perspective, executives identify the critical internal processes in which the organization must excel. These processes enable the business unit to: (Kaplan, Norton, 1996, p. 26)

- deliver the value propositions that will attract and retain customers in targeted market segments, and
- satiry shareholder expectations of excedent financial returns.

The internal-business-process measures focus on the internal processes that will have the greatest impact on customer satisfaction and achieving an organization´s financial objectives.

The internal-business-process perspective reveals two fundamental diferences between the traditional and the BSC approaches to performance measurement. Traditional approaches attempt to monitor and improve existing business processes. They may go beyond financial measures of performance by incorporating quality and time-based metrics. But they still focus on improvement of existing processes. The scorecard approach, however, will usually identify entirely new processes at which an organization must excel to meet customer and financial objectives. For example, a company may realize that it must develop a process to anticipace customer needs or one to deliver new services that target customers value. The BSC internal-business-process objektive highlight the processes, several of which it may not be currently be performing at all, that are most critical for an organization´s strategy to succeed. (Kaplan, Norton, 1996, p. 27)

The second departure of the BSC approach is to incorporate innovation processes into the internal-business-process perspective. Traditional performance measurement systems focus on the processes of delivering today´s products and services to today´s customers. They attempt to control and improve existing operations that represent the short wave of value creation. This short wave of value creation begins with the recept of na order forma n existing customer for an existing product (or service) and ens with the delivery of the product to the customer. The organization creates value from producing, delivering, and servicing this product and the customer at a cost below the price it receives.

But the driver sof long-term financial success may require an organization to create entirely new products and services that will meet the emerging needs of current and future customers. The innovation process, the long wave of value creation, is for many companies a more powerful driver of future financial performance than the short-term operating cycle. For many companies, their ability to manage successfully a multiyear product-development process or to develop a capability to reach entirely new categories of customers may be more critical for future economic performance than managing existing operations efficiently, consistently, and responsively.

Managers, however, do not have to choose between these two vital internal processes. The internal-business-process perspective of the BSC incorporates objectives and measures for both the longwave innovation cycle as well as the short-wave operations cycle.

Learning and Growth Perspective

The fourth perspecitve of the BSC, learning ang growth, identifies the infrastructure that the organization must build to create long-term growth and improvement. The customer and internal-business-process perspectives identify the factors most critical for current and future success. Businesses are unlikely to be able to meet their long-term targets for customers and internal processes using today´s technologies and capabilities. Also, intense global

competition requires that companies continually improve their capabilities for delivering value to customers and shareholders. (Kaplan, Norton, 1996, p. 28)

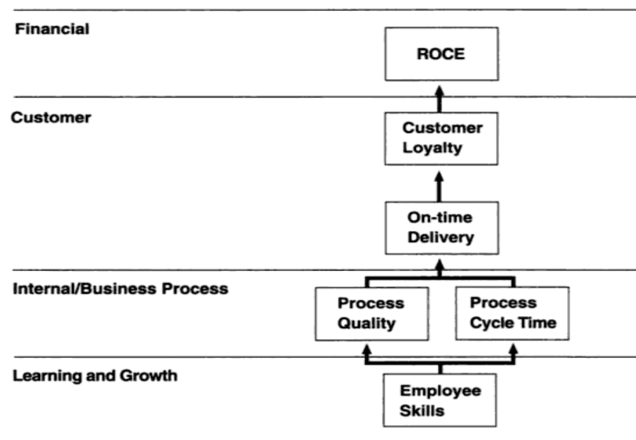
Organizational learning and growth come form three principal sources: people, systems, and organizational procedures. The financial, customer, and internal-business- process objectives on the BSC typically will reveal large gaps between the existing capabilities of people, systems, and procedures and what will be required to achieve breakthrough performance. To close these gaps, businesses will have to incest in reskilling employees, enhancing information technology and systems, and aligning organizational procedures and routines. These objectives are articulated in the learning and growth perspective of the BSC. As in the customer perspective, employee-based measures include a mixture of generic outcome measures – employee satisfaction, retention, training, and skills – along with specific drivers of these generic measures, such as detailed, business-specific indexes of the particular skills required for the new competitive environment. Information systems capabilities can be measured by real-time availability of accurate, critical customer and internal process information to employees on the front line of decision making and actions. Organizational procedures can examine alignment of employee incentives with overall organizational success factors, and measured rates of improvement in critical customer-based and internal processes. (Kaplan, Norton, 1996, p. 29)

Cause-and-Effect Relationships

A stretegy is a set of hypotheses about couse and effect. The measurement system should make the relationships (hypotheses) among objectives (and measures) in the various perspectives explicit so that they can be managed and validated. The chain of cause and effect should pervade all four perspectives of a BSC. For example, return-on-capital-employed may be a scorecard measure in the financial perspective. The driver of this measure could be repeat and expanded sales from existing customers, the result of a high degrese of loyalty among those customers. So, customer loyalty is included on the scorecard (in the customer perspective) becouse i tis expected to have a strong influence on ROCE. But how will the organization achieve customer loyalty? Analysis of customer preferences may erveal that on-time delivery of orders is highly valued by customers. Thus, improved on-time delivery (OTD) is expected to lead to higher customer loyalty, which, in turn, is expected to lead to higher financial performance. So both customer loyalty and OTD are incorporated into the customer perspective of the scorecard. (Kaplan, Norton, 1996, p. 30)

The process continues by asking what internal processes must the company excel at to achieve exceptional on-time delivery. To achieve improved OTD, the business may need to achieve shor cycle time in operating processes and high-quality internal processes, both factors that could be scorecard measures in the internal perspective. And how do organizations improve the quality and reduce the cycle times of their internal processes? By training and improving the skills of their operating employees, an objective that would be a candidate for the learning and growth perspective. We can now see how an entire chain of cause-and-effect relationships can be established as a vertical vector through the four BSC perspectives: (Kaplan, Norton, 1996, p. 30)

Figure 40 Cause relationship



Source: Kaplan, Norton, 1996, p. 31.

In a similar vein, recent work in the service profit chain has emphasized the causal relationships among employee satisfaction, customer satisfaction, customer loyalty, market share, and, eventually, financial performance.

Figure 41 Measuring Business Strategy

Perspective	Generic Measures
Financial	Return on investment and economic value-added
Customer	Satisfaction, retention, market, and account share
Internal	Quality, response time, cost, and new product introductions
Learning and Growth	Employee satisfaction and information system availability

Source: Kaplan, Norton, 1996, p. 44.

Thus, a properly constructed BSC should tell the story of the business unit´s strategy. It should identify and make explicit the semence of hypotheses about the cause-and-effect relationships between outcome measures and the performance drivers of those outcomes. Every measure selected for a BSC should be an element in a chain of cause-and-effect relationships that communicates the mening of the business unit´s strategy to the organization.

We can identify generic measures that show up in most organization´s scorecards, such as the following. (Kaplan, Norton, 1996)

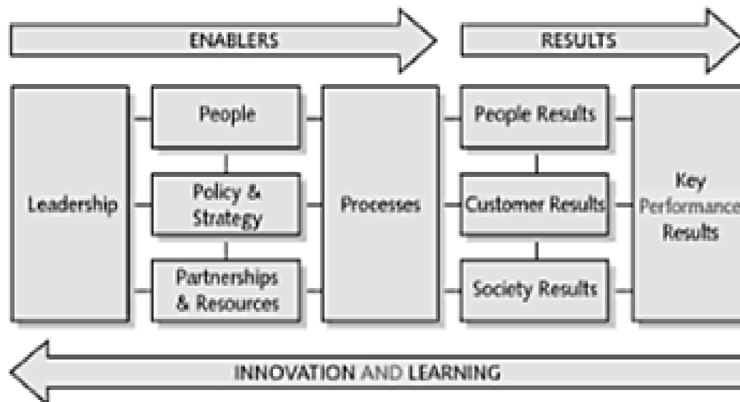
9.3.2 EFQM

Underpinning the EFQM Excellence Model, on which this Management Guide is based, is a set of eight core values. These so-called fundamental concepts created by EFQM in the early 1990s, where then, and continue to be, informed-renewed by their network and users.

The eight fundamental concepts of excellence that underpin the EFQM Excellence Model can be summarised as fallows: (Hakes, 2007, p. 13)

1. Leadership and constancy of purpose – excellence is about visionary and inspirational leadership, coupled with constancy of purpose.
2. Continuous learning, innovation and improvement – excellence is abou challenging the status quo and effecting change by utilising learning to create innovation and improvement opportunities.
3. People development and involvement – excellence is about maximizing the contribution of employees through their development and involvement.
4. Partnership development – excellence is about developing and maintaining value-adding partnerships.
5. Customer focus – excellence is about creating sustainable customer value.
6. Management by processes and factors – excellence is about managing the organization through a set of interdependent and interrelated systems, processes and facts.
7. Corporate social responsibility – excellence is about exceeding the minimum regulátory framework in which the organization operates, and to strive to understand and respond to the expectations of their stakeholders in society.
8. Results orientation – excellence is about achieving results that delikt all the organization´s stakeholders.

Figure 42 The EFQM Excellence Model



Source: Hakes, 2007, p. 16.

The EFQM Excellence Model translates eight fundamental concepts of management into a dynamic and non prescriptive operational model, by which performance can be assessed.

At the highest level the model consists of nine criteria (see figure): (Hakes, 2007, p. 16)

- Five key enablers of excellence (leadership, policy and strategy, people management, resources and processes). These criteria provide ways to assess what is being done in the organization which, if effective, should be dynamically driving excellence in
- The four results criteria (for customers, people, society and the business stakeholders). These criteria provide ways to assess what has been achieved.

All the nine criteria are defined as follows (Hakes, 2007, pp. 18 – 21):

Leadership – excellent leaders develop and facilitace the achievement of the mission and vision. They develop organizational values and systems required for sustainable success and implement these via their actions and behaviours. During periods of change they retain a constancy of purpose. Where required, such leaders are able to change the direction of the organization and inspire others to follow.

Policy and strategy – excellent organizations implement their mission and vision by developing a stakeholder-focused strategy that takes account of the market and sector in which it operates. Policies, plans, objectives and processes are developer and deployed to deliver strategy.

People – excellent organizations manage, develop and release the full potential of their people at an individual, team-based and organizational level. They promote fairness and equality, and involve and empower their people. They care for, communicate, reward and recognize, in a way that motivates staff and builds commitment to using their skills and knowledge for the bendit of the organization.

Partnerships and resources – excellent organizations plan to manage external partnerships, suppliers and internal resources in order to support policy and strategy and the effective operation of processes. During planning, and whilst managing partnerships and resources, they balance the current and future needs of the organization, the community, and the environment.

Processes – excellent organizations design, manage and improve processes in order to fully satisfy, and generate increasing value for, customers and other stakeholders.

Customer results – excellent organizations comprehensively measure and achieve outstanding results with respect to their customers.

People results – excellent organizations comprehensively measure and achieve outstanding results with respect to their people.

Society results – excellent organizations comprehensively measure and achieve outstanding results with respect to society.

Key performance results – excellent organizations comprehensively measure and achieve outstanding results with respect to the key elements of their policy and strategy.

Summary

One major problem of company theory and practice still remaining is the choice of the concept (tool and/or indicator) for the measurement and management of performance in order to achieve the most significant support of the basic financial goal of the companies, which is a long-term maximization of the market value. Company performance measurement and management belong to the crucial tasks of the management of a company. Many different concepts, tools and indicators for company performance measurement and management do exist. The approaches BSC, EVA, EFQM Excellence Model belong in the practice of measuring and management of company performance to widespread concepts (tools), which are at the same time also differently implemented. Each concept concentrates on important areas of management of the company performance.

Questions to test your knowledge:

1. *Among the most common types of indicators to measure financial performance we can involve which ones?*
2. *Which modern approaches of performance management do you know?*
3. *Try to characterise Balanced Scorecard method.*

SUMMARY

The study material "Management Economics" was designed for students who are interested in business or management and they want to become an entrepreneur in future career. Selection of applied fields related to business management expands knowledge necessary for orientation in business economics. Each section of the book helps students to understand sub-sections from business economics, especially focused on definition, nature, scope and cocenpts of business economics with an emphasis on principles of entrepreneurship; creation of business enterprise and basic elelement of every business concretely human ressource management.

Management is concerned with the effective use and coordination of materials and labour within organisations in the pursuit of the organisation's defined objectives. It considers the interrelationship and interactions between distinct parts of an organisation, and between the organisation and its environment. Management students look at theories, models and frameworks in order to understand how managers behave and consider their role in the process of decision-making.

Second part consists of principles of entrepreneurship divided into componen parts such as „what busines do" in which are introduced relation between outputs, resources, costs, revenues and business profits and also is extended about business functions and definitor of the entrepreneur profiles with condition for becoming an entrepreneur. The part of dececisions and downfalls of entrepreneurship and choosing a product and a market was not neglected. This part presented entry strategies for new ventures with criteria for choosing a form of business and role of the intellectual property. Third part of the book introduced creation of business enterprise with focused on capitalims and risk, financing the enterprise and possibilities of business financing existing in business environment.

Human resource management (HRM) was choosen as a basic element of every business units. This part followed by definiton on human resource strategy with outcomes in cycle of resource-based HRM model. Chapter was concluded by defining a role of HRM on organisational culture with the addition of factors influencing this culture. Fift part brought us to the issue of cost volume profit analysis with definiton of the different kinds of cost (e.g. manufacturing, administrative, total, direct, overhead, fixed, variable, lifecycle costs etc.).

Sixth chapter was addressed to break-even analysis which is very important indicator when revenues of product sales equal the total costs associated with the sale of product. Seventh chapter contained definition and practical aspects of business strategy with specifications in the global markets, competition, innovation and organization. During each business are, used various activities, among one of the most important is the investment activity included in the eighth chapter. Investment decision-making act was introduce in four principal factors followed by definition of investment process and investment appraisal. Investment decision-making act is introduced in eighth chapter forcefully on investment process and investment evaluation methods. Finally, business performance was devoted in ninth chapter and highlights the possibility of measurement of business performance (e.g. non-financial measures).

THE LIST OF LITERATURE

[1] Axelrod, C. W., 2004. Outsourcing Information Security. Norwood: Artech House. ISBN 1-58053-531-3.

[2] Barat, N., 1998. Investment Planning and Project Management. 1st edition. Calcutta: Academic Publishers Calcutta. ISBN 81-86358-70-6.

[3] Bowett, R. 2009. Organisation – how businesses organise themselves. [online]. [cit. 2013-10-02]. Available from: http://tutor2u.net/business/organisation/structures_intro.htm

[4] Bower, J. L., 1986. Managing the Resource Allocation Process. Boston: Harvard Business School Press. ISBN 0-87584-128-7.

[5] Bragg, S. M. The New CEO Corporate Leadership Manual: Strategic and Analytical Tools for Growth. New York: John Wiley and Sons. ISBN 978-0-470-91287-4.

[6] Break-Even Analysis: A Basic Calculation, 2013. Available from: http://www.inc.com/encyclopedia/break-even-analysis.html

[7] Burton, R. M., Obel, B., Hunter, S., Sondergaard, M. and D. Dojbak. 1998. Strategic Organizational Diagnosis and Design: Developing Theory for Application. Kluwer Academic Publishers. 2nd Editon. ISBN 0-792-38229-3.

[8] Cadbury, S. 1992. The code of best practice – report of the comittee on the financial aspects of corporate governance. Gee nad Co. Ltd.

[9] Cafferky, M. and J. Wentworth, 2010. Breakeven Analysis: The Definitive Guide to Cost-Volume-Profit Analysis. 1. Edition. New York: Business Expert Press. ISBN 978-1-60649-017-4.

[10] CIP. Break-Even Analysis. Available from: http://www.businessplantool.org/Dokumenti/Break-even%20point%20analysis.pdf

[11] Clegg, S. R., S. Clegg and C. Hardy, 1999. Studying Organization – Theory and Method. SAGE Publications. ISBN: 0-7619-6045-7.

[12] Čepelová, A. et al., 2007. Basics of Management. Prešov: University of International Business ISM Slovakia in Prešov. Published by Michael Vasek Publishing. ISBN 978-80-7165-610-4.

[13] Čepelová, A. et al., 2010. Governance and knowledge-based society. Pavol Jozef Safarik University in Kosice, ISBN 978-80-7097-842-9.

[14] Drucker, P. F. 1974. Management: Tasks, Responsibilities, Practices. New York: Harper & Row. Daft, Richard L. Organization Theory and Design. 6th Edition. Cincinnati: South-Western, 1997.

[15] Drucker, P. F. 2002. The Effective Executive. Harper Collins Publishers. ISBN 0-06-05160-70.

[16] Drury, C., 2008. Management and Cost Accounting. 7th edition. London: EMEA. ISBN 978-1-84480-566-2.

[17] Earl, P. and T. Wakeley. 2005. Business economics: A contemporary approach. McGraw-Hill. ISBN 0-07-7103920.

[18] Ehrlenspiel, K., A. Kiewert and U. Lindemann, 2013. Cost-Efficient Design. New York: Springer Berlin Heidelberg. ISBN 978-3-540-34647-0.

[19] Friedlob, G. T., L. F. Schleifer and J. P. J. Franklin, 2002. Essentials of Corporate Performance Measurement. New York: John Wiley and Sons. ISBN 0-471-20375-0.

[20] Geddes, R., 2002. Valuation and Investment Appraisal. Cauterburgy: Global Professional Publishing. ISBN 0-85297-6348.

[21] Goldman, G. and C. Nieuwenhuizen, 2006. Strategy: Sustaining Competitive Advantage in a Globalised Context. 1st edition. Wetton: Juta and Co. ISBN 0-7021-7195-6.

[22] Gomes, C. 2004. The influence of environmental, organisational and HRM factors on employee behaviours in subsidiarit. Journal of World Business, 39, pp. 1-11.

[23] Grant, J. I., 2003. Foundations of Economic Value Added. New Yersey: John Wiley and Sons. ISBN 0-471-23483-4.

[24] Hansen, D. R. and M. M.Mowen, 2010. Cornerstones of Cost Accounting. Mason: South-Western Cengage Learning. ISBN 978-0-538-73678-7.

[25] Harris, P. and M. Mongiello, 2006. Accounting and Financial Management. Developments in the International Hospitality Industry. 1st edition. Cornwall: MPG Books Ltd. ISBN 978-0-7506-6729-6.

[26] Heathfield, S. M. 2012. What is human ressource management? [online]. [cit. 2013-10-02]. Available from: http://humanresources.about.com/od/glossaryh/f/hr_management.htm

[27] Hill, Ch. W. L. and G. R. Jones, 2011. Essentials of Strategic Management. 3rd ed. Mason: 2011. ISBN 978-1-111-52519-4.

[28] Hill, Ch. W. L. and G. R. Jones, 2008. Strategic Management: An Integrated Approach. 10th ed. Mason: Cengage Learning. ISBN 978-1-111-82584-3.

[29] Hildegard, N. 2004. Arbeit und Geschlecht: Problemaufriss, in: Scholz u.a. (Hg.): Arbeit in der neuen Zeit. Regulierung der Ökonomie, Gestaltung der Technik, Politik der Arbeit. Ein Tagungsband. Münster.

[30] Hirshey, M. 2009. Managerial Economics. 12th Edition. South-Western. ISBN 978-0-324-58484-4.

[31] Chandra, P., 2008. Financial Management: Theory and Practice. New Delhi: Tata McGraw-Hill. ISBN 978-0-07-065665-9.

[32] Chong, Y. Y., 2004. Investment Risk Management. New York: John Wiley and Sons. ISBN 0-470-84951-7.

[33] Jindřichovsk, I. 2008. Corporate Governance in Transitional Countries – Shareholders or Stakeholders? QFinance [online]. [cit. 2013-09-04]. Available from: http://www.qfinance.com/corporate-governance-best-practice/corporate-governance-in-transitional-countriesshareholders-or-stakeholders?page=1

[34] Jeffrey, P. 1997. New Directions for Organization Theory: Problems and Prospects. Oxford University Press. ISBN 0-19-511434-5.

[35] Kaplan, R. S. and D. P. Norton, 1996. Balanced Scorecard. Boston: HBS Press. ISBN 0-87584-651-3.

[36] Margit, O. and W. Sigrid. 2004. Prospektive Gleichstellung durch Business Process Reengineering, in: Krell, Gertraudel (Hg.), Chancengleichheit durch Personalpolitik, pp. 263-276.

[37] Maginn, I. and L. John, 2007. Managing Investment. New Jersey: John Wiley and Sons. ISBN 978-0-470-63534-6.

[38] McAuley, J., Duberley, J. and P. Johnson. 2007. Organization Theory – Challenges and Perspectives. Prentice Hall. ISBN 978-0-273-68774-0

[39] Nickerson, J. A. and T. R. Zenger. 2002. Being Efficiently Fickle: A Dynamic Thory of Organizational Choice. Organization Science. Sep/Oct 2002, 13/5, p. 547.

[40] Nieven, P. R., 2006. Balanced Scorecard Step-by-Step. Maximizing Performance and Maintaining Results. 2nd edition. New Jersey: John Wiley and Sons. ISBN 978-0-471-78049-6.

[41] Senge, P. 1990. "The art & practice of the learning organization." in *The New Paradigm in Business: Emerging Strategies for Leadership and Organizational Change* (eds. Ray,

M. and Rinzler, A.) 1993 by the World Business Academy. p. 126-138. New York: Jeremy P. Tarcher.

[42] Senyucel, Z. 2009. Managing the Human Resource in the 21st Century. Ventus Publishing. ISBN 978-87-7681-468-7.

[43] Singer, B. and G., Fedorinchik, 2010. Investment Leadership and Portfolio Management. New Jersey: John Wiley and Sons. ISBN 978-0-470-43540-3.

[44] Sivagnanam, K. J. and R. Srinivasan, 2010. Business Economics. Tata McGraw-Hill. ISBN 978-0-07-068215-3.

[45] Stolz, W., 1999. Start Up: An Entrepreneur´s guide to Launching and managign a New Business. 5th Edition. Franklin Lakes, NJ: Career Press. ISBN: 978-1564144324.

[46] Tallman, S., 2010. Global Strategy. New Jersey: John Wiley and Sons. ISBN 978-14443-1661-2.

[47] Taticchi, P., 2010. Business Performance Measurement and Management. New Contexts, Themes and Challenges. Springer-Verlag Berlin Heidelberg. ISBN 978-3-642-04799-2.

[48] Torrington, D., Hall L. and S. Taylor, 2008. Human Resource Management. 7th Edition. Prentice Hall. ISBN 978-0-273-71075-2.

[49] Tsukamoto, S. W. 2003. Human nature and organization theory: On the economic approach to institutional organization. Edward Elgar Publishing. ISBN 1-84064-714-0.

[50] Walonick, D. S. 193. Organizational Theory and Behaviour. [online]. [cit. 2013-10-02]. Available from: http://www.statpac.org/walonick/organizational-theory.htm

[51] Weil, R. L. and M. W. Maher, 2005. Handbook of Cost Management. 2. edition. New Jersey: John Wiley and Sons. ISBN 978-0-471-67814-4.

[52] Wilkinson, J., 2007. The EFQM Excellence Model. For Assessing Organizational Performance. A management Guide. 1st edition. Zaltbommel: Van Haren Publishing. ISBN 78-90-8753-027-3.

[53] Winchell, W., 1989. Realistic Cost Estimating for Manufacturing. 2. edition. Michigan: Society of Manufacturing Engineers. ISBN 0-87263-364-0.

[54] Witcher, B. J. and V. J. Chau, 2010. Strategic Management: Principles and Practice. Hampshire: Cengage Learning EMEA. ISBN 978-1-84480-993-6.

Název: **Management Economics Selected Aspects of the Business**

Autoři: Ing. Pavel Adámek, Ph.D.
Ing. Žaneta Rylková, Ph.D.

Vydavatel: Slezská univerzita v Opavě
Obchodně podnikatelksá fakulta v Karviné

Určeno: studentům fakulty

Počet stran: 114

Vydání: on-line

ISBN 978-80-7248-991-6

Tato publikace neprošla jazykovou úpravou.