EBERT GRIFFIN DRACOPOULOS STARKE

BUSINESS ESSENTIALS

NINTH CANADIAN EDITION

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To Fran, for bringing a lifetime of friendship, fun, and love into our family.
—R.J.E.

For Paul and Sherry—Friends for life.
—R.W.G.

To Nitsa and Costa Dean.
—G.D.

To Ann, Eric, and Grant.
—F.A.S.

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HELPING STUDENTS BUILD A SOLID BUSINESS KNOWLEDGE FOUNDATION

Welcome to the ninth Canadian edition of *Business Essentials*. If you're like many students, you may be starting this term with some questions about why you're here. You may be taking this course at a community college, CEGEP, or at a university, and you may be taking it in a traditional classroom setting or online. Whatever the case, you may be wondering just what you're supposed to get from this course and how it will benefit you. In short, you may be wondering, "How will this help me?"

This is a survey course designed to introduce you to the exciting and challenging world of business, both in Canada and elsewhere. The course is designed to fit the needs of a wide variety of students. You may be taking this course as the first step towards earning a degree in business, or you may be thinking about business and want to know more about it, or you may know you want to study business but are unsure of the area you want to pursue. You may plan to major in another field but want some basic business background and are taking this course as an elective. Or you may be here because this course is required or is a prerequisite for another course. Whatever your situation, this course will be helpful to you.

If you don't have a lot of work experience, you may be uncertain as to what the business world is all about. If you do have a lot of work experience, you might be a bit skeptical as to what you can actually learn about business from an introductory course. One of our biggest challenges as authors is to write a book that meets the needs of such a diverse student population, especially when we acknowledge the legitimacy of your right to ask, "How will this help me?" We also want to do our best to ensure that you find the course challenging, interesting, and useful. To achieve this goal, we think it is helpful to use the old metaphor about people wearing different "hats" as they go through life. Each individual has different roles to play in different settings. For example, your roles may include student, child, spouse, employee, friend, and/or parent. You can think of each of these roles as needing a different hat—when you play the role of a student, for example, you wear one hat, but when you leave campus and go to your part-time job, you put on a different hat. From the perspective of studying and interfacing with the world of *business*, there are at least four distinct "hats" that you might wear:

- *The Employee Hat*. One hat is "worn" as an employee working for a business. Most people wear this hat throughout their working career. To wear the hat successfully, you will need to understand your "place" in the organization—your job duties and responsibilities, how to get along with others, how to work with your boss, what your organization is all about, and so on. You'll begin to see how best to wear this hat as you learn more about organizing business enterprises in Chapter 7, how organizations manage their human resources in Chapter 8, motivation and leadership in Chapter 9, and in several other places in this book.
- *The Employer or Boss Hat*. Another business hat that many people wear is as an employer or boss hat. Whether you start your own business or get promoted within someone else's business, people will be working for you. You'll still need to know your job duties and responsibilities, but you'll also need to understand how to manage other people—how to motivate and reward them, how to lead them, how to deal with conflict among them, and the legal parameters that may affect how you treat them. Chapters 3, 6, 8, and 9 provide a lot of information about how you can best wear this hat, although information about the role of employer is found throughout the book.
- *The Consumer Hat*. Even if you don't work for a business, you will still wear the hat of a consumer. Whenever you fill your car with Petro Canada gasoline; buy on Amazon, Zara, or Reitmans; or download a song from iTunes, you're consuming products or services created by businesses. To wear this hat effectively, you need to understand how to assess the value of what you're buying, your rights as a consumer, and so on. We discuss how you can best wear this hat in Chapters 1, 3, 12, and 13.
- *The Investor Hat*. The final business hat many people wear is that of an investor. You may buy your own business or work for a company that allows you to buy its stock. You may also invest in other companies through the purchase of stocks or shares of a mutual fund. In order for you to invest wisely, you must understand some basics, such as financial markets, business earnings, and the costs of investment. Chapters 4, 11, 14, and 15 will help you learn how to best wear this hat.

Most people wear more than one of these hats at the same time. Regardless of how many hats you wear or when you may be putting them on, you will interface with many different businesses in different ways. Knowing how to best wear all of these hats is what this book is all about.

The world is populated with a breathtaking range of businesses and business opportunities. Big and small businesses, traditional and online businesses, established and new businesses, broad-based and niche businesses, successful and unsuccessful businesses, global and domestic businesses—regardless of where your future plans take you, we hope that you will look back on this course as one of your positive first steps.

Keep in mind that what you get out of this course depends on at least three factors. One factor is this book and the information about business that you will acquire as a result of reading it. Another factor is your instructor, who is a dedicated professional who wants to help you grow and develop intellectually and academically. The third factor is YOU. Learning is an active process that requires you to be a major participant. Simply memorizing the key terms and concepts in this book may help you achieve an acceptable course grade, but true learning requires that you read, study, discuss, question, review, experience, evaluate—and wear the four hats—as you go along. Tests and homework are necessary, but we hope that you will finish this course with new knowledge and increased enthusiasm for the world of business. Your instructor will do his or her part to facilitate your learning. The rest, then, is up to you. We wish you success.

CHAPTER MATERIAL

NEW & UPDATED! Chapter Opening Cases Each chapter begins with a description of a problem or opportunity that is facing a Canadian company, or a general issue that impacts many different businesses in Canada. These chapter opening cases help students to bridge the gap between theory and practice. Topics include coverage of familiar companies that are global leaders in their industries such as Spin Master (toys and entertainment), Maple-Leaf, Couche-Tard (convenience stores), RBC, Tim Hortons, and Bombardier; the impact of the legalization of marijuana; stories about Canadian entrepreneurs and corporate leaders; business successes and failures; the increasing use of robots in business firms; new product marketing; the bitcoin and blockchain phenomenon; and many others that will be of great interest to students. Questions for Discussion at the end of each opening case direct student attention to important issues in the chapter that they should consider.

Future Directions for the Modern Accountant

In the future, although an accountant's knowledge of business aided by analytical and technical skills will be essential, a wider skill set will be necessary to meet market demands in this changing profession. The traditional accountant's role was centred on analyzing historical financial data, creating financial statements, and providing interpretations of financial data and documents to facilitate business decisions. The expectations for the modern CPAs increasingly call for the more intimate role of leadership in demonstrating financial implications for many additional parts of the business, including its overall operations, strategy, data management, human resources, and technical resources. In consultative roles, accountants are being asked for guidance on broad issues, including business development, evaluating strategic opportunities, assessments of risks and threats, and strategies for using massive databases to identify promising directions for developing new products, improving customer service, and evaluating new lines of business to gain competitive advantage. Beyond just technical expertise, such participation requires thorough knowledge of clients' businesses and the markets in which they operate. The following trends have emerged and are contributing to the additional roles of the modern accountant:

- *Fewer restrictions from physical and geographic boundaries*—With increasing globalization, many foreign-based firms are interacting with firms based elsewhere around the world. Coupled with modern technology, accountants and clients in other countries are working together remotely. An accountant based at company headquarters, or at a home-office in Halifax, can provide services to a client located in Saskatoon, Sao Paulo, or Singapore.

NEW & UPDATED! There's an App for That! Each chapter includes a description of several useful apps that are related to the chapter material. These apps allow students to understand business concepts in new and dynamic ways.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. **McKinsey Insights App** **Source:** McKinsey and Company **Key Features:** Provides the latest thinking on the biggest issues facing senior executives, everything from leadership and corporate strategy to globalization and technology's impact on business and society.	Apple, Android and Windows
2. **SWOT Canvas App** **Source:** Chanat Attopakorn **Key Features:** Allows you to conduct a SWOT analysis on your phone.	Apple and Windows
3. **Goal Tracker: GoalsOnTrack App** **Source:** Goal Software for High Achievers **Key Features:** Helps users develop and reach goals based on the SMART goal setting approach (specific, measurable, achievable, relevant, and time-framed).	Apple and Android

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" management apps and identify the key features.

NEW & UPDATED! Boxed Inserts on Key Topics The text contains four series of boxed inserts that are positioned at strategic points in the chapters. The first series—*E-Business and Social Media Solutions*—describes how rapidly changing technology has provided business firms with many new ways to connect with customers. The second series—*Disruptions in Business*—explains how existing businesses are being dramatically changed by new ways of doing business, and how entirely new industries are developing with astonishing speed and challenging traditional ways of doing business. The third series—*Entrepreneurship and New Ventures*—provides real-life examples of entrepreneurs who saw an opportunity to provide a new product or service in the marketplace, and the activities they carried out in order to be successful. The fourth series—*The Greening of Business*—analyzes the steps that businesses are taking to be more environmentally friendly. Critical thinking questions appear at the end of each boxed insert to motivate students to think about what they have read.

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

"Simon Says," Alexa, What Have You Done?

Pianodiaphragm/Shutterstock

Most of us are very familiar with the children's game "Simon Says." It taught us about the importance of paying attention by forcing us to act on instructions only after hearing those magic words. But today a whole new generation of kids may be far more likely to substitute Simon's name for Amazon's Alexa or Apple's Siri or Samsung's Bixby. After all, they may ask Alexa more questions than they ask their friends or parents on some days.

In the search for efficiency and the quest to effectively organize our lives, complete tasks, and find resources, many people have become reliant on e-assistants. The use of integrated technology is more common in people's homes than at work; however, these personal assistants are on guard, listening and waiting to engage while sitting on desks, tucked away inside purses, or in the jacket pockets in the workplace. Even if Alexa (and similar devices) have not officially conquered the business world, they are listening and preparing to gain more access in the years ahead. As you read the next paragraph, consider the business implications (security and otherwise) and the lessons from the following story that made headlines around the world.

A couple was having a private conversation in their home when their Echo speakers activated Alexa when a word that sounded like "Alexa" was recognized. Apparently, during the conversation that followed, a "send message command" was also triggered. Fortunately, the private discussion was about hardwood floors and not something more sensitive because Alexa then sent that recorded conversation, randomly, to a contact (one of their employees). He later called and told them details of that private conversation and warned them about what happened. Obviously, the couple felt like their privacy had been invaded; quite frankly, it had been totally violated! However, not without their partial cooperation. After the incident, they understandably decided to unplug all of their devices! Amazon explained the very unlikely string of events that led to this failure, but it did not guarantee that this could not happen again. Instead, their explanation was much more cautious but less reassuring to anyone who was paying attention.

So, what are the potential implications of this type of scenario in the business world? There's a lot of buzz about the promise of artificial intelligence. AI actually dates back to the 1950s; however, today we have computers with the processing power to make advanced decisions that were previously reserved for science fiction movies. We have seen many technologies creep in from the consumer world to the business world. But what if that recorded conversation had been about the private negotiation details between a manufacturer and a distributor on a potential distribution agreement? What if the management team had been talking about their costs, margins, sales goals, and bottom-line minimum price to close the deal? What if Alexa, or her future B2B version, had sent a recorded message of all those secret strategic details to (1) the other side of the negotiating table or (2) the competition or (3) had just simply posted it online?

Advanced technology can help us access and organize information for better decision making. As AI evolves even further, we must not forget that the first word in that term is "artificial." As kids, "Simon Says" taught us to listen carefully. We were penalized when we made a mistake. So Alexa can learn a lot from Simon.

"Simon Says" that artificial intelligence is impressive, but it remains a shadow of true knowledge.

CRITICAL THINKING QUESTIONS

1. List all the positive ways that you use such personal assistants. List all the ways a business person can use an e-assistant in his or her day-to-day job.
2. Conduct research to find information about this case and look for other similar stories. What did you find? How does this research impact your perception of e-assistants? How does this impact your perception of the business applications of this technology today?

NEW! Examples of Business Practice In addition to the boxed inserts, each chapter contains numerous examples of how actual Canadian and international businesses operate so that students can gain a better understanding of the dynamics of business practice in both Canada and elsewhere. These examples—which range in length from one sentence to several paragraphs—are in addition to the in-depth opening cases and end-of-chapter cases that appear in each chapter. These examples help students understand concepts that are discussed in the text.

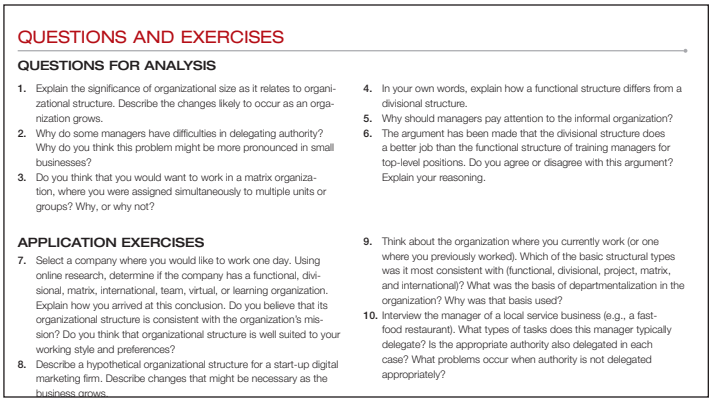
NEW & UPDATED! Key Terms In each chapter, the key terms that students should know are highlighted in the text and defined in the margin.

NEW & UPDATED! Figures and Tables The latest available data appear in tables and figures throughout the text.

END-OF-CHAPTER MATERIAL

UPDATED! Summary of Learning Objectives The material in each chapter is concisely summarized, using the learning objectives as the organizing scheme. This helps students understand the main points that were presented in the chapter.

NEW & UPDATED! Two types of questions are included at the end of each chapter: *analysis questions* (which require students to



QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Explain the significance of organizational size as it relates to organizational structure. Describe the changes likely to occur as an organization grows.
2. Why do some managers have difficulties in delegating authority? Why do you think this problem might be more pronounced in small businesses?
3. Do you think that you would want to work in a matrix organization, where you were assigned simultaneously to multiple units or groups? Why, or why not?
4. In your own words, explain how a functional structure differs from a divisional structure.
5. Why should managers pay attention to the informal organization?
6. The argument has been made that the divisional structure does a better job than the functional structure of training managers for top-level positions. Do you agree or disagree with this argument? Explain your reasoning.

APPLICATION EXERCISES

7. Select a company where you would like to work one day. Using online research, determine if the company has a functional, divisional, matrix, international, team, virtual, or learning organization. Explain how you arrived at this conclusion. Do you believe that its organizational structure is consistent with the organization's mission? Do you think that organizational structure is well suited to your working style and preferences?
8. Describe a hypothetical organizational structure for a start-up digital marketing firm. Describe changes that might be necessary as the business grows.
9. Think about the organization where you currently work (or one where you previously worked). Which of the basic structural types was it most consistent with (functional, divisional, project, matrix, and international)? What was the basis of departmentalization in the organization? Why was that basis used?
10. Interview the manager of a local service business (e.g., a fast-food restaurant). What types of tasks does this manager typically delegate? Is the appropriate authority also delegated in each case? What problems occur when authority is not delegated appropriately?

BUSINESS CASE 13

FREEMIUM MUSIC: TAKING OVER THE INDUSTRY

Pascal Le Segretain/Getty Images

You may or may not be surprised to hear that subscription streaming services are the fastest-growing form of music listening. According to the 2018 Global Music Report, there are 176 million music streaming subscribers, and the annual growth is tremendous, with 68 million people signing up in the previous 12 months alone. In Canada, streaming revenues were up 68.8 percent at the time. That report also marked the first time that such services registered more revenues ($6.6 billion) than physical music sales ($5.2 billion) and digital downloads ($2.8 billion).

Streaming is more than the future of music; it is also the present. For example, The Weeknd, a popular Canadian artist with global appeal, has capitalized on this platform. His song "I Can't Feel My Face" premiered on *Apple Music* and was streamed more than 1.5 billion times, on all the various services, in the first two years alone. That sort of exposure and popularity allows artists like The Weeknd to cash in. However, despite these impressive figures, he said, "We live in a world in which artists don't make the money until they hit the stage." What does he mean? In fact, royalty payouts are not what they once were; they amount to only about 0.006 to 0.0084 per stream, or less than 1 penny per stream. In addition, 99.9 percent of artists don't get 1.5 billion plays in their whole career! In other words, under this new streaming model, the nearly free access to music can help build popularity that is then fully monetized and that eventually pays off with lucrative tours and endorsement deals. In 2017, The Weeknd earned $92 million. That same year, Chance the Rapper earned $33 million without ever selling a physical album or even signing a record deal! His real paydays have come through endorsement deals with Kit Kat and Apple and of course through festival gigs and tour money.

SPOTIFY THE MARKET LEADER AND THE COMPETITION

Spotify was originally launched in Stockholm, Sweden, in 2008 by two entrepreneurs named Daniel Ek and Martin Lorentzon. As their website indicates, Spotify has led the fight from a "transaction based" music acquisition model to an "access based" model offering more than 35 million tracks to its customers. Spotify has more than 170 million monthly active users, with 75 million premium subscribers, in 65 countries. The company went public in 2018, with an initial public offering (IPO) valued at US$26.5 billion. Its most notable competitors are Pandora, SoundCloud, and Tidal. There is also one other late comer to the party going by a name you are quite familiar with: Apple.

APPLE THE MARKET FOLLOWER

Apple is one of the most innovative companies in the world; it helped transform the computer, smartphone, tablet, and music industries. However, the dominant position achieved by Apple iTunes (after the digital revolution disrupted the physical distribution model) is now threatened by streaming services. In fact, the digital download model championed by Apple's iTunes saw heavier declines than physical distribution in the previous 12-month period (20.5% vs. 11.2%). Apple saw the writing on the wall a few years back and entered the streaming business in 2015 (albeit as a late arrival). However, despite the delay, once it made the move, it was fully committed. When Apple bought Beats by Dr. Dre for $3 billion back in 2014, many scratched their heads at the high price tag. However, Apple was not simply buying the company for its headphones; part of that move was to acquire the Beats streaming service and brand equity.

CONCLUSION

So, where will the music industry be heading next? There have been a few major disruptions in the past couple of decades, from sales of CDs, to an epidemic of illegal streaming, to the emergence of iTunes, to the new rise in subscription streaming. The freemium model is the present hope for the future, but these days you can be sure of one thing: change is just around the corner. Survival of the quickest is the new norm!

QUESTIONS FOR DISCUSSION

1. In terms of degrees of competition, how would you describe the market for music streaming? Do you think this will change in the next five years? If so, how?
2. How can relatively unknown music artists promote themselves and their new music to help them gain traction on streaming sites? Provide concrete examples of promotional strategies that they can use.
3. Conduct some research and identify the top streaming global artists during the past year. What makes these artists so popular? How has that translated into actual revenues in the past 12 months?

think beyond simple factual recall and apply the concepts they have read about), and *application exercises* (which ask students to apply what they have learned). The exercises, which are designed to help students increase their understanding of how business firms actually operate, require students to engage in practical activities such as interviewing managers about concepts and issues that are discussed in the chapter.

NEW! Building a Business: Continuing Exercise This team exercise, which is found at the end of each chapter in the text, gives students the opportunity to develop an entirely new business venture that fits with their interests. Questions at the end of each exercise require students to carefully consider how the material in the chapter will influence the decisions they must make about their new venture.

NEW & UPDATED! Building Your Business Skills This feature asks students to examine some specific aspect of business. While working in a group context, students gather data about an interesting business issue and then develop a written report or a class presentation based on the information that was gathered. Each exercise begins with a list of goals, a description of the situation, a step-by-step methodology for proceeding, and follow-up questions to help students focus their responses to the challenge.

NEW & UPDATED! Exercising Your Ethics This exercise describes a situation that contains an ethical dilemma. Students are then asked several questions that focus on how to approach and resolve the dilemma. In the exercise, students take on the role of employee, owner, customer, or investor and examine a chapter-related business ethics dilemma through the perspective of that role. Students learn how to see an ethical dilemma from various points of view, and to decide what outcome is ultimately best in each situation.

NEW & UPDATED! Business Case Each chapter concludes with a case study that focuses on a real Canadian or international company, or on an issue that impacts businesses in general. These cases are designed to help students apply the chapter material to a company or an issue that is currently in the news. At the end of each case, several Questions for Discussion guide students in their analysis.

END-OF-PART MATERIAL

Crafting a Business Plan The business plan project is tailor-made to match and reinforce text content. It is *software-independent* and provides students with an easy-to-understand template that they work from as they create their business plans. The business plan project is divided into logical sections, and each part (e.g., marketing, production, finance, etc.) is located at the end of the section where that material is covered. With five parts in all, students can gradually apply the concepts they've learned in the chapters to their business plans throughout the course.

APPENDICES

There are five appendices in the text.

- Appendix A—**A Brief History of Canadian Business in Canada**—summarizes the high points of the development of business in Canada during the past 300 years.
- Appendix B—**Business Law**—includes key topics such as contracts, the concept of agency, warranties, copyrights and trademarks, and bankruptcy.
- Appendix C—**Using Technology to Manage Information in the Internet and Social Media Era**—focuses on the impact that IT has had on the business world, the IT resources businesses have at their disposal, the threats that information technology poses for businesses, and the ways in which businesses protect themselves from these threats. There is also an important section on the role of social media platforms in the modern business world.
- Appendix D—**Managing Your Personal Finances: A Synopsis**—presents a down-to-earth, hands-on approach that will help students manage their personal finances. Included in the supplement is a worksheet for determining personal net worth, insightful examples demonstrating the time value of money, a method for determining

how much money to invest now in order to build a future nest egg of a certain size, suggestions on how to manage credit card debt, guidelines for purchasing a house, and a personalized worksheet for setting financial goals.

- Appendix E—**Insurance as Risk Management**—provides information on insurable vs. uninsurable risks, the different types of insurance products that are available, and special forms of business insurance.

WHAT'S NEW IN THE NINTH CANADIAN EDITION?

New content has been included in all chapters. An illustrative (but not exhaustive) list is as follows:

Chapter 1—New material on government's role as a regulator with regard to agriculture; details of the bread price-fixing scandal in which the Competition Bureau made allegations and exposed over a decade of collusion between some of Canada's largest supermarkets: Loblaws, Metro, Sobeys, as well as Walmart; new examples of supply and demand principles linked to the real-world experiences of Atlantic fisherman; a new discussion on supply management that was a major source of dispute in the NAFTA negotiations and a key battle before the ultimate signing of the USMCA agreement.

Chapter 2—New and updated information on GDP, the national debt, and the business cycle; on how inflation is impacted by key social issues such as the push towards a $15 minimum wage in many provinces; and on the economic shocks caused by sudden fuel price changes (especially grocery products). You will also find a new section describing the important role R&D played in the emergence of the canola industry in Canada; new consumer preferences and tastes are examined as well how the concern for our environment and food supply are a big part of the push for natural products such as cricket-based protein bars and flour. A spotlight is also directed on modern-day strategic alliances between companies like Magna International and Lyft (the ridesharing service).

Chapter 3—New information on corruption and bribes in international business activity, examples of ethical failures such as improper financial management, B Corp certification for businesses that want to be environmentally responsible, how to incorporate various ethical norms into management decision making, the concept of carbon pricing, the fair trade movement, price fixing, whistle-blowers, counterfeit goods, and the role that consumers play in solving pollution problems.

Chapter 4—New information highlighting entrepreneurial goals and characteristics; a more detailed discussion on accessing resources and bootstrapping for entrepreneurs; a focus on the growing opportunities to buy existing businesses with an aging population of businesspeople heading towards retirement.

Chapter 5—A new look at the global economy through the lens of BREXIT, USMCA, and other major shocks to the economic world order (many of which are originating in the United States). A key underlying question is constantly considered: just how will the rise of protectionist rhetoric and policy shape the next few years? We look at recent tariff threats and policy as well as retaliations across the globe; we examine the implications of Brexit on the European zone, the continued emergence of the BRICS trading alliance, and the future of the Comprehensive Economic and Trade Agreement (CETA), as well as other new agreements like the Trans Pacific Partnership (TPP).

Chapter 6—New information on McDonald's planning process as managers try to improve the company's performance, what students should expect in a manager's job, how social media makes the activities of managers more visible to the public, and the practical realities of corporate strategy; new material on corporate culture, the importance of managers having "soft skills" (as opposed to technical skills), decision-making skills, and the importance of contingency planning.

Chapter 7—New information on job specialization in the age of automation and industrial robots; we look at new examples demonstrating the forms of departmentalization and the role of informal groups and the grapevine in an organization.

Chapter 8—New information on the impact of education on employee compensation, differences in salary progression for men and women in various jobs, male vs. female earnings, the salary impact for new employees who graduate from community colleges and universities, the debate about executive compensation, diversity issues at companies like Facebook and Google, union organizing strategies, right-to-work laws, union membership in Canada.

Chapter 9—New material on employee turnover and the importance of understanding the "regression to the mean" phenomenon.

Chapter 10—New material on changes in manufacturing over time, materials management for service organizations, global productivity comparisons, ISO 14000 certification, and supply chain disruptions.

Chapter 11—New and updated information about the CPA accounting designation as well as a look at the evolving role of the modern accountant. An explanation of the role of the International Accounting Standards Board (IASB), which developed International Financial Reporting Standards (IFRS), a sort of "global GAAP." We distinguish between Part I for publicly accountable enterprises (IFRS) and government private enterprises; Part II Accounting Standards for Private Enterprises (ASPE); Part III for not-for-profit organizations; and Part IV for pension plans.

Chapter 12—New material on niche marketing initiatives by Shoppers Drug Mart with its latest retail concept, Wellwise; we highlight a potential strategic alliance that would see Canadian coffee brand icon Second Cup become involved in the distribution of legalized marijuana; we identify a new low-cost airline; we take an extended look at the evolving topic of marketing observation through the lens of the Facebook scandal involving Cambridge Analytica.

Chapter 13—New examples on price lining are brought to life using the Apple iPad as an example; a new section outlining the redistribution of advertising budgets and the new emphasis on consumer engagement; a new discussion about corporate accountability in the sharing/social media economy is supported by the United Airlines scandal that erupted after a passenger was forcibly removed from a flight. Finally, there is an extensive look at how the retailing landscape is changing with consumers increasingly buying online and ignoring brick-and-mortar stores. Is there a future for traditional retailers and shopping malls?

Chapter 14—New information is presented on alternate financial transaction vehicles like Alipay and cryptocurrencies; updated information is given on the top banks and credit unions in Canada, as well as the latest Big Mac Index statistics; a discussion is provided on the role of the IMF in a period where many fundamental institutions are being questioned and tested.

Chapter 15—New information is provided on financial planning, managing risk with diversification, return on investment, the time value of money, fantasy stock markets, mutual funds, and securities regulation.

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His experience as a practitioner has fostered an advocacy for integrating concepts with best business practices in business education. The five business books he has written have been translated into Spanish, Chinese, Malaysian, and Romanian. Dr. Ebert has served as the editor of the *Journal of Operations Management*. He is a past-president and fellow of the Decision Sciences Institute. He has served as consultant and external evaluator for *Quantitative Reasoning for Business Studies,* an introduction-to-business project sponsored by the National Science Foundation.

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Dr. Griffin has served the Academy of Management as chair of the organizational behaviour division. He also has served as president of the southwest division of the Academy of Management and on the board of directors of the Southern Management Association. He is a fellow of both the Academy of Management and the Southern Management Association. He is also the author of several successful textbooks, each of which is a market leader. In addition, they are widely used in dozens of countries and have been translated into numerous foreign languages, including Spanish, Polish, Malaysian, and Russian.

George Dracopoulos is a member of the Business Administration Department at Vanier College. He has served as department chairman and is now the International Business Exchange Coordinator. In the past 15 years, George has built bridges with universities, government organizations, and multinational corporations throughout France and Belgium. Hundreds of students have benefitted from his initiatives. He is also the co-organizer and co-founder of the national BDC/Vanier Marketing Case Competition and was named the Vanier VIP for his dedication and devotion to the community.

Mr. Dracopoulos also serves as a lecturer at McGill University. He created an online pilot project, designing courses geared primarily to aboriginal students in remote communities. He was also honoured (among a select group) as "Professor of the Year" by a McGill University publication for his work in the Desautels Faculty of Management. He earned his MBA at McGill, as well as a graduate diploma in Education and a graduate degree in Applied Management. He earned his BA at Concordia University.

Outside his teaching career, Mr. Dracopoulos is an award-winning entrepreneur. George does not simply write about disruptive technology. A few years ago, he co-founded a company called Zero-Ohm Systems after negotiating and acquiring the global licensing and manufacturing rights to a patented invention (United States, Europe, and Russia) serving the audio industry. He has successfully marketed the device at international trade shows. In 2017 the company made a breakthrough in Orlando, Florida, when it was honoured with the Best New Product Technology Award at InfoComm (North America's biggest trade show for the AV market). In this capacity, Mr. Dracopoulos has been interviewed by top industry media and trade publications in North America and Europe.

George is continuously engaged in executing real-world strategies. He provides marketing and management consulting solutions (e.g., brand audits, customer relationship surveys, strategic consultations, and IMC campaigns). He has also built web-based materials and training documents for clients in various industries, including aviation/IT solutions, publishing, and higher education. Mr. Dracopoulos has been invited to provide motivational speeches and/or keynote addresses at events across North America on topics such as Connecting with Millennials, Effective Communication, and Transformational Leadership. He has worked on various other text projects, including *Business in Action,* 2nd Canadian edition (2009), co-authored with Courtland L. Bovée and John V. Thill; and *Business,* 8th Canadian edition (2014), co-authored with Ricky Griffin, Ronald J. Ebert, Frederick Starke, and Melanie Lang.

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Dr. Starke earned his BA and MBA from Southern Illinois University and his PhD in Organizational Behaviour from Ohio State University. He has published research articles in scholarly journals such as *Administrative Science Quarterly, Journal of Applied Psychology, Academy of Management Journal, Journal of Management Studies,* and *Journal of Business Venturing*. He has also written articles for professional journals, such as the *Journal of Systems Management, Information Executive,* and the *Canadian Journal of Nursing Administration*. Dr. Starke also writes textbooks that are used by university and community college students in business programs across Canada. These titles include *Organizational Behaviour, Business Essentials, Management,* and *Business*. Dr. Starke also presents seminars on the topics of decision making and goal setting to practising managers in both the public and private sectors.

PART

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CHAPTER

01

Understanding the Canadian Business System

LO AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Define the nature of Canadian *business* and identify its main goals.
- **LO-2** Describe different types of global *economic systems* according to how they control the *factors of production* through *input* and *output markets*.
- **LO-3** Describe the interactions between business and government in Canada.
- **LO-4** Show how *demand* and *supply* affect resource distribution in Canada.
- **LO-5** Identify the elements of *private enterprise* and explain the various *degrees of competition* in the Canadian economic system.

Spin Master: Canadian Toy Maker Becomes a Global Children's Entertainment Company

Here's a business success story that will inspire you. After graduating from university, two young Canadian entrepreneurs named Anton Rabie and Ronnen Harary formed a company called Spin Master and were later joined by a third co-founder, Ben Varadi. They started selling a fad product called Earth Buddy and managed to secure some significant sales and distribution. Never heard of it? Like all fads, it had its moment in the sun, but eventually those sales dried up. It was a nylon stocking, filled with sawdust, made to look like a head. It was topped with grass seeds that grew to look like hair. For a recent example of a big fad, think of the fidget spinner craze.

This initial success gave these entrepreneurs firsthand experience with real-world sales, manufacturing, finance, and accounting in an accelerated time frame as they scrambled to meet demand. Mistakes were made but lessons were learned, and their passion and energy were richly rewarded. In fact, at the beginning of 2018, Spin Master purchased Gund, a 120-year-old stuffed toy brand for $79.1 million, which marked the ninth acquisition in a three-year span. At the time, Anton and Ronnen were also being recognized on a list of the top 100 wealthiest people in Canada with an estimated net worth of $1.64 billion dollars each.

So how did they go from Earth Buddies to buying iconic toy brands? Well, have you heard of Paw Patrol or Hatchimals? Did you play with Air Hogs or Bakugan when you were younger? Have you recently purchased a Luvabella doll for your niece? Do the words Meccano and Zoomer mean something to children in your home and neighborhood? If you said yes, you have part of your answer. If you said no to all these questions, then where have you been? Let's dig deeper into the full story.

Then and Now: Evolving Models

Spin Master was founded approximately 25 years ago with one product and a dream. Today it employs over 1500 people globally with offices in Canada, the United States,

Frank Gunn/The CP Image

Mexico, France, Italy, the United Kingdom, Slovakia, Poland, Germany, Sweden, the Netherlands, China, Hong Kong, Japan, Vietnam, and Australia.

Long-term success in any industry demands the ability to evolve and to find new ways to satisfy customer needs. In some ways, this task has become more difficult as modern technologies are altering buying patterns and leaving many established companies struggling to survive. In other ways, this task has been greatly enhanced by modern technology. For example, today we have YouTube influencers like Ryan, a six-year-old toy-tester, with a following of 10.2 million subscribers and more than 17 billion uploads of his toy reviews. Spin Master teamed with this young millionaire (He and his parents made more than 14 million in 2017 alone!) to promote Soggy Doggy in a 10-minute video. That video was viewed six million times in just two months right before the peak holiday season.

These entrepreneurs have built an organization with the ability to pivot and thrive in changing times. Spin Master has received 92 Toy of The Year (TOTY) nominations and has 21 wins across a variety of product categories. As if this kind of success was not enough, Spin Master has branched out into the production of television series, including shows such as Bakugan, Battle Brawlers, and the current big hit PAW Patrol, which is broadcast in more than 160 countries and territories.

The Future

Spin Master is no longer just a toy company. It describes itself as "a leading global children's entertainment company that creates, designs, manufactures, licenses and markets a diversified portfolio of innovative toys, games, products and entertainment properties." It's a good thing too. The toy industry is under tremendous pressure with more and more children asking mom and dad for smartphones rather than stuffed animals at younger ages. The recent shutdown of the iconic Toys "R" Us outlets in the United States is yet another sign of the times. Although much of that failure is due to the shift toward online sales, in favor of companies like Amazon, industry experts have estimated that this closure may further reduce toy sales by 10 percent in the United States. The future of Toys "R" Us in Canada is also unclear.

So what does the future hold for Spin Master? Time will tell, but with their track record of success and their diversification experience, they clearly have the will to fight and the capacity to meet new challenges.

QUESTIONS FOR DISCUSSION

1. Based on what you read in the preceding case, what are the primary reasons for the long-term success of Spin Master?
2. In what ways does Spin Master demonstrate the basic principles of business, the power of entrepreneurship and creativity in a global economy?
3. In this chapter, we will discuss the different types of economic systems. After reading that section, answer the following question. What features of the Canadian economy helped make Spin Master's success a reality? In what ways would this task have been more difficult in a command economy? Explain.
4. What are the greatest challenges facing Spin Master today? What does the company need to do to thrive for another 25 years or more?

HOW WILL THIS HELP ME?

All businesses are subject to the influences of economic forces. But these same economic forces also provide smart managers and entrepreneurs with opportunities for profits and growth. The ideas presented in this chapter will help you to better understand (1) how *managers* deal with the challenges and opportunities resulting from economic forces and (2) how *consumers* deal with the challenges and opportunities of price fluctuations.

Billion Photos/Shutterstock

LO-1 THE IDEA OF BUSINESS AND PROFIT

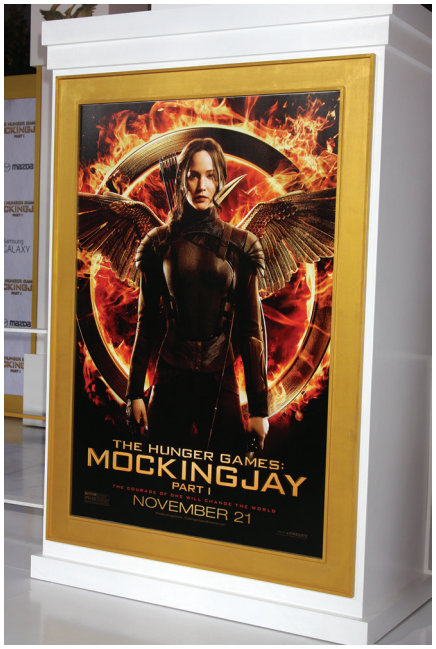
The opening Spin Master case provides an inspiring example of entrepreneurship and a free-market economy. It shows how businesses must evolve and stay in touch with new industry trends. It also shows how business managers must pay attention to issues such as corporate strategy, brand strategy, business–government relations, international business opportunities, mergers, and many other concepts that you will read about in this text.

Let's begin by asking what you think of when you hear the word *business*. Do you think of large corporations like Shoppers Drug Mart and Walmart or smaller companies like your local supermarket or favorite restaurant? Do you think about successful companies like Netflix, CN, and Telus? Each of these firms is a **business**—an organization that produces or sells goods or services to make a profit. Businesses produce most of the goods and services that we consume, and they employ most of the workforce in Canada. Taxes paid by businesses help support government at all levels. In addition, businesses help support charitable causes and provide community leadership. For example, Spin Master has donated domestically to local causes and has even created a global initiative called the Toy Movement; during the holiday season of 2017, Spin Master delivered more than 45 000 toys to underprivileged children in South Africa.[1]

Each year *Forbes* magazine evaluates and ranks 153 countries for ease of conducting business transactions. In 2017, the United Kingdom ranked first, followed by New Zealand, the Netherlands, Sweden, and Canada.[2]

Profit is what remains after a business's expenses have been subtracted from its revenues. Profits reward the owners of businesses for taking the risks involved in investing their time and money. Profits can be very large if a company produces something that consumers really like. For example, the *Hunger Games* series of movies have generated large profits for Lions Gate and achieved combined total gross revenues of approximately $1.5 billion.[3]

Many organizations in Canada do not try to make a profit. These **not-for-profit organizations** use the funds they generate from government grants or from the sale of goods or services to provide services to the public. Charities, educational institutions, hospitals, labour unions, and government agencies are examples of not-for-profit organizations. Business principles are helpful to these not-for-profit organizations as they try to achieve their service goals.



The Hunger Games Series has been a huge success for Lions Gate.

Kathy Hutchins/Shutterstock

BUSINESS An organization that seeks to earn profits by providing goods and services.

PROFIT What remains (if anything) after a business's expenses are subtracted from its sales revenues.

NOT-FOR-PROFIT ORGANIZATION An organization that provides goods and services to customers, but does not seek to make a profit while doing so.

LO-2 ECONOMIC SYSTEMS AROUND THE WORLD

A Canadian business is different in many ways from one in China, and both are different from businesses in Japan, France, or Argentina. A major determinant of how organizations operate is the kind of economic system that characterizes the country in which they do business. An **economic system** allocates a nation's resources among its citizens. Economic systems differ in terms of who owns and controls these resources, known as the "factors of production."

Factors of Production

The key difference between economic systems is the way in which they manage the **factors of production**—the basic resources that a country's businesses use to produce goods and services. The factors of production are labour, capital, entrepreneurs, natural resources, and information.[4]

Labour

The people who work for a company represent the first factor of production—*labour*. Sometimes called human resources, labour is the mental and physical capabilities of people. Carrying out the business of a huge company, such as Suncor Energy, requires a labour force with a wide variety of skills ranging from managers to geologists to truck drivers.

ECONOMIC SYSTEM The way in which a nation allocates its resources among its citizens.

FACTORS OF PRODUCTION The resources used to produce goods and services: labour, capital, entrepreneurs, and natural resources.

You are probably very familiar with Petro Canada, but (since 2009) the company behind the retail brand is Suncor Energy.

James Jones Jr/Shutterstock

Capital

Capital refers to the funds required to start a business and to keep it operating and growing. For example, Petro Canada needs capital to pay for its annual drilling costs, which run into millions of dollars each year. Major sources of capital for businesses are personal investment by owners, the sale of stock to investors, profits from the sale of products and services, and funds borrowed from banks and other lending institutions.

Entrepreneurs

Entrepreneurs are people who accept the opportunities and risks involved in creating and operating businesses. Sergey Brin and Larry Page (Google), Mark Zuckerberg (Facebook), and Tobias Lutke (Shopify) are well-known entrepreneurs.

Natural Resources

Natural resources include all physical resources, such as land, water, mineral deposits, and trees. Suncor Energy (which sells products to consumers through the Petro Canada retail brand) makes use of a wide variety of natural resources. It obviously has vast quantities of crude oil to process each year. But Suncor Energy also needs the land where the oil is located, as well as land for its refineries and pipelines.

Information

Information includes the specialized knowledge and expertise of people who work in businesses, as well as information contained in market forecasts and various other forms of economic data. Information is a key factor of production because, unlike land, labour, and capital, information can be shared without being diminished. For example, if two people exchange apples, they still each have only one apple, but if two people exchange ideas, each person now has two ideas instead of one.[5]

Types of Economic Systems

Different types of economic systems manage the factors of production in different ways. In some systems, ownership is private; in others, the government owns the factors of production. Economic systems also differ in the ways decisions are made about production and allocation. A **command economy**, for example, relies on a centralized government to control all or most factors of production and to make all or most production and allocation decisions. In a **market economy**, individuals—producers and consumers—make production and allocation decisions through the mechanism of supply and demand.

The boxed insert entitled "Disruptions Are Everywhere" is the opening box of a series that provides you with an overview of topics you will see throughout this book and how disruptive business models are changing the business landscape.

COMMAND ECONOMY An economic system in which government controls all or most factors of production and makes all or most production decisions.

MARKET ECONOMY An economic system in which individuals control all or most factors of production and make all or most production decisions.

Paul Warburton / Alamy Stock Photo

ZUMA Press, Inc. / Alamy Stock Photo

Foodfolio/Alamy Stock Photo

Starbucks uses various factors of production, including labour (a Starbucks barista), entrepreneurs (CEO Howard Schultz), and natural resources (such as coffee beans).

DISRUPTIONS IN BUSINESS

Disruptions are Everywhere!

Much has been said in the news lately about how technological change is disrupting traditional business practices. Of course, disruptions have been occurring for thousands of years. Think of the electric light disrupting the whale oil business or the automobile disrupting the wagon business. But those changes occurred at a time when the rate of change in society *overall* was much slower than it is now. Now everything seems to be changing all the time. Consider what has happened in just the past couple of decades:

- The business of travel agents was threatened and severely impacted by online reservations.
- The business of video rental (think Blockbuster) was disrupted by Netflix.
- Traditional food outlets such as Sobeys and Loblaw's are threatened by Amazon's purchase of Whole Foods.
- Uber and Lyft, the ride-hailing companies, have created great concern among both taxi companies and rental car companies.
- The abolition of the Canadian Wheat Board has resulted in substantial changes in the way crops are marketed and transported.
- The music industry has been severely disrupted by file sharing and iTunes.
- Robo-advisors have disrupted the investment advice industry.
- Vaporizers and e-cigarettes have disrupted the cigarette industry.
- Airbnb has disrupted the hotel industry.
- Self-driving cars may take the jobs of professional drivers (taxi, delivery, long-haul).
- If electric cars become popular, the oil industry may be disrupted because such cars will sharply reduce the demand for oil.

Disruption has become so common that companies cannot ignore it. In subsequent chapters, some of the disruptions mentioned above will be explained in more detail. All the changes that are occurring mean significant improvements for consumers in the form of new and useful products and services, but they also pose a real threat to the financial health of certain businesses, to the investors who buy their stock, and to the managers and workers who are employed by them. This is the reality of the dynamic world of business.

CRITICAL THINKING QUESTION

Consider the following statement: *The disruptions that are increasingly evident in the Canadian economy increase stress levels and the complexity of people's lives. We should be more concerned about our quality of life than we are about new gadgets and new ways of doing things.* Do you agree or disagree with the statement? Explain your reasoning.

Command Economies

The two basic forms of command economies are communism and socialism. As originally proposed by nineteenth-century German economist Karl Marx, **communism** is a system in which the government owns and operates all sources of production. Marx envisioned a society in which individuals would ultimately contribute according to their abilities and receive economic benefits according to their needs. He also expected government ownership of production factors to be only temporary (historical examples would tell us otherwise). During the past few decades, most countries have abandoned communism in favor of a more market-based economy. Even countries that still claim to be communist (e.g., China, Vietnam, and Cuba) now contain clear elements of a market-based economy. However, in China's case, that should not be confused with easing of political control. In 2018, Chinese leader Xi Jinping and his party eliminated term limits, which gave him the potential ability to stay in power for life. This was not a step forward toward continued reform.[6]

In a less extensive command economic system called *socialism*, the government owns and operates only selected major industries. Smaller businesses such as clothing stores and restaurants may be privately owned. Although workers in socialist countries can usually choose their occupations or professions, a substantial proportion generally work for the government. Many government-operated enterprises are inefficient because management positions are frequently filled based on political considerations rather than on ability. Extensive public welfare systems have also resulted in very high taxes. Because of these factors, socialism is generally declining in popularity.[7]

Xi Jinping is General Secretary of the Communist Party of China, President of the People's Republic of China, and Chairman of the Central Military Commission. With the recent change in rules and the elimination of term limits, he can theoretically remain in power until his death.

Justin Lane/Epa/Shutterstock

Market Economies

A **market** is a mechanism for exchange between the buyers and sellers of a good or service. For example, the internet is a technologically sophisticated market that brings buyers and sellers together through e-commerce. People usually think of e-commerce as being business-to-consumer (B2C) transactions, such as buying household goods from Amazon for personal use. But business-to-business (B2B) transactions far exceed B2C transactions in dollar value.

In a market economy, B2C and B2B exchanges take place without much government involvement. To understand how a market economy works, consider what happens when a customer goes to a fruit stand to buy apples. Assume that one vendor is selling apples for $1 per kilogram,

COMMUNISM A type of command economy in which the government owns and operates all industries.

MARKET An exchange process between buyers and sellers of a particular good or service.

and another is charging $1.50. Both vendors are free to charge what they want, and customers are free to buy what they want. If both vendors' apples are of the same quality, the customer will likely buy the cheaper ones. But if the $1.50 apples are fresher, the customer may buy them instead. Both buyers and sellers enjoy freedom of choice.

Input and Output Markets A useful model for understanding how the factors of production work in a pure market economy is shown in Figure 1.1.[8] In an **input market**, firms buy resources from households that supply the resources. In an **output market**, firms supply goods and services in response to demand on the part of the households. The activities of these two markets create a circular flow. Ford Motor Company, for example, buys labour directly from households, which may also supply capital from accumulated savings in the form of stock purchases. Consumer buying patterns provide information that helps Ford decide which models to produce and which to discontinue. In turn, Ford uses these inputs in many ways and becomes a supplier to households when it designs and produces various kinds of automobiles, trucks, and sport-utility vehicles and offers them for sale to consumers.

Individuals are free to work for Ford or an alternative employer and to invest in Ford stock or alternative forms of saving or consumption. Similarly, Ford can create whatever vehicles it chooses and price them at whatever value it chooses. Consumers are free to buy their next car from Ford, Toyota, BMW, or any other manufacturer. The political basis for the free-market economy is called **capitalism**, which allows private ownership of the factors of production and encourages entrepreneurship by offering profits as an incentive. This process contrasts markedly with that of a command economy, in which individuals may be told where they can and cannot work, companies may be told what they can and cannot manufacture, and consumers may have little or no choice as to what they purchase or how much they pay for items.

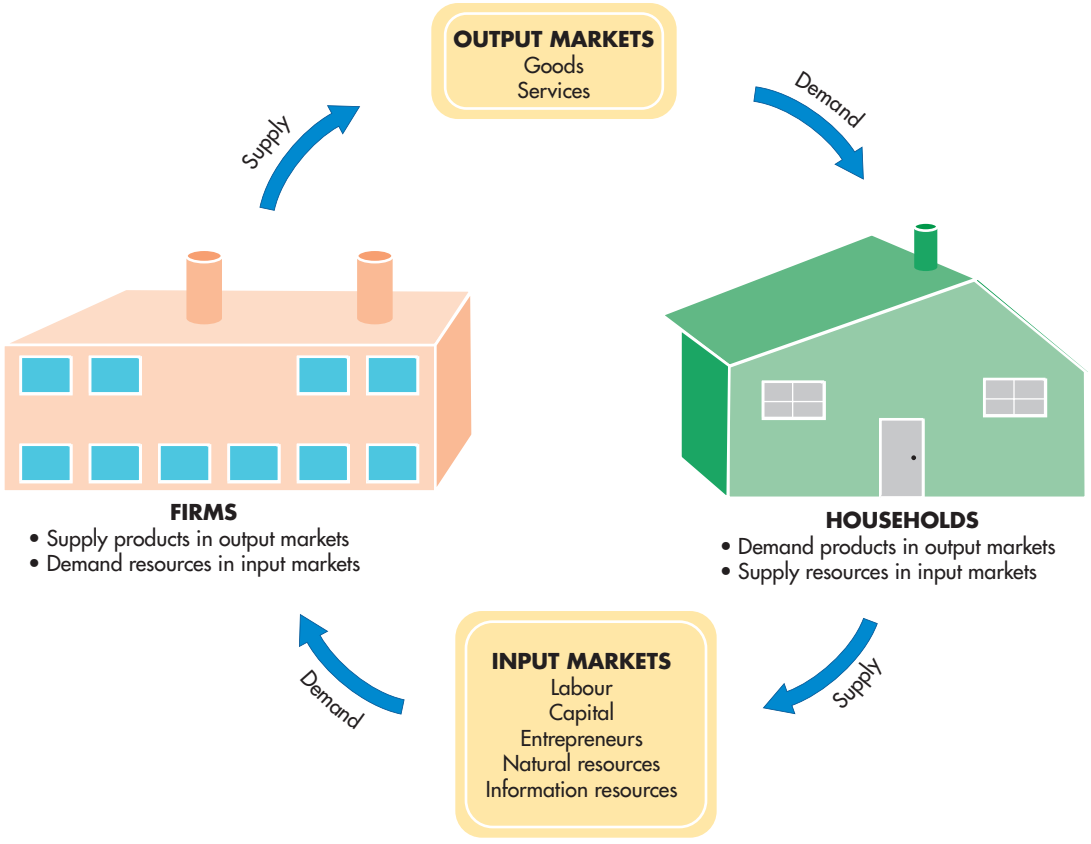
The People's Republic of China has used a planned economic model for many years but is now moving toward a mixed market economy. But Hong Kong has been using the mixed market model for years. These signs on a busy Hong Kong street are promoting a variety of goods and services provided by merchants along the street.

TungCheung/Shutterstock

INPUT MARKET Firms buy resources that they need in the production of goods and services.

OUTPUT MARKET Firms supply goods and services in response to demand on the part of consumers.

CAPITALISM An economic system in which markets decide what, when, and for whom to produce.



<<< FIGURE 1.1 Circular flow in a market economy

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. The Economist App **Source:** *The Economist* **Key Features:** Free access to the editor's top six must-read articles; access to the full magazine for subscribers.	Apple, Android, Windows, BlackBerry
2. Khan Academy App **Source:** Khan Academy Education **Key Features:** More than 10 000 educational videos with a wide selection of economics videos explaining core theory and concepts.	Apple, Android, Windows
3. Financial Post App **Source:** Postmedia Canada Network Inc. **Key Features:** Up-to-date source of Canadian business and investing news as well as market and financial data.	Apple, Android

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for "top 3" economic statistics apps and identify the key features.

Mixed Market Economies

Command and market economies are two extremes, or opposites. Most countries rely on some form of **mixed market economy** that features characteristics of both command and market economies. One trend in mixed market economies that began back in the 1990s is **privatization**—converting government enterprises into privately owned companies. In Canada, for example, the air traffic control system was privatized, and the federal government sold several other corporations, including Petro Canada, Canadian National Railway, and Air Canada. The Organization for Economic Co-operation and Development (OECD) said that Canada Post's monopoly should be ended, and it should be privatized.[9]

Deregulation means a reduction in the number of laws affecting business activity and in the powers of governmental enforcement agencies. A study by the Conference Board of Canada showed that deregulation (in tandem with privatization and increased competition) caused a sharp increase in productivity in sectors such as freight and airlines.[10]

MIXED MARKET ECONOMY An economic system with elements of both a command economy and a market economy, which in practice is typical of most nations' economies.

PRIVATIZATION The transfer of activities from the government to the private sector.

DEREGULATION A reduction in the number of laws affecting business activity.

LO-3 INTERACTIONS BETWEEN BUSINESS AND GOVERNMENT

In Canada's mixed market economy, there are many important interactions between business and government. The ways in which government influences business and the ways business influences government are described next.

How Government Influences Business

Government plays several key roles in the Canadian economy, and each of these roles influences business activity in some way. The roles government plays are as follows.

Government as a Customer

The government buys thousands of different products and services from business firms, including office supplies, office buildings, computers, battleships, helicopters, highways, water treatment plants, and management and engineering consulting services. Many businesses depend on government purchasing, if not for their survival, then at least for a certain level of prosperity. Total government expenditures in 2017 were $311.3 billion.[11]

Government as a Competitor

The government also competes with business through Crown corporations, which are accountable to a minister of parliament for their conduct. Crown corporations such as Hydro-Quebec and Canada Post generate billions of dollars of revenue and account for significant economic activity in Canada. Crown corporations exist at both provincial and federal levels.

Government as Regulator

Federal and provincial governments in Canada regulate many aspects of business activity through administrative boards, tribunals, and commissions, but there is a continuing debate about how much influence government regulators have and how much they *should* have. From 1935 until 2012, the Canadian Wheat Board regulated the price of wheat and prohibited farmers from selling their wheat directly to U.S. elevators. Instead, farmers were required to sell their wheat through the Wheat Board. That monopoly ended when the government introduced legislation to allow farmers to sell direct. The last step in the process occurred in 2015, when 50.1 percent of the organization was sold for US$250 million to the Global Grain Group (G3), a joint venture between the food company Bunge Ltd. and a unit of Saudi Agricultural and Livestock Investment Co. known as SALIC Canada Ltd. The rest of the shares were made available to farmers who chose to work with the organization, which has now promised to open new markets for farmers.[12]

The reasons for regulating business activity include protecting competition, protecting consumers, achieving social goals, and protecting the environment.

Promoting Competition Competition is crucial to a market economy, so government regulates business activity to ensure that healthy

TABLE 1.1 The Competition Act

Section 45	Prohibits conspiracies and combinations formed to unduly lessen competition in the production, transportation, or storage of goods. Persons convicted may be imprisoned for up to five years, fined up to $1 million, or both.
Section 50	Prohibits illegal trade practices. A company may not, for example, cut prices in one region of Canada while selling at a higher price everywhere else if this substantially lessens competition. A company may not sell at "unreasonably low prices" if this substantially lessens competition. (This section does not prohibit credit unions from returning surpluses to their members.)
Section 51	Prohibits giving allowances and rebates to buyers to cover their advertising expenses, unless these allowances are made available proportionally to other purchasers who are in competition with the buyer given the rebate.
Section 52	Prohibits marketing (promotion) activities that are false or misleading. Includes telemarketing activities.
Section 53	Prohibits the deceptive notice that a person has won a prize if the recipient is asked to pay money as a condition of winning the prize.
Section 54	Prohibits charging the higher price when two prices are shown on a product.
Section 55.1	Prohibits pyramid selling (a participant in the plan receives compensation for recruiting other individuals into the plan).
Section 61	Prohibits resale price maintenance. No person who produces or supplies a product can attempt to influence upward, or discourage reduction of, the price of the good in question. It is also illegal for the producer to refuse to supply a product to a reseller simply because the producer believes the reseller will cut the price.
Section 74	Prohibits bait-and-switch selling. No person can advertise a product at a bargain price if there is no supply of the product available to the consumer. (This tactic baits prospects into the store, where salespeople switch them to higher-priced goods.) This section also controls the use of contests to sell goods and prohibits the sale of goods at a price higher than the advertised one.

competition exists among business firms. Without these restrictions, a large company with vast resources could cut its prices and drive smaller firms out of the market. The guidelines for Canada's competition policy are contained in the **Competition Act**, which prohibits a variety of practices (see Table 1.1).

The Act prohibits agreements among companies that are designed to reduce competition. Formerly, the government had to prove that such agreements reduced competition, but recent changes to the legislation mean that the mere existence of a conspiracy is assumed to be proof that competition has been reduced.[13] Another major change is the dramatically increased fines for misleading marketing practices by corporations (formerly $100 000 for the first offence, now $10 million).[14]

In recent years, Loblaws has been under the microscope as it relates to the issue of competitive fairness. First, when Loblaws acquired Shoppers Drug Mart, the Competition Bureau imposed limits on how much the company could squeeze Shoppers' suppliers by demanding that those suppliers reduce their prices. Loblaw was also required to sell 18 stores and 9 pharmacies because the Bureau was concerned about anticompetitive practices.[15] Second, in 2018, Loblaws along with six other companies including Metro., Walmart, and Sobeys were accused of conspiring to inflate the price of bread for a period stretching back over a decade. According to the Competition Bureau, these companies committed illegal activities that violated the Competition Act.[16] Loblaws, for its part, has apologized and also offered its customers a $25 gift card in an attempt to recover some goodwill from upset customers. Accepting the gift card did not remove the legal rights of those customers to participate in a class action lawsuit against the company.[17] This story will surely be in the news for a few years to come as more legal actions are taken.

Businesses often complain that the Competition Bureau is too slow in making decisions and that it makes decisions that are unfriendly to business. One highly visible recent case has pitted the Competition Bureau against the Canadian Real Estate Association (CREA). The dispute began in 2010 when the Bureau alleged that CREA was acting in an anticompetitive manner because it was refusing to allow online, low-cost real estate brokers access to its Multiple Listing Service (MLS). The Bureau also told the Toronto Real Estate Board (TREB) that its practices were anticompetitive because brokers weren't being allowed to share information over the internet. TREB appealed, but in 2017, the courts upheld the initial ruling.[18]

Protecting Consumers The federal government has initiated many programs that protect consumers. Consumer and Corporate Affairs Canada administers many of these. Important legislation includes the *Tobacco Act* (which prohibits cigarette advertising on billboards and in stores), the *Weights and Measures Act* (which sets standards of accuracy for weighing and measuring devices), the *Consumer Packaging and Labelling Act* (which stipulates labelling requirements for products), the *Textile Labelling Act* (which regulates the labelling, sale, importation, and advertising of consumer textile articles), and the health care *Food and Drug Act* (which prohibits the sale of food that contains any poisonous or harmful substances).

Achieving Social Goals Social goals, which promote the well-being of Canadian society, include things such as universal access to health care, safe workplaces, employment insurance, and decent pensions. All these goals require the interaction of business firms and the Canadian government. But the decisions of foreign governments—as they pursue their own social goals—can also affect Canadian businesses.

Protecting the Environment Government legislation designed to protect the environment includes the *Canada Water Act* (which controls water quality in fresh and marine waters), the *Fisheries Act* (which controls the discharge of any harmful substance into water), and the *Environmental Contaminants Act* (which establishes regulations for airborne substances that are a danger to human health or the environment).

COMPETITION ACT Prohibits a variety of business practices that lessen competition.

Problems in the Ontario Power System

Ontario's Green Energy Act came into effect about a decade ago and was designed to make the province a world leader in renewable energy. But things didn't quite work out as planned, and electricity bills for consumers have doubled over the past decade. This increase has occurred even though the cost of generating electricity has declined to about 3 cents per kilowatt hour (kWh) due to the shale gas revolution. The "all-in" cost of electricity (which includes generation costs, transmission costs, and taxes) is now about 25 cents per kWh in Ontario, but only 16.5 cents in the United States.

Why did electricity rates go up so much in Ontario when the cost of generating electricity went down? The answer becomes clear when we look at something called the Global Adjustment (GA) tax, which is a surcharge that is added on to everyone's electric bill. This surcharge helps to cover the costs that were incurred as the province began its move to green energy sources like wind and solar. The province signed contracts that paid producers of wind-generated electricity 13.5 cents per kWh and paid solar generators even more. But the market price at the time was only 2.5 cents per kWh for electricity that was generated from traditional sources like hydro, natural gas, and coal. The impact of the GA has been dramatic. For example, at Automatic Coating Inc., the bill for one sample month showed a charge for electricity of $6500, but the GA added about $25 000 more. In defending its decisions, the government says that closing coal plants saved $4.4 billion in health care costs, and that thousands of new jobs will be created by the move to renewable energy. Critics reject both of these claims as false and note that the recent cancelling of several wind projects shows that the government is finally accepting the fact that there are big problems in the power generation industry.

At the beginning of the millennium, coal accounted for 20 percent of Ontario's electricity supply. It seemed like a good idea to replace coal-generated electricity with renewables like solar and wind power to reduce air pollution. So, the province decided to close all the coal-generated power plants (the last plant was shut down in 2014). But the business of generating electricity is a complex one, and organizations like Ontario's Society of Professional Engineers have been highly critical of the government for mismanaging the process of changing from coal to renewables. As well, Ontario's auditor general has estimated that it will cost about $130 billion to "go green" over the next 30 years. The most general criticism of the Ontario government is that politics and ideology have driven decisions, not economic analysis. Critics point out, for example, that coal plants could have been retrofitted to reduce pollution for a small fraction of the costs that have actually been incurred in paying subsidies to wind and solar power companies.

CRITICAL THINKING QUESTION

1. Consider the following statement: *"The criticisms that have been levelled at the Ontario government are unfair. While electric bills have gone up, the fact is that the movement to green energy sources like wind and solar is necessary to cope with the threat of climate change. The Ontario government has done the right thing by protecting the long-term quality of life for its citizens."* Do you agree or disagree with the statement? Defend your reasoning.

Hazardous products must have warning labels to protect consumers who use them.

Branislav/E+/Getty Images

Government as a Taxation Agent

Taxes are imposed and collected by the federal, provincial, and local governments. *Revenue taxes* (e.g., income taxes) are levied by governments primarily to provide revenue to fund various services and programs. *Progressive revenue taxes* are levied at a higher rate on higher-income taxpayers and at a lower rate on lower-income taxpayers. *Regressive revenue taxes* (e.g., sales tax) are levied at the same rate regardless of a person's income. They cause poorer people to pay a higher percentage of their income for these taxes than rich people pay. *Restrictive taxes* (e.g., taxes on alcohol, tobacco, and gasoline) are levied partially for the revenue they provide, but also because legislative bodies believe that the products in question should be controlled.

Government as a Provider of Incentives and Financial Assistance

Federal, provincial, and municipal governments offer incentive programs that attempt to stimulate economic development. According to a recent study, more than $29 billion is spent annually by the federal government and the four largest provinces: Ontario, Quebec, British Columbia, and Alberta.[19] In one high-profile example, provinces from across the nation have given hundreds of millions of dollars in subsidies to film companies to motivate them to make major films in their cities.[20]

Industry Canada offers many different programs designed to help small businesses. The Canada Business program, for example, provides

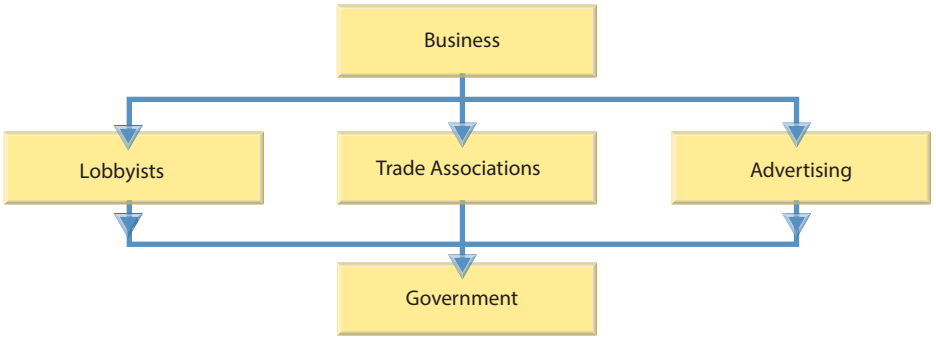


FIGURE 1.2 How business influences government

information on government programs, services, and regulations to improve the start-up and survival rates of small- and medium-sized businesses. It also encourages businesses to focus on sound business planning and the effective use of market research. *The Department of Foreign Affairs, Trade and Development* (DFATD) mandate helps Canadian companies doing business internationally by promoting Canada as a good place in which to invest and carry on business activities. It also assists in negotiating and administering trade agreements.

Governments also offer incentives through the many services they provide to business firms through government organizations. Examples include the *Export Development Corporation* (which assists Canadian exporters by offering export insurance against non-payment by foreign buyers and long-term loans to foreign buyers of Canadian products), *Natural Resources Canada* (which provides geological maps of Canada's potential mineral-producing areas), and *Statistics Canada* (which provides data and analysis on almost every aspect of Canadian society). *Industry Canada* offers many different programs designed to help small businesses.

There are many other government incentive programs, including municipal tax rebates for companies that locate in certain areas, design assistance programs, and deal with the remission of tariffs on certain advanced technology production equipment. Government incentive programs may or may not have the desired effect of stimulating the economy. They may also cause difficulties with our trading partners, as we shall see in Chapter 5.

Government as a Provider of Essential Services

The various levels of government facilitate business activity through the services they supply. The federal government provides highways, the postal service, the minting of money, the armed forces, and statistical data on which to base business decisions. It also tries to maintain stability through fiscal and monetary policy (discussed in Chapter 2). Provincial and municipal governments provide streets, sewage and sanitation systems, police and fire departments, utilities, hospitals, and education. All these activities create the kind of stability that encourages business activity.

In public–private partnerships (called P3s), the government pays a private sector company to build, finance, and operate organizations such as hospitals and transit lines. But studies show that P3s cost more money than the traditional approach in which the government puts up the money and then hires contractors to do the necessary work.[21]

How Business Influences Government

Businesses also try to influence the government by using lobbyists, trade associations, and advertising (see Figure 1.2). A **lobbyist** is a person hired by a company or industry to represent that company's interests with government officials. The Canadian Association of Consulting Engineers, for example, regularly lobbies the federal and provincial governments to make use of the skills possessed by private-sector consulting engineers on projects such as city water systems. Some business lobbyists have training in the industry, public relations experience, or a legal background. A few have served as legislators or government regulators.

The federal *Lobbying Act* requires lobbyists to register with the Commissioner of Lobbying so that it is clear which individuals are being paid for such activity. It also sets rules for accountability and transparency and requires lobbyists to report detailed information about their communications with what are known as Designated Public Office Holders (DPOHs).[22] For many lobbying efforts, there are opposing points of view. For example, the Canadian Cancer Society and the Tobacco Institute present very different points of view on cigarette smoking and cigarette advertising.

Employees and owners of small businesses that cannot afford lobbyists often join **trade associations**, which may act as an industry lobby to influence legislation. They also conduct training programs relevant to the industry, and they arrange trade shows at which members display their products or services to potential customers. Most publish newsletters featuring articles on new products, new companies, changes in ownership, and changes in laws affecting the industry.

LOBBYIST A person hired by a company or an industry to represent its interests with government officials.

TRADE ASSOCIATION An organization dedicated to promoting the interests and assisting the members of a particular industry.

LO-4 THE CANADIAN MARKET ECONOMY

Understanding the complex nature of the Canadian economic system is essential to understanding Canadian business. In this section, we will examine the workings of our market economy, including markets, demand, supply, private enterprises, and degrees of competition.

Demand and Supply in a Market Economy

In economic terms, a **market** is not a specific place, like a supermarket, but an exchange process between buyers and sellers. Decisions about

production in a market economy are the result of millions of exchanges. How much of what product a company offers for sale and who buys it depends on the laws of demand and supply.

The Laws of Supply and Demand

In a market economy, decisions about what to buy and what to sell are determined primarily by the forces of demand and supply. **Demand** is the willingness and ability of buyers to purchase a product or service. **Supply** is the willingness and ability of producers to offer a good or service for sale. The **law of demand** states that buyers will purchase (demand) more of a product as its price drops. Conversely, the **law of supply** states that producers will offer (supply) more for sale as the price rises.[23]

MARKET An exchange process between buyers and sellers of a particular good or service.

DEMAND The willingness and ability of buyers to purchase a product or service.

SUPPLY The willingness and ability of producers to offer a good or service for sale.

LAW OF DEMAND The principle that buyers will purchase (demand) more of a product as price drops.

LAW OF SUPPLY The principle that producers will offer (supply) more of a product as price rises.

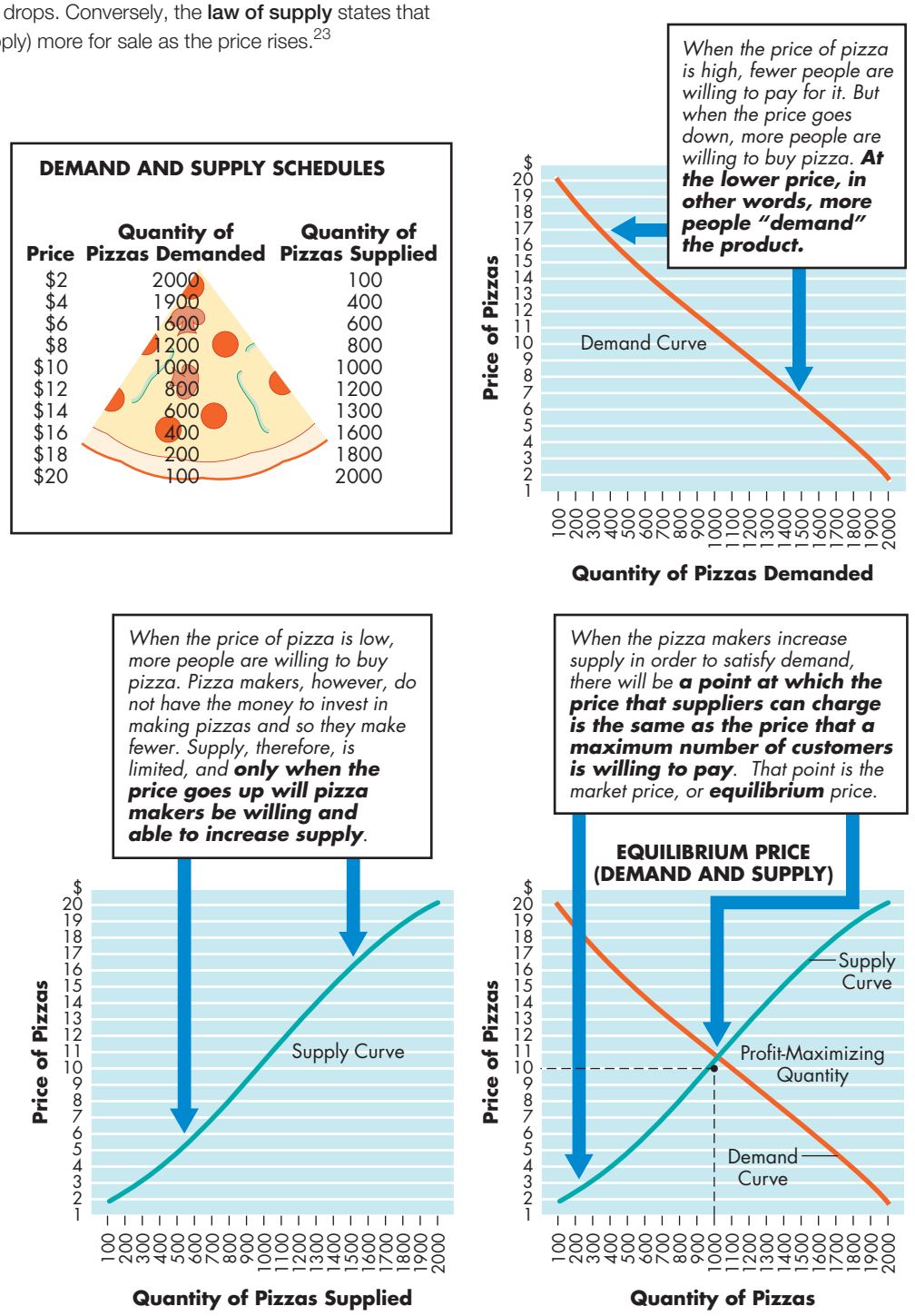


FIGURE 1.3 Demand and supply

Source: Adapted from Karl E. Case and Ray C. Fair, *Principles of Economics*, 8th ed., updated (Upper Saddle River, NJ: Prentice Hall, 2007).

Demand and Supply Schedules

To appreciate these laws in action, consider the market for pizza in a small town. If everyone is willing to pay $25 for a pizza (a relatively high price), the local pizzeria will produce a large supply. If, however, everyone is willing to pay only $5 (a relatively low price), the restaurant will make fewer pizzas. Through careful analysis, we can determine how many pizzas will be sold at different prices. These results, called a **demand and supply schedule**, are obtained from marketing research and other systematic studies of the market. Properly applied, they help managers understand the relationships among different levels of demand and supply at different price levels.

Demand and Supply Curves

The demand and supply schedule can be used to construct demand and supply curves for pizza. A **demand curve** shows how many products—in this case, pizzas—will be demanded (bought) at different prices. A **supply curve** shows how many pizzas will be supplied (cooked) at different prices.

Figure 1.3 shows the hypothetical demand and supply curves for pizzas in our illustration. As you can see, demand increases as price decreases, and supply increases as price increases. When the demand and supply curves are plotted on the same graph, the point at which they intersect is the **market price**, or **equilibrium price**—the price at which the quantity of goods demanded and the quantity of goods supplied are equal. In Figure 1.3, the equilibrium price for pizzas is $10. At this point, the quantity of pizzas demanded and the quantity of pizzas supplied are the same—1000 pizzas per week.

The E-Business and Social Media Solutions box entitled "The Lucrative Business of App Development" describes some of the success stories and major players in the social media environment.

DEMAND AND SUPPLY SCHEDULE Assessment of the relationships between different levels of demand and supply at different price levels.

DEMAND CURVE Graph showing how many units of a product will be demanded (bought) at different prices.

SUPPLY CURVE Graph showing how many units of a product will be supplied (offered for sale) at different prices.

MARKET PRICE (EQUILIBRIUM PRICE) Profit-maximizing price at which the quantity of goods demanded and the quantity of goods supplied are equal.

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

The Lucrative Business of App Development

Snap Inc., the maker of Snapchat, joins the ranks of notable companies started by individuals who have resisted big buyout offers from Facebook. Snap Inc. passed on an offer of $3 billion for the company back in 2013, two years after the company was created by two Stanford college roommates. As CEO and founder, Evan Spiegel eventually decided to sell shares to the public in the form of an initial public offering (IPO) of stock (listed as SNAP: NYSE) and raised almost $5 billion establishing a market value of $33 billion for the company.

Jack Dorsey, who founded Twitter, turned down a $500 million offer from Facebook and then five years later took the company public. By the end of the day, the company had reached a value of more than $32 billion. But not everyone sells their shares on a stock market in order to reap the rewards of innovation. At about the same time, JackMa was starting up Alibaba, two former employees of Yahoo! quit their jobs, took a sabbatical, and then applied for jobs with Facebook but got turned down. Ever the entrepreneurs, Jan Koum and Brian Acton saw future opportunities in mobile apps and designed WhatsApp—one of the first messaging applications for smartphones. In an ironic turn of events, Facebook bought WhatsApp for a whopping $19.3 billion.

ZoomTeam/Fotolia

Snapchat is a popular photo messaging application that allows users to share. On average 700 million videos and photos are shared per day. Users set a time limit of one to ten seconds for their snaps. After that time, the message is deleted.

Of course, any success in business, whether traditional or in the social media realm, is based on real numbers. In Snapchat's case, 187 million people globally spend time on the social media app every day. *The Economist* reported that approximately 41 percent of Americans aged 18 to 34 use Snapchat every day. However, for people in emerging markets, Snapchat's data-intensive app is costly to access, and it doesn't have as wide an appeal to the public or advertisers as Facebook or even Twitter do. Whether Snap Inc. will be able to withstand all the competition, only time will tell. But the early results are promising. In fact, Snapchat has a stronger reputation among teenagers while companies like Facebook (that has made gains with an older crowd) are losing favour with this key demographic.

Based on the short history of social media applications, we know that there is always room for innovation and for a new technology to feed a tech-savvy population increasingly glued to their phones and devices. It's also true that no company can get too comfortable, as change is inevitable.

CRITICAL THINKING QUESTION

1. Look at the most recent statistics available on Snapchat. Is their user base still growing? Do you believe Snapchat is gaining popularity, or do you see another new application eating into Snapchat's base?

Surpluses and Shortages

What would happen if the owner tried to increase profits by making more pizzas to sell? Or what if the owner wanted to reduce overhead, cut back on store hours, and reduce the number of pizzas offered for sale? In either case, the result would be an inefficient use of resources. For example, if the restaurant supplies 1200 pizzas and tries to sell them for $10 each, 200 pizzas will not be purchased. The demand schedule clearly shows that only 1000 pizzas will be demanded at this price. The pizza maker will therefore have a **surplus**—a situation in which the quantity supplied exceeds the quantity demanded. The restaurant will thus lose the money that it spent making those extra 200 pizzas.

Conversely, if the pizzeria supplies only 800 pizzas, a *shortage* will result, because the quantity demanded will be greater than the quantity supplied. The pizzeria will "lose" the extra money it could have made by producing 200 more pizzas. Even though consumers may pay more for pizzas because of the shortage, the restaurant will still earn lower profits than it would have if it had made 1000 pizzas. In addition, it may risk angering customers who cannot buy pizzas. To optimize profits, therefore, all businesses must constantly seek the right combination of price charged and quantity supplied. This "right combination" is found at the equilibrium point.

These supply and demand ideas apply to all sorts of commodities. The price of expensive truffles (an edible root) is also affected by the weather. Prices declined from about $5000 a pound to $2000 a pound in 2014 because good growing conditions caused large harvests of the product (more supply). That price declined as low as $1200 per pound in the next two years. However, in 2017 an unusually hot summer in Italy led to the worst crop in a decade, and with a minimal supply available, the price jumped back up to $4000 per pound.[24]

Atlantic fisherman must deal with supply and demand conditions. Even if they bring in a similar total catch from one year to the next, the rewards can vary greatly between seasons. Cape Breton fisherman Albert Sampson and his crew brought in over $500 000 worth of lobsters in one two-month season a couple of years ago. That was a particularly good year because the high demand for lobsters meant that he received $8 per pound, whereas he had received only $5.75 to $6.00 per pound the previous year. The supply is dependent on the overall catch of all fisherman, but when it comes to demand, many factors are at play. For example, the relative weakness of the Canadian dollar helped increase demand and contributed to higher prices for Albert and his fellow fisherman that season.[25]

Atlantic fisherman are all very familiar with the power of supply and demand.

Kevin Galvin/imageBROKER/Shutterstock

SURPLUS Situation in which quantity supplied exceeds quantity demanded.

LO-5 PRIVATE ENTERPRISE AND COMPETITION

Market economies rely on a **private enterprise** system—one that allows individuals to pursue their own interests with minimal government restriction. Private enterprise requires the presence of four elements: private property rights, freedom of choice, profits, and competition.

- *Private property.* Ownership of the resources used to create wealth is in the hands of individuals.[26]
- *Freedom of choice.* You can sell your labour to any employer you choose. You can also choose which products to buy, and producers can usually choose whom to hire and what to produce.
- *Profits.* The lure of profits (and freedom) leads some people to abandon the security of working for someone else and to assume the risks of entrepreneurship. Anticipated profits also influence individuals' choices of which goods or services to produce.
- *Competition.* Competition is evident when two or more businesses vie for the same resources or customers. While profits motivate individuals to *start* businesses, competition motivates them to *operate* their businesses efficiently. Competition forces businesses to make products better and/or cheaper.

Degrees of Competition

Economists have identified four basic degrees of competition within a private enterprise system: perfect competition, monopolistic competition, oligopoly, and monopoly.

Perfect Competition

In **perfect competition**, all firms in an industry are small, the number of firms in the industry is large, and the products produced by the different firms are virtually identical. Under these conditions, no single firm is powerful enough to influence prices, so the market forces of supply and demand determine them. Canadian agriculture is a good example of perfect competition. The wheat produced on one farm is the same as that on another. Both producers and buyers are aware of prevailing market prices. It is relatively easy to start producing wheat and relatively easy to stop when it is no longer profitable.

Monopolistic Competition

In **monopolistic competition**, there are fewer sellers, but many buyers. Businesses may be large or small, and small clothing stores, for example, can compete successfully with large apparel retailers such as Reitmans. Whatever their size, sellers try to make their products at least *seem* different from those of competitors, and this product differentiation (through

PRIVATE ENTERPRISE An economic system characterized by private property rights, freedom of choice, profits, and competition.

PERFECT COMPETITION A market or industry characterized by a very large number of small firms producing an identical product so that none of the firms has any ability to influence price.

Reitmans was founded in 1926 and serves Canadian men and women with 640 stores under the following retail banners: Reitmans, Penningtons Addition Elle, Thyme Maternity, RW&CO., and Hyba.

JHVEPhoto/Shutterstock

traditional media advertising, social media, and other brand-building tools) gives sellers some control over prices. For instance, even though a shirt sold at The Bay (from a fairly unknown brand) may look pretty much like a Ralph Lauren Polo shirt, the latter can be priced $20 higher.

Oligopoly

When an industry has only a handful of very large sellers, an **oligopoly** exists. Entry into an oligopolistic market is difficult because large capital investment is usually necessary. Thus oligopolistic industries (such as the automobile, rubber, and steel industries) tend to stay oligopolistic.

Companies in an oligopoly market have more control over their strategies than monopolistically competitive firms do, but the actions of one firm can significantly affect the sales of every other firm in the industry. For example, when one firm cuts prices or offers incentives to increase sales, the others usually protect sales by doing the same. Likewise, when one firm raises prices, others generally follow. Therefore the prices of comparable products are usually similar. Ultimately, the firms usually realize that they are better off fighting for market share on features and benefits rather than price. In simple terms, cooperation in this industry leads to better profits for all. Overly aggressive actions (especially price cuts) hurt all companies in an oligopoly industry.

To understand oligopoly competition, look no further than your game console. Nintendo, Sony, and Microsoft have been going head-to-head for years. The industry was worth US$36.2 billion in 2017. These three major console manufacturers literally own that market. Sony leads the pack (main console: PS4), Microsoft is second (main console: Xbox One), and Nintendo ranks third.[27]

Monopoly

When an industry or market has only one producer, a **monopoly** exists. Being the only supplier gives a firm complete control over the price of its product. Its only constraint is how much consumer demand will fall as its price rises. In Canada, laws such as the Competition Act forbid most monopolies. So-called *natural monopolies*—such as provincial electric utilities—are closely watched by provincial utilities boards, and the assumption that there is such a thing as a natural monopoly is increasingly being challenged. For example, the volume of mail that Canada Post handles has declined, and it has been losing millions

Nintendo, Sony, and Microsoft exemplify oligopoly conditions in the game console industry, as these three literally own the market.

Robtek/Shutterstock

of dollars annually in recent years.[28] There have been repeated calls to end its monopoly on letters weighing less than 500 grams (competition from companies such as FedEx and UPS is allowed for parcels and express mail). During the10 years since it became a Crown corporation, Canada Post has raised its rates by 41 percent. By contrast, postal rates have dropped in countries where the post office has been privatized (e.g., Germany and the Netherlands).[29]

Producers in several industries in Canada operate under a system called *supply management*, which has some of the characteristics of a monopoly. Domestic production quotas are established for commodities such as dairy products, maple syrup, eggs, chickens, and turkeys. Producers of these commodities are not allowed to produce more than the quota they have been granted. To prevent foreign competitors from entering the market, high tariffs are charged on imports of these commodities (e.g., the tariff on butter is 299 percent, on cheese 246 percent, and on milk 241 percent).[30] The supply management system continues to operate despite evidence that it increases costs to consumers, encourages smuggling, reduces innovation, and inhibits exports.

The recent North American Free Trade Agreement renegotiation talks put supply management back on the front pages. An article in *MacLean's* magazine put it this way: "Why Is Canada Jeopardizing NAFTA to Protect 13,500 Farmers?" Not only did the United States repeatedly point to the dairy, poultry, and egg producers supply system, but this issue was also a sticking point in the Trans-Pacific trade negotiations. In addition, this is not simply an issue with foreign governments; many opponents exist within Canada. One study estimated that supply management leads to approximately $399 in extra food costs annually, and because these extra amounts are attached to basic goods, they hit low-income families particularly hard.[31]

Clearly, supply management creates artificial barriers and is anti-free trade. Yet the Canadian government refuses to eliminate this system. The US maintains similar "America First:" policies that also go against the spirit of free trade. Despite these positions, in late 2018, Canada signed the newly named USMCA (NAFTA 2.0). In order to make the deal, the Canadian government agreed to further open up the dairy market by 3.59% to American Dairy farmers (this topic will be discussed in detail in chapter 5).

MONOPOLISTIC COMPETITION A market or industry characterized by a large number of firms supplying products that are similar but distinctive enough from one another to give firms some ability to influence price.

OLIGOPOLY A market or industry characterized by a small number of very large firms that have the power to influence the price of their product and/or resources.

MONOPOLY A market or industry with only one producer that can therefore set the prices of its products and resources.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 DEFINE THE NATURE OF CANADIAN *BUSINESS* AND IDENTIFY ITS MAIN GOALS.

Businesses are organizations that produce or sell goods or services to make a profit. *Profits* are the difference between a business's revenues and expenses. The prospect of earning profits encourages individuals and organizations to open and expand businesses. The benefits of business activities also extend to wages paid to workers and to taxes that support government functions.

LO-2 DESCRIBE DIFFERENT TYPES OF GLOBAL *ECONOMIC SYSTEMS* ACCORDING TO HOW THEY CONTROL THE *FACTORS OF PRODUCTION* THROUGH *INPUT* AND *OUTPUT MARKETS*.

An *economic system* is a nation's system for allocating its resources among its citizens. Economic systems differ in terms of who owns or controls the five basic *factors of production*: labour, capital, entrepreneurs, natural resources, and information. In *command economies*, the government controls all or most of these factors. In *market economies*, which are based on the principles of capitalism, individuals and businesses control the factors of production and exchange them through input and output markets. Most countries today have *mixed market economies* that are dominated by one of these systems but include elements of the other. The processes of *deregulation* and *privatization* are important means by which many of the world's planned economies are moving toward mixed market systems.

LO-3 DESCRIBE THE INTERACTIONS BETWEEN BUSINESS AND GOVERNMENT IN CANADA.

Government plays many important roles within the Canadian economic system, and in so doing, it influences business firms. Government can play the role of *customer*, *competitor*, *regulator*, *taxation agent*, *provider of incentives*, and *provider of essential services*. Businesses can influence government by lobbying, joining trade associations, and trying to convince voters to support or oppose certain regulations.

LO-4 SHOW HOW *DEMAND* AND *SUPPLY* AFFECT RESOURCE DISTRIBUTION IN CANADA.

The Canadian economy is strongly influenced by markets, demand, and supply. *Demand* is the willingness and ability of buyers to purchase a good or service. *Supply* is the willingness and ability of producers to offer goods or services for sale. Demand and supply work together to set a *market* or *equilibrium price*—the price at which the quantity of goods demanded and the quantity of goods supplied are equal.

LO-5 IDENTIFY THE ELEMENTS OF *PRIVATE ENTERPRISE* AND EXPLAIN THE VARIOUS *DEGREES OF COMPETITION* IN THE CANADIAN ECONOMIC SYSTEM.

The Canadian economy is founded on the principles of *private enterprise*: private property rights, freedom of choice, profits, and competition. Degrees of competition vary because not all industries are equally competitive. Under conditions of *pure competition*, numerous small firms compete in a market governed entirely by demand and supply. In *monopolistic competition*, there are fewer sellers, and each one tries to make its product seem different from the products of competitors. An *oligopoly* involves only a handful of sellers who compete with each other. A *monopoly* involves only one seller.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Give an example of a situation in which a surplus of a product led to decreased prices. Similarly, give an example of a situation in which a shortage led to increased prices. What eventually happened in each case? Why?
2. The Canadian government has provided export assistance to Bombardier Inc. with its Technology Transfer Program. Is this consistent with the principles of a free market system? Explain how this might distort the system.
3. Explain how current economic indicators, such as inflation and unemployment, affect you personally. Explain how they may affect you as a manager.
4. Familiarize yourself with a product or service that is sold under conditions of pure competition. Explain why it is an example of pure competition and identify the factors that make it so. Then do the same for a product in each of the other three competitive situations described in the chapter (monopolistic competition, oligopoly, and monopoly).
5. Government plays a variety of roles in the Canadian mixed economy (customer, regulator, taxation agent, provider of services, and so on). Consider each of the roles discussed in this chapter and state your view as to whether government involvement in each role is excessive, insufficient, or about right. What criteria did you use to make your assessments?

APPLICATION EXERCISES

6. Visit a local shopping mall or shopping area. List each store that you see and determine what degree of competition it faces in its immediate environment. For example, if there is only one store in the mall that sells shoes, that store represents a monopoly. Note those businesses with direct competitors (e.g., two jewellery stores) and show how they compete with one another.
7. Pick a specific product that you use. Explain how the factors of production work together to make that product available.
8. Interview a business owner or senior manager. Ask this individual to describe for you the following things: (1) how demand and supply affect the business, (2) what essential factors of production are most central to the firm's operations, and (3) how fluctuations in economic indicators affect his or her business.

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

Build a team of three to five classmates. You will be working with this team throughout the semester to make decisions about the launch of a new product.

ASSIGNMENT

Meet with your team members and develop specific responses to the following:

1. Have each team member work individually to identify at least three trends that will create business opportunities. Come together as a group and create a master list of trends.
2. Which trend do you think creates the greatest opportunity for success? Why?
3. Identify a product, either a good or a service, that will allow your team to take advantage of this opportunity. Although you will refine this throughout the semester, write a four- to six-sentence description of your product and how it will spark buyer interest.
4. Who is your competition for this product, either direct competition or substitute products? Is competition a good sign for your business?

BUILDING YOUR BUSINESS SKILLS

ANALYZING THE PRICE OF DOING BUSINESS

GOAL

To encourage students to understand how competition affects a product's price.

SITUATION

Assume that you are the owner of a local gym and fitness studio. You've worked hard to build a loyal customer base, and your facility is top-notch, with the latest equipment and a variety of classes for customers at all fitness levels. Within your geographical area, there are three other gyms, each charging the same price ($40 per month for individuals, $60 per month for couples, and $75 per month for families). However, you've become concerned because one of your competitors has just announced that it is reducing membership costs by $10 per month for each of the three categories of memberships. Rumour has it that another facility plans to follow suit in the near future. You can't afford to get into a price war because you are just barely making a profit at your current price structure.

METHOD

Divide into groups of four or five people. Each group is to develop a general strategy for handling competitors' price changes. In your discussion, take the following factors into account:

- how the demand for your product is affected by price changes
- the number of competitors selling the same or a similar product
- the methods—other than price—you can use to attract new customers and retain current customers

ANALYSIS

Develop specific pricing strategies based on each of the following situations:

- A month after dropping prices by $10 per month, one of your competitors returns to your current pricing level.
- Two of your competitors drop their prices even further, reducing membership costs by a further $5 per month. As a result, your business falls off by 25 percent.
- One of your competitors announces that it will keep its prices low, but it will charge members $2 per session for high-demand classes such as Pilates.
- Each of the competitors that lowered their price makes an adjustment, with reduced rates for families and couples, but they plan to return to $40 per month for singles.
- All four providers (including you) have reduced their monthly fees. One gym goes out of business, and you know that another one is in poor financial health.

FOLLOW-UP QUESTIONS

1. Discuss the role that various inducements other than price might play in affecting demand and supply in the market.
2. Is it always in a company's best interest to feature the lowest prices?
3. Eventually, what form of competition is likely to characterize this market?

EXERCISING YOUR ETHICS

GETTING CAUGHT OUT IN THE COLD

THE SITUATION

You are the owner of a small company that provides heating oil to residential and business customers in Central Canada. The business has been in your family for several generations, and you are a well-respected member of the community.

Although the business had once provided a steady income for you and your family, increased energy efficiency and a move away from oil heat have cut your profits to almost nothing in recent years.

THE DILEMMA

After the retirement of your long-time marketing manager, you've hired a recent college graduate named Seema. She has analyzed your firm's financial position, as well as the most up-to-date demographic and market information. In the prior heating season, oil prices were quite high, and your customers became accustomed to paying more than $1.15 per litre. You've done your research, though, and know that it's very likely that the price that you must pay suppliers will be much lower this winter because of an increase in the supply of heating oil as more and more customers in other geographic areas switch to natural gas. While you're hoping to pass these cost savings on to your customers, Seema is recommending just the opposite. She proposes that you send out a "special offer" to your customers, allowing them to lock into a price of $1.05 per litre for the upcoming heating season, although you think that you could sell profitably at a much lower price. She believes that many of your customers will jump at the opportunity and that you will be able to make a significant profit during the upcoming winter. On the one hand, it would be nice to generate a large profit and rebuild your savings, but on the other hand, you're wondering if this is really the right thing to do.

QUESTIONS TO ADDRESS

1. What are the roles of supply and demand in this scenario?
2. What are the underlying ethical issues?
3. What would you do if you were faced with this situation?

BUSINESS CASE 1

ALPHABET: G IS FOR GOOGLE

"Google is not a conventional company. We do not intend to become one." The co-founders also said: "As part of that, we also said that you could expect us to make 'smaller bets in areas that might seem very speculative or even strange when compared to our current businesses.' From the start, we've always strived to do more, and to do important and meaningful things with the resources we have." Sergey Brin and Larry Page represent the fundamental idea and driving force behind the company that now has over 80 000 employees worldwide and that has created multiple platforms that satisfy consumer needs, such as Search, Gmail, Google Maps, and Chrome. The co-founders recently chose to reorganize and name their new holding company Alphabet because they felt that it held a dual meaning, as a collection of letters that represent language and as a reference to the investment term alpha (returns above a benchmark).

Just as you observed in our opening case, the co-founders met at university (Who's sitting next to you now?). They were graduate students in computer science. At the time, Page was working on a software development project designed to create an index of websites by scouring sites for keywords and other links. Brin joined him on the project, and when they were satisfied that they'd developed something with commercial value, they tried to license the technology to other search companies. Fortunately, they couldn't find a buyer and settled instead for finding enough investment capital to keep refining and testing their product.

At the turn of the century, Brin and Page ran across the description of a business model based on the concept of selling advertising in the form of sponsored links and search-specific ads. They adapted it to their own concept and went into business for themselves, eventually building Google into the world's largest search engine. But their ambitions and

innovations didn't stop there. By 2018, they had purchased well over 200 companies, such as Android, YouTube, and DoubleClick, always striving to further their mission: to organize the world's information and make it universally accessible and useful. To better separate all the different directions the business had taken, Brin and Page created a holding company called Alphabet in 2015 and turned the control of Google over to an up-and-coming star manager named Sundar Pichai. Alphabet's annual revenue rose to US$110.9 billion in 2017 (up approximately 23%), as Google, its major subsidiary, provided more than 80 percent of the world's search market.

Mark Lennihan/Earns Alphabet/The CP Images

Brin and Page have been extremely effective in attracting talented, creative employees, like Pichai, and providing them with a work environment and culture that fosters productivity and innovation. They've also remained at the forefront of Alphabet's search for innovations, but nobody knows for sure what Brin and Page have on the drawing board. In fact, outsiders—notably potential investors—often criticize Google for being a "black box" whereas they want a few more details on the company's long-range strategy. "We don't talk about our strategy," explains Page, "… because it's strategic. I would rather have people think we're confused than let our competitors know what we're going to do."

One of the reasons for creating Alphabet was to provide greater transparency, but the company seems to have missed that mark. What we do know is that Alphabet's semi-secret research facility "X," also known as the "moonshot factory," is currently working on a self-driving car, fuel from seawater, and other long-shot, innovative projects that may or may not pan out. If there is a long-term strategic vision, it may be simply to provide the resources and freedom to some of the best and brightest dreamers in the world and then to let their ideas develop into the reality of the future.[35]

QUESTIONS FOR DISCUSSION

1. What are the secrets to Google's success? What role, if any, did luck play?
2. Describe the factors of production as they relate to Alphabet. How does this example demonstrate the foundations of free market economies?
3. What role do governments play in the day-to-day operations of a company like Alphabet? Describe some of the ways governments can help this global organization as well as ways that governments may hurt this organization.

MyLab Intro to Business

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The Environment of Business

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Explain the concepts of *organizational boundaries and multiple organizational environments*.
- **LO-2** Explain the importance of the *economic environment* to business and identify the factors used to evaluate the performance of an economic system.
- **LO-3** Describe the *technological environment* and its role in business.
- **LO-4** Describe the *political–legal environment* and its role in business.
- **LO-5** Describe the *socio-cultural environment* and its role in business.
- **LO-6** Identify emerging challenges and opportunities in the *business environment*.
- **LO-7** Understand recent trends in the *redrawing of corporate boundaries*.

Growth and Success: A Few Dollars at a Time

Quick, look at these numbers. In 2018, Dollarama had 1160 retail locations across Canada, with annual sales of $3.27 billion and a total market capitalization of $13 billion. The stock had already appreciated 1800 percent since going public nine years earlier! Are you impressed yet? You should be. At a time when retailers are struggling, Dollarama continues to grow and exceed market expectations. In 2018, revenues were up 10 percent, and same-store sales (a key retail metric) increased by 5.5 percent, while average customer transactions increased by 5.8 percent. Profits were also up 17 percent (at $519 million). At the time, Dollarama had also announced a 3-for-1 stock split. Those who invested in Dollarama shares at the initial public offering were richly rewarded. Plenty of analysts still predicted more sustained growth ahead. Irene Nantel, from RBC Dominion Securities, believed the stock could continue to appreciate in the15-to-20-percent growth range. Such positive reviews were based largely on projections of more store openings, higher price points, and the decision to accept credit cards. The dollar store is now also the $4 store; more than 67 percent of company sales now come from products priced above $1.25.

Dollarama Origins

How did this story take shape? Dollarama was founded in 1992 by Larry Rossy, but arguably this success goes back to 1910 when his grandfather Salim Rossy opened his first shop, S-Rossy Inc. Larry Rossy earned his stripes running that family business from 1973 to 1992. As a third-generation member of this business dynasty, Larry Rossy drew on a wealth of knowledge and experience in the retail trade, which he applied as the founder and chairman of Dollarama in 1992. Like most business success stories, the key ingredients to Dollarama's success were an innate ability to understand an ever-changing external environment; good, timely decisions; and strong execution.

Off-price retailers have always been in the marketplace, but Dollarama was formed to embrace the dollar

Kathy deWitt/Alamy Stock Photo

retail concept that was gaining prominence across North America at the time. Later, in 2009 when Dollarama went public with a stock market IPO, the economy was suffering, and consumers were scrambling for low-price solutions. The timely funding gave the company more financial tools to expand and establish a dominant place in Canadian retail. Dollarama satisfied the low-cost, no-frills niche and created a mega-success in the process. After presiding over the rise of the Dollarama empire, Larry Rossy officially stepped down in 2018 passing the reins to his son Neil Rossy (CEO and fourth-generation retailer) and Stephen Gunn (chairman).

Competition, Always Threatening

Success inevitably leads to new competition. Dollarama already has plenty of domestic dollar stores to contend with, but a new entry into the Canadian landscape threatens to put up a real fight. Miniso, based out of Japan, recently opened a handful of stores with plans to open 50 in British Columbia, Alberta, Quebec, and Ontario by the end of 2018. It also announced ambitious intentions to open 500 locations across Canada by the end of 2021.

According to CEO Neil Rossy, "The retail environment is relatively stable. It is always very competitive. Competitors enter, and others leave." Dollarama has found a way to meet all challenges. That does not mean the company is resting on its previous success. In 2018, Dollarama invested heavily in its e-commerce platform to begin selling some of its products in bulk online. In addition, it was also adding new technology, giving associates hand-held scanners to improve efficiency, while also adding smart cameras in stores. A new emphasis was placed on analytic tools to help improve merchandising and identify risks. In addition, Dollarama was in the process of doubling the size of its primary distribution centre to 500,000 square feet by the end of 2019.

Looking Abroad?

Foreseeing the upper limits of your potential expansion may be a difficult exercise in that everyone wants to imagine that the good times will continue forever, but there are limits to growth. Perhaps the future of Dollarama's story lies in international markets. With that in mind, Dollarama has already forged a relationship to sell products to Dollar City, which has 77 stores in El Salvador and Columbia. Dollarama has an option to buy the Latin American chain in 2020. Is this the beginning of a new phase?

Legal Questions and Government Challenges

International markets are a definite path to consider for growth, but such moves bring new challenges from foreign governments looking to protect local interests. Moreover, Dollarama faces legal issues at home; it has not always lived a squeaky-clean life in Canada. It is notorious for selling knock-off products such as "Might be Mars" chocolates and look-alike Milk-Bone treats for dogs. In fact, Dixon, maker of the classic yellow HB pencils that we all used in elementary school, is suing Dollarama for blatantly copying its product. Should Dollarama be worried? Well, the Canadian government did update its counterfeit laws in 2015 and promised a tougher stance. However, because of a lack of enforcement, the new laws have not changed practices so far. In one recent year, only 50 shipments were seized at Canadian customs for counterfeiting, whereas 36,500 shipments were seized in the United States. If the government decides to get aggressive in this matter, it may force Dollarama to make changes.

Moving Forward

According to Dollarama's own estimates, it is near the perceived saturation point for new stores in Canada. However, new competitors are entering from abroad. Will Dollarama rethink that maximum? The company is also looking at new

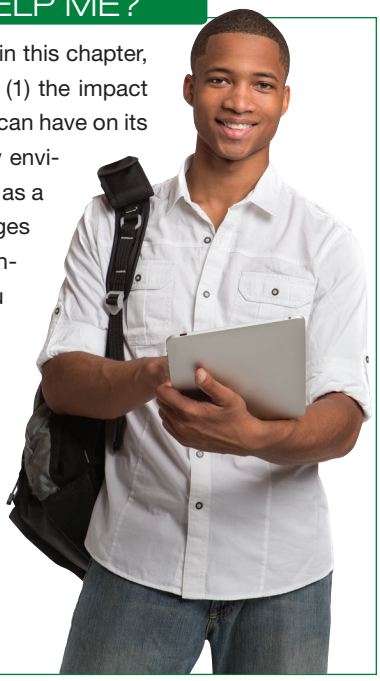
technology to help build bulk sales. If indeed the company is nearing a saturation point in Canada, it is not yet clear where the future resources will be placed. To continue this run of growth, the company will need to do what it has done in the past. Its leaders must ensure that they are effectively analyzing the external environment and executing strategies to take advantage of the key emerging trends. Based on their track record, it is hard to bet against them.

QUESTIONS FOR DISCUSSION

1. What are the biggest competitive challenges to long-term success and profitability for Dollarama?
2. How do the external factors other than competition (economy, technology, socio-cultural, and political–legal) impact Dollarama?
3. Form a group of four to six people and divide them into two groups. One group will provide arguments in favour of international expansion. The other group will prepare opposing arguments. Debate the main points.

HOW WILL THIS HELP ME?

By understanding the material in this chapter, you'll be better able to assess (1) the impact that events outside a business can have on its *owners* and *managers*, (2) how environmental change impacts you as a *consumer*, and (3) the challenges and opportunities that environmental change provides to you as an employee or an *investor*.



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LO-1 ORGANIZATIONAL BOUNDARIES AND ENVIRONMENTS

All businesses, regardless of their size, location, or mission, operate within a larger external environment that plays a key role in determining their success or failure. The **external environment** consists of everything outside an organization that might affect it. Managers must understand the key features of the external environment and then operate proactively to compete within it. The opening case on Dollarama is a great example of a company that understood external forces and made strategic decisions to exploit opportunities.

To better explain the environment of business, we begin by discussing organizational boundaries and multiple organizational environments.

Organizational Boundaries

An *organizational boundary* separates the organization from its environment. Consider the simple case of a neighbourhood grocery store that includes a retail customer area, a storage room, and the owner or manager's office. In many ways, the store's boundary coincides with its physical structure; when you walk through the door, you're crossing the boundary into the business, and when you leave and return to the sidewalk, you

EXTERNAL ENVIRONMENT Everything outside an organization's boundaries that might affect it.

Alex Brandon/AP images

>>> Bauer has been around since 1927, and in that time, it has adjusted to many external shocks (especially technological and economic ones). It has not been all smooth sailing in recent years, but the new owners, Peak Achievement Athletics, are monitoring the environment to meet the needs of consumers of a brand that's synonymous with hockey.

cross the boundary back into the environment. But this is an oversimplification. During the business day, distributors of soft drinks, snack foods, ice, and bread products may enter the store, inventory their products, and refill coolers and shelves just as though they were employees. These distributors are normally considered part of the environment rather than the organization, but while inside the store, they are essentially part of the business. Customers may even assume these distributors are store employees and ask them questions as they restock shelves.

Now consider cases of large domestic businesses (e.g., GM Canada) that are owned by even larger international corporations (e.g., U.S.-based General Motors). Domestic businesses have complex networks of relationships with other businesses. For example, Magna International conducts research and builds components for GM. GM Canada also deals with companies that supply tires, glass, steel, and engines. But GM Canada also functions within the boundaries of its international parent, which has its own network of business relationships, some overlapping and some distinct from GM Canada's network.

Multiple Organizational Environments

Organizations have multiple environments. Some conditions, such as current economic conditions, affect the performance of almost every business. But other environmental dimensions are much more specific. The neighbourhood grocery store, for example, will be influenced not only by an increase in unemployment in its area but also by the pricing and other marketing activities of its nearest competitors.

Figure 2.1 shows the major elements of the external environment: economic conditions, technology, political–legal considerations, social issues, the global environment, issues of ethical and social responsibility, the business environment itself, and emerging challenges and opportunities. We will cover ethical and global issues in detail in Chapters 3 and 5, respectively, so here we discuss ethical and global issues only as they relate directly to the other areas covered in this chapter.

LO-2 THE ECONOMIC ENVIRONMENT

The **economic environment** refers to the conditions of the economic system in which an organization operates.[1] In recent years, the economic environment has been characterized by low growth, fairly low unemployment rates, and low inflation. During periods of rising unemployment, people are less likely to make unnecessary purchases, and they may delay the purchase of a new car or new furniture. The fear of a potential job loss or an uncertain pay cheque is a very powerful enemy of the economy. It's only rational to reduce your spending in tougher times, but this also means that less needs to be produced, which can ultimately lead to more job losses for the economy. In a positive economic period, momentum pushes unemployment down as consumers spend more.

Despite low overall inflation, rising costs (i.e., from labour laws increasing minimum wage) have put economic pressure on businesses in many sectors. Restaurants and grocery stores have increased prices, reduced shifts, or reduced package sizes to compete. For example, Loblaws raised the price of its President's Choice Granola cereal from $4.99 to $5.79, while shrinking the package from 800 to 750 grams.[2] As seen in the opening case, many companies that cater to low-cost interests of consumers, such as Dollarama and Costco, thrive in the tough economic times as consumers search for cheaper prices.

Economic Growth

At one time, about half of the Canadian population was involved in producing the food that we eat. Today, approximately 2.1 percent of the population works in agriculture, mainly because agricultural efficiency has improved so much that far fewer people are needed to produce the food we need.[3] We can therefore say that agricultural production has grown because the total output of the agricultural sector has increased. We can apply the same idea to a nation's economic system, but the computations are much more complex, as we will see.

Aggregate Output and the Standard of Living

How do we know whether an economic system is growing? The main measure of growth is **aggregate output**: the total quantity of goods and services produced by an economic system during a given period.[4] To put it simply, an increase in aggregate output is economic growth.[5] When output grows more quickly than the population, two things usually follow: output per capita (the quantity of goods and services per person) goes up, and the system provides relatively more of the goods and services that people want.[6] And when these two things occur, people living in an economic system benefit from a higher *standard of living*—the total quantity and quality of goods and services they can purchase with the currency used in their economic system.

The Business Cycle

The growth (and contraction) pattern of short-term ups and downs in an economy is called the **business cycle**. It has four recognizable phases: peak, recession, trough, and recovery (see Figure 2.2). A recession is usually defined as two consecutive quarters when the economy shrinks, but it is probably more helpful to say that a recession starts just after the peak of the business cycle is reached and ends when the trough is reached.[7] A depression occurs when the trough of the business cycle extends two or more years. Periods of expansion and contraction can vary from several months to several years.

Gross Domestic Product and Gross National Product

The term **gross domestic product (GDP)** refers to the total value of all goods and services produced within a given period by a national economy through

ECONOMIC ENVIRONMENT Conditions of the economic system in which an organization operates.

AGGREGATE OUTPUT Total quantity of goods and services produced by an economic system during a given period.

BUSINESS CYCLE Pattern of short-term ups and downs (expansions and contractions) in an economy.

GROSS DOMESTIC PRODUCT (GDP) Total value of all goods and services produced within a given period by a national economy through domestic factors of production.

FIGURE 2.1 Dimensions of the external environment

domestic factors of production. Canada's GDP in 2017 was $2.1 trillion.[8] According to Statistics Canada, that represented a 3 percent increase, which was the best result in six years.[9] Global GDP was approximately $76 trillion; the top five countries were the United States, China, Japan, Germany, and the United Kingdom.[10] If GDP rises, a nation experiences economic growth.

GDP measures all business activity within a nation's borders, and it has widely replaced **gross national product (GNP)**, which refers to the total value of all goods and services produced by a national economy within a given period regardless of where the factors of production are located. For example, Bombardier is a Canadian company that manufactures planes and trains and has a total of 73 production and engineering facilities spread across 28 countries.[11] All the manufacturing that occurs in its foreign plants (including Kansas, Mexico, Ireland, and Morocco) is included in the Canadian GNP but not in its GDP—because its output is not produced in Canada. Conversely, those figures are included in the GDP of those nations (United States, Mexico, Ireland, and Morocco, respectively) but not their GNP—because the output is produced inside their borders by a Canadian company.

GDP is now the key measure of economic growth because it tracks an economy's performance over time. However, some argue that such measures are flawed. According to one study, more attention should be paid to other indicators, such as rising debt. An article in *The Economist* even referred to GDP as a "grossly deceptive product."[12]

Real Growth Rates GDP is the preferred method of calculating national income and output. The real growth rate of GDP—the growth rate of GDP adjusted for inflation and changes in the value of the country's currency—is what counts. Remember that growth depends on output increasing at a faster rate than population. If the growth rate of GDP exceeds the rate of population growth, then our standard of living should be improving.

GROSS NATIONAL PRODUCT (GNP) Total value of all goods and services produced by a national economy within a given period regardless of where the factors of production are located.

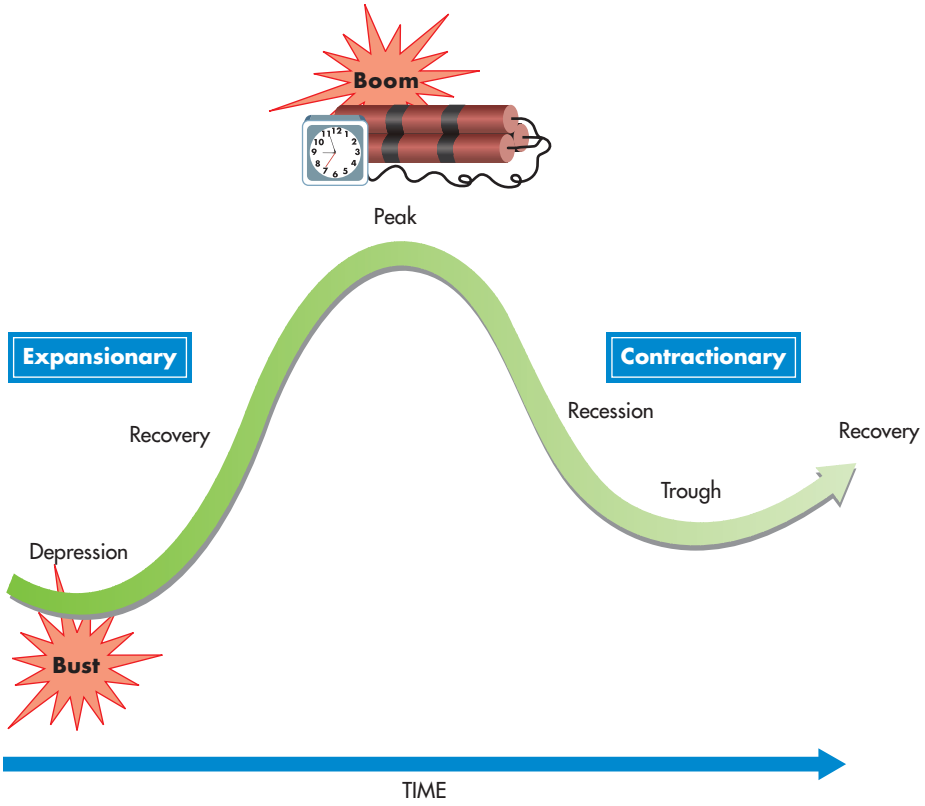

FIGURE 2.2 The business cycle

GDP Per Capita **GDP per capita** means GDP per person. We get this figure by dividing total GDP by the total population of a country. As a measure of the economic well-being of the average person, GDP per capita is a better measure than GDP. Luxembourg has the highest GDP per capita (approximately US$100 738), followed by Switzerland (US$79 887), Macao SAR, China (US$74 017), and Norway (US$70 068). Canada ranked eighteenth at US$42 183 GDP per capita.[13]

Real GDP **Real GDP** means that GDP has been adjusted. To understand why adjustments are necessary, assume that pizza is the only product in an economy. Assume that a pizza cost $10 in 2018 and $11 in 2019. In both years, exactly 1000 pizzas were produced. In 2018, the GDP was $10 000 ($10 × 1000); in 2019, the GDP was $11 000 ($11 × 1000). Has the economy grown? No. Because 1000 pizzas were produced in both years, the aggregate output remained the same. If GDP is not adjusted for 2019, it is called *nominal GDP*, that is, GDP measured in current dollars.[14]

Purchasing Power Parity In our example, current prices would be 2019 prices. On the other hand, we calculate real GDP when we account for changes in currency values and price changes. When we make this adjustment, we account for both GDP and **purchasing power parity**—the principle that exchange rates are set so that the prices of similar products in different countries are about the same. Purchasing power parity gives us a much better idea of what people can buy. In other words, it gives us a better sense of standards of living across the globe.

Productivity

A major factor in the growth of an economic system is **productivity**, which is a measure of economic growth that compares how much a system produces with the resources needed to produce it. Let's say, for instance, that it takes 1 Canadian worker and 50 Canadian dollars to make 10 pairs of leather boots in an 8-hour workday. Let's also say that it takes 1.2 Spanish workers and the equivalent of $60 (in euros, the official currency used in Spain) to make 10 pairs of equivalent leather boots in the same 8-hour workday. We can say, then, that the Canadian boot manufacturing industry is more productive than the Spanish boot manufacturing industry.

The two factors of production in this simple case are labour and capital. According to the Organisation for Economic Co-operation and Development (OECD) rankings, Canada stood in sixteenth place with a productivity ratio of 48.9 percent. Ireland, Luxembourg, and Norway were the most productive nations at 83.1, 81.2, and 79.2 percent, respectively.[15] If more products are being produced with fewer factors of production, what happens to the prices of these products? They go down. Therefore as a consumer, you will need less of your currency to purchase the same quantity of these products. Thus your standard of living—at least with respect to these products—has improved.

The Balance of Trade and the National Debt

Several factors can help or hinder the growth of an economic system, but here we focus on just two of them: balance of trade and the national debt.

Balance of Trade The **balance of trade** is the economic value of all the products that a country exports minus the economic value of its imported products. For decades, Canada had a positive balance of trade. For example, from 2006 to 2008, Canada received $43 to $47 billion more from exports than it spent on imports annually, but that long trend was reversed in 2009 when Canada had a trade deficit of $6 billion, mainly because of the sharp rise in the Canadian dollar relative to the U.S. dollar at the time. However, in recent years, despite the fact that the Canadian dollar is once again weaker relative to that of the United States (its main trading partner), Canada had an overall trade deficit of $23.7 billion in 2017 (following deficits of $25.8 and $23.7 billion in the two previous years).[16] So what has changed? More manufacturing has moved overseas (e.g., more companies are shifting manufacturing to China and other countries with low labour costs), so even with a cheaper Canadian dollar, fewer products are being made in Canada to sell abroad.

A trade deficit negatively affects economic growth because the money that flows out of a country can't be used to invest in productive enterprises, either at home or overseas.

GDP PER CAPITA Gross domestic product per person.

REAL GDP GDP calculated to account for changes in currency values and price changes.

PURCHASING POWER PARITY Principle that exchange rates are set so that the prices of similar products in different countries are about the same.

PRODUCTIVITY Measure of economic growth that compares how much a system produces with the resources needed to produce it.

BALANCE OF TRADE The total of a country's exports (sales to other countries) minus its imports (purchases from other countries).

The balance of trade looks at all products, including popular imports such as the Sony PlayStation. Of course, Sony is a very popular Japanese game console manufacturer that makes products in Japan and China.

Epa european press photo agency b.v./Alamy Stock Photo

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. Inflation Calculator App **Source:** Cal Stephens **Key Features:** Provides up-to-date data for 18 international currencies.	Apple
2. The Economist World in Figures App **Source:** *The Economist* **Key Features:** Provides facts and figures for 190 sovereign states (GDP, inflation, population, etc.).	Apple, Android, Windows
3. State Debt–Public Debt Clock App **Source:** Appisode **Key Features:** Provides figures on the public debt of 50 countries (including debt per person and debt as percentage of GDP).	Android

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" economics apps and identify the key features.

National Debt A country's **national debt** is the amount of money the government owes its creditors. Like a business, the government takes in revenues (e.g., taxes) and has expenses (e.g., military spending, social programs). For many years, the government of Canada incurred annual **budget deficits**; that is, it spent more money each year than it took in. These accumulated annual deficits created a huge national debt (estimated to be above $651.5 billion at the beginning of 2018). This figure amounts to approximately $17 500 per citizen. When you include the debt of the federal crown corporations, Canadian debt surpassed the 1-trillion-dollar debt marker for the first time in its history in the 2018–2019 fiscal year.[17]

How does the national debt affect economic growth? When the government of Canada sells bonds to individuals and organizations (both at home and overseas), this affects economic growth because the Canadian government competes with every other potential borrower—individuals, households, businesses, and other organizations—for the available supply of loanable money. The more money the government borrows, the less money is available for the private borrowing and investment that increase productivity.

Take a look at the following "There's an App for That!" feature, which outlines three economics apps.

Economic Stability

A key goal of an economic system is *stability*, a condition in which the amount of money available in an economic system and the quantity of goods and services produced in it are growing at about the same rate. Several factors threaten stability—namely, inflation, deflation, and unemployment.

Inflation

Inflation is evident when the amount of money injected into an economic system outstrips the increase in actual output. When inflation occurs, people have more money to spend, but there will still be the same quantity of products available for them to buy. As they compete with one another to buy available products, prices go up. Before long, high prices will erase the increase in the amount of money injected into the economy. Purchasing power therefore declines. The stated goal of the Bank of Canada is to help maintain steady prices in the economy and see modest increases on a year-to-year basis of between 1 to 3 percent, with a midpoint target of 2 percent per year.[18]

Inflation varies widely across countries. One dramatic example occurred in Zimbabwe about a decade ago, when inflation reached an astonishing annual rate above 40 million percent (most countries have rates between 2 and 15 percent). Within a three-year span, one Zimbabwean dollar would have been worth 1 trillion Zimbabwean dollars. Many workers simply stopped going to their jobs because their pay was not enough to cover their bus fare.[19] The problem was finally solved when the government began allowing people to pay their bills using other currencies, such as the U.S. dollar and the South African rand.[20] Inflation was 4 percent at the beginning of 2018 in South Africa (the rand is a more stable measure of value in the region).[21]

Measuring Inflation: The CPI The **Consumer Price Index (CPI)** measures changes in the cost of a "basket" of goods and services that a typical family buys. What is included in the basket has changed over the years. For example, the first CPI in 1913 included items such as coal and spirit vinegar, whereas today it includes bottom-freezer fridges, flat-screen TVs, energy-saving light bulbs, and laser eye surgery.[22] These changes in the CPI reflect changes that have occurred in the pattern of consumer purchases. Figure 2.3 shows how inflation has varied over the past 30 years in Canada.

NATIONAL DEBT The total amount of money that a country owes its creditors.
BUDGET DEFICITS The result of the government spending more in one year than it takes in during that year.
INFLATION Occurrence of widespread price increases throughout an economic system.
CONSUMER PRICE INDEX (CPI) Measure of the prices of typical products purchased by consumers living in urban areas.

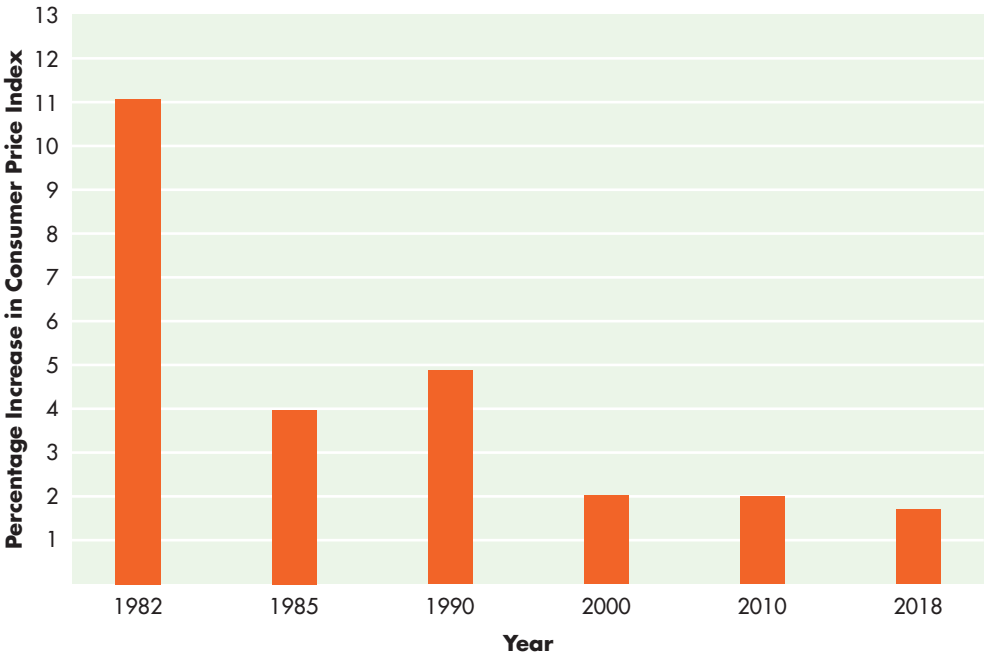

FIGURE 2.3 Price increases in Canada[23]

During the past 20 years, the rate of price increases in Canada has been low and quite stable.

Source: Bank of Canada website, CPI Statistics, https://www.bankofcanada.ca/rates/price-indexes/cpi/?page_moved=1, [April 1, 2018].

years, Maple Leaf Foods has increased prices based on rising costs for inputs such as corn and wheat, which have risen 95 percent and 102 percent, respectively, in one 12-month period alone.[24] What does this mean for consumers? According to Canada's Food Price report (drafted by researchers from Dalhousie University and the University of Guelph), average household food costs were set to increase by $348 for a family of four in 2018.[25]

Understanding the true source of inflation is not a simple task; it cannot be simplified and linked to just one issue. For example, lower oil prices logically lead to lower transport costs and therefore lower prices for food. However, lower oil prices tend to drive the Canadian dollar down (since Canada is an oil-producing country), and because Canadians rely on many food products from the United States (including meat, fruits, and vegetables), it becomes more expensive to buy those goods with a weaker exchange rate.[26] The government continuously monitors all known variables to try to make good decisions based on the reality in your local cities and shops.[27]

As mentioned earlier, even though official inflation rates, as measured by the CPI, have remained low, price (caused by issues such as increased fuel prices or minimum wage increases) has put pressure on companies in all sectors. Food manufacturers are particularly vulnerable. In recent

Deflation

Deflation (falling prices) is evident when the amount of money injected into an economic system lags behind increases in actual output. Prices may fall because industrial productivity is increasing and cost savings are being passed on to consumers (this is good) or because consumers have high levels of debt and are therefore unwilling to buy very much (this is bad).

Unemployment

At the beginning of 2018, 8.5 million men and 7.6 million women (over age 25) were working in Canada's labour force.[28] Many additional people wanted a job but could not get one. **Unemployment** is the level of joblessness among people actively seeking work. There are various types of unemployment: *frictional unemployment* (people are out of work temporarily while looking for a new job), *seasonal unemployment* (people are out of work because of the seasonal nature of their jobs), *cyclical unemployment* (people are out of work because of a downturn in the business cycle), and *structural unemployment* (people are unemployed because they lack the skills needed to perform available jobs). Unemployment rates have varied greatly over the years, as Figure 2.4 shows,

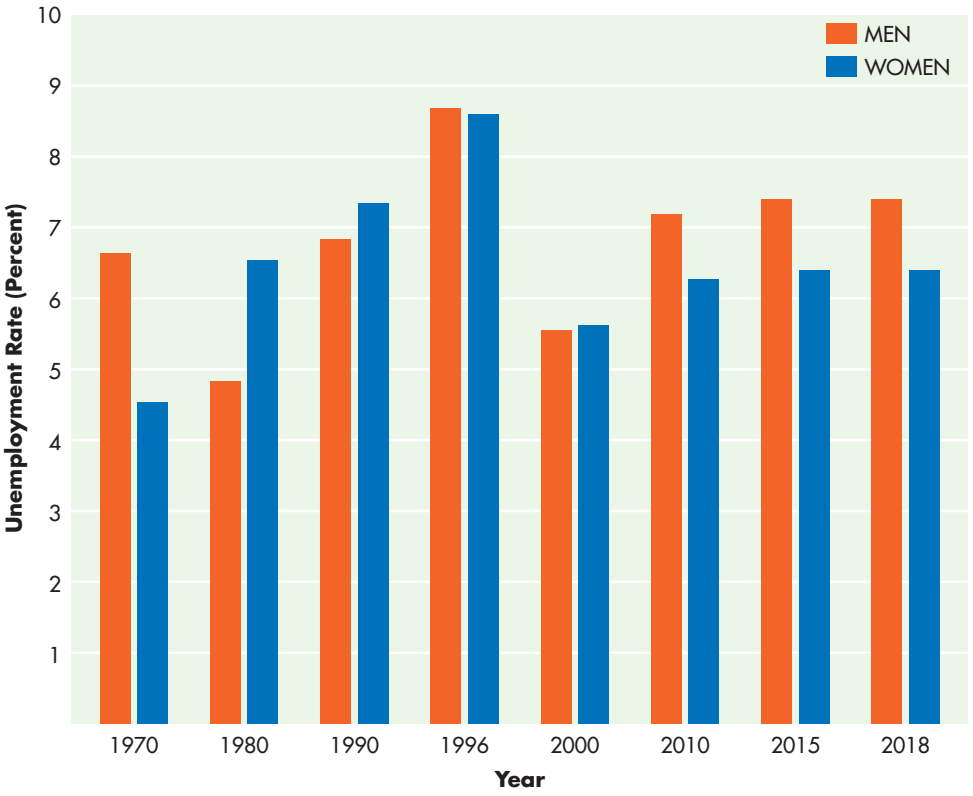

FIGURE 2.4 Historical unemployment rate[30]

Source: Statistics Canada, Labour Force Report.

DEFLATION A period of generally falling prices.
UNEMPLOYMENT The level of joblessness among people actively seeking work in an economic system.

with the rates for men generally being higher than the rates for women. At the beginning of 2018, the Canadian unemployment rate stood at 5.8 percent, which was the lowest rate in four decades![29]

When unemployment is low, there is a shortage of labour available for businesses. As businesses compete with one another for the available labour supply, they raise the wages they are willing to pay. Then, because higher labour costs eat into profit margins, businesses raise the prices of their products. If prices get too high, consumers will respond by buying less. Businesses will then reduce their workforces because they don't need to produce as much. But this causes unemployment to go up, and the cycle starts all over again.

Managing the Canadian Economy

The federal government manages the Canadian economic system through two sets of policies: fiscal and monetary. **Fiscal policies** involve the collection and spending of government revenues. For example, when the growth rate of the economy is decreasing, tax cuts will normally stimulate renewed economic growth. **Monetary policies** focus on controlling the size of the nation's money supply. Working primarily through the Bank of Canada (see Chapter 14), the government can influence the ability and willingness of banks throughout the country to lend money. The power of the Bank of Canada to make changes in the supply of money is the centrepiece of the Canadian government's monetary policy. The principle is fairly simple:

- Higher interest rates make money more expensive to borrow and thereby reduce spending by companies that produce goods and services and consumers who buy them. When the Bank of Canada restricts the money supply, we say it is practising a "tight" monetary policy.
- Lower interest rates make money less expensive to borrow and thereby increase spending by both the companies that produce goods and services and the consumers who buy them. When the Bank of Canada loosens the money supply, we say it is practising an "easy" monetary policy. During a financial crisis, central banks tend to cut their interest rates to stimulate their countries' economies.

FISCAL POLICIES Policies whereby governments collect and spend revenues.

MONETARY POLICIES Policies whereby the government controls the size of the nation's money supply.

LO-3 THE TECHNOLOGICAL ENVIRONMENT

As applied to the environment of business, *technology* generally includes all the ways firms create value for their constituents. Technology includes human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems that are used to perform business activities.

Research and Development (R&D)

Technological improvements and innovation in general are important contributors to the economic development of a country. The innovation process includes **research and development (R&D)**, which provides new ideas for products, services, and processes (see Chapter 12). There are two types of R&D. *Basic (or pure) R&D* involves improving knowledge in an area without a primary focus on whether any discoveries that might occur are immediately marketable. For example, chemists in a laboratory might examine how certain chemical compounds behave. The knowledge gained from this activity might or might not result in a marketable product. *Applied R&D*, on the other hand, means focusing specifically on how a technological innovation can be used in the making of a product or service that can be sold in the marketplace.

Do not simply link the importance of R&D to the new tech gadgets that consume all of us. Consider the canola industry, which is worth $8.6 billion and is still growing.[31] It was invented by Canadian scientists back in 1974 after they managed to remove undesirable elements from the rapeseed plant. Today canola oil is popular in cooking and deep frying because it is rich in fatty acids that lower bad cholesterol, and it does not have artery-clogging trans fats.[32] This crop occupies a large percentage of Canadian farmers' fields—25 percent of the total acres in Canada—and is surpassed only by wheat at 27 percent of farmers' land.[33]

The Canadian private sector accounted for about 54 percent of R&D, and universities supplied another 37 percent.[34] For a look at the important role and the long road from R&D to commercialization, read the boxed insert "Environmentally Friendly Automobiles."

Product and Service Technologies

Although many people associate technology with manufacturing, it is also a significant factor in the service sector. Just as an automobile follows a predetermined pathway along an assembly line, a hamburger at McDonald's is cooked, assembled, and wrapped as it moves along a predefined path. All aspects have been enhanced by technological developments with the latest being the ability to purchase a Big Mac trio via mobile order and payment systems.[35] The rapid advancement of the internet and

RESEARCH AND DEVELOPMENT (R&D) Those activities that are necessary to provide new products, services, and process.

Thanks to R&D conducted by Canadian Scientists, canola oil is now a staple product with $8.6 billion worth of demand. In recent decades, many farmers have converted their fields to take advantage of this demand.

Smileus/Shutterstock

THE GREENING OF BUSINESS

Environmentally Friendly Automobiles

Digital Storm/Shutterstock

At the 2017 Montreal Auto show, an impressive array of new electric vehicles (EVs) were on display. Included were Volkswagen's e-Golf, Honda's Clarity, Hyundai's Ioniq, and Nissan's Leaf. Suddenly there are lots of EVs to choose from; almost 50 new versions will come on the market by 2022. Toyota also introduced its Mirai fuel cell electric vehicle in 2018 in Quebec. In 2017, Volvo announced that all the new models it introduces in 2019 and later will be either hybrids or EVs. Countries such as France, Britain, Norway, China, and India have all announced plans to reduce or ban the sale of gas- and diesel-powered vehicles over the next couple of decades.

China has the largest number of registered EVs (336 000), but that is only 1.3 percent of the country's total car market. Worldwide in 2016, only 0.1 percent of the cars on the road were electric. But the number will likely rise to 10 percent of new cars sold by 2025, and by that year, EVs might constitute 4.5 percent of total vehicles on the road. At the time, electric car sales in Canada were 0.56 percent of total car sales. The Bourgeois Chevrolet Buick GMC car dealership in Rawdon, Quebec, is the top seller of EVs in Canada.

To date, the sale of EVs has been influenced by several factors: limited range, high purchase price, long charging times, and too few charging stations. But progress is being made in dealing with those shortcomings. For example, Toyota is introducing a hydrogen fuel cell vehicle that will get 1000 km per fill-up. That is double what the best EVs get now, and the fuel cell car can be refueled in just three minutes. Improved efficiencies in batteries have reduced battery prices, and this may make EVs cheaper than gas-powered cars by 2025. Work on further improvements in battery technology is ongoing at Dalhousie University and at Hydro Quebec's Montreal research lab.

Ontario has invested $200 million to build more charging stations and that increased availability should make consumers more willing to purchase an EV. Quebec and Ontario also pay subsidies to consumers who buy EVs. Ontario gives $13 000 to consumers who purchase a BMW i3 (the list price of the car is $48 000). Quebec also mandates minimum levels for sales of EVs. Starting in 2018, 3.5 percent of all auto sales in Quebec must be electric, hybrid, or hydrogen fuel cell vehicles. By 2025, the minimum increases to 15.5 percent. It is hoped that these incentives will result in a big increase in the number of EVs that are on the road. However, critics say that subsidizing electric cars is both expensive and ineffective. The Montreal Economic Institute says that the subsidies offered by Ontario and Quebec could cost those provinces a total of about $17 billion by 2030, but they will cut emissions by only 4 percent.

CRITICAL THINKING QUESTION

1. Consider the following statement: *"Giving money to consumers so they will be motivated to purchase an electric car is a bad idea. In a democratic, free-market society, it is much better to let consumers consider the various costs and benefits of each type of car and make their own decisions about which type they will purchase."* Do you agree or disagree with the statement? Explain your reasoning.

social media into all types of business functions, from human resources to marketing, to financial transactions, is also a reflection of the technological environment.

Companies must constantly be on the lookout for technological breakthroughs that might make their current products or services obsolete and thereby threaten their survival. Many breakthroughs do not come from direct competitors or even from the company's own industry. Technology is the basis of competition for some companies, especially when their goal is to be the technology leader in their industry. Apple revolutionized the home computer business and transformed the smartphone and music industries. More recently, the company has invested its resources in developing the Apple Watch. In 2018, Apple expected to increase annual sales from 16 million to anywhere between 22 and 24 million. To put this in perspective, traditional Swiss watchmakers were projected to sell 24 million watches as well.[36] Do you think those Swiss watchmakers saw Apple as a threat a decade ago? Times change.

Because of the rapid pace of new developments, keeping a leadership position based on technology is increasingly difficult. *Technology transfer* refers to the process of getting a new technology out of the lab and into the marketplace where it can generate profits for the company. Efficient technology transfer means an increased likelihood of business success,

Apple is betting consumers will flock to the new Apple Watch like they have to their other star products. Will the device deliver the promised benefits to the consumer and to the company's bottom line? Time will tell.

Pawan Kumar/Alamy Stock Photo

as discussed above. A related challenge is meeting the constant demand to decrease cycle time—the time from beginning to end that it takes a firm to accomplish a recurring activity or function. Since businesses are more competitive if they can decrease cycle times, many companies now focus on decreasing cycle times in areas such as developing products, making deliveries, and collecting credit payments.

LO-4 THE POLITICAL–LEGAL ENVIRONMENT

The **political–legal environment** reflects the relationship between business and government, including government regulation of business. The legal system defines what an organization can and can't do. Although Canada is a free-market economy, there is still significant regulation of business activity, as we saw in Chapter 1. At times, government policy can be tremendously advantageous to businesses. For example, the Yukon government has not raised taxes (royalties) on the extraction of gold since 1906. So the 2.5 percent export royalty is still based on a price of $15 per ounce of gold, which translates into a royalty of only 37.5 cents an ounce at a time when gold is selling at approximately US$1355 per ounce. In another case aimed to encourage an industry, there are over 100 000 electric vehicles (EVs) in Norway out of a population of 5 million. According to the government, there may not be any gas-fueled cars sold in the country by 2025. Why the boom? The government does not tax new electric vehicle purchases (other cars are taxed 25 percent). EVs also get a break on annual fees: they don't have to pay tolls, and they can use bus lanes to avoid traffic.[37] These are extreme examples of government-sponsored business-friendly practices.[38]

On the other hand, Shoppers Drug Mart has been very vocal about its opposition to Ontario government regulations that cut the price of generic drug payments to as low as 20 percent of the original brand name product's cost, down from 50 percent. This regulation is saving the province $55 million in costs but has hurt profits for pharmacies.[39] Recently, a similar fight took place between the Quebec government and Jean Coutu, and that public fight was a major reason behind a 30 percent decrease in the share price for the company.[40]

Society's general view of business (pro or anti) is also important. During periods of antibusiness sentiment, companies may find their competitive activities restricted. Even in positive times, the threat of government control is always there. Google was recently hit with a fine of 2.42 billion euros by European regulators! Why? The reason given was that Google was using its dominant search engine to favour its own shopping service.[41]

Political stability is also an important consideration, especially for multinational firms. No business wants to set up shop in another country unless trade relationships with that country are relatively stable. Thus Canadian firms are more likely to do business in England than in Iraq. Relations between sovereign governments can also affect business activity. On a smaller scale, similar issues occur at local and provincial levels. A new mayor or provincial leader can have an impact on organizations, especially small firms that do business in a single location and are subject to zoning restrictions, property and school taxes, and the like.

Read the following boxed insert, "The Physical Environment," to consider yet another important challenge for businesses that is beyond their control.

POLITICAL–LEGAL ENVIRONMENT Conditions reflecting the relationship between business and government, usually in the form of government regulation.

DISRUPTIONS IN BUSINESS

The Physical Environment

In this chapter, we focus on the impact of several "environments"—economic, technological, socio-cultural, political–legal, and emerging business trends—that have an impact on how business is conducted in Canada. But there is another "environment"—the physical environment—that also influences businesses activity. Extreme temperatures, floods, earthquakes, tornadoes, hurricanes, and drought can influence companies in both negative and positive ways. Consider how unusually cold weather can negatively affect business activity:

- Freight companies may have difficulty moving products from manufacturers to consumers because rivers are frozen or because highways are snow-covered.
- Airlines and railroads may have trouble keeping to their schedules because cold weather complicates operations.
- Retail outlets may experience decreased store traffic because fewer consumers are willing to venture out during freezing weather.
- Consumers pay more for natural gas and other heating fuels because prices rise as demand for those products rises.
- Cattle farmers lose money because cattle must expend more energy keeping warm in cold weather, and they therefore lose weight (and value).
- Consumers pay more for insurance because more claims are filed for things like ice damage.

But cold (and snowy) weather can be beneficial to companies like ski resorts, airlines that fly to tropical destinations, and retailers that sell products like heavy-duty car batteries, snow shovels, snow blowers, snowmobiles, and other winter products because winter weather increases the demand for these products and services. By contrast, warm (and sunny) weather benefits companies that sell products like sunglasses, air conditioners, fans, sporting events, soft drinks, and barbecues.

Business firms cannot do much to *change* the physical environment. Their best strategy is to *adapt* to the conditions the physical environment imposes. For example, retailers can adapt by having a good supply chain that allows them to quickly stock products (e.g., snow shovels, air conditioners, electric generators, etc.) that consumers need in varying weather conditions. Service providers such as commercial airlines can adapt by having contingency plans to move airplanes away from areas that are predicted to have a heavy snowfall.

CRITICAL THINKING QUESTION

1. How important is the *physical* environment compared to the other "environments of business" that are discussed in this chapter? Explain your reasoning.

LO-5 THE SOCIO-CULTURAL ENVIRONMENT

The **socio-cultural environment** includes the customs, values, attitudes, and demographic characteristics of the society in which a company operates. It influences the customer preferences for goods and services and what standards of business conduct are acceptable.

Customer Preferences and Tastes

Customer preferences and tastes vary both across and within national boundaries. In some countries, consumers are willing and able to pay premium prices for designer clothes with labels such as Armani. But the same clothes have virtually no market in other countries. Product usage also varies between nations. In China, bicycles are primarily seen as a mode of transportation, but in Canada, they are marketed primarily for recreational purposes. Although differences in tastes across national borders are sometimes clear and obvious, it is important to avoid stereotypical assumptions. Would you be surprised to hear that Canadian lingerie retailers such as La Senza and La Vie en Rose have a significant presence in the Middle East? Behind the conservative, strict exterior dress code, there is a significant market for lingerie.[42]

Consumer preferences and tastes also change over time. That's exactly what Loblaws is counting on since it recently added cricket flour to its shelves. Approximately 80 percent of the world's population consume bugs on a regular basis. Canadians are part of the minority. Many people also claim to be more environmentally friendly than previous generations. So, because people are concerned about food supply and because 2.5 tablespoons of cricket flour contain 13 grams of protein, perhaps the time has come. Maybe you start with cricket flour, or maybe you have already taken the leap and enjoyed a cricket-based protein bar? Times are changing.[43]

Are you ready for a cricket-based protein powder? Entomo Farms is just one company of many across the nation leading this charge.

Bloomberg/Getty

Ethical Compliance and Responsible Business Behaviour

An especially critical element of the socio-cultural environment is the practice of ethical conduct and social responsibility. Keeping up with today's increasingly fast-paced business activities is putting a strain on the accounting profession's traditional methods for auditing, financial reporting, and time-honoured standards for professional ethics. The stakeholders of business firms—employees, stockholders, consumers, labour unions, creditors, and the government—are entitled to a fair accounting so they can make enlightened personal and business decisions, but they often get a blurred picture of a firm's competitive health.

Mountain Equipment Cooperative (MEC) has always stood out from the crowd of retailers. From its initial founding in British Columbia, the company's mission has placed sustainability at its core. Many of the retail locations are among the most environmentally friendly commercial buildings in Canada, with a focus on reducing heating and cooling and the effective use of roof space. Solar panels are just the beginning; some locations collect rainwater to use for their sprinkler systems and for other non-drinkable uses for the stores. MEC is a cooperative, so the members are technically the owners. Those members led the charge recently and took an ethical stand against Vista Outdoor Inc. when they realized that the supplier that sold water bottles and stand-up paddleboards to MEC also made assault weapons like the ones used at yet another shooting in the United States, in Parkland, Florida. The movement that began from this tragedy led to an online petition and quick action from the executive team to cut all ties with this supplier.[44]

The Business Environment

Business today is faster-paced, more complex, and more demanding than ever before. As businesses aggressively try to differentiate themselves, there has been a trend toward higher-quality products, planned obsolescence, and product life cycles measured in weeks or months rather than years. This, in turn, has created customer expectations of instant gratification. Consumers and business customers want high-quality goods and services—often customized—for lower prices and with immediate delivery. Sales offices, service providers, and production facilities are shifting geographically as new markets and resources emerge in other countries. Employees want flexible working hours and opportunities to work at home. Shareholders' expectations also add pressure for productivity increase, growth in market share, and larger profits. At the same time, however, a more vocal public demands more honesty, fair competition, and respect for the environment.

SOCIO-CULTURAL ENVIRONMENT Conditions including the customs, values, attitudes, and demographic characteristics of the society in which an organization functions.

The Industry Environment

Every business firm operates in a specific industry, and every industry has different characteristics. The intensity of the competition in an industry has a big influence on how a company operates. To be effective, managers must understand the competitive situation and then develop a strategy to exploit opportunities in the industry.

One of the most popular tools to analyze competitive situations in an industry is Michael Porter's five forces model.[45] The model (see Figure 2.5) helps managers analyze five important sources of competitive pressure and then decide what their competitive strategy should be. We briefly discuss each of the elements of the model in the following paragraphs.

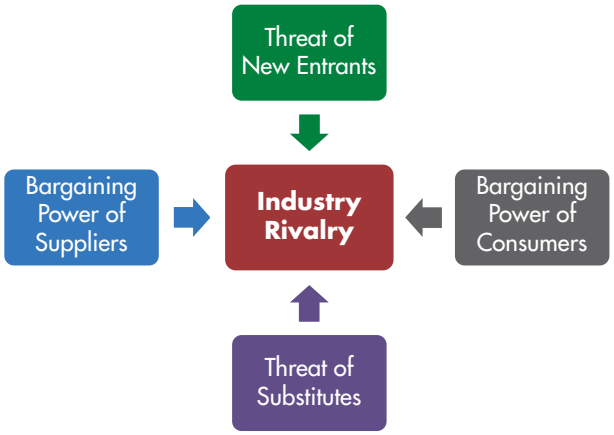

FIGURE 2.5 Michael Porter's five forces model

Rivalry Among Existing Competitors

The amount of rivalry among companies varies across industries. Rivalry can be seen in activities such as intense price competition, elaborate advertising campaigns, and an increased emphasis on customer service. For many years, Tim Hortons has dominated the Canadian coffee industry with its extensive coverage of the market and strong brand equity. More recently, however, we have seen stronger competitive efforts from the likes of Starbucks and McDonald's. McDonald's has made some aggressive moves (e.g., free coffee for a week and adding fireplaces to McCafé locations) to gain market share.[46]

Threat of Potential Entrants

When new competitors enter an industry, they may cause big changes. If it is easy for new competitors to enter a market, competition will likely be intense, and the industry will not be very attractive. Some industries (e.g., automobile manufacturing) are very capital-intensive and are therefore difficult to enter, but others (e.g., home cleaning and lawn-care services) are relatively easy to enter. Holt Renfrew has new competition with the entry of Nordstrom, Inc. north of the border. This American retailer is taking it slow with five locations across the nation: one in Calgary, one in Ottawa, one in Vancouver, and two in Toronto.[47] The company also opened its first Nordstrom Rack location (its off-price retail brand) in 2018, with plans to open 15 locations across the country.[48]

Nordstrom is taking it slow, but it is committed to building its presence in Canada.

RosalreneBetancourt 7/Alamy Stock Photo

Read the Entrepreneurship and New Ventures box entitled "Goldline Curling: Dealing with New Industry Threats" to see how one organization used technological advancements to gain attention while upsetting traditionalists.

Suppliers

The amount of bargaining power suppliers have in relation to buyers helps determine how competitive an industry is. When only a few suppliers are in an industry, they tend to have great bargaining power. The power of suppliers is influenced by the number of substitute products available (i.e., products that perform the same or similar functions). When only a few substitute products are available, suppliers obviously have more power.

Buyers

When there are only a few buyers and many suppliers, the buyers have a great deal of bargaining power. For example, retail powerhouse Walmart is often described as a buyer that puts tremendous pressure on its suppliers to reduce their prices. It can do this because it buys so much from them. In another example, when Canadian Tire purchased Forzani (owner of Sport Chek and Hockey Experts stores) for $771 million a few years ago, it was not necessarily good news for suppliers. When two of your biggest customers merge, the power relationship is somewhat altered. Bauer CEO Scott Davis indicated that this merger may lead to price pressure on his company.[49]

Substitutes

If many substitute products are available, the industry is more competitive. For example, various synthetic fibres can be used as substitutes for cotton. The internet has changed the way people pay bills. Because of online banking, people use postal services much less than they did in the past and thus spend less on stamps. This is bad news for Canada Post, as the threat from substitutes is expected to reduce mail volume by another 50 percent in the next decade.[50]

Goldline Curling: Dealing with New Industry Threats

When it comes to the sport of curling, Doug Flowers and his family can only be described as authentic entrepreneurs who represent the values of the sport and the spirit of the game. The company was founded by his father, Ed Flowers, back in 1967. Doug joined the business in the early eighties, and now his daughter Erin is the third generation to be involved in the business. According to Doug, his daughter began working for Goldline when she was only 7 years old by assembling brushes; today she has the true passion needed to ensure that Goldline continues to hold its place in the competitive curling landscape for years to come. In fact, Goldline is one of the most recognizable names in the sport and was awarded the right to be the official uniform supplier by Curling Canada for all teams at the Tim Hortons Brier, for the Scotties Tournament of Hearts, and for Team Canada at the 2018 Winter Olympics and Paralympics in Pyeong Chang, South Korea. These garments were proudly made in Canada, and the company created the Goldline Authentic Wear Program to provide royalties to Curling Canada and to the provincial and territorial associations.

The Game and the Market

According to the World Curling Federation (WCF), which sets the official rules and regulations for the game, curling is a game of skill and tradition; true curlers play to win, but they play fair. They never distract opponents, and no referees are needed because honour and fair play are core values of the sport. Forget the bravado of more mainstream sports like football, basketball, and hockey, where there is a completely separate set of player expectations.

The curling industry is worth approximately $18 million at retail. Canada represents the industry's largest market with approximately 80 percent of sales. To put this in perspective, there are more than 1300 curling clubs in Canada. The United States ranks second with approximately 130 clubs. The average curler spends approximately $1000 per year to curl, with about 30 percent of that money spent on equipment. It was predicted that, from 2017 to 2021, the curling equipment market would see considerable growth with an expected compound annual growth rate (CAGR) of 2.01 percent.

New Competitors, New Rules

Goldline had revenues of approximately $5 million and their products are sold through five brick and mortar stores in Alberta and Ontario and are also sold national and international dealers and direct to chains such as Sport Check and Canadian Tire. Its next strongest competitor had sales of approximately $2 million. The key players included Ashram Curling Supplies and Equipment, Balance Plus, Hardline, Olson, Performance, and Ultima.

A few years ago, the curling brush market was disrupted by a revolutionary product by Hardline (a more recent entry into the market). Innovation is part of all businesses, so why should curling be any different? The problem was that the new Hardline brush was made of a more abrasive material that marked rather than smoothed the ice and made even beginners experts capable of making impossible shots. In other words, the art of shot-making was gone! The respectful, cordial spirit of the game was tested as curlers began to feel cheated and accused each other of using an unfair advantage. The federation eventually stepped in and banned the new brush head after two Canadian scientists from the National Research Council of Canada tested it and confirmed the extreme effects of the material. With this information, the federation, with the support of top players, banned the new material and announced that all sanctioned events would require curlers to use Nylon Oxford 420D fabric to compete. The ban did not change what recreational curlers chose to do on a Sunday afternoon. However, when Doug Flowers launched his new line called the "Air" brush, little thought was given to copying Hardline. Doug Flowers was a traditionalist. Will that decision cost him? Time will tell, but Doug believes in the purity of the game.

Aaron Favila/The CP Images

CRITICAL THINKING QUESTION

1. Debate the following. Should Doug continue to uphold the spirit of the game, or should he create a sub-line for those recreational curlers who want that extra edge? Who is it hurting after all? Choose a side and debate with your classmates.

LO-6 EMERGING CHALLENGES AND OPPORTUNITIES IN THE BUSINESS ENVIRONMENT

The most successful firms are dealing with challenges and opportunities in today's business environment by focusing on their *core competencies*—the skills and resources with which they compete best and create the most value for owners. They outsource non-core business processes and pay suppliers and distributors to perform them, thereby increasing their reliance on suppliers. These new business models call for unprecedented coordination—not only among internal activities but also among customers, suppliers, and strategic partners—and they often involve globally dispersed processes and supply chains.

In this section, we discuss some of the most popular steps that companies have taken to respond to challenges and opportunities in the business environment. These include outsourcing, the growing role of social media, and business process management.

Outsourcing

Outsourcing is the strategy of paying suppliers and distributors to perform certain business processes or to provide needed materials or services. For example, the cafeteria in a museum may be important to employees and customers, but the museum's primary focus is on exhibits that will interest the public, not on food-service operations. That's why museums usually outsource cafeteria operations to food-service management companies. The result is more attention to museum exhibits and better food service for customers. Firms today outsource numerous activities, including payroll, employee training, and research and development.

The Growing Role of Social Media

Social media sites and applications such as Facebook and Snapchat are now an important part of everyday life for consumers (especially the youth market). Companies are addressing this new reality by providing content and creating various links to connect with consumers. Most organizations are being careful about their online presence because they don't want it to be an imposition, but rather a natural extension of their real-world relationship with clients. As we discuss throughout this book in the E-Business and Social Media Solutions boxes, some companies are making strong inroads as this new model evolves and companies learn to deal with an empowered consumer base.

Viral marketing predates the social media craze and first gained prominence through basic email transfer; it describes word-of-mouth marketing that spreads information like a virus from customer to customer and relies on the internet to replace face-to-face communications. Messages about new cars, sports events, and numerous other goods and services are transferred from consumer to consumer. Using various formats—games, contests, and instant messaging—marketers encourage potential customers to try out products and tell other people about them.[51] Viral marketing works because people increasingly rely on social media for information they used to get from traditional media and because the customer becomes a participant in the process of spreading the word by forwarding information to friends and followers. For example, think of all the crowdsourcing contests companies offer in which they ask their customers to develop a new flavour, a new design, or a new slogan in return for prizes, with the ultimate purpose of gaining information and increasing customer engagement.

Business Process Management

A *process* is any activity that adds value to an input, transforming it into an output for a customer (whether external or internal).[52] For example, human resources departments perform interviewing and hiring processes, payroll departments perform employee-payment processes, purchasing departments perform processes related to ordering materials, accounting departments perform financial reporting processes, and marketing departments perform processes involved in taking orders from customers.

Business process management means moving away from organizing around departments and moving toward organizing around process-oriented team structures that cut across old departmental boundaries. Companies often begin by asking, "What must we do well to stay in business and win new orders?" Next, they identify the major processes that must be performed well to achieve these goals. Then they organize resources and skills around those essential processes. By organizing according to processes rather than functional departments, decision-making is faster and more customer-oriented, materials and operations are coordinated, and products get to customers more rapidly.[53]

Instagram is a community of more than 800 million people who capture and share the world's moments on the service.

ALEX UGALEK/Shutterstock

OUTSOURCING Strategy of paying suppliers and distributors to perform certain business processes or to provide needed materials or services.

BUSINESS PROCESS MANAGEMENT Approach by which firms move away from department-oriented organization and toward process-oriented team structures that cut across old departmental boundaries.

LO-7 REDRAWING CORPORATE BOUNDARIES

Successful companies are responding to challenges in the external environment by redrawing traditional organizational boundaries and by joining together with other companies to develop new goods and services. Several trends have become evident in recent years: acquisitions and mergers, divestitures and spinoffs, employee-owned corporations, strategic alliances, and subsidiary/parent corporations.

Mergers and Acquisitions

In an **acquisition**, one firm simply buys another firm. For example, the Hudson's Bay Company (HBC) purchased Saks Inc. (Saks Fifth Avenue) for US$2.4 billion.[54] The transaction is like buying a car that becomes your property. In contrast, a **merger** is a consolidation of two firms, and the

arrangement is more collaborative. In 2017, mergers and acquisitions in Canada reached a total value of $243.5 billion.[55]

When companies in the same industry merge, it is called a *horizontal merger*. When one of the companies in the merger is a supplier or customer to the other, it is called a *vertical merger*. For example, the French company Essilor, the world's biggest lens maker, merged with the Italian company Luxottica, the largest eyewear frame maker in the world. The merger, valued at $70 billion, created Essilor Luxottica, which touted having well-known brands such as Oakley and Ray-Ban in its portfolio and had enormous industry power at all levels. On the other hand, when merged companies are in unrelated businesses, it is called a *conglomerate merger*.

A merger or acquisition can take place in one of several ways. In a *friendly takeover*, the acquired company welcomes the acquisition, perhaps because it needs cash or sees other benefits in joining the acquiring firm. For example, BCE Inc. bought Manitoba Telecom Services Inc. (MTS) for $3.1 billion in 2017. In the joint announcement, BCE talked about how it was going to invest heavily in building network improvements in the province and how it was going to offer its Fibe-branded services in Manitoba.[56] In a *hostile takeover*, the acquiring company buys enough of the other company's stock to take control, even though the other company is opposed to the takeover.

Companies that want to fight a takeover attempt have options. A **poison pill** is a defence tactic that management adopts to make a firm less attractive to an actual or potential hostile suitor in a takeover attempt. The objective is to make the "pill" so distasteful that a potential acquirer will not want to swallow it. A few years ago, Air Canada announced plans to institute a poison pill provision that would give all Class A and Class B shareholders the right to purchase stocks at a discounted price the moment any group or person announced the intention to buy more than 20 percent of the outstanding shares.[57]

Divestitures and Spinoffs

A **divestiture** occurs when a company decides to sell part of its existing business operations to another corporation. When Pfizer Inc. decided to divest its infant-nutrition and animal-health units, competitors jumped at the chance. Nestlé and Groupe Danone both showed interest in the strong infant-nutrition assets, and Nestlé eventually won the auction with a bid of US$11.85 billion.[58] Recently, Mosaic purchased Vale SA's fertilizer business for US$2.5 billion in cash and stock.[59]

In other cases, a company might set up one or more corporate units as a new, independent company because a business unit might be more valuable as a separate company. This is known as a **spinoff**. For example, PepsiCo spun off Pizza Hut, KFC, and Taco Bell into a new, separate corporation known as Yum! Brands, Inc.

Employee-Owned Corporations

Corporations are sometimes owned by their employees. The current pattern is for this ownership to take the form of *employee stock ownership plans,* or ESOPs. A corporation might decide to set up an ESOP to increase employee motivation or to fight a hostile takeover attempt. The company first secures a loan that it then uses to buy shares of its stock on the open market. Some of the future profits made by the corporation are used to pay off the loan. The stock, meanwhile, is controlled by a bank or other trustee. Employees gradually gain ownership of the stock, usually based on seniority. Even though they might not have physical possession of the stock for a while, they control its voting rights immediately.

Magna International and Lyft formed an alliance to jointly develop, finance, and manufacture self-driving systems.

Tero Vesalainen/Shutterstock

Strategic Alliances

A **strategic alliance**, or joint venture, involves two or more enterprises cooperating in the research, development, manufacture, or marketing of a product. For example, Magna International, the Canadian auto parts giant, invested $200 million to partner with Lyft, the ridesharing service, to jointly develop, finance, and manufacture self-driving systems. This deal brought together a traditional industry giant, with extensive manufacturing knowledge, and a new-age firm that is on the leading edge of disruptive new models.[60] Companies form strategic alliances for two main reasons: (1) to help spread the risk of a project and (2) to get something of value (such as technological or industry expertise) from their strategic partner.

Subsidiary and Parent Corporations

A *subsidiary corporation* is one that is owned by another corporation. The corporation that owns the subsidiary is called the *parent corporation*. For example, the Hudson's Bay Company (HBC) is the parent corporation of Home Outfitters.

ACQUISITION The purchase of a company by another, larger firm that absorbs the smaller company into its operations.

MERGER The union of two companies to form a single new business.

POISON PILL A defence that management adopts to make a firm less attractive to an actual or potential hostile suitor in a takeover attempt.

DIVESTITURE Occurs when a company sells part of its existing business operations to another company.

SPINOFF Strategy of setting up one or more corporate units as new, independent corporations.

STRATEGIC ALLIANCE An enterprise in which two or more persons or companies temporarily join forces to undertake a project.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 EXPLAIN THE CONCEPTS OF ORGANIZATIONAL BOUNDARIES AND MULTIPLE ORGANIZATIONAL ENVIRONMENTS.

All businesses operate within a larger *external environment* consisting of everything outside an organization's boundaries that might affect it. An *organizational boundary* is that which separates the organization from its environment. Organizations have multiple environments: economic conditions, technology, political–legal considerations, social issues, the global environment, issues of ethical and social responsibility, the business environment itself, and numerous other emerging challenges and opportunities.

LO-2 EXPLAIN THE IMPORTANCE OF THE ECONOMIC ENVIRONMENT TO BUSINESS AND IDENTIFY THE FACTORS USED TO EVALUATE THE PERFORMANCE OF AN ECONOMIC SYSTEM.

The *economic environment* is the economic system in which business firms operate. The key goals of the Canadian system are economic growth, economic stability, and full employment. *Gross domestic product* (GDP) is the total value of all goods and services produced within a given period by a national economy domestically. The government manages the economy through *fiscal and monetary policies*.

LO-3 DESCRIBE THE TECHNOLOGICAL ENVIRONMENT AND ITS ROLE IN BUSINESS.

Technology refers to all the ways firms create value for their constituents, including human knowledge, work methods, physical equipment, electronics and telecommunications, and various processing systems. The innovation process includes *research and development (R&D)*, which provides new ideas for products, services, and processes. There are two general categories of business-related technologies: *product and service technologies* and *business process technologies*.

LO-4 DESCRIBE THE POLITICAL–LEGAL ENVIRONMENT AND ITS ROLE IN BUSINESS.

The *political–legal environment* reflects the relationship between business and government. The legal system defines what an organization can and can't do. Various government agencies regulate important areas, such as advertising practices, safety and health considerations, and acceptable standards of business conduct. Pro-business or antibusiness sentiment in government can further influence business activity.

LO-5 DESCRIBE THE SOCIO-CULTURAL ENVIRONMENT AND ITS ROLE IN BUSINESS.

The *socio-cultural environment* includes the customs, values, and demographic characteristics of society. Socio-cultural processes determine the goods and services as well as the standards of business conduct that a society values and accepts. The shape of the market, the political influence, and the attitudes of its workforce are only a few of the many ways in which culture can affect an organization.

LO-6 IDENTIFY EMERGING CHALLENGES AND OPPORTUNITIES IN THE BUSINESS ENVIRONMENT.

Successful companies focus on their core competencies. The innovative ways in which companies respond to emerging challenges and opportunities include *outsourcing*, *the role of social media*, and *business process management*.

LO-7 UNDERSTAND RECENT TRENDS IN THE REDRAWING OF CORPORATE BOUNDARIES.

An *acquisition* occurs when one firm buys another. A *merger* occurs when two firms combine to create a new company. A *divestiture* occurs when a corporation sells a part of its existing business operations or sets it up as a new and independent corporation. When a firm's leadership sells part of the firm to raise capital, the strategy is known as a *spinoff.* An *ESOP* plan allows employees to own a significant share of a corporation through trusts established on their behalf. In a *strategic alliance*, two or more organizations collaborate on a project for mutual gain.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Why is it important for managers to understand the environment in which their businesses operate?
2. It has been argued that inflation is both good and bad. Explain. Are government efforts to control inflation well advised? Explain.
3. What are the benefits and risks of outsourcing? What, if anything, should be done about the problem of Canadian companies outsourcing jobs to foreign countries? Defend your answer.
4. Explain how current economic indicators such as inflation and unemployment affect you personally. Explain how they affect managers.
5. At first glance, it might seem as though the goals of economic growth and stability are inconsistent with one another. How can this apparent inconsistency be reconciled?
6. What is the current climate in Canada regarding the regulation of business? How might it affect you if you were a manager today?

APPLICATION EXERCISES

7. Select two businesses you are familiar with. Identify the major elements of their external environments that are most likely to affect them in important and meaningful ways.
8. Assume you are the owner of an internet pharmacy that sells prescription drugs to U.S. citizens. Analyze the factors in the external environment (economic, technological, political–legal, and socio-cultural) that might facilitate your company's activities. Analyze the factors in the external environment that might threaten your company's activities.
9. Select a technology product, such as the Samsung Galaxy smartphone or Fitbit, and research how the various environments of business (economic, technological, socio-cultural, global, political–legal, and general business) are currently affecting the sales possibilities of the product or service.
10. Interview two business owners or managers. Ask them to answer the following questions: (a) What business functions, if any, do they outsource? (b) Are they focusing more attention on business process management now than in the past? and (c) How have internet applications and the growth of social media changed the way they conduct business?

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members and develop specific responses to the following:

1. Describe how the state of the economy might help or hurt your chances of success in launching this new product? How sensitive do you think this product is to economic shocks?
2. How might political and legal issues impact your business? For example, are there any existing or proposed new laws that might either help or hurt your new product?
3. Analyze how technological, socio-cultural, global, and general business issues might impact your business.
4. Describe the importance of research and development in launching your new product or service. Also describe the importance of ongoing research to develop new features.

BUILDING YOUR BUSINESS SKILLS

HOW WEATHER IMPACTS THE BOTTOM LINE

PURPOSE OF THE ASSIGNMENT

To help students identify the important role played by uncontrollable natural events on the bottom line.

THE SITUATION

Rona is now part of the Lowe's Canada family of brands, and there are more than 430 Rona corporate and affiliate stores across Canada.

Financial performance and results in this industry are vulnerable to natural weather patterns. For example, an extra-long winter can result in fewer customers rushing out to buy things like home gardening supplies, which traditionally pad the bottom line during the spring sales period. It is not uncommon for home renovation stocks to see short-term declines in the stock market simply because of bad weather. Why? Because labour costs remain high while the staff has fewer customers to serve. Under such circumstances, there is an incentive to offer discounts to attract sales, but companies prefer to avoid such tactics. However, an extra buildup of inventory leads to a direct holding cost, which may lead to more drastic discounting once the shortened season arrives.

Weather patterns can play an important role in the short-term success or failure of many businesses.[61]

ASSIGNMENT

Divide the participants into groups of four or five students. Each group should begin by doing the following:

Step 1 Identify three *big companies* that might be *positively* affected by warmer-than-usual weather during a season.

Step 2 Identify three *big companies* that might be *negatively* affected by warmer-than-usual weather patterns during a season. If it is appropriate, a company can appear on both lists.

Step 3 Now respond to the following items:

1. For each company that you identify, describe the specific effects on each business.
2. Describe the most logical organizational response to these effects for each company.
3. What kinds of plans, if any, should each organization develop in the event of similar future events?

ALTERNATIVE ASSIGNMENT

Conduct the same exercise on *small businesses* and *entrepreneurs* and highlight some of the unique challenges that they face. Then proceed with Steps 1–3 above.

QUESTIONS FOR DISCUSSION

1. How could Rona better prepare for and handle negative weather patterns?
2. Are unfavourable natural weather patterns more dangerous for major retailers like Rona or for small businesses? Provide at least one argument on each side before making a choice.
3. Is it possible for a manager to spend too much time trying to anticipate future events? Why or why not?

EXERCISING YOUR ETHICS

PRESCRIBING A DOSE OF COMPETITIVE MEDICINE

THE SITUATION

You are a business person in a small town, where you run one of two local pharmacies. The population and economic base are stable. Each pharmacy controls about 50 percent of the market. Each is reasonably profitable, generating solid if unspectacular revenues.

THE DILEMMA

You have just been approached by the owner of the other pharmacy. He has indicated an interest either in buying your pharmacy or in selling his to you. He argues that neither company can substantially increase profits and complains that if one pharmacy raises its prices, customers will simply go to the other one. He tells you outright that if you sell to him, he plans to raise prices by 10 percent.

He believes that the local market will have to accept the increase for two reasons: (1) the town is too small to attract national competitors such as Shoppers Drug Mart and (2) local customers can't go elsewhere to shop because the nearest town with a pharmacy is 50 kilometres away.

TEAM ACTIVITY

Form groups of four and assign two members to represent the company that is making the proposition and two members to represent the company that was approached. Answer the questions for discussion found below and then role-play a discussion between the two company owners. Are there alternative solutions? Do they cross ethical lines?

QUESTIONS FOR DISCUSSION

1. What are the roles of supply and demand in this scenario?
2. What are the underlying ethical issues?
3. What would you do if you were faced with this situation?

BUSINESS CASE 2

CANADIAN SUPERMARKETS: MANY BRANDS, THREE MAJOR COMPANIES

Whether you know it or not, there are essentially three major supermarket chains left in Canada: (1) Loblaws, (2) Sobeys, and (3) Metro. Even if you shop at a retail outlet operating under another banner, chances are it is owned by one of these three entities. For example, are you wondering why Safeway was not mentioned? It was the fourth company until it was purchased by Sobeys. There have been many acquisitions in the past few years as threats intensify from Walmart, upscale supermarkets, and evolving online grocers. This Canadian consolidation has had a major impact on manufacturers, suppliers, and ultimately consumers. Let's look at the facts before analyzing the consequences.

LOBLAWS

Loblaws was founded in 1919. It is headquartered in Brampton, Ontario, and is a division of Loblaws Companies Limited. Today it has over 2500 retail outlets and more than 200 000 employees with annual revenues of $46.7 billion. After years of building up its grocery business and establishing different retail brands, Loblaws shifted gears when it bought Shoppers Drug Mart for $12.4 billion. It is no coincidence that this move occurred at a time when drugstores were transforming into megastores with increased shelf space being allocated to groceries.

Loblaws Family of Retail Brands: Arz Fine Foods, Atlantic Superstore, Dominion, Extra Foods, Fortinos, Loblaws City Market, Independent City Market, No Frills, Real Canadian Superstore, Save Easy, Maxi & Cie, Provigo, The Affiliated Independent Group, T&T, Your Independent Grocer, Valu-Mart, Wholesale Club, and Zehrs.

SOBEYS INC.

Sobeys Inc. (owned by Empire Co. Ltd.) was founded in 1907 and has headquarters in Stellarton, Nova Scotia. Sobeys has more than 1500 stores with outlets in all ten provinces and more than 380 retail fuel stations. It has over 125 000 employees and franchise affiliates. A few years ago, Sobeys made major waves with the purchase of Safeway for $5.8 billion. The integration was not easy, and Sobeys had to write-down half the purchase price: a disastrous outcome. On a positive note, annual revenues now stand at $24.6 billion. In the first quarter of 2018, the company posted net earnings of $89.9 million with more plans to replace outdated systems and inefficient processes to compete more effectively.

CNW Group/SOBEYS INC/Newscom

Sobeys Family of Retail Brands: Bonichoix, FreshCo., Foodland, IGA, Lawton's Drug Stores, Needs, Price Chopper, Rachelle-Béry, Safeway, Sobeys, Thrifty Foods, and Les Marchés Tradition.

METRO INC.

Metro was founded in 1947 and is a distant third to Sobeys and Loblaws. However, the Montreal-based company has 800 outlets and 65 000 employees with annual sales of $12 billion. These statistics demonstrate that Metro is another important force in the Canadian grocery business. Even if it does not have a true national reach like the other two companies, Metro has a major presence in Ontario and Quebec.

Metro Family of Retail Brands: Food Basics, Les 5 Saisons, Metro, Metro Plus, SuperC, Marché Richelieu, Marché Ami, Marché Extra, and Adonis. It also owns the pharmacy brand Brunet, as well as 421 convenience stores under the Service, Servi Express, and Dépanneurs Gem banners.

WHAT DOES THIS CONSOLIDATION MEAN?

After acquiring Shoppers Drug Mart, Loblaws sent a notice to its suppliers telling them that it would not accept any price increases for a full year. Similarly, after the Safeway deal, Sobeys demanded a 1 percent price cut from its suppliers; to make matters worse, it demanded that the reduction be retroactive (going back three months). Suppliers were obviously not pleased, but when dealing with a company that controls a thousand or more stores and billions in consumer purchases, what can you do? These mega companies have power, and they are not afraid to flex their muscles. In addition, they are pushing their own private-label brands (e.g., President's Choice at Loblaws), which means shelf space is now much tougher to acquire.

EXTERNAL THREATS AND OPPORTUNITIES

With suppliers being squeezed, consumers should expect cheaper prices, right? The short answer is … maybe. You can only push so far. Legitimate increases in costs will find their way to the aisles. To further complicate matters and highlight the danger of such power in the hands of a few powerful players, media outlets disclosed that the big three, along with Walmart and Giant Tiger, were involved with two major bread suppliers in a price-fixing scheme to artificially raise prices of bread for well over a decade. This is now a matter for the courts.

In a business where margins are very tight, external shocks are extremely important. Metro's CEO, Eric La Fleche, provided an interesting explanation as to why his company realized increased profits. He said that lower fuel prices in one six-month period led to increased consumer spending in Metro supermarkets. While economists were worried about the impact of the weak price of oil on the economy, at the time, supermarkets were seeing benefits because customers had an extra $20 to $30 per week in their pockets to spend. However, on the downside, the corresponding fall in the Canadian dollar (against the U.S. dollar) was leading to increases in the price of imported meat and produce, which meant consumers would have to pay more.

FINAL THOUGHTS

Next time you are pushing a cart at your favourite grocery store, you will realize that there is a great battle for your consumer dollar. Every square centimetre of shelf space earned by a manufacturer represents hard-fought territory. The external environment plays a key role in the potential profitability for supermarket chains and the suppliers that provide the products. This is a tough business operated on a low-margin, high-volume basis, which requires a very delicate balancing act.

QUESTIONS FOR DISCUSSION

1. What are the biggest challenges to long-term success and profitability for Loblaws, Sobeys, and Metro?
2. How would you categorize the threat from online retailers such as Amazon (which recently bought Whole Foods)?
3. How do the external factors other than competition (economy, technology, socio-cultural, and political–legal) impact the grocery business?
4. The three main players in the Canadian grocery market each operate under various brands. Why do you think they still use all those different brand names? Why don't they just rebrand all their stores?
5. What are the main challenges for suppliers as the industry continues to consolidate?

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CHAPTER

03

Conducting Business Ethically and Responsibly

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Explain how individuals develop their personal *codes of ethics* and why ethics are important in the workplace.
- **LO-2** Distinguish *ethics* from *social responsibility* and identify *organizational stakeholders*.
- **LO-3** Show how the concept of social responsibility applies both to environmental issues and to a firm's relationships with customers, employees, and investors.
- **LO-4** Identify four general *approaches to social responsibility* and describe the four steps a firm must take to implement a *social responsibility program*.
- **LO-5** Explain how issues of social responsibility and ethics affect small businesses.

Is Legalization of Marijuana a Good Idea?

Bill C-45—the Cannabis Act—legalized the recreational use of marijuana in Canada as of October 17, 2018. Surveys showed that a majority of Canadians (54 percent) thought marijuana should be legalized. A 2016 survey by Deloitte found that 22 percent of Canadians occasionally use marijuana, 7 percent use it daily, and 17 percent would try it if it became legal. Statistics Canada estimates that Canadians spent about $5.7 billion on marijuana in 2017 (by comparison, $22 billion was spent on alcohol and $16 billion on cigarettes).

Detailed rules and regulations regarding legalization are contained in the federal Cannabis Act. The minimum age for purchase and consumption of marijuana is 18, and a person can have up to 30 grams on his or her person at any time for personal use. The federal Health Minister has the power to approve prospective producers and distributors and to exclude people who are connected to organized crime. The Act recognizes several licensing categories, including cultivation, processing, testing, import/export, and research. A 10 percent tax is levied on recreational marijuana purchases, and the revenues from that tax will be shared by the federal and provincial governments (perhaps 75 percent going to the provinces and 25 percent to the federal government). The actual regulation of marijuana distribution will be under provincial control. Provinces can place their own restrictions on marijuana cultivation and distribution, and numerous variations exist across provinces.

Many people have moral and ethical objections to the legalization of marijuana (46 percent of Canadians think it is a bad idea). It is therefore not surprising that a vigorous debate has developed about the wisdom of the legislation. Supporters of legalization argue that it will reduce federal and provincial budget deficits because the tax on marijuana sales will mean increased tax revenues for both the federal and provincial governments. But critics point out that health

and social costs will also rise because increased marijuana use will result in more drug-induced car accidents, brain damage to young people, and lung damage from smoking marijuana. Critics argue that these costs will be far higher than the tax revenues from pot. They note that by mid-2017, the federal government had already budgeted more than $800 million for activities such as licensing, inspection, compliance, enforcement, and public education. These figures apply only to the federal government; the provinces will also incur significant costs to manage the provincial pot business.

Joe Hamilton Photography/Shutterstock

Part of the debate focuses on a comparison of marijuana and alcohol. Supporters of legalization argue that the two products are very similar and that because alcohol is legal, marijuana should also be legal. Critics argue that alcohol and marijuana are both intoxicants and that both generate public safety concerns because they can be detrimental to the physical and mental health of users. They can also be detrimental to "innocent bystanders" (e.g., people who are injured or killed by cars driven by individuals who are "under the influence"). Yet another part of the debate focuses on the image of the marijuana industry. In 2017, Environics Communications polled 1500 Canadians and asked them how much they trusted 20 different sectors in the economy to "do what is right for Canada." The marijuana sector ranked dead last, even behind sectors like media platforms and pipelines.

While the debate about the wisdom of legalizing marijuana was ongoing, several different groups—police organizations, medical doctors, human resource managers, and Canada's provincial premiers—expressed serious concerns about the idea. *Police organizations* opposed the timetable for legalization because they needed more time to train officers about the new laws and to double the number of officers who are qualified to do roadside drug-impaired driving tests.

Medical doctors expressed concern that legalization of marijuana would result in increased usage among teenagers and cited evidence showing that excessive marijuana use leads to lowered motivation levels and a reduced interest in important life activities such as having a career. The medical journal *Canadian Family Physician* expressed the view that marijuana is an ineffective and useless substance for medical treatments.

Human resource managers were concerned because most companies didn't have policies in place to deal with marijuana use and that if marijuana became legal, more workplace problems would be likely, including worker impairment, increased absenteeism, and decreased performance. Moreover, with the legalization of marijuana, the idea of a "smoke break" takes on a whole new meaning, and employees cannot automatically be disciplined for using it.

Canada's *provincial premiers* warned the federal government that the provinces might not be ready with provincial laws and regulations to accompany the federal legislation. Also, the specific provisions that would be legislated would not be consistent across all provinces.

The question of whether the legalization of marijuana is a good idea will be answered over the next few years as data are gathered on government revenues, the costs incurred regulating marijuana sales, and consumer behavior both on the job and off the job.

QUESTIONS FOR DISCUSSION

1. Consider the following statement: *Legalizing the recreational use of marijuana is a good idea because the majority of Canadians think it should be legal. If consumers are allowed to legally buy the product, this will also reduce the involvement of organized crime in the marijuana business.* Do you agree or disagree with the statement? Explain your reasoning.

2. Use the three-step model presented in the chapter to analyze the issue of whether the use of marijuana, alcohol, and cigarettes is ethical. In your analysis, indicate what each of the four common ethical norms (utility, rights, justice, and caring) would imply about the use of the three drugs. After performing your analysis, do you feel that it is ethical to use any of these products? Explain your reasoning.

HOW WILL THIS HELP ME?

There is a growing dilemma in the business world today: the economic imperatives (real or imagined) facing managers versus pressures to function as good citizens. By understanding the material in this chapter, you will be better able to assess ethical and social responsibility issues that you will face as an *employee* and as a *boss* or *business owner*. The information will also help you understand the ethical and socially responsible actions of businesses you deal with as a *consumer* and as an *investor*.

Chunumunu/Fotolia

ETHICS IN THE WORKPLACE

Ethics are beliefs about what is right and wrong or good and bad. An individual's personal values and morals—and the social context in which they occur—determine whether a particular behaviour is perceived as ethical or unethical. In other words, *ethical behaviour* is behaviour that conforms to individual beliefs and social norms about what is right and good. *Unethical behaviour* is behaviour that individual beliefs and social norms define as wrong and bad. **Business ethics** refers to ethical or unethical behaviours by a business's manager or employee.

LO-1 Individual Ethics

Because ethics are based on both individual beliefs and social concepts, they vary from person to person, from situation to situation, and from culture to culture. But they have some commonalities. For example, most societies view stealing as wrong. But what if you happen to see someone drop a $20 bill in a store? Most people would probably say that you should return it to the owner, but some might think it is OK to keep it. There will be even less agreement if you find $20 and don't know who dropped it. Should you turn it in to the lost-and-found department? Or, because the rightful owner isn't likely to claim it, is it ethical for you to just keep it?

It is important to make the distinction between *unethical* and *illegal* behaviour. A given behaviour may be ethical and legal (e.g., providing high-quality products to consumers), ethical and illegal (e.g., breaking the law in a totalitarian regime in order to carry out humanitarian efforts), unethical and legal (e.g., paying low wages to workers at a company facility in a foreign country), or unethical and illegal (e.g., "cooking the books" to make a company's financial situation look better than it really is). Some of these distinctions are controversial. Consider the case of Netsweeper, a Canadian company that sells web-filtering products that block pornography and computer viruses. That sounds good, but what if these products are used by a repressive government to block information it doesn't want its citizens to see (e.g., information on human rights)? While it is perfectly legal for Netsweeper to sell the software, critics argue that the sales are unethical because the company knows its products can be misused.[1]

Making ethical judgments is also complicated by the fact that practices that are legal in one country may not be legal in another. For example, selling Nazi memorabilia online is legal in the United States but not in Germany. In some cultures, ethically ambiguous practices are hallmarks of business activity. Brazilians, for example, apply the philosophy of *jeitinho*—meaning "to find a way"—by using personal connections, bending the rules, or making a "contribution."[2] If you need to get an official document, you might start out determined to take all the proper bureaucratic steps to get it. However, if you find yourself in a complex maze of rules and regulations and think you'll never get your document, you may resort to *jeitinho* to get the job done.

ETHICS Individual standards or moral values regarding what is right and wrong or good and bad.
BUSINESS ETHICS Ethical or unethical behaviours by a manager or employee of a business.

Individual Values and Morals

The ethical views of individuals in a business—managers, employees, agents, and other legal representatives—are determined by a combination of factors. We start to form ethical standards as children in response to our perceptions of the behaviour of parents and other adults. When we enter school, peers and the entertainment media also shape our lives and contribute to our ethical beliefs and our behaviour. We also develop values and morals that influence our behaviour. If you put financial gain at the top of your priority list, you may develop a code of ethics that supports the pursuit of material comfort. But if you put a high priority on family and friends, you'll probably adopt different standards. Because ethics are both personally and culturally defined, differences of opinion arise as to what is ethical or unethical. This means that people can rationalize almost any behaviour as ethical.

Business and Managerial Ethics

Managerial ethics are the standards of behaviour that guide individual managers in their work.[3] There are three broad categories.

Behaviour Toward Employees

Issues such as hiring and firing, wages and working conditions, and privacy are important ethical questions. In Canada, ethical and legal guidelines state that hiring and firing decisions should be based solely on a person's ability to perform a job. A manager who discriminates against any ethnic minority in hiring therefore exhibits both unethical and illegal behaviour. But what about the manager who hires a friend or relative when someone else might be more qualified? Such decisions may not be illegal, but in Canada, they may be seen as unethical. But they may not be seen as unethical in various other countries.

Wages and working conditions are also areas for debate. Consider a manager who pays a worker less than what is deserved because the manager knows that the employee can't afford to quit. Although some people will see that behaviour as unethical, others will see it as simply smart business.

In Canada, the Personal Information Protection and Electronic Documents Act (PIPEDA) requires organizations to obtain consent before they collect, use, or disclose information about individuals. Many people see these guidelines as necessary and useful, but others view them as yet another example of bureaucratic red tape and government interference in business.

Behaviour Toward the Organization

Ethical issues also arise with respect to how employees behave toward their employers. Common problems in the general area of honesty include things like employees stealing supplies or padding expense accounts. Most employees are honest, but organizations must be vigilant. Another problem is **conflict of interest**, which occurs when an activity benefits an employee at the expense of the employer. For example, suppose the shoe buyer for a large department store chain accepts a free vacation from a shoe supplier. If the supplier then asks the shoe buyer to increase the size of the next order, the buyer may feel an obligation to do so. The buyer might also conclude that more large orders will result in another vacation next year. Because this type of behavior can lead to suboptimal outcomes, most companies have policies that forbid buyers from accepting gifts from suppliers.

Behaviour Toward Other Economic Agents

Ethical disputes may arise in the relationships between a company and its customers, competitors, stockholders, suppliers, dealers, and unions. When Caterpillar Inc. demanded that union workers at its London, Ontario, factory take a 50 percent wage cut in order to help the company's operations become more cost-effective, the union refused. The company then closed the plant and moved the production to the United States. Some people feel that it is unethical for a company to give employees an ultimatum like Caterpillar did because the company knew the workers would not accept it. Others would disagree and say the company has to do what it thinks is necessary for its survival. Here's another example: What if a manager receives confidential information about a competitor from an unhappy, vengeful former employee of the competitor? Is it acceptable in that case for the manager to use the information? Some people would say that doing so is unethical, but others might argue that because the manager didn't go looking for the information, using it is acceptable.[4]

Difficulties may also arise because business practices vary globally. In some countries, bribes are a normal part of doing business, but in Canada (and increasingly in other countries as well), bribes are seen as clearly unethical and illegal. In 2017, Lee Jae-yong, then vice-president of Samsung, was convicted of bribing a friend of South Korea's president in return for government favours.[5] Also in 2017, construction giant Odebrecht admitted to paying almost $800 million in bribes across several Latin American countries to acquire construction contracts. The company was fined more than $2.5 billion.[6] In 2015, the RCMP charged Canada's SNC-Lavalin Group with offering millions of dollars in bribes to Libyan government officials.[7] Alstom SA, a French company, agreed to pay $772 million in fines as a result of a widespread bribery scheme that was used to help the company win energy contracts in various countries.[8]

A survey of global managers found that an average of 40 percent of managers felt that corruption was widespread in their country (only 20 percent of Canadian managers perceived that corruption was widespread in Canada).[9] The Organisation for Economic Co-operation and Development (OECD) has expressed concerns about loopholes in Canada's bribery laws and the lack of enforcement of bribery penalties.[10] (See Chapter 5 for more information about the issue of bribery.)

Assessing Ethical Behaviour

We can determine whether a particular action or decision is ethical or unethical by using a three-step model to systematically apply ethical judgments to situations that may arise during the course of business activities.[11]

1. Gather the relevant factual information.
2. Determine the most appropriate moral values.
3. Make an ethical judgment based on the rightness or wrongness of the proposed activity or policy.

Odebrecht Construction was fined $2.5 billion for paying $800 million in bribes in several Latin American countries in order to get lucrative construction contracts.

Joa Souza/Shutterstock

MANAGERIAL ETHICS Standards of behaviour that guide individual managers in their work.

CONFLICT OF INTEREST Occurs when an activity benefits the employee at the expense of the employer.

Let's see how this process might work for a common dilemma faced by managers: expense account claims. Companies routinely cover work-related expenses of employees when they are travelling on company business or entertaining clients for business purposes. Common examples of such expenses include hotel bills, meals, rental cars, and so forth. Employees are expected to claim only those expenses that are work-related. Suppose we have the following factual information (Step 1): A manager takes a client to dinner while travelling on business and spends $100; submitting a receipt for that dinner and expecting to be reimbursed for $100 is clearly appropriate. Suppose, however, the manager also has a $100 dinner the next night in that same city with a good friend for purely social purposes. Submitting the receipt for full reimbursement would be seen by most managers as unethical (but some might rationalize that it is acceptable because they are underpaid and this is a way to increase their pay).

Given this information, we need to determine the most appropriate moral values (Step 2). There are four commonly used ethical norms we can apply to make this determination:

Utility. Does a particular act optimize what is best for those who are affected by it?

Rights. Does it respect the rights of the individuals involved?

Justice. Is it consistent with what we regard to be fair?

Caring. Is it consistent with people's responsibilities to each other?

Figure 3.1 incorporates these ethical norms into a model of ethical decision making. Now, let's return to the case of the expense account and make an ethical judgment (Step 3). The *utility* norm would acknowledge that the manager benefits from padding an expense account, but co-workers and owners do not. Likewise, inflating an expense account does not respect the *rights* of others. It is also *unfair* and compromises

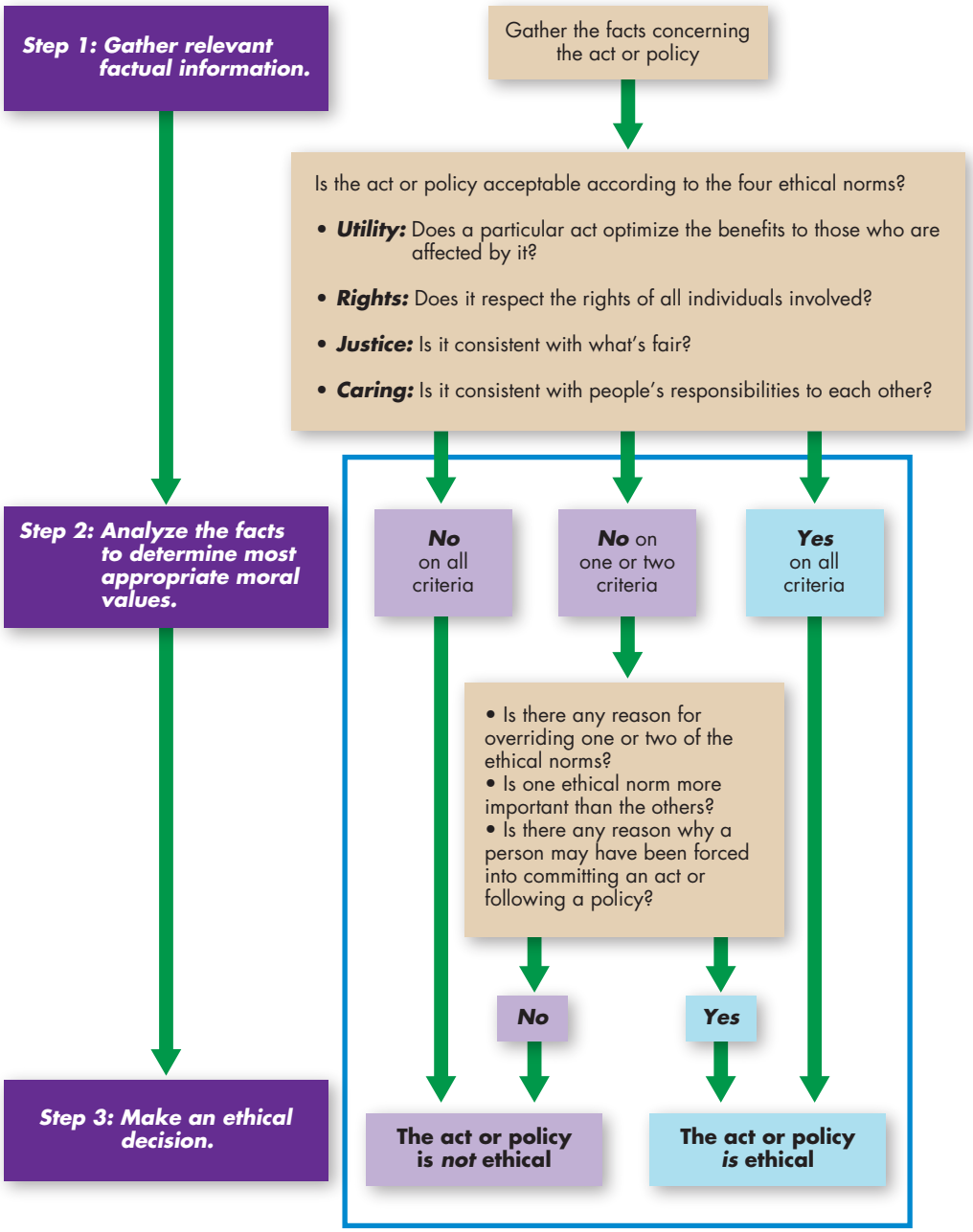

FIGURE 3.1 Model of ethical judgment making

the manager's *responsibilities* to others. This particular act, then, appears to be clearly unethical. But now suppose that the manager happens to lose the receipt for the legitimate dinner but does not lose the receipt for the social dinner. Would it be ethical to submit the illegitimate receipt because the manager is only doing so to be reimbursed for what he or she is entitled to? Or is submitting the second receipt unethical under any circumstances? Changes in the factual information about the case may make ethical issues more or less clear-cut.

Technological innovations such as the internet, cloning, satellite reconnaissance, sophisticated computer software, and bioengineered foods have created all sorts of new ethical dilemmas. For every innovation that promises convenience or safety, there seems to be a related ethical issue. For example, Volkswagen installed clever software on its diesel vehicles that could sense when the engine was being tested to determine if it adhered to emissions regulations established by the Environmental Protection Agency in the United States. The software caused the engine to function in such a way that it would pass the inspection, but only for the brief time when it was being tested. (For more detail on this incident, see Business Case 3 at the end of this chapter.) Other examples are the internet and email, which are convenient and efficient but present business people with a variety of ethics-related problems. One manager sent emails to his workers in which he pretended to be a recruiter from a competing firm. Employees who responded to the emails were skipped for promotion. Electronic communication also makes it possible to run swindles with greater efficiency than ever before.

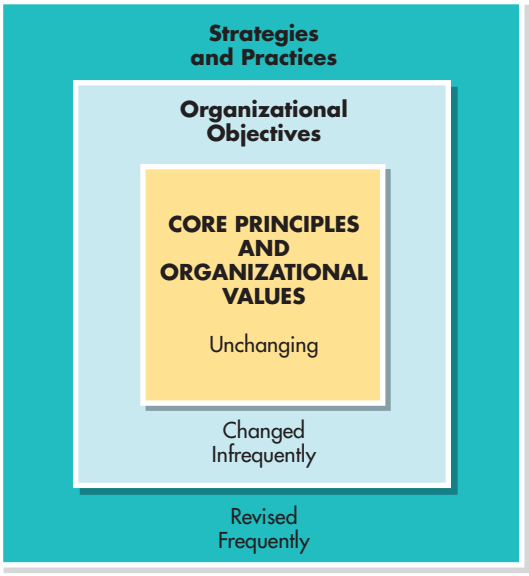

FIGURE 3.2 Core principles and organizational values

Source: Baron, David P. Business and Its Environment permission of Pearson Education, Inc Upper Saddle River, NJ.

Encouraging Ethical Behaviour in Organizations

To promote ethical behaviour, managers must understand *why* unethical behaviour occurs in the first place. Three general factors have been identified as important: *pressure* (the employee has some problem that cannot be solved through legitimate means), *opportunity* (the employee uses his or her position in the organization to secretly solve the problem), and *rationalization* (the employee sees himself or herself as basically an ethical person caught up in an unfortunate situation).[12] To reduce the chance of unethical behaviour, organizations should demonstrate top management commitment to ethical standards, adopt written codes of ethics, and provide ethics training for employees.

Demonstrate Top Management Commitment to Values and High Ethical Standards

It is crucial that top management demonstrates a serious public commitment to high ethical standards. For example, Mountain Equipment Co-op is publicly committed to the concept of *ethical sourcing*, which means monitoring factories that produce its products to make sure that those factories are providing good working conditions for their employees. Without this ethical "tone at the top," lower-level employees are not likely to take ethics very seriously.

Figure 3.2 illustrates the essential role corporate ethics and values should play in corporate policy. It shows that business strategies and practices can change frequently and business objectives may change occasionally, but an organization's core principles and values should remain the same. For example, Google's core principle is "Don't Be Evil." Google adapts its strategies and practices to meet the challenges posed by the rapidly changing technology industry, but Google must do so in a way that does not violate its core principle.

Adopt Written Codes of Ethics

A written code of ethics formally acknowledges that a company intends to do business in an ethical manner. Codes of ethics increase public confidence in a company, improve internal operations, and help managers respond on those occasions when there are problems with illegal or unethical employee behaviour. About two-thirds of Canada's largest corporations have codes of ethics (90 percent of large U.S. firms do). More and more regulatory and professional associations in Canada are recommending that corporations adopt codes of ethics. The Canada Deposit Insurance Corporation, for example, requires that all deposit-taking institutions have a code of conduct that is periodically reviewed and ratified by the board of directors. The Canadian Competition Bureau, the Canadian Institute of Chartered Accountants, and the Ontario Human Rights Commission are all pushing for the adoption of codes of ethics by corporations.[13] Many Canadian and U.S. firms are also adding a position called "ethics director" or "ethics officer."

If codes of ethics are to be effective, there must be a control system and consistent enforcement when unethical behaviour occurs. Employees will then know that the company is serious about its pursuit of high ethical standards.

Provide Ethics Training

Can business ethics be "taught," either in the workplace or in schools? Business schools are important players in the debate about ethics, as they sensitize students to academic integrity issues such as plagiarism and cheating and how these unethical activities harm students and the educational system. But most analysts agree that companies must take the lead in educating employees about ethics. More and more firms are actually doing ethics training in which managers are reminded of the importance of ethical decision making and are being updated on the most current laws and regulations that are relevant for their firm. In some companies, a more dramatic approach is used: ethics seminars are taught by former executives who have spent time in prison for their own ethical misdeeds.[14]

Mary Gentile, a management consultant, says that employees know the difference between right and wrong, but they occasionally behave in an unethical fashion because they don't know how to resist pressure from peers and bosses to behave unethically.[15] She provides suggestions to help individuals resist such pressure and to act out their ethical values.

Dealing with ethical issues is not a simple matter, and many companies struggle with ethical dilemmas. This is particularly true for those that operate internationally. For example, Wells Fargo's reputation was damaged in 2016 when it became known that employees were opening false accounts for the bank's current customers in order to make it look like the bank's customer base was growing. But that situation looked relatively minor compared to the tragedy in Bangladesh when more than 1100 workers were killed when a garment factory collapsed (owners ignored warnings that the building was unsafe for occupancy). That factory produced goods for Western companies such as Joe Fresh.[16]

LO-2 CORPORATE SOCIAL RESPONSIBILITY

Corporate social responsibility (CSR) refers to the way in which a business tries to balance its commitments to important individuals and groups in its external environment. Mountain Equipment Co-op (MEC) is an example of an organization with a strong sense of social responsibility. The company does not simply try to maximize shareholder wealth, but rather seeks a balance between financial and social and environmental goals. To demonstrate its concern for social responsibility, MEC provides a safe and healthy workplace for employees, audits suppliers who produce the products it sells, minimizes the negative impact of manufacturing and packaging on the environment, ensures that waste is disposed of in an environmentally responsible manner, treats workers with dignity, pays workers fairly, and emphasizes energy efficiency, pollution control, and recycling potential in MEC buildings.[17]

Business firms that want to meet rigorous standards for social and environmental responsibility can be certified by B Corp. Companies that want to be certified must provide certain information about their operations, and if they qualify, they are certified as a B Corp by the non-profit B Lab. There are about 175 B Corp companies in Canada, one of which is Fairware, which produces sustainable and ethically sourced promotional merchandise.[18] Another B Corp company is Oliberte, which obtains materials for its durable leather shoes from Africa and manufactures the shoes in Ethiopia.[19]

There is some debate about the extent to which businesses should be concerned about social responsibility. One view, called *managerial capitalism*, is that a company's only responsibility is to make as much money as possible for its *shareholders*, as long as the company doesn't break any laws. Some people also fear that if businesses become too active in social concerns, they will gain too much control over how those concerns are addressed. These people point to the influence many businesses have been able to exert on the governmental agencies that are supposed to regulate them. Other critics of business-sponsored social programs argue that companies lack the expertise needed. They believe that technical experts, not businesses, should decide how best to clean up a polluted river, for example.

These arguments have been strongly challenged by an opposing view that says that companies must be responsible to a variety of stakeholders, including *customers, employees, investors, suppliers*, and the *local communities* in which they do business. Supporters of CSR believe that corporations are citizens just like individuals and therefore should help improve our lives. Others point to the vast resources controlled by businesses and note that because businesses often create many of the problems social programs are designed to alleviate, they should use their resources to help. Still others argue that CSR is wise because it benefits firms in terms of good public relations and that companies have become interested in CSR because that is what consumers prefer.[20]

An example of social responsibility in action is the **fair-trade movement**, which is motivated by several concerns: that workers in developing countries who produce various products are not being fairly treated on the job, that they are not receiving fair payment for the products they produced, and that illegal child labour is being used to produce the products. Companies in developed countries that are concerned about this problem work with non-profit organizations such as the Fairtrade Foundation and the Rainforest Alliance that certify farming cooperatives are paying workers fairly and are not damaging the environment.

The Fairtrade Labelling Organizations International (FLO) is a global non-profit network of fair-trade groups that work with cooperatives that represent producers of products such as coffee and chocolate. The FLO establishes standards for the producers' products and operations and enforces child labour laws. The money to support this activity comes from importers, manufacturers, and distributors who buy and sell commodities from FLO-certified producers. These seller groups then have the right to promote their products as "fair trade." Consumers who want to support programs that empower farmers in developing countries are often willing to pay more for "organic fair trade" products.

ChocoSol is a Toronto-based company that produces 1.4 tons of chocolate per month. Even though owner Michael Sacco has never had his company certified by a fair trade organization, he goes beyond what most fair-trade companies do: he travels to Mexico to talk with the farmers who actually produce the beans that ChocoSol uses in making chocolate. He also pays farmers more than the fair-trade price for their beans.[21] Divine Chocolate is another company that is taking fair-trade cocoa to the next level by returning a share of its profits to the farmers in their supply chain. Divine's largest shareholder group is Kuapa Kokoo, a fair-trade cocoa cooperative. Cocoa farmers who belong to this group not only receive a fair-trade price for their cocoa but also receive dividends from the profits of Divine Chocolate.[22]

CORPORATE SOCIAL RESPONSIBILITY The idea that a business should balance its commitments to individuals and groups that are directly affected by the organization's activities.

FAIR-TRADE MOVEMENT A movement designed to help workers in developing countries receive fair payments for their work.

Starbucks helps local farmers gain access to credit, develops, and maintains sustainability of the coffee crop and builds farmer support centres in Latin America and Africa to provide local farmers with agricultural and technical education.

Haak78/Shutterstock

LO-3 The Stakeholder Model of Responsibility

Organizational stakeholders are individuals and groups that are directly affected by the practices of an organization and therefore have a stake in its performance.[23] As companies have put increasing emphasis on their social responsibility to stakeholders, there has been a move to go beyond traditional *financial* measures such as return on investment. A new measure—called the Social Return on Investment (SROI)—has been developed that helps companies understand, manage, and communicate the *social* value of their activities for stakeholders.[24]

Companies that strive to be socially responsible usually concentrate on the following stakeholders: (1) customers, (2) employees, (3) investors, (4) suppliers, and (5) the local communities where they do business (see Figure 3.3). They also show concern for protecting the natural environment.

Responsibility Toward Customers

There are three key areas regarding the social responsibility of business toward customers: *consumer rights, unfair pricing*, and *ethics in advertising*.

Consumer Rights **Consumerism** is a movement dedicated to protecting the rights of consumers in their dealings with businesses. Consumers have the following rights:

- *The right to safe products.* The physical or mental health of consumers should not be damaged when they use a company's product, but this

ORGANIZATIONAL STAKEHOLDERS Groups, individuals, and organizations that are directly affected by the practices of an organization and that therefore have a stake in its performance.

CONSUMERISM A social movement that seeks to protect and expand the rights of consumers in their dealings with businesses.

FIGURE 3.3 Major corporate stakeholders

right isn't always guaranteed. In one of the most famous Canadian cases, 20 people died after eating listeria-contaminated meat made by Maple Leaf Foods.[25] Some years earlier, Merck Pharmaceuticals marketed a painkiller under the brand name Vioxx. When clinical trials linked the drug to an increased risk of heart attacks and strokes, Merck was forced to discontinue sales of Vioxx and recall supplies that it had already shipped.

- *The right to be informed about all relevant aspects of a product.* Food products must list their ingredients, clothing must be labelled with information about its proper care, and banks must tell you exactly how much interest you are paying on a loan. An example of how Volkswagen violated this right is described in Business Case 3 at the end of this chapter.
- *The right to be heard.* Procter & Gamble puts a toll-free number on many of its products that consumers can call if they have questions or complaints. Many other retailers offer money-back guarantees if consumers are not happy with their purchase.
- *The right to choose what they buy.* Central to this right is free and open competition among companies. Sometimes companies in an industry divide up a market so that they do not have to truly compete against each other. Such practices are illegal.
- *The right to be educated about purchases.* All prescription drugs now come with detailed information regarding dosage, possible side effects, and potential interactions with other medications.
- *The right to courteous service.* This right is hard to legislate, but as consumers become increasingly knowledgeable, they are more willing to complain about bad service. Consumer hotlines can also be used to voice service-related issues.

The boxed insert entitled "Retailers Are Watching You" provides information on another aspect of the responsibility of businesses to customers.

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

Retailers Are Watching You: Is That Okay?

Can a retailer track your daily movements and know if you recently visited a yoga studio or coffee shop? The short answer is yes. That technology exists, and many of you are willing participants based on your smartphone settings and opt-in decisions (whether you fully understand the implications or not). Are you okay with that? Do you consider it an invasion of privacy or simply the cost of enjoying the benefits of a truly connected world?

Understanding what consumers want and providing it when they want it have always been good business practices for retailers. In small towns, general stores carry a variety of goods, and the owner's ability to understand individual customer needs goes a long way in satisfying those needs. Today, big-city retailers may lack a personal relationship with you, but they have tools to help them understand who you are and what you buy. In addition, they can track your location, monitor your actions in high definition, and see how much time you spend in certain departments. Retailers are only beginning to scratch the surface of what is possible with modern technology, but you might be surprised to find out just how far they have come. Retailers and malls have set up Wi-Fi networks to satisfy customer needs, but that same technology permits them to track you. Here are a few interesting examples:

- Turnstyle Analytics (based out of Toronto) placed more than 3500 data-recording beacons in businesses in Canada and the United States (including Subway and Burger King locations) in just five years. They gathered information by linking customer emails from free Wi-Fi logins and charged businesses a service fee for insights about their behavior, such as visits, length per visit, frequency, and so on. Turnstyle Analytics was purchased by Yelp for US$20 million and rebranded as Yelp WiFi in 2018.
- Boingo Wireless Inc. has more than one million Wi-Fi locations on six continents; it has systems that can monitor traffic patterns in malls.
- Nearbuy Systems created a tool to allow retailers to cross-reference the websites shoppers visit on their phones with their location in the outlet. The company was bought out by RetailNext, a leading provider of in-store analytics that claims to observe 800 million shoppers a month. That's a lot of data!
- Using a technology from iSign Media Corp., Mac's and Couche-Tard can strategically send ads to anyone within a 300 metre radius of one of their stores. The messages request your permission, but the reminder of the location's proximity is automatic and potentially quite effective.
- Alexander Fernandes founded Vancouver-based QImaging for medical and industrial use but found a great market in retail surveillance. Fernandes and his team developed High Definition Stream Management, which makes it less expensive and easier to store and send images.

Retailers are tracking you via surveillance cameras and your smartphone. So next time you are posing for a selfie, don't forget to smile for the camera above your shoulder as well.

William87/Fotolia

All of this brings up questions of privacy, but the companies pushing the intrusive smartphone technology point out that you can always turn off your smartphone or the tracking capability. Of course, most consumers are unaware. Even if they are aware, will they really care? Retailers will argue that they are just trying to understand your needs to meet demands efficiently. What do you think?

CRITICAL THINKING QUESTION

1. How do you feel about these practices? Do you believe retailers are crossing ethical lines with some of this modern technology? Is this an invasion of privacy? Do you think they have gone too far? If not, where do you set the limits? Justify your answers.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. GoodGuide App **Source:** UL GoodGuide **Key Features:** Green app that uses a barcode to inform you about that product's environmental footprint.	Apple, Android
2. Spotfund App **Source:** Spotfund Technologies, Inc. **Key Features:** Raises donations for causes by leveraging your social networks for matching donations starting at $1, $2, and $3.	Android
3. iRecycle App **Source:** Earth911 Inc. **Key Features:** iRecycle provides access to more than 800 000 ways to recycle more than 400 materials.	Apple, Android

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" socially responsible and green business apps and identify the key features.

Legal standards regarding advertising differ across countries. For example, in Canada and the United States, cigarette advertising is generally not permitted on radio, television, or in print media, but in some other countries, there are no such restrictions.

Jeff Morgan 02/Alamy Stock Photo

Unfair Pricing Interfering with competition can also mean illegal pricing practices. *Collusion* among companies—including getting together to "fix" prices—is against the law. In 2017, Loblaw Companies Limited admitted that it had conspired with other grocers to fix the price of bread during the period 2001–2016.[26] Sobeys and Metro immediately denied that they were involved in the price-fixing scheme.[27] A few years earlier, three gas companies in Kingston and Brockville—Canadian Tire, Pioneer Energy, and Mr Gas Ltd.—were fined a total of $2 million by the Canadian Competition Bureau for fixing gas prices.[28]

In 2010, new laws came into effect that were designed to make it easier for the Competition Bureau to convict price-fixers. In addition, the maximum prison sentence for price fixing has been tripled to 14 years, and the maximum fine has increased from $10 million to $25 million.[29]

Ethics in Advertising There are several ethical issues in advertising, including truth-in-advertising claims, the advertising of counterfeit brands, the use of stealth advertising, and advertising that is morally objectionable.

Truth in advertising means that advertising claims must be demonstrably true, but it is not hard to find examples where this principle is violated. For example, one movie critic regularly gave rave reviews to movies released by Sony's Columbia Pictures. But the critic was simply created by Sony and did not actually exist.

Stealth advertising occurs when companies pay individuals to extol the virtues of their products to other individuals. For example, one advertising agency hired models to pose as "tourists." The models asked real tourists to take their picture with a new camera cellphone. The models then talked up the advantages of the new product to the unsuspecting real tourists.[30]

Morally objectionable advertising involves portrayals of individuals or products that offend customers' sense of decency. Actions as diverse as showing young female models in skimpy underwear, or targeting teenagers with tobacco and alcohol advertisements, or the way that women are portrayed in some video games are all seen as morally objectionable by many people.

Advertising of counterfeit brands is a problem in many different product lines, including perfume, luggage, pharmaceuticals, designer clothing, shoes, cigarettes, watches, sports memorabilia, golf clubs, and fine wines, to name just a few. Because cancer drugs are so expensive, fake versions have started to appear in various countries.[31] In 2017, Louis Vuitton filed a lawsuit against Dr Flea's Flea Market in Etobicoke, charging copyright infringement. The flea market has been raided by police three times in the past 10 years, and one raid yielded more than $1 million in counterfeit goods.[32] The U.S. government claims that the sale of counterfeit goods is pervasive at the Pacific Mall in Markham, Ontario, and that local authorities have ignored requests for action against the mall.[33] In 2017, online pharmacy Canada Drugs was fined $5 million for selling counterfeit drugs in the United States.[34] More information on the problem of counterfeit goods is provided in Chapter 12.

Responsibility Toward Employees

In Chapter 8, we describe the human resource management activities that are essential to a smoothly functioning business. These same activities—recruiting, hiring, training, promoting, and compensating—are also the basis for socially responsible behaviour toward employees. Socially responsible companies hire and promote workers without regard to race, sex, or other irrelevant factors; provide a safe and non-bullying workplace; do not tolerate managers who sexually harasses subordinates; promote a work–life balance among employees; emphasize employee mental health; and pay a living wage.

Progressive companies go well beyond legal requirements, hiring and training the so-called hardcore unemployed (people with little

education and training and a history of unemployment) and those who have disabilities. Bank of Montreal, for example, sponsors a community college skills-upgrading course for individuals with hearing impairments. Royal Bank provides managers with discrimination awareness training. Rogers Communications provides individuals with mobility restrictions with telephone and customer-service job opportunities.[35]

Businesses also have a responsibility to respect the privacy of their employees, though there is some controversy about exactly how much control companies should have in areas like drug testing and computer monitoring. When Canadian National Railway instituted drug testing for train, brake, and yard employees, 12 percent failed. Trucking companies have found that nearly one-third of truckers who had an accident were on drugs.[36] It seems likely that safety will be compromised when employees in transportation companies use drugs, but there is controversy about what kind of testing is appropriate.

Differences of opinion are also evident with regard to the computer monitoring of employees while they are at work. New software programs allow bosses to see things like employees' Facebook comments and their opinions about pubs on Foursquare. Social Sentry, a tracking system developed by Social Logix, records employee social media activity from work or home. The program looks for workers who leak sensitive company information or badmouth the company.[37] Workers shouldn't damage the reputation of the company they work for, but there is no consensus on what constitutes going "too far."

Whistle-Blowers Respecting employees as people also means respecting their behaviour as ethically responsible individuals. Employees who discover that their company has been engaging in practices that are illegal, unethical, or socially irresponsible should be able to report the problem to higher-level management and be confident that managers will stop the questionable practices. If no one in the organization takes action to resolve the problem, the employee might decide to inform a regulatory agency or the media. At this point, the person becomes a **whistle-blower**—an employee who discovers and tries to put an end to a company's unethical, illegal, or socially irresponsible actions by publicizing them.

One of the most publicized cases was that of WestJet employee Melvin Crothers, who discovered that a fellow employee was somehow accessing a restricted Air Canada website in order to obtain data about Air Canada's "load factor" (the proportion of seats filled) on certain flights. It turned out that the employee had formerly worked for Air Canada, but his access to confidential Air Canada data had inadvertently not been cancelled. After discovering this fact, Crothers had a conversation with a former WestJet president who was heading up an Air Canada discount airline. That led to Air Canada filing a lawsuit against WestJet. Crothers resigned from WestJet four days later.[38]

Whistle-blowers are often demoted or fired when they go public with their accusations. Even if they are able to keep their jobs, they may still be treated as outsiders and experience hostility from co-workers. One study found that about half of all whistle-blowers eventually get fired, and about half of those who get fired subsequently lose their homes and/or families.[39]

Federal legislation to protect whistle-blowers was introduced in Canada in 2003. In 2009, the Investment Industry Regulatory Organization of Canada (IIROC) opened a whistle-blower hotline as a result of an increased incidence of securities fraud such as Ponzi schemes. Calls regarding fraud are forwarded to four of the top people at the IIROC so that swift action can be taken.[40] The boxed insert entitled "Key Issues in Whistle-Blower Programs" presents information on several dilemmas that are evident in whistle-blower programs.

The safety of workers is an important consideration for all organizations. The required use of protective clothing when dealing with toxic substances is just one example of precautions that companies can take to protect workers while they are on the job.

Ahn Young-joon/The Canadian Press

Responsibility Toward Investors

It might sound odd to say that managers can be irresponsible toward investors because the investors are the owners of the company, but managers behave irresponsibly when they do things like paying themselves outlandish salaries and bonuses or spending large amounts of company money for their own personal comfort. If managers do not use the firm's financial resources in a responsible way, the ultimate losers are the owners because they do not receive the earnings, dividends, or capital appreciation due to them. Financial mismanagement can take many forms, including *improper financial management, misrepresentation of finances, cheque kiting*, and *insider trading*.

Improper Financial Management Executives may make bad financial decisions, pay themselves outlandish salaries and bonuses, or use investor money to buy expensive personal items like yachts and $10 000 watches. In 2017, the government, investors, and the general public were outraged when five top executives at Bombardier received a nearly 50 percent salary increase. These increases were viewed as inappropriate because the company had received millions of dollars in government aid and because the company had been experiencing significant financial problems. After the outcry, the company delayed some of the increases.[41] A few years earlier, R. Allen Stanford, head of the Stanford Financial Group, was found guilty of wasting investor money on yachts, failing businesses, and cricket tournaments. He was sentenced to 110 years in prison.[42]

WHISTLE-BLOWER An individual who calls attention to an unethical, illegal, or socially irresponsible practice on the part of a business or other organization.

DISRUPTIONS IN BUSINESS

Key Issues in Whistle-Blower Programs

Several key issues must be understood if whistle-blowing programs are to be effective. The first issue is whether payment should be made to whistle-blowers for the information they provide. The first program to pay whistle-blowers in Canada was introduced in 2016 by the Ontario Securities Commission (OSC); it pays whistle-blowers up to $1.5 million under certain circumstances. Payments to U.S. whistle-blowers are much larger than those in Canada. As of mid-2017, the Securities and Exchange Commission (SEC) had paid out about $85 million to 32 different whistle-blowers. The largest award was $30 million.

Those who support paying whistle-blowers argue that it is a good idea because (a) it gives employees an incentive to report bad corporate practices, (b) companies try to discredit whistle-blowers and this likely reduces the person's future job prospects, and (c) the government can recover large sums of money from companies that behave badly if whistle-blowers come forward. Opponents argue that if whistleblowers are paid, they (a) will have an incentive to bypass existing compliance programs and go straight for the money, and (b) may make questionable charges as they put

Fred Lum/The Globe and Mail/The Canadian Press

their own financial interests ahead of the interests of the company they work for.

The second issue is the difficulty in actually collecting fines that are levied against companies that are found guilty of bad behaviour. For example, in 2013, the OSC assessed penalties of $80 million, but only $3.2 million was collected. In 2014, $61.6 million was assessed, but only $1.7 million was collected. In 2015, penalties totalled $52.9 million, but only $7.5 million was actually collected. Other regulatory organizations, such as the Investment Industry Regulatory Authority of Canada (IIROC) and the Mutual Funds Dealers Association, have also had trouble collecting on the penalties they have levied.

The third issue is that of leniency for whistle-blowers. If whistle-blowers know about bad company behaviour because they were actually involved in it (and may have profited from it), it seems somehow unreasonable to pay them for blowing the whistle. The OSC recognizes that there is an ethical dilemma when making payments to some whistle-blowers. The OSC can therefore reduce awards for a whistle-blower if that person was involved in directing or planning securities violations.

There is no simple way to resolve these three issues, but most people seem to think that at least some program should be in place to ensure that bad corporate behavior is brought to light. And whistle-blower programs have resulted in more people coming forward to report corporate misdeeds. In the United States, for example, the number of whistle-blower tips increased from 3000 in 2012 to 4000 in 2015.

CRITICAL THINKING QUESTIONS

1. In your own words, state the pros and cons of paying whistle-blowers for the information they provide. In your opinion, do the pros or the cons have more weight?
2. What are the arguments for and against granting leniency to whistle-blowers who have reported illegal or unethical activities but have themselves been involved in those illegal or unethical activities?

Misrepresentation of Finances One of the most highly publicized (and long-running) cases in this area started back in 1998 when Garth Drabinsky and Myron Gottlieb, the top managers at a theatre company called Livent, Inc., were charged with producing false financial statements to make the company look more profitable than it actually was. The case worked its way through the courts very slowly, but in 2009, both Drabinsky and Gottlieb were found guilty and sentenced to prison terms.[43] In another case, Conrad Black, who was then CEO of Hollinger International, was convicted of fraud and obstruction of justice and was sentenced to six and a half years in prison. The infamous Bernie Madoff pleaded guilty to swindling investors in a $50 billion fraud. He is likely to spend the rest of his life in prison.[44]

Cheque Kiting This involves writing a cheque from one account, depositing it in a second account, and then immediately spending money from the second account while the money from the first account is still in transit. A cheque from the second account can also be used to replenish the money in the first account, and the process starts all over again. This practice obviously benefits the person doing the kiting, but it is irresponsible because it involves using other people's money without paying for it. The Bank of Montreal sued several U.S. and Canadian businesspeople, alleging that they ran a cheque kiting scheme that cost BMO $20 million.[45]

Insider Trading Using confidential information to gain from the purchase or sale of stock is called **insider trading**. The trader uses information not available to the general investor by either buying stock just before its price goes up or selling stock just before its price goes down. The Alberta securities regulator charged several executives at Grande Cache Coal Corp. with insider trading for selling company stock before the company disclosed negative news about its sales.[46] Raj Rajaratnam, the co-founder of Galleon Group, was sentenced to 11 years in prison for insider trading,[47] and Matthew Martoma, who worked for an affiliate of SAC Capital Advisors, was sentence to nine years.[48] One study showed that there was "abnormal" trading in 25 percent of takeover deals between 1996 and 2012.[49] Critics say that the government is not doing nearly enough to stop insider trading, but the offence can be hard to prove because evidence is often circumstantial.[50]

INSIDER TRADING The use of confidential information to gain from the purchase or sale of stock.

Responsibility Toward Suppliers

Businesses that are socially responsible take care when managing their relationships with their suppliers because they recognize the importance of mutually beneficial partnership arrangements. Thus, they keep suppliers informed about the company's plans, and they negotiate delivery schedules and prices that are acceptable to both firms. Some firms go so far as to allow suppliers access to the firm's internal records so the supplier can better serve the firm. Toyota and Amazon.com are among the companies acknowledged to have excellent relationships with their suppliers.

In contrast, some large retailers put intense pressure on their suppliers to lower their prices. If the supplier cannot get the price down to the level the retailer demands, the retailer drops the supplier and finds another one that will meet the price. The retailer does this so it will be able to charge low prices to consumers and thereby improve its market share. Consumers like the low prices, but suppliers may have difficulty surviving because they cannot cover their costs.

Responsibility Toward Local and International Communities

Businesses can demonstrate socially responsible behaviour in their local communities by contributing to local programs like community hockey, by donating to charities such as the United Way, and by many other actions that support an improved quality of life for people who live in the local community where the business operates.

Corporate Charitable Donations Many companies donate money and time to different causes. Canada Goose, the outerwear company, pays for shipments to Arctic communities and supplies free fabrics, buttons, and zippers to Inuit sewers, who then make hand-made jackets and other clothing for their families and neighbours.[51] The "Celebration of Giving" program at Telus has generated millions of dollars of donations to charities, and Telus employees have donated thousands of hours of volunteer work.[52] At AltaGas, employees can take two paid days off per year to volunteer at a charity of their choice.[53] Unilever Canada gives employees four afternoons a year for community activities.[54] Tim Hortons' Children's Foundation built a camp for underprivileged children at Sylvia Lake in Manitoba. Almost all large Canadian companies make an annual charitable contribution of some sort, and the average of those contributions is in the hundreds of thousands of dollars.[55]

Socially responsible companies acknowledge their commitment to their stakeholders in each country where they do business. Daimler, for example, has investors not only in Germany but also in Canada, the United States, Japan, and various other countries. It also has suppliers, employees, and customers in multiple countries, so its actions affect communities in many different countries. International businesses must also address their social responsibilities in areas such as wages, working conditions, and environmental protection across different countries (that have varying laws and norms). ExxonMobil, for example, has helped build hospitals and expand schools in Angola, and it also supports a local anti-malaria program.

Responsibility Toward The Environment

Controlling **pollution**—the injection of harmful substances into the environment—is a significant social responsibility challenge for business firms. Air, water, and land pollution are the focus of most anti-pollution efforts by business and governments.

Air Pollution *Air pollution* results when a combination of factors lowers air quality. Large amounts of chemicals such as the carbon monoxide emitted by automobiles contribute to air pollution. So do smoke and other chemicals emitted by manufacturing plants. Australia is the world's largest greenhouse gas emitter *per capita*, contributing 7.3 percent of the world's total. The United States (at 6.5 percent) and Canada (at 6.4 percent) are close behind.

In Canada, air quality has actually improved over the past 30 years. Between 1979 and 2015, ground level ozone declined 27 percent, sulphur dioxide 92 percent, nitrogen dioxide 74 percent, and carbon monoxide 90 percent.[56] But in the developing countries, there are significant concerns about air pollution. In China, for example, 100 coal-fired power plants are being built every year, and each plant uses 1.2 million tonnes of

POLLUTION The introduction of harmful substances into the environment.

Canada Goose is one of hundreds of companies in Canada that make charitable donations of money, products, and employee volunteer time. In doing so, they fulfill their social responsibility to society.

Aaron Vincent Elkaim/The Canadian Press

High pollution levels in the city centre of Shanghai, China. Air pollution is a major problem in some large cities in China because power plants and factories have not installed proper pollution controls.

Oceanfishing/Shutterstock

coal and emits 3.7 million tons of carbon dioxide. High pollution levels in China in late 2016 caused demands for face masks and filters to soar and a "red alert" to be declared. Such an alert requires that schools and factories close, and automobile use is sharply curtailed.[57] The boxed insert entitled "Which Car Pollutes Less?" provides some interesting details on gasoline-powered and electric automobiles.

Concerns about air pollution have led to an increasing emphasis on the development of clean, renewable energy such as wind, solar, and hydroelectric power as a way to reduce the pollution caused by burning fossil fuels. Significant progress was made during the past decade, and the cost of solar and wind power has dropped 64 percent and 41 percent, respectively.[58] But many people are unwilling to make the sacrifices that are necessary to further reduce carbon emissions. A poll of 12 000 people in 11 countries showed that less than half of the respondents were willing to make lifestyle changes to reduce carbon emissions, and only 20 percent said they would be willing to spend extra money to fight climate change.[59]

Over the past 20 years, there have also been several attempts to get an international agreement that will involve all countries in the effort to reduce greenhouse gas emissions. The 2015 Paris Climate Agreement was signed by 196 countries that agreed to take actions that will mitigate the negative effects of global warming by reducing the amount of carbon dioxide in the atmosphere. The goal is to keep average global temperatures from rising more than 2 degrees Celsius. The United States is the only country that has refused to sign the Agreement. Critics argue that the Agreement has no effective enforcement mechanism and that carbon dioxide levels will continue to rise.

The impetus for the Paris Agreement was the fact that during the past 100 years, the amount of carbon dioxide in the atmosphere has increased from about 300 parts per million to 375 parts per million. Many scientists believe this increase is causing *global warming*—an increase in the earth's average temperature. But a debate is now evident on this issue, with some scientists arguing that solar fluctuations are much more important than carbon dioxide levels in causing global warming and cooling. The head of space research at the prestigious Russian Academy of Science's Pulkovo Observatory predicts that a cooling period has already begun, and a team of European researchers predicts a mini ice age starting in 2030.[60] These conflicting claims by qualified scientists make it difficult for consumers to know what actions they should take to protect the environment.

Some people think that the way to reduce greenhouse gas emissions is to introduce a carbon tax. For example, Ontario's "cap and trade"

THE GREENING OF BUSINESS

Which Car Pollutes Less? Electric or Gasoline?

As we saw in the Greening of Business insert in Chapter 2, electric cars may be about to start taking market share away from traditional gasoline-powered cars as consumers become more concerned about the environment. Because electric cars generate no air pollution when they are driven, many people assume that they are superior to pollution-generating gas-powered cars. But things are not quite that simple. We must take into account the amount of pollution that is generated in the total life cycle of both electric and gas-powered cars. Three important areas are: (1) the amount of pollution that is generated when the car is *manufactured*, (2) when the car is *driven*, and (3) when *fuel* (gas or electricity) is produced for the car.

Multiple comprehensive life-cycle studies have been conducted in recent years, and there is a general level of consensus on the following points:

- Both types of cars generate pollution.
- The process that is used to *manufacture* gas-powered cars produces less pollution than the process that is used to manufacture electric cars.
- The *operation* of electric cars produces less pollution than gas-powered cars.

Miroslav110/123RF

- In terms of *fuel*, if electricity is produced through wind, solar, or hydro power, then electric cars are less polluting (overall) than gas-powered cars; but if electricity is produced by burning coal, then gas-powered cars are less polluting (overall) than electric cars.

These findings make it difficult to draw any sweeping conclusions about which type of car is best for the environment. A further complication is that a substantial amount of the electricity that is produced worldwide is the result of burning coal. So there are many places where gas-powered cars will actually be less polluting than electric cars when the total life cycle is taken into account. Although there is a trend away from the use of coal to produce electricity, many experts think that coal is going to continue to be important in the generation of electricity for many years because it is abundant and relatively cheap. Because Canada has been active in reducing the use of coal, it might be argued that electric cars may be best here. But Canadians often drive long distances, and gasoline-powered cars have a much greater range than electric cars and are much easier to refuel. Both of these factors mean that consumers may be less willing to purchase electric cars.

Nothing is simple in the debate about electric versus gas-powered cars. For example, if we take factors beyond the preceding ones into account, such as cost, the subsidies that Ontario is giving for electric cars cost the equivalent of more than $500 per ton of emissions that are avoided by driving electric cars. But that number is much higher than the federal carbon pricing plan, which will be just $50 a tonne by 2022. One life-cycle analysis showed that a compact Mitsubishi Mirage with an internal combustion engine produced less carbon than an electric Tesla Model S. So why should Tesla buyers get a big rebate in Ontario?

CRITICAL THINKING QUESTIONS

1. All things considered, are electric cars more environmentally friendly than traditional gas-powered cars? Explain your reasoning.
2. Do you prefer an electric vehicle or a gas-powered car? Explain your reasoning.

system puts emissions caps on large industrial operations and on energy providers, and these caps decline by 4 percent each year. Companies that exceed their cap buy carbon credits from the government, and those credits give companies the right to exceed their cap.[61] The money that is collected is used to fund clean-air projects. Ontario received $1.9 million from purchases of carbon credits in 2017 and expects to receive between $5 billion and $9 billion over the next four years by selling carbon credits.[62] It is hoped that the declining caps will be an incentive for companies to reduce their greenhouse gas emissions.

In 2018, the federal government imposed a mandatory carbon price of $10/tonne; the price will rise to $50/tonne by 2022.[63] But the idea of a carbon tax is controversial, and critics argue that it will slow economic growth, increase business costs, reduce our standard of living, and undermine Canadian international competitiveness.[64] A major concern is that Canadian businesses will simply move to a lower-cost area that does not have a carbon tax (e.g., a U.S. state) and result in job losses in Canada. One way to avoid these problems is to exempt Canadian exports from the carbon tax when the exports are going to countries that do not have such a tax and to put tariffs on imports into Canada from countries that do not have a carbon tax.[65]

There are also concerns that the carbon tax idea is subject to fraud. Suppose, for example, that a forest operator sells a carbon permit to a manufacturing firm that is exceeding its cap. That one transaction is fine, but what if the forest firm sells the same carbon permit to several manufacturers instead of just one? That will make it appear like a lot more carbon dioxide has been reduced than is actually the case. Multibillion-dollar fraud has already occurred in the European Union's carbon trading market, and Europol's Criminal Finances and Technology section estimates that up to 90 percent of all carbon market volume in certain EU nations is fraudulent.[66]

Water Pollution For many years, businesses and municipalities dumped their waste into rivers, streams, and lakes with little regard for the effects. Thanks to new, stricter legislation and increased awareness on the part of businesses, water quality is improving in many areas. But water pollution is still a concern, and several high-profile oil spills—such as the BP disaster in the Gulf of Mexico in 2010—have occurred. Pollution of the oceans by both cargo and passenger ships is a significant problem, and ships cause more *air* pollution than all of the cars in the world combined.[67]

Land Pollution *Toxic wastes* are dangerous chemical and radioactive by-products of various manufacturing processes that are harmful to humans and animals. Changes in forestry practices, limits on certain types of mining, and new forms of solid waste disposal are all attempts to address the issue of toxic waste.

An entire industry—**recycling**—has developed as part of increased consciousness about land pollution. For example, MET Fine Printers in Vancouver, which used to spend $3000 each month on waste disposal, reduced that cost to just $300 after introducing a recycling program.[68] Keurig Canada Inc., which has received much negative publicity about the millions of its discarded coffee pods that pile up in landfills across Canada, announced that its popular coffee pods will now be recyclable.[69]

Plant and animal waste can be recycled to produce energy; this is referred to as *biomass*. Waste materials like sawdust, manure, and sludge are increasingly being turned into useful products. Ensyn Corp., for example, converts sawdust into liquid fuel by blasting wood waste with a sand-like substance that is heated. What's left is bio-oil.[70]

RECYCLING The reconversion of waste materials into useful products.

One concern regarding land pollution is the practice of fracking—the injection of water and chemical compounds into underground rock formations in order to break them apart. After this has been done, petroleum can be extracted in areas where drilling was previously impossible. Fracking has led to a dramatic increase in the supply of oil and has resulted in lower energy prices. But environmentalists argue that the chemical compounds used in fracking are polluting underground water sources and that fracking is causing an increase in earthquakes.[71]

Under the Canadian and Ontario Environmental Protection Acts, land pollution liability for a business firm can run as high as $2 million per day. To avoid such fines, companies must prove that they showed diligence in avoiding an environmental disaster such as an oil or gasoline spill.[72] The Environmental Choice program, sponsored by the federal government, licenses products that meet environmental standards set by the Canadian Standards Association. Firms whose products meet these standards can put the logo—three doves intertwined to form a maple leaf—on their products.[73]

Consumers and Pollution Consumers can take several actions to reduce air, water, and land pollution, including recycling, walking instead of driving, reducing household waste, using environmentally friendly products, and so on. But each of these actions requires consistent effort, and not everyone is motivated to make the effort. Even consumers who are motivated may be thwarted in their efforts to help the environment. For example, consumers may want to buy products that are environmentally friendly, but companies often make misleading claims about the green characteristics of their products. A study of 5296 products by TerraChoice, an environmental marketing company, found that there was at least one misleading green claim on 95.6 percent of the products they studied.[74] The study also found that 100 percent of toy manufacturers and 99.2 percent of baby-product makers were guilty of "*greenwashing*"—claiming that their products had environmental benefits when they didn't. Having a product certified by a recognized, independent third party reduced the incidence of greenwashing, but fake certifications are readily available on the internet.

Greenwashing has generated a certain level of skepticism among consumers and that may make them reluctant to adopt a more environmentally friendly lifestyle. A survey by the Boston Consulting Group in Toronto showed that one-third of Canadians say they often purchase environmentally friendly products, but 78 percent are unwilling to pay the higher price that is often evident for green products.[75] Another online survey of 1000 Canadians showed that people are willing to do certain small things (e.g., buying environmentally friendly lightbulbs), but they are skeptical about adopting bigger measures.[76] A third study, conducted by Procter & Gamble (P&G), showed that consumers are reluctant to spend more money just because a product is eco-friendly. Only 10 percent of consumers who were surveyed said they would pay a higher price (or accept a performance decrease) for a product that would benefit the environment. What's worse, 75 percent said they would not accept *any* tradeoff.[77]

The proliferation of green claims that are being made by companies is also creating confusion among consumers. They are confused about the green options that are available because there is such a wide array of eco-labels on products. Ecolabelling.org is a Vancouver-based company that has identified 274 eco-labels, 23 of them originating in Canada.[78] There are labels touting compostable products, fair-trade products, energy-efficient products, forest stewardship products, lake-friendly products, and organic products. These eco-labels are supposed to help consumers sift

through environmental claims, but what do these labels actually mean? How can shoppers know which products are really eco-friendly and which ones are simply hype?

One option is to look at websites like GoodGuide, which allows consumers to identify the ingredients found in the products they buy.[79] The website reports on both the environmental impact of products as well as their health effects. Website visitors enter a product name and get a score. The higher the score, the safer and more environmentally friendly the product is. The goal is to help consumers get past the green *claims* of companies and right to the *facts*.

IMPLEMENTING SOCIAL RESPONSIBILITY PROGRAMS

Thus far, we have discussed corporate social responsibility (CSR) as if there is agreement on how companies should behave in most situations. In fact, different companies have different approaches to social responsibility.

LO-4 Approaches to Social Responsibility

As Figure 3.4 illustrates, the four stances an organization can take concerning its obligations to society fall along a continuum ranging from the lowest to the highest degree of socially responsible practices. Keep in mind that organizations do not always fit neatly into one category or another. The Ronald McDonald House program has been widely applauded, for example, but McDonald's has also come under fire for allegedly misleading consumers about the nutritional value of its food products.

Obstructionist Stance

Businesses that take an *obstructionist stance* to social responsibility do as little as possible to solve social or environmental problems. When they cross the ethical or legal line that separates acceptable from unacceptable practices, their typical response is to deny or cover up their actions. Firms that adopt this position have little regard for ethical conduct and will generally go to great lengths to hide wrongdoing. Volkswagen's attempt to falsify test readings about the pollution produced by its diesel engines is an example of obstructionist behaviour.

Defensive Stance

An organization adopting a *defensive stance* will do everything required of it legally, but nothing more. Such a firm, for example, would install pollution-control equipment dictated by law, but would not install higher-quality equipment even though it might further limit pollution. Tobacco companies in Canada and the United States generally take this position in their marketing efforts because they are legally required to include warnings to smokers on their products and to limit advertising to prescribed media. They follow these rules to the letter of the law, but some use more aggressive marketing methods in countries that have no such rules.

Accommodative Stance

A firm that adopts an *accommodative stance* meets its legal and ethical requirements but also goes further in certain cases if they are asked, and solicitors must convince the firms that these programs are worthy of funding. Many organizations respond to requests for donations to community hockey teams, Girl Guides, youth soccer programs, and so forth. But someone has to knock on the door and ask; accommodative organizations do not necessarily or proactively seek avenues for contributing.

Proactive Stance

Firms that adopt a *proactive stance* take to heart the arguments in favour of CSR. They view themselves as good citizens of society, and they proactively seek opportunities to contribute. The most common—and direct—way to implement this stance is by setting up a foundation to provide direct financial support for various social programs. The foundation may be either private (controlled by a single donor or family) or public (managed by an independent board of directors that is not controlled by one donor or family). For example, The Calgary Foundation is a public foundation that manages assets of more than $750 million.[80] The money earned on these assets is disbursed to various charities.

Managing Social Responsibility Programs

The management of social responsibility programs can be done at both formal and informal levels.

Formal Activities

At the *formal level*, top management states strong support for CSR and makes it a factor in strategic planning. Without the support of top management, no program can succeed. A specific executive must be given the authority to act as the director of the firm's social agenda. This individual monitors the program and ensures that its implementation is consistent with the policy statement and the strategic plan. Some companies appoint a committee of top managers to develop plans that detail the level of

<<< FIGURE 3.4 Spectrum of approaches to social responsibility

support that will be provided for the firm's social responsibility initiatives. For example, the company may decide to set aside a percentage of profits for social programs. Levi Strauss has a policy of giving 2.4 percent of its pretax earnings to worthy causes.

All of the organization's formal activities are summarized in a **social audit**, which is a systematic analysis of how a firm is using funds earmarked for its social responsibility goals and how effective these expenditures have been.[81] An important related element in a social responsibility program is the idea of **sustainable development**, which means pursuing activities that meet current needs but will not put future generations at a disadvantage when they attempt to meet their needs. In 2015, Canada adopted the United Nations' 17 Sustainable Development Goals, which are designed to improve the health of people and the planet.[82] Agrium Inc., a fertilizer company, has described how it is pursuing seven of those goals.

More generally, Canadian businesses publish sustainability reports that explain how companies are performing on issues such as the environment, employee relations, workplace diversity, and business ethics. A study by Ottawa-based Stratos Inc. found that 60 percent of the 100 largest Canadian companies report at least some sustainability performance information.[83] For example, Artopex Inc., a furniture manufacturer in Quebec, has an active sustainability program.[84] Baxter Corp., a medical products company, publishes an annual Global Sustainability Report measuring the company's progress on nine sustainable priorities, including reductions in its carbon footprint.[85] Social audits and sustainability reports together constitute *triple-bottom-line reporting*—measuring the social, environmental, and economic performance of a company. Vancouver City Savings Credit Union (Vancity) uses triple-bottom-line reporting.[86] Companies that adopt mandatory sustainability reporting requirements see positive effects on corporate performance.[87]

The Global 100 list of the most sustainable corporations in the world is based on factors like energy productivity (the ratio of sales to energy consumption) and water productivity (sales to water usage). In the 2017 ranking, Siemens AG (Germany) was first, Storebrand ASA (Norway) second, and Cisco Systems (United States) third. Several Canadian companies made the list, including RBC (#37), Enbridge (#39), and Sun Life Financial (#45).[88]

SOCIAL AUDIT A systematic analysis of how a firm is using funds earmarked for social responsibility goals and how effective these expenditures have been.

SUSTAINABLE DEVELOPMENT Activities that meet current needs but will not put future generations at a disadvantage when they try to meet their needs.

Informal Activities

At the *informal level*, the culture of the organization (see Chapter 6) is very important in either inhibiting or facilitating social responsibility activities. Although members of the organization may not actually talk much about the culture, it can have a strong influence on their attitudes and behaviour, including their view of social responsibility. When organizational leaders demonstrate ethical leadership as part of the organizational culture, they convey to employees that socially responsible behaviour is valued.

Whistle-blowing behaviour by employees is another facet of informal activities that can enhance social responsibility (even though some members of top management may view such behaviour negatively). How an organization responds to whistle-blowing gives some insight into its actual stance on social responsibility. An employee who observes questionable behaviour usually reports the incident to his or her boss first. If nothing is done, the whistle-blower may then take more formal steps and report to higher-level managers or to an ethics committee. Eventually, the person may have to go to a regulatory agency or even the media to be heard. Whistle-blowing typically does not become a truly formal activity until the employee cannot get any satisfaction within the company.

LO-5 SOCIAL RESPONSIBILITY AND THE SMALL BUSINESS

In the most general sense, small businesses face many of the same ethical and social responsibility issues as large businesses. But small business owners face many specific ethical dilemmas that have an immediate (and perhaps profound) effect on their business. For example, as the owner of a small garden supply store, how would you respond to a building inspector's suggestion that a cash payment would "expedite" your application for a building permit? As the manager of a nightclub, would you call the police, refuse service, or sell liquor to a customer whose ID card looked forged? Or, as the owner of a small medical laboratory, would you call the board of health to make sure that it has licensed the company you want to contract with to dispose of the lab's medical waste? As the owner of a small manufacturing firm, are you justified in overcharging by 5 percent a customer whose purchasing agent is lax? As the owner of a small computer services company, should you pad your income statement a bit to increase the chance that you will get a much-needed bank loan?

Other dilemmas present themselves to small business owners in the form of social responsibility issues. For example, can a small business afford to pursue CSR objectives? Should it sponsor hockey teams, make donations to the United Way, and buy lightbulbs from the Lion's Club? Should it join the local chamber of commerce and support the Better Business Bureau because it is the responsible thing to do or just because it is good business? Most of these decisions have financial implications, and the owners of many small firms feel that they do not have any financial flexibility.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 EXPLAIN HOW INDIVIDUALS DEVELOP THEIR PERSONAL *CODES OF ETHICS* AND WHY ETHICS ARE IMPORTANT IN THE WORKPLACE.

Individual *codes of ethics* are derived from social standards of right and wrong. Ethical behaviour is behaviour that conforms to generally accepted social norms concerning beneficial and harmful actions. Because ethics affect the behaviour of individuals on behalf of the companies that employ them, many firms are adopting formal statements of ethics. Unethical behaviour can result in loss of business, fines, and even imprisonment.

LO-2 DISTINGUISH *ETHICS* FROM *SOCIAL RESPONSIBILITY* AND IDENTIFY *ORGANIZATIONAL STAKEHOLDERS.*

Ethics are individual beliefs about what is right and wrong, whereas *social responsibility* refers to the way a firm attempts to balance its commitments to organizational stakeholders. Stakeholders are individuals, groups, and organizations that are directly affected by the practices of an organization and that therefore have a stake in its performance. The stakeholders that businesses usually pay the most attention to are *investors, employees, customers*, and *local communities*. Businesses formerly paid almost exclusive attention to investors, but public pressure and government regulations have forced businesses to consider other stakeholders as well.

LO-3 SHOW HOW THE CONCEPT OF SOCIAL RESPONSIBILITY APPLIES BOTH TO ENVIRONMENTAL ISSUES AND TO A FIRM'S RELATIONSHIPS WITH CUSTOMERS, EMPLOYEES, AND INVESTORS.

Social responsibility toward the environment requires firms to minimize pollution of air, water, and land. Social responsibility toward customers requires firms to provide products of acceptable quality, to price products fairly, and to respect consumers' rights. Social responsibility toward employees requires firms to respect workers both as resources and as people who are more productive when their needs are met. Social responsibility toward investors requires firms to manage their resources and to represent their financial status honestly.

LO-4 IDENTIFY FOUR GENERAL *APPROACHES TO SOCIAL RESPONSIBILITY* AND DESCRIBE THE FOUR STEPS A FIRM MUST TAKE TO IMPLEMENT A *SOCIAL RESPONSIBILITY PROGRAM.*

An *obstructionist* stance on social responsibility is taken by a firm that does as little as possible to address social or environmental problems and that may deny or attempt to cover up problems that may occur. The *defensive* stance emphasizes compliance with legal minimum requirements. Companies adopting the *accommodative* stance go beyond minimum activities, if asked. The *proactive* stance commits a company to actively seeking to contribute to social projects. Implementing a social responsibility program entails four steps: (1) drafting a policy statement with the support of top management, (2) developing a detailed plan, (3) appointing a director to implement the plan, and (4) conducting social audits to monitor results.

LO-5 EXPLAIN HOW ISSUES OF SOCIAL RESPONSIBILITY AND ETHICS AFFECT SMALL BUSINESSES.

Managers and employees of small businesses face many of the same ethical questions as their counterparts at larger firms; they also face the same issues of social responsibility and the same need to decide on an approach to social responsibility. The differences are primarily differences of scale.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Write a one-paragraph description of an ethical dilemma you faced recently (including the outcome). Analyze the situation using the ideas presented in this chapter. Make particular reference to the ethical norms of utility, rights, justice, and caring in terms of how they impacted the situation. What would each of these suggest about the correct decision? Is this analysis consistent with the outcome that actually occurred? Why or why not?
2. What kind of company wrongdoing would most likely prompt you to be a whistle-blower? What kind of wrongdoing would be least likely? Explain the difference.
3. In your opinion, which area of social responsibility is most important to you? Why? Are there areas other than those noted in this chapter that you consider important as well? Describe those areas and indicate why they are important.
4. Identify some specific social responsibility issues that might be faced by small business managers and employees in each of the following areas: environment, customers, employees, and investors.
5. Choose a product or service and explain the social responsibility concerns that are likely to be evident in terms of the environment, customers, employees, and investors.
6. What role should the government play in social responsibility? Should government create more regulations to encourage businesses to uphold their responsibility to stakeholders? Or should government take a laissez-faire approach and allow businesses to be as socially responsible as they choose? Explain your reasoning.

APPLICATION EXERCISES

7. Describe your personal code of ethics. Include what you think constitutes right and wrong, as well as your ethical framework for making decisions. Do you think your personal code of ethics might clash with the practices of some companies? If so, how might you resolve these differences?
8. Develop a list of the major stakeholders of your college or university. What priority does the school assign to these stakeholders? Do you agree or disagree with this priority? Explain your reasoning.
9. Interview the owner of a local small business. Ask the owner to (a) describe the kinds of socially responsible activities the company is currently involved in, and (b) identify the factors that facilitate and inhibit socially responsible behaviour in small businesses.
10. Using newspapers, magazines, and other business references, identify a company that illustrates the obstruction approach. Then find one company that illustrates each of the other three approaches (defensive, accommodative, and proactive). For each company, briefly explain the actions it took that led you to categorize it as you did.

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members and discuss your new business venture within the context of this chapter. Develop specific responses to the following:

1. Thinking about your business venture and identify at least three ethical issues that could potentially arise.
2. Should your venture have a formal statement of company practices and business ethics or simply rely on your own individual ethical standards? What are the pros and cons of each approach?
3. Who are the primary stakeholders in your new venture? Rank them in order of their relative importance.
4. Does it make sense for a new business to develop a formal social responsibility program? Why or why not?

BUILDING YOUR BUSINESS SKILLS

TO LIE OR NOT TO LIE: THAT IS THE QUESTION

GOAL

To encourage students to apply general concepts of business ethics to specific situations.

BACKGROUND

Workplace lying, it seems, has become business as usual. According to one survey, one-quarter of working adults said that they had been asked to do something illegal or unethical on the job. Four in ten did what they were told. Another survey of more than 2000 secretaries showed that many employees face ethical dilemmas in their day-to-day work.

METHOD

Step 1 Working with four other students, discuss ways in which you would respond to the following ethical dilemmas. When there is a difference of opinion among group members, try to determine the specific factors that influence different responses.

- Would you lie about your supervisor's whereabouts to someone on the phone?
- Would you lie about who was responsible for a business decision that cost your company thousands of dollars to protect your own or your supervisor's job?

- Would you inflate sales and revenue data on official company accounting statements to increase stock value?
- Would you say that you witnessed a signature when you did not if you were acting in the role of a notary?
- Would you keep silent if you knew that the official minutes of a corporate meeting had been changed?
- Would you destroy or remove information that could hurt your company if it fell into the wrong hands?

Step 2 Research the commitment to business ethics at a company of your choice. Click on the company's website and read any material that is relevant to the company's view of business ethics. As a group, discuss ways in which the information that group members found would (or would not) influence the specific behaviours mentioned in Step 1.

Step 3 Working with group members, draft a corporate code of ethics that would discourage the specific behaviours mentioned in Step 1. Limit your code to a single typewritten page but make it sufficiently broad to cover different ethical dilemmas.

FOLLOW-UP QUESTIONS

1. What personal, social, and cultural factors do you think contribute to lying in the workplace?
2. Do you agree or disagree with the following statement? The term business ethics is an oxymoron. Support your answer with examples from your own work experience or that of a family member.
3. If you were your company's director of human resources, how would you make your code of ethics a "living document"?
4. If you were faced with any of the ethical dilemmas described in Step 1, how would you handle them? How far would you go to maintain your personal ethical standards?

EXERCISING YOUR ETHICS

THE CASE OF ORPHAN DRUGS

THE SITUATION

You are an executive at Bell-X Pharmaceuticals, Inc. The firm's mission is to produce drugs that make people's lives better. A team of your employees has been conducting research into new drugs for acid reflux, which is a common ailment. The researchers were surprised to discover that one of the products they were investigating was effective at treating a rare neurological disorder, although it was completely ineffective at treating acid reflux. The research team is elated with their discovery and would like the company to move forward with clinical trials, government approval, and commercialization.

THE DILEMMA

The financial manager for the pharmaceutical company has been asked by the CEO to make a decision about whether to move ahead with clinical trials for this new drug. There are many things to consider. On the one hand, advocacy groups have made company executives aware of the great suffering of children afflicted with this neurological disorder. They even organized a rally encouraging the company to move toward making the drug commercially available. Doing so could create a lot of great press for the company and could ease the suffering of children afflicted with the disorder.

In spite of these strong arguments for moving ahead with clinical trials, the financial manager is concerned that there is little potential for profit with this new drug. The costs associated with clinical trials, government approval, and production of the drug are greater than the potential revenues from sales. The financial manager feels a strong responsibility to stockholders to make the company as profitable as possible. From the perspective of maximizing profit, it just doesn't make sense to go ahead with this drug.

The CEO is pressing the financial manager for a recommendation to either go ahead with clinical trials or to focus the company's efforts on other new drugs that could generate profits.

TEAM ACTIVITY

Assemble a group of four students and assign each group member to one of the following roles:

- CEO of Bell-X
- the financial manager
- a member of the research team that developed the new drug
- the head of the advocacy group

ACTION STEPS

1. From the perspective of your assigned role, and before hearing any of your group's comments on this situation, decide what Bell-X should do. Write down the reasons for your decision.
2. From the perspective of your assigned role, and before hearing any of your group's comments on this situation, decide what the underlying ethical issues are in this situation. Write-down the issues.
3. When the group gathers, have each person, in turn, reveal their choices. Next, reveal the ethical issues listed by each member.
4. Appoint someone to record the main points of agreement and disagreement within the group. How do you explain the results? What accounts for any disagreements?
5. From an ethical standpoint, what does your group conclude is the most appropriate choice for the company in this situation?

BUSINESS CASE 3

DIESELGATE

In 2015, a major scandal developed when it became clear that Volkswagen had used special computer software as a "defeat device" that turned on pollution control systems only when a car was undergoing emissions tests conducted by the U.S. Environmental Protection Agency. When the device was turned off under normal driving conditions, the cars actually emitted up to 40 times the legal limit of pollutants. About 11 million Volkswagen diesel vehicles thus appeared to meet emission standards, but actually didn't. As a result of the scandal, sales of diesel-powered vehicles were suspended in both Canada and the United States in September 2015. The software that was used to perpetrate this fraud was very clever, but it was also illegal and unethical.

Gaertner/Alamy Stock Photo

Volkswagen eventually admitted its guilt and paid a huge fine ($23.9 billion). The fine was so large because officials said Volkswagen consciously planned the deception, then engaged in it, and then initially denied it when suspicions arose about the vehicles. In 2017, a U.S. federal grand jury indicted six current and former VW executives for their part in the emissions fraud. These senior executives worked in areas such as engine development, quality control, and regulatory compliance. In August 2017, a Volkswagen engineer was sentenced to 40 months in prison for his role in helping to develop the cheating software; he was also fined $200 000. Another VW manager had pleaded guilty earlier in August. Volkswagen admitted that these executives had deliberately deceived both regulators and customers and that they had tried to delete documents that showed their guilt. They were charged with conspiracy to defraud the United States and with violating the Clean Air Act. Volkswagen has also incurred multibillion-dollar expenses because of expenditures it had to make in order to buy back or retrofit problem vehicles.

In Canada, Volkswagen paid a $2.1 billion fine to 105 000 Canadians who owned Jettas, Golfs, Passats, Beetles, and Audi A3's from model years 2009–2016. Canadian owners each received between $5100 and $8000 in compensation. But this settlement was made six months after a much larger settlement was made for U.S. car owners, and Canadians complained that they were put in a very difficult position while they waited for the settlement. Some of them did not drive their Volkswagen vehicles because they feared that their insurance companies would not honor their insurance if they happened to get into an accident with their car.

Volkswagen also paid a $15 million fine (levied by the Competition Bureau) for misleading consumers and making the false claim that its diesel engines were cleaner than gas engines.

In September 2017, the province of Ontario's Ministry of the Environment and Climate Change charged Volkswagen with one count under the province's environment protection act because Volkswagen vehicles did not comply with Ontario's emissions standards. In 2018, Volkswagen agreed to pay $290.5 million on Canadian claims for the cheating scandal.

Volkswagen is not the only car company to be involved in emissions cheating; six other companies have also been charged. For example, in May 2017, General Motors was accused of using defeat devices in its trucks. GM truck owners filed a class action lawsuit alleging that the trucks emitted two to five times the legal limit under regular driving conditions, but much less when the defeat devices were operating during EPA tests. Fiat Chrysler, Renault SA, and the PSA Group are also being investigated. Daimler is recalling three million Mercedes-Benz diesel vehicles and will provide a software patch that will cost the company about US$255 million. If this is accepted by the U.S. government, Daimler might be able to avoid the massive penalties that were levied on VW.

When a scandal like this is widely publicized, people often ask this question: "What could possibly have motivated Volkswagen executives to engage in such bad behaviour?" There are many reasons (including human moral frailty), but one stands out. There was a push in Europe about a decade ago to move toward diesel vehicles. Subsidies were made available to encourage companies to develop "clean diesel" engines because their noxious emissions were too high. Companies worked to make diesel engines cleaner, but progress was slow and frustration was evident. The temptation therefore existed to do *something* that would allow the company to increase the sales of its diesel vehicles, particularly in the big (and profitable) U.S. market. But Volkswagen knew it couldn't sell its vehicles in the United States until it could certify that its diesel vehicles met U.S. emissions standards. Knowing that its diesel vehicles didn't meet the emissions standards, Volkswagen engineers and executives apparently decided that it was faster and easier to develop software that would make it *seem* like diesel vehicles were producing fewer emissions than they actually were. After the software was developed, Volkswagen started promoting its "clean diesel" vehicles as a way to sell more cars.

Some of Volkswagen's competitors have benefited from the scandal. For example, Toyota's sales jumped 40 percent in the year after the scandal broke. Toyota had emphasized hybrids, not diesels, so they were well positioned to benefit from Volkswagen's problems. However, it is interesting to note that in spite of the scandal, VW sold more vehicles than any other car company in 2016 (Toyota was second).

In the aftermath of the scandal, many experts now view diesel technology as a commercial dead end. One report predicts that diesel engines will almost disappear by 2025 and will be replaced by hybrids and battery electric vehicles. In an attempt to improve its image with consumers, Volkswagen will shift its focus to electric vehicles.

QUESTIONS FOR DISCUSSION

1. Use the three-step model described in this chapter to analyze this situation. In your analysis, consider each of the four ethical norms (utility, rights, justice, and caring). If Volkswagen executives had used this model, do you think it would have helped them to make a better decision? Explain your reasoning.
2. In your own words, explain why managers in a respected international company would become involved in such a scheme to fool government regulators and consumers.

MyLab Intro to Business

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- **Videos:** Learn more about the business practices and strategies of real companies.

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CHAPTER

04

Entrepreneurship, Small Business, and New Venture Creation

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Explain the meaning and interrelationship of the terms *small business*, *new venture creation*, and *entrepreneurship*.
- **LO-2** Describe the role of *small* and *new businesses* in the Canadian economy.
- **LO-3** Describe some key characteristics of *entrepreneurial personalities* and explain the *entrepreneurial process* and describe its key elements.
- **LO-4** Describe three alternative strategies for becoming a business owner—*starting from scratch*, *buying an existing business*, and *buying a franchise*.
- **LO-5** Identify four key *reasons for success* in small businesses and four key *reasons for failure*.
- **LO-6** Describe four forms of *legal organization* for a business and discuss the advantages and disadvantages of each.

Tim Hortons' Franchisee Challenges: Heroes, and Villains

What does it take to be an entrepreneur? Is there a common set of characteristics? What images immediately come to mind? You are probably picturing people who launch new ideas and concepts. These individuals take significant risks to commercialize a new product or retail concept. However, another way to start a business is to take a different calculated risk by joining a pre-established franchise chain like Tim Hortons. It is not quite as exciting as launching a new venture from scratch, but the success rates are much higher. Of course, there are still no guarantees. Plenty of business people thrive within the umbrella of a franchise system, but there are also many examples of individuals who regret the day they decided to travel down that road.

When you think of Tim Hortons, you may simply see a massive chain that seems to have a location on every busy corner in your city or town. However, most of these retail shops are run by entrepreneurs (they usually own one or two locations). They face the same challenges as independent business owners (hiring, managing staff, maximizing efficiency, controlling costs, etc.). In recent years, Tim Hortons has been a high profile case study highlighting the challenges for franchisees in the shadow of a powerful franchisor. The life of a Tim Hortons shop owner also demonstrates the harsh realities of managing a small business in an ever-changing economic climate.

Tim Hortons Franchise Revolt: Fight the Power

When you become a Tim Hortons franchisee, you gain the marketing knowledge, the business processes, and the magic formula for proven success, but in return, you pay hefty

Steve Russell/Toronto Star/Getty Images

royalty fees: (1) 4% to 6.5% of gross sales, (2) another 4% of gross sales for advertising, and (3) a lease for shop premises from 7% to 8.5% of gross sales. The franchisee must also purchase all products from the corporate head office. And that's not all. These small businesses are subject to a hard-nosed parent who demands that you follow its rules! There is not much room for entrepreneurial flair or creativity.

In late 2017, a group of Tim Horton franchisees filed an $850 million class action lawsuit against Restaurant Brands International (RBI), the parent company of both Tim Hortons and Burger King. The lawsuit claimed that RBI was trying to intimidate the franchisees, was interfering with the franchisees' right of association, and was trying to get rid of certain franchisees who had formed the Great White North Franchise Association (GWNFA). The complaints included charging franchisees excessive amounts for supplies, providing lower-quality ingredients, reducing profitability opportunities for franchisees, failing to meet system standards, compromising product quality, and failing to deal with health and safety concerns. The group also accused RBI of misusing the promotion fund to pay administrative expenses instead of spending it all on promoting the Tim Hortons brand. The most general complaint in the lawsuit was that RBI's cost-cutting campaign (designed to make corporate headquarters look good) was damaging the Tim Hortons brand and the financial well-being of franchisees.

RBI executives strongly disagreed with all these claims and said that the franchisees who had made public statements about the dispute were harming the company. RBI planned to take legal action against several franchisees whom they said had leaked confidential information to the press about Tim Hortons and made negative comments about the company.

Entrepreneurs often start businesses for freedom. As you can see, a franchise system is extremely restrictive, and the head office can dictate terms just as your boss does at work.

The Realities of Small Business Economics

In the fight with the corporate giant, public perception was on the side of the franchisees; however, those very same people were the villains just a few months later. In January 2018, the Ontario government increased the minimum wage from $11.6 to $14 per hour with an extra increase to $15 planned in 2019. This was essentially a 30% increase in two years (a growing issue in many provinces). The net result was that franchisees found themselves scrambling to figure out how to pay for a huge increase in labour costs without the ability to raise prices for their products. Independent entrepreneurs can and usually do pass costs to consumers, but in this case that decision was up to the Tim Hortons head office, which had indicated that no such move was coming.

These entrepreneurs may agree with the government argument that all employees deserve a fair living wage. However, when governments across the nation take aggressive, quick steps, small business owners need to figure out how to make the numbers work because labour is a key cost metric. In this case, because the Tim Hortons head office refused to raise prices, many franchisees decided to cut out certain employee benefits. For example, some shops informed staff that their breaks would now be categorized as unpaid time. Was that fair? This issue gained major media attention. Despite the pressure, many of these business people defended their actions and said they had to make cuts or risk laying off employees.

Tim Hortons Franchise Ownership: The Full Picture

So, the next time you are in your local Tim Hortons, remember this: behind the big corporate machine, the frontlines are being handled by individuals working hard for their wages and people trying to run a small business, all trying to satisfy consumers like you while being squeezed by a franchisor demanding royalties and new government regulations. Although it might seem easy to pinpoint heroes and villains,

those Tim Hortons' storeowners must deal with economics 101. They need to make up for their increased costs by increasing revenues or decreasing costs, just like every other entrepreneur must to. Are their actions to cut out paid breaks and other benefits justified? You be the judge. But as a business student, make sure you understand all the facts first.

CRITICAL THINKING QUESTIONS

1. How does this case help to demonstrate the challenges of entrepreneurship?
2. What are the greatest differences between starting a business from scratch and joining a franchise system?
3. Business owners must always analyze the external factors (the economy, government regulations, social trends, etc.) to compete and adjust to new marker realities. From the contents of the case and based on your knowledge of recent developments with Tim Hortons, what are the greatest external threats and opportunities for Tim Hortons franchisees?
4. Consider the following statement: *Franchisees should not complain about actions that a franchisor takes because franchisees sign an agreement that specifically lays out how the franchise will operate. Franchisees should be grateful to the franchisor, who provides a ready-made opportunity for individuals who want to run their own business.* Do you agree or disagree with the statement? Explain your reasoning.

HOW WILL THIS HELP ME?

A recent Gallup poll suggests that almost half of the young people surveyed were interested in entrepreneurship.[1] Even if you are not among that number, you will still be called on to interact with small businesses and entrepreneurs as a customer, as an investor, or as a client. You may also be trying to sell products or services to small businesses and entrepreneurs. One key to understanding entrepreneurship is to understand entrepreneurs themselves and what it takes for them to succeed. As an investor, you should also be well prepared to assess the market potential for new and up-and-coming businesses. This chapter discusses these and additional issues important for starting and owning a business, including the business plan, the reasons for success and failure, and the advantages and disadvantages of different kinds of ownership. We start by defining a small business and identifying its importance in the Canadian economy.

Minerva Studio/Fotolia

LO-1 INTERRELATIONSHIP OF SMALL BUSINESS, NEW VENTURE CREATION, AND ENTREPRENEURSHIP

In this chapter, we examine established companies with an enduring entrepreneurial spirit (MTY Group and Tim Hortons), exciting growth-oriented newcomers (Shopify), major family organizations that have stood the test of time (e.g., Kal Tire), and a host of small organizations with dreams and aspirations. Each of these examples gives us a glimpse of an important element of the Canadian business landscape. We begin by examining the lifeblood of an economy: small business, entrepreneurship, and new ventures.

Self-employed Canadians account for 15.3 percent of the workforce.[2] Every day, approximately 380 businesses are started in Canada.[3] New firms create the most jobs, are noted for their entrepreneurship, and are typically small.[4] But does this mean most small businesses are entrepreneurial? Not necessarily.

The terms *small business*, *new venture*, and *entrepreneurship* are closely linked, but each concept is distinct. In the following paragraphs, we explain these terms to help you understand them and how they are interrelated.

Small Business

The term *small business* is not easy to define. Locally owned and operated restaurants, dry cleaners, and hair salons are obviously small businesses, whereas giant corporations, such as Telus, Apple, and Canadian Tire, are clearly big businesses. Between these two extremes, though, fall thousands of companies that cannot be easily categorized. Various measures might be used, including the number of people the business employs, the company's sales revenue, the size of the investment required, or the type of ownership structure the business has. Some of the difficulties in defining a small business can be understood by considering the way the Canadian government collects and reports information on small businesses.

Industry Canada is the main federal agency responsible for small businesses. In reporting small business statistics, the government relies on two sources of information, both provided by Statistics Canada: the

Business Register (which tracks businesses) and the *Labour Force Survey* (which tracks individuals). To be included in the Register, a business must have at least one paid employee, have annual sales revenues of $30 000 or more, or be incorporated (we describe incorporation later in this chapter).[5] A goods-producing business in the Register is considered small if it has fewer than 100 employees, while a service-producing business is considered small if it has fewer than 50 employees. The Labour Force Survey uses information from individuals to make estimates of employment and unemployment levels. Individuals are classified as self-employed if they are working owners of a business that is either incorporated or unincorporated, if they work for themselves but do not have a business (some musicians would fall into this category), or if they work without pay in a family business.[6] In its publication *Key Small Business Statistics* (www.strategis.gc.ca/sbstatistics), Industry Canada reports that 2.2 million "business establishments" exist in Canada and about 2.8 million people are "self-employed."[7] There is no way of identifying how much these two categories overlap, but we do know that an unincorporated business operated by a self-employed person (with no employees) would not be counted among the 2.2 million businesses in the Register. This is an important point because the majority of businesses in Canada have no employees (just the owner), nor are they incorporated.

For our purposes, we define a **small business** as an owner-managed business with fewer than 100 employees. We do so because it enables us to make better use of existing information and because you are now aware of how definitions can affect our understanding of small businesses. According to Industry Canada's statistics, small businesses contributed approximately 30 percent of Canada's GDP over the past decade. The percentages are consistent across the country. According to research, British Columbia has the highest rate of GDP contribution from small businesses at 33 percent and Newfoundland and Labrador have the lowest percentage at 23 percent.[8]

Each year the Queen's Centre for Business Venturing, in conjunction with Aon Hewitt and *Profit* magazine, develops a ranking of the top 50 small and medium-sized employers. The top ten firms in the 2018 study are listed in Table 4.1. Each of these companies exhibited superiority in employee recognition, managing performance, career opportunities, and organizational reputation.[9]

The New Venture/Firm

Various criteria can help us determine when a new firm comes into existence. Three of the most common are: when it was formed, whether it was incorporated, and whether it sold goods and/or services.[10] A business is considered to be new if it has become operational within the previous 12 months, if it adopts any of the main organizational forms (proprietorship, partnership, corporation, or co-operative), and if it sells goods or services. Thus we define a **new venture** as a recently formed commercial organization that provides goods and/or services for sale.

Entrepreneurship

Entrepreneurship is the process of identifying an opportunity in the marketplace and accessing the resources needed to capitalize on it. People start new businesses because they want to control their own destiny and prefer to take a chance rather than looking for a secure job. **Entrepreneurs** are people who recognize and seize these opportunities.

For example, Mark Zuckerberg created Facebook from his dorm room, and by 2018, the company had over 2.1 billion active users accounting for nearly one-third of the planet's population. Zuckerberg worked long hours, and he and his team continue to constantly tailor the website to suit their expanding audience.[11] In another example, far from the kind generally found in Silicon Valley, we find a different tale of entrepreneurial success. After growing up in Toronto and studying in Montreal, Elena Rosenfeld left life in the big city behind to set up shop in the small town of Invermere, British Columbia. She and her partner, Leo Johnson, started Kicking Horse Coffee from their garage with the mission of selling fair-trade organic coffee. Today, the company operates a huge, 60 000 square foot facility in the town they fell in love with. The company now employs more than 100 people and sells coffee across the country and in the United States. It was recently honoured as one of the Top 10 Best Workplaces in Canada.[12]

Government attitudes toward entrepreneurship can have a strong impact through laws, taxation rules, and programs designed to nurture small business. Every year, the Heritage Foundation publishes an index of economic freedom, which assesses the extent to which entrepreneurs

SMALL BUSINESS An independently owned and managed business that does not dominate its market.

NEW VENTURE A recently formed commercial organization that provides goods and/or services for sale.

ENTREPRENEURSHIP The process of identifying an opportunity in the marketplace and accessing the resources needed to capitalize on it.

ENTREPRENEUR A businessperson who accepts both the risks and the opportunities involved in creating and operating a new business venture.

Company	City	Province	Industry
Addenda Capital Inc.	Montreal	QC	Finance
Axonify	Waterloo	ON	Software
BlueShore Financial	North Vancouver	BC	Credit Union
Bosa Properties	Vancouver	BC	Real Estate
Celero Solutions	Calgary	AB	IT Services
GEF Seniors Housing	Edmonton	AB	Diversified Consumer Services
NorWest Co-op Community Health	Winnipeg	MB	Health Care Providers & Services
Solvera Solutions	Regina	SK	IT Professional Services
The Berkeley Retirement Residences	Halifax	NS	Health Care Providers & Services
You.i TV	Kanata	ON	Software

<<< TABLE 4.1 Top Small and Medium-Sized Employers in Canada, AON Rankings 2018

Courtesy of Kicking Horse Coffee

Kicking Horse Coffee is a small-town success story with a large reach across Canada and in the United States. Co-founder and CEO Elana Rosenfeld has managed to build a solid business out of selling organic, Fair Trade coffee. Take a look at Kicking Horse Coffee's new line of Cold Brew coffee.

have freedom to pursue new business opportunities. In 2017, the top three countries were Hong Kong, Singapore, and New Zealand, with freedom scores of 89.8, 88.6, and 83.7, respectively. Canada ranked seventh with a score of 78.5, and North Korea ranked last with a score of 4.9.[13]

Entrepreneurship Goals

According to the Globe Careers Leadership Lab, 72 percent of millennials dream of being business owners, and 30 percent of all Canadians want to be their own boss.[14] People may decide to pursue entrepreneurship for a variety of reasons. Many entrepreneurs seek to launch a new business with the goal of independence—independence from working for someone else, coupled with some reasonable degree of financial security. Such entrepreneurs want to achieve a safe and secure financial future for themselves and their families but do not necessarily want to grow their business beyond their capacity to run it.

Other entrepreneurs, however, launch new businesses with the goal of growth and expansion—that is, to transform their venture into a large business. This was Howard Schultz's vision when he took over Starbucks; he made plans to grow and develop the coffee company into a much larger enterprise.

In still other cases, the goals of an entrepreneur may not always be clear in the early stages of business development. For instance, one entrepreneur might launch a business with little or no expectation that it will have huge growth potential but then find that it can grow dramatically. Another entrepreneur might start out with ambitious growth plans but eventually realize that the expected opportunities can't be achieved, perhaps the market is not large enough or another firm established dominance over that market first.

Entrepreneurial Characteristics

Regardless of their goals, many successful entrepreneurs share certain characteristics. Among these characteristics are resourcefulness and a concern for good long-term customer relations. Most of them also have a strong desire to be their own bosses. Many express a need to "gain control over my life" or "build for the family" and believe that building successful businesses will help them do it. They can also deal with uncertainty and risk.

Research shows that these characteristics are wide-ranging. Some are behavioural (e.g., taking initiative), others are personality traits (e.g., independence), and still others are skills (e.g., problem solving).[15] Some people think entrepreneurs are rare, but their characteristics have been found to be widely distributed in the population.[16] We also know that personal characteristics often have less impact on a person's action than the situation a person is in.[17] What is really important is not who the person is but what the person does.[18]

Consider Yoshiko Shinohara, who lost her father by the age of eight, was divorced by the age of 28, and never received a college education. At the age of 70, she is chairman and director of Tempstaff, a Japanese temp agency that she started out of her one-room apartment more than 35 years ago. Fueled by Japan's need for temporary workers during a period of stagnation in the 1990s and Shinohara's ambition, Tempstaff is now a $3.1 billion company with a high-rise headquarters in Tokyo.[19]

Among other things, Shinohara's story illustrates what is almost always a key element in entrepreneurship: risk. Interestingly, most successful entrepreneurs seldom see what they do as risky. Whereas others may focus on possibilities for failure and balk at gambling on a new venture, most entrepreneurs are so passionate about their ideas and plans that they see little likelihood of failure. For example, when Shinohara started Tempstaff, few Japanese businesses understood or had even heard of the temporary worker concept. But Shinohara felt that she "had nothing to lose anyway" and preferred taking that risk to ending up "serving tea or just being a clerical assistant."[20]

Intrapreneurs

Many successful managers in large organizations in both public and private sectors also exhibit similar characteristics. Entrepreneurial behaviour therefore occurs in a wide range of contexts. People who exhibit entrepreneurial characteristics and create something new within an existing firm or organization are **intrapreneurs**. Procter & Gamble, 3M, and Xerox encourage intrapreneurship by having divisions that focus on creating new products for specific markets. At Telus, a recent redesign of the company's website was accomplished by a small intrapreneurial team that was given the mandate to operate in a creative manner, independent of the bureaucratic structure that characterizes large companies.[21] A key difference between intrapreneurs and entrepreneurs is that intrapreneurs typically do not have to concern themselves with getting the resources needed to bring a new product to market because big companies tend to have the necessary resources already available.

As we explore the entrepreneurial process later in this chapter, we will do so within a new venture context. We now begin by outlining the role of small and new businesses in the Canadian economy.

INTRAPRENEURS People who create something new within an existing large firm or organization.

LO-2 THE ROLE OF SMALL AND NEW BUSINESSES IN THE CANADIAN ECONOMY

Small and new businesses play a key role in the Canadian economy. However, this role was not recognized and acknowledged until the previous two decades. Prior to that time, only large businesses were the focus of attention in terms of economic impact within industrialized nations.

Small Businesses

It may surprise you to learn that 97.9 percent of all businesses in Canada are small (they have fewer than 100 employees), and more than half of them have fewer than five employees. Medium-sized businesses (100 to 499 employees) make up 1.8 percent of employer businesses, and large businesses (those with 500 or more employees) represent just 0.3 percent.[22] This pattern is consistent across all provinces. Although one large business has many more employees than one small business does, as a group, small businesses provide more jobs than large ones. Small businesses also lead the way when it comes to innovation and new technology.

While the previous figures profile the number of businesses in Canada by size, we now look at how many people work in small versus medium- and large-sized businesses. According to Statistics Canada, in 2017, there were 11 885 600 employees in the **private sector** (the part of the economy consisting of companies and organizations not owned or controlled by the government).[23] In all industries, at least half the workforce is employed by small business. In addition, small businesses account for more than 80 percent of employment in four industries: agriculture, other services, accommodation and food services, and construction (see Figure 4.1).[24]

New Ventures

Not only are new firms the main source of job creation, but they are also responsible for the vast majority of new products and services. From 2005 to 2015, small businesses created 87.7 percent of all private-sector jobs in Canada (on average 100 000 per year).[25]

Women are playing a more prominent role than ever before in starting new ventures (see Figure 4.2). More and more women are starting and successfully operating their own small businesses, and they now account for half of all new businesses formed. However, on a negative note, women lead only 12 percent of the small and medium-sized businesses that export goods and services.[26]

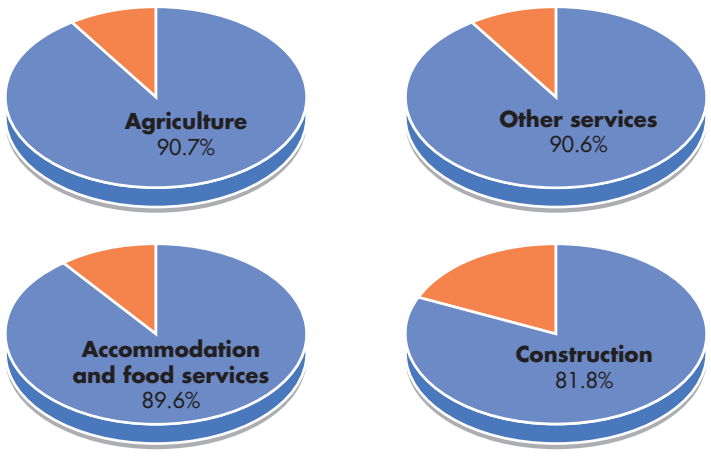


FIGURE 4.1 Small business employment

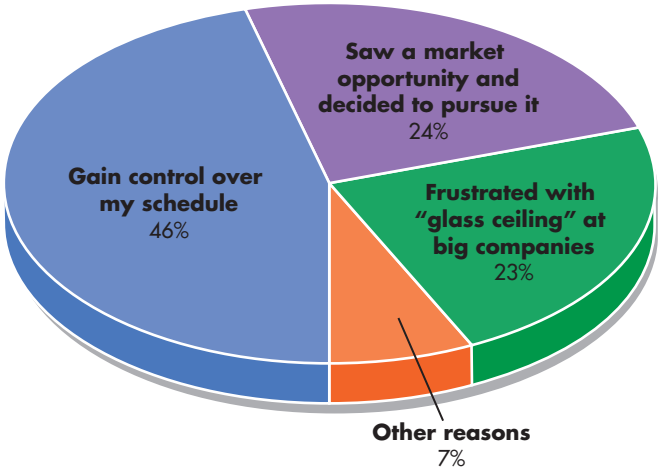


FIGURE 4.2 Reasons women give for starting their own businesses

The RBC Canadian Woman Entrepreneur Awards are held annually to recognize women that have made an impact. Previous winners include Trina Bailey, Bailey Veterinary Surgical Specialty Ltd., from Mount Pearl,

PRIVATE SECTOR The part of the economy made up of companies and organizations not owned or controlled by the government.

Courtesy of Hillberg & Berk

Rachel Mielke, from Regina, Saskatchewan, transformed her Hillberg & Berk designer jewellery brand from a high-school hobby into a successful business.

Newfoundland; Jennifer Carlson, Baby Gourmet, from Calgary; Emily (Shi Yu) Zhang, Willowest hospitality furnishings, from Vancouver; and Mandy Rennehan, FreschCo, from Oakville, Ontario.[27]

Women who run businesses from their homes are sometimes called "mompreneurs."[28] The Mompreneur Networking Group organizes seminars and publishes *Mompreneur*, a free magazine that helps women who want to start a business.

Young entrepreneurs are involved in creating new ventures in Canada. Rachel Mielke, from Regina, Saskatchewan, transformed her Hillberg & Burk designer jewellery brand from a high-school hobby into a successful business. She makes her hand-made jewellery out of sterling silver, semiprecious stones, and Swarovski crystals. Her designs have ended up in the Academy Award gift bags, and her company was featured on *Dragon's Den*.[29]

LO-3 THE ENTREPRENEURIAL PROCESS

The entrepreneurial process is like a journey (see Figure 4.3). It is influenced by the social, economic, political, and technological factors in the broader environment, but we will focus our attention on understanding the three key elements in the entrepreneurial process—the entrepreneur, the opportunity, and resources—and how they interact. As these key elements interact, they may or may not be well matched. For example, if an entrepreneur identifies an opportunity for a new health service but does not have the relevant background and skills to deliver the service, the business may never get off the ground. However, if all the elements are harmonious, the new business will likely become operational at some point. Entrepreneurs must (1) identify an opportunity and (2) access resources.

Identifying Opportunities

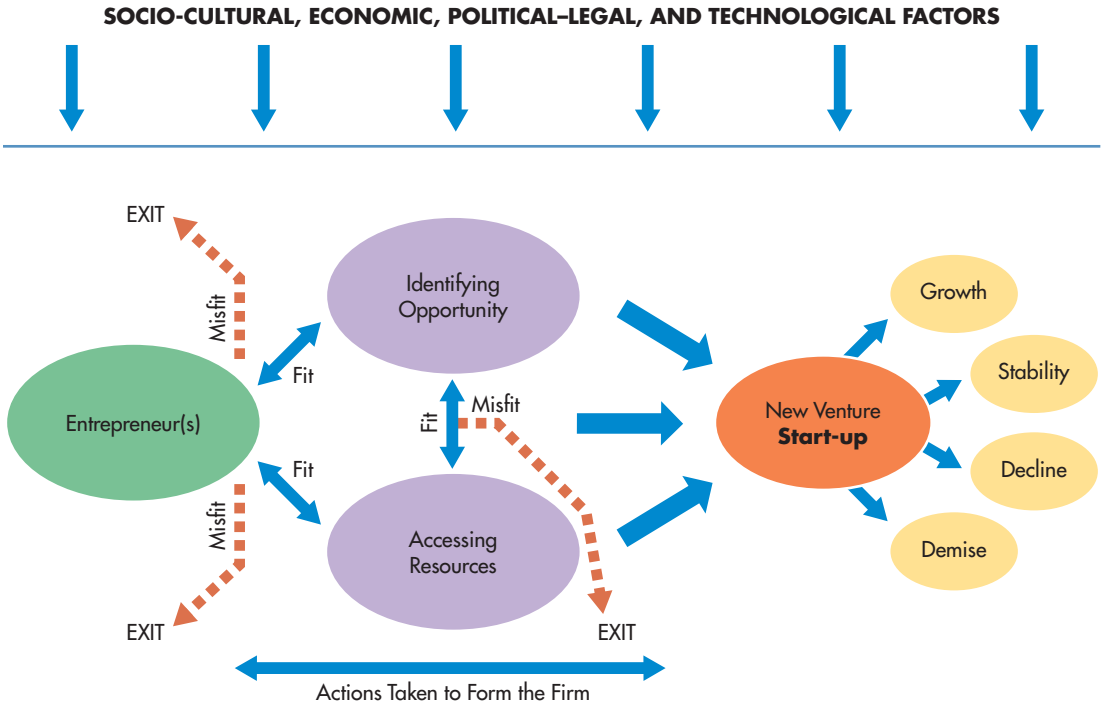
Identifying opportunities involves generating ideas for new (or improved) products, processes, or services, screening those ideas, and developing the best ones.

Idea Generation

Typically, generating ideas involves abandoning traditional assumptions about how things work and how they ought to be and seeing what others do not. If the prospective new (or improved) product, process, or service can be profitably produced and is attractive relative to other potential venture ideas, it might present an opportunity. For example, Kevin Systrom developed an app to allow people to virtually check in at locations visited and broadcast that to a person's social network. The idea eventually changed and evolved into a photo-sharing service, and Kevin's ability to pivot and evolve led to the creation of Instagram, which he sold to Facebook for $1 billion.[30]

Where do ideas come from? Most new ventures do not develop from a deliberate search for viable business ideas. Rather, the majority originate from events relating to work or everyday life.[31] In fact, work experience is the most common source of ideas, accounting for 45 to 85 percent of those generated. This happens because, as employees of a company, prospective entrepreneurs are familiar with the product or service, the customers, the suppliers, and the competitors. They are also aware of marketplace needs, can relate those needs to personal capabilities, and can determine whether they are capable of producing products or services that can fill the void.

Other frequent sources of new venture ideas include a personal interest or hobby (16 percent) or a chance happening (11 percent).[32] The latter refers to a situation in which a venture idea comes about unexpectedly. For example, while on vacation in another country, you might try a new snack food that you feel would be in demand if introduced to the Canadian market.



<<< FIGURE 4.3 The Entrepreneurial Process in a New Venture

Screening

Entrepreneurs often generate many ideas, and screening them is a key part of the entrepreneurial process. The faster you can weed out the "dead-end" venture ideas, the more time and effort you can devote to the ones that remain. The more of the following characteristics an idea has, the greater the opportunity it presents.

The Idea Creates or Adds Value for the Customer A product or service that creates or adds value for the customer is one that solves a significant problem or meets a significant need in new or different ways. Consider Polar Mobile, a Toronto-based developer of mobile applications that has made great strides since launching a few years ago. Polar provides a software platform called MediaEverywhere that makes it easy for media companies to launch apps for all types of smartphones and tablet devices. Polar must be doing something right because major companies are finding value in this relatively new company. In 2018, a mere decade after it was established, Polar had hundreds of customers around the world being served by four offices located in Toronto, New York, London, and Sydney. Its long list of media clients included *Vogue, Ad Week, USA Today, and The Economist*. It seems like Polar has clearly shown the capacity to add value based on this impressive list of partners.[33]

The Idea Provides a Competitive Advantage That Can Be Sustained A competitive advantage exists when potential customers see the product or service as better than that of competitors. Sustaining a competitive advantage involves maintaining it in the face of competitors' actions or changes in the industry. All other things being equal, the longer markets are in a state of flux, the greater the likelihood of being able to sustain a competitive advantage. The inability to develop a competitive advantage is a common fatal flaw in many new ventures.[34]

Cameron Piron founded Toronto-based Sentinelle Medical and spent 10 years developing a better cancer detection technology and another two years convincing General Electric to use it in its MRI machines. For his efforts, he received the Ontario Government Innovation Award. The technology proved successful and demonstrated a clear marketplace advantage leading Invivo (a Philips health-care company) to acquire Sentinelle Medical for this technology.[35]

The Idea Is Marketable and Financially Viable Although it is important to determine whether there are enough customers willing to buy a product or service, it is also important to determine whether sales will lead to profits.[36] Estimating the market demand requires an initial understanding of who the customers are, what their needs are, and how the product or service will satisfy their needs better than competitors' products will. Customers define the competition in terms of who can satisfy their needs best. However, success also requires a thorough understanding of the key competitors who can provide similar products, services, or benefits to the target customer.

After learning about the competition and customers, the entrepreneur must prepare a **sales forecast**, which is an estimate of how much of a product or service will be purchased by the prospective customers for a specific period of time—typically one year. Total sales revenue is estimated by multiplying the units expected to be sold by the selling price. The sales forecast forms the foundation for determining the financial viability of the venture and the resources needed to start it. For an example of how entrepreneurs are reaching their target markets in this modern age, check out the E-Business and Social Media box entitled "Shopify: Helping Entrepreneurs Expand and Monetize Their Client Base."

Determining financial viability involves preparing financial forecasts, that is, two-to-three-year projections of a venture's future financial position and performance. These forecasts typically consist of an estimate of start-up costs, a cash budget, an income statement, and a balance sheet (see Chapter 11 for more details about these financial documents). These projections serve as the basis for decisions regarding whether to proceed with the venture and, if so, the amount and type of financing to be used in financing it.

The Idea Has Low Exit Costs The final consideration is the venture's exit costs. Exit costs are low if a venture can be shut down without a significant loss of time, money, or reputation.[37] If a venture is not expected to make a profit for many years, its exit costs are high because the project cannot be reasonably abandoned in the short term.

Developing The Opportunity

As the "dead-end" venture ideas are weeded out, a clear notion of the business concept and an entry strategy for pursuing it must be developed. The business concept often changes from the original plan. Some new ventures develop entirely new markets, products, and sources of competitive advantage once the needs of the marketplace and the economies of the business are understood. So, while a vision of what is to be achieved is important, it is equally important to incorporate new information and to be on the lookout for unanticipated opportunities.

New ventures use one or more of three main entry strategies: they introduce a totally new product or service, they introduce a product or service that will compete directly with existing competitive offerings but add a twist (customization of the standard product), or they buy a franchise.[39] A **franchise** is an arrangement in which a buyer (franchisee) purchases the right to sell the product or service of the seller (franchiser). We discuss franchising in more detail later in the chapter.

When capital requirements are high, such as when a manufacturing operation is being proposed, there is a need for considerable research and planning. Similarly, if product development or operations are complex, research and analysis will be needed to ensure that the costs associated with effectively coordinating tasks will be minimized. In these circumstances, or when the aim is to attract potential investors, a comprehensive written business plan is required. A **business plan** is a document that describes the entrepreneur's proposed business venture, explains why it is an opportunity, and outlines its marketing plan, its operational and financial details, and its managers' skills and abilities.[38] The contents of a business plan are shown in Table 4.2.

If market conditions are changing rapidly, the benefits gained from extensive research and planning diminish quickly. By the time the entrepreneur is ready, new competitors may have entered the market, prices may have changed, a location may no longer be available, and so on. Similarly, if the product is highly innovative, market research

SALES FORECAST An estimate of how much of a product or service will be purchased by prospective customers over a specific period.

FRANCHISE An arrangement that gives franchisees (buyers) the right to sell the product of the franchiser (the seller).

BUSINESS PLAN Document in which the entrepreneur summarizes her or his business strategy for the proposed new venture and how that strategy will be implemented.

Shopify: Helping Entrepreneurs Expand and Monetize Their Client Base

M4OS Photos/Alamy Stock Photo

Shopify is an Ottawa-based tech company with more than 3000 employees serving customers from five offices across North America (Toronto, Montreal, Kitchener-Waterloo, San Francisco, and the head office in Ottawa). It is the leader in cloud-based, multi-channel commerce geared toward small and medium-sized businesses. In fact, it has helped more than 600 000 small and medium-sized companies set up online stores in 175 countries. Shopify merchants account for more than $55 billion worth of sales revenue on the platform. Their services simplify e-commerce and provide entrepreneurs with online payment options and smooth integration into Amazon's marketplace. But that's not all. Entrepreneurs can use the user-friendly software to design and manage their stores. It is built for reliability and scalability; so, as the merchant's company gets bigger, Shopify seamlessly helps it grow and integrate various sales channels from web, to mobile, to bricks and mortar, to marketplaces, to social media, to pop-up stores, and more. According to Shopify (www.shopify.ca/about): "We focus on making commerce better for everyone, so businesses can focus on what they do best: building and selling their products."

Like all tech companies, in a fast-moving environment, Shopify continues to evolve. It recently added a service enabling merchants to print shipping labels through a mobile app. Essentially, the merchants can create, print shipping labels, and manage the entire workflow through their Android or Apple devices. This is yet another way that Shopify helps small and medium-sized companies be quicker and more agile. Two of the greatest problems entrepreneurs face are the time crunch and lack of support employees to fulfill orders at all times of the day. So now, even while Jane and Bob are travelling halfway across the world, they can process customer orders from anywhere, anytime.

Shopify was founded by Tobias Lutke, back in 2006, and it has become one of the hottest tech stocks. According to Bloomberg, its founder has an estimated worth of more than US$1.1 billion from 9.7 million shares, which represents approximately 11 percent ownership of the company. Shopify has become a bit of a tech darling. So, when tech royalty appeared at one of the Shopify offices, it was no shock. Apple's CEO, Tim Cook, visited Toronto in early 2018, and he did not miss the chance to go to the local Shopify offices; he was extremely complimentary of the augmented reality capabilities on the platform. This is a key area of interest. According to Statista, the global market size for augmented reality and virtual reality is expected to reach US$215 billion by 2021. During the visit, Mr. Cook watched Shopify demonstrate three augmented reality-based applications it was developing for its merchants. On his end, Tobias Lutke announced that his company would be using ARKit, Apple's augmented reality kit, to become the largest AR-enabled e-commerce platform. The goal was to offer small companies tools that are usually reserved for the largest companies with deep pockets. Obviously, there was a mutual benefit here, for both companies, at the core of all these compliments, but Tim Cook said that he was a big fan of Shopify and declared that it was in the process of democratizing technology for entrepreneurs.

So, as you see traditional retail stores suffering and as you watch many of them, such as Sears Canada, shut their doors, e-commerce continues to grow at a rate of about 15% per year, with tremendous room with tremendous room for additional growth. Shopify is a Canadian tech company and a great vehicle to help merchants reach untapped potential.

CRITICAL THINKING QUESTIONS

1. What are Shopify's primary benefits for merchants who decide to use its services? What obstacles does Shopify help these merchants overcome?
2. Look at the latest news on Shopify's online site or search the company's press releases. Have they added any new features? Have they built any new major partnerships? What new challenges do they face?

is of less value because the development of entirely new products involves creating needs and wants rather than simply responding to existing needs.

Contrary to what many people think, planning does not have to be completed before action is taken. For example, if an electrical contracting business is being proposed in an area where there is a shortage of tradespeople, it would be important to seek out qualified employees prior to conducting other analyses that are needed to complete the business plan. Such early action also helps to build relationships that can be drawn on later. Obviously, some ventures do not lend themselves to early action, particularly those that are capital-intensive. Because most entrepreneurs have limited resources, it is important to concentrate on the issues that can be dealt with and that will help determine whether to proceed and how to proceed.[39]

TABLE 4.2 A Business Plan

A well-written business plan is formally structured, is easy to read, and avoids confusion. Organizing the information into sections makes it more manageable. The amount of detail and the order of presentation may vary from one venture to another and according to the intended audience (if the plan is intended for potential investors, it will require more detail than if it is intended for internal use by the entrepreneur). An outline for a standard business plan is provided below.

I.	**Cover Page.** Name of venture and owners; date prepared; contact person and his or her address, telephone and fax numbers, and email address; Facebook and LinkedIn information; and name of organization the plan is being presented to. The easier it is for the reader to contact the entrepreneur, the more likely the contact will occur.
II.	**Executive Summary.** One-to-three-page overview of the total business plan. Written after the other sections are completed, it highlights their significant points and aims to create enough excitement to motivate the reader to continue.
III.	**Table of Contents.** Lists major sections of the plan with page numbers for both the body and the appendices.
IV.	**Company Description.** Identifies the type of company: manufacturing, retail, and so on. Also describes the proposed form of organization: sole proprietorship, partnership, corporation, or co-operative. A typical organization of this section is as follows: name and location, company objectives, nature and primary product or service of the business, current status (start-up, buyout, or expansion) and history if applicable, and legal form of organization.
V.	**Product or Service Description.** Describes the product or service and indicates what is unique about it. Explains the value added for customers—why people will buy the product or service, features of the product or service providing a competitive advantage, legal protection (patents, copyrights, and trademarks, if relevant), and dangers of technical or style obsolescence.
VI.	**Marketing.** Has two key parts, the market analysis and the marketing plan. The market analysis convinces the reader that the entrepreneur understands the market for the product or service and can deal effectively with the competition to achieve sales projections. The marketing plan explains the strategy for achieving sales projections.
VII.	**Operating Plan.** Explains the type of manufacturing or operating system to be used. Describes the facilities, labour, raw materials, and processing requirements.
VIII.	**Management.** Identifies the key players—the management team, active investors, and directors—and cites the experience and competence they possess. Includes a description of the management team, outside investors and directors and their qualifications, outside resource people, and plans for recruiting and training employees.
IX.	**Financial Plan.** Specifies financial needs and expected financing sources. Presents projected financial statements, including cash budget, balance sheet, and income statement.
X.	**Supporting Details/Appendix.** Provides supplementary materials to the plan such as résumés and other supporting data.

Accessing Resources

Typically, entrepreneurs acquire the various resources needed to make the venture a reality by **bootstrapping**, which means "doing more with less." Usually the term refers to financing techniques whereby entrepreneurs make do with less and use other people's resources wherever they can. However, bootstrapping can also refer to the acquisition of other types of resources, such as people, space, equipment, or materials loaned or provided free by customers, suppliers, or other sources. For example, 26-year-old Omeed Asadi is the founder of Sherpa Tax, a website that helps people find all the tax breaks they are entitled to. In a short time, he has managed to attract the attention of major news media groups such as *The Globe and Mail*, BNN, and CTV. Omeed is a firm believer in the bootstrapping approach and proudly proclaimed in an article, "I would not be able to be an entrepreneur if I didn't live at home." With rising rents (especially in big cities), some young entrepreneurs like Omeed are finding ways to stretch their dollars to keep their business dreams alive.[40]

Financial Resources

There are two main types of financing—debt and equity (see Chapter 15). Because a business is at its riskiest point during the start-up phase, equity is usually more appropriate and accessible than debt. However, most new venture founders prefer debt because they are reluctant to give up any control to outsiders. To obtain debt financing, the entrepreneur must have an adequate equity investment in the business—typically 20 percent of the business's value—and collateral (or security).

Collateral refers to items (assets) owned by the business (such as a building and equipment) or by the individual (such as a house or car) that the borrower uses to secure a loan or other credit. These items can be seized by the lender if the loan isn't repaid according to the specified terms. To lenders, equity investment demonstrates the commitment of the entrepreneur, as individuals tend to be more committed to a venture if they have a substantial portion of what they own invested in it.

The most common sources of equity financing are:

1. *Personal savings.* New venture founders draw heavily on their own finances to start their businesses. Most save as much as they can in preparation for start-up.
2. *Love money.* This type of financing includes investments from friends, relatives, and business associates. It is called "love money" because it is often given based on the relationship, more than on the merit of the business concept.
3. *Private investors.* One popular source of equity is informal capital from private investors called *angels*. Usually, these persons are financially well

BOOTSTRAPPING Doing more with less.
COLLATERAL Assets that a borrower uses to secure a loan or other credit and that are subject to seizure by the lender if the loan isn't repaid according to the specified repayment terms.

off; many are successful entrepreneurs. For example, Harley Finkelstein was named Angel of the Year in 2017. He is the chief operating officer of Shopify, but he is also involved with Akira MD (medical mobile app), PopRx (pharmacy mobile app), Grobo (mini-greenhouses), Skip the Dishes (food delivery platform), and Raven Telemetry (artificial intelligence for manufacturing).[41] New Brunswick also appears to be a hotbed of angel investing, as Dan Martell won the Canadian Angel Investor of the Year award for his support of 18 start-ups one year after Gerry Pond won the same award.[42]

4. *Venture capitalists.* Investments by venture capitalists come from professionally managed pools of investor money (venture capital). Because the risk of receiving little or no return on investment is high, only deals that present an attractive, high-growth business opportunity with a return between 35 and 50 percent are considered. Very few new ventures meet this criterion. Venture capital investment in Canada was a source of concern a few years ago, but it has been increasing steadily in recent years, totalling $3.2 billion (from 530 deals) in 2016, more than double what was raised just five years earlier.[43]

The most common sources of debt financing are:

1. *Financial institutions.* Although commercial banks are the main providers of debt financing for established small businesses, it is usually hard for a new business to get a loan. Banks are risk-averse, and new businesses are considered very risky. Typically, entrepreneurs have more luck obtaining financing for a new venture with a personal loan (as opposed to a business loan). The most common way to obtain a personal loan is to mortgage a house or borrow against the cash value of a life insurance policy. In addition to commercial banks, other sources of debt financing include trust companies, co-operatives, finance companies, credit unions, and government agencies.
2. *Suppliers.* Another source of financing is suppliers who provide goods (i.e., inventory) or services to entrepreneurs with an agreement to bill them later. This is referred to as *trade credit*. Trade credit can be helpful in getting started because inventory can be acquired without paying cash, freeing up money to pay other start-up costs. This type of financing is short-term; 30 days is the usual payback period. The amount of trade credit available to a new firm depends on the type of business and the supplier's confidence in the firm. Frequently, though, a new business has trouble getting trade credit because its capacity to repay has not been demonstrated.

Courtesy of Shopify Inc.

Harley Finkelstein is a key figure in Shopify, but he is also a serial angel investor. In fact, he was named Angel Investor of the year.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. Trip It APP **Source:** Concur **Key Features:** Stores essential travel documents and provides access to your itinerary on your smartphone, tablet, computer, or wearable.	Apple, Android,
2. *Entrepreneur* Magazine APP **Source:** Entrepreneur Media **Key Features:** Looks at innovative approaches to businesses that create lasting opportunities.	Apple, Android, Windows, Blackberry
3. QuickBooks APP **Source:** Intuit **Key Features:** Access your finances: pay bills, send customer invoices, and send receipts directly from your phone.	Apple, Android, Windows

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" entrepreneurship and small business apps and identify the key features.

Besides these conventional sources of financing, the possibilities for bootstrap financing are endless. For example, an entrepreneur might require an advance payment from customers. Equipment can be leased rather than purchased (which reduces the risk of obsolete equipment). Office furniture can be rented, premises can be shared, and manufacturing can be subcontracted, thereby avoiding the expense of procuring materials, equipment, and facilities. All of these activities free up cash that can then be used for other purposes. The need for cost-reduction services is clear; Regus PLC, a temporary rental space company based in Dallas, has opened 30 office centres in Canada in the past decade. It has locations in 120 countries and cities across the nation, including Calgary, Edmonton, Winnipeg, Regina, Montreal, Toronto, Ottawa, Vancouver, Dartmouth, and Halifax.[44]

Other Resources

Businesses have other resources to help them with financing, legal, marketing, or operational advice or support. The federal and provincial governments have a wide range of financial-assistance programs for small businesses. Among the various forms of assistance are low-interest loans, loan guarantees, interest-free loans, and wage subsidies. We examine four sources of information and assistance below: Business Development Bank of Canada, business incubators, the internet, and crowdfunding vehicles.

Business Development Bank of Canada The Business Development Bank of Canada (BDC) has a mandate to help develop Canadian businesses, with a focus on small and medium-sized companies. It provides financing, venture capital, and consulting strategies. The BDC provides services to more than 30 000 businesses from coast to coast and serves them through over 100 branch offices. The BDC is a financial institution wholly owned by the Government of Canada. Information can be found at www.bdc.ca or by calling 1-877-BDC-Banx.[45]

Name	Industry Sector	Location
SFU Coast Capital Venture Connections	Mixed use	Vancouver, British Columbia
Flight Path	Software, Digital media	Edmonton, Alberta
Manitoba Technology Accelerator	Science and Technology	Winnipeg, Manitoba
Ryerson Digital Media Zone (DMZ)	Digital Media	Toronto, Ontario
Genesis Centre	Technology (software)	St. John's, Newfoundland
VennCentre	Technology	Moncton, New Brunswick
Innovacorp	Technology	Halifax, Nova Scotia
Springboard West Innovations	Mixed use	Regina, Saskatchewan
PEI BioAlliance	Human and Animal Health and Nutrition	Charlottetown, Prince Edward Island
Centre d'Entreprises et d'Innovation de Montréal (CEIM)	Cleantech and Life Sciences	Montreal, Quebec

<<< TABLE 4.3 Business Incubators across Canada[46]

Incubators Business **incubators** provide new businesses ("newborns") with support to help nurture them into a successful future. The type of support varies but some key forms of assistance include consulting services, legal advice, accounting services, business contacts, clerical services, and office space. According to the Canadian Association of Business Incubation (CABI), business survival rates are greatly improved by getting involved with an incubator. Survival rates after five years stand at about 80 percent, far above the average rates for businesses that don't use incubators. You can learn more by visiting www.cabi.ca. See Table 4.3 for examples of incubators across the country.

Internet Countless resources online can help budding entrepreneurs gather research information, write a business plan, and access government grants. The banks all have unique sites dedicated to small business and entrepreneurship resources. For example, Royal Bank of Canada (RBC) has a great site that provides checklists, business plan formats and samples, and advice on selecting business structures, and more (www.rbcroyalbank.com/business/startingabusiness/index.html). There are also government sites, such as the Canada Business Network, which is dedicated to providing information and advice on every aspect of starting a business, including accessing government grants (www.canadabusiness.ca/eng).

Crowdfunding Of course, the online world is now much more than a source for information. One important vehicle for financing is the use of crowdfunding to raise money to fund new projects. The term refers to the practice of collecting financial contributions from various individuals through an online platform. It gives regular people the chance to pledge funds to a company. For example, Revols is a Montreal-based company that managed to raise more than US$2 530 756 from 10 569 backers. The campaign to fund their revolutionary Quick Custom Fit Wireless Earphones (that are tailored to the person's ear within 60 seconds) was the most successful funding of a Canadian-based project on the platform.[47] To learn more about this approach, read the Entrepreneurship and New Ventures box entitled "Crowdfunding: Finance from the Masses."

Building the Right Team

One person might own a business, but entrepreneurship is not a solo process. Various stakeholders can provide resources to the venture. When ownership is shared, decisions must be made regarding how much each stakeholder will own, at what cost, and under what conditions. The form of legal organization chosen affects whether ownership can be shared and whether resources can be accessed.

Deciding whether to share ownership by forming a venture team involves consideration of two main issues:

- *The size and scope of the venture.* How many people does the venture require? Can people be hired to fill the key roles as they are required?
- *Personal competencies.* What are the talents, expertise, skills, track record, contacts, and resources that the entrepreneur brings to the venture? How do they match with what the venture needs to succeed?

The nature of the team depends upon the match between the lead entrepreneur and the opportunity and how quickly and aggressively he or she plans to proceed. Most teams tend to be formed in one of two ways: (1) one person has an idea (or wants to start a business), and then several associates join the team in the first few years of operation; or (2) an entire team is formed at the outset based on such factors as a shared idea, a friendship, or an experience. The ideal team consists of people with complementary skills covering the key areas of business (i.e., marketing, finance, and production). Small founding teams tend to work better than big ones. It is quite common for the initial team to consist of just two people—a craftsperson and a salesperson.

If the entrepreneur does not intend to establish a high-growth venture, going solo may be a realistic option. Some new venture founders bring on

INCUBATORS Facilities that support small businesses during their early growth phase by providing basic services, office space, legal advice, and more.

Crowdfunding: Finance from the Masses

Crowdfunding means raising money online through sites such as Kickstarter and Indiegogo, usually by getting a small amount of money from many investors. For example, Kickstarter was used to raise seed money for the Peachy Printer, an inexpensive ($100) 3-D printer made by Saskatoon-based Rinnovated Design. Because it acquired Vancouver-based Huzza Media Inc., Kickstarter now has an office in Canada. The popularity of crowdfunding is undeniable. By early 2018, more than US $3.5 billion had been pledged on Kickstarter alone.

For years, Canadian provincial securities regulations did not allow crowdfunding to be used to raise *equity* funds from investors, but crowdfunding *was* legal if the company gave investors a product rather than an equity stake. The restrictive rules protected contributors from fraud, but they also kept people who contributed from sharing in any financial gains the company made. Oculus VR Inc. (a maker of virtual reality hardware) raised funds on Kickstarter, but when Facebook bought Oculus, the people who had contributed money to Oculus did not make any gains because they didn't hold an equity stake in Oculus. The National Crowdfunding Association of Canada and the Canadian Advanced Technology Alliance both supported the idea of relaxing some of the restrictive rules governing crowdfunding, and this was finally done in 2014.

In a study conducted by PricewaterhouseCoopers LLP, women were found to be 32 percent more successful than men in achieving their funding goals on the platform. According to the survey, women seemed to have a better knack for writing emotional and inclusive language that was appealing in these pitches. However, men dominated fundraising for large campaigns; they led 89 percent of the campaigns that raised more than $1 million.

The news about crowdfunding is positive, but concerns have been expressed that Canada's performance is lagging that of other countries. In 2016, crowdfunding raised approximately $190 million in Canada, but far more was raised in the United States and Britain. Even considering our much smaller population, crowdfunding is lagging in Canada. Critics blame Canada's strict regulations and inconsistencies across different provinces. For example, start-ups that try to raise money specifically for social and environmental issues (called social impact investing) must follow strict rules. Investors must be "accredited," which means they must have a net worth of at least $1 million. This regulation is designed to protect individuals who don't have a lot of money to invest, but it does reduce the opportunities for investors who want to improve society. This regulation regarding social impact investing is stricter than the regulation for crowdfunding in general, where any individual investor can contribute, as long as it is limited to $2500 for each project and does not exceed $10,000 in one year.

Proponents of crowdfunding say that it is a way to turn social media enthusiasts into venture capitalists. But critics argue that crowdfunding will lead to fraud because unscrupulous operators will see an opportunity to rip off unsophisticated investors. They point out that if a start-up is really promising, it will attract the attention of venture capital firms. They conclude that if the rules are relaxed, most of the companies doing crowdfunding will be those that are not good investment options.

CRITICAL THINKING QUESTIONS

1. Go to Kickstarter, or another crowdfunding site, and pick one campaign to analyze. Describe the key benefits that the product offers? Do you think the concept is truly viable? What is the likelihood of success? Would you invest your hard-earned money?
2. Consider the following statement: "*Crowdfunding websites should not be allowed to raise equity funds because con artists will be able to fleece unsophisticated investors.*" Do you agree or disagree with the statement? Explain your reasoning.

additional team members only as the business can afford them. Most successful solo businesses are simple ventures (e.g., retail stores or service providers).[48] A team approach increases the odds for survival, growth, profitability, and attracting capital.[49]

Assessing the Fit between Elements in the Entrepreneurial Process

Assessing the fit between the various elements in the entrepreneurial process is an ongoing task because the shape of the opportunity, and consequently the resources and people needed to capitalize on it, typically changes as the opportunity is developed. The entrepreneur stands to gain the most by attending to these issues and making necessary changes; however, other stakeholders, such as investors, will be considering them as well.

The Entrepreneur–Opportunity Fit

The entrepreneur needs to decide whether the opportunity is something he or she can do and wants to do. A realistic self-assessment is important. Prospective ventures that are of limited personal interest and require skills and abilities that do not fit the entrepreneur should be quickly eliminated. No matter how good the product or service concept is, as the opportunity changes shape, it may demand skills a single entrepreneur lacks. This may prompt a decision to acquire the needed skills either by forming a team or by getting further training.

The Opportunity–Resources Fit

Assessing the opportunity–resources fit involves determining whether the resources needed to capitalize on the opportunity can be acquired. When challenges or risks appear, the aim is to determine whether they can be resolved and to deal with them quickly. For example, if the venture requires a greater financial investment than originally anticipated, this does not necessarily mean that the venture should be abandoned. Other options, such as taking on partners or leasing rather than building a facility, may be viable. Of course, some ventures may not be viable regardless of the alternatives considered.

The Entrepreneur–Resources Fit

Once the resource requirements of the venture have been determined, the entrepreneur needs to assess whether he or she has the capacity to meet

THE GREENING OF BUSINESS

Green Growth in Small Businesses

Small business owners are introducing many easy-to-implement initiatives that help to protect the environment; these include changing to energy-efficient lighting, using recycled paper, and buying eco-friendly cleaning supplies. One interesting development is the increasing use of cargo bicycles instead of delivery vans to move goods in congested urban areas. For example, in Toronto, both Vert Catering and Featherstone Two Wheels Green Delivery use cargo bikes instead of cars to make deliveries to customers. In Vancouver, SHIFT Urban Cargo Delivery uses cargo bikes to deliver everything from office supplies to small furniture. Cargo bicycles with electric-assist motors can move surprisingly heavy loads.

In 2017, the Canadian Federation of Independent Business (CFIB) published an in-depth report that summarized the responses of 5 982 small business owners to a survey asking them about various environmental issues. Some illustrative findings from the survey are as follows:

- Seventy-eight percent of the respondents felt that it was possible to "go green" *and* grow the economy at the same time.
- The three most important environmental issues identified by respondents were recycling (66 percent of respondents), clean water (52 percent), and energy conservation (50 percent).
- The three most frequently mentioned actions that small businesses have taken regarding the environment are introducing recycling (71 percent), reducing electricity usage (63 percent), and using more environmentally friendly products (39 percent).
- The three most frequently mentioned reasons for taking environmentally friendly actions were personal views such as "it's the right thing to do" (84 percent), cost saving (50 percent), and customers' views (35 percent).
- The three most frequently mentioned reasons that prevented businesses from implementing environmentally friendly actions were issues such as restrictive building codes where the small business was located (38 percent), the high cost of making the required changes (32 percent), and the business owner's lack of knowledge about what changes would be useful and effective (23 percent).

The report provided some interesting examples of what specific actions small business owners had taken to protect the environment. An Ontario cheese producer said that it was in the process of installing solar panels to generate electric power for its operations. A Manitoba grocery store was planting trees around its property. A Saskatchewan trucking company had introduced a program to minimize fuel use. A veterinary clinic in Newfoundland and Labrador had installed geothermal heating in its floors.

Dan Kelly, the president of CFIB, says that many small business owners would like to implement environmentally friendly activities but find the cost of doing so prohibitive. He says that the federal government could help by introducing a 100-percent Capital Cost Allowance for things such as clean technology purchases.

CRITICAL THINKING QUESTION

1. Consider the following statement: *Because the failure rate of small businesses is high, owners must focus all their energies on trying to survive. Although they can implement some inexpensive green practices that will have a slightly positive effect, they simply do not have the time or the money to implement significant green practices that will really make a difference.* Do you agree or disagree with the statement? Explain your reasoning.

those requirements. For example, an entrepreneur with a strong reputation for software development will have an easier time attracting employees for a venture specializing in software than someone with no track record. If that same entrepreneur is well connected with people in the industry, he or she will be more likely to gain commitments from customers and, in turn, investors.

Small businesses are increasingly seeing the need and investing in resources that promote environmentally friendly practices. Read the Greening of Business box entitled "Green Growth in Small Business."

LO-4 STARTING UP A SMALL BUSINESS

Most entrepreneurs start up a small business in one of three ways: they start from scratch, they buy an existing business, or they buy a franchise. We examined the "starting from scratch" alternative in detail in the preceding section, so we turn now to the latter two alternatives.

Buying an Existing Business

According to a BDC study, the opportunities to buy existing businesses are increasing. Approximately, 60 percent of Canada's small business owners are 50 or older. Forty percent of these entrepreneurs are planning to exit their business in the next few years, representing $300 billion worth of business value. Some businesses will be passed along to the next generation, but many will be sold. Therefore, in addition to people who sell for other reasons (health, lifestyle, etc.), the demographics indicate that plenty of additional buying opportunities will become available.[50]

Many experts recommend buying a successful existing business. Doing so increases the chances of success as the business has already proven its ability to attract customers and has established relationships with lenders, suppliers, and other stakeholders. The track record also gives potential buyers a clearer picture of what to expect rather than an estimate of a new business's prospects.

However, an entrepreneur who buys someone else's business may not be able to avoid certain problems. For example, there may be uncertainty about the exact financial shape the business is in, the business may have a poor reputation, the location may be poor, or it may be difficult to determine an appropriate purchase price.

Taking Over a Family Business

Taking over a family business poses both opportunities and challenges. On the positive side, a family business can provide otherwise unobtainable financial and management resources—it often has a valuable reputation that can result in important community and business relationships, employee loyalty is often high, and an interested, unified family management and shareholders group may emerge. On the other hand, there may be disagreements over which family members assume control. Choosing an appropriate successor is a key issue for continuity, but it is also a key source of conflict. In addition, if a parent sells his or her interest in the business, the price to be paid may be an issue. Expectations can also be problematic, as some family members may feel that they have a right to a job, promotion, and an impressive title based on birthrights.[51] Handling disagreements among family members about the future of the business can be a challenge. How do you fire a loved one if things are not working out?[52]

Plenty of companies have thrived for more than one generation. For example, Kal Tire is headed by a second-generation leader named Robert Foord. He took over from his late father, Tom Foord. Kal Tire was started in 1953 in Vernon, British Columbia, and now has more than 250 locations, 5600 employees, and annual sales of $1.4 billion. Among the large roster of employees, you can clearly trace the family tree: Tom Foord's five siblings, along with their spouses, children, and grandchildren.[53]

Buying a Franchise

If you drive around any Canadian town or city, you will notice retail outlets with names like McDonald's, RE/MAX, Canadian Tire, Chez Cora, and Tim Hortons. These diverse businesses have one thing in common—they are all franchises, operating under licences issued by parent companies to entrepreneurs who own and manage them. Depending on how it is defined, franchising now accounts for 40 percent of retail sales in Canada. There are approximately 78 000 franchise establishments in Canada that employ more than one million people and account for more than $68 billion in annual revenues.[54]

A **franchising agreement** outlines the duties and responsibilities of each party. It indicates the amount and type of payment that franchisees must make to the franchiser. These franchise agreements have become increasingly complicated, often 60 or even 100 pages long. Tim Hortons avoids this trend with a streamlined contract of about 26 pages.[55] As you saw in the opening case, franchisees usually make an initial payment for the right to operate an outlet. They also make royalty payments to the franchiser ranging from 2 to 30 percent of the franchisee's annual revenues or profits. The franchisee may also pay an advertising fee to the franchiser. Initial franchise fees vary widely, from $25 000 for a Bento Sushi franchise to hundreds of millions for a professional sports franchise.[56]

Kal Tire is a positive example of a family business that has stood the test of time and grown into a major company.

Rosanne Tackaberry/Alamy Stock Photo

Colin McConnell/Toronto Star/Getty Images

Bento Sushi has successfully franchised across Canada with more than 540 locations. Each franchisee must pay an initial fee of $25 000 for the name, and an approximate $150 000 investment is required to get the business started.

The Advantages and Disadvantages of Franchising

Both franchisers and franchisees benefit from the franchising way of doing business Table 4.4 clearly outlines the obvious advantages.

There are two sides to any story. However, many experienced people will tell you that buying a franchise is like buying a job. The agreements are long because franchisers want to protect their image and brand and want franchisees to follow their rules. If they don't abide by the agreement, franchisees may be sued. So, if you have a great new breakfast menu idea for your outlet and have creative promotional ideas, franchising may not be for you. If things go well, it can be rewarding, but it is important to do your homework—there are many disappointed franchise owners out there.

You need to read the agreement carefully and ensure that your territory is protected and that you have the right of first refusal on potential new stores within a certain distance (e.g., 10–15 kilometres or exclusivity of your town). Some franchisees have been shocked to see their franchiser place a new franchisee a few blocks away or even across the street. Franchisees can benefit from support and advertising, but that does not come for free. For example, a Harvey's franchisee pays a 5 percent royalty fee and a 4 percent advertising fee (based on gross sales), and these fees are payable each week in addition to regular operating costs and rent.[57] This after paying anywhere from $750 000 to $1 000 000 for a free-standing outlet. Plenty of franchisees who belong to popular chains that are barely surviving are wondering whatever happened to that promised success.

FRANCHISING AGREEMENT Stipulates the duties and responsibilities of the franchisee and the franchiser.

TABLE 4.4 The Benefits of Franchising

For the Franchiser	For the Franchisee
• The franchiser can attain rapid growth for the chain by signing up many franchisees in many different locations.	• Franchisees own a small business that has access to big business management skills.
• Franchisees share in the cost of advertising.	• The franchisee does not have to build up a business from scratch.
• The franchiser benefits from the investment money provided by franchisees.	• Franchisee failure rates are lower than when starting one's own business.
• Advertising money is spent more efficiently.	• A well-advertised brand name comes with the franchise, and the franchisee's outlet is instantly recognizable.
• Franchisees are motivated to work hard for themselves, which creates profit for the franchiser.	• The franchiser may send the franchisee to a training program run by the franchiser (e.g., the Canadian Institute of Hamburgerology run by McDonald's).
• The franchiser is freed from all details of a local operation, which are handled by the franchisee.	• The franchiser may visit the franchisee and provide expert advice on how to run the business. Burger King has 145 coaches who travel to franchisees to improve everything from cooking techniques to cost-cutting measures.[59]
• Economies in buying allow franchisees to get lower prices for the raw materials they must purchase.	
• Financial assistance is provided by the franchiser in the form of loans; the franchiser may also help the franchisee obtain loans from local sources.	
• Franchisees are their own bosses and get to keep most of the profit they make.	

In response to these issues, the provincial governments of Manitoba, Alberta, Ontario, New Brunswick, and Prince Edward Island have created laws to protect franchisees through Franchise Disclosure Documents (FDD) that provide clear details of the agreement and help protect franchisees in these jurisdictions.[58]

Is Franchising for You?

Do you think you would be happy being a franchisee? The answer depends on many factors, including your willingness to work hard, your ability to find a good franchise to buy, and the financial resources you possess. If you are thinking seriously of going into franchising, you should consider several areas of costs you will incur:

- the franchise sales price
- expenses that will be incurred before the business opens
- training expenses
- operational expenses for the first six months
- personal financial needs for the first six months
- emergency needs

LO-5 SUCCESS AND FAILURE IN SMALL BUSINESS

Of every 100 small businesses that begin operation, 85 will still be operating after one year, 70 after three years, and 51 after five years.[60] A study conducted by CIBC World Markets found that small businesses with above-average revenue growth were run by owners who had more education, used professional advisers, adopted the corporate form of ownership, did outsourcing work for other companies, had a high level of internet connectivity, and used the internet to sell outside Canada.[61]

Reasons for Success

Beyond the specific findings like the CIBC study, four general factors typically are cited to explain the success of small business owners:

1. *Hard work, drive, and dedication.* Small business owners must be committed to succeeding and be willing to put in the time and effort to make it happen. Long hours and few vacations generally characterize the first few years of new business ownership.
2. *Market demand for the product or service.* Careful analysis of market conditions can help small business owners assess the probable reception of their products. If the area around a college has only one pizza parlour, a new pizzeria is more likely to succeed than if ten are already in operation.
3. *Managerial competence.* Successful small business owners have a solid understanding of how to manage a business. They may acquire competence through training (taking courses), experience, or using the expertise of others. Few, however, succeed alone or straight out of school. Most spend time in successful companies or partner with others to bring expertise to a new business.
4. *Luck.* Luck also plays a role in the success of some firms. For example, after one entrepreneur started an environmental clean-up firm, he/she struggled to keep his business afloat. Then the government committed a large sum of money to toxic waste clean-up. He/she was able to get several large contracts, and his/her business is now thriving.

Co-founders Kevin Collins and Alex Clark of Bit Stew Systems Inc. exemplify the road to success, and their hard work eventually led to a buyout of their BC-based start-up by GE for $153 million. GE on its end bought the company to incorporate the technology into its operating systems for industrial internet applications.[62]

Reasons for Failure

Small businesses fail for many reasons. Entrepreneurs may have no control over some of these factors (e.g., weather, accidents), but they can influence most items on the list. Although no pattern has been established, four general factors contribute to failure:

1. *Managerial incompetence or inexperience.* Some entrepreneurs overestimate their own managerial skills or believe that hard work alone ensures success. If managers don't know how to make basic business decisions or don't understand basic management principles, they aren't likely to succeed.
2. *Neglect.* Some entrepreneurs try to launch ventures in their spare time, and others devote only limited time to new businesses. But starting a small business demands an overwhelming time commitment.
3. *Weak control systems.* Effective control systems keep a business on track and alert managers to potential trouble. If the control systems don't signal potential problems, the business may be in serious trouble before obvious difficulties are spotted.
4. *Insufficient capital.* Some entrepreneurs are overly optimistic about how soon they'll start earning profits. In most cases, it takes months or even years. Amazon.com didn't earn a profit for 10 years, but obviously still required capital to pay employees and cover expenses. Experts say you need enough capital to operate six months to a year without earning a profit.[63]

LO-6 FORMS OF BUSINESS OWNERSHIP

Before embarking on the road to success and facing all the potential problems, an entrepreneur must consider the best form of ownership: sole proprietorship, partnership, corporation, or co-operative. Whether entrepreneurs intend to run small farms, large factories, or online e-tailers, they must decide which option best suits their goals.

The Sole Proprietorship

The **sole proprietorship** is a business owned and operated by one person. Legally, if you set up a business as a sole proprietorship, your business is considered to be an extension of yourself (and not a separate legal entity). Though usually small, a sole proprietorship may be as large as a steel mill or as small as a lemonade stand. Although the majority of businesses in Canada are sole proprietorships, they account for only a small proportion of total business revenues.

Advantages of a Sole Proprietorship

Freedom may be the most important benefit of a sole proprietorship. Sole proprietors answer to only themselves, since they don't share ownership. A sole proprietorship is also easy to form. If you operate the business under your own name, with no additions, you don't even need to register your business name to start operating as a sole proprietor—you can go into business simply by putting a sign on the door. The simplicity of legal set-up procedures makes this form appealing to self-starters and independent spirits, as do the low start-up costs.

The tax benefits are also attractive features. Most businesses suffer losses in their early stages. Because the business and the proprietor are legally one and the same, these losses can be deducted from income the proprietor earns from personal sources other than the business.

Disadvantages of a Sole Proprietorship

A major drawback is **unlimited liability**, which means that a sole proprietor is personally liable (responsible) for all debts incurred by the business. If the business fails to generate enough cash, bills must be paid out of the owner's pocket. Another disadvantage is lack of continuity; a sole proprietorship legally dissolves when the owner dies. Finally, a sole proprietorship depends on the resources of one person whose managerial and financial limitations may constrain the business. Sole proprietors often find it hard to borrow money to start up or expand. Many bankers fear that they won't be able to recover loans if the owner becomes disabled.

The Partnership

A **partnership** is established when two or more individuals (partners) agree to combine their financial, managerial, and technical abilities to operate a business for profit. This form of ownership is often used by professionals such as accountants, lawyers, and engineers. Partnerships are often an extension of a business that began as a sole proprietorship. The original owner may want to expand, or the business may have grown too big for a single person to handle.

There are two basic types of partners in a partnership. **General partners** are actively involved in managing the firm and have unlimited liability. **Limited partners** don't participate actively in the business, and their liability is limited to the amount they invested in the partnership. A *general partnership* is the most common type and is similar to the sole proprietorship in that all the (general) partners are jointly liable for the obligations of the business. The other type, the *limited partnership*, consists of at least one general partner (who has unlimited liability) and one or more limited partners. The limited partners cannot participate in the day-to-day management of the business or they risk the loss of their limited liability status.

SOLE PROPRIETORSHIP Business owned and usually operated by one person who is responsible for all of its debts.

UNLIMITED LIABILITY A person who invests in a business is liable for all debts incurred by the business; personal possessions can be taken to pay debts.

PARTNERSHIP A business with two or more owners who share in the operation of the firm and in financial responsibility for the firm's debts.

GENERAL PARTNER A partner who is actively involved in managing the firm and has unlimited liability.

LIMITED PARTNER A partner who generally does not participate actively in the business and whose liability is limited to the amount invested in the partnership.

Advantages of a Partnership

The most striking advantage of a general partnership is the ability to grow by adding talent and money. Partnerships also have an easier time borrowing funds than sole proprietorships. Banks and other lending institutions prefer to make loans to enterprises that are not dependent on a single individual. Partnerships can also invite new partners to join by investing money.

Like a sole proprietorship, a partnership is easy to organize, with few legal requirements. Even so, all partnerships must begin with an agreement of some kind. It may be written, oral, or even unspoken. Wise partners, however, insist on a written agreement to avoid trouble later. This agreement should answer questions such as these:

- Who invested what sums of money in the partnership?
- Who will receive what share of the partnership's profits?
- Who does what and who reports to whom?
- How may the partnership be dissolved?
- How will leftover assets be distributed among the partners?
- How will surviving partners be protected from claims by surviving heirs if a partner dies?
- How will disagreements be resolved?

A partnership agreement is strictly a private document. No laws require partners to file an agreement with a government agency. Nor are partnerships regarded as legal entities. In the eyes of the law, a partnership is nothing more than two or more people working together. The partnership's lack of legal standing means that the partners are taxed as individuals.

Disadvantages of a Partnership

Unlimited liability is also the biggest disadvantage of a general partnership. By law, each partner may be held personally liable for all debts of the partnership. Also, if one partner incurs a debt, even if the other partners know nothing about it, they are all liable if the offending partner cannot pay up. Another problem with partnerships is the lack of continuity. When one partner dies or pulls out, a partnership dissolves legally, even if the other partners agree to continue the business.

A related drawback is the difficulty of transferring ownership. No partner may sell out without the other partners' consent. Thus the life of a partnership may depend on the ability of retiring partners to find someone compatible with the other partners to buy them out. Finally, a partnership provides little or no guidance in resolving conflicts between the partners. For example, suppose one partner wants to expand the business rapidly and the other wants it to grow slowly. If under the partnership agreement the two are equal, it may be difficult for them to decide what to do.

The Corporation

When you think of corporations, you probably think of giant businesses such as Air Canada, Walmart, or Telus. The very word "corporation" suggests bigness and power. Yet the tiny corner retailer has as much right to incorporate as a giant oil refiner. Both of them have the same basic characteristics that all corporations share—legal status as a separate entity, property rights and obligations, and an indefinite lifespan. (See Table 4.5 for a list of the top ten corporations in Canada.)

A corporation has been defined as "an artificial being, invisible, intangible, and existing only in contemplation of the law." As such, corporations may sue and be sued; buy, hold, and sell property; make products and sell them to consumers; and commit crimes and be tried and punished for them. Simply defined, a **corporation** is a business that is a separate legal entity, that is liable for its own debts, and whose owners' liability is limited to their investment.

TABLE 4.5 Top 10 Corporations in Canada, 2017[64]

Company	Sales Revenues (in billions of $)
1. Manulife Financial	53.5
2. Power Corp. of Canada	50.6
3. Power Financial	49.0
4. Magna International	48.6
5. George Weston Ltd.	48.0
6. Great-West Lifeco	46.6
7. Loblaw Companies	46.4
8. Royal Bank of Canada	46.3
9. Alimentation Couche-Tard	45.0
10. Toronto-Dominion Bank	40.9

Shareholders are investors who buy shares of ownership in the form of stock—they are the real owners of a corporation. (The different kinds of stockholders are described in Chapter 15.) Profits may be distributed to stockholders in the form of dividends, although corporations are not required to pay dividends. Instead, they often reinvest the profits in the business. Common stockholders have the last claim to all assets if a company folds. Dividends on **common stock** are paid on a per-share basis (if a dividend is declared). Thus a shareholder with 10 shares receives 10 times the dividend paid a shareholder with one share. When investors cannot attend a shareholders' meeting, they can grant voting authority to someone who will attend. This procedure, called *voting by proxy*, is how almost all individual investors vote.

The **board of directors** is the governing body of a corporation. Its main responsibility is to ensure that the corporation is run in the best interests of the shareholders. The directors choose the president and other officers of the business and delegate the power to run the day-to-day activities of the business to those officers. The directors set policy on paying dividends, on financing major spending, and on executive salaries and benefits. Large corporations tend to have large boards with as many as 20 or 30 directors, whereas smaller corporations tend to have no more than five directors. Usually, these are people with personal or professional ties to the corporation, such as family members, lawyers, and accountants.

Inside directors are employees of the company and have primary responsibility for the corporation. They are top managers, such as the president and executive vice-presidents. *Outside directors* are not employees of the corporation. Attorneys, accountants, university officials,

CORPORATION A business considered by law to be a legal entity separate from its owners with many of the legal rights and privileges of a person; a form of business organization in which the liability of the owners is limited to their investment in the firm.

SHAREHOLDERS Investors who buy shares of ownership in the form of stock.

COMMON STOCK Shares whose owners usually have last claim on the corporation's assets (after creditors and owners of preferred stock) but who have voting rights in the firm.

BOARD OF DIRECTORS A group of individuals elected by a firm's shareholders and charged with overseeing, and taking legal responsibility for, the firm's actions.

and executives from other firms are commonly used as outside directors. Diversity within board seats is a growing concern, and a group of senators has initiated Bill C-25 to encourage companies to be more inclusive and to help increase the participation of females on boards, which stood at only 14 percent in 2018.[65]

Corporate officers are the top managers hired by the board to run the corporation on a day-to-day basis. The **chief executive officer (CEO)** is responsible for the firm's overall performance. Other corporate officers typically include the president, who is responsible for internal management, and various vice-presidents, who oversee functional areas such as marketing or operations.

Types of Corporations

A **public corporation** is one whose shares of stock are widely held and available for sale to the general public. Anyone who has the funds to pay for them can buy shares of companies such as Petro-Canada, Bombardier, or Air Canada. The stock of a **private corporation**, on the other hand, is held by only a few people and generally is not available for sale. The controlling group may be a family, employees, or the management group. Pattison and Cirque du Soleil are two well-known Canadian private corporations.

Most new corporations start out as private corporations because few investors will buy an unknown stock. As the corporation grows and develops a record of success, it may issue shares to the public to raise additional money. This is called an **initial public offering (IPO)**. IPOs are not very attractive to investors during stock market declines, but they become more popular when stock markets recover. According to a PWC report, 38 IPOs in Canada raised more than $5.1 billion in 2017.[66]

A public corporation can also "go private," which is the reverse of going public. **Private equity firms** buy publicly traded companies and then make them private. They often make major changes to a company's operations to increase its value.

About a decade ago, many corporations converted to an **income trust** structure, which allowed them to avoid paying corporate income tax if they distributed all or most of their earnings to investors. Income trusts distribute much of their cash flow to investors each month.[67] However, the government eventually changed the laws and put a tax on distributions that essentially put them on par, from a tax perspective, with regular corporations.

At the beginning of 2018, Drake was actively promoting his partnership with spirits producer Brent Hocking for a planned IPO for US$30 million for their Virginia Black Decadent American Whiskey brand.

George Pimentel/Getty Images Entertainment/Getty Images

Formation of a Corporation

The two most widely used methods of forming a corporation are federal incorporation under the Canada Business Corporations Act and provincial incorporation under any of the provincial corporations acts. The former is used if the company is going to operate in more than one province; the latter is used if the founders intend to carry on business in only one province. Except for banks and certain insurance and loan companies, any company can be federally incorporated under the Canada Business Corporations Act. To do so, articles of incorporation must be drawn up. These articles include information such as the name of the corporation, the type and number of shares to be issued, the number of directors the corporation will have, and the location of the company's operations. The specific procedures and information required for provincial incorporation vary from province to province.

All corporations must attach the word "Limited" (Ltd./Ltée), "Incorporated" (Inc.), or "Corporation" (Corp.) to the company name to indicate clearly to customers and suppliers that the owners have limited liability for corporate debts. The same sorts of rules apply in other countries. British firms, for example, use PLC for "public limited company," and German companies use AG for *Aktiengesellschaft* (corporation).

Advantages of Incorporation

The biggest advantage of the corporate structure is **limited liability**, which means that the liability of investors is limited to their personal investment in the corporation. In the event of failure, the courts may seize a corporation's assets and sell them to pay debts, but the courts cannot touch the investors' personal possessions. If, for example, you invest $25 000 in a corporation that goes bankrupt, you may lose your $25 000, but no more. In other words, $25 000 is the extent of your liability.

Another advantage of a corporation is continuity. Because it has a legal life independent of its founders and owners, a corporation can, in theory, continue forever. Shares of stock may be sold or passed on to heirs, and most corporations also benefit from the continuity provided by professional management. Finally, corporations have advantages in

CHIEF EXECUTIVE OFFICER (CEO) The highest-ranking executive in a company or organization.

PUBLIC CORPORATION A business whose stock is widely held and available for sale to the general public.

PRIVATE CORPORATION A business whose stock is held by a small group of individuals and is not usually available for sale to the general public.

INITIAL PUBLIC OFFERING (IPO) Selling shares of stock in a company for the first time to a general investing public.

PRIVATE EQUITY FIRMS Companies that buy publicly traded companies and then make them private.

INCOME TRUST A structure allowing companies to avoid paying corporate income tax if they distribute all or most of their earnings to investors.

LIMITED LIABILITY Investors' liability is limited to their personal investments in the corporation; courts cannot touch the personal assets of investors if the corporation goes bankrupt.

raising money. By selling **stock**, they expand the number of investors and available funds. The term "stock" refers to a share of ownership in a corporation. Continuity and legal status tend to make lenders more willing to grant loans to corporations.

Disadvantages of Incorporation

One of the disadvantages for a new firm in forming a corporation is the cost (approximately $2500). In addition, corporations also need legal help in meeting government regulations because they are far more heavily regulated than proprietorships or general partnerships. **Double taxation** is another problem with the corporate form of ownership; a corporation must pay income taxes on its profits, and then shareholders must also pay personal income taxes on the **dividends** they receive from the corporation. The dividend a corporation pays is the amount of money, normally a portion of the profits, that is distributed to the shareholders. Because dividends paid by the corporation are paid with after-tax dollars, this amounts to double taxation. Others point out that shareholders get a dividend tax credit, which largely offsets double taxation.

The Co-Operative

A **co-operative** is an incorporated form of business organized, owned, and democratically controlled by the people who use its products and services and whose earnings are distributed based on the use of the co-operative rather than on level of investment. As such, a co-operative is established to benefit its owners in the form of reduced prices and/or the distribution of surpluses at year-end. Some popular forms of co-operatives include consumer co-operatives such as Mountain Equipment Co-op and financial co-operatives such as Vancity.

The process works like this. Suppose a group of farmers believe they can get cheaper fertilizer prices if they form their own company and purchase in large volumes. They might then form a co-operative, which can be either federally or provincially chartered. Prices are generally lower to buyers, and at the end of the fiscal year, surpluses are distributed to members based on how much they purchased. If farmer Jones bought 5 percent of all co-op sales, he will receive 5 percent of the surplus.

The co-operative's start-up capital usually comes from shares purchased by the co-operative's members. Sometimes all it takes to qualify for membership in a co-operative is the purchase of one share with a fixed (and often nominal) value. Federal co-operatives, however, can raise capital by issuing investment shares to members or non-members. Co-operatives, like investor-owned corporations, have directors and appointed officers.

In terms of numbers, co-operatives are the least important form of ownership. However, they are of significance to society and to their members and may provide services that are not readily available or that cost more than the members would otherwise be willing to pay. Table 4.6 compares the various forms of business ownership using different characteristics.

MEC is an example of a retail cooperative that has outdoor sporting goods stores across the country. Customers become members with an initial fee of $5.

JHVEPhoto/Shutterstock

Advantages of a Co-operative

Co-operatives have many of the same advantages as investor-owned corporations, such as limited liability of owners and continuity. A key benefit of a co-operative relates to its structure. Each member has only one vote in the affairs of the co-operative, regardless of how many shares he or she owns. This system prevents voting and financial control of the business by a few wealthy individuals. This is particularly attractive to the less wealthy members of the co-operative.

Unlike corporations, which are not allowed a tax deduction on dividend payments made to shareholders, co-operatives can deduct patronage refunds to members out of before-tax income. Thus income can be taxed only at the individual member level rather than at both the co-operative and member level.[68]

STOCK A share of ownership in a corporation.
DOUBLE TAXATION A corporation must pay income taxes on its profits, and then shareholders must also pay personal income taxes on the dividends they receive from the corporation.
DIVIDENDS The amount of money, normally a portion of the profits, that is distributed to the shareholders.
CO-OPERATIVE An organization that is formed to benefit its owners in the form of reduced prices and/or the distribution of surpluses at year-end.

Characteristic	Sole Proprietorship	Partnership	Corporation	Co-operative
Protection against liability for bad debts	Low	Low	High	High
Ease of formation	High	High	Medium	Medium
Permanence	Low	Low	High	High
Ease of ownership transfer	Low	Low	High	High
Ease of raising money	Low	Medium	High	High
Freedom from regulation	High	High	Low	Medium
Tax advantages	High	High	Low	High

<<< TABLE 4.6 A Comparison of Four Forms of Business Ownership

Disadvantages of a Co-operative

One of the main disadvantages of co-operatives relates to attracting equity investment. Because the benefits from being a member of a co-operative arise through the level of use of the co-operative rather than the level of equity invested, members do not have an incentive to invest in equity capital of the co-operative. Another drawback is that democratic voting arrangements and dividends based purely on patronage discourage some entrepreneurs from forming or joining a co-operative.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 EXPLAIN THE MEANING AND INTERRELATIONSHIP OF THE TERMS *SMALL BUSINESS*, *NEW VENTURE CREATION*, AND *ENTREPRENEURSHIP*.

A *small business* has fewer than 100 employees. A new firm is one that has become operational within the previous 12 months, has adopted any of four main organizational forms—sole proprietorship, partnership, corporation, or co-operative—and sells goods or services. *Entrepreneurship* is the process of identifying an opportunity in the marketplace and accessing the resources needed to capitalize on it. In relation to small and/or new businesses, entrepreneurship is the process by which a small business or a new business is created.

LO-2 DESCRIBE THE ROLE OF *SMALL AND NEW BUSINESSES* IN THE CANADIAN ECONOMY.

Although 98 percent of employer businesses in Canada are small (fewer than 100 employees), about half of the total private-sector labour force work for *small businesses*. The distribution of employment by size of firm varies across industries. The small business sector's capacity for entrepreneurship and innovation accounts for much of the job creation; this sector contributes to the economy, with start-ups accounting for most of the growth. Women are playing a major role in the growth of small businesses. *New businesses* are also important to the Canadian economy because they are the main source of new products and services.

LO-3 DESCRIBE SOME KEY CHARACTERISTICS OF ENTREPRENEURIAL PERSONALITIES AND EXPLAIN THE ENTREPRENEURIAL PROCESS AND DESCRIBE ITS KEY ELEMENTS.

Entrepreneurs are people who assume the risk of business ownership. Some entrepreneurs have a goal of independence and financial security, and others want to launch a new venture that can be grown into a large business. Most successful entrepreneurs are resourceful and concerned for customer relations. They have a strong desire to be their own bosses and can handle ambiguity and surprises. Today's entrepreneur is often an open-minded leader who relies on networks, business plans, and consensus and is just as likely to be female as male. Finally, although successful entrepreneurs understand the role of risk, they do not necessarily regard what they do as being risky.

The *entrepreneurial process* occurs within a social, political, and economic context and consists of three key elements: the entrepreneur, the opportunity, and resources. Entrepreneurs typically access the various resources needed by bootstrapping—doing more with less. These resources are both financial and non-financial. Two types of financing—debt and equity—can be accessed from a range of sources.

LO-4 DESCRIBE THREE ALTERNATIVE STRATEGIES FOR BECOMING A BUSINESS OWNER—*STARTING FROM SCRATCH*, *BUYING AN EXISTING BUSINESS*, AND *BUYING A FRANCHISE*.

It is necessary to work through the entrepreneurial process to *start a business from scratch*. Whether start-up efforts will result in a new business often depends upon how well matched the entrepreneur's skills and abilities are with the opportunity and the resources required, as well as how well matched the opportunity and resources are. Generally, when someone *buys an existing business*, the odds of success are better

because it has existing customers, established relationships (e.g., lenders and suppliers), and an existing track record. Potential buyers have a clearer picture of what to expect. However, the business may have a poor reputation or poor location, and it may be difficult to determine an appropriate purchase price. A special case of buying an existing business involves family businesses, which pose both opportunities and challenges. In *buying a franchise*, the buyer (franchisee) purchases the right to sell the product or service of the seller (franchiser) according to the terms of the franchising agreement. In return, the franchiser helps with the business's start-up as well as with ongoing operations once the business opens its doors.

LO-5 IDENTIFY FOUR KEY *REASONS FOR SUCCESS* IN SMALL BUSINESSES AND FOUR KEY *REASONS FOR FAILURE*.

Four basic factors explain most small business success: (1) hard work, drive, and dedication, (2) market demand for the products or services being provided, (3) managerial competence, and (4) luck. Four factors contribute to small business failure: (1) managerial incompetence or inexperience, (2) neglect, (3) weak control systems, and (4) insufficient capital.

LO-6 DESCRIBE FOUR FORMS OF *LEGAL ORGANIZATION* FOR A BUSINESS AND DISCUSS THE ADVANTAGES AND DISADVANTAGES OF EACH.

Sole proprietorships are owned and operated by one person, are easy to set up, have low start-up costs, and get tax benefits—and their owners enjoy freedom. However, they have unlimited liability, a lack of continuity, and limited resources.

Under a general partnership, all partners have unlimited liability. Partnerships may lack continuity and transferring ownership may be difficult. On the positive side, partnerships can grow by adding new talent and money, partners are taxed as individuals, and banks prefer to make loans to enterprises that are not dependent on one individual. All partnerships should have a partnership agreement.

Corporations are separate legal entities; they have property rights and obligations, and they have indefinite life spans. They may sue and be sued; buy, hold, and sell property; make and sell products; and commit crimes and be tried and punished for them. The biggest advantage of incorporation is limited liability. Other advantages include continuity, professional management, and improved ability to raise money by selling stock. Disadvantages of the corporation include high start-up costs, complexity, and double taxation. The majority of corporations are privately held. In forming a corporation, a business will incorporate federally if it is going to operate in more than one province and provincially if it is going to operate in only one province.

A co-operative is an organization that is established to benefit its owners in the form of reduced prices and/or the distribution of surpluses at year-end. On the positive side, co-operatives are democratically controlled, enjoy limited liability and continuity, and are not subject to double taxation. The main disadvantages include difficulty in raising equity.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. After considering the characteristics of entrepreneurs, do you think that you would be a good candidate to start your own business? Why or why not?
2. If you were going to open a new business, what type of business would it be? Why?
3. Which industries are easiest for a small business to enter? Which are hardest? Why?
4. Would you prefer to buy an existing business or start from scratch? Why?
5. Why might a private corporation choose to remain private? Why might it choose to "go public"?
6. Consider a new product or service that has recently become available for purchase by consumers. To what extent did this product or service possess the "screening" characteristics that are described in the chapter (adding value, providing competitive advantage, etc.)?

APPLICATION EXERCISES

7. There are thousands of mobile applications on the various mobile platforms (you probably use some of them on a weekly or daily basis). Identify an idea for a new application that can serve a consumer need that is currently unmet or can be improved upon.
8. Interview the owner/manager of a sole proprietorship or a general partnership. What characteristics of that business form led the owner to choose it? Does he or she ever plan on changing the form of the business?
9. Identify two or three of the fastest-growing businesses in Canada during the past year. What role has entrepreneurship played in the growth of these firms?
10. Although more than half of all small businesses don't survive five years, franchises have a much better track record. However, it can be difficult to buy a franchise. Research a popular food industry franchise, such as Subway, and detail the requirements for net worth and liquid cash for the franchisee as well as upfront and annual fees.

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members and discuss your new business venture within the context of this chapter. Develop specific responses to the following:

1. To what extent do each of you really want to be an entrepreneur?
2. For the specific business you are starting (in this exercise), does it make more sense to start from scratch, to buy an existing business, or to buy a franchise? Why?

BUILDING YOUR BUSINESS SKILLS

A TASTY IDEA

GOAL

To encourage you to identify options for financing a new business.

BACKGROUND INFORMATION

Suppose that you and three friends from college want to open a new restaurant. Collectively, you have almost 20 years of experience in the restaurant industry, and with lots of new houses in the area, you think there's an opportunity to make a lot of money if you can offer interesting food at good prices. You've even identified a great location, but you realize that it's going to take a great deal of money to get this business off the ground. As recent college graduates, you don't have a lot of money, so you're looking for the best source of funding. Realistically, you realize that you're going to need at least $100 000 to sustain operations until your business starts to return a profit.

METHOD

Step 1 Individually or in a group of two or three students, brainstorm a list of options for financing. You'll want to do a little online research to find out more about some of the loan programs identified in the text.

Step 2 For each of the funding options, develop a list of pros and cons. Be sure to consider all the implications of each form of financing, considering interest rates, repayment options, and eligibility requirements.

FOLLOW-UP QUESTIONS

1. Before getting financing, what will be expected of you and your business partners?
2. Which source of financing would be best for you and your partners? Why?
3. What form of business ownership would be most appropriate for your new restaurant and why?

EXERCISING YOUR ETHICS

BREAKING UP IS HARD TO DO

THE SITUATION

Connie and Mark began a 25-year friendship after finishing college and discovering their mutual interest in owning a business. They established a general partnership for their home-furnishings centre, which has sustained successfully for 20 years through their share-and-share-alike relationship. Start-up cash, daily responsibilities, and profits have all been shared equally. Each partner works four days each week, except when busy seasons require both to be in the store. Shared goals and compatible personalities have led to a solid give-and-take relationship that helps them overcome business problems while maintaining a happy interpersonal relationship.

The division of work is a natural match and successful combination because of the partners' different but complementary interests. Mark buys the merchandise and maintains up-to-date contacts with suppliers; he also handles personnel matters (hiring and training employees). Connie manages the inventory, buys shipping supplies, keeps the books, and manages the finances. Mark does more selling, with Connie helping out only during busy seasons. Both partners share in decisions about advertising and promotions. Mark has taken a particular interest in learning how to use the latest social media tools and has begun to implement these strategies successfully.

THE DILEMMA

Things began changing two years ago, when Connie became less interested in the business and got more involved in other activities. Whereas Mark's enthusiasm remained high, Connie's time was increasingly consumed by travel, recreation, and community-service activities. At first, she reduced her work commitment from four to three days a week. Then she indicated that she wanted to cut back further, to just two days. "In that case," Mark replied, "we'll have to make some changes."

Mark insisted that the profit sharing be adjusted from the original 50-50 arrangement to reflect his larger role in running the business. This was not addressed immediately; however, he also proposed that Connie's monthly salary be cut in half (from $4000 to $2000). Connie agreed. He recommended that the $2000 savings be shifted to his salary because of his increased workload, but this time Connie disagreed, arguing that Mark's current $4000 salary already compensated him for his contributions. She proposed to split the difference, with Mark getting a $1000 increase and the other $1000 going into the firm's cash account. Mark said no and insisted on a full $2000 raise. To avoid a complete falling out, Connie finally gave in, even though she thought it unfair for Mark's salary to jump from $4000 per month to $6000. At that point, she made a promise to herself: "To even things out, I'll find a way to get $2000 worth of inventory for personal use each month, and I won't give in on any future profit-sharing adjustments."

TEAM ACTIVITY

Assemble a group of four students and divide the four into two pairs and answer the questions from one of the following perspectives:

- Mark's perspective
- Connie's perspective

QUESTIONS TO ADDRESS

1. Identify the ethical issues, if any, regarding Mark's and Connie's respective positions on Mark's proposed $2000 salary increase.
2. What kind of salary and profit adjustments do you think would be fair in this situation? Explain why.
3. There is another way for Mark and Connie to solve their differences—because the terms of participation have changed, it might make sense to dissolve the existing partnership. What do you recommend in this regard?

BUSINESS CASE 4

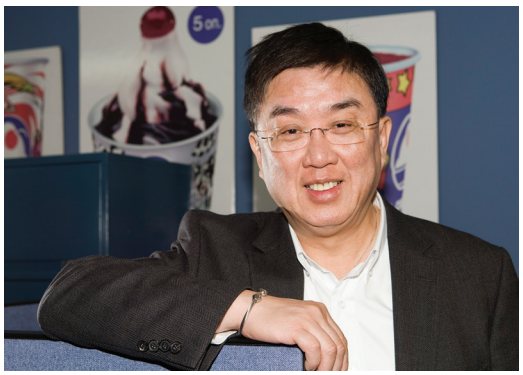
CANADIAN FOOD COURT KING EXPANDS HIS REACH

Stanley Ma is the undisputed king of the Canadian food court. At the beginning of 2018, the company he founded, the MTY group, was absorbing yet another massive acquisition when it purchased the Imvescor Restaurant Group for $248 million in cash and stocks. This move was aimed at diversifying the food court king's assets by boosting the number of sit-down restaurants in his portfolio. This acquisition included well-known brands in Eastern Canada, such as Baton Rouge, Pizza Delight, and Scores. Regardless of the industry, pure entrepreneurs share a passion and commitment for their businesses. Stanley Ma is a perfect example of a true entrepreneur. Let's find out more about his rise to success.

Who is he? You might not know the name, but you have probably had a meal at one (if not dozens) of his 5700 restaurants across North America. He built the MTY Group into a major force in the food-service sector, and in 2018 (before the latest acquisition), its franchisees employed more than 25 000 people. Some of you may have even worked at one of its locations at some point in your life. The MTY Group has restaurants that operate under 75 separate banners (that are wholly owned subsidiaries or operating under exclusive licenses)—Mr. Sub, Thai Express, Country Style, Jugo Juice, KimChi, Tiki-Ming, Cultures, and Yogen Früz, to name a few. In total, MTY has system-wide revenues of approximately $2.9 billion annually.

ORIGINS OF A SUCCESS STORY

It all began back in 1979 when a young entrepreneur named Stanley Ma opened his first restaurant serving Chinese and Polynesian food. By 1983, Mr. Ma had made his first steps into the world of franchising after launching Tiki-Ming. This was the path that would eventually lead to exponential growth. The organic expansion phase lasted from 1988 until 2008; it was centred on internal development of new restaurant concepts. During that time, 13 brands were created and nurtured from within. However, during the last few years of that time, Mr. Ma and his team began to simultaneously focus on expansion through acquisition. In fact, from 2001 until 2013, MTY spent more than $170 million acquiring 22 restaurant brands. Another key moment occurred in 2010 when MTY was listed on the Toronto Stock Exchange.



Montreal La Presse - Armand Trottier/ The Canadian Press

In recent years, additional acquisitions have enabled MTY to add to the roster with retail brands such as Van Houtte Coffee, Koryo Korean BBQ, Manchu Wok, Sense Asian, Wasabi Grill and Noodle, Extreme Pita, and Mr. Burrito.

NEW HORIZONS

Some of the new acquisitions have provided MTY with a growing footprint in the United States, but Mr. Ma is now looking beyond North American options. Look at some of the new MTY franchise locations that have opened their doors abroad: Sushi Shop in Qatar, Tiki-Ming in Lebanon, Vanelli's in Kuwait, Sukiyaki in the United Arab Emirates, Tandori in Bahrain, Pad Thai in Saudi Arabia, Extreme Pita in Australia, and many more. As you can see, it is not simply an expansion of a single restaurant concept to a strategic market; it is an expansion of the various brands under the MTY banner, with the supporting expertise, appearing where opportunities arise and where franchisees can be expected to thrive.

Despite the successful expansion, clearly this entrepreneur still has a passion for what he does. Recently, while eating lunch at a food court that houses about 20 of his restaurant banners, he was quoted as saying that all his brands were like his children and he could not pick a favourite.

Like any good parent (and entrepreneur), he still spends considerable time observing his children and trying to find new ways to improve their chances of success.

QUESTIONS FOR DISCUSSION

1. From what you have read, how does Mr. Ma fit the profile of an entrepreneur?
2. What are the reasons for Mr. Ma's success where so many others have failed (particularly in the food service business)?
3. How does the case demonstrate the important relationships between franchisors and franchisees in the modern business world? Describe the role each side plays in the success of the other.
4. How does the decision to list MTY on the Toronto Stock Exchange relate to the overall strategy pursued by MTY in recent years?
5. Conduct some research and read the latest news about MTY. Is the news positive or negative? Is there any additional news concerning acquisitions and expansions?

MyLab Intro to Business

Study, practise, and explore real business situations with these helpful resources:
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.
- **Videos:** Learn more about the business practices and strategies of real companies.

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CHAPTER

05

The Global Context of Business

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Describe the growing complexity in the *global business environment* and identify the *major world marketplaces*.
- **LO-2** Identify the evolving role of *emerging markets* and highlight the importance of the *BRICS nations*.
- **LO-3** Explain how different forms of *competitive advantage*, *import–export balances*, *exchange rates*, and *foreign competition* determine how countries and businesses respond to the international environment.
- **LO-4** Discuss the factors involved in conducting business internationally and in selecting the appropriate levels of *international involvement* and *organizational structure*.
- **LO-5** Describe some of the ways in which *social*, *cultural*, *economic*, *legal*, *and political differences* act as barriers to international trade.
- **LO-6** Explain how *free-trade agreements* assist world trade.

Couche-Tard: Your Global Convenience Store

Can you name the largest company in Canada? Did you guess one of the big Banks (TD, RBC, Scotiabank, BMO, CIBC)? If so, good guess, but you would be wrong! The largest company in Canada is not one of the insurance companies (like Manulife, which ranked second, or Sun Life) or one of the oil and gas companies (like Imperial Oil or Suncor). According to the 2018 Report on Business Top 1000 report, convenience store giant, Alimentation Couche-Tard Inc. is the correct answer. If you did not get it right, or if you have never heard of the company, don't feel too badly. In the words of Couche-Tard's CEO, Brian Hannasch, "Some people say we are the largest $50-billion company that nobody has ever heard of." Here are some of the facts that have taken them to the summit. Couche-Tard has 105 000 employees, creating revenues of $59.8 billion and a profit of $1.9 billion. On average, the company serves nine million customers and sells 190 million litres of fuel each day. In short, Couche-Tard is the undisputed leader in the Canadian convenience store market and one of the leaders in North America (along with 7-Eleven) with more than 10 000 stores on the continent and a global network of more than 15 0000 convenience stores.

A History of Acquisitions and Growth

Couche-Tard has plenty of experience in the merger and acquisition game. According to Derek Dley, analyst at Canaccord Genuity, "These guys are the premier consolidator in the convenience-store-space globally." Before

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conquering North America and setting their sights on global markets, Couche-Tard consolidated a huge percentage of the Canadian market. In the past three decades, it has acquired and integrated famous retail brands such as Mac's, Mike's Mart, Beckers, Dairy Mart, Daisy Mart, Winks, Provi-Soir, Perrette, and more recently, Esso convenience stores.

The major move into the United States occurred in 2003 with the acquisition of the Circle K chain from ConocoPhillips. In the deal, Couche-Tard added 1663 corporate stores as well as franchising or licensing relationships with more than 627 additional stores worldwide. This was a major period of growth and was key to its global branding future. In 2017, Couche-Tard completed its biggest deal (for now) paying US$4.4 billion for Texas-based CST Brands and adding US$9.3 billion annual revenue in the process.

In Europe, the company made its major mark in 2012 with the acquisition of 2233 outlets (most under its Statoil brand). Today, Couche-Tard is a leader in convenience stores and road transportation and fuel retail in the Scandinavian countries of Norway, Sweden, and Denmark and the Baltic countries of Estonia, Latvia, and Lithuania. The stores are also present in Ireland, Poland, and Russia.

In addition to the acquisitions, there is also a network of licensing agreements, under the Circle K banner, in 14 countries and territories, including China, Costa Rica, Egypt, Guam, Honduras, Hong Kong, Indonesia, Macau, Malaysia, Mexico, the Philippines, Saudi Arabia, the United Arab Emirates, and Vietnam.

SiljeAO/Shutterstock

The Global Branding Decision

Many of the original brands survived for years after their acquisition. For example, Mac's is a brand name with a heritage that spans more than five decades. Couche-Tard's initial purchase of Mac's led to a slight rebrand, with Mac's inheriting the winking owl logo, but the retail name remained the same for years. However, all that changed a few years ago. With more and more brands in its portfolio and a goal to "become the world's preferred destination for convenience and fuel," a decision was made to improve efficiency and rebrand all locations under the Circle K banner. Many of you have seen this change first-hand in your local towns and cities. The only locations that were spared the great rebrand (for now) were the Couche-Tard stores in Quebec; however, that decision may be based more on nostalgia for the founding name than on efficiency, and it may change in the future.

Looking to the Future

Couche-Tard does not simply buy companies for added revenues; it also tries to improve same-store sales and improve efficiencies for each location. To succeed long-term, all aspects must be constantly evaluated.

One clear threat for a company that makes a large percentage of its revenues from fuel sales and convenience purchases (related to refuelling) is the decline of gas-powered cars in favour of electric cars. Couche-Tard already has a clear action plan for that. It is currently testing fast-charging service centres in Norway that can charge an electric car in

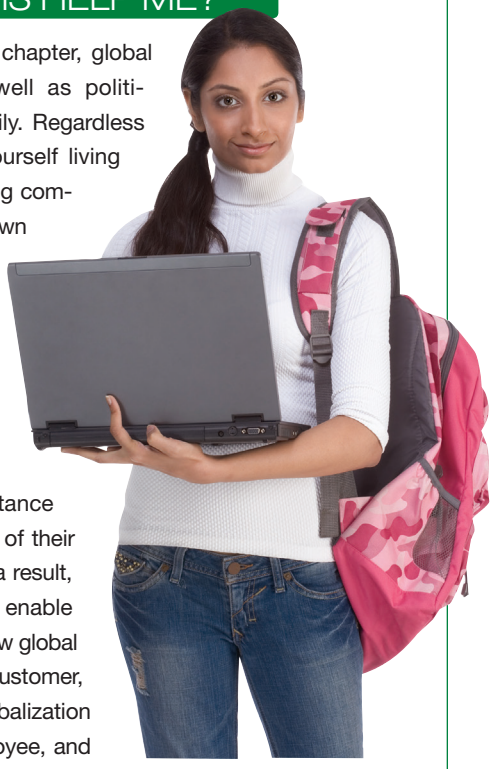
less than 10 minutes. You may be thinking, why Norway? If you are a global company, you must maximize your network and find solutions where it makes the most sense. In this case, Norway is the undisputed market leader with the highest penetration rate of electric vehicles. In fact, one in three cars sold in Norway are electric; therefore, this solution is already vital to these operations.

So, next time you are buying a cherry slush or a bag of chips at one of Couche-Tard's (Circle K) locations, you will fully realize that you are contributing to the largest company in Canada with a global footprint that is still growing.

QUESTIONS FOR DISCUSSION

1. What motivates Couche-Tard to continue to enter new foreign markets? What are some of the obstacles that they may face?
2. What role do social, economic, and political factors play in the successful expansion and management of a network of convenience stores around the world?
3. How might government policies (Canadian and foreign) hurt or help Couche-Tard as it continues to expand globally?
4. As you will read in this chapter, the ideological debate between protectionism and free trade is heating up. Which side of the debate do you think the directors of Couche-Tard are on? Explain the practical reasons for your answer from their perspective.

HOW WILL THIS HELP ME?



As you will see in this chapter, global forces—business as well as political—affect all of us daily. Regardless of whether you see yourself living abroad, working for a big company, or starting your own business, the global economy will affect you in a variety of ways. Exchange rates for different currencies and global markets for buying and selling are all of major importance to everyone, regardless of their role or perspective. As a result, this chapter will better enable you to (1) understand how global forces affect you as a customer, (2) understand how globalization affects you as an employee, and (3) assess how global opportunities and challenges can affect you as a business owner and as an investor. You will also gain insight into how wages and working conditions in different regions are linked to what we buy and the prices we pay.

We will explore the major world marketplaces and trade agreements that affect international business. We will examine some of the social, cultural, economic, legal, and political factors that affect doing business abroad. We will highlight several factors that help determine how countries and businesses respond to international opportunities and challenges. We will also describe some of the decisions managers must make if they intend to compete effectively in international markets.

Mocker bat/Fotolia

THE CONTEMPORARY GLOBAL ECONOMY

The total volume of world trade is immense—over $17 trillion in merchandise trade each year.[1] The world economy is increasingly transforming into a single, interdependent system in a process called **globalization**. However, as we will explore in this chapter, there are significant countertrends brewing, with "Brexit" and the U.S. policy actions as the centerpiece to the countertrend.

We often take for granted the diversity of goods and services available as a result of international trade. Your tablet, smartphone, clothing, and even the roast lamb on your dinner table may all be **imports**—that is, products made or grown abroad, but sold in Canada. At the same time, the success of many Canadian firms depends on **exports**—products made or grown domestically and shipped abroad.

Major companies such as McDonald's, Apple, Couche-Tard, and Canada Goose have found international markets to be a fruitful area for growth. But firms sometimes stumble when they try to expand abroad. Home Depot closed most of the stores it opened in China, for example, because labour costs are so low there that few homeowners are interested in do-it-yourself projects. Similarly, Best Buy closed its stores in China because consumers there tend to buy their electronics goods at lower prices from local or online merchants.[2]

The impact of globalization doesn't stop with firms looking to open locations abroad or closing locations that fail. Small firms with no international operations (such as an independent coffee shop) may still buy from

GLOBALIZATION Process by which the world economy is becoming a single interdependent system.
IMPORT Product made or grown abroad but sold domestically.
EXPORT Product made or grown domestically but shipped and sold abroad.

Some globalization protestors fear multinational companies will wipe out small domestic businesses and prioritize profits over fair wages and human rights.

CRM/Shutterstock

international suppliers, and even individual contractors or self-employed people can be affected by fluctuations in exchange rates.

Despite the major protectionist threats coming out of the United States and elsewhere in the past couple of years, international trade is central to the fortunes of most nations of the world, as well as businesses. The U.S. administration, under President Trump, seems to be borrowing policies from decades past, when nations followed strict policies to protect domestic companies. The problem is that trade is a two-way street. If you close your doors or put new restrictions into place, your partner will fight back and make it hard for your companies to sell in their country as well. We examine this trend in more detail later in the chapter.

Most countries are aggressively encouraging international trade. They are opening their borders to foreign businesses, offering incentives for their own domestic businesses to expand internationally and making it easier for foreign firms to partner with local firms through various alliances. Today, it is not simply a question of Western nations pushing trade abroad. China is making major inroads and increasing its economic and political influence in Africa with major deals with Nigeria, South Africa, Ethiopia, and Zambia and is now the largest trading partner in the region with trade totalling more than $114 billion.[3] In fact, China now ranks first in the world with total exports of more than $2.3 trillion (ahead of the United States at $1.54 trillion and Germany at $1.45 trillion).[4]

Several forces have combined to spark and sustain globalization. For one thing, governments and businesses became more aware of the benefits of globalization to their countries and stockholders. For another, modern technologies have made travel, communication, and commerce easier, faster, and cheaper. The cost of overseas calls and seaborne shipping costs per tonne have both declined sharply over the past several decades. Likewise, transatlantic travel takes only a few hours by air. The internet tore down barriers for large and small companies years ago. Social media is now connecting people from around the world daily. Finally, there are competitive pressures; sometimes a firm simply must enter foreign markets just to keep up with its competitors.

Globalization has critics who claim that businesses exploit workers in less developed countries and avoid domestic environmental and tax regulations. These critics also charge that globalization leads to the loss of cultural heritage and benefits the rich more than the poor. As a result, many international gatherings of global economic leaders (such as the G7 and G20) have been marked by protests. The leaders of the top seven economies met in La Mal Baie, a small town in Quebec, in 2018. But despite fears, globalization is an evolving reality.

LO-1 The Major World Marketplaces

Managers involved with international businesses need to have a solid understanding of the global economy, including the major world marketplaces. This section examines some fundamental economic distinctions between countries based on wealth and then looks at some of the world's major international marketplaces.

Distinctions Based on Wealth

The World Bank, an agency of the United Nations, uses *per-capita income*, average income per person, to make distinctions among countries. Its current classification method consists of four distinct categories of countries:[5]

1. *High-income countries.* Annual per-capita income greater than US$12 366. They include Canada, the United States, most countries in Europe, Australia, Japan, South Korea, Israel, Kuwait, the United Arab Emirates, and the Cayman Islands.
2. *Upper-middle-income countries.* Annual per-capita income between US$3956 and US$12 235. This group includes China, Colombia, Lebanon, Turkey, Argentina, and South Africa.
3. *Low-middle-income countries.* Annual per-capita income between US$1006 and US$3955. This group includes Ukraine, Philippines, Armenia, Guatemala, Pakistan, and Vietnam.
4. *Low-income countries (often called developing countries)*. Annual per-capita income of US$1005 or less. Malawi, Bangladesh, Haiti, Togo, and Afghanistan are among the countries in this group. Because of low literacy rates, weak infrastructures, unstable governments, and related problems, these countries are less attractive for international business.

Geographic Clusters

The world economy is evolving quickly with emerging markets playing an ever-increasing role. However, this economy continues to revolve primarily around three major marketplaces: North America, Europe, and Asia. These clusters include relatively more of the upper-middle-income and high-income nations, but relatively few low-income and low-middle-income countries. For instance, because Africa consists primarily of low-income and low-middle-income countries, it is not generally seen as a major marketplace. The three key geographic regions are home to most of the world's largest economies, biggest corporations, influential financial markets, and highest-income consumers.

North America The United States dominates the North American business region. It is the single largest national marketplace and has been the most stable economy in the world for decades. However, the United States now has major problems, mainly due to recent policy decisions to cut taxes that threaten to substantially increase the country's already high level of debt. In addition, nations are increasingly concerned about the United States' erratic behaviour in trade policy, especially toward traditional allies such as Canada, Europe, and Mexico. Some of those concerns were decreased with the new USMCA deal (discussed later) but there are many other disputes and battles with other counties and with Mexico and Canada as well despite the deal. Canada also plays a key role in the global economy. Many U.S. firms, such as Procter & Gamble, have maintained successful Canadian operations for decades, and many Canadian firms, such as Scotiabank, are also major international competitors.

Mexico has become a major manufacturing centre, especially along the U.S. border, where cheap labour and low transportation costs encourage many firms from the United States and other countries to build factories. The auto industry has been very active, with Daimler, General Motors, Volkswagen, Nissan, and Ford all running large assembly plants; and major suppliers have also built facilities in the region. This is one of the key reasons behind the United States' new protectionist policies. However, in reality, Mexico's role as a low-cost manufacturing hub has been threatened as many companies have shifted production to China instead.[6]

Europe Europe was traditionally divided into two regions—Western and Eastern. Western Europe, dominated by Germany, the United Kingdom, France, Spain, and Italy, has long been a mature but fragmented marketplace. But the transformation of this region, via the European Union (EU) (discussed later in this chapter), into an integrated economic system has further increased its importance. Major international firms such as Unilever, the Renault Group, Royal Dutch Shell, Michelin, Siemens, and Nestlé are headquartered in Western Europe. Eastern Europe, once primarily communist, has also gained importance, both as a marketplace and as a producer. Multinational corporations such as Nestlé and General Motors have set up operations in Poland. Ford, General Motors, and Volkswagen have built new factories in Hungary. However, governmental instability has slowed development in Bulgaria, Albania, Romania, and other nations.

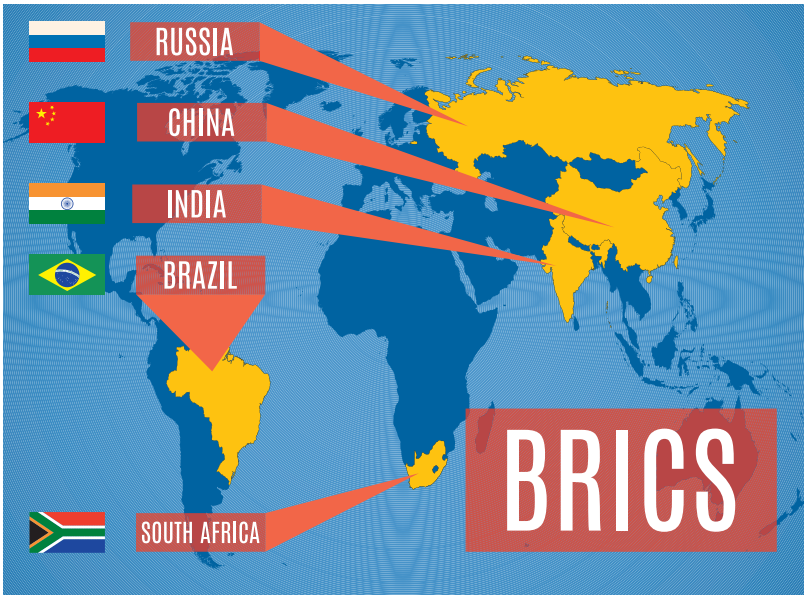
In recent years, the traditional view of Europe has been severely altered by the European Union, the common currency, and a clear divide between Northern Europe (led by Germany, the Netherlands, and, to a lesser extent, France) and Southern Europe (including Spain, Italy, Greece, and Portugal).

Asia Pacific Asia Pacific consists of Japan, China, Thailand, Malaysia, Singapore, Indonesia, South Korea, Taiwan, the Philippines, Vietnam, and Australia (which is technically not in Asia, but is included because of proximity). Fuelled by strong companies in the automobile, electronics, and banking industries, the economies of these countries have grown rapidly in the past few decades.

Asia Pacific is a major force on the world economic stage, and its influence is growing. The Japanese are the traditional regional force through firms such as Toyota, Toshiba, and Nippon Steel. However, after catching up a few years ago, China's GDP is now nearly three times that of Japan. Other key nations and regions are South Korea (Samsung and Hyundai), Taiwan (China Petroleum Corporation and manufacturing for foreign firms), and Hong Kong (a major financial hub). Many economists predicted that the twenty-first century would be dominated by China. The early evidence seems to indicate that the predictions have validity. China is the world's most densely populated country, and now it has the world's second-largest economy with a GDP of $14 trillion. That figure (an increase of $2 billion in just one year!) puts the country behind only the United States, which had a GDP of US$20.4 trillion (with China catching up quickly).[7]

LO-2 Emerging Markets: BRICS and Beyond

The term *BRIC* denotes a group of four increasingly important nations in global trade: Brazil, Russia, India, and China. The BRIC concept was first used by Goldman Sachs in 2001. At first, these four nations began to act like a unit, holding unofficial summits and discussing common strategies.



The BRICS nations are a force to be respected in the modern global economy.

WindVector/Shutterstock

The status of these countries has risen in international trade for several reasons. Brazil is strong in commodities and agriculture, Russia is a powerful energy supplier, and China is a major hub of manufacturing activity. India has become a leading service provider at various levels, ranging from basic customer service call centres to engineering solutions providers. The growth and quick market development of the consumer market in these nations is also providing great sales opportunities for companies that manufacture cars and high-end clothing brands, and so on.[8]

In fact, the old international trading patterns and activities are changing. In the past, Western companies used less developed markets to acquire natural resources and to carry out simple assembly tasks. But the BRIC nations now demonstrate relationships that are much more complex. A clear signal of this shift was evident a decade ago when Indian carmaker Tata acquired Jaguar and Land Rover from Ford. This was not quite business as usual in the traditional sense.[9] More recently, the initial group of four extended an invitation to South Africa to form **BRICS**. The move was surprising to many analysts, because there seemed to better candidates for admission. However, it was clear that the informal group was developing into an important political club with its own goals. South Africa is rich in minerals and other resources, something that these emerging markets need to sustain growth. In addition, the new member, with over a billion potential consumers, serves as a gateway to the African continent.[10]

In an even stronger sign of the changing times, a formal BRICS meeting was held in Durban, South Africa, to negotiate a $100 billion reserve fund to protect their currencies and a $50 billion seed-capital plan (i.e., to promote new businesses). In addition, they negotiated details for the creation of a development bank to compete with the World Bank. There are even talks of an expansion plan called BRICS-Plus as the bloc matures and flexes its muscles by inviting observer nations to meetings, including Mexico, Thailand, Egypt, Guinea, and Tajikistan.[11] The message is clear:

BRICS A term denoting a group of five important and powerful emerging markets in the business world: Brazil, Russia, India, China, and South Africa.

protectionist policies from the United States or elsewhere will face united responses.

Emerging economies are clearly not relying on "old world" economies, and the BRICS nations clearly have their own, independent agendas. The New Development Bank (as it is called) is based in China with its first regional office in South Africa. The first chair of the board of governors is Russian, and the first chair of the board of directors is from India.[12] Although the BRICS nations have received a lot of publicity, there are still major challenges to greater integration; and at the same time, there are many tremendous opportunities in other emerging nations, including Indonesia, South Korea, and Ukraine, to name just a few. According to the Global Institute of Research, the opportunity in emerging markets amounts to an annual projected consumption of $30 trillion by 2025.[13] A new world order is evolving, and "old" economic powers like the United States, Japan, Germany, and even Canada are going to need to adapt.

It is not just the emerging markets that have adapted. Canadian companies such as Canada Goose are also changing strategic patterns to capture new opportunities, as shown in the E-Business and Social Media Solutions boxed insert entitled "The Goose Is Flying East: CanadaGoose.cn."

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

The Goose Is Flying East: CanadaGoose.cn

Galit Rodan/Bloomberg/Getty Images

Canada Goose might be the poster company for our national identity on the global stage. At a minimum, it has appropriated the image of the true north strong and free. It has created an authentic brand that is built on quality products that can help a person survive the Arctic cold. However, most of its consumers live in cities and towns in Canada and around the world with much milder winters. Style meets good design with the seal of the iconic brand, whether you live in Vancouver, Calgary, Halifax, New York, Tokyo, or Milan. Beyond the image, Canada Goose can be viewed as a patriotic company that is doing something most companies have long abandoned. It is manufacturing all its coats in six Canadian facilities. Yes, the price tag is heavy (coats retail between $725 and $1695), but the company's high margins (reported to be in the 60 percent range for online and in-store sales and 43 percent for wholesale purchases) give it the financial ability to make such a decision. Nevertheless, Canada Goose has gone totally against the trend.

In this section of the chapter, we have seen how emerging world markets have created a new world order. These countries no longer simply serve as resource providers; instead, they have their own ambitions and multinational companies doing business globally. Canada Goose is a company that also demonstrates a new, unique approach. Usually goods are made in China and sold in Canada the United States, Europe, and elsewhere. However, even while making a new major push to increase sales in China, with a new dedicated e-commerce site, to serve the 1.4 billion Chinese consumers, Canada Goose is resisting the temptation of cheap overseas manufacturing.

We may live in a global village, but true success still requires special attention to key markets. In 2018, the company launched Canadagoose.cn, a dedicated e-commerce site for the Chinese market. Why now? Well, look at the following stats. Global luxury sales are on the rise, and the premium segment in China is worth US$24.7 billion and has a projected 10.2 percent annual growth rate from 2017–2022. The new emphasis on direct online sales was phase one of a strategy to take advantage of the opportunity. It started with a pilot project on a limited run of items, but these products quickly sold out. Because the appetite for Canada Goose was so strong, the company decided to step up its e-commerce presence by teaming up with Alibaba Group's Tmall, which is China's largest consumer platform for brands and retailers with approximately 500 million active users per month. That's a lot of traffic! One year earlier, Canada Goose expanded its e-commerce channel to include seven new markets in Germany, Sweden the Netherlands, Ireland, Belgium, Luxembourg, and Austria. In total, between direct retail and a growing e-commerce footprint, Canada Goose products are readily available in 87 countries. Smart e-commerce strategy coupled with a strong social media presence is vital for most companies today.

We often hear that Canadian manufacturing jobs are being lost to places like China; however, in this case, if the projections are correct, with the help of online communications, social media, and e-commerce, Canada Goose may be further expanding manufacturing in Canada to meet its growing venture in the Chinese marketplace. How's that for a reversal and a new world order?

CRITICAL THINKING QUESTION

1. What factors will influence the long-term success or failure of Canada Goose's e-commerce venture in China? Find recent articles to see just how strong Canada Goose's sales are in China.

LO-3 Forms of Competitive Advantage

No country can produce all the goods and services its people need. Thus countries export products they can make more efficiently or cheaper than other countries. The proceeds are then used to import products they cannot produce effectively. However, this principle does not fully explain why nations export and import. Such decisions depend on the kinds of advantages a country may enjoy regarding its abilities to create and/or sell various products and resources.[14] Traditionally, economists have focused on absolute and comparative advantages to explain international trade. But because this approach focuses narrowly on factors such as natural resources and labour costs, the more contemporary view of national competitive advantage has emerged.

Absolute Advantage

An **absolute advantage** exists when a country can produce something more efficiently than any other country—in other words, if it can produce a larger output of goods or services using the same or fewer input resources. The concept was first proposed by economist Adam Smith in 1776. Saudi oil, Brazilian coffee beans, and Canadian timber approximate absolute advantage. The theory is simple: countries should focus on producing goods and services that they have an absolute advantage in and buy products that they do not produce more efficiently than other nations.[15] Canada exports timber because of its natural strengths and imports bananas because the Canadian climate does not permit farmers to grow bananas efficiently. If trade were limited to two countries, you might negotiate which nation should produce which items for the greater good. However, the global economy is a complex network and most decisions are not that simple. In addition, true absolute advantage is very rare; most advantages are actually relative.

Comparative Advantage

A country has a **comparative advantage** in goods that it can produce more efficiently or better than other goods. For example, if businesses in a given country can make computers more efficiently than they can make automobiles, that nation's firms have a comparative advantage in computer manufacturing. Canada has a comparative advantage in farming (because of fertile land and a temperate climate), while South Korea has a comparative advantage in electronics manufacturing (because of efficient operations and cheaper labour). As a result, Canadian firms export grain to South Korea and import electronic equipment from South Korea. All countries have a comparative advantage in some products, but no country has a comparative advantage in all products.

Developed countries tend to have a comparative advantage in making high-tech products, while developing countries tend to have a comparative advantage in making products that require lots of low-cost labour. For example, in the past two decades, most of the textile manufacturing jobs in Canada (and elsewhere) have moved to China. But the race to the bottom (in terms of labour costs) now sees countries like Cambodia, Bangladesh, and Vietnam taking manufacturing jobs away from China. Why? In Cambodia, textile workers are paid $76 for a 60-hour week, whereas in China, the wages range from $280 to $460. In other words, Cambodia is like China was 20 years ago—bad news for Chinese manufacturing.[16]

National Competitive Advantage

In more recent years, the theory of national competitive advantage has become a more widely accepted model of why nations engage in international trade. **National competitive advantage** is based on four conditions:

Chinese textile workers are now learning what North American textile workers learned years ago. Manufacturers are increasingly moving textile manufacturing from China to lower-cost locations like Cambodia, where workers (like the ones seen in this photo) earn on average $76 for a 60-hour week as opposed to $280–$460 in China.

Kzenon/Shutterstock

1. *Factor conditions* are the factors of production that we identified in Chapter 1 (labour, capital, entrepreneurs, natural resources, and information).
2. *Demand conditions* reflect a large domestic consumer base that promotes strong demand for innovative products.
3. *Related and supporting industries* include strong local or regional suppliers and/or industrial customers.
4. *Strategies, structures, and rivalries* refer to firms and industries that stress cost reduction, product quality, higher productivity, and innovative new products.

When all these conditions exist in an industry, the companies in that industry are motivated to be very innovative and to excel. This combination also increases the likelihood that the companies will engage in international business. Japan, for instance, has a strong domestic demand for automobiles. Its automobile producers have well-developed supplier networks, and Japanese firms have competed intensely with each other for decades. This set of circumstances explains why Japanese automobile companies such as Toyota, Honda, Nissan, and Mazda are generally successful in foreign markets.

International competitiveness refers to the ability of a country to generate more wealth than its competitors in world markets. Every year,

ABSOLUTE ADVANTAGE The ability to produce something more efficiently than any other country.

COMPARATIVE ADVANTAGE The ability to produce some products more efficiently than others.

NATIONAL COMPETITIVE ADVANTAGE International competitive advantage stemming from a combination of factor conditions; demand conditions; related and supporting industries; and firm strategies, structures, and rivalries.

INTERNATIONAL COMPETITIVENESS Competitive marketing of domestic products against foreign products.

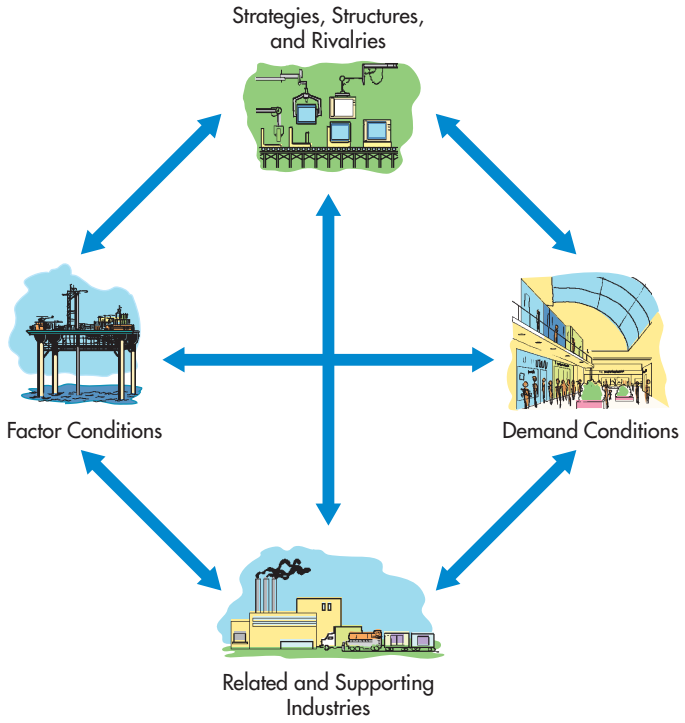


FIGURE 5.1 Attributes of national competitive advantage

the World Economic Forum publishes a global competitiveness ranking. The ranking is based on both hard-economic data and a poll of business leaders. In 2018, the top three countries on the list were Switzerland, the United States, and Singapore. Canada ranked 14th; high taxes and regulated industries put downward pressure on that ranking. At the time, another concern was the trade uncertainties from US policy that were threatening to disrupt free trade policies.[17]

The Balance of Trade

A country's **balance of trade** is the difference in value between its total exports and its total imports. A country that exports more than it imports has a favourable balance of trade, or a **surplus**. A country that imports more than it exports has an unfavourable balance of trade, or a **deficit**. In 2017, Canada had a trade deficit of $23.9 billion.[18] For many years, Canada had a large trade surplus mainly because of a favorable relationship with the United States. But in 2017 that surplus with the United States amounted to $12 billion, which was substantially lower than in the past (it was $49 billion just a few years earlier). This subject was a central talking point of the U.S. representatives in the NAFTA (USMCA) trade negotiations in 2018.[19]

The Balance of Payments

Even if a country has a favourable balance of trade, it can still have an unfavourable balance of payments. A country's **balance of payments** is the difference between money flowing into the country and money flowing out because of trade and other transactions. An unfavourable balance means more money is flowing out than in. For Canada to have a favourable balance of payments for a given year, the total of our exports, of the foreign-tourist spending and foreign investments in our country, and of the earnings from overseas investments must be greater than the total of our imports, of Canadian-tourist spending overseas, of our foreign aid grants, of our military spending abroad, of the investments made by Canadian firms abroad, and of the earnings of foreigners from their investments in this country. Canada has had an unfavourable balance of payments for the past two decades; in 2017, it amounted to $63.9 billion.[20]

Exchange Rates

An **exchange rate** is the rate at which the currency of one nation can be exchanged for another.[21] For example, the exchange rate between Canadian dollars and British pounds in 2018 was 1 to 1.73, which means that it cost $1.73 in Canadian dollars to "buy" one British pound. Alternatively, it cost only 0.58 of a British pound to "buy" one Canadian dollar. This exchange rate means that 0.58 of a British pound and one Canadian dollar should have the same purchasing power.

BALANCE OF TRADE The economic value of all the products that a country exports minus the economic value of all the products it imports.

SURPLUS Situation in which a country exports more than it imports, creating a favourable balance of trade.

DEFICIT Situation in which a country's imports exceed its exports, creating a negative balance of trade.

BALANCE OF PAYMENTS Flow of all money into or out of a country.

EXCHANGE RATE Rate at which the currency of one nation can be exchanged for the currency of another nation.

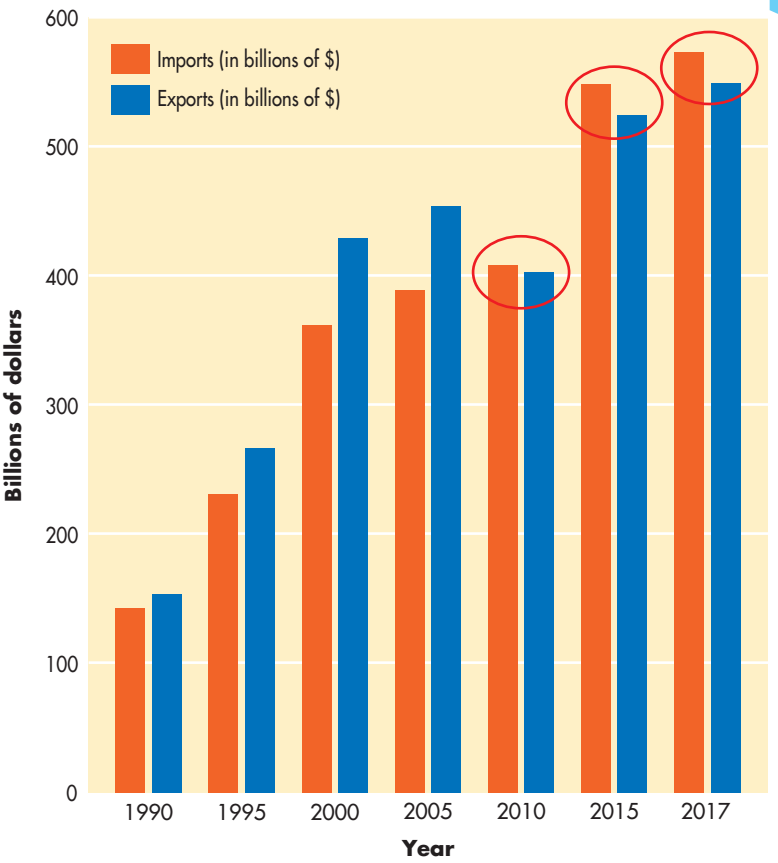


FIGURE 5.2 Canadian imports and exports of merchandise

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. Google Translate APP **Source:** Google Inc. **Key Features:** Overcomes language barriers by translating 103 languages (59 languages are available for offline translation as well).	Apple, Android, Windows
2. XE Currency App **Source:** XE.COM Inc. **Key Features:** Allows you to access live rates for every currency in the world.	Apple, Android, BlackBerry, Windows
3. International Business Guide App **Source:** Avant Web Solutions **Key Features:** Offers up-to-date information and economic profile of the hottest upcoming investment destinations and comprehensive insight into trading, investment opportunities, and current business climate (with a focus on Eurasia).	Apple, Android, Windows

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" global business apps and identify the key features.

The value of one country's currency relative to another varies with market conditions. For example, when many English citizens want to spend pounds to buy Canadian dollars (or goods), the value of the dollar relative to the pound increases, or becomes "stronger," and demand for the Canadian dollar is high. It is also "strong" when there is high demand for goods manufactured in Canada. Thus the value of the Canadian dollar rises with the demand for Canadian goods. Exchange rates typically fluctuate by very small amounts daily. More significant variations usually occur over greater spans of time.

One of the most significant developments in foreign exchange has been the introduction of the **euro**—a common currency among 19 of the 28 members of the European Union.[22] The euro was officially introduced in 2002 and quickly became as important as the U.S. dollar and the Japanese yen in international commerce. The euro quickly rose in value against the U.S. and Canadian dollars and stood as high as $1.73 within six years. However, when the European crisis began a decade ago, it threatened the stability and future of the currency, so the euro dropped as low as $1.22. It was valued at around $1.51 against the Canadian dollar in mid-2018.[23] But a new potential crisis was brewing in Italy causing downward pressure and spreading fear.[24] In addition, even though the United Kingdom never adopted the euro currency, the decision to leave the European Union (Brexit), was a serious threat. Markets love stability; therefore, signs of potential stress usually lead to lower currency values.

Exchange Rates and Competition

Companies that conduct international operations must watch exchange-rate fluctuations closely because these changes affect overseas demand for their products and can be a major factor in international competition. In general, when the value of a country's domestic currency rises—becomes "stronger"—companies based in the country find it harder to export products to foreign markets, and it is easier for foreign companies to enter local markets. It also makes it more cost-efficient for domestic companies to move production operations to lower-cost sites in foreign countries. When the value of a country's currency declines—becomes "weaker"—just the opposite patterns occur. Thus, as the value of a country's currency falls, its balance of trade should improve because domestic companies should experience a boost in exports. There should also be a corresponding decrease in the incentives for foreign companies to ship products into the domestic market.

These dollar fluctuations have also had a significant impact on businesses. Canadian companies find it harder to compete internationally when the dollar rises (because Canadian products become more expensive in foreign currencies). However, on the flip side, companies such as Nova Scotia–based High Liner Foods (which buys most of its raw fish on the world markets in U.S. dollars) see a net benefit from a stronger Canadian dollar.[25]

EURO A common currency shared among most of the members of the European Union.

LO-4 INTERNATIONAL BUSINESS MANAGEMENT

Wherever a firm is located, its success depends largely on how well it is managed. International business is challenging because the basic management responsibilities—planning, organizing, leading, and controlling—are much more difficult to carry out when a business operates in several markets scattered around the globe. (We discuss the functions of management in Chapter 6.)

Managing means making decisions. In this section, we examine the three most basic decisions managers must make when faced with the prospect of a global market. The first is whether to "go international" at all. Often that decision is made because a company feels it must shift its production to a low-cost foreign country to remain competitive. Once that decision has been made, managers must decide on the company's level of international involvement and on the organizational structure that will best meet its global needs.

Going International

The world economy is transforming into one large global village. As Figure 5.3 shows, several factors enter the decision to go international. One overriding factor is the business climate in other nations. Even experienced firms have encountered cultural, legal, and economic roadblocks, as we will see later in this chapter. In considering international expansion, a company should also consider at least two other questions: Is there a demand for its products abroad? If so, do those products have to be adapted for international consumption?

Gauging International Demand

Products seen as vital in one country may be useless in another. Snowmobiles are popular for transportation and recreation in Canada and the

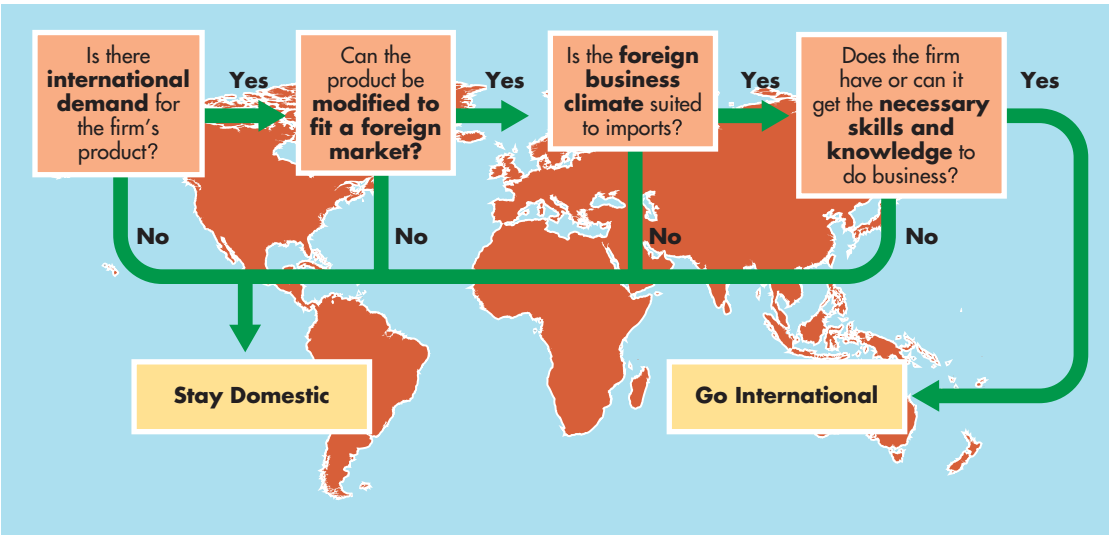


FIGURE 5.3 Going international

Northern United States, but there would be no demand at all for them in Central America. Although this is an extreme example, the point is quite basic to the decision to go international. Specifically, foreign demand for a company's product may be greater than, the same as, or weaker than domestic demand. Even when there is demand, advertising may still need to be adjusted. For instance, in Canada, bicycles and small motorcycles are mainly used for recreation, but in many parts of Asia, they are simply transportation. Market research and/or the prior market entry of competitors may indicate whether there is an international demand for a firm's products.

The Fate of the Furious **earned over a billion dollars in international sales in its first year alone. Here is a poster from Russia.**

Renovacio/Shutterstock

Some products—such as smartphones, Hollywood movies, and video games—are popular all over the world. Movies such as *Wonder Woman* and *Justice League* earn significant revenues in North America but generate even more revenues overseas. For example, *The Fate of the Furious* earned approximately US$1.23 billion for Universal Studios in its first year alone; $1 billion of that total was from international sales.[26]

Adapting to Customer Needs

If there is international demand for its product, a firm must still figure out whether to adapt the product. If they decide to do so, they must figure out how to change the product to meet the special demands and expectations of foreign customers. For example, New Brunswick–based McCain Foods Limited has worked hard to build market share in South Africa. It even developed single-sized portions of frozen vegetables to serve customers that do not have proper refrigeration.[27] Likewise, McDonald's restaurants sell beer in Germany and meatless sandwiches in India to accommodate local tastes and preferences. KFC's dishes in China come with a side order of rice and hot soy milk.[28] They must be doing something right, because at last count, KFC had more than 5000 outlets in 1100 Chinese cities.[29]

To sell its popular Echo speakers in India, Amazon gave Alexa (the virtual assistant) a local makeover. In India, she now speaks "Hinglish" (a mix of Hindi and English) with a clear accent. Speech scientists, engineers, and developers worked hard to adapt to local needs, and this was just a start. With a total population of 1.3 billion people, India has many languages and dialects and a few (such as Bengali, Telugu, Marathi, Tamil, Urdu, Kannada, and Gujarati) are spoken by more people than the entire population of Canada! Smart companies are identifying minor adaptations to better appeal to groups and ultimately help make more sales.[30]

Levels of Involvement in International Business

After a firm decides to go international, it must decide on the level of its international involvement. Several options are available. At the most basic level, it may act as an exporter or importer, organize as an international firm, or operate as a multinational firm. Most of the world's largest industrial firms are multinationals.

Exporters and Importers

An **exporter** is a firm that makes products in one country and then distributes and sells them in other countries. An **importer** buys products in foreign markets and then imports them for resale in its home country. These approaches represent the lowest level of involvement in international operations and are excellent ways to learn the fine points of global business. Exporters and importers tend to conduct most of their business in their home nations. It is not just large companies that are exporting; small firms also export products and services.

Large and small Canadian firms export products and services. McCain Foods began in New Brunswick, but the company has a worldwide presence. On a smaller scale, Target Marine Hatcheries, based in Sechelt, British Columbia, is Canada's lone producer of certified-organic farmed sturgeon (selling under the brand name of Northern Divine). Their tanks have more than 200 000 Fraser River sturgeon, and the company can produce between 1 and 2 tonnes of caviar per year. The product retails anywhere from $88 (for a 30-gram tin) to $4320 (for a 1.8-kilogram tin), and it is sold to clients as far away as Japan, Europe, and Australia.[31]

International Firms

As firms gain experience and success as exporters and importers, they may move to the next level. An **international firm** conducts a sizable portion of its business abroad. Hershey, for example, sells its products in 90 foreign countries, and it buys ingredients for its chocolates from several foreign suppliers. But it manufactures the majority of its products in the United States. In fact, most of that manufacturing occurs in Pennsylvania.[32] So an international firm may be large and influential in the global economy but remain basically a domestic firm with international operations. Its central concern is its own domestic market.

Multinational Firms

Most **multinational firms** do not think of themselves as having domestic and international divisions. Instead, planning and decision making are geared toward global markets.[33] The locations of headquarters are almost irrelevant. Royal Dutch Shell, Nestlé, IBM, and Ford are well-known multinationals.

McDonald's adapts its menu offerings in different regions of the world to address unique tastes and expectations and to better satisfy its consumers.

Bill Bachmann/Alamy Stock Photo

The economic importance of multinational firms should not be underestimated. Consider the economic impact of the 500 largest multinational corporations: they employ millions of people; buy supplies, parts, equipment, and materials from thousands of other firms; and pay billions of dollars in taxes. Moreover, their activities and products affect the lives of hundreds of millions of consumers, competitors, and investors (sometimes not in a very positive way). Organized protests against the activities of multinational corporations have become quite common. In 2018, Walmart ranked first in the Fortune 500 Global rankings of multinationals with US$500 billion in revenues. Exxon Mobil was a distant second at US$244 billion.[34]

International Organizational Structures

Various levels of involvement in international business require different organizational structures. For example, a structure that would help coordinate an exporter's activities would be inadequate for the activities of a multinational firm. In this section, we briefly consider the international organizational strategies, including independent agents, licensing arrangements, branch offices, strategic alliances, and foreign direct investment.

Independent Agents

An **independent agent** is a foreign individual or organization that agrees to represent an exporter's interests in foreign markets. Independent agents often act as sales representatives—they sell the exporter's products, collect payment, and ensure that customers are satisfied. Independent agents often represent several firms at once and usually do not specialize in a product or market. Levi Strauss uses agents to market clothing products in many small countries in Africa, Asia, and South America.

Licensing Arrangements

Canadian companies seeking more involvement in international business may choose **licensing arrangements**. Firms give individuals or companies in a foreign country the exclusive right to manufacture or market their products in that area. In return, the exporter typically receives a fee plus ongoing payments called *royalties*.[35] Royalties are usually calculated as a percentage of the licence holder's sales. For example, Can-Eng Manufacturing, Canada's largest supplier of industrial furnaces, exports its furnaces under licensing arrangements to Japan, Brazil, Germany, Korea, Taiwan, and Mexico. Franchising is a special form of licensing that is also very popular.[36]

Both Amazon and Apple are currently pursuing direct licensing agreements in Saudi Arabia after Crown Prince Mohammed Bin Salman

EXPORTER Firm that distributes and sells products to one or more foreign countries.

IMPORTER Firm that buys products in foreign markets and then imports them for resale in its home country.

INTERNATIONAL FIRM Firm that conducts a significant portion of its business in foreign countries.

MULTINATIONAL FIRM Firm that designs, produces, and markets products in many nations.

INDEPENDENT AGENT Foreign individual or organization that agrees to represent an exporter's interests.

LICENSING ARRANGEMENT Arrangement in which firms choose foreign individuals or organizations to manufacture or market their products in another country.

announced that he wanted to help make the conservative kingdom a more high-tech nation. With 70 percent of the population below the age of 30 (many of them glued to social media sites), the wealthy nation has great additional potential for these tech giants. Apple is in talks with SAGIA, the country's foreign investment authority to increase its presence in the nation.[37]

Branch Offices

Instead of developing relationships with foreign companies or independent agents, a firm may simply send some of its own managers to overseas branch offices. A company has more direct control over branch managers than agents or licence holders. **Branch offices** also provide a more visible public presence in foreign countries. Potential customers tend to feel more secure when a business has branch offices in their country.

When a business operates branches, plants, or subsidiaries in several countries, it may assign one plant or subsidiary the responsibility for researching, developing, manufacturing, and marketing one product or line of products. This is known as *world product mandating*.

Strategic Alliances

The concept of a strategic alliance was introduced in Chapter 2. In international business, a *strategic alliance* means that a company finds a partner in a foreign country where it would like to conduct business. Each party agrees to invest resources and capital in a new business or else to cooperate in some way for mutual benefit.

The number of strategic alliances among major companies has increased significantly over the past decade and is likely to grow further. In many countries, including India and China, laws make alliances virtually the only way to do business within their borders.[38] Whirlpool, the world's largest manufacturer of home appliances, has partnered with Hisene Kelon Electrical Holdings Co. in China to manufacture appliances locally. In addition, the company has signed a preferential distribution agreement with Suning Appliance Co., which owns 1700 retail stores in 300 Chinese cities.[39] This approach eases the way into new markets; alliances also give firms greater control over their foreign activities than independent agents and licensing arrangements do. (All partners in an alliance retain some say in its decisions.) Perhaps most important, alliances allow firms to benefit from the knowledge and expertise of their foreign partners.

Foreign Direct Investment

The term **foreign direct investment (FDI)** means buying or establishing tangible assets (e.g., a manufacturing plant) in another country.[40] For example, Bombardier built a manufacturing facility in Casablanca, Morocco.[41] The Royal Bank of Canada recently purchased Los Angeles–based City National Corp. for US$5.4 billion.[42] However, despite such moves, a debate has been going on for years about how FDI by foreign firms in Canada affects Canadians. Recently, foreign buyouts of major Canadian firms such as Rona, Four Seasons Hotels, Cirque du Soleil, and Alcan have caused some Canadian business leaders to express concern. The most general fear is that such buyouts will damage the economy because head offices will move to foreign countries and major decisions will be made there, not in Canada.

Investment Canada has a mandate to help attract foreign investment to the nation, and, in the past three decades, foreign direct investment in Canada has been growing steadily; it now averages more than $600 billion annually. More than half of that amount is flowing from the United States; however, nearly half of FDI flowing from Canadian firms goes to the United States as well.[43]

BRANCH OFFICE A location that an exporting firm establishes in a foreign country to sell the company's products more effectively.
FOREIGN DIRECT INVESTMENT (FDI) Buying or establishing tangible assets in another country.

LO-5 BARRIERS TO INTERNATIONAL TRADE

Whether a business is selling to just a few foreign markets or is a true multinational, several differences between countries will affect its international operations. How a firm responds to and manages social, economic, and political issues will go a long way toward determining its success.

Social and Cultural Differences

Any firm involved in international business needs to understand something about the society and culture in the countries it plans to operate in. Unless a firm understands these cultural differences—either itself or by acquiring a partner that does—it probably will not be successful in its international activities.

Some differences are relatively obvious. Language can be a key factor. Beyond the barriers posed by people who speak different languages, subtle differences in meaning can also play a significant role. Language barriers can cause inappropriate naming of products. For example, Imperial Oil markets gasoline under the brand name Esso in Canada. When the firm tried to sell its gasoline in Japan, it learned that *esso* means "stalled car" in Japanese. Many differences are discovered the hard way. In Japanese, the word *hai* (pronounced "hi") means "yes." In conversation, however, this word is used much like people in the United States use "uh-huh"; it moves a conversation along or shows the person with whom you are talking that you are paying attention. So, when does *hai* mean "yes" and when does it mean "uh-huh"? This turns out to be a relatively tricky question to answer. If a Canadian manager asks a Japanese manager if he agrees to some trade arrangement, the Japanese manager is likely to say, "*Hai*"—but this may mean "Yes, I agree" or "Yes, I understand" or "Yes, I am listening." Many Canadian managers get frustrated in negotiations because they believe that the Japanese continue to raise issues already settled (because the Japanese managers seem to have said yes). What many of these managers fail to recognize is that yes does not always mean yes in Japan.

The average physical stature of people in different countries can make a difference. For example, the Japanese are slimmer and shorter on average than Canadians, an important consideration for firms that intend to sell clothes. Differences in the average age of the local population can also impact product development and marketing. Countries with growing populations tend to have a high percentage of young people. Thus

A Better Coconut Water

Harmless Harvest is the manufacturer and distributor of a popular line of organic coconut water that is available at select retailers such as Whole Foods and online through Amazon. Douglas Riboud and Justin Guilbert saw an opportunity with the sudden popularity of coconut water, but they were troubled by environmental and economic concerns. After extensive research, Riboud and Guilbert concluded that the best-tasting coconut water could be produced from a single species of coconut from Thailand, despite lower yields and more complex cultivation. Unlike other producers, their coconut water is pasteurized through high-pressure treatment rather than heat, creating a raw, better tasting product. According to Riboud, "The most important thing for us is taste. And the best we can do, the hardest job you can do as a manufacturer who works in food, is not screw up the ingredient you had in the first place."

Harmless Harvest has addressed environmental concerns by making sure that their product is organic. They made an early commitment to working with farmers to make sure that no harmful pesticides or synthetic fertilizers were used and worked to obtain organic certification. Although this process was time consuming and costly, it assured Riboud and Guilbert that their entire supply chain was built upon their vision of sustainability. However, not all the news is good in this area. The company recently got into some trouble when a class-action lawsuit was filed claiming that the advertising was misleading. Harmless paid a fine and agreed to remove the words "100 percent organic and raw" from the packaging.

Despite that setback, the core mission of positive change is clear and unchanged. Harmless Harvest has contributed to positive economic and social change in several ways. A couple of years ago, the company combined its Nam Hom coconut water with organic coffee, creating a drink with 50 mg of naturally occurring caffeine, the equivalent of a shot of espresso. The Peruvian cooperative that harvests Harmless Harvest's organic coffee beans has a focus on empowering women and the impoverished, with more than 50 percent of members located in areas of extreme poverty. The organization has seen a significant decrease in domestic abuse against women, as well as an increased priority on educating children to strengthen the community. Guilbert notes: "Sourcing from this cooperative is just more proof that better products can be made to benefit everyone involved. It's worth the extra effort."

Brent T. Madison/Alamy Stock Photo

CRITICAL THINKING QUESTIONS

1. What are some of the challenges of selling products from North America to locations around the world with products sourced from locations such as Thailand and Peru? What impact might trade agreements have on your success? How do these uncertain times impact long-term planning?

electronics and fashionable clothing would likely do well. Countries with stable or declining populations tend to have more elderly people. Generic pharmaceuticals might be more successful in such markets.

A wide range of subtle value differences can also have an important impact. For example, many Europeans shop daily. To Canadians, used to weekly trips to the supermarket, the European pattern may seem like a waste of time. But for Europeans, shopping is not just "buying food." It is also meeting friends, exchanging political views, gossiping, and socializing. What implications does this kind of shopping have for firms selling in European markets? People who go shopping every day do not need the large refrigerators and freezers common in North America. In Canada, prepared and frozen foods are important, but Europeans often prefer to buy fresh ingredients to do their own food preparation. These differences are gradually disappearing, however, so firms need to be on the lookout for opportunities as they emerge.

Business activity can be influenced by even more subtle behavioural differences than this. For example, crossing your legs in a business meeting in Saudi Arabia is inappropriate, because showing the sole of your foot is viewed as an insult to the other people in the room. In Portugal, it is considered rude to discuss business during dinner, and in Taiwan tapping your fingers on the table is a sign of appreciation for a meal. In China, don't give a businessman a green hat and don't wrap a gift in white or black (a green hat on a Chinese man is said to indicate that his wife is unfaithful, and black and white are associated with death). Deals can be lost based on cultural misunderstandings. Local dos and don'ts are important in international business activity. Do your homework.[44]

One important social trend is the growing demand for healthy, natural, and organic goods. Read the Entrepreneurship and New Ventures box entitled "A Better Coconut Water" to see how one company is making a difference abroad while selling organic goods at home and overseas.

Economic Differences

Although cultural differences are often subtle, economic differences can be fairly pronounced. In dealing with economies like those of France and Sweden, firms must be aware of the extent of government involvement. For example, the French government is more heavily involved in key industries and manufacturing. Similarly, a foreign firm doing business in a pure

command economy must understand the unfamiliar relationship of government to business. Another very important consideration is the level of economic development and the financial infrastructure in a country. What percentage of retail transactions are completed by credit card? Is financing readily available? Is it a cash economy? And so on.

Navigating the economic differences and identifying the global opportunities is a major challenge for today's corporations. Growth is quite often fuelled by nations across the globe. For instance, luxury goods manufacturers can see major benefits as economies grow, and a taste for global brands increases. Swiss watchmaker Patek Philippe experienced growth of approximately 20 percent in two consecutive years, due largely to growing demand in China, where Swiss watches are often given to government officials.[45] According to Euromonitor, sales of cosmetics in China are set to surpass those in the United States by 2021 (with a projected figure of $40 billion). L'Oréal has every intention of maintaining its number-one position in the country. According to Sanford Browne, a growing percentage of Chinese consumers have the willingness and capacity to pay for premium quality, but they are the most demanding consumers in the world and expect clear, identifiable benefits.[46]

Legal and Political Differences

Legal and political differences are often closely linked to the structure of the economic systems in different countries. These issues include tariffs and quotas, local-content laws, and business-practice laws.

Quotas, Tariffs, and Subsidies

Even free-market economies often use some form of quota and/or tariff that affects the prices and quantities of foreign-made products in those nations. A **quota** restricts the total number of certain products that can be imported into a country. It indirectly raises the prices of those imports by reducing their supply. For example, the United States imposed quotas on ice cream; Belgian ice-cream makers can't ship more than 922 315 kilograms each year to the United States. The ultimate form of quota is an **embargo**, a government order forbidding exportation and/or importation of a product—or even all the products—of a country.

A **tariff** is a tax charged on imported products. Tariffs directly affect the prices of products, effectively raising the price of imports to consumers. Tariffs raise money for the government and somewhat discourage the sale of imported products. Governments from around the world impose quotas and tariffs. A couple of years ago, the Canadian government announced a reduction in tariffs on sporting goods and baby clothes, which could lead to potential annual savings of $76 million for consumers. However, at the same time, the government announced higher tariffs on goods imported from 72 countries, which could lead to a $330 million increase in costs for Canadian shoppers. For example, the new rules cost Danier Leather an estimated $1.2 million a year (or about $10–$20 per jacket). You can bet that extra cost was passed along to the consumer.[47]

In the past few years, the U. S. government has increasingly demonstrated an anti-free trade, protectionist attitude. It continued its targeting of Canadian softwood lumber; Canadian producers were estimated to be facing $1.3 billion in U.S. duties in 2018.[48] The United States then shocked the aviation industry, and one of Bombardier's American clients, when it slapped a 220 percent tariff on the Bombardier C-series planes (in an effort to shield Boeing).[49] The government actually increased that tariff to 300 percent a few months later, before an independent U.S. International Trade Commission voted 4–0 to eliminate the excessive tariff on the grounds that it caused no injury to U.S. companies.[50]

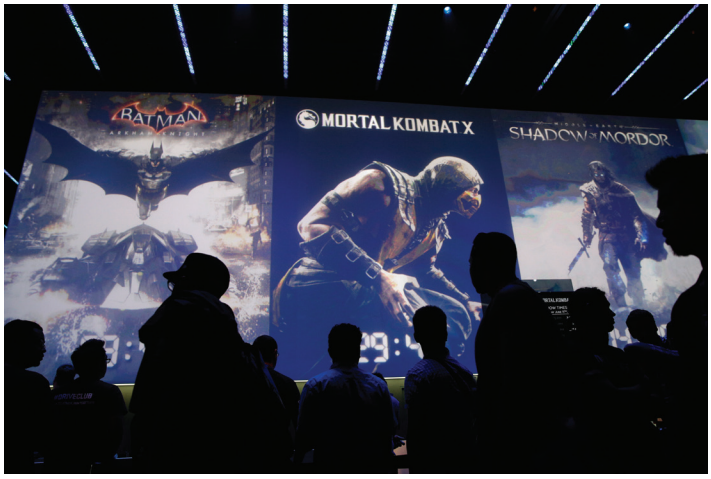
After focusing mainly on steel and aluminum produced in other nations, such as China, in mid-2018, the United States turned its attention to its closest ally when President Donald Trump announced that Canada would also face a 25 percent tariff on steel and a 10 percent tariff on aluminum. Canada is the largest supplier of these products to the United States with annual sales of $20 billion.[51] The stated goal is to protect domestic producers, but these actions also hurt American companies (that rely on that steel and aluminum) and consumers (who must pay more). The Canadian government had been hearing these threats for many months, so the response was quick. Prime Minister Justin Trudeau announced new tariffs on goods worth an equal amount on U.S. imports the very next day. However, he did announce that the tariffs would take effect 30 days later.[52] Some saw this as a sign of weakness, while others saw this as a strategic move giving the Americans a chance to rethink their move. Regardless of political opinion, economists agree that this tit-for-tat approach is dangerous; however, being bullied is not an option that can be tolerated. No nation is simply going to accept such moves and bow down. For example, China also announced 128 new duties toward the United States in response to the new steel and aluminum tariffs from the United States.[53] The next few years will see a lot of twists and turns in this area.

A **subsidy** is a government payment given to a domestic business to help it compete with foreign firms. When the government of a country pays subsidies to one of its domestic companies or industries, this can have a negative effect on producers in other countries. Bombardier has received subsidies from both federal and provincial governments. These funds, or sometimes low-interest loans, have helped the company compete and develop its major projects. The company and its main rival, Brazil-based Embraer, have accused each other of receiving excessive unfair government support, which has led to official disputes at the World Trade Organization (more information about the WTO is available at the end of the chapter).

Protectionism—the practice of protecting domestic business at the expense of free market competition—has advocates and critics. Supporters argue that tariffs and quotas protect domestic firms and jobs. These practices protect new industries until they can compete internationally. Some claim they are necessary because other nations have such measures. Still others justify protectionism in the name of national security and argue that advanced technology should not be sold to potential enemies.

But opponents of protectionism are equally vocal. They note that protectionism reduces competition and drives up prices. It is also a cause of friction between nations. The opponents maintain that while jobs in some industries would be lost if protectionism stopped, jobs in other industries would expand if all countries abolished tariffs and quotas. As we have already seen with the recent tariff fights, the debate between protectionism and free trade is heating up.

QUOTA A restriction by one nation on the total number of products of a certain type that can be imported from another nation.
EMBARGO A government order forbidding exportation and/or importation of a particular product.
TARIFF A tax levied on imported products.
SUBSIDY A government payment to help domestic business compete with foreign firms.
PROTECTIONISM Protecting domestic business at the expense of free market competition.



Subsidies are designed to support domestic companies; however, in this free-trade era, governments are increasingly generous with foreign firms that can help develop local industries and provide local jobs. A few years ago, Warner Bros. opened a new studio to develop high-end video games in Montreal. Local talent, reputation, and knowledge were key factors, but government funding helped close the deal. The Quebec government provided $7.5 million to get the studio off the ground.

Jae C. Hong/AP Images

Local-Content Laws

A country can affect how a foreign firm does business there by enacting **local-content laws** that require products sold in a country to be at least partly made in that country. These laws typically mean that firms seeking to do business there must either invest directly or have a local joint-venture partner. In this way, some of the profits in a foreign country are shared with the people who live there.

Many countries have local-content laws. In an extreme case, Venezuela forbids the import of any product if a similar product is made there. A few years ago, Venezuela's president said he would cancel all mining licences and stop issuing new ones to foreign companies. This move was designed to protect the many small local miners. Oil and gas licences held by foreign companies had already been cancelled. These actions make foreign companies more reluctant to invest in Venezuela.[54] In fact, GM recently halted all operations in Venezuela, even though it had been the market leader for 35 years, after a judge ordered the seizure of one of its plants. The company took a $100-million write-down and let go of 2700 workers.[55]

Local-content laws might even exist within a country, and when they do, they act just like trade barriers. In Canada, for example, a low bid on a bridge in British Columbia was rejected because the company that made the bid was from Alberta; the job was given to a B.C. company. A window manufacturer from New Brunswick lost a contract in Nova Scotia despite having made the lowest bid; the job went to a company in Nova Scotia.

The Agreement on Internal Trade (AIT) requires all ten provinces to remove barriers to agricultural trade. However, internal conflicts are still common. According to Perrin Beatty, president of the Canadian Chamber of Commerce, interprovincial trade barriers are putting Canadian companies at a huge disadvantage. This must change if they are to survive and thrive in a global marketplace.[56]

For another example of local protectionist laws read the Disruption Management box entitled "Is Supply Management Doomed?"

Business-Practice Laws

Many businesses entering new markets encounter problems in meeting strict regulations and bureaucratic barriers. Such practices are affected by the **business-practice laws** that host countries set in their jurisdictions. They can be frustratingly effective. Walmart left Germany and South Korea because the company did not effectively adapt to local tastes or rules and was unable to achieve economies of scale.[57] In Germany, for example, it had to stop refunding price differences on items sold for less by other stores because the practice is illegal in that country. In another case, Google agreed to pay $500 million to settle a case with the U.S. government over advertising revenue earned from Canadian online pharmacies; the government had accused the company of enabling the illegal importation of drugs.[58]

Bribes to government officials to get business is another problem area. A few years ago, SNC-Lavalin executives Ben Aissa and Stefane Roy were accused of paying $160 million to Libyan officials (under the old regime) to secure more than $2 billion worth of contracts in Libya (to build an airport, a prison, and a water filtration plant) over a ten-year span.[59] Canada's Corruption of Foreign Public Officials Act prohibits bribery of foreign officials, but as more Canadian companies do business abroad, they find themselves competing against companies only too happy to pay bribes. Clearly, practices and expectations vary around the world. Transparency International (TI) sheds some light on the issue and publishes a "Corruption Perceptions Index" that ranks countries based on the amount of corruption perceived to exist according to ratings by business people, academics, and risk analysts. The index showed that the least corrupt countries were New Zealand, Denmark, Finland, and Norway and that the most corrupt were Afghanistan, North Korea, Cambodia, and Bangladesh. Canada ranked eight on the list.[60]

Cartels and Dumping A **cartel** is an association of producers whose purpose is to control the supply and price of a commodity. The most famous cartel is the Organization of the Petroleum Exporting Countries (OPEC). It has given oil-producing countries great power in the past 60 years or so. At various times, other cartels have been evident in diamonds, shipping, and coffee. Although nothing much can be done when governments form a cartel like OPEC, private-sector businesses can be prosecuted for doing so. Canada was involved in a potash cartel with Belarus and Russia (these three nations account for almost 80 percent of potash production), but when Uralkali (a Belarussian company) quit the cartel, the price of Potash fell, and the cartel essentially collapsed.[61]

Many countries forbid **dumping**—selling a product abroad for less than the comparable price charged in the home country. Antidumping legislation typically defines dumping as occurring if products are being sold at prices less than fair value, or if the result unfairly harms domestic industry. For example, India has accused China of dumping products on the Indian market that it can't sell elsewhere.[62]

LOCAL-CONTENT LAWS Laws requiring that products sold in a particular country be at least partly made in that country.
BUSINESS-PRACTICE LAW Law or regulation governing business practices in given countries.
CARTEL Any association of producers whose purpose is to control supply of and prices for a given product.
DUMPING Selling a product for less abroad than in the producing nation.

DISRUPTIONS IN BUSINESS

Is Supply Management Doomed?

Canada's supply management system sets production quotas, controls prices, and levies high tariffs on imported dairy, poultry, and egg products. The merits of the system have been debated for decades. Supporters argue that the system protects family farms, stabilizes supply and prices, and protects Canadian jobs. Opponents argue that it raises the prices that consumers pay for milk products, gives consumers fewer options at the grocery store, causes a low level of innovation in the industry, and isolates Canada from international markets. They note that the Organization for Economic Cooperation and Development (OECD) estimates that Canadian consumers annually pay $3 billion more than they should for poultry, egg, and dairy products. The opponents think Canada should emulate New Zealand, which successfully converted its protected dairy sector into an exporting powerhouse. Interestingly, this debate is also evident in the U.S., with some farm groups there actually arguing that the U.S. should *introduce* supply management.

In 2017, ultrafiltered milk became a political hot potato because Canadian dairy farmers decided to reduce the price that milk processors had to pay for this type of milk. The lower price was designed to give Canadian milk processors an incentive to buy the milk from Canadian dairy farmers instead of importing it from the U.S. The price reduction did indeed cause Canadian milk processors to start using Canadian milk. But the positive outcome for Canadian milk producers was matched by a negative outcome for milk producers in U.S. states like Wisconsin and Minnesota because demand for their ultrafiltered milk suddenly declined. Milk processors there sent letters to scores of dairy farmers in those two states saying that they would no longer be buying their milk because there was no demand for it.

With their livelihoods threatened, these dairy farmers appealed to influential elected representatives in the U.S. Congress to do something to protect them. U.S. President Donald Trump soon commented that U.S. dairy farmers were being harmed by Canada's actions and that NAFTA would have to be renegotiated to give the U.S. a better deal. In October 2018, a revised NAFTA agreement (called the U.S.-Mexico-Canada-Agreement, or USMCA) was signed; in the new deal, significant concessions were made that will give U.S. producers increasing access to the Canadian poultry and dairy markets. Canadian producers immediately complained that increased U.S. access to the Canadian market would harm Canada's supply management system. Ontario Premier Doug Ford was critical of the deal and wanted to know what kind of government compensation poultry producers would be receiving. Other industry observers noted that Canada's supply management system is being eroded by the Trans-Pacific Partnership, the Comprehensive European Trade Agreement (CETA), and by the new USMCA.

CRITICAL THINKING QUESTION

1. Consider the following statement: *Canada's supply management system should be abolished because it inhibits free trade and raises the prices that consumers pay for dairy products, poultry, and eggs. Canada will be at a disadvantage in future trade negotiations if it retains the supply management system.* Do you agree or disagree with the statement? Explain your reasoning.

LO-6 OVERCOMING BARRIERS TO TRADE

Despite the barriers to trade described so far, international trade is flourishing. This is because both organizations and free-trade treaties exist to promote trade. The most significant of these are the General Agreement on Tariffs and Trade (GATT), the World Trade Organization (WTO), the European Union (EU), and the North American Free Trade Agreement (NAFTA) which is now known as the (USMCA- US-Mexico-Canada Agreement) after some key terms were renegotiated in 2018. We will also examine newly signed and potential agreements that promise to make a significant impact: The Trans-Pacific Partnership (TPP) and the Canada-European Union Comprehensive Economic and Trade Agreement (CETA).

General Agreement on Tariffs and Trade (GATT)

Governments typically view exports as good (because they create jobs in the country) and imports as bad (because they cause job losses in the country). Consequently, governments may be tempted to build trade barriers to discourage imports. But if every country does so, international trade is damaged. To avoid this problem, the **General Agreement on Tariffs and Trade (GATT)** was signed after World War II. Its purpose was to reduce or eliminate trade barriers, such as tariffs and quotas, by encouraging nations to protect domestic industries within agreed-upon limits and to engage in multilateral negotiations.

Although 92 countries signed GATT, not all complied with its rules. The United States was one of the worst offenders. A revision of GATT went into effect in 1994, but many issues remained unresolved—for example, the opening of foreign markets to most financial services.

World Trade Organization

On January 1, 1995, the **World Trade Organization (WTO)** came into existence as the successor to GATT. The 160 member countries are required to open markets to international trade, and the WTO is empowered to pursue three goals:

1. Promote trade by encouraging members to adopt fair trade practices.

GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT) International trade agreement to encourage the multilateral reduction or elimination of trade barriers.

WORLD TRADE ORGANIZATION (WTO) Organization through which member nations negotiate trading agreements and resolve disputes about trade policies and practices.

This beautiful view from Summerland, British Columbia, overlooking Okanagan Lake was part of the escalating trade battleground. The United States accused British Columbia of unfair trade practices because of the rules governing wine sales in the province. This issue was resolved with the USMCA deal providing better access for US wine producers.

Stan Jones/Shutterstock

2. Reduce trade barriers by promoting multilateral negotiations.
3. Establish fair procedures for resolving disputes among members.

The WTO is overseeing reductions in import duties on thousands of products that are traded between countries. Canada, the United States, and the European Union are founding members of the WTO.[63] Unlike GATT, the WTO's decisions are binding, and many people feared that it would make sweeping decisions and boss countries around. Those fears were overstated.[64] The WTO has served its role as a ruling body, but appeals can often drag on for years.

It is a place to file complaints and to be heard in a civilized setting. For example, the United States has filed complaints to the WTO against B.C. wine sales practices noting that only local wines can be sold in grocery stores in British Columbia. The United States sees this as an unfair advantage.[65] While that case may drag on for a long time, each country is free to take its own actions. Canada is not waiting for the WTO to deal with the U.S. steel and aluminum tariffs. In a clear act of trade retaliation, it has its eyes set on California wine and maple syrup from Vermont as tensions grow.[66]

Despite all this protectionist momentum, new free-trade agreements are promising to change the landscape once again (see upcoming descriptions of TPP and CETA). Many senior trade officials are openly questioning the long-term relevance of the WTO if the members don't adjust. Many of the new agreements have more modern, faster rules, such as better coordination of standards and regulations (which sometimes act as obstacles to trade).

The European Union

The **European Union (EU)** initially included only the principal Western European nations such as Italy, Germany, France, and the United Kingdom. But by 2018, 28 countries belonged to the EU (see Figure 5.4). Other countries were in the process of applying for membership, including Serbia, Montenegro, and Turkey. The EU eliminated most quotas and set uniform tariff levels on products imported and exported within its group; it is the largest free marketplace in the world and produces nearly one-quarter of total global wealth.[67]

FIGURE 5.4 The nations of the European Union

However, the foundation of the EU was challenged in 2016 when the citizens of the United Kingdom voted to withdraw. Being part of the single market gave UK businesses easy access to all 500 million customers and allowed UK consumers and companies to purchase goods and services from across the continent free of most tariffs and restrictions. It also allowed the relatively free movement of people across borders. Still, the British people continued to voice concerns. So former Prime Minister David Cameron promised to put a referendum on the ballot asking voters to decide if they wanted to stay in the EU or exit. The expected logical outcome was to remain with the EU, but the main issues turned out to be a British desire for full sovereignty and a fear of immigrants pouring into the country. On the day of the vote, 51.9 percent of voters opted to leave.[68] The United Kingdom began the official process in 2017 and was scheduled to officially leave in 2019. Of course, nothing is final until the papers are signed, but there are no real signs of a reversal. In fact, Amsterdam and Paris were recently granted two new agencies, the European Medicine Authority (EMA) and the European Banking Authority (EBA). Both were formerly based in London.[69]

What does this mean for businesses around the world? The full impact of this decision won't be fully understood for several years. As the economy and political climates change, expect to see traditional, long-standing relationships, treaties, and trade organizations struggle to keep up with the ups and downs of globalization.

EUROPEAN UNION (EU) Agreement among major Western European nations to eliminate or make uniform most trade barriers affecting group members.

This photo of a Mexican autoworker is the type of image that protectionists fear and point to. Jobs that were once reserved for places like Detroit and Windsor are now taking place down south.

Rainer Unkel/Vario images GmbH & Co.KG/Alamy Stock Photo

The North American Free Trade Agreement and the New US-Mexico-Canada Agreement (USMCA)

On January 1, 1994, the **North American Free Trade Agreement (NAFTA)** took effect. Its objective was to create a free-trade area for Canada, the United States, and Mexico. It eliminated trade barriers, promoted fair competition, and increased investment opportunities.

Surveys conducted before the deal showed most Canadians opposed to NAFTA. They feared that jobs would be lost or Canada's sovereignty would be threatened and that Canada would be flooded with products manufactured in Mexico, where wages are much lower. Supporters of NAFTA argued that the agreement would open U.S. markets for Canadian products and create more employment and that it would not threaten Canada's sovereignty.

What happened after NAFTA took effect? A group of economists at the Canadian Economics Association concluded that free trade has not been as good for Canada as predicted by its supporters or as bad as predicted by its detractors.[70] Several specific effects are noticeable:

- NAFTA has created a much more active North American market.
- Direct foreign investment has increased in Canada.
- U.S. imports from (and exports to) Mexico have increased.
- Canada has become an exporting powerhouse.
- Trade between the United States and Canada has risen sharply, and for most of those years Canada had a large trade surplus with the United States.

In fact, the feared Canadian manufacturing job losses have occurred, but the majority have gone to low-cost nations. More recently, there has been evidence that the benefits of NAFTA are slowly being lost by ever-increasing delays at border crossings because of security concerns. However, on the positive side, there is now an extensive Canadian presence in Mexico in everything from mining, to auto parts, to banking. For example, Scotiabank, the most international Canadian bank, has made great inroads in Mexico with more than two million Mexican clients.[71]

Most observers agree that NAFTA achieved its basic purpose over a quarter century—to create a more active and unified North American market. However, the position of the United States changed dramatically a few years ago. In fact, President Trump said that NAFTA was one of the worst deals ever signed and he would seriously consider canceling it. In his first two years in office, he continued the tough talk. Negotiations on a new NAFTA agreement went on for many months and got very ugly at times with the American President openly insulting members of the negotiating team and the Prime Minister. In fact, at one point American negotiators put Canada aside and focused on striking a deal with Mexico. After reaching a deal with Mexico, the US threatened the Canadian negotiating team to either get on board quickly or be left out.[72]

Trade deals are created to help with economic stability and provide opportunities for growth for companies and governments. One way or another, it was in everyone's best interests to settle this dispute and to move forward. On September 30, 2018 Canada and its partners agreed to a new revised deal that had a few minor and a couple of major changes, and a new name. Here are some of the key items of note in this US-Mexico-Canada Agreement (USMCA):

- It maintains the independent and impartial Chapter 19 binational dispute resolution review panel.
- It opens up to 3.59% of the Canadian dairy market to the US.
- The revised automotive rules of origin require higher levels of North American content (from 62.5% to 75%)
- USMCA will see the "de minimis threshold" on imported goods purchased online – the limit on the amount of goods that can be imported duty-free – lifted from $20 to $150.
- Article 32.10 (referred to by many as the China clause) has language about procedures when starting free trade negotiations with non-member countries.[73]

Major New Agreements: TPP and CETA

Canada is actively seeking more open trade and participation in major new agreements.

- *The Trans-Pacific Partnership:* Originally this agreement was to include 12 member-states, including Canada, the United States, Australia, Brunei Darassalum, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. As you can probably guess from the previous section in this chapter, the United States changed course and decided to walk away in 2017. The other members are moving forward and the agreement has been renamed as Comprehensive and Progressive Agreement for Trans-Pacific Partnership.[74]

UNITED STATES-MEXICO-CANADA AGREEMENT This trade agreement replaces NAFTA as the deal to clarify trade between these three nations by gradually eliminating tariffs and reducing other trade barriers.

- TPP is a comprehensive agreement that will increase Canada's foothold in Asia-Pacific. This region may account for two-thirds of the world's middle class by 2030, and 40 percent of global middle class consumption.[75] It promises to help open new markets. For example, Canadian beef and pork producers will gain access to the sheltered Japanese market. However, TPP has many domestic opponents, including dairy farmers, the auto sector, and other groups.
- *Canada-European Union Comprehensive Economic and Trade Agreement (CETA):* Canada has negotiated a comprehensive deal with the EU. As previously stated, the 28 member states account for a market of 500 million people. Since relations with the US and the future of NAFTA were fairly unclear at the time, these negotiations took even greater importance. Before CETA, only 25 percent of Canadian goods were duty-free in the EU. With CETA, 98 percent are now duty-free, and eventually 99 percent of tariffs will be eliminated.[76]

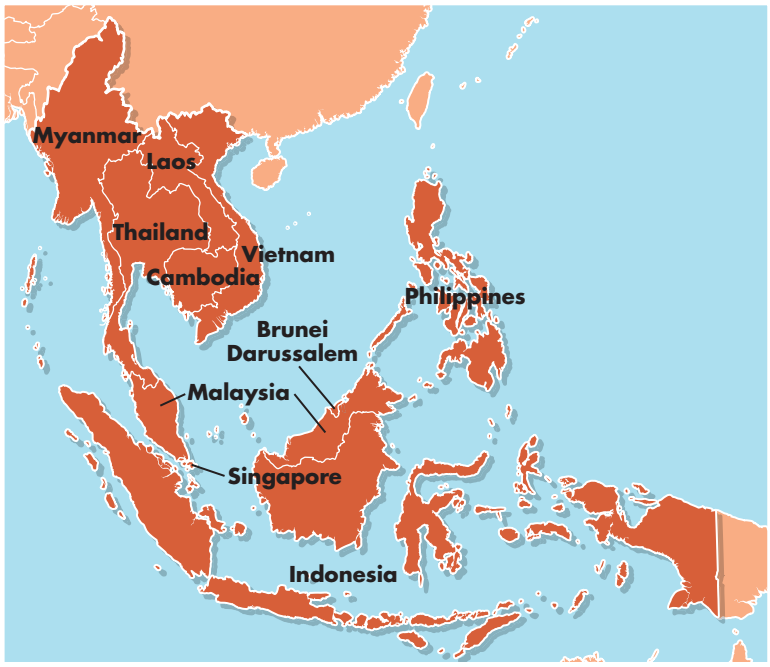


FIGURE 5.5 The nations of the Association of Southeast Asian Nations (ASEAN)

Other Free Trade Agreements Around the World

On January 1, 1995, a free-trade agreement known as Mercosur went into effect between Argentina, Brazil, Uruguay, and Paraguay. Venezuela became the fifth member in 2012 but was suspended in 2017 because of President Nicolas Maduro's brutal policies and actions.[77] In 2018, Canada actively started formal negotiations with Mercosur to create a trade deal with this bloc that represents 260 million people.[78]

Around the world, groups of nations are banding together to form regional trade associations for their own benefit. Some examples include

- the ASEAN Free Trade Area (see Figure 5.5);
- the Economic Community of Central African States (many nations in Equatorial Africa);
- the Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates); and
- the Asia-Pacific Economic Cooperation (many nations of the Pacific Rim, as well as the United States, Canada, and Mexico).

SUMMARY OF

LEARNING OBJECTIVES

LO-1 DESCRIBE THE GROWING COMPLEXITY IN THE *GLOBAL BUSINESS ENVIRONMENT* AND IDENTIFY THE *MAJOR WORLD MARKETPLACES*.

The world economy is changing, and emerging markets are playing a bigger role. However, world trade still revolves greatly around three major marketplaces: North America, Europe, and Asia.

LO-2 IDENTIFY THE EVOLVING ROLE OF *EMERGING MARKETS* AND HIGHLIGHT THE IMPORTANCE OF THE *BRICS NATIONS*.

Old international trading patterns and activities are changing. In the past, Western companies used less developed markets to acquire natural resources and to carry out simple assembly tasks. Although this is still evident in international trade, the relationships have become much more complex, and many former have-nots are now exploiting relationships for their own gain. There are great opportunities in places like Thailand, Indonesia, South Korea, and Ukraine. However, the *BRICS nations* are getting most of the attention. *BRICS* stands for *Brazil, Russia, India, China, and South Africa*.

LO-3 EXPLAIN HOW DIFFERENT FORMS OF *COMPETITIVE ADVANTAGE*, *IMPORT–EXPORT BALANCES*, *EXCHANGE RATES*, AND *FOREIGN COMPETITION* DETERMINE HOW COUNTRIES AND BUSINESSES RESPOND TO THE INTERNATIONAL ENVIRONMENT.

With an *absolute advantage*, a country engages in international trade because it can produce a good or service more efficiently than any other nation. Countries usually trade because they enjoy *comparative advantages*; they can produce some items more efficiently than they can produce other items. A country that exports more than it imports has a favourable *balance of trade*, whereas a country that imports more than it exports has an unfavourable balance of trade. If the *exchange rate* decreases, our exports become less expensive for other countries, so they will buy more of what we produce. The reverse happens if the value of the Canadian dollar increases. Changes in the exchange rate, therefore, have a strong impact on our international competitiveness.

LO-4 DISCUSS THE FACTORS INVOLVED IN CONDUCTING BUSINESS INTERNATIONALLY AND IN SELECTING THE APPROPRIATE LEVELS OF *INTERNATIONAL INVOLVEMENT* AND *INTERNATIONAL ORGANIZATIONAL STRUCTURE*.

In deciding whether to do business internationally, a firm must determine whether a market for its product exists abroad and whether the firm has the skills and knowledge to manage such a business. Firms must also assess the business climates in other nations and the preferred *level of international involvement: (1) exporter or importer, (2) international firm, or (3) multinational firm*. The choice will influence the organizational structure of its international operations, specifically its use of *independent agents, licensing arrangements, branch offices, strategic alliances, and direct investment*.

LO-5 DESCRIBE SOME OF THE WAYS IN WHICH *SOCIAL, CULTURAL, ECONOMIC, LEGAL, AND POLITICAL DIFFERENCES* ACT AS BARRIERS TO INTERNATIONAL TRADE.

Social and cultural differences that can serve as barriers to trade include language, social values, and traditional buying patterns. Differences in economic systems may force businesses to establish close relationships with foreign governments before they are permitted to do business abroad. *Quotas, tariffs, subsidies, and local-content laws* offer protection to local industries. Differences in *business-practice laws* can make standard business practices in one nation illegal in another.

LO-6 EXPLAIN HOW *FREE-TRADE AGREEMENTS* ASSIST WORLD TRADE.

Several trade agreements have attempted to eliminate restrictions on free trade internationally. The *World Trade Organization (WTO)* has 160 members with the mandate to help open markets to international trade. *The European Union (EU)* has eliminated virtually all trade barriers among the 28 member nations. *The North American Free Trade Agreement (NAFTA)* eliminates many of the barriers to free trade between the United States, Canada, and Mexico.

In the past few years, the United States has been increasing its protectionist tone as it demanded a renegotiation of NAFTA. The resulting deal has been re-branded as USMCA with a few important changes. As part of the Canadian openness to globalization and as protection against further actions south of the border, despite the deal, Canada has moved forward with new partner agreements such as CETA and TPP, and possibly with Mercosur.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. What are the advantages and disadvantages of globalization from a Canadian consumer's point of view? From a Canadian manufacturer's point of view?
2. Do you think a firm operating in many countries is better advised to adopt a single global standard of ethical conduct or to adapt to local conditions? Under what conditions might each approach be preferable?
3. Explain how it is possible for a country to have a positive balance of trade and a negative balance of payments.
4. The EU includes most of the Western European countries, but some (such as Switzerland) have chosen not to join. Why might that be? What are the implications for countries that do not join?
5. Make a list of five things you own, such as an item of furniture, a vehicle, electronics, and other consumer goods, making sure that each one was made in a different country. Develop a hypothesis about why each product was made in that country.

APPLICATION EXERCISES

6. China is one of the fastest-growing markets in the world. Conduct research to uncover how to best describe China's economic and social environment.
7. Visit the website of a major global company such as Coca-Cola and enter some of its international sites. Make sure to choose countries from various parts of the world. What are some of the differences that you see on the websites? Identify some of the similar themes and report your findings.
8. The World Bank uses per-capita income to make distinctions among countries. Research and identify at least three countries in the following categories for last year: high-income countries, upper-middle-income countries, lower-middle-income countries, and lower-income countries. In addition, identify the source of the data that you used to draw these conclusions.
9. What attributes of your province or region (cultural, geographical, economic, etc.) would be of interest to a foreign firm thinking about locating there? Visit provincial government sites and find resources that are available for businesses to help them invest in your province. Identify a company that has recently invested in your province. What reasons did it give for its decision?
10. The United States has forced a renegotiation of the North American Free Trade agreement. Research the latest articles and news about the deal and write a short report on NAFTA and other trade deals involving Canada, the United States, and Mexico.

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members and discuss your new business venture within the context of this chapter. Develop specific responses to the following:

1. Are you likely to acquire any of your materials, products, or services from abroad? Why, or why not?
2. Are there likely to be any export opportunities for your products or services? Why, or why not? If you can export your product, will it need to be adapted to sell in foreign markets?
3. To what extent, if any, will your new venture be affected by social and cultural differences, economic differences, and/or legal and political differences across cultures?

BUILDING YOUR BUSINESS SKILLS

WEIGHING THE TRADE-OFFS

GOAL

To encourage students to understand the reasons why companies shift labour offshore and to understand the perspective of all the stakeholders in such a major decision.

THE SITUATION

Able Systems is a software company specializing in technology solutions for the food industry, including supermarkets and restaurants. All your customers are in Canada and operate nearly 24 hours a day. You provide excellent phone support for customers who have an issue, but your expenses are increasing and you're looking for ways to contain costs.

Able Systems has tried to reduce ever-increasing phone support costs by limiting the number of specialists working on each shift, but long wait times have angered customers. Because of the technical and problem-solving skills needed to provide remote support, hiring less qualified employees is just not an option. Looking at competitors, you've noticed that many have offshored their operations—hiring employees in other countries to provide support. Because of a large number of English speakers and an adequate supply of applicants with the education needed for a support position, you are considering setting up a phone support centre in Jamaica.

This solution is not without concerns. If you offshore your support operation, you will have to lay off most of the support employees. You're willing to provide outplacement services to make sure that they can find new jobs, but you're still concerned about the impact of layoffs on your remaining employees. A group of programmers who heard of

this proposal have begun to wonder if their jobs are next. Additionally, local elected officials are concerned about the impact of layoffs on the local economy. Your boss is pressuring you for a recommendation, and you're weighing the pros and cons of both options.

METHOD

Step 1 Assemble a group of four students and assign each group member to one of the following roles:

- CEO of the Able Systems
- programmer at Able Systems
- liaison from a technical college in Jamaica who has graduates looking for jobs in their country
- local government official

Step 2 Each member should write-down notes to express the position of his or her role. Before hearing any of your group's comments on this situation, and from the perspective of your assigned role, do you think that phone support should be offshored to Jamaica? Write-down the reasons for your position.

Step 3 Gather your group together and reveal, in turn, each member's comments on whether phone support should be offshored. Appoint someone to record main points of agreement and disagreement within the group.

FOLLOW-UP QUESTIONS

1. Considering the interests of all stakeholders, what is the best option in this situation?
2. Develop a group response to the following question: Can your team identify other solutions to this dilemma?

EXERCISING YOUR ETHICS

PAYING ATTENTION TO FOREIGN PRACTICES

THE SITUATION

Assume you're an up-and-coming manager in a regional Canadian distribution company. Firms in your industry are placing more emphasis on foreign markets, and you've been assigned to head up your company's new operations in a Latin American country. Because at least two of your competitors are also trying to enter this same market, your boss wants you to move as quickly as possible. You also sense that your success in this assignment will likely determine your future with the company.

You have just completed meetings with local government officials, and you're pessimistic about your ability to get things moving quickly. You've learned, for example, that it will take ten months to get a building permit for a needed facility. Moreover, once the building is up, it will take another six months to get utilities. Finally, the phone company says that it might take up to six additional months to get high-speed internet access.

THE DILEMMA

Various officials have indicated that time frames could be considerably shortened if you were willing to pay special "fees." You realize that these "fees" are bribes, and you're well aware that the practice of paying such "fees" is both unethical and illegal in Canada. In this foreign country, however, it's not illegal and not even considered unethical. Moreover, if you don't pay and one of your competitors does, you'll be at a major competitive disadvantage. In any case, your boss isn't likely to understand the long lead times necessary to get the operation running. Fortunately, you have access to a source of funds you could spend without the knowledge of anyone in the home office.

TEAM ACTIVITY

Assemble a group of four students and divide the four into two pairs and answer the questions from one of the following perspectives:

- your perspective as an employee who is being tasked with the authority to complete the job
- the perspective of the boss (assume that despite your assumptions, this manager is actually aware of the business practices in this country)

QUESTIONS TO ADDRESS

1. What are the key ethical issues in this situation?
2. What do you think most managers would do in this situation?
3. What would you do?

BUSINESS CASE 5

ALIBABA AND THE GLOBAL ECONOMY

China is officially a communist country, but what does that mean exactly? The terminology can be confusing. In 1978, China moved away from its socialist roots, where the government (in the form of the Chinese Communist Party) owned the factories and farms, toward a more free-market economy that China calls a "socialist market economy." This relatively new version of China allows individuals to own property and to take risks, as Jack Ma did when he started Alibaba. The growth and diversification has been impressive. The company provides online marketplaces that connect buyers and sellers; Alibaba earns commissions and advertising dollars for this service. It is the leading platform in China with a strong footprint outside the country and global ambitions. In fact, Alibaba has set a goal to serve two billion customers (one out of every four people in the world) by 2036.

Ma's story isn't one of overnight success, even though it may seem that way today. It took Ma Yun, aka Jack Ma, four years to pass the

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tough entrance exams for college in China, but he fought hard and finally received a degree in English. Shortly after that, he worked his way through graduate school, teaching English, to earn a degree in business. Still, he couldn't land a job in the tough Chinese job market. In the mid-1990s, he took a trip to the United States and experienced the internet for the first time. Back in China, he started building simple websites for Chinese companies, and in 1999, he founded what is now known as the Alibaba Group, a family of online wholesale and retail companies.

The empire began with Alibaba.com, a business-to-business platform that allowed even small businesses access to a large network of sellers. Building upon this success, Ma launched Taobao and Tmall.com, retail sites targeting the growing Chinese middle class. One of the keys to the success of these sites is Alipay, a financial services firm that provides safe transactions. Through Alipay, money is held (in escrow) until the quality of goods is confirmed. This protection has helped to overcome concerns about subpar and fake goods and inadequate remedies through the Chinese legal system.

Jack Ma took the company public in September of 2014, raising $25 billion overnight and making him one of the richest men in the world; it has also allowed Alibaba to expand almost exponentially. In 2017, Alibaba reported sales of almost US$25 billion, and counting third-party sales through its websites (known as Gross Merchandise Volume, or GMV), the company surpassed $547 billion. To put that in perspective, the value of goods sold on Alibaba's platforms was greater than the gross domestic product of Sweden.

Marketing has played a big part in the company's success. China is experiencing a high volume of unmarried citizens, and Alibaba managed to adopt an informal holiday, called Singles Day, on November 11 of each year (11.11), which is like Valentine's Day. Marketing gurus at Alibaba began launching Double 11 deals to bolster sales during the slow period before Christmas, and they hit a magic button. Sales went through the roof, and Alibaba trademarked "Singles Day." In just one 24-hour period, Alibaba posted $17.8 billion in GMV.

It should be no surprise that sales in China are strong since China's population is now almost 1.4 billion (roughly 18.5 percent of the world population). Compare that to a population in Canada of approximately 36.7 million. The middle-class consumers in China are still a small proportion of the total population, but they are growing in power and size and are consuming more and more goods, as evidenced by Alibaba's sales volume and that of Bombardier, General Motors, and the many other international businesses selling to the Chinese markets. Some experts estimate that right now the United States accounts for nearly half of total world consumptions of goods and services, with only 5 percent of the total population. What happens to the world economy when China catches up with and maybe even surpasses the Americans per capita rate of consumption? Will there be enough goods and services to supply that amount of demand? Will there be enough natural resources? One of the great challenges of this generation of business people will be to find the socio-economic balance between global demand and supply.

Meanwhile, protectionist threats from the United States and elsewhere are a key concern. However, when all interests are examined, cooler heads will likely win. The future opportunities for intelligent entrepreneurs seem to be limited only by the imagination as the economy becomes global and borders—both physical and political—continue to disappear. But while the Alibaba Group is a leader in e-commerce, it did just buy a 36-percent stake in China's largest Walmart-style hypersmart named Sun Art Retail Group. Is that a hedge against the drumbeat of threats of trade wars or simply a wise investment in a local business? Time will tell. But one thing is certain: The Alibaba Group is a global company with big ambitions and a proven record of adapting to the times.

QUESTIONS FOR DISCUSSION

1. In what ways does Alibaba demonstrate the true promise of the global economy?
2. How does the increased formalization of the BRICS group benefit Alibaba?
3. In the past couple of years, we have seen growing protectionism threats (especially from the United States). What is the potential impact of these threats if a full trade war breaks out?
4. What impact do current trade agreements and proposed trade agreements play on online global companies like Alibaba?

MyLab Intro to Business

Study, practise, and explore real business situations with these helpful resources:
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.
- **Videos:** Learn more about the business practices and strategies of real companies.

THE CONTEMPORARY BUSINESS ENVIRONMENT

GOAL OF THE EXERCISE

In Chapter 4, we discussed how the starting point for virtually every new business is a business plan. Business plans describe the business strategy for any new business and demonstrate how that strategy will be implemented. One benefit of a business plan is that in preparing it, would-be entrepreneurs must develop their idea on paper and firm up their thinking about how to launch their business before investing time and money in it. In this exercise, you'll get started on creating your own business plan.

EXERCISE BACKGROUND: PART 1 OF THE BUSINESS PLAN

The starting point for any business plan is coming up with a "great idea." This might be a business that you've already considered setting up. If you don't have ideas for a business already, look around. What are some businesses that you come into contact with on a regular basis? Restaurants, childcare services, and specialty stores are a few examples you might consider. You may also wish to create a business connected with a talent or interest you have, such as crafts, cooking, or car repair. It's important that you create a company from scratch rather than use a company that already exists. You'll learn more if you use your own ideas.

Once you have your idea, your next step is to create an "identity" for your business. This includes determining a name for your business and a concept of what your business will do, and identifying the type of ownership your business will take, a topic we discussed in Chapter 4. The first part of the plan also briefly looks at who your ideal customers are, how your business will stand out from the crowd, and how the business will interact with the community and demonstrate social responsibility (these last topics were discussed in Chapter 3). Finally, almost all business plans today include a perspective on the impact of global business.

YOUR ASSIGNMENT

MyLab Intro to Business

Step 1 To complete this assignment, you first need to download the Business Plan Student Template file from this text's MyLab Intro to Business. This is a Microsoft Word file you can use to complete your business plan. For this assignment, you will fill in Part 1 of the plan.
Step 2 Once you have the Business Plan Student Template file, you can begin to answer the following questions in Part 1: The Contemporary Business World.

1. What is the name of your business?

   Hint: When you think of the name of your business, make sure it captures the spirit of the business you're creating.

2. What will your business do?

   Hint: Imagine that you are explaining your idea to a family member or a friend. Keep your description to 30 words or fewer.

3. What form of business ownership (sole proprietorship, partnership, or corporation) will your business take? Why did you choose this form?

   Hint: For more information on types of business ownership, refer to the discussion in Chapter 4.

4. Briefly describe your ideal customer. What are they like in terms of age, income level, and so on?

   Hint: You don't have to give too much detail in this part of the plan; you'll provide more details about customers and marketing in later parts of the plan.

5. Why will customers choose to buy from your business instead of your competition?

   Hint: In this section, describe what will be unique about your business. For example, is the product special, or will you offer the product at a lower price?

6. All businesses have to deal with ethical issues. One way to address these issues is to create a code of ethics. List three core principles your business will follow.

   Hint: To help you consider the ethical issues that your business might face, refer to the discussion in Chapter 3.

7. A business shows social responsibility by respecting all its stakeholders. What steps will you take to create a socially responsible business?

   Hint: Refer to the discussion of social responsibility in Chapter 3. What steps can you take to be a good citizen in the community? Also consider how you may need to be socially responsible toward your customers and, if applicable, investors, employees, and suppliers.

8. Will you sell your product in another country? If so, what countries and why? What challenges will you face?

   Hint: To help you consider issues of global business, refer to this chapter. Consider how you will expand internationally (e.g., independent agent, licensing). Do you expect global competition for your product? What advantages will foreign competitors have?

Note: Once you have answered the questions, save your Word document. You'll be answering additional questions in later chapters.

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PART

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CHAPTER

06

Managing the Business Enterprise

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Describe the four activities that constitute the *management process*.
- **LO-2** Identify *types of managers* by level and area.
- **LO-3** Describe the five basic *management skills*.
- **LO-4** Explain the importance of *goal setting* and *strategic management* in organizational success.
- **LO-5** Discuss *contingency planning* and *crisis management* in today's business world.
- **LO-6** Explain the idea of *corporate culture* and why it is important.

A Surprising Change in Corporate Strategy at Bombardier

Montreal-based Bombardier Inc. is a high-profile manufacturer of commercial jets. The company has been successful with its regional jets, which seat 50 to 90 passengers, but the regional jet market has been declining because airline companies want planes with longer ranges, lower operating costs, and wider cabins. Bombardier planners reasoned that if they did not develop a new jet, they would gradually be forced out of the commercial airplane business. In 2008, at the Farnborough International Airshow near London, England, the company announced it was going forward with a new C Series commercial jet, a plane designed for transcontinental flights that would seat 110 to 130 passengers. Bombardier's adoption of this strategy meant that it would be going head to head with two global giants, Airbus and Boeing. Although obviously risky, if this strategy proved to be successful, Bombardier could expect huge sales revenues and profits. In addition, Canada would be one of only three countries to produce intercontinental commercial jet aircraft.

Bombardier started work on the jet in 1998, temporarily abandoned the project in 2000, and then restarted it a few years later. The program was put on hold again in 2006 and then reactivated in 2008. However, from 2008 to 2016, three significant problems developed. First, the C Series project was plagued with cost overruns and failures to meet promised delivery dates. The plane was supposed to be delivered in late 2013, but was not actually available until 2015. The C Series jet carried its first passengers in July 2016 (from Zurich to Paris). At that point, the project was two and a half years behind schedule. Second, the estimated development costs (about $3.4 billion) were too low. Bombardier actually spent at least $6 billion on the C Series jet. Third, sales of the new jet were not nearly as high as anticipated, and there was continual difficulty in

convincing airlines to buy the plane. In September 2016, Bombardier announced it would build only half the planes it had previously expected to build. Bombardier did get a contract from Delta Airlines for 75 jets in 2016, and in 2017 Swiss Air International and Air Baltic Corp. also bought the plane.

Graham Hughes/Alamy Stock Photo

On October 16, 2017, a stunning announcement was made: Paris-based Airbus Group SE would take control of the C Series aircraft. The deal that was struck gave Airbus 50.01 percent ownership of the C Series, the province of Quebec 19 percent ownership, and Bombardier 31 percent ownership. Investors seemed to like the deal because Bombardier's shares went up 30 percent in the month after the deal was announced. But when more details emerged, optimism turned to outrage. For example, Airbus didn't pay any money for its majority share, and it didn't assume any of the debt that Bombardier had amassed while developing the plane. Critics blasted the deal as being bad for Canada and for Canadian taxpayers who had supported the project through government subsidies and loans. The critics pointed out that, even though the province of Quebec and the federal government had invested more than $1 billion on development of the plane, they were willing to make Airbus the majority shareholder for *free*. The critics chastised the Quebec government and Bombardier for giving away the province's greatest technical and manufacturing accomplishment, and they thought it was terrible that the expertise that had been used to make the plane had fallen into foreign hands. They also said Bombardier was naïve for taking on Airbus and Boeing and not realizing that those companies would respond to the C Series threat.

Those who supported the deal defended it on the grounds that it would increase the likelihood that more C Series planes would be sold because greater sales revenue would be generated through Airbus's global sales network and supply chains. The deal would also preserve 12 500 high-paying jobs in Quebec. Also, Bombardier won a surprisingly favourable ruling from the U.S. International Trade Commission that rejected a 300 percent duty the United States had originally levied on sales of the planes in the United States. That ruling meant that customers in the United States would pay a lower price for the airplane, which would likely boost sales. Supporters also noted that Bombardier had been on shaky financial ground for a few years and that the deal was the best that could be salvaged from a bad situation. The supporters said it was better to own half of a plane that had a better chance of selling well than owning most of a plane that would not sell well. They also said that the chances of getting the investment in the C Series back were higher than they would have been without the Airbus takeover.

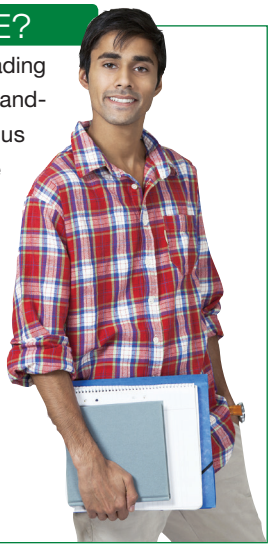
Some critics say that all three manufacturers—Boeing, Bombardier, and Airbus—are failures because they need government help to survive. Shareholders cash in when things go well, but taxpayers have to foot the bill when things go poorly. These three companies are "too big to fail" because they have too many employees, too many government contracts, and too many suppliers.

• QUESTIONS FOR DISCUSSION •

1. What are the three basic steps in strategy formulation? What specific activities were evident at Bombardier for each of these three steps?
2. Consider the following statement: *Airbus struck a great deal for itself when it took over the C Series jet project. Airbus got a great airplane and didn't have to pay a cent for it.* Do you agree or disagree with the statement? Defend your answer.
3. Explain how each of the four functions of management played out in this story. Was one function significantly more important than another? Explain your reasoning.

HOW WILL THIS HELP ME?

From the perspective of a *manager*, after reading this chapter, you will have a clearer understanding of how to effectively carry out various management responsibilities. From the perspective of a *consumer* or *investor*, you'll be better able to assess and appreciate the quality of management in various companies.



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WHO ARE MANAGERS?

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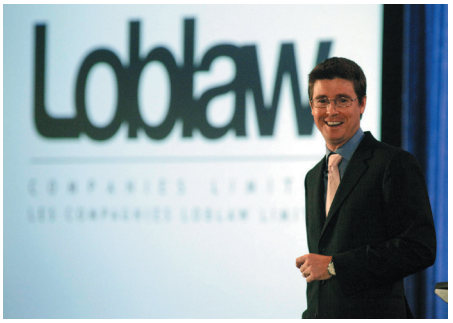


Mark Blinch/Thomson Reuters (Markets) LLC

As top managers, Shahrzad Rafati of Broadband TV Corp. (left), Linda Hasenfratz of Linamar (centre), and Galen Weston, Jr. CEO of Loblaw Companies (right) are important resources for their companies. They set the strategic direction for their companies and provide leadership to other managers. They are also accountable to shareholders, employees, customers, and other key constituents for the performance and effectiveness of their businesses.

Managers are the people who plan, organize, lead, and control the operations of an organization. All businesses depend on effective management. Regardless of the type of organization they work in, managers perform many of the same basic functions, are responsible for many of the same tasks, and have many of the same responsibilities. Although our focus is on managers in business settings, management is important for all kinds of organizations, including charities, religious organizations, community organizations, educational institutions, and government agencies. The prime minister of Canada, the president of the University of Toronto, the executive director of the United Way, the dean of your business school, and the chief administrator of your local hospital are all managers. Regardless of the nature and size of an organization, managers are among its most important resources.

MANAGERS The people who plan, organize, lead, and control the operations of an organization.

LO-1 THE MANAGEMENT PROCESS

Management is the process of planning, organizing, leading, and controlling an enterprise's financial, physical, human, and information resources to achieve the organization's goals. There are two important overall points to keep in mind when thinking about the management process. First, the planning, organizing, leading, and controlling aspects of a manager's job are interrelated. This means that a manager is likely to be engaged in all these activities during the course of any given business day.

MANAGEMENT The process of planning, organizing, leading, and controlling a business's financial, physical, human, and information resources in order to achieve its goals.

Second, there is a difference between management effectiveness and management efficiency. *Efficiency* means achieving the greatest level of output with a given amount of input. *Effectiveness*, on the other hand, means achieving organizational goals that have been set. Thus, efficiency means doing things right, whereas effectiveness means doing the right things. A manager who focuses on being effective is likely to be efficient also, but a manager who focuses on being efficient may or may not be effective.

Planning

Planning is the process of determining the firm's goals and developing a strategy for achieving those goals. The planning process involves five steps:

- *Step 1.* Goals are established for the organization. A commercial airline, for example, may set a goal to fill 90 percent of the seats on each flight.
- *Step 2.* Managers identify whether a gap exists between the company's desired and actual position. For example, the airline may analyze load data and find that only 73 percent of the seats on the average flight are filled.
- *Step 3.* Managers develop plans to achieve the desired objectives. For example, the airline may reduce fares on heavily travelled routes in order to increase the percentage of the seats that are filled.
- *Step 4.* The plans that have been decided upon are implemented. For example, the fare from Toronto to Montreal may be reduced by 10 percent.
- *Step 5.* The effectiveness of the plan is assessed. The airline measures the percentage of seats that were filled after the change was implemented to determine whether the goal was reached.

McDonald's experience in Canada over the past decade demonstrates the importance of the planning process. When sales started to decline in 2012, McDonald's set a goal to reinvent itself and begin to grow again (step 1). The gap between where McDonald's was and where it wanted to be (step 2) was obvious, so McDonald's top managers developed a strategic plan that included the rollout of an all-day breakfast menu and an increased emphasis on healthy foods (step 3). These changes did not result in the level of improvement desired, so additional changes were announced, including ordering and paying for food via mobile devices as well as delivering food in some major markets. These plans were implemented from 2015 through 2016 (step 4). By 2017, both sales and earnings had exceeded estimates (step 5). McDonald's is also planning to focus on global expansion, and by 2022, it hopes to have about 4500 stores in China.[1]

Organizing

Organizing involves mobilizing the resources required to complete a particular task (organizing is examined in detail in Chapter 7). The importance and complexity of the organizing function can be seen by considering the restructuring that has taken place at Hewlett-Packard during the past 20 years. HP had long prided itself on being a corporate confederation of individual businesses. Each business made its own decisions quickly and efficiently, and the competition kept each unit on its toes. This structure served the firm well for many years. But as time passed, HP somehow lost its competitive edge. The decision was then made to centralize company activities and develop an integrated, organization-wide Internet strategy. A reorganized HP then bounced back, at least for a few years.[2] But when HP again experienced profitability problems in its PC division in 2005, then-CEO Carly Fiorina decided to combine the PC and printing divisions in order to increase hardware sales to customers. Although Fiorina's successor Mark Hurd reversed those changes, when Hurd left a few years later, the new CEO Meg Whitman reinstated them.[3]

Leading

Leading (or directing) involves the interactions between managers and their subordinates as they work to meet the firm's objectives. Legendary leaders such as Sam Walton (Walmart), Clive Beddoe (WestJet), and Steve Jobs (Apple) were able to unite their employees in a clear and targeted manner and to motivate them to work in the best interests of the company. While managers have the power to give orders and demand results, leading goes beyond merely giving orders. Leaders must also have the ability to motivate their employees to set challenging goals and to work hard to achieve them. This means that employees will respect their leaders, trust them, and believe that by working together both company and employees will benefit. We discuss leadership in detail in Chapter 9.

Controlling

Controlling is the process of monitoring a firm's performance to make sure it is meeting its goals. Managers at WestJet and Air Canada, for example, focus relentlessly on numerous indicators of performance that they can measure and adjust. Everything, from on-time arrivals to baggage-handling errors to the number of empty seats on an airplane to surveys of employee and customer satisfaction, is regularly and routinely monitored. If on-time arrivals start to slip, managers focus on the problem and get it fixed. No single element of the firm's performance can slip too far before it is noticed and fixed.

Figure 6.1 illustrates the control process, which begins when management establishes standards (often for financial performance). If, for example, a company sets a goal of increasing its sales by 20 percent over the next five years, an appropriate standard to assess progress toward that goal might be an increase of about 4 percent a year. Managers then measure actual performance each year against standards. If the two amounts agree, the organization continues on its present course. If they vary significantly, however, one or the other needs adjustment. If sales have increased 3.9 percent by the end of the first year, things are probably fine. But if sales have dropped 1 percent, some revision in plans is needed.

Consider how controlling applies to the courses you are now taking. The instructor first indicates the knowledge areas where you must show competence and the level of competence you must show. Next, he or she measures your performance, usually through assignments and exams. The instructor then determines whether your performance meets the standard.

PLANNING That portion of a manager's job concerned with determining what the business needs to do and the best way to achieve it.
ORGANIZING That portion of a manager's job concerned with mobilizing the necessary resources to complete a particular task.
LEADING (OR DIRECTING) That portion of a manager's job concerned with guiding and motivating employees to meet the firm's objectives.
CONTROLLING That portion of a manager's job concerned with monitoring the firm's performance and, if necessary, acting to bring it in line with the firm's goals.

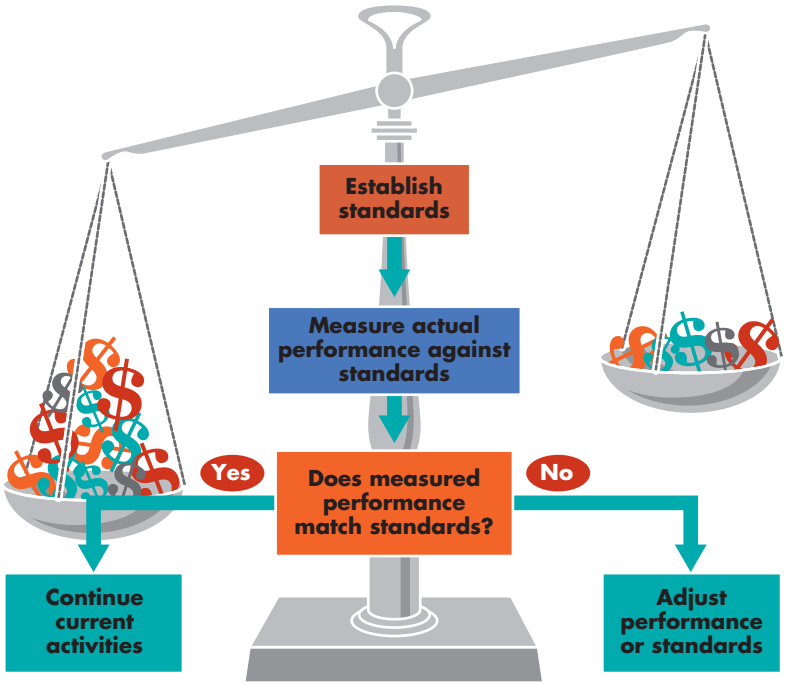


FIGURE 6.1 The control process

If your performance is satisfactory (or unsatisfactory), you receive feedback in the form of a passing (or failing) grade in the course. The boxed insert entitled "Managing Customer Service Touch Points" describes how StellaService assesses customer satisfaction with online retailers.

Control can also show where performance is better (or worse) than expected and can serve as a basis for providing rewards or reducing costs. For example, when the distributor of the surprise hit movie *The March of the Penguins* saw how popular the movie was becoming, the firm was able to increase advertising and distribution, making the niche movie into a major commercial success. In contrast, when the sales of the Chevrolet Super Sport Roadster (a classic, late-1940s pickup-style vehicle with a two-seat roadster design) were much lower than expected, production of the vehicle was suspended.

Management: Science or Art?

Many management problems can be approached in ways that are rational, logical, objective, and systematic. Managers can use quantitative models and decision-making techniques to arrive at "correct" decisions. This approach is especially useful when managers deal

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

Managing Customer Service Touch Points

Good decision making requires timely information. Companies are constantly monitoring trends, competitor actions, and social media posts to understand and improve their reputation. As online purchases keep increasing, the human touch is being replaced by cold, impersonal online interactions. Poor customer service can disappoint and anger customers, resulting in lost sales and nasty online reviews (which impact buying decisions of others as well). So how can companies ensure that each touch point is as effective and pleasant as possible? That is a vital question for managers today. StellaService Inc. provides a better way to measure online service, enabling it to become a market winner for online shoppers and retailers alike. Let's read a little more about how the company did that.

Following its start-up, StellaService (Stella) spent two years gathering data on customer satisfaction with thousands of online retailers, including giants like Amazon. They measured satisfaction in four service areas—phone support, email support, delivery, and returns/refunds—for each retailer. Each area included from 9 to 25 different measurements. Phone support, for example, considered speed of answering the call and the respondent's knowledge of the product. Delivery measurements included delivery time and product accuracy. By combining the data, Stella enabled consumers to find summary scores for each of the four service areas. These results provide competitor rankings that clearly demonstrate where each retailer stands and allow period-to-period tracking and revealing trends for improvements.

With these measurement tools, Stella can better inform consumers on the range of customer services that they can expect from online retailers. Knowing that success hinges on the validity and believability of their methods, Stella uses an independent third-party rating system. "Secret shoppers" (trained employees) use strict and controlled measurement methods as they engage online retailers via emails, phone calls, and live chats to purchase, await deliveries, or make returns for refunds. As added assurance for validity, the company maintains a "Customer Service Measurement Process Audit" detailing its measurements and procedures for gathering and processing data, with specific steps to improve accuracy. In an independent auditing report, KPMG stated that Stella's methodologies are complying with their stated policies.

Today, StellaService has two core programs. *Stella Connect* uses real-time customer feedback to allow companies to understand perceptions and improve the performance of their frontline teams. *Stella Metrics* provides multi channel mystery shopping that allows companies to measure and improve customer experience at every stage with real-time surveys and performance measurements from both online and in-store channels.

StellaService has raised more than US$37 million in venture capital and received the greatest compliment (as well as a financial boost) when Google licensed StellaService's data to rate retailers on its search engine. Clearly, the business of helping companies provide good customer service is just good business, and StellaService has proven it can deliver the information and analysis that managers need to do their jobs.

CRITICAL THINKING QUESTION

1. How do the results of customer service reports influence a manager's decisions? In answering this question, refer to Figure 6.1 (the control process).

with relatively routine and well-defined issues. But managers also make many decisions that are not routine, and when doing so, they must rely heavily on interpersonal skills and abstract conceptual thinking. Thus, effective management is a blend of science and art, and successful executives recognize the importance of combining both the science and the art of management as their carry out the functions of management.[4]

BECOMING A MANAGER

How do you acquire the skills necessary to blend the science and art of management? Although there are many variations, the most common path involves a combination of *education* and *experience*.

If you are reading this text, you are probably doing so because you are enrolled in a management course at a community college or university. When you complete the course, you will have a foundation for developing your management skills in more advanced courses. A degree or diploma has become almost a requirement for career advancement in business, and MBA degrees are increasingly common among successful managers. Even after obtaining a degree, managers have not seen the end of their formal management education. Many middle and top managers periodically return to campus to participate in executive or management development programs. Large companies often have in-house training programs for furthering the education of their managers. Some firms (McDonald's and Shell Oil) have even created corporate universities for this purpose. There is also a trend toward online education.

Ulrich Baumgarten/Getty Images

Education plays a vital role in becoming a manager. Prospective managers usually complete at least one degree in business, taking courses in finance, marketing, accounting, management, and other areas.

The primary advantage of education as a source of management skills is that you can follow a well-developed program of study and become familiar with current research and thinking on management. This text, for example, will give you a solid foundation for enhancing your management skills. However, management education is often general (in order to meet the needs of a variety of students), so specific know-how may be hard to obtain. This is where experience comes in. The day-to-day experiences that managers have as they try to achieve company goals and keep their subordinates productive and happy are crucial in improving their effectiveness. Because companies recognize the importance of experience, they assign people to a variety of jobs. Over time, individuals are exposed to most of the major aspects of the organization. In this way, managers learn by experience.

The CEOx1Day (CEO for a Day) program, which is organized by the executive recruiting firm Odgers Berndtson, pairs students with experienced executives to help the students understand what it is like to be a top manager. For example, Olivia Poulin, a student at Brock University, followed Paul Parisi, the president of PayPal Canada for one day.[5]

The boxed insert entitled "Innovations in Management" describes how one entrepreneur became involved in helping others learn about what is involved in management.

What Should You Expect in a Management Job?

In your first career position, you are likely to land a job where you can use the technical skills that you have developed during college or university (accountant, engineer, lawyer, salesperson, computer technician, etc.). Your focus will be largely on your own performance and how you can contribute to the organization. If you perform well, you may be promoted to a management position after a while. When you become a manager, your focus must shift, and making this shift is a challenge for many newly appointed managers.

In *Be the Boss Everyone Wants to Work For: A Guide for New Leaders*, William Gentry identifies five changes that newly appointed managers must make in their thinking if they hope to be successful:[6]

- Change from thinking "it's all about *me*" to "it's all about *we*" (be concerned about the performance of *other* people, i.e., your subordinates).
- Focus on developing skills in communication, influencing, leading team achievement, and developing other people's abilities.
- Do not give your former colleagues and friends special treatment.
- Let subordinates know you trust their work by "letting go" of much of the technical work you used to do and allow your subordinates to do it. If you fail to delegate work to others, you will not have enough time to do your own work, and you will also reduce the morale and productivity of your subordinates. A survey of 250 Canadian CEOs revealed that the biggest challenge for new managers was balancing individual responsibilities with time spent overseeing subordinates. [7]
- Your decisions will have a big impact on others, so act with integrity and build trust with others.

Individuals in their first management job are not the only ones who have difficulty making the transition to a new level. Individuals who already have management experience (e.g. managing a functional department such as marketing) and are promoted to a more general management position also have to change the way they think about management. An information technology manager, for example, may know quite a bit about the technical work being done by her subordinates, but when she is promoted to be the general manager of a division, she will find that she is now supervising people in multiple functional areas such as marketing, finance, and production. To succeed in this new position, she must change her narrow functional perspective and start focusing on managing in such a way that multiple functional areas are well coordinated.[8]

Innovations in Management

Back in 2004, Salman Khan made a series of simple web videos that went viral. Five years later, Mr. Khan had quit his day job (as a hedge fund manager) to build his organization and keep up with the massive demand for his videos. By 2018, the Khan Academy had a team of 150 full-time staff members and a website that drew more than 10 million unique visitors every month. It has become an international adaptive learning system providing free education to anyone with access to the Web. Lessons are translated into 36 languages, and the academy now claims more than 57 million registered users (many people also use the site without registering). In total, more than one billion lessons have been provided.

In an interview with Stephen Meyer, of *Forbes* magazine, Khan identified his three core management strategies:

1. *Motivate managers by linking talent development to their compensation.* As a not-for-profit organization, Khan Academy can't offer big bonuses and stock options. But Khan pays well—comparable to the upper-quartile of Silicon Valley. He's a firm believer in rewarding good work with good pay, and the productivity of his team proves his point.
2. *Make it easier for managers by giving them tools.* One of his goals is to create a library of internal videos that capture the Khan approach to every imaginable management challenge, from how to read a financial statement to delegation. He says, "It would be very hypocritical if we're out there trying to make tools and resources for the rest of the world to learn, but we weren't doing that with our own people."
3. *Set an example.* Khan is just discovering management for himself. He'd rather be making videos and coding, but as the organization has grown, so has his role, and he's begun to develop a whole new generation of managers, leading and teaching by example.

Khan's perspective is that the role of management is mentoring rather than motivating. "It's an eighteenth- or nineteenth-century phenomenon to say the role of a manager is to get someone to do work," he explains. "That's wrong. The role of a modern manager is, 'How do I develop my people?'"

CRITICAL THINKING QUESTION

1. Based on what you have read in this boxed insert, as well as the management theory notes in this chapter, what type of leader is Salman Khan? Explain your reasoning.

(Note: Also read the "Leadership and Motivation" section in Chapter 9 before answering this question.)

One other important issue that you, as an aspiring manager, should be aware of is the expectations that the organization has for you. Put simply, you will be expected to focus on successfully completing tasks in an effective manner, no matter how long it takes. You should not expect to be paid overtime if you have to work long hours to complete your assigned tasks. Non-managerial employees typically receive overtime pay when they work more than a 40-hour week, but this is not true for managers. Some people who are promoted to their first management job are dismayed to find that there is no overtime pay no matter how many hours per week they work.

LO-2 TYPES OF MANAGERS

Although all managers plan, organize, lead, and control, not all managers have the same degree of responsibility for each activity. Moreover, managers differ in the specific application of these activities. Thus, we can differentiate among managers on the basis of their level of responsibility and their area of responsibility.

Levels of Management

The three basic levels of management are top, middle, and first-line management. As Figure 6.2 shows, most firms have more middle managers than top managers and more first-line managers than middle managers. Moreover, as the categories imply, the authority of managers and the complexity of their duties increase as they move up the pyramid.

Top Managers

The executives who guide the fortunes of companies are **top managers**. Common titles for top managers are president, vice president, chief operating officer (COO), chief executive officer (CEO), and chief financial officer (CFO). Top managers are responsible to the board of directors and shareholders of the firm for its overall performance and effectiveness. They set general policies, formulate strategies, oversee significant decisions, and represent the company in its dealings with other businesses and government.[9] In some companies, a group of managers act as the CEO; they use consensus decision making to manage the company. For example, DPR Construction and software maker Peakon both rely on committees at the top of the hierarchy. [10]

Each year, Waterstone Human Capital asks a sample of top managers which manager they admire most. The 2017 winners included Debra Hewson, president and CEO of Odlum Brown; John Anderson, chairman, president, and CEO of the Oppenheimer Group; and Catherine Zahn, president and CEO of the Centre for Addiction and Mental Health.

Although top managers have a lot of authority, they also have something of an image problem. One study ranked CEOs very low on the "trust" dimension, and this means that some of Canada's most successful people have low credibility.[11] Social media have also made the actions of top

TOP MANAGERS Those managers responsible for a firm's overall performance and effectiveness and for developing long-range plans for the company.

FIGURE 6.2 Organizations have three basic levels of management

(Top to Bottom) Adrian Weinbrecht/Alamy Stock Photo; Auremar/Fotolia; Hurst Photo/Shutterstock

managers (and others) much more visible. Desmond Hague, the CEO of food services company Centerplate, was forced to resign after an elevator security video showed him kicking a dog.[12]

Middle Managers

Although below the ranks of the top executives, **middle managers** still occupy positions of considerable autonomy and importance. Titles such as plant manager, operations manager, and division manager are typical middle-management positions. The producer of a Lion's Gate film such as *Precious* is a middle manager. In general, middle managers are responsible for implementing the strategies, policies, and decisions made by top managers. For example, if top management decides to bring out a new product in 12 months or to cut costs by 5 percent, middle management will have to decide to increase the pace of new product development or to reduce the plant's workforce.

First-Line Managers

First-line managers spend most of their time working with and supervising the employees who report to them. Common titles include supervisor, office manager, and group leader. A transit supervisor who monitors bus schedules, passenger safety, and the behaviour of bus drivers is a first-line supervisor. So is the flight-services manager for a specific Air Canada flight. Table 6.1 summarizes the duties of the three basic levels of management.

MIDDLE MANAGERS Those managers responsible for implementing the decisions made by top managers.

FIRST-LINE MANAGERS Those managers responsible for supervising the work of employees.

John Woods/CP images

Managers are needed in all kinds of business firms, including professional sports teams. Paul Maurice, the head coach of the Winnipeg Jets, is a first-line manager who is responsible for the day-to-day success of the team.

Areas of Management

Within any large company, the top, middle, and first-line managers work in a variety of areas, including human resources, operations, information, marketing, and finance.

Human Resource Managers

Human resource managers can be found in most companies; they hire employees, train them, evaluate their performance, decide how they should be compensated, and deal with labour unions (if the workforce is unionized). Large firms may have several human resource departments, each dealing with specialized activities. Imperial Oil, for example, has separate departments to deal with recruiting and hiring, wage and salary levels, and labour relations. Smaller firms may have a single department, while very small organizations may have a single person responsible for all human resource activities. Chapters 8 and 9 address human resource management issues.

Operations Managers

Operations managers are responsible for a company's system for creating goods and services. This includes production control, inventory control, and quality control, among other duties. Manufacturing companies such as Steelcase, Bristol Aerospace, and Sony need operations managers at many levels. Such firms typically have a vice president for operations (top), plant managers (middle), and supervisors (first-line). In recent years, sound operations management practices have also become increasingly important to service-producing organizations like hospitals, the government, and colleges and universities. Operations management is the subject of Chapter 10.

Information Managers

Dramatic increases in both the amount of information available to managers and the ability to manage it have led to the emergence of *information managers*. These persons are responsible for designing and implementing various systems to gather, process, and disseminate information. CEOs increasingly interact with their chief information officer (CIO). Information technology (IT) is no longer just a "back-room function," but a key element

>>> TABLE 6.1 The three levels of management

Level	Examples	Responsibilities
Top managers	President, vice president, treasurer, chief executive officer (CEO) and chief financial officer (CFO)	• Responsible for the overall performance and effectiveness of the firm • Set general policies, formulate strategies, and approve all significant decisions • Represent the company in dealings with other firms and with government bodies
Middle managers	Plant manager, operations manager, division manager and regional sales manager	• Responsible for implementing the strategies of and working toward the goals set by top managers
First-line managers	Supervisor, office manager, project manager, group leader and sales manager	• Responsible for supervising the work of employees who report to them • Ensure employees understand and are properly trained in company policies and procedures

in strategic planning.[13] Middle managers in information management help design information systems for divisions or plants. Computer systems managers within smaller businesses or operations are first-line managers. Information management is discussed in Appendix 4 at the end of the book.

Marketing Managers

Marketing includes the development, pricing, promotion, and distribution of products and services. *Marketing managers* are responsible for getting these products and services to buyers. Marketing is especially important for firms producing consumer products, such as Procter & Gamble, Coca-Cola, and Sun Ice. These firms may have numerous marketing managers at various levels. For example, a large firm will probably have a vice president for marketing (top manager), regional marketing managers (middle managers), and several district sales managers (first-line managers). We examine marketing in Chapters 12 and 13.

Financial Managers

Management of a firm's finances is extremely important to its survival. Nearly every company has *financial managers* to plan and oversee its financial resources. Levels of financial management may include a vice president for finance (top), a division controller (middle), and an accounting supervisor (first-line). For large financial institutions, effective financial management is the company's reason for being. Chapters 14 and 15 describe financial management in detail.

Other Managers

Some firms have more specialized managers. Chemical companies such as CIL have *research and development managers*, for example, whereas companies such as Petro-Canada and Apple have *public relations managers*. The range of possibilities is almost endless, and the areas of management are limited only by the needs and imagination of the company.

LO-3 MANAGEMENT ROLES AND SKILLS

Regardless of their level or area within an organization, all managers must play certain roles and possess certain skills if they are to be successful. In this section, we first describe the basic roles that managers play and then describe the skills they need to be effective.

Management Roles

Describing managers' jobs by referring to functions like planning, organizing, leading, and controlling gives us a good *general* picture of what managers do, but it may not provide a clear idea of the *specific* activities managers are involved in. The answer to the question, "What do managers actually do?" is that they play a variety of roles. The work of Henry Mintzberg of McGill University illustrates the roles approach to management. In a now-classic work, Mintzberg conducted a detailed study of the work of five chief executive officers and found that (1) they worked at an unrelenting pace; (2) their activities were characterized by brevity, variety, and fragmentation; (3) they preferred "live" action and emphasized work activities that were current, specific, and well defined; and (4) they were attracted to verbal media.[14]

Mintzberg believes that a manager's job can be described as ten roles (in three general categories) that must be performed. The manager's formal authority and status give rise to three *interpersonal roles*: (1) figurehead (duties of a ceremonial nature, such as attending a subordinate's wedding), (2) leader (being responsible for the work of the unit), and (3) liaison (making contact outside the vertical chain of command). These interpersonal roles give rise to three *informational roles*: (1) monitor (scanning the environment for relevant information), (2) disseminator (passing information to subordinates), and (3) spokesperson (sending information to people outside the unit).

The interpersonal and informational roles allow the manager to carry out four *decision-making roles*: (1) entrepreneur (improving the performance of the unit), (2) disturbance handler (responding to high-pressure disturbances, such as a strike at a supplier), (3) resource allocator (deciding who will get what in the unit), and (4) negotiator (working out agreements on a wide variety of issues, such as the amount of authority an individual will be given).

Managers play a variety of important roles. One key interpersonal role is that of figurehead, for example, attending a ribbon cutting ceremony for the opening of a new business.

Ryan Miller/Getty Images Entertainment/Getty Images

Management Skills

Effective managers must have several skills, including technical, human relations, conceptual, time management, and decision-making skills.

Technical Skills

Technical skills allow managers to perform specialized tasks. A secretary's ability to type, an animator's ability to draw a cartoon, and an accountant's ability to audit a company's records are all technical skills. People develop their technical skills through education and experience. The secretary, for example, probably took an office systems technology course and has had many hours of practice both on and off the job. The animator may have had training in an art school and probably learned a great deal from experienced animators on the job. The accountant earned a university degree and a professional certification.

It has become increasingly important for managers to develop certain technology skills, especially with respect to communicating and interacting with others in the organization. Managers are confronted with vast amounts of information, but new forms of technology have enabled managers to efficiently process this information and decide what is useful and what is not. Technology has also changed the shape of the corporate structure. Elaborate networks now control the flow of information in organizations, and the formerly simple up and down flow has been replaced by lateral flows that keep far more people informed. This allows decisions to be made more quickly, and more people are involved. With email and videoconferencing, neither time nor distance nor corporate departments and divisions can prevent people from working together closely. The effect of technology on business is discussed in more detail in Appendix 4 at the end of the book.

As Figure 6.3 shows, technical skills are especially important for first-line managers. Most first-line managers spend considerable time helping employees solve work-related problems, monitoring their performance, and training them in more efficient work procedures. They need a basic understanding of the jobs they supervise. As a manager moves up the corporate ladder, however, technical skills become less and less important. Top managers, for example, often need only a general familiarity with the mechanics of basic tasks performed within the company. A top manager at Disney, for example, probably can't draw Mickey Mouse or build a ride for Disney World.

TECHNICAL SKILLS Skills associated with performing specialized tasks within a firm.

HUMAN RELATIONS SKILLS Skills in understanding and getting along with people.

Human Relations Skills

Human relations skills help managers lead, motivate, communicate with, and get along with their subordinates. Managers with poor human relations skills will likely have conflicts with subordinates, cause valuable employees to quit or transfer, and contribute to poor morale. Figure 6.3 shows that human relations skills are important at all levels of management. This is true because all managers in the hierarchy act as "bridges" between their bosses, their subordinates, and other managers at the same level in the hierarchy. A study by DDI Canada found that the top reason for managerial failure was poor people skills,[15] and a study by Google found that technical expertise ranked last among a list of eight "Habits of Highly Effective Google Managers." At the top of the list were even-tempered bosses who made time for one-on-one meetings and who helped subordinates work through problems.[16] Rob Quinn, a partner at the executive search firm Odgers Berndtson, says that to be successful, managers must have good self-awareness, have superb written and verbal communication skills, and be critical thinkers—all of which are so-called "soft" skills, not technical skills.[17]

To improve their insight into employee needs and company operations, some managers work temporarily alongside lower-level employees. For example, the CEO of ING Direct sits beside call centre agents and personally answers caller inquiries.[18] When the CEO of 7-Eleven (Joseph DePinto) worked undercover at a 7-Eleven outlet, he discovered how hard the people worked and why the location was selling so much coffee. Larry O'Donnell, the CEO of Waste Management, did jobs like sorting trash, picking up paper at a landfill, and cleaning portable toilets. The experience taught him the pressure for production that employees had to cope with, and he introduced changes based on what he had learned.[19]

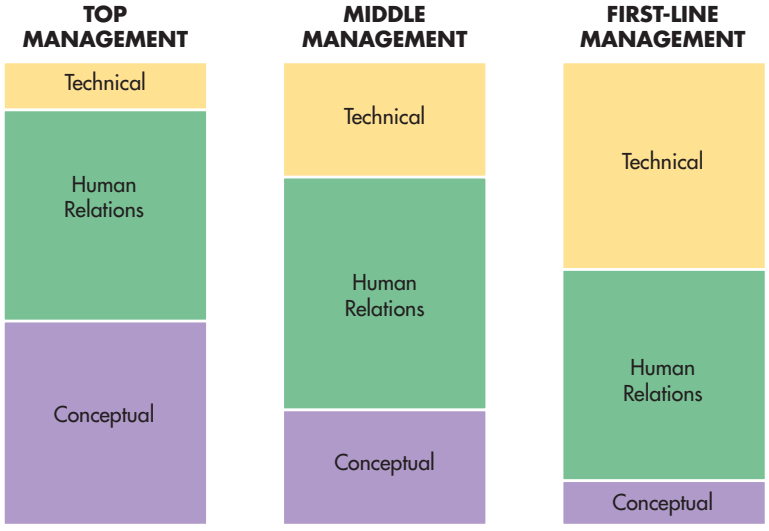


FIGURE 6.3 Different levels in an organization require different combinations of managerial skills

Conceptual Skills

Conceptual skills refer to a person's ability to think in the abstract, to diagnose and analyze various situations, and to see beyond the present situation. Conceptual skills help managers recognize new market opportunities and threats. For example, in e-commerce businesses, conceptual skills help managers foresee how a particular business application will be affected by, or can be translated to, the Internet. Figure 6.3 shows that top managers depend mostly on conceptual skills, and first-line managers least, but that some conceptual skills are needed in almost any management job.

Time Management Skills

Time management skills refer to the productive use that managers make of their time. Effective time management is particularly important for highly paid top managers. For example, in 2014, the total compensation paid to Steven Williams, the CEO of Suncor Energy, was $12.8 million.[20] Assuming that he worked 50 hours a week and took two weeks' vacation, Williams earned about $5120 per hour, or about $85 per minute. Any time that he wastes represents a large cost to Suncor and its shareholders.

To manage time effectively, managers must address four leading causes of wasted time:

- *Paperwork.* Some managers spend too much time deciding what to do with letters and reports. Most documents of this sort are routine and can be handled quickly. Managers must learn to recognize those documents that require more attention.
- *The telephone.* Experts estimate that managers are interrupted by the telephone every five minutes. To manage time more effectively, they suggest having a secretary screen all calls and setting aside a certain block of time each day to return the important ones.
- *Meetings.* Many managers spend as much as four hours per day in meetings. To help keep this time productive, the person handling the meeting should specify a clear agenda, start on time, keep everyone focused on the agenda, and end on time.
- *Email.* With the introduction of devices like the BlackBerry, managers are relying more heavily on email and other forms of electronic communication. But many email messages are not important, and some are downright trivial. As the number of electronic messages grows, the potential time wasted also increases.

Decision-Making Skills

Decision-making skills help managers define problems or opportunities and select the best course of action. Decision making is a critical management skill because it affects all functions of management. Managers must deal with three basic decision characteristics. First, managers must make both *problem decisions* (there is a specific problem that must be resolved) and *opportunity decisions* (there is no specific problem but rather an opportunity presents itself).

Second, the decisions that managers make are either *programmed decisions* (those that are made frequently and are highly structured) or *non-programmed decisions* (those that are made infrequently and are poorly structured).

Third, managers make decisions under several different risk conditions. In the condition of *certainty*, the manager knows what alternatives are available and what conditions are associated with each alternative. For example, when Singapore Airlines decides to buy new jumbo jets, it knows that only two alternatives exist (Boeing and Airbus), and it knows the price of each plane. In the condition of *risk*, the alternatives may be known, but their costs are probabilities rather than certainties. For example, when a labour negotiator receives a "final" offer from the union before a strike deadline, the two alternatives are to accept or reject the offer. If the company accepts the offer, a strike will be avoided, but perhaps the company will find that it has accepted a deal that is very costly. If the offer is rejected, a strike may occur, but the company may eventually be able to get a deal that is less costly. In the condition of *uncertainty*, the manager does not know all of the possible alternatives or outcomes associated with each alternative. For example, a company that wants to manufacture a new product may not know how many different manufacturing technologies (if any) will work, nor the costs associated with each.

Table 6.2 shows the steps in the rational decision-making process. The key elements of each step are described below.

Recognizing and Defining the Decision Situation The first step in rational decision making is recognizing that a decision is necessary. There must be some stimulus or spark to initiate this process. For example, when equipment malfunctions, managers must decide whether to repair or replace it. The stimulus for a decision may be either a problem or an opportunity. A manager facing cost overruns on a project is faced with a problem decision, whereas a manager trying to decide how to invest surplus funds is faced with an opportunity decision.

Understanding precisely what the problem or opportunity is comes from careful analysis and thoughtful consideration of the situation. Consider the international air travel industry. Because of the growth of international travel related to business, education, and tourism, global carriers such as Singapore Airlines, KLM, JAL, British Airways, and American Airlines need to increase their capacity for international travel. Because most major international airports are already operating at or near capacity, adding a significant number of new flights to existing schedules is not feasible. As a result, the most logical alternative is to increase capacity on existing flights. Thus, Boeing and Airbus, the world's only manufacturers of large commercial aircraft, recognized an important opportunity and defined their decision situation as how best to respond to the need for increased global travel capacity.[21]

Identifying Alternatives After the need for a decision has been recognized and defined, the second step is to identify possible alternative courses of effective action. In general, the more important the decision, the more attention is directed to developing alternatives. If the decision involves a multimillion-dollar relocation, a great deal of time and expertise should be devoted to identifying alternatives, but if the decision involves choosing a name for the company softball team, far fewer resources should be devoted to the task (although there might be a lot of arguing about what the name should be!).

Managers must accept that factors such as legal restrictions, moral and ethical norms, and available technology can limit their alternatives. For example, after assessing the question of how to increase international airline capacity, Boeing and Airbus identified three alternatives: they could independently develop new large planes, they could collaborate in a joint

CONCEPTUAL SKILLS Ability to think in the abstract, diagnose and analyze various situations, and see beyond the present situation.

TIME MANAGEMENT SKILLS Skills associated with the productive use of time.

DECISION-MAKING SKILLS Skills in defining problems and selecting the best courses of action.

>>> TABLE 6.2 Steps in the rational decision-making process

	Step	Details	Example
1.	Recognizing and defining the decision situation	Some stimulus indicates that a decision must be made. The stimulus may be positive or negative.	The plant manager sees that employee turnover has increased by 5 percent.
2.	Identifying alternatives	Both obvious and creative alternatives are desired. In general, the more important the decision, the more alternatives should be generated.	The plant manager can increase wages, increase benefits, or change hiring standards.
3.	Evaluating alternatives	Each alternative is evaluated to determine its feasibility, its satisfactoriness, and its consequences.	Increasing benefits may not be feasible. Increasing wages and changing hiring standards may satisfy all conditions.
4.	Selecting the best alternative	Consider all situational factors and choose the alternative that best fits the manager's situation.	Changing hiring standards will take an extended period of time to cut turnover, so increase wages.
5.	Implementing the chosen alternative	The chosen alternative is implemented into the organizational system.	The plant manager may need permission from corporate headquarters. The human resource department establishes a new wage structure.
6.	Following up and evaluating the results	At some time in the future, the manager should ascertain the extent to which the alternative chosen in Step 4 and implemented in Step 5 has worked.	The plant manager notes that six months later, turnover dropped to its previous level.

venture to create a single new large plane, or they could modify their largest existing planes to increase capacity.

Evaluating Alternatives After alternatives are identified, they must be thoroughly evaluated to increase the chance that the chosen alternative will be successful. Some alternatives may not be feasible because of legal or financial barriers. Limited human, material, and information resources may make other alternatives impractical. During its analysis of alternatives, Airbus concluded that it would be at a disadvantage if it tried to simply enlarge its existing planes, because the competitive Boeing 747 was already the largest aircraft being made and could be readily expanded. Boeing was concerned about the risk inherent in building a new and even larger plane, even if it shared the risk with Airbus as a joint venture.

Selecting the Best Alternative Choosing the best available alternative is a key activity in decision making. Even though many situations do not lend themselves to objective mathematical analysis, managers can often develop subjective estimates for choosing an alternative. Decision makers should also remember that finding multiple acceptable alternatives may be possible, so selecting just one alternative and rejecting all the others might not be necessary. For example, Airbus proposed a joint venture with Boeing, but Boeing decided that its best course of action was to modify its existing 747 to increase its capacity. Airbus then decided to proceed on its own to develop and manufacture a new jumbo jet called the A380. Meanwhile, Boeing decided that, in addition to modifying its 747, it would also develop a new plane (the 787).

Implementing the Chosen Alternative After an alternative has been selected, managers must implement it. Boeing implemented its chosen alternative by setting its engineers to work on expanding the capacity of its existing 747 by adding 30 feet to the plane's body. Airbus engineers developed design concepts for a new jumbo jet equipped with escalators and elevators and capable of carrying 655 passengers. Airbus's development costs were estimated to exceed $12 billion.

One of the key considerations during implementation is employee resistance to change. The reasons for such resistance include insecurity, inconvenience, and fear of the unknown. Managers must also recognize that even when all alternatives have been evaluated as precisely as possible and the consequences of each alternative have been weighed, unanticipated consequences are still likely. For example, both Boeing and Airbus experienced unexpected delays in bringing their new planes to market.

Following Up and Evaluating the Results The final step in the decision-making process requires managers to evaluate the effectiveness of their decision—that is, they should make sure that the chosen alternative served its original purpose. If an implemented alternative appears not to be working, they can respond in several ways. Another previously identified alternative (e.g., the original second or third choice) could be adopted. Or they might recognize that the situation was not correctly defined to begin with and start the process all over again. Or they might decide that the original alternative was in fact appropriate but either has not yet had time to work or should be implemented in a different way.

Both Boeing and Airbus had difficulties with their decisions during follow-up. The Airbus A380 made its first commercial flight almost a decade ago, but delays pushed back its production schedule. The plane has also been hampered by technical problems. Boeing's expanded 747 was launched on schedule, but its 787 Dreamliner experienced numerous delays as well as some serious technical problems. For example, its lithium-ion batteries sometimes started fires during flights, and the plane was grounded by the U.S. Federal Aviation Administration for several months in 2013.[22]

Behavioural Aspects of Decision Making

Most managers try to be logical when they make decisions. But even when they try, they may not succeed. When Starbucks opened its first coffee shops in New York, it relied on scientific marketing research, taste tests, and rational deliberation in making a decision to emphasize drip over espresso coffee. However, that decision proved wrong when it became clear that New Yorkers strongly preferred the same espresso-style coffees that were Starbucks' mainstays in the west. Thus, the firm had to reconfigure its stores hastily to meet customer preferences.

To complicate matters, non-logical and emotional factors often influence managerial decision making. These factors include *organizational politics*, *intuition*, *escalation of commitment*, and *risk propensity*.

Organizational Politics The term *organizational politics* refers to the actions that people take as they try to get what they want. These actions may or may not be beneficial to the organization, but they do influence decision making, particularly if the person taking the action is a powerful manager. A study of 293 Canadian office workers found that 71 percent believed that office politics was at least somewhat necessary in order to get ahead in their organization.[23]

Intuition Managers sometimes decide to do something because they think it "feels right" or they have a "hunch." *Intuition* is usually based on years of experience and practice in making decisions in similar situations. Such an inner sense may actually help managers make an occasional decision without going through a rational sequence of steps. For example, the New York Yankees once contacted three major sneaker manufacturers—Nike, Reebok, and Adidas—and informed them that they were interested in signing a sponsorship deal. While Nike and Reebok were carefully and rationally assessing the possibilities, managers at Adidas quickly responded to the idea and ended up hammering out a contract while the competitors were still analyzing details.[24] These occasional successes can be very dramatic, but they should not cause managers to rely too heavily on intuition.

Escalation of Commitment When a manager makes a decision and then remains committed to its implementation in spite of clear evidence that it was a bad decision, *escalation of commitment* has occurred.[25] A good example of this is Expo 86, the world's fair held in British Columbia. When the project was first conceived, the deficit was projected at about $56 million. Over the next few years, the projected deficit kept rising until it was over $300 million. In spite of that, the project went forward.

Managers can avoid such overcommitment by setting specific goals ahead of time regarding the time and money they are willing to spend on a given project. This makes it harder for managers to interpret unfavourable news in a positive light.

Risk Propensity *Risk propensity* refers to how much a manager is willing to gamble when making decisions. Managers who are very cautious when making decisions are more likely to avoid mistakes, and they are unlikely to make decisions that lead to big losses (or big gains). Other managers are extremely aggressive in making decisions and are willing to take risks.[26] They rely heavily on intuition, reach decisions quickly, and often risk big money on their decisions. These managers are more likely than their conservative counterparts to achieve big successes, but they are also more likely to incur greater losses.[27] The organization's culture is a prime ingredient in fostering different levels of risk propensity.

LO-4 STRATEGIC MANAGEMENT

Strategic management is the process of effectively aligning an organization with its external environment. The starting point in strategic management is setting **goals** that a business wants to achieve. Every business needs goals. Remember, however, that deciding what it intends to do is only the first step for an organization. Managers must also make decisions about what actions will and will not achieve company goals. Decisions cannot be made on a problem-by-problem basis or merely to meet needs as they arise. In most companies, a broad program underlies those decisions. That program is called a **strategy**—the broad set of organizational plans for implementing the decisions made for achieving organizational goals.

Setting Business Goals

Goals are performance targets, the means by which organizations and their managers measure success or failure at every level. They indicate *what* results are desired, in contrast to plans, which indicate *how* these goals are to be achieved. Managers must understand the purposes of goal setting and the kinds of goals that need to be set.

The Purposes of Goal Setting

There are four main purposes in organizational goal setting:

- *Goal setting provides direction, guidance, and motivation for all managers.* Edmonton-based Fluid Life, which helps industrial clients keep their equipment running, set a goal to help its customers save $250 million by 2025.[28]
- *Goal setting helps firms allocate resources.* 3M allocates more resources to new projects with large sales potential than it allocates to mature products with low growth potential.
- *Goal setting helps to define corporate culture.* General Electric's goal is to have each of its divisions be #1 or #2 in its industry. The result is a competitive corporate culture that rewards success and has little tolerance for failure.
- *Goal setting helps managers assess performance.* The North American standard for container "dwell time" (the time containers sit on a dock) is three days. At Port Metro Vancouver, the dwell time was formerly 3.7 days, but now it has been reduced to 2.5 days.[29]

In addition to the traditional profit and performance goals like those described above, organizations are increasingly setting "green" goals to improve their performance with respect to sustainability and environmental protection. For example, Scotiabank set a goal to be in the top 10 percent

STRATEGIC MANAGEMENT The process of helping an organization maintain an effective alignment with its environment.

GOALS Objectives that a business plans to attain.

STRATEGY The broad set of organizational plans for implementing the decisions made for achieving organizational goals.

of the companies listed on the Dow Jones Sustainability World Index. Coca-Cola's goal is to recycle, by 2030, the equivalent of all the packaging it produces.[30] The province of Ontario has set a goal to have an electric vehicle in every multi-vehicle driveway in the province by 2026.[31]

Goal setting is effective for individuals as well as organizations. For example, when students set goals, they achieve higher grades, lower their chance for dropping out of school, and experience greater well-being as adults. Unfortunately, less than half of the students aged 10 to 18 are aggressively pursuing goals.[32]

Kinds of Goals

Goals differ from company to company, depending on the firm's vision and mission. Every organization has a **vision** (or **purpose**) that indicates why it exists and what kind of organization it wants to be. For example, businesses seek profit, universities discover and transmit new knowledge, and government agencies provide services to the public. Most organizations also have a **mission statement**—a statement of how they will achieve their purpose. A mission indicates *what* an organization intends to do, whereas a purpose indicates *why* it is being done.[33]

Atco Ltd.'s mission is to provide products and services to the energy and resource industries and to invest in energy-related assets in North America. Facebook's mission is to give people the power to share and make the world more open and connected.[34] CEO Mark Zuckerberg consistently mentions the company's mission in his speeches and interviews, and he is very disciplined as he pursues the mission.

Two business firms can have the same vision—for example, to sell watches at a profit—yet have very different missions. Timex sells low-cost, reliable watches in outlets ranging from department stores to corner drugstores. Rolex, on the other hand, sells high-quality, high-priced fashion watches through selected jewellery stores. Regardless of a company's purpose and mission, it must set long-term, intermediate, and short-term goals.

- *Long-term goals* relate to extended periods of time—typically five years or more into the future. American Express, for example, might set a long-term goal of doubling the number of participating merchants during the next 10 years.
- *Intermediate goals* are set for a period of one to five years into the future. When Kazuo Hirai became CEO of Sony in 2012, he was determined to improve the performance of the consumer electronics company. He therefore set a sales target of US$105 billion for the division that makes medical equipment and electric car batteries. The goal was to be achieved in two years. He also set a goal to triple revenue in the mobile phone division.[35]
- Like intermediate goals, *short-term goals*—which are set for one year or less—are developed for several different areas. Increasing sales by 2 percent this year, cutting costs by 1 percent next quarter, and reducing turnover by 4 percent over the next six months are all short-term goals.

Whatever the time frame of the goals set, research shows that managers who set **SMART goals** (goals that are Specific, Measurable, Achievable, Results-oriented, and Time-framed) have higher performance than managers who don't.

Formulating Strategy

After a firm has set its goals, it must develop a strategy for achieving them. In contrast to planning, strategy is wider in scope and is a broad program that describes how a business intends to meet its goals, how it will respond to new challenges, and how it will meet new needs. For example, Brookfield Asset Management's strategy is to buy high-quality assets at less than replacement cost.[36] **Strategy formulation** involves three basic steps: (1) setting strategic goals, (2) analyzing the organization and its environment, and (3) matching the organization and its environment (see Figure 6.4).

Step 1: Setting Strategic Goals

Strategic goals are long-term goals that are derived directly from the firm's mission statement. For example, Disney continually focuses on expanding its dominance of the family entertainment industry by investing in its existing properties (it expanded its theme parks in Orlando in 2017 and 2018), and by opening new theme parks (a new theme park was

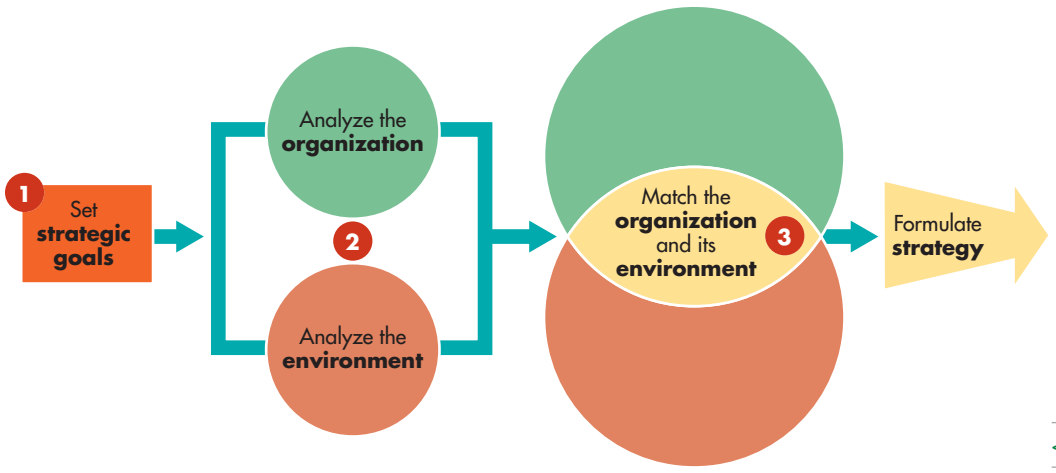
VISION (OR PURPOSE) A statement indicating why an organization exists and what kind of organization it wants to be.

MISSION STATEMENT An organization's statement of how it will achieve its purpose in the environment in which it conducts its business.

SMART GOALS Goals that are Specific, Measurable, Achievable, Results-oriented, and Time-framed.

STRATEGY FORMULATION Creation of a broad program for defining and meeting an organization's goals.

STRATEGIC GOALS Long-term goals derived directly from the firm's mission statement.



<<< FIGURE 6.4 Strategy formulation

opened in Shanghai in 2016). Disney has also made a number of strategic acquisitions, including Pixar, Marvel, and Lucas Films. Each of these initiatives has helped the company increase its revenues and profits. A negative example is the Dieselgate fiasco at Volkswagen (see Business Case 3 in Chapter 3), which caused the company to reconsider its strategic goals.

Step 2: Analyzing The Organization and Its Environment

After strategic goals have been set, managers assess both their organization and its environment using a **SWOT analysis**. This involves identifying organizational Strengths and Weaknesses, and identifying environmental Opportunities and Threats. Strengths and weaknesses are factors internal to the firm and are assessed using *organizational analysis*. Strengths might include surplus cash, a dedicated workforce, an ample supply of managerial talent and technical expertise. For example, Pepsi's strength in beverage distribution through its network of soft-drink distributors was successfully extended to distribution of its Aquafina brand of bottled water. Weaknesses might include a cash shortage, aging factories, and a poor public image. Garden.com's reliance on the Internet-based e-tailing model was its downfall when the dot-com bubble burst.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. **McKinsey Insights App** **Source:** McKinsey and Company **Key Features:** Provides the latest thinking on the biggest issues facing senior executives, everything from leadership and corporate strategy to globalization and technology's impact on business and society.	Apple, Android and Windows
2. **SWOT Canvas App** **Source:** Chanat Attopakorn **Key Features:** Allows you to conduct a SWOT analysis on your phone.	Apple and Windows
3. **Goal Tracker: GoalsOnTrack App** **Source:** Goal Software for High Achievers **Key Features:** Helps users develop and reach goals based on the SMART goal setting approach (specific, measurable, achievable, relevant, and time-framed).	Apple and Android

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" management apps and identify the key features.

Opportunities and threats are factors external to the firm and are assessed using *environmental analysis*. Opportunities include, for example, market demand for new products, favourable government legislation, or shortages of a raw material that a company requires. For example, when Pepsi managers recognized a market opportunity for bottled water, they moved quickly to launch their Aquafina brand and position it for rapid growth. Threats include new products developed by competitors, unfavourable government regulations, and changes in consumer tastes. For example, online music services such as iTunes dramatically reduced consumer demand for CDs and CD players. Now, however, streaming music services such as Spotify and SoundCloud have emerged as threats to iTunes. Likewise, the emergence of digital photography dramatically weakened companies tied to print photography. The Province of Ontario introduced a new law that reduced the revenue pharmacies received for dispensing prescription drugs. Some external threats are unpredictable, like the volcanic eruption in Iceland a few years ago that halted air travel in Europe for a week. Commercial airlines lost hundreds of millions of dollars of revenue, while alternative service providers like trains saw demand for their services soar.

Step 3: Matching The Organization and Its Environment

The final step in strategy formulation is matching environmental threats and opportunities with corporate strengths and weaknesses. Matching companies with their environments lays the foundation for successfully planning and conducting business. A firm should attempt to leverage its strengths so as to capitalize on opportunities and counteract threats. It should also attempt to shield its weaknesses, or at least not allow them to derail other activities. For example, knowing how to distribute consumer products (a strength) allows Pepsi to add new businesses and extend existing ones that use the same distribution models. But a firm that lacks a strong understanding of consumer product distribution would be foolish to add new products whose success relies on efficient distribution. Just because two companies are in the same industry does not mean they will use the same strategies. The Toronto-Dominion Bank, for example, aggressively expanded into the U.S. retail banking industry by acquiring U.S. banks, but the Royal Bank of Canada has been much less aggressive in this area.[37]

Understanding strengths and weaknesses may also determine whether a firm takes risks or behaves more conservatively. Either approach can be successful. For example, Google's reputation as an innovator, its cadre of creative product designers and engineers, and its strong cash reserves all allow the firm to constantly look for new product ideas and quickly test them in the marketplace. But Apple, which has many of the same strengths, is more deliberate in rolling out new products because its products require longer design and manufacturing cycles and, in most cases, more financial investment.

Some Strategy Realities: Sobeys In 2013, Sobeys acquired rival Safeway. At the time, industry observers thought it was a good strategic decision that would create greater efficiencies and give Sobeys a national footprint. But it's one thing to formulate a strategy, and quite another to successfully implement it. Sobeys integration of Safeway into its business was messy, and consumers complained about higher prices and out-of-stock situations for products they wanted to buy. A loyalty program at Safeway was also terminated, and some Safeway house brands were replaced with Sobeys-branded goods. Safeway customers were unhappy, and the resulting decline in sales led to a nearly $1 billion loss in a single quarter for Sobeys. The stock price also dropped 22 percent in 2016. As a result, the CEO was removed; the new CEO pledged to get the company back on track. "Project Sunrise," which was instituted in May 2017, involved integrating regional corporate structures into the national structure, taking advantage of economies of scale, winning back lost customers, and introducing measures to increase productivity. By late 2017, sales were once again rising, as was the price of the company's stock.

SWOT ANALYSIS Identification and analysis of organizational strengths and weaknesses and environmental opportunities and threats as part of strategy formulation.

But Sobey's competitors then introduced various aggressive marketing promotions in an attempt to increase their own market share, so Sobey's will have to continue to work hard to achieve its strategic goals.[38]

A Hierarchy of Plans

In the most general terms, the three-step strategy formulation process requires a hierarchy of plans on three different levels. Each level reflects plans for which managers at that level are responsible. These levels constitute a hierarchy because implementing plans is practical only when there is a logical flow from one level to the next. **Strategic plans** reflect decisions about resource allocations, company priorities, and the steps needed to meet strategic goals and are usually set by top management. In 2010, Maple Leaf Foods developed a five-year strategic plan designed to increase its earnings by more than 75 percent by 2015.[39] **Tactical plans** are shorter-range ones concerned with implementing specific aspects of the company's strategic plan; they typically involve upper and middle management. Coca-Cola's decision to increase sales in Europe by building European bottling facilities is an example of tactical planning. **Operational plans**, developed by middle and lower-level managers, set short-term targets for daily, weekly, or monthly performance. McDonald's, for example, establishes operational plans when it explains precisely how Big Macs are to be cooked, warmed, and served.

Levels of Strategy

There are three levels of strategy in a business firm (see Figure 6.5). A **corporate-level strategy** identifies the various businesses a company will be in and how they will relate to each other. A **business-level (competitive) strategy** identifies the ways a business will compete in its chosen line of products or services. **Functional strategies** identify the basic courses of action each department will pursue so that it contributes to the business's overall goals.

Corporate-Level Strategies

A company might pursue any of several different corporate-level strategies: concentration, growth, integration, diversification, and investment reduction.

Concentration A *concentration strategy* involves focusing the company on one product or product line that it knows very well. Organizations that have successfully pursued a concentration strategy include McDonald's and Canadian National Railway.

STRATEGIC PLANS Plans that reflect decisions about resource allocations, company priorities, and steps needed to meet strategic goals.

TACTICAL PLANS Generally, short-range plans concerned with implementing specific aspects of a company's strategic plans.

OPERATIONAL PLANS Plans setting short-term targets for daily, weekly, or monthly performance.

CORPORATE-LEVEL STRATEGY Identifies the various businesses a company will be in and how the businesses will relate to each other.

BUSINESS-LEVEL (COMPETITIVE) STRATEGY Identifies the ways a business will compete in its chosen line of products or services.

FUNCTIONAL STRATEGIES Identifies the basic courses of action each department in the firm will pursue so that it contributes to the business's overall goals.

FIGURE 6.5 Hierarchy of strategy

Based on Thomas L. Wheelen and J. David Hunger, *Strategic Management and Business Policy*, 8th ed. (Upper Saddle River, NJ: Prentice Hall, 2002), 14.

Growth Companies have several growth strategies available to them, including *market penetration* (boosting sales of present products by more aggressive selling in the firm's current markets), *geographic expansion* (expanding operations into new geographic areas), and *product development* (developing improved products for current markets). These three strategies focus on internal activities that will result in growth.

Integration There are two basic integration strategies. *Horizontal integration* means acquiring control of competitors in the same or similar markets with the same or similar products. For example, Hudson's Bay owns Home Outfitters (Déco Découverte in Quebec). Bauer Performance Sports Ltd., famous for its hockey sticks, is growing by acquiring other sport-related companies such as Easton, which makes baseballs.[40] *Vertical integration* means owning or controlling the inputs to the firm's processes and/or the channels through which the products or services are distributed. Oil companies such as Shell not only drill and produce their own oil but also sell it through company-controlled outlets across Canada. These two strategies focus on external activities that will result in growth.

Diversification *Diversification* helps the firm avoid the problem of having all of its eggs in one basket by spreading risk among several products or markets. *Related diversification* means adding new but related products or services to an existing business. For example, Maple Leaf Gardens Ltd., which already owned the Toronto Maple Leafs, acquired the Toronto Raptors basketball team. *Conglomerate diversification* means diversifying into products or markets that are not related to the firm's present businesses. Under legendary CEO Jack Welch, General Electric was an extremely successful company. But it was a collection of many different businesses, and the "conglomerate" approach has fallen out of favour with investors. As a result, the total value of GE's stock has declined by about $100 billion during the past few years, and the current CEO is trying to regain the trust of investors by "de-conglomerating" the company.[41] Some observers wonder if GE will go the way of Eastman Kodak, the legendary leader for many years in the film-based photography business. It fell on hard times when digital cameras were introduced and eventually declared bankruptcy.[42]

Investment Reduction *Investment reduction* means reducing the company's investment in one or more of its lines of business. One investment-reduction strategy is *retrenchment*, which means the reduction of activity or operations. One of the most famous examples of retrenchment occurred in 2015 when Target withdrew from the Canadian market after failing to attract enough customers to its retail stores.[43] *Divestment* involves selling or liquidating one or more of a firm's businesses. For example, BCE sold its Yellow Pages and White Pages for $4 billion.

Business-Level (Competitive) Strategies

Whatever corporate-level strategy a firm decides on, it must also have a competitive strategy. A **competitive strategy** is a plan to establish a profitable and sustainable competitive position.[44] Michael Porter identifies three competitive strategies. *Cost leadership* means becoming the low-cost leader in an industry. Walmart is the best-known industry cost leader. Montreal-based Gildan Activewear is dedicated to achieving the lowest possible costs in producing its T-shirts.[45] A firm using a *differentiation strategy* tries to be unique in its industry along some dimension that is valued by buyers. For example, Caterpillar emphasizes durability, Volvo safety, Apple user-friendly products, and Mercedes-Benz quality. A *focus strategy* means selecting a market segment and serving the customers in that market niche better than competitors. Before it was acquired by Nexfor, Fraser Inc. focused on producing the high-quality, durable, lightweight paper used in bibles.

Functional Strategies

Each business's choice of a competitive strategy (cost leadership, differentiation, or focus) is translated into supporting functional strategies for each of its departments to pursue. A functional strategy is the basic course of action that each department follows so that the business accomplishes its overall goals. To implement its cost-leadership strategy, for example, Walmart's distribution department pursued a functional strategy of satellite-based warehousing that ultimately drove distribution costs below those of its competitors.

LO-5 CONTINGENCY PLANNING AND CRISIS MANAGEMENT

Business environments are often difficult to predict because unexpected events may occur. Two common methods of dealing with the unforeseen are *contingency planning* and *crisis management*.

Contingency Planning

Contingency planning means identifying in advance changes that might occur that would affect a business and developing a plan to respond to such changes. For example, airlines know that snowstorms at, say, Toronto's Pearson International Airport are likely, so they develop contingency plans for coping with that eventuality. These plans typically involve rescheduling flights into neighbouring airports and providing passengers with ground transportation into Toronto. Assessing the costs and benefits of these and other options ahead of time helps managers cope with problems when they arise. This sounds like a good idea, but sometimes it can be hard to put into practice. For example, in January 2014, ice and cold weather forced the closure of Pearson International. This resulted in major flight delays and inconvenienced thousands of passengers.[46]

Crisis Management

Crisis management means dealing with an emergency that demands an immediate response. The emergency may be self-inflicted (like the Dieselgate crisis at Volkswagen), or it may be imposed by forces outside the company's control (an ice storm that damages a company's ability to operate). Crisis management plans outline who will be in charge in different kinds of circumstances, how the organization will respond, and the plans that exist for assembling and deploying crisis management teams.

Business crises are more common than you might think. Consider these examples:

- In 2014, Malaysian Airlines faced a crisis when one of its flights simply disappeared from radar and was never heard from again.
- In 2018, Starbucks faced a crisis when two black men were arrested in a Starbucks store while they were simply waiting for a friend. CEO Kevin Johnson met with the two men and apologized, and Starbucks announced it was closing all of its stores for one afternoon to have diversity training for its employees.
- In 2010, BP faced a crisis when an explosion at a drilling rig in the Gulf of Mexico resulted in the death of 11 workers and caused a huge oil spill.
- In 2008, Maple Leaf Foods faced a crisis when tainted meat was discovered at one of its processing plants. Maple Leaf quickly recalled 686 000 kilograms of meat (an action that cost the company $19 million).

The boxed insert entitled "When Disaster Strikes" explains the increasing importance of contingency planning and crisis management in order to deal with cyberattacks.

COMPETITIVE STRATEGY A plan to establish a profitable and sustainable competitive position.

CONTINGENCY PLANNING Identifying aspects of a business or its environment that might require changes in strategy.

CRISIS MANAGEMENT An organization's methods for dealing with emergencies.

DISRUPTIONS IN BUSINESS

When Disaster Strikes

Matejmo/iStock/Getty Images

From exploding Samsung smartphones to Volkswagen fraud, companies have experienced their share of self-inflicted bungles in recent years. But sometimes crises arise from external events—fires, floods, earthquakes, network failure, and data loss—that a company has little control over. A good strategic plan includes both contingency planning and a crisis management plan that helps a company recover from these externally imposed disasters.

In recent years, network failures and data loss have become all too common. In October 2016, for example, major websites such as Twitter, Netflix, Spotify, and Airbnb were shut down by a cyberattack on Dyn, a company whose servers monitor and reroute Internet traffic. Dyn is one of many hosts for the Domain Name System (DNS), which translates user-friendly web addresses like Amazon.com into numerical addresses. Without the DNS servers operated by Internet service providers, the Internet could not function.

The attack on Dyn was a distributed Denial-of-Service (DoS) attack on hundreds of thousands of Internet-connected devices like cameras, baby monitors, and home routers. All were infected with malware to flood the company servers with traffic until it collapsed under the load. Such attacks are not only becoming more common, but are also more powerful, more sophisticated, and increasingly aimed at core Internet infrastructure providers.

Security researchers have long warned that the increasing number of devices being hooked up to the Internet would present an enormous security issue. In this case, the attack was on the Dyn infrastructure that supports Internet connections. Although the attack did not affect the websites themselves, it blocked or slowed users who were trying to gain access to the sites.

Because of these attacks, many companies are pushing at least parts of their infrastructure to cloud computing networks because that decentralizes their system and makes them harder to attack. But that doesn't guarantee that there will be no problems. In March 2017, Amazon's web servers, the largest and most secure in the world, suffered an hours-long outage that affected Internet functionality across the world. The cause? A typo in a coding update. The giant S3 storage system had grown beyond Amazon's capacity to serve, and a single innocuous command issued during a routine debugging attempt caused a series of cascading failures that shut down the cloud storage service for hours, creating millions of dollars of costly business disruption.

CRITICAL THINKING QUESTIONS

1. What is the difference between contingency planning and crisis management? Briefly describe a problem that three different businesses have had, as reported in the business section of publications such as the *The Globe and Mail* or the *National Post*. For each problem, explain why either contingency planning or crisis management was useful.
2. Explain how contingency planning and crisis management are relevant for dealing with the problem of cyberattacks.

LO-6 MANAGEMENT AND THE CORPORATE CULTURE

Just as every individual has a unique personality, every company has a unique identity. This is its **corporate culture**—the shared experiences, stories, beliefs, and norms that characterize it. More informally, it is "the way we do things around here." Consider these examples of corporate culture:

- Key elements of Costco's culture include a learning environment, a focus on customer service, employee satisfaction, internal collaboration, and employee training and growth.[47]
- The culture of W.L. Gore (the company that invented the waterproof fabric Gore-Tex) emphasizes innovation. The company recently formed an Innovation Center of Expertise to identify promising employee ideas.[48]
- Google creates a culture of "yes" in order to encourage innovation. Employees focus on what is right with a new idea rather than what is wrong.[49]
- Mountain Equipment Co-op's headquarters in Vancouver reflects its corporate culture. It includes space for yoga and CrossFit classes, a bouldering room, bike lockers, and a view of the mountains.[50]
- The hot pink that is splashed on the walls of PUR Company Inc. (the world's top maker of aspartame-free gum) hints at its fun corporate culture.[51]
- At Interface Inc., the corporate culture emphasizes protection of the environment (see the boxed insert entitled "Mission Zero").

Companies that focus largely on one type of product (e.g., Starbucks Coffee) may have a fairly homogeneous culture throughout the organization. But companies with many different divisions and many different types of customers (e.g., the Royal Bank of Canada) are likely to have several different subcultures, because the various divisions pursue different goals and because different types of people are found in the different divisions.

A *strong corporate culture* guides everyone to work toward the same goals and helps newcomers learn accepted behaviours. In a strong culture

CORPORATE CULTURE The shared experiences, stories, beliefs, and norms that characterize a firm.

THE GREENING OF BUSINESS

Mission Zero

Nobel Prize-winning economist Milton Friedman once said that the only responsibility that a business has is to make a profit for its owners. That idea has been a guiding force in corporate culture for Canadian and American business firms for many years. However, some business leaders see it differently. Consider Ray Anderson, who founded Interface Inc., the world's largest provider of modular carpet. In 1994, Anderson was asked to speak to a small task force that had been organized to answer questions customers were having about the company's stance on environmental issues. Stymied by the request, he came upon the book *The Ecology of Commerce* by Paul Hawken. It took a position that was the opposite of Friedman's, and it convinced Anderson that our modern industrial system is destroying the planet and that only leaders of industry had the power to change things for the better. Anderson became an outspoken proponent for social responsibility and set Interface on a quest to become 100 percent sustainable by 2020.

As he put it, "I stand convicted by me, myself alone, not by anyone else, as a plunderer of the earth, but not by our civilization's definition. By our civilization's definition, I'm a captain of industry. In the eyes of many, I'm a kind of modern day hero. But really, the first industrial revolution is flawed; it is not working. It is unsustainable. It is a mistake, and we must move on to another and better industrial revolution and get it right this time."

Rob245/Fotolia

To put Anderson's ideas into practice, Pearson Education. Interface uses life cycle analysis (LCA) to assess its carbon footprint. Between 2008 and 2016, Interface reduced its carbon footprint by 35 percent. Consider some statistics from the company's Belleville, Ontario, location. The plant used to produce 500 000 litres of waste water every month. That problem was solved by eliminating a printing process that used a lot of water (and the company saved $15 000 a month as an added benefit). Carpet remnant waste was reduced from 474 tonnes per year to just 39 tonnes by making some design changes in the product. Several other innovations, such as using smaller motors, reduced the company's utility bills by 70 percent.

Anderson died in 2011, but the corporate culture he established and his vision for the company live on. In 2016, Interface was awarded Best Company at the Ethical Corporation's Responsible Business Awards. As it approaches the achievement of its sustainability goal, the company has adopted a new mission called Climate Take Back, which focuses on driving positive impacts in the world to create a climate fit for life.

CRITICAL THINKING QUESTION

1. Consider the following statement: *When a company focuses too obsessively on its environmental impact, financial performance can decline because managers are not paying enough attention to efficiency and profitability. If financial performance is poor, both investors and employees are harmed.* Do you agree or disagree with this statement? Explain your reasoning.

where financial success is the key issue, newcomers quickly learn that they are expected to work long, hard hours and that the "winner" is the one who brings in the most revenue. But if quality of life is the key issue in the culture, newcomers learn that it's acceptable to balance work and non-work activities. Vancouver entrepreneur Cameron Herold says that a corporate culture should be "more than a business and slightly less than a religion."[52]

At a Small Business Summit sponsored by *The Globe and Mail*, entrepreneurs identified five factors they felt were important in developing a strong corporate culture:[53]

- Create careers, not just jobs (this increases employee motivation and commitment).
- Lead by example (leaders must model the behaviours they desire from employees).
- Give millennials what they want (tailor the workplace to meet employee needs).
- Emphasize the mission (tell employees what the leader's dream is).
- Explicitly tell employees what behaviours are unacceptable.

The issue of corporate culture can become important when two companies with different cultures attempt to merge. For example, the Brazilian mining company Vale and the Swiss miner Glencore Plc discussed merging their nickel assets in Sudbury. But Vale's culture was risk-averse, whereas Glencore's culture was much more risk-seeking, and the merger idea was eventually abandoned.[54] A planned acquisition of Sun Microsystems by IBM also fell through. When rumours of the merger started circulating, a Sun vice president warned there would be a culture clash. He said the staff at Sun were "weirder" than those at IBM. In fact, Sun did have a somewhat radical culture, because it had been pushing open systems like Unix. This contrasted with IBM's more proprietary approach. The talks eventually broke off because the two companies could not agree on terms.[55]

Each year, Waterstone Human Capital conducts in-depth interviews with senior managers at many different Canadian organizations and asks them which public- and private-sector cultures they admire most. The 2017 winners included BMO Financial Group (Toronto), SAP Canada (Vancouver), Duck Unlimited (Stonewall, Manitoba), Travel Alberta (Calgary), and Killam Apartment REIT (Halifax).[56]

Many companies do not systematically monitor their corporate cultures, but Starbucks is one company that does. Once every 18 months, employees fill out a Partner View Survey containing questions that are designed to help the company determine whether it is making progress toward one of its key values—providing a work environment where people treat one another with respect and dignity. The survey is voluntary, but about 90 percent of employees fill it out (on company time). One reason the participation rate is so high is that the company actually pays attention to what employees say in the survey. For example, when one survey showed that employees were not clear about career progression possibilities in the company, Starbucks held career fairs in several Canadian cities where company managers spoke with employees about management opportunities at Starbucks.[57]

Communicating the Culture and Managing Change

Managers must carefully consider the kind of culture they want for their organization and then work to nourish that culture by communicating with everyone who works there. Walmart, for example, assigns veteran managers to lead employees in new territories. The Royal Bank of Canada and Four Seasons Hotels and Resorts also survey their employees to determine how well they are progressing toward their corporate culture goals.[58] At HootSuite, an initiative called #randomcoffee brings employees from different departments together (blind-date style) to get to know each other over a cup of coffee. The company introduced this idea because it had grown quickly and started operations in a dozen offices around the world, and it wanted to ensure that the corporate culture was clear to all employees.[59]

Walter Bibikow/Danita Delimont/Alamy Stock Photo

Sam Walton honed his craft as a retailer at Walton's Five and Dime. He then used his experience to create a unique corporate culture when he founded Walmart.

If a problem arises with a company's products, it may create pressure for change in the company's culture. For example, General Motors recalled 2.6 million cars with bad ignition switches that sometimes shut off the car engine and made it difficult to steer. Accidents that were caused by this problem resulted in the deaths of 13 people. An investigation revealed that the culture at GM (which emphasized cost-cutting) was partly to blame for the problem. Even though fixing the problem would have cost very little money, nothing was done.[60]

Sometimes the culture of an organization can be harmful to the people who work in it. For example, in 2017, a software engineer at Uber tweeted that the company's "toxic" culture encouraged harassment and discrimination against women. She alleged that she had been propositioned by her manager and then undermined by Uber's human resource department. The CEO of Uber, Travis Kalanick and several other executives were eventually removed from their positions.[61]

Communicating The Culture

To use a company's culture to full advantage, its managers must accomplish several tasks, all of which hinge on effective communication. First, managers themselves must have a clear understanding of the culture. Second, they must transmit the culture to others in the organization. Communication is a key aim in training and orienting newcomers. A clear and meaningful statement of the organization's mission is also a valuable communication tool. Finally, managers can maintain the culture by rewarding and promoting those who understand it and work toward maintaining it.

Managing Change

Organizations must sometimes change their cultures. Ontario Hydro, for example, had an "engineering" culture for many years. That meant everything was planned and analyzed down to the last detail before any action was taken. But Ontario Hydro's culture has changed to a more consumer-oriented, risk-taking culture as it tries to cope with large debt and changes in its markets.

It can be difficult to change an organization's culture. More than a decade ago, the RCMP completed a "visioning" process that resulted in a new mission statement, a new set of core values, and a commitment to the communities where it worked. But soon afterward, there were allegations that the commissioner had exercised absolute power and had created a "tone" at the top of the organization that resulted in little respect for employees. An investigator's report concluded that the culture at the RCMP was "horribly broken."[62] Apparently not much had changed. In 2018, Brenda Lucki was appointed to lead the RCMP; she promised to deal with complaints about sexism, workplace bullying, and discrimination against Indigenous Peoples.[63]

SUMMARY OF

LEARNING OBJECTIVES

LO-1 DESCRIBE THE FOUR ACTIVITIES THAT CONSTITUTE THE *MANAGEMENT PROCESS*.

Management is the process of planning, organizing, leading, and controlling an organization's financial, physical, human, and information resources to achieve the organization's goals. *Planning* means determining what the company needs to do and how best to get it done. *Organizing* means determining how best to arrange a business's resources and the necessary jobs into an overall structure. *Leading* means guiding and motivating employees to meet the firm's objectives. *Controlling* means monitoring the firm's performance to ensure that it is meeting its goals.

LO-2 IDENTIFY *TYPES OF MANAGERS* BY LEVEL AND AREA.

Managers can be differentiated in two ways: by level and by area. By level, *top managers* set policies, formulate strategies, and approve decisions. *Middle managers* implement policies, strategies, and decisions. *First-line managers* usually work with and supervise employees. By area, managers focus on *marketing*, *finance*, *operations*, *human resources*, and *information*. Managers at all levels may be found in every area of a company.

LO-3 DESCRIBE THE FIVE BASIC *MANAGEMENT SKILLS*.

Most managers agree that five basic management skills are necessary for success. *Technical skills* are needed to perform specialized tasks ranging from typing to auditing. *Human relations skills* are needed to understand and get along with other people. *Conceptual skills* allow managers to think in the abstract, to diagnose and analyze various situations, and to see beyond present circumstances. *Decision-making skills* allow managers to define problems and to select the best course of action. *Time management skills* refer to managers' ability to make productive use of the time available to them.

LO-4 EXPLAIN THE IMPORTANCE OF *GOAL SETTING* AND *STRATEGIC MANAGEMENT* IN ORGANIZATIONAL SUCCESS.

Goals—the performance targets of an organization—can be *long-term*, *intermediate*, and *short-term*. They provide direction for managers, they help managers decide how to allocate limited resources, they define the corporate culture, and they help managers assess performance. *Strategic management* involves three major activities: setting strategic goals, analyzing the organization and its environment, and matching the organization and its environment. The strategies that are decided upon are then translated into *strategic*, *tactical*, and *operational* plans.

LO-5 DISCUSS *CONTINGENCY PLANNING* AND *CRISIS MANAGEMENT* IN TODAY'S BUSINESS WORLD.

To deal with crises or major environmental changes, companies develop contingency plans and plans for crisis management. *Contingency planning* tries to identify in advance the important aspects of a business or its markets that might change and how the company will respond if such changes actually occur. *Crisis management* means developing methods and actions for dealing with an emergency that requires an immediate response. To prepare for such emergencies, organizations develop crisis plans.

LO-6 EXPLAIN THE IDEA OF *CORPORATE CULTURE* AND WHY IT IS IMPORTANT.

Corporate culture is the shared experiences, stories, beliefs, and norms that characterize an organization. A strong, well-defined culture can help a business reach its goals and can influence management styles. Culture is determined by several factors, including top management, the organization's history, stories and legends, and behavioural norms. If carefully communicated and flexible enough to accommodate change, corporate culture can be managed for the betterment of the organization.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. How are the four *functions* of management related to the five *skills* of management? Use examples to clarify your answer.
2. What is the relationship between Mintzberg's *roles* of management and the more traditional *functions* of management? Use examples to clarify your answer.
3. Identify the managers by level and area at your college or university.
4. Consider the following statement: *In some companies, it is important that the CEO put more emphasis on technical skills than on human relations skills."* Do you agree or disagree with the statement? Defend your answer.

5. What differences might you expect to find in the corporate cultures of a 100-year-old manufacturing firm based in Winnipeg and a 5-year-old e-commerce firm based in Ottawa?
6. Consider the various corporate-level strategies discussed in the chapter (concentration, growth, integration, diversification, and investment reduction). What is the relationship among these various strategies? Are they mutually exclusive? Complementary? Explain.

APPLICATION EXERCISES

7. Interview a manager at any level of a local company. Identify the manager's job according to level and area. Explain what planning, organizing, directing, and controlling mean in terms of the manager's job. Give examples. Also indicate which management skills are most important for the manager's job.
8. Analyze mission statements from three companies. How effective do you think the mission statements are? Explain your reasoning. Do you think the mission statements clearly reflect the identity of the company? Explain.
9. Interview an administrator at your college or university and get that person's views on the school's strengths and weaknesses and on the threats and opportunities the school is facing. Then use this information to write up a SWOT analysis for the school.
10. Select any organization of which you are a member (your company, your family, your place of worship, or a club). Explain the relevance of the management functions of planning, organizing, directing, and controlling for that organization.

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members and discuss your new business venture within the context of this chapter. Develop specific responses to the following:

1. What areas of management will be most important in your business? Will these change over time?
2. What basic management skills will be most important to your business? Will these change over time?
3. What are the specific business goals of your new venture?
4. For your venture, is there a difference between your corporate and business strategies?
5. Does your management team need to develop any contingency plans? Why, or why not?
6. What sort of corporate culture do you want to create for your venture? What steps will you take to do so?

BUILDING YOUR BUSINESS SKILLS

DREAMS CAN COME TRUE

THE SITUATION

Arturo Juarez, who is ready to start his own business, has 14 years of experience in the travel industry as a manager at a high-end hotel and as a sales director at a large travel agency. His new business will be called Dream Vacations, and it will offer travel planning services to individuals and families. His company will research destinations, hotels, and activities and help its customers make travel memories by giving them top-notch services and creative solutions. To achieve this goal, Arturo is working to develop contracts with resorts in the Caribbean, South America, and the Mediterranean to get better pricing for his customers. He hopes that his business will grow at least 10 percent annually for the first five years as a result of advertising and referrals. Initially, Arturo plans to operate out of office space in Toronto, but his goal is to have offices in Victoria, Winnipeg, and Calgary within two years.

TEAM ACTIVITY

Arturo has asked for a team of students to provide him with assistance in getting his company going. Form a group of three to five students to provide guidance to Arturo.

ACTION STEPS

1. Working with your group, develop a mission statement for Dream Vacations. Why is developing a mission statement important?
2. Considering the mission statement you developed for Dream Vacations and the information provided in the case, state several key short- , medium- , and long-term SMART goals for the company. How should Arturo determine if the goals have been achieved? What types of correction action should Arturo take if the company fails to meet these goals?
3. What would contingency plans look like for Dream Vacations? What about crisis management plans?

EXERCISING YOUR ETHICS

CLEAN UP NOW OR CLEAN UP LATER?

THE SITUATION

The top management team of a medium-sized manufacturing company is on a strategic planning "retreat" where it is formulating ideas and plans for spurring new growth in the company. As one part of this activity, the team, working with the assistance of a consultant, has conducted a SWOT analysis. During this activity, an interesting and complex situation has been identified. Next year, the federal government will be issuing new—and much more stringent—pollution standards for the company's industry. The team sees this as a potential threat in that the company will have to buy new equipment and change some of its manufacturing methods in order to comply.

THE DILEMMA

One member of the team, James Smith, has posed an interesting option—not complying. His logic can be summarized as follows:

1. The firm has already developed its capital budgets for the next two years. Any additional capital expenditures will cause major problems with the company's cash flow and budget allocations.
2. The company has a large uncommitted capital budget entry available in three years; those funds might be used to upgrade pollution control systems at that time.
3. Because the company has a spotless environmental record so far, James Smith argues that if the company does not buy the equipment for three years, the most likely outcomes will be (a) a warning in year 1; (b) a small fine in year 2; and (c) a substantial fine in year 3. However, the total amounts of the years 2 and 3 fines will be much lower than the cost of redoing the company budgets and complying with the new law next year.

TEAM ACTIVITY

Assemble a group of four students and assign each group member to one of the following roles:

- management team member
- lower-level employee at the company
- company customer
- company investor

ACTION STEPS

1. Before hearing any of your group's comments on this situation and from the perspective of your assigned role, decide whether James Smith's suggestion regarding ignoring pollution standards is a good one. Write down the reasons for your position.
2. Before hearing any of your group's comments on this situation and from the perspective of your assigned role, determine what the underlying ethical issues are in this situation.
3. Gather your group together and reveal, in turn, each member's comments on James Smith's suggestion. Next, reveal the ethical issues listed by each member.
4. Appoint someone to record main points of agreement and disagreement within the group. How do you explain the results? What accounts for any disagreement?
5. From an ethical standpoint, what does your group conclude would be the most appropriate action by the company in this situation?
6. Develop a group response to the following question: What are the respective roles of profits, obligations to customers, and obligations to the community for the firm in this situation?

BUSINESS CASE 6

A DECISION-MAKING DILEMMA

Belford Inc. is a large consumer products company that has operations in Canada and the United States. It has approximately 23 000 employees. This week, the executive team at Belford Inc. is meeting to discuss a high-profile issue that is currently very much in the news: salary disparities between newly hired men and women. The meeting is particularly important because top management was informed last week that a female employee (who was hired last year) is suing the company for pay discrimination. At this early point in the process, the company does not know the name of the employee, but it is known that she is suing on the grounds that (a) her starting salary was lower than the average starting salary paid to newly hired male employees and (b) newly hired female employees on average were being paid about $2000 less than newly hired male employees. The meeting of the executive committee has been called to work proactively on this potentially difficult situation and to see if a decision can be reached. The members of the executive team are as follows:

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Gerald Jones (CEO)
Chi Kim (vice president—Finance)
Marilyn Trent (vice president—HRM)
Dan Schultz (vice president—Manufacturing)
Tyann Choudry (vice president—Marketing)

The meeting began with CEO Gerald Jones commenting that this was a critical issue that had to be decided properly, both for external public relations reasons (the company did not want to get a reputation for pay discrimination) and for internal reasons (a bad decision could negatively affect employee morale and productivity). To get the discussion started, he asked Marilyn Trent to provide some overall salary data on people who were hired last year. She reported that the average salary paid to new male employees was $63 817 and that the average for new female employees was $61 706. After hearing these numbers, the following exchange took place among the members of the executive team:

Choudry: Well, it looks like female employees really are paid less than male employees.

Schultz: Well, on average, yes, but averages are pretty meaningless. Just because there are differences in the average doesn't mean there is actually pay discrimination. There are good reasons why the salaries of new hires in our company differ. For example, one very obvious explanation is different educational qualifications. We pay higher salaries to those with MBAs.

Trent: That's true. The average for males with MBAs is $70 970 and for females with MBAs it's $70 200.

Schultz: Is that difference big enough to conclude that there is pay discrimination?

Choudry: That sounds pretty dismissive of the employee's claims in her lawsuit. We are being sued on the grounds that the female employee's starting salary was less than the starting salary of her male counterparts. In any case, how does the MBA data bear on this issue? We don't even know how many male employees have MBAs and how many female employees have MBAs.

Trent: Yes, we do. There were 54 male employees hired with MBAs and 18 females hired with MBAs.

Schultz: I don't see how those numbers help us make a decision.

Kim: How about looking at the total number of male and female employees hired last year? Will that help?

Trent: I don't know if it will help, but I can tell you that there were 184 males hired last year and 206 females.

Jones: I'm not sure what all these numbers imply for our decision. Let's hear some analysis.

Schultz: OK. I'll take a run at it. If we employ more males who have MBAs, and MBAs get higher salaries than non-MBAs, it makes intuitive sense to conclude that an overall statistic like the average salary would mean that men in our company will have higher average salaries than women. But that doesn't mean there is pay discrimination. It simply means that more men have the higher qualification, that is, an MBA.

Choudry: You can't just assume that a person with an MBA is more valuable than a person who doesn't have an MBA. I also think we have to look beyond the specific female employee's case and remember her claim that females *on average* are being paid about $2000 less than male employees. That is a very negative fact, and it will make us look bad in terms of public relations.

Kim: I don't think we should get into a debate about whether or not an MBA-qualified employee is more valuable than a non-MBA-qualified employee. That's not the issue here.

Schultz: I agree. I also repeat my earlier objection to the argument about using average salaries to make a decision regarding this lawsuit. We can't just make a decision to give money to a certain *group* of employees based on some overall average. We've got to do a more systematic analysis of the data that we have so we can logically determine whether pay discrimination really exists. If the analysis shows she is being discriminated against, then we'll move forward with a solution. But if we don't do a proper analysis, we won't know whether she is being discriminated against in terms of pay. Also, we may damage the logic of our entire pay structure, as well as the morale and satisfaction levels of our most highly qualified employees if we don't do a proper analysis.

At this point, CEO Gerald Jones intervened in the discussion. He said it was obvious that the issue was more complex than he had originally thought, and he felt that a subcommittee of the executive team should systematically analyze the relevant data before a decision was made. After some further discussion, Schultz, Choudry, and Trent agreed to serve on the subcommittee. They committed to making their recommendation in three days at the next meeting of the executive committee.

QUESTIONS FOR DISCUSSION

1. Do you think that the female employee's claim that she is being discriminated against is accurate? To make your decision, use the data presented at the meeting and clearly indicate (quantitatively) how it does, or does not, support the employee's claim of pay discrimination.
2. Are there data that are missing that would be useful in this case? Explain.
3. To what extent do the discussions of the executive team follow the six steps of the rational decision-making process that are presented in this chapter? If you decide there are differences, explain why those differences exist.

MyLab Intro to Business

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CHAPTER

07 Organizing the Business Enterprise

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Discuss the elements that influence a firm's *organizational structure*.
- **LO-2** Explain how *specialization* and *departmentalization* are the building blocks of organizational structure.
- **LO-3** Distinguish between *responsibility* and *authority* and explain the differences in decision making in *centralized* and *decentralized organizations*.
- **LO-4** Explain the differences among *functional*, *divisional*, *project*, *matrix,* and *international organization structures*, and describe the most popular forms of organizational design.
- **LO-5** Understand how the *informal organization* is different from the formal organization.

Building a Foundation and Structure for Long-Term Success

Two key determinants of a business's organizational structure are its mission and its strategy. Entrepreneurs must be particularly conscious of defining an organizational structure that will help them reach their goals, even though their organization may outgrow its initial structure over time. On the other hand, in some cases, change can be difficult because it's hard to separate structure from culture. Take, for example, Matthew Yglesias' (of Vox.com) comments on tech-giant Apple: "If GE can build jet engines, tidal energy farms, freight rail data systems, mining equipment, and medical devices, how is it that the world's most valuable company can't find the time to make a full line of personal computers and PC peripherals alongside its market leading smartphones and tablets? The answer goes back to Apple's corporate structure, which, though fairly common for a start-up, is extremely unusual for an enormous company."

In an entrepreneurial organization, simple, flat organizational structures with very few top managers usually work well. Unlike more complex companies, an ideal entrepreneurial organization is relatively unstructured and informal. The advantages are that decisions can be made quickly and the structure is flexible enough to adapt to a rapidly changing market. However, with very few top managers, it's also easy to become overwhelmed by decision-making tasks.

Perhaps one of the best examples of a simple entrepreneurial structure is Valve Software, the company that

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created Half-Life, Counter-Strike, and other video game series. Although Valve has 360 employees, it has no managers—none. According to the employee handbook, "Of all the people at this company who aren't your boss, Gabe [the co-founder] is the MOST not your boss, if you get what we're saying." In an interview with Bloomberg Business, Gabe Newell explained it this way: "When we started Valve [back in 1996], we thought about what the company needed to be good at. We realized that here, our job was to create things that hadn't existed before. Managers are good at creating procedures, but in our line of work that's not always good. Sometimes the skills in one generation of product are irrelevant to the skills in another generation. Our industry is in such technological, design, and artistic flux that we need somebody who can recognize that. It's pretty rare for someone to be in a lead role on two consecutive projects."

Employees at Valve move from project to project, often taking on different roles from one project to the next. A "group contributor" is responsible for helping others be more productive, although their ability to think creatively is often limited by this role. At other times, Valve employees may work on a more individual project, where they can work more independently.

During the development of their iconic video game, Half-Life, the company developed cross-discipline teams called "cabals" to design the final product and bring it to market. Even though the company has grown to more than 360 employees with billions of dollars in revenue, it's still privately held, and the organizational structure remains flat. It's not surprising that Gabe Newell and Mike Harrington adopted a family-like work environment when they started Valve. Both had worked for Bill Gates as Microsoft engineers during the early years when the structure was still relatively flat. However, Microsoft eventually became more divisional by necessity. In fact, a few years ago, Microsoft completed a corporate reorganization that left it looking classically divisional after a previous reorganization effort had attempted to align the business functionally.

Large companies often develop a divisional organizational structure. When Google mutated into Alphabet, its structure became more divisional and less function-based, with Google and division "X" being the most prominent units, each focused on a specific market segment or submission. In a divisional organization, people work for units (like Google), and they are responsible for lines of business. Some areas are still aligned functionally (e.g., accounting), but for the most part, large businesses seem to do better with a divisional rather than a functional structure.

So, what has happened to Apple in the years since Steve Jobs founded it? Apple is still clinging to its functional roots. Functional structures allow for more collaboration. At Apple, top managers are responsible for broad areas such as software engineering, hardware, and marketing. These areas cross each other and cross markets as well. It may seem like a fuzzy distinction, but whereas the CEO for Google is responsible for the success of the search engine functionality and not the success of the mobile phone division, a manager at Apple may be responsible for chip development across the board, from the Apple. Watch to the iPhone to the MacBook and the iPad; and another manager may be responsible for across-the-board marketing. This structure can make product management an extremely complicated process for a large company, and it may not designate anyone as the point of accountability for the final product.

QUESTIONS FOR DISCUSSION

1. Based on the details provided in the box, describe how companies like Valve and Apple use organizational structure to help them achieve their specific needs and goals?
2. Why do you think Microsoft changed and then quickly reorganized its structure? Begin by looking at the advantages and disadvantages of divisional versus functional structures.
3. What sort of structure does your university or college have? In what ways does this structure help or hurt the mission?
4. If you were hired by your college or university to help reorganize for better efficiency and better provision of service, what tangible advice could you offer?

HOW WILL THIS HELP ME?

Companies frequently introduce changes to improve their organizational structures. By understanding the material in this chapter, as an *employee*, you'll understand your "place" in the organization that employs you. As a *boss* or *owner*, you'll be better equipped to decide on the optimal structure for your own organization.

Radu Razvan/Fotolia

WHAT IS ORGANIZATIONAL STRUCTURE?

Organizational structure is the specification of the jobs to be done within a business and how those jobs relate to one another. To better understand what organizational structure is all about, compare a business to an automobile. All automobiles have an engine, four wheels, fenders and other structural components, an interior compartment for passengers, and various operating systems, including those for fuel, brakes, and climate control. Each component has a distinct purpose but must also work in harmony with the others. Automobiles made by competing firms all have the same basic components, although the way they look and fit together may vary. Similarly, all businesses have common structural and operating components, each of which has a specific purpose. Each component must fulfill its unique purpose while simultaneously fitting in with the other components. And, just like automobiles made by different companies, how these business components look and fit together varies from company to company.

Every institution—be it a for-profit business such as Cineplex Odeon, a not-for-profit organization such as the University of Saskatchewan, or a government agency such as the Competition Bureau—must develop an appropriate structure for its unique situation. What works for Air Canada is not likely to work for the Canada Revenue Agency. Likewise, the structure of the Red Cross will not likely work for the online health, wellness, baby, and beauty products retailer Well.ca.

LO-1 Determinants of Organizational Structure

How is an organization's structure determined? Does it happen by chance or is there some strategy that managers use to create structure? Or is it a combination of the two? Ideally, managers should assess a variety of factors as they plan for and then create a structure that will make their organization effective. Unfortunately, because of the time pressures most organizations face, structure may often develop without much planning.

What factors influence structure? The organization's purpose, mission, and strategy are obviously important. A dynamic and rapidly growing enterprise, for example, needs a structure that contributes to flexibility and growth, whereas a stable organization with only modest growth will function best with a different structure. Size, technology, and changes in environmental circumstances also affect structure. A large manufacturing firm operating in a strongly competitive environment requires a different structure than a local barbershop or convenience store.

Whatever structure an organization adopts, it is rarely fixed for long. Indeed, most organizations change their structures almost continually. Since it was first incorporated in 1903, for example, Ford Motor Co. has undergone literally dozens of major structural changes, hundreds of moderate changes, and thousands of minor changes. In just the past 15 years, Ford has initiated several major structural changes designed to eliminate corporate bureaucracy, speed up decision making, and improve communication and working relationships among people at various levels.

Read the following inspiring story in the Entrepreneurship and New Ventures box entitled "Organizing for Growth" to see an example of how entrepreneurs often approach the question of structure (especially in the early stages).

ORGANIZATIONAL STRUCTURE The specification of the jobs to be done within a business, and how those jobs relate to one another.

Organizing for Growth

Nine out of ten new businesses fail. For a start-up to succeed, the entrepreneur needs a great product or service and a lot of business savvy. A major part of the challenge lies in building a great team to efficiently utilize people and effectively bring ideas to life. However, for most start-ups, organizational structure is the last thing the owner is thinking about.

Does structure grow organically, or is it developed? For Gauri Nanda, creator of Clocky—the perky little robot alarm clock marketed by her company Nanda Home—organizational structure wasn't an issue. When she was a graduate student in 2004, Nanda designed Clocky as a project for her MIT Media Lab class. However, having no entrepreneurial leanings at the time, she threw it in the back of her closet and continued with her master's degree. However, Clocky had already gained a tiny online presence, and in 2005, she suddenly discovered that she had unearthed a potential gold mine. Rather than going big with production facilities and employees and all the risks and headaches that might produce, she found a manufacturer in Hong Kong (via Alibaba.com) and outsourced production. Her first run of 500 clocks sold out overnight. Since then,

Toymail/Ferex/AP Images

she's incorporated Nanda Home, but as of mid-2018, her website still sports only the one product. Although its scope is limited, her business is among the 10 percent of survivors.

Gauri Nanda, like many entrepreneurs, did not stop at one venture. A few years ago, she started a new, more ambitions company called Toymail, with a partner named Audry Hill. The main product has two parts—an app for the parents and the Talkies, vaguely bat-shaped stuffed toys that connect kids to their friends and family via voice chat.

The two partners started small, selling more than 20 000 units on a limited marketing campaign while beta-testing with real families to develop the most useful and marketable Talkies. Early results were excellent, and the entrepreneurs had already raised $1.5 million from Amazon, Verizon, and a venture capital company called Y Combinator when they received an invitation from the television show *Shark Tank* to pitch their idea. The appearance landed them a $600 000 co-investment from Shark's Lori Greiner and Chris Sacca in exchange for a 5 percent stake in the company.

Now it's up to Nanda and Hill to turn their creative attention toward the design of the company itself as they begin the transition from small start-up to a large company capable of meeting additional demand and scale.

CRITICAL THINKING QUESTION

1. What sort of organizational challenges will these entrepreneurs face as they expand their sales and their workforce?

The Chain of Command

Most businesses prepare **organization charts** that illustrate the company's structure and show employees where they fit into the firm's operations. Figure 7.1 shows the organization chart for a hypothetical company. Each box represents a job within the company. The solid lines that connect the boxes define the *chain of command*, or the reporting relationships within the company. Thus, each plant manager reports directly to the vice-president of production who, in turn, reports to the president. When the chain of command is not clear, many kinds of problems can result. An actual organization chart would, of course, be far more complex and include individuals at many more levels. Large firms cannot easily draw an organization chart with everyone on it.

ORGANIZATION CHART A physical depiction of the company's structure showing employee titles and their relationship to one another.

THE BUILDING BLOCKS OF ORGANIZATIONAL STRUCTURE

The first step in developing the structure of any business, large or small, involves three activities:

1. *Specialization.* Determining who will do what
2. *Departmentalization.* Determining how people performing certain tasks can best be grouped together
3. *Establishment of a Decision-Making Hierarchy.* Deciding who will be empowered to make which decisions and who will have authority over others

These three activities are the building blocks of all business organizations. In this section, we discuss specialization and departmentalization. Because the decision-making hierarchy actually includes several elements, we cover it in more detail in the next section.

LO-2 Job Specialization

Job specialization is the process of identifying the specific jobs that need to be done and designating the people who will perform them. In a sense, all businesses have only one major "job"—making a profit

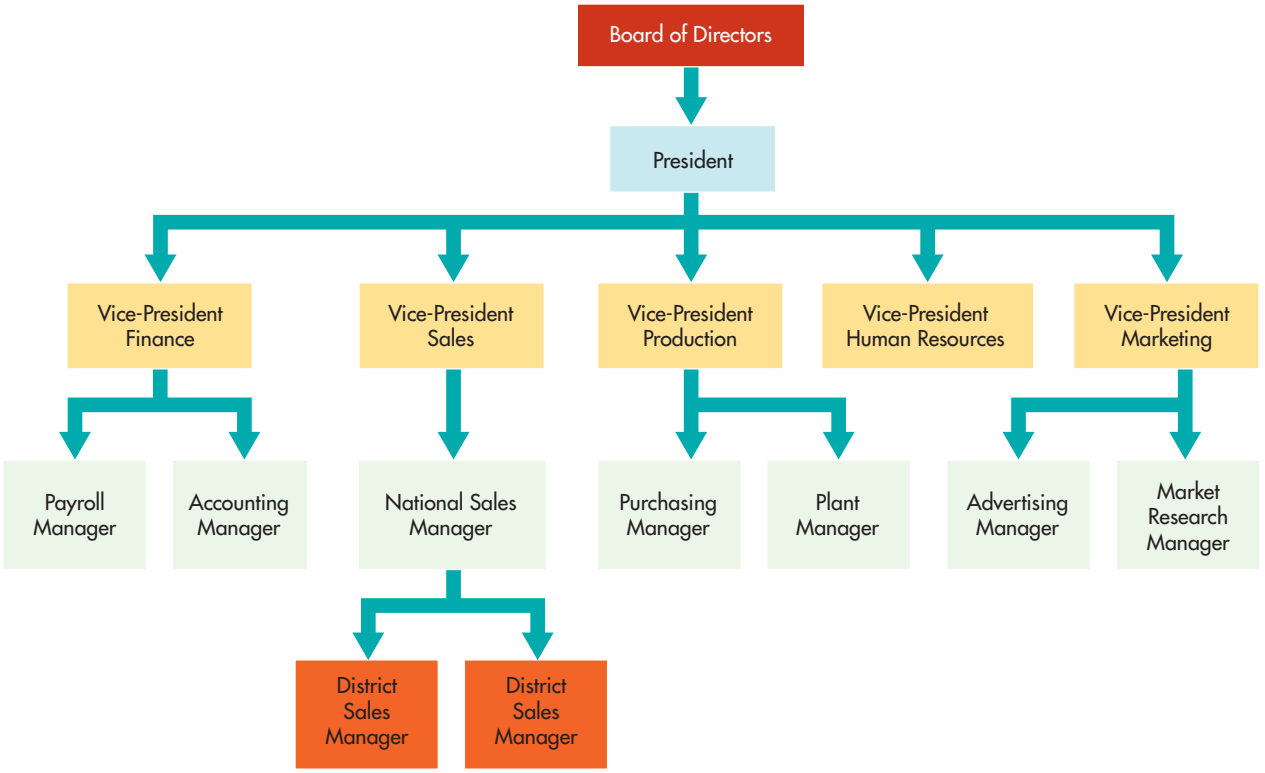

FIGURE 7.1 An organization chart

An organization chart shows key positions in the organization and interrelationships among them. An actual organization chart would, of course, be far more complex and include individuals at many more levels. Indeed, because of their size, larger firms cannot easily draw a diagram with everyone on it.

by selling products and services to consumers. But this big job must be broken into smaller components which are then assigned to individuals. Consider the manufacturing of men's shirts. Because several steps are required to produce a shirt, each job is broken down into its components—that is, into a set of tasks to be completed by a series of individuals or machines. One person, for example, cuts material for the shirt body, another cuts material for the sleeves, and a third cuts material for the collar. Components are then shipped to a sewing room, where a fourth person assembles the shirt. In the final stage, a fifth person sews on the buttons.[1]

JOB SPECIALIZATION The process of identifying the specific jobs that need to be done and designating the people who will perform them.

Pictorial Press Ltd/Alamy Stock Photo

Walt Disney Pictures/Entertainment Pictures/Alamy Stock Photo

When Walt Disney was just starting out, he did most of the work on his animated features all by himself. But today's features such as Zootopia, Frozen, Inside Out, and Coco all require the work of thousands of people.

Specialization and Growth

In a very small organization, the owner may perform every job. As the firm grows, however, so does the need to specialize jobs so that others can perform them. When Mrs. Fields Cookies began, Debbi Fields did everything herself: bought the equipment, negotiated the lease, baked the cookies, operated the store, and kept the records. As the business grew; however, she found that her job was becoming too much for one person. She first hired a bookkeeper to handle her financial records; then, she hired an in-store manager and a cookie baker. Her second store required another set of employees—another manager, another baker, and some salespeople. While Fields focused on other expansion opportunities, she turned promotions over to a professional advertising director. Thus, the job that she once did all by herself was increasingly broken down into components and assigned to different individuals.

Job specialization is a natural part of organizational growth. It is neither a new idea nor limited to factory work. It carries with it certain advantages—individual jobs can be performed more efficiently, the jobs are easier to learn, and it is easier to replace people who leave the organization. But if job specialization is carried too far and jobs become too narrowly defined, people get bored, become less satisfied with their jobs, and lose sight of how their contributions fit into the overall organization.

In recent years, many of the manufacturing jobs that were highly repetitive have been replaced by automation. According to a recent report, automation might further reduce the workforce in manufacturing and natural resources (mining), which may hit some smaller communities and cities hard. For example, the following cities have a high percentage of their workforce (close to 50 percent) in manufacturing that is at risk: Ingersoll, Ontario; Quesnel, British Columbia; Brooks, Alberta; Steinbach, Manitoba; Estevan, Saskatchewan; and Granby, Quebec, to name a few.[2] Many of the tasks conducted by miners are very dangerous, so it's not all bad news. Some high-risk tasks have already been taken over by driverless diggers and loaders and flying drones (to spot deposits and danger zones deep underground).[3]

Bibiphoto/Shutterstock

A key factor in the efficiency of truck and automobile production is the organization of the workstations. At some stations, workers install just about everything that the driver touches inside the vehicle. Other stations take care of the vehicle frame, the entire electrical system, or completed doors.

Departmentalization

Departmentalization is the process of grouping specialized jobs into logical units. Departmentalization improves control and coordination because managers can see more easily how various units are performing. It allows a firm to treat a department as a *profit centre*—a separate unit responsible for its own costs and profits. Thus, by assessing profits from sales in a particular area—for example, men's clothing—Zara can decide whether to expand or reduce promotions in that area. Departmentalization may occur along *functional*, *customer*, *product*, *geographic*, or *process* lines (or some combination of these).

Functional Departmentalization

Functional departmentalization means organizing departments according to the function they perform—marketing, finance, production, human resources, and so on. Each of these departments might be further subdivided; for example, the marketing department might be divided geographically or into separate staff for market research and advertising.

Product Departmentalization

Both manufacturers and service providers often choose **product departmentalization**, dividing an organization according to the specific product or service being created. This becomes especially the case when a firm grows and starts to offer multiple products or services. The 3M Company, which makes both consumer and industrial products, operates different divisions for Post-it brand tape flags, Scotch-Brite scrub sponges, and the Sarns 9000 perfusion system for open-heart surgery. A few years ago, home improvement giant Lowe's reorganized its merchandising operations into two product divisions: (1) building and outdoor products and (2) kitchen, bath, and home decor products.[4]

Customer Departmentalization

Customer departmentalization involves setting up departments or divisions that focus on meeting the needs of specific customers. Some retail stores get their generic name—department stores—from the manner in which they are structured—a men's department, a women's department, a luggage department, a lawn and garden department, and so on. Each department targets a specific customer category (men, women, people who want to buy luggage, and people who want to buy a lawn mower) by using customer departmentalization to create departments that offer products and meet the needs of identifiable customer groups. Thus, a customer shopping for a baby's crib at Walmart can bypass lawn and garden supplies and head straight for children's furniture. In general, the store is more efficient, and customers get better service because salespeople tend to specialize and gain expertise in their departments. Another illustration of customer departmentalization is reflected in most banks. An individual wanting a consumer loan goes to the retail banking office, whereas a small business owner goes to the commercial banking office and a farmer goes to the agricultural loan department.

DEPARTMENTALIZATION The process of grouping jobs into logical units.

FUNCTIONAL DEPARTMENTALIZATION Departmentalization according to functions or activities.

PRODUCT DEPARTMENTALIZATION Departmentalization according to the products being created or sold.

CUSTOMER DEPARTMENTALIZATION Departmentalization according to the types of customers likely to buy a given product.

Fiphoto/123RF

Many department stores are departmentalized by product. Concentrating different products in different areas of the store makes shopping easier for customers.

Process Departmentalization

Process departmentalization means dividing the company according to the production process used. Vlasic, a pickle maker, has separate departments that transform cucumbers into fresh-packed pickles, relishes, or pickles cured in brine.

Geographic Departmentalization

Geographic departmentalization means creating departments based on the area of the country—or even the world—they serve. Nike is organized around six geographic regions: North America, Western Europe, Central & Eastern Europe, Greater China, Japan, and emerging markets. (Yet Nike has a single global division for its Nike licensing activities and for the Converse brand, which Nike owns.)[5]

Multiple Forms of Departmentalization

Because different forms of departmentalization have different advantages, as firms grow in size, they tend to adopt different types of departmentalization for various levels. The company illustrated in Figure 7.2 uses functional departmentalization at the top level. At the middle level, production is divided along geographic lines. At a lower level, marketing is departmentalized by product group. Most larger firms use a combination of all of these different forms of departmentalization in various areas.

PROCESS DEPARTMENTALIZATION Departmentalization according to the production process used to create a good or service.
GEOGRAPHIC DEPARTMENTALIZATION Departmentalization according to the area of the country or world supplied.

ESTABLISHING THE DECISION-MAKING HIERARCHY

A major question that must be asked about any organization is this: Who makes which decisions? This leads to a consideration of the decision-making hierarchy, which generally results from a three-step process:

1. *Assigning tasks.* Determining who can make decisions and specifying how they should be made
2. *Performing tasks.* Implementing decisions that have been made
3. *Distributing authority.* Determining whether the organization is to be centralized or decentralized

LO-3 Assigning Tasks

Authority is the power to make the decisions necessary to complete a task. **Responsibility** is the duty to perform an assigned task. These ideas may seem simple, but two distinct problems may arise when they are applied in practice. First, authority and responsibility may not be balanced. For example, suppose a buyer for a department store has an unexpected opportunity to make a large purchase of inventory at

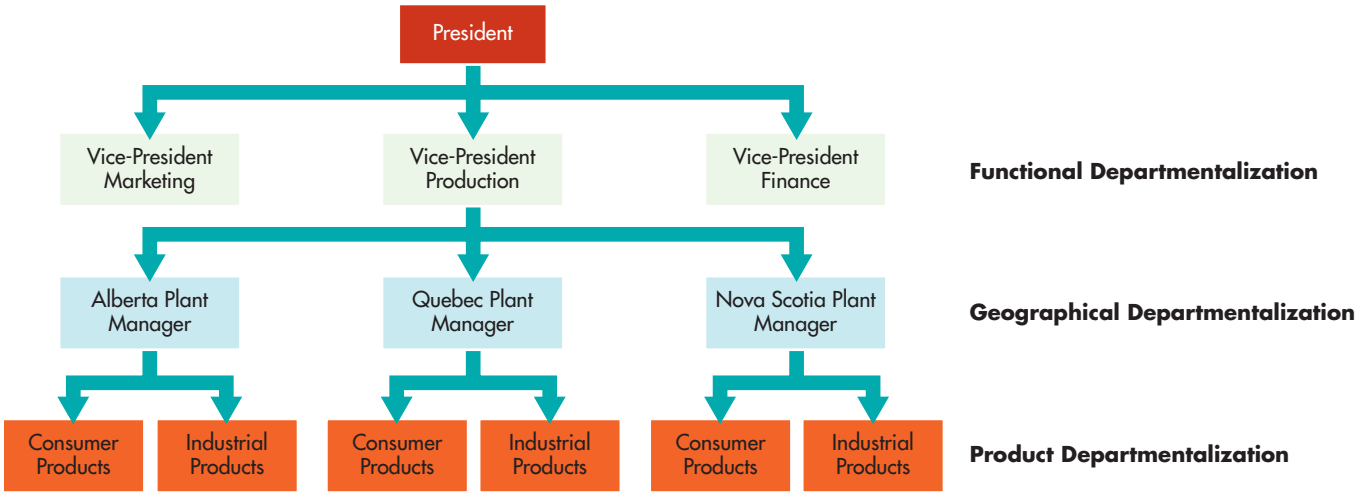

FIGURE 7.2 Multiple forms of departmentalization

Most organizations use multiple bases of departmentalization. This organization, for example, is using functional, geographic, and product departmentalization.

an extremely good price but does not have the authority to make the purchase without confirmation from above. The company's policies on authority and responsibility are inconsistent because the buyer is responsible for purchasing the clothes that will be sold in the store but lacks the discretion (authority) to make the needed purchases. Second, when things go wrong, there is often debate about who is responsible. In response to the News of the World phone.-hacking scandal, Rupert Murdoch said he was not responsible for the actions his reporters had engaged in. But observers say that top managers *were* responsible because they put pressure on reporters to get "scoops" so the paper's circulation would increase, and this drove the reporters to take extreme measures to get stories.[6]

Performing Tasks

Delegation means assigning a task to a subordinate. Once authority has been delegated, **accountability** falls to the subordinate, who must then complete the task and justify the outcome. When Winnipeg-based Frantic Films first began operations, the principal shareholders made all the decisions. But the CEO, Jamie Brown, thought that it was important to delegate more authority to lower-level workers so that they would gain experience in making decisions that affected the company. So he gave lower-level managers the authority to spend up to $5000 without having to get the approval of top management. This change was also made because the top managers were spending too much time dealing with requests for small amounts of money.[7] Table 7.1 lists some common obstacles that hinder the delegation process, along with strategies for overcoming them.

Managers who fail to delegate don't have time to do long-range planning, and they may be uninformed about important industry trends and competitive products because they are too involved in day-to-day operations. Jeffrey Kindler, the former CEO of Pfizer Inc., quit after he lost the support of other executives who were frustrated with his focus on detail and his micromanaging style.[8]

Managers should keep the following points in mind when they are delegating authority:

- Decide on the nature of the work to be done.
- Match the job with the skills of subordinates.
- Make sure the person chosen understands the objectives he or she is supposed to achieve.
- Make sure subordinates have the time and training necessary to do the task.

Nikomi/Fotolia

When managers do not properly delegate tasks to subordinates, or when there are disagreements about how much authority should be delegated, both managers and workers become frustrated.

Distributing Authority: Centralization and Decentralization

Some managers make the conscious decision to retain as much decision-making authority as possible at the higher levels of the organizational structure; others decide to push authority as far down the hierarchy as possible. Although we can think of these two extremes as anchoring a continuum, most companies fall somewhere between the middle of such a continuum and one end-point or the other.

In a **centralized organization**, top management retains the right to make most decisions that need to be made. Most lower-level decisions must be

AUTHORITY The power to make the decisions necessary to complete a task.
RESPONSIBILITY The duty to perform an assigned task.
DELEGATION Assignment of a task, a responsibility, or authority by a manager to a subordinate.
ACCOUNTABILITY Obligation of subordinates to accomplish tasks and justify outcomes to managers.
CENTRALIZED ORGANIZATION Top managers retain most decision-making rights for themselves.

TABLE 7.1 Learning to delegate effectively

I'm afraid to delegate because …	Solution
My team doesn't know how to get the job done.	If members of your team are exhibiting opportunities for improved performance, offer them the training necessary for them to become more effective at their jobs.
I like controlling as many things as possible.	Recognize that trying to accomplish everything yourself while your team does nothing only sets you up for burnout and failure. As you begin to relinquish control, you will come to trust your team more as you watch your team members succeed.
I don't want anyone on my team outperforming me.	High-performing team members are a reflection of your success as a manager. Encourage them to excel, praise them for it, and share the success of your team with the rest of the organization.
I don't know how to delegate tasks effectively.	Consider taking a management training course or reading some books on the topic of delegating effectively.

approved by upper management before they can be implemented.[9] McDonald's, for example, uses centralization as a way to standardize its operations. All restaurants must follow precise steps in buying products and making and packaging burgers and other menu items. Most advertising is handled at the corporate level, and any local advertising must be approved by a regional manager. Restaurants even must follow prescribed schedules for facilities' maintenance and upgrades like floor polishing and parking-lot cleaning.[10]

In a **decentralized organization**, more decision-making authority is delegated to managers at lower levels in the hierarchy. The purpose of decentralization is to make a company more responsive to its environment by giving lower-level managers more autonomy. At FedEx, for example, the commitment to decentralization promotes innovation. Managers are encouraged and rewarded for questioning, challenging, and developing innovative ideas, which are always given serious consideration. Developments have included teaming up with Motorola and Microsoft to create proprietary products for small business logistics.[11]

Tall and Flat Organizations

Decentralized firms tend to have a *flat* organizational structure with only a few layers, such as the one shown in Figure 7.3a. In contrast, centralized organizations usually have multiple layers of management and a *tall* organizational structure (see Figure 7.3b).

Span of Control

As shown in Figure 7.3, the **span of control** refers to how many people are supervised by an individual manager. The span of control may be wide (many subordinates reporting to a boss) or narrow (few subordinates reporting to a boss). Factors influencing the span of control include employees' abilities, the supervisor's managerial skills, the nature of the tasks being performed, and the extent to which tasks are interrelated. For example, when many employees perform the same simple task or a group of interrelated assembly-line tasks, a wide span of control is possible. Because all the jobs are routine, one supervisor may well control an entire assembly line with 40 or more workers. Because tasks are interrelated—if one workstation stops, they all stop—having one supervisor ensures that all stations receive equal attention. In contrast, when jobs are not routine, or when they are unrelated, a narrower span of control is preferable.

Downsizing—the planned reduction in the scope of an organization's activity—affects the span of control. For example, in the past few years, the CBC has had many rounds of cuts. One of the latest led

DECENTRALIZED ORGANIZATION Lower- and middle-level managers are allowed to make significant decisions.

SPAN OF CONTROL The number of people managed by one manager.

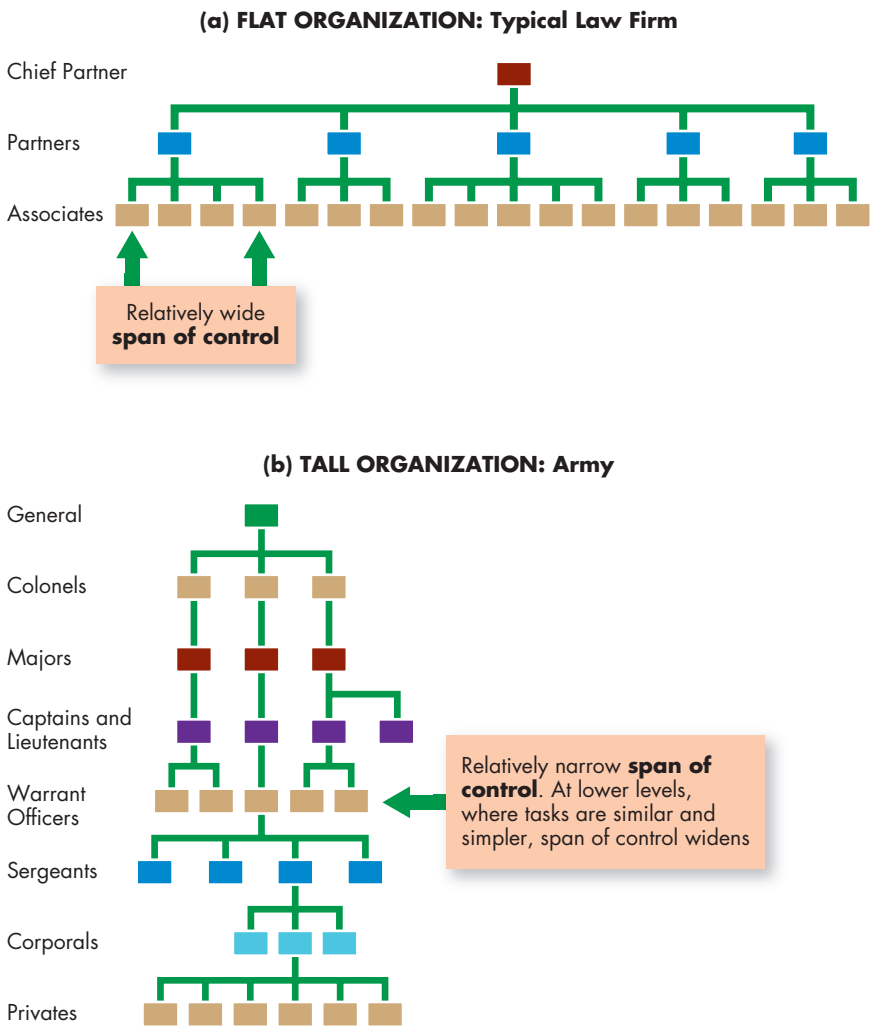

FIGURE 7.3 Organizational structures and span of control

to a reduction of 300 employees in its Toronto production offices that had been the home of popular series such as *Mr. Dressup* and *Royal Canadian Air Farce.*[12] When downsizing leads to cutting large numbers of managers, entire layers of management are eliminated. When this happens, the remaining managers often end up with larger spans of control. Because spans of control are wider, corporate structures are flatter after downsizing.

Three Forms of Authority

As individuals are delegated responsibility and authority, a complex web of interactions develops. These interactions may take one of three forms of authority: line, staff, or committee and team. All three may be found in a single company, especially a large one.

Line Authority

Line authority flows up and down the chain of command (refer back to Figure 7.1). Most companies rely on *line departments*, those directly linked to the production and sale of specific products. For example, Clark, an equipment manufacturer, has a division that produces forklifts and small earthmovers (see Figure 7.4). In this division, line departments include purchasing, materials handling, fabrication, painting, and assembly (all of which are directly linked to production), along with sales and distribution (both of which are directly linked to sales).

Each line department is essential in achieving the goals the company has set. Line employees are the "doers" and producers in a company. If any line department fails to complete its task, the company cannot sell and deliver finished goods. Thus, significant authority is usually delegated to line departments.

Staff Authority

Companies often employ individuals with Technical expertise in areas such as law, accounting, marketing research, and human resources. These experts may be given **staff authority**; that is, they help line departments in making decisions, but they do not have the authority to make the final decision. For example, if the fabrication department at Clark has an employee with a drinking problem, the line manager of the department might consult a human resource staff expert for advice on how to handle the situation. The staff expert might suggest that the worker stays on the job but enter a counselling program. But if the line manager decides that the job is too dangerous to be handled by a person whose judgment is impaired by alcohol, the line manager's decision will most likely prevail.

Andres Rodriguez/Fotolia

Business firms are increasingly using work teams and allowing groups of employees to plan and organize their own work with a minimum of supervision. This contributes to employee empowerment.

Typically, line authority is represented on organization charts by solid lines, while staff authority is shown by dotted lines. Line managers are directly involved in producing the firm's products or services, while staff members generally provide services to management. But remember, the goals of the organization influence the distinction between line and staff authority. At Aluminum Company of Canada, for example, the director of personnel has staff authority because the personnel department supports the primary function of the company (the production and marketing of aluminum). But at Office Overload, the director of personnel is a line manager because the primary goal of that firm is to provide personnel to other firms.

DOWNSIZING The planned reduction in the scope of an organization's activity.

LINE AUTHORITY Authority that flows in a direct chain of command from the top of the company to the bottom.

STAFF AUTHORITY Authority based on expertise and that usually involves advising line managers.

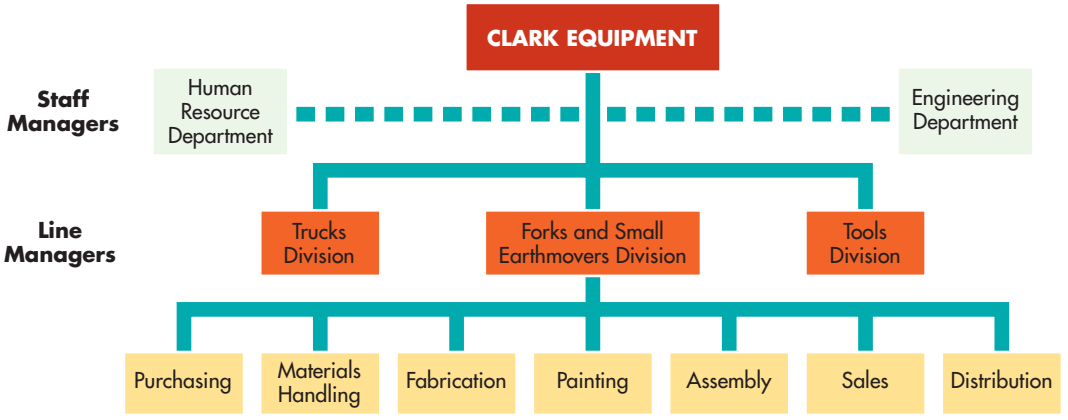

FIGURE 7.4 Line and staff organization

Committee and Team Authority

More and more organizations have started to use **committee and team authority**—authority granted to committees or work teams that play central roles in the firm's daily operations. A committee, for example, may consist of top managers from several major areas of the company. If the work of the committee is especially important, and if the committee will be working together for an extended time, the organization may even grant it special authority as a decision-making body that goes beyond the individual authority possessed by each of its members.

Firms are also increasingly using work teams at the operating level. These teams are made up of workers (not managers) and are empowered to plan, organize, and perform their work with a minimum of supervision. Organizations usually find it beneficial to grant special authority to work teams so that they will function more effectively.[13] More information about teams is presented in Chapter 9.

COMMITTEE AND TEAM AUTHORITY Authority granted to committees or work teams involved in a firm's daily operations.

LO-4 BASIC ORGANIZATIONAL STRUCTURES

A glance at the organization charts of many organizations reveals what appears to be an almost infinite variety of structures. However, closer examination shows that most of them fit into one of four basic categories: functional, divisional, project, or international.

The Functional Structure

In the **functional structure**, the various units in the organization are formed based on the key functions that must be carried out to reach organizational goals. The functional structure—an example of which was shown in Figure 7.1—makes use of departmentalization by function. The advantages and disadvantages of the functional structure are summarized in Table 7.2. To overcome one of the disadvantages of the functional structure—poor interdepartmental communication—some companies have established *customer innovation centres* that have expertise on product development, brand management, and sales. At these centres, key customers provide feedback on product performance and brainstorm innovative ideas for products that will better satisfy customers.[14]

The Divisional Structure

The **divisional structure** divides the organization into several divisions, each of which operates as a semi-autonomous unit and profit centre. An example of a divisional structure is shown in Figure 7.5. Divisions in organizations can be based on products, customers, or geography. For example, Winnipeg-based Frantic Films has three product divisions: live action (which produces programs such as *Pioneer Quest* and *Til Debt Do Us Part*), TV commercials (which produces television commercials for national and international clients), and software (which creates new, stand-alone software to enhance certain visual effects).[15] Sometimes a company reorganizes divisions in order to be more effective. Yahoo Inc. established three divisions—consumers, regions, and technology—to focus its activities and to increase growth prospects.[16] Sometimes a company reorganizes to streamline operations and to put new emphasis on key areas. After the VW diesel-testing scandal, the company decided to make some fundamental changes. They removed the former CEO Mattias Mueller and replaced him with Herbert Diess; they also organized the business into six new business divisions plus a special division for China.[17]

Whatever basis is used, divisional performance can be assessed because each division operates almost as a separate company. Divisionalized companies can buy, sell, create, and disband divisions without disrupting the rest of their operations. Different divisions can sponsor separate advertising campaigns and foster different corporate identities. They can also share certain corporate-level resources (such as market research data). But sometimes unhealthy competition develops between divisions, or the efforts of one division may be duplicated by those of another. At PepsiCo, for example, each of the company's three major beverage brands—Pepsi, Gatorade, and Tropicana—formerly operated as independent divisions. But this became a problem because the

FUNCTIONAL STRUCTURE Various units are included in a group based on functions that need to be performed for the organization to reach its goals.

DIVISIONAL STRUCTURE Divides the organization into divisions, each of which operates as a semi-autonomous unit.

TABLE 7.2 Advantages and disadvantages of a functional structure

Advantages	Disadvantages
1. It focuses attention on the key activities that must be performed.	1. Conflicts may arise among the functional areas.
2. Expertise develops within each function.	2. No single function is responsible for overall organizational performance.
3. Employees have clearly defined career paths.	3. Employees in each functional area have a narrow view of the organization.
4. The structure is simple and easy to understand.	4. Decision making is slowed because functional areas must get approval from top management for a variety of decisions.
5. It eliminates duplication of activities.	5. Coordinating highly specialized functions may be difficult.

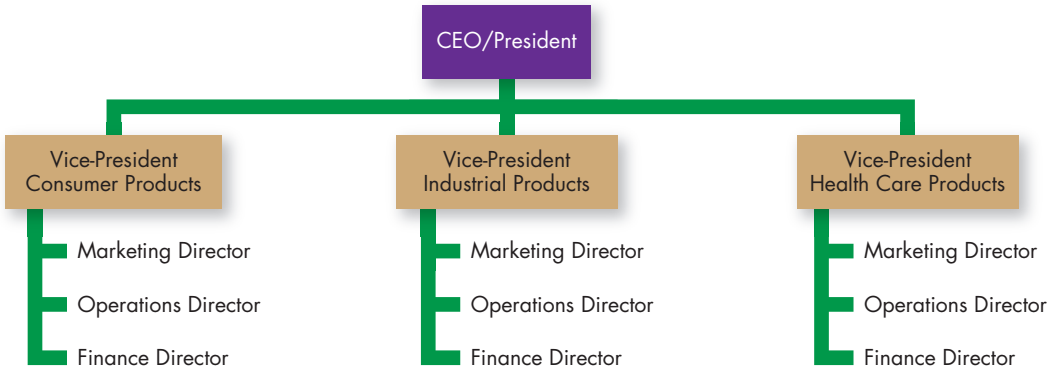

FIGURE 7.5 Divisional structure

brands were competing for the same resources, and there was very little coordination and sharing of information. Now all three brands are in one division so that a unified approach to brand management is achieved. The advantages and disadvantages of the divisional structure are summarized in Table 7.3.

Project Organization

A typical organization is characterized by unchanging vertical authority relationships because the organization produces a product or service in a repetitive and predictable way. But some organizations find themselves faced with new product opportunities or with projects that have a definite starting and ending point. These organizations often use a project structure to deal with the uncertainty encountered in new situations. **Project organization** involves forming a team of specialists from different functional areas of the organization to work on a specific project.[18] A project structure may be temporary or permanent; if it is temporary, the project team disbands once the project is completed and team members return to their regular functional area or are assigned to a new project.

Project organization is used extensively by Canadian firms in the construction of hydroelectric generating stations like those developed by Hydro-Quebec on the La Grande River and by Manitoba Hydro on the Nelson River. Once the generating station is complete, it becomes part of the traditional structure of the utility. Project organization has also proven useful for coordinating the many elements needed to extract oil from the tar sands.

Set/Shutterstock

The project organizational structure is very useful for construction projects like this hydroelectric generating station on the La Grande River in Quebec. The construction of installations like this has a specific beginning and ending point. Once completed, the generating station becomes part of the traditional organizational structure of the provincial utility.

Matrix Structure

A **matrix structure** (a variation of the project organization) is a combination of two separate structures that can work better than either approach alone. This form gets its matrix-like appearance, when shown in a diagram, by using one underlying "permanent" organizational structure (say, the divisional structure flowing up and down in the diagram), and then superimposing a different organizing framework on top of it (e.g., the functional form flowing side-to-side in the diagram). This highly flexible and readily adaptable structure was pioneered by NASA for use in developing specific space programs (in other words, it is often a type of project structure).

PROJECT ORGANIZATION An organization that uses teams of specialists to complete specific projects.

MATRIX STRUCTURE An organizational structure created by superimposing one structure onto another. (Employees report to two separate supervisors.)

TABLE 7.3 Advantages and disadvantages of a divisional structure

Advantages	Disadvantages
1. It accommodates change and expansion.	1. Activities may be duplicated across divisions.
2. It increases accountability.	2. A lack of communication among divisions may occur.
3. It develops expertise in the various divisions.	3. Adding diverse divisions may blur the focus of the organization.
4. It encourages training for top management.	4. Company politics may affect the allocation of resources.

Ford recently announced that it would stop making cars for the North American market, except for the Mustang and one other new model, to concentrate on SUV and truck sales.[19] The flagship Mustang is designed using a matrix project approach. A design team composed of people with engineering, marketing, operations, and finance expertise is created to design the new generation of the car. After the work is done, the team members move back to their permanent functional jobs.[20]

In other settings, the matrix organization is a semi-permanent fixture. Figure 7.6 shows how Martha Stewart Living Omnimedia created a permanent matrix organization for its lifestyle business. As you can see, the company organized into media and merchandising groups, each of which has specific products and product groups. For instance, there is an internet group housed within the media group. Layered on top of this structure are teams of lifestyle experts led by area specialists organized into groups, such as cooking, entertainment, weddings, crafts, and so forth. Although each group targets specific customer needs, they all work as necessary across all product groups. An area specialist in weddings, for example, might contribute to an article on wedding planning for an Omnimedia magazine, contribute a story idea for an Omnimedia cable television program, and supply content for an Omnimedia site. This same individual

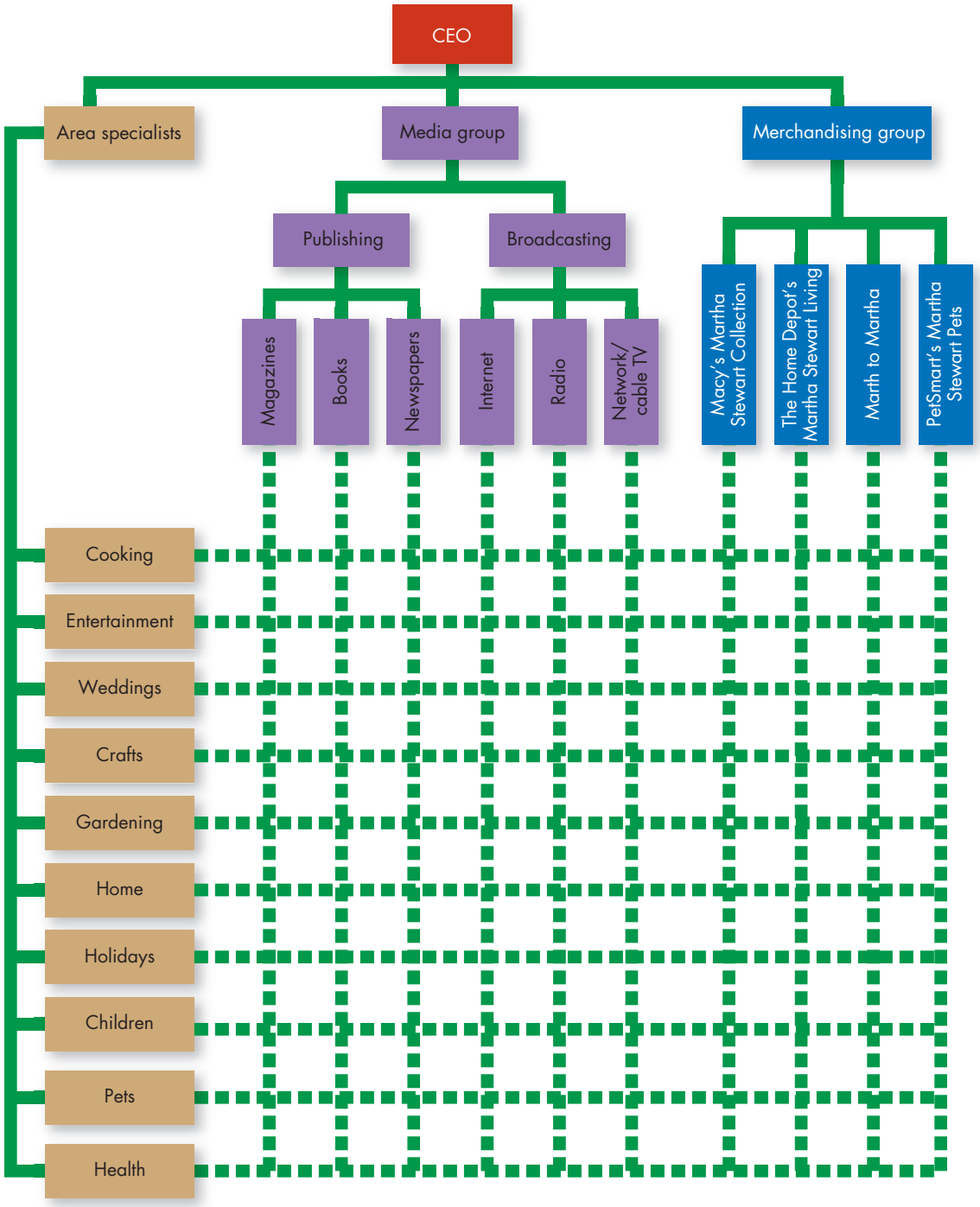

FIGURE 7.6 Matrix organization of Martha Stewart Living Omnimedia

might also help select fabrics suitable for wedding gowns that are to be retailed. However, this structure is surely evolving as the company was recently sold for US$353 million to the Sequential Brands Group.[21]

International Structures

Several types of **international organizational structures** have emerged as competition on a global scale has become more intense and companies have experimented with the ways in which they might respond. For example, when Walmart opened its first store outside the United States in the early 1990s, it set up a special projects team to handle the logistics. As more stores were opened during the next decade, the firm created a small international department to handle overseas expansion. By then, however, international sales and expansion had become such a major part of Walmart's operations that the firm created a separate international division headed up by a senior vice-president. International operations are now so important to Walmart that the international division has been further divided into geographic areas where the firm does business, such as Mexico and Europe. Walmart's structure is of the general type shown in Figure 7.7. And as the firm has expanded into more foreign markets, such as Russia and India, new units have been created to oversee those operations.

Some companies adopt a truly global structure in which they acquire resources (including capital), produce goods and services, engage in research and development, and sell products in whatever local market is appropriate, without consideration of national boundaries. For years, General Electric (GE) kept its international business operations as separate divisions. Now, however, the company functions as one integrated global organization. GE businesses around the world connect and interact with each other constantly, and managers freely move back and forth among them. This integration is also reflected in GE's executive team, which includes executives from Spain, Japan, Scotland, Ireland, and Italy.

When Canadian firms "go global," they need to address three organizational structure questions: (1) Is the business going to be centralized in the home base in Canada or is going to allow decentralized decision making in its various foreign offices? (2) Is the business going to communicate a single global message or is it going to tailor its message to each of the countries it operates in? (3) How is collaboration going to be achieved between the home office in Canada and the company's offices in foreign countries?[22]

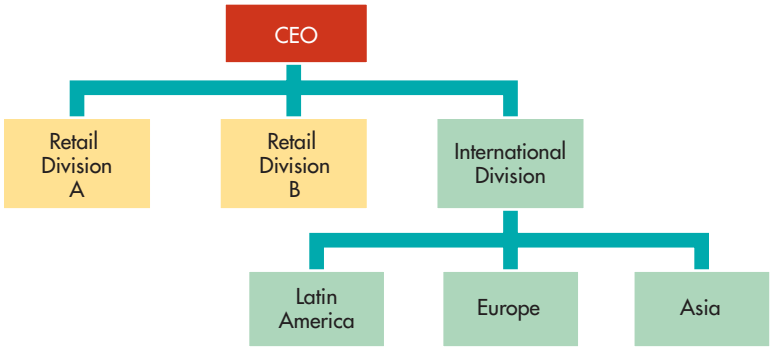

FIGURE 7.7 International division structure

Chiaki Tsukumo/AP Images

All the signs at this 8000 square metre store in Numazu identify it as a Seiyu outlet run by Japan's fifth-largest supermarket chain. However, Walmart owns 38 percent of Seiyu, and this giant store is part of Walmart's effort to enter the world's second-largest retail market.

INTERNATIONAL ORGANIZATIONAL STRUCTURE An organizational structure designed to help a company succeed in international markets. International departments, international divisions, and an integrated global organization are all variations of the international organizational structure.

ORGANIZATIONAL DESIGN FOR THE TWENTY-FIRST CENTURY

As the world grows increasingly complex and fast-paced, companies continue to seek new forms of organization that permit them to compete effectively. Among the most popular of these new forms are the boundaryless organization, the team organization, the virtual organization, and the learning organization.

Boundaryless Organization

The boundaryless organization is one in which traditional boundaries and structures are minimized or eliminated altogether. For example, General Electric's fluid organizational structure, in which people, ideas, and information flow freely between businesses and business groups, approximates this concept. Similarly, as firms partner with their suppliers in more efficient ways, external boundaries disappear. Some of Walmart's key suppliers are tied directly into the retailer's information system. As a result, when Walmart distribution centres start running low on, say, Tide detergent, the manufacturer (P&G) receives the information as soon as the retailer does. Procter and Gamble proceeds to manufacture or simply send new inventory and restock the distribution centre without Walmart having to place a new order.

Team Organization

Team organization relies almost exclusively on project-type teams, with little or no underlying functional hierarchy. People "float" from project to project as dictated by their skills and the demands of those projects. At Cypress Semiconductor, units or groups that become large are simply split into smaller units. Not surprisingly, the organization is composed entirely of small units. This strategy allows each unit to change direction, explore innovative ideas, and try new methods without having to deal with a rigid bureaucratic superstructure. Although few large organizations have reached this level of adaptability, Apple and Xerox are among those moving toward it.

Virtual Organization

Closely related to the team organization is the virtual organization. A virtual organization has little or no formal structure. Typically, it has only a handful of permanent employees, a very small staff, and a modest administrative facility. As the needs of the organization change, its managers bring in temporary workers, lease facilities, and outsource basic support services to meet the demands of each unique situation. As the situation changes, the temporary workforce changes in parallel, with some people leaving the organization and others entering it. Facilities and subcontracted services also change. In other words, the virtual organization exists only in response to its own needs.

Global Research Consortium (GRC) is a virtual organization. GRC offers research and consulting services to firms doing business in Asia. As clients request various services, GRC's staff of three permanent employees subcontracts the work to an appropriate set of several dozen independent consultants and/or researchers with whom it has relationships. At any given time; therefore, GRC may have several projects under way and 20 or 30 people working in various capacities. As the projects change, so does the composition of the organization. Figure 7.8 illustrates the basic structure of a virtual organization.

Using apps and modern technologies can help us organize our lives. Efficient organization and communication among organization members is vital particularly for virtual organizations. Read the following cautionary tale in the E-Business and Social Media box entitled "'Simon Says,' Alexa, What Have You Done?"

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

"Simon Says," Alexa, What Have You Done?

Most of us are very familiar with the children's game "Simon Says." It taught us about the importance of paying attention by forcing us to act on instructions only after hearing those magic words. But today a whole new generation of kids may be far more likely to substitute Simon's name for Amazon's Alexa or Apple's Siri or Samsung's Bixby. After all, they may ask Alexa more questions than they ask their friends or parents on some days.

In the search for efficiency and the quest to effectively organize our lives, complete tasks, and find resources, many people have become reliant on e-assistants. The use of integrated technology is more common in people's homes than at work; however, these personal assistants are on guard, listening and waiting to engage while sitting on desks, tucked away inside purses, or in the jacket pockets in the workplace. Even if Alexa (and similar devices) have not officially conquered the business world, they are listening and preparing to gain more access in the years ahead. As you read the next paragraph, consider the business implications (security and otherwise) and the lessons from the following story that made headlines around the world.

A couple was having a private conversation in their home when their Echo speakers activated Alexa when a word that sounded like "Alexa" was recognized. Apparently, during the conversation that followed, a "send message

Pianodiaphragm/Shutterstock

command" was also triggered. Fortunately, the private discussion was about hardwood floors and not something more sensitive because Alexa then sent that recorded conversation, randomly, to a contact (one of their employees). He later called and told them details of that private conversation and warned them about what happened. Obviously, the couple felt like their privacy had been invaded; quite frankly, it had been totally violated! However, not without their partial cooperation. After the incident, they understandably decided to unplug all of their devices! Amazon explained the very unlikely string of events that led to this failure, but it did not guarantee that this could not happen again. Instead, their explanation was much more cautious but less reassuring to anyone who was paying attention.

So, what are the potential implications of this type of scenario in the business world? There's a lot of buzz about the promise of artificial intelligence. AI actually dates back to the 1950s; however, today we have computers with the processing power to make advanced decisions that were previously reserved for science fiction movies. We have seen many technologies creep in from the consumer world to the business world. But what if that recorded conversation had been about the private negotiation details between a manufacturer and a distributor on a potential distribution agreement? What if the management team had been talking about their costs, margins, sales goals, and bottom-line minimum price to close the deal? What if Alexa, or her future B2B version, had sent a recorded message of all those secret strategic details to (1) the other side of the negotiating table or (2) the competition or (3) had just simply posted it online?

Advanced technology can help us access and organize information for better decision making. As AI evolves even further, we must not forget that the first word in that term is "artificial." As kids, "Simon Says" taught us to listen carefully. We were penalized when we made a mistake. So Alexa can learn a lot from Simon.

"Simon Says" that artificial intelligence is impressive, but it remains a shadow of true knowledge.

CRITICAL THINKING QUESTIONS

1. List all the positive ways that you use such personal assistants. List all the ways a business person can use an e-assistant in his or her day-to-day job.
2. Conduct research to find information about this case and look for other similar stories. What did you find? How does this research impact your perception of e-assistants? How does this impact your perception of the business applications of this technology today?

FIGURE 7.8 The virtual organization

Learning Organization

A learning organization facilitates the lifelong learning and personal development of all of its employees while continually transforming itself to respond to changing demands and needs. The most frequent goals are improved quality, continuous improvement, and performance measurement. The idea is that the most consistent and logical strategy for achieving continuous improvement is to constantly upgrade employee talent, skill, and knowledge. For example, if each employee in an organization learns one new thing each day and can translate that knowledge into work-related practice, continuous improvement will logically follow.

In recent years, many different organizations have implemented this approach on various levels. Shell, for example, purchased an executive conference centre called the Shell Learning Centre. The facility boasts state-of-the-art classrooms and instructional technology, lodging facilities, a restaurant, and recreational amenities such as a golf course, a swimming pool, and tennis courts. Line managers at the firm rotate through the centre and serve as teaching faculty. All Shell employees routinely attend training programs, seminars, and related activities, gathering the latest information they need to contribute more effectively to the firm.

LO-5 THE INFORMAL ORGANIZATION

The formal organization of a business is the part that can be seen and represented on the organization chart. The structure of a company, however, is not limited to the organization chart and the formal assignment of authority. Frequently, the **informal organization**—the everyday social interactions among employees that go beyond formal jobs and job interrelationships—effectively alters a company's formal structure. Indeed, the informal organization is sometimes more powerful than the formal structure. The power of the informal organization was evident in the highly publicized rescue of the Chilean miners a few years ago. In the underground cavern where they were trapped, there were no top managers, so much of what the miners did was informal (dividing up chores, singing, providing mutual support, and so on). These activities kept the miners' hopes alive until they were rescued.[23] The team ethics exercise at the end of this chapter presents an interesting situation that illustrates the informal organization.

Is the informal organization good or bad? On the positive side, the informal organization can help employees feel that they "belong," and it gives them an outlet for "letting off steam" in a safe environment. It also provides information that employees are interested in hearing. On the negative side, the informal organization can reinforce office politics that put the interests of individuals ahead of those of the company. Likewise, a great deal of harm can be caused by distorted or inaccurate information communicated without management input or review. For example, if the informal organization is generating false information about impending layoffs, valuable employees may act quickly (and unnecessarily) to seek other employment. Two important elements of the informal organization are informal groups and the organizational grapevine.

Informal Groups

Informal groups are simply groups of people who decide to interact among themselves. They may be people who work together in a formal sense or who just get together for lunch, during breaks, or after work. They may talk about business, the boss, or non-work-related topics such as families, movies, or sports. Their impact on the organization may be positive (if they work together to support the organization), negative (if they work together in ways that run counter to the organization's interests), or irrelevant (if what they do is unrelated to the organization).

Informal groups can be a powerful force that managers cannot ignore.[24] One writer described how a group of employees at a furniture factory blocked their boss's efforts to increase production. They basically agreed to produce a reasonable amount of work but not to work too hard. One man kept a stockpile of completed work hidden as a backup in case he got too far behind. In another example, autoworkers described how they left out gaskets and seals and put soft drink bottles inside doors to cause customer complaints.[25] Of course, informal groups can also be a positive force, as when people work together to help a colleague who has suffered a personal tragedy. For example, several instances of this behavior were reported after hurricanes devastated parts of the Northeast and the Caribbean.

In recent years, the internet has served as a platform for the emergence of different kinds of informal or interest groups. As one example, Chevron uses its internal network to facilitate a wide range of groups that bring together people with common interests. And increasingly workers who lose their jobs as a result of layoffs band together electronically to offer moral support to one another and to facilitate networking as they all look for new jobs.[26] Indeed, social media plays a major role in informal groups today.

The Organizational Grapevine

The **grapevine** is the informal communication network that runs through the entire organization.[27] The grapevine is found in all organizations, and it does not always follow the same patterns as formal channels of authority

INFORMAL ORGANIZATION A network of personal interactions and relationships among employees unrelated to the firm's formal authority structure.

GRAPEVINE An informal communications network that carries gossip and other information throughout an organization.

ESB Professional/Shutterstock

The grapevine is a powerful communications network in most organizations. These workers may be talking about any number of things—an upcoming deadline on an important project, tonight's hockey game, the stock market, rumours about an impending takeover, or gossip about who's getting promoted.

and communication. Formerly, when people gathered around the water cooler or on the golf course to exchange gossip and pass on information, they had names and faces. But with the internet (a worldwide grapevine), you may not know whom you are talking to, or how reliable the person providing the information is.[28]

There is some disagreement about how accurate the information carried by the grapevine is, but research is increasingly finding it to be fairly accurate, especially when the information is based on fact rather than speculation. One study found that the grapevine may be between 75 percent and 95 percent accurate.[29] That same study also found that informal communication is increasing in many organizations for several reasons. One contributing factor is the widespread availability of information technology that makes it easier than ever before for people to communicate quickly and easily. Much like in informal groups, social media plays a growing role in the grapevine.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. Evernote App **Source:** Evernote Corp. **Key Features:** Tool to make notes, remember key items, and organize your professional and personal projects.	Apple, Android, Windows
2. SAP Business One App **Source:** SAP SE **Key Features:** Designed for enterprise resource planning applications for small business.	Apple, Android, Windows
3. My Teams App **Source:** Davis Fredenvals **Key Features:** Helps you pick, manage, and communicate with workplace teams.	Android

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" business organization apps and identify the key features.

More recently, another study looked at the effects of the recent recession and large-scale job losses on informal communication. More than half of the survey's participants reported a sharp increase in gossip and rumours in their organizations. The same survey also reported an increase in the amount of eavesdropping in most businesses.[30] Further, in another recent survey, 32 percent of people claimed to use their work email inappropriately, and 48 percent admitted gossiping with other employees through their email.[31] A recent poll found that 47 percent of those responding indicated that they gossiped at work and 18 agreed that no topics were "off-limits." And yet another study reported that 55 percent of conversations in the workplace among men and 67 percent of conversations among women involved at least some gossip.[32]

Attempts to eliminate the grapevine are fruitless, but fortunately, the manager does have some control over it. By maintaining open channels of communication and responding quickly and clearly to inaccurate information, the manager can minimize the damage the grapevine can do. The grapevine can be an asset. By learning who the key people in the grapevine are, for example, the manager can partially control the information they receive and use the grapevine to sound out employee reactions to new ideas, such as a change in human resource policies or benefit packages. The manager can also get valuable information from the grapevine and use it to improve decision making.[33]

SUMMARY OF LEARNING OBJECTIVES

LO-1 DISCUSS THE ELEMENTS THAT INFLUENCE A FIRM'S *ORGANIZATIONAL STRUCTURE.*

Every business needs structure to operate. *Organizational structure* varies according to a firm's mission, purpose, and strategy. Size, technology, and changes in environmental circumstances also influence structure. In general, although all organizations have the same basic elements, each develops the structure that contributes to the most efficient operations.

LO-2 EXPLAIN HOW *SPECIALIZATION* AND *DEPARTMENTALIZATION* ARE THE BUILDING BLOCKS OF ORGANIZATIONAL STRUCTURE.

As a firm grows, it usually has a greater need for people to perform specialized tasks (specialization). It also has a greater need to group types of work into logical units (departmentalization). Common forms of departmentalization are *customer*, *product*, *process*, *geographic*, and *functional*. Large businesses often use more than one form of departmentalization.

LO-3 DISTINGUISH BETWEEN *RESPONSIBILITY* AND *AUTHORITY* AND EXPLAIN THE DIFFERENCES IN DECISION MAKING IN *CENTRALIZED* AND *DECENTRALIZED ORGANIZATIONS*.

Responsibility is the duty to perform a task, whereas *authority* is the power to make the decisions necessary to complete tasks. *Delegation* begins when a manager assigns a task to a subordinate; *accountability* means that the subordinate must and justify the outcome. *Span of control* refers to the number of people who work for a manager. The more people supervised by a manager, the wider his or her span of control. Wide spans are usually desirable when employees perform simple or unrelated tasks. When jobs are diversified or prone to change, a narrower span is generally preferable.

In a *centralized organization*, only a few individuals in top management have real decision-making authority. In a *decentralized organization*, much authority is delegated to lower-level management. Where both *line* and *line-and-staff authority* exist in an organization, *line departments* generally have authority to make decisions while *staff departments* have a responsibility to advise. *Committee and team authority* empowers committees or work teams to make decisions about various aspects of operations.

LO-4 EXPLAIN THE DIFFERENCES BETWEEN *FUNCTIONAL*, *DIVISIONAL*, *PROJECT*, *MATRIX,* AND *INTERNATIONAL ORGANIZATION STRUCTURES*, AND DESCRIBE THE MOST POPULAR FORMS OF ORGANIZATIONAL DESIGN.

In a *functional organization*, authority is usually distributed among basic functions such as marketing and finance. In a *divisional organization*, the various divisions operate in a relatively autonomous fashion. In *project organization*, a company creates project teams to address specific problems or to complete specific projects. A *matrix structure* is a combination of divisional and functional structures; it imposes one type of structure on top of another. A company that has divisions in many countries may require an additional level of *international organization* to coordinate those operations. Four of the most popular forms of organizational design are *boundaryless organizations* (traditional boundaries and structures are minimized or eliminated), *team organizations* (relying on project-type teams, with little or no functional hierarchy), *virtual organizations* (which have little formal structure and only a handful of permanent employees, a small staff, and a modest administrative facility), and *learning organizations* (which facilitate employees' lifelong learning and personal development while transforming the organization to meet changing demands and needs).

LO-5 UNDERSTAND HOW THE *INFORMAL ORGANIZATION* IS DIFFERENT FROM THE FORMAL ORGANIZATION.

The *formal organization* is the part that can be represented in chart form. The *informal organization*, everyday social interactions among employees that go beyond formal jobs and job interrelationships, may alter formal structure. There are two important elements in most informal organizations. *Informal groups* consist of people who decide to interact among themselves. Their impact on a firm may be positive, negative, or irrelevant. The *grapevine* is an informal communication network that can run through an entire organization. Because it can be harnessed to improve productivity, some organizations encourage the informal organization.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Explain the significance of organizational size as it relates to organizational structure. Describe the changes likely to occur as an organization grows.
2. Why do some managers have difficulties in delegating authority? Why do you think this problem might be more pronounced in small businesses?
3. Do you think that you would want to work in a matrix organization, where you were assigned simultaneously to multiple units or groups? Why, or why not?
4. In your own words, explain how a functional structure differs from a divisional structure.
5. Why should managers pay attention to the informal organization?
6. The argument has been made that the divisional structure does a better job than the functional structure of training managers for top-level positions. Do you agree or disagree with this argument? Explain your reasoning.

APPLICATION EXERCISES

7. Select a company where you would like to work one day. Using online research, determine if the company has a functional, divisional, matrix, international, team, virtual, or learning organization. Explain how you arrived at this conclusion. Do you believe that its organizational structure is consistent with the organization's mission? Do you think that organizational structure is well suited to your working style and preferences?
8. Describe a hypothetical organizational structure for a start-up digital marketing firm. Describe changes that might be necessary as the business grows.
9. Think about the organization where you currently work (or one where you previously worked). Which of the basic structural types was it most consistent with (functional, divisional, project, matrix, and international)? What was the basis of departmentalization in the organization? Why was that basis used?
10. Interview the manager of a local service business (e.g., a fast-food restaurant). What types of tasks does this manager typically delegate? Is the appropriate authority also delegated in each case? What problems occur when authority is not delegated appropriately?

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members and discuss your new business venture within the context of this chapter. Develop specific responses to the following:

1. Thinking ahead one year, how many employees do you expect that you will have in your business? How did you come to this conclusion?
2. Draw a sample organization chart for your business in one year. Although you won't know the names of all your employees, your organization chart should include job titles.
3. Will decision making in your business be centralized or decentralized? Be sure to support your conclusion.
4. How do you think that your organizational structure will change over time? Will it be the same in 10 years?

BUILDING YOUR BUSINESS SKILLS

GETTING WITH THE PROGRAM

GOAL

To encourage students to understand the relationship between organizational structure and a company's ability to attract and keep valued employees.

SITUATION

You are the founder of a small but growing high-tech company that develops new computer software. With your current workload and new contracts in the pipeline, your business is thriving, except for one problem—you cannot find computer programmers for product development. Worse yet, current staff members are being lured away by other high-tech firms. After suffering a particularly discouraging personnel raid in which competitors captured three of your most valued employees, you schedule a meeting with your director of human resources to plan organizational changes designed to encourage worker loyalty. You already pay top dollar, but the continuing exodus tells you that programmers are looking for something more.

METHOD

Working with three or four classmates, identify some ways in which specific organizational changes might improve the working environment and encourage employee loyalty. As you analyze the following factors, ask yourself the obvious question, *If I were a programmer, what organizational changes would encourage me to stay?*

- *Level of job specialization.* With many programmers describing their jobs as tedious because of the focus on detail in a narrow work area, what

changes, if any, would you make in job specialization? Right now, for instance, few of your programmers have any say in product design.

- *Decision-making hierarchy.* What decision-making authority would encourage people to stay? Is expanding employee authority likely to work better in a centralized or decentralized organization?
- *Team authority.* Can team empowerment make a difference? Taking the point of view of the worker, describe the ideal team.
- *Intrapreneuring (see Chapter 4).* What can your company do to encourage and reward innovation?

FOLLOW-UP QUESTIONS

1. With the average computer programmer earning nearly $70 000, and with all competitive firms paying top dollar, why might organizational issues be critical in determining employee loyalty?
2. If you were a programmer, what organizational factors would make a difference to you? Why?
3. As the company founder, how willing would you be to make major organizational changes in light of the shortage of qualified programmers?

EXERCISING YOUR ETHICS

I HEARD IT THROUGH THE GRAPEVINE

THE SITUATION

Assume that you are a divisional manager at a large high-tech company. The company has just lost a large contract, and the human resources director has just advised company executives that they must cut the workforce by 10 percent within three months to preserve their financial position. You are upset at the prospect of losing long-time employees, especially those nearing retirement or with young families.

THE DILEMMA

As you think of the situation, another regional member has brought up a potential solution that will spare you from actually laying off employees. "The grapevine has worked against us in the past, so let's make it work for us this time. If we leak word that the company is planning to cut pay by 15 percent for most of the workforce because of the loss of this contract, people will get scared. They'll start looking for jobs or re-evaluating retirement and the layoff will take care of itself. Once we've reached the desired level of resignations, we will reassure the remaining employees that their jobs are secure."

TEAM ACTIVITY

Assemble a group of four students and assign each group member to one of the following roles:

- A loyal employee who has worked for the company for 25 years
- An employee who was thinking of leaving the company
- A company shareholder
- A local reporter who has been tipped off about the potential wage cut to one of the key employers in the community

ACTION STEPS

1. Before hearing any of your group's comments on this situation and from the perspective of your assigned role, determine the underlying ethical issues. Write them down.
2. Gather your group together and reveal, in turn, each member's comments on the situation. Next, reveal the ethical issues listed by each member.
3. What do you think most people would do in this situation? What would you do if you were the division manager in this situation?
4. What are the potential positive and negative repercussions? Provide an example of a negative chain of events that might lead to unexpected consequences of these actions if they are taken.
5. From an ethical standpoint, what does your group conclude is the most appropriate action the division manager should take in this situation?

BUSINESS CASE 7

REORGANIZING AND IMPROVING EFFICIENCY

In our fast-paced, modern economy, business organizations must constantly change their organizational structures to remain competitive. Listed below are just some of the companies that changed their structures recently:

- Bombardier Inc. changed its organizational structure after experiencing many delays in the development of the CSeries jet. The company previously had just two business units (Transportation and Aerospace), but it now has four (Transportation, Aerostructures and Engineering Services, Business Aircraft, and Commercial Aircraft). The new structure is designed to reduce costs, increase profitability, increase responsiveness to customer needs, and focus attention on Bombardier's growth areas. More, recently Bombardier reached a deal and gave managing control of the C-Series to Airbus.
- Nissan Canada Inc. streamlined its organizational structure as part of a larger effort to increase sales. Formerly, Nissan dealers reported to a regional general manager, who reported to a sales director, who reported to a regional vice-president. The new structure eliminates the sales director position and shortens the chain of command, so decisions can be made more quickly.
- After experiencing a decline in sales, McDonald's announced that it was changing its organizational structure to more effectively respond to consumer needs in the diverse markets that it serves. The new organizational structure is based on geographic zones: Northeast, South, Central, and West. It will give local managers more autonomy to develop menu items that consumers in their area prefer.
- Coty Inc., the cosmetics company, has introduced a new organizational structure that is based on four product categories (fragrance, skin care, colour cosmetics, and body care) in four distinct regions (North America; Europe; Latin America; and Asia-Pacific/Middle East, Africa). The new structure replaces one that had just two divisions (Coty Prestige and Coty Beauty).

When companies decide to reorganize, they may face certain dilemmas. Three of the most common are: (1) whether to emphasize centralization or decentralization, (2) whether to use geographical or product

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departmentalization, and (3) whether to split a single company into two (or more) companies.

CENTRALIZATION VERSUS DECENTRALIZATION

It may not be easy to decide whether to operate with a centralized structure (where decision-making authority is concentrated at the top of the organizational hierarchy) or a decentralized structure (where decision-making authority is pushed down to lower levels in the hierarchy). This dilemma can clearly be seen in the long history of General Motors (GM). In the 1920s, GM's president, Alfred Sloan, introduced a decentralized structure that gave each car division considerable autonomy to produce what the division managers thought would attract whatever market segment the division was pursuing. It worked so well that GM became the largest automobile manufacturer in the world by the middle of the twentieth century. But all this autonomy resulted in widely differing car designs that were very expensive to produce. As decades passed, costs soared and competition from cost-conscious Japanese automakers became ferocious. GM's sales and overall profitability declined year-by-year and turned into major losses that led to near collapse. In response, GM took away much of the autonomy that managers in various international divisions had and forced its worldwide units to work more closely together to design cars that could be sold (with modest variations) worldwide. A "Global Council" in Detroit made key decisions about how much would be spent on new car development. GM also consolidated product lines and turned into a more focused company.

GEOGRAPHIC VERSUS PRODUCT DEPARTMENTALIZATION

Some firms use geographic departmentalization (organizing on the basis of geographic regions) and some use product departmentalization (organizing on the basis of products that are sold). But it is not always easy to decide which form is best. In recent years, increased global competition and reduced impediments to cross-border communication have led some companies to switch from geographic to product departmentalization. For example, Heinz abandoned geographical departmentalization in favour of product departmentalization. Managers in various countries work with each other to apply the best ideas from one region to all the others. Exide Corp.'s structure formerly consisted of several "country organizations" that had considerable latitude to make decisions that were best for that country. But it adopted a new product structure with global business units to oversee the company's various product lines, such as car and industrial batteries.

Either approach—products or geography—can cause problems if taken to an extreme. If a company organizes by products, it can standardize manufacturing, introduce new products around the world faster, and eliminate overlapping activities. But if too much emphasis is put on product and not enough on geography, a company is likely to find that local decision making is slowed and products are not tailored to a specific country's customers. When Ford Motor Co. moved to product departmentalization, the reorganization saved the company $5 billion in its first few years of operation, but Ford's market share declined during the same period. Ford responded by giving executives in various regions more authority to decide what types of vehicles were best for their local market. In other words, it moved back a bit toward the geographical model.

SPLITTING A SINGLE COMPANY INTO TWO (OR MORE) COMPANIES

A few years ago, Kraft Foods decided to split into two distinct companies, one focusing on worldwide snacks (including brand names such as Oreo and Lu cookies, Cadbury chocolate, and Trident gum), and the other on the North American grocery business (including brands such as Velveeta cheese and Maxwell House coffee). The North American grocery business was launched as a publicly traded company called Kraft Foods Group, and the remainder of Kraft Foods Inc. was renamed Mondelez International with a focus on the international snack and confectionary business. One reason for the restructuring was the realization that sales revenue in the grocery business was growing more slowly than in the snacks business.

OTHER ISSUES IN REORGANIZING

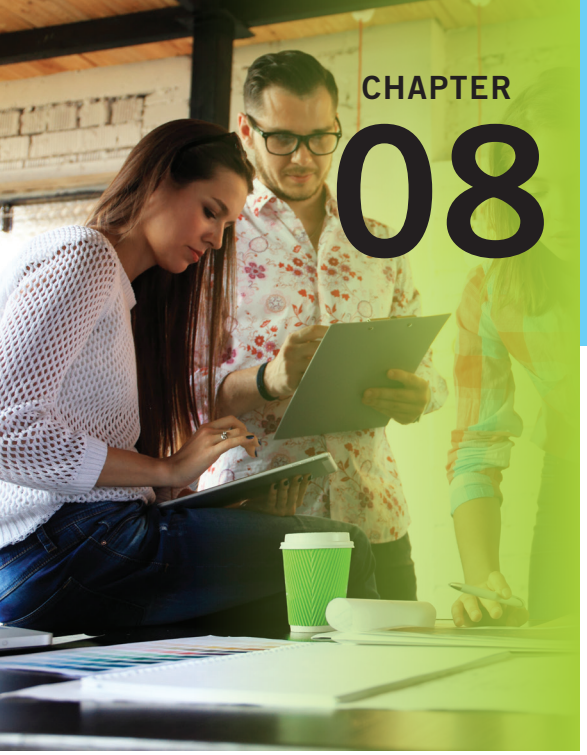
Sometimes a dispute in a family business forces a change in a company's organizational structure. Consider the Irving family of New Brunswick, which owns nearly 300 businesses in areas as diverse as oil refining, forestry, shipbuilding, food processing, publishing, transportation, and home improvement. The company was founded by J.D. Irving in 1882 and expanded dramatically under his son K.C, who then passed it on to his three sons—J.K., Arthur, and Jack. These brothers then had five sons. But tensions developed between two of the five regarding the strategic direction of the company. The brothers wanted to avoid a bitter family feud, so they reorganized the company and let the two main parts (forestry and oil) go their separate ways.

QUESTIONS FOR DISCUSSION

1. In your own words, explain the dilemma that exists when managers are trying to decide whether to use a geographic or product basis for departmentalization. Do the same for the centralization/decentralization dilemma.
2. Why would a company decide to split into two (or more) companies?
3. Consider the following statement: *We should not pay too much attention to what an organization's structure looks like. It is far more important to have a good corporate strategy and leaders who can motivate employees who work well together than it is to worry about the mechanical structure of an organization.* Do you agree or disagree? Explain your reasoning.

MyLab Intro to Business

Study, practise, and explore real business situations with these helpful resources:
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.
- **Videos:** Learn more about the business practices and strategies of real companies.



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CHAPTER

08

Managing Human Resources and Labour Relations

LO

AFTER READING THIS CHAPTER, YOU WILL BE ABLE TO:

- **LO-1** Define *human resource management*, discuss its strategic significance, and explain how managers plan for human resources.
- **LO-2** Identify the issues involved in staffing a company, including *internal* and *external recruiting* and *selection*.
- **LO-3** Discuss different ways in which organizations go about developing the capabilities of employees and managers.
- **LO-4** Discuss the importance of *wages and salaries*, *incentives*, and *benefit programs* in attracting and keeping skilled workers.
- **LO-5** Describe some of the key legal issues involved in hiring, compensating, and managing workers in today's workplace.
- **LO-6** Discuss *workforce diversity*, the *management of knowledge workers*, and the use of *contingent* and *temporary workers* as important changes in the contemporary workplace.
- **LO-7** Trace the evolution of, and discuss trends in, *unionism* in Canada.
- **LO-8** Describe the *major laws governing unionism*.
- **LO-9** Identify the steps in the *collective bargaining process*.

An Avalanche of Sexual Harassment Cases.

Over the years, human resource management professionals in both public- and private-sector organizations have worked very hard to develop policies to deal with the issue of sexual harassment in the workplace. In 2017, Facebook took the unusual step of publicly releasing its policies on workplace harassment and workplace bullying, including enforcement procedures.

Most companies have developed anti-harassment guidelines, but numerous problems still exist because managers don't enforce the policies, or because employees don't fully comprehend the policies, or because individuals who have been harassed are hesitant to make a formal complaint.

An Angus Reid Institute poll found that one-quarter of the respondents had experienced unwelcome sexual advances at work. Women were four times as likely as men to report sexual harassment (but 80 percent never reported the incident). It's quite likely that the number of incidents is underreported because women fear reprisals from powerful men if they do speak out against abuses. Some insight into this problem is provided by an experiment where researchers asked one group of women to *imagine* that in a job interview they were asked three inappropriate questions, and then to think about how they would feel and how they would react. A second group in the experiment was *actually asked* these inappropriate questions during what they

thought was a real job interview. Sixty-eight percent of the women in the first group said they would refuse to answer at least one of the inappropriate questions, but not a single woman in the real interview group actually refused to answer the questions. Another key finding of the study was that women who imagined that they were asked inappropriate questions thought they would feel angry, but what they actually felt was fear, not anger.

But things might be changing. During 2017, women in many different organizations went public with allegations that they had been harassed in some way by well-known actors, politicians, and media people. Consider the following sample of complaints:

- U.S. Senator Al Franken, formerly a comedian on Saturday Night Live, resigned his Senate seat after allegations surfaced that he had inappropriately touched multiple women.
- Harvey Weinstein (see photo), a Hollywood producer with a great deal of clout in the industry, was fired from his position after multiple women accused him of sexual harassment.
- Steve Kirby, director of Jazz Studies at a Canadian university, suddenly resigned after allegations that he had behaved inappropriately with students. He then took a position at the prestigious Berklee College of Music in the United States. When that school learned of his problems in Canada, he was placed on leave while the school conducted an investigation.
- Jian Ghomeshi, the former host of CBC Radio's *Q*, apologized for acting in a sexually inappropriate manner toward a co-worker; he was acquitted of sexual assault charges.
- Three prominent media personalities in the United States—Charlie Rose, Matt Lauer, and Bill O'Reilly—lost their jobs after allegations of sexual harassment surfaced.
- Mario Batali, the renowned chef and co-host of the daytime show, *The Chew*, stepped down from the show after admitting that he sexually harassed and inappropriately touched women he worked with.
- Comedy mogul Gilbert Rozon and Quebec talk-show host Eric Salvail both lost their positions after several women accused them of sexual improprieties.

Curtis Means/ACE Pictures/Shutterstock

Their departure was accelerated by the social media hashtags #metoo and #moiaussi that publicize the bad experiences women have had with sexual harassment.

These examples provide some sense of what women are facing in the workplace regarding sexual harassment, but they do not convey the fear and anxiety that the harassment can cause the victims. A lawsuit filed against Harvey Weinstein by a woman who was allegedly sexually harassed by him brings the severity of the problem clearly into focus. The woman went to Weinstein's office to meet with him to read a script for a part she was hoping to get. Weinstein allegedly told her that to get the part she had to disrobe. When she repeatedly refused, Weinstein ushered her into a dark stairwell and locked the door behind her. A maintenance worker finally heard her cries for help and unlocked the door. A *New York Times* article said that people who could have stopped Weinstein's outrageous behaviour typically didn't do so because they were benefiting from their collaboration with him.

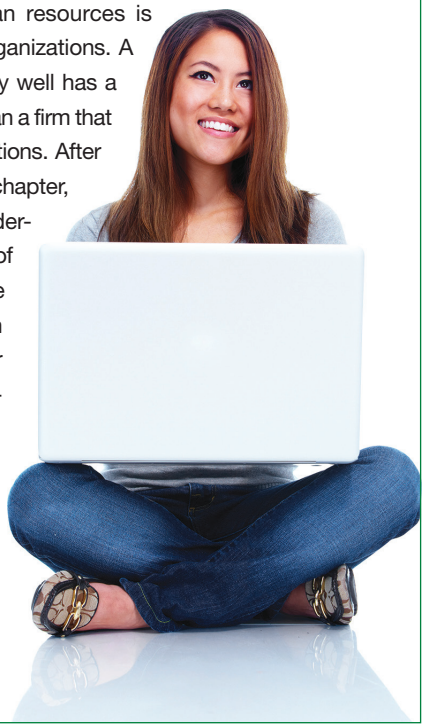
Sexual harassment is not the only issue where improvement is needed. For example, workplace bullying has received increased attention in recent years. Bullying sometimes involves physical intimidation, but more common bullying behaviours involve accusing a worker of making mistakes, constant criticism, gossip, belittling comments, and purposeful exclusion from projects or meetings. In a CareerBuilder survey, 28 percent of workers said that they had been bullied at work. About one-fifth of the workers who said they were bullied left their job as a result. Bullying typically leads to several counterproductive attitudes and behaviours for victims: disengagement, job dissatisfaction, anxiety, depression, and burnout. Some of the individuals in the CareerBuilder survey said they had confronted the person who was bullying them, but that approach was successful only about half the time. They also said that contacting human resources for help was even less effective.

QUESTIONS FOR DISCUSSION

1. Why do you think there has been such a dramatic increase in the number of sexual harassment allegations lately?
2. The CEO of Facebook, Sheryl Sandberg, warned that the recent spate of sexual harassment allegations could lead to a backlash against women. She urged companies to develop clear policies and procedures indicating how sexual harassment allegations will be handled. Do you think Sandberg's concerns about a backlash are accurate, or do you think that all the publicity about sexual harassment will lead to a reduction in this bad behaviour? Explain your reasoning.

HOW WILL THIS HELP ME?

Effectively managing human resources is critical to the success of organizations. A firm that handles this activity well has a better chance for success than a firm that simply goes through the motions. After reading the material in this chapter, you'll be better able to understand—from the perspective of a *manager*—the importance of properly managing human resources in a department or business you own or supervise. You'll also understand—from the perspective of an *employee*—why your employer has adopted certain approaches to dealing with issues like hiring, training, compensation, and benefits.



Kurhan/Fotolia

LO-1 THE FOUNDATIONS OF HUMAN RESOURCE MANAGEMENT

Human resource management (HRM) is the set of organizational activities directed at attracting, developing, and maintaining an effective workforce. Human resource management takes place within a complex and ever-changing environmental context and is increasingly being recognized for its strategic importance.[1]

The Strategic Importance of HRM

The importance of HRM (or personnel) has grown dramatically in the past two decades because of increased legal complexities, the recognition that human resources are a valuable means for improving productivity, and an awareness of the costs associated with poor human resource management. For example, during the previous decade, Microsoft announced two different large-scale layoffs totaling nearly 20 000 employees, mostly individuals working in software development. However, the firm has continued to expand and hire thousands of other highly talented people for jobs related to internet search and network integration, which are important growth areas for the company. This careful and systematic approach to talent management—reducing employees in areas where they are no longer needed and adding new talent to key growth areas—reflects a strategic approach to HRM.

The effectiveness of HR functions has a substantial impact on a firm's bottom-line performance. Poor human resource planning can result in spurts of hiring followed by layoffs—a process that is costly in terms of unemployment compensation payments, training expenses, and morale. Haphazard compensation systems do not attract, keep, and motivate good employees, and outmoded recruitment practices can expose the firm to expensive and embarrassing legal action. Consequently, the chief human resource executive of most large businesses

HUMAN RESOURCE MANAGEMENT (HRM) Set of organizational activities directed at attracting, developing, and maintaining an effective workforce.

is a vice-president directly accountable to the CEO, and many firms are developing strategic HR plans that are integrated with other strategic planning activities.

Even organizations with as few as 200 employees usually have an HR manager and an HR department charged with overseeing these activities. Responsibility for HR activities, however, is often shared between the HR department and line managers. The HR department may recruit and initially screen prospective new employees, but the final hiring decisions are usually made by managers in the department where the new employees will work. The HR department may also establish performance appraisal policies and procedures, but the actual evaluation and coaching of employees are generally done by their immediate superiors.

The growing awareness of the strategic significance of HRM has led to new terminology to reflect a firm's commitment to people. **Human capital** reflects an organization's investment in attracting, retaining, and motivating an effective workforce. Just as financial capital is an indicator of a firm's financial resources and reserves, human capital serves as an indicator of the value of the people in an organization. **Talent management** reflects the view that the people in an organization represent a portfolio of valuable talents and skills that can be effectively managed and tapped in ways best targeted to organizational success.

Human Resource Planning

Planning is the starting point in attracting qualified human resources. Human resource planning involves job analysis, forecasting the demand for and supply of labour, and matching supply and demand.

Job Analysis

Job analysis is a systematic analysis of jobs within an organization. A job analysis is made up of two parts:

1. The **job description** lists the duties of a job; its working conditions; and the tools, materials, and equipment used to perform it.
2. The **job specification** lists the skills, abilities, and other credentials needed to do the job.

Job analysis information is used in many HR activities. For instance, knowing about job content and job requirements is necessary to develop appropriate selection methods, performance appraisal systems, and equitable compensation rates.

HUMAN CAPITAL The organization's investment in having an effective workforce.

TALENT MANAGEMENT Using employee skills to facilitate organizational success.

JOB DESCRIPTION The objectives, responsibilities, and key tasks of a job; the conditions under which it will be done; its relationship to other positions; and the skills needed to perform it.

JOB SPECIFICATION The specific skills, education, and experience needed to perform a job.

Forecasting HR Demand and Supply

Planning for the organization's future HR needs requires managers to assess trends in past HR usage, future organizational plans, and general economic trends. A good sales forecast is often the foundation, especially for smaller organizations. Historical ratios can then be used to predict expected demand for different types of employees, such as operating employees and sales representatives. Large organizations use much more complicated models to predict HR needs.

Forecasting the supply of labour involves two tasks:

- *Forecasting internal supply.* Relates to the number and type of employees who will be in the firm at some future date.
- *Forecasting external supply.* Relates to the number and type of people who will be available for hiring from the labour market at large.

The simplest approach to forecasting *internal* supply is to adjust present staffing levels for anticipated turnover and promotions. At higher levels of the organization, managers plan for specific people and positions. The technique most commonly used is the *replacement chart*, which lists each important managerial position, who occupies it, how long he or she will probably stay in it before moving on, and who is now qualified or will soon be qualified to move into the position. To facilitate planning and identify people for transfer or promotion, organizations may also use **employee information systems** (or **skills inventories**). These systems contain information on each employee's education, skills, work experience, and career aspirations. For example, using such a system, a company can quickly locate every employee who is qualified to fill a position requiring a degree in chemical engineering, three years of experience in an oil refinery, and fluency in French.

Forecasting the *external* supply of labour is more difficult. For example, how does a manager predict how many electrical engineers will be seeking work in Ontario or British Columbia three years from now? To get an idea of the future availability of labour, planners must rely on information from outside sources, including population and demographic statistics and other data that is supplied by colleges and universities on the number of students in major fields.

Matching HR Supply and Demand

After comparing future demand and internal supply, managers can make plans to deal with predicted shortfalls or overstaffing. If a shortfall is predicted, new employees (temporary or permanent) can be hired, existing employees can be retrained and transferred to understaffed areas, individuals approaching retirement can be persuaded to stay on, or labour-saving or productivity-enhancing systems can be installed. If overstaffing is expected to be a problem, the main options are transferring employees, not replacing individuals who leave, encouraging early retirement, and laying off workers.

EMPLOYEE INFORMATION SYSTEMS (SKILLS INVENTORIES) Systems that contain information on each employee's education, skills, work experience, and career aspirations.

LO-2 RECRUITING HUMAN RESOURCES

After deciding which positions need to be filled, managers must find and hire individuals who meet the job requirements. Staffing a business with qualified individuals is one of the most complex and important aspects of good human resource management. A study by the Canadian Federation of Independent Business found that the top three characteristics employers are looking for are a good work ethic, reliability, and willingness to

stay on the job.[2] A survey of 823 business leaders found that 41 percent thought that universities in their province were doing a good job of preparing graduates to address the needs of employers, 31 percent said universities were doing a poor job, and 21 percent were neutral.[3] Other surveys have shown that graduates often lack "soft skills," such as good communication and writing skills, and the ability to think strategically.

Recruiting is the process of attracting qualified people to apply for available jobs. *Internal recruiting* means considering present employees as candidates for openings. Promotion from within can help build morale and keep high-quality employees from leaving. For higher-level positions, a skills inventory system may be used to identify internal candidates, or managers may be asked to recommend individuals for consideration.

RECRUITING The phase in the staffing of a company in which the firm seeks to develop a pool of interested, qualified applicants for a position.

External recruiting means attracting people outside the organization to apply for jobs. External recruiting methods include advertising, campus interviews, employment agencies, executive search firms, referrals by present employees, and hiring "walk-ins" (people who show up without being solicited). Private employment agencies can be a good source of clerical and technical employees, and executive search firms specialize in locating top management talent. Newspaper and online job-search ads are often used because they reach a wide audience and also give minorities "equal opportunity" to learn about and apply for job openings.

The biggest change in recent years in external recruiting has been the advent of online recruiting. Companies post positions on websites such as Monster, Workopolis, and LinkedIn, and interested applicants respond. Internet recruiting gives employers and those seeking employment a fast, easy, and inexpensive way of interacting. But there are drawbacks. Employers receive huge numbers of applications, and many are

THE GREENING OF BUSINESS

What Are "Green" Jobs?

What exactly is a "green job?" GoodWork.ca, one of Canada's most popular green job sites, defines a green job as one that *genuinely* contributes to a more sustainable world. In private-sector businesses, those jobs can be found in a green company (e.g., a solar energy company) or in a traditional company (e.g., an oil and gas company) that is making a real effort to change the way it operates. Green jobs can also be found in educational, governmental, charitable, and non-profit organizations.

Well over half a million Canadians are now employed in environmentally related jobs (e.g., consultants who assess homes to see how energy efficient they are). Many of these jobs didn't even exist a generation ago. According to the Environmental Careers Organization (ECO) of Canada, the following five *sectors* accounted for the highest percentages of green job vacancies:

- Environmental protection
- Resource conservation
- Renewable green energy
- Green services
- Sustainability planning

In a survey conducted by Monster.ca, 78 percent of respondents said they would quit their current job if they could get one at a company that had an environmentally friendly focus. In a second survey, 81 percent of the respondents said that their current employer was not environmentally friendly. Only 18 percent said the employer was "extremely green." This survey showed that people have a high interest in having a green job.

Younger Canadians have become increasingly concerned about the environment, so it is not surprising that many of them want to work for companies that share their concerns. The head of ECO says that environmental jobs are available in virtually every sector of the economy, including the oil and gas industry. That may sound surprising, since the oil and gas industry is not generally perceived to be environmentally friendly. But many green jobs are available in the industry because oil and gas companies are looking for ways to become more sustainable. For example, a "wetland and reclamation research and development coordinator" at Suncor works with biologists, wetland ecologists, foresters, and engineers to construct new ecosystems. One specific project was to transform an oil sands tailing pond into a surface that was solid enough to be reforested. At Nexen, an "environmental advisor" involves planning mitigation measures to limit the company's footprint and to minimize wildlife disturbance. Other green jobs have titles like "solar installer," "climate change intern," "conservation biologist," "environmental researcher," "health and safety inspector," "control system operator," "quality assurance manager," and "sustainability analyst," to name just a few.

Several websites provide employment information on green jobs. They include workcabin.ca, goodwork.ca, eco.ca, and greenjobs.ca. For the list of Canada's Greenest Companies in 2017, see: www.newswire.ca/news-releases/sustainability-is-here-to-stay-winners-of-canadas-greenest-employers-for-2017-are-announced-620061913.html.

Zhang kan/Shutterstock

CRITICAL THINKING QUESTIONS

1. What are the advantages of working for an environmentally friendly company? Are there any disadvantages?
2. Consider the following statement: *"All the publicity about graduates looking for jobs at environmentally friendly companies is exaggerated. Many graduates are merely claiming they want to work for an environmentally friendly company to increase the chance that they will be hired."* Do you agree or disagree with the statement? Explain your reasoning.

ChinaFotoPress/The Canadian Press

At this job fair in Chongqing, China, students and recruiters talk face-to-face about jobs that are available and the characteristics and training that applicants must have to secure a job.

from unqualified people. Starbucks, for example, gets millions of applications every year. Many companies now use résumé-filtering software that searches out keywords on applications. If the words aren't there, the applicant is not contacted.[4] IGN Entertainment, a gaming and media company, doesn't even ask for a résumé. Instead, candidates respond to challenges on IGN's website, which is designed to assess thought processes.[5] The boxed insert entitled "What Are 'Green' Jobs?" illustrates the increasing importance of environmental considerations in external recruiting.

When doing external recruiting, some large companies can influence the labour market where they are located. For example, in 2018 Amazon announced that it would be setting up a second headquarters somewhere in North America and that it would be hiring up to 50 000 people in that area. Companies located in the city where Amazon might set up its second headquarters were concerned that some of their best employees might quit and go to work for Amazon.[6]

Other examples of external recruiting include *job fairs*, where candidates browse through the positions available and talk face-to-face with recruiters. Job fairs are cheaper than posting jobs with an employment agency. At a *virtual job fair* (unlike campus job fairs), participants click on the virtual booths of employers they are interested in and employers interview candidates via video.[7] *Internships* are short-term paid or unpaid positions where students focus on a specific project. The Canadian Undergraduate Survey Consortium found that 55 percent of graduating students had completed an internship.[8]

Whatever approach to external recruiting is used, it is important to give potential employees a real picture of what it would be like doing the job the company is trying to fill. Failure to provide a *realistic job preview* means that any person hired may soon become dissatisfied. Hiring the "wrong" employee for $50 000 per year could cost the company at least $25 000. These costs stem from training, counseling, low productivity, termination, and recruiting and hiring a replacement.

Selecting Human Resources

After the recruiting process attracts a pool of applicants, the next step is to select someone to hire. The intent of the selection process is to gather information from applicants that will predict their job success and then hire the candidates who are most likely to be successful. The process of determining the predictive value of information is called *validation*. To reduce the element of uncertainty, managers use a variety of selection techniques, the most common of which are shown in Figure 8.1. Each organization develops its own mix of selection techniques and may use them in almost any order.

Application Forms

The first step in selection is asking the candidate to fill out an application form. An application form is an efficient method of gathering information

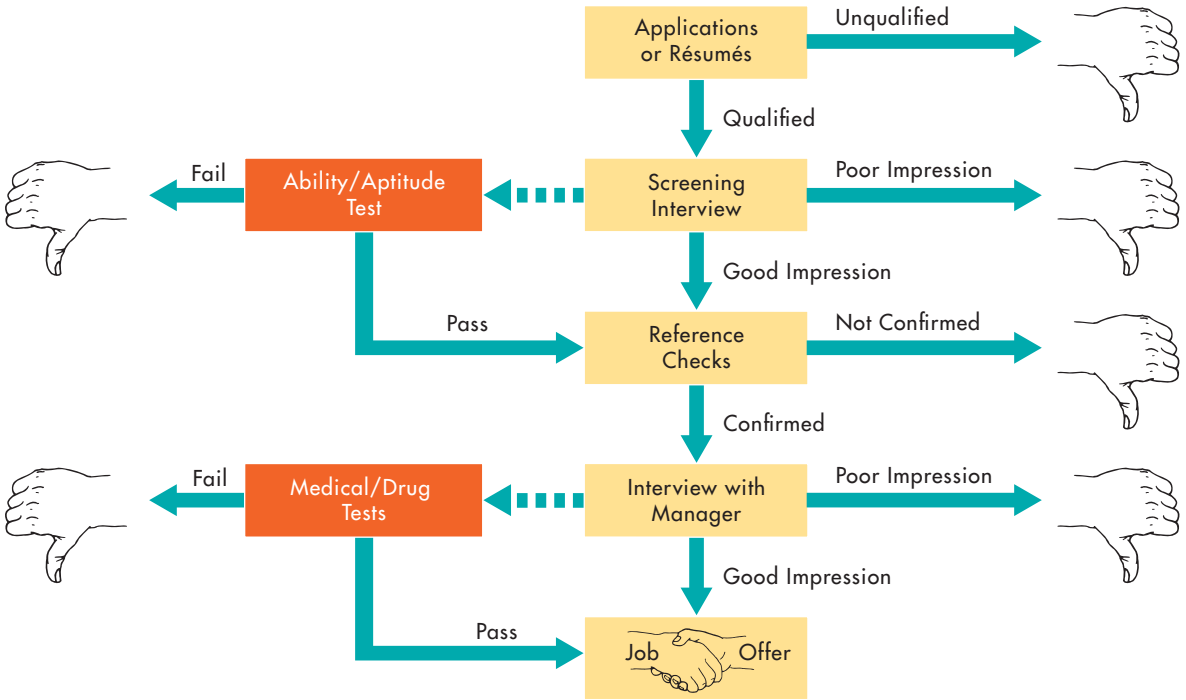


FIGURE 8.1 General steps in the selection process

about the applicant's previous work history, educational background, and other job-related demographic data. It should not contain questions about areas unrelated to the job, such as gender, religion, or national origin. The data on application forms are generally used to decide whether a candidate merits further evaluation, and interviewers use application forms to familiarize themselves with candidates before interviewing them.

Home Depot has reduced the amount of information potential employees must provide and has reduced the application time to just 15 minutes. Potential employees can complete prescreening and choose an interview time on Home Depot's website. Simplifying the application process was important because Home Depot hires thousands of people for the spring selling season.[9]

Tests

Tests of ability, skill, aptitude, or knowledge relevant to a particular job are usually the best predictors of job success, although tests of general intelligence or personality are occasionally useful as well. Some companies administer tests to determine how well applicants score on the "big five" personality dimensions (see Chapter 9). In addition to being validated, tests should be administered and scored consistently. All candidates should be given the same directions, allowed the same amount of time, and offered the same testing environment.

An **assessment centre** involves a series of exercises in which candidates perform realistic management tasks under the watchful eye of expert appraisers. Candidates take selection tests, engage in management simulations, make individual presentations, and conduct group discussions. Assessors check to see how each participant reacts to stress or to criticism by colleagues. *Video assessment* involves showing potential hires videos of realistic work situations and asking them to choose a course of action to deal with the situation.

ASSESSMENT CENTRE A series of exercises in which management candidates perform realistic management tasks while being observed by appraisers.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. **HR Management APP** **Source:** Management Solutions Australia Ltd. **Key Features:** Highlights key HR management strategies and HR-based news and information.	Apple, Android, Windows
2. **LinkedIn Job Search APP** **Source:** LinkedIn **Key Features:** Provides quick access to local jobs. Apply with your LinkedIn profile with just a couple of taps.	Apple, Android, Windows
3. **Monster Job Search APP** **Source:** Monster Worldwide **Key Features:** Recommends the best positions for you from more than one million jobs. You can also apply instantly.	Apple, Android

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" human resources apps and identify the key features.

Interviews

The interview is a popular selection device, but it has become increasingly evident that it is a poor predictor of job success because of biases inherent in the way people perceive and judge others when they first meet them. Many companies are therefore placing more emphasis on testing and less emphasis on interviewing because job candidates are becoming clever at giving all the "right" answers during interviews.[10]

Interview validity can be improved by training interviewers to be aware of potential biases, by writing questions in advance and by asking all interviewees the same set of questions. Interviewers can also increase interview validity by asking "curveball" questions—ones job applicants would never expect—to make applicants think on their feet. Examples might be, "How would you move Mount Fuji?" or "How would you sell me a glass of water?"[11] Interview validity can also be improved by using **behaviour-based interviewing**, which focuses on behaviour rather than on what a person says. It can be used to test for either technical skills (e.g., accounting, welding, or computer programming) or management skills (e.g., organizing, motivating others, or communicating). The approach, which is based on the assumption that a person's past behaviour is a good predictor of his or her future behaviour, requires the interviewer to first identify the characteristics, skills, and behaviours important in the job to be filled. Then, instead of asking a traditional interview question—for example, "Do you often take the initiative?"—behaviour-based interviewing asks questions like, "Tell me about a situation where you took action to solve a problem that you were facing." Individuals who cannot answer a question like this satisfactorily are not likely to be hired.

Other Techniques

Organizations also use other selection techniques that vary with the circumstances. For example, a manufacturing company that is concerned about workers being injured on the job might require new employees to have a physical examination performed. This gives the company some information about whether the applicants are physically fit to do the work and any pre-existing injuries they might have. Reference checks with previous employers are also used, but they may be of limited value because

BEHAVIOUR-BASED INTERVIEWING An approach to improving interview validity by asking questions that focus the interview much more on behaviour than on what a person says.

Photographee.eu/Fotolia

The job interview can be a stressful time for job candidates.

Artificial Intelligence Meets HR

Human resource functions are vital to the success of any business. Yet the human component is sometimes lost because HR professionals are overworked and buried under tasks that take them far away from their core mission. What if we could free them from some of the more tedious tasks? What if we could reduce bias, improve information processing, and fine-tune selection? Well, thanks to artificial intelligence (AI) tools, vast improvements are possible. Are you one of the 1.8 million people already talking to Amazon's Alexa asking her to lower the volume on your music system or asking her for a stock quote? If so, then you are already actively engaging with an AI system. So, what are the positive and negative implications for the workplace? Critics will argue that AI is just a way to reduce the HR workforce in favour of a dangerous "big brother." However, according to Scott Allinson, director of Public Affairs for the Human Resources Professional Association (HRPA), using AI intelligent assistants is not a recipe for worker elimination but instead a useful tool, if used with human judgment, to help reduce burdens of administrative paperwork.

Reducing Paperwork & Streamlining

HR professionals often struggle to process vast amounts of information. According to an article in *The Economist*, Johnson & Johnson receives 1.2 million applications each year for 25 000 available positions. AI systems can help streamline the process by using algorithms that serve as a virtual screening mechanism and that also eliminate human bias. According to Kate Guarino, the director of human resources at Pegasystems, AI helps remove repetitive, low-value tasks, thus increasing the time that is available to complete high-end strategic work.

Interactive Chatbots

Interactive chatbots are being adapted to meet internal and external human resource needs. Chatbots can engage employees and respond to frequently asked questions like: What are my health insurance benefits? But that's not all. AI systems can proactively engage employees and promote new benefits. A chatbot may also suggest a fitness class, a time slot, and offer to book a session, all while telling you that you have put in a lot of overtime at work and should take time for yourself. Chatbots can aid in talent acquisition and orientation by combining multiple data sources to develop candidate profiles and help screen and make decisions in the preliminary stages of selection. Chatbots are also starting to be employed as teaching assistants with popular online courses known as MOOCs (massive open online courses). The applications for HR training are endless.

Analytics and Tracking

AI systems also have the capability to track employee behaviour using real-time analytics. For example, the system can identify and alert the company that an abnormal number of employees are asking questions about their vacation allotment or the current rate of tax deductions at source. Obviously, identifying such patterns is a win-win. However, AI does not end there. A platform designed by Veriato can track and analyze emails, browsing history, the tone of communications, and ultimately flag employees whose behaviour is problematic. It therefore serves as an early warning that certain employees may be looking to leave their jobs. But critics think that this type of monitoring may be a step too far.

The AI Wave

Alexa's artificial sister may help you land a new job and play a role in orienting, training, and promoting you in the future. AI is no longer reserved for science fiction movies; it's a brave new HR world!

CRITICAL THINKING QUESTION

1. What do you think of the application of AI in the field of Human Resources? What are the most useful online and offline applications from the following perspectives: (a) the company, (b) new employees, and (c) HR professionals?

individuals are likely to provide only the names of former employers who will give positive recommendations.

Some companies feel that it is important to administer drug tests, but according to Canadian Human Rights Commission policy, pre-employment drug testing and random drug testing are not permitted. In 2013, the Supreme Court ruled that companies *can* use random drug testing if the workplace is inherently dangerous and there is an existing problem with drug use.[12] But in 2014, the Alberta Arbitration Board ruled that Suncor could not introduce random drug testing at one of its locations. These conflicting rulings have created much uncertainty for human resource managers. The recent legalization of marijuana may complicate this issue even more.

The boxed insert entitled "Artificial Intelligence Meets HR" describes how artificial intelligence (AI) can streamline human resource selection processes and other human resource activities.

LO-3 DEVELOPING HUMAN RESOURCES

After a company has hired new employees, they are "developed" through activities like new employee orientation, training, and performance appraisal.

New Employee Orientation

A new employee's first 30 days have a big influence on whether the person will stay.[13] An Ipsos Reid survey of more than 1000 workers revealed that 50 percent felt they didn't always fit in well.[14] Thus orientation of new workers is a very important activity. **Orientation** is the process of introducing new employees to the company's policies and programs, the co-workers and supervisors they will interact with, and the nature of their job. Orientation plays a key role in job satisfaction, performance, and retention. If it is done poorly, it can result in disenchantment, dissatisfaction, anxiety, and turnover.

ORIENTATION The process of introducing new employees to the company's policies and programs, the co-workers and supervisors they will interact with, and the nature of their job.

Training

Beyond orientation, employees may need to be trained to improve the quality and quantity of their work. The starting point in assessing training is a *needs analysis*, which determines the organization's needs and the training programs necessary to satisfy those needs. The needs analysis focuses on two things: the organization's job-related needs and the capabilities of the current workforce. There are several popular training techniques, including on-the-job training, off-the-job training, and management development programs.

On-the-job training means placing the employee in an actual work situation and having a supervisor or experienced employee demonstrate how to perform the task. Much on-the-job training is informal, as when one employee shows another how to operate the photocopy machine. Training may also be formal, as when a trainer shows employees how to operate a new software program. *Job rotation* means having employees learn a wide array of tasks and acquire more abilities as they are moved from one job to another. This method is most likely to be used for lower-level managers or for operating employees who are being groomed for promotions to supervisory or management positions.

Off-the-job training is performed at a location away from the work site. It might be in a classroom within the same facility or at a different location altogether. *Vestibule training* involves employees performing work under conditions that closely simulate the actual work environment. Montreal-based CAE is famous for building flight simulators that enable airline pilots to learn how to fly a new jet without ever leaving the ground. CAE also develops mock-up operating rooms where medical students can learn in a simulated environment.[15] Another example is McDonald's Hamburger University, where management trainees learn how to grill a burger and how to provide good customer service.

Management development programs are designed to enhance conceptual, analytical, and problem-solving skills. Most large companies run formal in-house management development programs or send managers to programs on university campuses. In many companies, training for managers is not very systematic. In one survey of over 1000 managers, 57 percent said they had to learn how to manage by trial and error, and 89 percent said they had not been groomed to be a leader.[16]

Some management development takes place informally, often through processes such as networking and mentoring. **Networking** refers to informal interactions among managers for the purpose of discussing mutual problems, solutions, and opportunities. Networking takes place in a variety of settings, both inside and outside the office. The boxed insert entitled "Are You LinkedIn?" describes how LinkedIn is used by professionals who are networking in order to make connections about possible jobs.

ON-THE-JOB TRAINING Development programs in which employees gain new skills while performing them at work.

OFF-THE-JOB TRAINING Development programs in which employees learn new skills at a location away from the normal work site.

MANAGEMENT DEVELOPMENT PROGRAMS Development programs in which managers' conceptual, analytical, and problem-solving skills are enhanced.

NETWORKING Informal interactions among managers, both inside and outside the office, for the purpose of discussing mutual problems, solutions, and opportunities.

ENTREPRENEURSHIP AND NEW VENTURES

Are You LinkedIn?

Unless you are part of a small minority, you probably use one or many social network platforms. But are you LinkedIn? If not, what are you waiting for? If you're out of work, looking for a job, and wondering where to turn, help is as close as your computer, tablet, or smartphone. Even if you are a full-time student, it's never too early to start building your career network. Although popular entertainment sites YouTube and Twitter began as cyber highways for recreational and friendship interactions, social networking today is used for much more than entertainment. In today's economy, there's a different kind of traffic—professional networking for career transition—among the list of cyber networking products for job-hunting assistance. Leading the way in this regard is LinkedIn.

Let's look at how the company reached these heights and the entrepreneurs behind the scenes. LinkedIn was started by five people (Reid Hoffman, Allen Blue, Konstantin Guericke, Eric Ly, and Jean-Luc Vaillant) in Reid Hoffman's living room back in 2002, and it had 4500 members after just one month.

Today LinkedIn serves professionals in more than 200 countries. Profiles are posted from more than 546 million members, including executives from all Fortune 500 companies. Users can post résumés, search for companies, and find job openings. The jobs directory allows searching by industry, function, geographic region, title, or company. In fact, more than 10 million jobs were posted in 2017 alone. However, the key attraction is personal connections: one member knows other LinkedIn users, who link with still others, and so on, as information flows to those looking for candidates until they find a word-of-mouth prospect that looks good. The system is based on trusted relationships and connections, and it works; LinkedIn is the world's largest business network, and it connects a huge pool of talent that keeps on growing.

In addition to professionals looking for jobs, there are also business members, some searching for prospective employees, industry experts, potential clients, or new business opportunities. Others are interested in sharing the latest business developments within their networks of contacts. LinkedIn Groups, for example, consists of specialty network groups of businesses and professionals focused on industries, including Social Media Marketing, Finance and Accounting Professionals, and Business in Japan, to name just three of many. Group members may share industry-specific information on performance-enhancing practices, legal issues, and current events, and even participate in determining new directions for their industry.

LinkedIn's growth is due to meeting its members' needs relative to professional fulfillment. But its innovations are yielding attractive financial results to the point that the company became so valuable that Microsoft paid $26 billion to acquire it.

CRITICAL THINKING QUESTION

1. Entrepreneurs are constantly seeking opportunities to get their organization and products noticed in the marketplace. List all the ways LinkedIn can be used to achieve that goal and explain how entrepreneurs can use other social media tools to support their LinkedIn profiles. In answering this question, assume that you are, in turn, (a) a financial advisor and (b) a music producer.

Andrey Popov/Fotolia

Video conferencing has become an important part of the training function. Travel costs are reduced, and interactions between the trainer and the trainees are facilitated.

Mentoring means having a more experienced manager sponsor and teach a less experienced manager. In 2014, a mentoring program called Ten Thousand Coffees was launched. It gives aspiring leaders access to experienced leaders for conversations over a cup of coffee.[17] *Reverse mentoring* means having younger, more tech-savvy employees mentor senior staff members on everything from viral marketing to blogging to the use of Facebook and YouTube.

More and more organizations are using teams as a basis for doing their jobs, so it is not surprising that many companies are developing training programs that are specifically designed to train teams of workers, not just individuals. For example, Eagle's Flight is an innovative leader in the development and delivery of practical training programs for the global business community. Their offering of training programs includes team and training experiences, as well as leadership development and learning.[18]

Evaluating Employee Performance

Performance appraisal means assessing how well employees are doing their jobs. Evaluating employee performance helps in making decisions about pay raises, promotions, and training, and also provides feedback to employees to help them improve their performance. Appraisals may be either objective or judgmental. *Objective* measures of performance include factors such as actual output (number of units produced), the scrap rate, the dollar volume of sales, and the number of claims processed. Objective performance measures may be contaminated by "opportunity bias" if one employee has a better chance to perform than another. For example, a sales representative in a region that is economically poor will likely sell less than an agent in an economically rich area. In cases like this, raw performance figures must be adjusted for the effect of opportunity bias. *Subjective* (or judgmental) measures include ranking and rating methods.

It is best to rely on multiple information sources when conducting appraisals. A system called *360-degree feedback* gathers information from supervisors, subordinates, and co-workers. The most accurate information comes from individuals who have known the person being appraised for one to three years. Eight or ten individuals should take part in the evaluation.[19] The use of social media in appraisals is increasing. When Facebook decided that traditional appraisals were not suited to its employees, it turned to Toronto-based Rypple, Inc., a company that specializes in software tools, to provide real-time feedback using a Facebook-style interface. Managers can "like" tasks, ask for feedback, and monitor employee progress toward goals.[20]

The appraisal process typically begins when a manager defines performance standards for an employee. The manager then observes the employee's performance. The manager and the employee then meet to discuss the appraisal. The process concludes when the manager's written assessment is issued. This sounds fairly straightforward, but for it to work properly managers must clearly state performance measures, track performance in real time, use multiple measures of performance, gather information on peer recognition, and stick to the evaluation schedule.[21]

Many managers are not effective when conducting performance appraisals, partly because they don't understand how to do it properly

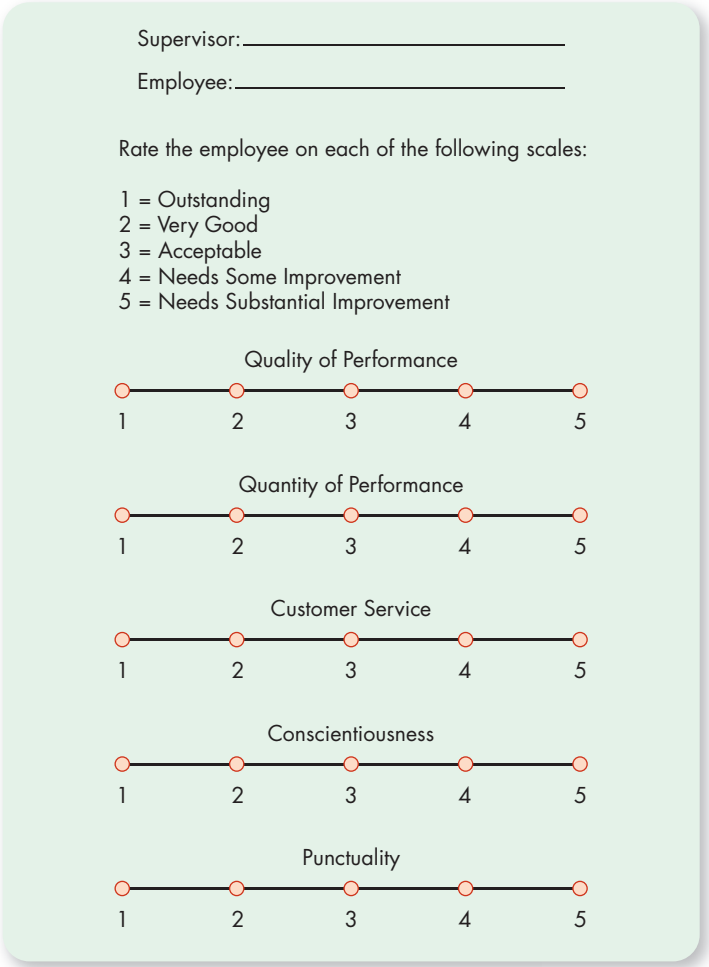


FIGURE 8.2 Performance rating scale

MENTORING Having a more experienced manager sponsor and teach a less experienced manager.

PERFORMANCE APPRAISALS A formal program for evaluating how well an employee is performing a job; helps managers determine how effective they are in recruiting and selecting employees.

and partly because they don't enjoy it. As a result, managers may have a tendency to avoid giving negative feedback because they know that an employee who receives it may be angry, hurt, discouraged, or argumentative. Some companies have actually abandoned performance appraisals. The argument is that it may not be helpful to look back at employees' performances over the past year to see if they met targets that have suddenly become irrelevant due to disruptive changes that have forced the company to change its strategy. In other words, performance appraisals must be more forward-looking.[22] Australia-based Atlassian Inc., for example, replaced annual appraisals with weekly one-on-one meetings between managers and workers. Discussions focus on goals and performance.[23]

Methods for Appraising Performance

The *simple ranking method* is a subjective method that requires a manager to rank-order from top to bottom or from best to worst each member of a particular workgroup or department. The one ranked first is the top performer, the one ranked second is the second-best performer, and so forth. Ranking is difficult for large groups because the individuals in the middle of the distribution may be hard to distinguish from one another. Comparing people in different workgroups is also difficult. For example, an employee ranked third in a high-performing group may be more valuable than an employee ranked first in a lower-performing group.

Another subjective method, *forced distribution*, involves grouping employees into predefined frequencies of performance ratings. Those frequencies are determined in advance and are imposed on the rater. A decision might be made, for instance, that 10 percent of the employees in a workgroup will be categorized as outstanding, 20 percent as very good, 40 percent as average, 20 percent as below average, and the remaining 10 percent as poor. The forced distribution method will be familiar to students—it is the principle used by professors who grade on a "bell curve" or "normal curve."

The graphic rating scale (see Figure 8.2), a third subjective measure, rates employee performance on various performance dimensions that are deemed to be important (punctuality, conscientiousness, customer service, etc.). Rating differs from ranking because it compares each employee to a fixed standard rather than with other employees. The rating scale provides the standard.

A fourth subjective measure is the *critical incident method*, which focuses attention on an example of especially good or poor performance on the part of the employee. Raters then describe what the employee did (or did not do) that led to success or failure. This technique not only provides information for feedback but also defines performance in fairly clear behavioural terms.

LO-4 COMPENSATION AND BENEFITS

Compensation refers to the rewards that organizations provide in return for employees' willingness to perform various tasks. Compensation includes things such as base salary, incentives, bonuses, benefits, and other rewards.

Determining Basic Compensation

Wages generally refer to hourly compensation paid to operating employees. Most jobs that are paid on an hourly-wage basis are lower-level operating jobs. Rather than expressing compensation on an hourly basis, an organization may instead describe compensation on an annual or monthly basis. Many college and university graduates, for example, compare job offers on the basis of an annual **salary**, such as $40 000 versus $38 000 a year. A new idea that is being promoted by technology start-ups such as Daily Pay and FlexWage is to pay employees as soon as their shift ends, rather than on a bi-weekly or monthly basis.[24]

Companies often use *pay surveys* to determine pay levels. These surveys show the compensation being paid to employees by other employers in a particular geographic area, industry, or occupational group. For example, the Canadian Federation of Business School Deans publishes an annual summary of salaries for professors teaching in business schools in Canadian universities. The internet allows job seekers and current employees to more easily get a sense of what their true market value is. If they can document the claim that their value is higher than what their current employer now pays, they are in a position to demand a higher salary.

Another means of determining basic compensation is *job evaluation*, a method for determining the relative value or worth of a job to the organization, so that individuals who perform it can be compensated appropriately. In other words, it is concerned with establishing internal pay equity. There should be a logical rank-ordering of compensation levels from the most valuable to the least valuable jobs throughout the organization.

COMPENSATION What a firm offers its employees in return for their labour.
WAGES Dollars paid based on the number of hours worked.
SALARY Dollars paid at regular intervals in return for doing a job, regardless of the amount of time or output involved.

The Impact of Education on Compensation

Education has an important influence on a person's salary. Individuals with a post-secondary degree make more money than those without one; they are also less likely to be unemployed, and they are more likely to end up in the top 1 percent of income earners.[25] However, it is also true that an increasing proportion of people with low-paying jobs have advanced degrees (MA or PhD). For example, in 1997, only 7.7 percent of individuals with an advanced degree were in the low-income category, but by 2014, 12.4 percent of individuals with an advanced degree were in that category.[26]

A 2016 study examined the salaries of 340 000 college and university graduates from Alberta, British Columbia, Ontario, and Atlantic Canada in the eight years immediately following their graduation. The average starting salary for *university grads* was $45 200 in their first year after graduation, and the amount increased to almost $75 000 by the eighth year. The starting salary for *college grads* was $33 900 in their first year after graduation and increased to $54 000 in the eighth year. University grads who majored in engineering, mathematics, computer science, and business earned more than those who majored in other areas (e.g., engineering graduates reached $100 000 in salary by year eight). The study also

compared salary differences between men and women. Male university grads earned $2800 more than females in their first year after graduation and $27 300 more after eight years. Male college grads earned $5500 more than female grads in their first year after graduation and $23 600 more after eight years.[27]

Studies in both Canada and the United States show that women still earn less for doing comparable jobs. For example, a Canadian study found that female lawyers who worked as corporate counsels earned 15 percent less than their male counterparts and that male accountants who were chief financial officers earned $40 000 per year more than their female counterparts.[28] Depending on how pay is measured, women in Canada earn somewhere between 74 and 87 cents for every dollar that males earn, and not much progress toward equity has been made over the years.[29] In the United States, the pay gap between men and women actually increased between 2011 and 2015. In 2011, women earned 97 percent of what men earned, but by 2015 that had decreased to 90 percent.[30] In 2018, Starbucks announced that it would eliminate pay disparities based on gender and would achieve 100 percent equal pay for employees who do similar work.[31]

The issue of pay differences between men and women can be very controversial. In 2018, a former *female* employee at Google sued the company, alleging that it discriminated against women. One week later, a former *male* employee sued Google, claiming that the company favoured women when hiring.[32] The company said it disagreed with both lawsuits and that it has a rigorous process for ensuring that no bias exists in its hiring and promotions decisions.

The Debate about Executive Compensation

The compensation received by CEOs can be extremely large, especially when bonuses are included. For example, Joseph Papa, the CEO of Valeant Pharmaceuticals, received total compensation of just over $83 million in 2016; and Donald Walker, the CEO of Magna International received $28.6 million.[33] The top 100 Canadian CEOs were paid an average of $10.4 million in 2016, which was 209 times what the average Canadian worker earned ($50 000).

Critics have frequently questioned the wisdom of paying executives such large amounts of money, but most attempts to rein in executive salaries have not been very successful. This was very evident when five top executives at Bombardier received a nearly 50 percent salary increase in 2017. When this became public, investors, government officials, and the general public were outraged because the company had received millions of dollars in government aid, and because the company had been experiencing significant financial problems. After the public outcry, the company delayed some of the increases.[34]

In recent years, there has been a trend to give shareholders a voice in executive compensation through non-binding shareholder votes. In 2017, 46 percent of IBM shareholders voted against the board of directors' pay proposal for top executives (but the vote was non-binding).[35] In Sweden, Norway, and the Netherlands, shareholders have a binding vote on executive pay packages. Investors are particularly angry when executives are given large salary increases even though the company they head is doing poorly.[36] For example, the compensation of Enbridge's CEO increased 50 percent during the same time period that the company's share price fell 23 percent and it lost $37 million.[37] When Marissa Mayer stepped down as CEO of Yahoo, she received a payout of more than $236 million, even though Yahoo's profit per share dropped from $3.31 to -$0.23 per share during her tenure as CEO.[38]

Incentive Programs

Employees feel better about themselves and their company when they believe they are being fairly compensated. But money motivates employees only if tied directly to performance, and the most common method of establishing this link is the use of *incentive programs*—special pay programs designed to motivate high performance. These programs can be applied to individuals or teams. A survey by the Conference Board of Canada found that while 80 percent of Canadian companies offer incentive programs, 69 percent of them don't measure their effectiveness.[39]

Individual Incentives

Rather than increasing a person's base salary only at the end of the year, an employer may give an individual a salary increase or some other financial reward for outstanding performance immediately or shortly after the performance occurs. Individual incentive systems are most common where performance can be assessed objectively (e.g., by number of units produced or by sales revenues generated).

Under a **piece-rate incentive plan**, employees receive a certain amount of money for every unit they produce. An assembly-line worker might be paid $1 for every 12 units successfully completed. Sales employees are often paid a *bonus*—a special payment above their salaries—when they sell a certain number of units or a certain dollar amount of goods for the year. Bonuses are also given in non-sales jobs. For example, many baseball players have contract clauses that pay them bonuses for hitting over .300, making the all-star team, or being named the most valuable player. Procter & Gamble pays annual bonuses to senior managers based on the performance of the specific business unit they run.[40]

Pay-for-knowledge plans encourage workers to learn new skills and to become proficient at different jobs. With *pay for performance (or variable pay)* schemes, managers are rewarded for especially productive output—for producing earnings that significantly exceed the cost of bonuses. Such incentives go to middle managers on the basis of company-wide

PIECE-RATE INCENTIVE PLAN A compensation system in which an organization pays an employee a certain amount of money for every unit produced.

Individual incentive plans have been a big part of professional sports for many years. Players have received multimillion-dollar annual compensation for outstanding individual performance.

Darren Calabrese/CP images

performance, business-unit performance, personal record, or all three factors. The most dramatic pay-for-performance idea so far was announced by Tesla, Inc. in 2018. The CEO, Elon Musk, will receive no guaranteed compensation of any kind. Instead, he will be paid only if the company and its shareholders do well. Specifically, if Tesla's market capitalization reaches $100 billion, Musk will receive $1 billion. He will receive additional large sums if Tesla's market capitalization goes even higher.[41]

Other forms of individual incentives are also used, such as more time off or recognition in the form of points awarded on a supervisor's recommendation. In the latter case, recipients might convert their points into money and buy merchandise or trips from a special online catalogue. Some retailers have adopted *workforce management systems*, which schedule the most productive staff to work at the store's busiest times. When employees type their code into the cash register, it displays their "performance metrics," such as average sales per hour and dollars per transaction. Less productive employees are given fewer or less desirable hours.[42] Not surprisingly, this system is disliked by some workers.

Team and Group Incentives

Some incentive programs apply to all the employees in a firm. Under **profit-sharing plans**, profits earned above a certain level are distributed to employees. At the Great Little Box Company in Richmond, British Columbia, 15 percent of company profits are split evenly among staff. The company also has an "open book" policy of providing financial information to employees so they can relate financial performance of the company to their share of the profits.[43]

Gainsharing plans distribute bonuses to employees when a company's costs are reduced through greater employee efficiency and/or productivity. The underlying assumption in gainsharing is that employees and the employer have the same goals and should therefore share in incremental economic gains.

Benefits

Benefits are rewards, incentives, and other things of value that an organization gives to employees in addition to wages, salaries, and other forms of direct financial compensation. Because these benefits have tangible value, they represent a meaningful form of compensation even though they are not generally expressed in financial terms. According to a PricewaterhouseCoopers survey, some of the top benefits sought, other than money, were gift cards, extra vacation days, and being fast-tracked for promotion.[44]

Mandated Protection Plans

Protection plans assist employees when their income is threatened or reduced by illness, disability, unemployment, or retirement. *Employment insurance* provides a basic subsistence payment to employees who are unemployed but are actively seeking employment. Both employers and employees pay premiums to an employment insurance fund. The insurance also covers maternity leave and pays 55 percent of a new mother's annual earnings.

The *Canada Pension Plan* (CPP) provides income for retired individuals to help them supplement their personal savings, private pensions, and part-time work. It is funded through employee and employer taxes that are withheld from payroll. In 2016, changes to the CPP were made so that beneficiaries will receive increased payments. The maximum benefit will now be about $17 400 per year instead of $13 000.[45] Premiums will also go up to fund the larger outflow to beneficiaries.

Workers' compensation is mandated insurance that covers individuals who suffer a job-related illness or accident. Employers bear the cost of workers' compensation insurance. The premium is related to each employer's past experience with job-related accidents and illnesses. For example, a steel company might pay $20 per $100 of wages, while an accounting firm might pay only $0.10 per $100 of wages.

Optional Protection Plans

Health insurance, the most important type of coverage, has expanded in recent years to include vision care, mental health services, dental care, and prescription drugs. Employee prescription drug plan costs are doubling about every five years, and companies are increasingly concerned about their ability to offer this kind of coverage.[46] Pension liabilities are also a problem.

Paid Time off

Paid vacations are usually for periods of one, two, or more weeks. Most organizations vary the amount of paid vacation with an individual's seniority, but some companies are reducing the time required to qualify for paid vacations. At Carlson Wagonlit Travel Canada, employees get four weeks of paid vacation after working at the company for just five years. Formerly, 10 years of service were required.[47]

Another common paid time-off plan is sick leave, which is provided when an individual is sick or otherwise physically unable to perform his or her job. Sometimes an organization will allow an employee to take off a few days simply for "personal business." The Catholic Children's Aid Society provides its child protection workers with time off when they need it, because they routinely face high-stress situations.[48]

Other Types of Benefits

In addition to protection plans and paid time off, many organizations offer a number of other benefit programs. *Wellness programs*, for example, concentrate on preventing illness in employees rather than simply paying their expenses when they become sick. The Employee Recommended Workplace Award recognizes companies for excellence in achieving a healthy and engaged workforce. The award is given based on the average score of a company's employees as they respond to a survey that deals with health and wellness issues.[49] The Canada Green Building Council administers the WELL designation for buildings. The Toronto-Dominion Bank renovated the 23rd floor of its Toronto headquarters to WELL's requirements.[50]

Cafeteria-style benefit plans allow employees to choose the benefits they really want. The organization typically establishes a budget, indicating how much it is willing to spend, per employee, on benefits. Employees are then presented with a list of possible benefits and the cost of each. They are free to put the benefits together in any combination they wish.

PROFIT-SHARING PLANS An incentive program in which employees receive a bonus depending on the firm's profits.

GAINSHARING PLANS An incentive program in which employees receive a bonus if the firm's costs are reduced because of their greater efficiency and/or productivity.

BENEFITS What a firm offers its workers other than wages and salaries in return for their labour.

PROTECTION PLANS A plan that protects employees when their income is threatened or reduced by illness, disability, death, unemployment, or retirement.

CAFETERIA-STYLE BENEFIT PLANS A flexible approach to providing benefits in which employees are allocated a certain sum to cover benefits and can "spend" this allocation on the specific benefits they prefer.

LO-5 THE LEGAL CONTEXT OF HRM

HRM is influenced by federal and provincial law, so managers must be aware of the most important and far-reaching areas of HR regulation. These include *equal employment opportunity*, *comparable worth*, *sexual harassment*, *employee safety and health*, and *retirement*.

Equal Employment Opportunity

The basic goal of all **equal employment opportunity regulations** is to protect people from unfair or inappropriate discrimination in the workplace. Note that differentiating between employees—for example, giving one person a raise and denying the raise to another person—is not automatically illegal. As long as the basis for this distinction is purely job-related (i.e., based on performance or qualifications) and is applied objectively and consistently, the action is legal and appropriate. Problems arise when distinctions among people are not job-related. In such cases, the resulting discrimination is illegal.

Anti-Discrimination Laws

The key federal anti-discrimination legislation is the *Canadian Human Rights Act* of 1977 (each province has also enacted human rights legislation). The goal of the Act is to ensure that any individual who wishes to obtain a job has an equal opportunity to do so. The Act applies to all federal agencies, federal Crown corporations, employees of the federal government, and business firms that do business interprovincially. The Act prohibits a wide variety of practices in recruiting, selecting, promoting, and dismissing personnel. It specifically prohibits discrimination on the basis of age, race and colour, national and ethnic origin, physical handicap, religion, gender, marital status, or prison record (if pardoned). Some exceptions to these blanket prohibitions are permitted. Discrimination cannot be charged if a blind person is refused a position as a bus driver or crane operator. Likewise, a firm cannot be charged with discrimination if it does not hire a deaf person as an audio engineer.

Difficulties in determining whether discrimination has occurred are sometimes dealt with by using the concept of **bona fide occupational requirement**. That is, an employer may choose one person over another on the basis of overriding characteristics of the job in question. If a fitness centre wants to hire only women to supervise its women's locker room and sauna, it can do so without being discriminatory because it has established a bona fide occupational requirement.

Enforcement of the Human Rights Act is carried out by the Canadian Human Rights Commission. The commission can either respond to complaints from individuals who believe they have been discriminated against or launch an investigation on its own if it has reason to believe discrimination has occurred. If a claim of discrimination is substantiated, the offending organization or individual may be ordered to compensate the victim.

The *Employment Equity Act of 1986* addresses the issue of discrimination in employment by designating four groups as employment-disadvantaged—women, visible minorities, Aboriginal people, and people with disabilities. These four groups comprise six of every ten individuals in the Canadian workforce, and it is estimated that their underemployment costs the Canadian economy around $50 billion each year.[51] Companies covered by the Employment Equity Act are required to publish statistics on their employment of people in the four designated groups.

Comparable Worth

Comparable worth is a legal concept that aims at paying equal wages for jobs that are of comparable value to the employer. This might mean comparing dissimilar jobs, such as those of secretaries and mechanics or nurses and electricians. Proponents of comparable worth say that all the jobs in a company must be evaluated and then rated in terms of basic

EQUAL EMPLOYMENT OPPORTUNITY REGULATIONS Regulations to protect people from unfair or inappropriate discrimination in the workplace.

BONA FIDE OCCUPATIONAL REQUIREMENT When an employer may choose one applicant over another based on overriding characteristics of the job.

COMPARABLE WORTH A legal concept that aims to pay equal wages for work of equal value.

Michael jung/Fotolia

Oneinchpunch/Fotolia

The idea behind comparable worth is to pay equal wages for jobs that are of comparable value to the employer. This may require a comparison of jobs that are quite different.

dimensions such as the level of skill they require. All jobs can then be compared on the basis of a common index. People in different jobs that rate the same on this index will be paid the same. The hope is that this will help to reduce the gap between men's and women's pay. In a long-standing comparable worth dispute, the Supreme Court of Canada ruled that flight attendants at Air Canada—who had been trying for years to achieve pay equity with male-dominated groups of employees—could compare their pay with the pay of ground crews and pilots because all these employees work for the same company.[52]

Sexual Harassment

Within the job context, **sexual harassment** refers to requests for sexual favours, unwelcome sexual advances, or verbal or physical conduct of a sexual nature that creates an intimidating or hostile environment for a given employee. As the opening case in this chapter clearly shows, sexual harassment continues to be a problem in many different types of organizations. Sexual harassment is illegal, and the organization is responsible for controlling it. If a manager is found guilty of sexual harassment, the company is liable because the manager is an agent of the company. The Canadian Human Rights Act takes precedence over any policies that a company might have developed on its own to deal with sexual harassment problems.

Quid pro quo harassment is the most blatant form of sexual harassment. It occurs when the harasser offers to exchange something of value—for example, a promotion—for sexual favours. The creation of a *hostile work environment* is a subtler form of sexual harassment. For example, a group of male employees who continually make off-colour jokes may create a hostile work environment for female employees. Other situations are harder to assess. For example, an employee sued Citibank, claiming she was fired because she dressed too provocatively and was, therefore, a workplace distraction. But some of her co-workers said she was just an attention-seeking gold digger who was fired for poor performance.[53]

Employee Safety and Health

Employee health and safety programs help to reduce absenteeism and turnover, raise productivity, and boost morale by making jobs safer and more beneficial to health. In Canada, each province has developed its own workplace health and safety regulations. The *Ontario Occupational Health and Safety Act* is typical. It requires all employers to ensure that equipment and safety devices are used properly. Employers must also show workers the proper way to operate machinery. At the job site, supervisors are charged with the responsibility of ensuring that workers use equipment properly. The Act also requires workers to behave appropriately on the job. Employees have the right to refuse to work on a job if they believe it unsafe; a legal procedure exists for resolving any disputes in this area. In most provinces, the Ministry of Labour appoints inspectors to enforce health and safety regulations. If the inspector finds a sufficient hazard, he or she has the authority to clear the workplace. Inspectors can usually arrive at a firm unannounced to conduct an inspection.

SEXUAL HARASSMENT Requests for sexual favours, unwelcome sexual advances, or verbal or physical conduct of a sexual nature that create an intimidating or hostile environment for a given employee.

Dan Parrett/Design Pics Inc/Alamy Stock Photo

These fishermen are doing a very dangerous job, but if they have a good catch, they will be amply rewarded.

Walmart reduced injuries in its warehouses by half after having workers view a mobile app that featured three-minute presentations about how to do routine tasks such as driving a forklift. Employees were tested to see how much they remembered from the presentation.[54] International efforts to improve safety are also evident. In 2013, a building that housed five garment factories that made brand-name clothing for Western European and North American companies collapsed, killing more than 1000 workers. After that disaster, representatives of those companies joined together to pursue actions that would improve worker safety.[55]

Some industrial work—logging, construction, fishing, and mining—can put workers at risk of injury in obvious ways. But other types of work—such as typing or lifting—can also cause painful injuries. *Repetitive strain injuries (RSIs)* occur when workers perform the same functions over and over again. These injuries disable more than 200 000 Canadians every year and account for nearly half of all work-related lost-time claims.

Retirement

Until the 1990s, Canadian courts generally upheld 65 as the mandatory retirement age, but most Canadian provinces have now abolished mandatory retirement. New rules also took effect in December 2012 abolishing mandatory retirement at federally regulated employers such as Air Canada.[56] Some managers fear that the abolition of mandatory retirement will allow less productive employees to remain at work after age 65, but research shows that the employees who stay on the job past 65 are usually the most productive ones. But it is also true that workers over age 65 are nearly four times as likely to die from work-related causes as younger workers, and older workers have double the health-care costs of workers in their 40s.[57]

In recent years, lower returns on investments have meant that more and more workers are delaying their retirement because they think they aren't going to have enough money to retire. So the retirement age has started increasing again. A Sun Life poll of 3000 Canadian workers in 2015 found that about one-third of them expected to be working full-time at age 66. The same survey in 2008 showed that only 16 percent expected to still be working full-time at age 66.[58] A survey conducted by Willis Towers Watson found that the number of Canadians estimating that they would not retire until at least the age of 70 increased from 5 percent in 2012 to 21 percent in 2016.[59]

Pension Plans

Two basic types of pension plans are offered by Canadian public- and private-sector organizations. *Defined benefit* (DB) pension plans guarantee employees a certain annual income when they retire. Employees like DB plans because they receive a guaranteed income during retirement, but employers don't like DB plans because they are forced to make guaranteed payments to retirees even if the company runs into financial difficulties. In contrast, *defined contribution* (DC) pension plans require companies to contribute a certain amount of money each year for employee pensions. The value of the pension upon the employee's retirement depends on how much the pension fund has earned over the years. Employees may not like DC plans because they don't know how much income they will get when they retire, but employers like DC plans because they put a ceiling on how much money the company must pay out. One survey showed that workers with a DC pension plan will have to work three years longer than they expected because they will not have enough retirement income to fund their desired lifestyle.[60]

A hybrid DB/DC model—called the Target Benefit pension plan—has been proposed to resolve the tension between DB and DC pension plans. Under this system, an expected (target) benefit is defined, and the contribution necessary to get such a benefit is calculated. Because the investment environment regularly changes, every year a "new" expected benefit is communicated to workers. The benefit is not guaranteed, but rises and falls depending on returns in financial markets.

All these developments mean that the financial situation for retirees has become more uncertain. The trend of dropping DB pensions in favour of DC pensions is one reason, but uncertainty has also increased because (a) people are living longer, (b) interest rates are relatively low (so pensioners cannot earn as much money on their investments), and (c) investment fees reduce portfolio returns.[61]

There is also concern that workers in the public-sector have far more pension security than workers in the private-sector. About 80 percent of public-sector workers still have DB pensions, whereas only 10 percent of private-sector workers do. And a majority of private-sector workers have no pension at all.[62] Some help is available in the federal Pooled Registered Pension Plan Act, which allows individuals to pay into a DC pension plan even if their employer does not offer one.

LO-6 NEW CHALLENGES IN THE CHANGING WORKPLACE

HR managers face various challenges in their efforts to keep their organizations staffed with effective workers. To complicate matters, new challenges arise as the economic and social environments of business change. Several of the most important HRM issues facing business today are *managing workforce diversity*, *managing knowledge workers*, and *managing contingent and temporary workers*.

Managing Workforce Diversity

Workforce diversity refers to the range of workers' attitudes, values, beliefs, and behaviours that differ by gender, race, age, ethnicity, physical ability, and other characteristics. The situation for visible minorities is currently one of the most publicized aspects of diversity. There are currently about 8.5 million people in Canada who are visible minorities; they constitute about 22 percent of Canada's population and make up more than 50 percent of the populations of Toronto and Vancouver.

Organizations are increasingly recognizing that diversity can be a competitive advantage. By hiring the best people available from every group—rather than from just one or a few groups—a firm can develop a higher-quality workforce. A diverse workforce can bring a wider array of information to bear on problems and can provide insights on marketing products to a wider range of consumers. Diverse companies develop more innovative products, have more satisfied customers, and generate better financial returns than less-diverse companies. The Thomson Reuters organization created a Diversity and Inclusion (D&I) index, which annually examines diversity in more than 5000 companies. The 2017 list of top companies that proactively pursue a diverse workforce includes Procter & Gamble, Johnson & Johnson, Bank of Montreal, Gap Inc., and Colgate-Palmolive.[63]

It is interesting to note that some of the most highly visible tech companies do not score well on diversity. For example, Facebook has been criticized because its workforce is dominated by white males. As of 2017, only 1 percent of Facebook's tech team was Black, 3 percent were Hispanic, and 17 percent were women.[64] In an attempt to increase diversity, the company now requires that hiring managers interview at least one member of the underrepresented groups for each open position. It has also started a summer training program for students from underrepresented groups in the hope that some of these students will join the company after graduation.

Google is another tech company that has been criticized in recent years for having a workforce that is mostly male. In 2016, 71 percent of Google employees were male, and 57 percent were white. Latinos represent about 5 percent of the workforce and blacks 1.8 percent. Asians are fairly well represented (one-third of the workforce).[65] Other tech companies report similar statistics.

Many Canadian companies are actively pursuing the management of diversity. For example, at the Royal Bank of Canada, 64 percent of the employees are women, 4.6 percent are people with disabilities, 31 percent are visible minorities, and 1.5 percent are aboriginals. These percentages match pretty well with the composition of the Canadian labour force as a whole.[66]

Diversity is also evident if a company's workforce consists of people from different age groups, but some concerns have been expressed about how well these different age groups work together. For example, Baby Boomers (those born between 1947 and 1966) are the oldest group in the workforce, and they often hold senior management positions where they manage GenXers (those born between 1966 and 1980). Some studies show that GenXers are not happy about their situation because they feel stuck between the Baby Boomers (who have more authority) and the younger Millennials (born between 1980 and 1999), who GenXers feel get too much attention. Managing potential conflicts between these three groups is an essential part of any diversity program.

WORKFORCE DIVERSITY The range of workers' attitudes, values, beliefs, and behaviours that differ by gender, race, age, ethnicity, physical ability, and other relevant characteristics.

Managing Knowledge Workers

Knowledge workers include computer scientists, engineers, physical scientists, game developers, and software application designers, among others. Knowledge workers typically require extensive and highly specialized training. Once they are on the job, additional training is critical to prevent their skills from becoming obsolete. It has been suggested, for example, that the half-life of a technical education in engineering is about three years. A firm's failure to update the skills of its knowledge workers not only results in the loss of competitive advantage but also increases the likelihood that those workers will go to other firms that are more committed to updating their skills.

There are also challenges in recruiting new knowledge workers. Given both the high demand for knowledge workers and their relative short supply, firms often resort to extreme measures to recruit the best and brightest. For example, Google, Facebook, and Zynga compete head-to-head for programmers and software engineers. To help recruit knowledge workers, these firms offer special perks such as free massages, laundry services, gourmet meals and snacks, and premium coffee.

Managing Contingent Workers

A contingent worker is one who works for an organization on something other than a permanent or full-time basis. Categories of contingent workers include part-time workers, independent contractors (freelancers), on-call workers, temporary employees (usually hired through outside "temp" agencies), contract workers, and guest workers (foreigners working in Canada for a limited time). When economic times are uncertain, companies usually make greater use of contingent workers; when the economy improves, companies hire more full-time workers.[67] Although many contingent workers are hired at lower levels in organizations, there is also a demand for these workers in top management positions because of the high rate of turnover at this level. These "temps at the top" usually stay for a year or less until a permanent person is found.[68]

Sometimes there are disagreements about what constitutes a contingent worker. For example, Uber and its drivers have an ongoing dispute about the drivers' employment status. Uber views the workers as independent contractors. It supports its case by pointing to a survey that found that 87 percent of drivers signed up to be their own boss and set their own schedule. But an $800 million class-action lawsuit has been filed claiming that Uber drivers are actually employees and are therefore entitled to earn minimum wage and to receive overtime and vacation pay.[69]

The effective management of contingent workers requires consideration of three issues. First, careful planning must be done so that the organization brings in contingent workers only when they are actually needed and in the quantity needed to complete necessary tasks. Second, the costs and benefits of using contingent workers must be understood. Many firms bring in contingent workers in order to reduce labour costs, but if contingent workers are less productive than permanent workers, there may be no gain for the organization. Third, contingent workers should be integrated into the mainstream activities of the organization as much as possible. This involves deciding how they will be treated relative to permanent workers. For example, should they have the same access to employee benefits? Managers must develop a strategy for integrating contingent workers according to some sound logic and then follow that strategy consistently over time.[70]

LO-7 DEALING WITH ORGANIZED LABOUR

A **labour union** is a group of individuals working together to achieve shared job-related goals, such as higher pay, shorter working hours, greater benefits, or better working conditions.[71] When people think of unions, they often picture modestly paid production workers in a factory who have joined a union in an attempt to improve their wages and benefits. But some highly paid workers also belong to unions. For example, *all* professional athletes in the four major professional sports in North America—hockey, baseball, football, and basketball—belong to unions.

Labour relations refers to the overall process of dealing with employees who are represented by a union. **Collective bargaining** is the process by which union leaders and company management negotiate terms and conditions of employment for those workers represented by unions.

KNOWLEDGE WORKERS Workers who are experts in specific fields, such as computer technology and engineering, and who add value because of what they know, rather than how long they have worked or the job they do.

LABOUR UNION A group of individuals who work together to achieve shared job-related goals.

LABOUR RELATIONS The overall process of dealing with employees who are represented by a union.

COLLECTIVE BARGAINING The process through which union leaders and management personnel negotiate common terms and conditions of employment for those workers represented by the union.

The Development of Canadian Labour Unions

The labour movement was born with the Industrial Revolution, which also gave birth to the factory-based production system. Job specialization and mass production allowed businesses to create ever-greater quantities of goods at ever-lower costs. But there was also a dark side, as some owners treated their workers simply as resources to be deployed, with little or no regard for the well-being of workers. Employees often worked 60-hour weeks, their pay was minimal, they had no job security, they received few benefits, and safety standards were virtually non-existent. Mining and textile companies employed large numbers of children at poverty wages, and if people complained, they were fired. Unions developed to compel management to listen to the complaints of all their workers rather than to just the few brave enough to speak out.

The earliest evidence of labour unions in Canada comes from the Maritime provinces in the nineteenth century. These unions typically included individuals with a specific craft (e.g., printers, shoemakers, barrel makers). Most of these unions were small and had only limited success. However, they laid the foundation for the rapid increase in union activity that occurred during the late nineteenth and early twentieth centuries.

A succession of labour organizations sprang up and just as quickly faded away during the years 1840–1870. In 1873, the first national labour organization was formed—the Canadian Labour Union. By 1886, the

Knights of Labour (a U.S.-based union) had more than 10 000 members in Canada. The Canadian labour movement began to mature with the formation of the Trades and Labour Congress (TLC) in 1886. The TLC's purpose was to unite all labour organizations and to work for the passage of laws that would ensure the well-being of the working class.

The growth of labour unions began in earnest early in the twentieth century, but sometimes disputes arose within the ranks. For example, there was concern that U.S.-based unions would have a detrimental effect on Canadian ones, so the Canadian Federation of Labour was formed in 1908 to promote national (Canadian) unions over U.S. ones. These and other disputes—such as how communists in the movement should be handled—often led to the creation of rival union organizations that competed for membership. By 1956, these disputes had been largely resolved, and the two largest congresses of affiliated unions—the Trades and Labour Congress and the Canadian Congress of Labour—merged to form the Canadian Labour Congress. This amalgamation brought approximately 80 percent of all unionized workers into one organization.

Unionism Today

Almost five million Canadian workers belong to unions, but union membership as a proportion of the non-agricultural workforce (called *union density*) is less than one-third. In the private sector in Canada, 16 percent of workers are unionized.[72] In the United States, the proportion is even lower—just 6.4 percent.[73] Union density varies widely across countries. In Canada, union density is about 30 percent; in the United States 11 percent; in France 9 percent; and in Sweden 82 percent.[74] Density also varies across occupations. In some occupations, such as teaching and nursing, more than 80 percent of workers are unionized. In other occupations, such as management and food and beverage services, less than 10 percent belong to a union.[75]

Unions are not restricted to the private sector. In fact, the public sector is far more unionized (about 75 percent) than the private sector.[76] There has been controversy recently about the perceived "rich" compensation and benefits available to public-sector workers (whether or not they are unionized). For example, federal workers usually have a defined benefit pension that, after 35 years, pays 70 percent of the worker's highest five-year earning average. By contrast, in the private sector, two-thirds of workers don't even have a pension.

Historically, unions were often successful in their attempts to win certification votes, and they became the sole representative for various employee groups. But in recent years, they have had less success because (a) today's workforce is increasingly diverse and contains both women and ethnic minorities who have weaker traditions of union affiliation than white males; (b) the workforce is increasingly employed in the service sector, which traditionally has been less heavily unionized; (c) companies have become more aggressive in opposing unions; and (d) more companies are providing a work environment in which employees are allowed to participate and be actively involved.[77]

These changes have led to substantial differences in union–management relations. Not so long ago, most union–management bargaining was very adversarial, with unions making demands for dramatic improvements in wages, benefits, and job security. But with organizational downsizing and a decade of low inflation in Canada, many unions today find themselves able to achieve only modest improvements in wages and benefits. A common goal of union strategy is, therefore, to preserve what has already been won.

Although conflict between unions and management still exists, both sides realize that at least some cooperation is necessary if both groups are to survive and prosper. The goal is to create win-win partnerships in which managers and workers share the same goals—that is, profitability, growth, and effectiveness—with equitable rewards for everyone. For example, in 2014, Air Canada and the Air Canada Pilots Association (ACPA) signed a new 10-year collective agreement. The signing came after a decade of very poor labour relations between Air Canada and ACPA. The agreement with the pilots was surprising, because it was signed 18 months before their existing contract expired. The president of the union said that over the previous decade, the union had learned that confrontation had not benefited either the union or the company.

The Future of Unions

Unions face some serious challenges. In the *private sector*, some companies are now more willing to take drastic action to make their point. For example, in 2012, Electro-Motive Canada moved production from its London, Ontario, plant to the United States when workers wouldn't agree to a 50 percent wage cut.[78] In the *public sector*, the federal and provincial governments are looking for ways to save money because of large budget deficits, so there is pressure to hold the line on wages and benefits.

Unions are facing other challenges as well: the decline of the so-called "smokestack industries" (where union power was formerly very strong), the globalization of business (which has caused the movement of jobs to areas of the world with lower labour costs), technological change (which often reduces the number of workers needed), and the increasing importance of contract and part-time workers (who are difficult to organize). Unions are responding to these challenges in a variety of ways. For example, in 2013, two of Canada's largest unions—the Canadian Auto Workers and the Communications, Energy and Paperworkers—merged to form a new union called Unifor.[79]

LO-8 THE LEGAL ENVIRONMENT FOR UNIONS IN CANADA

Political and legal barriers to collective bargaining existed until well into the twentieth century (see Table 8.1). Courts held that some unions were conspiracies in restraint of trade. Employers viewed their employees' efforts to unionize as attempts to deprive the employers of their private property. The employment contract, employers contended, was between the individual worker and the employer—not between the employer and employees as a group. The balance of bargaining power was very much in favour of the employer.

The employer–employee relationship became much less direct as firms grew in size. Managers were themselves employees, and hired managers dealt with other employees. Communication among owners, managers, and workers became more formalized. Big business had more power than workers. Because of mounting public concern, laws were passed to put workers on a more even footing with employers.

The *Constitution Act* (originally called the BNA Act), passed in 1867, has also affected labour legislation. This Act allocated certain activities to

TABLE 8.1 Key Canadian labour legislation

Date	Legislation	Accomplishments/Goals
1900	Conciliation Act	• Designed to help settle labour disputes through voluntary conciliation • First step in creating more favourable labour conditions
1907	Industrial Disputes Investigation Act	• Compulsory investigation of labour disputes by a government-appointed board before any strike action (found to violate a provision of the British North America Act)
1943	Privy Council Order 1003	• Recognized the right of employees to bargain collectively • Prohibited unfair management labour practices • Established a labour board to certify bargaining authority • Prohibited strikes and lockouts (except in collective bargaining agreements)

the federal government (e.g., labour legislation for companies operating interprovincially) and others to individual provinces (labour relations regulations in general). Thus labour legislation comes from both the federal and provincial governments, but is basically a provincial matter. That is why certain groups of similar employees might be allowed to go on strike in one province but not in another.

Federal Legislation—The Canada Labour Code

The **Canada Labour Code** is a comprehensive piece of legislation that applies to the labour practices of firms operating under the legislative authority of parliament. One issue under review is whether managers and supervisors should be protected by labour code restrictions on the number of hours they work each week and whether they should receive overtime pay. The issue came to the forefront after the Manitoba Labour Board ruled that Sharon Michalowski, a manager at Nygard International, was entitled to overtime pay, even though she was a manager and had signed a contract stipulating that she would work whatever hours were required to earn her annual salary of $42 000.[80]

The Canada Labour Code has four main sections: fair employment practices; standard hours, wages, vacations, and holidays; safety of employees; and industrial relations regulations.

Fair Employment Practices

This section of the Code prohibits an employer from either refusing employment on the basis of a person's race or religion or using an employment agency that discriminates against people on the basis of their race or religion. These prohibitions apply to trade unions as well, but not to non-profit, charitable, and philanthropic organizations. Any individual who believes a violation has occurred may make a complaint in writing to Labour Canada. The allegation will then be investigated, and if necessary, an Industrial Inquiry Commission will be appointed to make a recommendation in the case. Since 1982, fair employment practices have been covered by the Canadian Human Rights Act; they are also covered by the Canadian Charter of Rights and Freedoms.

CANADA LABOUR CODE Legislation that applies to the labour practices of firms operating under the legislative authority of parliament.

Standard Hours, Wages, Vacations, and Holidays

This section of the Code deals with issues such as standard hours of work (eight-hour day and 40-hour week), maximum hours of work per week (48), overtime pay (at least one and a half times the regular pay), minimum wages, equal wages for men and women doing the same jobs, vacations, general holidays, and parental leave. The specific provisions are changed frequently to take into account changes in the economic and social structure of Canada, but their basic goal is to ensure consistent treatment of employees in these areas.

Safety of Employees

This section of the Code requires that every person running a federal work project do so in a way that will not endanger the health or safety of any employee. It also requires that safety procedures and techniques be implemented to reduce the risk of employment injury. The section requires employees to exercise care to ensure their own safety; however, even if it can be shown that the employee did not exercise proper care, compensation must still be paid. The section also makes provisions for a safety officer whose duty it is to ensure the provisions of the code are fulfilled. The safety officer has the right to enter any federal project "at any reasonable time."

Industrial Relations Regulations

The final major section of the Canada Labour Code deals with all matters related to collective bargaining.

Provincial Labour Legislation

Each province has enacted legislation to deal with the personnel practices covered in the Canada Labour Code. These laws vary across provinces and are frequently revised; however, their basic approach and substance is the same as in the Canada Labour Code. Certain provinces may exceed the minimum requirements on some issues (e.g., minimum wages).

Union Organizing Strategy

A union might try to organize workers when a firm is trying to move into a new geographical area, or when some workers in a firm are members and the union wants to represent other workers, or when one union is attempting to outdo a rival union, or when a union wants to increase the number of its members. For example, the United Food and Commercial

Workers (UFCW) union conducted an organizing drive at Shoppers Drug Mart (after it was acquired by Loblaw Companies Limited) and at Sobeys Inc. (after it acquired Safeway).[81] Sometimes these organizing drives are successful, and sometimes they are not. When the International Association of Machinists tried to organize the workers at Boeing's Charleston, South Carolina, manufacturing plant, the majority of workers voted not to join the union.[82] But when the Air Line Pilots Association tried to organize WestJet pilots in 2017, the drive was successful.[83] And shortly after that successful organizing drive, two unions began planning organizing drives for flight attendants.[84] Newsroom employees at the *National Post* also became interested in organizing after the company cut benefits as part of an austerity program.[85]

Union organizing drives can create conflict between management and the union that is trying to organize the company's workers. One of the most prominent Canadian examples in recent years is the organizing effort by the United Food and Commercial Workers (UFCW) to organize Walmart's workers. The company has aggressively (and mostly successfully) fought off the UFCW's organizing attempts.

Other labour-management conflicts are possible as well. When WestJet decided to start the ultra-low-cost airline Swoop, the recently certified union for WestJet pilots alleged that the company was trying to transfer pilots to the non-unionized Swoop. The union urged pilots to refuse to go to work for Swoop.[86] If the union is successful, WestJet may have difficulty finding pilots to fly for Swoop.

Conflict can also arise between unions. In 2018, Unifor (Canada's largest private-sector union) discontinued its relationship with the Canadian Labour Congress (the national lobby group for the labour movement). Unifor claimed that the CLC had not been supportive enough of Unifor's efforts to protect Canadian workers in local unions from being badly treated by U.S.-based unions. Unifor also thought it was outrageous that Canada's largest private-sector union had no representatives on a CLC committee that was studying workers' rights to switch unions. The CLC responded by claiming that Unifor was trying to raid one of its unions for members, and said that behaviour was totally unacceptable.[87]

Each province has somewhat different rules for certifying unions. For example, suppose a union is trying to organize employees of a Manitoba company. If it can show that at least 50 percent of the employees are members of the union, it can apply to the Manitoba Labour Board (MLB) for certification as the sole bargaining agent for the employees. During the process, there may be an issue regarding the right of different types of workers to join or not join. For example, supervisors may or may not be included in a bargaining unit along with non-management workers. The **bargaining unit** includes those individuals deemed appropriate by the province, and the MLB has final authority in determining the appropriateness of the bargaining unit. Once the MLB has determined that the unit is appropriate, it may order a **certification vote**. If a majority of those voting are in favour of the union, it is certified as the sole bargaining agent for the unit.

The same law that grants employees the right to unionize also allows them to cease being represented by a union. **Decertification** is the process by which employees legally terminate their union's right to represent them. This happened during a labour dispute over job security and safety that arose at Goldcorp Inc.'s mine near Red Lake, Ontario, which led to a strike involving 100 workers. The strike was settled when workers agreed to decertify their union in return for severance pay that was four times the rate mandated by Ontario law.[88]

Lee Brown/Alamy Stock Photo

The Canadian Labour Congress says that Unifor, which is Canada's largest private-sector union, has been raiding other unions in order to increase its own membership.

Union Security

The greatest union security exists in the **closed shop**, in which an employer can hire only union members. For example, a plumbing or electrical contractor who hires workers through a union hiring hall can hire only union members. In a **union shop**, an employer may hire non-union workers even if the employer's current employees are unionized. But newly hired workers must join the union within a stipulated period of time (usually 30 days). In an **agency shop**, all employees for whom the union bargains must pay union dues, but they need not join the union. In an **open shop**, an employer may hire union and/or non-union labour. Employees need not join a union or pay dues to one.

In the United States, *right-to-work laws* have been enacted in many southern states. These laws stipulate that workers cannot be forced to pay union dues. Many new automobile manufacturing facilities have been built in these states by companies that want to avoid having a unionized workforce. These laws are obviously a big problem for unions because they cannot collect dues from all the workers to support union activities. During the past few years, three northern U.S. states that have traditionally been strongholds of unions—Indiana, Michigan, and Wisconsin—have also passed right-to-work laws.[89] In Canada, no provinces have right-to-work laws at present, but the Conservative Party of Ontario is thinking

BARGAINING UNIT Individuals grouped together for purposes of collective bargaining.

CERTIFICATION VOTE A vote supervised by a government representative to determine whether a union will be certified as the sole bargaining agent for the unit.

DECERTIFICATION The process by which employees legally terminate their union's right to represent them.

CLOSED SHOP A union–employer relationship in which the employer can hire only union members.

UNION SHOP A union–employer relationship in which the employer can hire non-unionized workers, but they must join the union within a certain period.

AGENCY SHOP A union–employer relationship in which all employees for whom the union bargains must pay dues, but they are not required to join the union.

OPEN SHOP A union–employer relationship in which the employer may hire union or non-union workers.

about bringing the concept to Canada. The argument is that more and more U.S. states are planning to pass right-to-work laws and that corporate taxes in the United States have been sharply reduced. Both of these factors will lead to lower costs for U.S. companies, and that will put Canadian companies at a competitive disadvantage.[90]

Types of Unions

There are two basic types of unions: craft and industrial. *Craft unions* are organized by crafts or trades—plumbers, barbers, airline pilots, and so forth. Craft unions restrict membership to workers with specific skills. Craft unions have a lot of power over the supply of skilled workers, because a person who wants to become a member of a plumbers union, for example, must go through a training (apprenticeship) program. After sufficient training, the apprentice is qualified as a journeyman plumber. *Industrial unions* are organized according to industry, for example, steel, auto, and clothing. Industrial unions include semi-skilled and unskilled workers and were originally started because industrial workers were not eligible to join craft unions. An industrial union has a lot of say regarding pay and human resource practices within unionized firms.

The *local union* is the basic unit of union organization in a specific geographical area. A local of a craft union is made up of artisans in the same craft, whereas a local of an industrial union is made up of workers in a given industry or manufacturing plant. Thus plumbers may be members of the local plumbers (a craft union), while truck drivers in that same area may be members of the Teamsters (an industrial union).

An *independent local union* is one that is not formally affiliated with any labour organization. It conducts negotiations with management only at a local level, and the collective agreement is binding at that location only. The faculty associations at many Canadian universities are examples of independent local unions.

A *national union* has members across Canada, whereas an *international union* has members in more than one country. There are many national unions in Canada, including the Canadian Union of Public Employees, the National Railway Union, and the Canadian Airline Pilots Union. The United Steelworkers of America is an international union made up of locals in the United States and Canada. National unions represent about two-thirds of unionized Canadian workers and international unions about one-third of them.[91]

LO-9 COLLECTIVE BARGAINING

Collective bargaining is an ongoing process involving both the drafting and administration of the terms of a labour contract.

Reaching Agreement on the Contract's Terms

The collective bargaining process begins when the union is recognized as the exclusive negotiator for its members. The bargaining cycle begins when union leaders meet with management representatives to begin working on a new contract. By law, both parties must negotiate "in good faith." After each side presents its demands, sessions focus on identifying the bargaining zone. This process is shown in Figure 8.3. For example, although an employer may initially offer no pay raise, it may do so knowing that eventually it might have to grant a raise of up to 4 percent. Likewise, the union may initially demand a 7 percent pay raise knowing that it might have to accept a raise as low as 2 percent. The bargaining zone, then, is a raise between 2 and 4 percent. Obviously, compromise is needed on both sides if agreement is to be reached. The new tentative agreement is then submitted for a ratification vote by union membership.

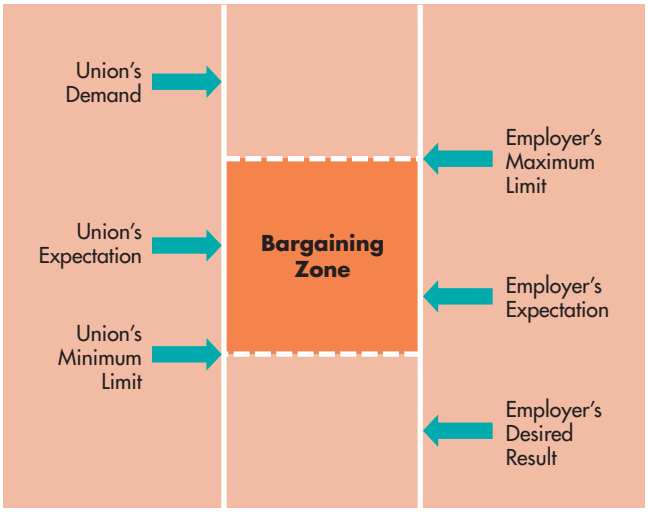


FIGURE 8.3 The bargaining zone

Fundamental differences may be evident when labour and management try to develop a new collective agreement. At the Great Blue Heron Charity Casino in Port Perry, Ontario (operated by the Mississaugas of Scugog Island First Nation), a collective agreement was in place with the Canadian Auto Workers union that covered 1000 casino workers (very few of whom were band members). The band wanted to replace the collective agreement with its own labour agreement, which would have denied employees the right to strike. The band felt it could drop the collective agreement with the CAW because it had aboriginal treaty and self-government rights. When it tried to implement the new labour agreement, the CAW filed a grievance. Eventually, the Ontario Court of Appeal rejected the band's arguments on the grounds that the band had not proven that a labour code was part of its tradition, nor that it was integral to its ancestral culture.[92]

Contract Issues

Most of the issues in a labour contract arise from demands that unions make on behalf of their members. Issues that are typically most important to union negotiators include *compensation, benefits*, and *job security*. Certain management rights issues are also negotiated in most bargaining agreements.

Compensation

The most common issue is compensation. Unions want their employees to earn higher wages immediately, so they try to convince management to raise wages for all or some employees. Of equal concern to unions is future compensation that is to be paid during subsequent years of the contract. One common tool for securing wage increases is a *cost-of-living adjustment (COLA)*. Most COLA clauses tie future raises to the Consumer

Price Index (CPI), a government statistic that reflects changes in consumer purchasing power. A *wage reopener clause*—which allows wage rates to be renegotiated at preset times during the life of the contract—is sometimes included in labour contracts where a union is uncomfortable with a long-term contract based solely on COLA wage increases.

Benefits

Benefits commonly addressed during negotiations include insurance, retirement benefits, paid holidays, working conditions, and the cost of supplementary health care (prescription drugs, eye care, dental care, and so on). The health-care issue is becoming increasingly contentious during negotiations because the cost of such care is rapidly increasing.

Job Security

In some cases, a contract may dictate that if the workforce is reduced, seniority will be used to determine which employees keep their jobs. Unions are also increasingly setting their sights on preserving jobs for workers in Canada in the face of business efforts to outsource production in some sectors to countries where labour costs are cheaper. For example, Gildan Activewear outsources much of its production to low-wage countries in the Caribbean.

Other Union Issues

Other issues might include details such as working hours, overtime policies, rest periods, differential pay plans for shift employees, the use of temporary workers, grievance procedures, and allowable union activities (dues collection, union bulletin boards, and so on). In addition, some contracts are beginning to include formal mechanisms for greater worker input in management decisions.

Management Rights

Management wants as much control as possible over hiring policies, work assignments, and so forth. Unions, meanwhile, often try to limit management rights by specifying hiring, assignment, and other policies. At one Chrysler plant, the contract stipulated that three workers were needed to change fuses in robots: a machinist to open the robot, an electrician to change the fuse, and a supervisor to oversee the process. Such contracts often bar workers in one job category from performing work that falls within the domain of another. Unions try to secure jobs by defining as many different categories as possible (the Chrysler plant had over 100). Management resists this practice because it limits flexibility and makes it difficult to reassign workers.

When Bargaining Fails

An impasse occurs when, after a series of bargaining sessions, management and labour are unable to agree on a first-time contract or a contract to replace an agreement that is about to expire. Both union and management may try various tactics to support their demands until the impasse is resolved.

Union Tactics

A **strike** occurs when employees temporarily walk off the job and refuse to work. In 2017, for example, workers at the CAMI car plant in Ingersoll, Ontario, were on strike for a month before they were able to reach an agreement with management about job security issues. During a strike, unions may picket or launch a boycott. *Picketing* involves having workers march at the entrance to the company with signs explaining their reasons for striking. In May 2017, clerical workers at the law firm Cavalluzzo Shilton McIntyre Cornish LLP picketed the firm's downtown location, claiming that the firm was underpaying staff relative to other law firms.[93] *Sympathy strikes* (also called *secondary strikes*) occur when one union strikes in sympathy with a strike initiated by another union. *Wildcat strikes*—those that are not authorized by the union or that occur during the life of a contract—deprive strikers of their status as employees and thus of the protection of labour laws. In 2012, Air Canada ground crews engaged in a wildcat strike that caused hundreds of flights to be delayed or cancelled.[94] The boxed insert entitled "Community College Strike Disrupts Students' Lives" describes some of the dynamics of a strike.

Unions are more reluctant to use the strike weapon than they used to be. One reason is that more and more workers are in profit-sharing plans, meaning they receive a portion of company profits. Going on strike has a negative effect on profits, so workers are hurting themselves if they go on strike. Other reasons are the decline in union power, the bad publicity generated by strikes, and the fact that technology and globalization mean companies can easily displace highly paid but low-skilled workers.[95]

In some situations, unions are not permitted to strike. For example, the Province of Nova Scotia passed a law that forbids strikes by health-care workers in that province.[96] Hospital workers cannot strike in Alberta, Prince Edward Island, or Ontario, either. Strikes may also be illegal if the union does not go through certain necessary steps before striking.

Union workers have other options they can pursue if they don't want to go on strike. A *boycott* occurs when union members agree not to buy the products of the firm that employs them. Workers may also urge other consumers to shun their firm's products. In a *work slowdown*, workers perform their jobs at a much slower pace than normal. A variation is the *sickout*, during which large numbers of workers call in sick in order to disrupt a company's normal activities.

Management Tactics

Management can also respond forcefully to an impasse. A **lockout** occurs when employers physically deny employees access to the workplace. In 2012, National Hockey League owners locked out the players for four months, and in 2018, workers were locked out of the ABI aluminum smelter in Bécancour, Quebec.[97] As an alternative to a lockout, firms may hire temporary or permanent replacements (*strikebreakers*) for the absent employees (but the use of replacement workers is illegal in Quebec and British Columbia).

Companies can also lessen the impact of unions by contracting out—to non-union contractors—much of the assembly work they had previously done internally. This action results in fewer union workers within the company. Companies can also join *employers' associations*—groups of companies that get together to plan strategies and exchange information about how to manage their relations with unions. The British Columbia Maritime Employers Association—which includes 67 companies that employ longshoremen in Vancouver and other seaports in British Columbia—is an example of an employers' association. In extreme cases, management may simply close down a plant if an agreement cannot be reached with the union. For example, Maple Leaf Foods closed its Edmonton hog processing plant when its workers went on strike. This decision resulted in 850 workers losing their jobs.

STRIKE A tactic of labour unions in which members temporarily walk off the job and refuse to work in order to win concessions from management.

LOCKOUT A tactic of management in which a firm physically denies employees access to the workplace to pressure workers to agree to the company's latest contract offer.

DISRUPTIONS IN BUSINESS

Richard Lautens/Toronto Star/ZUMA Press/Newscom

Community College Strike Disrupts Students' Lives

On October 15, 2017, members of the Ontario Public Service Employees Union (OPSEU) went on strike at Ontario's 24 community colleges. The union included 12 000 professors, instructors, counsellors, and librarians. Two key issues in the strike were academic freedom (the professors wanted more power to determine what and how they taught) and job security (the union wanted more job security for contract teachers, but they also wanted half of all jobs to be full-time jobs to combat a movement toward more contract workers). Wages were also an issue. OPSEU represented the professors during negotiations, and the College Employer Council (CEC) represented the province's community colleges. Over the next five weeks, negotiations did not go well, and a mediator was appointed to help the disputing parties reach a negotiated settlement. But still a settlement could not be reached. Negotiations ended on November 19 when the CEC rejected the final offer from OPSEU.

As the strike dragged on, students became increasingly anxious because their academic progress was being disrupted. The practical nature of community college programs meant that workplace learning was being missed as long as the strike continued. Students who had internships that started in January 2018 were particularly concerned that if the term was not completed in 2017, they would not be able to start their internship. The strike also caused layoffs of food service workers at various community colleges. For example, at Fleming College in Peterborough, Aramark laid off 40 part-time and student food service employees and closed four of its seven locations. At George Brown College, most of the food service staff were laid off. Collaborative academic programs between provincial universities and community colleges were also cancelled or put on hold because of the strike.

On November 19, 2017, the province of Ontario introduced legislation that forced the striking professors to go back to work. This decision allowed students to return to class on November 21. The colleges announced that the term would end in two weeks. But this meant that students would have to do five weeks of work in just two weeks, and this added to their stress levels. As the strike ended, students were given two options: continue with the abbreviated term or take a full tuition refund. Students who decided to continue were also eligible for up to $500 to pay for unexpected costs such as childcare fees and rebooked tickets. The province also wanted the colleges to use the money they saved during the strike (by not paying professors) to create a fund to help students who had experienced financial hardship because of the strike.

CRITICAL THINKING QUESTION

1. Consider the following statement: "*Professors at community colleges and universities should not be allowed to go on strike because that action causes great harm to students who are trying to make progress toward their degree.*" Do you agree or disagree with the statement? Explain your reasoning.

Conciliation, Mediation, and Arbitration

Rather than using their weapons on one another, labour and management can agree to call in a third party to help resolve a dispute. In **conciliation**, a neutral third party (the *conciliator*) helps the two sides clarify the issues that are separating them. The conciliator cannot impose a settlement on the disputing parties.

In **mediation**, a neutral third party (the *mediator*) goes beyond conciliation and advises the disputing parties about specific steps they might take to reach a settlement. The mediator, however, cannot impose a settlement, either. When the Air Canada Pilots Association received support from its members for a strike, a mediator was appointed to assist in the negotiations between Air Canada and the union in the hope of reaching a negotiated settlement without a strike occurring.[98]

In **arbitration**, a neutral third party (the *arbitrator*) imposes a settlement on the disputing parties. When *voluntary arbitration* is used, the disputing parties agree to submit the dispute to outside judgment. For example, a pension dispute between Air Canada and the Canadian Auto Workers union was sent to an arbitrator, who ruled in favour of the union's proposal for a hybrid pension plan that included elements of both defined benefit and defined contribution pension plans.[99] In some cases, arbitration is legally required to settle bargaining disputes. This *compulsory arbitration* is often used to settle disputes between government and public employees such as firefighters and police officers.

CONCILIATION A method of settling a contract dispute in which a neutral third party helps the two sides clarify the issues that are separating them.

MEDIATION A method of settling a contract dispute in which a neutral third party is asked to hear arguments from both the union and the management and offer a suggested resolution.

ARBITRATION A method of settling a contract dispute in which a neutral third party imposes a binding settlement on the disputing parties.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 DEFINE *HUMAN RESOURCE MANAGEMENT*, DISCUSS ITS STRATEGIC SIGNIFICANCE, AND EXPLAIN HOW MANAGERS PLAN FOR HUMAN RESOURCES.

Human resource management, or *HRM*, is the set of organizational activities directed at attracting, developing, and maintaining an effective workforce. HRM plays a key strategic role in organizational performance. Planning for human resource needs entails several steps: (1) conducting a job analysis, (2) forecasting demand and supply, and (3) matching HR supply and demand.

LO-2 IDENTIFY THE ISSUES INVOLVED IN STAFFING A COMPANY, INCLUDING *INTERNAL* AND *EXTERNAL RECRUITING* AND *SELECTION*.

Recruiting is the process of attracting qualified people to apply for open jobs. *Internal recruiting* involves considering present employees for new jobs. It builds morale and rewards the best employees. *External recruiting* means attracting people from outside the organization. Key *selection techniques* include application forms, tests, and interviews. The techniques must be valid predictors of expected performance.

LO-3 DISCUSS DIFFERENT WAYS IN WHICH ORGANIZATIONS GO ABOUT DEVELOPING THE CAPABILITIES OF EMPLOYEES AND MANAGERS.

Nearly all employees undergo some initial *orientation* process. Many employees are also given the opportunity to acquire new skills through various *work-based* and/or *instructional-based programs*.

LO-4 DISCUSS THE IMPORTANCE OF *WAGES AND SALARIES*, *INCENTIVES*, AND *BENEFIT PROGRAMS* IN ATTRACTING AND KEEPING SKILLED WORKERS.

Wages and salaries, *incentives*, and *benefit packages* may all be parts of a company's *compensation program*. By providing competitive compensation levels, a business can attract and keep qualified personnel. *Incentive programs* can also motivate people to work more productively. *Indirect compensation* also plays a major role in effective and well-designed compensation systems.

LO-5 DESCRIBE SOME OF THE KEY LEGAL ISSUES INVOLVED IN HIRING, COMPENSATING, AND MANAGING WORKERS IN TODAY'S WORKPLACE.

Managers must obey a variety of federal and provincial laws in the areas of *equal opportunity* and *equal pay*, *sexual harassment*, and *comparable worth*. Firms are also required to provide employees with safe working environments, as per the guidelines of provincial occupational health and safety acts.

LO-6 DISCUSS *WORKFORCE DIVERSITY*, THE *MANAGEMENT OF KNOWLEDGE WORKERS*, AND THE USE OF *CONTINGENT* AND *TEMPORARY WORKERS* AS IMPORTANT CHANGES IN THE CONTEMPORARY WORKPLACE.

Workforce diversity refers to the range of workers' attitudes, values, beliefs, and behaviours that differ by gender, race, ethnicity, age, and physical ability. Many firms now see diversity as a source of competitive advantage and work actively to achieve diversity in their ranks. Additional challenges exist in *managing knowledge workers* (rapidly increasing salaries and high turnover). *Contingent workers* are hired to supplement an organization's permanent workforce. The use of contingent workers gives managers flexibility; also, these workers are usually not covered by employers' benefit programs—two reasons why their numbers are growing.

LO-7 TRACE THE EVOLUTION OF, AND DISCUSS TRENDS IN, *UNIONISM* IN CANADA.

The first unions were formed in the early nineteenth century in the Maritime provinces. Labour organizations sprang up and faded away during the nineteenth century and unions began to develop in the twentieth century. Since the mid-1970s, labour unions in Canada have had difficulty attracting new members. Membership as a percentage of total workforce has declined. Increasingly, unions recognize that they have lost significant power and that it is in everyone's best interests to work with management instead of against it.

LO-8 DESCRIBE THE *MAJOR LAWS GOVERNING UNIONISM*.

Privy Council Order 1003 gave unions the right to bargain collectively in Canada. The *Constitution Act, 1867* allowed the federal government to pass labour legislation (e.g., the *Canada Labour Code*) for companies that operate interprovincially and allowed the provincial governments to pass legislation (e.g., the Ontario Labour Relations Act) for companies that operate in only one province.

LO-9 IDENTIFY THE STEPS IN THE *COLLECTIVE BARGAINING PROCESS*.

Once certified, the union engages in collective bargaining with the organization. The initial step is reaching agreement on a *labour contract*. Contract demands usually involve wages, job security, or management rights. Both labour and management have several tactics that can be used against the other if negotiations break down. Unions may attempt a *strike*, a *boycott*, or a *work slowdown*. Companies may hire *strikebreakers* or *lockout* workers. Sometimes *mediation* or *arbitration* may be used to settle disputes.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Why is the formal training of workers so important to most employers? Why don't employers simply let people learn about their jobs as they perform them?
2. Why is a good employee–job match important? Who benefits more, the organization or the employee? Explain your reasoning.
3. How is it possible for unemployment to be high while at the same time companies are complaining that they are having trouble hiring people?
4. What advantages accrue to companies that have a diverse workforce? Are there disadvantages associated with diversity? Explain.
5. Why do you think the unionization rate in the public sector is so much higher than in the private sector? Do you think this will change in the foreseeable future? Explain your reasoning.
6. Consider the following statement: "*In a union shop, newly hired employees must join the union within 30 days of starting work. Forcing workers to join a union in order to keep their job is unreasonable and violates their freedom of choice. Workers should be allowed to decide whether they want to join a union or not. Union shops should therefore not be allowed.*" Do you agree or disagree? Explain your reasoning.

APPLICATION EXERCISES

7. Interview a human resource manager at a local company. Select a position for which the firm is currently recruiting applicants and identify the steps in the selection process. Do the steps match those shown in Figure 8.1? Why or why not?
8. Go online and find three companies that are reported as being "great places to work." Describe the compensation, benefits, and perks that these companies provide for employees. Which of the three firms is most appealing to you? Explain your reasoning.
9. Select a job currently held by you or a close friend. Draw up a job description and job specification for this position.
10. Interview the managers at two local companies, one unionized and one non-unionized. Compare the wage and salary levels, benefits, and working conditions at the two firms. Do you find any differences? If so, what are they?

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members to consider your new business venture and how it relates to the concepts of HRM discussed in this chapter. Develop specific responses to the following:

1. As your new venture grows, you will need to hire employees. How will you recruit people to apply for jobs within your organization?
2. Ideally, you will be able to select from many applicants for jobs within your company. How will you select the best employee from the pool of applicants?
3. How will employees be compensated in your company? How do you think this compensation system will reflect your company's mission and goals?
4. What types of benefits will you offer to employees? Understanding the high cost of benefits, how have you selected these benefits?
5. Describe your system for performance appraisal and training. How will you reward good employees? When you have weak employees, how will you change their behaviour?

BUILDING YOUR BUSINESS SKILLS

STARTING FROM SCRATCH

GOAL

To help you understand job analysis and the process of recruiting and selecting employees.

THE SITUATION

You are an employee at a growing home improvement company. The company has recently moved to a new office space, complete with a showroom highlighting some of the company's work. There are 15 employees, including the president, sales staff, and accounting department. The company has decided to hire a receptionist who can greet prospective customers and assist in social networking and other marketing activities.

ASSIGNMENT

Form groups of three to five students who will play the role of "co-workers" on a hiring committee. The committee's task is to complete the process of job analysis, creating a job description and job specification for the receptionist position. Because this is a completely new position, you are starting from scratch. As a group, develop a job description that clearly explains the duties of the job; its working conditions; and the tools, materials, and equipment that are used to do the job. Be specific. Once this is complete, your group must agree on a job specification that lists the skills, abilities, and other credentials the person needs to do the job.

QUESTIONS FOR DISCUSSION

1. What is the most difficult part of developing a job description? Do you feel that you needed additional information?
2. When developing the job specification, how did your group determine the education and experience necessary for the job?
3. Because this is an entry-level position, it is likely that you will receive a large number of applications. How will you screen the applications and decide whom to interview? What knowledge, skills, or abilities will be most important in the person that you hire?

EXERCISING YOUR ETHICS

HANDLING THE LAYOFFS

THE SITUATION

The CEO of a moderate-sized company is developing a plan for laying off employees. He wants each manager to rank his or her employees according to the order in which they should be laid off, from first to last.

THE DILEMMA

One manager has just asked for help. He is new to his position and has little experience to draw from. The members of the manager's team are as follows:

- *Tony Jones.* White male, 10 years with the company, average performer, reportedly drinks a lot after work.
- *Amanda Wiggens.* White female, very ambitious, 3 years with the company, above-average performer, puts in extra time at work; is known to be abrasive when dealing with others.
- *George Sinclair.* Aboriginal, 20 years with the company, average performer, was previously laid off but called back when business picked up.
- *Dorothy Henderson.* White female, 25 years with the company, below-average performer, has filed five sexual harassment complaints in the past 10 years.
- *Wanda Jackson.* Black female, 8 years with the company, outstanding performer, is rumoured to be looking for another job.
- *Jerry Loudder.* White male, single parent, 5 years with the company, average performer.
- *Martha Strawser.* White female, 6 years with company, excellent performer but spotty attendance, is putting husband through university.

TEAM ACTIVITY

Assemble a group of four students. Your group has agreed to provide the manager with a suggested rank ordering of the manager's employees.

ACTION STEPS

1. Working together, prepare this list, ranking the manager's employees according to the order in which they should be laid off, from first to last. Identify any disagreements that occurred along the way, and indicate how they were resolved.
2. As a group, discuss the underlying ethical issues in this situation and write them down.
3. As a group, brainstorm any legal issues involved in this situation and write them down.
4. Do the ethical and legal implications of your choices always align?
5. Do the ethical and performance implications of your choices always align?

BUSINESS CASE 8

WHAT HAPPENS WHEN THE MINIMUM WAGE IS INCREASED?

In 2017, the Ontario government decided to raise the minimum wage in the province (to $14 per hour in 2018 and to $15 per hour by 2019). This was part of a trend in several Canadian provinces and U.S. states to boost minimum wages. The announcement generated an immediate reaction from two different groups. Labour unions and social activists said it was a great idea, but most business owners panned the idea. What a surprise!

Those who welcome the change say that it will improve the economic situation for workers receiving the lowest pay, which will help reduce income inequality in Canada. Supporters point out that the percentage of the working age population with jobs is higher in countries such as Sweden, Denmark, and Germany, even though those countries have higher minimum wages than Canada. They also note that business owners respond to a higher minimum wage by finding ways to improve worker productivity (labour productivity is higher in Germany and in Scandinavian countries than it is in Canada).

Business owners who oppose the change (e.g., those in the restaurant industry) argue that increasing the minimum wage will force them to either reduce staffing levels or raise prices (or some combination of the two). The change will therefore *reduce* employment opportunities, particularly for workers in the 15–24 age bracket. This is a bad thing because young workers usually take minimum wage jobs as they embark on their careers. If fewer of these jobs are available, the long-term career prospects of young workers are reduced.

In a debate such as this one (where adversaries hold strong ideological positions), it is often the case that more heat than light is generated. Consider this incident: When Loblaw CEO Galen Weston commented that the $15 minimum wage would cost his company about $190 million in increased wage costs, he was immediately accused by the social advocacy group Leadnow of trying to sabotage the Ontario government's move to raise the minimum wage. Weston responded that Loblaw does not oppose the wage hikes, but that he felt he had a responsibility to inform his investors of the impact the changes would have on Loblaw's bottom line.

Here's another example: In July 2017, a group of 53 economic experts who support an increase in the minimum wage sent a letter to Ontario Premier Kathleen Wynne saying that fearmongering by opponents of the minimum wage increase was out of step with economic research. This statement was immediately challenged by analysts at the Fraser Institute, who said that what the 53 experts were saying was false and that economic research over the past 30 years has consistently shown that increases in the minimum wage reduce job prospects for young workers.

Some companies have proactively increased the wages of certain employees. When the CEO of insurance giant Aetna, Mark Bertolini, learned that many of his lowest-paid employees were on public assistance, he decided to increase their wage to $16 per hour. The increase affected 12 percent of Aetna's 48 000 employees. The lowest-paid employees (who had a base pay range of $12 per hour) received a 33 percent pay increase, and the average pay increase of employees who were affected by the change was 11 percent. The total cost of the wage and benefit enhancements was estimated at $14 million in 2015 and $25 million in 2016. That may sound high, but research shows that low-wage workers are more likely to quit than their higher paid

Kristoffer Tripplaar/Alamy Stock Photo

counterparts. This means that high turnover costs are incurred at companies that pay low wages. At Aetna, the costs associated with high employee turnover (e.g., recruiting, hiring, and training new employees to replace those who leave) were about $120 million a year. That cost far exceeded the cost of raising the pay of employees. So the company actually saved money by raising the pay of its lowest-paid workers.

Research has shown that raising the pay of employees increases their productivity. One study showed that more than half of the cost of a pay increase can be offset by increases in employee productivity and decreases in turnover-related costs. By offering higher wages, companies are also able to recruit and hire better employees and to decrease the likelihood of disciplinary issues. Janet Yellen, chair of the Federal Reserve System Board of Governors in the United States, says that higher wages also reduce shirking by employees because they don't want to lose a high-paying job. The benefits of higher wages also extend to quality and customer service. Several studies show that employers reported improvements in both customer service and the quality of production.

QUESTIONS FOR DISCUSSION

1. The two sides in the minimum wage debate hold very strong views. Explain the motivations of the two sides and how this influences the positions they hold.
2. Consider the following statement: *"All things considered, raising the minimum wage will result in good outcomes for workers and for Canada's economic performance."* Do you agree or disagree with the statement? Explain your reasoning.
3. Do you think that companies have a social responsibility to pay higher wages? Explain your reasoning.
4. Analyze the situation at Aetna using expectancy theory, equity theory, and the two-factor theory. What does each theory say about the importance of wages? (**Note:** Read the relevant sections in Chapter 9 before answering this question.)

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- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
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- **Videos:** Learn more about the business practices and strategies of real companies.

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CHAPTER

09

Motivating, Satisfying, and Leading Employees

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Identify and discuss the basic *forms of behaviour* that employees exhibit in organizations.
- **LO-2** Describe the nature and importance of *individual differences* among employees.
- **LO-3** Explain the meaning and importance of *psychological contracts* and the person–job fit in the workplace.
- **LO-4** Identify and summarize the most important models of *employee motivation*.
- **LO-5** Describe the *strategies* used by organizations to improve job satisfaction and employee motivation.
- **LO-6** Define *leadership* and distinguish it from *management*.
- **LO-7** Summarize the *approaches to leadership* that developed during the twentieth century.
- **LO-8** Describe the most recent ideas about effective leadership.

Hunter Harrison

Hunter Harrison, whose achievements in the Canadian railroad industry are legendary, died unexpectedly in December 2017. He began his rail career as a "car oiler" while he was still in university, and over the next 40 years, he worked his way to the top. He was most recently the CEO of Florida-based CSX Rail Corporation, a large U.S. railroad, but he made a name for himself as a result of successfully leading three major railroads: Canadian National, Canadian Pacific, and Illinois Central. His "precision railroading" system focused on controlling costs, tight scheduling of trains, and making the best use of assets. In practice, that meant running fewer (and longer) trains on a rigid schedule, getting rid of customers that weren't profitable, cutting the number of operating employees, and putting hundreds of locomotives and thousands of rail cars into storage. His system cut the amount of time trains spent in rail yards, improved network speed, and reduced the operating ratio (costs divided by revenue). During his tenure as CEO at CP, for example, the operating ratio improved from 83 percent to 58 percent (the lower the number, the greater the operating efficiency). Harrison's system also resulted in big gains for investors as CP's stock price rose.

But workers at CP weren't nearly as impressed with the idea of precision railroading as stockholders were. The workers saw job cuts, big changes in the way train scheduling was done, and firings for relatively minor reasons. For example, when a locomotive engineer stepped in a gopher hole and twisted his ankle, he didn't see a doctor until the next day, which was a safety violation. He was fired a few weeks later, even though he had worked for CP for 34 years and had nothing more on his record than a warning for missing one call to work. The engineer belonged to the Teamsters Canada Rail Conference union, which appealed his firing. An arbitrator ordered CP to give the engineer his job back. This was not an unusual case. During the period 2012–2016,

Chris Young/The Canadian Press

there were 92 dismissals (an average of 23 a year). Arbitrators ruled that 77 of those firing were unjustified, and the employees were reinstated. Between 2003 and 2012 (prior to Harrison's time at CP), there were only five firings a year.

The president of the Teamsters said that CP treated workers badly and that a culture of fear and intimidation existed. Workers felt that the financial gains that were recorded at CP came at the expense of workers. One union official said that the precision railroading system caused lower-level managers to be harsh with workers in order to keep trains moving. Workers were afraid to ask their bosses questions for fear their boss would think they were incompetent and fire them. Harrison's successor at CP tried to improve employee relations and end the conflict between management and the workers that had developed under Harrison's leadership. CP management met with union leaders and introduced a new disciplinary system that was designed to reduce the number of suspensions and firings for minor safety violations that had been so upsetting when Harrison was CEO.

In March 2017, Harrison took over as the CEO of CSX Rail Corporation. Even before he was actually on the job, the stock price of CSX had risen 30 percent, apparently because investors thought that Harrison would be able to improve profit and operations at CSX just as he had done at several other railroads in previous years. Shareholders approved a compensation plan of about $300 million for a four-year contract. During Harrison's first few months at CSX, his precision railroading system was implemented and initially the outcomes were positive. The percentage of on-time arrivals rose from 58 to 79 percent, and CSX shares jumped 42 percent. But by the summer of 2017, shippers were complaining about missed shipments, lost sales, and trains that arrived late or not at all.

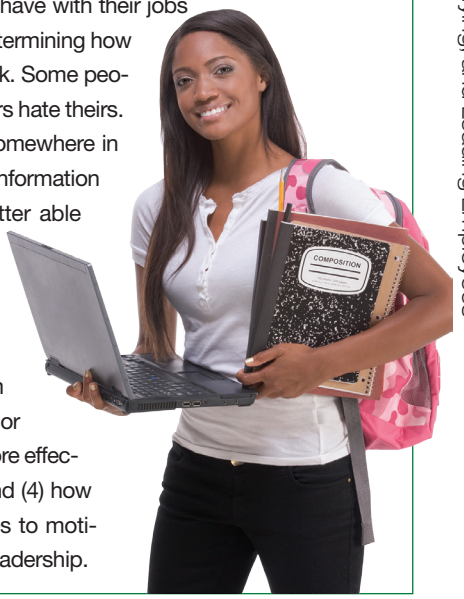
The Surface Transportation Board (STB), a U.S. regulator, received complaints from many industry groups and from CSX customers. A survey conducted by the investment bank Cowen Inc. found that 80 percent of shippers reported service problems after Harrison took over at CSX. Forty percent said they switched some shipments to CSX's competitor (Norfolk Southern Corp.), and 67 percent said they moved freight through a trucking company. The STB required CSX to provide weekly reports on how well its network was moving freight. At a public hearing in September 2017, various shippers complained that they experienced longer transit times, unreliable switching operations, inefficient car routings, and poor communication with CSX customer service. These stories revealed significant disruption to customers' business operations.

QUESTIONS FOR DISCUSSION

1. What is the difference between a transformational leader and a transactional leader? What type of leader is Hunter Harrison? Explain your reasoning.
2. What is the difference between leadership and management? Is Hunter Harrison a leader or a manager, or both? Explain your reasoning.
3. Consider the following statement: *"It is inevitable that there will be conflict between a strong leader like Hunter Harrison and lower-level employees in the organization because the leader is demanding and because the leader's expectations are very high."* Do you agree or disagree with the statement? Explain your reasoning.

HOW WILL THIS HELP ME?

The connections employees have with their jobs can go a long way toward determining how happy they are with their work. Some people love their jobs, while others hate theirs. Most people, however, fall somewhere in between. After studying the information in this chapter, you'll be better able to understand (1) your own feelings toward your work from the perspective of an *employee*, (2) the feelings of others toward their work from the perspective of a *manager* or an *owner*, (3) how you can more effectively function as a *leader*, and (4) how your manager or boss strives to motivate you through his or her leadership.



Mocker bat/Fotolia

LO-1 FORMS OF EMPLOYEE BEHAVIOUR

Employee behaviour is the pattern of actions by the members of an organization that directly or indirectly influences the organization's effectiveness. *Performance behaviours* are those that are directly involved in performing a job. An assembly-line worker who stands next to a moving conveyor and attaches parts to a product as it passes by has relatively simple performance behaviours, but a research-and-development scientist who works in a lab trying to find new scientific breakthroughs that have commercial potential has much more complex performance behaviours.

Other behaviours—called *organizational citizenship*—provide positive benefits to the organization in more indirect ways. An employee who does satisfactory work in terms of quantity and quality but refuses to work overtime, won't help newcomers learn the ropes, and is generally unwilling to make any contribution beyond the strict performance requirements of the job is not a good organizational citizen. In contrast, an employee with a satisfactory level of performance who works late when the boss asks and takes time to help newcomers learn their way around is a good organizational citizen.

Counterproductive behaviours are those that detract from organizational performance. *Absenteeism* is an example of a counterproductive behavior. When an employee is absent from work, whether legitimately or not, that person's work does not get done, and a substitute must be hired to do it or others in the organization must pick up the slack. Private-sector workers average 9.9 days of absences each year, whereas public-sector workers average about 13 days per year. About two-thirds of employees who are absent from work are not actually ill.[1]

Tardiness is also a counterproductive behaviour. A survey conducted by CareerBuilder.com revealed that 19 percent of workers admitted being late for work at least once a week.[2]

Turnover occurs when people quit their jobs. It results from a number of factors, including the nature of the job, the nature of supervision, a poor person–job fit, the external labour market, and family influences. Stress and burnout also cause turnover. Stress and anxiety were mentioned by 70 percent of people who called a phone-counseling line at U.S.-based Workplace Options, which provides employee assistance programs. Total calls to those lines increased 18 percent from 2016 to 2017.[3] Burnout results when workers feel overwhelmed for an extended period of time; it eventually leads to apathy and numbness regarding work.

Management style influences the level of turnover. One survey of 660 workers showed that 84 percent of respondents who worked for a "kind" manager planned to stay with their company a long time, whereas only 47 percent of those who worked for a "bully" said they planned to stay.[4] A 2018 survey conducted by ADP Canada found that 20 percent of employees were actively looking for a new job, and another 43 percent were open to the idea of a new job but were not actively looking. The survey also found that 57 percent of employees felt loyal to their employer (which is below the global average of 70 percent).[5]

Other forms of counterproductive behaviour are also costly. Theft and sabotage, for example, result in direct financial costs for an organization. Sexual and racial harassment also cost an organization, both directly (through financial liability if the organization responds inappropriately) and indirectly (by lowering morale, producing fear, and driving off valuable employees). Workplace aggression and violence are also counterproductive.

EMPLOYEE BEHAVIOUR The pattern of actions by the members of an organization that directly or indirectly influences the organization's effectiveness.
COUNTERPRODUCTIVE BEHAVIOURS Behaviours that detract from organizational performance.

Ryan Remiorz/The Canadian Press

Wavebreakmedia/Shutterstock

For some jobs (e.g., assembly-line work), performance behaviours can be narrowly defined and easily measured. For many other jobs (e.g., research scientists or doctors), performance behaviours are less objective, more diverse, and more difficult to assess.

LO-2 INDIVIDUAL DIFFERENCES AMONG EMPLOYEES

Individual differences are physical, psychological, and emotional attributes that vary from one person to another. The individual differences that characterize a specific person make that person unique. Personality and attitudes are two main categories of individual differences.

Personality

Personality is the relatively stable set of psychological attributes that distinguish one person from another. In recent years, researchers have identified five fundamental traits that are especially relevant to organizations. These "big five" traits (shown in Figure 9.1) can be summarized as follows:

- *Agreeableness* is a person's ability to get along with others. A person with a high level of agreeableness is gentle, cooperative, forgiving, understanding, and good-natured in his or her dealings with others. A person with a low level of agreeableness is often irritable, short-tempered, uncooperative, and generally antagonistic toward other people.
- *Conscientiousness* refers to the number of things a person tries to accomplish. Highly conscientious people tend to focus on relatively few tasks at one time; as a result, they are likely to be organized, systematic, careful, thorough, responsible, and self-disciplined. Less conscientious people tend to pursue a wider array of tasks; as a result, they are often more disorganized and irresponsible, as well as less thorough and self-disciplined.
- *Emotionality* refers to the degree to which people tend to be positive or negative in their outlook and behaviours toward others. People with positive emotionality are relatively poised, calm, resilient, and secure; people with negative emotionality are more excitable, insecure, reactive, and subject to mood swings. People with positive emotionality are better able to handle job stress, pressure, and tension.
- *Extraversion* refers to a person's comfort level with relationships. Extroverts are sociable, talkative, assertive, and open to establishing new relationships, while introverts are much less sociable, talkative, and assertive, and more reluctant to begin new relationships. Extroverts tend to be higher overall job performers than introverts and are more likely to be attracted to jobs based on personal relationships, such as sales and marketing positions.
- *Openness* reflects how open or rigid a person is in terms of his or her beliefs. People with high levels of openness are curious and willing to listen to new ideas and to change their own ideas, beliefs, and attitudes in response to new information. People with low levels of openness tend to be less receptive to new ideas and less willing to change their minds. People with more openness are often better performers because of their flexibility and the likelihood that they will be better accepted by others in the organization.

Emotional Intelligence

Emotional intelligence, or emotional quotient (EQ), refers to the extent to which people possess social skills, are self-aware, can manage their emotions, can motivate themselves, and can express empathy for others.[6] Research suggests that people with high EQs may perform better than others, especially in jobs that require a high degree of interpersonal interaction and that involve influencing or directing the work of others. EQ appears to be something that isn't biologically based but that can be developed.[7] A survey of 2660 managers conducted by CareerBuilder.com found that 34 percent of hiring managers put a high priority on emotional intelligence when making hiring decisions.[8]

INDIVIDUAL DIFFERENCES Personal attributes that vary from one person to another.
PERSONALITY The relatively stable set of psychological attributes that distinguish one person from another.
EMOTIONAL INTELLIGENCE (EMOTIONAL QUOTIENT [EQ]) The extent to which people are self-aware, can manage their emotions, can motivate themselves, express empathy for others, and possess social skills.

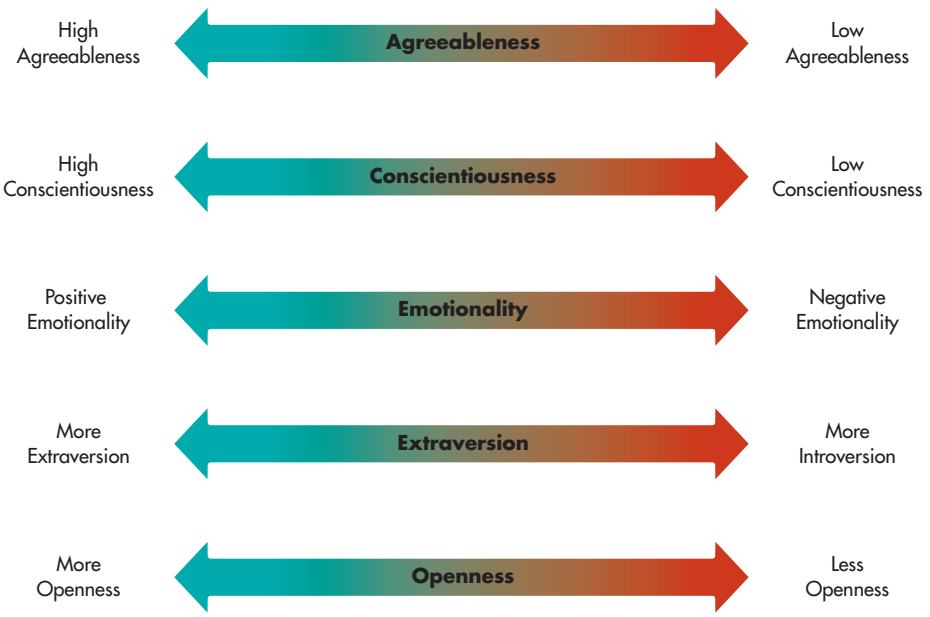


FIGURE 9.1 The "big five" personality traits

Other Personality Traits

Several other personality traits beyond the "big five" influence behaviour in organizations: locus of control, self-efficacy, authoritarianism, Machiavellianism, self-esteem, and risk propensity.

Locus of control is the extent to which people believe that their behaviour has a real effect on what happens to them.[9] Individuals with an *internal locus of control* believe that they control what happens to them. For example, they believe that if they work hard, they will get a promotion. Individuals with an *external locus of control* believe that fate or luck controls what happens to them. For example, an employee who does not get a promotion may attribute it to the manipulative political behaviour of others.

Self-efficacy is a person's belief about his or her capabilities to perform a task. People with high self-efficacy believe that they can perform well on a specific task, but people with low self-efficacy have doubts about their ability to perform a specific task. A person's belief in his or her ability to perform a task results in that person being more self-assured and better able to focus attention on performance.[10]

Authoritarianism is the extent to which a person believes that power and status differences are appropriate within social systems such as organizations.[11] An employee who is highly authoritarian may accept directives or orders from someone with more authority purely because the other person is "the boss." But an employee who is not highly authoritarian is more likely to question things or express disagreement with the boss.

Machiavellianism refers to behaviour that is designed to gain power and control.[12] Individuals high in Machiavellianism tend to be rational and non-emotional, may be willing to lie to attain their personal goals, put little emphasis on loyalty and friendship, and enjoy manipulating other people. Individuals low in Machiavellianism have the opposite characteristics.

Self-esteem is the extent to which a person believes that he or she is a worthwhile and deserving individual. A person with high self-esteem is more likely to seek higher-status jobs, be more confident in his or her ability to achieve higher levels of performance, and focus on intrinsic satisfaction like feeling good about doing useful work. By contrast, a person with low self-esteem may be more content to remain in a lower-level job, be less confident of his or her ability, and focus more on extrinsic rewards such as money.

Risk propensity is the degree to which a person is willing to take chances and make risky decisions. A person with a high risk propensity is willing to experiment with new ideas, gamble on new products, and take financial risks. By contrast, a person with a low risk propensity is reluctant to experiment with new ideas, gamble on new products, or take financial risks.

Attitudes at Work

Attitudes reflect our beliefs and feelings about specific ideas, situations, or other people. People in organizations have attitudes about many different things: their salary, their promotion possibilities, their boss, their employee benefits, and so on. Attitudes are shaped by our personal values, our experiences, and our personalities. For example, if an employee values honesty and integrity, that employee will have a favourable attitude toward managers who are honest and moral. Or, if an employee has an unpleasant experience with a co-worker, that employee is likely to develop a negative attitude toward that co-worker.

Attitudes contain three components: cognition, affect, and intention. *Cognition* is the knowledge a person has about someone or something. Cognitions are influenced by perceptions about reality, and perceptions may or may not be consistent with reality. *Cognitive dissonance* occurs when two sets of perceptions are contradictory or incongruent, or when people behave in a way that is inconsistent with their attitudes. For example, a person who thinks that smoking is dangerous may nevertheless smoke because the person finds the behaviour pleasurable. The person may try to reduce the associated anxiety by deciding to stop smoking (but not until next week!).

Affect is a person's feelings toward someone or something. For example, you may like one of your classes and dislike another one. If the class you dislike is an elective, you may not be particularly concerned about your participation or your final grade. But if the class you like is required for your major, you may work very hard to get a good grade.

Intention guides a person's behaviour. If you like a certain instructor, you may intend to take another class from that instructor next term. But intentions are not always translated into actual behaviour. If the instructor's course next term is scheduled for 8:30 a.m., you may decide that it is not convenient for you take it.

Two key work-related attitudes are job satisfaction and organizational commitment.

Job Satisfaction

Job satisfaction reflects the extent to which people have positive attitudes toward their jobs. A related concept—*morale*—refers to the overall attitude people have toward their workplace. Satisfied employees tend to be absent less often, to be good organizational citizens, and to stay with the organization. Dissatisfied employees may be absent more often, may experience stress that disrupts co-workers, and may be continually looking for another job. Contrary to what a lot of managers believe, high levels of job satisfaction do not automatically lead to high levels of productivity.

Organizational Commitment

Organizational commitment (also called *job commitment*) reflects an individual's identification with the organization and its mission. Highly committed employees see themselves as true members of the firm, overlook minor sources of dissatisfaction, and want to remain with the organization. Less committed employees are more likely to see themselves as outsiders, to express more dissatisfaction about their work, and to not see themselves as long-term members of the organization. One way to increase employee commitment is to give employees a voice.

Sometimes employees make disparaging comments about the company they work for, or about their co-workers or managers. Even if this happens when the employee is not at work, managers may see it as a sign of poor organizational commitment. The boxed insert entitled "Caution: Words Matter and Online Posts Can Haunt You" describes several of these incidents.

ATTITUDES A person's beliefs and feelings about specific ideas, situations, or people.

JOB SATISFACTION The extent to which people have positive attitudes toward their jobs.

ORGANIZATIONAL COMMITMENT An individual's identification with the organization and its mission.

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

Caution: Words Matter and Online Posts Can Haunt You

What you say and do outside your workplace can affect your career. In fact, what you post online today can hurt you many years later. Fair or not, it reflects your attitude and beliefs (at least in some way), and companies and organizations will judge you based on those words long into the future. In 2018, former Ontario Conservative leadership hopeful Tanya Granic Allen joined a long list of candidates who were called out for something they commented on many years earlier. In Allen's case, her posts dating back five years were seen by the opposition as proof that she has homophobic and Islamophobic views. Such examples can be found in every corner of the country. Ala Buzreba, who was a candidate for the Alberta Liberal Party, resigned when her four-year-old tweets were discovered in which she told someone they should have been aborted with a coat hanger.

While attending a Toronto FC soccer match, Shawn Simoes was caught on TV making obscene comments to a City TV news reporter. The incident went viral, and within hours, Simoes was dismissed from his job at Hydro One. Mr. Simoes was not at the game in an official work capacity, nor was he there with a client, but his on-camera comments were very offensive and juvenile. His employer made a clear statement that such behaviour would not be tolerated no matter what the setting. This incident shows that your behaviour can negatively influence your work, even if the incident does not occur while you are at work.

Not every immature comment gets broadcast on the news, but every day people post comments on social media sites that can damage their job prospects. An estimated 93 percent of recruiters check the social media profiles of potential recruits. A potential employer may not tell you that you didn't get the job because of the drunken, embarrassing picture you posted (from that wild party three years ago), but make no mistake, quite often these images are a determining factor. Although the dangers are particularly clear for younger workers who are often accustomed to broadcasting their lives, this is a cautionary note for everyone.

- A British teen was fired from a marketing job after describing it as extremely "dull," even though she didn't mention the name of the company she worked for. Her colleagues and boss saw the post on Facebook and that was enough to relieve her of her "boring" job.
- Two employees at a car dealership near Vancouver were fired after they posted extremely negative comments about their employer and the managers at the company. The workers complained about the legitimacy of the decision, but the British Columbia Labour Relations Board upheld their dismissal.

Employer interests seem to be well protected in Canada. Up to this point, the labour tribunals have supported the management positions and indicated that such acts violate the legal "duty of loyalty." Of course, this is a new and quickly evolving area of labour relations, so the challenges will continue. However, watch what you say in public and what you write in your social media posts because you may be judged.

CRITICAL THINKING QUESTION

1. Do you believe that employers should have the right to terminate an employee based on comments the employee made in a private setting or on Twitter or Facebook posts?

LO-3 MATCHING PEOPLE AND JOBS

Given the array of individual differences that exist across people and the many different forms of employee behaviour that can occur in organizations, it is important to have a good match between people and the jobs they are performing. Two key methods for facilitating this match are psychological contracts and the person–job fit.

Psychological Contracts

A **psychological contract** is the set of expectations held by an employee concerning what he or she will contribute to an organization (referred to as *contributions*) and what the organization will provide to the employee (referred to as *inducements*). If either party perceives an inequity in the contract, that party may seek a change. The employee, for example, might ask for a pay raise, a promotion, or a bigger office, or might put forth less effort or look for a better job elsewhere. The organization can also initiate change by training workers to improve their skills, transferring them to new jobs, or terminating them. Unlike a business contract, a psychological contract is not written on paper, nor are all of its terms explicitly negotiated. Figure 9.2 illustrates the essential features of a psychological contract.

PSYCHOLOGICAL CONTRACT The set of expectations held by an employee concerning what he or she will contribute to an organization (contributions) and what the organization will provide the employee (inducements) in return.

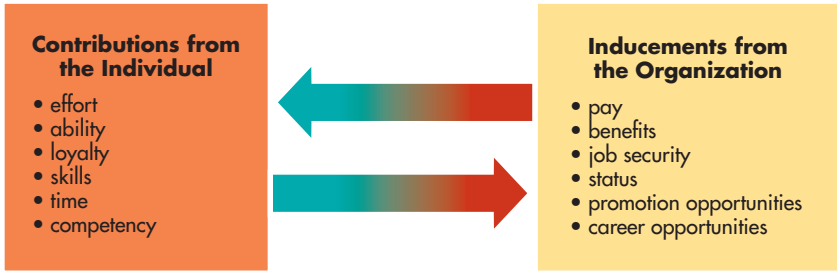


FIGURE 9.2 The psychological contract

The Person–Job Fit

The **person–job fit** refers to the extent to which a person's contributions and the organization's inducements match one another. Each employee has a specific set of needs that he or she wants fulfilled and a set of job-related behaviours and abilities to contribute. If the organization can take perfect advantage of those behaviours and abilities and exactly fulfill those needs, it will have achieved a perfect person–job fit. A good person–job fit can result in higher performance and more positive attitudes, whereas a poor person–job fit can have just the opposite effect.

PERSON–JOB FIT The extent to which a person's contributions and the organization's inducements match one another.

Person–job fit is an important consideration when hiring people to perform specific jobs. Some people might thrive working in extreme weather conditions, travelling most of the time, or performing risky jobs (like ironworkers on a high-rise building). They can handle jobs like these, but other workers will prefer far less "exciting" jobs.

Michael Doolittle/Alamy Stock Photo

MOTIVATION IN THE WORKPLACE

Motivation means the set of forces that cause people to behave in certain ways. While one worker may be motivated to work hard to produce as much as possible, another may be motivated to do just enough to get by. *Extrinsic motivation* is evident when a worker does a task in order to get a reward from someone else (e.g., a supervisor). By contrast, *intrinsic motivation* occurs when a worker does a task because that task is inherently satisfying, enjoyable, or meaningful to the person. The boxed insert entitled "Rebooting with Lessons from Past Ventures" describes the motivation of one entrepreneur.

Effective managers recognize that different employees have different needs and are motivated by different things. One company that stopped handing out T-shirts with the company logo on them found that professional workers didn't much care, but immigrant workers in entry-level jobs were unhappy because the T-shirts had symbolic value for them (the shirts apparently made them feel like they belonged in Canada).[13] This example, and thousands more, show that managers must think very carefully about how to motivate employees.

Many theories have been proposed to explain the complex issue of motivation. In the following discussion, we focus on four major approaches that reflect a chronology of thinking about motivation: classical theory, early behavioural theory, behavioural theory in the mid-twentieth century, and contemporary motivational theories.

The Hawthorne studies were an important step in developing an appreciation for the human factor at work. These women worked under different lighting conditions as researchers monitored their productivity. The researchers were amazed to find that productivity increased regardless of whether lighting levels increased or decreased.

Courtesy of AT&T Archives and History Center

Classical Theory

In the **classical theory of motivation**, it is assumed that workers are motivated solely by money. In his book *The Principles of Scientific Management (1911)*, industrial engineer Frederick Taylor proposed a way for both companies and workers to benefit from this view of motivation in the workplace.[14] If workers are motivated by money, Taylor reasoned, then paying them more would prompt them to produce more. Meanwhile, the firm that analyzed jobs and found better ways to perform them would be able to produce goods more cheaply, make higher profits, and thus pay—and motivate—workers better than its competitors.

Taylor's approach is known as *scientific management*, and his ideas captured the imagination of many managers in the early twentieth century. Soon, plants across Canada and the United States were hiring experts to

MOTIVATION The set of forces that causes people to behave in certain ways.
CLASSICAL THEORY OF MOTIVATION A theory of motivation that presumes workers are motivated almost solely by money.

Rebooting with Lessons from Past Ventures

At the heart of the definition of an entrepreneur is the willingness to take risks. An entrepreneur will risk his or her financial security and reputation in hopes of receiving a significant reward. We are all familiar with the rags-to-riches stories of those who struck it big, but we tend to forget that many entrepreneurs have a more humbling start. As Henry Ford once said, "Failure is only the opportunity to begin again more intelligently."

At the age of 22, Sophia Amoruso started out selling vintage clothing on eBay and built a customer base around the cool, slightly gritty-style that she dubbed "nasty gal." Nasty Gal grew and managed to secure significant financing; the company eventually opened brick-and-mortar stores, and *Forbes* magazine predicted gross sales would exceed $300 million in 2015. In addition, the magazine put Amoruso on its list of America's richest self-made women, and the Council of Fashion Designers of America inducted her into its hall of fame that year. But growth can bring challenges as well as success.

Nasty Gal faced a series of lawsuits brought by women who had been laid off just before they took maternity leave, as well as a suit by an employee who had been laid off after a five-week leave because of kidney disease. Along with employee issues, the company was overextended with debt and overhead costs and had burned through its initial venture capital funds. Without a constant influx of dollars into the marketing budget, sales declined, and the once profitable company quickly became insolvent. Just a year after all that recognition and praise for her success, Nasty Gal was in bankruptcy and Amoruso was out of a job.

A fair amount of research documents the role of failure in entrepreneurial growth and success. Entrepreneurs who experience failure may find themselves discouraged and lack effectiveness if they are too focused on their role in the failure. On the other hand, if one is to learn from failure, a certain amount of self-analysis is essential. Indeed, in research published by Yamakawa, Peng, and Deeds, entrepreneurs are discouraged from focusing too much on the role of the external environment or luck and are advised to take advantage of the opportunity to learn. Entrepreneurs must pick themselves up after failure, dust themselves off, and make wiser and more informed choices about their new venture.

Amoruso was 33 years old when she launched a new venture called Girlboss in 2018. Armed with first-hand lessons of success and failure, Amoruso admitted that, in the past, she had raised capital too early and eagerly and made hiring decisions too quickly. She was quoted as saying, "I was a young naïve boss who hired c-level executives and figured they would write their own job descriptions." She indicated that she is now much more hands-on and focused on the details. Ideas are great but numbers matter.

Robin Marchant/Getty Images Entertainment/Getty Images

The company may be different, but some of the new messaging is familiar. Girlboss has hosted a few live events called "Girlboss Rallies," and according to the founder, 50 percent of her audience owned a business, and the rest aspired to own a business. Part of the Girlboss experience was a show that was carried on Netflix, but it was cancelled after one season.

Amoruso is trying to leverage her experience into a message of strength and inspiration for women entrepreneurs. Time will tell if this new venture will become a long-term success, but one thing is certain, Sophia Amoruso displays the motivation and fight of a true entrepreneur.

CRITICAL THINKING QUESTION

1. Using theories of motivation and leadership described in this chapter, analyze this entrepreneur's drive to succeed and suggest tools to help her reach long-term goals.

perform time-and-motion studies, which were the first "scientific" attempts to break jobs down into easily repeated components and to devise more efficient tools and machines for performing them.[15] The results were impressive. For example, studies of workers loading iron onto rail cars showed that productivity tripled when scientific management principles were used.

Early Behavioural Theory

In 1925, a group of Harvard researchers began a study at the Hawthorne Works of the Western Electric Company. Their intent was to examine the relationship between changes in the physical environment and worker output, with an eye to increasing productivity. The results of the experiment at first confused, then amazed, the scientists. Increasing lighting levels improved productivity, but so did lowering lighting levels. And, against all expectations, raising the pay of workers failed to increase their productivity. Gradually, they pieced together the puzzle. In essence, the researchers determined that almost any action on the part of management that made workers believe they were getting special attention caused their productivity to rise. This result came to be known as the **Hawthorne effect**. Following the Hawthorne studies, managers and researchers alike focused more attention on how good *human relations*—the interactions between employers and employees and their attitudes toward one another—helped in motivating employees.

HAWTHORNE EFFECT The tendency for workers' productivity to increase when they feel they are getting special attention from management.

LO-4 Behavioural Theory in the Mid-Twentieth Century

During the years from 1940 to 1970, researchers developed several now-classic motivation theories: *Theory X and Theory Y,* the *hierarchy of needs, two-factor theory*, and the *acquired needs theory*.

Theory X and Theory Y

Behavioural scientist Douglas McGregor concluded that managers had different beliefs about how best to use a company's human resources. He classified these beliefs into sets of assumptions that he labelled "Theory X" and "Theory Y."[16] Managers who subscribe to **Theory X** tend to believe that people are naturally lazy and uncooperative and must therefore be either punished or rewarded to be made productive. Managers who subscribe to **Theory Y** tend to believe that people are naturally energetic, growth-oriented, self-motivated, and interested in being productive.

McGregor generally favoured Theory Y beliefs and argued that Theory Y managers are more likely to have satisfied, motivated employees. Of course, the model's distinctions are somewhat simplistic and offer little concrete basis for action. Their value lies primarily in their ability to highlight and analyze the behaviour of managers as a result of their attitudes toward employees.

The Hierarchy of Human Needs

Psychologist Abraham Maslow's **hierarchy of human needs model** proposed that people have a number of different needs that they attempt to satisfy in their work.[17] He classified these needs into five basic types and suggested that they are arranged in a hierarchy of importance, where lower-level needs must be met before a person will try to satisfy higher-level needs (see Figure 9.3).

- *Physiological needs* are those concerned with survival; they include food, water, shelter, and sleep. Businesses address these needs by providing both comfortable working environments and salaries sufficient to buy food and shelter.
- *Security needs* include the needs for stability and protection from the unknown. Many employers thus offer pension plans and job security.
- *Social needs* include the needs for friendship and companionship. Making friends at work can help to satisfy social needs, as can the feeling that you "belong" in a company.
- *Esteem needs* include the needs for status, recognition, and self-respect. Job titles and large offices are among the things that businesses can provide to address these needs.
- *Self-actualization needs* are needs for self-fulfillment. They include the needs to grow and develop one's capabilities and to achieve new and meaningful goals. Challenging job assignments can help satisfy these needs.

According to Maslow, once needs at one level have been satisfied, they cease to motivate behaviour. For example, if you feel secure in your job, a new pension plan will probably be less important to you than the chance to make new friends and join an informal network among your co-workers. If, however, a lower-level need suddenly becomes unfulfilled,

THEORY X A management approach based on the belief that people must be forced to be productive because they are naturally lazy, irresponsible, and uncooperative.

THEORY Y A management approach based on the belief that people want to be productive because they are naturally energetic, responsible, and cooperative.

HIERARCHY OF HUMAN NEEDS MODEL Theory of motivation describing five levels of human needs and arguing that basic needs must be fulfilled before people work to satisfy higher-level needs.

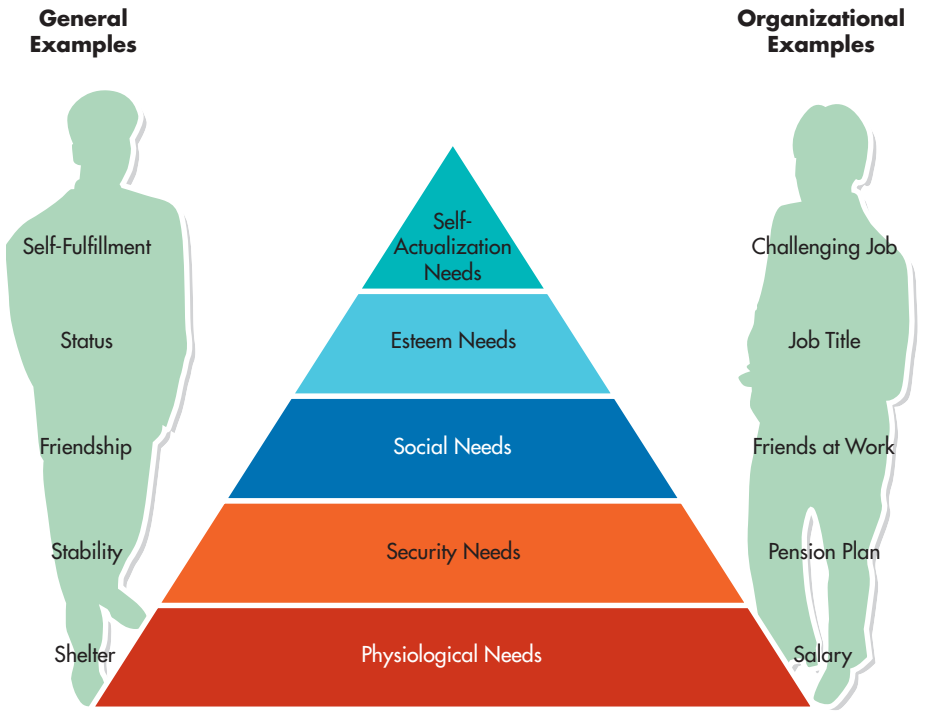


FIGURE 9.3 Maslow's hierarchy of human needs

Source: Maslow, Abraham H.; Frager, Robert D..; Fadiman, James, Motivation And Personality, 3rd Ed., © 1987. Adapted and Electronically reproduced by permission of Pearson Education, Inc., Upper Saddle River, New Jersey.

most people immediately refocus on that lower level. For example, if you are trying to meet your esteem needs by working as a divisional manager at a major company and you learn that your division and your job may be eliminated, you might very well find the promise of job security at a new firm very motivating.

Two-Factor Theory

After studying a group of accountants and engineers, psychologist Frederick Herzberg proposed the **two-factor theory**, which says that job satisfaction and dissatisfaction depend on two separate factors: *hygiene factors* (such as working conditions, quality of supervision, interpersonal relations, pay, and job security) and *motivating factors* (such as recognition, responsibility, advancement, and achievement).[18] Motivation factors cause movement along a continuum from no satisfaction to satisfaction. For example, if workers receive no recognition for successful work, they may not be satisfied, but neither will they be dissatisfied. If recognition is provided, they will likely become more satisfied. *Hygiene factors* cause movement along a different continuum, one from no dissatisfaction to dissatisfaction. For example, workers will be dissatisfied if they feel that working conditions are poor, but if working conditions are improved, workers will not become satisfied; rather, they will no longer be dissatisfied. Generally speaking, motivation factors are related to the work that employees perform, while hygiene factors are related to the environment in which they perform it (see Figure 9.4). This theory suggests that managers must first ensure that hygiene factors are acceptable (to avoid worker dissatisfaction) and then offer motivating factors (to improve satisfaction and motivation).

The Acquired Needs Theory

There are three needs in David McClelland's acquired needs theory: achievement, affiliation, and power.[19] One of these typically dominates a given individual's need structure. People who are high in *need for achievement* have a strong desire to accomplish a goal or task as effectively as possible. They tend to set moderately difficult goals and to make moderately risky decisions. They are preoccupied with work, and they take personal responsibility for getting things done. They want immediate feedback on their performance, so they often take sales jobs because they get immediate feedback from customers. They avoid jobs in areas such as research and development where feedback comes much more slowly.

Individuals with a high *need for affiliation* focus on human companionship.[20] They want reassurance and approval from others and are genuinely concerned about others' feelings. They are likely to act and think as they believe others want them to, especially those with whom they strongly identify. They most often work in jobs with a lot of interpersonal contact, such as teaching.

Individuals with a high *need for power* are driven by the desire to control their environment (including the financial, material, information, and human resource aspects).[21] People with a high need for power can be successful managers if they use their power to help the organization perform better, have good self-control, and are not excessive in their use of power.[22]

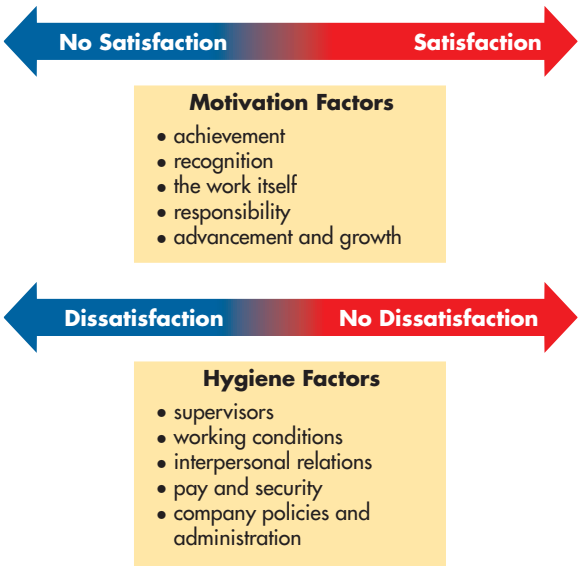


FIGURE 9.4 Two-factor theory of human motivation

Contemporary Motivation Theory

In recent years, other, more complex models of employee behaviour and motivation have been developed. Two of the most interesting and useful models are *expectancy theory* and *equity theory*.

Expectancy Theory

Expectancy theory suggests that people are motivated to work toward rewards they want and which they believe they have a reasonable chance—or expectancy—of obtaining.[23] A reward that seems out of reach, for example, is not likely to be motivating even if it is intrinsically positive (see Figure 9.5). For example, if an assistant department manager learns that a division manager has retired and that the firm is looking for a replacement, even though she wants the job, the assistant manager does not apply for it because she doubts that she would be selected. Then she learns that the firm is looking for a production manager on a later shift. She thinks that she could get this job but does not apply for that one either because she does not want to change shifts. But when she learns of an opening one level higher—department manager—in her own division, she applies for this job because she both wants it and thinks she has a good chance of getting it.

Expectancy theory helps to explain why some people do not work as hard as they can when their salaries are based purely on seniority. Because they are paid the same whether they work very hard or just hard enough to get by, there is no financial incentive for them to work harder. Similarly, if hard work will result in one or more undesirable outcomes—say, a transfer to another location or a promotion to a job that requires unwanted travel—employees may not be motivated to work hard.

TWO-FACTOR THEORY A theory of human relations developed by Frederick Herzberg that identifies factors that must be present for employees to be satisfied with their jobs and factors that, if increased, lead employees to work harder.

EXPECTANCY THEORY The theory that people are motivated to work toward rewards that they want and that they believe they have a reasonable chance of obtaining.

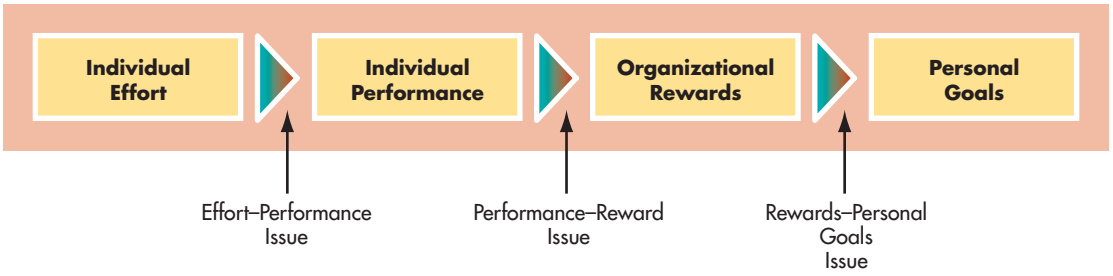


FIGURE 9.5 Expectancy theory model

Equity Theory

Equity theory says that people's motivation levels are influenced by their perception of how they are treated compared to others. People begin by analyzing what they contribute to their jobs (time, effort, education, experience, etc.) relative to what they get in return (salary, benefits, recognition, security). The result is a ratio of contribution to return. Employees then compare their own ratio to a "comparison others" ratio (other employees who are similar in terms of experience and training). Depending on their assessments, they experience feelings of equity or inequity.[24]

For example, suppose a new college graduate gets a starting job at a large manufacturing firm. His starting salary is $38 000 per year, he gets a compact company car, and he shares an office with another new employee. If he later learns that another new employee has received the same salary, car, and office arrangement, he will feel equitably treated. But if he finds out that another newcomer received $45 000, a full-size company car, and a private office, he may feel he has been inequitably treated. When people think they are being inequitably treated, they might do various things to restore fairness. For example, they might ask for a raise, reduce their work effort, work shorter hours, or complain to their boss. They might also rationalize their situation, find a different comparison person, or simply quit.

EQUITY THEORY The theory that people compare (1) what they contribute to their job with what they get in return and (2) their input/output ratio with that of other employees.

LO-5 STRATEGIES FOR ENHANCING MOTIVATION

Companies have instituted a wide range of programs designed to increase motivation levels of their employees. The most common strategies are reinforcement/behaviour modification, goal setting, participative management and empowerment, team management, job enrichment and redesign, and modified work schedules.

Reinforcement/Behaviour Modification

Reinforcement is a two-step process. The first step is to define the specific behaviours managers want their employees to exhibit (working hard, being courteous to customers, stressing quality, etc.) and the specific behaviours they want to eliminate (wasting time, being rude to customers, ignoring quality, absenteeism, etc.). The second step is to "shape" employee behaviour by using reinforcement.

Reinforcement means applying (or withholding) positive (or negative) consequences in order to motivate employees to exhibit behaviour the manager wants. This strategy includes four basic options: (1) *positive reinforcement* (apply positive consequences when employees exhibit desired behaviours), (2) *punishment* (apply negative consequences when employees exhibit undesirable behaviours), (3) *omission* (withhold positive consequences when employees exhibit undesirable behaviours), and (4) *negative reinforcement* (withhold negative consequences when employees exhibit desired behaviours).

Managers generally prefer positive reinforcement because it contributes to good employer–employee relationships. They generally dislike punishing employees, partly because workers may respond with anger, resentment, hostility, or even retaliation. Most people think of monetary rewards when they think of positive reinforcement, but one of the simplest, though uncommon, ways for managers to motivate workers is to praise them. A web poll done by *The Globe and Mail* on employer–employee relationships showed that 27 percent of the 2331 respondents had *never* received a compliment from their boss. Another 10 percent had not received a compliment in the past year, and 18 percent had not received a compliment in the past month.[25] Other non-monetary rewards are also useful. Calgary-based Pacesetter Directional and Performance Drilling rewards top employees with time off, and Markham, Ontario–based Nobis, a manufacturer of hats and apparel, rewards employees by allowing them to name hats after family and friends.[26]

The fact that the performance of individual employees varies quite a bit is annoying for managers. It also causes managers to have strong beliefs in the value of rewards and punishments. Consider the following example: You are the general manager of a supermarket, and you've just finished a department-by-department year-end performance review of your managers. You observe that all departments have performed well except one (the produce department fell 12 percent short of management's forecast). You therefore decide to reward all your department managers with bonuses, except for your produce manager.

This seems pretty logical, but Daniel Kahneman, a psychologist who won the Nobel Prize in economics for his work on behavioural and decision-making models, would probably challenge your decision. He would first note the logic you apparently used in making your decision:

Manager's department performs well → you reward manager → you expect the department to continue to perform well in the future

Managers' department performs poorly → you punish manager → you expect the department to perform better in the future

REINFORCEMENT Controlling and modifying employee behaviour through the use of systematic rewards and punishments for specific behaviours.

Kahneman argues that your logic is flawed. The key to his criticism is a concept called *regression to the mean*: the principle that, from one performance measure to the next, the change in performance will be toward the overall average level of performance.[27] Say that you're an avid runner and on average it takes you 7 minutes to run a kilometre. If you run it on Monday in 6 minutes and 10 seconds, on Tuesday your time will probably be longer, that is, closer to 7 minutes. You *might* run even faster on Tuesday, but most of the time, if you run faster than your average one day, you will run slower than your average the next day. Likewise, if you run slower than your average one day, you are likely to run faster than your average the next day. Regression to the mean occurs because many factors influence your running speed (e.g., how much sleep you got last night, the temperature while you're running, or your emotional level while you're running). Just like a runner's performance, a produce manager's performance will be affected by many things (e.g., market conditions, how hard the manager's subordinates work, the supply of produce, or decisions made by other managers). Taking these things into account, we can develop a model that more accurately reflects reality:

Manager's department performs above average in one period → department will probably not perform as well in the next period

Manager's department performs below average in one period → department will probably perform better in the next period

Kahneman says that the failure to recognize regression to the mean causes people to reward others when they perform well and punish them when they perform poorly. But even without the reward or punishment, their performance is likely to change simply because regression to the mean is operating.

Goal-Setting Theory

Goal-setting theory is based on research showing that SMART goals (Specific, Measurable, Achievable, Results-Oriented, and Time-framed) increase employee motivation and performance. SMART goals can be very powerful and may on occasion lead to bad behaviour on the part of managers. For example, if managers are told they will receive a bonus if they achieve a certain level of sales revenue, they may focus all their attention on generating sales revenue and not pay enough attention to other important issues (e.g., after-the-sale service).

One of the most popular methods for setting performance goals is **management by objectives (MBO)**, which involves managers and subordinates collaboratively setting goals and evaluating progress. When employees meet with managers to set goals, the employees learn more about company-wide objectives, feel that they are an important part of a team, and see how they can improve company-wide performance by achieving their own goals. For example, Investors Group Financial Services has used MBO to motivate its sales force in selling financial services. Sales reps think through their personal and financial goals for the coming year and then meet with their division managers to reach a consensus about the specific goals they will pursue during the next year.[28]

Participative Management and Empowerment

Participative management and empowerment involves tapping into workers' knowledge about their job, encouraging them to be self-motivated and to make suggestions for improvements, and giving them more authority and responsibility so that they feel they are a real part of the company's success. For example, SAP Canada, a provider of software and technology solutions, has made a conscious effort to empower employees by encouraging diverse opinions on work issues, by giving employees a lot of autonomy, and by providing employees with opportunities to grow. The company was rated #1 on Glassdoor's 2018 list of "Best Places to Work."[29]

Research has shown that goals that are specific, measurable, and moderately difficult to achieve result in high performance for employees.

Tetra Images/Shutterstock

Some companies try to operate without the usual hierarchy and empower workers by giving them unusual amounts of autonomy. At Morning Star Company—the world's largest tomato processor—workers write up a mission statement that describes how they will contribute to the overall goals of the company. Employees are expected to propose the hiring of new people if they are overloaded or if they see a need that should be met. Each employee also develops a "Colleague Letter of Understanding" with other employees who are affected by the person's work. At the end of the year, employees receive feedback on their performance from colleagues with whom they have a Letter of Understanding. Pay is determined by an elected committee. All business units are ranked (on the basis of performance), and those that rank poorly have to explain what happened. One employee said that "nobody is your boss, everyone is."[30]

Here are a few other examples of empowerment in Canadian and international businesses:

- At WestJet, front-line staff have the right to issue travel credits to customers they feel have not been treated properly. WestJet thinks that the goodwill generated by the practice will increase repeat business.[31]
- At Toronto's Delta Chelsea Hotel, employees noticed that fewer business guests and more vacationers' children were in the hotel during the summer months. As a result of employee suggestions, the hotel installed a waterslide, appointed a "kids' concierge," and set up a game room for teens to better serve this market segment.[32]

GOAL-SETTING THEORY The theory that people perform better when they set specific, quantified, time-framed goals.
MANAGEMENT BY OBJECTIVES (MBO) A system of collaborative goal setting that extends from the top of an organization to its bottom.
PARTICIPATIVE MANAGEMENT AND EMPOWERMENT Method of increasing job satisfaction by giving employees a voice in the management of their jobs and the company.

- At ING Direct Canada, a webpage has been set up that allows employees to submit ideas for peers to vote on. An innovation team then evaluates the ideas.[33]
- AES Corporation is a large energy company where multifunctional teams manage themselves without the assistance of any legal, human resources, or other functional department, or any written policies or procedures. As a result of this structure (some call it "empowerment gone mad"), employees exhibit flexibility and continuous learning.[34]

Some companies are now using wikis—websites that allow employees to add content on issues that are of interest to the business—as a means of empowerment. This is part of a move toward "mass collaboration" that is going on in businesses.[35] Another technique is the **quality circle**, a group of employees who meet regularly to consider solutions for problems in their work area. At Great-West Life Assurance Company, for example, quality circles are made up of volunteers who meet once a week (on company time) to consider ways to do higher quality, more effective work.

Managers must remember that empowerment is not desired by all employees. Some will be frustrated by responsibilities they are not equipped to handle, and others will be dissatisfied if they think that the invitation to participate is merely symbolic. A good approach is to invite participation if employees want to have input and if participation will have real value for an organization.

Team Management

Companies traditionally gave individual employees the responsibility to complete certain tasks, but in recent years, there has been an increased emphasis on teams. These teams take a variety of forms. *Problem-solving teams* focus on developing solutions to specific problems. They are based on the idea that the best solutions to problems are likely to come from the employees who actually do the work. For example, at the Bowmanville, Ontario, plant of St. Mary's Cement Inc., members of various departments joined a problem-solving team that developed a list of energy-saving initiatives that saved the company $800 000 over a three-year period.[36] *Self-managed teams* set their own goals, select their own team members, evaluate their own performance, and generally manage themselves. At Johnsonville Foods, self-managing teams recruit, hire, evaluate, and terminate low performers on their own.[37] *Project teams* (also called *venture teams*) work on specific projects such as developing new processes, new products, or new businesses. The classic example of a project team is the one that developed IBM's first personal computer many years ago. *Transnational teams*, composed of members from many different countries, have also become common. For example, Fuji Xerox Co., Ltd. sent 15 engineers from Tokyo to New York to work with U.S. engineers as they developed a "world copier," a product that became a big success.[38] *Virtual teams* are groups of geographically dispersed co-workers who are assembled to accomplish a specific task, using a combination of telecommunications and information technologies.

Teams provide monetary benefits for companies that use them, but they can also provide non-monetary benefits such as increasing motivation and job satisfaction levels for employees, enhancing company-wide communication, and making members feel like they are an integral part of the organization.[39] But, as with participative management, managers must remember that teams are not for everyone, nor are they effective in every situation.[40] At Levi Strauss, for example, individual workers who performed repetitive tasks like sewing zippers into jeans were paid according to the number of jobs they completed each day. In an attempt to boost productivity, company management reorganized everyone into teams of 10 to 35 workers and assigned tasks to the entire team. Each team member's pay was determined by the team's level of productivity. But faster workers became resentful of slower workers because they reduced the group's total output. Slower workers, meanwhile, resented the pressure put on them by faster-working co-workers. As a result, motivation, satisfaction, and morale all dropped, and Levi Strauss eventually abandoned the teamwork plan.[41]

Teams work best when successful task completion requires input from several people, when there is interdependence between tasks (as in team sports), and when working together can accomplish tasks that an individual could not do alone (as in a hospital surgical team).[42]

Action Sports Photography/Shutterstock

This pit crew must work as a team in order to minimize the time the race car is in the pit getting serviced. Coordination among team members is crucial because even a few wasted seconds can make the difference between victory and defeat in the race.

Job Enrichment and Redesign

Job enrichment means adding one or more motivating factors to a job. In a now-classic study, a group of eight typists worked in isolated cubicles taking calls from field sales representatives and then typing up service orders. They had no contact with customers, so if they had a question about an order, they had to call the sales representative. They also received little performance feedback. Interviews with these workers suggested that they were bored with their jobs and did not feel valued. As part of a job enrichment program, each typist was paired with a small group of designated sales representatives and became a part of their team. Typists were also given permission to call customers directly if they had questions about the order. A new feedback system was also installed to give the typists more information about their performance. As a result, their performance improved and absenteeism decreased markedly.[43]

QUALITY CIRCLE A technique for maximizing quality of production. Employees are grouped into small teams that define, analyze, and solve quality and other process-related problems within their area.

JOB ENRICHMENT A method of increasing employees' job satisfaction by extending or adding motivating factors such as responsibility or growth.

Job enrichment is accomplished by *job redesign*, which involves combining tasks to increase job variety, forming natural workgroups, and establishing client relationships. Redesigning work to achieve a more satisfactory person–job fit motivates individuals who have a high need for growth or achievement.[44]

Combining Tasks

This involves enlarging jobs and increasing their variety to make employees feel that their work is more meaningful. In turn, workers are more motivated. For example, the job done by a computer programmer who maintains computer systems might be redesigned to include some system design and development work. The programmer is then able to use additional skills and is involved in the overall system package.

Forming Natural Workgroups

People working on different jobs on the same project can be brought together to form natural workgroups, which can help employees get an overview of their jobs and see their importance in the total structure. This approach also helps managers, and the firm in general, because the people working on a project are usually the ones most knowledgeable about it and are thus able to solve problems related to it. For example, the jobs of workers who are assembling iPhones could be redesigned to allow the group to decide who does what and in what order. The workers can also exchange jobs and plan their work schedules.

Establishing Client Relationships

A third way of redesigning a job is to establish client relationships, that is, to let employees interact with customers. This approach increases the variability of a job. It also gives workers greater feelings of control over their jobs and more feedback about their performance. Software writers at Microsoft watch test users work with programs and discuss problems with them directly rather than receiving feedback from third-party researchers.

Modified Work Schedules

Several types of modified work schedules have been developed to increase job satisfaction; they include *flextime, compressed workweeks, telecommuting*, and *workshare programs*.

Flextime

Flextime allows people to pick their working hours. Figure 9.6 illustrates how a flextime system might be arranged and how different people might use it. The office is open from 6 a.m. until 7 p.m. Core time is 9 a.m. until 11 a.m. and 1 p.m. until 3 p.m. Joe, being an early riser, comes in at 6 a.m., takes an hour lunch between 11 a.m. and noon, and finishes his day by 3 p.m. Sue, on the other hand, prefers a later day. She comes in at 9 a.m., takes a long lunch from 11 a.m. to 1 p.m., and then works until 7 p.m. Pat works a more traditional day from 8 a.m. until 5 p.m.

One survey found that 88 percent of Canadian businesses offer some form of flexible work arrangements (but many businesses offer them only to the most senior employees).[45] Because many employees work more than 40 hours per week, more and more companies are offering flexible working schedules to help them cope.[46] Flextime options are available at organizations such as Next Level Games Inc. (Vancouver), the National Energy Board (Calgary), and the Office of the Auditor General (Ottawa).[47]

FLEXTIME A method of increasing employees' job satisfaction by allowing them some choice in the hours they work.

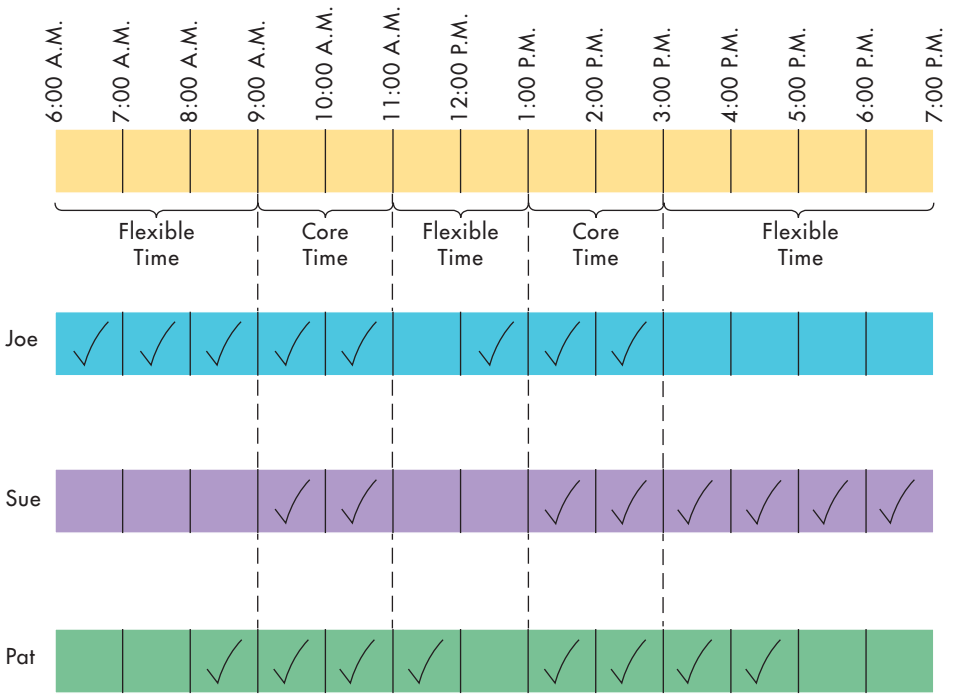


FIGURE 9.6 Flextime schedules

Flextime schedules include core time, when everyone must be at work, and flexible time, during which employees can set their own working hours.

In a survey of 3000 people, the U.S.-based National Bureau of Economic Research found that workers like increased flexibility in their job but aren't very willing to accept lower pay in return for that flexibility. About 60 percent of those responding were not willing to take *any* cut in pay in return for a more flexible job; about 25 percent were willing to take a 10 percent pay cut in return for more flexibility.[48]

Compressed Workweeks

In the **compressed workweek**, employees work fewer days per week but more hours on the days they do work. The most popular compressed workweek is four days, 10 hours per day, which is used in many companies and municipalities. Companies providing a compressed workweek option include Chubb Insurance Company of Canada (Toronto), Next Level Games Inc. (Vancouver), and Cameco Corp. (Saskatoon).[49] The Catholic Children's Aid Society of Toronto has introduced the compressed workweek to help staff cope with long, unpredictable hours.[50]

Telecommuting

A third variation in work design is **telecommuting**, which allows people to do some or all of their work away from their office. The availability of networked computers, fax machines, smartphones, tablets, email, and overnight delivery services makes it possible for many independent professionals to work at home or while travelling. About one-third of the world's labour force now works wherever they are, not just in the office.[51] At LoyaltyOne, 50 percent of call centre employees work remotely.[52] At Cisco Systems, 500 people work out of the downtown Toronto office, but only 200 desks are there.[53]

Telus Corp. has been offering telecommuting options for more than 10 years. Its formal telecommuting program—called Work Styles—allows employees to earn the right to work remotely, and about 70 percent of those who are eligible actually take the option. Employees who exhibit low productivity are not likely to qualify.[54] Surveys show that 90 percent of employees who work remotely said it was a factor in convincing them to stay with Telus.

Telecommuting has advantages and disadvantages for individual workers and for the organization (see Table 9.1).

One research study showed that telecommuters are 50 percent less likely to get a promotion than employees who are in the office every day.[55] For this and other reasons, telecommuting may not be for everyone. Would-be telecommuters must ask themselves several important questions: Can I meet deadlines even when I'm not being closely supervised? What will it be like to be away from the social context of the office five days a week? Can I renegotiate family rules so my spouse doesn't come home expecting to see dinner on the table just because I've been home all day?

The boxed insert entitled "The Compressed Workweek and Telecommuting: Are They Really Green?" presents some interesting information on the environmental impact of compressed workweeks and telecommuting.

Workshare Programs

A fourth type of modified work schedule, **worksharing (also called job sharing**), benefits both employees and the employer. This approach allows two (or more) people to share one full-time job. For example, two people might share a position advising the human resources department.

COMPRESSED WORKWEEK Employees work fewer days per week, but more hours on the days they do work.
TELECOMMUTING Allowing employees to do all or some of their work away from the office.
WORKSHARING (JOB SHARING) A method of increasing employee job satisfaction by allowing two people to share one job.

TABLE 9.1 Advantages and Disadvantages of Telecommuting

Advantages of Telecommuting	Disadvantages of Telecommuting
For Employees	
• health benefits (lower stress levels) • lower costs (reduced car expenses) • better use of time (no commuting long distances) • better use of time (no interruptions)	• feeling "out of the loop" (not being knowledgeable about important business issues or interesting personal gossip) • having difficulty separating personal and professional life (work intrudes at home) • feeling ill suited for telework (lack of discipline and feeling lonesome) • finding it difficult to work closely with colleagues when necessary • fear of career derailment
For the Organization	
• increases productivity (two-thirds of employers surveyed said that employee productivity went up) • cost savings (fewer offices and office supplies are needed; lower vehicle expenses) • lower electric bills (fewer lights and computers are turned on in offices) • access to qualified staff (who otherwise wouldn't be available because they don't live in the area or don't want to drive so far to work) • lower travel expenses (teleconferencing, email, networking systems take the place of travel) • lower employee turnover	• requires a change in management thinking (forces managers to adopt an attitude of trust regarding employees) • many managers still think if they can't see employees, the employees aren't working (may threaten the control of bosses who are used to having employees in sight) • bosses have to spend more time with subordinates on the phone or other media (they may prefer face-to-face communication) • bosses don't know when employees are actually working • telecommuting may not work well for companies where customers are frequently in the office • telecommuting may not work well if colleagues frequently need intense face-to-face collaboration to complete rush jobs on time

THE GREENING OF BUSINESS

The Compressed Workweek and Telecommuting: Are They Really Green?

The compressed workweek (e.g., four 10-hour days) has been touted as good not only for employee morale and satisfaction but also for the environment. Two main points are usually made in support of the argument. First, since workers will be driving to work only four days each week instead of five, they will be using less gas and will therefore reduce the amount of greenhouse gas emissions. But whether the four-day workweek really saves gas depends on what workers do on the fifth day. If they drive their SUV 400 kilometres to go visit relatives, they will burn more gas than they would have by simply driving to and from work. On the other hand, maybe they would have taken the same trip on the weekend if they had to work a traditional five-day workweek.

Second, a four-day workweek should mean that less electricity is used by businesses because machines, computers, and heating systems will be running at very low levels (or not at all) on the fifth day. While it is true that factory machines will not be running on the fifth day, there may be no actual savings because those machines have already run for 40 hours as a result of the four previous days at 10 hours. Other electricity savings may also be elusive unless the company is committed to turning down the heat and turning off the lights on the fifth day. But that may be impossible because there always seem to be people who need to be at work on the fifth day. Even if workers do stay at home on the fifth day, they may do other tasks that require the equivalent amount of electricity or gas that they would have consumed at work (e.g., using power tools as they renovate their home).

You can see why it might be difficult to determine whether the four-day workweek is better for the environment than the five-day workweek. But telecommuting may be a more effective strategy because workers who telecommute don't go to the office very much. If they are at home working, they will not be driving their car, so that should save gas. As well, companies that encourage telecommuting may save considerable money on real estate and other operating costs. But even here, we need to analyze what individual workers do on a day-to-day basis before we can conclude that telecommuting is good for the environment.

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CRITICAL THINKING QUESTIONS

1. Using material contained in this insert as well as other material that you may find, develop a list of arguments that the *four-day workweek* is better for the environment than the five-day workweek. Then develop a list of arguments that the four-day workweek is no better for the environment than the five-day workweek. Which list is most persuasive?
2. Using material contained in this insert as well as other material you may find, develop a list of arguments that *telecommuting* is better for the environment than the four-day workweek. Then develop a list of arguments that telecommuting is not better than the four-day workweek. Which list is most persuasive?

One person works Mondays through Wednesdays, and the other works Wednesdays through Fridays. Or five people might share one reservationist's job at Air Canada, each working one day a week. Each person earns some money, remains in the job market, and enjoys some travel benefits. Worksharing programs can also help ease experienced workers into retirement while training their replacements, and they allow co-op students to combine academic learning with practical experience. The worksharing option is used in organizations as diverse as the Ontario Public Service and the National Hockey League (where two goalies share duties during the high-stress playoffs).[56]

LO-6 LEADERSHIP AND MOTIVATION

Leadership refers to the processes and behaviours used by managers to motivate, inspire, and influence subordinates to work toward organizational goals. People often assume that "leadership" and "management" mean the same thing, but there are important differences. A person can be a manager, a leader, or both.[57] Consider a hospital setting. The chief of staff (chief physician) of a large hospital is clearly a manager by virtue of the position the person occupies. But this individual may or may not be respected or trusted by others and may have to rely solely on the authority vested in the position to get people to do things. Thus being a manager does not ensure that a person is also a leader. In contrast, an emergency room nurse with no formal authority may be quite effective at taking charge of a chaotic situation and directing others on how to deal with specific patient problems. Others in the emergency room may respond because they trust his or her judgment and have confidence in

LEADERSHIP The process of motivating others to work to meet specific objectives.

TABLE 9.2 Kotter's Distinctions between Management and Leadership

Activity	Management	Leadership
Creating an agenda	Planning and budgeting. Establishing detailed steps and timetables for achieving needed results; allocating the resources necessary to make those needed results happen.	Establishing direction. Developing a vision of the future, often the distant future, and strategies for producing the changes needed to achieve that vision.
Developing a human network for achieving the agenda	Organizing and staffing. Establishing some structure for accomplishing plan requirements, staffing that structure with individuals, delegating responsibility and authority for carrying out the plan, providing policies and procedures to help guide people, and creating methods or systems to monitor implementation.	Aligning people. Communicating the direction by words and deeds to all those whose cooperation may be needed to influence the creation of teams and coalitions that understand the vision and strategies and accept their validity.
Executing plans	Controlling and problem solving. Monitoring results versus plan in some detail, identifying deviations, and then planning and organizing to solve these problems.	Motivating and inspiring. Energizing people to overcome major political, bureaucratic, and resource barriers to change by satisfying very basic, but often unfulfilled, human needs.
Outcomes	Produces a degree of predictability and order and has the potential to consistently produce major results expected by various shareholders (e.g., for customers, always being on time; for stockholders, being on budget).	Produces change, often to a dramatic degree, and has the potential to produce extremely useful change (e.g., new products that customers want, new approaches to labour relations that help make a firm more competitive).

that person's decision-making skills. In this case, the nurse is a leader, but not a manager. Finally, the head of pediatrics, supervising a staff of 20 other doctors, nurses, and attendants, may also enjoy the staff's complete respect, confidence, and trust. They readily take the head's advice, follow directives without question, and often go far beyond what is necessary to help carry out the unit's mission. In this case, the head of pediatrics is both a manager and a leader. The key distinctions between leadership and management are summarized in Table 9.2.[58]

Organizations need both management and leadership if they are to be effective. Leadership is necessary to create and direct change and to help the organization get through tough times, and management is necessary to achieve coordination and systematic results and to handle administrative activities during times of stability and predictability.[59] Management—in conjunction with leadership—can help achieve planned orderly change. Leadership—in conjunction with management—can keep the organization properly aligned with its environment. Both managers and leaders play a major role in establishing the moral climate of the organization and in determining the role of ethics in its culture.[60]

Leadership and Power

To fully understand leadership, it is also necessary to understand *power*, which is the ability to affect the behaviour of others. There are several different types of power. *Legitimate power* is the power granted through the formal organizational hierarchy. Managers have legitimate power because of the specific position they occupy in the hierarchy. This power gives them the right to assign tasks to subordinates. A subordinate who refuses to do the tasks can be reprimanded or fired. Legitimate power is synonymous

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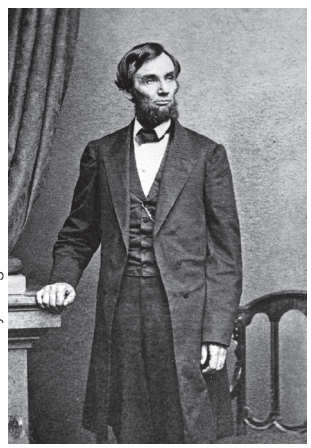
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When asked to identify important leaders, people often mention influential historical figures such as Winston Churchill, Abraham Lincoln, Martin Luther King, and Mother Teresa.

with authority, as discussed in Chapter 7. Keep in mind that the mere possession of legitimate power does not make a manager a leader.

Reward power is the power to give or withhold rewards such as salary increases, bonuses, promotions, praise, and interesting job assignments. The greater the number of rewards a manager controls and the more valued these rewards are to subordinates, the greater the manager's reward power.

Coercive power is the power to force another person to comply by means of psychological, emotional, or physical threat. In most organizations today, coercion is limited to verbal or written reprimands, layoffs, demotion, or termination. The more punitive the elements under a manager's control, the more power the manager possesses.

Expert power is derived from information or expertise that the manager possesses. Managers who know how to interact with important customers or scientists who achieve an important technical breakthrough have expert power. The more important the information and the fewer the people with access to it, the greater the degree of expert power possessed by a manager or leader.

Referent power is the most abstract form of power. It is based on identification, imitation, loyalty, or charisma of the leader (see the discussion on charisma later in this chapter). Because followers highly value what the leader stands for, the leader gains power over the followers. Followers might choose to imitate a leader by wearing the same kind of clothes, working the same hours, or supporting the same management philosophy that the leader uses.

LO-7 Approaches to Leadership

Political, religious, and business leaders have influenced the course of human events throughout history, but the systematic study of leadership began only about a century ago. Three general approaches have been evident: the trait approach, the behavioural approach, and the situational approach.

The Trait Approach

The **trait approach**—which was emphasized by researchers in the first two decades of the twentieth century—was based on the idea that leaders had unique traits that distinguished them from non-leaders. Many traits were thought to be important, including intelligence, dominance, self-confidence, energy, height, and knowledge about the job. As time passed, the list became so long that it lost any practical value. The trait approach was all but abandoned by the middle of the twentieth century, but some researchers now argue that certain traits (e.g., intelligence, drive, motivation, honesty, integrity, and self-confidence) provide the *potential* for effective leadership, but only if the person is really motivated to be a leader. The implication is that people without these traits are not likely to be successful leaders even if they try.[61]

The Behavioural Approach

Because the trait approach was a poor predictor of leadership success, attention shifted from managers' traits to their behaviours. The goal of the **behavioural approach** was to determine how the behaviours of effective leaders differed from the behaviours of less effective leaders. This research led to the identification of two basic forms of leadership behaviour: task-oriented (focusing on how tasks should be performed in order to achieve important goals) and employee-oriented (focusing on the satisfaction, motivation, and well-being of employees). Task-oriented leaders tend to have higher-performing followers, while employee-oriented leaders tend to have more satisfied followers.

Researchers have also identified three main leadership styles: the *autocratic style* (the manager issues orders and expects them to be obeyed without question), the *democratic style* (the manager requests input from subordinates before making decisions, but retains final decision-making power), and the *free-rein style* (the manager serves as an advisor to subordinates who are given a lot of discretion when making decisions). Most leaders tend to regularly use one style and may, in fact, find it difficult to change from one style to another. But some leaders do manage to change their style. For example, Andrall (Andy) Pearson was an abrasive, numbers-oriented, hard-to-please manager when he was president and COO of PepsiCo. But as director of Yum Brands, he softened and transformed and truly cared about employees.[62]

The Situational Approach to Leadership

The **situational approach to leadership** assumes that appropriate leadership behaviour varies from one situation to the next (see Figure 9.7). The trait and behavioural approaches to leadership are both "universal" in nature because they attempt to prescribe leadership traits and behaviours that work in every situation. Supporters of these universal perspectives might argue, for example, that tall and intelligent people or people who are always employee-focused will always be effective leaders. But leadership research has found that this is not true. So the situational approach to

TRAIT APPROACH A leadership approach focused on identifying the essential traits that distinguished leaders.

BEHAVIOURAL APPROACH A leadership approach focused on determining what behaviours are employed by leaders.

SITUATIONAL (CONTINGENCY) APPROACH TO LEADERSHIP A leadership approach in which appropriate leadership behaviour varies from one situation to another.

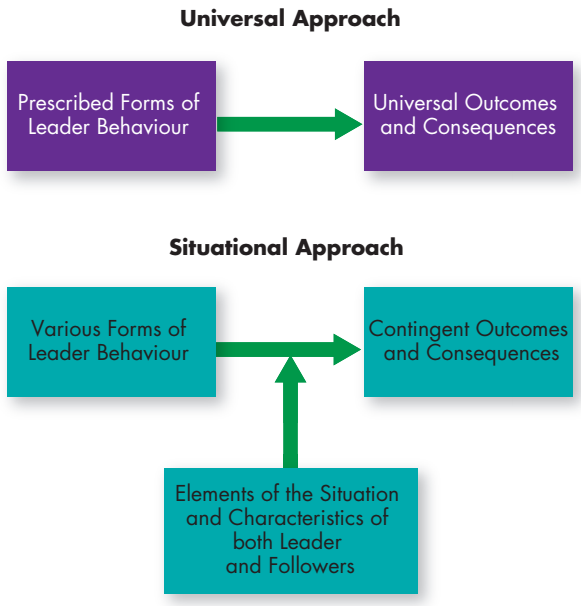


FIGURE 9.7 The situational approach to leadership

leadership attempts to identify contingencies (i.e., characteristics of the leader, the subordinates, and the situation) that can influence outcomes.

Leadership characteristics include the manager's value system, confidence in subordinates, personal inclinations, feelings of security, and actual behaviour. Subordinate characteristics include the subordinate's need for independence, readiness to assume responsibility, tolerance for ambiguity, interest in the problem, and understanding of goals, knowledge, experiences, and expectations. Situational characteristics that affect decision making include the type of organization, group effectiveness, the problem itself, and time pressure.

Many different contingency theories have been developed. Briefly described below are the *path-goal theory*, the *decision tree approach*, and the *leader-member exchange (LMX) model*.

The *path-goal theory* of leadership is an extension of the expectancy theory of motivation discussed earlier in this chapter.[63] Recall that the primary components of expectancy theory include the likelihood of attaining various outcomes and the value associated with those outcomes. The path-goal theory of leadership suggests that the primary functions of a leader are to make valued or desired rewards available in the workplace and to clarify for the subordinates the kinds of behaviours that will lead to goal accomplishment and valued rewards. The leader clarifies the paths to goal attainment and can use four kinds of behaviours to achieve this, depending on the situation. *Directive leader behaviour* lets subordinates know what is expected of them, gives guidance and direction, and schedules work. *Supportive leader behaviour* is being friendly and approachable, showing concern for subordinates' welfare, and treating members as equals. *Participative leader behaviour* means consulting with subordinates, soliciting suggestions, and allowing participation in decision making. *Achievement-oriented behaviour* sets challenging goals, expects subordinates to perform at high levels, encourages subordinates, and shows confidence in subordinates' abilities.

Like the path-goal theory, the *decision tree approach* attempts to prescribe a leadership style that is appropriate in different situations. It also assumes that the leader is able to display different leadership styles. This approach concerns itself with only a single aspect of leader behaviour: subordinate participation in decision making. It assumes that the degree to which subordinates should participate in decision making depends on the characteristics of the situation and that no one decision-making process is best for all situations. After evaluating a variety of problem attributes, the leader determines an appropriate decision style that specifies the amount of subordinate participation.

The *leader-member exchange (LMX) model* focuses on the differential relationships leaders establish with different subordinates.[64] Each superior-subordinate pair represents a "vertical dyad." The model suggests that supervisors establish a special relationship with a small number of trusted subordinates (the "in-group"). The in-group usually receives special duties and special privileges. Subordinates who are not a part of this group are called the "out-group," and they receive less of the supervisor's time and attention.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. Habit Tracker APP **Source:** App Holdings **Key Features:** A multi-platform productivity companion to keep track of your day-to-day habits and routines.	Apple, Android, Windows
2. Leadership and Management APP **Source:** Tototomato **Key Features:** Leadership and management articles and e-books for references.	Android
3. Leadership Quotes APP **Source:** Special Daily **Key Features:** Excellent quotes about being an effective leader.	Android, BlackBerry

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" economics apps and identify the key features.

LO-8 Recent Trends in Leadership

During the late twentieth and early twenty-first centuries, many new ideas about leadership have been developed. We conclude this chapter with a brief discussion of several of these ideas.

Transformational Leadership

Transformational leadership is the set of abilities that allows a leader to recognize the need for change, to create a vision to guide that change, and to execute the change effectively. In contrast, **transactional leadership** involves routine, regimented activities that are necessary during periods of stability.

Mark Zuckerberg, the founder of Facebook, exhibits transformational leadership. He is clearly a visionary who is obsessive about innovation, having built Facebook into a media powerhouse that has nearly two billion users and is valued at $350 billion. His management approach emphasizes looking far into the future, consistency, and discipline (not being unduly attracted to "bright, shiny objects" that may look great but don't really contribute much to success.)[65] One of the company's key innovations is its "growth team," which develops strategies for Facebook and designs measures of success for those strategies. The growth team "owns" any issues that might prevent people from signing up for Facebook. All of these elements align very closely with the definition of transformational leadership.

Many leaders may find it difficult to exercise both types of leadership. For example, when Michael Eisner took over the Walt Disney organization, the company was stagnant and was heading into decline. Relying on transformational skills, Eisner turned things around in dramatic fashion. Among many other things, he quickly expanded the company's theme parks, built new hotels, improved Disney's movie business, created a successful Disney cruise line, launched several other major initiatives, and changed the company into a global media powerhouse. But when the firm began to plateau and needed some time to let the changes all settle in, Eisner was unsuccessful at changing his own approach from transformational leadership to transactional leadership and was pressured into retiring.

TRANSFORMATIONAL LEADERSHIP The set of abilities that allows a leader to recognize the need for change, to create a vision to guide that change, and to execute the change effectively.

TRANSACTIONAL LEADERSHIP The set of abilities that involves routine, regimented activities that are necessary during periods of stability.

Charismatic Leadership

Charismatic leadership is a type of influence based on the leader's personal charisma. Figure 9.8 portrays the three key elements of charismatic leadership that most experts acknowledge today.[66]

Charismatic leaders have a high level of self-confidence and a strong need to influence others. They also communicate high expectations about follower performance and express confidence in their followers. A highly charismatic leader will generally be more successful in influencing followers' behaviour than a leader who lacks charisma. The late Steve Jobs, the legendary CEO of Apple, commanded a cult-like following from both employees and consumers. He exhibited charisma, confidence, originality, brilliance, and vision. He was clearly a leader who could deliver success in businesses that were rapidly changing, highly technical, and demanding. Yet he also was portrayed as intimidating, power-hungry, and an aggressive egotist.[67]

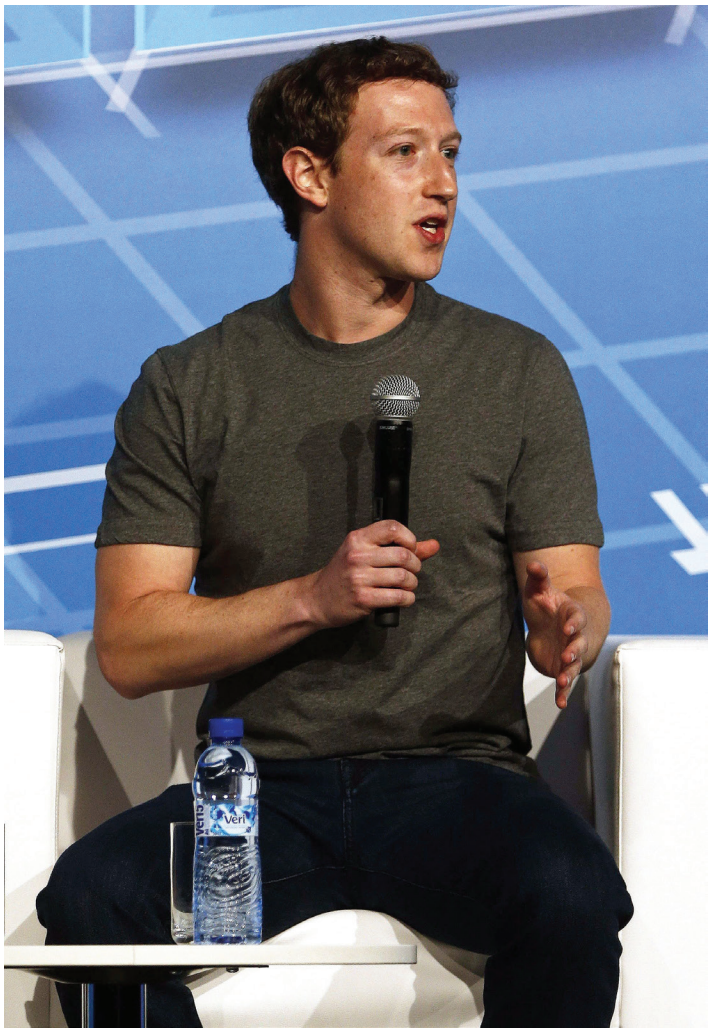
Charismatic leadership ideas are popular among managers today and are the subject of numerous books and articles.[68] One concern is that some charismatic leaders will inspire such blind faith in their followers that the followers may engage in inappropriate, unethical, or even illegal behaviours simply because the leader instructs them to do so. This tendency likely played a role in the collapse of both Enron and Arthur Andersen about 15 years ago. People followed orders from their charismatic bosses to hide information, shred documents, and mislead investigators. The film *Enron: The Smartest Guys in the Room* documented this problem.

Leaders As Coaches

Many organizations are now attempting to become less hierarchical—that is, to eliminate the old-fashioned command-and-control mentality that is often evident in bureaucratic organizations—and to motivate and empower individuals to work independently. This changes the role of leaders. Whereas leaders were once expected to control situations, direct work, supervise people, closely monitor performance, make decisions, and structure activities, many leaders today are being asked to become coaches instead of overseers.[69]

Consider the parallel with an athletic team. The coach selects the players for the team and decides on the general direction to take (such as emphasizing offence versus defence). The coach also helps develop player talent and teaches team members how to execute specific plays. But at game time, it's up to the players to execute plays and get the job done. Although the coach may get some of the credit for the victory, he or she doesn't actually score any of the points.

For business leaders, a coaching perspective calls for the leader to help select team members and other new employees, to provide overall direction, to help train and develop the team and the skills of its members, and to help the team get the information and other resources it needs. The leader may also have to help resolve conflict among team members and mediate other disputes that arise. And coaches from different teams need to link the activities and functions of their respective teams.



Mark Zuckerberg is a prime example of a charismatic leader.

Alberto Estevez/Epa/Shutterstock

CHARISMATIC LEADERSHIP Type of influence based on the leader's personal charisma.

FIGURE 9.8 Charismatic leadership

Women in Leadership

Research on leadership has historically focused on men and the ways in which they lead. As more women entered the workforce during the past 30 years, research appeared that evaluated the differences between men and women as leaders. But the conclusion often seemed to be that women should adapt their innate style to be more like men. This didn't sit well with Ruzwana Bashir, the co-founder of the travel site Peek.com. During her time as an employee at Goldman Sachs, she felt pressure to act like her male counterparts. She says that "in that environment, as a woman, you can feel crowd-forced to conform." While earning her MBA at Harvard, she realized that traditionally feminine attributes can actually be an advantage. She says, "Those 'female' traits of empathy and compassion—of being collaborative—are true business strengths."

Born in Pakistan and educated at Oxford University in the United Kingdom, Bashir has made her mark. She was president of the Oxford Union, the prestigious debating society famed for hosting famous guest speakers. Benazir Bhutto, the former president of Pakistan, was also president of the Union. In 2012, after spending a lot of time trying to arrange a get-away with friends to Turkey, she and co-founder Oskar Bruening launched Peek.com. That put her in select company: a woman who has been involved in founding a tech company. Although there are many travel websites, Peek.com occupies a unique space in the market because it focuses on helping travellers plan the perfect vacation, including itineraries for a "Perfect Day" at their destination.

Nils Jorgensen/Shutterstock

At Peek.com, the company maintains a staffing mix of 50 percent men and 50 percent women, with considerable ethnic diversity. Bashir encourages and supports female employees and introduces them to mentors. She also practises what she preaches—allowing herself to show vulnerability rather than behaving in the traditionally male decisive and authoritative style. In addition, she is an outspoken advocate for women's rights worldwide. In 2014, she wrote a ground-breaking essay that drew attention to the abuse of women in the U.K.'s Asian communities. "Growing up the way I did gave me empathy and understanding for different walks of life" she says. "It inspired me to choose the kind of company I wanted to build."

CRITICAL THINKING QUESTION

Consider the following statement: "*The notion that there are 'female' traits like empathy and compassion, and 'male' traits like decisiveness and authoritativeness is not very helpful. To be effective, leaders should not focus on these characterizations; rather, they should focus on getting men and women to effectively work together to achieve organizational goals.*" Do you agree or disagree with the statement? Explain your reasoning.

Gender and Leadership

Another factor that is altering the face of leadership is the growing number of women advancing to the highest levels in organizations (see the boxed insert entitled "Women in Leadership"). Given that most leadership theories and research studies have focused on male leaders, developing a better understanding of how women lead is clearly an important next step. For example, do women and men lead differently? Some early observers, for instance, predicted that (consistent with prevailing stereotypes) female leaders would be relatively warmer and more supportive and nurturing as compared to their male counterparts. But research suggests otherwise. Likewise, male leaders are not systematically more harsh, controlling, or task-focused than female leaders. Women do seem to have a tendency to be more democratic when making decisions, whereas men have a tendency to be somewhat more autocratic.[70]

Cross-Cultural Leadership

Culture is a broad concept that encompasses both international differences and diversity-based differences within one culture. For instance, when a Japanese firm sends an executive to head up the firm's operation in Canada, that person will need to be sensitive to the cultural differences that exist between the two countries and consider changing his or her leadership style accordingly. Japan is generally characterized by collectivism (group before individual), whereas Canada is based more on individualism (individual before group). The Japanese executive, then, will find it necessary to recognize the importance of individual contributions and rewards and the differences in individual and group roles that exist in Japanese and Canadian businesses.

Culture plays a growing role in organizations as their workforces become more diverse. Most leadership research, for instance, has analyzed white male leaders because those individuals have historically dominated leadership positions in North America. But as Asians, Blacks, Aboriginals, and Hispanics achieve leadership positions, it will be necessary to reassess how applicable current models of leadership are when applied to an increasingly diverse pool of leaders.

Canadian versus American Management Styles The management styles of Canadian managers might look a lot like that of Americans, but there are several notable differences. In general, Canadian managers are more subtle and subdued than American managers, more

committed to their companies, less willing to mindlessly follow the latest management fad, and more open to different cultures because of the multicultural nature of Canada.[71] The Global Leadership and Organizational Behavior Effectiveness study found that Canadian managers are very oriented toward fairness, are less likely to protect their own interests above those of their teams, and put more emphasis on long-term goals rather than on short-term gratification.[72] All of these characteristics are advantageous for Canadian companies that increasingly compete in global markets.

Strategic Leadership

Strategic leadership—which focuses on leadership in top management—is a leader's ability to understand the complexities of both the organization and its environment in order to lead change toward enhanced competitiveness. Steve Jobs was an effective strategic leader. For example, he recognized the potential growth of MP3 players and the fact that those devices used technology similar to that found in computers. He therefore directed the development of the Apple iPod, the iPhone, and iTunes, which have become enormously successful and profitable products.

Ethical Leadership

In the wake of multiple corporate scandals in recent years, faith in business leaders has been shaken. They are now being called on to maintain high ethical standards for their own conduct, to unfailingly exhibit ethical behaviour, and to hold others in their organizations to the same standards—in short, to practise ethical leadership. Those responsible for hiring new leaders are looking more closely at the backgrounds of candidates. The emerging pressure for stronger corporate governance models is likely to further increase the commitment to select for leadership positions only those individuals with high ethical standards and to hold them more accountable for both their actions and the consequences of those actions.

Virtual Leadership

Virtual leadership involves carrying out leadership activities when the leader does not have regular personal contact with followers. This contrasts with earlier times, when leaders and their employees worked together in the same physical location and engaged in personal (i.e., face-to-face) interactions on a regular basis. The challenges of virtual leadership have confronted Alexey Saltykov, the CEO of InsurEye Inc., a company that helps consumers understand their insurance costs. Alexey is located in Toronto, but he has two employees in Russia, one in Montreal and a business advisor in Australia. The company uses Skype and web-based collaboration software, but neither approach works as well as Alexey would like. He wants more in-person communication with all the people in one room.[73]

Under virtual leadership, communication between leaders and their subordinates still occurs, but it may be largely by videoconferencing, telephone, and email. In these situations, leaders have to work harder at creating and maintaining relationships with their employees. Nonverbal communication is not possible with email, for example, so managers have to make a special effort to convey appreciation, reinforcement, and constructive feedback to subordinates.

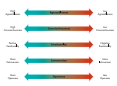
SUMMARY OF

LEARNING OBJECTIVES

LO-1 IDENTIFY AND DISCUSS THE BASIC *FORMS OF BEHAVIOUR* THAT EMPLOYEES EXHIBIT IN ORGANIZATIONS.

Employee behaviour is the pattern of actions by the members of an organization that directly or indirectly influences the organization's effectiveness. *Performance behaviours* are the total set of work-related behaviours that the organization expects employees to display. *Organizational citizenship* refers to the behaviour of individuals who make a positive overall contribution to the organization. *Counterproductive behaviours* are those that detract from, rather than contribute to, organizational performance.

LO-2 DESCRIBE THE NATURE AND IMPORTANCE OF *INDIVIDUAL DIFFERENCES* AMONG EMPLOYEES.



Individual differences are personal attributes that vary from one person to another. *Personality* is the relatively stable set of psychological attributes that distinguish one person from another. The *"big five" personality traits* are agreeableness, conscientiousness, emotionality, extraversion, and openness. *Emotional intelligence*, or emotional quotient (EQ), refers to the extent to which people are self-aware, can manage their emotions, can motivate themselves, express empathy for others, and possess social skills. *Attitudes* reflect our beliefs and feelings about specific ideas, situations, or other people. Especially important attitudes are *job satisfaction* and *organizational commitment.*

LO-3 EXPLAIN THE MEANING AND IMPORTANCE OF *PSYCHOLOGICAL CONTRACTS* AND THE PERSON–JOB FIT IN THE WORKPLACE.

A *psychological contract* is the overall set of expectations held by employees and the organization regarding what employees will contribute to the organization and what the organization will provide in return. A good *person–job fit* is achieved when the employee's contributions match the inducements the organization offers. Having a good match between people and their jobs can help enhance performance, job satisfaction, and motivation.

LO-4 IDENTIFY AND SUMMARIZE THE MOST IMPORTANT MODELS OF *EMPLOYEE MOTIVATION*.

Motivation is the set of forces that causes people to behave in certain ways. Early approaches to motivation were based first on the assumption that people work only for money and then on the assumption that social needs are the primary way to motivate people. The *hierarchy of human needs* model holds that people at work try to satisfy one or more of five different needs. The *two-factor theory* argues that job satisfaction is influenced by motivational factors such as recognition for a job well done, whereas job dissatisfaction depends on hygiene factors such as working conditions. *Expectancy theory* suggests that people are motivated to work toward rewards that they desire and have a reasonable expectancy of obtaining. *Equity theory* focuses on social comparisons—people evaluating their treatment by the organization relative to the treatment of others.

LO-5 DESCRIBE THE *STRATEGIES* USED BY ORGANIZATIONS TO IMPROVE JOB SATISFACTION AND EMPLOYEE MOTIVATION.

Reinforcement involves applying (or withholding) positive (or negative) consequences in an attempt to motivate employees to exhibit behaviour the manager wants. *Goal setting* involves setting SMART goals that will motivate workers to achieve high performance. *Participative management and empowerment* involves tapping into workers' knowledge about the job, encouraging them to be self-motivated, and giving them more authority and responsibility so that they feel they are a real part of the company's success. *Team management* means forming teams of employees and empowering the team to make decisions on issues such as production scheduling, work procedures, work schedules, and hiring new employees. *Job enrichment* means adding motivating factors to job activities. *Modified work schedules*—such as *work sharing* (job sharing), *flextime*, and *telecommuting*—increase employee satisfaction by providing increased flexibility for workers.

LO-6 DEFINE *LEADERSHIP* AND DISTINGUISH IT FROM *MANAGEMENT*.

Leadership refers to the processes and behaviours a person uses to motivate, inspire, and influence others' behaviours. Leadership and management are not the same thing. Leadership involves things such as developing a vision, communicating that vision, and directing change. *Management* focuses more on following procedures, monitoring results, and working toward outcomes.

LO-7 SUMMARIZE THE *APPROACHES TO LEADERSHIP* THAT DEVELOPED DURING THE TWENTIETH CENTURY.

The *trait approach* to leadership focused on identifying the traits of successful leaders. Recent research has focused on traits such as emotional intelligence, drive, honesty and integrity, self-confidence, and charisma. The *behavioural approach* identified two common leader behaviours: *task-focused* and *employee-focused* behaviours. Three leadership styles—*autocratic, democratic*, and *free-rein*—were also identified. The *situational approach* to leadership assumes that factors in the leader, factors in the followers, and factors in the situation determine which leadership behaviour is most effective.

LO-8 DESCRIBE THE MOST RECENT IDEAS ABOUT EFFECTIVE LEADERSHIP.

Transformational leadership (as distinguished from *transactional leadership*) focuses on the set of abilities that allows a leader to recognize the need for change, to create a vision to guide that change, and to execute the change effectively. *Charismatic leadership* is influence that is based on a leader's personal charisma. Leaders are often expected to play the role of *coach*, which involves selecting team members; providing direction, training, and developing; and allowing the group to function autonomously. Research on *gender and leadership* is reexamining assumptions about how men and women lead. *Cross-cultural leadership* is becoming increasingly important as companies become more diverse in a globalized economic system. *Strategic leadership* is a leader's ability to direct change in an organization so as to enhance its competitiveness. *Ethical leadership* requires that leaders maintain high ethical standards for their own conduct and to hold others in their organizations to the same standards. *Virtual leadership* is becoming important as more leaders and their followers work in physically separate places.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Describe the psychological contract you currently have or have had in the past with an employer. If you have never worked, describe the psychological contract that you have with the instructor in this class.
2. What is the difference between "leadership" and "management"? Give an example of each in practice.
3. How is the job enrichment/job redesign approach to motivation different from the modified work schedules (flextime, compressed workweek) approach to motivation? Are there similarities between the two approaches? Explain.
4. How can participative management programs enhance employee satisfaction and motivation? Why don't some employees want to get involved in participative management?
5. What is the relationship between performance behaviours and organizational citizenship behaviours? Which are more important to an organization?
6. What are the pros and cons of charismatic leadership? Demonstrate these pros and cons by describing several specific behaviours of a charismatic leader of your choice.

APPLICATION EXERCISES

1. Interview your employer or an administrator at your college. Ask the person what he or she believes motivates his or her employees. Determine whether the person's beliefs about motivation are consistent or inconsistent with each of the motivation theories discussed in this chapter.
2. Ask a manager what traits he or she thinks are necessary for success. How does the manager's list compare with the "big five" list in this chapter? How many differences are there? Why would these differences exist?
3. Interview the human resource manager of a local company and ask what strategies the company uses to enhance employee job satisfaction. Also determine why the company does not use certain strategies that are described in this chapter.
4. Think of the job you now have or a job you had in the past. How many of the five kinds of power did your boss use? Give specific examples.

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members and discuss your new business venture within the context of this chapter. Develop specific responses to the following:

1. Thinking about your new business venture, choose two dramatically different positions in the company and define performance behaviours for each position. What counterproductive behaviours would be most detrimental to your business?
2. If you were able to measure the emotional intelligence of prospective employees, which dimension or dimensions will be most important to you?
3. There are many theories of motivation. If you believe that Maslow's needs hierarchy best explains motivation in the workplace, how will you motivate your employees to work hard?
4. Another popular theory of motivation is Herzberg's two-factor theory. How could you apply this theory to your new business venture?
5. In your new company, will employees be able to work from home or have work flexible hours? Why or why not?

BUILDING YOUR BUSINESS SKILLS

TOO MUCH OF A GOOD THING

GOAL

To encourage you to apply motivation theories to realistic work situations.

BACKGROUND INFORMATION

For many years now, employees at CBR Corp. have been treated as though they are members of a big family. Unfortunately, this "family" is slowly going broke because too few members work hard enough to make money for the company. Employees are happy, comfortable, and complacent (and some are just lazy).

When sales dropped for the fifth consecutive year in both the pharmaceutical and specialty-chemicals divisions, the top management team decided to bring in outside consultants to analyze the situation and make recommendations for resolving this significant threat to the company's survival. After interviews with more than 80 of the firm's 200 workers, the consultants identified a serious motivational problem in the sales force. Among other things, they found that sales representatives not only were being paid a handsome salary but also were receiving automatic year-end bonuses regardless of their performance. Salespeople were also treated to bagels every Friday and regular group birthday lunches that cost as much as $800 each. Employees indicated that they were very satisfied with their working conditions, but they didn't seem to have much incentive to work very hard. The top management team at CBR eagerly waited to hear the consultants' recommendations for turning the situation around.

METHOD

Step 1 In groups of four, step into the role of the external consultants. Start by analyzing your client's workforce motivation problems from the following perspectives:

- *Job satisfaction and morale.* As part of the business, CBR employees were happy and loyal, in part because they were treated well. Can high satisfaction and morale have a downside? What can managers do to prevent stagnation from taking hold?
- *Theory X versus Theory Y.* The behaviour of these workers seem to make a case for introducing Theory X management. Explain why that might not be a good idea.
- *Two-Factor Theory.* Analyze the various ways in which improving motivational factors such as recognition, responsibility, advancement, and growth might reduce the importance of hygiene factors, including pay and job security.
- *Expectancy Theory.* Analyze the effect on productivity of redesigning the company's sales force compensation structure (by paying lower base salaries while offering greater earnings potential through a sales-based incentive system). Why would linking performance with increased pay that is achievable through hard work motivate employees?

Step 2 Develop your recommendations for change. What is your group's most important recommendation? Explain why you think your most important recommendation is likely to succeed.

EXERCISING YOUR ETHICS

EXERCISING CHARISMA

THE SITUATION

You are the chief financial officer (CFO) for Advanced Nutriceuticals, a company that manufactures and sells nutritional supplements. The company's CEO is passionate about health and the value of nutritional supplements, and he has a compelling story to tell because he is a survivor of Stage IV skin cancer. He attributes his survival to the use of nutritional supplements. He is featured widely in company advertising and is admired by the company's employees. The CEO is a charismatic individual with boundless enthusiasm and optimism about the company's future and his important role in that future.

Unlike prescription medications, nutritional supplements are not subject to much government regulation, and the company does not have a lot of well-supported research to support its claims about the efficacy of its products. In addition, there is considerable competition from U.S. companies that can produce the products at a much lower cost because they can achieve significant economies of scale. The CEO is very committed to increasing the scope and size of Advanced Nutriceuticals; as a result, the top management team has spent a year developing a long-term strategy that involves increasing production and expanding into markets outside Canada.

THE DILEMMA

As the CFO, you were asked to develop a budget for the next three years. Given the company's expansion plans, you have projected that there will be a need for a large amount of new capital to achieve the goals of the strategic plan. You have presented your budget to the CEO and board of directors and have discussed various options for raising additional capital, such as the sale of bonds and a public offering of additional company stock. After analyzing each of the alternatives that you presented, the CEO has come back with a new option: He wants to change all of the employees' retirement funds to stock in Advance Nutriceuticals and encourage every employee to show "company spirit" by investing as much additional money as possible. The CEO is very excited about this idea because it will move him closer to his dream of a much larger and more important company. He is convinced that he can sell this idea to the employees based on his enthusiasm, charm, and charisma. You are concerned that this is a risky move for employees because, if the company is not successful, the employees will be out of a job *and* their retirement funds. But you are also aware that the employees respect the CEO and believe in him and that they might actually agree with the CEO's recommendations. You have mentioned your concerns about the CEO's idea to him, but he has responded by putting considerable pressure on you to "get on board" with his idea.

TEAM ACTIVITY

Without discussing this issue with others, develop an answer for each of the following questions:

1. What are the ethical issues in this situation?
2. What do you think most managers would do in this situation?
3. What would you do?

Form a small group (with three or four of your classmates). Have each individual briefly share the answers they came up with for the three preceding questions. Then have a team discussion about the issues and try to come to a consensus with respect to the three questions.

BUSINESS CASE 9

SATISFACTION, PRODUCTIVITY, AND EMPLOYEE ENGAGEMENT

Managers would like to know the answer to two very important questions: (1) Are *satisfied* (happy) employees more *productive* than unsatisfied (unhappy) employees?; (2) How important is *employee engagement* in generating satisfaction and productivity?

ARE SATISFIED EMPLOYEES MORE PRODUCTIVE?

There is a "chicken and egg" element to this question, so we have to ask what comes first: employee satisfaction or employee productivity? Some managers think that satisfied employees are more productive *because* they are satisfied (i.e., satisfaction → productivity), while others think that employees are satisfied *because* they are productive (i.e., productivity → satisfaction). Managers who believe the former argue that employees who are happy in their work will be very productive because they work better with others, make better decisions, complain less, take less sick time, and are more optimistic. By contrast, managers who believe the latter argue that when people are highly productive, they are satisfied because they feel intrinsically good about themselves.

HOW IMPORTANT IS EMPLOYEE ENGAGEMENT?

Because the relationship between happiness and productivity is complicated, we need to consider another factor that might help to clarify the situation. This is where *engagement* comes in. Workers who have more positive work experiences than negative ones will be more engaged in their work, and the key to increasing positive experiences is playing to an employee's strengths. Thus, engagement is not about making employees happy. Rather, it's about having employees who are committed to being highly productive.

Surveys have shown that businesses that score in the top half of an employee-engagement ranking system are nearly twice as likely to be successful than companies that are in the bottom half of the ranking. Telus Corp.'s experience is illustrative. Its score increased from 53 percent in 2007 to 85 percent in 2014. The increase in the score was accompanied by lower turnover rates among its employees, higher customer satisfaction, and a boost in the company's stock price. Engaged employees are also a great source of ideas for improving company productivity. Consider these examples:

- At Algoma Steel, a shop floor employee came up with a more efficient process for producing heat-treated steel plates that resulted in $90 million in additional revenue for the company.
- At ISL Engineering and Land Services, a senior urban designer was interested in making the company "greener," but he didn't want to force the idea on employees from the top down. Rather, he wanted them to help develop ideas. So 25 employees known to be particularly keen about sustainability were named "green champions." They were encouraged to spend up to 10 percent of their time every day working on environmental issues.
- Coast Capital Savings, which is based in Surrey, British Columbia, has focused on increasing employee engagement by improving the physical space where people work. Employee input was important in determining the kinds of design changes that would be implemented. The design changes that were eventually made include an expansive lookout patio space with barbecues and a fire pit, themed cafes, chat rooms, and an open work concept (no offices, even for top executives). These interior design changes have done more than just create pleasant surroundings; they have also increased employee engagement.

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In a Psychometrics Canada poll of 368 Canadian HR managers, 69 percent of respondents said that low employee engagement was a problem in their organization, and 82 percent felt that company management should be doing more to increase employee engagement. The respondents also expressed the opinion that managers should give employees more recognition and praise (58 percent), should listen more to employee opinions (71 percent), and should provide employees with more learning and development opportunities (57 percent).

Another study—this one involving 30 000 workers in 17 different countries—was conducted by the global consulting firm Mercer. It found that there has been a decline in employee engagement over the past decade. Declines were evident in (1) the sense of commitment employees felt to their organization, (2) the pride they had in their organization, (3) employee willingness to go beyond stated job requirements, and (4) the feeling of accomplishment that employees got from their job.

Brad Hams, an organizational change expert, says that employee engagement is typically low because business owners and employees have different perspectives. Owners are concerned about things like profit, cash flow, and cost control, while employees are concerned about things like pay, benefits, and job security. Employee engagement can be increased by giving employees the right incentives (so that they benefit when company performance improves), providing the right education for employees (so that they understand how the business works), and adopting the right performance measures (to help employees accurately monitor their performance).

Another way to increase employee engagement is to use social media, and many companies are taking very specific actions to capitalize on the employee engagement characteristics of social media. At Toronto-Dominion bank, the company's internal website has been made into a social media platform that includes blogs, chat forums, surveys, and a feature that allows employees to leave comments on blog pages, news items, and memos. Sun Life Financial Inc. also uses social media—blogs, online communities, and wikis—to get ideas from employees, and the company has pilot-tested a social media feature that allows employees to respond to the ideas of colleagues. Managers have also noticed that the more casual nature of social media encourages timid employees to speak up and become engaged, whereas they often wouldn't do so in formal meetings.

QUESTIONS FOR DISCUSSION

1. How do you think happiness and productivity relate to one another? Defend your answer.
2. What factors influence your happiness on the job?
3. Consider the following statement: *"The use of social media by employees is harmful to productivity because employees are distracted from their work and spend too much time on personal matters instead.* Do you agree or disagree? Support your position.

MyLab Intro to Business

Study, practise, and explore real business situations with these helpful resources:
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.
- **Videos:** Learn more about the business practices and strategies of real companies.

CRAFTING A BUSINESS PLAN

PART 2(A):

THE BUSINESS OF MANAGING

GOAL OF THE EXERCISE

In Part 1 of the business plan project, you formulated a basic identity for your business. Part 2(a) asks you to think about the goals of your business, some internal and external factors affecting the business, and the organizational structure of the business.

EXERCISE BACKGROUND: PART 2(A) OF THE BUSINESS PLAN

As you learned in Chapter 6, every business sets goals. In this part of the plan, you'll define some of the goals for your business. Part 2(a) also asks you to perform a basic SWOT analysis for your business. As you'll recall from Chapter 6, a SWOT analysis looks at the business's Strengths, Weaknesses, Opportunities, and Threats. The strengths and weaknesses are internal factors—things the business can control. The opportunities and threats are generally external factors that affect the business:

Socio-cultural forces. Will changes in population or culture help your business or hurt it?

Economic forces. Will changes in the economy help your business or hurt it?

Technological forces. Will changes in technology help your business or hurt it?

Competitive forces. Does your business face much competition or very little?

Political–legal forces. Will changes in laws help your business or hurt it?

Each of these will affect different businesses in different ways, but some may not apply to your business at all.

Part 2(a) of the business plan also asks you to determine how the business is to be run. One thing you'll need to do is create an organizational chart to get you thinking about the different tasks needed for a successful business. You'll also examine various factors relating to operating your business.

YOUR ASSIGNMENT

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Step 1 Open the saved Business Plan file you began working on in Part 1. You will continue to work from this file.

Step 2 For the purposes of this assignment, you will answer the questions in Part 2(a): The Business of Managing:

1. Provide a brief mission statement for your business.

   Hint: Refer to the discussion of mission statements in Chapter 6. Be sure to include the name of your business, how you will stand out from your competition, and why a customer will buy from you.

2. Consider the goals for your business. What are three of your business goals for the first year? What are two intermediate- to long-term goals?

   Hint: Refer to the discussion of goal setting in Chapter 6. Be as specific and realistic as possible with the goals you set. For example, if you plan on selling a service, how many customers do you want by the end of the first year, and how much do you want each customer to spend?

3. Perform a basic SWOT analysis for your business, listing its main strengths, weaknesses, opportunities, and threats.

   Hint: We explained previously which factors you should consider in your basic SWOT analysis. Look around at your world, talk to classmates, or talk to your instructor for other ideas in performing your SWOT analysis.

4. Who will manage the business?

   Hint: Refer to the discussion of managers in Chapter 6. Think about how many levels of management and what kinds of managers your business needs.

5. Show how the "team" fits together by creating a simple organizational chart for your business. Your chart should indicate who will work for each manager and each person's job title.

   Hint: As you create your chart, consider the different tasks involved in the business. To whom will each person report? Refer to the discussion of organizational structure in Chapter 7 for information to get you started.

Note: Once you have answered the questions, save your Word document. You'll be answering additional questions in later chapters.

PART 2(B):

THE BUSINESS OF MANAGING

GOAL OF THE EXERCISE

At this point, your business has an identity, and you've described the factors that will affect your business and how you will operate it. Part 2(b) of the business plan project asks you to think about your employees, the jobs they will be performing, and the ways in which you can lead and motivate them.

EXERCISE BACKGROUND: PART 2(B) OF THE BUSINESS PLAN

To complete this part of the plan, you need to refer to the organizational chart you created in Part 2(a). In this part of the business plan exercise, you'll take the different job titles you created in the organizational chart and give thought to the skills that employees will need to bring to the job before they begin. You'll also consider training you'll need to provide after they are hired and how you'll compensate your employees. Part 2(b) of the business plan also asks you to consider how you'll lead your employees and keep them happy and motivated.

YOUR ASSIGNMENT

MyLab Intro to Business

Step 1 Open the Business Plan file you have been working on.

Step 2 For the purposes of this assignment, you will answer the questions in Part 2(b): The Business of Managing:

1. What do you see as the "corporate culture" of your business? What types of employee behaviours, such as organizational citizenship, will you expect?

   Hint: Will your business demand a casual environment or a more professional environment? Refer to the discussion on employee behaviour in this chapter for information on organizational citizenship and other employee behaviours.

2. What is your philosophy on leadership? How will you manage your employees on a day-to-day basis?

   Hint: Refer to the discussion on leadership in this chapter to help you formulate your thoughts.

3. Looking back at your organizational chart in Part 2(a), briefly create a job description for each team member.

   Hint: As you learned in Chapter 8, a job description lists the duties and responsibilities of a job; its working conditions; and the tools, materials, equipment, and information used to perform it. Imagine your business on a typical day. Who is working and what are each person's responsibilities?

4. Next, create a job specification for each job, listing the skills and other credentials and qualifications needed to perform the job effectively.

   Hint: As you write your job specifications, consider what you would write if you were preparing an ad for the position. What would the new employee need to bring to the job in order to qualify for the position?

5. What sort of training, if any, will your employees need once they are hired? How will you provide this training?

   Hint: Refer to the discussion of training in Chapter 8. Will you offer your employees on-the-job training? Off-the-job training? Vestibule training?

6. A major factor in retaining skilled workers is a company's compensation system—the total package of rewards that it offers employees in return for their labour. Part of this compensation system includes wages or salaries. What wages or salaries will you offer for each job? Why did you decide on that pay rate?

   Hint: Refer to Chapter 8 for more information on forms of compensation.

7. As you learned in Chapter 8, incentive programs are special programs designed to motivate high performance. What incentives will you use to motivate your workforce?

   Hint: Be creative and look beyond a simple answer, such as giving pay increases. Ask yourself: Who are my employees and what is important to them? Refer to Chapter 8 for more information on the types of incentives you may want to consider.

Note: Once you have answered the questions, save your Word document. You'll be answering additional questions in later chapters.

PART

03 MANAGING OPERATIONS AND INFORMATION

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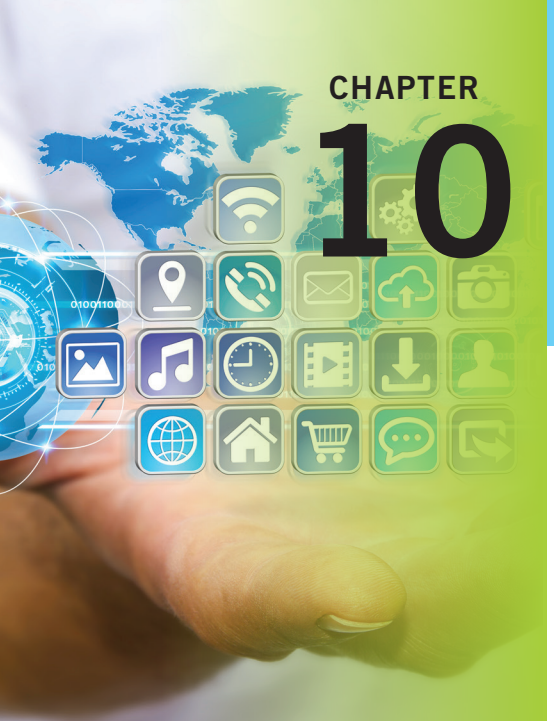

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CHAPTER

10

Operations Management, Productivity, and Quality

LO

AFTER READING THIS CHAPTER, YOU WILL BE ABLE TO:

- **LO-1** Explain the meaning of the term *production* (or *operations*) and describe the four kinds of *utility* it provides.
- **LO-2** Identify the characteristics that distinguish *service operations* from *goods production* and explain the main differences in the *service focus*.
- **LO-3** Describe two types of *operations processes*.
- **LO-4** Describe the factors involved in *operations planning* and *operations control*.
- **LO-5** Explain the connection between *productivity* and *quality*.
- **LO-6** Understand the concept of *total quality management* and describe nine tools that companies can use to achieve it.
- **LO-7** Explain how a *supply-chain strategy* differs from traditional strategies for coordinating operations among businesses.

The Robots Keep Coming.

In recent years, the use of industrial robots has been rapidly increasing because they provide several advantages to businesses: they don't make salary demands, they don't take vacations, and they work long hours without complaining or getting tired. But the most important advantage is that robots increase efficiency levels by monitoring worker output, analyzing huge amounts of production data, and improving warehousing and logistics tasks. For example, General Motors has just one-third the number of workers it had in the 1970s, but it now produces more cars than it did then. The steel industry shows the same trend; since 1997, the number of workers employed has declined, but output has increased 38 percent.

During the past decade, thousands of industrial robots were purchased by manufacturers in various countries. Korea now has 531 robots per 10 000 workers, Germany has 301, the United States has 176, and China has 49. The cost of industrial robots has been steadily declining; an industrial robot used to cost about $100 000, but the price has come down to about $25 000. Even small- and medium-sized companies can now afford to buy robots, and this will likely mean even more widespread use of robots. The robotics industry was worth US$10.7 billion in 2014 and is expected to grow to US$83 billion by 2020.

Robots have had a significant positive effect in the area of production management. Here are just a few examples:

- After adding robots to its factory, Vickers Engineering increased revenues from $8 million to $50 million and, at the same time, cut its factory labour costs by one-third. The number of employees actually increased from 100 to 180 because the company has been able to generate more sales revenue as a result of using robots.

- Etalex, a Montreal-based maker of metal shelving, has more than 20 robots in its factory. The robots weld parts, operate punch presses, and stack shelves. They work up to 19 hours each day. By using robots, Etalex has cut its labour costs by about 75 percent. But robots haven't reduced the number of employees because the robots have helped the company remain competitive.
- At General Electric's Bromont, Quebec plant, 180 robots now do the work that humans used to do. But employment has increased from 600 to 900 people because the plant has more business now than it used to have because it is more productive as a result of using the robots.
- Kitchener, Ontario-based Clearpath Robotics makes unmanned Kingfisher vehicles that measure tailings in potash mines so that humans are not exposed to harsh chemicals.
- The candy maker Just Born Quality Confections has installed 16 robots with squishy "fingers" that can pick up and hold those brightly coloured marshmallow treats known as Peeps.
- At Amazon's new warehouse in a Chicago suburb, 2000 employees work alongside a fleet of robots filling customer orders.

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All these examples sound pretty positive, but some experts think that robots are going to reduce employment opportunities for humans. They point to the following facts to make their case:

- A PricewaterhouseCoopers study found that 58 percent of CEOs planned to reduce their employee head count as the result of planned robotic adoptions.
- Several million production jobs could be at risk over the next 15 years.
- The World Economic Forum estimates that 1.6 million manufacturing jobs will be lost globally between 2015 and 2020.
- Thousands of jobs in textile and furniture manufacturing were lost during the past 40 years. Robots account for about 87 percent of the jobs that have been lost.
- McKinsey & Co., a consulting firm, estimates that half of all jobs could eventually be performed by robots.

The possibility that robots will take jobs away from people sounds pretty scary, but there are two reasons why many other experts think that robots and automation will *not* reduce employment opportunities. First, they point out that even though automation has been steadily increasing for many decades, the number of people who are employed now far exceeds the number who were employed 100 years ago. Although many *factory* jobs (and other low-level repetitive jobs) have disappeared because of automation, many more jobs have been created *because* of automation. In addition to all the jobs that have been created for people who actually *make* the robots and other automated machinery, millions of other people have jobs that didn't even exist just a few years ago. For example, there are now thousands of jobs for web designers; obviously, these jobs did not exist prior to the development of the Internet. The second reason is that human beings have skills that robots cannot duplicate (social skills, emotional intelligence, creativity, and critical thinking skills), and these skills are crucial to the success of businesses today. Machines can replace the logic/math aspect of human intelligence, but not the spatial, interpersonal, linguistic, and musical aspects.

QUESTIONS FOR DISCUSSION

1. Consider the following statement: *"The use of robots is not a good idea. Although they do increase efficiency, they depersonalize the work environment and the positive*

aspects of human interaction, and this will be lost when robots are introduced." Do you agree or disagree with the statement? Explain your reasoning.

2. Describe the chain of events that is likely to occur after a robot starts doing a job that a human used to do. In your description, consider issues such as the overall effect of robots on employment levels, the effect of robots on individual employees, the types of jobs that are negatively (and positively) affected by robotics, the impact on efficiency, the type of job skills that are necessary in an era of robotics, and any other issues you think are important. What is your overall conclusion about the impact of robotics on companies and the people who work in them?

HOW WILL THIS HELP ME?

You will benefit in three ways by reading and understanding methods that managers use for managing production operations and improving quality: (1) as an *employee*, you'll get a clearer picture of why everyone in a business should be concerned about productivity and quality and how your job depends on the goods and services your company provides; (2) as a *manager*, you'll understand that if companies want to remain competitive, they must continually analyze their production methods so they can efficiently produce high-quality products and services; and (3) as a *consumer*, you'll gain an appreciation of the significant efforts that companies expend in order to efficiently produce high-quality goods and services for consumers.

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LO-1 PROVIDING GOODS AND SERVICES TO CUSTOMERS

Businesses exist to provide goods and services to their customers. Companies that make tangible products such as radios, iPhones, newspapers, automobiles, and textbooks are engaged in **goods production**, whereas organizations that provide intangible services such as consulting, accounting services, transportation, investment advice, and entertainment are engaged in **service operations**. We will examine the distinction between products and services in more detail later in this chapter, but at this point, we note that the difference between products and services is not always clear-cut. For example, are energy sources like oil, natural gas, and coal physical products, or are they intangible services? They are typically viewed as products by the miners who produce them, but they are viewed as services by consumers who use them. When you heat your home with natural gas, for example, you don't actually see the product. Rather, you see it as a service provided by your provincial utility.

Changes in Canadian Manufacturing over Time

During the period 1800–1950, the production of tangible products was the focus of the Canadian economy. In the early years, agriculture, trapping, and fishing were important, but by the twentieth century, manufacturing became dominant. When people hear the term "manufacturing," they often envision large factories with thousands of unskilled or semi-skilled workers doing repetitive (and sometimes dangerous) jobs on assembly lines that make products such as steel, cement, rubber tires, automobiles, home appliances, toothpaste, and thousands of other products. But big changes have occurred in many traditional manufacturing industries over the past 100 years. For example, in the *paper making* business, many mills have been closed because of the emergence of the Internet, which caused more and more people to go online for their information. Newspapers and magazines struggled (often unsuccessfully) to cope with declining readership and advertising revenues, and many of them went out of business. The demand for newsprint then declined. The *automobile manufacturing* business used to generate an annual trade surplus of $20 billion, but now it shows an annual *deficit* of $12 billion. Canada's share of North American production has dropped to a record low of 14 percent (Mexico's share is about 20 percent). In 2000, 198 000 people worked in the Canadian auto industry, but the number has now declined to about 125 000. In the manufacturing of *consumer durables,* a similar pattern is evident. Many manufacturing operations that formerly made products such as microwave ovens, refrigerators, washers, dryers, and televisions have ceased to exist in Canada and are now located overseas, often in low-wage countries.

Changes in manufacturing have occurred as companies introduced automation and other new technologies in order to remain competitive. Manufacturers are becoming high-tech operations that require highly skilled workers such as software engineers and data scientists.[1] Here's just one typical example: Leclerc Groupe operates six factories in Canada and the United States that produce cookies and snacks. The company had problems that many companies face (e.g., poor transfer of information among shifts in a given manufacturing plant, poor dissemination of new ideas among manufacturing plants, and workers who didn't read training manuals). Alexandre Leclerc, the son of the company's founder and his friend software engineer Antoine Bisson devised a system called Poka that allows workers to use iPads at each workstation to make short videos that document problems and how they are solved. This information can then be made available to other workers.[2] Poka is now used in 150 factories, including ArcelorMittal's steelmaking facility

GOODS PRODUCTION Production activities that yield tangible products.

SERVICE OPERATIONS Production activities that yield tangible and intangible service products.

in Montreal. The boxed insert entitled "Entrepreneurship That Matters: Speaking Loud and Clear" describes another high-tech solution developed by entrepreneurs.

These changes have led to increased output, but fewer workers are now employed in manufacturing. During the past 30 years or so, factory *output* has increased nearly 60 percent, but factory *employment* has decreased 16 percent. A typical example of this trend can be seen at Maple Leaf Foods, which closed five old food processing factories that were inefficient and replaced them with *one* new, highly efficient factory in Hamilton, Ontario. The new plant produces more than the five old plants combined, but about 1500 fewer jobs are available.

During World War II, the manufacturing-to-GDP ratio in Canada was nearly 30 percent, but by the 1960s, it had declined to 23 percent, and then to just 14 percent during the most recent decade. Over the past 60 years, most developed economies have also experienced similar declines in manufacturing's share of GDP, so Canada has lots of company. For example, in the United States, manufacturing's share of GDP dropped from 24 percent in 1970 to just 13 percent at the present time.

During the decades of decline in the manufacturing sector, tremendous growth was occurring in the service sector. By 2017, the service sector provided 79 percent of the total jobs in Canada, whereas the goods-producing sector provided just 21 percent.[3] This growth in services was often generated by visionary entrepreneurs. For example, Netflix provides online streaming of movies, and Facebook offers its members a venue for networking and interacting with others.

Industrial Revolutions

Over the past 300 years, there have been several industrial revolutions. The first occurred in Britain in the 1800s, and the second in the United States in the early 1900s. Now, a third one is under way, based on new technologies, software, robots, and miniaturization.[4] For example, 3-D printing produces goods such as car parts and dresses using successive layers of plastic ink, and Ford Motor Company is using this process to design and test new engineering ideas.[5] The technology means that new product prototypes can be developed within a day or two of the development of a new design, rather than the three- to-four-month time frame required with traditional methods. Voodoo Manufacturing has taken this idea one step further and can now mass-produce a variety of plastic goods with 160 different 3-D printers that resemble toaster ovens. The company can produce up to 160 different products at once, or 160 items of the same product.[6] Other new technologies allow machines to run more cleanly, quickly, and safely and to operate on a global scale. In a

ENTREPRENEURSHIP AND NEW VENTURES

Entrepreneurship That Matters: Speaking Loud and Clear

The great Stephen Hawking died in 2018, but fortunately his voice was heard for the final 33 years of his life even though he lost the ability to speak. The world scientific community was able to gain valuable knowledge from this brilliant man who was able to communicate verbally because of artificial voice technology. Despite major advances in the last three decades of his life, Mr. Hawking chose to keep his robotic-sounding voice box until his final days, saying that it was a fundamental part of his persona. Voice technology has grown by leaps and bounds in recent years because programmers and entrepreneurs have been pushing for quality improvements to create a more natural-sounding voice interface to enhance IT systems with vocal output, beyond traditional print and visual output.

Matthew Aylett and Nick Wright formed CereProc (short for Cerebral Processing) in Edinburgh, Scotland, with quality at the core of their mission. From the beginning, the firm was dedicated to creating better synthetic voices with character and emotion that stimulate listeners with natural-sounding messages. Before CereProc, these lofty goals were hard to achieve. Speech experts couldn't create text-to-voice software that sounded realistically conversational, by varying tone-of-voice and providing various vocal inflections for different situations. Previous software couldn't adapt incoming text (from word processors or from text messages) into natural voice formats. To attack these challenges, CereProc brought together a team of leading speech experts. It also partnered with leading universities and research programs in developing speech science technology and new applications and markets for voice output.

The company's main product is CereVoice, an advanced text-to-voice technology available on mobile devices, computers, servers, and headsets that has applications in nearly every company's products for better synthetic voices. Any computer's existing voice system can be replaced with more natural-sounding speech through a choice of accents that can be sampled with live voice demos at the firm's website. Potential business applications are endless—kitchen appliances, alarm systems, traffic controllers, automobiles, radio broadcasting, telephone messaging, and movies, to name a few. Although consumers may not see the CereVoice label, they will be hearing its various voices often in their everyday lives.

CereProc's voice creation system can create a synthesized imitation of a person's voice, including its tones and inflections. Beyond its technical success, this project vividly displays a compassionate side in CereProc's business. While CereProc has clearly established a niche in the market, many other companies are working on similar technology for various applications.

Apple assembled an in-house team to develop enhanced capabilities in this area and recently acquired a start-up AI company called VocalIQ for $100 million. Even though Apple is investing heavily in vocal recognition and speech technology, the competition is fierce. Google Assistant, Amazon's Alexa, Microsoft's Cortana, and other AI operating systems are breaking new ground daily. As more and more of our cars, appliances, and even houses begin to communicate with us in spoken words, we are seeing that the future is now. Voice recognition and voice creation have entered the mainstream of IT capabilities and are rapidly becoming the norm, rather than a curiosity.

CRITICAL THINKING QUESTION

1. Describe some specific workplace applications for the advanced technology developed by CereProc and other companies in the industry.

modern factory with online manufacturing, machines can log into the Internet, adjust their own settings, and make minor decisions without human help. They can communicate with other machines in the company (via an intranet) and with other companies' machines (via the Internet). So-called "smart" equipment stores performance data that becomes available on desktops around the world, where designers can click on machine data, simulate machine action, and evaluate performance, before the machines themselves ever swing into action. With the Internet, producers of both services and goods are integrating their production activities with those of far-off suppliers and customers.

CREATING VALUE THROUGH OPERATIONS

Products (both goods and services) provide customers with **utility** (want satisfaction). By making a product available at a time when consumers want it, production creates *time utility*, as when a company turns out tree ornaments in time for Christmas. By making a product available in a place convenient for consumers, production creates *place utility*, as when a local department store creates a "Trim-a-Tree" section. By making a product that consumers can take pleasure in owning, production creates *ownership (possession) utility*, as when you take a box of ornaments home and decorate your tree. By turning raw materials into finished goods, production creates *form utility*, as when an ornament maker combines glass, plastic, and other materials to create tree decorations.

Operations (or **production) management** is the systematic direction and control of the processes that transform resources into finished goods and services. As Figure 10.1 shows, *operations managers* bring raw materials, equipment, and labour together under a production plan that effectively uses all the resources available in the production facility. As the demand for a product increases, managers must schedule and control work to produce the amount required. Meanwhile, they must control costs, quality levels, inventory, and plant and equipment.

Some operations managers work in service centres like FedEx package-sorting depots, whereas others work in traditional factories that make physical products like cell phones. Still others work in offices, restaurants, hospitals, and stores. Farmers are operations managers who create utility by transforming soil, seeds, fuel, and other inputs into soybeans, milk, and other outputs.

UTILITY The power of a product to satisfy a human want; something of value.

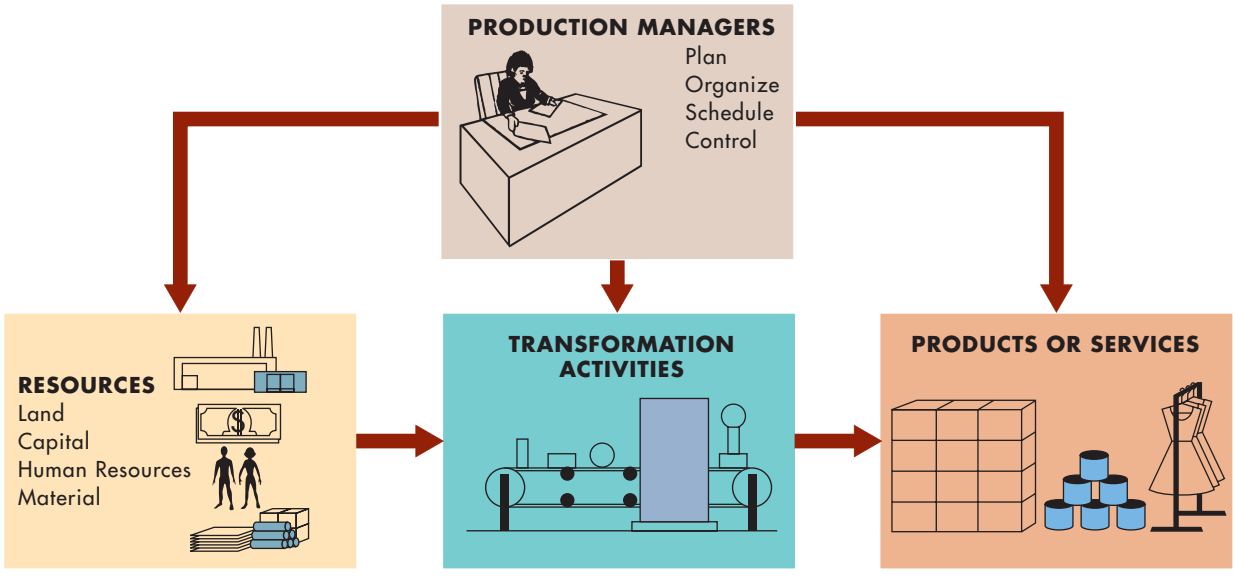
OPERATIONS (OR PRODUCTION) MANAGEMENT A set of methods and technologies used in the production of a good or a service.

LO-2 Differences between Service and Manufacturing Operations

Both service and manufacturing operations transform raw materials into finished products. In service operations, however, the raw materials, or inputs, are not things like glass or steel. Rather, they are people who have either unsatisfied needs or possessions needing care or alteration. The output of service operations is not physical products, but people with needs met and possessions serviced. Service operations are more complicated than goods production in four ways: (1) the interaction with consumers, (2) the intangible and unstorable nature of some services, (3) the customer's presence in the process, and (4) service quality considerations.

The Interaction with Consumers

Manufacturing operations emphasize outcomes in terms of physical goods—for example, a new jacket. But the outcomes of most service operations are really combinations of goods and services—both making a pizza and serving (or delivering) it. Service workers need human relations skills. For example, gas company employees may need to calm frightened



>>> FIGURE 10.1
The transformation system

customers who have reported gas leaks. Thus, their job includes more than just repairing pipes. In contrast, factory workers who install gas pipes in manufactured homes have no contact with customers and don't need such skills.

Intangibility and Unstorability

Often, services can't be touched, tasted, smelled, or seen. An important satisfier for customers, therefore, is the intangible value they receive in the form of pleasure, gratification, or a feeling of safety. For example, when you hire an attorney, you purchase not only the intangible quality of legal expertise but also the equally intangible reassurance that help is at hand. Many services—such as trash collection, transportation, child care, and house cleaning—can't be produced ahead of time and then stored for high-demand periods. If a service isn't used when available, it is usually wasted. Services, then, are typically unstorable.

The Customer's Presence in the Operations Process

When services are provided, the customer is often present in the operations process. To get a haircut, for example, most of us have to go to the barbershop or hair salon. As a customer, you expect the salon to be conveniently located (place utility), to be open for business at convenient times (time utility), to provide safe and comfortable facilities, and to offer quality grooming (form utility) at reasonable prices (value for money spent). As they participate in the operations process, consumers can affect it. For example, what happens if a customer who was scheduled to receive a haircut also asks for an additional service, such as highlighting? The service provider must balance customer satisfaction with a tight schedule. High customer contact has the potential to significantly affect the process.

The growth of e-commerce has introduced a "virtual presence," as opposed to a physical presence, of the customer in the operations process. Consumers interact electronically and in real time with sellers, collecting information about product features, delivery availability, and after-sales service. Many companies have invited "the virtual customer" into their service systems by building customer-communications relationships. For example, the online travel agency Expedia.ca responds to your personalized profile with a welcome email, presents you with a tailor-made web page the next time you sign in, offers chat rooms in which you can compare notes with other customers, and notifies you of upcoming special travel opportunities.

The hair styling services that are being provided to this customer are classified as "high-contact" because the customer must be part of the operations process. The services also illustrate the three key features of service operations: intangibility, customization, and unstorability.

Peathegee Inc/Blend Images/Getty Images

Service Quality Considerations

Consumers use different measures to judge services and goods because services include intangibles, not just physical objects. Service managers know that quality of *work* and quality of *service* are not necessarily the same thing. Your car, for example, may have been flawlessly repaired (quality of work), but you'll probably be unhappy with the service if you're forced to pick it up a day later than promised (quality of service).

LO-3 Operations Processes

An **operations process** is a set of methods and technologies used in the production of a good or a service. Banks, for example, use document shredding and data encryption to protect confidential information. Automakers use precision painting methods to produce a glittering paint finish.

Goods-Producing Processes

At the most general level, operations processes for the production of physical products are either *make-to-order* (producing custom-designed products for special order) or *make-to-stock* (producing standard items in large quantities for consumers in general). More specifically, operations processes in manufacturing firms can be classified on the basis of (1) the kind of transformation technology that is used and (2) whether the operations process combines resources or breaks them into component parts.

Types of Transformation Technologies Manufacturers use the following types of transformation technologies to turn raw materials into finished goods:

- In *chemical* processes, raw materials are chemically altered. Such techniques are common in the aluminum, steel, fertilizer, petroleum, and paint industries.
- *Fabrication* processes mechanically alter the basic shape or form of a product. Fabrication occurs in the metal forming, woodworking, and textile industries.
- *Assembly* processes put together various components. These techniques are common in the electronics, appliance, and automotive industries.
- In *transport* processes, goods acquire place utility by being moved from one location to another. For example, bicycles are routinely moved from manufacturing plants to consumers by trucks and through warehouses and discount stores.
- *Clerical* processes transform information. Combining data on employee absences and machine breakdowns into a productivity report is a clerical process. So is compiling inventory reports at a retail outlet.

Lucky Business/Shutterstock

^^ The decorations for a Christmas tree illustrate the importance of the concepts of time, place, ownership, and form utility to consumers.

Analytic versus Synthetic Processes An *analytic process* breaks down basic resources into their component parts. For example, aluminum is manufactured by extracting it from an ore called bauxite. The reverse approach, a *synthetic process*, combines a number of raw materials to produce a finished product such as fertilizer or paint.

Service-Producing Processes

One useful way of classifying services is to determine whether a given service can be provided without the customer being part of the production system. In **high-contact systems**, the customer is part of the process. For example, when you purchase transportation, you must board a bus, a train, or an airplane. Transportation managers, therefore, must pay attention to the cleanliness of the trains, buses, and airplanes. Dental and medical services, hair salons, and guided tours are also high-contact systems. By contrast, in **low-contact systems**, the customer is not physically present. The cheque-processing centre at a bank is a low-contact system, because customers are not in contact with the bank while the service is being performed. Gas and electric utilities, auto repair shops, and lawn-care services are also low-contact systems.

OPERATIONS PROCESS A set of methods and technologies used in the production of a good or a service.

HIGH-CONTACT SYSTEM A system in which the service cannot be provided without the customer being physically in the system (e.g., transit systems).

LOW-CONTACT SYSTEM A system in which the service can be provided without the customer being physically in the system (e.g., lawn-care services).

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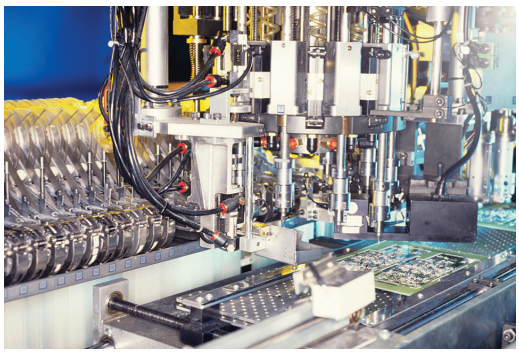

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<<< The various types of transformation technologies used by businesses provide an impressive array of products and services to consumers. The basic technologies shown here are *chemical* (top left), *fabrication* (top centre), *assembly* (top right), *transport* (bottom left), and *clerical* (bottom right).

TABLE 10.1 Business Strategies That Win Customers for Four Companies

Company	Strategy for Attracting Customers	What the Company Does to Implement Its Strategy
Toyota	Quality	Cars perform reliably, have an appealing fit and finish, and consistently meet or exceed customer expectations at a competitive price.
No Frills	Low price	Foods and everyday items are offered at prices significantly lower than conventional food chains.
3M	Flexibility	Provides innovation, with more than 55 000 products in a constantly changing line of convenience items for home and office.
FedEx	Dependability	Every delivery is fast and on time, as promised.

Business Strategy as the Driver of Operations

Production is a flexible activity that can be moulded into many shapes to give quite different capabilities for different purposes. The kind of production that is best for a particular company should be decided from above by the firm's business strategy.[7] In the following paragraphs, we present examples of four firms—two in goods production and two in services—that have different business strategies and, therefore, different operations capabilities. As shown in Table 10.1, each company has identified a business strategy it can use to attract customers in its industry.

Because the four firms have different business strategies, we should expect to see differences in their operations. The top-priority *operations capability (production capability)*—the activity or process that production must do especially well, with high proficiency—is listed for each firm in Table 10.2, along with key operations characteristics for implementing that capability. Each company's operations capability matches up with its business strategy so that the firm's activities—from top to bottom—are focused in a particular direction.

Over time, excellent firms learn how to achieve more than just one competence. For example, in addition to dependability, FedEx is also noted for world-class service quality and cost containment. To reduce costs, the company eliminates jobs that become unnecessary with advances in technology; sells off its older, inefficient airplanes; and reduces the number of flights by careful scheduling.

TABLE 10.2 Operations Capabilities and Characteristics for Four Companies

Operations Capability	Key Operations Characteristics
Quality (Toyota)	• High-quality standards for suppliers of materials. • Just-in-time material flows for lean manufacturing. • Specialized, automated equipment for consistent product buildup. • Operations personnel expert on continuous improvement of product, work methods, and materials.
Low Cost (No Frills)	• Avoids excess overhead and costly inventory (no floral departments, sushi bars, or banks that drive up costs). • Originally provided a limited assortment of "No Name" products and only the most basic customer service (more recently, stores have expanded both products and customer services). • Customers are required to pack their own groceries and provide their own bags. • Low labour costs are achieved by minimum staffing. • Labour and shelving costs are reduced by selling merchandise out of custom shipping cartons (in recent years, more conventional product displays have been introduced).
Flexibility (3M)	• Maintains some excess (expensive) production capacity available for fast start-up on new products. • Adaptable equipment/facilities for production changeovers from old to new products. • Hires operations personnel who thrive on change. • Many small- to-medium-sized facilities in diverse locations to enhance creativity.
Dependability (FedEx)	• Customer automation: uses electronic and online tools with customers to shorten shipping time. • Wireless information system for package scanning by courier, updating of package movement, and package tracking by customer. • Maintains a company air force, global weather forecasting centre, and ground transportation for pickup and delivery, with backup vehicles for emergencies. • Each of 30 automated regional distribution hubs processes up to 45 000 packages per hour for next-day deliveries.

LO-4 OPERATIONS PLANNING

Managers from many departments contribute to a firm's decisions about operations management. As Figure 10.2 shows, however, no matter how many decision makers are involved, the process can be described as a series of logical steps. The business plan and forecasts developed by top managers guide operations planning. The business plan outlines goals and objectives, including the specific goods and services that the firm will offer. Managers also develop long-range production plans through *forecasts* of future demand for both new and existing products. Covering a period of two to five years, the production plan specifies the number of plants or service facilities and the amount of labour, equipment, transportation, and storage that will be needed to meet demand. It also specifies how resources will be obtained. There are five main categories of operations planning: *capacity, location, layout, quality*, and *methods planning*.

Capacity Planning

The amount of a product a company can produce under normal working conditions is its **capacity**. A firm's capacity depends on how many people it employs and the number and size of its facilities. A supermarket, for instance, has far more cash registers than it needs on an average day. But on a Saturday morning or during the three days before Christmas, all registers will be running at full speed.

If capacity is too small for demand, the company must turn away customers, a situation that cuts into profits and alienates both customers and salespeople. If capacity is too large for demand, the firm wastes money by maintaining facilities that are not needed or employing too many workers. In goods-producing operations, capacity planning means ensuring that a firm's capacity just slightly exceeds the normal demand for its product. In low-contact service-producing operations, capacity should be set at the level of average demand. Orders that arrive faster than expected can be set aside in a "to be done" file and processed later, during a slower period. In high-contact service-producing systems, managers must plan capacity to meet peak demand. When Alaska Airlines introduced self-service check-in machines and staffed "bag drop" stations, it doubled its capacity, halved its staffing needs, and cut costs, all while speeding travellers through the check-in process.[8]

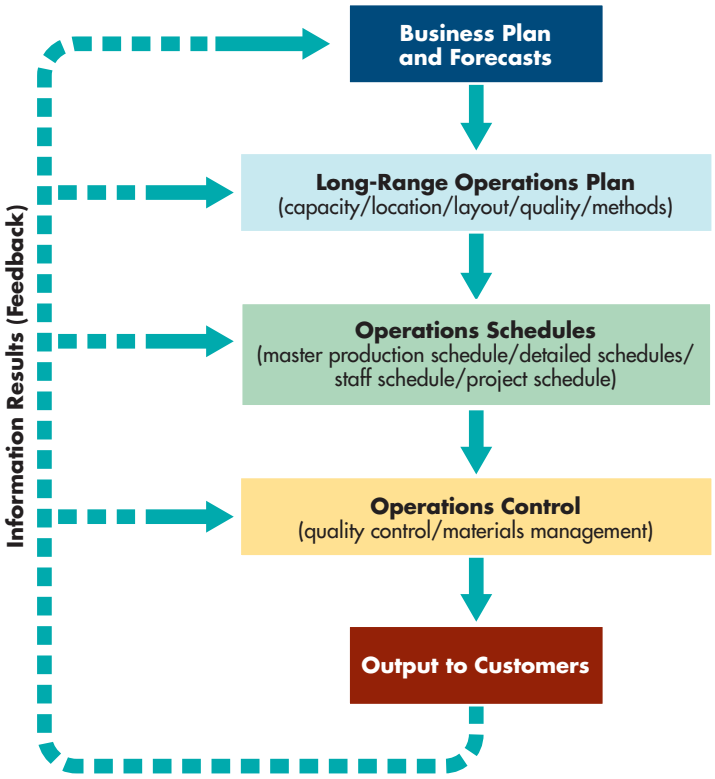


FIGURE 10.2 Operations planning and control

Location Planning

In goods-producing operations, location decisions are influenced by proximity to raw materials and markets, availability of labour, energy and transportation costs, local regulations and taxes, and community living conditions. For example, the central European country of Slovakia is an ideal place to produce automobiles. It has a good railroad system and nearby access to the Danube River, which allows for economical transportation for incoming materials and outgoing cars once automobile factories are in operation. The area also has skilled, hard-working labourers and wages lower than those of surrounding countries.

Low-contact service systems can be located near resource supplies, labour, or transportation outlets. For example, the typical Walmart distribution centre is located near the hundreds of Walmart stores it supplies, not near the companies that supply the distribution centre. Distribution managers regard Walmart stores as their customers. By contrast, high-contact services must locate near the customers who are a part of the system. Thus, fast-food restaurants such as Taco Bell and McDonald's locate near areas with high traffic, such as college campuses, hospital cafeterias, and shopping malls.

Layout Planning

After a site has been selected, managers must decide on plant layout. The layout of machinery, equipment, and supplies determines whether a company can respond quickly and efficiently to customer requests for more and different products and services, or whether it will find itself unable to match competitors' production speed or convenience of service. Three of the most widely used layouts are *process, product*, and *fixed position*.

Process Layouts

In a **process layout** (also called **custom-product layout**), equipment and people are grouped according to function. This layout is well suited to make-to-order shops (or job shops) that specialize in custom work. FedEx Office stores (formerly, Kinko's Copy Centers) use custom-product layouts to accommodate a variety of custom jobs. Specific activities or processes, such as photocopying, faxing, computing, binding, and laminating, are performed in separate specialized areas of the store. Walk-in customers move from area to area using the form of self-service they need. In a woodworking shop, machines cut the wood in one area, sanding occurs

CAPACITY The amount of a good a firm can produce under normal working conditions.

PROCESS LAYOUT (CUSTOM-PRODUCT LAYOUT) A way of organizing production activities such that equipment and people are grouped together according to their function.

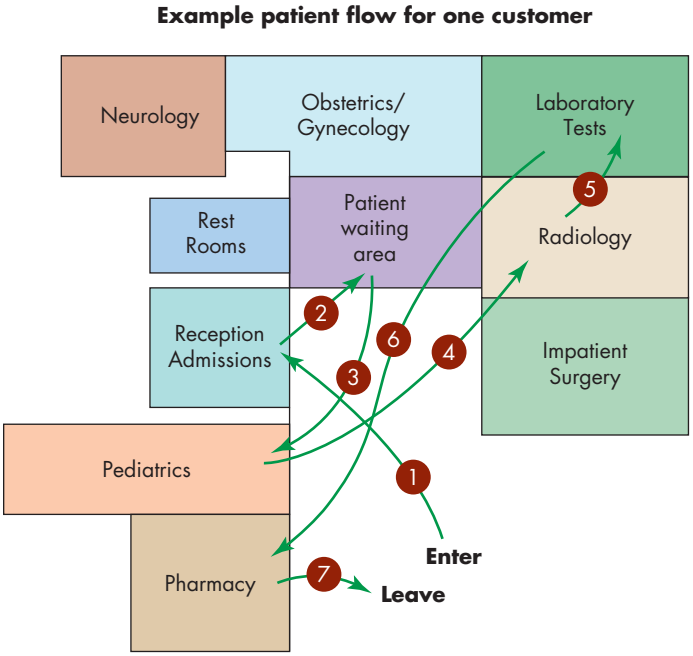


FIGURE 10.3 Process layout for a service provider—a medical clinic

With the "Kiva MFS" system, operators stand still while products come to them. Pallets, cases, and orders are stored on inventory pods that are picked up and moved by mobile robotic drive units (the small orange device under the shelves in the centre of the picture).

Chris Mueller/Redux

in another area, and jobs that need painting are taken to a dust-free area where all the painting equipment is located.

The main advantage of process layouts is flexibility. At any time, the shop can process individual customer orders, each requiring a different kind of work. Depending on its work requirements, a client being served or a job being processed may flow through three activity areas, another through just one area, and still others through four or more work areas. Figure 10.3 shows the process layout of a service provider (a medical clinic). The path taken through the facility reflects the unique treatments for one patient's visit.

Product Layouts

A **product layout** (also called a *same-steps* or **assembly line** *layout*) is set up to provide one type of service or to make one type of product in a fixed sequence of production steps. All units go through the same set of steps. This layout is efficient for large-volume, make-to-stock operations that mass-produce many units of a product. A partially finished product moves step by step through the plant on conveyor belts or other equipment, often in a straight line, as it passes through each stage until the product is completed. Automobile, food processing, and television assemblies are examples of the use of the same-steps layout, as is mail processing at UPS and FedEx facilities. Figure 10.4 shows a product layout at a service provider (an automatic carwash), while Figure 10.5 shows a goods producer assembling parts needed to make storm windows.

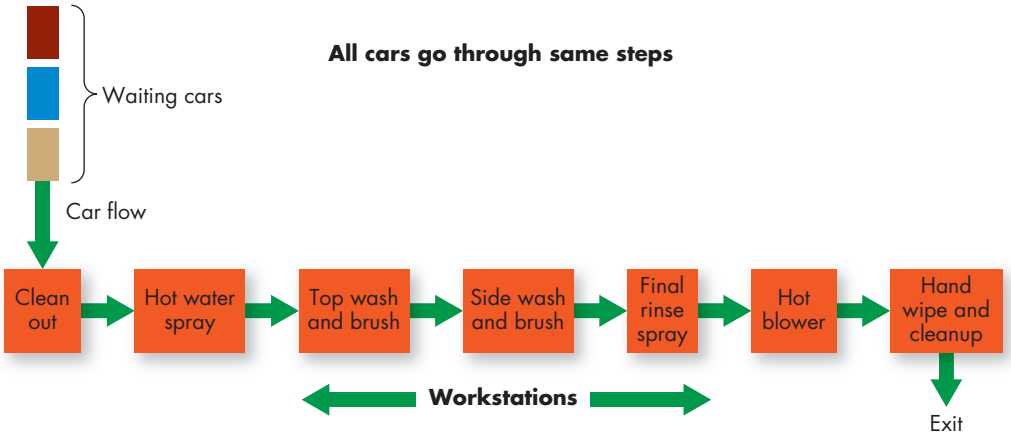
Fixed Position Layout

A **fixed position layout** is a way of organizing production that takes labour, equipment, materials, and other resources to the location where

PRODUCT LAYOUT A way of organizing production activities such that equipment and people are set up to produce only one type of good.

ASSEMBLY LINE A type of product layout in which a partially finished product moves through a plant on a conveyor belt or other equipment.

FIXED POSITION LAYOUT A way of organizing production activities in which labour, equipment, materials, and other resources are taken to the geographic location where all operations work is done.



<<< FIGURE 10.4 Product layout for a service—automated carwash

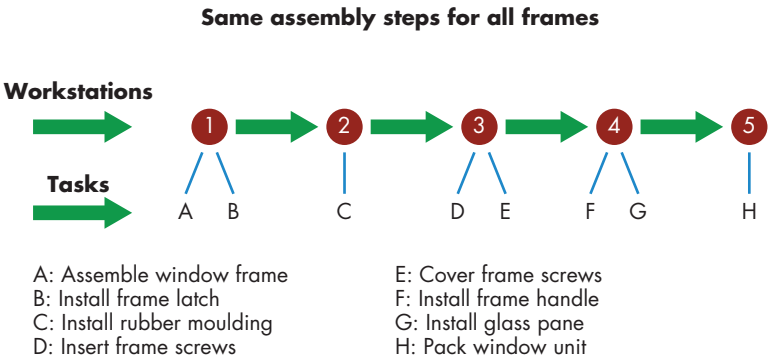


FIGURE 10.5 Product layout for goods production—storm window assembly

work is to be done. For example, physical rehabilitation specialists go to the home of patients who are recovering from knee replacement surgery, and plumbers go to consumers' homes to make repairs when the pipes leak. The fixed position layout is also used for building huge ships that can't be moved, for constructing buildings, and for agricultural operations such as plowing, fertilizing, and harvesting.

Recent Developments in Layout Planning

Several recent developments have increased the flexibility of operations for goods-producing operations. With a **flexible manufacturing system (FMS)**, a single factory can produce a wide variety of products. Automobile manufacturers, for example, now build several models of cars using the same basic "platform" (the underbody of the car). Nissan, Toyota, and Honda make the majority of their cars using FMS, and North American carmakers are now rapidly adopting the strategy.[9] The Oakville, Ontario, Ford plant was the first flexible assembly plant in Canada.[10]

Some companies use **soft manufacturing**, which reduces huge FMS operations to smaller, more manageable groups of machines. Automation is less likely to fail when relegated to jobs it does best, while human workers perform the assembly-line jobs that require dexterity and decision making. Both are supported by networks of computers that are programmed to assist in all sorts of tasks.

Another development is the *movable factory*. Because FMS is so expensive, some developing countries with lots of labour but little capital are buying up used equipment from industrialized countries and then using it to produce products in their own country. For example, a used press from the Buffalo-Niagara region, capable of shaping steel with its 14 000 tons of pressure per square inch, is used to manufacture the internal workings of new Chinese nuclear power plants.[11]

Quality Planning

In planning production systems and facilities, managers must keep in mind the firm's quality goals.[12] Thus, any complete production plan includes systems for ensuring that goods are produced to the firm's quality standards.

Methods Planning

In designing production systems, managers must clearly identify all production steps and the specific methods for performing them. They can then work to reduce waste, inefficiency, and poor performance by examining procedures on a step-by-step basis, an approach sometimes called *methods improvement*.

Improving process flows at goods-producing operations begins by documenting current production practices. A detailed description using a diagram called a *process flowchart* is helpful in organizing and recording information. The flowchart identifies the sequence of production activities, movement of materials, and work performed at each stage of the process. It can then be analyzed to isolate wasteful activities, sources of delays, and other inefficiencies. The final step is implementing improvements.

Similar procedures are useful in designing and evaluating service systems. In a low-contact service system such as a bank, the cash-management unit collects accounts receivable for corporate clients; the sooner cheques are collected and deposited, the sooner the client begins collecting interest. In high-contact services, the demands of systems analysis are somewhat different. In these cases, the steps in the process must be analyzed to see where improvements can be made. Consider the traditional checkout method at hotels. The process flowchart in Figure 10.6 shows five stages of customer activities. A more efficient method eliminates Steps 1, 2, 3A, and 5. Customers now scan their bills on the TV in their rooms before departure. If the bill is correct, no further checkout is required, and the hotel submits the charges against the credit card the customer showed at check-in.

FLEXIBLE MANUFACTURING SYSTEM (FMS) A production system that allows a single factory to produce small batches of different goods on the same production line.

SOFT MANUFACTURING Emphasizes computer software and computer networks instead of production machines.

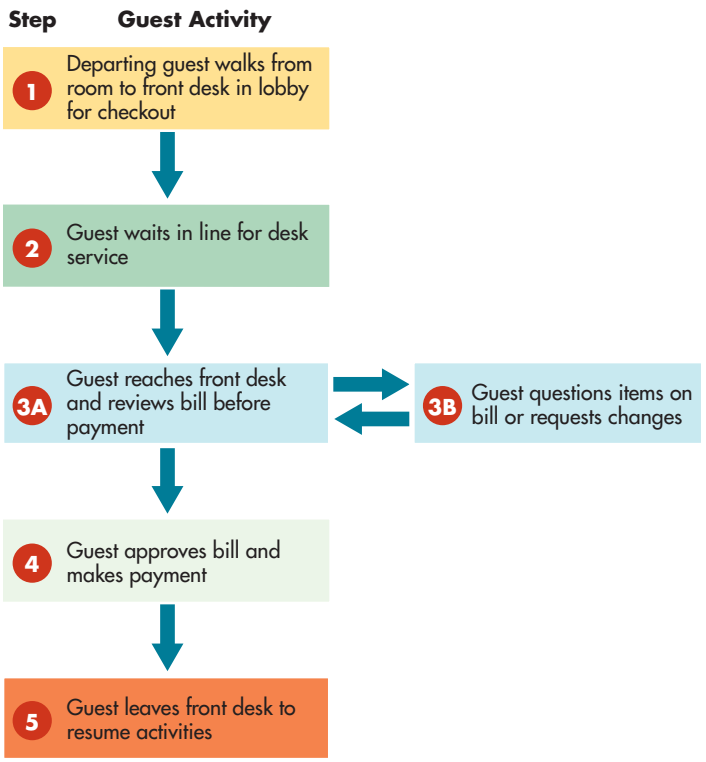


FIGURE 10.6 Flowchart of a traditional guest checkout

Coil # (Product)	8/4/18	8/11/18	8/18/18	...	11/3/18	11/10/18
TC016	1500	2500			2100	600
TC032	900		2700		3000	
TR020	300		2600			1600

FIGURE 10.7 Example of partial master operations schedule

Referring again to Figure 10.2, we see that once plans have been developed, operations managers must develop timetables for implementing the plans. This aspect of operations is called *scheduling*. There are four different kinds of schedules: (1) the master operations schedule (the "game plan" for deciding the volume of upcoming activities over a period of months), (2) detailed schedules (which show day-to-day activities of production), (3) staff schedules (which identify how many employees will be working and when), and (4) project schedules (which provide coordination for completing large-scale projects).

The Master Operations Schedule

A **master operations schedule** shows which products will be produced, when production will occur, and what resources will be used during the scheduled time period. Consider the case of Logan Aluminum Inc., which makes coils of aluminum for companies that make beverage cans. Logan's master schedule (with a format like the partial schedule shown in Figure 10.7) covers production for 60 weeks in which more than 300 000 tons (about 272,000 tonnes) will be produced. For various types of coils (products), the master schedule specifies how many tonnes will be produced every week, which helps managers determine the kinds of material, equipment, and other resources needed for each upcoming week.

The master schedule for a service provider, such as a regional food retailer, may begin with the planned number of retail stores to be operating in each quarter of the next two years. Then, key resources needed in each quarter to provide customer services for all stores are estimated (see Figure 10.8). The master schedule provides information for planning on how many people the company will have to hire and train, planning for purchases of food products and the financing needed for those purchases, and planning for construction requirements of new stores.

Detailed Schedules

Detailed schedules show daily work assignments with start and stop times for assigned jobs at each workstation. At Logan Aluminum, for example, production personnel need to know the locations of all the coils in the plant and their various stages of completion. Managers must assign start and stop times, and employees need scheduled work assignments daily, not just weekly. Detailed short-term schedules allow managers to use

MASTER OPERATIONS SCHEDULE Schedule showing which products will be produced, when production will take place, and what resources will be used.

KEY RESOURCES	Quarter/Year 1/2018	2/2018	3/2018	4/2018	1/2019	2/2019	3/2019	4/2019
Number of Stores	17	17	18	19	20	20	21	22
Staffing Level (no. of employees)	1360	1360	1530	1615	1700	1700	1653	1827
Fresh Vegetables (tonnes)	204	204	192	228	240	240	230	260
Canned Goods (case loads)	73 950	77 350	80 100	80 100	83 000	84 500	88 600	90 200
Fresh Meats Etc.	–	–	–	–	–	–	–	–
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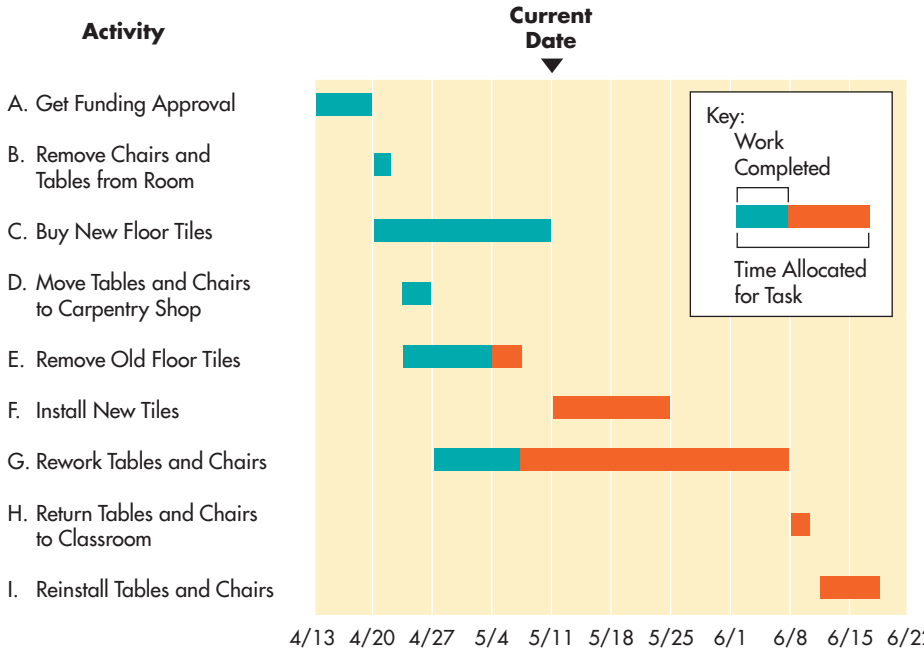
FIGURE 10.8 Food retailer's partial operations schedule



>>> FIGURE 10.9 A Gantt chart

customer orders and information about equipment status to update sizes and the variety of coils to be made each day.

Staff Schedules and Computer-Based Scheduling

Scheduling is useful for employee staffing in service companies, too, including restaurants, hotels, and transportation and landscaping companies. Staff schedules, in general, specify assigned working times in upcoming days, perhaps for as many as 30 days or more, for each employee on each work shift. Staff schedules consider employees' needs and the company's efficiency and costs, including the ebb and flow of demand for production.

Computer-based scheduling, using tools such as the ABS Visual Staff Scheduler PRO (VSS Pro) software, can easily handle multi-shift activities for many employees, both full-time and part-time employees. It accommodates vacation times, holiday adjustments, and daily adjustments in staffing for unplanned absences and changes in production schedules.

GANTT CHART Scheduling tool that diagrams steps to be performed and specifies the time required to complete each step.

PERT CHART Production schedule specifying the sequence and critical path for performing the steps in a project.

Project Scheduling

Special projects, such as plant renovations or relocations, often require close coordination and precise timing. In these cases, special tools, such as Gantt and PERT charts, facilitate scheduling.

Gantt Charts

A **Gantt chart** diagrams steps to be performed and specifies the time required to complete each step. The manager lists all activities needed to complete the work, estimates the time required for each step, and checks the progress of the project against the chart. If the project is ahead of schedule, some workers may be shifted to another project. If it is behind schedule, workers may be added or completion delayed.[13]

Figure 10.9 shows a Gantt chart for the renovation of a college classroom. It shows progress to date and schedules for the remaining work. The current date is 5/11. Note that workers are about half a week behind in removing old floor tiles and reworking tables and chairs.

PERT Charts

The *program evaluation and review technique (PERT)* is useful for customized projects in which numerous activities must be coordinated. Like Gantt charts, **PERT charts** break down large projects into steps and specify the time required to perform each. Unlike Gantt charts, however, PERT charts not only show the necessary sequence of activities but also identify the critical path for meeting project goals.[14] Figure 10.10 shows a PERT chart for the classroom renovation reviewed above. The critical path consists of activities A, B,

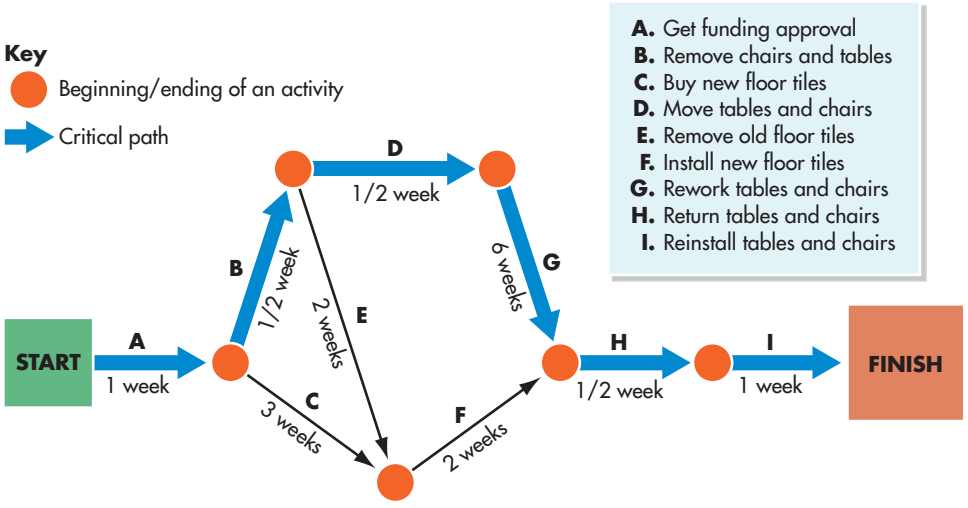


FIGURE 10.10 A PERT chart

D, G, H, and I. It is critical because any delay in completing any activity will cause workers to miss the completion deadline (nine and a half weeks after start-up). No activity along the critical path can be started until all preceding activities are done. Chairs and tables can't be returned to the classroom (H) until after they've been reworked (G) and after new tiles are installed (F). The chart also identifies activities that will cause delays unless special action is taken at the right time. By reassigning workers and equipment, managers can speed up potentially late activities and keep on schedule.

OPERATIONS CONTROL

Operations control requires production managers to monitor production performance by comparing results with detailed plans and schedules. If schedules or quality standards are not met, these managers must take corrective action. *Follow-up*—checking to ensure that production decisions are being implemented—is an essential and ongoing facet of operations control. Operations control also involves *materials management* and *production process control*. Both activities ensure that schedules are met and that production goals are fulfilled, both in quantity and in quality.

Materials Management

Materials management involves planning, organizing, and controlling the flow of materials. Even before production starts, materials management focuses on product design by emphasizing materials *standardization*—the use, where possible, of standard and uniform components, rather than new or different components. Standardization simplifies paperwork, reduces storage requirements, eliminates unnecessary material flows, and saves money, by reducing the number of different parts that are needed.

Materials Management for Physical Goods

The five major areas of materials management for physical goods are as follows:

- *Transportation.* Includes the means of transporting resources to the company and finished goods to buyers.
- *Warehousing.* Storage of both incoming materials for production and finished goods for physical distribution to customers.
- *Inventory control.* Includes the receiving, storing, handling, and counting of all raw materials, partly finished goods, and finished goods. It ensures that enough material inventories are available to meet production schedules.
- *Supplier selection.* Finding and choosing suppliers of services and materials to buy from. It includes evaluating potential suppliers, negotiating terms of service, and maintaining positive buyer–seller relations.
- *Purchasing.* Acquisition of all the raw materials and services a company needs to produce its products. Most large firms have purchasing departments to buy proper materials in the amounts needed.

Managers must take timing into consideration when managing materials. **Lean production systems** are designed for smooth production flows that avoid inefficiencies, eliminate unnecessary inventories, and continuously improve production processes. **Just-in-time (JIT) production systems** are one type of lean production that brings together all the needed materials and parts at the precise moment they are required for each production stage, and not before. JIT reduces inventory of goods in process to practically nothing and saves money by replacing stop-and-go production with smooth movement. Sobeys, for example, has invested in more efficient inventory management that has allowed it to reduce the size of storage rooms by 10 percent, because products now move more quickly to the shelves.[15]

Nathan Denette/CP Images

Just-in-time (JIT) production, a type of lean manufacturing, is used at this plant to bring together all needed materials at the precise moment they are required for each stage in the production process.

Materials Management for Services

Material management is also important for service providers. A low-contact service provider such as UPS delivers 18 million packages every day and promises that all of them will arrive on schedule. It keeps this promise by tracking the locations, schedules, and on-time performance of 542 aircraft and more than 100 000 vehicles. The most important "inventory" for many high-contact services is not physical goods, but information about service product offerings and clients, their interests, their needs, their activities, and even their plans for interactions with other clients.

Production Process Control

Companies use various tools for process control, including *worker training, material requirements planning*, and *quality control*.

OPERATIONS CONTROL Managers monitor production performance by comparing results with plans and schedules.

MATERIALS MANAGEMENT Planning, organizing, and controlling the flow of materials from purchase through distribution of finished goods.

LEAN MANUFACTURING PRODUCTION SYSTEMS Avoid inefficiencies by eliminating unnecessary inventories and continuously improving production processes.

JUST-IN-TIME (JIT) PRODUCTION SYSTEMS A type of lean production that brings together all the needed materials and parts at the precise moment they are required.

Worker Training

When providing services, employees are both producers and salespeople. Thus, human relations skills are vital for anyone who has contact with the public. Service employees with poor attitudes reduce sales, but the right attitude is a powerful sales tool. Disney World has a team of sweepers constantly at work picking up bits of trash as soon as they fall to the ground. When visitors have questions about directions or time, they often ask one of the sweepers. Because their responses affect visitors' overall impressions of Disney World, sweepers are trained to respond in appropriate ways. Their work is evaluated and rewarded based on strict performance appraisal standards.[16]

Material Requirements Planning

Material requirements planning (MRP) uses a **bill of materials** that is basically a "recipe" for the finished product. It specifies the necessary raw materials, the order in which they should be combined, and the quantity of each ingredient needed to make one "batch" of the product (say 2000 finished telephones). The recipe is fed into a computer that controls inventory and schedules each stage of production. The result is fewer early arrivals, less frequent stock shortages, and lower storage costs.

Manufacturing resource planning, or MRP II, is an advanced version of MRP that ties together all parts of the organization into the company's production activities. For example, MRP inventory and production schedules are translated into cost requirements for the financial management department and personnel requirements for the human resources department. Information on capacity availability for new customer orders goes to the marketing department.

Quality Control

Quality control refers to the management of the production process so as to manufacture goods or supply services that meet specific quality standards. McDonald's, for example, is a pioneer in quality control in the restaurant industry. The company oversees everything from the farming of potatoes for french fries to the packing of meat for Big Macs. Quality-assurance staffers even check standards for ketchup sweetness and french-fry length. Quality control is discussed in detail in the following section.

MATERIAL REQUIREMENTS PLANNING (MRP) A method of inventory control in which a computerized bill of materials is used to estimate production needs so that resources are acquired and put into production only as needed.

BILL OF MATERIALS Production-control tool that specifies the necessary ingredients of a product, the order in which they should be combined, and how many of each are needed to make one batch.

MANUFACTURING RESOURCE PLANNING (MRP II) An advanced version of MRP that ties together all parts of the organization into the company's production activities.

QUALITY CONTROL The management of the production process so as to manufacture goods or supply services that meet specific quality standards.

LO-5 THE PRODUCTIVITY–QUALITY CONNECTION

As noted in Chapter 2, productivity measures how much is produced relative to the resources used to produce it. By using resources more efficiently, the quantity of output will be greater for a given amount of input. But unless the resulting goods and services are of satisfactory quality, consumers will not want them. **Quality** means fitness for use—offering features that consumers want. We will look at quality in a moment, but let's first examine the concept of productivity.

Newscom

Workers at this call centre in Bangalore, India, field calls from the customers of multinational firms headquartered in North America and Europe. Many jobs are outsourced to service suppliers in India because workers there receive less than their North American counterparts. This translates into higher productivity because costs are lower for a given level of output.

Meeting the Productivity Challenge

A country that uses its resources efficiently can increase the wealth of all its inhabitants. Conversely, a decline in productivity shrinks a nation's total wealth. Additional wealth from higher productivity can be shared among workers (as higher wages), investors (as higher profits), and customers (as stable or declining prices).

Measuring Productivity

How do we know how productive a country is? Most countries use **labour productivity**, which compares the amount of labour used with the benefits (the country's GDP) that results from using that resource. Labour productivity is computed by using the following formula:

$$\text{Labour productivity} = \frac{\text{GDP for the year}}{\text{Total number of labour hours worked for the year}}$$

QUALITY A product's fitness for use in terms of offering the features that consumers want.

LABOUR PRODUCTIVITY Partial productivity ratio calculated by dividing gross domestic product by total number of workers.

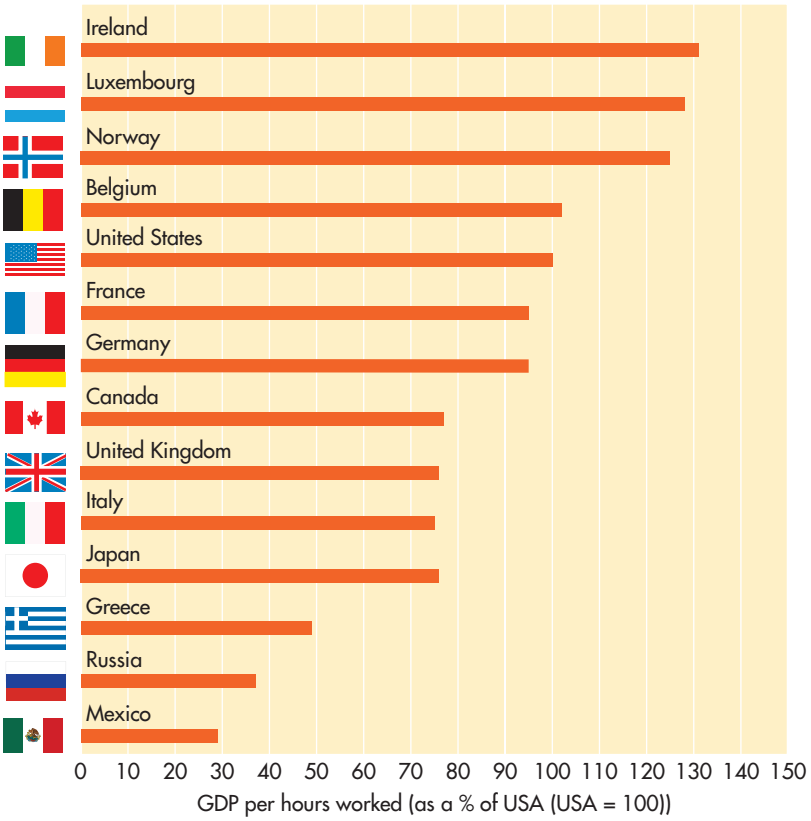


FIGURE 10.11 **Productivity of output per hour worked** (selected countries, 2016)

Source: Data from Organisation for Economic Co-operation and Development (OECD)

Productivity Among Global Competitors

A nation's productivity determines how large a piece of the global economic-resource pie it gets. A country whose productivity fails to increase as rapidly as that of other countries will see its people's standard of living fall relative to the rest of the world. The Organisation for Economic Co-operation and Development (OECD) reported on 2016 productivity levels in various countries (see Figure 10.11).[17] For example, Canadian productivity was $49.00 per hour worked by the Canadian workforce. The productivity of U.S. workers was substantially higher than Canadian productivity ($63.30), but productivity in Ireland was even higher ($83.10).

Why do such productivity differences exist across nations? There are many reasons: differences in technologies, human skills, economic policies, natural resources, and even traditions. In Japan, for example, the food production industry is fragmented and highly protected and, compared with Canadian and U.S. food production, extremely inefficient (the average U.S. worker produces 3.5 times as much food as a Japanese worker).[18]

Manufacturing versus Service Productivity

Manufacturing productivity is higher than service productivity. It is important to improve service productivity because the service sector is an important and growing part of the Canadian economy. For many years, it was believed that the service sector suffered from "Baumol's disease" (named after economist William Baumol); the idea is that since the service sector focuses more on hands-on activity that machines can't replace, it will be more difficult to increase productivity in services. But the Opera Company of Brooklyn is challenging that notion. It now puts on the opera *The Marriage of Figaro* with only 12 musicians and a technician who oversees a computer program that plays all the other parts. The orchestra's productivity has increased sharply because it does not have to pay for the usual complement of musicians.[19]

Industry Productivity

Productivity varies across industries, and within any given industry, it also varies across countries (e.g., Canadian agriculture is more productive than agriculture in many other nations because we use more sophisticated technology and possess superior natural resources). The productivity of many industries has increased over time. In the steel industry, for example, about 10 hours of labour were required to produce a tonne of steel in the 1980s, but now only about four hours of labour are needed. In forestry, Canfor Corporation developed a strategic planning tool called Genus to manage its forestry operations, using it to determine how the company should adjust its logging plans to reflect market demand.[20]

Company Productivity

The productivity of individual companies is important to investors, workers, and managers. High productivity gives a company a competitive edge because its costs are lower. As a result, it can offer its product at a lower price (and gain more customers), or it can make a greater profit on each item sold. Some companies have found they can increase their productivity by monitoring employee interactions.

MEETING THE QUALITY CHALLENGE

It is not enough for a company to be highly productive. It must also create products and services that have the level of quality consumers want. Consider just one example. In 2014, automobile companies had to recall millions of vehicles because airbags made by Takata Corp. sometimes exploded and killed or injured drivers and their passengers.[21]

The importance of quality was recognized many years ago by American business consultant W. Edwards Deming. In the decades after World War II, he tried to persuade U.S. firms that they needed to improve the quality of their products. Like many prophets, he was not honoured in his homeland. But his arguments won over the Japanese. Through years of meticulous hard work, Japan's manufacturers changed "Made in Japan" from a synonym for cheap, shoddy merchandise into a hallmark of reliability (although recent problems in several Japanese manufacturing firms have been inconsistent with that reputation, as described in Business Case 10).

Quality advocates such as Joseph Juran and Kaoru Ishikawa introduced methods and tools for improving quality. Ishikawa, for example, developed "fishbone diagrams" (also known as "cause-and-effect

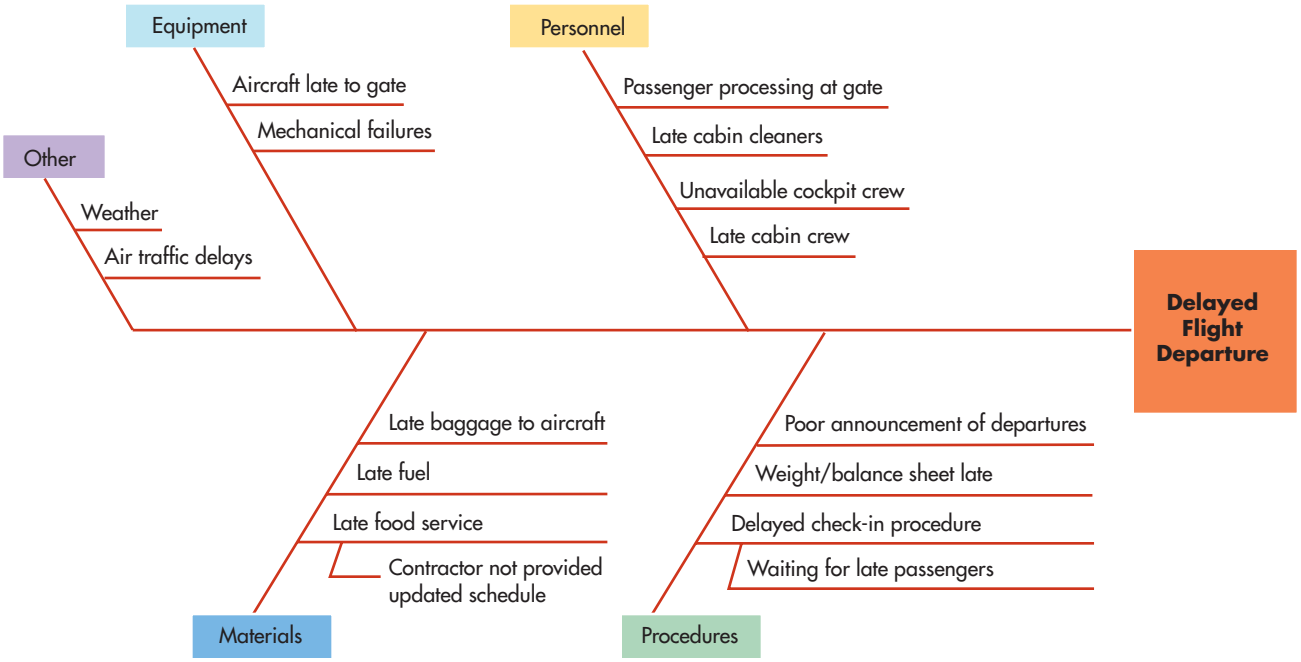


FIGURE 10.12 "Fishbone" or "cause-and-effect" diagram

diagrams" or "Ishikawa diagrams") that help employees figure out the causes of quality problems in their work areas. The diagram in Figure 10.12, for instance, was developed to help an airport manager find out why the facility had so many delayed departures. Focusing on five major categories of possible causes, the manager then noted several possible causes of the problem in each category. It turned out there weren't enough tow trucks to handle baggage transfers.[22]

LO-6 Managing for Quality

Total quality management (TQM) includes all the activities necessary for getting high-quality goods and services into the marketplace. TQM emphasizes that no defects are tolerable and that employees are responsible for maintaining quality standards. For example, at Toyota's Cambridge, Ontario, plant, workers can push a button or pull a rope to stop the production line when something is not up to standard.[23]

A customer focus is the starting point for TQM. It includes using methods for determining what customers want and then making sure that all the company's activities and people are focused on fulfilling those needs. Total participation is critical; if all employees are not working toward improved quality, the firm is wasting potential contributions from its human resources and is missing a chance to become a stronger competitor in the marketplace. TQM in today's competitive markets demands continuous improvement of products; after-sales service; and all of the company's internal processes, such as accounting, delivery, billing, and information flow.

Consider the example of Standard Aero in Winnipeg, which is in the business of aircraft overhaul. When the company instituted TQM, the process began with the formation of a "change council" consisting of the CEO and five senior managers. Next, a nine-person task force was formed that consisted of employees who had done the full range of jobs on one of Standard's major overhaul contracts. The task force's first job was to find out what the customer wanted. It did so by designing a questionnaire and visiting customer plants around the world to gather information. It also worked within Standard Aero to determine exactly how the company did its aircraft overhaul work. After weeks of analysis, the task force was able to reduce the time required for overhaul work significantly. The number of times a certain gearbox was handled as it moved through the repair process, for example, was reduced by 84 percent.[24]

These quality control inspectors are checking finished goods to make sure that they meet or exceed the standards that are required by their customers.

Michael jung/Fotolia

TOTAL QUALITY MANAGEMENT (TQM) A concept that emphasizes that no defects are tolerable and that all employees are responsible for maintaining quality standards.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. GanttMan APP **Source:** Martin Doudera **Key Features:** A project scheduling and management tool that allows you to create new or edit existing projects anywhere.	Android, Windows
2. Productivity Wizard APP **Source:** Success Wizard Inc. **Key Features:** A powerful tool to help you plan and create results.	Apple
3. PERT Estimator APP **Source:** Burriss Consulting Group LLC **Key Features:** Takes the best, worst, and most likely estimates along with the hourly cost to provide an accurate estimate for a given task.	Android

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" operations management apps and identify the key features.

Planning for Quality

Planning for quality should begin before products are designed or redesigned. **Performance quality** refers to the features of a product and how well it performs. For buyers of Godiva premium chocolates, performance quality includes sensory delights such as aroma, flavour, colour, and texture. Superior performance quality helps Godiva remain one of the world's top brands.

Quality reliability refers to the consistency or repeatability of performance. At Marriott Hotels, for example, consistency is achieved by maintaining the same features at all of Marriott's nearly 700 locations (high-speed Internet access, meeting space, access to an exercise room and swimming pool, and 24-hour access to food).

Organizing for Quality

Having a separate "quality control" department is no longer enough. Everyone, from the chair of the board to the part-time clerk, must work to assure quality. At Germany's Messerschmitt-Bölkow-Blohm aerospace company, for example, all employees are responsible for inspecting their own work. The goal is to minimize problems by making the product correctly from the beginning.

Leading for Quality

Leading for quality means that managers must inspire and motivate employees throughout the company to achieve quality goals. They need to help employees see how they affect quality and how quality affects their jobs and their company. If managers succeed, employees will ultimately accept **quality ownership**—the idea that quality belongs to each person who creates or destroys it while performing a job.

Controlling for Quality

By closely monitoring its products and services, a company can detect mistakes and make corrections. To do so, however, managers must first establish specific quality standards and measurements. Sometimes, companies that have had high-quality standards in the past fail to maintain good quality control. At Kobe Steel, one factory manager said that quality-checking workers were laid off because they didn't seem to be as busy as production line workers. That meant that production line workers had to do quality checking, and many of them weren't qualified to do that work, and sometimes they falsified data regarding quality.[25] The company acknowledged that quality control was not up to its usual standard.

Tools for Quality Assurance

Many tools exist for achieving the desired level of quality: *competitive product analysis, value-added analysis, statistical process control, quality/cost studies, quality improvement teams, benchmarking, getting closer to the customer, the ISO series, re-engineering*, and *adding value through supply chains*.

Competitive Product Analysis

Ideas for improving both the product and the production process may come from **competitive product analysis**. For example, Toshiba will take apart a Xerox photocopier and test each component to see how it compares with its own competing product. It can then decide which of its own product features are satisfactory, which need to be upgraded, and whether production processes need improvement.

Value-Added Analysis

Value-added analysis means evaluating all work activities, material flows, and paperwork to determine the value that they add for customers. Value-added analysis often reveals wasteful or unnecessary activities that can be eliminated without harming customer service. For example, when Hewlett-Packard reduced its customer contracts from 20 pages to as few as two, computer sales rose by more than 18 percent.

Statistical Process Control

Companies can improve uniformity in their outputs by understanding the sources of variation. **Statistical process control (SPC)** methods—especially process variation studies and control charts—allow managers to analyze variations in production data.

PERFORMANCE QUALITY The overall degree of quality; how well the features of a product meet consumers' needs and how well the product performs.

QUALITY RELIABILITY The consistency of quality from unit to unit of a product.

QUALITY OWNERSHIP The concept that quality belongs to each employee who creates or destroys it in producing a good or service; the idea that all workers must take responsibility for producing a quality product.

COMPETITIVE PRODUCT ANALYSIS Process by which a company analyzes a competitor's products to identify desirable improvements.

VALUE-ADDED ANALYSIS The evaluation of all work activities, material flows, and paperwork to determine the value they add for customers.

STATISTICAL PROCESS CONTROL (SPC) Statistical analysis techniques that allow managers to analyze variations in production data and to detect when adjustments are needed to create products with high-quality reliability.

Process Variation While some amount of *process variation* is acceptable, too much can result in poor quality and excessive operating costs. Consider the box-filling operation for Honey Nuggets cereal. Each automated machine fills two 400-gram boxes per second. Even under proper conditions, slight variations in cereal weight from box to box are normal. Equipment and tools wear out, the cereal may be overly moist, and machinists make occasional adjustments. But how much variation is occurring? How much is acceptable?

Information about variation in a process can be obtained from a process capability study. Boxes are taken from the filling machines and weighed. The results are plotted, as in Figure 10.13, and compared with the upper and lower specification limits (quality limits) for weight. These limits define good and bad quality for box filling. Boxes with more than 410 grams are a wasteful "giveaway." Underfilling has a cost because it is unlawful.

In Figure 10.13, we see that none of Machine A's output violates the quality limits, and it is fully capable of meeting the company's quality standards. But Machines B and C have problems and cannot reliably meet Honey Nuggets' quality standards. The company has to take special—and costly—actions to sort the good boxes from the bad before releasing the cereal for shipment.

Control Charts Knowing a process is capable of meeting quality standards is not enough. Managers still have to monitor the process to keep it from going astray. To detect the beginning of bad conditions, managers can check production periodically and plot the results on a **control chart**. For example, several times a day, a machine operator at Honey Nuggets might weigh several boxes together to ascertain the average weight.

Quality/Cost Studies for Quality Improvement

Quality/cost studies identify a firm's current costs and also reveal areas with the largest cost-saving potential.[26] For example, Honey Nuggets must determine its costs for *internal failures*. These are expenses—including the costs of overfilling boxes and the costs of sorting out bad boxes—that are incurred during production and before a bad product leaves the plant. *External failures* occur when bad boxes get out of the factory and reach the customer. The costs of correcting them—refunds to customers, transportation costs to return bad boxes to the factory, possible lawsuits, factory recalls—are also tabulated in a quality/cost study.

Quality Improvement Teams

Quality improvement (QI) teams are groups of employees from various work areas who meet regularly to define, analyze, and solve common production problems. Their goal is to improve both their own work methods and the products they make.[27] Many QI teams organize their own work, select leaders, and address problems in the workplace. Motorola, for example, sponsors company-wide team competitions to emphasize the value of the team approach, to recognize outstanding team performance, and to reaffirm the team's role in the company's continuous-improvement culture. Teams get higher marks for dealing with projects closely tied to Motorola's key initiatives.[28]

Benchmarking

With **benchmarking**, a company compares its current performance against its own past performance (internal benchmarking) or against the

CONTROL CHART A statistical process control method in which results of test sampling of a product are plotted on a diagram that reveals when the process is beginning to depart from normal operating conditions.

QUALITY/COST STUDIES A method of improving product quality by assessing a firm's current quality-related costs and identifying areas with the greatest cost-saving potential.

BENCHMARKING Comparing the quality of the firm's output with the quality of the output of the industry's leaders.

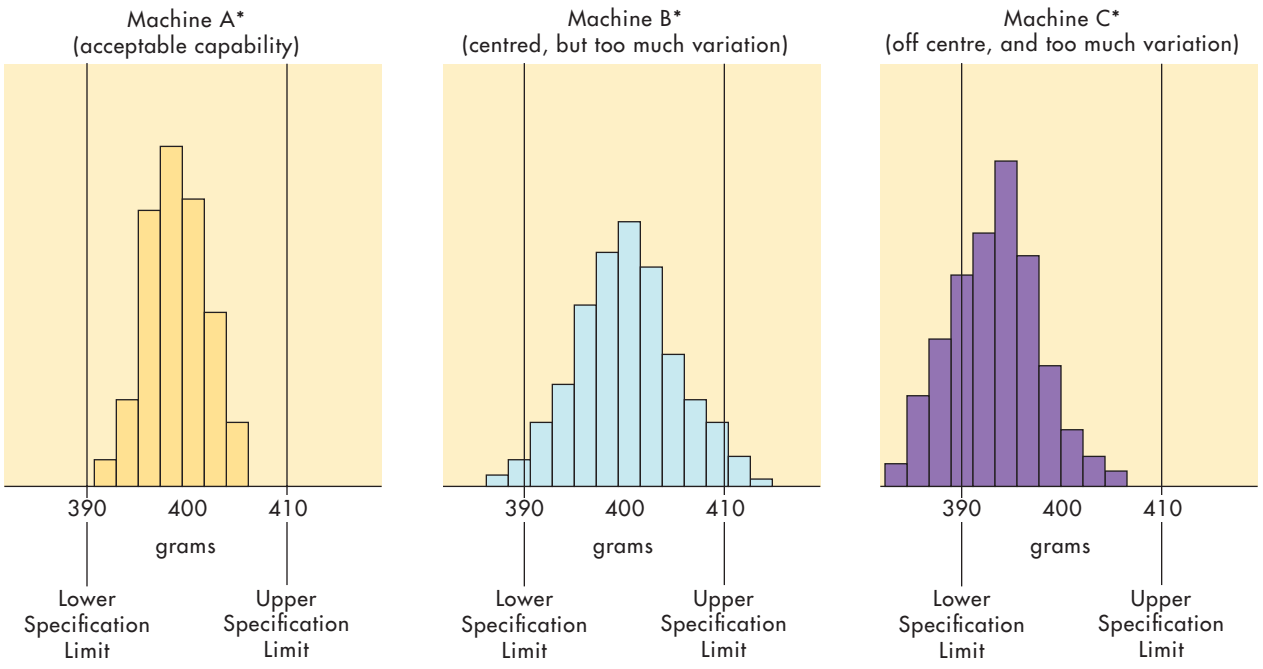


FIGURE 10.13 Process variation in box filling for Honey Nuggets cereal

performance of its competitors (external benchmarking). As an example of the former, the percentage of customer phone calls last month requiring more than two minutes of response time may be compared to the required response time the month before that. As an example of the latter, Toronto Hospital gathered performance data on 26 indicators from various Canadian hospitals so that it could determine how well it was performing compared to other organizations in the healthcare industry.[29]

At its Small Business Week event in 2016, the Business Development Bank of Canada introduced its free online business productivity benchmarking tool, which businesses can use to compare themselves to 60 000 other companies based on five key indicators.[30]

Getting Closer to the Customer

Successful businesses take steps to know what their customers want in the products or services they buy. For example, the Coast Capital Savings Credit Union branch in Surrey, British Columbia, simplified the banking experience of its customers and developed an innovative new service called "You're the Boss Mortgage," which was named Mortgage of the Year by CanadianMortgageTrends.com.[31]

The ISO Series

Perhaps, you've driven past companies that display banners saying "This Facility Is ISO Certified." **ISO 9000** is a certification program attesting to the fact that a factory, a laboratory, or an office has met the rigorous quality-management requirements set by the International Organization for Standardization. More than 170 countries have adopted ISO 9000 as a national standard, and more than one million certificates have been issued to organizations worldwide that meet ISO standards. To get certified, companies must document the procedures followed by workers during every stage of production. The purpose is to ensure that a manufacturer's product is exactly the same today as it was yesterday and as it will be tomorrow. Ideally, standardized processes would ensure goods are produced at the same level of quality, even if all employees were replaced by a new set of workers.

The **ISO 14000** program certifies improvements in environmental performance by requiring a firm to develop an environmental management system, which is a plan documenting how the company has acted to improve its performance in using resources (such as raw materials) and in managing pollution. A company must not only identify hazardous wastes that it expects to create but also stipulate plans for treatment and disposal.

Business Process Re-Engineering

Business process re-engineering is the fundamental rethinking and radical redesign of business processes to achieve dramatic improvements as measured by cost, quality, service, and speed.[32] It requires rethinking of each of the steps in a process, starting from scratch. For example, when Caterpillar Financial Services changed to an online system for customers, it re-engineered the entire payments and financing process by improving equipment, retraining employees, and connecting customers to its databases.[33]

LO-7 Adding Value Through Supply Chains

Companies usually belong to a network of firms that must coordinate their activities. As each firm performs its transformation processes, it relies on others in the network. A **supply chain** (or **value chain**) for any product is the flow of information, materials, and services that starts with raw-material suppliers and continues by adding value through other stages in the network of firms until the product reaches the end customer.[34]

Figure 10.14 shows the supply-chain activities that are involved in supplying baked goods to consumers. Each stage adds value for the final

ISO 9000 Certification program attesting to the fact that a factory, a laboratory, or an office has met the rigorous quality management requirements set by the International Organization for Standardization.

ISO 14000 A program that certifies improvements in environmental performance.

BUSINESS PROCESS RE-ENGINEERING Redesigning of business processes to improve performance, quality, and productivity.

SUPPLY CHAIN (VALUE CHAIN) Flow of information, materials, and services that starts with raw-material suppliers and continues through other stages in the operations process until the product reaches the end customer.

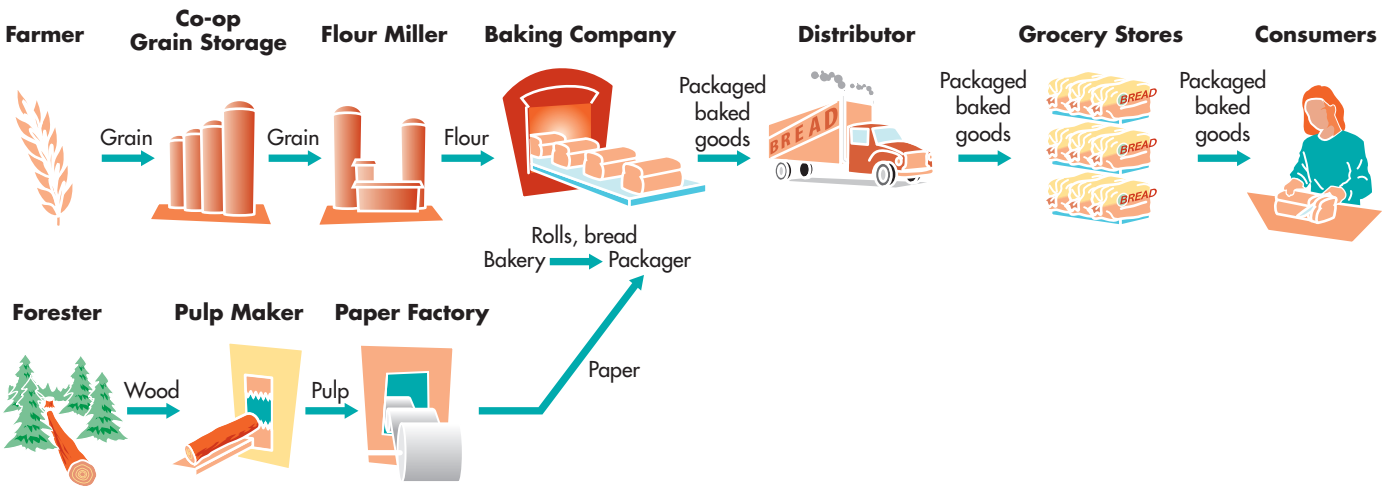


FIGURE 10.14 Supply chain for baked goods

customer, and each stage depends on the others for success in getting fresh-baked goods to consumers. A traditionally managed bakery would focus simply on getting production inputs from flour millers and paper suppliers and supplying baked goods to distributors. But that approach limits the bakery's performance and doesn't allow for possible improvements by more carefully coordinating activities.

Supply-chain management (SCM) improves the overall flow through a system composed of companies working together. The smooth flow of accurate information and products through the chain reduces unwanted inventories, avoids delays, and cuts supply times. Overall, SCM means faster deliveries and lower costs than customers would get if each member acted only according to its operations requirements. Because customers ultimately get better value, SCM creates a competitive advantage for each supply-chain member.[35] Supply-chain management can improve performance and, as a result, provide higher quality at lower prices.

Walmart's director of operations support says that variability is the No. 1 killer of the supply chain. To reduce variability, Walmart introduced stringent new rules in 2017, which included fines for suppliers who deliver products late (*or* early). Fines are also levied if shipments are on time but not properly packed.[36]

Ottawa-based Kinaxis has developed a system that helps companies solve their supply-chain problems. The company's RapidResponse system runs on cloud-based software that gives users the ability to look at their suppliers' data and identify bottlenecks in the supply chain. It also allows users to answer important questions like, "Can our supply chain handle a new order"? and "How will a new order affect our other commitments"? RapidResponse provides the answer to questions like these in minutes. The system can cut lead times by 50 percent and reduce rush orders by 83 percent.[37]

The boxed insert entitled "Too Good to Waste" explains how effective supply chains can reduce food waste.

Supply-chain management is also important for services. As mentioned in Chapter 6, Port Metro Vancouver developed a supply-chain

SUPPLY-CHAIN MANAGEMENT (SCM) Principle of looking at the chain as a whole to improve the overall flow through the system.

THE GREENING OF BUSINESS

Too Good to Waste

In 2013, the United Nations Food and Agriculture Organization (FAO) released a report on the impact of food waste. Among its more disturbing findings was that approximately one-third of all food that is produced is wasted or lost. The FAO Director-General noted that 870 million people go hungry every day, so the nations of the world cannot allow one-third of all the food that is produced to go to waste or be lost because of inappropriate practices. According to the UN study, food waste occurs all along the supply chain, with 54 percent occurring during production, post-harvest handling, and storage. Downstream waste at the retail and consumer level is much higher in the developed economies of the world, so opportunities exist in those countries for consumer education on reducing food waste.

Kaliantye/123RF

Beyond the problem of people starving because food is wasted, there are dire environmental consequences. Meat wastage has the most severe environmental consequences because the land use and carbon footprint associated with meat production is much higher than for other types of food. But other areas are not without problems. Unused grain and cereal products also impact both land use and methane emissions (which are particularly high in rice production). The impact of fruit waste tends to be primarily associated with excess water consumption. Given the increasing scarcity of water supplies, this is also a concern.

Some efforts are being made to reduce food waste. In France, a law was passed that bans retailers from throwing out products that are still edible. In Canada, the Greater Vancouver Food Bank (GVFB) gets "seconds" of certain agricultural commodities such as tomatoes directly from producers. These commodities would normally turn up in landfills because retailers would judge them to be unsaleable (even though they are perfectly safe to eat). At GVFB, Chef Karen Barnaby uses overripe or bruised tomatoes to make tasty tomato soup.

The key to minimizing food waste lies in effective supply-chain management. Beginning with the producer, it is essential that production is balanced with downstream demand for products. Rather than disposing of excess food in the supply chain, intermediaries need to be more diligent about finding alternative uses, whether it is donating the surplus to food banks or diverting it for livestock feed. Consumers must also be educated about the importance of planning their food spending to avoid over-purchasing, as well as the actual meaning of "best-before" dates. Each member of the supply chain, from producer to consumer, has a role to play in reducing food waste and becoming a better steward of our planet and its resources.

CRITICAL THINKING QUESTION

1. Consider the following statement: *"It is difficult to reduce the problem of food waste because consumers demand all sorts of food items that cannot be grown in their local area. This means that international supply chains are necessary, but these supply chains are complex and food waste during processing and distribution is inevitable."* Do you agree or disagree with the statement? Explain your reasoning.

strategy that reduced container "dwell time"—the time containers sit on the dock—from 3.7 days to 2.5 days after managers determined that the port had to become more competitive with American ports. This reduction also improved the port's relationships with operators such as Canadian National Railway and Canadian Pacific Railway Ltd.[38] Supply chains are also becoming increasingly global. For example, an architect from Malaysia might sketch out a new office tower for the city of London, an architect from the Philippines might do the detailed renderings, and an engineer from China might assess the structural soundness of the building.[39]

Supply-Chain Disruption Supply chains can be disrupted by natural disasters and shortages of parts. During the frigid Canadian winter of 2013–2014, transporting goods became more difficult. Many companies therefore stockpiled inventories in the fall of 2014 so they could keep their operations going if the weather was also bad during the winter of 2014–2015.[40] The devastating earthquake and tsunami that struck northeastern Japan in 2011 disrupted the production of automobiles, automobile parts, and electronic components such as flash memory and dynamic random-access memory for computing devices and smartphones. Also, the Bombardier factory in Thunder Bay had to lay off about 50 workers because it could not get enough parts to manufacture streetcars for the city of Toronto.[41]

SUMMARY OF

LEARNING OBJECTIVES

LO-1 EXPLAIN THE MEANING OF THE TERM *PRODUCTION* (OR *OPERATIONS*) AND DESCRIBE THE FOUR KINDS OF *UTILITY* IT PROVIDES.

Production (or *operations*) refers to the processes and activities for transforming resources into finished services and goods for customers. Production creates *time utility* (products are available when customers want them), *place utility* (products are available where they are convenient for customers), *ownership utility* (customers benefit from possessing and using the product), and *form utility* (products are in a form that is useful to the customer).

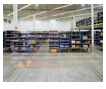
LO-2 IDENTIFY THE CHARACTERISTICS THAT DISTINGUISH *SERVICE OPERATIONS* FROM *GOODS PRODUCTION* AND EXPLAIN THE MAIN DIFFERENCES IN THE *SERVICE FOCUS*.

In service production, raw materials are not things but rather people, so services are performed, whereas goods are produced. Also, services are largely *intangible*, more likely than physical goods to be *customized* to meet the purchaser's needs, and more *unstorable* than most products. Because services are intangible, for instance, providers work to ensure that customers receive value in the form of pleasure, satisfaction, or a feeling of safety. Service providers also focus on the *customer–service link*, often acknowledging the customer as part of the operations process.

LO-3 DESCRIBE TWO TYPES OF *OPERATIONS PROCESSES*.

In manufacturing, *analytic processes* break down resources into component parts, and *synthetic processes* combine raw materials to produce a finished product. Services use either *high-contact processes* (the customer is in the system while the service is being performed) or *low-contact processes* (the customer is not in the system while the service is being performed).

LO-4 DESCRIBE THE FACTORS INVOLVED IN *OPERATIONS PLANNING* AND *OPERATIONS CONTROL*.



Operations planning involves *forecasting* (determining future demand for products), *capacity planning* (calculating how much of a product can be produced), *location planning* (analyzing proposed facility sites), *layout planning* (designing a facility to enhance production efficiency), *quality planning* (ensuring that products meet a firm's quality standards), and *methods planning* (identifying specific production steps and methods for performing them). *Operations control* requires production managers to monitor production performance (by comparing results with detailed plans and schedules) and then to take corrective action as needed. *Materials management* involves the planning, organizing, and controlling of the flow of materials. There are several tools for helping managers control operations processes, including *worker training programs, just-in-time (JIT) production systems, material requirements planning (MRP)*, and *quality control*.

LO-5 EXPLAIN THE CONNECTION BETWEEN *PRODUCTIVITY* AND *QUALITY*.

Productivity is a measure of economic performance; it compares how much is produced with the resources used to produce it. *Quality* is a product's fitness for use. However, an emphasis solely on productivity or solely on quality is not enough. Profitable competition in today's business world demands high levels of both productivity and quality.

LO-6 UNDERSTAND THE CONCEPT OF *TOTAL QUALITY MANAGEMENT* AND DESCRIBE NINE TOOLS THAT COMPANIES CAN USE TO ACHIEVE IT.

Total quality management (TQM) includes all the activities necessary for getting high-quality goods and services into the marketplace. Tools that are available to managers include *value-added analysis, statistical process control methods, quality/cost studies, quality improvement teams, benchmarking, getting closer to the customer, ISO 9000, re-engineering, and supply-chain management*.

LO-7 EXPLAIN HOW A *SUPPLY-CHAIN STRATEGY* DIFFERS FROM TRADITIONAL STRATEGIES FOR COORDINATING OPERATIONS AMONG BUSINESSES.

The *supply-chain strategy* is based on the idea that members of the supply chain can gain competitive advantage by working together as a coordinated system of units. Sharing information allows companies to reduce inventories, improve quality, and speed the delivery of products to consumers.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. What are the resources needed and the finished "products" produced in the following services: real estate firm, child-care facility, bank, city water and electric department, and hotel?
2. Apply the five major categories of operations planning to your college or to a local business.
3. Pick three physical products (not services) that you use regularly. Which of the basic production processes are used to produce these products (chemical, fabrication, assembly, transport, or clerical processes)? To what extent are multiple processes used in the production of the product?
4. Pick three services (not physical products) that you use regularly. Explain what customization, unstorability, and intangibility mean for each of the services. How do these factors influence the way the service is delivered to customers?
5. Develop a service-flow analysis for some service that you use frequently, such as buying lunch at a cafeteria, having your hair cut, or riding a bus. Identify areas of potential quality or productivity failures in the process.
6. Describe three high-contact service operations and three low-contact service operations. Do the concepts of intangibility and unstorability have different implications for low- and high-contact service operations?

APPLICATION EXERCISES

7. Interview the manager of a local service business, such as a restaurant or hair salon. Identify the major decisions involved in planning the business's service operations. Determine how the factors of intangibility and unstorability affect the business.
8. Choose a product that you use regularly and trace its supply chain. Can you see areas where improvements might be made?
9. Interview a production manager in a local firm and determine which of the tools for total quality management the company is using. Also determine why the company has chosen not to use some other tools.
10. Think of an everyday activity—either personal or professional—that you would like to do more efficiently (e.g., going to work or school, enrolling in classes, or filling up your car at the gas station). Describe how you would use methods planning to achieve increased efficiency in that activity. Draw a process flowchart that shows the stages in the activity you chose, and then explain how you would use it.

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members to consider your new business venture and how it relates to the operations management and quality topics in this chapter. Develop specific responses to the following:

1. In what ways is your business connected with service operations? Identify the ways it is connected with goods production. Which of these, service operations or goods production, is more important to your business? Why?
2. Explain what must be done to ensure that your operations capabilities are consistent with your business strategy. How does your mission statement support operations? What kinds of quality control measures should you consider?
3. Discuss how your team is going to identify the key operations characteristics that best provide support for accomplishing your business strategy. Based on the discussion, what are the key characteristics that seem to be most prominent at this stage of your business's development?
4. Analyze the planned production activities for your business to determine the operations processes for which total quality management will be important.
5. In what ways, if any, will supply chains be of concern for your business? Explain.

BUILDING YOUR BUSINESS SKILLS

THE IMPACT OF EFFICIENCY

PURPOSE OF THE ASSIGNMENT

To encourage students to think critically about the idea of productivity and its effects on people and organizations.

THE SITUATION

In 1865 (yes, 1865), William Jevons published a book entitled *The Coal Question*. In it, he argued that increased efficiency in the use of coal in iron making would not lead to less consumption of coal (as most people would think), but to more consumption of coal. He gave the following example to support this seemingly counter-intuitive argument. If a technological improvement allowed more iron to be made with less coal than previously, the iron company's profits would increase, and new investment dollars would flow into the company. The company's reduced costs would allow it to reduce the price of its products. That price reduction, in turn, would cause increased demand from customers. Over time, as more and more companies efficiently produced more and more iron, the total consumption of coal needed to make all that iron would be greater than it was before the increase in efficiency occurred. The most general point that Jevons made was that increased economy in the use of fuel would actually lead to increased consumption of that fuel. This is because increasing energy efficiency really means increasing the productivity of energy. And when you increase the productivity of something, its price goes down.

In 2011, David Owen wrote a book entitled *The Conundrum* (New York, NY: Riverhead Books) that contains many examples of how Jevons' basic idea works in modern society. He notes, for example, that improving roads (i.e., making them more efficient) does not reduce traffic congestion, but makes it worse over time. Why? Because better roads attract more drivers, and this increases congestion. All the extra cars also produce a large amount of air pollution. If governments want to reduce air pollution by attracting more people to public transit, they must increase the cost of driving. That can be accomplished by providing poor (i.e., congested) roads for drivers, who will then get so fed up with driving that they will be motivated to use public transit.

ASSIGNMENT

Step 1 Get together with three other students. Assign one or two of the chapters in Owen's 2011 book to each group member (the chapters are very short). Chapters 1, 2, 6, 12, 13, 19, 20, and 21 are particularly recommended.

Step 2 Gather the group together for a discussion of the idea that increased efficiency actually results in increased use, rather than decreased use of a resource. Use the Follow-up Questions below as a starting point.

Step 3 Write a brief report summarizing your group's conclusions.

FOLLOW-UP QUESTIONS

1. Is Jevons' idea sound? Defend your answer.
2. Briefly describe several areas where Jevons' ideas apply. Are there areas where his ideas do not apply?
3. Assume for a moment that you agree with the argument that increased efficiency means more consumption rather than less. If you wanted to decrease consumption, give a specific example of the actions you would take. Also, note whether you think the actions are politically feasible.

EXERCISING YOUR ETHICS

CALCULATING THE COST OF CONSCIENCE

THE SITUATION

Product quality and cost affect every firm's reputation and profitability, as well as the satisfaction of customers. This exercise exposes you to some ethical considerations that pertain to certain cost and service decisions that must be made by operations managers.

THE DILEMMA

As director of quality for a major appliance manufacturer, Ruth was reporting to the executive committee about the results of a program for correcting problems with a newly redesigned compressor that the company had recently begun putting in its refrigerators. Following several customer complaints, the quality lab had determined that some of the new compressor units ran more loudly than expected. One option for correcting the problem was simply to wait until customers complained and then respond to each complaint if and when it occurred. Ruth, however, decided that this approach was inconsistent with the company's policy of being the high-quality leader in the industry. Insisting on a proactive, "pro-quality" approach, Ruth initiated a program for contacting all customers who had purchased refrigerators containing the new compressor.

Unfortunately, her "quality and customers first" policy was expensive. Service representatives across Canada had to phone every customer, make appointments for home visits, and replace original compressors with a newer model. Because replacement time was only 30 minutes, customers were hardly inconvenienced and food stayed refrigerated without interruption. Customer response to the replacement program was overwhelmingly favourable.

Near the end of Ruth's report, an executive vice president was overheard to comment, "Ruth's program has cost this company $400 million in service expenses." Two weeks later, Ruth was fired.

TEAM ACTIVITY

Assemble a group of four students and assign each group member one of the following roles:

- Ruth
- Ruth's boss
- Customer
- Company investor

ACTION STEPS

1. Before hearing any of your group's comments on this situation and from the perspective of your assigned role, take a moment to consider whether Ruth's firing is consistent with the company's desire for industry leadership in quality. Write down the reasons for your position.
2. Before hearing any of your group's comments on this situation and from the perspective of your assigned role, consider what underlying ethical issues, if any, exist in this situation. Write down the issues.
3. Gather your group together and reveal, in turn, each member's comments on Ruth's firing. Next, reveal the ethical issues listed by each member.
4. Appoint someone to record the main points of agreement and disagreement within the group. How do you explain the results? What accounts for any disagreement?
5. From an ethical standpoint, what does your group conclude is the most appropriate action the company could have taken in this situation?
6. Develop a group response to the following question: What are the respective roles of profits, obligations to customers, and employee considerations for the firm in this situation?

BUSINESS CASE 10

PRODUCT QUALITY PROBLEMS

During the past few years, a large number of highly publicized stories of product quality problems have appeared in the news. These quality problems are diverse and have occurred with regard to both tangible products and intangible services. In most of the stories, there is also an element of concern about consumer safety when products have quality problems.

SAMSUNG'S NOTE 7 PHONE

Samsung's Note 7 cell phone was recalled after multiple incidents where the phone burst into flames (see photo). An investigation revealed that two sets of bad batteries were the cause of the fires. After phones containing the first set of batteries experienced problems (there wasn't enough room in the phone for routine expansion of components), Samsung recalled those phones. It then re-introduced the Note 7 with different batteries. But then another problem occurred (this time there was a bad weld caused by a manufacturing defect). In both cases, the quality problem caused the phone to short-out and catch fire. Samsung eventually abandoned production of the Note 7 and recalled 2.5 million phones from the global market (22 000 were recalled in Canada) because of all the bad publicity.

MEDICAL MARIJUANA

In Canada, multiple individuals who were prescribed medical marijuana from a federally regulated drug company reported symptoms such as

Poravute Siriphiroon/Shutterstock

weight loss, skin blisters, muscles aches, and persistent coughing. An investigation determined that the medical marijuana these people were using was unfit for human consumption because it contained myclobutanil (which is used to kill mildew) and bifenazate (an insecticide whose use is prohibited for use on marijuana plants). Three other banned pesticides were also found. An investigation concluded that the insecticides had been purposely applied to reduce insect infestation on the marijuana plants.

CANADA REVENUE AGENCY

The 2017 Auditor General's report criticized the Canada Revenue Agency (CRA) for providing poor quality service to Canadians. Two major criticisms were evident. First, the report said that the CRA had blocked more than half of the 53 million incoming calls it received from people who were asking questions about their income tax returns. The blocking meant that many callers simply heard a busy signal and were told to call back at another time. The CRA had reported that 90 percent of callers were able to talk with a call-centre agent or CRA's automated self-serve system. This claim was actually technically correct, but what the CRA didn't say was that the average person had to call four times before even being admitted to the wait queue. Second, even when callers eventually did get through to an agent, they were given inaccurate answers to their questions about 30 percent of the time. This figure was much higher than the figure the CRA had reported (6.5 percent).

WOODEN RAILROAD TIES

In the United States, Norfolk Southern Corp. had to replace five million defective wooden railroad ties because the manufacturer of those ties—Boatright Railroad Products, Inc.—did not use the proper coating material (creosote), and the ties wore out prematurely. This created financial problems because the railroad incurred increased costs when it had to replace the ties. For *passenger* trains, there are both safety and service issues. Passengers may be killed or injured when a derailment occurs, and train schedules may be disrupted when ties have to be replaced unexpectedly. For *freight* trains, fires may occur when trains carrying flammable materials are derailed.

THE AUTOMOBILE INDUSTRY

Multiple instances of quality problems in the automobile industry have come to light recently. For example, in October 2017, an executive VP at Nissan expressed public remorse for widespread quality inspection failures at the company (final inspections were being done routinely by unauthorized staff). A few days later, the CEO of Subaru also apologized; he admitted that his company had been carrying out flawed inspections of cars for years. As a result of these admissions, millions of cars had to be recalled. In another instance, Mitsubishi was caught inflating fuel economy figures for its minicar models. Kobe Steel also admitted that it had falsified data on its products that are used by 500 companies worldwide. All of these situations with Japanese manufacturers are in addition to the infamous Takata Corp. airbag disaster of a few years ago when millions of vehicles had to be recalled because they were outfitted with airbags that sometimes exploded and killed or injured drivers and their passengers. Takata paid $1 billion in fines after admitting that it falsified data in airbag testing reports that were provided to automakers. These problems have tarnished Japan's legendary reputation for producing high-quality products. Problems are also evident with other automobile manufacturers in other countries. In 2017, the U.S. Supreme Court ruled that class action lawsuits against General Motors regarding a defective ignition switch could proceed. At least 124 people died after the defective switch disabled steering controls and caused fatal accidents.

THE AIRLINE INDUSTRY

Consumer unhappiness with the airline industry is often in the news. Complaints from passengers include reduced in-flight services, baggage fees, lost baggage, cramped seats, overbooked flights, and cancelled flights. All of this has led to a decline in customer satisfaction with commercial airlines. An extreme example of dissatisfaction occurred in 2017 when a United Airlines passenger was told he had to give up his seat because the flight was overbooked. When he refused, security personnel then violently removed the man from the plane. Unfortunately for United, the incident was filmed and then went viral. United settled with the passenger for an undisclosed amount of money (probably in the millions of dollars) and then publicized changes it was making to improve the quality of service that is provided to passengers. Social media has caused many airlines to staff social media departments that monitor Internet chatter for signs of public relations problems.

QUESTIONS FOR DISCUSSION

1. In the chapter, the term *quality* is defined as "fitness for use." Explain how that applies in each of the examples given in the case.
2. Most of the quality problems described in the case occurred in *tangible physical* products. Are quality problems different when *intangible services* are involved, or are they the same? When answering this question, address the issues of intangibility, customization, and unstorability as key characteristics of services. Give examples to support your conclusions about the similarities and differences in quality problems for tangible physical products and intangible services.
3. Why do you think the various quality problems described in the case occurred? Analyze several possible reasons. Is there a different reason in each situation, or is there an underlying similarity across all of the situations?
4. Consider the following statement: *"The emphasis on quality is misplaced. What consumers really want is reliable and inexpensive products. The emphasis on quality simply raises the price of products and frustrates consumers because they have to pay so much for products and services."* Do you agree or disagree with the statement? Explain your reasoning.

MyLab Intro to Business

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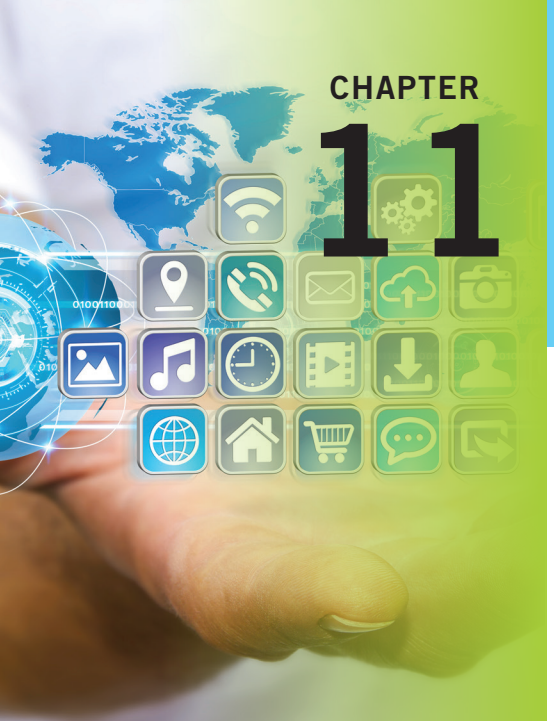
- **Videos:** Learn more about the business practices and strategies of real companies.



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CHAPTER

11

Understanding Accounting

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Explain the *role of accountants*, distinguish between the three traditional *professional accounting designations* in Canada, and understand the new unified role of the *Canadian Chartered Professional Accounting (CPA) designation.*
- **LO-2** Explain how the *accounting equation* is used.
- **LO-3** Describe three basic *financial statements* and show how they reflect the activity and financial condition of a business.
- **LO-4** Explain the key *standards* and *principles* for *reporting financial statements*.
- **LO-5** Explain how computing *financial ratios* can help in analyzing the financial strengths of a business.
- **LO-6** Discuss the role of *ethics in accounting*.
- **LO-7** Describe the *evolving role of the modern accountant*.

Future Directions for the Modern Accountant

In the future, although an accountant's knowledge of business aided by analytical and technical skills will be essential, a wider skill set will be necessary to meet market demands in this changing profession. The traditional accountant's role was centred on analyzing historical financial data, creating financial statements, and providing interpretations of financial data and documents to facilitate business decisions. The expectations for the modern CPAs increasingly call for the more intimate role of leadership in demonstrating financial implications for many additional parts of the business, including its overall operations, strategy, data management, human resources, and technical resources. In consultative roles, accountants are being asked for guidance on broad issues, including business development, evaluating strategic opportunities, assessments of risks and threats, and strategies for using massive databases to identify promising directions for developing new products, improving customer service, and evaluating new lines of business to gain competitive advantage. Beyond just technical expertise, such participation requires thorough knowledge of clients' businesses and the markets in which they operate. The following trends have emerged and are contributing to the additional roles of the modern accountant:

- *Fewer restrictions from physical and geographic boundaries*—With increasing globalization, many foreign-based firms are interacting with firms based elsewhere around the world. Coupled with modern technology, accountants and clients in other countries are working together remotely. An accountant based at company headquarters, or at a home-office in Halifax, can provide services to a client located in Saskatoon, Sao Paulo, or Singapore.

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- *Social media have changed relationships and the way business is conducted*—Modern accountants establish professional relationships through active participation through social media. No longer do CPAs rely solely on face-to-face interactions at occasional professional meetings. Social media such as LinkedIn provide platforms at your fingertips for remote interactions allowing exchanges of information, professional advice, and temporary collaborations among accountants to serve clients in need of particular skill sets. New business opportunities arise, too, when accountants use a social networking presence to establish their business reputations.
- *Effectiveness as a communicator is a must for the accountant*—Communication skills are vital in the modern accountant's role in advising clients on global business trends and strategic perspectives. The accountant's thorough knowledge, to be leveraged into meaningful advice, must be communicated to clients on time, clearly and convincingly, both verbally and in writing. Effectiveness can be critical in a variety of communications contexts, ranging from formal presentations, to interactive group meetings, to one-to-one informal conversations, either face to face or remotely.
- *Project management in the accountant's expanded role*—Serving as project manager is becoming commonplace for accountants because they provide guidance on the client's strategy, overall operations, and business development. These broad-based issues typically involve large-scale teams of specialists requiring long-term participation in activities such as financial forecasting, product and process engineering, financial interpretations, cost estimation, and human resources analysis. Success depends on the project manager's ability to divide the project into manageable tasks, gain acceptance of task assignments, encourage timely reporting by task groups, and merge the project's many steps into clearly structured conclusions.

It is evident, then, that tomorrow's accountants need to be prepared with more than just traditional skills. They need to know the nature of the client's business and its competitive environment so that they can assist the client in gaining greater competitive advantage.

QUESTIONS FOR DISCUSSION

1. In what ways, if any, does the discussion in this case apply to forensic accountants rather than to general CPAs? Explain your response.
2. Does this case change your perceptions of what skills CPAs need to become effective accountants in the modern world? Explain your answer.
3. Ethical standards are vital in the accounting profession. Will the emerging role of the modern accountant bring with it a greater emphasis on ethics (as compared with traditional accounting)? Explain. Will the emerging roles bring more challenges and potential conflicts? Explain.

HOW WILL THIS HELP ME?

For many of us, the words and ideas in accounting can seem like a foreign language, and the specialized terminology can be used to mask fraud and corruption. However, accounting terminology is a necessary tool that allows professionals in every industry to analyze growth, understand risk, and communicate detailed ideas about a firm's financial health. This chapter will cover the fundamental concepts of accounting and apply them to familiar business situations. By understanding the basic accounting vocabulary, you—as an employee, taxpayer, or owner—will be able to participate when the conversation turns to the financial matters that make up a part of a firm's daily operations.

Se media/Fotolia

WHAT IS ACCOUNTING, AND WHO USES ACCOUNTING INFORMATION?

Accounting is a comprehensive information system for collecting, analyzing, and communicating financial information. It measures business performance and translates the findings into information for management decisions. Accountants prepare performance reports for owners, the public, and regulatory agencies. To perform these functions, accountants keep records of transactions such as taxes paid, income received, and expenses incurred—a process called **bookkeeping**—and they analyze the effects of these transactions on business activities. By sorting and analyzing such transactions, accountants can determine how well a business is being managed and assess its overall financial strength.

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A simple accounting audit uncovered a theft of more than $18 million in maple syrup from the Strategic Maple Syrup Reserve.

Because businesses engage in many thousands of transactions, ensuring that financial information is consistent and dependable is mandatory. This is the job of the **accounting information system (AIS)** An organized procedure for identifying, measuring, recording, and retaining financial information so that it can be used in accounting statements and management reports. The system includes all the people, reports, computers, procedures, and resources for compiling financial transactions.[1]

Users of accounting information are numerous:

- *Business managers* use accounting information to set goals, develop plans, set budgets, and evaluate future prospects.
- *Employees and unions* use accounting information to get paid and to plan for and receive benefits such as health care, insurance, vacation time, and retirement pay.
- *Investors and creditors* use accounting information to estimate returns to stockholders and to determine a company's growth prospects and whether it is a good credit risk before investing or lending.
- *Tax authorities* use accounting information to plan for tax inflows, determine the tax liabilities of individuals and businesses, and ensure that correct amounts are paid on time.
- *Government regulatory agencies* rely on accounting information to fulfill their duties. Provincial securities regulators, for example, require firms to file financial disclosures so that potential investors have valid information about a company's financial status.

If a company does not produce accurate accounting information, all these groups may be hurt. For example, in one recent, famous example, an accountant played the role of hero by discovering that the Global Strategic Maple Syrup Reserve statements were incorrect. When he arrived at the central warehouse, all seemed fine. As you would expect, barrels were stacked far and wide. However, when he started opening the barrels to verify the assets, he quickly realized that many of the barrels were filled with water rather than maple syrup and others were empty. There was a significant difference between reality and what was registered in the books. In total, he uncovered a theft of more than $18 million worth of maple syrup. The discovery had important implications for maple syrup producers, government agencies, and customers (who ultimately may have purchased stolen products unknowingly). It took a few years but eventually three men were sentenced to jail time and fined.[2] In this case, the standard procedures completed by this accountant ensured that all the stakeholders learned the truth about the true assets of the organization.

The Sarbanes-Oxley Act (passed in the United States in 2002) required senior managers in companies to certify that their company had an effective internal control system in place. In Canada, this idea was partially adopted two years later through National Instrument 52-109.[3] Critics of this type of legislation argue that it has been very expensive to implement and has not achieved the goal of more reliable accounting information.[4]

ACCOUNTING A comprehensive system for collecting, analyzing, and communicating financial information.

BOOKKEEPING Recording accounting transactions.

ACCOUNTING INFORMATION SYSTEM (AIS) An organized procedure for identifying, measuring, recording, and retaining financial information for use in accounting statements and management reports.

A financial report is an integral component of the financial accounting system.

DamirK/iStock/Getty Images

LO-1 WHO ARE ACCOUNTANTS AND WHAT DO THEY DO?

The **controller**, or chief accounting officer, manages a firm's accounting activities by ensuring that the AIS provides the reports and statements needed for planning, decision-making, and other management activities. This range of activities requires diverse types of accounting specialists. In this section, we begin by distinguishing between the two main fields of accounting: *financial* and *managerial*. Then we discuss the distinct functions and activities of the three traditional professional accounting groups in Canada and the new, unified CPA designation.

Financial versus Managerial Accounting

In any company, the two fields of financial and managerial accounting can be distinguished by the users they serve: those outside the company and those within.[5]

Financial Accounting

A firm's **financial accounting system** is concerned with external users of information, such as consumer groups, unions, stockholders, and government agencies. Companies prepare and publish income statements and balance sheets at regular intervals, as well as other financial reports that are useful for stockholders and the general public. All of these documents focus on the activities of the company as a whole, rather than on individual departments or divisions.

Managerial Accounting

In contrast, **managerial (or management) accounting** serves internal users. Managers at all levels need information to make decisions for their departments, to monitor current projects, and to plan for future activities. Other employees also need accounting information. Engineers, for instance, want to know the costs for materials and production so they can make product operation improvements. To set performance goals, salespeople need data on past sales by geographic region. Purchasing agents use information on material costs to negotiate terms with suppliers and to set performance goals. Salespeople need historical sales data for each geographic region and for each of its products.

Professional Accountants

Over the years, three accounting organizations developed in Canada to certify accounting professionals. The three designations they created are chartered accountant (CA), certified management accountant (CMA), and certified general accountant (CGA). Next we discuss each of these and its traditional strengths and roles; however, the three organizations have now united under the banner of **chartered professional accountant (CPA)**. In fact, in 2018, there were over 210 000 CPAs in Canada.[6] We will discuss the unification as well as the transition process after a brief explanation of their three traditional roles.

Chartered Accountants

The Canadian Institute of Chartered Accountants (CICA) managed the **chartered accountant (CA)** designation (now known as **CPA**, **CA**). To achieve this designation, a person earned a university degree and then completed an educational program and passed a national exam. About half of all CAs work in CA firms that offer accounting services to the public; the other half work in government or industry. CA firms typically provide audit, tax, and management services. CAs focus on external financial reporting, that is, certifying for various interested parties (stockholders, lenders, the Canada Revenue Agency, etc.) that the financial records of a company accurately reflect the true financial condition of the firm.

Certified General Accountants

The Certified General Accountants Association of Canada managed the **certified general accountant (CGA)** designation (now known as **CPA**, **CGA**). To become a CGA, a person completed an education program and passed a national exam; to be eligible, a person also required an accounting job within a company. CGAs can audit corporate financial statements in most provinces. Most work in private companies, but there

CONTROLLER The individual who manages all the firm's accounting activities.

FINANCIAL ACCOUNTING SYSTEM The process whereby interested groups are kept informed about the financial condition of a firm.

MANAGERIAL (OR MANAGEMENT) ACCOUNTING Internal procedures that alert managers to problems and aid them in planning and decision-making.

CHARTERED PROFESSIONAL ACCOUNTANT (CPA) The banner (designation) that is being used to unify the accounting profession in Canada.

CHARTERED ACCOUNTANT (CA now referred to as **CPA, CA)** An individual who has met certain experience and education requirements and has passed a licensing examination; acts as an outside accountant for other firms.

CERTIFIED GENERAL ACCOUNTANT (CGA, now referred to as **CPA, CGA)** An individual who has completed an education program and passed a national exam; works in private industry or a CGA firm.

TABLE 11.1 Top 10 Accounting Firms in Canada[7]

	Company	Annual Revenues (millions of dollars)
1	Deloitte LLP	2008
2	KPMG LLP	1324
3	PricewaterhouseCoopers LLP	1290
4	Ernst & Young LLP	1111
5	Grant Thornton Canada	597
6	MNP LLP	597
7	BDO Canada LLP	534
8	Collins Barrow National Cooperative Inc.	213
9	Richter LLP	102
10	Mallette	72

are a few CGA firms. Some also work in CA firms. CGAs also focus on external financial reporting and emphasize the use of the computer as a management accounting tool.

Certified Management Accountants

The Society of Management Accountants of Canada managed the **certified management accountant (CMA)** designation (now known as **CPA**, **CMA**). To achieve the designation, a person required a university degree, passed a two-part national entrance examination, and completed a strategic leadership program while gaining practical experience in a management accounting environment. CMAs work in organizations of all sizes and focus on applying best management practices in all the operations of a business. CMAs bring a strong market focus to strategic management and resource deployment, synthesizing and analyzing financial and non-financial information to help organizations maintain a competitive advantage. They emphasize the role of accountants in the planning and overall strategy of the firm in which they work.

Look at the "There's an App for That!" feature, which outlines three accounting apps.

The New Rules: Transition from CA, CGA, and CMA to CPA

Students completing accounting studies now earn a CPA designation since the various bodies have approved the transition.[8] All the existing accounting professionals currently in the workforce (as well as individuals who completed their studies during the transition period) will refer to themselves as CPA, CA; CPA, CMA; CPA or CGA; CPA until November 2022. After that they can simply refer to themselves as CPAs.

The new CPA structure borrows some of the best practices from all three former organizations. It gives students a well-rounded accounting education and also permits them to specialize in another area such as strategy, auditing, finance, and tax.[9] For the most up-to-date information on the transition process, look at the following site: www.cpacanada.ca.

THERE'S AN **APP** FOR THAT!

APP DETAILS	PLATFORMS
1. QuickBooks App **Source:** Intuit **Key Features:** Allows you to manage customers, invoices, sales receipts, estimates, and small business finances.	Apple, Android, BlackBerry, Windows
2. BK Book Keeper App—Accounting, GST, Invoicing, Inventory **Source:** Just Apps Pvt. Inc. **Key Features:** Sends invoices and estimates, tracks expenses and receipts, manages inventory, and views and sends financial reports with seamless syncing across devices.	Apple, Android, Windows
3. Learn Accounting by GoLearningBus App **Source:** WAGmob **Key Features:** Provides a summary of key accounting concepts through videos, tutorials, quizzes, and flashcards.	Apple, Android, Windows

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" accounting apps and identify the key features.

Accounting Services

CPA, CAs and CPA, CGAs usually perform several accounting services for their clients. The most common of these are auditing, tax services, and management services.

Auditing

In an **audit**, accountants examine a company's AIS to ensure that it follows prescribed accounting rules (see below for the appropriate categories). An audit involves examination of receipts such as shipping documents, cancelled cheques, payroll records, and cash receipts records. In some cases, an auditor may physically check inventories, equipment, or other assets, even if it means descending 200 metres into a mine. The earlier discussion about stolen maple syrup provides some concrete evidence as to why accountants must be thorough in their evaluations of assets. At the end of an audit, the auditor will certify whether the client's financial reports comply with accounting rules.

International Accounting Standards For many years, Canadian accountants followed standard rules simply referred to as Generally Accepted Accounting Rules (GAAP), and each nation had its own version that its professional body regulated. However, in a globalized economy, users of financial information want assurances that accounting procedures are comparable from country to country. So the International Accounting Standards Board (IASB) developed **International Financial Reporting Standards (IFRS)**, a sort of "global GAAP," which is now being used by more than 140 countries.[10] Canadian companies adopted the IFRS on January 1, 2011, but a lot of work is required to determine how to present accounting information in a way that satisfies the new standards.[11] IASB financial statements require an income statement, balance sheet, and statement of cash flows, which are similar to those that have historically been developed in Canada. The transition has taken some time, and adjustments have been made to best serve the needs of clients. The CPA Canada Handbook now has various parts, including Part I for publicly accountable enterprises (IFRS) and government private enterprises; Part II **Accounting Standards for Private Enterprises (ASPE)**; Part III for not-for-profit organizations; and Part IV for pension plans.[12]

The new IASB standards have a noticeable impact on the way Canadian companies report some financial results. For example, suppose a company has a customer loyalty plan that gives customers points for purchases they make and then these points can be redeemed for free products. If a customer makes $1000 in purchases and earns points that

CERTIFIED MANAGEMENT ACCOUNTANT (CMA, now referred to as **CPA, CMA)** An individual who has completed a university degree, passed a national examination, and completed a strategic leadership program; works in industry and focuses on internal management accounting.

AUDIT An accountant's examination of a company's financial records to determine if it used proper procedures to prepare its financial reports.

INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) Standard accounting rules developed by the International Accounting Standards Board (IASB) and used by publicly accountable enterprises and private government enterprises.

ACCOUNTING STANDARD FOR PRIVATE ENTERPRISES (ASPE) Standard accounting rules that can be used by private businesses in Canada in preparing financial reports.

can be redeemed for $25 worth of merchandise, the company may have historically counted the $1000 as sales revenue and then also counted the $25 as sales revenue when the points were redeemed. But under the new IFRS, companies cannot add the $25 to the original $1000. The new rules reduce the apparent same-stores sales growth numbers for these companies.[13]

Some experts argue that IFRS gives managers too much leeway to report the figures they want, which means less protection for investors.[14] Hans Hoogervorst, chairman of the IASB, notes that a company using IASB standards can report balance sheet figures that are twice the size of those using GAAP accounting standards.[15] Which of the reports tells how well the company is doing? Such inconsistencies in reporting are unacceptable in a global economy and, accordingly, protection against them is the goal of IASB in the push to this global standard.

Detecting Fraud In recent years, there has been much publicity about the failure of auditors to detect fraud. Therefore, when audits are being conducted, **forensic accountants** may be used to track down hidden funds in business firms. Because of the increase in white-collar crime, forensic accounting is one of the fastest-growing areas in the field. Forensic accountants must be good detectives. They look behind the corporate walls instead of accepting financial records at face value. In combining investigative skills with accounting, auditing, and the instincts of a bloodhound, they assist in the investigation of business and financial issues that may have application to a court of law. Forensic accountants may be called upon by law enforcement agencies, insurance companies, law firms, and business firms. They may conduct criminal investigations of internet scams and misuse of government funds. Forensic accountants also assist business firms in tracing and recovering lost assets from employee business fraud or theft.

Fraud examiners interview high-level executives, pursue tips from employees or outsiders, and search through emails, looking for suspicious words and phrases. Accountants can earn the Certified in Financial Forensics (CFF) credential from CPA Canada. It is granted to professional accountants "that demonstrate considerable expertise in forensic accounting through a combination of knowledge, skills and experience."[16]You can get more information on the topic at the website for the Association of Certified Fraud Examiners (CFE) at www.acfe.com and from www.cpacanada.ca.

Tax Services

Tax services include helping clients not only with preparing their tax returns but also with their tax planning. Tax laws are complex, and an accountant's advice can help a business structure (or restructure) its operations and investments and save millions of dollars in taxes. To serve their clients best, of course, accountants must stay up to date on all changes in tax laws—no simple matter.

Management Consulting Services

Management consulting services range from personal financial planning to planning corporate mergers. Other services include plant layout and design, marketing studies, production scheduling, computer feasibility studies, and design and implementation of accounting systems. Some CA firms even assist in executive recruitment. Small wonder that the staffs of accounting firms include engineers, architects, mathematicians, and even psychologists.

Thanks to smartphones, financial information is now much more accessible wherever you might be located.

Pizuttipics/Fotolia

Private Accountants

Private accountants are salaried employees who deal with a company's day-to-day accounting needs. Large businesses employ specialized accountants in areas such as budgets, financial planning, internal auditing, payroll, and taxation. In a small firm, a single individual may handle all accounting tasks. The work of private accountants varies, depending on the nature of the specific business and the activities needed to make that business a success. An internal auditor at Suncor, for example, might go to an oil platform off the coast to confirm the accuracy of oil-flow metres on the offshore drilling platform. But a supervisor responsible for $200 million in monthly accounts payable to vendors and employees may travel no farther than the executive suite.

The Accounting Cycle

Private accountants use a six-step process to develop and analyze a company's financial reports (see Figure 11.1). The first step is to analyze data generated from the company's regular business operations (sales revenue, income tax payments, interest income, inventory purchases, etc.). These transactions are entered in a journal (which lists them in chronological order) and then in a ledger (which shows the increases and decreases in the various asset, liability, and equity accounts). Then the ledger amounts for each account are listed in a trial balance (which assesses the accuracy of the figures). Financial statements (balance sheet, income statement, and statement of cash flows) are then prepared. The last step in the process involves analyzing the financial statements (e.g., by using ratio analysis). Many years ago, these steps were done slowly, step by step, by hand; today computer systems help private accountants work efficiently through the six steps.

FORENSIC ACCOUNTANT Accountants who track down hidden funds in business firms.

MANAGEMENT CONSULTING SERVICES Specialized accounting services to help managers resolve a variety of problems in finance, production scheduling, and other areas.

PRIVATE ACCOUNTANT An accountant hired as a salaried employee to deal with a company's day-to-day accounting needs.

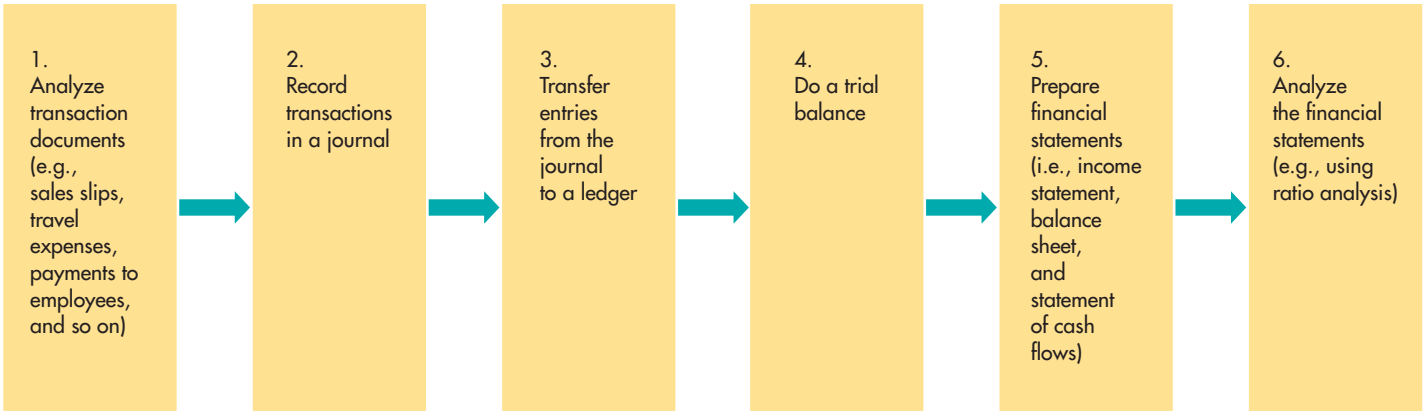

FIGURE 11.1 The accounting cycle

LO-2 THE ACCOUNTING EQUATION

All accountants, whether public or private, rely on record keeping. Underlying all record-keeping procedures is the most basic tool of accounting: the **accounting equation**. At various points in the year, accountants use the following equation to balance the data pertaining to financial transactions:

Assets = Liabilities + Owners' equity

After each transaction (e.g., payments to suppliers, sales to customers, wages to employees), the accounting equation must be in balance. To understand the importance of this equation, we must understand the terms *assets, liabilities*, and *owners' equity*.[17]

Assets and Liabilities

An **asset** is any economic resource that is expected to benefit a firm or an individual who owns it. Assets include land, buildings, equipment, inventory, and payments due to the company (accounts receivable). A **liability** is a debt that the firm owes to an outside party.

Owners' Equity

You may have heard of the equity that a homeowner has in a house—that is, the amount of money that could be made by selling the house and paying off the mortgage. Similarly, **owners' equity** is the amount of money that owners would receive if they sold all the company's assets and paid all its liabilities. We can rewrite the accounting equation to highlight this definition:

Assets − Liabilities = Owners' equity

If a company's assets exceed its liabilities, owners' equity is positive; if the company goes out of business, the owners will receive some cash (again) after selling assets and paying off liabilities. If liabilities outweigh assets, owners' equity is negative; assets are insufficient to pay off all debts. If the company goes out of business, the owners will get no cash and some creditors won't be paid. Owners' equity is meaningful for both investors and lenders. Before lending money to owners, for example, lenders want to know the amount of owners' equity in a business. Owners' equity consists of two sources of capital:

1. The amount the owners originally invested
2. Profits earned by and reinvested in the company

When a company operates profitably, its assets increase faster than its liabilities. Owners' equity, therefore, will increase if profits are retained in the business instead of paid out as dividends to shareholders. Owners' equity also increases if owners invest more of their own money to increase assets. However, owners' equity can shrink if the company operates at a loss or if owners withdraw assets.

Look at some considerations in the Entrepreneurship and New Ventures box entitled "Working with the Accounting Equation."

ACCOUNTING EQUATION Assets = Liabilities + Owners' equity; the formula used by accountants to balance data for the firm's financial transactions at various points in the year.

ASSET Anything of economic value owned by a firm or individual.

LIABILITY Any debt owed by a firm or individual to others.

OWNERS' EQUITY Any positive difference between a firm's assets and its liabilities; what would remain for a firm's owners if the company were liquidated, all its assets were sold, and all its debts were paid.

An asset is an economic resource that benefits the firm. Apple's assets include retail outlets and the inventories of Apple products that the stores keep on hand to sell to customers.

Tooykrub/Shutterstock

Working with the Accounting Equation

Dinis Tolipov/123RF

Perhaps you have heard people talking about having equity in their home. A homeowner's equity is simply the difference between what a home is worth (the market value) and the amount owed to the bank. The same could be said of a person's car. If you buy a car for $1000 and pay cash, your equity is $1000, but if you pay a $500 down payment and finance the rest, your equity is only $500. You gain equity as you pay the loan down, unless the car loses value faster than you pay the loan. Accounting is based on that equation:

Assets = Liabilities + Owners' Equity.

There's one small difference in accounting rules, though: For the most part, instead of using the market value of the asset, business accountants use the historical cost. Generally, the first step in creating a business is to establish the business entity, often by setting up a business bank account.

Suppose that you start a woodworking business by filing for a business license and depositing $10 000 into a business bank account. Your business now has $10 000 in assets, the cash that you deposited, no liabilities, and $10 000 in equity. Equity then is the value of the business to the owner—what you would receive if you discontinued operations.

Perhaps you've decided that your best opportunity to make money is to make custom wooden shutters for the windows of historic homes. But, to be able to do this work efficiently, you'll need to buy an expensive piece of equipment costing $20 000. This greatly exceeds your cash, so you take out a loan to purchase the equipment. After this transaction, your business now has two assets—$10 000 in cash and a $20 000 piece of equipment—making your total assets $30 000. On the other side of the accounting equation, you have liabilities of $20 000 and your owners' equity is $10 000, making the total liabilities and owner's equity $30 000, just the same as your total assets. Imagine that you're lucky enough to receive an order for 10 sets of custom shutters and your profit on this sale is the $20 000 sales price less your cost of $5000 for wood and other supplies. Once the shutters have been delivered and the bill has been paid, you will have $15 000 in cash, which will be added to your beginning cash balance of $10 000. Your total assets are $45 000, consisting of $25 000 in cash and $20 000 in equipment. On the other side of the equation, your liabilities have remained the same, but your equity has now increased by your profit on your first sale, increasing from $10 000 to $25 000. As a result, your total liabilities and owners' equity is $20 000 in liabilities and $25 000 in equity or $45 000—the same as your total assets.

Finally, after all your hard work, you decide to pay yourself, so you can go on a nice vacation. You withdraw $8000 cash from the business, which reduces both your cash and your equity by this amount. As a result, the accounting equation remains in balance, with total assets of $37 000 ($17 000 in cash and $20 000 in equipment) and total liabilities and owner's equity of $37 000 ($20 000 in liabilities and $17 000 in equity). As you can see, the accounting equation provides the framework around which financial information is organized.

CRITICAL THINKING QUESTION

1. In what ways do such standardized accounting rules keep companies honest and help stakeholders analyze and value companies?

LO-3 FINANCIAL STATEMENTS

If a business purchases inventory with cash, then cash decreases and inventory increases. Similarly, if the business purchases supplies on credit, then supplies increase and so do accounts payable. Because every transaction affects two accounts, *double-entry accounting systems* are used to record the dual effects of financial transactions. These transactions are reflected in three important **financial statements**: balance sheets, income statements, and statements of cash flows.[18]

Balance Sheets

Balance sheets supply detailed information about the accounting equation factors: assets, liabilities, and owners' equity. Figure 11.2 shows the balance sheet for Apple Inc. Please note that all figures quoted from the balance sheet for Apple Inc. are in millions of dollars.

Assets

As we have seen, an asset is any economic resource that a company owns and from which it can expect to derive some future benefit. Most companies have three types of assets: current, fixed, and intangible.

Current Assets **Current assets** include cash, money in the bank, and assets that can be converted into cash within a year. The act of converting something into cash is called *liquidating*. Assets are normally listed in order of **liquidity**, the ease of converting them into cash. Debts, for example, are usually paid in cash. A company that needs but cannot generate cash—a company that's not "liquid"—may be forced to sell assets at reduced prices or even to go out of business.

By definition, cash is completely liquid. *Marketable securities* purchased as short-term investments are slightly less liquid but can be sold quickly. These include stocks or bonds of other companies, government securities,

and money market certificates. Many companies hold other non-liquid assets such as *merchandise inventory*, the cost of merchandise that's been acquired for sale to customers and is still on hand, and *prepaid expenses* (supplies on hand and rent paid for the period to come). Figure 11.2 shows that Apple Inc. had current assets of $128 645 (in millions).

Fixed Assets

Fixed assets (e.g., land, buildings, and equipment) have long-term use or value. As buildings and equipment wear out or become obsolete, their value depreciates. Various methods can be used to calculate depreciation, but, in its simplest sense, **depreciation** means determining an asset's useful life in years, dividing its worth by that many years, and then subtracting the resulting amount each year. The asset's remaining value therefore decreases each year.

Intangible Assets

Although their worth is hard to set, intangible assets have monetary value. **Intangible assets** usually include the cost of obtaining rights or privileges such as patents, trademarks, copyrights, and franchise fees. **Goodwill** is the amount paid for an existing business beyond the value of its other assets. Apple Inc. had goodwill assets totalling $ 5717 (in millions) and other net intangible assets on the books totalling $ 2298 (once again in millions of dollars).

Liabilities

Current liabilities are debts that must be paid within one year. These include **accounts payable** (unpaid bills to suppliers for materials, as well as wages and taxes that must be paid in the coming year). Apple Inc. had current liabilities of $100 814 (in millions).

Long-term liabilities are debts that are not due for at least one year. These normally represent borrowed funds on which the company must pay interest. Apple Inc.'s long-term liabilities are $ 140458 (in millions).

Owners' Equity

The last section of the balance sheet in Figure 11.2 shows owners' equity broken down into *common stock*, *paid-in capital*, and *retained earnings*. Apple Inc.'s common stock and **paid-in capital** amounts to $35 867 (in millions) in the books.

Retained earnings are net profits minus dividend payments to shareholders. Retained earnings accumulate when profits, which could have been distributed to shareholders, are kept instead for use by the company. At the close of 2017, Apple Inc. had retained earnings of $98 330 (in millions).

FINANCIAL STATEMENTS Any of several types of broad reports regarding a company's financial status; most often used in reference to balance sheets, income statements, and/or statements of cash flows.

BALANCE SHEET A type of financial statement that summarizes a firm's financial position on a particular date in terms of its assets, liabilities, and owners' equity.

CURRENT ASSETS Cash and other assets that can be converted into cash within a year.

LIQUIDITY The ease and speed with which an asset can be converted to cash; cash is said to be perfectly liquid.

FIXED ASSETS Assets that have long-term use or value to the firm, such as land, buildings, and machinery.

DEPRECIATION Accounting method for distributing the cost of an asset over its useful life.

INTANGIBLE ASSETS Non-physical assets, such as a patent or trademark, that have economic value in the form of expected benefit.

GOODWILL The amount paid for an existing business beyond the value of its other assets.

CURRENT LIABILITIES Debt that must be paid within one year.

ACCOUNTS PAYABLE Amounts due from the firm to its suppliers for goods and/or services purchased on credit; a form of current liability.

LONG-TERM LIABILITIES Any debts owed by the firm that are not due for at least one year.

PAID-IN CAPITAL Any additional money invested in the firm by the owners.

RETAINED EARNINGS A company's net profits less any dividend payments to shareholders.

Apple Inc.
Summary of Balance Sheet (Condensed)
As of September 30, 2017
(in millions)

Assets

Current Assets:	
Cash	$20 289
Short-Term Marketable Securities	53 892
Accounts receivable	17 874
Inventories	4 855
Other	31 735
Total current assets	**$128 645**
Long-term marketable assets	
Long-Term Marketable Securities	194 714
Fixed assets	
Property, Plant and Equipment, net	33 783
Intangible assets:	
Goodwill	5 717
Intangible Assets, net	2 298
Other non-current assets	10 162
Total assets	**$375 319**

Liabilities and Owners' Equity

Current liabilities:	**Current Year**
Accounts payable	$49 049
Accrued expenses	25 744
Other	26 021
Total current liabilities	**$100 814**
Long-term liabilities:	**Current Year**
Long-term debt	97 207
Other long-term liabilities	43 251
Total long-term liabilities	**$140 458**
Owners' Equity:	**Current Year**
Common Stock and paid in capital	35 867
Retained earnings	98 330
Other	(150)
Total owners' equity	**$134 047**
Total liabilities and shareholders' equity	**$375 319**

FIGURE 11.2 Apple Inc.'s Balance Sheet (in millions)[19]

This balance sheet shows clearly that the firm's total assets equal its total liabilities and owners' equity.

Source: Balance Sheet, Apple Inc.'s Annual Financial Statement 2017, http://investor.apple.com/secfiling.cfm?filingid=320193-17-70&cik=320193, [accessed June 20, 2018].

LO-4 INCOME STATEMENTS

The **income statement** is sometimes called a profit-and-loss statement because its description of revenues and expenses results in a figure showing the firm's annual profit or loss. In other words,

Revenues − Expenses = Profit (or loss)

Profit or loss, popularly known as "the bottom line," is probably the most important figure in any business enterprise. Figure 11.3 shows the 2017 income statement for Apple Inc., whose bottom line that year was $48 351(in millions). The income statement is divided into three major categories: revenues, cost of goods sold, and operating expenses. Unlike a balance sheet, which shows the financial condition at a specific *point in time*, an income statement shows the financial results that occurred during a *period of time*, such as a month, quarter, or year.

Apple Inc.
Summary of Income Statement (Condensed)
October 1, 2016–September 30, 2017
(in millions)

Net Sales		**$229 234**
Cost of Goods Sold		**141 048**
Gross profit (Loss)		**88 186**
Operating expenses:		
Research and Development	11 581	
Selling: Administrative and General	15 261	
Total operating expenses		**26 842**
Operating income		61 344
Other Operating Income/(expense) net		2 745
Income before Provision for Income Taxes		64 089
Provision for Income Taxes		15 738
Net Income (Loss)		**$ 48 351**

FIGURE 11.3 Apple Inc.'s income statement[24]
The final entry on the income statement, the bottom line, reports the firm's profit or loss.

Source: Income Statement, Apple Inc.'s Annual Financial Statement 2017, http://investor.apple.com/secfiling.cfm?filingid=320193-17-70&cik=320193, [accessed June 20, 2018].

Revenues

When a law firm receives $700 for preparing a will or when a supermarket collects $100 from a customer buying groceries, both are receiving **revenues**—the funds that flow into a business from the sale of goods or services. In 2017, Apple reported revenues of $229 234 (in millions) from the sale of iPhones, iPads, Apple Watches, music streams, and all the other products and services.

Revenue Recognition and Matching Revenue recognition is the formal recording and reporting of revenues in the financial statements. Although all firms earn revenues continuously as they make sales, earnings are not reported until the earnings cycle is completed. Revenues are recorded for the accounting period in which sales are completed and collectible (or collected).

The **matching principle** states that expenses will be matched with revenues to determine net income for an accounting period.[20] This principle is important because it permits the user of the statement to see how much net gain resulted from the assets that had to be given up to generate revenues during the period covered in the statement.

Cost of Goods Sold

In the income statement, the **cost of goods sold** category shows the costs of obtaining materials to make the products sold during the year. Apple began 2017 with existing inventory and manufactured more items during the year to meet demand. After the existing stock (of finished iPads, iPhones, etc.) was added to the newly manufactured finished items (and the ending inventory was subtracted), Apple registered $141 048 (in millions) as the total cost of goods sold.

Gross Profit (or Gross Margin) To calculate **gross profit (or gross margin)**, subtract the cost of goods sold from revenues. Apple's gross profit in 2017 was $88 186 ($229 234 minus $141 048). Expressed as a percentage of sales, gross profit is 38.5 percent ($88 186 divided by $229 234 times 100).

Gross profit percentages vary widely across industries. In retailing, Home Depot reports 34.5 percent;[21] in manufacturing, Magna International reports 14.2 percent;[22] and in pharmaceuticals, Pfizer Inc. reports 80.14 percent.[23] For companies with low gross margins, product costs are a big expense. If a company has a high gross margin, it probably has low cost of goods sold but high selling and administrative expenses.

Operating Expenses

In addition to costs directly related to acquiring goods, every company has general expenses ranging from erasers to the president's salary. Like cost of goods sold, **operating expenses** are resources that must flow out of a company for it to earn revenues. As you can see in Figure 11.3, Apple Inc. had operating expenses of $26 842 (in millions). This figure consisted of $11 581 (in millions) in research and development expenses and $15 261 (in millions) in selling and general administrative expenses.

Selling expenses result from activities related to selling the firm's goods or services. These may include salaries for the sales force, delivery costs, and advertising expenses. *General and administrative expenses*, such as management salaries, insurance expenses, and maintenance costs, are expenses related to the general management of the company.

Operating Income and Net Income Sometimes managers calculate **operating income**, which compares the gross profit from business operations against operating expenses. This calculation for Apple Inc.

INCOME STATEMENT (PROFIT-AND-LOSS STATEMENT) A type of financial statement that describes a firm's revenues and expenses and indicates whether the firm has earned a profit or suffered a loss during a given period.

REVENUES Any monies received by a firm as a result of selling a good or service or from other sources such as interest, rent, and licensing fees.

REVENUE RECOGNITION The formal recording and reporting of revenues in the financial statements.

MATCHING PRINCIPLE Expenses should be matched with revenues to determine net income for an accounting period.

COST OF GOODS SOLD All expenses directly involved in producing or selling a good or service during a given time period.

GROSS PROFIT (GROSS MARGIN) A firm's revenues (gross sales) less its cost of goods sold.

OPERATING EXPENSES Costs incurred by a firm other than those included in cost of goods sold.

($88 186 minus $26 842) reveals an operating income, or income before taxes, of $61 344 (+ other operating income [expense] net of $2745 = $64 089). Subtracting income taxes from total operating income before taxes ($64 089 minus $15 738) reveals **net income (also called net profit or net earnings)**. In 2017, Apple Inc.'s net income was $48 351.

Statements of Cash Flows

To survive, a business must earn a profit (i.e., its sales revenues must exceed its expenses), but it must also make sure it has cash available when it needs it (e.g., to pay employees). Cash-flow management requires the development of a **statement of cash flows**, which describes a company's yearly cash receipts and cash payments. It shows the effects on cash of three important business activities:

- *Cash flows from operations.* This part of the statement is concerned with the firm's main operating activities: the cash transactions involved in buying and selling goods and services. It reveals how much of the year's profits result from the firm's main line of business (e.g., Ferrari's sales of automobiles), rather than from secondary activities (e.g., licensing fees that a clothing firm paid to Ferrari to use its logo).
- *Cash flows from investing.* This section reports net cash used in or provided by investing. It includes cash receipts and payments from buying and selling stocks, bonds, property, equipment, and other productive assets.
- *Cash flows from financing.* The final section reports net cash from all financing activities. It includes cash inflows from borrowing or issuing stock, as well as outflows for payment of dividends and repayment of borrowed money.

The overall change in cash from these three sources provides information to lenders and investors. When creditors and stockholders know how a firm obtained and used its funds during a year, it is easier for them to interpret the year-to-year changes in the firm's balance sheet and income statement. Look at Figure 11.4 for an example of Apple Inc.'s Statement of Cash flows.

OPERATING INCOME Compares the gross profit from business operations against operating expenses.

NET INCOME (NET PROFIT OR NET EARNINGS) A firm's gross profit less its operating expenses and income taxes.

STATEMENT OF CASH FLOWS A financial statement that describes a firm's generation and use of cash during a given period.

BUDGET Detailed statement of estimated receipts and expenditures for a future period of time.

At the end of its accounting period, this pharmaceuticals company will subtract the cost of making the goods that it sells from the revenues it receives from sales. The difference will be its gross profit (or gross margin).

RGtimeline/Fotolia

The Budget: An Internal Financial Statement

For planning, controlling, and decision-making, the most important internal financial statement is the **budget**, a detailed report on estimated receipts and expenditures for a future period. Although that period is usually one year, some companies also prepare three- or five-year budgets, especially when considering major capital expenditures. The budget differs from the other statements we have discussed in that budgets are not shared outside the company, hence the "internal financial statement" title.

Although the accounting staff coordinates the budget process, it needs input from many areas regarding proposed activities and required resources. In preparing next year's budget, accounting must obtain projections from the sales group about units to be sold and expected expenses for the coming year. Then accounting draws up the final budget and throughout the year compares it to actual expenditures and revenues. Budgets are also useful for keeping track of weekly or monthly performance. For example, Procter & Gamble evaluates all of its business units monthly, by comparing actual financial results with monthly budgeted amounts. Discrepancies in "actual versus budget" totals signal potential problems and initiate action to get financial performance back on track.

Apple Inc.
Summary of Cash Flow (Condensed)
October 1, 2016–September 30, 2017
(in millions)

Net cash/cash equivalents at beginning of year		**$20 484**
Cash Flows from Operating Activities:		
Net Income	48 351	
Depreciation & amortization	10 157	
Deferred income tax	5 966	
Other Adjustments to reconcile net income to cash	4 674	
Changes in operating assets and liabilities	–5 550	
Net Cash Flow from Operating Activities		**$63 598**
Cash Flows from Investing Activities:		
Purchase of marketable securities	–159 486	
Proceeds from sales of marketable securities	94 564	
Payments for acquisition of property, plant & Eq	–12 451	
Other investing activities	30 927	
Net Cash Flow from Investing Activities		**–46 446**
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	555	
Payments for dividends	–12 769	
Payments of term debt	–3 500	
Other financing activities	–1 633	
Net Cash Flow from Financing Activities		**–17 347**
Net Change in Cash		
Beginning Cash Balance		
Net Cash & Cash Equivalents at end of year		**$20 289**

FIGURE 11.4 Apple Inc.'s Statement of Cash Flows[25]

Source: Statement of Cash Flow, Apple Inc.'s Annual Financial Statement 2017, http://investor.apple.com/secfiling.cfm?filingid=320193-17-70&cik=320193, [accessed June 20, 2018].

LO-5 ANALYZING FINANCIAL STATEMENTS

Financial statements present a great deal of information, but what does it all mean? How, for example, can statements help investors decide what stock to buy or help managers decide whether to extend credit? Statements provide data, which in turn can be used to compute solvency, profitability, and activity ratios that are useful in analyzing the financial health of a company compared to other companies and to check a firm's progress by comparing its current and past statements. Ratios are normally grouped into three major classifications:

1. Solvency ratios for estimating short-term and long-term risk
2. Profitability ratios for measuring potential earnings
3. Activity ratios for evaluating management's use of assets

Depending on the decisions to be made, a user may apply none, some, or all these ratios.

Solvency Ratios: Borrower's Ability to Repay Debt

What are the chances that a borrower will be able to repay a loan and the interest due? This question is first and foremost in the minds of bank lending officers, managers of pension funds and other investors, suppliers, and the borrowing company's own financial managers. **Solvency ratios** measure the firm's ability to meet its debt obligations.

Short-Term Solvency Ratios

Short-term solvency ratios measure a company's liquidity and its ability to pay immediate debts. The most commonly used ratio is the

DISRUPTIONS IN BUSINESS

Skimming off the Top

Africa Studio/Shutterstock

Jennifer Mayberry runs a small coffee shop. For years she has dropped her daily receipts off in the night deposit slot at the local bank where her friend works. But Jennifer never reconciled her deposit slips to her accounting records. When her accountants started calculating revenues for tax reporting, they found a $1000 discrepancy in the November deposit. That led to the hiring of a forensic accountant who discovered that despite internal controls at the bank, Jennifer's *friend* had been skimming the cash from the deposits. This was done by changing the deposit slips, and then making the smaller deposit into the account. Over the course of 18 months, the friend stole more than $42 000 from Jennifer.

At the Collins Street Bakery, owner Bob McNutt was trying to figure out a decade of embezzlement. It started when the head accountant, who felt underpaid, bought himself a new Lexus and paid for it with a company cheque. He covered his tracks by voiding that cheque in the system and writing another cheque to a legitimate vendor (which he never sent). Since there was only one accountant in the business and the owner didn't audit the records, no one caught the theft. Soon the accountant was taking up to $98 000 a month from the bakery and he and his wife were living a lavish lifestyle. They explained it away as the result of an inheritance. McNutt examined the accounting data as he tried to figure out how his business—which appeared to be so successful—continued to struggle year after year. But he found nothing helpful. One day a new hire in the accounting department found a curious voided cheque in the system and that was the beginning of the end for the thief. McNutt eventually discovered that the accountant had managed to skim over $17 million from the Collins Street Baker, using an unsophisticated scheme that could have been prevented by a few simple internal control procedures.

Small and medium-sized businesses aren't the only ones that get hit by embezzlers. Cargill Inc. is a global corporation that is on the Fortune 500 list. Recently, one of the accounting managers pled guilty to skimming more than $3 million from the company by depositing customer payments into her personal account. All three of the examples described above occurred because the business owners took a rather relaxed view about how to protect one of the most valuable (and easily lifted) assets: cash. That's why it pays to become educated in basic financial accounting (and human resource management).

CRITICAL THINKING QUESTION

1. Consider the following statement: *Because business owners cannot know for certain whether all their employees are honest, it is best for the owners to assume that at least some employees will try to embezzle money from the company. Making this assumption will motivate business owners to install sophisticated control systems that will catch any attempted embezzlement very early in the process.* Do you agree or disagree with the statement? Explain your reasoning.

current ratio, which reflects a firm's ability to generate cash to meet obligations through the normal, orderly process of selling inventories and collecting revenues from customers. It is calculated by dividing current assets by current liabilities. The higher a firm's current ratio, the lower the risk it represents to investors. For many years, the guideline was a current ratio of 2:1 or higher—which meant that current assets were at least double current liabilities. More recently, many firms that are financially strong operate with current ratios of less than 2:1. For example, according to the balance sheet in Figure 11.2, Apple Inc. has a current ratio of 1.28.

$$\frac{\text{Current assets}}{\text{Current liabilities}} = \frac{128\ 645}{100\ 814} = 1.28$$

Long-Term Solvency

Stakeholders are also concerned about long-term solvency. Has the company been overextended by borrowing so much that it will be unable to repay debts in future years? A firm that can't meet its long-term debt obligations is in danger of collapse or takeover, a risk that makes creditors and investors quite cautious. To evaluate a company's risk of running into this problem, creditors turn to the balance sheet to see the extent to which a firm is financed through borrowed money. Long-term solvency is calculated by dividing **debt** (total liabilities) by owners' equity. The lower a firm's debt, the lower the risk to investors and creditors. Companies with **debt-to-equity ratios** above 1.0 may be relying too much on debt. Companies with more debt may find themselves owing so much that they lack the income needed to meet interest payments or to repay borrowed money. For example, according to the information in the consolidated balance sheet in Figure 11.2, Apple Inc. has the following debt-to-equity ratio:

$$\frac{\text{Debt}}{\text{Owners' equity}} = \frac{\$241\ 458}{\$134\ 047} = 1.8$$

Sometimes, high debt can not only be acceptable but also desirable. Borrowing funds gives a firm **leverage**—the ability to make otherwise unaffordable investments. In leveraged buyouts, firms have sometimes taken on huge debt to get the money to buy out other companies. If owning the purchased company generates profits above the cost of borrowing the purchase price, leveraging makes sense. Unfortunately, many buyouts have caused problems because profits fell short of expected levels or because rising interest rates increased payments on the buyer's debt.

Profitability Ratios: Earnings Power for Owners

Although it is important to know that a company is solvent, safety or risk alone is not an adequate basis for investment decisions. Investors also want some measure of the returns they can expect. Return on equity, return on sales, and earnings per share are three commonly used **profitability ratios** (sometimes these are called shareholder return ratios or performance ratios).

Return on Equity

Owners are interested in the net income earned by a business for each dollar invested. **Return on equity** measures this performance by dividing net income (recorded on the income statement, Figure 11.3) by total owners' equity (recorded on the balance sheet, Figure 11.2). For Apple Inc., the return-on-equity ratio was:

$$\frac{\text{Net income}}{\text{Total owners' equity}} = \frac{\$48\ 351 \times 100}{\$134\ 047} = 0.36 \text{ or } 36\%$$

Is this ratio good or bad? There is no set answer. If Apple's ratio this year is higher than in previous years, owners and investors should be encouraged. In fact, the ratio had fluctuated between 35 to 45 percent in the previous three years; however, those rate were all above the industry average, which stood at 29.4 percent.[26]

Return on Sales

Companies want to generate as much profit as they can from each dollar of sales revenue they receive. The **return on sales** ratio is calculated by dividing net income by sales revenue (see Figure 11.3. For Apple Inc., the return on sales ratio was:

$$\frac{\text{Net income}}{\text{Sales revenue}} = \frac{\$48\ 351 \times 100}{\$229\ 234} = 0.211 \text{ or } 21.1\%$$

Is this figure good or bad? Once again, there is no set rule. However, Apple's 21 percent would be the envy of most organizations that typically aim for a 5 to 10 percent return (depending on industry).

Earnings Per Share

Earnings per share—calculated by dividing net income by the number of shares of common stock outstanding—influences the size of the dividend a company can pay to its shareholders. Investors use this ratio to decide whether to buy or sell a company's stock. As the ratio gets higher, the stock value increases because investors know that the firm can better afford to pay dividends. The market value of a stock will typically decline if the latest financial statements report a decline in earnings per share. For Apple Inc., we can use the net income (shown in millions on the income statement) in Figure 11.3 and divide by the total outstanding shares (*shown in thousands* in Apple's financial statements)[27] to calculate earnings per share:

$$\frac{\text{Net income}}{\text{Number of common shares outstanding}}$$

$$= \frac{\$48\ 351 \text{ (in millions)}}{5\ 217\ 242 \text{ (in thousands)}} = \$9.27 \text{ per share}$$

SOLVENCY RATIOS Ratios that estimate the financial risk that is evident in a company.

SHORT-TERM SOLVENCY RATIO Financial ratio for measuring a company's ability to pay immediate debts.

CURRENT RATIO Financial ratio for measuring a company's ability to pay current debts out of current assets.

DEBT A company's total liabilities.

DEBT-TO-EQUITY RATIOS A form of debt ratio calculated as total liabilities divided by owners' equity.

LEVERAGE Using borrowed funds to make purchases, thus increasing the user's purchasing power, potential rate of return, and risk of loss.

PROFITABILITY RATIOS Measures of a firm's overall financial performance in terms of its likely profits; used by investors to assess their probable returns.

RETURN ON EQUITY A form of profitability ratio calculated as net income divided by total owners' equity.

RETURN ON SALES Ratio calculated by dividing net income by sales revenue.

EARNINGS PER SHARE A form of profitability ratio calculated as net income divided by the number of common shares outstanding.

Activity Ratios: How Efficiently Is the Firm Using Its Resources?

The efficiency with which a firm uses resources is linked to profitability. As a potential investor, you want to know which company gets more mileage from its resources. Information obtained from financial statements can be used to calculate **activity ratios**. For example, suppose that two firms use the same amount of resources or assets. If Firm A generates greater profits or sales, it is more efficient, and thus has a better activity ratio.

One of the most important activity ratios is the **inventory turnover ratio**, which calculates the average number of times that inventory is sold and restocked during the year.[28] Once a company knows its average inv entory (calculated by adding end-of-year inventory to beginning-of-year inventory and dividing by 2), it can calculate the inventory turnover ratio, which is expressed as the cost of goods sold divided by average inventory:

$$\frac{\text{Cost of goods sold}}{\text{Average inventory}} = \frac{\text{Cost of goods sold}}{(\text{Beginning inventory} + \text{Ending inventory}) \div 2}$$

$$= \frac{\$141\,048}{[(2132 + 4855)/2]} = \frac{\$141\,048}{3493.5} = 40.37$$

In other words, new merchandise replaces old every nine days (365 days divided by 40.37).

The inventory turnover ratio measures the average number of times that a store sells and restocks its inventory in one year. The higher the ratio, the more products get sold and the more revenue comes in. Zara had a 28.05 inventory turnover ratio in 2018—far superior to the industry average for clothing.

Bjanka Kadic/Alamy Stock Photo

ACTIVITY RATIOS Measures how efficiently a firm uses its resources; used by investors to assess their probable returns.

INVENTORY TURNOVER RATIO An activity ratio that measures the average number of times inventory is sold and restocked during the year.

LO-6 BRINGING ETHICS INTO THE ACCOUNTING EQUATION

The ultimate purpose of strong ethical standards in accounting is to maintain public confidence in business institutions, financial markets, and the products and services of the accounting profession. Without ethics, all accounting tools and methods would be meaningless because their usefulness depends ultimately on their honest application.

Why Accounting Ethics?

In recent years, we have seen many corporations demonstrate poor judgment and ethical lapses; we will examine the case of Valeant (now known as Bausch Health Companies Inc.) at the end of this chapter. In some instances, this has led to a minor problem; in others (such as Nortel), it has contributed to the demise of a company. Ethics remains an area where one person who is willing to "do the right thing" can make a difference—and people do, every day.

With the unification process of the accounting designations, a new Canadian Chartered Professional Accounting Code of Ethics is evolving that borrows from the best practices of the three current designations and that is driven by the various provincial bodies. In Table 11.2, you can see the existing CPA code of ethics in the United States.

A code of ethics is a good start; it clearly outlines good practices and points out improper behaviour. Ultimately, the actions of conscientious accountants will maintain and improve the level of faith investors have in accounting reports. As discussed earlier in the chapter, legislation to improve clarity and increase accountability, the Sarbanes-Oxley Act in the United States and the National Instrument 52-109 in Canada, has been developed to ensure public confidence.

TABLE 11.2 Highlights from the CPA Code of Ethics[29]

The new Canadian CPA designation is merging best practices from the previous designations to form a similar code to the one found south of the border for American Certified Public Accountants.
Responsibilities as a Professional Exercise their duties with a high-level of morality and in a manner that is sensitive to bringing credit to their profession.
Serving the Public Interest Demonstrate commitment to the profession by respecting and maintaining the public trust and serving the public honourably.
Maintaining Integrity Perform all professional activities with highest regards for integrity, including sincerity and honesty, to promote the public's confidence in the profession.
Being Objective and Independent Avoid conflicts of interest, and the appearance of conflicts of interest, in performing their professional responsibilities. They should be independent from clients when certifying to the public that the client's statements are true and genuine.
Maintaining Technical and Ethical Standards Exercise "due care," through professional improvement, abiding by ethical standards, updating personal competence through continuing accounting education, and improving the quality of services.
Professional Conduct in Providing Services In public practice, abide by the meaning and intent of the Code of Professional Conduct when deciding on the kinds of services and the range of actions to be supplied for clients.

Source: AICPA Website, "Code of Professional Conduct," www.aicpa.org/research/standards/codeofconduct/pages/default.aspx

LO-7 THE EVOLVING ROLE OF THE MODERN ACCOUNTANT

The lessons from the last global recession along with evolving information technologies are among the prominent forces shaping the future for accounting professionals. However, the accountant's knowledge of business aided by analytical and technical skills, although essential, are not sufficient capabilities for meeting current and future market demands in this changing profession. The traditional accountant's role was centred on analyzing historical financial data, creating financial statements, and providing interpretations of financial data and documents to facilitate business decisions. As discussed in the opening case, there is an increasing expectation for modern CPAs to provide more intimate leadership in demonstrating financial implications for many additional facets of the business, including its overall operations, strategy, data management, human resources, and technical resources. The accountant, in this increasing participation with client firms, uses additional competencies beyond those of the traditional financial accounting expert. Table 11.3 provides additional details on this subject.

To thrive in today's demanding environment, CPAs must now leverage specialty skills through effective communication. They need to know the nature of the client's business, and its competitive environment, to assist that client in achieving a competitive advantage.[30]

TABLE 11.3 Emerging Competencies for Success in Accounting

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

Source: Based on "The CPA Vision Project and Beyond," The American Institute of Certified Public Accountants, at http://www.aicpa.org/RESEARCH/CPAHORIZONS2025/CPAVISIONPROJECT/Pages/CPAVisionProject.aspx, accessed on April 15, 2017.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 EXPLAIN THE *ROLE OF ACCOUNTANTS*, DISTINGUISH BETWEEN THE THREE TRADITIONAL *PROFESSIONAL ACCOUNTING DESIGNATIONS* IN CANADA, AND UNDERSTAND THE NEW UNIFIED ROLE OF THE *CANADIAN CHARTERED PROFESSIONAL ACCOUNTING (CPA) DESIGNATION.*

By collecting, analyzing, and communicating financial information, accountants provide business managers and investors with an accurate picture of a firm's financial health. Traditionally, *chartered accountants (CAs)* and *certified general accountants (CGAs)* provide accounting expertise for client organizations that must report their financial condition to external stakeholders. *Certified management accountants (CMAs)* provide accounting expertise for the firms that employ them. However, these three separate designations have joined forces to create the *Canadian chartered professional accountant (CPA) designation*.

LO-2 EXPLAIN HOW THE *ACCOUNTING EQUATION* IS USED.

Accountants use the following equation to balance the data pertaining to financial transactions:

Assets − Liabilities = Owners' equity

After every financial transaction (e.g., payments to suppliers, sales to customers, wages to employees), the *accounting equation* must be in balance. If it isn't, an accounting error has occurred. The equation also provides an indication of the firm's financial health. If assets exceed liabilities, owners' equity is positive; if the firm goes out of business, owners will receive some cash (a gain) after selling assets and paying off liabilities. If liabilities outweigh assets, owners' equity is negative and assets aren't enough to pay off debts. If the company goes under, owners will get no cash and some creditors won't be paid, thus losing their remaining investments in the company.

LO-3 DESCRIBE THREE BASIC *FINANCIAL STATEMENTS* AND SHOW HOW THEY REFLECT THE ACTIVITY AND FINANCIAL CONDITION OF A BUSINESS.

The *balance sheet* summarizes a company's assets, liabilities, and owners' equity at a given point in time. The *income statement* details revenues and expenses for a given period and identifies any profit or loss. The *statement of cash flows* reports cash receipts and payment from operating, investing, and financial activities.

LO-4 EXPLAIN THE KEY *STANDARDS* AND *PRINCIPLES* FOR *REPORTING FINANCIAL STATEMENTS*.

Accountants follow standard reporting practices and principles when they prepare financial statements. Otherwise, users wouldn't be able to compare information from different companies and they might misunderstand—or be led to misread—a company's true financial status. *Revenue recognition* is the formal recording and reporting of revenues in financial statements. The *earnings cycle* is complete when the sale has been made, the product is delivered, and the sale price has been collected or is collectible. This practice assures interested parties that the statement gives a fair comparison of what was gained for the resources that were given up. The *matching principle* states that expenses will be matched with revenues to determine net income for an accounting period. This principle permits the user of the statement to see how much net gain resulted from the assets that had to be given up to generate revenues during the period covered in the statement.

LO-5 EXPLAIN HOW COMPUTING *FINANCIAL RATIOS* CAN HELP IN ANALYZING THE FINANCIAL STRENGTHS OF A BUSINESS.

Drawing upon data from financial statements, ratios can help creditors, investors, and managers assess a firm's finances. The *current, short-term solvency (liquidity)* and *debt-to-owners' equity ratios* all measure solvency, a firm's ability to pay its debt in both the short and long terms. Return on sales, return on equity, and earnings per share are all ratios that measure profitability. The inventory turnover ratio shows how efficiently a firm is using its funds.

LO-6 DISCUSS THE ROLE OF *ETHICS IN ACCOUNTING*.

The purpose of *ethics in accounting* is to maintain public confidence in business institutions, financial markets, and the products and services of the accounting profession. Without ethics, all of accounting's tools and methods would be meaningless because their usefulness depends, ultimately, on truthfulness in their application. Accordingly, professional accounting associations enforce codes of professional conduct that include ethics-related areas, such as the accountant's responsibilities, the public interest, integrity, and so on. The associations include ethics as an area of study to meet requirements for certification. The codes prohibit, among other things, misrepresentation and fraud in financial statements.

LO-7 DESCRIBE THE *EVOLVING ROLE OF THE MODERN ACCOUNTANT*.

The role of accounting professionals is evolving. The traditional accountant's role was centred on analyzing historical financial data, creating financial statements, and providing interpretations of financial data and documents to facilitate business decisions. The expectations for modern CPAs increasingly call for a more intimate role of leadership in demonstrating financial implications for many additional facets of the business, including its overall operations, strategy, data management, human resources, and technical resources.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Balance sheets and income statements are supposed to be objective assessments of the financial condition of a company. But the accounting scandals of the past few years show that certain pressures may be put on accountants as they audit a company's financial statements. Describe these pressures. To what extent do these pressures make the audit more subjective?
2. If you were planning to invest in a company, which of the three types of financial statements would you want most to see? Why?
3. A business hires a professional accountant to assess the financial condition of the company. Why would the business also employ a private accountant?
4. How do financial ratios help managers monitor their own efficiency and effectiveness?
5. Explain the difference between financial and managerial accounting. In your answer, describe the different audiences for the two types of accounting and the various individuals involved in the process.
6. Use the accounting equation to determine your net worth. Identify your assets and liabilities. With this information, how would you increase your net worth in the future?

APPLICATION EXERCISES

7. Interview an accountant at a local business, non-profit organization, or government entity. How does the firm use budgets? How does budgeting help managers plan business activities? How does budgeting help them control activities? Give examples.
8. Suppose that Inflatables Inc., makers of air mattresses for swimming pools, had the following transactions in one week: sold three deluxe mattresses to Al Wett (paid $50 in cash, remaining $25 on credit) on 7/16, received cheque from Ima Flotein as payment for mattresses bought on credit ($120) on 7/13, received new shipment of 200 mattresses from Airheads Mfg. (total cost $3000, paid 50 percent cash on delivery) on 7/17. Construct a journal for Inflatables Inc.
9. Flynn Plastics Company reports the following data in its September 30, 2018, financial statements:
   Gross sales $225 000
   Current assets $50 000
   Long-term assets $130 000
   Current liabilities $33 000
   Long-term liabilities $52 000
   Net income $11 250

a. Compute the owners' equity.
b. Compute the current ratio.
c. Compute the debt-to-equity ratio.
d. Compute the return on sales.
e. Compute the return on owners' equity.

10. Interview the manager of a local business and ask about the role of ethics in the company's accounting practices. How important is ethics in accounting? What measures does the firm take to ensure that its internal reporting is ethical? What steps does the company take to maintain ethical relationships in its dealings with external accounting firms?

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members to consider your new business venture and how it relates to the accounting topics in this chapter. Develop specific responses to the following:

1. In your first year of operation, who will perform accounting functions inside your company? Will you contract some or all the work to a public accounting firm?
2. Create a list of the types of transactions that your accountant will record, including the purchase and sale of assets as well as revenues and expenses.
3. Based on the development of your business to date, create a preliminary or pro forma income statement for your firm's first year of operation. Be sure it includes listings of relevant terms from the accounting equation. See if you can estimate anticipated data for each element in the income statement.
4. Based on the development of your business to date, create a preliminary or pro forma balance sheet for your firm's first year of operation. Be sure it includes listings of relevant terms from the accounting equation. See if you can estimate anticipated data for each element in the balance sheet.
5. Consider the sources for start-up funds you will need to finance your business. What financial ratios (ratio analysis), if any, are likely to be of interest to lending institutions, personal investors (including yourselves), or other providers of funds? Explain why ratio analysis will be of interest to them, or why it will not be of interest.

BUILDING YOUR BUSINESS SKILLS

A CANADIAN LEGEND

GOAL

To encourage students to research, analyze, and evaluate financial statements from a historical and a current basis.

METHOD

Step 1 The Bay is a historic Canadian retail brand, but as you will read in Chapter 13, like many brick-and-mortar retailers, it has been struggling to maintain market share. For this exercise, you and your team need to find the financial information for the parent company (Hudson's Bay Company). Look for the most recent annual financial statements, including the income statement and balance sheet. There are many sources for this data but one quick source is Globe Investor (www.theglobeandmail.com/investing). If you enter the company's ticket symbol, "HBC," in the quote box, you will find a report on the company's stock price as well as a host of other information, such as performance, key ratios, and financials.

Step 2 Find recent articles and news on the Hudson's Bay Company. Look for recent quarterly reports and read the notes in the press releases and statements.

QUESTIONS FOR DISCUSSION

1. Looking at HBC's income statement, what has been the trend in sales (total revenue) as well as net income over the past three years?
2. As you have learned, gross profit is the difference between sales (or total revenues) and cost of sales (or cost of revenues). Gross profit percentage is calculated by dividing gross profit by sales (or total revenues). What is HBC's gross profit percentage for the past three years? What does this data tell you about HBC's overall pricing strategy and costs?
3. Looking at the balance sheet, what is HBC's current ratio for the three most recent years? What is the significance of these numbers? Have they been improving or getting worse?
4. What is the relationship between the price of HBC's stock and earnings? What are the earnings per share for each of the past three years and what does that number mean to investors?

EXERCISING YOUR ETHICS

GIVE AND TAKE WITH ACCOUNTING CLIENTS

THE SITUATION

Accountants provide valuable services for their clients, both businesses and individuals. Although it's important to make clients happy, accountants have additional considerations when preparing financial statements and tax returns.

THE DILEMMA

Aaron Ault is the owner of a small contracting business. In late January 2019, he delivered original expense and income records so that his CPA, Katrina Belinski, could prepare 2018 financial statements and tax returns for Ault's small business firm. Several weeks later, Belinski delivered the

completed financial statements and tax return to Ault. Ault was pleased with the financial statements but realized that he was going to owe a lot of money in taxes. His business is just recovering from tough times, and he can't afford to pay such a large tax bill. One particularly large job was completed at the end of the year, and Ault has decided that he'd like to record this during the current year. This would result in a much lower taxable income for 2018. However, Ault is disappointed with Belinski. She tells him that she's not able to make this change and he's threatening to take his business elsewhere. Belinski is torn because Ault has been a long-time client and she doesn't want to lose his business.

FOLLOW-UP QUESTIONS

1. What are the ethical issues in this situation?
2. What are the basic arguments for and against Aaron Ault's position in this situation? For and against Katrina Belinski's position?
3. What do you think Ault and Belinski should do in this situation?

BUSINESS CASE 11

BIG PHARMA, BIG BUSINESS & ACCOUNTING FOUNDATIONS

A few years ago, Valeant Pharmaceuticals International Inc. was the pride and joy of the Canadian pharmaceutical industry. At the time, it was the nation's most valuable company by stock market value. Fast forward to 2018, the very same company had lost more than 95 percent of its stock market value before slightly rebounding and stabilizing. The company had let go of its CEO, and it had been rebranded as Bausch Health Companies Inc. So what happened? Whether you are a pharmaceutical health-care company, a retailer, a manufacturer, or a mom-and-pop shop on main street, there are fundamental business, accounting, and ethical practices that must be respected. Let's go back and document the rise, fall, and future of this company.

Ryan Remiorz/CP Images

BUILDING VALUE: R&D AND GROWTH PLAN

At the peak of Valeant's perceived value, its stock stood at $262.52; however, less than two years later, it had plunged to a low of $8.51. In mid-2018, the stock was trading in the $20-to-$25 range. So let's look at the fundamentals behind these dramatic changes. The company's rise to glory was initially based on internal development and, in large part, by the product portfolio it built through major acquisitions. For example, Valeant bought Bausch & Lomb for $8.7 billion, Medicis for $2.4 billion, and Obagi Medical Products for $418 million.

Because the company was acquiring assets and adding to its brand portfolio, it was spending less on research and development than a traditional pharmaceutical company typically does. The net result was a strong bottom line and short-term profitability that pleased the markets. However, the acquisition spree also left the company with long-term problems: (1) a heavy debt load and (2) the need to invest more to build its future product pipeline internally. There were other problems that would lead stakeholders to look even closer at the company's books.

PAYING THE PRICE FOR LOOSE ETHICAL PRACTICES

One of the early signs that Valeant was playing fast and loose with the truth was when it restated (corrected) its earnings target by $600 million in 2016. Why did this happen? Well, the company blamed it on a typo. Yes, a typo. Try that excuse with your instructors on your projects, and it will not work out well for you. However, this was not a school assignment. It was an official company report, from a multibillion-dollar, publicly traded, international company with a responsibility to all its stakeholders (shareholders, government agencies, employees, etc.).

If improper accounting was strike one, the second strike was based on predatory price policies to boost growth. This issue gained the attention down south when Bernie Sanders and other politicians demanded answers as to why a vital heart drug increased dramatically overnight. Everyone knows that pharmaceutical companies have tremendous margins, but they also have major research and development costs. However, when you increase the price of a drug that patients need to survive by 5500 percent overnight, people are going to take notice and demand answers. A report from a Deutsche Bank analyst also revealed that the company inflated prices on 54 consumer drugs in a single year with an average increase of 66 percent (far above industry averages and normal protocol).

The company was under siege for its actions when a "special relationship" with an online pharmacy called Philidor Rx Services was brought to light. There were rumours of shady practices, including the use of fake names like "Brian Wilson and Peter Parker" in covert email communications from top executives. This eventually led to the conviction of a former Valeant executive and the CEO of Philidor for a multibillion-dollar kickback scheme. The link and appearance of impropriety added to people's concerns about Valeant.

MOUNTAIN OF DEBT: A CRUSHING CONCERN

The run of acquisitions helped build the company's reputation and fueled its revenue stream but it also led to a heavy debt load. When a company is a rising star and there are expectations of major growth ahead, investors and bankers may feel reassured. However, with all the other issues facing the company, the debt load became a central source of concern. So, in the past two years, under financial pressure, Valeant the "acquisition machine" began the process of divesting certain major assets and reduced its debt load by more than 20 percent, or $6.9 billion. In the process, it sold three skin care brands to L'Oréal for $1.3 billion, and it also sold its Dendreon Pharmaceuticals unit to the SanPower Group company for $820 million.

THE WAY FORWARD: REBRANDING AND REBUILDING TRUST

Changing the name of the company was the easy part. Bausch Health Companies Inc. was selected to reflect the company's diverse activities, including pharmaceuticals, medical devices, and over-the-counter consumer products. However, rebuilding trust and regaining the faith of all stakeholders will require that the company follow proper accounting

procedures, respect ethical guidelines, and demonstrate consistent profitability through solid cost management and successful product development and commercialization.

The Valeant Annual Report of 2017 began with a letter to the shareholders signed by CEO Joseph C. Papa, indicating three core goals: (1) investing in core franchises with attractive growth potential, (2) launching new products with meaningful opportunities, and (3) resolving legacy issues (lawsuits) and de-risking. The plan referred to three phases. In phase one, the goal was to stabilize the ship back in 2016. Phase two, 2017–2018, was referred to as the turnaround stage. The forward-looking third phase was called the transformation.

Let's dig into some of the details from the annual report. Revenues were down from $9.5 billion to $8.6 billion but that was to be expected because the company was selling off divisions and product lines. As previously noted, the company had reduced its debt by about 20 percent. Net income stood at $2.4 billion, whereas the company had suffered a loss of $2.4 billion in the previous year. So the question remained, what would the turnaround phase look like in two or three years? That is unclear today, but the Valeant/Bosch Health Companies will be judged on fundamental accounting metrics, good business decisions, and sound ethical practices. There is no other way forward. The market is watching.

QUESTIONS FOR DISCUSSION

1. Describe some of the fundamental accounting metrics discussed in this case and explain their importance as they relate to the company's market valuation.
2. How did some of the questionable practices impact the company's bottom line and its strategic direction during the past few years?
3. Find the company's most recent annual report (SEDAR.com). Compare the results for the past three years and analyze the trends. Are they positive or negative? Explain.
4. Conduct some research and find articles discussing Valeant/Bausch Health Companies Inc. Has the company bought or sold any additional product assets (acquisition or divestment)?

MyLab Intro to Business

Study, practise, and explore real business situations with these helpful resources:
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.
- **Videos:** Learn more about the business practices and strategies of real companies.

MANAGING OPERATIONS AND INFORMATION

GOAL OF THE EXERCISE

This part of the business plan project asks you to think about your business in terms of both accounting concepts and information technology (IT) needs and costs. See Chapter Supplement 03 for material on IT.

MANAGING OPERATIONS AND INFORMATION

An increasingly important part of a business plan is a consideration of how IT—computers, the internet, social media, software, and so on—influences businesses. This part of the business plan asks you to assess how you will use technology to improve your business. Will you, for example, use a database to keep track of your customers? How will you protect your business from hackers and other IT security risks?

This part of the business plan also asks you to consider the costs of doing business, such as salaries, rent, and utilities. You'll also be asked to complete the following financial statements:

- *Balance sheet.* The balance sheet is a foundation for financial reporting. This report identifies the valued items of the business (its assets) as well as the debts that it owes (its liabilities). This information gives the owner and potential investors a snapshot revealing the health of the business.
- *Income statement (or profit-and-loss statement).* This is the focus of the financial plan. This document will show you what it takes to be profitable and successful as a business owner for your first year.

YOUR ASSIGNMENT

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Step 1 Open the saved Business Plan file you have been working on.
Step 2 For the purposes of this assignment, you will answer the following questions:

1. What kinds of IT resources will your business require?

   Hint: Think about the employees in your business and what they will need in order to do their jobs. What computer hardware and software will they need? Will your business need a network and an internet connection? What type of network? Refer to Chapter Supplement 03 for a discussion of IT resources you may want to consider.

2. How will you use IT to keep track of your customers and potential customers?

   Hint: Many businesses—even small ones—use databases to keep track of their customers. Will your business require a database? What about other information systems? Refer to Chapter Supplement 03 for more information on these topics.

3. What are the costs of doing business? Equipment, supplies, salaries, rent, utilities, and insurance are just some of these expenses. Estimate what it will cost to do business for one year.

   Hint: The Business Plan Student Template file provides a table for you to insert the costs associated with doing business. Note that these are just estimates—just try your best to include accurate costs for the expenses you think will be a part of doing business.

4. How much will you charge for your product? How many products do you believe you can sell in one year (or how many customers do you think your business can attract)? Multiply the price you will charge by the number of products you hope to sell or the amount you hope each customer will spend. This will give you an estimate of your revenues for one year.

   Hint: You will use the amounts you calculate in the costs and revenues questions in this part of the plan in the accounting statements in the next part, so be as realistic as you can.

5. Create a balance sheet and an income statement (profit-and-loss statement) for your business.

   Hint: You have two options for creating these reports. The first is to use the Microsoft Word versions that are found within the Business Plan Student Template itself. The second is to use the specific Microsoft Excel templates created for each statement, which can be found on this book's MyLab Intro to Business. These Excel files are handy because the worksheet calculations are preset—all you have to do is plug in the numbers and the calculations will be performed automatically for you. If you make adjustments to the different values in the Excel worksheets, you'll automatically see how changes to expenses, for example, can improve the bottom line.

6. Create a floor plan of the business. What does it look like when you walk through the door?

   Hint: When sketching your floor plan, consider where equipment, supplies, and furniture will be located.

7. Explain what types of raw materials and supplies you will need to run your business. How will you produce your good or service? What equipment do you need? What hours will you operate?

   Hint: Refer to the discussion of operations in Chapter 10 for information to get you started.

8. What steps will you take to ensure that the quality of the product or service stays at a high level? Who will be responsible for maintaining quality standards?

   Hint: Refer to the discussion of quality improvement and total quality management in Chapter 10 for information to get you started.

Note: Once you have answered the questions, save your Word document. You'll be answering additional questions in later chapters.

PART

04 PRINCIPLES OF MARKETING

12 UNDERSTANDING MARKETING PRINCIPLES AND DEVELOPING PRODUCTS 262

13 PRICING, PROMOTING, AND DISTRIBUTING PRODUCTS 287

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CHAPTER

12

Understanding Marketing Principles and Developing Products

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Explain the concept of *marketing* and identify the five forces that constitute the *external marketing environment*.
- **LO-2** Explain the purpose of a *marketing plan* and identify the four components of the *marketing mix*.
- **LO-3** Explain *market segmentation* and how it is used in *target marketing* and *positioning*.
- **LO-4** Discuss the purpose of *marketing research* and compare marketing research methods.
- **LO-5** Describe the *consumer buying process* and the key factors that influence that process.
- **LO-6** Discuss the three categories of *organizational markets* and the characteristics of business-to-business (B2B) buying behaviour.
- **LO-7** Explain the definition of a product as a *value package* and classify *goods and services*.
- **LO-8** Describe the key considerations in the new *product development process* and explain the importance of *branding and packaging*.

Maple Leaf: Capitalizing on the Meatless Meat Movement

Successful companies adapt to the times and create products that fit current market needs. They identify key trends and use resources and capabilities to capitalize on new growth opportunities. They build a competitive advantage to fight the competition. Maple Leaf Foods traces its history back more than 100 years. It has approximately 11 500 employees serving customers in Canada, the United States, and Asia with annual sales totalling over $3.5 billion. That is a nice legacy, but Maple Leaf clearly has its sights set on thriving for another century.

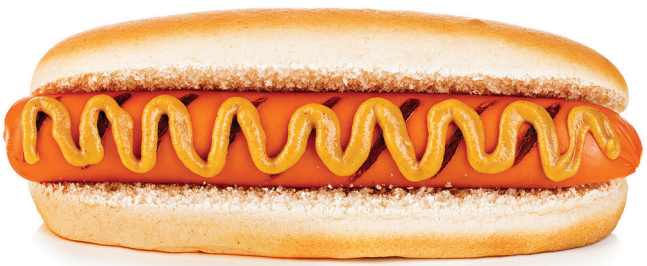
Maple Leaf's website describes the organization as a leading "protein company." You probably associate their brand more with traditional cold cuts and bacon, but their broader description includes a growing category with tremendous potential: meatless meat. Maple Leaf is serious about this diversification. In 2018, they closed a deal to acquire Field Roast Grain Meat Company, for USD$120 million. One year earlier, Maple Leaf Foods acquired LightLife Foods for USD$140 million. These significant purchases marked a clear commitment. In the words of President and CEO Michael McCain, "the acquisitions complement our portfolio in the fast-growing market of alternative proteins." Maple Leaf plans to build significant share through investment, brand building, and continued innovation.

What Exactly Is Meatless Meat?

Throughout this book, we have examined disruptions in business. Well, this is yet another example. Plant-based farming along with scientific advances from places such as Silicon Valley are aiming to eventually eliminate the use of animals for meat production altogether and shut down slaughterhouses for good. They have already made a significant impact. Various plant-based and clean meat options look and taste like regular meat. Some of the products even bleed and sizzle, and Maple Leaf is not alone in pursuing this market. According to David Lee, CFO and COO of Impossible Foods, it takes 95 percent less land and one-quarter of the water to make these products. They also produce one-eighth of the greenhouse gas emissions of an equivalent amount of regular meat. In addition, advocates point to a hidden benefit of clean meat. It enables producers to potentially replace unhealthy saturated animal fats with healthy fats (like the ones found in flax seed). There are a lot of benefits!

According to Nestlé, plant-based protein will be worth $5 billion in the United States alone in 2020. The global market is estimated at $13 billion, and it is expected to double in the next two decades. Here are some of the companies, people, and organizations betting on this category.

- Tyson Foods (the largest meat producer in the United States) has invested heavily in a company called Beyond Meat, which is now distributed in more than 19 000 locations. The executive VP of Tyson used a similar line when he said; "We are no longer solely focused on meat; we now view ourselves as a protein company."
- Impossible Foods has raised more than USD$300 million in financing.



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Helen Sessions/Alamy Stock Photo

- Nestlé acquired Sweet Earth Foods, which sells products like "harmless ham."
- Richard Branson, Bill Gates, and Cargill invested $17 million in Memphis Meats.
- An alliance of 120 companies (focused on developing plant-based proteins) won a spot in the $950 million supercluster with major funding from the Canadian Federal Government. Dan Prefontaine, president of Saskatchewan Food Industry Development Centre, indicated that this move was driven by a demand for choice in protein sources.

Opposition: What's in a Name?

But not everyone is welcoming this new product category growth with open arms. For example, the U.S. Cattlemen's Association, is trying to legally block these alternative meat companies from using the terms "meat" and "beef." Similar actions are already being debated in the European Union. Activists are also spreading fear. For example, Dana Pearls, from a group called Friends of the Earth, claims that companies are rushing food to consumers without proper testing and says that people are being used as "guinea pigs."

Promoting Innovations: Understanding the Product Life Cycle

So, have you had a meatless burger yet? Will you try one soon? Is this a great way for us to consume our diet, with

foods that are cruelty-free and sustainable, or do you consider these products Frankenstein meat? Perceptions change. It is important for companies to look at the external environment and understand trends. Clearly, Maple Leaf is an old dog learning new tricks. Based on the numbers, and the players involved, it looks like meatless meat is here to stay. With the world population growing and science creating new advances, Maple Leaf is moving forward. However, as you will find in this chapter, new products and product categories face major challenges when moving from the initial introduction stage, to growth, and then to successful maturity. The questions for Maple Leaf are: How can it successfully promote and position its branded products in a way that appeals to consumers? Should it actively promote these products to meat lovers and try to convert them? Should it focus on traditional vegetarians? The next few years will witness a lot of strategizing on how to best convince consumers to buy alternative protein products. Your local supermarket will be ground zero.

• QUESTIONS FOR DISCUSSION •

1. How are the elements of the external marketing environment influencing Maple Leaf's marketing strategy? Explain your reasoning.
2. After reading this chapter, examine the product development process and link it to the evolution of the meatless meat category.
3. Explain the roles of target marketing and market segmentation as they apply to this case.
4. Describe how you and your group might try to target "meat eaters" to help convert them to a plant-based burger?

HOW WILL THIS HELP ME?

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Adjusting its marketing strategy is an example of how a company can apply marketing basics to appeal to the forces of the external marketing environment. This chapter examines the marketing plan, components of the marketing mix, and the roles of targeting, market segmentation, and positioning. It also explores the fundamentals of market research and the key factors that influence the consumer and organizational buying processes. The chapter concludes with a look at how new products are developed and how they are defined by branding and packaging. By grasping the marketing methods and ideas in this chapter, you will be better prepared not only as a marketing professional but also as an informed consumer.

LO-1 WHAT IS MARKETING?

What comes to mind when you think of marketing? Most people think of advertisements such as those designed for detergents and soft drinks. Or they think of promoting products to customers through social media outlets. However, marketing covers a much wider range of activities. **Marketing** can be defined as "an organizational function and a set of processes for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders."[1]

A company that employs the **marketing concept** is coordinated to achieve one goal—to serve its present and potential customers at a profit. This concept means that a firm must get to know what customers really want and closely follow evolving tastes. The various departments of the firm—marketing, production, finance, and human resources—must operate as a well-coordinated system unified in the pursuit of customer satisfaction.

Delivering Value

What attracts buyers to one product instead of another? Although our desires for the many goods and services available to us may be unlimited, financial resources force most of us to be selective. Accordingly, customers buy products that offer the best value when it comes to meeting their needs and wants.

MARKETING An organizational function and a set of processes for creating, communicating, and delivering value to customers and for managing customer relationships in ways that benefit the organization and its stakeholders.

MARKETING CONCEPT The idea that the whole firm is directed towards serving present and potential customers at a profit.

Value and Benefits

The **value** of a product compares its benefits with its costs. Benefits include not only the functions of the product, but also the emotional satisfaction associated with owning, experiencing, or possessing it. But every product has costs, including sales price, the expenditure of the buyer's time, and even the emotional costs of making a purchase decision. A satisfied customer perceives the benefits gained from the purchase to be greater than its costs. Thus, the simple but important ratio for value is derived as follows:

$$\text{Value} = \text{Benefits}/\text{Costs}$$

The marketing strategies of leading firms focus on increasing value for customers. Marketing resources are deployed to add benefits and decrease costs of products to provide greater value. To satisfy customers, a company may do any of the following:

- develop an entirely new product that performs better (provides greater performance benefits) than existing products
- keep a store open longer hours during a busy season (adding the benefit of greater shopping convenience)
- offer price reductions (the benefit of lower costs)
- offer information that explains how a product can be used in new ways (the benefit of new uses at no added cost)

Value and Utility

To understand how marketing creates value for customers, we need to know the kind of benefits that buyers get from a firm's goods or services. As we discussed in Chapter 10, those benefits provide customers with **utility**—the ability of a product to satisfy a human want or need. Marketing strives to provide four kinds of utility in the following ways:

- *Form utility.* Marketing has a voice in designing products with features that customers want.
- *Time utility.* Marketing creates a time utility by providing products when customers will want them.
- *Place utility.* Marketing creates a place utility by providing products where customers will want them.
- *Possession utility.* Marketing creates a possession utility by transferring product ownership to customers by setting selling prices, by setting terms for customer credit payments if needed, and by providing ownership documents.

Because they determine product features and the timing, place, and terms of sale that provide utility and add value for customers, marketers must understand customers' wants and needs. The methods that marketers use for creating utility are described in this and the following chapter.

Goods, Services, and Ideas

The marketing of tangible goods is obvious in everyday life. It applies to two types of customers: those who buy consumer goods and those who buy industrial goods. Think of the products that you bought the last time you went to the mall or the grocery store or on the internet. In a department store, an employee asks if you'd like to try a new brand of cologne. Your local auto dealer offers an economy car at an economy price. These products are **consumer goods**: tangible goods that you can buy for personal use. Firms that sell goods to consumers for personal consumption are engaged in consumer marketing, also known as B2C (business-to-consumer) marketing.

Marketing also applies to **industrial goods**: physical items used by companies to produce other products. Surgical instruments and bulldozers are industrial goods, as are many components and raw materials such as integrated circuits, steel, and plastic. Firms that sell goods to other companies are involved in industrial marketing, also known as B2B (business-to-business) marketing.

But marketing techniques are also applied to **services**—products with intangible (non-physical) features, such as professional consulting advice, timely information for decisions, or arrangements for a vacation. Service marketing—the application of marketing for services—continues to be a major growth area in Canada. Insurance companies, airlines,

VALUE A relative comparison of a product's benefits versus its costs.

UTILITY The ability of a product to satisfy a human want or need.

CONSUMER GOODS Physical products purchased by consumers for personal use.

INDUSTRIAL GOODS Physical products purchased by companies to produce other products.

SERVICES Products with non-physical features, such as information, expertise, or an activity that can be purchased.

Fairmont Hotels actively use CRM techniques to satisfy customers in more than 60 luxury properties around the globe, including the scenic Fairmont Chateau Lake Louise.

Achinthamb/Shutterstock

public accountants, and health clinics all engage in service marketing, both to individuals (consumer markets) and to other companies (industrial markets).

Finally, marketers also promote ideas. Ads in theatres, for example, warn us against copyright infringement and piracy. Other marketing campaigns may stress the advantages of avoiding fast foods, avoiding texting while driving, or quitting smoking—or they may promote a political party or candidate.

Here's an example of a campaign promoting the values of preservation that led to discussions at the provincial level and official promises of additional protection from the government. Most of Canada's woodland caribou populations are in decline. Mandy Gull, deputy chief of the Waswanipi Cree Nation (in Northern Quebec), and her team created an old-fashioned letter-writing campaign after presenting their case to a Global Conference of Executives in New York with the goal of preserving their ancestral forest lands. The land they are fighting for is believed to be one of the last untouched boreal forests.[2]

Relationship Marketing and Customer Relationship Management

Although marketing often focuses on single transactions for products, services, or ideas, marketers also take a longer-term perspective. Thus **relationship marketing** emphasizes building lasting relationships with customers and suppliers. Stronger relationships—including stronger economic and social ties—can result in greater long-term satisfaction, customer loyalty, and customer retention.[3] A recent survey by Northstar indicated that 74 percent of consumers reported switching from one brand to another in the previous year.[4] Clearly, companies must find more effective ways to connect with consumers. Like many other marketing areas, the ways that marketers go about building relationships with customers are evolving. Tim Hortons has a traditional rewards card known as the Tim Card and another version in the form of the Tim Hortons mobile app that attracts return customers with free coffee refills and other extras.

Customer relationship management (CRM) is an organized method that enterprises use to build better information connections with clients. The power of internet communications, coupled with the ability to gather and assemble information on customer preferences, allows marketers to better predict what clients will want and buy. Compiling and storing customers' data, known as *data warehousing*, provides the raw materials from which marketers can gather information that allows them to find new clients. It also identifies their best customers who can then be informed about upcoming new products and supplied with special information such as post-purchase service reminders. *Data mining* automates the massive analysis of data by using computers to sort and search for previously undiscovered clues about what customers look at and react to and how they might be influenced.[5]

Toronto-based Fairmont Resort Hotels first used data mining to rebuild its customer-relations package by finding out what kinds of vacations their customers prefer and then placing ads where they were more likely to reach those customers. When data mining revealed the worldwide destinations of Fairmont customers, it helped determine Fairmont's decision to buy its customers' number one preference—the Savoy in London.[6] More recently, Fairmont's enhanced CRM is attracting new guests, along with heightening relationships and loyalty among existing clients, through web-based promotions and incentives. Using profiles of guest information, Fairmont identifies target traveller segments and supplies travellers with personalized price discounts and special hotel services.[7] Many hotels offer guests elite services, for valuable customers, such as the use of Bentley or Lexus cars during their stay. But experts will tell you that the key is "experience choreography" ensuring that everything from the extraordinary services like these to the quality of toilet paper all align.[8]

For a more detailed discussion on data warehousing and data mining refer to **Chapter Supplement 03**: Using Technology to Manage Information in the Internet and Social Media Era.

FIGURE 12.1 The external marketing environment

The Marketing Environment

Marketing strategies are not determined unilaterally by a business—rather, they are strongly influenced by powerful outside forces. As you see in Figure 12.1, every marketing program must recognize the factors in a company's external environment, that is, everything outside an organization's boundaries that might affect it. In this section, we discuss how these external forces affect the marketing environment.

Political–Legal Environment

Political activities, both global and domestic, have a major influence on marketing. For example, environmental legislation has determined the destinies of entire industries. The political push for alternative energy sources is creating new markets and products for emerging companies, such as India's Suzlon Energy Limited (large wind turbines). Marketing managers try to maintain favourable political and legal environments to gain public support.

RELATIONSHIP MARKETING A marketing strategy that emphasizes building lasting relationships with customers and suppliers.

CUSTOMER RELATIONSHIP MANAGEMENT (CRM) Organized methods that a firm uses to build better information connections with clients so that stronger company–client relationships are developed.

Socio-Cultural Environment

Changing social values force companies to develop and promote new products. Just a few years ago, organic foods were available only in specialty food stores such as Whole Foods. Today, in response to a growing demand for healthy foods, we see new organic lines in traditional supermarkets such as Loblaws (notably the PC Organics line). In addition, Whole Foods and other grocers like it are expanding. In 2018, Whole Foods had 479 stores in Canada, the United States, and the United Kingdom.[9] The acquisition of Whole Foods by Amazon was yet another sign of the trend, and now with the addition of home delivery service, Whole Foods is positioned to take advantage of the growing socio-cultural trend.[10]

Technological Environment

New technologies create new goods and services. New products make existing products obsolete, and many products change our values and lifestyles. In turn, lifestyle changes often stimulate new products not directly related to the new technologies themselves. For example, smartphones facilitate business communication just as prepackaged meals provide convenience for busy household cooks. Both kinds of products also free up time for recreation and leisure.

Economic Environment

Because they determine spending patterns by consumers, businesses, and governments, economic conditions influence marketing plans for product offerings, pricing, and promotional strategies. Marketers are concerned with economic variables such as inflation, interest rates, and recession. Thus they monitor the general business cycle to anticipate trends in consumer and business spending. Subtle consumer shifts in attitude can affect all areas of business and must be considered when building marketing strategies.[11]

Competitive Environment

In a competitive environment, marketers must convince buyers that they should purchase one company's products rather than those of another seller. Because both consumers and commercial buyers have limited resources, every dollar spent on one product is no longer available for other purchases. Each marketing program, therefore, seeks to make its product the most attractive one. Expressed in business terms, a failed program loses the buyer's dollar forever (or at least until it is time for the next purchase decision).

New technologies lead to new products, such as the electric car. The long-term success of this product category will depend largely on the creation of proper infrastructure. These stations enable customers to recharge their vehicles. As cities and businesses increase investment in such stations, the electric car will become more practical for the mass consumer.

Sopotnicki/Shutterstock

To promote products effectively, marketers must first understand which of three types of competition they face:

- *Substitute products* may not look alike, or they may seem very different from one another, but they can fulfill the same need. For example, your cholesterol level might be controlled with either of two competing products: a physical fitness program or a drug regimen. The fitness program and the drugs compete as substitute products.
- *Brand competition* occurs between similar products and is based on buyers' perceptions of the benefits of products offered by companies. For internet searches, do you turn to the Google or Bing search engine? Brand competition is based on users' perceptions of the benefits offered by each product.
- *International competition* matches the products of domestic marketers against those of foreign competitors. The intensity of international competition has been heightened by the formation of alliances, such as the European Union, USMCA, and the Canada-European Union Comprehensive Economic and Trade Agreement (CETA).

Having identified the kind of competition, marketers can then develop a strategy for attracting more customers.

LO-2 DEVELOPING THE MARKETING PLAN

The **marketing plan** identifies the marketing objectives stating what marketing will accomplish in the future. It contains a strategy that identifies the specific activities and resources that will be used to meet the needs and desires of customers in the firm's chosen target markets, so as to accomplish the marketing objectives.

A marketing manager at a major home appliance manufacturing company explains the concept of *developing the marketing plan* by using the analogy of planning for a trip:

- "First, you decide where you want to go and what you want to happen when you get there. Why take this trip and not others, instead?"

  [Identify the *objective* or *goal* to be achieved.]
- "At some stage you decide when the trip will happen and how you'll get to the destination."

  [*Plan* for *when* it will happen, and for the *paths* (or *routes*) that will be taken to get there.]
- "Every trip requires resources, so you identify the requirements and compare them against resources that are available."

  [*Evaluate resource* requirements and availabilities.]

MARKETING PLAN Detailed strategy for focusing marketing efforts on consumers' needs and wants

- "If available resources are too expensive, then you adjust the trip so it becomes more affordable."

  [*Adjust plans* as needed to become *realistic* and *feasible*.]

- "During and after the trip, you assess the successes (what went right) and the drawbacks (what went wrong) and consider them to make the next trip even better."

  [Keep notes and data about what happened because *learning* from this experience increases the chances for *greater success on the next*.]

First and foremost, marketing plans are futuristic, showing what will be happening with marketing's upcoming activities. Every well-founded marketing plan, as shown in Figure 12.2, begins with objectives or goals setting the stage for everything that follows. **Marketing objectives**, the goals the marketing plan intends to accomplish, are the foundation that guides all the detailed activities in the plan. The marketing objectives themselves, however, exist solely to support the company's overall business mission (at the top in Figure 12.2) and typically focus on maintaining or enhancing the organization's future competitive position in its chosen markets. Hypothetically, Starbucks's overall business mission could aim at being the world's leading retailer of specialty coffee. Two supporting marketing objectives, then, could be (1) achieve a 5 percent increase in its worldwide market share by 2020 and (2) become the leading retailer (in dollar sales) of specialty coffee in China by 2022.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. Hootsuite—Social Media Tool **Source:** Hootsuite Social **Key Features:** Permits you to manage and schedule posts to multiple social media profiles on Twitter, Facebook, LinkedIn, Instagram, and more.	Apple, Android, BlackBerry, Windows
2. Icon Pop Brand **Source:** Alegrium **Key Features:** A logos quiz game that challenges players to name products, brands, companies, and organizations using imaginative, handcrafted visual clues inspired by each answer.	Apple, Android, Windows
3. Fiverr—Freelance Services **Source:** Fiverr Business **Key Features:** Provides access to a global network of freelancers for services to start or grow your business (logo design, product description, editing videos, etc.)	Apple, Android, BlackBerry, Windows

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" marketing apps and identify the key features.

Strategy: The Marketing Mix

The marketing team can develop a strategy once it has clarified the marketing objectives. Specifically, **marketing strategy** identifies the planned marketing programs, all the marketing activities that a business will use to achieve its marketing goals, and when those activities will occur. If planned activities are not affordable, then marketers need to adjust the activities or goals until realistic plans emerge. Finally, marketing planning is an ongoing process; it can be improved through experience by learning from past triumphs and mistakes.

Marketing managers are the people responsible for planning, organizing, leading, and controlling the organization's marketing resources towards supporting and accomplishing the organization's overall mission. To meet these responsibilities, marketing managers rely on mapping out a clear strategy for planning and implementing all the activities that result in the transfer of goods or services to customers. As you can see in Figure 12.2, the marketing strategy focuses on the needs and wants of customers in the company's chosen target markets. Marketing strategy also includes four basic components (often called the "4 Ps") of the **marketing mix**, *product, pricing, place*, and *promotion,* that marketing managers use to satisfy customers in target markets. The specific activities for each of the 4 Ps will be designed differently to best meet the needs of each target market.

You can learn more about many of the key terms and concepts in this chapter by examining and downloading the contents from the box entitled "There's an App for That!"

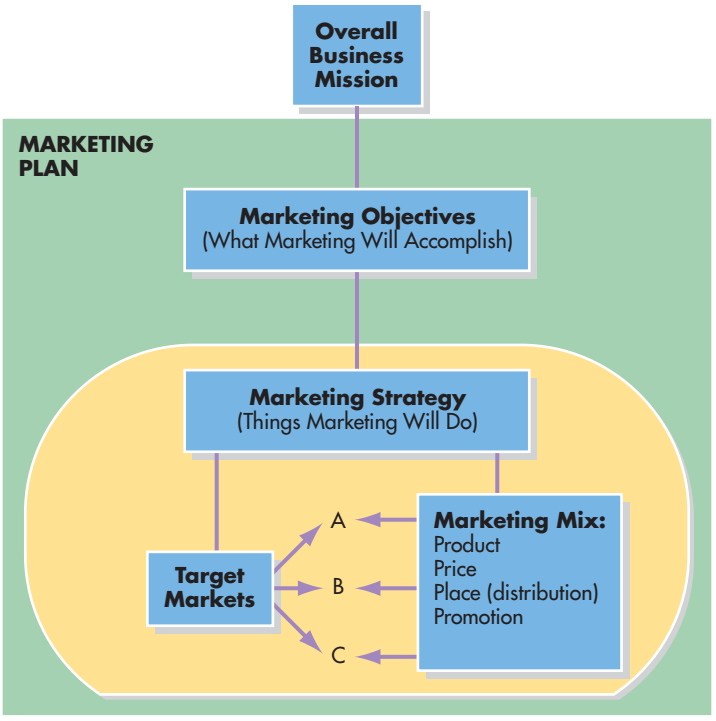

FIGURE 12.2 Components of the marketing plan

Product

Marketing begins with a **product**—a good, a service, or an idea designed to fill a customer's needs or wants. Conceiving and developing

MARKETING OBJECTIVES The things marketing intends to accomplish in its marketing plan.

MARKETING STRATEGY All the marketing programs and activities that will be used to achieve the marketing goals.

MARKETING MIX A combination of product, pricing, promotion, and place (distribution) strategies used to market products.

PRODUCT Good, service, or idea that is marketed to fill consumers' needs and wants.

new products is a constant challenge for marketers, who must always consider changing technology, changing wants and needs of customers, and changing economic conditions. Recently, Second Cup announced that it would convert some underperforming locations in Western Canada into recreational marijuana dispensaries under the META brand name. The pilot project includes 20 stores in Alberta. Second Cup has applied for licenses in partnership with National Access Cannabis. The company indicated that a location that currently has revenues of $750 000 can possibly bring in as much as $5 million in revenues. If those numbers are accurate, then this experiment may be the first of a larger integrated strategy for Second Cup.[12]

Producers often promote features of products to distinguish them in the marketplace. **Product differentiation** is the creation of a feature or image that makes a product differ enough from existing products to attract customers. For example, Lululemon has a clear identity based on a yoga-inspired theme and has carved out a strong presence in the athletic clothing market. We cover the development process and the branding of products in detail in the closing section of the chapter.

Pricing

Pricing a product—selecting the best price at which to sell it—requires consideration of several variables and is a difficult balancing act. From a manufacturer's point of view, prices must support the organization's operating, administrative, research, and marketing costs. On the other hand, prices cannot be so high that consumers turn to competing products. Successful pricing means finding a profitable middle ground between these two requirements. For example, WestJet has launched a new sub-brand called Swoop to serve the ultra-low-cost market of no-frills travellers. The goal is to reduce the number of Canadian consumers crossing the border to take cheap flights out of the United States. The long-term plans are to offer flights from Canadian cities to destinations in the United States; however, the initial flights were launched within Canada and were advertised at prices as low as $39 for a one-way trip from Abbotsford, British Columbia, to Edmonton, Alberta.[13]

Both low- and high-price strategies can be effective, depending on the situation. Low prices will generally lead to a larger volume of sales. High prices will usually limit the size of the market but will increase a firm's profits per unit. In some cases, however, high prices may attract more customers by implying that the product is especially good or rare. We discuss pricing in more detail in Chapter 13.

Tara Walton/CP Images

Swoop is WestJet's new sub-brand aimed at the ultra-low-cost no-frills segment.

Place (Distribution)

In the marketing mix, **place** refers to **distribution**. Placing a product in the proper outlet—for example, a retail store—requires decisions about several activities, all of which are concerned with getting the product from the producer to the consumer. Decisions about warehousing and inventory control are distribution decisions, as are decisions about transportation options.

Firms must also make decisions about the channels through which they distribute products. Many manufacturers, for example, sell goods to other companies that, in turn, distribute them to retailers. Others sell directly to major retailers, such as The Bay. Still others sell directly to final consumers. We explain distribution decisions further in Chapter 13.

Promotion

The most visible component of the marketing mix is, no doubt, **promotion**, which refers to techniques for communicating information about products. The most important promotional tools include advertising, personal selling, sales promotions, publicity/public relations, and direct or interactive marketing. Promotion decisions are discussed further in Chapter 13.

PRODUCT DIFFERENTIATION Creation of a product feature or product image that differs enough from existing products to attract customers.

PRICING The process of determining the best price at which to sell a product.

PLACE (DISTRIBUTION) The part of the marketing mix concerned with getting products from producers to consumers.

PROMOTION The aspect of the marketing mix concerned with the most effective techniques for communicating information about products.

LO-3 MARKETING STRATEGY: MARKET SEGMENTATION, TARGET MARKETING, AND POSITIONING

Market segmentation refers to dividing a market into categories of customer types or "segments." Marketers have long known that products cannot be all things to all people. The emergence of the marketing concept and the recognition of customers' needs and wants has led marketers to think in terms of **target markets**—groups of people or organizations with similar wants and needs, who can be expected to show interest in the same products.

After they have identified segments, companies may adopt a variety of strategies. Some firms target more than one segment (with different

MARKET SEGMENTATION The process of dividing a market into categories of customer types or "segments."

TARGET MARKET A group of people who have similar wants and needs and can be expected to show interest in the same products.

offers). For example, General Motors offers a wide variety of automobiles with various features and price points. In contrast, some businesses offer a narrower range of products, such as Ferrari's high-priced sports cars, aiming at a narrow segment. Note that segmentation is a strategy for analyzing consumers, not products. When a target segment is identified, the marketing of products for that segment begins.

The process of fixing, adapting, and communicating the nature of the product itself is called **product positioning**. In the Canadian coffee-house landscape, two companies stand out with very different value propositions and positioning approaches. Tim Hortons emphasizes a standardized product and provides fast service to people in a hurry, while Starbucks provides more customized products in more leisurely surroundings.

Identifying Market Segments

Members of a market segment must share some common traits that affect their purchasing decisions. In identifying consumer segments, researchers look at several different influences on consumer behaviour. The next section examines five of the most important segmentation approaches: demographic, geographic, geo-demographic, psychographic, and behavioural segmentation.

Demographic Segmentation

Demographic variables describe populations by identifying characteristics such as age, income, gender, ethnic background, marital status, race, religion, and social class as detailed in Table 12.1. Note that these are objective criteria that cannot be altered. Marketers must work with or around them.

Depending on the marketer's purpose, a segment can be a single classification (e.g., age 20 to 34) or a combination of categories (e.g., age 20 to 34, married with children, earning $40 000 to $59 999). For example, specialized services and products are being developed to serve the growing retirement needs of aging baby boomers. Shoppers Drug Mart launched a new retail concept called Wellwise with this segment in mind. It aims to get past stereotypes and create a positive bright experience compared to other aging-products stores.[14]

TABLE 12.1 Demographic Variables

Age	Under 5; 5–11; 12–19; 20–34; 35–49; 50–64; 65+
Education	Elementary school or less; some high school; graduated high school; some college or university; college diploma or university degree; advanced degree
Family Life Cycle	Young single; young married without children; young married with children; older married with children under 18; older married without children under 18; older single; other
Family Size	1, 2–3, 4–5, 6+
Income	Under $20 000; $20 000–$39 999; $40 000–$59 999; $60 000–$79 999; $80 000 and over
Nationality	Including but not limited to English, French, Irish, Italian, Latin American, Middle Eastern, and Scandinavian
Race	Including but not limited to Aboriginal, Asian, Black, and White
Religion	Including but not limited to Buddhist, Catholic, Hindu, Jewish, Muslim, and Protestant
Gender	Male, female, trans

In Canada, the two dominant cultures—English and French—have historically shown significant differences in consumer attitudes and behaviour. Researchers have found that compared with English Canadians, French Canadians are more involved with home and family, attend the ballet more often, travel less, eat more chocolate, and are less interested in convenience food. Canada's great ethnic diversity requires companies to pay

PRODUCT POSITIONING The process of fixing, adapting, and communicating the nature of a product to appeal to the selected target market.

DEMOGRAPHIC VARIABLES Characteristics of populations that may be considered in developing a segmentation strategy.

Pearson Canada

Alamy Stock Photo

Wellwise is a retail brand launched by Shoppers Drug Mart aimed squarely at the needs of aging baby boomers.

close attention to ethnicity as a segmentation variable. These consumers can be precisely targeted using one of the 358 media outlets geared towards 93 ethnic groups in Canada. Ethnic TV stations include the Fairchild Network (Cantonese and Mandarin) and ATN (South Asian).[15]

Geographic Segmentation

Many buying decisions are affected by the places people call home. **Geographic variables** are the geographical units, from countries to neighbourhoods, that may be important in a segmentation strategy. For example, the heavy rainfall in British Columbia prompts its inhabitants to purchase more umbrellas than people living in Arizona's desert climate. Urban dwellers have less demand for pickup trucks than their rural counterparts. Sailboats sell better along both coasts than they do in the Prairie provinces. These patterns affect marketing decisions about what products to offer, at what price to sell them, how to promote them, and how to distribute them. Consider the marketing of down parkas in rural Saskatchewan. Demand will be high, price competition may be limited, local newspaper advertising may be very effective, and the best location may be one easily reached from several small towns.

Geo-Demographic Segmentation

Geo-demographic variables are a combination of geographic and demographic traits, and they are becoming the most common segmentation tool. An example would be Young Urban Professionals—well-educated, 25-to-34-year-olds with high-paying professional jobs living in the "downtown" core of major cities. This type of segmentation is more effective because the greater number of variables define the market more precisely.

Psychographic Segmentation

Members of a market can also be segmented according to **psychographic variables** such as lifestyles, opinions, interests, and attitudes. Psychographic variables help us understand why two demographically identical people (e.g., male, 28 years old, with one child, earning $55 000 per year) may make totally different purchases. One person may be very environmentally friendly and prefer to purchase an electric car, and the other may be more of a thrill-seeker who prefers performance and is not particularly concerned with environmental issues. In other words, statistics alone are not enough.

Psychographics are also important to marketers because, unlike demographics and geographics, they can sometimes be changed by marketing efforts. Many companies have succeeded in changing some consumers' opinions by running ads highlighting products that they have improved directly in response to consumer desires.

Behavioural Segmentation

Behavioural segmentation refers to dividing a market into groups based on consumer knowledge, use, or response to a product.[16] **Behavioural variables** include *benefits sought* (e.g., Head and Shoulders shampoo addresses dandruff control), *user status* (i.e., ex-users, current users, non-users, etc.), *usage rate* (i.e., heavy users vs. light users), *loyalty status* (i.e., highly brand-loyal vs. brand-promiscuous), and *occasion for use* (e.g., time of day, special occasion, etc.).

GEOGRAPHIC VARIABLES Geographic units that may be considered in developing a segmentation strategy.
GEO-DEMOGRAPHIC VARIABLES A combination of geographic and demographic traits used in developing a segmentation strategy.
PSYCHOGRAPHIC VARIABLES Consumer characteristics, such as lifestyles, opinions, interests, and attitudes that may be considered in developing a segmentation strategy.
BEHAVIOURAL VARIABLES Behavioural considerations, such as benefits sought, loyalty status, usage rate, user status, and occasion for use that may be used in developing a segmentation strategy.

LO-4 MARKETING RESEARCH

Marketing decisions are seldom perfect, yet the consequences of a firm's choices of marketing mix and segmentation strategy can be long-lasting. Effective decisions must be customer-focused and based on timely information about marketplace trends. **Marketing research**, the study of what customers need and want and how best to meet those needs and wants, is a powerful tool for gaining decision-making information.

The relationship of research to the overall marketing process is shown in Figure 12.3. Ultimately, its role is to increase competitiveness by clarifying the interactions among a firm's stakeholders (including customers), marketing variables, environmental factors, and marketing decisions. Researchers use several methods to obtain, interpret, and apply information about customers. Such data helps determine what information is needed for decisions on marketing strategy, goal setting, and target market selection. Researchers may conduct studies on customer responses to proposed changes in the marketing mix. One researcher, for example, might study response to an experimental paint formula (new product). Another might explore the response to a price reduction (new price) on condominiums. Still a third might check responses to a proposed advertising campaign (new promotion). Marketers also try to learn whether customers are more likely to purchase a product in a specialty shop or on the internet (new place).

The Research Process

Market research can occur at almost any point in a product's existence, but it is most frequently used when a new or altered product is being considered. There are five steps to performing market research:[17]

1. *Study the current situation*. What is the need, and what is currently being done to meet it?
2. *Select a research method.* In choosing a method, marketers must bear in mind the effectiveness and costs of different methods.
3. *Collect secondary data. Secondary data* refers to information already available from previous research by the firm or other organizations. For example, Statistics Canada publishes a great deal of useful data for business firms. Using secondary data can save time, effort, and money. But in some cases, secondary data is unavailable or inadequate, so *primary data*—new research by the firm or its agents—must be obtained.

MARKETING RESEARCH The study of what customers need and want and how best to meet those needs and wants.

4. *Analyze the data.* Data is not useful until it has been organized into clear information.
5. *Prepare a report.* This report normally includes a summary of the study's methodology and findings, various alternative solutions (where appropriate), and recommendations for an appropriate course of action.

Research Methods

The four basic types of methods used by market researchers are *observation, survey, focus groups*, and *experimentation*.

Observation

Probably the oldest form of market research is simple **observation**. It is also a popular research method because it is relatively low in cost, often drawing on data that must be collected for some other reason, such as reordering. In the past, when a store owner noticed that customers were buying red children's wagons, not green ones, the owner reordered more red wagons, the manufacturer's records showed high sales of red wagons, and the marketing department concluded that customers wanted red wagons. Today, sophisticated high-definition cameras record consumer actions for analysis.

Observation does not end at simple surveillance techniques with an anthropological perspective. Electronic observation and data analytics tools are permitting companies and organizations (e.g., political parties) to gain information that can be used for micro-targeting purposes. Some of these practices have been called into question because of the high-profile role Cambridge Analytica played in the U.S elections. This company designed micro campaigns based on building voter profiles from detailed information that they gained from the private profile information of 87 million Facebook users. At the time, Mark Zuckerberg and his team faced serious questions about their privacy policies and the way they handle user information. In early 2018, Mr. Zuckerberg was actually called into the U.S. Congress to face serious questions from lawmakers.[18]

OBSERVATION A market research technique involving viewing or otherwise monitoring consumer buying patterns.

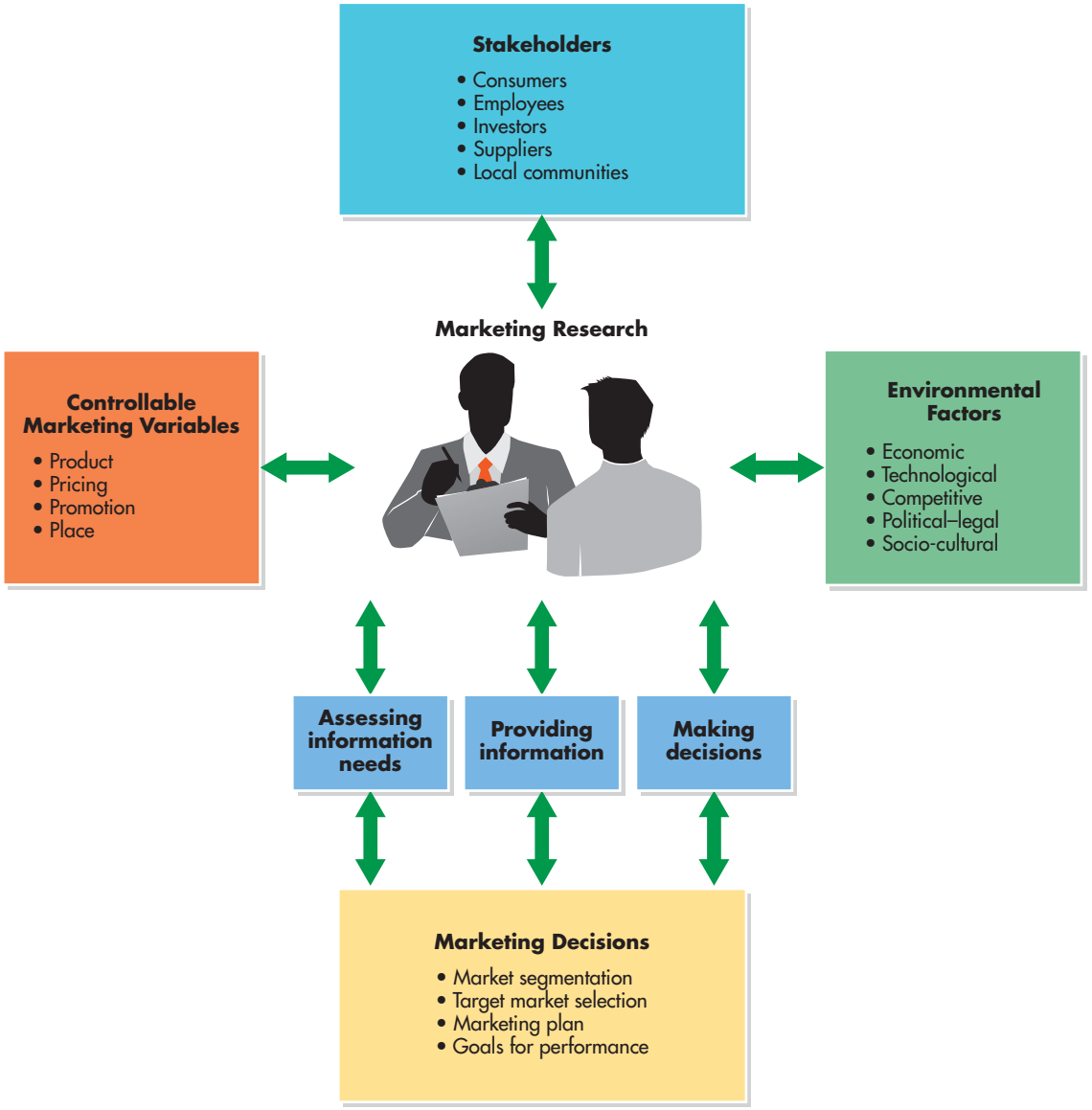

FIGURE 12.3 Market research and the marketing process

Survey

Sometimes observation of current events is not enough, and marketers need to conduct a **survey** to find out what consumers want. The heart of any survey is a questionnaire carefully designed to give the company honest answers about specific research issues. Traditional surveys can be expensive to carry out and may vary widely in their accuracy. Because no firm can afford to survey everyone, marketers carefully select a representative group of respondents. In the past, surveys have been mailed to individuals, but online surveys are now extremely popular and have revolutionized the field. Survey Monkey is a leader in this space; its site claims that it is the number one survey software site with over 16 million questions answered daily.[19] Survey Monkey recently expanded its operations in Canada after buying a start-up in Ottawa for an estimated $70 million.[20]

Focus Groups

Many firms also use **focus groups** in which 6 to 15 people are brought together to talk about a product or service. A moderator leads the group's discussion, and employees from the sponsoring company may observe the proceedings from behind a one-way mirror. People's comments are taped, and researchers go through the data looking for common themes. The groups are not usually told which company is sponsoring the research.

For an interesting modern look at the subject of interactive research, check out the E-Business and Social Media Solutions box entitled "Crowdsourcing: Wisdom from the Consumer World."

Experimentation

Experimentation compares the responses of the same or similar individuals under different circumstances. For example, a firm that is trying to decide whether to include walnuts in a new candy bar probably would not learn much by asking people what they thought of the idea. But if it made some bars with nuts and some without nuts and then asked people to try both, the responses could be very helpful.[21]

SURVEY A market research technique based on questioning a representative sample of consumers about purchasing attitudes and practices.

FOCUS GROUP A market research technique involving a small group of people brought together and allowed to discuss selected issues in depth.

EXPERIMENTATION A market research technique in which the reactions of similar people are compared under different circumstances.

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

Crowdsourcing: Wisdom from the Consumer World

Rawpixel/123RF

Two decades ago, Marc Stiegler wrote a novel called *EarthWeb* based on the idea that the people of Earth were desperately seeking new ways to defeat the systematic attacks of an advanced, mechanical alien enemy. The government supplied small computers (like iPads) to the public to devise battle strategies that went beyond the abilities of any single individual. Even though the technology is no longer fiction, this novel was written long before any kind of crowdsourcing of ideas was possible. Earth is not under attack, but certainly we have seen the advent of big data, crowdsourcing, and information accessibility. Wikipedia is an example of the collective wisdom of a large group of people, demonstrating both the power and the weaknesses of such a system. Errors and omission are common, and yet there is an incredible amount of expert information available. Companies such as Amazon are using big data, collected from millions of consumers, to drive critical business decisions. Even more recently, the information age has given rise to crowdsourcing companies such as Tongal, so named in honour of Sir Francis Galton, a half-cousin of Charles Darwin, who observed a county fair contest for guessing the weight of an oxen and noted that the average of the crowd's guesses was much closer to the actual weight than any individual guess.

Tongal specializes in crowdsourcing creative work, such as instructional videos, marketing materials, and original content for websites for companies such as Gillette (creating 18 authentic "how-to-shave" videos for YouTube), General Mills (designing digital ads targeted to the gaming culture), Fiat (a story-based campaign spread across social networks such as Facebook, YouTube, and Twitter), and many others. Colgate-Palmolive worked with the Tongal community on a two-month, $17 000 challenge to develop ads for Speed Stick deodorant and selected one of the resulting submissions for its Super Bowl ad.

Apple encourages users and developers from around the world to create apps that enhance its products. Merck offered a $40 000 prize through a crowdsourcing site called Kaggle for innovative ideas in drug development. Competition was intense, with more than 2900 entries in just 60 days. The winners used a deep learning model originally developed for speech recognition. The artificial neural network they adapted to the problem provided a 17 percent improvement over the industry standard benchmark.

Despite the success of using big data and crowdsourcing to improve both life and the bottom line, it may have reached a plateau. Businesses, researchers, and even government entities are looking for the next big breakthrough in gaining wisdom from the web, and it's likely that the next great innovation is out there, in the crowd.

QUESTION FOR DISCUSSION

1. Which of the techniques described above do you find the most effective? Which do you find least effective?

LO-5 UNDERSTANDING CONSUMER BEHAVIOUR

Market research in its many forms can help marketing managers understand how common traits of a market segment affect consumers' purchasing decisions. It helps with fundamental questions: Why do people buy a certain product? What desire are they fulfilling with the product? Is there a psychological or sociological explanation for why they purchase one product and not another? These questions and many others are addressed in the study of **consumer behaviour**—the study of the decision process by which people buy and consume products.

Influences on Consumer Behaviour

To understand consumer behaviour, marketers draw heavily on fields such as psychology and sociology. The result is a focus on four major influences on consumer behaviour: psychological, personal, social, and cultural. By identifying which influences are most active in certain circumstances, marketers try to explain consumer choices and predict future buying behaviour.

- *Psychological influences* include an individual's motivations, perceptions, ability to learn, and attitudes.
- *Personal influences* include lifestyle, personality, and economic status.
- *Social influences* include family, opinion leaders (people whose opinions are sought by others), and reference groups such as friends, co-workers, and professional associates.
- *Cultural influences* include culture (the way of living that distinguishes one large group from another), subculture (smaller groups with shared values), and social class (the cultural ranking of groups according to criteria such as background, occupation, and income).

The Consumer Buying Process

When consumers are in the process of buying a new product (especially a big purchase), they pass through five key stages: (1) problem/need recognition, (2) information seeking, (3) evaluation of alternatives, (4) purchase decision, and (5) post-purchase evaluation. Marketers are always trying to understand what makes consumers tick and how to provide information and solutions to help consumers see the benefits of buying their products at every stage. Let's take a closer look.

Problem/Need Recognition

This process begins when the consumer recognizes a problem or need. Need recognition also occurs when you have a chance to change your buying habits. After an exercise workout, you recognize that you are thirsty and in need of a refreshment. When you obtain your first job after graduation, your new income may let you buy things that were once too expensive for you. You may find that you need professional clothing, apartment furnishings, and a car. RBC and Scotiabank cater to such shifts in needs when they market credit cards to recent graduates.

Information Seeking

Having recognized a need, consumers often seek information. The search is not always extensive. When you are thirsty, you may simply look for the nearest vending machine; however, before making major purchases, most people seek information from personal sources, public sources, and experience. When buying a new car, you may take months to gather information from various sources (online, from friends, mechanics, etc.) before you even consider a purchase.

Evaluation of Alternatives

People who are in the market for skis probably have some idea of who makes skis and how they differ. By analyzing product attributes (price, prestige, quality) of the consideration set (the group of brands they will consider buying), consumers compare products before deciding which one best meets their needs.

Purchase Decision

Ultimately, consumers make purchase decisions. "Buy" decisions are based on rational motives, emotional motives, or both. *Rational motives* involve the logical evaluation of product attributes: cost, quality, and usefulness. *Emotional motives* involve non-objective factors and include sociability, imitation of others, and aesthetics. For example, you might buy the same brand of jeans as your friends to feel accepted in a certain group, not because your friends happen to have the good sense to prefer durable, comfortable, low-priced jeans (usually it is the opposite scenario).

Post-Purchase Evaluation

Marketing does not stop with the sale of a product. What happens after the sale is just as important. Marketers want consumers to be happy after buying products so that they are more likely to buy them again. Because consumers do not want to go through a complex decision process for every purchase, they often repurchase products. Dissatisfied consumers may complain, file a lawsuit, or publicly criticize the product and the company on social media.

CONSUMER BEHAVIOUR The study of the decision process by which people buy and consume products.

LO-6 ORGANIZATIONAL MARKETING AND BUYING BEHAVIOUR

In the consumer market, buying and selling transactions are visible to the public. Equally important, though far less visible, are organizational (or commercial) markets. Marketing to organizations that buy goods and services used in creating and delivering consumer products involves various kinds of markets and buying behaviours different from those in consumer markets.

Business Marketing

Business marketing involves organizational or commercial markets that fall into three B2B categories: industrial, reseller, and government/institutional markets. Taken together, B2B markets account for more than two times the sales amount of the consumer market. Amazon is looking to expand its reach in the B2B market with its Amazon Business division for good reason. It is estimated that B2B sales in the United States alone amount to $8 trillion.[22]

Industrial Market

The **industrial market** includes businesses that buy goods to be converted into other products or that are used up during production. It includes farmers, manufacturers, and some retailers. For example, computer manufacturers buy microchips, plastics, and screens from other companies to make products for end consumers. They also buy office supplies, tools, and factory equipment—items never seen by consumers—that are used during production.

Reseller Market

Before products reach consumers, they pass through a **reseller market** consisting of intermediaries, including wholesalers and retailers that buy and resell finished goods. For example, as a leading distributor of parts and accessories for the pleasure boat market, Coast Distribution System buys lights, steering wheels, and propellers and resells them to marinas and boat-repair shops.

Government and Institutional Market

Federal, provincial, and municipal governments are very important, not only for the laws they create and maintain but also for their economic spending power. The Canadian federal government, for example, spent an estimated $246 billion in 2017. A new website enables Canadians to track this spending at www.tbs-sct.gc.ca/ems-sgd/edb-bdd/index-eng.html.[23] The **institutional market** consists of non-governmental organizations, such as religious organizations, museums, and charities, that also use supplies and equipment as well as legal, accounting, and transportation services.

B2B Buying Behaviour

In some respects, organizational buying behaviour bears little resemblance to consumer buying practices. Consumer–seller relationships are often impersonal, short-lived, one-time interactions. In contrast, B2B situations often involve frequent and long-term buyer–seller relationships. Unlike most consumers, organizational buyers purchase in large quantities and are professional, specialized, and well informed. They make decisions based on rational motives such as relative performance, cost, efficiency, and maintenance costs.

INDUSTRIAL MARKET An organizational market consisting of firms that buy goods that are either converted into products or used during production.

RESELLER MARKET An organizational market consisting of intermediaries that buy and resell finished goods.

INSTITUTIONAL MARKET An organizational market consisting of non-governmental buyers of goods and services such as hospitals, religious organizations, museums, and charitable organizations.

LO-7 WHAT IS A PRODUCT?

In developing the marketing mix for any product, whether goods or services, marketers must consider what customers really want when they purchase products. Only then can these marketers plan strategies effectively.

Riversong guitars

Courtesy of Riversong Guitars

The Value Package

Whether it is a physical good, a service, or some combination of the two, customers get value from the numerous benefits, features, and even intangible rewards associated with a product. **Product features** are the qualities, tangible and intangible, that a company builds into its products. However, as we discussed earlier, to attract buyers, features must also provide benefits.

Today's customers see a product as a bundle of attributes—benefits and features—that, taken together, marketers call the *value package*. Increasingly, buyers expect to receive products with greater value—with more benefits and features at reasonable costs—so firms must compete based on enhanced value packages. For example, home-delivered meal-kits are a growing trend. According to the marketing research firm NPD, home-delivered meal-kits have grown rapidly for a few years and now account for $120 million in annual sales in Canada alone. So, what are the core benefits of this type of service: (1) it provides consumers with ready-to-prepare meals; (2) its recipe instructions are easy to follow; (3) its portions are premeasured and prepared; and (4) its packages usually emphasize good nutrition. Convenience and simplicity are major selling points here, and the market is reacting favourably.[24]

PRODUCT FEATURES Tangible and intangible qualities that a company builds into its products.

Classifying Goods and Services

We can classify products according to two groups of buyers: buyers of consumer products and buyers of organizational products. As we saw earlier in this chapter, the consumer and industrial buying processes differ significantly. Similarly, marketing products to consumers is vastly different from marketing products to companies and other organizations.

Classifying Consumer Products

Consumer products are commonly divided into three categories that reflect buyer behaviour: **convenience goods and services**, **shopping goods and services**, and **specialty goods and services**. These are outlined in Table 12.2.

Classifying Organizational Products

Depending on how much they cost and how they will be used, organizational products can be divided into three categories: *production items, expense items*, and *capital items*. These are explained in Table 12.3.

The Product Mix

The group of products that a company makes available for sale, whether consumer, industrial, or both, is its **product mix**. Black+Decker makes toasters, vacuum cleaners, electric drills, and a variety of other appliances, tools, and more recently (based on the popular Bob the Builder wave), children's toys.

Richard Pipes/Albuquerque Journal/ZUMA Press Inc/Alamy Stock Photo

Black+Decker has a wide range of product categories, but one recent addition has proven quite successful. The company now sells branded toy replicas to kids so that they can catch the do-it-yourself bug at a young age.

CONVENIENCE GOOD/CONVENIENCE SERVICE An inexpensive good or service purchased and consumed rapidly and regularly.

>>> TABLE 12.2 Categories of Consumer Products

Category	Description	Examples
Convenience Goods and Services	• Consumed rapidly and regularly • Inexpensive • Purchased often and with little input of time and effort	• Milk • Newspaper • Fast food
Shopping Goods and Services	• Purchased less often • More expensive • Consumers may shop around and compare products based on style, performance, colour, price, and other criteria	• Television set • Tires • Car insurance
Specialty Goods and Services	• Purchased infrequently • Expensive • Consumer decides on a precise product and will not accept substitutions, and spends a good deal of time choosing the "perfect" item	• Jewellery • Wedding gown • Catering

>>> TABLE 12.3 Categories of Organizational Products

Category	Description	Examples
Production Items	• Goods or services used directly in the production process	• Loads of tea processed into tea bags • Information processing for real-time production
Expense Items	• Goods or services that are consumed within a year by firms producing other goods or supplying other services	• Oil and electricity for machines • Building maintenance • Legal services
Capital Items	• Permanent (expensive and long-lasting) goods and services • Life expectancy of more than a year • Purchased infrequently so transactions often involve decisions by high-level managers	• Buildings (offices, factories) • Fixed equipment (water towers, baking ovens) • Accessory equipment (computers, airplanes)

Many companies begin with a single product. Over time, they find that the initial product fails to suit every customer shopping for the product type. To meet market demand, they introduce similar products. For example, Starbucks expanded its line of coffees by adding various Italian-style espresso beverages, including mochas, cappuccinos, lattes (hot and iced), and flavoured blended cremes. A group of products that are closely related because they function in a similar manner (e.g., flavoured coffees) or are sold to the same customer group (e.g., stop-in coffee drinkers) who will use them in similar ways is a **product line**.

SHOPPING GOOD/SHOPPING SERVICE A moderately expensive, infrequently purchased good or service.

SPECIALTY GOOD/SPECIALTY SERVICE An expensive, rarely purchased good or service.

PRODUCT MIX A group of products that a firm makes available for sale.

PRODUCT LINE A group of products that are closely related because they function in a similar manner or are sold to the same customer group who will use them in similar ways.

DISRUPTION IN BUSINESS

Counterfeit Products

The activity of legitimate businesses is disrupted by counterfeiters. The International Chamber of Commerce estimates the value of global trade in counterfeit goods at nearly $2 trillion. Counterfeit goods are harmful in three ways. First, companies spend a lot of time and money developing their brands, but counterfeit products deny these companies the sales revenues they deserve. In 2016, the office of the U.S. Trade Representative (USTR) added Alibaba's Taobao to its list of marketplaces that are notorious for selling fake products. Although online companies like Amazon and Google immediately remove listings that companies report as fake, Alibaba conducts an investigation to determine if the alleged sites really do sell fakes. That investigation can take weeks, and during that time many fake products are sold.

Second, fake products do not give consumers value for their money. Although it may seem that consumers benefit because they get low prices for goods that look like the real thing, in fact consumers often pay far too much for counterfeit goods because those goods have very low quality. Some fake products—for example, fake pharmaceuticals, electrical products, and motorcycles—can be dangerous to use. In December 2017, Canada Drugs, a Winnipeg-based online pharmacy, was fined $5 million for selling counterfeit cancer drugs in the U.S. market. Nearly one-third of the counterfeit goods seized in Canada in one recent year were considered harmful to the user by the RCMP to be.

Third, counterfeit goods provide an opening for organized crime because credit card information that is obtained when fake goods are purchased (particularly online) can lead to identity theft or additional illegal purchases with the credit card. What can you do to protect yourself from financial loss as the result of purchasing counterfeit goods? When you make a purchase online, check to see that the website address starts with https:// rather than simply http://. The "s" indicates that the seller uses more secure encryption, and this reduces the chance that your credit card will be compromised. Another safeguard is Project Chargeback—which is a coordinated effort between the Canadian Anti-Fraud Centre, credit card companies, and banks—to get reimbursement for consumers who discover that they have purchased a fake product. The consumer files a complaint with the Centre and provides a photo of the goods, the name of the website where the product was purchased, and the date and amount of the purchase. If the Centre confirms that the product is a counterfeit, the credit card company is informed, and the charge is removed from the credit card. A chargeback is sent to the seller who then does not get paid for the product. The seller can appeal the chargeback, but records show that none have ever done so.

CRITICAL THINKING QUESTION

1. "Consider the following statement" *Counterfeit goods aren't as big a problem as everyone says. Consumers who don't have much money can buy well-known brands and feel good about themselves knowing that other people will observe their possession of high-status products like expensive handbags."* Do you agree or disagree with the statement? Explain your reasoning.

LO-8 DEVELOPING NEW PRODUCTS AND BRANDING

To expand or diversify product lines—in fact, just to survive—firms must develop and introduce streams of new products. Faced with competition and shifting customer preferences, no firm can count on a single successful product to carry it forever.

The New Product Development Process

Product development is a long and expensive process. Many top firms invest heavily in their research and development (R&D) departments to explore new product possibilities. One company is consistently at the top of that list. It is estimated that 3M has invented more than 50 000 products ranging from Scotch Tape to stethoscopes.[25]

It is estimated that it takes 50 new ideas to generate one product that finally reaches the market. Even then, only a few products become successful. Those with the best chances are innovative and deliver unique benefits ("me too" products often fade into the background). In addition, by introducing new products ahead of competitors, companies can establish market leadership. How important is *speed to market*? One study reports that a product that is only three months late to market (three months behind the leader) loses 12 percent of its lifetime profit potential. At six months, it will lose 33 percent.

The Seven-Step Development Process

To increase their chances of developing successful new products or services, many firms use a basic seven-step process. Steps 2, 3, 4, 6, and 7 are the same for both products and services, but there are some differences in Steps 1 and 5.

1. *Product ideas.* Product development begins with a search for ideas for new products. Product ideas can come from consumers, the sales force, research and development, or engineering. Procter & Gamble has invented hundreds of products including many category firsts: household detergent, fluoride toothpaste (Crest), stackable chips (Pringles), and a time-saving cleaning system (Swiffer). The company has over 1000 PhDs among its 8000 employees located in 26 research facilities around the world.[26]
2. *Screening.* This stage is an attempt to eliminate all product ideas that do not mesh with the firm's abilities, expertise, or objectives. Representatives from marketing, engineering, and production must have input at this stage.
3. *Concept testing.* Once ideas have been initially reviewed, companies use market research to solicit consumers' input. Firms can identify benefits that the product must provide, as well as an appropriate price level for the product.
4. *Business analysis.* This involves developing a comparison of costs and benefits for the proposed product. Preliminary sales projections are compared with cost projections from finance and production to determine whether the product can meet minimum profitability goals.
5. *Prototype development.* Using input from the concept-testing phase, engineering and/or research and development produce a preliminary version of the product. Prototypes can be extremely expensive, often requiring extensive handcrafting, tooling, and development of components, but this phase can help identify potential production problems.
6. *Product testing and test marketing.* The company begins limited production of the item. If the product meets performance requirements, it is made available for sale in limited areas (test markets). This stage is very costly because promotional campaigns and distribution channels must be established. Test marketing gives a company its first information on how consumers will respond to a product under real market conditions.
7. *Commercialization.* If test-marketing results are positive, the company will begin full-scale production and marketing of the product. Gradual commercialization, with the firm moving the product into more and more areas over time, reduces stress on the firm's initial production capabilities, but delays in commercialization may give competitors a chance to bring out their own version.

For an example of a company that has successfully launched a new business concept take a look at the Entrepreneurship and New Ventures box entitled "Copper Branch: Plant-Based Power Food."

Product Life Cycle

When a product reaches the market, it enters the **product life cycle (PLC)**, a series of stages through which it passes during its commercial life. Depending on the product's ability to attract and keep customers, its PLC may be a matter of months, years, or decades. Strong, mature products (such as Coca-Cola and H&R Block) have had long, productive lives.

Stages in the PLC

The life cycle for both goods and services is a natural process in which products are born, grow in stature, mature, and finally decline and die. Look at the two graphics in Figure 12.4. In Figure 12.4(a), the four phases of the PLC are applied to several products with which you are familiar:

1. *Introduction.* This stage begins when the product reaches the marketplace. Marketers focus on making potential customers aware of the product and its benefits. Because of extensive promotional and development costs, profits are non-existent. But the use of modern

PRODUCT LIFE CYCLE (PLC) A series of stages in a product's commercial life.

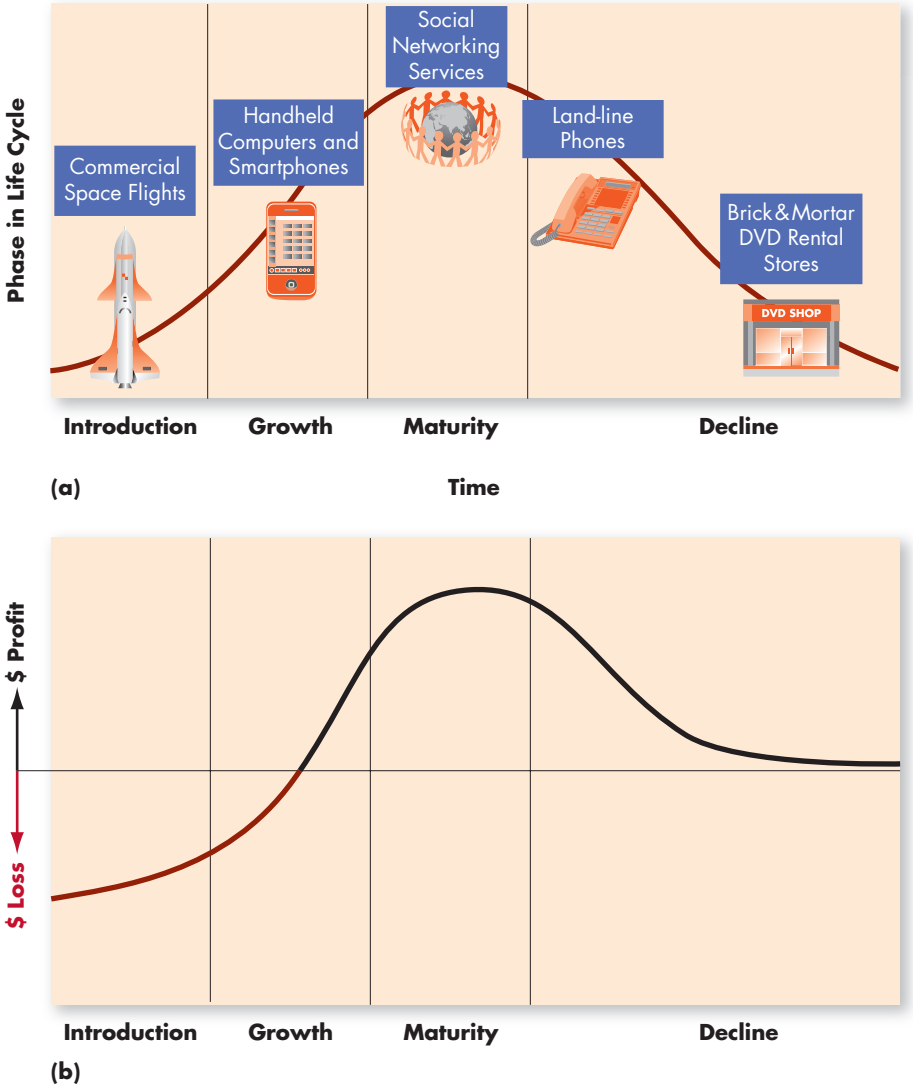

FIGURE 12.4 Products in the life cycle: (a) phases and (b) profit (or loss)

Copper Branch: Plant-Based Power Food

Are you part of the plant-based food revolution? In the opening case, we saw that even traditional meat-producing powerhouses, such as Maple Leaf and Tyson, are expanding their scope and describing themselves as "protein providers" rather than meat companies. What does that mean at the consumer dining level? Entrepreneurial companies such as Copper Branch are now feeding evolving consumer tastes at the front lines of this movement. Who is Copper Branch? It is a small business with 17 locations in Quebec, Ontario, and a new location in Alberta with ambitious plans to expand to 50 outlets nationally by the end of 2019. Copper Branch aspires to be the leader in the healthy fast-casual food category. Their mission is clear "to empower, energize and make people feel their best by nourishing the community with whole food, plant-based products that are good for their clients and the planet." They actively promote organic farming and sell non-GMO (non-genetically modified organisms), naturally gluten-free ingredients.

Business Origins

Copper Branch was founded in 2014 by an entrepreneur with more than 30 years' experience in the business named Rio Infantino. In those three-plus decades, he owned several franchises and lived the franchisor-franchisee relationship first-hand. During that time, he saw a major evolution in the industry. Now that he is selling his own concept to potential investors, he can apply that insight to address the challenges ahead. But what led this entrepreneur to leave the comfort of pre-established brands? Essentially, he was tired of serving food that was often unhealthy, led to weight gain, or contributed to heart disease. It was that inspiration that led him and his son Andrew to open Copper Branch to serve fast food with high-quality, whole foods. Although the menu is entirely vegan, the scope is not simply a narrow niche. According to Andrew Infantino, director of marketing, "This movement has broad appeal and it has so many health benefits that it cannot simply be a fad." We are in a time and age in which people are more health conscious. Capitalizing on the trends, Copper Branch is targeting a wide audience of people looking for simple, clean, and healthy food options.

Megan Duhamel promotes Copper Branch; she is a Plant-Powered Olympic Figure Skater.

Alexander Hassenstein/Getty Images

Promoting a Concept

Creating a concept is one challenge; promoting it and gaining awareness and acceptance are quite another. To help spread a positive message to consumers, Copper Branch enlisted a group of brand ambassadors referred to as Plant-Powered Pros, for example, Olympic medalist and Plant-Powered figure skater Meagan Duhamel and Plant-Powered high diver Lysanne Richard. Copper Branch also actively engages clients on social media platforms such as Instagram and offers an important selection of educational videos to spread the message, while highlighting the core consumer benefits of eating the Copper Branch Way!

On the business side, the company is front and center at trade shows such as vegan festivals, franchise shows, the National Women's Expo, and yoga expositions. In short, company representatives attend events that fit the profile of healthy consumers and potential franchisees. If you think you might be interested in joining their franchise family, here are some numbers: The initial franchise fee is $35 000. Locations range from 400-square-foot mall kiosks (estimate: $250 000 to $325 000 investment) to a street or strip mall outlet, with seating, ranging from 600 to 2000 square feet (estimate: $325 000 to $425 000 investment).

Conclusion

This is a tough business with tremendous competition coming from all angles. What does the future hold for Copper Branch? Only time will tell; however, the core idea, the messaging, and the concept for fast-casual health food is perfectly aligned to serve customer needs and to succeed in the current environment.

CRITICAL THINKING QUESTION

1. Consider the product development process (that we discussed in this section of the book) and identify all the steps top management at Copper Branch had to take at each stage.

media tools such as Twitter and YouTube is providing cost-efficient alternatives for companies to generate attention and buzz.

2. *Growth.* If the new product attracts and satisfies enough consumers, sales begin to climb rapidly. During this stage, the product begins to show a profit. Other firms in the industry move speedily to introduce their own versions. Heavy promotion is often required to build brand preference over the competition.
3. *Maturity.* Sales growth starts to slow. Although the product earns its highest profit level early in this stage, increased competition eventually forces price-cutting, increasing advertising and promotional expenditures, and lowering profits. Towards the end of this stage, sales start to fall.
4. *Decline.* Sales and profits continue to fall, as new products in the introduction stage take away sales. Firms end or reduce promotional support (ads and salespeople) but may let the product linger to provide some profits.

Figure 12.4(b) plots the relationship of the PLC to a product's typical profits or losses. Although the early stages of the PLC often show financial losses, increased sales for successful products recover earlier losses and continue to generate profits until the decline stage. For many products, profitable life spans are short—hence the importance so many firms place on the constant replenishment of product lines.

Extending Product Life: An Alternative to New Products

Companies try to keep products in the maturity stage as long as they can. Over the years, sales of TV sets, for example, have been revitalized by changes in features such as colour, portability, miniaturization, stereo capability, high definition, 3-D and 4K. Companies can extend product life through a few creative means. Foreign markets offer three possibilities for lengthening product life cycles:

1. In *product extension*, an existing product is marketed globally; Coca-Cola is a prime example of international product extensions.
2. With *product adaptation*, the product is modified for greater appeal in different countries. In Germany, a McDonald's meal includes beer; in Japan, Ford puts the steering wheel on the right side. After Kraft Foods changed the shape of the traditional round Oreo Cookie to be long and thin (and coated the cookie in chocolate), it became the best-selling cookie in China. The new shape is also sold in Canada.[27]
3. *Reintroduction* means reviving in new markets products that are becoming obsolete in older markets. For example, NCR reintroduced manually operated cash registers in Latin America.

The Coca-Cola brand has been consistently at or near the top of brand rankings. It is instantly recognizable worldwide.

Michael Kemp/Alamy Stock Photo

Identifying Products: Branding and Packaging

Marketers must also identify products so that consumers are able to recognize them. Two important tools for this task are branding and packaging/labelling.

Branding Products

Branding is the use of symbols to communicate the qualities of a product made by a producer. Coca-Cola might be the best-known brand in the world. Some Coke executives claim that if all the company's other assets were destroyed, they could go to the bank and borrow $100 billion on the strength of the brand name alone. According to Millward Brown Optimor, which creates the BrandZ Top 100 Global Brands Ranking, the Coke brand was worth more than $76 billion in 2018. But the technology companies were at the top of the value list: #1 Google ($286 billion), #2 Apple ($279 billion), and #3 Amazon ($165 billion).[28] Two Canadian brands made the Global Top 100 list: #47 RBC, and #56 TD.[29]

Adding Value Through Brand Equity

Brand equity is the added value a brand name provides to a product beyond its basic functional benefits. Widely known and admired brands are valuable because of their power to attract customers. Those with higher brand equity take advantage of greater brand awareness and loyalty on the part of consumers, have larger market shares than competing brands (in equivalent segments), and are perceived to have greater quality. This often allows them to charge huge price premiums. Companies work hard to build brand equity, but they also must make decisions that maintain and preserve it. For example, Ferrari is one of the world's premier automakers with an estimated market value of USD$20 billion. That is an impressive figure when you also consider the fact that they only manufacture approximately 8000 cars per year. All aspects of the Ferrari image are built on a foundation of premier quality and speed. That is why many industry experts were surprised when Ferrari announced that it would follow many of its competitors into the SUV market after years of resisting such a move. Critics argue that a Ferrari truck will hurt the image and negatively impact brand equity.[30]

Gaining Brand Awareness

The expensive, sometimes fierce, struggle for brand recognition is a growing concern in most industries. Today, marketers are finding more effective, less expensive ways to gain brand awareness. Recent successes have been found with several methods, including product placement, buzz marketing, viral marketing, and social networking.

Product Placement Television commercials can be a real turnoff for many viewers, but entertainment programming gets our full attention. And that's when marketers turn up the promotional juice with **product placement**—a promotional tactic for brand exposure in which characters in television, film, music, magazines, or video games use a real product with its brand visible to viewers. These commercials are effective because the message is delivered in an attractive setting that holds the customer's interest. When used in successful films and TV shows, the brand's association with famous performers is an implied celebrity endorsement. The idea is to legitimize the brand in the mind of the customer. In all, nearly $5 billion is spent annually on product placements, especially on television, and major marketers are putting more into product placements than advertisements in that medium.

BRANDING A process of using symbols to communicate the qualities of a product made by a particular producer.

BRAND EQUITY The added value a brand name provides to a product beyond its basic functional benefits.

PRODUCT PLACEMENT A promotional tactic for brand exposure in which characters in television, film, music, magazines, or video games use a real product with its brand visible.

Buzz Marketing One method for increasing brand awareness is **buzz marketing**, which relies on word of mouth to spread "buzz" about a product or idea. Buzz marketing agencies provide volunteer participants with new products to try and ask them to share the buzz with their friends, family, co-workers, and others in their social network. Here's the key—most companies running word-of-mouth campaigns require full disclosure, which means the participants should let people know they are participating in a campaign. This is essential so that those on the receiving end of the "buzz" don't feel tricked or taken advantage of.

Viral Marketing and Social Networking **Viral marketing** is buzz that relies on social networking to spread information "like a virus" from person to person. Messages about new cars, sports events, and numerous other goods and services flow via networks among potential customers who pass the information on to others. Using various social network formats—games, contests, blogs, and so on—marketers encourage potential customers to try out products and tell other people about them.

Viral marketing is used to achieve consumer awareness goals faster, with wider reach, and at lower cost than via traditional media messages. It works for two reasons. First, people rely on the internet for information they used to get from traditional media. Equally important, however, is the interactive element: the customer becomes a participant in the process of spreading the word by forwarding information to other internet users.

Types of Brand Names

National brands are those produced and distributed by the manufacturer across an entire country (e.g., Chips Ahoy). When a company with a well-known brand sells another company the right to place that brand on its products, the term *licensed brands* applies. Harley-Davidson's famous logo—emblazoned on boots, eyewear, gloves, purses, lighters, and watches—brings the motorcycle maker more than $210 million annually. Along with brands such as Coors and Ferrari, licensing for character-based brands, such as Spider-Man, is equally lucrative.

Private brands carry the retailer's own brand name, even though they are manufactured by another firm. Loblaw Companies Ltd. created a line of upscale products under the private brand President's Choice (PC). If you want Loblaws's famous PC Decadent Chocolate Chip cookies, you need to visit a Loblaws outlet or one of its subsidiaries. These brands are often 25 percent cheaper for consumers, and yet the profit margins tend to be 15 percent higher for the company. This is a clear win-win scenario.[31] In recent years, we have seen this trend find its way beyond the food aisles. Private labels are now linked to branded apparel from unusual sources, such as Joe Fresh (a Loblaws's creation).[32]

Generic brands are also gaining more shelf space; they are the products that you see in grocery stores that simply state a category name like "bacon" or "peanut butter." If you've been to Costco recently, you may have picked up its very popular generic chocolate chip cookies. Major retailers are carrying fewer national brands and more of their own private brands as well as these less expensive, no-frills generic brands.

Packaging Products

Except for products like fresh fruits and vegetables and structural steel, almost all products need some form of **packaging** so they can be transported to the market. Packaging also serves several other functions—it is an in-store advertisement that makes the product attractive; it clearly displays the brand; it identifies product features and benefits; and it reduces the risk of damage, breakage, or spoilage. The package is the marketer's last chance to say "buy me" to the consumer. Maison Orphée, a Quebec City–based maker of oils, mustards, sea salts, and vinegars, took the advice of consultants and redesigned its packaging with slimmer bottles and a high-end label design. The result was a 70 percent increase in sales without a dime spent on traditional advertising.[33] Packaging counts!

The very nature of GoPro's durable, high-tech video recorders (crash cams) makes them perfect for creating content and generating buzz for organizations (not to mention for GoPro itself).

JULIAN STRATENSCHULTE/Alamy Stock Photo

Labelling Products

Every product has a **label** on its package. Like packaging, labelling can help market the product. First, it identifies the product or the brand, such as the name "Campbell" on a can of soup or "Chiquita" on a banana. Labels also promote products by getting consumers' attention. Attractive colours and graphics provide visual cues to products that otherwise might be overlooked on the shelf. Finally, the label describes the product by providing information about nutritional content, directions for use, proper disposal, and safety.

The federal government regulates the information on package labels. The *Consumer Packaging and Labelling Act* has two main purposes: first, to provide a comprehensive set of rules for packaging and labelling of consumer products; second, to ensure that manufacturers provide full and factual information on labels. All prepackaged products must state in French and English the quantity enclosed in metric units, as well as the name and description of the product.

BUZZ MARKETING Marketing that relies on word of mouth to spread "buzz" about a product or idea.

VIRAL MARKETING Buzz that relies on social networking on the internet to spread information "like a virus" from person to person.

NATIONAL BRANDS Products distributed by and carrying a name associated with the manufacturer.

PRIVATE BRANDS Products promoted by and carrying a name associated with the retailer or wholesaler, not the manufacturer.

GENERIC BRANDS No-frills products sold under the general category name rather than a specific company name.

PACKAGING Physical container in which a product is sold, advertised, or protected.

LABEL That part of a product's packaging that identifies the product's name and contents and sometimes its benefits.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 EXPLAIN THE CONCEPT OF *MARKETING* AND IDENTIFY THE FIVE FORCES THAT CONSTITUTE THE *EXTERNAL MARKETING ENVIRONMENT*.

Marketing is responsible for creating, communicating, and delivering value and satisfaction to customers at a profit. Marketing manages customer relationships to benefit the organization and its stakeholders. After identifying customers' needs and wants, marketing managers develop plans to satisfy customers by creating products and establishing their prices, their methods of distribution, and the ways to promote them to potential customers. Marketing is successful if satisfied buyers perceive that the benefits derived from purchases outweigh their costs and if the firm, in exchange for providing the products, meets its organizational goals. Five outside factors make up a company's external environment and influence its marketing programs: (1) *political and legal actions,* (2) *socio-cultural factors,* (3) *technological changes,* (4) *economics, and* (5) *competition.*

LO-2 EXPLAIN THE PURPOSE OF A *MARKETING PLAN* AND IDENTIFY THE FOUR COMPONENTS OF THE *MARKETING MIX*.

The marketing plan is a detailed strategy for focusing marketing efforts on meeting consumer needs and wants. The plan defines the organization's marketing goals and identifies all the activities for reaching those goals that will result in the successful transfer of goods and services to its customers. In planning and implementing strategies, marketing managers focus on the four elements (4 Ps) of the marketing mix: (1) *products for consumers*, (2) *pricing of products*, (3) *place (distribution) of products to consumers*, *and* (4) *promotion of products.*

LO-3 EXPLAIN *MARKET SEGMENTATION* AND HOW IT IS USED IN *TARGET MARKETING* AND *POSITIONING*.

Marketers think in terms of target markets—groups of people or organizations with similar wants and needs that can be expected to show interest in the same products. Target marketing requires *market segmentation*—dividing a market into categories of customer types or "segments." Members of a market segment must share some common traits that influence purchasing decisions. After they identify segments, companies adopt a variety of strategies for attracting customers in one or more of the chosen target segments. The following are *five variables used for segmentation:* (1) *Demographic variables* describe populations by identifying traits such as age, income, gender, ethnic background, and marital status. (2) *Geographic variables* are the geographical units that may be considered in developing a segmentation strategy. (3) *Geo-demographic variables* combine demographic variables with geographic variables, such as an age category coupled with urban areas. (4) *Psychographic variables* include lifestyles, interests, and attitudes. (5) *Behavioural* variables include benefit sought, user status, usage rate, loyalty status, and occasion for use.

LO-4 DISCUSS THE PURPOSE OF *MARKETING RESEARCH* AND COMPARE MARKETING RESEARCH METHODS.

Market research is the study of what buyers need and the best ways to meet those needs. This process involves (1) *studying the current situation*, (2) *selecting a research method*, (3) *collecting and analyzing data*, *and* (4) *preparing the report*. The four most common research methods are *observation*, *surveys*, *focus groups*, *and experimentation*.

LO-5 DESCRIBE THE *CONSUMER BUYING PROCESS* AND THE KEY FACTORS THAT INFLUENCE THAT PROCESS.

One consumer behaviour model considers five influences that lead to consumption: (1) *Problem/need recognition:* The buying process begins when the consumer recognizes a problem or need. (2) *Information seeking:* Having recognized a need,

consumers seek information. The information search leads to a consideration set—a group of products they will consider buying. (3) *Evaluation of alternatives:* By analyzing product attributes (price, prestige, quality) of the consideration set, consumers compare products to decide which product best meets their needs. (4) *Purchase decision:* "Buy" decisions are based on rational motives, emotional motives, or both. (5) *Post-purchase evaluations:* Consumers continue to form opinions after their purchase. Marketers want consumers to be happy after the consumption of products so that they are more likely to buy them again.

LO-6 DISCUSS THE THREE CATEGORIES OF *ORGANIZATIONAL MARKETS* AND THE CHARACTERISTICS OF BUSINESS-TO-BUSINESS (B2B) BUYING BEHAVIOUR.

(1) The *industrial market* consists of businesses that buy goods to be converted into other products or that are used during production. This market includes farmers, manufacturers, and some retailers. (2) Before products reach consumers, they pass through a *reseller market* consisting of intermediaries—wholesalers and retailers—that buy finished goods and resell them. (3) The government and *institutional market* includes federal, provincial, and local governments and non-governmental buyers—hospitals, religious organizations, and charities—that purchase goods and services needed for serving their clients. Taken together, these organizational markets annually do more than twice the business of the consumer markets.

LO-7 EXPLAIN THE DEFINITION OF A PRODUCT AS A *VALUE PACKAGE* AND CLASSIFY *GOODS AND SERVICES*.

Customers buy products to receive value that satisfies a want or a need. Thus a successful product is a *value package*—a bundle of attributes that, taken together, provides the right features and offers the right benefits that satisfy customers' wants and needs. Features are the qualities, tangible and intangible, that are included with the product. To be satisfying, features must provide benefits that allow customers to achieve the end results they want. The value package has services and features that add value by providing benefits that increase the customer's satisfaction.

Products (both *goods and services*) can be classified according to expected buyers as either *consumer products (convenience*, *shopping*, *and specialty goods)* or *organizational products (production items*, *expense items*, *or capital items)*.

LO-8 DESCRIBE THE KEY CONSIDERATIONS IN THE NEW *PRODUCT DEVELOPMENT PROCESS* AND EXPLAIN THE IMPORTANCE OF *BRANDING AND PACKAGING*.

To expand or diversify product lines, new products must be developed and introduced. Many firms have research and development (R&D) departments for continuously exploring new product possibilities because high mortality rates for new ideas result in only a few new products reaching the market. Even then, only a few of these survivors become successful products. *Speed to market*—how fast a firm responds with new products or market changes—determines a product's profitability and success. A continuous product development process is necessary because every product has a product life cycle—a series of stages through which it passes during its commercial life.

Branding and *packaging* identify products so that consumers recognize them. Branding is the use of names and symbols, such as "Coca-Cola" or McDonald's golden arches, to communicate the qualities of a product made by a producer. The goal in developing a brand is to distinguish a product from others so that consumers develop a preference for that brand name. Most products need some form of packaging—a physical container in which it is sold, advertised, or protected. A package makes the product attractive, displays the brand name, and identifies features and benefits. It also reduces the risk of damage, breakage, or spoilage, and it lessens the likelihood of theft.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. What does *brand equity* mean and how do companies such as Apple take advantage of their strong brand equity?
2. Select a good or service that you have purchased recently. Try to retrace the relevant steps in the buyer decision process as you experienced it. Which steps were most important to you?
3. What are the various classifications of consumer and industrial products? Give an example of a good and a service for each category other than those discussed in this text.
4. How is the concept of the value package useful in marketing to consumers and industrial customers?
5. Why has the in-store use of hidden cameras become so popular? Is this "video mining" ethical? If not, how could it be made more acceptable?
6. Some companies have very narrow product mixes, producing just one or two products, whereas others have many different products. What are the advantages of each approach?

APPLICATION EXERCISES

7. Identify a company with a product that interests you. Consider ways the company could use customer relationship management (CRM) to strengthen relationships with its target market. Specifically, explain your recommendations on how the company can use each of the four basic components of the marketing mix in its CRM efforts.
8. Select a product made by a foreign company and sold in Canada. What is the product's target market? What is the basis on which the target market is segmented? Do you think that this basis is appropriate? How might another approach, if any, be beneficial? Why?
9. Choose a product that could benefit from word-of-mouth buzz marketing. Then create a marketing campaign kit for participants to spread the word about this product.
10. Interview the manager of a local manufacturing firm. Identify the company's different products according to their positions in the product life cycle.

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members to consider your new business venture and how it relates to the product and branding topics in this chapter. Develop specific responses to the following:

1. Consider the customers in your target market(s). Are they individual consumers, or organizations, or a combination of both? For each of your target markets, identify what customers will expect in the product features and in the value-package features.
2. Identify your business's product mix, including its product line(s), if any. How do you justify this product mix rather than others you might have chosen?
3. Will your product(s) require new product development, modifications of existing products, or are they fully developed and ready to go? How quickly do you anticipate your product(s) will be developed and ready for market? How long a life span do you expect for your product(s)?
4. Describe your brand name, logo, and other features. What three keywords do you want people to associate with your brand?

BUILDING YOUR BUSINESS SKILLS

THE GREAT OUTDOORS

GOAL

To understand the product and pricing strategy decisions made by marketers.

BACKGROUND INFORMATION

You and your team have been hired as consultants by a manufacturer that has been making camping equipment for more than a century. Although their original target market was gold miners and loggers, they primarily sell to recreational campers. The company has a long history of quality, long-lasting products with few frills, including tents, sleeping bags, lanterns, and camp stoves.

METHOD

Step 1 Working with your group, brainstorm how the company might make their products more appealing to recreational campers today. Be creative and think outside the box. How could the company make their tents, sleeping bags, lanterns, and camp stoves more exciting and desirable?

Step 2 The company's marketing manager has suggested that the company branch beyond the company's long-established product line into other products for camping. Work with your group to develop a list of products that the company should consider selling. Don't filter your suggestions; try to develop a long and detailed list.

Step 3 As a group, determine which new products as well as modifications to existing products hold the most promise and develop a recommendation that you present to your client.

FOLLOW-UP QUESTIONS

1. How do you think the market for camping equipment has changed over the past 50 years? How did this influence your decision making?
2. As you developed your list of new products, which wants and needs of the target market were most important?
3. What pricing strategy should the company use for its existing products?
4. What pricing strategy should the company use for its new products? Is skimming or penetration more appropriate?

EXERCISING YOUR ETHICS

DRIVING A LEGITIMATE BARGAIN

THE SITUATION

A firm's marketing methods are sometimes at odds with the consumer's buying process. This exercise illustrates how ethical issues can become tangled with personal selling activities, products, pricing, and customer relations.

THE DILEMMA

In buying his first new car, Matt visited showrooms and websites for every make of SUV. After weeks of reading and test-driving, he settled on a brand-new, well-known Japanese-made vehicle with a manufacturer's suggested retail price of $37 500. The price included accessories and options that Matt considered essential. Because he planned to own the car for at least five years, he was willing to wait for just the right package rather than accept a less-equipped car already on the lot.

Negotiations between Gary and the sales representative continued for two weeks. Finally, a sales contract was signed for $33 500, with delivery due no more than two to three months later if the vehicle had to be special-ordered from the factory and earlier if Gary found the exact car when he searched other dealers around the country. On August 30, to secure the terms of the agreement, Matt gave the dealer a check for $1000.

Matt received a call on September 14 from Angela, Gary's sales manager: "We couldn't get the model you ordered," she reported, "because the new models just came out, but we've got your car, just as you ordered. We've discounted it by the same amount, so it's $35 500 to you instead of the MSRP of $39 500." After some argument, he told Angela to send him back everything he had signed plus his $1000 deposit, claiming that the deal was off.

QUESTIONS TO ADDRESS

1. How would you characterize the ethical issues in this situation?
2. From an ethical standpoint, what are the obligations of the sales representative and the sales manager regarding the pricing of the product in this situation?
3. If you were Angela, the sales manager, how would you defend your actions?
4. If you were responsible for maintaining good customer relations at the dealership, how would you handle this matter, considering the interests of both the consumer and the business?

BUSINESS CASE 12

P&G MARKETING: MIDDLE-CLASS ADJUSTMENT

Tide, Pampers, Bounty, Gillette, Crest, Scope, and Febreze. What do they all have in common? They are just a few of the brands owned by Procter & Gamble (P&G), the iconic marketer of household products. The company was established in 1837 and today serves more than five billion people in more than 70 countries. In 2017, sales exceeded US$65 billion. Of the large collection of brands, 23 have annual sales above US$1 billion. It is estimated that 98 percent of North American households use at least one P&G product, a position that has grown largely by targeting middle-class consumers. However, P&G is facing a puzzling marketing dilemma because the number of mid-range shoppers is shrinking.

The source of the problem is the reduction in middle-class purchasing power. Many families are now pinched with rising prices for housing, food, gasoline, and medical products but little or no wage increases. This economic condition has been described as the "Consumer Hourglass Theory." Advocates of the theory believe that purchasing power has shifted away from the once-massive middle and is concentrated now at the bottom and top. That's where consumer action is now, at the high-end market and the low-end market.

Is this simply a short-term issue? Based on P&G's research, Melanie Healey, group president for P&G's business in North America, expects middle-class downsizing will be a continuing trend. Accordingly, P&G and other companies are rethinking their target markets. Aiming at the high-end segment, the company introduced its more expensive Olay Pro-X skin-care product. Previously, P&G introduced Gain, the bargain-priced

DragonImages/Fotolia

Kristoffer Tripplaar/Alamy Stock Photo

dish soap, which is aimed at the growing lower portion of the previous middle-class market following a dip in sales of the mid-priced Tide brand. During the previous recession, P&G's lower-priced Luvs diapers gained market share from their higher-priced Pampers brand. Following a path like that of P&G, H. J. Heinz has developed more food products for the lower-priced markets. Meanwhile, retailers focusing on lower-income consumers, such as Winners and Dollarama, are attracting customers from higher-priced retailers.

Refocusing away from the mainstream middle onto high- and low-end consumers is a new marketing experience at P&G. They have increased market research on lower-income households, often using face-to-face interviews to gain in-depth understanding of these consumers. So far, the low-end and the high-end segments each are generally smaller than the former massive middle-class market, which means P&G is splitting its marketing efforts. As one company official noted, historically they have been good at doing things on a larger scale, but now they are learning how to deal with smaller sales volumes for products in each of two segments. New product development is affected, too, because the high-end segment often involves fewer products with attractive extra features that will sell profitably at higher prices. P&G is betting that the Hourglass Theory has set the course for the company's future.

QUESTIONS FOR DISCUSSION

1. How would you best describe P&G's marketing strategy for the situation presented in this case?
2. What elements of P&G's external marketing environment are influencing the company's marketing strategy? Explain your reasoning.
3. P&G's marketing research includes face-to-face interviews for the situation described in this case. Would other forms of marketing research also be useful in this situation? Explain your reasoning.
4. Explain the roles of target marketing and market segmentation as they apply in this case.
5. In what ways are the components of P&G's marketing mix being affected by the situation described in this case? Give examples.

MyLab Intro to Business

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Rawpixel.com/Shutterstock

CHAPTER

13

Pricing, Promoting, and Distributing Products

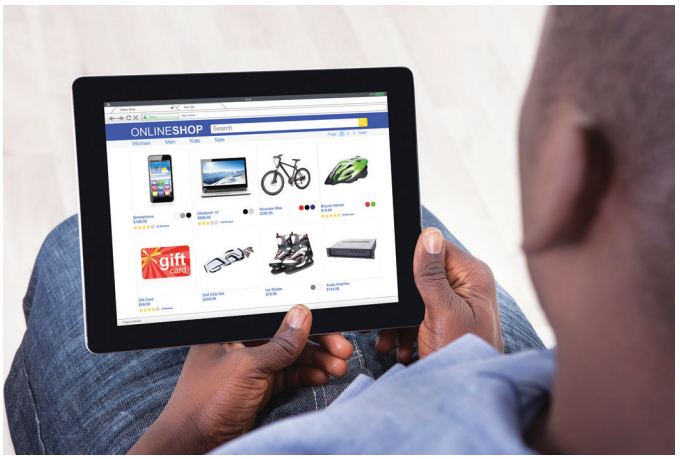
LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

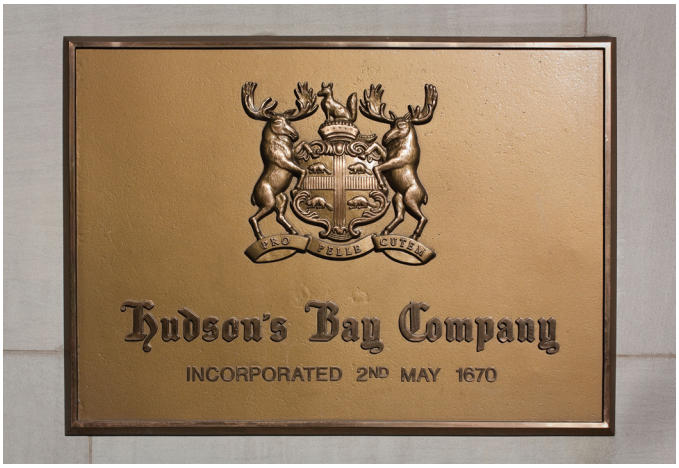
- **LO-1** Identify the various *pricing objectives* that govern pricing decisions and describe the *price-setting tools* used in making these decisions.
- **LO-2** Discuss *pricing strategies* that can be used for different competitive situations and identify the *pricing tactics* that can be used for setting prices.
- **LO-3** Identify the important *objectives of promotion* and discuss the considerations in selecting a *promotional mix*.
- **LO-4** Define the *role of advertising* and describe the key *advertising media*.
- **LO-5** Outline the tasks involved in *personal selling*, describe the types of *sales promotions*, describe *direct (or interactive) marketing*, and distinguish between *publicity* and *public relations*.
- **LO-6** Explain the *distribution mix* and identify the different *channels of distribution*.
- **LO-7** Describe the role of *intermediaries*. Explain the functions of *wholesalers* and identify the types of *retailers* and *e-intermediaries*.
- **LO-8** Describe the *physical distribution process*.

Amazon Versus the Bay: Past, Present, and Future of Retail

Amazon and The Bay were founded centuries apart. One is the poster child for innovation and the online economy, whereas the other is synonymous with Canadian history and heritage. Amazon has already contributed heavily to the demise of The Bay's traditional competitors, such as Sears Canada, and is a leading force in the bankruptcy of Toys "R" Us in the United States. Retail shopping malls are experiencing reduced traffic, and the trends do not look promising (especially for department stores). According to Forrester Research, ecommerce sales were expected to increase from 12.9 percent in 2017 to 17 percent by 2022. That same year, Credit Suisse released a report predicting that more than 8600 brick-and-mortar stores would close their doors by year-end. So, it should be no surprise to see Ivanhoé Cambridge (the global real estate company) trying to sell its stakes in three large Canadian malls for an estimated $1 billion. Is this a simple routine reallocation of funds (Ivanhoe still has 46 major malls in its portfolio), or is this move partially based on the grim predictions of a retail apocalypse? Is this the first of many such moves to lower exposure in this sector? Is big mall retail slowly heading towards the museums? One thing is certain: retail outlets (especially major department stores) like The Bay must make a dramatic shift. But how?



Andrey Popov/Fotolia



Andrew Rubtsov/Alamy Stock Photo

Amazon: Leading the Retail Revolution

Amazon's revenues in 2017 were nearly $178 billion. To get a sense of its tremendous growth, just consider that the company had revenues of $20 billion a decade ago. That is impressive growth! In only 25 years or so, Amazon has severely affected the retail sector just as Google transformed the world of media. Amazon expertly collects and analyzes individual and marketplace buying patterns and tracks shopping preferences. Algorithms then predict purchasing patterns that allow for effective suggestions. Amazon has already disrupted the retail sector for books, clothing, and entertainment by eliminating sales forces, reducing real estate costs, and replacing warehouse workers with robots. It is also disrupting the relationship between brands and brick-and-mortar stores and is trying to convince the world's biggest brands to further bypass retailers; it wants the makers of these top brands to shift their thinking from how a brand will look on a store shelf to how brands can best be shipped to consumers. More recently, Amazon made a big move in the food and packaged goods market. Its purchase of organic food seller Whole Foods is another threating step in that direction. Companies such as Loblaws, Sobeys, and Metro are on full alert.

The Bay: History and the Path Forward

Growing up in Canada, we all learn about the Hudson's Bay Company in our high school history classes. Any company that survives a decade or two is to be applauded, but an organization that traces its history back to 1670 must be respected. However, holding the title as North America's oldest company does not mean that The Bay has a ticket to future success. To survive for another 100 years, or even 5 to 10 years, the company must evolve and confront this retail revolution.

With the exit of Sears Canada from the Canadian retail landscape and the quick entry and failure of Target in Canada, you would think that The Bay would be in a great position. It is not. Parent company HBC, which also includes the retail brands Saks Fifth Avenue and Lord and Taylor, may have total sales of $15 billion, but the key financials are in the red. Most analysts point out that, in a world where online sales are increasingly replacing in-person sales, large, expensive downtown spaces and high-rent suburban spaces just don't add up. Therefore, part of the new strategy for HBC is to trim its large spaces (especially downtown on the upper floors of its massive stores) and focus more on retail space on the main and second floors. In a deal with RhoneCapital LLC and New York-based WeWork Cos., HBC's prime spaces in New York, Toronto, Vancouver, and Germany will be converted into WeWork's shared office workspaces catering to entrepreneurs, freelancers, and small businesses. This is a viable way to improve the bottom line and increase efficiency, but the question remains: how does HBC draw people to the remaining space?

Rethinking Physical Locations: Customer Engagement

All types of retailers are searching for the next level of differentiation. Even though Amazon is responsible for this sense of urgency, the company is not standing still. For example, it is already experimenting with self-driving

delivery. So how can The Bay capitalize and improve on its strengths? Authentic human interaction in a retail setting is key. So the questions The Bay and other traditional retailers need to answer are: How can we improve our customer engagement levels? How can we improve those interactions and create the conditions that will lead to more customer loyalty?

The Bay has a special place in the hearts of Canadians. Students will continue to learn about the Hudson's Bay Company in history books, but if The Bay is to survive as a retail brand, it will need to continue to make tough business decisions and wise strategic marketing moves.

QUESTIONS FOR DISCUSSION

1. Why are online retailers taking so much market share from the traditional brick-and-mortar stores?
2. Do you think that legacy stores such as The Bay will be able to compete with online stores in the future? How do they have to change to be more competitive?
3. If all goods were available to purchase online, would there still be products and services you would want to buy in person? How can online retailers become more competitive against traditional stores for items that people still prefer to buy in person?
4. Consider the following statement: "*There is a need for stricter government regulation of Amazon because its strategy of bypassing retailers is going to eventually result in the loss of millions of retail jobs, and this will dramatically increase the unemployment rate.*" Do you agree or disagree with the statement? Explain your reasoning.

HOW WILL THIS HELP ME?

Darrin Henry/Fotolia

To become the number one brand or retailer in any market takes a solid understanding of how best to set prices, reach market-share objectives, promote and distribute products to customers, and, ultimately, achieve profits. This chapter examines those topics and the different types of intermediaries involved with an emphasis on wholesalers and retailers. It also highlights how the online marketplace has changed the nature of how companies do business. By understanding methods for pricing, distributing, and promoting products, you'll be more prepared to evaluate a company's marketing programs, distribution methods, and competitive potential.

As we saw in Chapter 12, product development managers decide which products a company will offer to its customers. In this chapter, we'll look at three of the 4 Ps of the marketing mix. We'll start by looking at the concept of pricing and the tools used in making pricing decisions. Then we'll look at promotion and discuss the considerations in selecting a promotional mix. We will also describe the tasks involved in personal selling, sales promotions, publicity, and public relations. Finally, we'll discuss place—the distribution mix and the different channels and methods of distribution.

LO-1 DETERMINING PRICES

After *product*, the second major component of the marketing mix is **pricing**—determining what the customer pays and the seller receives in exchange for a product. Setting prices involves understanding how they contribute to achieving the firm's sales objectives.

Pricing to Meet Business Objectives

Pricing objectives are the goals that sellers hope to achieve in pricing products for sale. Some companies have profit-maximizing pricing objectives, while others have market-share pricing objectives. Pricing decisions are also influenced by the need to compete in the marketplace, by social and ethical concerns, and even by corporate image. eBay, the popular internet auction site, has a straightforward pricing structure: Let buyers make offers until a price is finally settled. Although eBay sellers hope for a high price, they are sometimes willing to give up some profit in return for a quick sale. Unfortunately, the eBay pricing model, one-on-one price setting, isn't feasible for all companies with lots of customers and products.

PRICING Process of determining what a company will receive in exchange for its products.

PRICING OBJECTIVES The goals that sellers hope to achieve in pricing products for sale.

Profit-Maximizing Objectives

The seller's pricing decision is critical for determining the firm's revenue, which is calculated using the following formula:

$$\text{Revenue} = \text{Selling price} \times \text{Units sold}$$

Companies that set prices to maximize profits want to set the selling price to sell the number of units that will generate the highest possible total profits. If a company sets prices too low, it will probably sell many units, but may miss out on additional profits on each unit (and may even lose money on each exchange). If a company sets prices too high, it will make a large profit on each item, but will sell fewer units. Again, the firm loses money, and it may also be left with excess inventory because of fewer units sold.

In calculating profits, managers weigh sales revenues against costs for materials and labour, as well as capital resources (plant and equipment) and marketing costs (such as maintaining a large sales staff). To use these resources efficiently, many firms set prices to cover costs and achieve a targeted level of return for owners.

Market-Share (Market Penetration) Objectives

In the long run, a business must make a profit to survive. Because they are willing to accept minimal profits, even losses, to get buyers to try products, companies may initially set low prices for new products to establish **market share** (or **market penetration**)—a company's percentage of the total industry sales for a specific product type. Even with established products, market-share leadership may outweigh profit as a pricing objective. For brands such as Doritos and iTunes, dominating a market means that consumers are more likely to buy something with which they are familiar. Market domination means continuous sales of more units and higher profits, even at lower unit prices.

Pricing for E-Business Objectives

When pricing for online sales, marketers must consider different costs and different forms of consumer awareness. Many e-businesses reduce both costs and prices because of the internet's unique marketing capabilities. Because the web provides a more direct link between producer and customer, buyers often avoid the added costs of wholesalers and retailers. Another factor is the ease of comparison shopping. Obviously, point-and-click shopping can be much more efficient than driving from store to store in search of the best price. Moreover, both consumers and business buyers can get lower prices by joining together for greater purchasing power.

Price-Setting Tools

Whether a company's central objective is maximizing profits or market share, managers like to measure the potential impact of price before finalizing what they will charge for their product. Two tools used for this purpose are cost-oriented pricing and breakeven analysis. Although each can be used alone, both are often used because they provide different kinds of information for determining prices that will allow the company to reach its objectives.

Cost-Oriented Pricing

Cost-oriented pricing considers a firm's desire to make a profit and its need to cover production costs.

$$\text{Selling price} = \text{Seller's costs} + \text{Profit}$$

For example, a T-shirt store manager would price shirts by calculating the cost of making them available to shoppers. Thus price would include the costs of store rent, employee wages, utilities, product displays, insurance, and the shirt manufacturer's price. If the manufacturer's price is $8 per shirt and the store sells shirts for $8, the store won't make any profit. Nor will it make a profit if it sells shirts for $8.50 each—or even $10 or $11. To be profitable, the company must charge enough to cover product and other costs. Together, these factors determine the **markup**—the amount added to an item's purchase cost to sell it at a profit. In this case, a reasonable markup of $7 over the purchase cost means a $15 selling price. The following equation calculates the markup percentage and determines what percent of every dollar of revenue is gross profit:

$$\text{Markup percentage} = \frac{\text{Markup}}{\text{Sales price}}$$

For our T-shirt retailer, the markup percentage is 46.7:

$$\text{Markup percentage} = \frac{\$7 \times 100}{\$15} = 46.7\%$$

Out of every $1 taken in, $0.467 will be gross profit. Out of gross profit, the store must still pay rent, utilities, insurance, and all other costs. For experienced price setters, an even simpler method uses a standard cost-of-goods percentage to determine the markup amount. Many retailers, for example, use 100 percent of cost of goods as the standard markup. If the manufacturer's price is $8 per shirt, the markup (100 percent) is also $8, so the selling price is $16.

Breakeven Analysis: Cost-Volume-Profit Relationships

Using cost-oriented pricing, a firm will cover **variable costs**—costs that change with the number of units of a product produced and sold, such as raw materials, sales commissions, and shipping. Firms also need to pay **fixed costs**—costs such as rent, insurance, and utilities that must be paid *regardless of the number of units produced and sold.*

Costs, selling price, and the number of units sold determine how many units a company must sell before all costs, both variable and fixed, are covered and it begins to make a profit. **Breakeven analysis** assesses costs versus revenues for various sales volumes and shows, at any selling price, the amount of loss or profit for each possible volume of sales.

If you were the manager of a T-shirt store, how would you determine how many shirts you needed to sell to break even? We know that the *variable cost* of buying each shirt from the manufacturer is $8. This means

MARKET SHARE (MARKET PENETRATION) A company's percentage of the total industry sales for a specific product type.

COST-ORIENTED PRICING Pricing that considers the firm's desire to make a profit and its need to cover production costs.

MARKUP Amount added to an item's purchase cost to sell it at a profit.

VARIABLE COST Cost that changes with the quantity of a product produced and sold.

FIXED COST Cost that is incurred regardless of the quantity of a product produced and sold.

BREAKEVEN ANALYSIS For a particular selling price, assessment of the seller's costs versus revenues at various sales volumes.

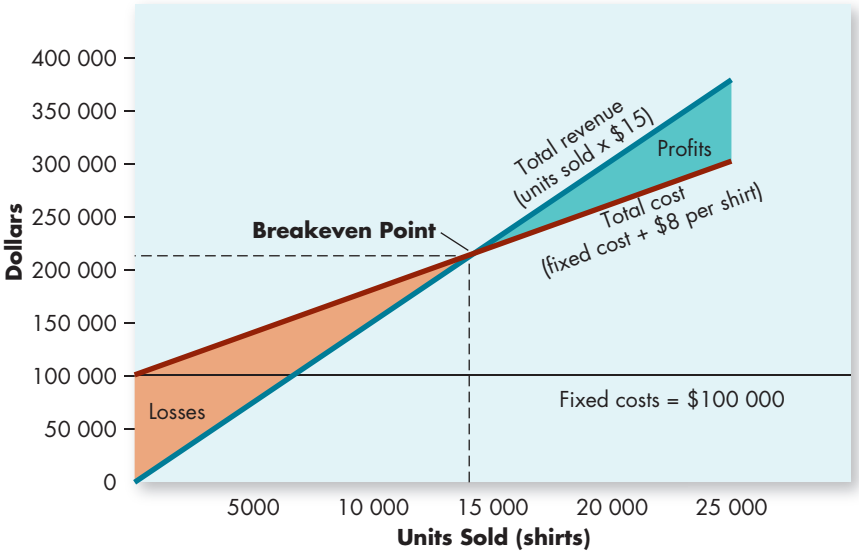


FIGURE 13.1 Breakeven analysis

that the store's annual variable costs depend on how many shirts are sold, the number of shirts sold times the $8 cost for each shirt. Say that *fixed costs* for keeping the store open for one year are $100 000 (no matter how many shirts are sold). At a selling price of $15 each, how many shirts must be sold *so that total revenues exactly cover both* fixed and variable costs? The answer is the **breakeven point**, which is 14 286 shirts:

$$\text{Breakeven point (in units)} = \frac{\text{Total fixed cost}}{\text{Price} - \text{variable cost}}$$

$$= \frac{\$100\,000}{\$15 - \$8} = 14\,286 \text{ Shirts}$$

Look at Figure 13.1. If the store sells fewer than 14 286 shirts, it loses money for the year. If sales go over 14 286, profits grow by $7 for each additional shirt. If the store sells exactly 14 286 shirts, it will cover all its costs, but earn zero profit.

BREAKEVEN POINT The sales volume at which the seller's total revenue from sales equals total costs (variable and fixed) with neither profit nor loss.

Zero profitability at the breakeven point can also be seen by using the profit equation:

$$\text{Profit} = \begin{matrix}\text{Total}\\ \text{revenue}\end{matrix} - \left(\begin{matrix}\text{Total}\\ \text{fixed}\\ \text{cost}\end{matrix} + \begin{matrix}\text{Total}\\ \text{variable}\\ \text{cost}\end{matrix}\right)$$

$$= (14\,286 \text{ shirts} \times \$15) - (\$100\,000 \text{ Fixed cost} + [14\,286 \text{ shirts} \times \$8 \text{ Variable cost}])$$

$$\$0 = (\$214\,290) - (\$100\,000 + \$114\,288)$$

(rounded to the nearest whole shirt)

Of course, this is a simplistic example with only one product and one price. In this situation, the store would need to sell approximately 1200 T-shirts per month, approximately 40 T-shirts per day (assuming the store is open seven days a week). Is that realistic? In reality, the store would probably carry some higher-margin products to upsell while pushing accessories to reduce the unit sales requirements and improve its chances for success.

Amazon has become a low-price leader for most products. The firm operates a network of warehouses and distribution centres and can package and deliver most products cheaper and faster than its competitors.

Mark Passmore/Apex News and Pictures Agency/Alamy Stock Photo

LO-2 PRICING STRATEGIES AND TACTICS

The pricing tools discussed in the previous section help managers set prices on specific goods. They do not, however, help them decide on pricing philosophies for diverse competitive situations. In this section, we discuss pricing strategy (pricing as a planning activity) and some basic pricing tactics (ways in which managers implement a firm's pricing strategies).

Pricing Strategies

Pricing is an essential element in the marketing mix, as well as a flexible marketing tool—it is certainly easier to change prices than to change products or distribution channels. This section looks at how pricing strategies can result in widely differing prices for very similar products.

Pricing Existing Products

A firm has three options for pricing existing products:

1. Pricing *above* prevailing market prices for similar products to take advantage of the common assumption that higher price means higher quality
2. Pricing *below* market prices while offering a product of comparable quality to higher-priced competitors
3. Pricing *at* or near market prices

Godiva chocolates and Patek Philippe watches can be priced high as they promote prestigious and high-quality images. In contrast, both

Helen Sessions/Alamy Stock Photo

Godiva chocolates are not the cheapest on the market; the company chooses to provide quality for a premium price.

Budget and Dollar car-rental companies promote themselves as low-priced alternatives to Hertz and Avis. Pricing below prevailing market price works if a firm offers a product of acceptable quality while keeping costs below those of higher-priced competitors.

Pricing New Products

When introducing new products, companies must often choose between very high prices or very low prices. **Price skimming**—setting an initial high price to cover development and introduction costs and generate a large profit on each item sold—works only if marketers can convince customers that a new product is truly different from existing products and that no major competition is on the foreseeable horizon. Apple's iPod is a good example. With no strong competitors entering the market for several years, Apple was able to maintain a high retail price with little discounting, even at Walmart. In contrast, **penetration pricing**—setting an initial low price to establish a new product in the market—seeks to create customer interest and stimulate trial purchases. This is the best strategy when introducing a product that already has competitors or expects to have competitors very quickly.

Fixed Versus Dynamic Pricing for Online Business

The digital marketplace has introduced a highly variable pricing system as an alternative to conventional fixed pricing for both consumer and business-to-business (B2B) products. At present, fixed pricing is still the most common option for cyber shoppers. Ecommerce giant Amazon.com has maintained this practice as its pricing strategy for its millions of retail items. In contrast, dynamic pricing, such as eBay's auction bidding, uses flexibility between buyers and sellers in setting a price and uses the web to instantly notify millions of buyers of product availability and price changes.

Another kind of dynamic pricing—the reverse auction—allows sellers to alter prices privately on an individual basis. At Priceline.com, for example, consumers set a price (below the published fixed price) they are willing to pay for airfare (or a rental car or a hotel room); then an airline can complete the sale by accepting the bid price.[1]

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. ShopSavvy APP **Source:** ShopSavvy Inc. **Key Features:** Allows you to scan or search items and compare the in-store and online costs while identifying in-store sales.	Apple, Android, Windows
2. The Get Response App **Source:** GetResponse Inc. **Key Features:** Helps you plan, quantify (with a dashboard), and verify the level of success of email marketing campaign.	Apple, Android
3. Adzi—Advertising Expert APP **Source:** WannaBiz **Key Features:** Enables you to use the power of professional advertising campaigns for your small business.	Android, Windows

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" marketing apps and identify the key features.

Pricing Tactics

Regardless of its pricing strategy, a company may adopt one or more pricing tactics. Companies selling multiple items in a product category often use **price lining**—offering all items in certain categories at a limited number of prices. A clothing retailer, for example, might predetermine $299, $399, $499, and $599 as the price points for men's suits, so all men's suits would be set at one of these four prices. This allows the store to have a suit for the different customer segments it hopes to attract. Apple also sells iPads at various price points based on processor speed. Apple recently lowered its price on two of its iPad models, but it extended capacity and price on higher-level models.[2] In Canada, prices range from $429 for 32GB, to $549 for 128GB, to $1049 for 64GB, to $1229 for 256GB, and to $1479 for 512GB.[3]

Psychological pricing takes advantage of the fact that customers are not completely rational when making buying decisions. One type, *odd-even pricing*, is based on the theory that customers prefer prices that are not stated in even dollar amounts. Thus customers regard prices of $1000, $100, $50, and $10 as significantly higher than $999.95, $99.95, $49.95, and $9.95, respectively. Finally, sellers must often resort to price reductions—**discounts**—to stimulate sales.

PRICE SKIMMING Setting an initially high price to cover new product costs and generate a profit.
PENETRATION PRICING Setting an initially low price to establish a new product in the market.
PRICE LINING Setting a limited number of prices for certain categories of products.
PSYCHOLOGICAL PRICING A pricing tactic that takes advantage of the fact that consumers do not always respond rationally to stated prices.
DISCOUNT A price reduction offered as an incentive to purchase.

LO-3 PROMOTING PRODUCTS AND SERVICES

Promotion refers to techniques for communicating information about products and is part of the communication mix—the total message any company sends to customers about its product. Promotional techniques, especially advertising, must communicate the uses, features, and benefits of products, and marketers use an array of tools for this purpose.

The ultimate objective of promotion is to increase sales. However, marketers also use promotion to increase consumer awareness of their products, to make consumers more knowledgeable about product features, and to persuade consumers to prefer a particular brand over others. Today's value-conscious customers gain benefits when the specific elements in the promotional mix are varied to communicate value-added benefits. Burger King shifted its promotional mix by cutting back on advertising and using those funds for customer discounts. Receiving the same food at a lower price is "value added" for Burger King's customers. Many companies, such as Hallmark Cards, experience seasonal sales patterns. By increasing their promotional activities in slow periods, they can achieve a more stable sales volume throughout the year. As a result, they can keep their production and distribution systems running evenly. Tim Hortons achieves the same goal with its annual Roll Up the Rim contest.

1. When consumers first recognize the need to make a purchase, marketers use advertising and publicity, which can reach many people quickly, to make sure buyers are *aware of their products*.
2. As consumers search for information about available products, advertising and personal selling are important methods *to educate them*.
3. Personal selling can become vital as consumers compare competing products. Sales representatives can *demonstrate product quality, features, benefits, and performance* in comparison with competitors' products.
4. When buyers are ready to purchase products, sales promotion can give consumers *an incentive to buy*. Personal selling can help by bringing products to convenient purchase locations.
5. After making purchases, consumers evaluate products and note (and remember) their strengths and deficiencies. At this stage, advertising and personal selling can *remind customers that they made wise purchases.*

Figure 13.2 summarizes the effective promotional tools for each stage in the consumer buying process.

Promotional Strategies

After a firm's promotional objectives are clear, it must develop a promotional strategy to achieve those objectives. Promotional strategies may be of the push or pull variety. A company with a **push strategy** will "push" its product to wholesalers and retailers, who then persuade customers to buy it. In contrast, a company with a **pull strategy** appeals directly to customers, who demand the product from retailers, who in turn demand the product from wholesalers, who in turn demand the product from the manufacturer. Advertising "pulls," whereas personal selling "pushes."

Makers of industrial products often use a push strategy, while makers of consumer products often use a pull strategy. Many large firms use a combination of the two. For example, Coca-Cola uses advertising to create consumer demand (pull) for its various beverages—Coke, Fanta, Vitaminwater, Minute Maid, and Powerade. It also pushes wholesalers and retailers to stock those products. In total, the company has more than 4100 products that are sold in more than 200 countries.[4]

PROMOTION Aspect of the marketing mix concerned with the most effective techniques for communicating information about and selling a product.

PUSH STRATEGY A promotional strategy in which a company aggressively pushes its product through wholesalers and retailers, which in turn persuade customers to buy it.

PULL STRATEGY A promotional strategy in which a company appeals directly to customers, who then demand the product from retailers, which then demand the product from wholesalers.

PROMOTIONAL MIX The combination of tools used to promote a product.

The Promotional Mix

Five of marketing's most powerful promotional tools are advertising, personal selling, sales promotions, direct or interactive marketing, and publicity and public relations. The best combination of these tools—the best **promotional mix**—depends on many factors. The most important is the target audience.

In establishing a promotional mix, marketers match promotional tools with the five stages in the buyer decision process:

S K D/Alamy Stock Photo

Beats by Dre was built though a non-traditional approach; the message and reputation was spread through social media buzz, YouTube videos, and more traditional techniques such as cinema ads. A few years ago, Apple bought the company for more than $3 billion.

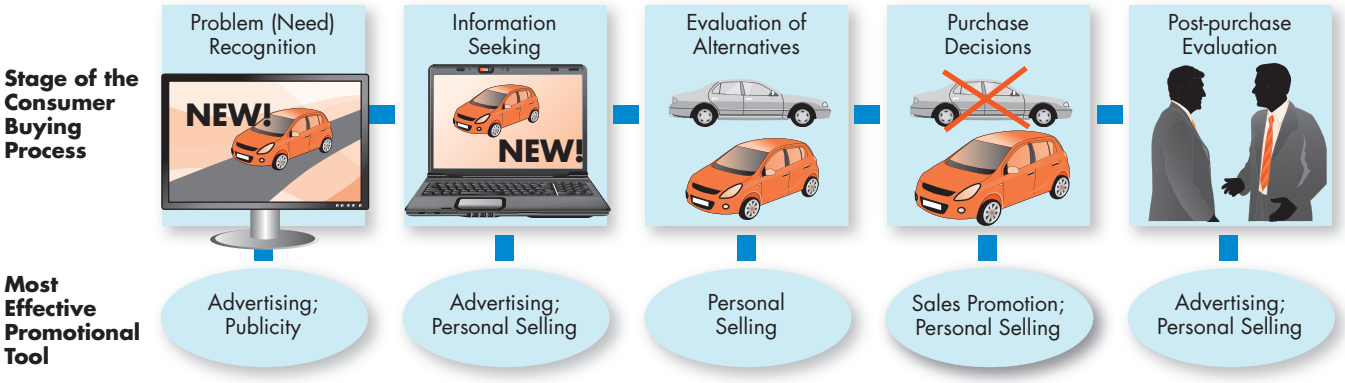


FIGURE 13.2 The consumer buying process and the promotional mix

LO-4 ADVERTISING PROMOTIONS AND MEDIA

Advertising is paid, non-personal communication by which an identified sponsor informs an audience about a product. You can probably remember many jingles and slogans from your early childhood. If a friend tells you that he or she has dandruff, you might instinctively tell them to use Head and Shoulders shampoo. Companies such as McDonald's have been planting messages in your mind for years. Like it or not, we are all a little bit brainwashed. Consumers remember brand names more easily if the company has a catchy advertising slogan. Advertising can convince customers to try a company's product or service, but it has limits. It is the customers' experience with the product or service that determines whether they will make repeat purchases.

Advertising Media

Consumers tend to ignore most advertising messages that bombard them—they pay attention only to what interests them. Thus marketers use several different **advertising media**—specific communication devices for carrying a seller's message to potential customers. The combination of media through which a company advertises is called its media mix. Table 13.1 shows the strengths and weaknesses of various media.

Traditional Media: Changing Times

The advertising industry is dynamic, and it is changing to meet the interests and preferences of both customers and advertisers. Metrics like the relative number of listeners, viewers, and "eye-balls" attracted by each medium are driving this change in advertising spending. For example, although newspaper ads are rated as more informative and useful than some other media, advertisers continue to shift away because the audience for newsprint is shrinking. To survive, newspapers are adopting a "digital first" strategy. Radio stations are feeling the heat from subscriber-based satellite radio. Even television is under pressure. The increase in subscription-based services such as Netflix and Crave TV enable commercial-free "binge watching" thus reducing network viewership. According to the CRTC, almost one-quarter of Canadians 18–34 are already watching TV exclusively online.[6] As we have stated, advertiser dollars follow viewers and listeners. However, in some instances, most prominently the Super Bowl, TV advertising maintains considerable power. Many people acknowledge that they watch the game only to see the commercials. In 2018, a 30-second commercial televised during the NFL Super Bowl cost more than $5 million.[7] A national 30-second spot in Canada during the Super Bowl costs approximately $170 000 to $200 000.[8] A comparable 30-second Grey Cup spot costs about $65 000.[9]

A combination of additional traditional media—including catalogues, sidewalk handouts, Yellow Pages, skywriting, special events, and door-to-door communications—makes up the remaining advertising vehicles.

Online: The Power of Consumer Engagement

As the statistics in Table 13.1 indicate, the relative power of online advertising is unquestionable. It encompasses various forms, including search, display, classifieds, email, video, and video gaming. Online advertising offers advantages such as flexibility, feedback (sellers can measure the success of messages by counting how many people see each ad and tracking the number of people who click-through to their websites), reach, and a capacity for relationship building (with customers on interactive websites).[10]

ADVERTISING Paid, non-personal communication by which an identified sponsor informs an audience about a product.

ADVERTISING MEDIA The specific communication device—television, radio, online, newspapers, direct mail, magazines, outdoor, mobile—used to carry a firm's advertising message to potential customers.

Pearson Canada

WestJet has been able to maximize the power of online campaigns by using various forms of online advertising to make an impact.

TABLE 13.1 Total Media Usage, Strengths, and Weaknesses

Advertising Medium	Total $ Spent and Percentage of Total Advertising[5]	Strengths	Weaknesses
Television	$3.34 billion (26.6% of total)	Program demographics allow for customized ads Large audience Combines sight, sound, and motion	Most expensive Ads increasingly skipped (DVRs) Shift to online "binge watching" (i.e., Netflix)
Online (includes search, display, classifieds, email, video, and video gaming)	$2.98 billion (23.8% of total)	Targeted audience Measurable success	Some forms are annoying for consumers Easy to ignore
Mobile	$1.62 billion (12.9% of total) (up from 3.5% two years earlier!)	Accessibility Relative cost Ability to personalize Growing Importance	Sometimes difficult to read Lack of standardization
Newspapers	$2.02 billion (16.1% of total) (*)daily and community papers	Broad coverage Ads can be changed daily Larger percentage of readers have high income & educated	Quickly discarded Quality of ad images is limited
Radio	$1.58 billion (12.6% of total)	Inexpensive Large audience Fairly easy to identify segments	Easy to ignore Message quickly disappears
Outdoor	$586 million (4.7% of total)	Inexpensive Difficult to ignore Repeat exposure	Presents limited information Little control over audience
Magazines	$412 million (3.3% of total)	Often reread and shared Fairly easy to identify segments	Require advanced planning Little control over ad placement

To truly highlight the transformational power of this medium, consider the strategic fortress of TV advertising—the Super Bowl. Even this sacred advertising event has changed to some extent. Instead of tightly guarding secret campaigns for the big day, companies are now creating teaser campaigns on YouTube and Facebook to build interest weeks before the big day, actively encouraging consumers to participate in events. In addition, the immense audience is being directed from TV to the internet during the game. For example, the media check-in service Get Glue worked with Pepsi to help the company maximize its expensive halftime show sponsorship (starring Beyoncé). The result was that 95 747 virtual stickers were unlocked (and could be posted by the participants) reaching an estimated 36 million people (who saw those messages).[11]

In short, advertisers are measuring consumer media behaviour, and as a result, they are shifting more spending online. For example, a survey conducted by the Solutions Research Group indicated that Canadians are truly hooked on YouTube. They asked respondents: When was the last time you visited YouTube? The results: 57 percent within 24 hours, 25 percent within the past week, 9 percent within the past month, and only 8 percent within more than a month and 12 percent answering never.[12] As a result, many companies have changed how they interact with customers. The engagement is now more likely to be two-way, with companies asking consumers to get involved with the brand and influence marketing decisions. You can include Starbucks (name a flavour), Crayola (new colours), and Frito-Lay (flavour ideas and ad themes) in the growing crowd.[13] For maximum effect, these interactions are always tied to smart social media ad campaigns.

Finally, many of the online interactions are now occurring on mobile phones. So, if you add up the online and mobile media spending numbers from Table 13.1 (12.9% + 23.8% = 36.7%), you can see that, in combination, these two far exceed the 26.6 percent of media spending that was allocated to the traditional king of advertising: TV. Worldwide mobile ad spending is expected to reach US$156 billion in 2019.[14]

Edgar Negrete/Clasos/LatinContent/Getty Images

Yuya is a Mexican vlogger who provides beauty tips to more than 21 million subscribers to her YouTube channel. She has amassed more than two billion views.

LO-5 PERSONAL SELLING, SALES PROMOTIONS, DIRECT (OR INTERACTIVE) MARKETING, PUBLIC RELATIONS, AND PUBLICITY

In this section, we outline the tasks involved in personal selling, describe the various types of sales promotions, look at direct (or interactive) marketing, and distinguish between publicity and public relations.

Personal Selling

Personal selling is the most expensive form of promotion per contact, because presentations are generally made to one or two individuals at a time. Personal-selling expenses include salespeople's compensation and their overhead (travel, food, and lodging). The average cost of an industrial sales call has been estimated at $300 to $500.[15] Costs have prompted many companies to turn to telemarketing, using telephone solicitations to conduct the personal-selling process. It is estimated that telemarketing returns $6.25 for every dollar spent.[16] Overall sales within Canada from telemarketing and call centres is estimated at $2 billion (much higher if you include all of the activity that has moved overseas in recent years).[17]

Sales Promotions

Sales promotions are short-term promotional activities designed to stimulate consumer buying or cooperation from distributors, sales agents, or other members of the trade. They are important because they increase the likelihood that buyers will try products. They also enhance product recognition and can increase purchase size and amount. For example, soap is often bound into packages of four with the promotion, "Buy three and get one free."

To be successful, sales promotions must be convenient and accessible when the decision to purchase occurs. If Harley-Davidson has a one-week motorcycle promotion and you have no local dealer, the promotion is neither convenient nor accessible to you, and you will not buy. But if Herbal Essences offers a 20 percent–off coupon that you can save for use later, the promotion is convenient and accessible. Like anything else, too much of a good thing can be destructive. The Bay has been criticized for holding too many scratch-and-save "Bay Days." The goal of such programs is to generate immediate sales, as people are given an incentive to buy now or buy before the end of the weekend. But in the case of The Bay, many customers have been conditioned to expect these sales. The result is that some customers delay purchases, waiting for the next sale. This is clearly not the goal of a sales promotion program.

Types of Sales Promotions

Most consumers have taken part in a variety of sales promotions designed to encourage customers to try new products, to attract them away from competitors, or to persuade them to buy more of a product—for example, free samples (giveaways), which let customers try products without risk, and **coupon** promotions, which use certificates entitling buyers to discounts. **Premiums** are free or reduced-price items, such as pencils, coffee mugs, and six-month, low-interest credit cards, that are given to consumers in return for buying a specified product. Contests can boost sales by rewarding high-producing distributors and sales representatives with vacation trips to places like Hawaii or Paris.

To grab customers' attention and make it easier for them to find certain products, as well as help eliminate competitors from consideration, companies use **point-of-purchase** (or **sale**) **displays** at the ends of aisles or near checkout counters. In addition to physical goods, point-of-purchase pedestals also provide services, namely information for consumers. Bank lobbies and physicians' waiting rooms, for example, might have interactive kiosks inviting clients to learn more about bank products or educational information about available treatments on consumer-friendly touchscreen displays. For B2B promotions, industries sponsor **trade shows** where companies rent booths to display and demonstrate products to potential customers who have a special interest or who are ready to buy. For example, the Consumer Electronics Show (CES) is a showcase of the latest innovative technologies and is

PERSONAL SELLING Promotional tool in which a salesperson communicates one-to-one with potential customers.

SALES PROMOTIONS Short-term promotional activities designed to stimulate consumer buying or cooperation from distributors and other members of the trade.

COUPON A method of sales promotion featuring a certificate that entitles the bearer to a specified savings on a product's regular price.

PREMIUM A method of sales promotion in which an item is offered free or at a bargain price to customers in return for buying a specified product.

POINT-OF-PURCHASE (OR SALE) A method of sales promotion in which a product display is located in a retail store in order to encourage consumers to buy the product.

TRADE SHOW A method of sales promotion in which members of a particular industry gather for displays and product demonstrations designed to sell products to customers.

The Consumer Electronic show (CES) is the top trade show for companies displaying their new innovations. More than 170 000 people attend it each year.

UzFoto/Shutterstock

held in Las Vegas each January with nearly 4000 exhibiting companies and with more than 170 000 attendees from 150 countries.[18] According to IBISWorld, the trade show and event planning industry in Canada is worth an estimated $1 billion annually.[19]

Direct (or **interactive**) **marketing** is one-on-one, non-personal selling that tries to get consumers to make purchases from places other than retail stores and, instead, to purchase from home, at work, or by using a smartphone. This fast-growing selling method includes non-store retailers (catalogues, telemarketing, home video shopping), direct mail, direct-response advertising (such as infomercials and direct-response magazine and newspaper ads), and most important, online connections. When used by B2B businesses, direct marketing is primarily lead generation, so a salesperson can close the sale where interest has been shown. In B2C businesses, it has primarily a selling goal. The advantage of direct marketing is that you can target the message to the individual and measure the results. For example, Amazon knows when you sign in who you are and what you have purchased in the past and makes recommendations based on your purchase history. Moreover, when you select a certain book or item, Amazon can suggest other items bought by customers who bought the same item you did, and in that way potentially increase sales to you.

The internet has clearly enhanced traditional direct marketing methods. For example, by using *permission marketing*—a form of email where consumers give a company permission to contact them—a company compiles a list of customers' emails. The company regularly notifies those customers about special offers and deals based on their past purchases. The emails come from a company that the consumer has experience with and has agreed to receive messages from; the emails contain a direct link to the company's website and the sale item. Companies such as Lululemon, Dell, and Gap are among those that have used this direct marketing approach successfully.

For a good example of a company that has used direct marketing and online communications effectively, read the Disruption in Business box entitled "Now Here's a Story about Disruption."

Publicity and Public Relations

Much to the delight of marketing managers with tight budgets, **publicity** is free. Moreover, because it is presented in a news format, consumers see publicity as objective and believable. However, marketers may have little control over bad publicity, and that can have a very negative impact. For example, United Airlines received a lot of negative press when a passenger was forcibly removed from a flight that was overbooked. The company initially offered passengers up to $800 as a reward to give up their seat voluntarily; however, when nobody took the bait, company officials proceeded to a random lottery. The unlucky winner of the lottery

DIRECT (OR INTERACTIVE) MARKETING One-on-one non-personal selling by non-store retailers and B2B sellers using direct contact with prospective customers, especially via the internet.

PUBLICITY Information about a company, a product, or an event transmitted by the general mass media (with no direct cost to the company).

DISRUPTIONS IN BUSINESS

Now Here's a Story About Disruption!

Michael Dubin met a gentleman at a cocktail party who needed to unload a warehouse full of surplus razor blades. Dubin imagined that he could mail blades to customers at a fraction of the price they were paying currently in the grocery store, and that would save them time, effort, and money. So, on March 6, 2012, at 6 a.m. Pacific Time, he published a video that announced the Dollar Shave Club to the world. It opened with Dubin at a desk, pitching his razors in one of the most famous viral videos of all time. Although it cost only $4500 to make the video, the company received 12 000 orders on its first day, and the video has been watched 24 million times since then.

When Dubin launched Dollar Shave Club, industry-leader Gillette held a 72 percent market share, with Schick a distant second place. Dubin started by undercutting them on razors, but then went on to release a full range of men's grooming products over the next few years. As a result, he quickly garnered a loyal following. He also expanded operations internationally, selling in both Canada and Australia starting in 2012. His success paved the way for other small mail-order companies, such as Harry's and ShaveMOB, and by 2015, web sales for men's shaving gear had more than doubled to $263 million for the industry. By 2016, Dollar Shave Club had soared to control 51 percent of the razor market, while Gillette's share had dropped to just 21.2 percent. Dollar Shave Club projected more than $250 million in revenue for 2017, up from $6 million just five years earlier.

Katarzyna Bialasiewicz/123RF

In 2017, both Gillette and Schick began to cut prices on all their men's care products to regain market share. But it may be too little too late, because Dubin added a lot of muscle to his company by selling it to Unilever for $1 billion. He's still in charge, though, and even though his initial competitive edge was built on low price, his core philosophy is still one of creating a great customer experience.

CRITICAL THINKING QUESTIONS

1. Consider the following statement: "*The dramatic changes that have taken place in the razor blade market are just one more indication of how widespread disruption is. Both consumers and businesses would be better off if markets and marketing strategies were not changing so much.*" Do you agree or disagree with the statement? Defend your reasoning.
2. What are the advantages and disadvantages (for consumers and for businesses) of disruption?

was dragged from the plane when he refused to leave. Other passengers were shocked, and a video of the aggressive actions went viral.[20] Key lessons from this incident should be highlighted and understood: (1) never underestimate the power of social media, (2) move quickly to get in front of the situation, (3) initiate a full investigation and ensure it does not happen again, and (4) always respect your customers' rights and wishes![21]

In contrast, **public relations** is a term that describes company-influenced publicity. It attempts to create goodwill between the company and its customers through public-service announcements and actions that enhance the company's image. For example, a bank may announce that senior citizens' groups can have free use of a meeting room for their social activities. Volvo managed to get a major public relations boost when it carefully planned a major announcement: starting in 2019 none of its vehicles would be powered solely by gasoline or diesel engines. Each car would now also be available in hybrid or full electric formats. Critics have argued that Volvo is no further ahead of their competition in this area, but the carefully orchestrated announcement and public relations push, based on a time-sensitive official date, earned Volvo a lot of praise and great coverage worldwide.[22]

PUBLIC RELATIONS Company-influenced information directed at building goodwill with the public or dealing with unfavourable events.

Maximimages.com/Alamy Stock Photo

>>> Kate Upton wore a Canada Goose jacket on the cover of the *Sports Illustrated Swimsuit Issue* and generated a lot of attention at no cost to the company.

LO-6 THE DISTRIBUTION MIX

In addition to a good product mix and effective pricing and promotion, the success of any product also depends on its **distribution mix**—the combination of distribution channels by which a firm gets products to end users. In this section, we look at intermediaries and different kinds of distribution channels. Then we discuss some benefits consumers reap from services provided by intermediaries.

Intermediaries and Distribution Channels

Intermediaries, once called "middlemen," help to distribute goods, either by moving them or by providing information that stimulates their movement from sellers to customers. **Wholesalers** are intermediaries that sell products to other businesses for resale to final consumers. **Retailers** sell products directly to consumers.

Distribution of Goods And Services

A **distribution channel** is the path a product follows from producer to end user. Figure 13.3 shows how four popular distribution channels can be identified according to the channel members involved in getting products to buyers.

Channel 1: Direct Distribution In a **direct channel**, the product travels from the producer to the consumer or organizational buyer without intermediaries. Dell built its name using this channel approach. Most business goods, especially those bought in large quantities, are sold directly by the manufacturer to the industrial buyer.

Channel 2: Retail Distribution In Channel 2, producers distribute consumer products through retailers. Goodyear, for example, maintains its own system of retail outlets. Levi's has its own outlets, but also produces jeans for other retailers. Large outlets, such as Walmart, buy

DISTRIBUTION MIX The combination of distribution channels by which a firm gets its products to end users.
INTERMEDIARY An individual or firm that helps to distribute a product.
WHOLESALER An intermediary that sells products to other businesses for resale to final consumers.
RETAILER An intermediary that sells products directly to consumers.
DISTRIBUTION CHANNEL The network of interdependent companies through which a product passes from producer to end user.
DIRECT CHANNEL A distribution channel in which a product travels from producer to consumer without intermediaries.

THE GREENING OF BUSINESS

Single-Use Packaging Under Fire

Consumers (and governments) are starting to discourage the use of all kinds of *single-use packaging* (e.g., Styrofoam cups, plastic plates, eating utensils, takeout containers, and plastic bags). More than 100 cities in Canada and the United States prohibit restaurants and other food vendors from using Styrofoam containers. Consumers are also demanding that retailers provide more eco-friendly packaging that is biodegradable, recyclable, or reusable. One alternative to traditional plastic bottles is polyethylene terephthalate plastic bottles, which can be produced from recycled material. And remember that old-fashioned glass is 100 percent recyclable. Consumers also want less packaging overall, whatever type it is.

One type of single-use packaging—the plastic bag—has received a great deal of negative publicity. Cities as diverse as Seattle, Washington; Austin, Texas; Leaf Rapids, Manitoba; and Fort McMurray, Alberta (and many others) have either banned plastic bags completely or levy fees on plastic bags. Vancouver spends $2.5 million each year managing the collection of plastic bags from public waste bins. It has set a goal of having zero waste from single-use plastic bags by 2040. A new bylaw came into effect in Montreal on January 1, 2018, that prohibits retailers from offering customers single-use plastic bags. Retailers such as Walmart, IKEA, and No Frills charge customers for plastic bags. Mountain Equipment Co-op makes a five-cent donation to environmental groups each time a customer declines to take a plastic bag.

In spite of these trends, the hard-scientific evidence about plastic, cloth, or paper bags suggests that determining which type is most environmentally friendly can be difficult. Many factors must be considered, including the level of environmental emissions that are generated at the production, distribution, and reclamation stages. Plastic bags can take up to 1000 years to degrade in landfills, and they contain toxins that get into the soil. They are also an eyesore when they blow around landfills and elsewhere. Paper bags are often seen to be better than plastic bags because they are made from natural materials, but studies show that, compared to paper bags, plastic bags consume 40 percent less energy, produce 70 percent fewer atmospheric emissions, and produce 94 percent fewer waterborne wastes. Reusable cotton bags are eco-friendly, but growing cotton requires a lot of water and the use of pesticides. A cotton bag has to be used about 130 times to be carbon-equivalent to a plastic bag. As well, cloth bags may contain bacterial contaminants. Plastic bags protect consumers from bacteria precisely because they are disposable. One study showed that emergency room visits increased soon after the ban on plastic bags went into effect in San Francisco.

CRITICAL THINKING QUESTIONS

1. All things considered, which shopping bag do you think is best: plastic, paper, or reusable cloth bags? Explain your reasoning.
2. Is there some way that businesses can provide consumers with convenient single-use packaging without harming the environment?

merchandise directly from producers. Many industrial buyers, such as businesses buying office supplies at Staples, rely on this channel.

Read the Greening of Business Box entitled "Single-Use Packaging Under Fire" to learn more about a growing trend in retail outlets.

Channel 3: Wholesale Distribution Channel 2, once the most widely used method of non-direct distribution, requires a large and costly amount of floor space for storing and displaying merchandise. Wholesalers relieve the space problem by using Channel 3—that is, storing merchandise and restocking store displays frequently. With approximately 90 percent of its space used to display merchandise and only 10 percent left for storage and office facilities, the combination convenience store/gas station's use of wholesalers is an example of this channel.

Channel 4: Distribution by Agents or Brokers Sales agents or brokers represent producers and receive commissions on the goods they sell to consumers or industrial users. **Sales agents**, including many travel agents, generally deal in the related product lines of a few producers, such as tour companies, to meet the needs of many customers. Vancouver-based UNIGLOBE Travel International, a travel agency representing airlines, car rental companies, hotels, and tour companies, books flight reservations and arranges complete recreational travel services for consumers. The firm also services companies whose employees need lodging and transportation for business travel. In contrast to agents, **brokers**, in industries such as real estate and stock exchanges, match numerous sellers and buyers as needed to sell properties, often without knowing in advance who they will be.

SALES AGENT An independent intermediary who generally deals in the related product lines of a few producers and forms long-term relationships to represent those producers and meet the needs of many customers.

BROKER An independent intermediary who matches numerous sellers and buyers as needed, often without knowing in advance who they will be.

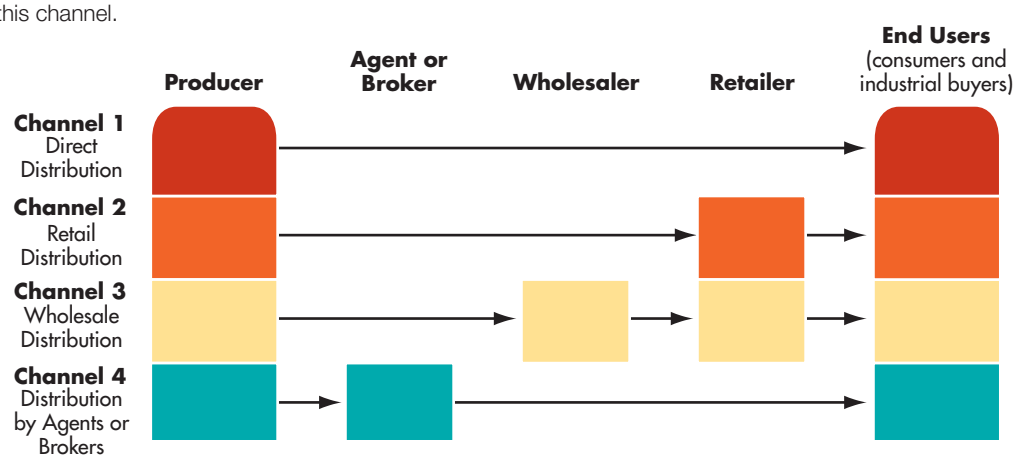


FIGURE 13.3 Channels of Distribution

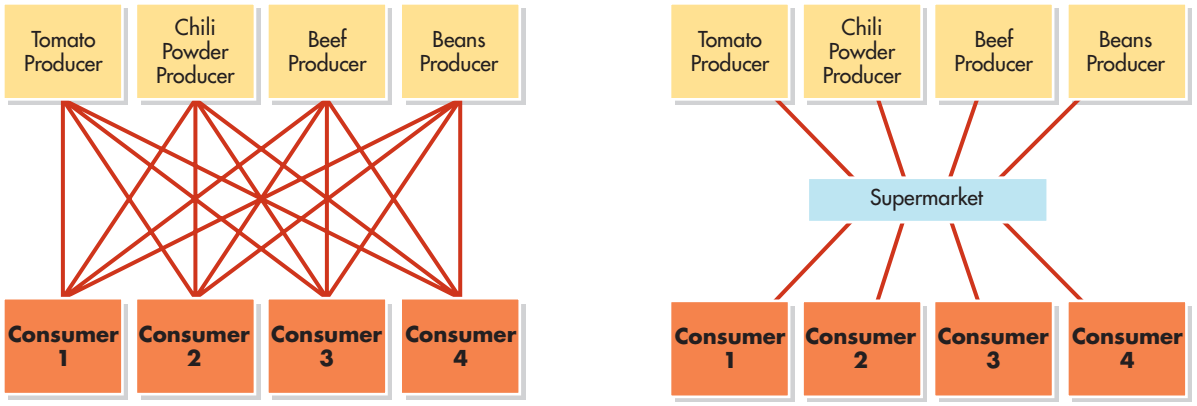


FIGURE 13.4 The Value-Adding Intermediary

The Pros and Cons of Non-Direct Distribution

One problem with non-direct distribution is higher prices. The more members there are in the channel—the more intermediaries making a profit by charging a markup or commission—the higher the final price. But this is not always true. Sometimes, as in the case of fruit distribution (like bananas), the efficiencies provided by members can more than pay off what the channel member earns on the transaction. Imagine how much it would cost and how much time it would take for a restaurant to order and receive all fruits and vegetables it uses directly to their location from suppliers located around the world. Channel members buy in large quantities, so transaction costs are spread across many units.

Intermediaries deliver added value by providing time-saving information and making the right quantities of products available where and when consumers need them. Figure 13.4 illustrates the problem of making chili without the benefit of a common intermediary—the supermarket. As a consumer, you would obviously spend a lot more time, money, and energy if you tried to gather all the ingredients from separate producers. In short, intermediaries exist because they provide necessary services that get products efficiently from producers to users.

Distribution Strategies

The choice of a distribution strategy determines the amount of market exposure the product gets and the cost of that exposure. **Intensive distribution** occurs when a product is distributed through as many channels and channel members as possible. Doritos chips flood the market through many different outlets. Intensive distribution is normally used for low-cost consumer goods, such as candy and magazines. In contrast, **exclusive distribution** occurs when a manufacturer grants the exclusive right to distribute or sell a product to one wholesaler or retailer in a given geographic area. For example, Maserati luxury automobiles are sold by only a single dealer servicing a large city (where the demand merits). **Selective distribution** falls between intensive and exclusive distribution. A company that uses this strategy selects only wholesalers and retailers that will give special attention to the product in terms of sales efforts, display position, and so on. This method is usually embraced by companies such as Black+Decker, whose product lines do not require intense market exposure to increase sales.

Channel Conflict and Channel Leadership

Channel conflict occurs when members of the distribution channel disagree over the roles they should play or the rewards they should receive. John Deere, for example, would no doubt object if its dealers began distributing Russian and Japanese tractors. Channel conflict may also arise if one member has more power than the others or is viewed as receiving preferential treatment. Such conflicts defeat the purpose of the system by disrupting the flow of goods to their destinations. Usually, one channel member—the *channel captain*—is the most powerful in determining the roles and rewards of other members. The channel captain might be a manufacturer, or it might be a large retailer like Walmart that generates large sales volumes.

INTENSIVE DISTRIBUTION A distribution strategy in which a product is distributed in nearly every possible outlet, using many channels and channel members.

EXCLUSIVE DISTRIBUTION A distribution strategy in which a product's distribution is limited to only one wholesaler or retailer in a given geographic area.

SELECTIVE DISTRIBUTION A distribution strategy that falls between intensive and exclusive distribution, calling for the use of a limited number of outlets for a product.

CHANNEL CONFLICT Conflict arising when the members of a distribution channel disagree over the roles they should play or the rewards they should receive.

LO-7 THE ROLE OF INTERMEDIARIES

Wholesaling

The roles differ among the various intermediaries in distribution channels. As noted earlier, most wholesalers are independent operations that buy products from manufacturers and sell them to various consumers or other businesses. They usually provide storage, delivery, and additional value-adding services, including credit, marketing advice, and merchandising services, such as marking prices and setting up displays. Merchant wholesalers take title to merchandise; that is, they buy and own the goods they resell to other businesses.

Unlike wholesalers, agents and brokers do not own their merchandise. Rather, they serve as sales and merchandising arms for producers or sellers that do not have their own sales forces. The value of agents and brokers lies in their knowledge of markets and their merchandising expertise. They show sale items to potential buyers and, for retail stores, they provide services such as shelf and display merchandising and advertising layout. They remove open, torn, or dirty packages; arrange products neatly; and generally keep goods attractively displayed.

Retailing

You may not have had much contact with wholesalers, but, like most Canadians, you buy nearly all the goods and services you consume from retailers. Most retailers are small operations, often consisting of just the owners and part-time help. But retailers also include huge operations, such as Walmart, the world's largest corporate employer, as well as other global players like Carrefour in France, and domestic players like Canadian Tire and The Bay. As we saw in the opening case, all physical brick-and-mortar retailers are feeling the pressure today. The model that, with the rise of the large retail suburban malls, dominated for decades is under attack by the threat of online retailers. In fairness, those large malls, anchored by department stores, put many small mom and pop shops out of business in decades past. Models evolve, times change. The winners and losers, like everything else in business, come down to satisfying consumer needs based on the basics: price, convenience, environment, ease of ordering, and customer service.

Types of Brick-and-mortar Retail Outlets

Canadian retail operations vary widely by type as well as size. They can be classified by their pricing strategies, location, range of services, or range of product lines. Choosing the right types of retail outlets is a crucial aspect of distribution strategy. Table 13.2 describes retail stores using three classifications: *product-line retailers, bargain retailers*, and *convenience stores*.

TheStoreGuy/Alamy Stock Photo

Canadian Tire has 493 stores serving consumers from coast to coast.

Non-Store Retailing

Some of the largest retailers sell all or most of their products without brick-and-mortar stores. Certain types of products—snack foods and candy—sell well from card- and coin-operated machines. For all products, global annual sales through vending are approximately $200 billion. But this is still a very small percentage (1% to 2%) of total retail sales.[23] Non-store retailing also includes **direct-response retailing**, in which firms contact customers directly to inform them about products and to receive sales orders. See Table 13.3 for a description of certain forms of direct-response retailing.

DIRECT-RESPONSE RETAILING A form of non-store retailing in which firms directly interact with customers to inform them of products and to receive sales orders.

TABLE 13.2 Types of Retailers

Product-Line Retailers	Description	Examples
Department Stores	Organized into specialized departments (e.g., shoes, furniture, women's petite sizes, and so on); usually large, wide range of goods, and a variety of services.	**The Bay**
Supermarkets	Organized and divided based on related products (e.g., food products, household products, and so on); stress low prices, self-service, and wide selection.	**Loblaws, Sobeys, Metro**
Specialty Stores	Serve specific market segments with full product lines and knowledgeable sales personnel in narrow product fields.	**Aldo Shoes, Sunglass Hut**
Category Killers	Very large form of specialty store; focuses on specific categories on a giant scale and often dominates retail sales in the category.	**Best Buy, Staples**
Bargain Retailers	**Description**	**Examples**
Discount Stores	Provide a wide variety of merchandise with minimal service at low prices.	**Walmart**
Factory Outlets	Large discount stores; usually sell last season's merchandise, discontinued items, and factory seconds at a low price.	**Nike Outlet Store**
Wholesale Clubs	Offer large discounts on a wide range of brand-name merchandise to customers who pay annual membership.	**Costco**
Convenience Stores	**Description**	**Examples**
Convenience Stores	Characterized by easily accessible locations, extended store hours, and speedy service.	**Couche-Tard, Circle K**

TABLE 13.3 Non-Store and Direct-Response Retailing

Direct-Response	Description
Catalogue Marketing	A form of non-store retailing in which customers place orders for merchandise in catalogues and receive orders by mail.
Telemarketing	Uses telephone calls to sell directly to consumers. Telemarketing also includes inbound toll-free calls, which most catalogue and other retail stores make available.
Direct Selling	The oldest form of retailing, selling door to door or through home-selling parties. Avon Products, the world's largest direct seller, has 3.5 million door-to-door sales representatives in more than 130 countries.[24]
Video/TV	A form of retailing that lets viewers shop at home from special channels on their TVs. For example, QVC displays and demonstrates products on TV, as well as on Facebook, YouTube, and Twitter, and allows viewers to phone in or email orders.

E-intermediaries

The ability of ecommerce to bring together millions of widely dispersed consumers and businesses has changed the types and roles of intermediaries. **E-intermediaries** are internet-based channel members who perform one or both of two functions: (1) collect information about sellers and present it to consumers or (2) help deliver products to buyers. More than 85 percent of the world's online population—over one billion consumers—have made purchases online. *Electronic retailing (online retailing)* allows sellers to inform, sell to, and distribute to consumers via the web. Amazon .com is the world's largest online retailer, with annual sales of $178 billion.[25]

Large or small, online selling just makes sense. Millions of small businesses around the globe have their own websites. Many regular Canadians are "small retailers" who make some of their annual income by selling goods and services on sites such as Kijiji. Even major luxury brands and retailers have stopped resisting and are increasing accessibility. Hermes recently relaunched its online shop in Canada and is now carrying more than 3000 items online, with good reason. Sales of luxury items like handbags, apparel, and jewellery are expected to account for 25 percent of that total market by 2025.[26] In fact, total global online spending already stands at $2.3 trillion and is expected to grow to US$4.9 trillion by 2021. Online spending in Canada is expected to top $29 billion in 2019.[27]

Read the E-Business and Social Media Solutions box entitled "The Long Tail, Revisited" to get an extra perspective on how e-distribution is changing the economics of selling.

E-INTERMEDIARY An internet distribution channel member that assists in delivering products to customers or that collects information about various sellers to be presented to consumers.

E-BUSINESS AND SOCIAL MEDIA SOLUTIONS

The Long Tail, Revisited

It's been well over a decade since the editor of *Wired Magazine*, Chris Anderson, wrote the book *The Long Tail: Why the Future of Business Is Selling Less of More*. He proposed that, because of the expansion of ecommerce, consumers now have access to an amazing range of products that traditional brick-and-mortar stores would never keep in stock. The term *long tail* refers to the long tapering off portion of the overall demand curve. Without the constraints of physical shelf space and with more access to distribution channels, narrowly targeted goods and services can be as economically attractive as mainstream products.

Anderson argued that traditional retail economics dictate that stores stock only the most popular items because shelf space is expensive but that online retailers, such as Amazon, can stock virtually everything, in theory. Amazon's success in generating profits from its endless aisles of products has led many competitors to adopt long-tail strategies. However, Amazon doesn't stock all the specialty items itself—instead, Amazon offers a marketplace for long-tail items. In other words, Amazon focuses on directly selling and fulfilling high-demand products and leaves long-tail merchandise for its independent sellers to fulfill. Next time you are shopping on Amazon, look for yourself. Search for clothing, electronics, household items, or anything else of interest to you and try to sort out Amazon the store from Amazon the intermediary.

For the consumer, there is a definite upside to the long tail. Products that were previously unavailable in the open market are now available. For example, a how-to book on breeding and raising hamsters may have been impossible to find before the "endless aisles" of the internet, but now niche marketers can provide items that are extremely specific and that have an audience that may be scattered geographically. Niche sellers, even though they might be working out of a small home office, know their niche markets better, and they have better access to and relationships with niche suppliers.

For Amazon though, allowing third-party sales on its website provides long-tail data that it can then use to directly offer products that have begun to sell well. Essentially, Amazon crowdsources its market research using demographic and sales data provided by the long-tail sellers. Is that ethical? Well. Amazon will tell you that it provides a platform for these transactions to occur and that it is acting like any other business that sees an opportunity to increase the bottom line by capitalizing on a growing trend. Regardless of your beliefs, one thing is clear, Amazon has helped diversify and extend the endless aisles of the internet.

CRITICAL THINKING QUESTIONS

1. What kinds of products do you think you would find in Anderson's "long tail"? Give examples.
2. Would you start a niche marketing business? If so, why and how would you market your products or services? If not, why not?

LO-8 PHYSICAL DISTRIBUTION

Physical distribution refers to the activities needed to move products from manufacturer to customer and includes warehousing and transportation operations. Its purpose is to make goods available when and where customers want them, keep costs low, and provide services to satisfy customers. Because of distribution's importance for customer satisfaction, some firms have adopted it as their core marketing strategy of choice. Companies are constantly seeking efficient solutions. For example, Maersk Line and Aqualife A/S have partnered to create a transport system to ship seafood from Canada's east coast aquaculture companies to customers in Europe. Specialized tanks on the ships oxygenate water without having to use pumps. The new system will help to open new markets for aquaculture products grown in Canada.[28]

Warehousing Operations

Warehousing is the physical distribution operation concerned with the storage of goods. In selecting a distribution strategy, managers must keep in mind both the different characteristics and the costs of warehousing operations. Warehouses may be owned by a single manufacturer, wholesaler, or retailer that deals in mass quantities and needs regular storage (such as The Brick). Other warehouses are independently owned and rent space to companies as required (e.g., during peak periods).

Transportation Operations

Physically moving a product creates the highest cost many companies face. In addition to transportation methods, firms must also consider the nature of the product, the distance it must travel, the speed with which it must be received, and customer wants and needs.

Differences in cost among the major transportation modes—trucks, railroads, planes, digital transmission, water carriers, and pipelines—are usually most directly related to delivery speed. See Table 13.4 for more details about transportation modes.

PHYSICAL DISTRIBUTION Activities needed to move a product efficiently from manufacturer to consumer.

WAREHOUSING A physical distribution operation concerned with the storage of goods.

FedEx has more than 140 000 employees worldwide and operates a fleet of 654 airplanes that help the company deliver speedy service to clients around the world.

Hady Khandani/Vario images GmbH & Co.KG/Alamy Stock Photo

TABLE 13.4 Pros and Cons of the Various Modes of Transporting Goods

Mode of Transport	Pros and Cons
Trucks	+ Flexibility, fast service, and dependability – Increased truck traffic is raising safety concerns
Planes	+ Fastest traditional method (potential for lower-inventory costs; reduces the need to store items that might spoil) – Most expensive approach
Digital Transmission	+ Newest, fastest, and least expensive method – Restricted to certain products (e.g., music, movies, software, and so on)
Water Carriers	+ Least expensive traditional mode – Slowest method
Railroads	+ Economically transport high-volume, heavy, bulky items (e.g., cars, steel) – Delivery routes are limited by fixed railway lines
Pipelines	+ Good for specialized products (liquids and gases); economical and reliable – Slow, lack of flexibility

Distribution through Supply Chains as a Marketing Strategy

Instead of just offering advantages in product features, quality, price, and promotion, many firms have turned to supply chains that depend on distribution as a cornerstone of business strategy. This approach means assessing, improving, and integrating the entire stream of activities—upstream suppliers, wholesaling, warehousing, transportation, delivery, and follow-up services—involved in getting products to customers.

Walmart built its distribution system utilizing the best practices of both just-in-time (JIT) and supply chains (as discussed in Chapter 10), instead of the industry practice of relying on outside freight companies and wholesalers. When you buy a product (e.g., Tide) at Walmart, the checkout scanner reads the barcode on the box, and Walmart's inventory system is updated instantly, showing that a replacement is needed on the shelf. When the supply of Tide dwindles to its automatic triggering number, Walmart's distribution centre receives a digital signal notifying that this store needs more Tide, and at the same time, the system also notifies the manufacturer (in this case, Procter & Gamble) that this location needs a replenishment supply—a predetermined number of boxes. Walmart's data mining system determines the reorder number for every product based on sales (daily, weekly, and even by the time of year). Because of Walmart's constant, rapid restocking from upstream sources, its store shelves are resupplied without the company's having to keep large inventories in its warehouses and retail stores, thus reducing inventory costs and providing lower prices.

Walmart's JIT system has allowed it to achieve a short (as low as a two-day) turnaround from manufacturer to store shelf, providing cost control and product availability. It maintains lower levels of inventory, meets customer demand, and keeps the lowest prices in the retail industry.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 IDENTIFY THE VARIOUS *PRICING OBJECTIVES* THAT GOVERN PRICING DECISIONS AND DESCRIBE THE *PRICE-SETTING TOOLS* USED IN MAKING THESE DECISIONS.

Two major pricing objectives are (1) pricing to maximize profits—that is, set the price to sell the number of units that will generate the highest possible total profits; and (2) employing market-share objectives—pricing is used for establishing market share. The seller is willing to accept minimal profits, even losses, to get buyers to try products. Two basic tools are used: (1) cost-oriented pricing, which begins by determining total costs for making products available to shoppers, after which a figure for profit is added in to arrive at a selling price; and (2) breakeven analysis, which assesses total costs versus revenues for various sales volumes. It shows, at each possible sales volume, the amount of loss or profit for any chosen sales price. It also shows the breakeven point, the number of sales units for total revenue to equal total costs.

LO-2 DISCUSS *PRICING STRATEGIES* THAT CAN BE USED FOR DIFFERENT COMPETITIVE SITUATIONS AND IDENTIFY THE *PRICING TACTICS* THAT CAN BE USED FOR SETTING PRICES.

Pricing for existing products can be set above, at, or below market prices for similar products. High pricing is often interpreted as meaning higher quality and prestige, while low pricing may attract a greater sales volume. Strategies for new products include price skimming, setting an initially high price to cover costs and generate a profit; and penetration pricing, setting a low price to establish a new product in the market. Strategies for e-businesses include dynamic versus fixed pricing. Dynamic pricing establishes individual prices via real-time interactions on the internet between the seller and each customer. Fixed pricing is the traditional one-price-for-all arrangement.

Three tactics are often used for setting prices: (1) With price lining, any product category (such as ladies' shoes) will be set at three or four price levels, and all shoes will be priced at one of those levels. (2) Psychological pricing acknowledges that customers are not completely rational when making buying decisions, as with odd-even pricing in which customers regard prices such as $10 as being significantly higher than $9.95. (3) Discount pricing uses price reductions to stimulate sales.

LO-3 IDENTIFY THE IMPORTANT *OBJECTIVES OF PROMOTION* AND DISCUSS THE CONSIDERATIONS IN SELECTING A *PROMOTIONAL MIX*.

Although the ultimate goal of any promotion is to increase sales, other goals include communicating information, positioning a product, adding value, and controlling sales volume. In deciding on the appropriate promotional mix, the best combination of promotional tools (e.g., advertising, personal selling, sales promotions, direct [or interactive] marketing, public relations), marketers must consider the good or service being offered, characteristics of the target audience, the buyer's decision process, and the promotional mix budget.

LO-4 DEFINE THE *ROLE OF ADVERTISING* AND DESCRIBE THE KEY *ADVERTISING MEDIA*.

Advertising is paid, non-personal communication by which an identified sponsor informs an audience about a product. Marketers use several different advertising media—specific communication devices for carrying a seller's message to potential customers—each with its specific advantages and drawbacks. The most common media—television, newspapers, direct mail, radio, magazines, outdoor advertising, online, mobile—differ in their cost and their ability to segment target markets. Advertising dollars are shifting from traditional media to online and mobile media based on changing consumer viewing and listening habits.

LO-5 OUTLINE THE TASKS INVOLVED IN *PERSONAL SELLING*, DESCRIBE THE VARIOUS TYPES OF *SALES PROMOTIONS,* DESCRIBE *DIRECT* (*OR INTERACTIVE*) *MARKETING,* AND DISTINGUISH BETWEEN *PUBLICITY* AND *PUBLIC RELATIONS*.

Personal selling is a promotional tool in which a salesperson communicates one on one with potential customers; it provides the personal link between seller and buyer. Sales promotions include point-of-purchase (or sale) displays to attract consumers' attention, help them find products in stores and offices, and provide product information. Other sales promotions give purchasing incentives, such as samples (customers can try products without having to buy them), coupons (a certificate for price reduction), and premiums (free or reduced-price rewards for buying products). At trade shows, B2B sellers rent booths to display products to industrial customers. Contests intend to stimulate sales, with prizes to high-producing intermediaries and consumers who use the seller's products.

Direct (or interactive) marketing is one-on-one, non-personal selling that tries to get consumers to make purchases away from retail stores and, instead, to purchase them from home, at work, or by using a mobile device. It includes non-store retailers (catalogues, telemarketing, home video shopping), direct mail, direct-response advertising (such as infomercials and direct-response magazine and newspaper ads), and targeted emails.

Publicity is information about a company, a product, or an event transmitted by the general mass media to attract public attention. Control of the message's content is determined by outside writers and reporters. In contrast to publicity, public relations is company-influenced information that seeks either to build good relations with the public or to deal with unfavourable events.

LO-6 EXPLAIN THE MEANING OF *DISTRIBUTION MIX* AND IDENTIFY THE DIFFERENT *CHANNELS OF DISTRIBUTION*.

The combination of distribution channels for getting products to end users—consumers and industrial buyers—is the distribution mix. Intermediaries help to distribute a producer's goods by moving them from sellers to customers; wholesalers sell products to other businesses, which resell them to final users. Retailers, sales agents, and brokers sell products directly to end users. In Channel 1, the simplest of the four distribution channels, the producer sells directly to users. Channel 2 includes a retailer, Channel 3 involves both a retailer and a wholesaler, and Channel 4 includes an agent or broker.

LO-7 DESCRIBE THE ROLE OF *INTERMEDIARIES*. EXPLAIN THE FUNCTION OF *WHOLESALERS* AND IDENTIFY THE DIFFERENT TYPES OF *RETAILERS* AND *E-INTERMEDIARIES*.

The roles differ among the various intermediaries in distribution channels. Wholesalers provide a variety of services, including delivery, credit arrangements, and product information. In buying and reselling an assortment of products, wholesalers provide storage, marketing advice, and assist customers by marking prices and setting up displays. Retail stores range from broad product-line department stores and supermarkets to small specialty stores for specific market segments seeking narrow product lines. Non-store retailing includes direct-response retailing, mail order (or catalogue marketing), telemarketing, and direct selling.

E-intermediaries are internet-based channel members who perform one or both of two functions: (1) they collect information about sellers and present it to consumers and (2) they help deliver internet products to buyers. For example, electronic retailers interact online with customers and add value by informing, selling to, and distributing products to them.

LO-8 DESCRIBE THE *PHYSICAL DISTRIBUTION PROCESS*.

Physical distribution activities include providing customer services, warehousing, and transportation of products. Warehouses provide storage for products, whereas transportation operations physically move products from suppliers to customers. Trucks, railroads, planes, water carriers (boats and barges), digital transmission, and pipelines are the major transportation modes used in the distribution process.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Describe the types of distribution channels that may be used to get products from manufacturers to end users and give an example of each.
2. Discuss the goal of price skimming and penetration pricing.
3. How do cost-oriented pricing and breakeven analysis help managers measure the potential impact of prices? What general factors motivate marketing managers to price their products at, above, or below prevailing market prices?
4. Why are advertising dollars increasingly shifting from traditional media like newspapers and magazines to online and mobile media? Link your answer to the definition of advertising.
5. Select four advertising media and compare the advantages and disadvantages of each.
6. Give three examples (other than those provided in the chapter) of products that use intensive distribution. Do the same for products that use exclusive distribution and selective distribution. What are the characteristics of the products in each category? For which category was it easiest to find examples? Why?

APPLICATION EXERCISES

7. Search for some of the best viral marketing videos of all time and choose one to analyze. What is the product being marketed, and who is the target market? How does the advertisement appeal to the target market? Why do you think this video was effective?
8. Select a product and analyze pricing objectives for it. What information would you want if you were to adopt a profit-maximizing objective or a market-share objective?
9. In addition to being a major online retailer, Amazon.com acts as an e-intermediary for many small to medium-sized businesses. Imagine that you are interested in selling refurbished cell phones. Using the information on Amazon's website, how would you become a seller on Amazon? What costs are associated with selling your products through Amazon? If you decided to sell your products through your own website instead, what would be the pros and cons?
10. Choose two advertising campaigns that have recently been conducted by business firms in your area. Choose one that you think is effective and one that you think is ineffective. What differences in the campaigns make one better than the other? Why would a business use a push strategy rather than a pull strategy?

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members to consider your new business venture and how it relates to the pricing, distribution, and promotion topics in this chapter. Develop specific responses to the following:

1. Consider various pricing objectives and strategies to use when your product(s) first goes to market. Which pricing objective(s) seems most appropriate for your entry into the market(s)? Identify the pricing strategy(s) that seems best suited for your business. Explain.
2. Various pricing tactics are also available for planning your business. Describe the pricing tactics you expect to use on opening the business. Explain your choice(s). Might you resort to different pricing tactics as your product(s) moves through various stages in the life cycle(s)? Explain your reasoning.
3. Consider once again the target market(s) for your business. For that target market, develop a "Statement of Promotional Objectives" for your company. What do you intend to accomplish with your chosen promotional objectives?
4. Considering your target market, discuss alternative promotional strategies that may be appropriate for your company. What are the pros and cons for each strategy you considered? Which strategy seems more favourable, and why?
5. Outline the elements for your promotional mix, including specific promotional tools to be included in the early days of your company. Rank, in order, the relative importance of each tool in your promotional efforts. How might those rankings change, if at all, after your company is better established?
6. Develop a preliminary design of your company's start-up distribution mix, including the reasons for your choices on distribution channels and physical distribution. Explain why (how) your chosen distribution mix is appropriately matched to your target market.
7. Estimate the costs required to implement the distribution mix and the promotional mix, if those mixes are to be ready to go when your company opens for business.

BUILDING YOUR BUSINESS SKILLS

A BIG PUSH FOR PUBLICITY

GOAL

To encourage you to work in teams to develop a promotional campaign aimed at the specific needs of an organization.

BACKGROUND INFORMATION

A new theme park is opening just a few kilometres away from your campus. It will feature lots of rides and roller coasters as well as a water park. There will be lots of food options, from fast food to fine dining, and something for people of all ages. Two other theme parks are within a 200-kilometre radius of your college, but the new park will be significantly closer than the competition.

The developers of the park have been so impressed with your college that they have invited teams of students to develop proposals. Your group is one of several that have been charged with developing the promotional mix for the new park. You will present your proposal to the company, and company executives will select the one they think is most appropriate. Although this is, at the time, an activity for your class, it could turn into a full-time job with the company, so the stakes are high.

METHOD

Step 1 Working with your groups assign each member to one of the following components of the promotional mix: Advertising, Personal Selling, Sales Promotion, Publicity, and Public Relations. As a group, develop your promotional objectives. What are the initial objectives of your promotional campaign?

Step 2 Each group member will work on ideas (based on the agreed-upon objectives) from the perspective of his or her assigned role. What specific promotional activities within your category would you recommend?

Step 3 Get together again and share your ideas and make decisions; be sure that there is a good match between the promotional activities. Develop a one- to two-page recommendation that you can present to the company's executives.

QUESTIONS FOR DISCUSSION

1. Do you think that the promotional mix will change over time? How might it be different in three years?
2. What role will online communications play for this theme park: (a) before the launch, (b) during the launch, and (c) on an ongoing basis?

EXERCISING YOUR ETHICS

THE CHAIN OF RESPONSIBILITY

THE SITUATION

Because several stages are involved when distribution chains move products from supply sources to end consumers, the process offers ample opportunity for ethical issues to arise. This exercise encourages you to examine some of the ethical issues that can emerge during transactions among suppliers and customers.

THE DILEMMA

A customer bought an expensive wedding gift at a local store and asked that it be shipped to the bride in another province. Several weeks after the wedding, the customer contacted the bride, who had not confirmed the arrival of the gift. It hadn't arrived. Charging that the merchandise had not been delivered, the customer requested a refund from the retailer. The store manager uncovered the following facts:

- All shipments from the store are handled by a well-known national delivery firm.
- The delivery firm verified that the package had been delivered to the designated address two days after the sale.
- Normally, the delivery firm does not obtain recipient signatures; deliveries are made to the address of record, regardless of the name on the package.

The gift giver argued that, even though the package had been delivered to the right address, it had not been delivered to the named recipient. It turns out that, unbeknownst to the gift giver, the bride had moved. It stood to reason, then, that the gift was in the hands of the new occupant at the bride's former address. The manager informed the gift giver that the store had fulfilled its obligation. The cause of the problem, she explained, was the incorrect address given by the customer. She refused to refund the customer's money and suggested that the customer might want to recover the gift by contacting the stranger who received it at the bride's old address.

TEAM ACTIVITY

Assemble a group of four students and assign each group member one of the following roles:

- customer (the person who had originally purchased the gift)
- employee (of the store where the gift was purchased)
- bride (the person who was supposed to receive the gift)
- customer service manager (of the delivery company)

QUESTIONS FOR DISCUSSION

1. Before hearing any of your group's comments and from the perspective of your assigned role, decide whether there are any ethical issues in this situation. If so, write them down.
2. Before hearing any of your group's comments and from the perspective of your assigned role, decide how this dispute should be resolved.
3. Together with your group, share the ethical issues that were identified. What responsibilities does each party—the customer, the store, and the delivery company—have in this situation?
4. What does your group recommend be done to resolve this dispute? What are the advantages and disadvantages of your recommendations?

BUSINESS CASE 13

FREEMIUM MUSIC: TAKING OVER THE INDUSTRY

You may or may not be surprised to hear that subscription streaming services are the fastest-growing form of music listening. According to the 2018 Global Music Report, there are 176 million music streaming subscribers, and the annual growth is tremendous, with 68 million people signing up in the previous 12 months alone. In Canada, streaming revenues were up 68.8 percent at the time. That report also marked the first time that such services registered more revenues ($6.6 billion) than physical music sales ($5.2 billion) and digital downloads ($2.8 billion).

Streaming is more than the future of music; it is also the present. For example, The Weeknd, a popular Canadian artist with global appeal, has capitalized on this platform. His song "I Can't Feel My Face" premiered on *Apple Music* and was streamed more than 1.5 billion times, on all the various services, in the first two years alone. That sort of exposure and popularity allows artists like The Weeknd to cash in. However, despite these impressive figures, he said, "We live in a world in which artists don't make the money until they hit the stage." What does he mean? In fact, royalty payouts are not what they once were; they amount to only about 0.006 to 0.0084 per stream, or less than 1 penny per stream. In addition, 99.9 percent of artists don't get 1.5 billion plays in their whole career! In other words, under this new streaming model, the nearly free access to music can help build popularity that is then fully monetized and that eventually pays off with lucrative tours and endorsement deals. In 2017, The Weeknd earned $92 million. That same year, Chance the Rapper earned $33 million without ever selling a physical album or even signing a record deal! His real paydays have come through endorsement deals with Kit Kat and Apple and of course through festival gigs and tour money.

Pascal Le Segretain/Getty Images

SPOTIFY THE MARKET LEADER AND THE COMPETITION

Spotify was originally launched in Stockholm, Sweden, in 2008 by two entrepreneurs named Daniel Ek and Martin Lorentzon. As their website indicates, Spotify has led the fight from a "transaction based" music acquisition model to an "access based" model offering more than 35 million tracks to its customers. Spotify has more than 170 million monthly active users, with 75 million premium subscribers, in 65 countries. The company went public in 2018, with an initial public offering (IPO) valued at US$26.5 billion. Its most notable competitors are Pandora, SoundCloud, and Tidal. There is also one other late comer to the party going by a name you are quite familiar with: Apple.

APPLE THE MARKET FOLLOWER

Apple is one of the most innovative companies in the world; it helped transform the computer, smartphone, tablet, and music industries. However, the dominant position achieved by Apple iTunes (after the digital revolution disrupted the physical distribution model) is now threatened by streaming services. In fact, the digital download model championed by Apple's iTunes saw heavier declines than physical distribution in the previous 12-month period (20.5% vs. 11.2%). Apple saw the writing on the wall a few years back and entered the streaming business in 2015 (albeit as a late arrival). However, despite the delay, once it made the move, it was fully committed. When Apple bought Beats by Dr. Dre for $3 billion back in 2014, many scratched their heads at the high price tag. However, Apple was not simply buying the company for its headphones; part of that move was to acquire the Beats streaming service and brand equity.

CONCLUSION

So, where will the music industry be heading next? There have been a few major disruptions in the past couple of decades, from sales of CDs, to an epidemic of illegal streaming, to the emergence of iTunes, to the new rise in subscription streaming. The freemium model is the present hope for the future, but these days you can be sure of one thing: change is just around the corner. Survival of the quickest is the new norm!

QUESTIONS FOR DISCUSSION

1. In terms of degrees of competition, how would you describe the market for music streaming? Do you think this will change in the next five years? If so, how?
2. How can relatively unknown music artists promote themselves and their new music to help them gain traction on streaming sites? Provide concrete examples of promotional strategies that they can use.
3. Conduct some research and identify the top streaming global artists during the past year. What makes these artists so popular? How has that translated into actual revenues in the past 12 months?

MyLab Intro to Business

Study, practise, and explore real business situations with these helpful resources:
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.
- **Videos:** Learn more about the business practices and strategies of real companies.

MANAGING MARKETING

GOAL OF THE EXERCISE

So far, your business has an identity, you've described the factors that will affect your business, and you've examined your employees, the jobs they'll be performing, and the ways in which you can motivate them. Part 4 of the business plan project asks you to think about marketing's 4 P's—product, price, place (distribution), and promotion—and how they apply to your business. You'll also examine how you might target your marketing toward a certain group of consumers.

EXERCISE BACKGROUND: PART 4 OF THE BUSINESS PLAN

In Part 1, you briefly described what your business will do. The first step in Part 4 of the plan is to more fully describe the product (good or service) you are planning to sell. Once you have a clear picture of the product, you'll need to describe how this product will stand out in the marketplace—that is, how will it differentiate itself from other products?

In Part 1, you also briefly described who your customers would be. The first step in Part 4 of the plan is to describe your ideal buyer, or target market, in more detail, listing their income level, education level, lifestyle, age, and so forth. This part of the business plan project also asks you to discuss the price of your products, as well as where the buyer can find your product.

Finally, you'll examine how your business will get the attention and interest of the buyer through its promotional mix—advertising, personal selling, sales promotions, and publicity and public relations.

This part of the business plan encourages you to be creative. Have fun! Provide as many details as you possibly can, as this reflects an understanding of your product and your buyer. Marketing is all about finding a need and filling it. Does your product fill a need in the marketplace?

YOUR ASSIGNMENT

MyLab Intro to Business

Step 1 Open the saved Business Plan file you have been working on.
Step 2 For the purposes of this assignment, you will answer the following questions in Part 4: Managing Marketing:

1. Describe your target market in terms of age, education level, income, and other demographic variables.

   Hint: Refer to Chapter 12 for more information on the aspects of target marketing and market segmentation that you may want to consider. Be as detailed as possible about who you think your customers will be.

2. Describe the features and benefits of your product or service.

   Hint: As you learned in Chapter 12, a product is a bundle of attributes—features and benefits. What features does your product have—what does it look like and what does it do? How will the product benefit the buyer?

3. How will you make your product stand out in the crowd?

   Hint: There are many ways to stand out in the crowd, such as having a unique product, outstanding service, or great location. What makes your great idea special? Does it fill an unmet need in the marketplace? How will you differentiate your product to make sure that it succeeds?

4. What pricing strategy will you choose for your product, and what are the reasons for this strategy?

   Hint: Refer to this chapter for more information on pricing strategies and tactics. Since your business is new, so is the product. Therefore, you probably want to choose between price skimming and penetration pricing. Which will you choose and why?

5. Where will customers find your product or service? (That is, what issues of the distribution mix should you consider?)

   Hint: If your business does not sell its product directly to consumers, what types of retail stores will sell your product? If your product will be sold to another business, which channel of distribution will you use? Refer to this chapter for more information on aspects of distribution you may want to consider.

6. How will you advertise to your target market? Why have you chosen these forms of advertisement?

   Hint: Marketers use several different advertising media—specific communication devices for carrying a seller's message to potential customers—each with advantages and drawbacks. Refer to this chapter for a discussion of the types of advertising media you may wish to consider here.

7. What other methods of promotion will you use and why?

   Hint: There's more to promotion than simple advertising. Other methods include personal selling, sales promotions, and publicity and public relations. Refer to the discussion of promotion for ideas on how to promote your product that go beyond just advertising.

Note: Once you have answered the questions, save your Word document. You'll be answering additional questions in later chapters.

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CHAPTER 14

Money and Banking

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Define *money* and identify the different forms it takes in Canada's money supply.
- **LO-2** Understand the different kinds of *financial institutions* that make up the *Canadian financial system* and explain the services they offer.
- **LO-3** Explain the functions of the *Bank of Canada* and describe the tools it uses to control the money supply.
- **LO-4** Explain the role of *alternate banks, specialized lending and savings intermediaries*, and *investment dealers* in the Canadian financial system.
- **LO-5** Discuss some of the institutions and activities in *international banking and finance*.

RBC: A Symbol of Canadian Banking Strength

As you will read in this chapter, RBC operates in the highly competitive Canadian banking system, which is essentially dominated by five or six very familiar names: The Royal Bank of Canada (RBC), Toronto Dominion (TD), Canadian Imperial Bank of Commerce (CIBC), Bank of Montreal (BMO), Scotiabank, and to a lesser extent the National Bank. We will focus on RBC and its rich history that dates back to its founding in Halifax, Nova Scotia, in 1864. Today RBC is a diversified company that has more than 81 000 employees serving more than 16 million customers in Canada, the United States, and 34 other countries. It is Canada's largest bank and one of the biggest in the world based on market capitalization. RBC's primary services are offered by various divisions, including personal banking, wealth management, commercial banking, capital market products and services, and insurance.

RBC has quite a history, but it also has big plans. CEO Dave McKay foresees a major disruption in the retail (branch) banking sector and is implementing a new vision. The path ahead is founded on certain key strategic decisions, including (a) embracing new models of banking, (b) a new targeted U.S. expansion, and (c) a renewed focus to improve customer service.

Njene/Shutterstock

New Roles of Banks: Embracing Innovation

According to Bloomberg News, RBC planned to spend $3.2 billion on technology in 2018 with the goal of attracting $2.5 million new Canadian banking customers by 2023. That allocation was quite large, but RBC executives believed that the change in consumer habits deserved such an aggressive move. As we have seen throughout this book, disruption has impacted all types of businesses. Ridesharing apps such as Uber and Lyft have upended the taxi business. Amazon's Echo devices and virtual assistants like Alexa and Siri are being relied on for quick and easy information. In other words, the way people interact and the way they collect information is changing in a fundamental way. With that in mind, RBC decided to make some changes in how it promotes and how it connects. The $3.2 billion was to be spent on artificial intelligence programs, social media initiatives, and digital products. In the 12 months previous to this move, RBC had already increased its "active" digital users by 8 percent to 6.5 million. It created a new unit called RBC Ventures to formalize that new push. For example, it has a new platform, with the abbreviated name "ownr," that is designed to guide entrepreneurs through all the key steps in setting up a business, from registration to creating a logo. Of course, the goal is to provide tools to engage consumers and ultimately sell services linked to RBC, such as business accounts, loans, lines of credit, and so on.

RBC's American Footprint

RBC is also planning a new push in the United States. RBC is not alone; in fact, TD and BMO have much more substantial footprints south of the border. All hockey fans from coast-to-coast should be familiar with the home of the Boston Bruins. In following your favourite Canadian hockey team, you have surely noticed that the name of the arena, in Beantown, is the TD Garden. Yes, the Bruins essentially play in the Toronto Dominion Garden. TD has built a network of 1300 locations across the East Coast. TD's slogan down south is "America's Most Convenient Bank." The Bank of Montreal (BMO) operates under the name BMO Harris Bank in the United States and has more than 600 locations in the Midwest.

RBC also made a major move down south a couple of decades ago, but that expansion was not quite as successful as the ones made by TD and BMO. RBC absorbed losses for many financial quarters and was forced to retreat from some of those assets. Ever since, RBC has been looking for the right approach for a new American expansion. But what direction should it take? A couple of years ago, the answer to that question was delivered by CEO Dave McKay when he indicated that RBC would avoid focusing on the hyper-competitive U.S. retail banking market and instead would target the wealth management business. With that in mind, RBC purchased City National Bank (based out of Los Angeles) for $7.1 billion. Unlike with its previously failed expansion, RBC decided not to rebrand the acquired bank under the RBC banner. Therefore, City National has continued to leverage its history and heritage without a complete takeover and re-naming initiative from RBC. Over the years, City National has served some of the most famous Hollywood clients, including Martin Scorsese, Helen Mirren, and even Frank Sinatra (back in the day). So, if you are going after high-net-worth individuals, why not keep a famous brand that has been serving famous clients for decades. At least that is the RBC philosophy in phase one of this new expansion.

Customer Service

There are very few things Canadians like to complain about more than rising bank fees (and for good reason). Headlines of record banking profits continue to surface year after year, yet fees have continued to climb. When you equate the two, there is an obvious reason for dissatisfaction. However, this is an overall banking industry issue, and when RBC is compared to its competitors, it is getting more positive feedback from the most important source: its customers. According to JD Power, in 2018, RBC received the honour of being named "*Highest in Customer Satisfaction Among the Big Five Retail Banks"* for the third straight year. That does not mean RBC is perfect. Far from it (and even their most loyal customers would like a break on those fees!).

One of the measures of good customer service is how a company responds to a service failure. A few years ago, during a routine compliance check, the company found that 50 000 customers had been overcharged on their mutual fund and fee-based accounts. RBC self-reported the mistake to the Ontario Securities Commission and eventually repaid $21.8 million to clients. In addition, RBC made a voluntary payment of $925 000 for good measure.

Economic Role: Past, Present, and Future

Chartered banks play a vital role, and they are a key part of the foundation of the Canadian financial system. The rules are changing, and all the major Canadian banks have plotted their own course towards expansion in search of a clear competitive advantage. They are all adjusting and creating new platforms to serve the increasingly complicated and demanding needs of consumers in this era of disruption. RBC may have been founded in 1864, but it is clearly not stuck in the past. It is changing with the times, yet again!

QUESTIONS FOR DISCUSSION

1. As you read, RBC's primary services are divided into various divisions, including personal banking, wealth management, commercial banking, capital market products and services, and insurance. Find recent financial articles or look at the most recent RBC Annual Report on the RBC website or on Sedar.ca. How did each division perform?
2. Search for articles and press releases about RBC from the past two years. Has it made any new acquisitions in Canada, the United States, or abroad? How well do you think these acquisitions fit into the plans outlined in this case?
3. Look at the new RBC Ventures platform that goes by the acronym "ownr." How well do you think it meets the basic needs of today's entrepreneurs? What are its strengths and weaknesses?
4. After reading the chapter, explain how RBC helps to fulfill the roles of chartered banks in the Canadian financial services industry.

HOW WILL THIS HELP ME?

Dealing in matters of money is far more complicated than counting the cash and coins in your pocket, especially when technology and globalization come into play. At its core are questions about where money comes from, how national economies depend on it, and the public's trust in its value. This chapter will give you a solid understanding of the different forms of money and how its supply is created and controlled by different kinds of financial institutions and government regulations.

Sergey Nivens/Fotolia

LO-1 WHAT IS MONEY?

If someone asks you how much money you have, do you count the dollar bills and coins in your pockets? Do you include your chequing and savings accounts? Do you check your balance in Apple Pay, PayPal, or another digital payment option? What about stocks and bonds? Do you count your car? Taken together, the value of all these forms combined is your personal wealth. Not all of it, however, is "money." This section considers more precisely what money is and what it does.

The Characteristics of Money

Modern money generally takes the form of stamped metal or printed paper issued by governments (e.g., dollars or euros). The Chinese were using metal money to represent the objects they were exchanging as early as 1100 BCE. However, many different objects (cows, shells, stones, and dolphin teeth) have been used as money in different societies. Theoretically, just about anything *portable, divisible, durable*, and *stable* can serve as **money**. To appreciate these qualities, imagine using something that lacks these characteristics:

- *Portability.* Try lugging a 500-kilo cow as a unit of exchange from shop to shop, as was done in ancient farming economies. In contrast, modern currency is light and easy to handle.
- *Divisibility.* How would you divide your cow if you wanted to buy a cap from your favourite sports team, an iPad, and a Hero 6 GoPro camera from three different locations? Is a kilo of head worth as much as a kilo of leg? Modern currency is easily divisible into smaller parts with fixed values a 500-kilo—for example, a dollar for 10 dimes.
- *Durability.* Your cow will lose value every day (and eventually die). Modern currency, however, neither dies nor spoils, and, if it wears out, it can be replaced. The Canadian government recently converted paper bills into polymer plastic bills to increase durability. However, just months after the release, there were questions about the bills' ability to withstand heat when a family claimed that the bills shrivelled and melted after being placed close to a heater.[1]
- *Stability.* If cows were in short supply, you might be able to make quite a deal for yourself. In the middle of a year with an abundant cow supply, however, the market would be flooded with cows, so their value would fall. The value of our paper money also fluctuates, but it is considerably more stable and predictable.

MONEY Any object generally accepted by people as payment for goods and services.

The Functions of Money

Imagine, for a moment, a successful cow rancher who needs a new fence. In a *barter economy*—one in which goods are exchanged directly for one another—he or she would have to find someone willing to exchange a fence for a cow (or parts of it). If no fence maker wants a cow, the rancher must find someone else—for example, a wagon maker—who does want a cow. Then the rancher must hope that the fence maker will trade for a new wagon. In a money economy, the rancher would sell his or her cow, receive money, and exchange the money for goods, like a new fence.

Thus the barter economy is relatively inefficient. This example demonstrates the three functions of money:

1. *It is a medium of exchange.* Like the rancher "trading" money for a new fence, money is used to buy and sell things. Without money, we would be stuck in a system of barter.
2. *It is a store of value.* Pity the rancher whose cow gets sick on Monday and who wants to buy some clothes on the following Saturday, by which time the cow may have died and lost its value. In the form of currency, however, money can be used for future purchases, since it "stores" value.
3. *It is a unit of account.* Money lets us measure the relative values of goods and services. It acts as a measure of worth because all products can be valued and accounted for in terms of money. For example, the concepts of $1000 worth of clothes or $500 in labour costs have universal meaning.

As you can see, money adds convenience and simplicity to our everyday lives, for consumers and businesses alike. Employees, consumers, and businesses use money as the measure of worth for determining wages and for buying and selling products—everything from ice cream to housing rentals. Consumers with cash can make purchases wherever they go because businesses everywhere accept money as a medium for exchange. As long as money is stable, businesses and individuals save their money, trusting that its value will be available for future use.

The Spendable Money Supply: M-1

For money to serve as a medium of exchange, a store of value, or a unit of account, buyers and sellers must agree on its value. The value of money depends in part on its supply (how much money is in circulation). When the money supply is high, the value of money drops. When the money supply is low, the value of money increases.

Cattle are not portable, durable, or stable, making them an unsuitable medium of exchange in the modern monetized economy.

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It is not easy to measure the supply of money, nor is there complete agreement on exactly how it should be measured. The "narrow" definition of the money supply is called **M-1**, which includes only the most liquid forms of money—currency and demand deposits (chequing accounts) in banks. As of April 2018, M-1 totalled $877 billion in Canada.[2]

Currency is paper money and coins issued by the Canadian government. It is widely used to pay small bills. Canadian currency—which clearly states, "This note is legal tender"—is money the law requires a creditor to accept in payment of a debt. Counterfeiting of paper currency is now a worldwide problem, partly because modern technologies allow counterfeiters to make real-looking bills rather easily. To reduce counterfeiting, the Bank of Canada has issued new, high-tech polymer $20, $50, and $100 bills.[3]

A **cheque** is an order instructing the bank to pay a given sum to a specified person or firm. Cheques enable buyers to make large purchases without having to carry large amounts of cash. Money in chequing accounts, known as *demand deposits*, is counted in M-1 because such funds may be withdrawn at any time without notice.

M-1 Plus the Convertible Money Supply: M-2

M-2 includes everything in M-1 plus items that cannot be spent directly but are easily converted to spendable forms: time deposits, money market mutual funds, and savings deposits. M-2 accounts for nearly all the nation's money supply. As this overall supply of money increases, more is available for consumer purchases and business investment. When this supply decreases, less is available for consumer purchases and business investment. As of April 2018, M-2 totalled $1596 billion in Canada, up approximately 5 percent during the year.[4]

Unlike demand deposits, **time deposits** require prior notice of withdrawal and cannot be transferred by cheque. The supply of money in time deposits—such as *certificates of deposit (CDs)* and *savings certificates*—are not nearly as popular today in a low interest rate environment as they were when 10 to 15 percent interest rates were common.

Money market mutual funds are operated by investment companies that bring together pools of assets from many investors. The fund buys a collection of short-term, low-risk financial securities. Ownership of and profits (or losses) from the sale of these securities are shared among the fund's investors.

Credit Cards and Debit Cards: Plastic Money?

The use of credit and debit cards has become so widespread that many people refer to them as "plastic money." Credit cards, however, are not money and, accordingly, are not included in M-1 or M-2 when measuring

M-1 Only the most liquid forms of money (currency and demand deposits).

CURRENCY Paper money and coins issued by the government.

CHEQUE An order instructing the bank to pay a given sum to a specified person or firm.

M-2 Everything in M-1 plus savings deposits, time deposits, and money market mutual funds.

TIME DEPOSIT A deposit that requires prior notice to make a withdrawal; cannot be transferred to others by cheque.

MONEY MARKET MUTUAL FUNDS Funds operated by investment companies that bring together pools of assets from many investors to buy short-term, low-risk financial securities.

Chip encryption technology was introduced to reduce credit card fraud.

Freebird/Fotolia

the nation's money supply. Why? Because spending with a credit card creates a debt but does not move money until later when the debt is paid by cash or cheque. Credit cards are a money substitute; they serve as a temporary medium of exchange but are not a store of value. Debit card transactions, in contrast, transfer money immediately from the consumer's bank account, so they affect the money supply the same way as spending with a cheque or cash and are included in M-1.

With growing fears of rising debt as an incentive, the Canadian government is adopting a new code of conduct to further regulate credit and debit cards.[5] Canadians hold 74.3 million credit cards. The value of goods and services bought with credit cards in Canada amounts to approximately US$469 billion annually.[6] Worldwide, the total value of goods purchased with credit cards exceeds $20 trillion annually.[7] Chartered Banks such as the Bank of Montreal, the Canadian Imperial Bank of Commerce, the Bank of Nova Scotia, and TD Canada Trust are the biggest issuers of credit cards in Canada. Every time a card is used, the banks receive an "interchange" fee, a percentage of the purchase value of the transaction from the merchant. However, most credit cards issued in Canada also charge a 2.5 percent foreign currency conversion when you are travelling. So, when you use your card south of the border or elsewhere, you are paying this extra conversion fee whether you pay off the balance on time or not![8]

Although consumers enjoy the convenience of credit cards, they are also finding that irresponsible use of the cards can be hazardous to their financial health. Credit card fraud is another major concern for both consumers and retailers. To deal with this problem, credit card companies have developed new chip encryption technology that requires an additional password. A discussion on managing the use of credit cards is presented at the end of the book in Supplement 04, "Managing Your Personal Finances: A Synopsis."

LO-2 THE CANADIAN FINANCIAL SYSTEM

Many forms of money, especially demand deposits and time deposits, depend on the existence of financial institutions to provide a broad range of services to both individuals and businesses. In this section, we describe the major types of financial institutions, explain how they work, and describe some of the special services they offer. We also explain their role as creators of money and discuss the regulation of the Canadian banking system.

Financial Institutions

There are several types of financial institutions in Canada, but the main function of all of them is to facilitate the flow of money from sectors with surpluses to those with deficits by attracting funds into chequing and savings accounts. Incoming funds are loaned to individuals and businesses and, perhaps, are invested in government securities.

For many years, the financial community in Canada has been divided rather clearly into four distinct legal areas. These "four financial pillars" are (1) chartered banks, (2) alternate banks (e.g., trust companies and credit unions/caisses populaires), (3) life insurance companies and other specialized lending and saving intermediaries (e.g., factors, finance companies, venture capital firms, mutual funds, and pension funds), and (4) investment dealers. We will discuss each of these in detail in this chapter, but it is important to understand that many changes have taken place in the financial services industry in the past couple of decades, and the lines between the four pillars have blurred. For example, banks are now permitted to own securities dealers, to establish subsidiaries to sell mutual funds, and to sell commercial paper (see Chapter 15). Trust companies have declined in importance, and many of them have been bought by banks or insurance companies.

FINANCIAL PILLAR #1—CHARTERED BANKS

A **chartered bank** is a privately owned, profit-seeking financial intermediary that serves individuals, businesses, and non-business organizations. Chartered banks are the largest and most important financial institutions in Canada. In February 2018, Canadian chartered banks had assets totalling $2.39 trillion.[9] Chartered banks offer chequing and savings accounts, make loans, and provide many services to their customers. They are the main source of short-term loans for business firms.

Unlike in the United States, where there are hundreds of banks each with only a few branches, in Canada, there are only a few banks, each with hundreds of branches. The five largest Canadian banks account for

CHARTERED BANK A privately owned, profit-seeking firm that serves individuals, non-business organizations, and businesses as a financial intermediary.

TABLE 14.1 Top 10 Banks in Canada (ranked by revenues)[10]

Company	Sales Revenue (billions of dollars)
1. Royal Bank of Canada	50.4
2. Toronto-Dominion Bank	45.1
3. Bank of Nova Scotia	36.1
4. Bank of Montreal	28.1
5. Canadian Imperial Bank of Commerce	20.9
6. National Bank of Canada	8.9
7. HSBC Bank Canada (Schedule II bank)	2.8
8. Laurentian Bank	1.6
9. Canadian Western Bank	1.1
10. Versa Bank	0.044

about 90 percent of total bank assets. *The Guardian* referred to Canadian banks as the envy of the world, and *The Economist* referred to them as the primary reason for Canada's economic resilience.[11]

Schedule I banks are those that are Canadian-owned and have no more than 10 percent of voting shares controlled by a single interest. Schedule II banks are those that may be domestically owned but do not meet the 10 percent limit, or they may be foreign-controlled. Several foreign banks have set up Schedule II subsidiaries in Canada. The *Bank Act* limits foreign-controlled banks to deposits that do not exceed 8 percent of the total domestic assets of all banks in Canada. The largest chartered banks in Canada are shown in Table 14.1 ranked based on revenues.

Services Offered by Banks

The banking business is highly competitive; therefore, banks no longer just accept deposits and make loans. Most now offer pension services, trust services, international services, and financial advice.

Pension Services

Most banks help customers establish savings plans for retirement. Banks serve as financial intermediaries by receiving funds and investing them as directed by customers. They also provide customers with information on investment possibilities.

Trust Services

Many banks offer trust services—the management of funds left "in the bank's trust." In return for a fee, the trust department will perform tasks such as making your monthly bill payments and managing your investment portfolio. Trust departments also manage the estates of deceased persons.

International Services

The three main international services offered by banks are currency exchange, letters of credit, and banker's acceptances. Suppose that a Canadian company wants to buy a product from a French supplier. For a fee, the company can use one or more of three services offered by its bank:

1. It can exchange Canadian dollars for euros at a Canadian bank and then pay the French supplier in euros.
2. It can pay its bank to issue a *letter of credit*—a promise by the bank to pay the French firm a certain amount if specified conditions are met.
3. It can pay its bank to draw up a *banker's acceptance*, which promises that the bank will pay some specified amount at a future date.

Financial Advice

Many banks, both large and small, help their customers manage their money. Depending on the customer's situation, the bank may recommend different investment opportunities. The recommended mix might include guaranteed investment certificates, mutual funds, stocks, and bonds. Today, bank advertisements often stress the growing role of banks as financial advisors.

Beyond the basic services offered in branches, the blurring of the lines has led to deals like the one Scotiabank made in 2018 when it bought investment firm Jarislowsky Fraser Ltd. for $950 million. Jarislowsky Fraser has more than $40 billion in assets in its portfolio with approximately $27 billion coming from pension funds, corporations, and foundations. With this deal, Scotiabank's investment arm now has more than $166 billion under management, trailing only the Royal Bank of Canada and Toronto Dominion Bank.[12]

Look at the following "There's an App for That!" feature, which underlines three banking and financial investment apps.

Electronic Funds Transfer

Electronic funds transfer (EFT) provides for payments and collections by transferring financial information electronically. PayPal, Alipay, and other similar services offer online payments and money transfers among businesses and individuals, nationally and internationally, in various currencies, requiring only that recipients have an email address. Instead of writing personal cheques, consumers using bank debit cards and mobile devices enjoy EFTs' convenience and speed at checkouts. In addition, EFT systems enable automatic payroll deposits, ATM transactions, bill payments, and automatic funds transfers. In short, these systems can help businesspeople close important business deals by transferring money from

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. **Canadian Mortgage App** **Source:** Bendiji Technologies Inc. **Key Features:** Allows buyers to calculate home ownership cost, compare interest rates, and determine affordability.	Apple, Android, Windows,
2. **Mint.com Personal Finance App** **Source:** Intuit **Key Features:** Permits you to track, budget, and manage your money in one place.	Apple, Android
3. **PayPal App** **Source:** PayPal Inc. **Key Features:** Allows you to make payment and money transfers and receive money on business accounts.	Apple, Android, Windows

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for "Top 3" finance apps and identify the key features.

Vancouver to Halifax within seconds. In addition to internet and telephone banking, other examples include:[13]

- *Automated banking machines/automated teller machines (ABMs/ATMs).* These machines allow you to bank at almost any time of day or night. There are more than 65 000 ABMs (also known as ATMS) in Canada and more than 18 711 are bank-owned.[14] FirstOntario Credit Union has an updated version it calls the Personal Assistant Teller (PAT). This system provides a video link with a teller who can talk to the consumer about loans or listen to complaints in addition to offering the traditional ABM transactions.[15] (See Figure 14.1 for more about ABMs/ATMs.)
- *Direct deposits and withdrawals.* These transactions allow users to authorize, in advance, specific, regular deposits and withdrawals. Paycheques and social assistance cheques are automatically deposited, and recurring expenses, such as insurance premiums and utility bills, are automatically paid.
- *Debit cards.* Unlike credit cards, **debit cards** do not increase the funds at an individual's disposal but only allow users to transfer money between accounts to make retail purchases. Debit cards are used more than credit cards as payment for consumer transactions. Approximately 94 percent of Canadians have debit cards, which are accepted in over 460 000 retail establishments across the nation. More than 5.7 billion transactions were completed in 2017 using the Interac network (through which you can access your money anywhere).[16]
- *Blink credit cards.* "Blink" technology uses a computer chip that sends radio-frequency signals in place of magnetic strips that have been embedded in credit cards for the past 30 years. The "contactless" payment system lets consumers wave the card in front of a merchant's terminal at a gas pump or retailer without waiting to swipe and sign. Radio-frequency identification, although new to credit cards, is familiar on toll roads with electronic passes that allow drivers to avoid waiting in line to pay.
- *Smart cards.* A **smart card** has an embedded computer chip that can be programmed with "electronic money." Also known as *electronic purses* or *stored-value cards,* they have existed for more than a decade. They are most popular in gas pump payments, followed by prepaid phone service, ATMs, self-operated checkouts, vending machines, and automated banking services.[17] Embedded chip technology is also replacing the standard magnetic strips on traditional credit cards and debit cards. This technology provides greater security for both parties during financial transactions.
- *Mobile (digital) wallet.* At a recent meeting of the Canadian Bankers Association, the country's largest banks agreed to standards to set the tone for the transition from plastic cards to mobile wallets. CIBC and Rogers Communications were among the first to sign a deal to provide the service.[18] For example, Tim Hortons recently launched an app that allows customers to pay for their "double-double" with their mobile phones.[19]

Most of Tim Hortons's 4000+ outlets across Canada now accept payment via mobile apps.

Tim Hortons/Hand-out/Newscom

Beyond simple convenience, some of these systems can help increase business. For example, Alipay was established by Alibaba, the Chinese internet giant, and it claims more than 600 million users. A merchant in Canada can target these customers whether they are locals or tourists visiting from China or elsewhere and send promotional deals through the platform. Therefore, Alipay is not only a convenient form of EFT, it can also be used as a promotional tool.[20] In 2017, EFT payments surpassed the totals of cheque payments in Canada for the first time.[21]

EFTs have changed the ways that businesses and people interact. Instant online tools and one-click order capabilities have changed the way stocks are traded as well. Read the E-Business and Social Media Solutions box entitled "Real-Time Investing: Just a Click Away."

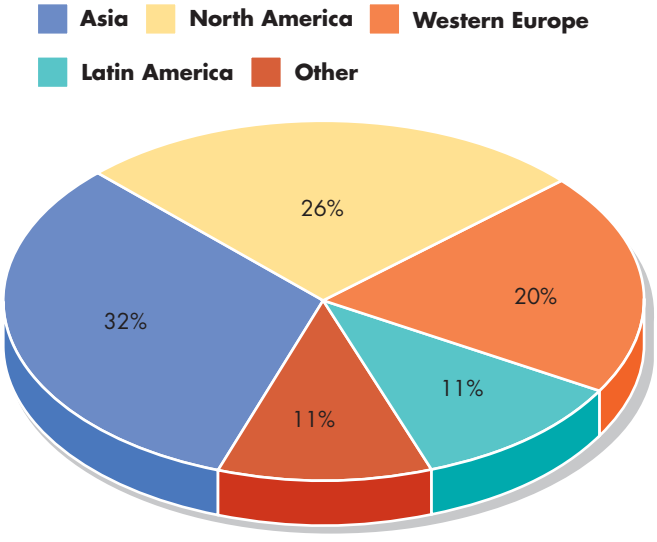

FIGURE 14.1 Global dispersion of ABMs (ATMs)

Bank Loans

Banks are the major source of short-term loans for business. Although banks make long-term loans to some firms, they prefer to specialize in providing short-term funds to finance inventories and accounts receivable. A *secured* loan is one backed by collateral (e.g., accounts receivable); if the borrower cannot repay, the bank sells the collateral. An unsecured loan is backed only by the borrower's promise. Only the most creditworthy borrowers can get unsecured loans.

DEBIT CARD Plastic card that allows an individual to transfer money between accounts.
SMART CARD Credit card sized plastic card with an embedded computer chip that can be loaded with "electronic money."

Real-Time Investing: Just a Click Away

Trading stocks was once a fairly difficult chore. Information was not instantly available, and there were time lags before the public could access information such as market trends, daily high and low prices, and current trading prices. Moment-to-moment information was available only by calling a stockbroker or by visiting a brokerage where data were visible for each transaction on an overhead screen. Many investors relied on newspaper reports summarizing the most recent day's market transactions before making buy or sell decisions.

Today's trading environment is different. Instead of reading *The Globe and Mail* to see what happened yesterday, mass communication and online financial networks and even social media provide current market information nearly anywhere. Financial television networks, such as BNN, display transactions and market conditions as they occur at the TSX or NYSE or NASDAQ exchanges. Investors and traders seeking financial opportunities abroad have access to developments in global financial markets as well as currency exchange rates.

Investors seeking market information on specific stocks can visit sites such as www.theglobeandmail.com/investing. Going beyond mere information gathering, web trading has become a popular tool for investors. You can place trades—buying and selling stocks, bonds, and commodities—by establishing an account with one of the many online brokers.

Online trading has also increased the popularity of *day trading*. As contrasted with investing, in which a buyer intends to hold the stock (or other financial instrument) into the future before selling for a long-term profit, a day trader holds a stock for only a brief period before selling to capture a short-term profit. Day trading is an even more specialized form of trading, because the buying and selling is accomplished within one day, without holding the stock overnight. Day traders rely on speedy transactions to profit from small differences between buying and selling prices during the day, sometimes holding a stock for only a few seconds or minutes before selling.

More recently, mobile investing has emerged as an important investment tool. Basic mobile banking has been around for a while, but most Canadian institutions have been slower to build mobile investing apps (trading platforms designed for your smartphone). However, that is changing. According to an informal poll by *The Globe and Mail*, 22 percent of individuals claimed that they were either currently conducting mobile trading or were open to it.

Easy access and speed does not necessarily lead to successful trades. In fact, it can be quite the opposite, so do your homework. Investment articles and blogs found on sites such as TMX Money (www.tmxmoney.com/en/index.html) and *The Wall Street Journal's* Deal Journal (www.wsj.com/public/page/news-financial-markets-deals.html) are a good place to start.

Pictoores/Fotolia

CRITICAL THINKING QUESTIONS

1. Have you ever bought or sold securities using an online or mobile investing platform? Are you open to this approach? Explain your response.
2. Consider the following statement: *Mobile investing is dangerous. People need to carefully analyze investment data and not make quick on-the-go decisions. This approach may cause inexperienced investors to feel a false sense of security and will lead to more foolish impulse investments.* Do you agree with the statement? Defend your answer.

Borrowers pay interest on their loans. Large firms with excellent credit records pay the **prime rate of interest**, which is the lowest rate charged to borrowers. This rate changes often because of changes in the demand and supply of loanable funds, as well as Bank of Canada policies. The so-called "Big Six" Canadian banks (Royal Bank, CIBC, Bank of Montreal, Bank of Nova Scotia, TD Canada Trust, and National Bank of Canada) typically act in concert with respect to the prime rate.

Banks as Creators of Money

Financial institutions provide a special service to the economy—they create money. They don't mint bills and coins, but by taking in deposits and making loans, they expand the money supply. We will first look at how this expansion process works, assuming that banks have a *reserve requirement*, which means they must keep a portion of their chequable deposits in vault cash or as deposits with the Bank of Canada. (The reserve requirement was dropped more than two decades ago, and the implications of this change are described later.)

Suppose you saved $100, took it to a bank, and opened a chequing account. Let's assume, for the moment, that there is a reserve requirement, and that it is 10 percent. Your bank must therefore keep $10 of your $100 deposit in reserve, so it has only $90 to lend to other borrowers. Now, suppose a person named Jennifer Leclerc borrows $90 from your bank. She now has $90 added to her chequing account. Assume that she writes a cheque for $90 payable to Canadian Tire. Canadian Tire's bank ends up with a $90 deposit, and that bank is also required to keep $9 in reserve. It therefore has $81 to lend out to someone else. This process of deposit expansion can continue as shown in Figure 14.2, and your original deposit of $100 could result in an increase of $1000 in new deposits for all banks in the system.

PRIME RATE OF INTEREST The lowest rate charged to borrowers.

Deposit	Money Held in Reserve by Bank	Money to Lend	Total Supply
$100.00	$10.00	$90.00	**$190.00**
90.00	9.00	81.00	**271.00**
81.00	8.10	72.90	**343.90**
72.90	7.29	65.61	**409.51**
65.61	6.56	59.05	**468.56**

FIGURE 14.2 How the chartered banking system creates money

But what happens if there is no reserve requirement? At the extreme, it means that banks could (theoretically) create infinite amounts of money, because they wouldn't have to keep any in reserve. But banks will not do this because it is risky. So, in practice, the dropping of the reserve requirement simply means that banks will be able to create more money than they did when there was a reserve requirement.

Other Changes in Banking

Substantial changes in addition to those already described are taking place in banking, including *deregulation, changes in customer demands*, and *changes in international banking*.

Deregulation

Deregulation has allowed banks to alter their historical role as intermediaries between depositors and borrowers. Canada's banks have been diversifying to provide more financial products to their clients. Training bankers to be effective in this environment is necessary, and more than 100 executives at TD Canada Trust attended a Harvard University course that taught them to think like investment bankers. They have learned the lessons well and have embraced their new role.

Changes in Consumer Demands

Many consumers refuse to keep their money in a traditional bank when they can get more elsewhere. They are turning to electronic banks such as Tangerine that pay higher interest on savings accounts. Such companies can pay higher rates because they don't incur the costs associated with having branches like traditional banks do. Traditional banks are responding to this new competition by selling more services in their branches. Banks are finding new ways to attract and serve their clientele to remain competitive and attract a new generation that does not have the same loyalties as previous generations. In addition, Scotiabank purchased Tangerine (from ING) and has shown every intention of capitalizing on this new segment.[22]

Banks also want to get much more involved in selling insurance, but the Bank Act has prohibited them from selling insurance in their branch offices (they can sell it elsewhere). Consequently, Canadian banks are finding creative ways to keep insurance and banking activities separate (but not too separate). In Oakville, Ontario, for example, Royal Bank of Canada consumers who enter the branch will notice the RBC bank on the right and RBC Insurance on the left. The two operations are separated by a glass wall. Dan Danyluk, the CEO of the Insurance Brokers Association of Canada, says that RBC's strategy is ignoring the intent of the law. He argues that credit-granting institutions like banks should not be allowed to sell insurance in their branches, because they might try to tie, say, approval of a loan to buy a car to the purchase of car insurance.[23] The government agrees, and it recently sent a message by banning banks from selling unauthorized insurance on their websites.[24]

All this activity is transforming the profit base of banks. In the past, they made most of their money from the spread between interest rates paid to depositors and the rates charged on loans. Investment banking, on the other hand, is fee-based. Banks are making a larger proportion of their profits from fees, and this is blurring the traditional boundary between banks and securities firms.

Changes in International Banking

Canada's banks are going to experience increased competition because foreign banks are now allowed to do business in Canada. Canadian banks are responding with a variety of tactics, including attempts to merge with one another. But bank mergers have been blocked by the federal government because it fears the mergers will reduce competition and harm consumers. However, as we saw in the opening case on RBC, Canadian banks have grown and strengthened through acquisitions overseas and improved efficiencies in their home market.

LO-3 The Bank of Canada

The **Bank of Canada**, formed in 1935, is Canada's central bank. It has a crucial role in managing the Canadian economy and in regulating certain aspects of chartered bank operations. The Bank of Canada is managed by a board of governors composed of a governor, a deputy governor, and 12 directors appointed from different regions.

The rate at which chartered banks can borrow from the Bank of Canada is called the **bank rate**, or **rediscount rate**. It serves as the basis for establishing the chartered banks' prime interest rates. In practice, chartered banks seldom have to borrow from the Bank of Canada. However, the bank rate is an important instrument of monetary policy as a determinant of interest rates. For over a decade, the Bank of Canada and central banks across the globe kept rates very low. This extended period of low rates led citizens to increase their debt load and fuelled housing price booms. There were loud calls for the governor of the Bank of Canada to increase rates and restore some order. In late 2017 and early 2018, the Bank of Canada began that process with three separate increases of 0.25 (total 0.75).[25] More importantly, the message was sent to the market that rising rates were on the horizon and debt loads should be lowered or at least maintained.[26] More details on this crucial topic for the Canadian economy are discussed in the closing case of this chapter.

The Money Supply and the Bank of Canada

The Bank of Canada plays a vital role in managing the money supply in Canada (see Figure 14.3). If it wants to increase the money supply, it can buy government securities. The people who sell these bonds then deposit the proceeds in their banks. These deposits increase banks' reserves and their willingness to make loans. The Bank of Canada can also lower the

BANK OF CANADA Canada's central bank; formed in 1935.
BANK RATE (REDISCOUNT RATE) The rate at which chartered banks can borrow from the Bank of Canada.

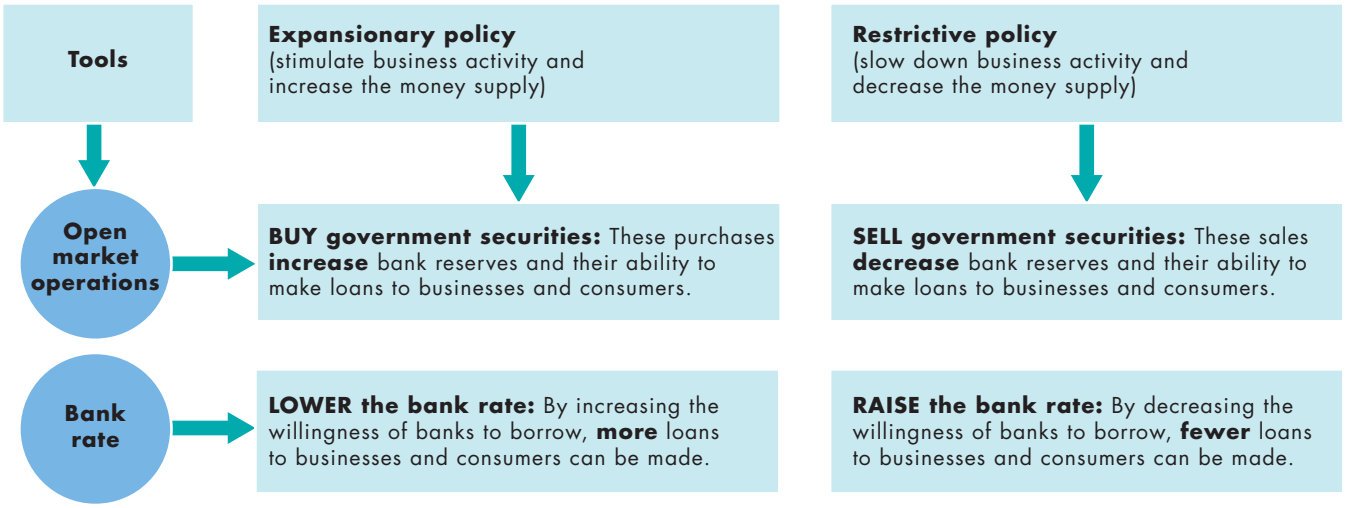

FIGURE 14.3 Bank of Canada monetary policy actions

bank rate; this action will cause increased demand for loans from businesses and households because these customers borrow more money when interest rates drop.

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

The federal government and the Bank of Canada got strong endorsements of their management of the money supply a few years ago when it was reported that Iceland was considering adopting the Canadian dollar as its official currency. Iceland has not made major steps in that direction, but the idea was still floated based on a well-earned reputation.[27]

LO-4 FINANCIAL PILLAR #2—ALTERNATE BANKS

Trust Companies

A **trust company** safeguards property—funds and estates—entrusted to it. It may also serve as trustee, transfer agent, and registrar for corporations, and provide other services as well.

For example, a corporation selling bonds to investors appoints a *trustee*, usually a trust company, to protect the bondholders' interests. A *transfer agent* records changes in ownership of a corporation's shares of stock, and a *registrar* certifies to the investing public that stock issues are correctly stated and comply with the corporate charter. *Other services* include preparing and issuing dividend cheques to stockholders and serving as trustee for employee profit-sharing funds. Trust companies also accept deposits and pay interest on them. As noted previously, however, trust companies have declined in importance.

Credit Unions/Caisses Populaires

Credit unions and **caisses populaires** are cooperative savings and lending associations formed by a group with common interests. They are important because they lend money to businesses and to consumers who use the money to buy durable goods such as cars and furniture from businesses. Members (owners) can add to their savings accounts by authorizing deductions from their paycheques or by making direct deposits. They can borrow short-term, long-term, or mortgage funds from the credit union. Credit unions invest substantial amounts of money in corporate and government securities and sell certificates of deposits to the general public. According to a Moody's Investor Services report, credit unions are gaining in popularity because they offer many services available at banks and tend to pay dividends to members when they make profits. Table 14.2 identifies the top 10 credit unions in Canada ranked by total members.

TRUST COMPANY Safeguards funds and estates entrusted to it; may also serve as trustee, transfer agent, and registrar for corporations.
CREDIT UNIONS (CAISSES POPULAIRES) Cooperative savings and lending association formed by a group with common interests.

TABLE 14.2 Top 10 Credit Unions/Caisses Populaires in Canada (ranked by number of members)[28]

Company	Members
1. Mouvement des Caisses Desjardins	5 581 000
2. Coast Capital Savings Credit Union	547 210
3. Vancity	488 824
4. Servus Credit Union Ltd.	370 348
5. Meridian Credit Union Ltd.	309 705
6. First West Credit Union	230 394
7. UN Financial Cooperation	147 271
8. Alterna Savings and Credit Union	133 309
9. Conexus Credit Union	123 422
10. Affinity Credit Union	116 913

FINANCIAL PILLAR #3—SPECIALIZED LENDING AND SAVINGS INTERMEDIARIES

Life Insurance Companies

A **life insurance company** shares risk with its policyholders in return for payment of a premium from them. It lends some of the money it collects from premiums to borrowers. Life insurance companies are substantial investors in real estate mortgages and in corporate and government bonds. Next to chartered banks, they are the largest financial intermediaries in Canada. The industry has more than $810 billion invested in Canada with 38 percent invested in bonds (provincial, federal, and corporate bonds), 6 percent in mortgages, 3 percent in real estate, 17 percent in stocks, and 30 percent in mutual funds, with the rest in cash. The industry also employs more than 154 800 people.[29]

Manulife is the leading Canadian insurance company, with a history exceeding 130 years. In fact, the first Prime Minister of Canada, Sir John A. Macdonald, was also the first president of the company. How's that for history. Today the company serves more than 26 million customers in Canada and around the world. It serves its U.S. customers under the John Hancock brand but as Manulife everywhere else. The company has 35 000 employees and earned more than $4 billion in profits in 2017 and $1.4 billion in the first quarter of 2018.[30]

Factoring Companies

Important sources of short-term funds for many firms are factoring companies. A **factoring company (or factor)** buys accounts receivable (amounts due from credit customers) from a firm. The factor pays less than the face value of the accounts but collects the entire face value of the accounts. The difference, minus the cost of doing business, is the factor's profit. A firm that sells its accounts receivable to a factor shifts the risk of credit loss to the factor. If an account turns out to be uncollectible, the factor suffers the loss. Commercial Capital LLC Canada is an example of a factoring company.

Financial Corporations

A **sales finance company** specializes in financing instalment purchases made by individuals and firms. When you buy durable goods from a retailer on an instalment plan with a sales finance company, the loan is made directly to you. The item itself serves as security for the loan. Sales finance companies enable firms to sell on credit, even though the firms could not afford to finance credit sales on their own. Ally Financial (formerly General Motors Acceptance Corporation) is a sales finance company that now finances the instalment contracts resulting from sales made by General Motors.

A **consumer finance company** makes personal loans to consumers. Often, the borrower pledges no security (collateral) for the loan. For larger loans, collateral may be required. These companies do not make loans to businesses, but they do provide the financing that allows consumers to buy goods and services from businesses.

Venture Capital Firms

A **venture capital firm** provides funds for new or expanding firms that seem to have significant potential. Venture capital firms may demand an ownership stake of 50 percent or more before they will buy into a company. Because financing new, untested businesses is risky, venture capital firms also want to earn a higher-than-normal return on their investment. They may insist that they be given at least one seat on the board of

LIFE INSURANCE COMPANY A mutual or stock company that shares risk with its policyholders for payment of premiums.

FACTORING COMPANY (OR FACTOR) Buys accounts receivable from a firm for less than their face value and then collects the face value of the receivables.

SALES FINANCE COMPANY Specializes in financing instalment purchases made by individuals or firms.

CONSUMER FINANCE COMPANY Makes personal loans to consumers.

VENTURE CAPITAL FIRM Provides funds for new or expanding firms thought to have significant potential.

Manulife is the leading Canadian life insurance company, and it has a global footprint.

Chrisdorney/Shutterstock

Many of you are quite familiar with TV programs like *Dragons' Den* and *Shark Tank* that provide a simplified, made-for-TV version of the venture capital process.

Leon Switzer/ZUMA Press/Newscom

directors to observe how their investment is faring. Venture capital firms look for companies with growth potential that could lead to substantial increases in stock value.

Venture capital firms obtain their funds from initial capital subscriptions, from loans from other financial intermediaries, and from retained earnings. Salesforce.com, the cloud-computing giant, recently launched a $100 million Canadian Venture Capital fund targeting early stage companies using their software.[31] The amount of venture capital that is raised varies according to economic conditions. In 2017, venture capital firms raised a total of $3.5 billion in Canada from 592 deals, which was twice as high as the figure raised just five years earlier.[32] These deals are vital to the growth of many of these firms. For example, in 2018, Ratehub, the Toronto-based financial technology company, received $12 million in VC funding. Two years earlier, the company had refused a million-dollar deal from two Dragons that made an offer on an episode of the hit CBC show the Dragons' Den.[33]

Pension Funds

A **pension fund** accumulates money that will be paid out to plan subscribers at some time in the future. The money collected is invested in corporate stocks and bonds, government bonds, or mortgages until it is to be paid out. Many private pension funds are being evaluated, and there are great concerns about long-term funding with an aging population and some examples of poor management in this area. Nevertheless, the funds themselves have tremendous financial clout and are a key source of capital. For example, the OPSEU Pension Fund, which manages over $20 billion in assets on behalf of 92 000 government employees, recently committed $20 million towards an Innovation Growth Fund.[34]

PENSION FUND Accumulates money that will be paid out to plan subscribers in the future.

FINANCIAL PILLAR #4—INVESTMENT DEALERS

Investment dealers (stockbrokers or underwriters) are the primary distributors of new stock and bond issues (the underwriting function). They also facilitate secondary trading of stocks and bonds, both on stock exchanges and on over-the-counter stock and bond markets (the brokerage function).

For example, when Cara (owner of Swiss Chalet, Harvey's, and other fast-food outlets) and GoDaddy recently decided to sell stock to the public for the first time (i.e., make an initial public offering), they turned to investment dealers to underwrite them. GoDaddy's stock price valued the company at approximately $4 billion.[35] These functions of investment dealers are described in more detail in Chapter 15.

As you will see in the Entrepreneurship and New Ventures box called "Risky Business," financial institutions have their ups and downs as they operate in an ever-changing environment. However, sometimes even a negative event, with devastating short-term consequences, can lead to something great (assuming lessons are learned!).

ENTREPRENEURSHIP AND NEW VENTURES

Risky Business

When Larry Fink graduated from business school in 1976, he went straight to Wall Street and took a job at First Boston as a bond trader. He put in his time, proved himself, and within three years, he oversaw what was then a fairly new business segment for the company—structuring and trading mortgage-backed securities. Over the years, his hard work and talent led him to fame as one of the architects of the innovative multitrillion-dollar debt-securitization market. The idea was to take all kinds of consumer debt, from credit cards and car loans to mortgages, consolidate them, and then slice them into pieces again and sell the pieces to investors. His talent for innovation and deal-making helped him increase the bottom line by a billion dollars, and he was on track to be a partner in the firm. Some even said he would one day run the show. He was one of Wall Street's up-and-comers, embracing the hard-nosed money-making culture of the industry. But in 1986, predicting that interest rates would rise, Fink took a risky position in the market. Interest rates defied his predictions, and his department lost $100 million. Once First Boston's golden boy, he lost his shining reputation overnight.

Samuel Sanchez/El Pais Photos/Newscom

Being forced out of his job was a turning point for Larry Fink. He was tired of the way Wall Street treated its clients and its traders. Realizing that he'd failed because he wasn't aware of the risks involved, he promised never to be in that kind of situation again. Coming from that model, he decided to build a company that would invest money for clients and offer sophisticated risk management. From its humble beginning, Larry Fink has taken BlackRock from its initial $5 million line of credit to more than $6 trillion in clients' money, more than any asset manager in the world—even more than Vanguard.

What makes BlackRock even more unique is Aladdin—a state-of-the-art computerized risk-management system composed of 5000 computers managed by a team of engineers, analysts, statisticians, and programmers. Aladdin monitors millions of variables and applies its risk assessments to clients' portfolios. The company also formed BlackRock Solutions, a consulting company, not just for risk avoidance but also for advising clients for whom things have already gone wrong.

For Fink, though, it's not all about money. In a recent annual report, Fink wrote, "We believe that if our employees seek to act always with integrity, performance follows." From the moment that an employee is hired, BlackRock emphasizes putting the customer first. This means that employees must understand more than just their role in the company; they also must be committed to the values of the organization. For example, a core practice at BlackRock is helping customers to understand risk. As Fink states, performance follows integrity.

CRITICAL THINKING QUESTION

1. What are the main lessons that you take away from the story of Larry Fink and BlackRock as they relate to entrepreneurship and the financial industry?

OTHER SOURCES OF FUNDS

Government Financial Institutions and Granting Agencies

In Canada, several government suppliers of funds are important to business. In general, they supply funds to new and/or growing companies; however, established firms can also use some of them.

The *Business Development Bank of Canada (BDC)* makes term loans, primarily to smaller firms judged to have growth potential but unable to secure funds at reasonable terms from traditional sources. It provides proportionally more equity financing and more management counselling services. A variety of provincial industrial development corporations also provide funds to developing business firms in the hope that they will provide jobs in the province. Several federal and provincial programs are specifically designed to provide loans to agricultural operators. Most of these, except for farm improvement loans that guarantee bank loans to farmers, are long-term loans for land purchase.

The federal government's *Export Development Corporation (EDC)* finances and insures export sales for Canadian companies. The *Canada Mortgage and Housing Corporation (CMHC)* is involved in providing and guaranteeing mortgages. The CMHC is particularly important to the construction industry. Governments are also involved in providing grants to business operations.

International Sources of Funds

The Canadian capital market is just one part of the international capital market. Canadian provinces borrow extensively in foreign markets, such as those in London and New York. Canadian corporations likewise find it attractive to borrow in foreign markets. Foreign sources of funds have been important throughout the economic development of Canada. Although many groups and individuals have expressed concern about foreign ownership of Canadian businesses, projections of Canada's future capital requirements indicate that we will continue to need these funds. Canadian financial institutions will continue to play a significant role in making these funds available.

LO-5 INTERNATIONAL BANKING AND FINANCE

Electronic technologies permit nearly instantaneous financial transactions around the globe. These business exchanges—the prices asked and paid—are affected by *values of the currencies* among the various nations involved in the transactions. Once agreements are reached, the *international payments process* that moves money between buyers and sellers on different continents is not subject to any worldwide policy system beyond loosely structured agreements among countries.

Currency Values and Exchange Rates

Euros, pesos, yuan, dollars, and yen—money comes in all sizes and stripes. With today's global activities, travellers, shoppers, investors, and businesses often rely on banks to convert their dollars into other currencies. When it comes to choosing one currency over others, the best choice changes from day to day. Why? Because every currency's value changes, reflecting global supply and demand—what traders are willing to pay—for one currency relative to others.

Strong Currency or Weak: Which is Better?

Most people would prefer a "strong" currency, right? Well, not so fast. It depends on how it will be used.

A good case in point is the fluctuation of the Canadian dollar relative to the American dollar. As we entered the new millennium, Canadians had grown accustomed to a weak dollar, in the 65-to-70-cent range against the U.S. dollar. A dollar at parity with the American dollar was almost unthinkable. Yet, on November 9, 2007, the dollar was actually stronger than its American counterpart when it reached US$1.09, a level that had not been seen for decades. That movement and strength encouraged Canadians to cross the border and purchase everything from clothing, to cars, to condos. However, after a few years of near-parity, the Canadian dollar retreated and stood at approximately US$0.76 in June 2018.[36]

These fluctuations have a significant impact on businesses. When the Canadian dollar was at par with or stronger than the U.S. dollar, Canadian companies found it more difficult to compete internationally because they could no longer rely on a cheap Canadian dollar to make their products more affordable. According to the chairman and CEO of Clearwater Seafoods Income Fund, "The way to deal with a stronger Canadian dollar is to increase the efficiency of your operations."[37] However, other companies saw a net benefit, such as Nova Scotia–based High Liner Foods, which buys most of its raw fish on the world markets in U.S. dollars. The rise in the Canadian

David Gee 4/Alamy Stock Photo

This sign in the Mexico City airport is quoting exchange rates for buying and selling Canadian and U.S. dollars, euros, pounds, and other major currencies relative to the Mexican peso.

dollar helped that company increase profits by 40 percent in one year.[38] By the same logic, clearly, the recent decline in price has had the opposite effect.

The Law of One Price

When a country's currency is overvalued, its exchange rate is higher than warranted by its economic conditions, and its high costs make it less competitive. In contrast, an undervalued currency means low costs and low prices. When a currency becomes overvalued, a nation's economic authorities may devalue the nation's currency (deliberate efforts to lower its value) to make their goods less expensive for other countries to buy.

But how do we know whether a currency is overvalued or undervalued? One method involves a simple concept called the **law of one price**: the principle that identical products should sell for the same price in all countries. In other words, if the different prices of a Rolex watch in different countries were converted into a common currency, the price should be the same everywhere.

A simple example that illustrates overvalued and undervalued currencies is the Big Mac Index, published annually in *The Economist*. The index lists a variety of countries and their Big Mac prices in terms of U.S. dollars (see Figure 14.4).[39] In 2018, a Big Mac cost $5.28 in the United States. If a Big Mac in another country costs more than $5.28, the currency is overvalued; if it costs less than $5.28, the currency is undervalued. In 2018, the most overvalued currencies were those of Switzerland ($6.76) and Norway ($6.24). The Canadian currency was slightly undervalued at $5.26. Ukraine ($1.64), Egypt ($1.93), and Malaysia ($2.28) were considered to have the most undervalued currencies.

The International Payments Process

Financial settlements between buyers and sellers in different countries are simplified through services provided by banks. For example, payments from Canadian buyers start at a local bank that converts them from dollars into the seller's currency, such as into euros to be sent to a seller in Spain. At the same time, payments and currency conversions from separate transactions also are flowing between Spanish businesses and Canadian sellers in the other direction.

Andrew Vaughan/CP Images

While many Canadian companies found it more difficult to compete or earn high margins because of the increase in the value of the Canadian dollar, High Liner Food was a beneficiary because it buys most of its fish in U.S. dollars on the world market. The recent decline in the value of the Canadian dollar has had the opposite effect.

If trade between the two countries is in balance—if money inflows and outflows are equal for both countries—then *money does not actually have to flow between the two countries*. If inflows and outflows are not in balance at the Canadian bank (or at the Spanish bank), then a flow of money—either to Spain or to Canada—is made to cover the difference.

Bitcoin and other cryptocurrencies are also being used to make international payments off the traditional grid. We will examine the growing cryptocurrency influence in Chapter 15, but for now read the Greening of Business box entitled "Is Bitcoin Environmentally Friendly?"

LAW OF ONE PRICE The principle that identical products should sell for the same price in all countries.

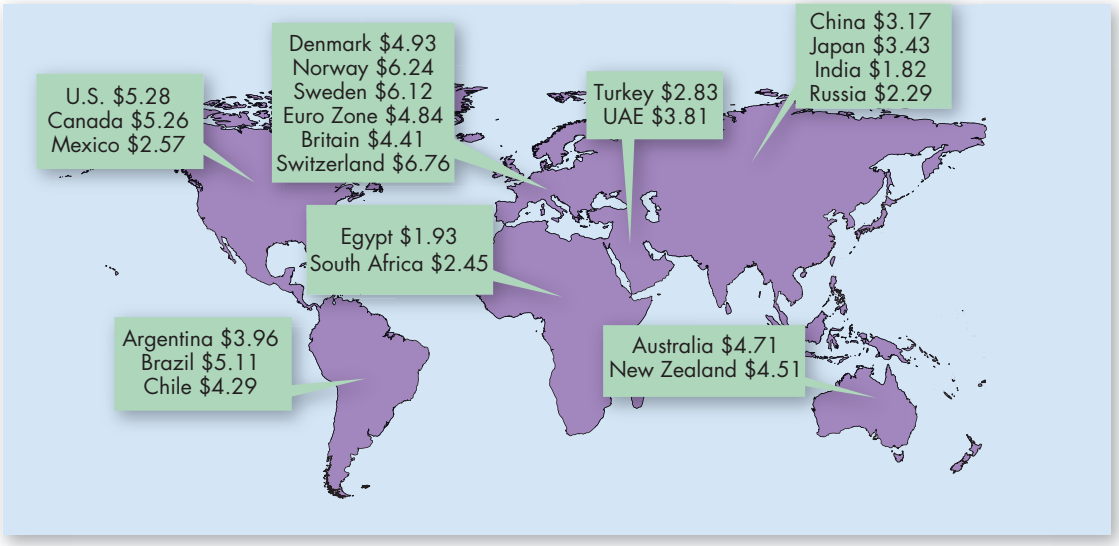

FIGURE 14.4 The Big Mac Map

Source: Based on the Economist Website, "The Big Mac Index," January 22, 2015, https://www.economist.com/content/big-mac-index, [accessed June 25, 2018].

Is Bitcoin Environmentally Friendly?

Bitcoin is an electronic currency that is traded in cyberspace. Bitcoins are earned by owners of computers that solve complex puzzles. An encrypted digital ledger keeps track of all the work that computer owners (called "miners") do. If you want to buy bitcoins, you can install a "virtual wallet" on your computer and then pay for the bitcoins with a credit card or with cash. Some companies—for example, Dell Computers, Expedia, and Microsoft—accept bitcoins as payment for goods and services, but most retailers don't. As of 2018, only three of the top 500 online retailers accepted bitcoins.

You might wonder how any of this activity would cause anyone to conclude that bitcoin is environmentally unfriendly. Here's the answer. The electricity used by thousands of "miners" to generate bitcoins is rapidly increasing. Many of these miners are in China. In Erdors, Inner Mongolia, for example, there is a server farm with 25 000 computers that solve the puzzles that generate bitcoins. Electric power to run all these computers is provided by burning coal, which is very polluting. Globally, the power used to generate bitcoins equals that used by about three million homes. Some people think this is not a big problem because the worldwide electric power usage associated with bitcoin mining is currently very small (just 0.1 percent of the world's total electric usage). But other people note that demand is rapidly increasing. In just one month, for example, the total electricity used in bitcoin mining increased by 30 percent. China provides relatively cheap power with coal-fired power plants, and this keeps miners' costs down.

This situation is going to get worse because the puzzles that are solved to earn bitcoins become more complex as more bitcoins are produced. Therefore, more computer time (and more electricity) is needed. There is also the growing issue of noise pollution as bitcoin mining facilities are launched in Canadian cities and towns near populated areas. The problem is that the computers need to be cooled with loud air cooling units and extremely large fans because thousands of computers are running 24 hours a day in a warehouse.

Other concerns about bitcoin go far beyond environmental issues. First, traditional currencies are issued by central governments and are relatively stable in value, but bitcoin is not backed by any central government, and its value can fluctuate wildly. For example, in December 2013, one bitcoin was worth more than US$1000, but by January 2015, the value had dropped to just $179. In December 2017, the value of a bitcoin had skyrocketed to $19 000, only to fall to $5850 by mid-2018. Second, there is concern that bitcoin is being used for "laundering" drug money or for supporting terrorist organizations. Third, the currency can be stolen by hackers. For example, a bitcoin exchange called Mt. Gox declared bankruptcy after losing $425 million in bitcoins to hackers. Fourth, consumers using bitcoins have discovered that there are significant transaction costs and delays in confirming transactions.

CRITICAL THINKING QUESTIONS

1. What are the four basic *characteristics* of money? How well does bitcoin fit these characteristics?
2. What are the three *functions* of money? How does bitcoin rate in terms of each of these functions?

The International Bank Structure

No worldwide banking system is comparable, in terms of policymaking and regulatory power, to the system of any single industrialized nation. Rather, worldwide banking stability relies on a loose structure of agreements among individual countries or groups of countries. In addition, local standards and laws vary greatly.

Two United Nations agencies, the World Bank and the International Monetary Fund, help to finance international trade. Unlike true banks, the **World Bank** provides only a very limited scope of services. For instance, it funds national improvements by making loans to build roads, schools, power plants, and hospitals. The resulting improvements eventually enable borrowing countries to increase productive capacity and international trade. The **International Monetary Fund (IMF)** is a group of 189 nations that have combined their resources to

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

In 2018, the IMF had about $1 trillion available for loans.[40]

In the past decade or so, we have seen major economic turmoil created by the housing and commercial paper crisis in the United States and the European debt crisis. In looking back, economists and governments are openly questioning the efficiency of these international structures. For example, the IMF was criticized for its handling of the European debt crisis by preaching austerity at all costs. The IMF's top economists, Olivier Blanchard and Daniel Leigh, drafted a document that highlighted errors in predicting the impact of austerity (cuts) in the European economies. They pointed to a very large underestimation of the increase in unemployment and the decline in domestic demand that would result from such policies.[41] So it should not be surprising that some nations have declined IMF funds rather than accept the economic changes that the IMF demands. Some developing countries reject the IMF's requirement that they cut back social programs and spending to bring inflation under control.

It is now clearly up to the group of 20 major economies (G20), the IMF, and the other major economic bodies to improve the clarity of rules and re-examine and improve the overall international financial structure. Some change is needed. However, like so many areas of international trade and finance, the United States, under the Trump administration, is threatening to destabilize the system. Despite some rules violations (like every other nation), the United States has been a stabilizing force in the push towards global free trade for decades; however, in 2018, there were reports that the president wanted to withdraw from the WTO.[42] It probably won't happen, but the instability caused by such news can be damaging to world trade.

If we learned one thing from the NAFTA renegotiations (now re-branded as USMCA) there will surely be some pressure applied.

WORLD BANK A United Nations agency that provides a limited scope of financial services, such as funding national improvements in undeveloped countries.

INTERNATIONAL MONETARY FUND (IMF) United Nations agency consisting of 189 nations that have combined resources to promote stable exchange rates, provide temporary short-term loans, and serve other purposes.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 DEFINE *MONEY* AND IDENTIFY THE DIFFERENT FORMS IT TAKES IN CANADA'S MONEY SUPPLY.

Any item that is portable, divisible, durable, and stable satisfies the four basic *characteristics of money*. Money also serves three functions: a *medium of exchange*, a *store of value*, and a *unit of account*. The nation's money supply is often determined by two measures. *M-1* includes liquid (or spendable) forms of money: currency (bills and coins), demand deposits, and other "chequable" deposits. *M-2* includes M-1 plus items that cannot be directly spent but that can be easily converted to spendable forms: time deposits, money market funds, and savings deposits. Credit must also be considered as a factor in the money supply.

LO-2 UNDERSTAND THE DIFFERENT KINDS OF *FINANCIAL INSTITUTIONS* THAT MAKE UP THE *CANADIAN FINANCIAL SYSTEM* AND EXPLAIN THE SERVICES THEY OFFER.

There are four financial pillars in Canada: *chartered banks, alternate banks, life insurance companies*, and *investment dealers*. Chartered banks are the most important source of short-term funds for business firms. They create money in the form of expanding demand deposits. The four types of institutions offer services like financial advice, brokerage services, electronic funds transfer, pension and trust services, and lending of money. Some of the differences between these institutions are disappearing. The financial services industry continues to evolve in Canada.

LO-3 EXPLAIN THE FUNCTIONS OF THE *BANK OF CANADA* AND DESCRIBE THE TOOLS IT USES TO CONTROL THE MONEY SUPPLY.

The Bank of Canada manages the Canadian economy, controls the *money supply*, and regulates certain aspects of chartered banking operations. If the Bank of Canada wants to increase the money supply, it can buy government securities or lower the *bank rate*. If it wants to decrease the money supply, it can sell government securities or increase the bank rate.

LO-4 EXPLAIN THE ROLE OF *ALTERNATE BANKS, SPECIALIZED LENDING AND SAVINGS INTERMEDIARIES*, AND *INVESTMENT DEALERS* IN THE CANADIAN FINANCIAL SYSTEM.

Alternate banks include trust companies and credit unions. *Trust companies* safeguard property that is entrusted to them. *Credit unions* are cooperative savings and lending associations formed by a group with common interests. They lend money to both businesses and consumers. *Specialized lending and savings intermediaries* include life insurance companies (which share risks with their policyholders in return for payment of a premium), *factoring companies* (which buy accounts receivable from businesses at a discount and then collect the face value of the account receivable), *financial corporations* (which specialize in financing instalment purchases made by businesses and individuals), *venture capital firms* (which provide funds for new or expanding businesses), and *pension funds* (which accumulate and invest money that will be paid out to plan subscribers at some time in the future).

LO-5 DISCUSS SOME OF THE INSTITUTIONS AND ACTIVITIES IN *INTERNATIONAL BANKING* AND *FINANCE*.

Changes in currency values and exchange rates reflect global supply and demand for various currencies. Policies by central banks on money supplies and interest rates influence the values of currencies on the foreign currency exchange markets. Electronic technologies now permit speedy global financial transactions to support the growing importance of international finance. Country-to-country transactions rely on an *international payments process* that moves money between buyers and sellers in

different nations. If trade between two countries is in balance—if money inflows and outflows are equal for both countries—money does not have to flow between the two countries. If inflows and outflows are not in balance, then a flow of money between them is made to cover the difference. The *World Bank* and the *International Monetary Fund* were developed by the United Nations with the goal of providing stability to encourage international trade.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. Explain the roles of chartered banks, credit unions (caisses populaires), and non-deposit institutions in the Canadian financial system.
2. As a consumer, when would you favour a strong dollar? What about a weak dollar? Would you consider these factors differently as an employee or employer?
3. Should credit cards be counted in the money supply? Why or why not? Support your answer by using the definition of money.
4. Should banks be regulated, or should market forces be allowed to determine the money supply? Defend your answer.
5. Customers who deposit their money in online-only chequing and savings accounts can often get higher interest rates than at brick-and-mortar banks. Why do you think that online banks can offer these rates? What might be some drawbacks to online-only banking?
6. What is the logic behind the "law of one price" concept? Give an example using Switzerland and China.

APPLICATION EXERCISES

7. Start with a $1000 deposit and assume a reserve requirement of 15 percent. Now trace the amount of money created by the banking system after five lending cycles.
8. Interview several consumers to determine which banking services and products they use (debit cards, ATMs, smart cards, online brokerage, etc.). If interviewees are using these services, determine the reasons. If they are not, find out why.
9. Interview the manager of a local chartered bank branch. Identify the ways in which the Bank of Canada helps the bank and the ways in which it limits the bank.
10. Consider historical currency exchange rates for the Canadian dollar versus the U.S. dollar and the euro. If you had bought those currencies with Canadian dollars five years ago, what would their Canadian-dollar values be today?

TEAM EXERCISES

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members to consider your new business venture and how it relates to the money and banking topics in this chapter. Develop specific responses to the following:

1. How will your business venture be connected with banks and other financial institutions? In what ways, if any, are such institutions important to your business? Of these relationships, which will be most critical?
2. Sales of the product(s) your business offers to customers will depend, in part, on their ability to pay for those products. In what ways, if any, will customers rely on financial institutions for such purchases? Will your company assist customers in connecting with financial institutions to finance their purchases?
3. Consider the ways that currency exchange rates will affect your company. Consider also how those rates will affect your customers and their willingness to buy your product(s). Discuss how your team will adjust pricing of your product(s) when the Canadian dollar is strong and when the dollar is weak versus other currencies.
4. In what ways will your plans and methods for marketing change, if at all, when the currency values of the Canadian dollar change significantly? Explain.

BUILDING YOUR BUSINESS SKILLS

A VIRTUAL CREDIT UNION: AN IDEA WHOSE TIME HAS COME?

GOAL

To help you to understand the complicated scenarios that an organization (in this case, a credit union) must consider when making core strategic decisions.

BACKGROUND INFORMATION

Imagine that Key Credit West is a multibranch credit union located in Western Canada. It has 30 branches scattered across British Columbia, Alberta, Saskatchewan, and Manitoba. The credit union has been well

managed and profitable for decades, but it is finding it difficult to add new customers or replace ones that leave. A member of the credit union's board of directors has recommended that they consider closing branch operations and operating solely as a virtual credit union. Its existing members could maintain their accounts and would have 24-hour access online. Mobile deposit technology permits them to deposit cheques from their homes and offices. Members will continue to be able to withdraw cash through ATMs. Other services would be available online as well, such as car loans and mortgages. Closing the branches would save Key Credit West millions of dollars, but it has employees and customers to consider.

METHOD

Step 1 Assemble a group of four students and assign each group member one of the following roles: Bill Decker (Key Credit West member and client), Gloria Liu (Key Credit West employee), Carolyn Kleen (vice-president, financial security), and Karl Mason (another board member).

Step 2 Before hearing any of your group's comments on this situation and from the perspective of your assigned role, consider the advantages and disadvantages of becoming a virtual credit union.

Step 3 Get together with your group and share the advantages and disadvantages of becoming a virtual credit union.

FOLLOW-UP QUESTIONS

1. Do you think that going virtual would attract new members? What types of members would be most interested in a virtual credit union?
2. What are the potential risks of a virtual credit union for both Key Credit West and the members? How can all the stakeholders protect themselves?
3. What new services might Key Credit West be able to offer if it goes virtual?

EXERCISING YOUR ETHICS

TELLING THE ETHICAL FROM THE STRICTLY LEGAL

THE SITUATION

When upgrading services for convenience to customers, chartered banks are concerned about setting prices that cover all costs so that, ultimately, they make a profit. This exercise challenges you to evaluate one banking service—ABM transactions—to determine if there are also ethical issues that should be considered in a bank's pricing decisions.

THE DILEMMA

Assume that a bank has more than 300 ABMs serving the nearly 400 000 chequing and savings accounts of its customers. Customers are not charged a fee for their 30 million ABM transactions each year, so long as they use their bank's ABMs. For issuing cash to non-customers, however, the bank charges a $2 ABM fee. The bank's officers are re-examining their policies on ABM surcharges because of public protests.

In considering its current policies, the bank's vice-president for community relations is concerned about more than mere legalities. She wants to ensure that her company is "being a good citizen and doing the right thing." Any decision on ABM fees will ultimately affect the bank's customers, its image in the community and industry, and its profitability for its owners.

TEAM ACTIVITY

Assemble a group of four students and assign each group member to one of the following roles:

- A bank customer
- The bank's vice-president for community relations
- A bank shareholder
- The bank's CEO

QUESTIONS FOR DISCUSSION

1. Before discussing the situation with your group and from the perspective of your assigned role, do you think there are any ethical issues in this situation? If so, write them down.
2. Before discussing the situation with your group and from the perspective of your assigned role, decide how this dispute should be resolved.
3. For the various ethical issues that were identified, decide as a group which one is the most important for the bank to resolve. Which issue is second in importance?
4. From an ethical standpoint, what does your group recommend be done to resolve the most important ethical issue? To resolve the second most important ethical issue? What are the advantages and disadvantages of your recommendations?

BUSINESS CASE 14

TOUGH MORTGAGE DECISIONS: SHOULD WE ASK SIRI?

Should consumers be consulting Siri for mortgage advice? The answer to this question, to a traditionalist, is "Heck no!" On the other hand, some of you embrace all technological tools; therefore, your answer might be "Of course. Siri is my virtual assistant!" The reality is that both sides are right, to some extent. Major high-involvement decisions, like the choice of mortgage options, require serious thought and consideration of the advantages and disadvantages of each element: (1) issuer (big banks, credit unions, e-mortgage), (2) amortization period (20, 25, 30 years), and (3) structure (fixed vs. variable rate). Sorry, SIRI can't answer all these questions for your needs. However, she can start the guidance process. Online research and bots can help you locate the best deals. Siri can lend a hand in stage one, but you must do your homework and understand your realistic options based on your situation. Your choice matters! A small savings of one-quarter of 1 percent (0.25%) can save you $2500 or more on a typical five-year mortgage (see below). You must also consider things such as your personal income, your spouse's income, your total expenses and current payments (cars, student loans, etc.), and your job stability. What if you or your partner lose your jobs? Can you make ends

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meet? What are the current rental prices and supply in your city? What is the opportunity cost of investing your equity in the current housing market? The list goes on, and the parameters vary, so there are no complete answers without human thought.

DON'T BLAME SIRI FOR YOUR DEBT: WARNINGS HAVE BEEN CLEAR

With or without virtual assistants, Canadians have taken on tremendous debt over the past two decades. The average Canadian debt-to-income ratio hit a record high of 171 percent in early 2018. To put this in perspective, the Americans and the British reached levels above 160 percent before it caught up to them in the form of a major housing market crisis. This was already a problem in Canada a few years ago when rates were at historic lows, but what does it mean in a time when the government has started increasing rates and has signalled that higher rates are sure to follow?

The average price for a home in Canada in 2018 was $495 100 (which was a minor correction in the overall market). The headlines indicated an 11 percent decrease in that value in the past 12 months, but that figure was still well above where that statistic stood three years earlier. In fact, prices have more than doubled in the past decade or so. With this long-term rise in prices, Canadian debt levels have risen as well. Of course, mortgage debt is based on an asset. Other debts incurred for more frivolous items are a bigger concern; however, because of the massive size of mortgage debt, it is the central focus. In fact, Ottawa has made some adjustments through the Canada Mortgage and Housing Corporation (CMHC), which provides mortgage insurance to financial institutions. Ottawa reduced the maximum permitted amortization period to 30 years, which means that mortgage payments are now calculated based on a maximum 30-year repayment period versus a 40-year repayment as was the case a few years earlier.

GETTING THE BEST RATES AND TERMS

If you ask Siri, "What is the best interest rate on a five-year fixed or variable mortgage in Canada?" she will refer you to sites like ratehub.ca that constantly monitor rates of regular banks and alternative sources. At least in that way, Siri is actually a better source of information than relying on your bank manager since he or she will simply quote the bank's own rate. When it comes to mortgages, banks are in the business of making money by lending to people who can pay back their loans and the interest. If you have a good relationship with your manager, you may get their best rate, but it may be still 0.25 percent to even 1 percent higher than the best you can get elsewhere.

Let's look at an example. A couple buys a house at a price of $525 000 (slightly above the average price of a detached home in Canada) and makes a down payment of $125 000 and finances the balance of $400 000. They choose a 25-year amortization, with a five-year fixed rate. They look online and see that the posted rate from the TD site (on Canada Day in 2018) was 5.59 percent before discount. Therefore, on a $400 000 mortgage at 5.59 percent, the monthly payment would be $2462.57. However, the best rate available, for a five-year mortgage, in a simple search on ratehub.ca was from Canadian Lender at 3.04 percent. So, this couple could have owned the same house at a 3.04 percent interest rate with a monthly payment of $1901.21. Because of the lower interest rate, the monthly payments would be $561.36 lower per month, $6736.32 lower per year, and *$33 681.60 lower over five years!*

A client with a good credit rating at TD (or any other bank) would get a discount of 1 percent or more on the posted rate of 5.59 percent, so let's investigate further. On that date, according to ratehub.ca, a five-year fixed mortgage could be obtained at TD for as low as 3.34 percent, for creditworthy clients. However, even once the bank manager approves this best rate (for TD at the time), there is still quite a difference. The new payment at the bank would be $1963.45 per month (as opposed to $1901.21 at 3.04%). If these clients want to stick to their bank, they are still paying an extra $62.24 per month, an extra $746.88 per year, and an extra total of $3734.40 over the five years!

KNOWLEDGE IS POWER

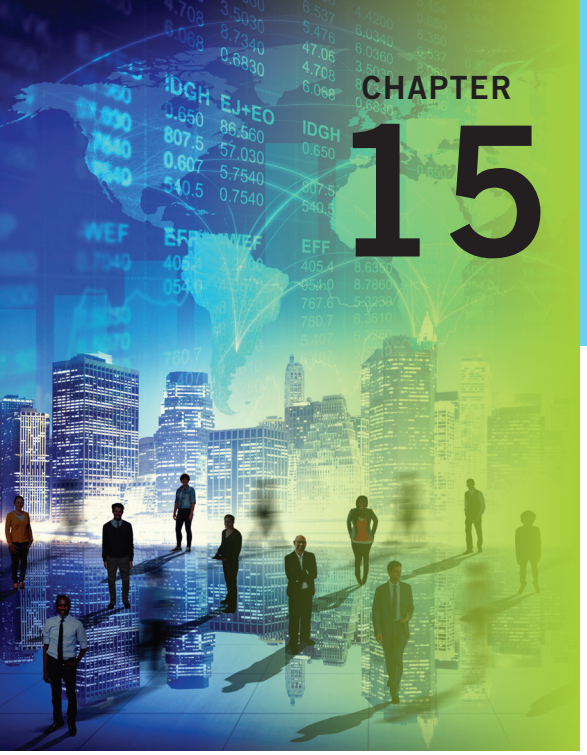
So, are you ready to fight for a few measly percentages and fractions of a percentage? You should be! Keep your credit record clean to have access to better rates and fight for every fraction. Start by doing your homework. Listen to advisors, regulators, bankers, read articles, and, yes, even ask Siri for basic advice. Conduct online searches and take your time. Compile all the information, analyze it, and save yourself thousands of dollars. It's up to you to make the right choice for your circumstances and your financial health.

QUESTIONS FOR DISCUSSION

1. Find the latest rates on ratehub.ca or another similar site that compares rates across the industry. What is the current rate for a three-year and five-year fixed mortgage? What's the variable mortgage rate?
2. Have the rates increased or decreased since this case was written? Go to a bank website such as TD or RBC and search for the mortgage calculator tool and recalculate the new monthly payments based on the new rates to see the impact.
3. Visit the Canadian Real Estate Association (CREA) website (www.crea.ca/content/national-average-price-map) and find out the average price of homes in Canada, in your province, and in your city. Have prices increased or decreased since 2018? Figure out the percentage increase and decrease in each market.

MyLab Intro to Business

Study, practise, and explore real business situations with these helpful resources:
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.
- **Videos:** Learn more about the business practices and strategies of real companies.



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CHAPTER 15

Financial Decisions and Risk Management

LO

AFTER READING THIS CHAPTER, YOU SHOULD BE ABLE TO:

- **LO-1** Describe the responsibilities of a *financial manager*.
- **LO-2** Distinguish between *short-term* (operating) and *long-term* (capital) expenditures.
- **LO-3** Identify three sources of *short-term financing* for businesses.
- **LO-4** Identify three sources of *long-term financing* for businesses.
- **LO-5** Discuss the value of *common stock* and *preferred stock* to stockholders and describe the secondary market for each type of security.
- **LO-6** Explain the process by which securities are bought and sold.
- **LO-7** Describe the investment opportunities offered by *mutual funds, exchange-traded funds, hedge funds*, and *commodities*.
- **LO-8** Explain how *risk* affects business operations and identify the five steps in the *risk management process*.

Blockchain and Bitcoin: New Models or Modern-Day Bubbles?

Bitcoin has been in the headlines for a few years now. Depending on your perspective, it may appear to be the symbol of a brave new world, rewarding the bold who embrace innovation. Or maybe you perceive bitcoin as a classic bubble that rivals some of the greatest boom and busts in history, such as the "Tulip Craze." Never heard of it? About 400 years ago, a speculative bubble swept through the Netherlands when tulip bulbs became a highly sought-after commodity. In 1636, they were being sold on stock exchanges with people trading fortunes to acquire rare tulip bulbs. Seems silly right? How can a flower be worth as much as a house? Well, ask yourself, if the bitcoin bubble truly bursts, what exactly do you own? According to economist and Nobel Laureate Eric Maskin: "Bitcoin has a fundamental value of $0." At least you can hold a flower and enjoy its appearance and smell. All kidding aside, that tulip bubble ended in 1637. When those prices collapsed, realization quickly set in, and the panic to sell those once-valued tulips took over. As a result, some cashed out early and made fortunes, but many others lost everything. The vehicle is different today and comes with the promise of technology backed by a revolution called blockchain, but human nature has not changed. How will this story end?

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Some people have already made great gains, whereas others have lost heavily, but the question remains: what is the future of these cryptocurrencies? Do they represent a revolutionary change, or are they just a simple footnote in history? Regardless of where you stand on this debate, one thing is clear, bitcoin and other cryptocurrencies are very speculative, high-risk, and high-reward trading options (at least for now). Let's look at the cryptocurrency boom. We will start by trying to understand the technology that makes it (blockchain) possible. We will also evaluate the trading history of bitcoin to help determine where we might go from here.

What Is Blockchain?

The technology behind bitcoin may be far more valuable than the cryptocurrencies that were born from it. According to a definition by the BDC, "Blockchain is a continuously updated digital record of who holds what. Information about transactions (time, date, amount, participants) is held and encrypted into a 'block' linked to other blocks to form a chain." *Wired Magazine* refers to blockchain as a "super-secure, hard-to-understand, tamperproof database." In the bitcoin example, blockchain is a decentralized ledger where identical entries are stored simultaneously on more than 200 000 computers. Therefore, every node in the network records each crypto transaction instantly.

All participants have access to encrypted information, which increases transparency and permits constant reconciliation. The fact that this capability exists on many computers around the world means that there is no centralized computer that hackers can break into. Blockchain is not solely for currencies. A wide variety of companies, such as Unilever, the World Wild Life Fund, Volkswagen, and Maersk (the shipping company), are already investing heavily in its development for their own applications. In short, blockchain is a vehicle enabling efficient decentralized transactions, verification, and tracking.

Bitcoin: The Great Roller Coaster Ride

As discussed in Chapter 14, the bitcoin ride would rival any roller coaster; it is full of twists and turns. It has seen tremendous highs followed quickly by deep lows. By tracking the monthly highs for bitcoin over a three-year period (during the month of December), we see that it peaked at US$467.71 in 2015, at US$982.57 in 2016, and at US$19 870.62 in 2017. In isolation, this trend is unbelievable! It points to nothing but success. However, those who invested in bitcoin at its peak in December of 2017 lost two-thirds of their money by July 5, 2018, when the price stood at $6691.32. In other words, for every dollar invested, they were left with about 34 cents. The volume of traded bitcoins was also down considerably even after a slight rebound. Of course, there are no guarantees of the future direction despite good lessons and warnings from the past. At that very moment, bitcoin bulls were pumping the market and calling for another meteoric rise. In a CNBC interview, Tom Lee predicted that the cryptocurrency would be trading at $25 000 within a year, and he was not alone. Other supporters were calling for even higher figures, whereas many finance experts were predicting the demise of bitcoin as a modern-day reminder of the tulip craze. Still others were moving on to other crypto currencies such as Ethereum as a new door to the future. Regardless of which side is right, this is one of the most volatile investments in the modern age, so it is up to the investor to BEWARE!

• QUESTIONS FOR DISCUSSION •

1. What is the current price of bitcoin? Research the monthly trends since mid-2018. How volatile has the price been? How does the future look for bitcoin now?

2. Find recent articles about blockchain and identify companies that are investing resources in it. Name two high-profile companies and explain why they are using blockchain for their organization.
3. As you saw in this chapter, evaluating any potential investment requires an understanding of the risk–reward relationship. Do you believe that the average investor in bitcoin fully understands both ends of this relationship? Explain your answer.
4. *People who invest in bitcoin are simply investing in momentum and nothing else; therefore, this is a bubble that will burst once and for all.* Agree or disagree? Conduct some research and back up your arguments with supporting facts.

HOW WILL THIS HELP ME?

The material in this chapter will benefit you in two ways: (1) you will be better able to use your knowledge about finance in your career both as an *employee* and as a *manager,* and (2) you will be a more informed *consumer*, with greater awareness of how businesses use financial instruments to support their activities.

Iodrakon/Fotolia

LO-1 THE ROLE OF THE FINANCIAL MANAGER

Financial managers plan and control the acquisition and distribution of the company's financial assets. The business activity known as **finance** (or corporate finance) typically involves four responsibilities:

1. Determining a firm's long-term investments
2. Obtaining funds to pay for those investments
3. Conducting the firm's everyday financial activities
4. Managing the risks that the firm takes

The skill set of CFOs is expanding because they have access to a great deal of information about the internal workings of companies and because they are responsible for setting budgets and dealing with regulatory agencies.[1] Rowan O'Grady, president of Hays Canada, a recruiting firm, says that CFOs do much more than simply focus on financial documents like spreadsheets; they also work extensively with people, and they have a significant leadership role to play in their organizations.[2] In recent years, more and more chief financial officers (CFOs) have been appointed as chief executive officers (CEOs).

Objectives of the Financial Manager

A financial manager's overall objective is to increase a firm's value and stockholders' wealth. Financial managers do many specific things to increase a firm's value: collect funds, pay debts, establish trade credit, obtain loans, control cash balances, and plan for future financial needs. Whereas accountants create data to reflect a firm's financial status, financial managers make decisions for improving that status. Financial managers must ensure that a company's revenues exceed its costs—in other words, that it earns a profit. In sole proprietorships and partnerships, profits translate directly into increases in owners' wealth. In corporations, profits translate into an increase in the value of common stock.

Responsibilities of the Financial Manager

The various responsibilities of the financial manager in increasing a firm's wealth fall into three broad categories: *cash-flow management, financial control*, and *financial planning*.

Cash-Flow Management

To increase a firm's value, financial managers must ensure that it always has enough funds on hand to purchase the materials and human resources that it needs to produce goods and services. Funds that are not needed immediately must be invested to earn more money. This activity—**cash-flow management**—requires careful planning. If excess cash balances sit idle instead of being invested, a firm loses the interest that it could have earned. One study revealed that companies averaging $2 million in annual sales typically hold $40 000 in non-interest-bearing accounts. Larger companies hold even larger sums. By putting idle cash to work, firms gain additional investment income.

Financial Control

Because things never go exactly as planned, financial managers must be prepared to adjust for actual financial changes that occur each day.

FINANCE The business function involving decisions about a firm's long-term investments and obtaining the funds to pay for those investments.

CASH-FLOW MANAGEMENT Managing the pattern in which cash flows into the firm in the form of revenues and out of the firm in the form of debt payments.

Financial managers have the responsibility of ensuring that the financial assets of their company are used effectively. This includes the performance of investments the company may have in other companies in the form of shares of stock. Regular assessment of how these investments are performing is an important responsibility of financial managers.

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Financial control is the process of checking actual performance against plans to ensure that the desired financial outcome occurs. For example, planned revenues based on forecasts usually turn out to be higher or lower than actual revenues. Why? Simply because sales are unpredictable. Control involves monitoring revenue inflows and making appropriate financial adjustments. Higher-than-expected revenues, for instance, may be deposited in short-term interest-bearing accounts, or they may be used to pay off short-term debt. In contrast, lower-than-expected revenues may require short-term borrowing to meet current debt obligations.

Budgets are important in financial control (see Chapter 11) and provide the "measuring stick" against which performance is evaluated. The cash flows, debts, and assets, not only of the whole company but also of each department, are compared at regular intervals against budgeted amounts. Discrepancies indicate the need for financial adjustments so that resources are used to the best advantage.

Financial Planning

The cornerstone of effective financial management is the development of a **financial plan**, which describes a firm's strategies for reaching some future financial position. For example, a few years ago, a sharp drop in the price of oil caused companies to cut their capital spending. Canadian Natural Resources cut $2.4 billion from its budget that year, which meant that the company would drill far fewer wells than previously planned.[3] Crescent Point Energy Corp. also cut $1.45 billion from its capital budget, which meant that the company produced fewer barrels of oil than it did a year earlier.[4]

When constructing a financial plan, several questions must be answered:

- What funds are needed to meet immediate plans?
- When will the firm need more funds?
- Where can the firm get the funds to meet both its short- and its long-term needs?

To answer these questions, a financial manager must develop a clear picture of why a firm needs funds. Managers must also assess the relative costs and benefits of potential funding sources. In the following sections, we examine the main reasons why companies generate funds and describe the main sources of business funding, for both the short and the long term.

FINANCIAL CONTROL The process of checking actual performance against plans to ensure that the desired financial status is achieved.

FINANCIAL PLAN A description of how a business will reach some financial position it seeks for the future; includes projections for sources and uses of funds.

LO-2 WHY BUSINESSES NEED FUNDS

Every company needs money to survive. Failure to make a contractually obligated payment can lead to bankruptcy and the dissolution of the firm. Financial managers must distinguish between short-term (operating) expenditures and long-term (capital) expenditures. The time frame for short-term expenditures is typically less than one year, whereas for long-term expenditures, the time frame is greater than one year.

Short-Term (Operating) Expenditures

A firm incurs short-term expenditures regularly in its everyday business activities. To handle these expenditures, financial managers must pay attention to *accounts payable, accounts receivable*, and *inventories*.

Accounts Payable

In Chapter 11, we defined accounts payable as unpaid bills owed to suppliers plus wages and taxes due within a year. For most companies, this is the largest single category of short-term debt. To plan for funding flows, financial managers want to know in advance the amounts of new accounts payable, as well as when they must be repaid. For information about such obligations and needs—say, the quantity of supplies required by a certain department in an upcoming period—financial managers must rely on other managers. The "Exercising Your Ethics" section at the end of this chapter presents an interesting dilemma regarding accounts payable.

Accounts Receivable

Accounts receivable refer to funds due from customers who have bought on credit. Because accounts receivables represent an investment in products for which a firm has not yet received payment, they temporarily tie up its funds. Clearly, the seller wants to receive payment as quickly as possible. A sound financial plan requires financial managers to project accurately both how much credit is advanced to buyers and when they will make payments. For example, managers at Kraft Foods must know how many dollars' worth of cheddar cheese Sobeys supermarkets will order each month; they must also know Sobeys's payment schedule.

This warehouse manager is checking inventory levels in a large warehouse.

Wavebreak Media Ltd/Fotolia

Credit Policies Predicting payment schedules is a function of *credit policy*—the rules governing a firm's extension of credit to customers. This policy sets standards as to which buyers are eligible for what type of credit. Typically, credit is extended to customers who can pay and who honour their obligations. Credit is denied to firms with poor payment histories.

Credit policy also sets specific payment terms. For example, credit terms of "2/10, net 30" mean that the selling company offers a 2 percent discount if the customer pays within 10 days. The customer has 30 days to pay the regular price. Under these terms, the buyer would have to pay only $980 on a $1000 invoice on days 1 to 10, but all $1000 on days 11 to 30. The higher the discount, the more incentive buyers have to pay early. Sellers can thus adjust credit terms to influence when customers pay their bills.

Inventories

Between the time a firm buys raw materials and the time it sells finished products, it ties up funds in **inventory**—materials and goods that it will sell within the year. Failure to manage inventory can have grave financial consequences. Too little inventory of any kind can cost a firm sales, while too much inventory means tied-up funds that cannot be used elsewhere. In extreme cases, a company may have to sell excess inventory at low prices simply to raise cash.

The basic supplies a firm buys to use in its production process are its *raw-materials inventory*. Levi Strauss's raw-materials inventory includes huge rolls of denim. *Work-in-process inventory* consists of goods partway through the production process. Cut-out but not-yet-sewn jeans are part of the work-in-process inventory at Levi's. Finally, *finished-goods inventory* refers to items that are ready for sale (completed blue jeans ready for shipment to Levi's dealers).

The boxed insert entitled "Social Capital Is Making the World a Better Place" describes short-term financing with a social mission.

Long-Term (Capital) Expenditures

Companies need funds to cover long-term expenditures for fixed assets such as land, buildings, and machinery. For example, Walmart Canada spent $750 million on remodelling, expanding, or relocating 73 different retail outlets.[5] Long-term expenditures are more carefully planned than short-term outlays because the former poses special problems. They differ from short-term outlays in the following ways, all of which influence the ways that long-term outlays are funded:

- Unlike inventories and other short-term assets, they are not normally sold or converted to cash.
- Their acquisition requires a very large investment.
- They represent a binding commitment of company funds that continues long into the future.

INVENTORY Materials and goods currently held by the company that will be sold within the year.

ENTREPRENEURSHIP AND NEW VENTURES

Social Capital Is Making the World a Better Place

While big banks strive for profitability, sometimes through seemingly questionable lending practices, smaller companies like not-for-profit Kiva strive to reduce poverty by connecting people through micro-lending. The loans are crowdfunded by accumulating donations as small as $25. Since its founding 10 years ago, Kiva's micro-lending platform has helped entrepreneurs in emerging markets in 82 countries borrow $945 million with a 97 percent repayment rate, and most of the borrowers are women. In addition, organizations such as the International Rescue Committee (IRC) are making micro-loans and providing training and support for refugees to help them get a fresh start, and Women's Empowerment International is making micro-loans worldwide to help lift women from poverty. One commonality these organizations share is reliance on character, trust, and potential community benefits to determine who gets a loan, rather than credit reports and financial statements.

Micro-lending isn't limited to crowdfunded sources. There are small, community-based micro-lenders that receive their funding from governments. However, where the crowdfunded micro-lenders rely on social capital to determine the borrower's creditworthiness, traditional lenders rely on a more traditional underwriting process. Even so, with small loan amounts and short payback periods, these micro-loans are designed for entrepreneurs who have limited credit history and personal funds.

Crowdfunding sites such as KickStarter and GoFundMe can also help start-ups get product to market, but they tend to favour more commercial products rather than the smaller entrepreneurial ventures that the micro-lenders target. Even so, there is some evidence that the crowdfunding sites favour women entrepreneurs over men.

CRITICAL THINKING QUESTION

1. Consider the following statement: "*Not-for-profit micro-lending organizations, like Kiva, are good socially conscious citizens; however, their practices are not justified by basic business fundamentals.*" Debate the pros and cons of this argument.

LO-3 SOURCES OF SHORT-TERM FUNDS

Firms can call on many sources for the funds they need to finance day-to-day operations and to implement short-term plans. These sources include *trade credit, secured short-term loans*, and *unsecured short-term loans*.

Trade Credit

Accounts payable are not merely an expenditure. They are also a source of funds to the company, which has the use of both the product purchased and the price of the product until the time it pays its bill. **Trade credit**, the granting of credit by one firm to another, is effectively a short-term loan. Trade credit can take several forms.

- The most common form, *open-book credit*, is essentially a "gentlemen's agreement." Buyers receive merchandise along with invoices stating credit terms. Sellers ship products on faith that payment will be forthcoming.
- When sellers want more reassurance, they may insist that buyers sign legally binding *promissory notes* before merchandise is shipped. The agreement states when and how much money will be paid to the seller.
- The *trade draft* is attached to the merchandise shipment by the seller and states the promised date and amount of payment due. To take possession of the merchandise, the buyer must sign the draft. Once signed by the buyer, the document becomes a *trade acceptance*. Trade drafts and trade acceptances are useful forms of credit in international transactions.

Secured Short-Term Loans

For most firms, bank loans are a vital source of short-term funding. Such loans almost always involve a promissory note in which the borrower promises to repay the loan plus interest. In **secured loans**, banks also require the borrower to put up collateral—to give the bank the right to seize certain assets if payments are not made. Inventories, accounts receivable, and other assets (e.g., stocks and bonds) may serve as *collateral* for a secured loan. Secured loans allow borrowers to get funds when they might not qualify for unsecured credit. Moreover, they generally carry lower interest rates than unsecured loans.

Inventory as Collateral

When a loan is made with inventory as a collateral asset, the lender lends the borrower some portion of the stated value of the inventory. Inventory is more attractive as collateral when it can be readily converted into cash. Boxes full of expensive, partially completed lenses for eyeglasses are of little value on the open market, but a thousand crates of canned tomatoes might well be convertible into cash.

Accounts Receivable as Collateral

When accounts receivable are used as collateral, the process is called *pledging accounts receivable*. In the event of non-payment, the lender may seize the receivables (funds owed the borrower by its customers). If these assets are not enough to cover the loan, the borrower must make up the difference. This option is especially important to service companies such as accounting firms and law offices. Because they do not maintain inventories, accounts receivable are their main source of collateral. Typically, lenders that will accept accounts receivable as collateral are financial institutions with credit departments capable of evaluating the quality of the receivables.

Factoring Accounts Receivable A firm can also raise funds by *factoring* (i.e., selling) its accounts receivable. The purchaser of the receivables (called a factor) might, for example, buy $50 000 worth of receivables for 80 percent of that sum ($40 000). The factor then tries to collect on the receivables and profits to the extent that the money it eventually collects exceeds the amount it paid for the receivables. Usually the factor ends up with a profit of 2 to 4 percent, depending on the quality of the receivables, the cost of collecting them, and interest rates. Factoring essentially means outsourcing the collection process. About $4 billion worth of goods are factored each year in Canada, but this is far below the $300 billion in the United States.

Unsecured Short-Term Loans

With an **unsecured loan**, the borrower does not have to put up collateral. In many cases, however, the bank requires the borrower to maintain a compensating balance—the borrower must keep a portion of the loan amount on deposit with the bank in a non-interest-bearing account.

The terms of an unsecured loan—amount, duration, interest rate, and payment schedule—are negotiated. To receive such a loan, a firm must ordinarily have a good banking relationship with the lender. Once an agreement is made, a promissory note will be executed and the funds transferred to the borrower. There are three common types of unsecured loans: *lines of credit, revolving credit agreements*, and *commercial paper*.

Lines of Credit

A standing agreement with a bank to lend a firm a maximum amount of funds on request is called a **line of credit**. With a line of credit, the firm knows the maximum amount it will be allowed to borrow. For example, suppose that Scotiabank provides Greenway Gardening Inc. a $100 000 line of credit for the coming year. Greenway's borrowings can total up to $100 000 at any time. Greenway benefits from the arrangement by knowing in advance that the bank regards the firm as creditworthy and will lend funds to it on short notice.

Revolving Credit Agreements

Revolving credit agreements are like bank credit cards for consumers. Under a **revolving credit agreement**, a lender agrees to make some amount of funds available on demand to a firm for continuing short-term loans. The

TRADE CREDIT The granting of credit by a selling firm to a buying firm.
SECURED LOANS A short-term loan in which the borrower is required to put up collateral.
UNSECURED LOAN A short-term loan in which the borrower is not required to put up collateral.
LINE OF CREDIT A standing agreement between a bank and a firm in which the bank specifies the maximum amount it will make available to the borrower for a short-term unsecured loan; the borrower can then draw on those funds, when available.
REVOLVING CREDIT AGREEMENT A guaranteed line of credit for which the firm pays the bank interest on funds borrowed, as well as a fee for extending the line of credit.

lending institution guarantees that funds will be available when sought by the borrower. In return, the bank charges a commitment fee—a charge for holding open a line of credit for a customer even if the customer does not borrow any funds. The commitment fee is often expressed as a percentage of the loan amount, usually 0.5 to 1 percent of the committed amount. For example, suppose that RBC agrees to lend Greenway Gardening up to $100 000 under a revolving credit agreement. If Greenway borrows $80 000, it still has access to $20 000. If it pays off $50 000 of the debt, reducing its debt to $30 000, then $70 000 is available. Greenway pays interest on the borrowed funds and pays a fee on the unused funds in the line of credit.

Commercial Paper

Commercial paper, which is backed solely by the issuing firm's promise to pay, is an option for only the largest and most creditworthy firms. Here's how it works: Corporations issue commercial paper with a face value. Companies that buy commercial paper pay less than that value. At the end of a specified period (usually 30 to 90 days, but legally up to 270 days), the issuing company buys back the paper—at the face value. The difference between the price the buying company paid and the face value is the buyer's interest earned. For example, if Air Canada needs to borrow $10 million for 90 days, it might issue commercial paper with a face value of $10.2 million. If an insurance company with $10 million in excess cash buys the paper, after 90 days, Air Canada will pay $10.2 million to the insurance company. So the insurance company earns $200 000 for its $10 million investment.

COMMERCIAL PAPER A method of short-run fundraising in which a firm sells unsecured notes for less than the face value and then repurchases them at the face value within 270 days; buyers' profits are the difference between the original price paid and the face value.

LO-4 SOURCES OF LONG-TERM FUNDS

Firms need long-term funding to finance expenditures on fixed assets such as the buildings and equipment that is necessary for conducting business. They may seek long-term funds through *debt financing, equity financing*, or *hybrid financing*.

Debt Financing

Long-term borrowing from outside the company—**debt financing**—is a major component of most firms' long-term financial planning. Debt financing is most appealing to companies that have predictable profits and cash-flow patterns. For example, demand for electric power is quite steady from year to year and predictable from month to month. Thus provincial hydroelectric utilities rely heavily on debt financing. There are two primary sources of debt financing: *long-term loans* and the sale of *bonds*.

Long-Term Loans

Most corporations get their long-term loans from a chartered bank, usually one with which the firm has developed a long-standing relationship. Long-term loans are usually matched with long-term assets. Interest rates for the loan are negotiated between the borrower and lender. Although some bank loans have fixed rates, others have floating rates tied to the prime rate that they charge their most creditworthy customers (see Chapter 14). For example, a company might negotiate a loan at "prime + 1 percent." If prime is 3 percent at that time, the company will pay 4 percent. Credit companies, insurance companies, and pension funds also grant long-term business loans.

Long-term loans have several advantages. They can be arranged quickly, the duration of the loan is easily matched to the borrower's needs, and if the firm's needs change, the loan usually contains clauses making it possible to change the terms. But long-term loans also have some disadvantages. Large borrowers may have trouble finding lenders to supply enough funds. Long-term borrowers may also have restrictions placed on them as conditions of the loan. They may have to pledge long-term assets as collateral. And they may have to agree not to take on any more debt until the borrowed funds are repaid.

Bonds

A **corporate bond** is a contract—a promise by the issuing company or organization to pay the bondholder a certain amount of money (the principal) on a specified date, plus interest in return for use of the investor's money. The *bond indenture* spells out the terms of the bond, including the interest rate that will be paid, the maturity date of the bond, and which of the firm's assets, if any, are pledged as collateral. Alibaba Group Holdings Ltd. began planning to sell bonds just two months after its very successful IPO.[6] In another example, Twitter raised $1 billion by issuing bonds in 2018.[7]

Bonds are the major source of long-term debt financing for most large corporations. Bonds are attractive when companies need large amounts of funds for long periods of time; in many cases, bonds may not be redeemed for 30 years. But bonds involve expensive administrative and selling costs, and they may also require high interest payments if the issuing company has a poor credit rating. If a company fails to make a bond payment, it is in *default*.

DEBT FINANCING Raising money to meet long-term expenditures by borrowing from outside the company; usually takes the form of long-term loans or the sale of corporate bonds.

CORPORATE BOND A promise by the issuing company to pay the holder a certain amount of money on a specified date, with stated interest payments in the interim; a form of long-term debt financing.

Corporations aren't the only organizations that sell bonds. Governments also sells bonds to finance its activities.

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Registered bonds register the names of holders with the company, which then mails out cheques to the bondholders. *Bearer (or coupon) bonds* require bondholders to clip coupons from certificates and send them to the issuer to receive payment. Coupons can be redeemed by anyone, regardless of ownership. With **secured bonds**, borrowers can reduce the risk of their bonds by pledging assets to bondholders in the event of default. If the corporation does not pay interest when it is due, the firm's assets can be sold and the proceeds used to pay the bondholders. Unsecured bonds are called *debentures*. No specific property is pledged as security for these bonds. Holders of unsecured bonds generally have claims against property not otherwise pledged in the company's other bonds. Accordingly, debentures have inferior claims on the corporation's assets. Financially strong corporations often use debentures.

Regarding maturity dates, there are three types of bonds: *callable, serial*, and *convertible*.

Callable Bonds The issuer of *callable bonds* may call them in and pay them off before the maturity date at a price stipulated in the indenture. Usually the issuer cannot call the bond for a certain period after issue, often within the first five years. Issuers usually call in existing bonds when prevailing interest rates are lower than the rate being paid on the bond. The issuer must still pay a *call* price to call in the bond. The call price usually gives a premium to the bondholder. The premium is merely the difference between the face value and call price. For example, a bond that bears a $100 face value might be callable by the firm for $108.67 any time during the first year after issue. The call price (and therefore the premium) decreases annually as the bonds approach maturity.

The boxed insert entitled "What Are the Prospects for 'Green Bonds'?" describes a new development in the market.

Serial Bonds Some corporations issue serial or convertible bonds. With a *serial bond*, the firm retires portions of the bond issue in a series of different preset dates. For example, a company with a $100 million issue maturing in 20 years may retire $5 million each year.

Convertible Bonds *Convertible bonds* can be converted into the common stock of the issuing company. For example, suppose that Bell Canada Enterprises sold a $100 million issue of 4.5 percent convertible bonds in 2015. The bonds were issued in $1000 denominations, and they will mature in 2025. At any time before maturity, each bond of $1000 is convertible into 19.125 shares of the company's common stock. Suppose that between October 2015 and March 2022, the stock price ranges from a low of $28 to a high of $67. Therefore, within that time frame, 19.125 common shares would have a market value ranging from $535 to $1281; and the bondholder could exchange the $1000 bond in return for stock to be kept or sold at a possible profit (or loss).

SECURED BONDS Bonds issued by borrowers who pledge assets as collateral in the event of non-payment.

THE GREENING OF BUSINESS

What Are the Prospects for "Green Bonds"?

Green bonds are like regular bonds except that the funds generated are directed towards projects that are environmentally friendly. Green bonds have been issued by both private-sector corporations and by provincial governments. Here are some examples from 2017:

- Export Development Canada (EDC) issued a green bond that raised $500 million. The money will be spent on companies that want to help the environment.
- TD Bank issued a green bond in the United States for $1 billion. The proceeds will be used to increase building efficiency, transportation efficiency, and wind energy.
- The province of Ontario issued its third green bond ($800 million); the proceeds will be used to fund 12 projects in the areas of clean transportation, energy efficiency, and conservation.

The market for green bonds has been growing rapidly during the past few years. Globally, green bonds generated US$119 billion in 2017, and the prediction for 2018 is US$160 billion. In 2018, Ontario received $1 billion from its latest green bond offering. All of this looks promising, but there are several hurdles that must be cleared before green bonds become a mainstream financial product. First, investors may assume that a choice must be made between "doing something good" and "doing something that makes financial sense." At a Global Capital conference in Toronto in April 2017, it was noted that this kind of thinking has hurt the development of green bonds. What is necessary is to show the value proposition of green bonds, namely that doing good does make financial sense.

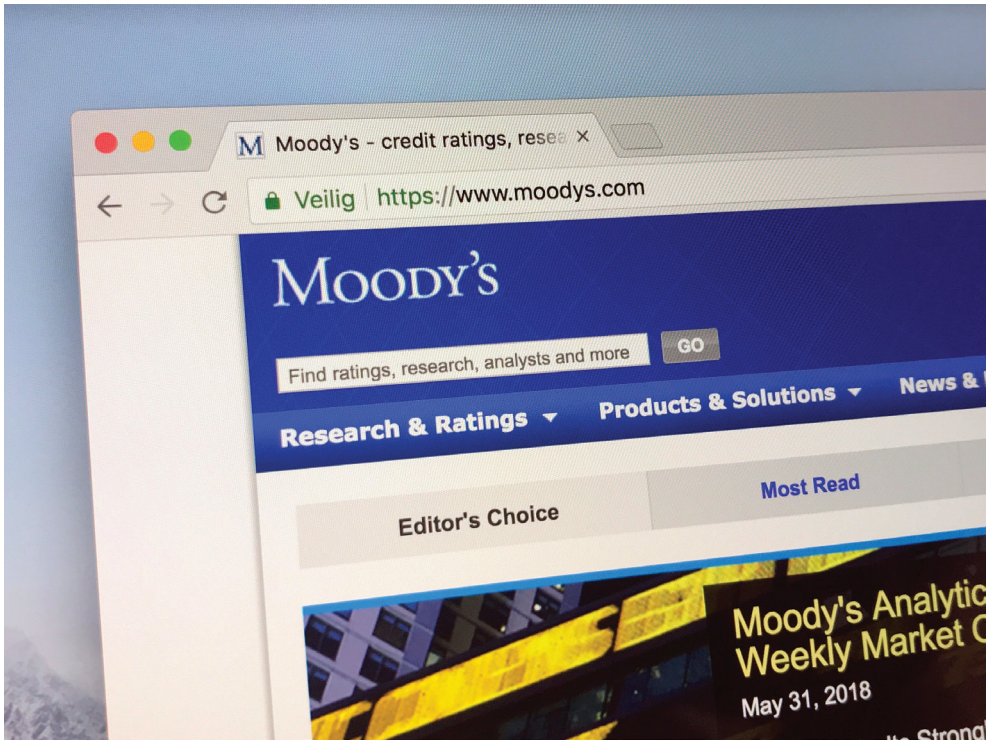
Second, exactly what qualifies as a "green" bond may not be clear. Some bonds are explicitly called green bonds, but others are unlabelled (e.g., bonds issued by hydroelectric utilities). Agreement must be reached on what qualifies as a green bond. Such an agreement should also include follow-up measures to ensure that the money raised by the bonds is spent on legitimate green projects. If follow-up is not done, "greenwashing" (claiming that a project is green when it really isn't) may be a problem.

Third, it can be time-consuming to get the approvals required for green bond issuers. Consultation with various groups is necessary, and third-party accreditation happens in Ontario only after an Ontario government advisory panel determines whether a project is green or not.

Fourth, interest in the green bond market lags in the United States, and since the U.S. economy is so important globally, that has inhibited the development of green bonds. The United States does not have a long history of focusing on carbon reduction like Europe does, and there is currently intense partisan debate about climate issues in the United States. This also depresses interest in green bonds.

CRITICAL THINKING QUESTION

1. Consider the following statement: "*Green bonds motivate corporations to overstate the environmental-friendliness of the projects they are selling green bonds to support. Potential investors are therefore misled into thinking these companies are actually doing something that is good for the environment when they aren't.*" Do you agree or disagree with the statement? Explain your reasoning.



Jarretera/Shutterstock

If bond rating agencies like Moody's downgrade a company's ratings to low enough levels, its bonds become junk bonds. When that happens, investors demand higher interest rates to reflect the increased risk of investing in the company.

TABLE 15.1 Bond Ratings

	High Grade	Medium Grade (Investment Grade)	Speculative	Poor Grade
Moody's	Aaa Aa	A Baa	Ba B	Caa C
Standard & Poor's	AAA AA	A BBB	BB B	CCC D

Bonds differ from one another in terms of their level of risk. To help bond investors make assessments, several services rate the quality of bonds from different issuers. Table 15.1 shows ratings by Moody's and Standard & Poor's (S&P). The rating measures the bond's default risk—the chance that one or more promised payments will be deferred or missed altogether. For example, Moody's downgraded Enbridge Inc.'s bond rating in 2017 (just above junk level) right after the company took over Spectra Energy for $37 billion. The agency said that, although Enbridge potential revenues were clear, the execution risks were also substantial.[8]

LO-5 Equity Financing

Sometimes, looking inside the company for long-term funding is preferable to looking outside. In most cases, **equity financing** takes the form of *issuing stock* or *retaining the firm's earnings*. Both options involve putting the owners' capital to work.

Issuing Common Stock

By selling shares of common stock, the company obtains the funds it needs to buy land, buildings, and equipment. Individuals and companies buy a firm's stock, hoping that it will increase in value (a capital gain) and/or will provide dividend income. Let's look at an example. Suppose that Greenway Gardening's founders invested $10 000 in buying the original 500 shares of common stock (at $20 per share) in 2008. Say that the company used these funds to buy equipment and succeeded financially and that by 2017 it needed further funds for expansion. A pattern of profitable operations and regularly paid dividends would enable Greenway to raise $50 000 by selling 500 new shares of stock for $100 per share. This additional paid-in capital would increase the total shareholders' equity to $60 000, as shown in Table 15.2.

EQUITY FINANCING Raising money to meet long-term expenditures by issuing common stock or by retaining earnings.

TABLE 15.2 Stockholders' Equity for Greenway Gardening

Common Stockholders' Equity, 2008	
Initial common stock (500 shares issued @ $20 per share, 2008)	$10 000
Total stockholders' equity	$10 000
Common Stockholders' Equity, 2017	
Initial common stock (500 shares issued @ $20 per share, 2008)	$10 000
Additional paid-in capital (500 shares issued @ $100 per share, 2017)	$50 000
Total stockholders' equity	$60 000

Common stock values are expressed in three ways. The face value of a share of stock—its **par value**—is set by the issuing company's board of directors. The **book value** of common stock represents stockholders' equity (the sum of a company's common stock par value, retained earnings, and additional paid-in capital) divided by the number of shares. A stock's real value is its **market value**—the current price of a share in the stock market. For successful companies, the market value is usually greater than its book value. Thus, when market price falls to near book value, some investors buy the stock on the principle that it is underpriced and will increase in value in the future. The price of a share of stock can be influenced by both objective factors (company profits) and by subjective factors such as *rumours* (e.g., claims that a company has made a big gold strike), *investor relations* (publicizing the positive aspects of a company's financial condition to financial analysts and financial institutions), and *stockbroker recommendations* (a recommendation to buy a stock may increase demand and cause its price to increase, while a recommendation to sell may decrease demand and cause the price to fall).

The **market capitalization** of a company's stock is computed by multiplying the number of a company's outstanding shares times the market value of each share. Because stock prices change every day, so do market capitalizations. In Canada, banks and resource companies dominate the top 10 list of companies with the largest market capitalizations. The top five included Royal Bank of Canada at $122.1 billion, Toronto-Dominion Bank at $110.9 billion, Bank of Nova Scotia at $79.69 billion, Enbridge Inc. at $68.87 billion, and Canadian National Railway Company at $62.87 billion.[9] Although these figures are all very impressive, two American companies, Apple and Amazon were flirting with US$1 trillion valuations. Apple stood at US$934 billion and Amazon stood at US$780 billion. Analysis projected that both would cross that threshold soon based on growth projections.[10]

The use of equity financing via common stock can be expensive because paying dividends is more expensive than paying bond interest. This is because interest paid to bondholders is tax deductible, but dividends paid to stockholders are not. Even though equity financing is expensive, financial managers cannot rely totally on debt capital because long-term loans and bonds carry fixed interest rates and represent a promise to pay regardless of the profitability of the firm. If the firm defaults on its obligations, it may lose its assets and even go into bankruptcy.

A firm's market capitalization (or market cap) is the number of outstanding shares of stock multiplied by the current price of that stock. Enbridge Inc. is one of Canada's most valuable businesses; that is, it has one of the largest market caps, which stood at $68.87 billion in early 2018. Not surprisingly energy companies and banks continue to make up the majority of the top spots.

Casimiro PT/Shutterstock

Retaining The Firm's Earnings

Another approach to equity financing is to use retained earnings. These earnings represent profits not paid out in dividends. Using retained earnings means that the firm will not have to borrow money and pay interest on loans or bonds. A firm that has a history of reaping much higher profits by successfully reinvesting retained earnings may be attractive to some investors. But the smaller dividends that can be paid to shareholders because of retained earnings may decrease demand for—and thus the price of—the company's stock.

Let's revisit our Greenway Gardening example. If the company had net earnings of $50 000 in 2017, it could pay a $50-per-share dividend on its 1000 shares of common stock. But if it plans to remodel at a cost of $30 000 and retains $30 000 of earnings to finance the project, only $20 000 is left to distribute for stock dividends ($20 per share).

Hybrid Financing: Preferred Stock

Preferred stock is a hybrid because it has some of the features of corporate bonds and some features of common stock. As with bonds, payments on preferred stock are for fixed amounts. Unlike bonds, however, preferred stock never matures. It can be held indefinitely, like common stock. And dividends need not be paid if the company makes no profit. If dividends are paid, preferred stockholders receive them first in preference to dividends on common stock. A major advantage of preferred stock to the issuing corporation is its flexibility. It secures funds for the firm without relinquishing control, since preferred stockholders have no voting rights. It does not require repayment of principal or the payment of dividends in lean times.

Preferred stock is usually issued with a stated par value, such as $100. Dividends paid on preferred stock are usually expressed as a percentage of the par value. For example, if a preferred stock with a $100 par value pays a 6 percent dividend, stockholders would receive an annual dividend of $6 on each share. For example, in 2017, satellite-radio company Sirius XM bought US$480 million worth of preferred stock in the music-streaming company Pandora Inc.[11]

Some preferred stock is *callable*, meaning that the issuing firm can require the preferred stockholders to surrender their shares in exchange for a cash payment. The amount of this cash payment, known as the call price, is specified in the agreement between the preferred stockholders and the firm.

PAR VALUE The arbitrary value of a stock set by the issuing company's board of directors and stated on stock certificates; used by accountants but of little significance to investors.

BOOK VALUE The value of a common stock expressed as total stockholders' equity divided by the number of shares of stock.

MARKET VALUE The current price of one share of a stock in the secondary securities market; the real value of a stock.

MARKET CAPITALIZATION The dollar value (market value) of stocks listed on a stock exchange.

Choosing between Debt and Equity Financing

Financial planning involves striking a balance between debt and equity financing to meet the firm's long-term need for funds. The mix of debt and equity a firm uses is called its **capital structure**. Financial plans contain targets for the capital structure, but choosing a target is not easy. A wide range of debt-versus-equity mixes is possible.

The most conservative strategy is to use all-equity financing and no debt, because a company has no formal obligations for financial payouts. But as we have noted, equity is a very expensive source of capital. The riskiest strategy would be to use all debt financing. While less expensive than equity funding, indebtedness increases the risk that a firm will be unable to meet its obligations and will go bankrupt. Financial managers try to find a mix somewhere between these two extremes that will maximize stockholders' wealth. Figure 15.1 summarizes the factors management considers when deciding between debt and equity financing.

The Risk–Return Relationship

Every investor has a personal preference for safety versus risk. Investors generally expect only modest returns for secure investments such as government-insured bonds but expect higher returns for riskier investments. Each type of investment, then, has a **risk–return relationship**. Figure 15.2 shows the general risk–return relationship for various financial instruments. High-grade corporate bonds, for example, rate low in terms of risk, but they also provide low returns. Junk bonds, on the other hand, rate high in terms of risk (because the company might default), but they also provide high returns to attract investors.

CAPITAL STRUCTURE Relative mix of a firm's debt and equity financing.

RISK–RETURN RELATIONSHIP Shows the amount of risk and the likely rate of return on various financial instruments.

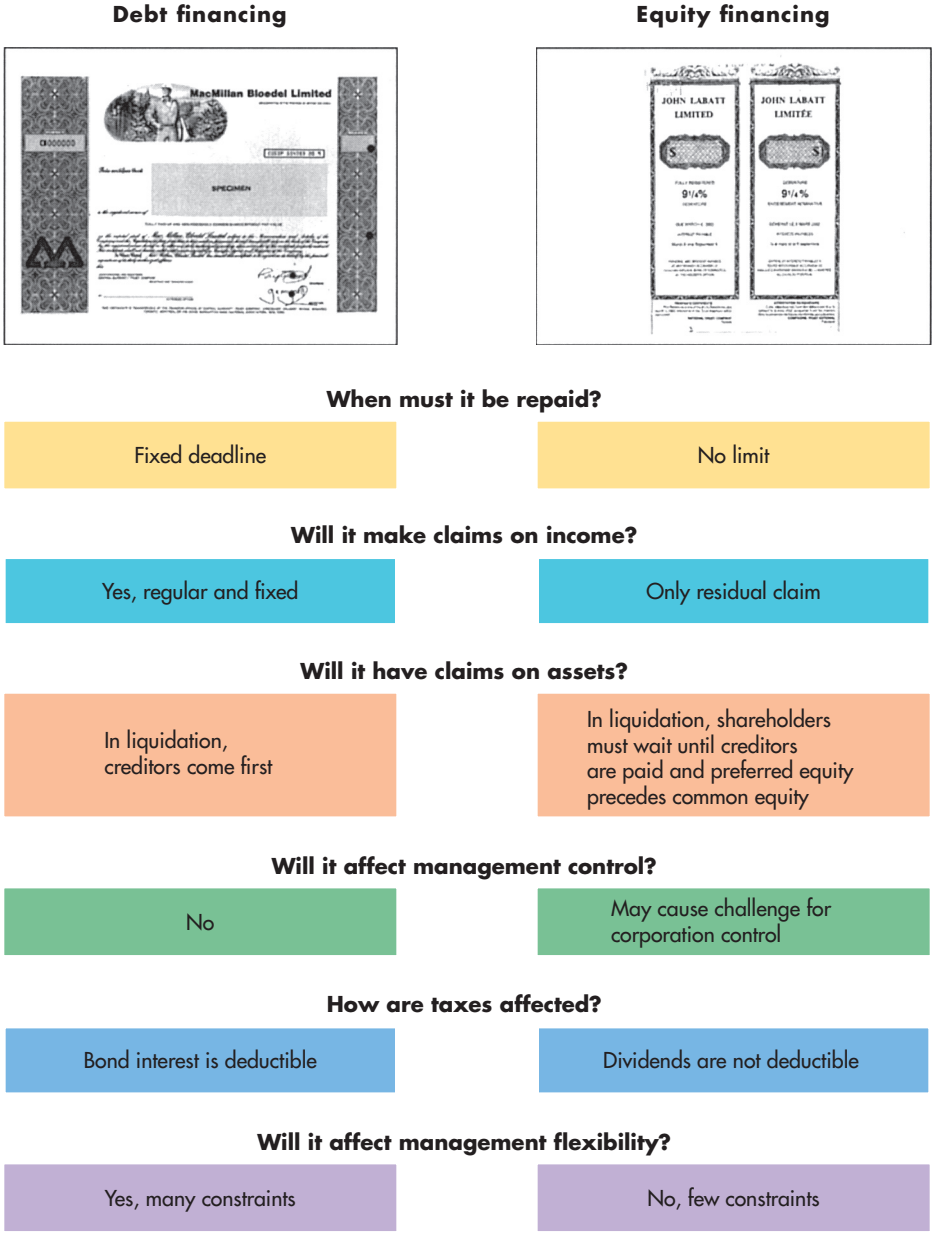


FIGURE 15.1 Comparing debt and equity financing

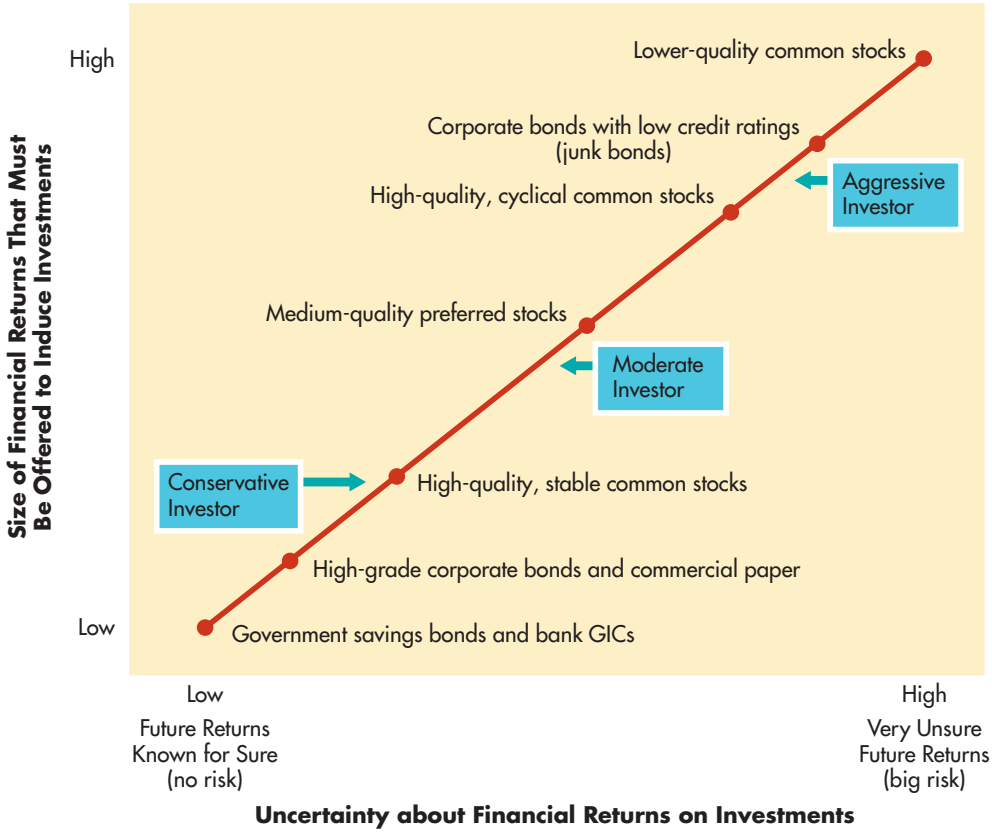


FIGURE 15.2 The risk–return relationship

Risk–return differences are recognized by financial planners, who try to gain access to the greatest funding at the lowest possible cost. By gauging investors' perceptions of their riskiness, a firm's managers can estimate how much it must pay to attract funds to its offerings. Over time, a company can reposition itself on the risk continuum by improving its record on dividends, interest payments, and debt repayment.

Managing Risk With Diversification And Asset Allocation

Investors seldom take an extreme approach (total risk or total risk avoidance) when selecting their investments. Instead, most investors select a mix of investments, with some being riskier and some being more conservative. *Diversification* means buying several kinds of investments rather than just one kind. For example, as applied to common stocks, diversification means that you invest in the stocks of several different companies in different industries and in different countries. This reduces the risk of loss because, although any one stock may tumble, the chances are slim that all of them will decline at the same time. Diversification is furthered when a variety of investments is used (stocks, bonds, mutual funds, real estate, etc.).

Asset allocation is the proportion of funds invested in each of the investment alternatives. Young investors may decide to allocate, say, 70 percent of their funds to common stocks, 20 percent to bonds, and 10 percent to money market funds. But older investors would typically have a larger proportion in more conservative investments (such as bonds and money market funds) and a smaller proportion in stocks.

Return on Investment

In evaluating investments, investors look at returns from dividends (or interest), returns from price appreciation, and total return.

Dividends The rate of return from dividends paid to shareholders is commonly referred to as the *current dividend yield* (or in the case of interest from a loan, the *current interest yield*). It is calculated by dividing the yearly dollar amount of dividend income by the investment's current market value. For example, if each share of stock in Western Star Mining receives an annual dividend of $1.80 and on a given day the share price is $35.67, the current yield will be 5.05 percent ($1.80/$35.67 × 100). This dividend can then be compared against current yields from other investments to see which one is better.

Price Appreciation Another source of returns depends on whether the investment is increasing or decreasing in dollar value. *Price appreciation* is an increase in the dollar value of an investment. Suppose, for example, that you purchased a share of Western Star Mining for $35.67 and then sold it one year later for $37.45. The price appreciation will be $1.78 ($37.45 – $35.67). This profit, realized from the increased market value of the stock, is known as a *capital gain*.

Total Return The sum of an investment's current dividend (or interest) yield plus any capital gain is its total return. Total return cannot be computed until it is compared to the investment that was required to get that return. Total return as a percentage of investment is calculated as follows:

$$\text{Total return (\%)} = (\text{Current dividend payment} + \text{Capital gain})/\text{Original investment} \times 100$$

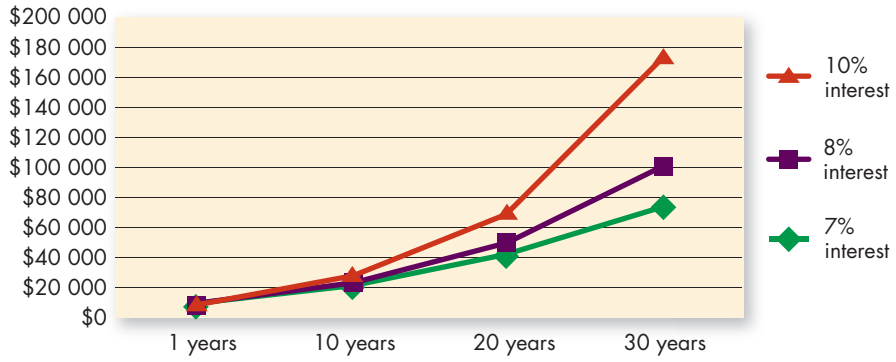


FIGURE 15.3 Amount to which an initial $10 000 investment grows

To complete our Western Star Mining example, the total return as a percentage of our one-year investment would be 10.04 percent [($1.80 + $1.78)/$35.67 × 100].

The Time Value of Money and Compound Growth

The most proven "road to wealth" lies in a strategy of saving and investing over a period of many years. Although the "I want it all right now" mentality might sound good, it rarely leads to wealth. The time value of money is one of the most important concepts in business finance. It recognizes the fact that when it's invested over time, money grows by earning interest. Time value stems from the principle of **compound growth**, which is the cumulative growth from interest paid to the investor over various time periods. With each additional time period, the investment grows as interest payments accumulate and earn more interest, thus multiplying the earning capacity of the investment.

The Rule of 72 How long does it take to double an investment? You can use the Rule of 72 to easily determine the number of years needed to double your money. Simply divide the annual interest rate (in percent) into 72. If, for example, you invest at 8 percent, you'll double your money in about 9 years (72/8 = 9 years). By the same reasoning, if you invest at 4 percent, your money will double in about 18 years. The Rule of 72 can also calculate how much interest you must get if you want to double your money in a given number of years. Simply divide 72 by the desired number years. For example, if you want to double your money in 10 years, you need to get 7.2 percent annual interest (72/10 = 7.2 percent interest rate).

Making Better Use of Your Time Value What if you invested $10 000 at 7 percent interest for one year? You would earn $700 on your $10 000 investment. If you reinvested the principal amount plus the interest you earned during the first year, and then continued to reinvest both the original principal and all interest annually for another four years, you'd end up with $14 025. Now, if you were planning for retirement and reinvested that money at the same interest rate for another 25 years, you could retire with $76 122—almost eight times the amount you started with!

Figure 15.3 illustrates how the returns from an initial investment of $10 000 accumulate substantially over longer periods of time. Notice that the gains for the last 10 years are much greater than for the first 10 years, illustrating the power of compound growth. This is because each year the interest is applied to a larger sum. The figure also illustrates that the accumulations grow even faster at higher interest rates. Even a seemingly small increase in rates, from 7 to 8 percent, results in much larger accumulations. Of course, you will not earn 7 to 8 percent keeping your money in a bank account today, although higher rates have been possible in the past; however, an average return of 6 to 8 percent is quite reasonable over a long period of time with a diversified portfolio. You can read more about this topic in Supplement 4 at the end of the book.

As you can see from Figure 15.3, the best way to take advantage of the time value of money is to obtain a high rate of return on your investment. However, various kinds of investments offer opportunities for fulfilling different financial objectives, such as aggressive growth, financial safety, and others, which we discuss later.

COMPOUND GROWTH Compounding of interest over time—with each additional time period, interest returns accumulate and earn more interest

SECURITIES MARKETS

Stocks and bonds are known as **securities** because they represent a secured (asset-based) claim on the part of investors. Collectively, the market in which stocks and bonds are sold is called the securities market. *Primary securities markets* handle the buying and selling of new shares (initial public offerings or IPOs) of stocks and bonds by firms or governments. When new securities are sold to one buyer or a small group of buyers, these *private placements* allow the businesses that use them to keep their plans confidential. But new securities represent only a small portion of securities traded. The market for existing stocks and bonds—the *secondary securities market*—is handled by organizations like the Toronto Stock Exchange. Companies do not receive any money when shares of stock are bought and sold in the secondary securities market.

Corporate financial managers (and individual investors) need to be knowledgeable about securities markets if they hope to be successful. In this section, we look at the following aspects of securities markets: *investment banking, stock exchanges, buying and selling securities*, and *financing securities purchases*. We also describe several other investments that investors may purchase.

Investment Banking

Most new stocks and some bonds are sold to the public market. To bring a new security to market, the issuing corporation must obtain approval from a provincial securities commission. It also needs the services of an investment banker. **Investment bankers** serve as financial specialists in

SECURITIES Stocks, bonds, and mutual funds representing secured, or asset-based, claims by investors against issuers.
INVESTMENT BANKERS Financial specialists in issuing new securities.

When firms go public, they sell part of their ownership to other investors through a public offering of stock. Monitors such as this one show current prices and overall stock price indicators such as the Nasdaq. Investors then use this information to decide when to buy or sell stock.

Cosmo Condina stock market/Alamy Stock Photo

issuing new securities. Well-known institutions such as RBC Dominion Securities and TD Securities provide the following services:

1. They advise companies on the timing and financial terms for a new issue.
2. By underwriting (buying) the new securities, they bear some of the risk of issuing a new security.
3. They create the distribution network that moves the new securities through groups of other banks and brokers into the hands of individual investors.

Stock Exchanges

A **stock exchange** is composed of individuals (stockbrokers) and organizations (investment banks) that provide a setting in which shares of stock can be bought and sold. The exchange enforces certain rules to govern its members' trading activities. Most exchanges are non-profit corporations established to serve their members. To become a member, an individual must purchase one of a limited number of "seats" on the exchange. Only members (or their representatives) can trade on the exchange. Memberships can be bought and sold like other assets.

A **stockbroker** receives buy and sell orders from those who are not members of the exchange and executes the orders. In return, the broker earns a commission from the person who placed the order. Like many products, brokerage assistance can be purchased either at *full-service* or at *discount* prices. *Full-service brokers* offer services to clients who either are not very well informed about investment possibilities or are simply not interested in the details of investing. These brokers offer services such as consulting advice for personal financial planning, estate planning, and tax strategies, along with a wider range of investment products. In addition to delivering and interpreting information, full-service brokers can identify investments that clients might not otherwise notice in the large amount of online financial data that is available.

By contrast, *discount brokers* offer well-informed individual investors a fast, low-cost way to participate in the market. Discount brokerage services cost less because sales personnel receive fees or salaries, not commissions. Discount brokers do not offer investment advice or person-to-person sales consultations. However, they do offer automated online services: stock research, industry analysis, and screening for specific types of stocks. Online trading is popular because of convenient access and fast, no-nonsense transactions and the opportunity for self-directed investors to manage their own investments while paying low fees. For example, buying 200 shares of a $20 stock might cost an investor up to $100 at a full-service broker, but as little as $6.99 at a discount broker. Price differences are evident even among the discount brokers. For example, you could buy 100 shares of a $50 stock and pay just $1 in brokers' commissions if you use Virtual Brokers, because they charge only $0.01 per share with a minimum charge of $0.99.[12]

Canadian Stock Exchanges

The TMX Group owns and operates the Toronto Stock Exchange (TSX) and the TSX Venture Exchange. The TSX is the largest stock exchange in Canada. It is made up of about 110 individual members who hold seats. The securities of most major corporations are listed there. A company must pay a fee before it can list its security on the exchange.

Foreign Stock Exchanges

Many foreign countries also have active stock exchanges, and several foreign stock exchanges—most notably those in the United States and the United Kingdom—trade far more shares every day than the TSX does. For some people, "the stock market" means the New York Stock Exchange (NYSE). However, today the annual dollar value of trades on exchanges in London, Tokyo, and other cities is now in the trillions. In fact, the London Stock Exchange exceeds even the NYSE in the number of stocks listed.

The Over-The-Counter Market

The **over-the-counter (OTC) market** is so called because its original traders were somewhat like retailers—they kept supplies of shares on hand and, as opportunities arose, sold them over the counter to interested buyers. Even today, the OTC market has no trading floor. It consists of many people in different locations who hold an inventory of securities that are not listed on any of the major exchanges. The OTC market consists of independent dealers who own the securities that they buy and sell at their own risk.

NASDAQ

The *National Association of Securities Dealers Automated Quotation (NASDAQ)* operates by broadcasting trading information on an intranet to more than 350000 terminals worldwide. NASDAQ orders are paired and executed on a network. The stocks of nearly 3600 companies are traded by NASDAQ. Many newer firms are listed there when their stocks first become available in the secondary market. Highly traded listings include Apple, Microsoft, Intel, Baidu, and Netflix.[13]

STOCK EXCHANGE A voluntary organization of individuals formed to provide an institutional setting where members can buy and sell stock for themselves and their clients in accordance with the exchange's rules.

STOCKBROKER An individual licensed to buy and sell securities for customers in the secondary market; may also provide other financial services.

OVER-THE-COUNTER (OTC) MARKET Organization of securities dealers formed to trade stock outside the formal institutional setting of the organized stock exchanges.

Company	Volume	High	Low	Close	Change
Bombardier	**5875**	**3.82**	**3.66**	**3.67**	**–0.11**
Royal Bank	664	50.89	49.84	49.99	–1.56
Magna Intl.	892	41.30	39.14	39.50	–2.25
IAMGold	4615	12.26	11.36	12.15	+1.08
Kinross	3232	8.41	8.94	8.88	+0.59

- *Stock*
  Bombardier (Name of Company).
- *Volume*
  5875 (total number of shares traded on this date [in 100s]).
- *High and Low*
  During the trading day, the highest price was $3.82 and the lowest price was $3.66.
- *Close*
  At the close of trading on this date, the last price paid per share was $3.67.
- *Net Change*
  Difference between today's closing price and the previous day's closing price. Price decreased by $0.11 per share.

FIGURE 15.4 How to read a daily stock quotation

LO-6 Buying and Selling Securities

When buying and selling stocks, bonds, and other financial instruments, financial managers and individuals need to gather information about possible investments and match them to their investment objectives.

Using Financial Information Services

Have you ever seen the financial section of a newspaper and found yourself wondering what all those tables and numbers mean? Fortunately, this skill is easily mastered.

Stock Quotations Figure 15.4 shows the type of information newspapers provide about daily market transactions of individual stocks. The corporation's name is shown along with the number of shares sold, the high and low prices of the stock for that trading day, the closing price of the stock, and the change from the closing price on the previous day.

Bond Quotations Bond prices also change daily. These changes form the coupon rate, which provides information for firms about the cost of borrowing funds. Prices of domestic corporation bonds, Canadian government bonds, and foreign bonds are reported separately. Bond prices are expressed in terms of 100, even though most have a face value of $1000. Thus a quote of 85 means that the bond's price is 85 percent of its face value, or $850.

A corporate bond selling at 155¼ would cost a buyer $1552.50 ($1000 face value multiplied by 1.5525), plus commission. The interest (coupon) rate on bonds is also quoted as a percentage of par, or face, value. Thus "6½s" pay 6.5 percent of par value per year. Typically, interest is paid semi-annually at half of the stated interest or coupon rate.

The market value (selling price) of a bond at any given time depends on three things: its stated interest rate, the "going rate" of interest in the market, and its redemption or maturity date. A bond with a higher stated interest rate than the going rate on similar quality bonds will probably sell at a premium above its face value—its selling price will be above its redemption price. A bond with a lower stated interest rate than the going rate on similar quality bonds will probably sell at a discount—its selling price will be below its redemption price. How much the premium or discount is depends largely on how far in the future the maturity date is. The maturity date is shown after the interest rate. Figure 15.5 shows the type of information daily newspapers provide.

Suppose you bought a $1000 par-value bond in 2010 for $650. Its stated interest rate is 6 percent, and its maturity or redemption date is 2030. You therefore receive $60 per year in interest. Based on your actual investment of $650, your *bond yield* is 9.2 percent. If you hold it to maturity, you get $1000 for a bond that originally cost you only $650. This extra $350 increases your true, or effective, yield.

Market Indexes Although they do not indicate how specific securities are doing, **market indexes** provide a useful summary of trends in specific industries and the overall stock market. Such information can be crucial in choosing investments. For example, market indexes reveal bull and bear market trends. **Bull markets** are periods of upward-moving stock prices. Periods of falling stock prices are called **bear markets**.

The most widely cited market index is the *Dow Jones Industrial Average (DJIA)*, which is the sum of market prices for 30 of the largest industrial firms listed on the NYSE. By tradition, the Dow is an indicator of blue-chip (top-quality) stock price movements. Because of the small number of firms, however, it is a limited gauge of the overall stock market.

The *S&P/TSX index* is an average computed from 246 large Canadian stocks from various industry groups. The index has also been very volatile during the past few years. It moved sharply upwards during the bull market of the 1990s and topped 11 000 in the summer of 2000. It dropped below 8000 by 2009 but increased to over 16 000 by mid-2018.[14]

The *S&P 500* (Standard & Poor's Composite Index) consists of 500 stocks, including 400 industrial firms, 40 utilities, 40 financial institutions, and 20 transportation companies. The index average is weighted according to market capitalization of each stock, so the more highly valued companies exercise a greater influence on the index.

MARKET INDEX A measure of the market value of stocks; provides a summary of price trends in a specific industry or of the stock market as a whole.

BULL MARKET A period of rising stock prices; a period in which investors act on a belief that stock prices will rise.

BEAR MARKET A period of falling stock prices; a period in which investors act on a belief that stock prices will fall.

Issuer	Coupon	Maturity	Price	Yield
GOVERNMENT OF CANADA				
Canada	4.20	June 1, 18	117.45	3.57
Canada	3.5	June 1, 20	115.40	3.03
PROVINCIALS				
Hy Que	6.50	Feb. 15, 35	147.09	4.42
BC	4.7	June 18, 37	124.83	3.76
CORPORATE				
Telus	**4.95**	**Mar. 3, 20**	**101.92**	**4.86**
Bank of Mon.	5.10	Apr. 21, 21	109.38	4.66

- *Issuer*
  Company name is Telus.
- *Coupon*
  The annual rate of interest at face value is 4.95 percent.
- *Maturity*
  The maturity date is March 3, 2020.
- *Price*
  On this date, $101.92 was the price of the last transaction.
- *Yield*
  The yield is computed by dividing the annual interest paid by the current market price. (*Note:* Yield to maturity [YTM] would also take into account duration and capital repayment.)

FIGURE 15.5 How to read a bond quotation

Some stock market observers regard the *NASDAQ Composite Index* as the most important of all market indexes. Unlike the Dow and the S&P 500, all NASDAQ-listed companies are included in the index. The NASDAQ market has been very volatile. In early 2000, it reached 5000, but one year later, it had dropped to just 1300. In mid-2018, it had risen to just over 7500.[15]

Buying and Selling Stocks

Based on your own investigations and/or recommendations from your stockbroker, you can place many types of orders. A *market order* requests the broker to buy or sell a certain security at the prevailing market price at the time. A *limit order* authorizes the purchase of a stock only if its price is less than or equal to a given limit. For example, a limit order to buy a stock at $80 per share means that the broker is to buy it if and only if the stock becomes available for a price of $80 or less. Similarly, a *stop order* instructs the broker to sell a stock if its price falls to a certain level. For example, a stop order of $85 on a particular stock means that the broker is to sell it if and only if its price falls to $85 or below.

You can also place orders of different sizes. A *round lot* order requests 100 shares or some multiple thereof. Fractions of a round lot are called *odd lots*. Trading odd lots is usually more expensive than trading round lots, because an intermediary called an odd-lot broker is often involved, which increases brokerage fees.

Stock Options

A **stock option** is the right to buy or sell a stock. A *call option* gives its owner the right to buy a particular stock at a certain price, with that right lasting until a particular date. A *put option* gives its owner the right to sell a particular stock at a specified price, with that right lasting until a particular date. These options are traded on several stock exchanges.

Here's how stock options work: Say that you think the price of Goldcorp Inc. (G) (which sold for $18 per share in July 2018) will go up, and you buy a call option giving you the right to buy 1000 shares any time in the next two months at a so-called strike price of $23. If the stock rises to $23 before July, you will exercise your call option. Your profit will be $5 per share ($23 – $18); therefore, $5 * 1000 shares = $5000 (minus the price you paid to buy the option). However, if the stock price falls instead of rising, you will not exercise your call option, because Goldcorp shares will be available on the open market for less than $23 per share. Your stock option will be "under water"; that is, it will be worthless. You will lose whatever you paid for the option. In recent years, there has been much negative publicity about stock options given to executives to motivate them to work hard for the company.

Financing Securities Purchases

When you place a buy order of any kind, you must tell your broker how you will pay for the purchase. You might maintain a cash account with your broker. Then, as stocks are bought and sold, proceeds are added into the account and commissions and costs of purchases are withdrawn by the broker. You can also buy shares on credit.

Margin Trading

Shares of stock can be purchased on **margin**—putting down only a portion of the stock's price. You borrow the rest from your broker, who, in turn, borrows from the banks at a special rate and secures the loans with stock. Suppose you purchase $100 000 worth of stock in WestJet. Let's also say that you paid $50 000 of your own money and borrowed the other $50 000 from your broker at 10 percent interest. Valued at its market price, your stock serves as your collateral. If shares have risen in value to $115 000 after one year, you can sell them and pay your broker $55 000 ($50 000 principal + $5000 interest). You will have $60 000 left over. Your original investment of $50 000 will have earned a 20 percent profit of $10 000. If you had paid the entire price out of your own pocket, you would have earned only a 15 percent return.

Although investors often recognize possible profits to be made in margin trading, they sometimes fail to consider that losses can be amplified. If

STOCK OPTION The purchased right to buy or sell a stock.
MARGIN The percentage of the total sales price that a buyer must put up to place an order for stock or a futures contract.

the value of your initial WestJet investment of $100 000 had instead fallen to $85000 after one year, you would have lost 15 percent if you had paid out of pocket. However, if you had used margin trading, you would have lost $20 000 ($5000 interest payment + $15 000 share decrease) on a $50 000 investment, which amounts to a 40 percent loss.

As you can see, this tool has a nice upside, but it is also riskier. This is a lesson learned by many *day traders* who visit websites online to buy and sell a stock in the same day (so-called *intraday trades*), seeking quick in-and-out fractional gains on large volumes (many shares) of each stock.

Short Sales

In addition to money, brokerages also lend buyers securities. A **short sale** involves borrowing a security from your broker and selling it (one of the few times it is legal to sell what you do not own). At a given time in the future, you must restore an equal number of shares of that issue to the brokerage, along with a fee.

For example, suppose that in June you believe the price of Bombardier stock will soon fall. You order your broker to sell short 1000 shares at the market price of $5 per share. Your broker will make the sale and credit $5000 to your account. If Bombardier's price falls to $3.50 per share in July, you can buy 1000 shares for $3500 and give them to your broker, leaving you with a $1500 profit (before commissions). The risk is that Bombardier's price will not fall but will hold steady or rise, leaving you with a loss. The boxed insert entitled "Short Sellers Are Everywhere" describes recent cases of short selling that caused a lot of controversy.

Pictoores/Fotolia

When the stock market is volatile, there are often spreads between bid prices (what traders pay for a share of stock) and ask prices (what they charge for it). The difference isn't necessarily large, but if you can make a number of quick hits during the day, you can make money. That strategy appeals to traders at large firms, but also to individual traders working on their own.

SHORT SALE Selling borrowed shares of stock in the expectation that their price will fall before they must be replaced so that replacement shares can be bought for less than the original shares were sold for.

DISRUPTIONS IN BUSINESS

Short Sellers Are Everywhere

In October 2017, Citron Research announced it was short selling Shopify, the successful online company. Citron claimed that Shopify was promoting a "get-rich-quick" scheme. After Citron's announcement, Shopify's stock price dropped 11.5 percent. Shopify is just one of many companies that have recently been the target of short sellers. Here are a few others:

- In July 2017, short seller Marc Cohodes announced that he was short selling the shares of Winnipeg-based Exchange Income Corp. He argued that the company's payout policy was unsustainable. After the announcement, the company's share price fell 10 percent.
- Two months earlier, Cohodes also announced that he was short selling the shares of Badger Daylighting Inc., a Calgary-based oilfield services company. He said he did this because he felt the company had made some bad purchasing decisions that would harm its profits. After the announcement, Badger's stock price declined 25 percent.
- Within a couple of months, a firm called Muddy Waters announced that it was short selling the shares of Asanko Gold Inc., which was developing a mine in Ghana. Muddy Waters argued that Asanko's mine would not likely yield any profit for the company. After the announcement, Asanko's share price dropped 18 percent.
- Finally, Kerrisdale Capital Management announced that it was short selling the shares of Vancouver-based North Dynasty Minerals Ltd. during that same period. Kerrisdale said it was confident that North Dynasty would never get environmental approval to start production at its mine in Alaska.

When short sellers attack, the top managers of the companies that are targeted usually respond immediately and say that the short seller's claims are nonsense and that the company is financially sound. Sometimes this response works and sometimes it doesn't. For example, Badger Daylighting's share price was $30 on May 25, 2017. After the short seller's attack, it dropped to $23/share, and by March 2018, it had dropped a bit further to $23/share. Exchange Income Corp.'s share price was $31 just before the short seller's attack in July 2017. It then dropped to $27/share, but by March 2018, it had risen to $32/share.

Sometimes it takes years to determine how successful a short seller's attack has been. The most famous recent case is that of Herbalife International, which sells energy drinks, vitamins, and body care products. In April 2012, William Ackerman, the head of Pershing Square Capital Management, announced that he was shorting Herbalife's shares, claiming that Herbalife was an illegal pyramid scheme. In April 2012, Herbalife's price was $72/share. Over the next few years, Herbalife's price fluctuated between $25/share and $80/share. In March 2018, the price was about $96/share. Ackman finally ended his crusade after having lost more than $1 billion in the process.

CRITICAL THINKING QUESTIONS

1. Consider the following statement: *Short sellers try to drive down the price of a company's stock just so they can make a profit. The claims of short sellers are unnecessarily disruptive for the businesses that are targeted. The practice of short selling should be banned because it creates instability in the price of a company's shares and this harms investors.* Do you agree or disagree with the statement? Explain your reasoning.

LO-7 OTHER INVESTMENTS

Although stocks and bonds are very important, they are not the only marketable securities for businesses. Financial managers are also concerned with investment opportunities in *mutual funds, exchange-traded funds, hedge funds,* and *commodities*.

Mutual Funds

Mutual funds pool investments from individuals and other firms to purchase a portfolio of stocks, bonds, and short-term securities. For example, if you invest $1000 in a mutual fund that has a portfolio worth $100 000, you own 1 percent of the portfolio. Mutual funds usually have portfolios worth many millions of dollars. Investors in *no-load funds* are not charged a sales commission when they buy into or sell out of the mutual fund. *Load funds* carry a charge of between 2 and 8 percent of the invested funds. Mutual funds give small investors access to professional financial management. Their managers have up-to-date information about market conditions and the best large-scale investment opportunities.

Mutual funds vary by the investment goals they stress. Some stress safety and invest in treasury bills and other safe issues that offer income (liquidity). Other funds seek higher current income and are willing to sacrifice some safety. Still other mutual funds stress growth. Aggressive-growth mutual funds seek maximum capital appreciation; they sacrifice current income and safety and invest in new companies and other high-risk securities.

There are mutual funds that stress socially responsible investing. They will not invest in cigarette manufacturers or companies that make weapons, for example, and instead focus on investing in companies that produce safe and useful products and show concern for their employees, for the environment, and for human rights. While many companies offer such investments, the company Ethical Funds is dedicated to this mission.

Ethical Funds, a division of NEI Investments, does not invest in companies involved primarily in the production of tobacco, weapons, or nuclear power.

NEI Investments

Mutual funds are actively managed by "experts" who pick the stocks the fund holds to benefit investors with above average returns. But research suggests that most mutual funds do not perform as well as the average return of the overall stock market. For example, a recent Standard & Poor's SPIVA Canada Scorecard showed that only one-third of mutual funds beat the S&P/TSX index over the past three years. In the United States, only 1 in 70 mutual funds beat the S&P 500 index over the past three years.[16] This poor performance is the result of high management fees and poor stock picking by the "experts." This has motivated many investors to drop mutual funds and buy into exchange-traded funds. However, mutual funds still accounted for 36 percent of the 4.5 trillion in financial wealth in Canada in 2018.[17]

Exchange-Traded Funds

An **exchange-traded fund (ETF)** is a bundle of stocks (or bonds) that is in an index that simply tracks the overall movement of the market. Unlike mutual funds—which are priced only at the end of each day—you can buy or sell ETFs at any time during the day when the market reaches your target price. Also, unlike mutual funds—which incur the costs of active management—ETFs have lower operating expenses because they are bound by rules that specify what stocks will be purchased and when. Once the rule is established, active management is not needed, and this reduces expenses. Annual fees for mutual funds average 1.4 percent of assets, but for ETFs the rate is as low as 0.04 percent.[18]

Hedge Funds

Hedge funds are private pools of money that try to give investors a positive return regardless of stock market performance. Hedge funds often engage in risky practices like short selling (essentially betting that a company's stock price will go down) and leveraging (borrowing money against principal). Historically, interest in hedge funds has been limited to wealthy people (called *accredited investors*) assumed to be very knowledgeable about financial matters and able to weigh the risks. But recently hedge funds have begun marketing their products to the average investor with something called *principal-protected notes*. They guarantee that investors will get their original investment back at a certain time, but they do not guarantee that any additional returns will be forthcoming.

MUTUAL FUND Any company that pools the resources of many investors and uses those funds to purchase various types of financial securities, depending on the fund's financial goals.

EXCHANGE-TRADED FUND (ETF) A bundle of stocks (or bonds) that is in an index that tracks the overall movement of the market.

HEDGE FUNDS Private pools of money that try to give investors a positive return regardless of stock market performance.

FUTURES CONTRACT Agreement to purchase specified amounts of a commodity (or stock) at a given price on a set future date.

Commodities

Futures contracts—agreements to purchase a specified amount of a commodity at a given price on a set date in the future—are available for commodities ranging from coffee beans and live hogs to propane and platinum, as well as for stocks. Because selling prices reflect traders' beliefs about the future, prices of such contracts are very volatile, and futures trading is very risky.

For example, on July 4, 2018, the price of gold was $1253 per ounce. If futures gold contracts for December 2018 were selling for $1203 per ounce, this price would reflect investors' judgment that gold prices would be slightly lower in December. Now, suppose that you purchased a 100-ounce gold futures contract in July for $120 300 ($1203 × 100). In September, if the December gold futures sold for $1328, you could sell your contract for $132 800. Your profit after the two months would be $12 500. Of course, if the futures contract had been selling for less than $1203, you would have lost money. Usually, buyers of futures contracts need not put up the full purchase amount; rather, they post a smaller amount—the margin—that may be as little as $3000 for contracts of $100 000.

THERE'S AN APP FOR THAT!

APP DETAILS	PLATFORMS
1. BNN GO App **Source:** Bell Media Inc. **Key Features:** Real-time Canadian stock quotes from the Toronto Stock Exchange + breaking news from Canada's Business News Network.	Apple, Android
2. CFA Institute App **Source:** CFA Institute **Key Features:** Provides summaries and blog posts on the latest developments in finance and investing.	Apple, Android,
3. Financial Terms App **Source:** Winjit **Key Features:** A guide for beginners to key definitions, and a quick reference for the most frequently used terms and ratios; easy navigation.	Apple, Android, BlackBerry

APP DISCOVERY EXERCISE

Because app availability changes, conduct your own search for the "Top Three" finance and insurance apps and identify the key features.

SECURITIES REGULATION

Unlike the United States, Canada does not have comprehensive federal securities legislation or a federal regulatory body. Government regulation is primarily provincial and emphasizes self-regulation through the various provincial securities exchanges. A report by a government-appointed committee that studied Canada's system of securities regulation noted that Canada is the only country in the industrialized world with a patchwork of provincial regulations, and it recommended a single regulator for Canada. The main concerns the committee noted were a lack of meaningful enforcement of securities laws, unnecessary costs, and delays that make Canada's capital markets uncompetitive internationally.

But some progress is being made. Saskatchewan, New Brunswick, Ontario, British Columbia, Nova Scotia, Prince Edward Island, and Yukon have signed an agreement-in-principle on the Co-operative Capital Markets Regulatory System.[19] There was also an announcement in mid-2018 that Newfoundland and Labrador would also sign.[20] However, Manitoba, Alberta, and Quebec have not signed on. Their big concern is that the new regulator will be too focused on Ontario.

In 1912, the Manitoba government pioneered Canadian laws applying mainly to the sale of new securities. Under these **blue-sky laws**, corporations issuing securities must back them up with something more than the "blue sky." Similar laws were passed in other provinces. Provincial laws also generally require that stockbrokers be licensed and that securities be registered before they can be sold. In each province, issuers of proposed new securities must file a *prospectus* with the provincial securities exchange. The prospectus must be made available to investors who might want to invest. The province of Ontario wants to relax some of the rules regarding the prospectus for individual investors with at least $1 million in financial assets; this should make it easier for small businesses to raise capital. But critics argue that some investors will get involved in ventures that are excessively risky.[21]

BLUE-SKY LAWS Laws regulating how corporations must back up securities.

FINANCIAL MANAGEMENT FOR SMALL BUSINESSES

Most new businesses have inadequate funding. Why are so many start-ups underfunded? Entrepreneurs often underestimate the value of establishing bank credit as a source of funds and use trade credit ineffectively. In addition, they often fail to consider venture capital as a source of funding, and they are notorious for not planning cash-flow needs properly. Many of them are also not aware of government programs available for support.

For example, programs such as the Canada Small Business Funding Program enable entrepreneurs to receive up to $350 000 worth of loans and up to $500 000 for the purchase of real property. The organization has provided approximately 63 000 loans for more than $9.5 billion of financing in the past decade.[22] Of course, companies that do not apply or are unaware of the program get $0, even if they are good potential candidates.

Establishing Bank Credit and Trade Credit

Some banks have liberal credit policies and offer financial analysis, cash-flow planning, and knowledgeable advice. Some provide loans to small businesses in tough times and work to keep them going. Obtaining credit, therefore, begins with finding a bank that can—and will—support a small firm's financial needs. Once a line of credit is obtained, the small business can seek more liberal credit policies from other businesses. Sometimes suppliers give customers longer credit periods—say, 45 or 60 days rather than 30 days. Liberal trade credit terms with their suppliers lets firms increase short-term funds and avoid additional borrowing from banks.

Start-up firms without proven financial success usually must present a business plan to demonstrate creditworthiness.[23] As we saw in Chapter 4, a business plan is a document that tells potential lenders why the money is needed, the amount needed, how the money will be used to improve the company, and when it will be paid back.

Venture Capital

Many newer businesses—especially those undergoing rapid growth—cannot get the funds they need through borrowing alone. They may, therefore, turn to venture capital—outside equity funding provided in return for part ownership of the firm (see Chapter 4).

Planning for Cash-Flow Requirements

All businesses should plan for their cash flows, but it is especially important for small businesses to do so. Success or failure may hinge on anticipating times when cash will be short and when excess cash is expected. Figure 15.6 shows possible cash inflows, cash outflows, and net cash position (inflows minus outflows), month by month, for Slippery Fish Bait Supply. In this highly seasonal business, bait stores buy heavily from Slippery during the spring and summer months. Revenues outpace expenses, leaving surplus funds that can be invested. During the fall and winter, expenses exceed revenues. Slippery must borrow funds to keep going until sales revenues pick up again in the spring. Comparing predicted cash inflows from sales with outflows for expenses shows the firm's monthly cash-flow position.

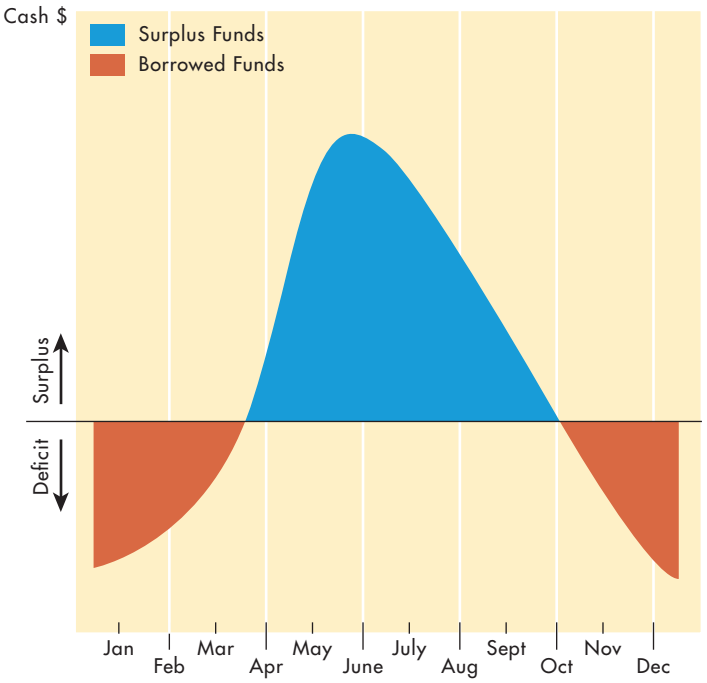


FIGURE 15.6 Cash flow for Slippery Fish Bait Supply Company

By anticipating shortfalls, a financial manager can seek advance funds and minimize their cost. By anticipating excess cash, a manager can plan to put the funds to work in short-term, interest-earning investments.

LO-8 RISK MANAGEMENT

Risk—uncertainty about future events—is a factor in every manager's job because nearly every managerial action raises the possibility for either positive or negative outcomes. Risk management is therefore essential.[24] Firms devote considerable resources not only to recognizing potential risks but also to positioning themselves to make the most advantageous decisions regarding risk.

According to a survey of 600 executives conducted by Toronto-based recruitment firm Watson Gardner Brown, the most difficult jobs to staff are in the risk management and compliance areas. Why? Firms are increasing the size of these divisions because of the scandals and the meltdown in some securities in recent years. Institutional investors are demanding more attention to risk oversight before they will trust their funds to such organizations. Finding enough highly qualified people to fill these spots, even with generous salaries, has been a challenge.[25]

Coping with Risk

Businesses constantly face two basic types of risk—**speculative risks**, such as financial investments, which involve the possibility of gain or loss, and **pure risks**, which involve only the possibility of loss or no loss. For example, designing and distributing a new product is a speculative risk. The product may fail or succeed. The chance of a warehouse fire is a pure risk.

For a company to survive and prosper, it must manage both types of risk in a cost-effective manner. We can thus define the process of **risk management** as "conserving the firm's earning power and assets by reducing the threat of losses due to uncontrollable events."[26] The risk-management process usually involves five steps.

RISK Uncertainty about future events.
SPECULATIVE RISK An event that offers the chance for either a gain or a loss.
PURE RISK An event that offers no possibility of gain; it offers only the chance of a loss or no loss.
RISK MANAGEMENT Conserving a firm's (or an individual's) financial power or assets by minimizing the financial effect of accidental losses.

Step 1: Identify Risks and Potential Losses

Managers analyze a firm's risks to identify potential losses. For example, a firm with a fleet of delivery trucks can expect that one of them will eventually be involved in an accident. The accident may cause bodily injury to the driver or others and may cause physical damage to the truck or other vehicles as well as damage to any goods being carried by the truck.

Step 2: Measure the Frequency and Severity of Losses and Their Impact

To measure the frequency and severity of losses, managers must consider both history and current activities. How often can the firm expect the loss to occur? What is the likely size of the loss in dollars? For example, our firm with the fleet of delivery trucks may have had two accidents per year in the past. If it adds more trucks to its fleet, it may reasonably expect the number of accidents to increase.

Step 3: Evaluate Alternatives and Choose Techniques that Will Best Handle Losses

Having identified and measured potential losses, managers are in a better position to decide how to handle them. They generally have four choices: *avoidance, control, retention*, or *transfer*.

Risk Avoidance A firm opts for **risk avoidance** by declining to enter or by ceasing to participate in a risky activity. For example, the firm with the delivery trucks could avoid any risk of physical damage or bodily injury by closing its delivery service. Similarly, a pharmaceutical maker may withdraw a new drug for fear of liability lawsuits.

Risk Control When avoidance is not practical or desirable, firms can practise **risk control**—say, the use of loss-prevention techniques to minimize the frequency of losses. A delivery service, for instance, can prevent losses by training its drivers in defensive-driving techniques, mapping out safe routes, and conscientiously maintaining its trucks.

Risk Retention When losses cannot be avoided or controlled, firms must cope with the consequences. When such losses are manageable and predictable, firms may decide to cover them out of company funds. The firm is thus said to "assume" or "retain" the financial consequences of the loss: hence the practice known as **risk retention**. For example, the firm with the fleet of trucks may find that each vehicle suffers vandalism totalling $300 per year. Depending on its coverage, the company may find it cheaper to pay for repairs out of pocket rather than to submit claims to its insurance company.

Risk Transfer When the potential for large risks cannot be avoided or controlled, managers often opt for **risk transfer**. They transfer the risk to another firm—namely, an insurance company. In transferring risk to an insurance company, a firm pays a premium. In return, the insurance company issues an insurance policy—a formal agreement to pay the policyholder a specified amount in the event of certain losses. In some cases, the insured party must also pay a deductible—an agreed-upon amount of the loss that the insured must absorb prior to reimbursement. Thus the truck company may buy insurance to protect itself against theft, physical damage to trucks, and bodily injury to drivers and others involved in an accident.

Step 4: Implement the Risk Management Program

The means of implementing risk management decisions depend on both the technique chosen and the activity being managed. For example, risk avoidance for certain activities can be implemented by purchasing those activities from outside providers, such as hiring delivery services instead of operating delivery vehicles. Risk control might be implemented by training employees and designing new work methods and equipment for on-the-job safety. For situations in which risk retention is preferred, reserve funds can be set aside out of revenues. When risk transfer is needed, implementation means selecting an insurance company and buying the right policies.

Step 5: Monitor Results

Because risk management is an ongoing activity, follow-up is always essential. New types of risks emerge with changes in customers, facilities, employees, and products. Insurance regulations change, and new types of insurance become available. Consequently, managers must continually monitor a company's risks, re-evaluate the methods used for handling them, and revise them as necessary.

RISK AVOIDANCE Stopping participation in or refusing to participate in ventures that carry any risk.
RISK CONTROL Techniques to prevent, minimize, or reduce losses or the consequences of losses.
RISK RETENTION The covering of a firm's unavoidable losses with its own funds.
RISK TRANSFER The transfer of risk to another individual or firm, often by contract.

SUMMARY OF

LEARNING OBJECTIVES

LO-1 DESCRIBE THE RESPONSIBILITIES OF A FINANCIAL MANAGER.

A financial manager's overall objective is to increase a firm's value and stockholders' wealth. They must ensure that earnings exceed costs so that the firm generates a profit. The responsibilities of the financial manager fall into two general categories: (1) *cash-flow management* and (2) *financial control*.

LO-2 DISTINGUISH BETWEEN *SHORT-TERM* (OPERATING) AND *LONG-TERM* (CAPITAL) EXPENDITURES.

Short-term (operating) expenditures are incurred in a firm's everyday business activities. To handle these expenditures, managers must pay attention to accounts payable, accounts receivable, and inventories. *Long-term* (capital) expenditures are required to purchase fixed assets.

LO-3 IDENTIFY THREE SOURCES OF *SHORT-TERM FINANCING* FOR BUSINESSES.

Trade credit is really a short-term loan from one firm to another. *Secured short-term loans*, such as bank loans, usually involve promissory notes in which the borrower promises to repay the loan plus interest. These loans require collateral, which can be seized if payments are not made as promised. *Unsecured short-term loans* are those in which a borrower does not have to put up collateral. The bank may, however, require the borrower to maintain a compensating balance—a portion of the loan amount kept on deposit with the bank.

LO-4 IDENTIFY THREE SOURCES OF *LONG-TERM FINANCING* FOR BUSINESSES.

The three sources of long-term financing for businesses are debt financing, equity financing, and hybrid financing. *Debt financing* involves long-term borrowing from outside the company; it is a major component of most firms' long-term financial planning. The most common forms of debt financing are long-term loans and the issuing of bonds. A *bond* is a contract—a promise by the issuing company or organization to pay the bondholder a certain amount of money (the principal) on a specified date, plus interest, in return for use of the investor's money. *Equity financing* takes the form of issuing stock or retaining the firm's earnings. Both options involve putting the owners' capital to work. By selling shares of common stock, the company obtains the funds it needs to buy land, buildings, and equipment. The use of preferred stock is a *hybrid* approach; it has features of both corporate bonds and common stocks.

LO-5 DISCUSS THE VALUE OF *COMMON STOCK* AND *PREFERRED STOCK* TO STOCKHOLDERS AND DESCRIBE THE SECONDARY MARKET FOR EACH TYPE OF SECURITY.

Common stock gives investors the prospect of capital gains and dividend income. Common stock values are expressed in three ways: *par value* (the value set by the issuing company's board of directors), *market value* (the current price of a share on the stock market), and *book value* (stockholders' equity divided by the number of shares). *Preferred stock* is less risky than common stock because dividends are paid before common shareholders receive any returns. Both common and preferred stock are traded on stock exchanges (and in over-the-counter [OTC] markets).

LO-6 EXPLAIN THE PROCESS BY WHICH SECURITIES ARE BOUGHT AND SOLD.

Investors generally use financial information services such as newspapers and online stock, bond, and OTC quotations. Market indexes such as the Toronto Stock Exchange index, the Dow Jones Industrial Average, Standard & Poor's Composite Index, and the NASDAQ Composite provide useful summaries of trends. Investors can then place different types of orders. Market orders are orders to buy or sell at current prevailing prices. Investors can issue limit or stop orders that are executed only if prices rise or fall below specified levels. Round lots are purchased in multiples of 100 shares. Odd lots are purchased in fractions of round lots. Securities can be bought on margin or as part of short sales.

LO-7 DESCRIBE THE INVESTMENT OPPORTUNITIES OFFERED BY *MUTUAL FUNDS, EXCHANGE-TRADED FUNDS, HEDGE FUNDS*, AND *COMMODITIES*.

Mutual funds offer investors different levels of risk and growth potential. Load funds require investors to pay commissions of 2 to 8 percent; no-load funds do not charge commissions when investors buy in or out. *Hedge funds* are private pools of money that try to give investors a positive return, regardless of stock market performance. Futures contracts (agreements to buy specified amounts of *commodities*, like coffee, at given prices on preset dates) are traded in the commodities market. Commodities traders often buy on margin, which means that only a percentage of the total sales price is put up to order futures contracts. A *stock option* gives the holder the right to buy or sell a stock at a certain price until a specific date.

LO-8 EXPLAIN HOW *RISK* AFFECTS BUSINESS OPERATIONS AND IDENTIFY THE FIVE STEPS IN THE *RISK MANAGEMENT PROCESS*.

Businesses face both *speculative risks* (where a gain or loss is possible), and *pure risks* (where only a loss or no loss is possible). Risk management means conserving earning power and assets by reducing the threat of losses due to uncontrollable events. The five-step *risk management process* requires managers to (1) identify risks and potential losses, (2) measure the frequency and severity of losses and their impact, (3) evaluate alternatives, (4) implement the risk management program, and (5) monitor results.

QUESTIONS AND EXERCISES

QUESTIONS FOR ANALYSIS

1. In what ways do the two sources of debt financing differ from each other? How do they differ from the two sources of equity financing?
2. Suppose that you are a business owner and you are seeking funds for expansion. From what sources could you gain the capital you need, and what are some of the characteristics of these sources? Are you limited by your form of doing business, and if so, how? How do these kinds of funding sources differ from funding sources for new equipment and short-term operating expenses?
3. What is the basic relationship between the amount of risk associated with a project and the likelihood of gains (or losses) on the project? Explain how several financial instruments (money market funds, common stocks, preferred stocks, corporate bonds) illustrate this basic relationship.
4. Which of the three measures of common stock value is most important? Why?
5. Suppose that you are a business owner and you need and immediate funds to meet short-term operating expenses. From what sources could you gain the capital you need, and what are some of the characteristics of those sources?
6. What are the risks and benefits associated with the sources of short-term funds (trade credit, secured loans, and unsecured loans)? How do these risks and benefits compare with those associated with sources of long-term funds (debt and equity)?

APPLICATION EXERCISES

7. Interview the financial manager of a local business. What are the investment goals of the organization? What mix of securities does it use? What advantages and disadvantages do you see in its portfolio?
8. Contact a stock broker for information about setting up a personal account for trading securities. Prepare a report on the broker's requirements for placing buy/sell orders, credit terms, cash account requirements, services available to investors, and commissions/fees schedules.
9. Go to Sedar.com and find the balance sheets of two corporations operating in the same industry (such as Telus and Rogers). Determine the relative emphasis each company has placed on raising money through debt versus equity. Why might these differences exist?
10. Do an online search to find a case involving insider trading. Who was accused of insider trading, and what was that person's relationship to the company? Was the person convicted of insider trading, and if so, what was the penalty? How could the person accused of insider trading have avoided these charges?

BUILDING A BUSINESS: CONTINUING EXERCISE

ASSIGNMENT

Meet with your team members to consider your new business venture and how it relates to the finance topics in this chapter. Develop specific responses to the following:

1. What role will debt financing play in your business's financial plan? What types of debt financing will you use? Why?
2. As your business grows, will you consider bringing in angel investors or venture capital? Why or why not? How would you structure such a transaction?
3. Would you consider selling stock to the general public? What advantages would a public sale of stock bring? Are there any downsides to this decision?
4. If you decide to sell stock through an initial public offering, what factors will be most important in the valuation of your stock?
5. How will the financing of your business change over time?

BUILDING YOUR BUSINESS SKILLS

MARKET UPS AND DOWNS

GOAL

To encourage students to understand the forces that affect fluctuations in stock prices.

SITUATION

Investing in stocks requires an understanding of the various factors that affect stock prices. These factors may be intrinsic to the company itself or part of the external environment.

- Internal factors relate to the company itself, such as an announcement of poor or favourable earnings, earnings that are more or less than expected, major layoffs, labour problems, management issues, and mergers.
- External factors relate to world or national events, such as a threatened war in the Persian Gulf, the BP oil spill in the Gulf of Mexico, weather conditions that affect sales, the Bank of Canada's adjustment of interest rates, and employment figures that were higher or lower than expected. By analyzing these factors, you will often learn a lot about why a stock did well or why it did poorly. Being aware of these influences will help you anticipate future stock movements.

METHOD

Step 1 Working alone, choose a common stock that has experienced considerable price fluctuations in the past few years. Here are several examples (but there are many others): IBM, Amazon.com, Shopify, and Apple Computer. Find the symbol for the stock and the exchange on which it is traded.

Step 2 Visit the Globe Investor website (or a similar site) and gather information on the particular stock and study its trading pattern. You can also visit your library and find the *Daily Stock Price Record*, a publication that provides a historical picture of daily stock closings. There are separate copies for the various stock exchanges.

Step 3 Find four or five days over a period of several months or even a year when there have been major price fluctuations in the stock. (A two- or three-point price change from one day to the next is considered major.) Then research what happened on that day that might have contributed to the fluctuation. The best place to begin is *The Globe and Mail* or *The Wall Street Journal*.

Step 4 Write a short analysis linking changes in stock price to internal and external factors. As you analyze the data, be aware that it is sometimes difficult to know why a stock price fluctuates.

Step 5 Get together with three other students who studied different stocks. As a group, discuss your findings, looking for fluctuation patterns.

FOLLOW-UP QUESTIONS

1. Do you see any similarities in the movement of the various stocks during the same period? For example, did the stocks move up or down at about the same time? If so, do you think the stocks were affected by the same factors? Explain your thinking.
2. Based on your analysis, did internal or external factors have the greater impact on stock price? Which factors had the longer-lasting effect? Which factors had the shorter effect?
3. Why do you think it is so hard to predict changes in stock price on a day-to-day basis?

EXERCISING YOUR ETHICS

DOING YOUR DUTY WHEN PAYABLES COME DUE

THE SITUATION

Sarah Keats is the vice-president of finance at Multiverse, a large firm that manufactures consumer products. On December 15 (two weeks before the end of the fiscal year), she attends an executive committee meeting at which Jack Malvo, the CEO, expresses concern that the firm's year-end cash position will be less favourable than projected. The firm has exceeded analysts' performance expectations in each of his eight years at the helm, and Malvo is determined that stockholders will never be disappointed as long as he is CEO. The purpose of the meeting is to find solutions to the cash problem and decide on a course of action.

THE DILEMMA

To open the meeting, Malvo announces, "We have just two weeks to reduce expenses or increase revenues. We need a $100 million swing

to get us where market analysts predicted we'd be on cash flows for the year. Any suggestions?"

In the discussion that ensues, it is noted that Multiverse owes $150 million to about 80 companies that supply component parts and other operating supplies to Multiverse. The money is due before year-end. Sarah Keats says, "Our cash outflows for the year will be lower if we delay paying suppliers, which will help the bottom line. And it's like getting a free loan." The procurement director, Julie Levin, expresses the following concern: "Our agreements with suppliers call for faithful payments at designated times, and many of the smaller firms depend on receiving that cash to meet their obligations. Also, we've worked hard for two years at improving relationships with all suppliers, and that effort could go down the drain if we don't meet our financial commitments as promised."

As the meeting ends, Malvo announces, "Keep me posted on any unexpected developments, but if nothing helpful comes up in the next few days, let's go ahead and withhold supplier payments for three weeks."

TEAM ACTIVITY

Assemble a group of four students and assign each group member to one of the following roles:

- Jack Malvo (CEO of Multiverse)
- Sarah Keats (vice-president of finance)
- Julie Levin (procurement director)
- A stockholder of Multiverse

ACTION STEPS

1. Before discussing the situation with your group and from the perspective of your assigned role, decide whether there are any ethical issues here.
2. Before discussing the situation with your group and from the perspective of your assigned role, decide what action you think should be taken. Write down your recommended action.
3. Gather your group together and reveal, in turn, each member's comments and recommendations.
4. Appoint someone to record the main points of agreement and disagreement within the group. How do you explain the results? What accounts for any disagreements?
5. From an ethical standpoint, what does your group recommend?

BUSINESS CASE 15

IPOS: GAME OF FUNDS

Taking a company public is a serious matter and takes great planning, strategy, and some luck as well. The initial public offering (IPO) is a key moment in the life of a business. There are three primary groups involved in the process: the owners of the company, the investment bank that facilitates the IPO, and the investors (both individuals and institutions) who want to buy shares in the company. All these people are interested in one thing: making money out of the deal. And there is a great deal of money to be made if the market judges the company to be a winner. But there is no guarantee that an IPO will be successful.

More than 160 companies went public in the United States in 2017, and many of them saw their share price underperform compared to the S&P 500 stock index. That same year, 38 IPOs in Canada helped to raise $5.1 billion. In the first six months of 2018, 20 new IPOs had already raised more than $11 billion. But keep in mind that an IPO is just the beginning. It is a key stage for a company, allowing it to raise funds for future usage. However, the long-term value of those shares, for the investors who buy them, may hold many twists and turns and ups and downs based on the performance and the perceptions for the future of the company. Let's look at some recent IPOs internationally and in Canada.

MaximP/Shutterstock

MAJOR INTERNATIONAL IPOS

- **Snap Inc.'s** IPO (i.e., Snapchat) took place in 2017. The stock listed at $17 on its opening day, but by the end of that very same day, the stock was up 44 percent. Quite a nice return for anyone who sold the stock at the end of that day. However, after the hype, Snap settled back into its original price range, and on its one-year anniversary, in March 2018, the stock was worth about $18. To put that into perspective, the stock was up 5.5 percent for the year at a time when the S&P 500 was up 12 percent during the same time. Not exactly a great return for investors.
- **Spotify's** chief executive, Daniel Ek, said all the right things as the company listed in 2018: "Today is like all others; what really matters is the day-to-day work that we do moving forward." The streaming music giant listed at $132 in April 2018, and the shares closed at $149.60 at the end of day one, giving the company a value of $26.5 billion in market capitalization. In July 2018, those shares were trading at $172.
- **Alibaba**, a Chinese ecommerce firm, raised US$25 *billion* with its IPO back in 2014. That was the biggest IPO in U.S. history, which is saying quite a lot. The stock was offered at $68 per share, which some analysts thought was too high to create much interest. But the stock immediately surged in value when it was made available to the public. By July 2018, the price was trading at $184.50 per share. That's a nice return!
- **Go-Pro** makes special cameras for daredevils and regular consumers. The stock was originally offered in June 2014 at $24 but surged to more than $100 per share within a few weeks. But here is an example of how initial hype does not guarantee long-term investor success. In July 2018, the shares were selling at only $6.50! For

those who bought the shares at $24, the stock was trading at about one-quarter of its initial value. What's worse is that some people bought in at much higher prices and saw their investment drop to mere fractions of what they had spent.

BIG CANADIAN IPOS

- **Canada Goose** went public in 2017 with a share price of $17, which valued the company at approximately $1.7 billion. The shares rose by 41 percent immediately upon opening and closed the first day with an increase of 26 percent. Although the stock dipped slightly soon after, it has remained very positive for investors, rising to as high as $89.73 in mid-2018.
- **Roots** went public just a few months after Canada Goose, but the results were not the same. In fact, investors who took the plunge at $12 per share on day one of the company listing saw their shares slip to $10 by the end of that day. Not exactly a great endorsement of the IPO. Investors all technically lost money (meanwhile TD, Credit Suisse, and BMO made $11 million for advising and issuing shares). In July 2018, the stock was still trading in the $10.70 cent range (still below the initial listing price).
- **Freshii** is a Canadian health-food restaurant chain that has expanded to 15 countries. In 2017, Freshii's IPO raised $125 million after opening at $11.50 per share. This funding has permitted the company to push forward its aggressive expansion plans. As for shareholders, they have seen their stock value decline. In July 2018, these shares were worth only $6.50 or about half what they were worth after the exciting IPO day.

AFTER THE IPO

The hype surrounding an IPO results in a lot of publicity and can cause frenzied trading of a company's stock in the short run. But in the long run, the price of any stock is based on fundamentals such as revenue, growth prospects, and profitability. The newly minted public companies described above must compete in the "real world" of stock evaluations, and it can be a brutal world because unexpected events can occur that boost or suppress the value of a company's stock. The complexity of the business world makes it difficult to predict which companies will be successful and which companies will have problems. But that does not stop optimistic entrepreneurs from starting new companies and issuing IPOs.

QUESTIONS FOR DISCUSSION

1. Research the current stock price of all the firms listed above. Have the stock prices increased or decreased recently? Are they up or down since their IPO? Research some of the reasons behind recent upward or downward movement.
2. Why is it difficult to predict which IPOs will be long-term successes?
3. What factors influence the market price of a stock?
4. What other IPOs have recently taken place beyond those companies mentioned above? How have they performed during their first year of public ownership?

MyLab Intro to Business

Study, practise, and explore real business situations with these helpful resources:
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.
- **Videos:** Learn more about the business practices and strategies of real companies.

PART 5:

MANAGING FINANCIAL ISSUES

GOAL OF THE EXERCISE

In this final part of the business plan project, you'll consider how to finance your business and create an executive summary for your plan.

EXERCISE BACKGROUND: PART 5 OF THE BUSINESS PLAN

In a previous part of the business plan, you discussed the costs of doing business, as well as how much revenue you expect to earn in one year. It's now time to think about how to finance the business. To get a great idea off the ground requires money. But how will you get these funds?

You'll then conclude this project by creating an executive summary. The purpose of the executive summary is to give the reader a quick snapshot of your proposed business. Although this exercise comes at the end of the project, once you're done writing it, you'll end up placing the executive summary at the beginning of your completed business plan.

YOUR ASSIGNMENT

Step 1 Open the saved Business Plan file you have been working on.
Step 2 For the purposes of this assignment, you will answer the following questions, shown in Part 5: Managing Financial Issues.

1. How much money will you need to get your business started?

   Hint: Refer to Part 3 of the plan, in which you analyzed the costs involved in running your business. Approximately how much will you need to get your business started?

2. How will you finance your business? For example, will you seek a bank loan? Borrow from friends? Sell stocks or bonds initially or as your business grows?

   Hint: Refer to this chapter for information on securities such as stocks and bonds. Refer to this chapter and Chapter 4 for more information on sources of short-term and long-term funds.

3. Now, create an executive summary for your business plan. The executive summary should be brief—no more than two pages—and cover the following points:

   - the name of your business
   - where your business will be located
   - the mission of your business
   - the product or service you are selling
   - who your ideal customers are
   - how your product or business will stand out in the crowd
   - who the owners of the business are and what experience they have
   - an overview of the future prospects for your business and industry

   Hint: At this point, you've already answered all of these questions, so what you need to do here is put the ideas together into "snapshot" format. The executive summary is really a sales pitch—it's the investor's first impression of your idea. Therefore, as with all parts of the plan, write in a clear and professional way.

Congratulations on completing the business plan project!

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APPENDIX A

A Brief History of Business in Canada

In this appendix, we summarize the broad outlines of the development of business activity in Canada.

THE EARLY YEARS

Business activity and profit from commercial fishing were the motivation for the first European involvement in Canada. Beginning in the 1500s, French and British adventurers began trading with the Native Peoples. The governments of these countries were strong supporters of the mercantilist philosophy, and colonists were expected to export raw materials like beaver pelts and lumber at low prices to the mother country. Attempts to develop industry in Canada were hindered by England and France, which enjoyed large profits from mercantilism.

THE FACTORY SYSTEM AND THE INDUSTRIAL REVOLUTION

British manufacturing took a great leap forward around 1750 with the coming of the *Industrial Revolution*. This revolution was made possible by advances in technology and by the development of the *factory system*. Instead of hundreds of workers turning out items one at a time in their cottages, the factory system brought together in one place all of the materials and workers required to produce items in large quantities, along with newly created machines capable of *mass production*. In spite of British laws against the export of technology and manufacturing to North America, modest manufacturing operations were evident in sawmills, breweries, grist mills for grinding grain, tanneries, woollen mills, shoemakers' shops, and tailors' shops. These operations became so successful that by 1800 exports of manufactured goods were more important than exports of fur.

THE ENTREPRENEURIAL ERA

In the last half of the nineteenth century, entrepreneurs emerged who were willing to take risks in the hope of earning large profits. Some individuals became immensely wealthy through their aggressive business dealings. But the size and economic power of some firms meant that other businesses had difficulty competing against them. At the same time, some business executives decided that it was more profitable to collude than to compete. They decided among themselves to fix prices and divide up markets. Hurt by these actions, Canadian consumers called for more regulation of business.

THE PRODUCTION ERA

Henry Ford's introduction of the moving assembly line in the United States in 1913 ushered in the *production era*. The Scientific Management Movement focused management's attention on production. Increased efficiency via the "one best way" to accomplish tasks became a major management goal. During the production era, less attention was paid to selling and marketing than to technical efficiency when producing goods. The growth of corporations and improved production output resulting from assembly lines sometimes came at the expense of worker freedom. To restore some balance within the overall system, both government and labour had to develop and grow.

THE SALES AND MARKETING ERAS

By the 1930s, businesses' focus on production had resulted in spectacular increases in the amount of goods and services available for sale. As a result, buyers had more choices and producers faced greater competition in selling their wares. According to the ideas of that time, a business's profits and success depended on hiring the right salespeople, advertising heavily, and making sure products were readily available. In the marketing era (the 1950s and 1960s), businesses increasingly used market research to determine what customers wanted, and then made it for them.

THE FINANCE ERA

In the finance era (the 1980s), there was a sharp increase in mergers and in the buying and selling of business enterprises. Some people now call it the "decade of greed." During the finance era, there was a great deal of financial manipulation of corporate assets by so-called corporate raiders.

THE GLOBAL ERA

During the past three decades, we have witnessed the emergence of the global economy and further dramatic technological advances in production, computer technology, information systems, and communication capabilities. While some Canadian businesses have been hurt by foreign imports, numerous others have profited by exploring new foreign markets themselves. Global and domestic competition has also forced all businesses to work harder than ever to cut costs, increase efficiency, and improve product and service quality.

THE INTERNET ERA

The rapid increase in internet usage has facilitated global business activity. Neither large nor small businesses are restricted to thinking simply in terms of local markets. Web-based services and social media tools are helping businesses "go global" and connect with communities and consumers around the world.

APPENDIX B

Business Law

Law means the set of rules and standards that a society agrees upon to govern the behaviour of its citizens. Both the British and the French influenced the development of law in Canada. In 1867, the British North America (BNA) Act created the nation of Canada. The BNA Act was "patriated" to Canada in 1982 and is now known as the Constitution Act. This act divides legislative powers in Canada between the federal and provincial governments.

SOURCES OF LAW

The law in Canada has evolved and changed in response to our norms and values. Our laws have arisen from three sources: (1) customs and judicial precedents (the source of common law), (2) the actions of provincial and federal legislatures (the source of statutory law), and (3) rulings by administrative bodies (the source of administrative law).

Common law is the unwritten law of England, derived from ancient precedents and judges' previous legal opinions. Common law is based on the principle of equity, the provision to every person of a just and fair remedy. Canadian legal customs and traditions derive from British common law. All provinces except Quebec, which uses the French Civil Code, have laws based on British common law, and court decisions are often based on precedents from common law. That is, decisions made in earlier cases that involved the same legal point will guide the court.

Statutory law is written law developed by city councils, provincial legislatures, and parliament. Most law in Canada today is statutory law.

Administrative law is the rules and regulations that government agencies and commissions develop based on their interpretations of statutory laws. For example, Consumer and Corporate Affairs Canada develops regulations on false advertising using federal legislation.

THE COURT SYSTEM

In Canada, the judiciary branch of government has the responsibility of settling disputes among organizations or individuals by applying existing laws. Both provincial and federal courts exist to hear both criminal and civil cases. The Supreme Court of Canada is the highest court in Canada. It decides whether to hear appeals from lower courts.

BUSINESS LAW

Business firms, like all other organizations, are affected by the laws of the country. **Business law** refers to laws that specifically affect how business firms are managed. Some laws affect all businesses, regardless of size, industry, or location. For example, the Income Tax Act requires businesses to pay income tax. Other laws may have a greater impact on one industry than on others. For example, pollution regulations are of much greater concern to Vale, a mining corporation, than they are to Carlson Wagonlit Travel.

Business managers should have at least a basic understanding of the following nine important concepts in business law:

1. contracts
2. agency
3. bailment
4. property
5. warranty
6. trademarks, patents, and copyrights
7. torts
8. negotiable instruments
9. bankruptcy

CONTRACTS

Agreements about transactions are common in a business's day-to-day activity. A **contract** is an agreement between two parties to act in a specified way or to perform certain acts. A contract might, for example, apply to a customer buying a product from a retail establishment or to two manufacturers agreeing to buy products or services from each other. A contract may be either **express** or **implied**. An express contract clearly specifies (either orally or in writing) the terms of an agreement. By contrast, an implied contract depends on the two parties' behaviours. For example, if you hire a fishing guide to help you catch fish, you have an implied contract that obligates you to pay the fishing guide for the service you receive.

LAW The set of rules and standards that a society agrees upon to govern the behaviour of its citizens.

COMMON LAW The unwritten law of England, derived from precedent and legal judgments.

STATUTORY LAW Written law developed by city councils, provincial legislatures, and parliament.

ADMINISTRATIVE LAW The rules and regulations that government agencies and commissions develop based on their interpretations of statutory laws.

BUSINESS LAW Laws that specifically affect how business firms are managed.

CONTRACT An agreement between two parties to act in a specified way or to perform certain acts.

EXPRESS CONTRACT Clearly specifies the terms of an agreement.

IMPLIED CONTRACT Specifies the necessary behaviours of the parties to the contract.

A valid contract includes several elements:

- *An agreement.* All parties must consciously agree to the contract.
- *Consideration.* The parties must exchange something of value (e.g., time, products, services, money, and so on).
- *Competence.* All parties to the contract must be legally able to enter into an agreement. Individuals who are below a certain age or who are legally insane, for example, cannot enter into legal agreements.
- *Legal purpose.* What the parties agree to do for or with each other must be legal. An agreement between two manufacturers to fix prices is not legal.

The courts will enforce a contract if it meets the preceding criteria. Most parties honour their contracts, but occasionally one does not do what it is supposed to do. **Breach of contract** occurs when a party to an agreement fails, without legal reason, to live up to the agreement's provisions. The party that has not breached the contract has three alternatives under the law in Canada: (1) discharge, (2) sue for damages, or (3) require specific performance.

An example will demonstrate these three alternatives. Suppose that Barrington Farms Inc. agrees to deliver 100 dozen long-stemmed roses to the Blue Violet Flower Shop the week before Mother's Day. One week before the agreed-upon date, Barrington informs Blue Violet that it cannot make the delivery until after Mother's Day. Under the law, the owner of Blue Violet can choose among any of the following actions:

1. *Discharge.* Blue Violet can also ignore its obligations in the contract. That is, it can contract with another supplier.
2. *Sue for damages.* Blue Violet can legally demand payment for losses caused by Barrington's failure to deliver the promised goods on time. Losses might include any increased price Blue Violet would have to pay for the roses or court costs incurred in the damage suit.
3. *Require specific performance.* If monetary damages are not sufficient to reimburse Blue Violet, the court can force Barrington to live up to its original contract.

AGENCY

In many business situations, one person acts as an agent for another person. Well-known examples include actors and athletes represented by agents who negotiate contracts for them. An **agency–principal relationship** is established when one party (the agent) is authorized to act on behalf of another party (the principal).

The agent is under the control of the principal and must act on behalf of the principal and in the principal's best interests. The principal remains liable for the acts of the agent as long as the agent is acting within the scope of authority granted by the principal. A salesperson for IBM, for example, is an agent for IBM, the principal.

BAILMENT

Many business transactions are not covered by the agency–principal relationship. For example, suppose that you take your car to a mechanic to have it repaired. Because the repair shop has temporary possession of something you own, it is responsible for your car. This is a bailor–bailee relationship. In a **bailor–bailee relationship**, the bailor (e.g., the car owner) gives possession of his or her property to the bailee (e.g., the repair shop) but retains ownership of the item. A business firm that stores inventory in a public warehouse is in a bailor–bailee relationship. The business firm is the bailor and the warehouse is the bailee. The warehouse is responsible for storing the goods safely and making them available to the manufacturer upon request.

THE LAW OF PROPERTY

Property includes anything of tangible or intangible value that the owner has the right to possess and use. **Real property** is land and any permanent buildings attached to that land. **Personal property** is tangible or intangible assets other than real property. Personal property includes cars, clothing, furniture, money in bank accounts, stock certificates, and copyrights.

TRANSFERRING PROPERTY

From time to time, businesses and individuals need to transfer property to another person or business. A **deed** is a document that shows ownership of real property. It allows the transfer of title of real property.

A **lease** grants the use of an asset for a specified period of time in return for payment. The business or individual granting the lease is the lessor and the tenant is the lessee. For example, a business (the lessee) may rent space in a mall for one year from a real estate development firm (the lessor).

A **title** shows legal possession of personal property. It allows the transfer of title of personal property. When you buy a snowmobile, for example, the former owner signs the title over to you.

WARRANTY

When you buy a product or service, you want some assurance that it will perform satisfactorily and meet your needs. A **warranty** is a promise that the product or service will perform as the seller has promised it will.

There are two kinds of warranties—express and implied. An **express warranty** is a specific claim that the manufacturer makes about a product. For example, a warranty that a screwdriver blade is made of case-hardened steel is an express warranty. An **implied warranty** suggests that a product will perform as the manufacturer claims it will. Suppose

BREACH OF CONTRACT When one party to an agreement fails, without legal reason, to live up to the agreement's provisions.

AGENCY–PRINCIPAL RELATIONSHIP Established when one party (the agent) is authorized to act on behalf of another party (the principal).

BAILOR–BAILEE RELATIONSHIP In a bailor–bailee relationship, the bailor (the property owner) gives possession of his or her property to the bailee (a custodian) but retains ownership of the item.

PROPERTY Anything of tangible or intangible value that the owner has the right to possess and use.

REAL PROPERTY Land and any permanent buildings attached to that land.

PERSONAL PROPERTY Tangible or intangible assets other than real property.

DEED A document that shows ownership of real property.

LEASE Grants the use of an asset for a specified period of time in return for payment.

TITLE Shows legal possession of personal property.

WARRANTY A promise that the product or service will perform as the seller has promised it will.

EXPRESS WARRANTY A specific claim that the manufacturer makes about a product.

IMPLIED WARRANTY A suggestion that a product will perform as the manufacturer claims it will.

that you buy an outboard motor for your boat and the engine burns out in one week. Because the manufacturer implies by selling the motor that it will work for a reasonable period of time, you can return it and get your money back.

Because opinions vary on what is a "reasonable" time, most manufacturers now give limited-time warranties on their products. For example, they will guarantee their products against defects in materials or manufacture for six months or one year.

TRADEMARKS, PATENTS, AND COPYRIGHTS

Because developing brand names is very expensive, companies do not want others using their brand name and confusing consumers. Many companies therefore apply to the Canadian government and receive a **trademark**, which is the exclusive legal right to use a brand name. Trademarks are granted for 15 years and may be renewed for further periods of 15 years, but only if the company continues to protect its brand name. In 2008, a European court ruled that the construction toys made by LEGO could no longer be protected by trademark law. Montreal-based Mega Brands Inc., which makes a competitive product called Mega-Bloks, had challenged LEGO's trademark.[1]

Just what can be trademarked is not always clear. If the company allows the name to lapse into common usage, the courts may take away protection. Common usage occurs when the company fails to use the ® (registered) symbol for its brand. It also occurs if the company fails to correct those who do not acknowledge the brand as a trademark. Windsurfer, a popular brand of sailboards, lost its trademark, and the name can now be used by any sailboard company. The same thing has happened to other names that were formerly brand names—trampoline, yo-yo, thermos, snowmobile, kleenex, and aspirin. But companies like Xerox, Coca-Cola, Jell-O, and Scotch tape have successfully defended their brand names.

A **patent** protects an invention or idea for a period of 20 years. The cost is $1600 to $2500, and it takes 18 months to three years to secure a patent from the Canadian Intellectual Property Office.[2] Patents can be very valuable. In 2006, BlackBerry agreed to pay $612.5 million to NTP Inc., a U.S. firm that claimed BlackBerry was infringing on some patents that NTP held.[3] In 2010, BlackBerry was found not guilty by a judge in the United Kingdom for a claim by Motorola.[4] In yet another patent dispute, Pfizer Inc. reached an agreement in 2008 with an Indian generic drug maker that kept a cheaper version of the cholesterol-lowering drug Lipitor out of the U.S. market until 2011. Sales revenues of Lipitor are about US$13 billion annually, so this was a very important deal for Pfizer.[5]

Copyrights give exclusive ownership rights to the creators of books, articles, designs, illustrations, photos, films, and music. Computer programs and even semiconductor chips are also protected. Copyrights extend to creators for their entire lives and to their estates for 50 years thereafter. Copyrights apply to the tangible expressions of an idea, not to the idea itself. For example, the idea of cloning dinosaurs from fossil DNA cannot be copyrighted, but Michael Crichton, the author of *Jurassic Park*, could copyright his novel because it is the tangible result of the basic idea.

There is much debate about how copyrights apply to material that appears on the internet. In 2005, the U.S.-based Authors Guild and several publishers sued Google, claiming that its book-scanning project was infringing on their copyrights. In 2008, Google agreed to pay US$125 million to settle the lawsuits. Google can now make available millions of books online.[6] The issue of file sharing is making copyright a big issue these days. New laws and new interpretations of old ones will redefine the role of copyright over the next few years.

TORTS

A **tort** is a wrongful civil act that one party inflicts on another and that results in injury to the person, to the person's property, or to the person's good name. An **intentional tort** is a wrongful act intentionally committed. If a security guard in a department store suspects someone of shoplifting and uses excessive force to prevent him or her from leaving the store, the guard might be guilty of an intentional tort. Other examples are libel, embezzlement, and patent infringement.

Negligence is a wrongful act that inadvertently causes injury to another person. For example, if a maintenance crew in a store mops the floors without placing warning signs in the area, a customer who slips and falls might bring a negligence suit against the store.

In recent years, the most publicized area of negligence has been product liability. **Product liability** means that businesses are liable for injuries caused to product users because of negligence in design or manufacturing. **Strict product liability** means that a business is liable for injuries caused by their products even if there is no evidence of negligence in the design or manufacture of the product.

NEGOTIABLE INSTRUMENTS

Negotiable instruments can be transferred among individuals and business firms. Cheques, bank drafts, and certificates of deposit are examples of negotiable instruments. The Bills of Exchange Act specifies that a negotiable instrument must

- be written;
- be signed by the person who puts it into circulation (the maker or drawer);
- contain an unconditional promise to pay a certain amount of money;
- be payable on demand; and
- be payable to a specific person (or to the bearer of the instrument).

Negotiable instruments are transferred from one party to another through an endorsement. An **endorsement** means signing your name to a negotiable instrument—this makes it transferable to another person or organization. If you sign only your name on the back of a cheque, you are

TRADEMARK The exclusive legal right to use a brand name.
PATENT Protects an invention or idea for a period of 20 years.
COPYRIGHT Exclusive ownership rights granted to creators for the tangible expression of an idea.
TORT A wrongful civil act that one party inflicts on another and that results in injury to the person, to the person's property, or to the person's good name.
INTENTIONAL TORT A wrongful act intentionally committed.
NEGLIGENCE A wrongful act that inadvertently causes injury to another person.
PRODUCT LIABILITY The liability of businesses for injuries caused to product users because of negligence in design or manufacturing.
STRICT PRODUCT LIABILITY The liability of businesses for injuries caused by their products even if there is no evidence of negligence in the design or manufacture of the product.
NEGOTIABLE INSTRUMENTS Instruments like cheques, bank drafts, and certificates of deposit that can be transferred among individuals and business firms.
ENDORSEMENT Signing your name to a negotiable instrument, making it transferable to another person or organization.

making a blank endorsement. If you state that the instrument is being transferred to a specific person, you are making a special endorsement. A qualified endorsement limits your liability if the instrument is not backed up by sufficient funds. For example, if you get a cheque from a friend and want to use it to buy a new stereo, you can write "Without Recourse" above your name. If your friend's cheque bounces, you have no liability. A restrictive endorsement limits the negotiability of the instrument. For example, if you write "For Deposit Only" on the back of a cheque and it is later stolen, no one else can cash it.

BANKRUPTCY

At one time, individuals who could not pay their debts were jailed. Today, however, both organizations and individuals can seek relief by filing for **bankruptcy**, which is the court-granted permission to not pay some or all of their debts.

Thousands of individuals and businesses file for bankruptcy every year. They do so for various reasons, including cash-flow problems, reduced demand for their products, or some other problem that makes it difficult or impossible for them to resolve their financial problems. In recent years, large businesses like Eaton's, Olympia & York, and Enron have sought the protection of bankruptcy laws. Three main factors account for the increase in bankruptcy filings:

1. The increased availability of credit
2. The "fresh-start" provisions in current bankruptcy laws
3. The growing acceptance of bankruptcy as a financial tactic

In Canada, jurisdiction over bankruptcy is provided by the Bankruptcy and Insolvency Act. An **insolvent person (or company)** is defined as one who cannot pay current obligations to creditors as they come due, or whose debts exceed their assets. A **bankrupt person (or company)** is one who has either made a voluntary application to start bankruptcy proceedings (voluntary bankruptcy) or been forced by creditors into bankruptcy (involuntary bankruptcy) by a process referred to as a *receiving order*. A person who is insolvent may or may not be bankrupt, and a person who is bankrupt may or may not be insolvent, as there are other bases for bankruptcy under the Act. Another procedure under the Act is referred to as a proposal, which can delay or avoid liquidation by providing the debtor with time to reorganize affairs and/or propose a payment schedule to creditors.

Business bankruptcy under the Act may be resolved or avoided by one of three methods:

1. Under a liquidation plan, the business ceases to exist. Its assets are sold and the proceeds are used to pay creditors.
2. Under a repayment plan, the bankrupt company works out a new payment schedule to meet its obligations. The time frame is usually extended, and payments are collected and distributed by a court-appointed trustee.
3. Reorganization is the most complex form of business bankruptcy. The company must explain the sources of its financial difficulties and propose a new plan for remaining in business. Reorganization may include a new slate of managers and a new financial strategy. A judge may also reduce the firm's debts to ensure its survival. Although creditors naturally dislike debt reduction, they may agree to the proposal, since getting, say, 50 percent of what you are owed is better than getting nothing at all.

THE INTERNATIONAL FRAMEWORK OF BUSINESS LAW

Laws vary from country to country, and many businesses today have international markets, suppliers, and competitors. Managers in such businesses need a basic understanding of the international framework of business law that affects the ways in which they can do business. Issues such as pollution across borders are matters of **international law**—the very general set of cooperative agreements and guidelines established by countries to govern the actions of individuals, businesses, and nations themselves.

International law has several sources. One source is custom and tradition. Among countries that have been trading with one another for centuries, many customs and traditions governing exchanges have gradually evolved into practice. Although some trading practices still follow ancient unwritten agreements, there has been a clear trend in recent years to approach international trade within a formal legal framework. Key features of that framework include a variety of formal trade agreements (see Chapter 5).

Organizations such as the WTO and EU also provide legal frameworks within which participating nations agree to abide.

BANKRUPTCY The court-granted permission for organizations or individuals to not pay some or all of their debts.

INSOLVENT PERSON (OR COMPANY) One who cannot pay current obligations to creditors as they come due, or whose debts exceed their assets.

BANKRUPT PERSON (OR COMPANY) One who has either made a voluntary application to start bankruptcy proceedings (voluntary bankruptcy) or has been forced by creditors into bankruptcy (involuntary bankruptcy) by a process referred to as a receiving order.

INTERNATIONAL LAW The very general set of cooperative agreements and guidelines established by countries to govern the actions of individuals, businesses, and nations themselves.

APPENDIX C

Using Technology to Manage Information in the Internet and Social Media Era

Throughout the text, we examined how the internet and the integration of social media have improved communications, revolutionized distribution, augmented human resource practices, transformed industries (and threatened others), developed new marketing communication channels, and changed the most basic business systems. In this supplement, we will begin by providing additional supporting material about the internet and social media. We will also examine the evolving role of technology in managing information.

INTERNET USAGE

Before we investigate the specific impact of the internet on business, let's examine some of the key Canadian internet statistics. Hong Kong has the fastest internet connections in the world; Canada ranks seventeenth.[1] However, Canada ranks ninth among G20 countries in terms of internet contribution to GDP. Canadians also spend an average of 36.3 hours per month on their computers (not including the vast amount of time spent on mobile devices) which ranks first in the world.[2] In addition, 94 percent of Canadians who live in households with incomes above $85 000 are connected (77 percent are connected in households with incomes below $35 000 per year).[3]

The federal government has also set its sights on increasing and improving the connectivity in rural settings. The improved infrastructure will help increase rural access, build further opportunities for companies wishing to sell to rural Canadian clients, and provide more incentive and opportunity for small businesses to operate in rural settings.[4]

THE IMPACT OF INFORMATION TECHNOLOGY (IT)

No matter where we go, we can't escape the impact of **information technology (IT)**—the various devices for creating, storing, exchanging, and using information in diverse modes, including images, voice, multimedia, and business data. We see ads all the time for the latest smartphones, laptops, iPads and other tablets, and software products, and most of us connect daily to the internet (many of you never disconnect). Email, texting, and instant messaging have become staples in business, and even such traditionally "low tech" businesses such as hair salons and garbage collection companies are becoming dependent on the internet, computers, and networks. As consumers, we interact with databases every time we withdraw money from an ATM, order food at McDonald's, use an Apple or Android application to order food or movie tickets, or check on the status of a package at UPS or FedEx.

IT has had an immense effect on businesses—in fact, the growth of IT has changed the very structure of business organizations. Its adoption has altered workforces in many companies, contributed to greater flexibility in dealing with customers, and changed how employees interact with each other. E-commerce has created new market relationships around the globe.

We begin by looking at how businesses are using IT to bolster productivity, improve operations and processes, create new opportunities, and communicate and work in ways not possible before.

THE IMPACT OF THE INTERNET ON MARKETING

E-commerce refers to buying and selling processes that make use of electronic technology, while **internet marketing** refers to the promotional efforts of companies to sell their products and services to consumers over the internet.[5]

Although internet marketing has some obvious advantages for both buyers (access to information, convenience, etc.) and sellers (reach, direct distribution, etc.), it also has weaknesses, including profitability problems (many internet marketers are still unprofitable, and the failure rates are high) and information overload (consumers may not know what to do with all the information available to them). In addition to these weaknesses, internet marketers must also cope with consumer concerns about security-related issues.

Consumers also object to *spyware* software, which monitors websites they visit and observes their shopping habits. Spyware is often implanted on their personal computers as they wander through the web, generating advertisements targeted to them specifically.

INFORMATION TECHNOLOGY (IT) The various devices for creating, storing, exchanging, and using information in diverse modes, including visual images, voice, multimedia, and business data.

E-COMMERCE Buying and selling processes that make use of electronic technology.

INTERNET MARKETING The promotional efforts of companies to sell their products and services to consumers over the internet.

CREATING PORTABLE OFFICES: PROVIDING REMOTE ACCESS TO INSTANT INFORMATION

IT devices such as Samsung mobile phones and Apple iPhones, along with IBM wireless internet access and PC-style office applications, save businesses time and travel expenses by enabling employees, customers, and suppliers to communicate from any location. Mobile messaging capabilities mean that a geographic separation between the workplace and headquarters is more common.

Employees no longer work only at the office or the factory, nor are all a company's operations performed at one place; employees take the office with them. When using such devices, off-site employees have continuous access to information, instead of being forced to be at a desk to access their files and the internet. Client project folders, email, and voice messaging are accessible from any location.

ENABLING BETTER SERVICE BY COORDINATING REMOTE DELIVERIES

Company activities may be geographically scattered but remain coordinated through a networked system that provides better service for customers. Many businesses, for example, coordinate activities from one centralized location, but their deliveries flow from several remote locations, often at lower cost. When you order furniture from an internet storefront—a chair, a sofa, a table, and two lamps—the chair might come from a warehouse in Toronto, the lamps from a manufacturer in China, and the sofa and table from a supplier in North Carolina. In response to the customer's order, activities are coordinated through the company's network, as if the whole order were being processed at one place. This avoids the expensive in-between step of first shipping all the items to a central location.

Studies by Deloitte in the United States and Ebates.com in Canada found that Canadians planned to spend approximately 38 percent of their holiday gift budgets online; this figure was even higher south of the border with an estimated 51 percent of holiday budgets dedicated to online merchants in the United States in 2017.[6] This trend is growing year after year. As discussed in the opening case of Chapter 13, Amazon is taking many traditional sales away from brick-and-mortar retailers like The Bay in cities and is also serving consumers in rural locations with an unmatched convenience.

CREATING LEANER, MORE EFFICIENT ORGANIZATIONS

Networks and technology are also leading to leaner companies with fewer employees and simpler structures. Because networks enable firms to maintain information linkages between employees and customers, more work and customer satisfaction can be accomplished with fewer people. Bank customers can access 24-hour information systems and monitor their accounts without employee assistance. Instructions that once were given to assembly workers by supervisors are now delivered to workstations electronically. IT communications provide better use of employee skills and greater efficiencies from physical resources. For example, truck drivers used to return to a shipping terminal to receive instructions from supervisors on reloading freight for the next delivery. Today, one dispatcher using IT has replaced several supervisors. Instructions to the fleet arrive on electronic screens in trucks on the road so drivers know in advance the next delivery schedule, and satellite navigation services such as the XM NavTraffic alert drivers of traffic incidents ahead so they can reroute to avoid delays.

ENABLING INCREASED COLLABORATION

Interaction among internal units and with outside firms is greater when firms use collaboration software and other IT communication devices (which we discuss below). Companies are learning that complex problems can be better solved through IT-supported collaboration, either with formal teams or spontaneous interaction among people and departments. The design of new products was once largely an engineering responsibility. Now it is a shared activity using information from people in marketing, finance, production, engineering, and purchasing, who collectively determine the best design. For example, the design of Boeing's 787 Dreamliner aircraft is the result of collaboration, not just among engineers, but also from passengers (who wanted electronic outlets to recharge personal electronic devices), cabin crews (who wanted more bathrooms and wider aisles), and air traffic controllers (who wanted larger, safer airbrakes). Although recent performance problems grounded the 787, solutions involved a worldwide network of Boeing engineers, suppliers, customers, and NASA.[7]

ENABLING GLOBAL EXCHANGE

The global reach of IT is enabling business collaboration on a scale unheard of just a few years ago. Consider Lockheed Martin's contract for designing the Joint Strike Fighter and supplying thousands of the planes in different versions for Canada, the United States, Britain, Italy, Denmark, and Norway. Lockheed can't do the job alone. Over the

TonyV3112/Shutterstock

This Boeing aircraft was the result of collaboration among Boeing engineers, suppliers, and customers.

project's 20-year life, more than 1500 companies will supply everything from radar systems to engines to bolts. Web collaboration on a massive scale is essential for coordinating design, testing, and construction, while avoiding delays, holding down costs, and maintaining quality.[8]

IMPROVING MANAGEMENT PROCESSES

IT has also changed the nature of the management process. At one time, upper-level managers didn't concern themselves with all the detailed information filtering upward from the workplace because it was expensive to gather, slow in coming, and quickly outdated. Workplace management was delegated to middle and first-line managers. With databases, specialized software, and networks, however, instantaneous information is accessible and useful to all levels of management.

For example, consider *enterprise resource planning* (ERP), a system for organizing and managing a firm's activities across product lines, departments, and geographic locations. An ERP stores real-time information on work status and upcoming transactions and notifies employees when action is required if certain schedules are to be met. It coordinates internal operations with activities of outside suppliers and notifies customers of upcoming deliveries and billings.

Consequently, more managers use it routinely for planning and controlling operations. A manager at Hershey Foods might use ERP to check on the current status of any customer order for Hershey Kisses, inspect productivity statistics for each workstation, and analyze the delivery performance on any shipment. Managers can better coordinate company-wide performance because they can identify departments that are working well together and those that are lagging behind schedule and creating bottlenecks.

In addition, high-tech processes have replaced many simple functions in the name of better management oversight and better decisions. Presotea Co. Ltd., a tea retailer with 12 locations in Toronto, moved away from the traditional customer reward punch card and replaced it with an electronic service that allows consumers to tap into a digital program, thus avoiding an extra card in their wallet. From the company's point of view, it is a great way to gather information on their customers and track loyalty.[9]

PROVIDING FLEXIBILITY FOR CUSTOMIZATION

IT has also created new manufacturing capabilities that enable businesses to offer customers greater variety and faster delivery cycles. Whether it's a personal computer from Dell, one of Samsung's smartphones, or Vaughn goalie pads, today's design-it-yourself world has become possible through fast, flexible manufacturing using IT networks. At Timbuk2's website, for example, you can "build your own" custom messenger bag at different price levels with choices of size, fabric, colour combinations, accessories, liner material, strap, and even left- or right-hand access.[10] The principle is called **mass customization**—although companies produce in large volumes, each unit features the unique options the customer prefers. As shown in Figure C.1, flexible production and speedy delivery depend on an integrated network of information to coordinate all the activities among customers, manufacturers, suppliers, and shippers.

MASS CUSTOMIZATION Although companies produce in large volumes, each unit features the unique options the customer prefers.

Vaughn goalie pads are used by some of the top goaltenders in the NHL, like Tukka Rask of the Boston Bruins and Jonathan Quick of the LA Kings. You can purchase the gear off the rack, but Vaughn offers a mass customization series that permits you to adjust your gear to your needs (for colour, size, and so on).

Keith Birmingham/Alamy Stock Photo

PROVIDING NEW BUSINESS OPPORTUNITIES

Not only is IT improving existing businesses, but it is also creating entirely new ones. For big businesses, this means developing new products, offering new services, and reaching new clients. Only a few years ago, Google was a fledgling search engine. In 2018, Alphabet Inc. (Google's parent company) had nearly $102 billion in cash and short-term investments, and it was no longer simply a search engine; Google had email (Gmail) and other productivity software (Google Docs, and so on), the Android cell phone platform, and YouTube.[11]

The IT landscape has also presented small business owners with new e-business opportunities. eBay was one of the early pioneer platforms to assist start-up businesses. eBay's services network offers a ready-made online business model (not just an auction market). Services range from credit financing to protection from fraud and misrepresentation, information security, international currency exchanges, and post-sales management. These features enable users to complete sales transactions, deliver merchandise, and get new merchandise for future resale, all from the comfort of their homes.

Of course, today countless organizations help entrepreneurs connect with consumers and provide all types of services from branding help to sales and finance transactions. As discussed in Chapter 4, Shopify is one example of an e-commerce platform that helps consumers sell online, on social media, or out of their garages. The solutions are endless, and the tools are now easily accessible from various providers.

IMPROVING THE WORLD AND OUR LIVES

Can advancements in IT really make the world a better place? Developments in smartphones, social networking, home entertainment, automobile safety, and other applications have certainly brought enjoyment and convenience to the everyday lives of millions around the globe. Extending technology beyond previous-model cell phones and PCs, new technologies provide access to endless choices of *apps*,

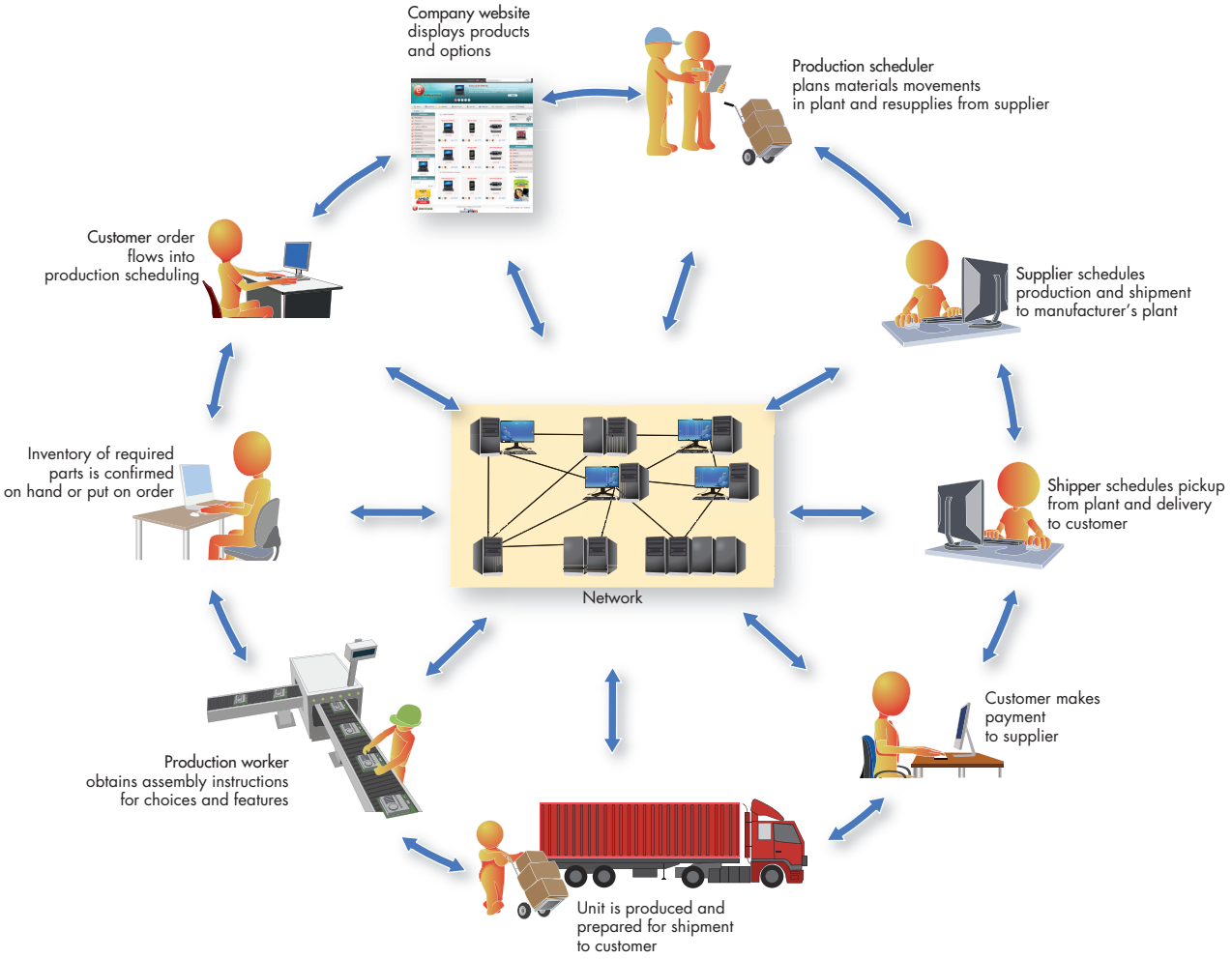
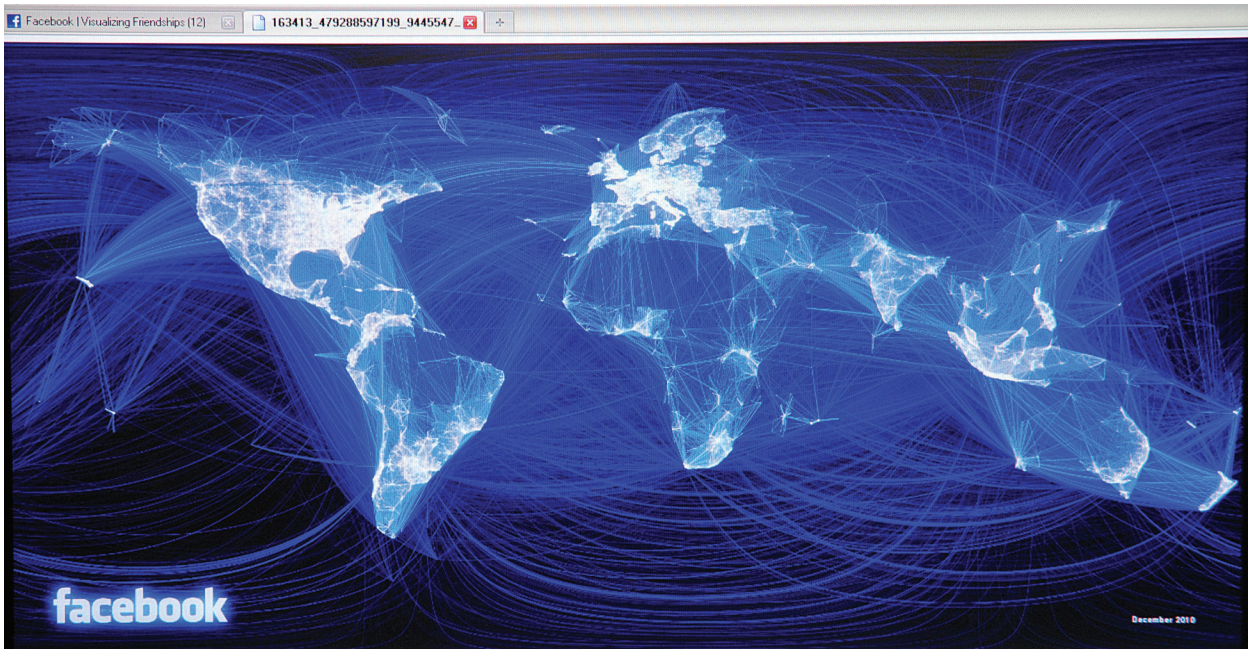


FIGURE C.1 Networking for mass customization



Karen Bleier/Newscom

In this map of the internet, from the OPTE Project, each line represents a connection between computers or other network devices.

allowing each user to "build it your way," depending on what you want your device to do and how and where you'll be using it. Apps for computers and smartphones include *programs* for learning languages, music, work, games, travel, art, and almost any other area of interest. Apple's App Store had supplied more than 180 billion downloads worldwide to users of Macs, iPhones, and iPads.[12] The range of current applications is immense and is increasing to meet the needs of business and consumers. We have also included a feature in this text called "There's an App for That!" to encourage you to use your smartphone or tablet to access resources related to all the functions of business.

THE IMPACT OF THE INTERNET ON YOUR POCKETBOOK

Many people complain that the cost of internet service is yet another expense in their lives that did not exist in the past. However, these complaints fail to recognize the cost-saving benefits. A recent study conducted by the Internet Innovation Alliance (IIA) indicates that the average person saves approximately $9000 per year because of the internet (compared with those not connected). See Table C.1.[13]

SOCIAL NETWORKING: PROVIDING A SERVICE

The many forms of social media—blogs and networks such as LinkedIn, Twitter, and Facebook—are no longer just playthings for gossips and hobbyists. Today, job seekers turn to online networking—tapping leads from friends, colleagues, and acquaintances—for contacts with companies that may be hiring. Peers and recruiters are networking using a combination of social media sites, company website tools, professional associations and trade groups, technical schools, and alumni organizations. Some social sites provide occupation-specific career coaching and job tips. For example, health-care professionals are connecting with Doximity, while top managers can use Meet the Boss.[14]

IT BUILDING BLOCKS: BUSINESS RESOURCES

Businesses today have a wide variety of IT resources at their disposal. In addition to the internet and email, they include communications technologies, networks, hardware devices, and software as shown at technology media sites such as Techcrunch.com.

THE INTERNET AND OTHER COMMUNICATION RESOURCES

The **internet** is a gigantic system of interconnected computer networks belonging to millions of collaborating organizations and agencies—government, business, academic, and public—linked by voice, electronic, and wireless technologies.[15] Computers within the networks are connected by various communications *protocols*—standardized coding systems—such as the *hypertext transfer protocol (HTTP)*, which is used for the *World Wide Web*, a branch of the internet consisting of interlinked hypertext documents, or webpages. Other protocols serve a variety of purposes such as sending and receiving email. The World Wide Web and its protocols provide the common language that allows information sharing on the internet. For thousands of businesses, the internet has replaced the telephone, fax machine, and standard mail as the primary communication tool.

The internet has spawned several other business communications technologies, including *intranets, extranets, electronic conferencing*, and *VSAT satellite communications*.

Intranets

Many companies have extended internet technology by maintaining internal websites linked throughout the firm. These private networks or **intranets**, accessible only to employees, may contain confidential information on benefits programs, a learning library, production management tools, or product design resources. Maple Leaf Foods recently redesigned its intranet and called it myMLF; the new intranet structure was acknowledged as the best new design by the independent Ragan Intranet Awards. myMLF has increased engagement and improved communication allowing employees to share information on products, distribution, marketing, customer service, or any other matter across the internal network.[16]

Extranets

Extranets allow outsiders limited access to a firm's internal information network. The most common application allows buyers to enter a system to see which products are available for sale and delivery, thus providing convenient product availability information.

INTERNET Gigantic system of interconnected computer networks linked together by voice, electronic, and wireless technologies.

INTRANET An organization's private network of internally linked websites accessible only to employees.

EXTRANET A system that allows outsiders limited access to a firm's internal information network.

TABLE C.1 Source of Internet Savings

Typical Sources of Savings from Internet Connections	Result
1. Online comparison shopping	• Better-negotiated deals based on online research (savings of hundreds or even thousands of dollars) • Savings on fuel (less running around)
2. Paying bills online	• Savings on fuel • No stamps, envelopes, and so on
3. Accessing cheaper inventory (deals)	• Easy access to online aggregator sites (discount retailers, coupons, etc.)

Industrial suppliers are often linked into customers' information networks so that they can see planned production schedules and prepare supplies for customers' upcoming operations.

Electronic Conferencing **Electronic conferencing** allows groups of people to communicate simultaneously from various locations via email, phone, or video, thereby eliminating travel time and saving money. One form, called *data conferencing*, allows people in remote locations to work simultaneously on one document. *Videoconferencing* allows participants to see one another on video screens while a conference is in progress. For example, Lockheed Martin's Joint Strike Fighter project, discussed earlier, uses internet collaboration systems with both voice and video capabilities. Although separated by oceans, partners can communicate as if they were in the same room while redesigning components and creating production schedules. Electronic conferencing is attractive to many businesses because it eliminates travel and saves money.

VSAT Satellite Communications Another internet technology businesses use to communicate is **VSAT satellite communications**. VSAT (short for "very small aperture terminal") systems have a transmitter-receiver (transceiver) that sits outdoors with a direct line of sight to a satellite. The hub—a ground-station computer at the company's headquarters—sends signals to and receives signals from the satellite, exchanging voice, video, and data transmissions. An advantage of VSAT is privacy. A company that operates its own VSAT system has total control over communications among its facilities, no matter their location, without dependence on other companies. A firm might use VSAT to exchange sales and inventory information, advertising messages, and visual presentations between headquarters and store managers at remote sites.

NETWORKS: SYSTEM ARCHITECTURE

A *computer network* is a group of two or more computers linked, either hardwired or wirelessly, to share data or resources (e.g., a printer). The most common type of network used in businesses is a **client-server network**. In client-server networks, clients are usually the laptop or desktop computers through which users make requests for information or resources. Servers are the computers that provide the services shared by users. In big organizations, servers are usually assigned a specific task. For example, in a local university or college network, an application server stores the word-processing, spreadsheet, and other programs used by all computers connected to the network. A print server controls the printers, stores printing requests from client computers, and routes jobs as the printers become available. An email server handles all incoming and outgoing email. With a client-server system, users can share resources and internet connections—and avoid costly duplication.

Networks can be classified according to geographic scope and means of connection (either wired or wireless).

Wide Area Networks (WANs) Computers that are linked over long distances—province-wide or even nationwide—through telephone lines, microwave signals, or satellite communications make up what are called **wide area networks (WANs)**. Firms can lease lines from communications vendors or maintain private WANs. Walmart, for example, depends heavily on a private satellite network that links thousands of U.S. and international retail stores to its Bentonville, Arkansas, headquarters.

Local Area Networks (LANs) In **local area networks (LANs)**, computers are linked in a smaller area, such as an office or a building. For example, a LAN unites hundreds of operators who enter call-in orders at Home Shopping Network's facility. The arrangement requires only one computer system with one database and one software system. *Virtual private networks (VPNs)* connect two or more LANs through a public network like the internet. This saves companies' money because they don't have to pay for private lines, but it is important that strong security measures be in place, so that unauthorized persons can't gain access.

Wireless Networks Wireless networks use airborne electronic signals to link network computers and devices. Like wired networks, wireless networks can either reach across long distances or exist within a single building or small area. For example, smartphone systems allow users to send and receive transmissions on the **wireless wide area networks (WWANs)** of hundreds of service providers—such as Rogers (Canada), T-Mobile (United States), and Vodafone (Italy)—in countries throughout the world. In such a system, a firewall provides privacy protection. We'll discuss firewalls in more detail later in this supplement.

Wi-Fi hotspots are locations such as coffee shops, hotels, and airports that provide wireless internet connections for people on the go. Each hotspot, or **Wi-Fi** (short for "wireless fidelity") access point, uses its own small network, called a *wireless local area network (wireless LAN or WLAN)*. Although wireless service is free at some hotspots, others charge a daily or hourly rate. For example, to find new revenue sources, airlines are scrambling to provide in-flight Wi-Fi service through ground-based or satellite connections. WestJet is working with a U.S.-based air-to-ground service provider named Gogo LLC.[17]

HARDWARE AND SOFTWARE

Any computer network or system needs **hardware**—the physical components, such as keyboards, monitors, system units, and printers. In

ELECTRONIC CONFERENCING IT that allows groups of people to communicate simultaneously from various locations via email, phone, or video.

VSAT SATELLITE COMMUNICATIONS A network of geographically dispersed transmitter-receivers (transceivers) that send signals to and receive signals from a satellite, exchanging voice, video, and data transmissions.

CLIENT-SERVER NETWORK A common business network in which clients make requests for information or resources and servers provide the services.

WIDE AREA NETWORK (WAN) Computers that are linked over long distances through telephone lines, microwave signals, or satellite communications.

LOCAL AREA NETWORK (LAN) Computers that are linked in a small area, such as all of a firm's computers within a single building.

WIRELESS WIDE AREA NETWORK (WWAN) A network that uses airborne electronic signals instead of wires to link computers and electronic devices over long distances.

WI-FI Short for "wireless fidelity"; a wireless local area network.

HARDWARE The physical components of a computer network, such as keyboards, monitors, system units, and printers.

dpa picture alliance/Alamy Stock Photo

After conquering the consumer market (taking sales away from other major players including Apple), Samsung is pushing its smartphone hardware platform and trying to carve out a bigger share of the business market by emphasizing features and security.

addition to laptops, desktop computers, tablets, and smartphones are also used in businesses. For example, Walmart employees roam store aisles using handheld devices to identify, count, and order items, track deliveries, and update backup stock at distribution centres to keep the shelves stocked.

The other essential component in any computer system is **software**—programs that tell the computer how to function. Software includes system software, such as the latest version of Microsoft Windows, which tells the computer's hardware how to interact with the software. It also includes application software, which meets the needs of specific users (e.g., Adobe Photoshop). Some application programs are used to address common, long-standing needs such as database management and inventory control; others have been developed for a variety of specialized tasks such as mapping the structure of underground oil fields or the anatomy of the human body.

Computer graphics convert numeric and character data into pictorial information like charts and graphs. They allow managers to see relationships more easily and generate clearer and more persuasive reports and presentations. As Figure C.2 shows, both types of graphics can convey different kinds of information—in this case, the types of materials that should be ordered by a picture framing shop like Artists' Frame Service.

Groupware—software that connects group members for email distribution, electronic meetings, message storing, appointments and schedules, and group writing—allows people to collaborate from their own desktop PCs, even if they're remotely located. It is especially useful when people work together regularly and rely heavily on information sharing. Groupware systems include IBM Domino, Microsoft Exchange Server, and Micro Focus GroupWise.

INFORMATION SYSTEMS: HARNESSING THE COMPETITIVE POWER OF INFORMATION TECHNOLOGY

Business today relies on information management in ways that no one could foresee even a decade ago. Managers now treat IT as a basic organizational resource for conducting daily business. At major firms, all activities—designing services, ensuring product delivery and cash flow, evaluating personnel—are linked to information systems. An **information system (IS)** uses IT resources and enables managers to take *data*—raw facts and figures that by themselves may not have much meaning—and turn that data into *information*—the meaningful, useful interpretation of data. Information systems also enable managers to collect, process, and transmit that information for use in decision making.

One of the most widely publicized examples of the strategic use of information systems is Walmart. The company's IS drives down costs and increases efficiency because the same methods and systems are applied

SOFTWARE Programs that tell the computer's hardware what resources to use and how.
COMPUTER GRAPHICS Programs that convert numeric and character data into pictorial information like charts and graphs.
GROUPWARE Software that connects group members for email distribution, electronic meetings, message storing, appointments and schedules, and group writing.
INFORMATION SYSTEM (IS) A system that uses IT resources to convert data into information and to collect, process, and transmit that information for use in decision making.

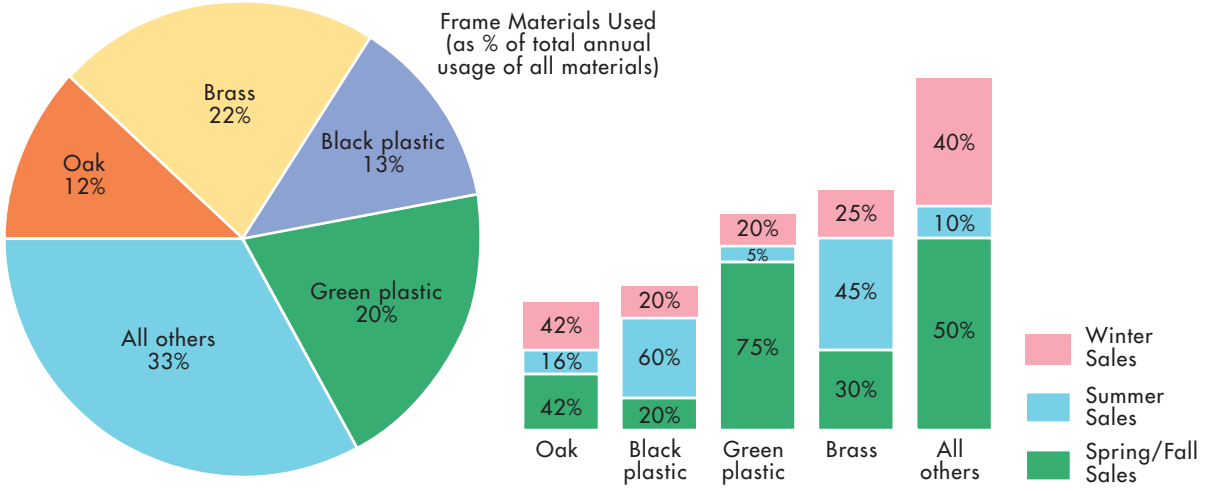


FIGURE C.2 Artists' frame service

for all 11 700-plus stores in Europe, Asia, and North America. Data on the billions of sales transactions—time, date, place—flows to company headquarters in Bentonville, Arkansas. Keeping track of nearly 700 million stock-keeping units (SKUs) weekly, the information system enforces uniform reordering and delivery procedures—on packaging, timing, and quantities—for more than 30 000 suppliers. It also regulates the flow of more than five billion cases through its distribution centres and deliveries by nearly 8000 Walmart truck drivers to its stores. Beyond the firm's daily operations, information systems are also crucial in planning. Managers routinely use the IS to decide on products and markets for the next five to ten years. The company's vast database enables marketing managers to analyze demographics, and it is also used for financial planning, materials handling, and electronic funds transfers with suppliers and customers.

Like most businesses, Walmart regards its information as an asset that is planned, developed, and protected. Therefore, it's not surprising that businesses have *information systems managers* who operate the systems used for gathering, organizing, and distributing information, just as they have production, marketing, and finance managers. These managers use many of the IT resources we discussed earlier to sift through this information and apply it to their jobs. The effective use of information is so critical that many companies have appointed *chief information officers* who are responsible for managing all aspects of information resources and information processes.

There are so many new challenges and opportunities for IT managers! For example, **cloud computing** is a major buzzword in those circles. The term has different meanings to different people, but in essence, cloud computing is the internet-based, as opposed to locally based, development and use of computer technology. Individuals have been using this approach for years with email and photo sharing (think Google and Flickr). Organizations are now increasingly integrating cloud-based tools into their infrastructure.

At the conceptual level, cloud computing means placing some infrastructure online and having someone else run it rather than doing it in-house. Some of the major advantages of this approach include lower costs, quicker setup, easy scalability, easier software integration, reduced financial risk, less downtime, potential services for small business (that otherwise could not afford them), automatic updates that don't disrupt or endanger other systems, and empowered users.[18] Cadillac Fairview, the Toronto-based commercial real-estate company, switched its email service to Gmail and reduced its costs to $50 per person from $210 with their previous provider. In addition, the company gets an impressive amount of storage for the service. Cadillac Fairview is also looking at adopting Salesforce.com, a customer relationship management provider that would allow the company to eliminate in-house servers for its customer relationship needs.[19]

Many of you routinely use such services (e.g., iCloud). Today, most companies also use at least one cloud-based solution; however, many still have some reservations about this approach. According to a 2018 survey by McAfee, 65 percent of 1400 information technology workers, from 11 countries, said their organization had a "cloud first" strategy. This number was down from 82 percent two years earlier. The primary reason for this decline is cyber-security risk. In fact, one in four organizations reported that their public cloud had been subject to data theft.[20]

LEVERAGING INFORMATION RESOURCES: DATA WAREHOUSING, BIG DATA, AND DATA MINING

Almost everything you do leaves a trail of information about you. Preferences in Netflix binge-watching, internet sites, and groceries; the destinations of phone calls, credit-card charges, financial status; and personal information about age, gender, marital status, and even health are just a few of the items about each of us that are stored in scattered databases. The behaviour patterns of millions can be traced by analyzing files gathered over time from their internet usage and in-store purchases.

Data Warehousing The collection, storage, and retrieval of such data in electronic files is called **data warehousing**. In recent years, many data warehouses have been locating or relocating existing facilities to Canada. This is partly because of our climate: data warehouses generate a lot of heat, and the natural environment in a northern climate helps cool facilities. But the natural cooling effect of our winters is only part of the story; cheaper, clean energy sources are another important consideration. According to Mike O'Neil, president of IT Market Dynamics, "It is far cheaper and easier to set up a data center next to a hydro dam." Finland and Sweden are also popular destinations.[21]

Big Data and Data Mining Companies are increasingly faced with larger and larger sets of data collected about their consumers. Every single day we create 2.5 quintillion bits' worth of it. If that sounds like a big number, it is! According to IBM, 90 percent of the data in the world has been created in the past two years alone. This data originates from purchase transaction records, sensors, pictures and video posts on social media sites, and smartphone GPS signals, to name just a few.[22] This surge is forcing IT specialists to change their perspective and adapt. *Big data* can be defined as "high-volume, high-velocity, and high-variety information assets that demand cost-effective, innovative forms of information processing for enhanced insight and decision making."[23] In

CLOUD COMPUTING Internet-based development and use of computer technology; at the conceptual level, placing some infrastructure online and having someone else run it rather than doing it in-house.

DATA WAREHOUSING The collection, storage, and retrieval of data in electronic files.

Many data warehouses are setting up or relocating to countries like Canada, Finland, and Sweden to take advantage of the natural cooling provided by the weather (during winter) and because of inexpensive electricity.

Serp/Shutterstock

other words, we have more data than ever before, and our processes are now quicker than ever. The real test for businesses is to create systems to extract this information in a fast, cost-effective manner. Some firms are actively using this information in real time, while others' information resources remain untapped.

According to market researcher IDC, in Canada alone businesses are expected to produce over 90 trillion gigabytes by 2020. Even so, Canadian businesses lag in the use of big data. Internet retailers like Shop.ca have been early adopters. According to Trevor Newell, president of Shop.ca, sales of a projector increased by 800 percent after the company sent automated targeted emails to members and promoted the product on social media sites.[24]

Trying to access the gold mine of information in company databases is nothing new. To make sense of the mountains of information, companies have used **data mining**—the application of electronic technologies for searching, sifting, and reorganizing pools of data to uncover useful information—for years. Data mining helps managers plan for new products, set prices, and identify trends and shopping patterns. By analyzing what consumers actually do, businesses can determine what subsequent purchases they are likely to make and then send them tailor-made ads. For example, a grocery chain can collect data on customer shopping habits to find ways to gain greater customer loyalty. It can accumulate information from its shopper cards, analyze the data to uncover shopping patterns, and send money-saving coupons to regular customers for the specific products they usually buy. One supermarket chain in the United States, analyzing data, realized that men coming to buy baby diapers were also buying beer. So the supermarket decided to place beer and diapers side by side, stimulating more sales.[25]

Philosophically, "big data" is replacing "data mining," moving users from a perspective of searching for that golden nugget of information after the fact (data mining) to a quick-moving, interactive, systematic flow of real-time (or near-time) information (the big data approach).[26]

Information Linkages with Suppliers

The top priority for Walmart's IS—improving in-stock reliability—requires integration of Walmart's and suppliers' activities with store sales. That is why Procter & Gamble, Johnson & Johnson, and other suppliers connect into Walmart's information system to observe up-to-the-minute sales data on individual items, by store. They can use the system's computer-based tools—spreadsheets, sales forecasting, and weather information—to forecast sales demand and plan delivery schedules. Coordinated planning avoids excessive inventories, speeds up deliveries, and holds down costs throughout the supply chain, while keeping shelves stocked for retail customers.

TYPES OF INFORMATION SYSTEMS

Since employees have a variety of responsibilities and decision-making needs, a firm's information system may actually be a set of several information systems that share data, while serving different levels of the organization, different departments, or different operations. One popular information system is called the **transaction processing system (TPS)**, which processes information for many different, day-to-day business transactions like customer order-taking by online retailers, approval of claims at insurance companies, receiving and confirming reservations by airlines, and payroll processing.

Because they work on different kinds of problems, managers and their subordinates need access to the specialized information systems that satisfy their different information needs. In addition to different types of users, each business function—marketing, human resources, accounting, production, finance—has its own information needs, as do groups working on major projects. Each user group and department, therefore, may need a special IS. Two important groups are knowledge workers and managers.

Information Systems for Knowledge Workers

As we discussed in Chapter 8, knowledge workers are employees for whom information and knowledge are the raw materials of their work, such as engineers, scientists, and IT specialists who rely on IT to design new products or create new processes. These workers require **knowledge information systems** that provide resources to create, store, use, and transmit new knowledge for useful applications—for instance, databases to organize and retrieve information, and computational power for data analysis.

Specialized support systems have also increased the productivity of knowledge workers. **Computer-aided design (CAD)** helps knowledge workers design products ranging from cell phones to jewellery to auto parts, by simulating them and displaying them in 3-D graphics. The older method—making handcrafted prototypes from wood, plastic, or clay—is replaced with faster, cheaper prototyping. The CAD system electronically transfers instructions to a computer-controlled machine that builds the prototypes.

Information Systems for Managers

Each manager's information activities and IS needs vary according to his or her functional area (accounting, marketing, and so on) and management level. The following are some popular information systems used by managers for different purposes.

Management information systems (MISs) support managers by providing reports, schedules, plans, and budgets that can then be used for making decisions, both short- and long-term. For example, at a publishing company, managers rely on detailed information—current customer orders, staffing schedules, employee attendance, production schedules, equipment status, and materials availability—for moment-to-moment decisions during the day. They require similar information to plan mid-range activities such as personnel training, materials movements, and cash flows. They also need to anticipate the status of the jobs and projects assigned to their departments. Many MISs—cash flow, sales, production scheduling, and shipping—are indispensable for helping managers complete these tasks.

For longer-range decisions involving business strategy, managers need information to analyze trends in the publishing industry and overall company performance. They need both external and internal

DATA MINING The application of electronic technologies for searching, sifting, and reorganizing pools of data to uncover useful information.

TRANSACTION PROCESSING SYSTEM (TPS) Applications of information processing for basic day-to-day business transactions.

KNOWLEDGE INFORMATION SYSTEMS Information system that supports knowledge workers by providing resources to create, store, use, and transmit new knowledge for useful applications.

COMPUTER-AIDED DESIGN (CAD) IS with software that helps knowledge workers design products by simulating them and displaying them in 3-D graphics.

MANAGEMENT INFORMATION SYSTEM (MIS) Computer system that supports managers by providing information—reports, schedules, plans, and budgets—that can be used for making decisions.

information, current and future, to compare current performance data to data from previous years and to analyze consumer trends and economic forecasts.

Managers who face a particular kind of decision repeatedly can get assistance from **decision support systems (DSSs)**—interactive systems that create virtual business models and test them with different data to see how they respond. When faced with decisions on plant capacity, managers can use a capacity DSS. The manager inputs data on anticipated sales, working capital, and customer-delivery requirements. The data flows into the DSS processor, which then simulates the plant's performance under the proposed conditions. After experimenting with various conditions, the DSS makes recommendations on the best levels of plant capacity for each future time period.

Artificial intelligence (AI) refers to the development of computer systems to imitate human behaviour—in other words, systems that perform physical tasks, use thought processes, and learn. In developing AI systems, business specialists, modellers, and information-technology experts try to design computer-based systems capable of reasoning so that computers, instead of people, can perform certain activities. For example, a credit-evaluation system may decide which loan applicants are creditworthy and which are too risky, and it may then compose acceptance and rejection letters accordingly. Some AI systems possess sensory capabilities, such as lasers that "see," "hear," and "feel."

The *expert system* is designed to imitate the thought processes of human experts in a particular field. Expert systems incorporate the rules that an expert applies to specific types of problems, such as the judgments a physician makes when diagnosing illnesses. In effect, expert systems supply everyday users with "instant expertise."

Coca-Cola has over 500 brands and sells approximately 1.9 billion servings per day to customers in over 200 countries. It is also one of the pioneers in the use of AI and Big Data. According to Greg Chambers, Global Director of Digital Innovation, *"AI is the foundation for everything we do. We create intelligent experiences. AI is the kernel that powers the experience."*[27] The applications include product development; every morsel of information is analyzed and used for insight. The company is also planning to develop an AI bot like Alexa and Siri that would serve as a helpful assistant, residing in their vending machines, and creating blended mixes of flavors for drinks on demand.[28]

In the past few years, Canada has emerged as one of the leaders in the field of AI with hubs developing in Toronto, Montreal, and Edmonton in particular. Some of the high-profile companies that have invested in Canadian AI facilities and labs include Samsung, Facebook, Google, Uber, Alphabet Inc. (Google), and Microsoft.[29]

IT RISKS AND THREATS

As with other technologies throughout history, IT has attracted abusers intent on mischief, of severity ranging from a small annoyance to outright destruction. Eager IT users everywhere are finding that even social networking and cell phones have a "dark side"—privacy invasion. Facebook postings of personal information about users can be intercepted and misused. Beacon, a now-defunct part of Facebook's advertising system, caused a public uproar when it published peoples' online purchases in their Facebook newsfeeds. Maintaining privacy is a problem with cell phone advancements. Bluetooth connections allow savvy intruders to read a victim's text messages, listen in on live conversations, and even view users' photos.[30, 31] With the tremendous rise in the use of smartphones, the threat of information theft is that much higher today.

Businesses, too, are troubled with IT's dark side. Hackers break into computers, stealing personal information and company secrets and launching attacks on other computers. Meanwhile, the ease of information sharing on the internet has proven costly for some companies, which are having increasing difficulty protecting their intellectual property; and viruses that crash computers have cost companies millions. In this section, we'll look at these and other IT risks.

HACKERS

Breaking and entering no longer refers only to physical intrusion. Today, it applies to IT intrusions as well. **Hackers** are cybercriminals who gain unauthorized access to a computer or network, either to steal information, money, trade secrets, or property or to tamper with data. One of the most famous cases occurred in 2014 when hackers succeeded in penetrating Sony's systems. They caused major problems, releasing sensitive information including personal details and embarrassing emails. They also made threats of violence if Sony released the satirical movie *The Interview* (about the fictional assassination of North Korean leader Kim Jong-Un) into movie theatres. Eventually, Sony decided to release the movie online rather than in theatres (the movie was downloaded two million times in its first few days). In an interesting twist, Sony also decided to pull their old BlackBerry devices out of storage (that they had not used in years) to protect their information during the crisis. Although they have lost a tremendous amount of market share, BlackBerry smartphones are still considered the safest because of their advanced encryption technology.[32]

Another common hacker activity is to launch *denial of service (DoS)* attacks—which flood networks or websites with bogus requests for information and resources, shutting the networks or websites down, and preventing legitimate users from accessing them.

Accessing unsecured wireless networks is a profitable industry for cyber criminals. Once inside, hackers can commit identity theft and steal credit-card numbers, among other things. When police officers try to track down these criminals, they're long gone, leaving the network host exposed to criminal prosecution.

IDENTITY THEFT

Once inside a computer network, hackers are able to commit **identity theft**, the unauthorized stealing of personal information (such as social insurance numbers and addresses) to get loans, credit cards, or other monetary benefits by impersonating the victim. Clever crooks get information on unsuspecting victims by digging in trash, stealing mail, or using phishing or pharming schemes to lure internet users to bogus websites. For instance, a cybercriminal might send TD Bank online customers an email notifying them of a billing problem with their accounts. When the customers click on the link, they are transferred to a spoofed (falsified)

DECISION SUPPORT SYSTEM (DSS) Interactive system that creates virtual business models for a particular kind of decision and tests them with different data to see how they respond.

ARTIFICIAL INTELLIGENCE (AI) The development of computer systems to imitate human thought and behaviour.

HACKER Cybercriminal who gains unauthorized access to a computer or network, either to steal information, money, trade secrets, or property or to tamper with data.

IDENTITY THEFT Stealing of personal information (such as social insurance number and address) to get loans, credit cards, or other monetary benefits by impersonating the victim.

webpage, modelled after TD Bank's site. The customers then submit the requested information—credit-card number, social insurance number, and PIN—into the hands of the thief. Today, consumers are more aware of these scams, but many are still victimized. Major organizations like the Canadian Bankers Association and the Competition Bureau are working with organizations to identify patterns and inform consumers.[33]

In Canada, the federal government has created new privacy legislation in the Personal Information Protection and Electronic Documents Act (PIPEDA), designed to promote e-commerce while protecting personal information. The Act outlines the rules for managing personal information in the private sector.[34]

INTELLECTUAL PROPERTY THEFT

Nearly every company faces the dilemma of protecting product plans, new inventions, industrial processes, and other **intellectual property**—something produced by the intellect or mind that has commercial value. Its ownership and the right to its use may be protected by patent, copyright, trademark, and other means. Intellectual property theft is evident when, for example, individuals illegally download unpaid-for movies, music, and other resources from file-swapping networks. But the activities are not limited to illegal entertainment downloads. For example, according to the U.S. Intelligence Agency, Chinese cyber spies steal about $40 to $50 billion worth of intellectual property each year.[35]

COMPUTER VIRUSES, WORMS, AND TROJAN HORSES

Another IT risk facing businesses is rogue programmers who disrupt IT operations by contaminating and destroying software, hardware, or data files. Viruses, worms, and Trojan horses are three kinds of malicious programs that, once installed, can shut down any computer system.

A computer *virus* exists in a file that attaches itself to a program and migrates from computer to computer as a shared program or as an email attachment. It does not infect the system unless the user opens the contaminated file, and users typically are unaware they are spreading the virus by file sharing. It can, for example, quickly copy itself over and over, using up all available memory and effectively shutting down the computer.

Worms are a particular kind of virus that travel from computer to computer within networked computer systems, without the need for any software to be opened. In a matter of days, the notorious Blaster worm infected some 400 000 computer networks, destroying files and even allowing outsiders to take over computers remotely. The worm replicated rapidly, sending out thousands of copies to other computers in the network. Travelling through internet connections and email address books in the network's computers, it absorbed system memory and shut down network servers, web servers, and individual computers.

Unlike viruses, a *Trojan horse* does not replicate itself. Instead, it most often comes into the computer, at your request, masquerading as a harmless, legitimate software product or data file. Once installed, the damage begins. For instance, it may simply redesign desktop icons or, more maliciously, delete files and destroy information.

SPYWARE

As if forced intrusion isn't bad enough, internet users unwittingly invite spies masquerading as friendly files available as a giveaway or shared among individual users on their PCs. This so-called **spyware** is downloaded by users who are lured by "free" software. Once installed, it crawls around to monitor the host's computer activities, gathering email addresses, credit-card numbers, passwords, and other inside information that it transmits back to someone outside the host system. Spyware authors assemble incoming stolen information to create their own "intellectual property" that they then sell to other parties to use for marketing and advertising purposes or for identity theft.[36]

Spam **Spam**—junk email sent to a mailing list or a *newsgroup* (an online discussion group)—is a greater nuisance than postal junk mail because the internet is open to the public, email costs are negligible, and massive mailing lists are accessible through file sharing or by theft. Spam operators send unwanted messages. In addition to wasting users' time, spam also consumes a network's bandwidth, reducing the amount of data that can be transmitted in a fixed amount of time for useful purposes.

IT PROTECTION MEASURES

Security measures against intrusion and viruses are a constant challenge. Businesses guard themselves against intrusion, identity theft, and viruses by using firewalls, special software, and encryption.

FIREWALLS

Firewalls are security systems with special software or hardware devices designed to keep computers safe from hackers. A firewall is located where two networks—for example, the internet and a company's internal network—meet. It contains two components for filtering each incoming data:

1. *The company's security policy.* Access rules that identify every type of message that the company doesn't want to pass through the firewall.
2. *A router.* A table of available routes or paths, a "traffic switch" that determines which routes or paths on the network to send each message to after it is tested against the security policy.

Only those messages that meet the conditions of the user's security policy are routed through the firewall and permitted to flow between the two networks. Messages that fail the test are blocked.

PREVENTING IDENTITY THEFT

Internet privacy experts say that a completely new identity verification system is needed to stop the rising tide of internet identity theft. One possibility is an "infocard," which would act like a credit card and would allow websites to verify a customer's identity without keeping personal information on the customer. While foolproof prevention is impossible, steps can be taken to reduce the chance that you will be victimized. A visit to the Identity Theft Resource Center (www.idtheftcenter.org) is a valuable first source of information on everything from scam alerts to

INTELLECTUAL PROPERTY A product of the mind that has commercial value.

SPYWARE Program unknowingly downloaded by users that monitors their computer activities, gathering email addresses, credit-card numbers, and other information that it transmits to someone outside the host system.

SPAM Junk email sent to a mailing list or a newsgroup.

FIREWALL Security system with special software or hardware devices designed to keep computers safe from hackers.

victim issues (assistance on lost and stolen wallets, and so on) to media resources, current laws, and prevention of identity theft in the workplace.

PREVENTING VIRUSES: ANTI-VIRUS SOFTWARE

Many viruses take advantage of weaknesses in operating systems in order to spread. Network administrators must make sure that the computers on their systems are using the most up-to-date operating system that includes the latest security protection. Combating viruses, worms, and Trojan horses has become a major industry for systems designers and software developers. Installation of **anti-virus software** products protects systems by searching incoming email and data files for "signatures" of known viruses and files with virus-like characteristics. Contaminated files are discarded or placed in quarantine for safekeeping.

PROTECTING ELECTRONIC COMMUNICATIONS: ENCRYPTION SOFTWARE

Unprotected email can be intercepted, diverted to unintended computers, and opened, revealing contents to intruders. Protective software is available to guard against those intrusions, adding a layer of security by encoding emails so that only intended recipients can open them. An **encryption system** works by scrambling an email message so that it looks like garbled nonsense to anyone who doesn't possess the key.

AVOIDING SPAM AND SPYWARE

To help their employees avoid privacy invasion and to improve productivity, businesses often install anti-spyware and spam-filtering software on their systems. Dozens of anti-spyware products provide protection—software such as Webroot's Spy Sweeper—but they have to be continually updated to keep pace with new spyware techniques. While it cannot be prevented entirely, spam is reduced by many internet service providers (ISPs) that ban the spamming of ISP subscribers.

ANTI-VIRUS SOFTWARE Product that protects systems by searching incoming emails and data files for "signatures" of known viruses and files with virus-like characteristics.

ENCRYPTION SYSTEM Software that assigns an email message to a unique code number (digital fingerprint) for each computer so only that computer, not others, can open and read the message.

APPENDIX D

Managing Your Personal Finances: A Synopsis

Below are some important personal finance tips and practical hands-on examples.

DEVELOPING A PERSONAL FINANCIAL PLAN

Like it or not, dealing with personal finances is a lifelong job. As a rule, it involves rational management of your personal finances—controlling them as a way of life and helping them grow. Figure D.1 provides a summary of the key steps in developing a financial plan.

THE TIME VALUE OF MONEY AND THE RULE OF 72

The time value of money is perhaps the single most important concept in personal finance. It's especially relevant for setting financial goals and evaluating investments. The concept of *time value* recognizes the basic fact that, while it's invested, money grows by earning interest or yielding some other form of return. Thus, whenever you make everyday purchases, you're giving up interest that you could have earned with the same money if you'd invested it instead. From a financial standpoint, "idle" or uninvested money is a wasted resource.

How long does it take to double an investment? A handy rule of thumb is "The Rule of 72." You can find the number of years needed to double your money by dividing the annual interest rate (in percent) into 72. If, for example, you reinvest annually at 8 percent, you'll double your money in about 9 years.

Look at Table D.1 for a clearer picture of the importance of this simple rule.

How does a $10 000 investment grow under different interest-rate scenarios? These days most banks pay 1 percent interest (if you're lucky). You would have to live another 72 years to see your money double at that rate. Thirty years later that $10 000 initial investment would only be worth $13 800, whereas the same investment would be worth $174 000 if you earned 10 percent. On average, the stock market has earned an average return of 10 percent in the last 75 years. However, if you are risk-averse, you could still put the money in something safer (like bonds) and still turn that $10 000 into $32 430 or more. More detailed explanations and examples are available in the online appendix.

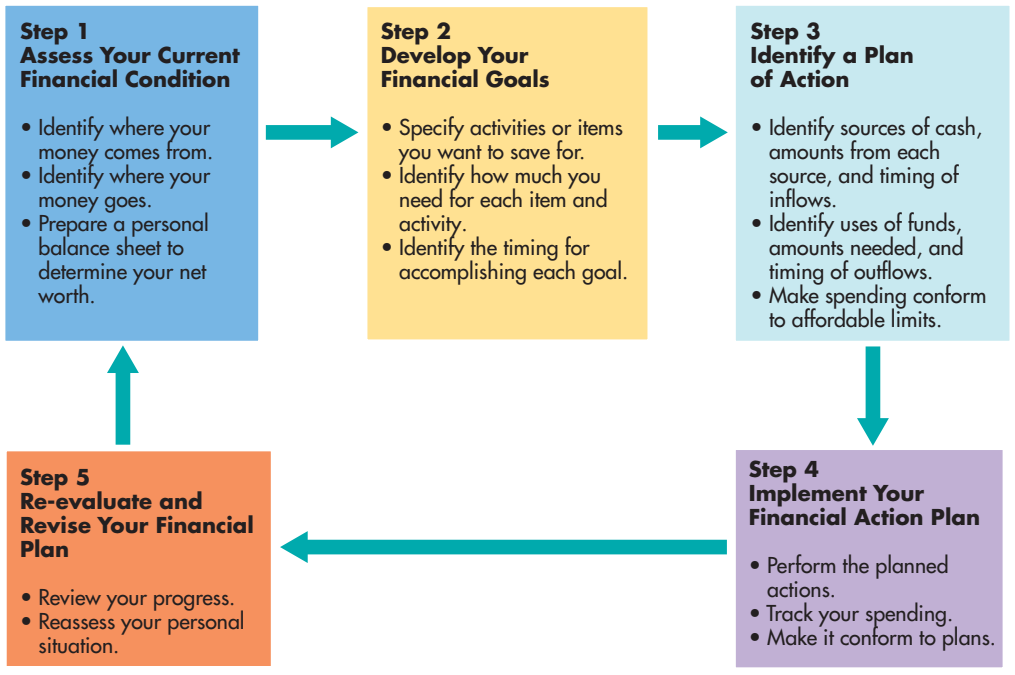


FIGURE D.1 Developing a personal financial plan

TABLE D.1 The Rule of 72 and the Time Value of Money

The Number 72	Interest Rate	Number of Years for Money to Double	How Much a $10 000 Investment Is Worth after 30 Years
72	1	72	$ 13 800
72	4	18	$ 32 430
72	6	12	$ 57 430
72	8	9	$ 100 620
72	10	7.2	$174 490

Where you invest your money counts! Never forget the rule of 72 and the time value of money!

USE CREDIT CARDS RESPONSIBLY

Although some credit cards don't charge annual fees, all of them charge interest on unpaid (outstanding) balances. Because credit-card debt is one of the most expensive sources of funds, you need to understand the costs before you start charging.

For example, if you have $5000 worth of credit-card debt on a Visa that charges 18 percent, you are paying $960 in interest per year for that debt. You could probably think of better ways to spend that money (fancy clothes or a weekend getaway perhaps). Most people never make that calculation because the credit-card companies allow you to make the "minimum payment" and are happy collecting the interest from you (especially as you increase your debt from $5000 to $10 000 to $20 000 over time). If you only make the minimum payment, that *$5000 credit-card debt (at 18 percent) will take 115 months to pay off*. Guess what, the rule of 72 also applies to your debts. So be smart.

Don't destroy your personal wealth by ignoring the cost of your interest payments. If you are stuck with debt, try to transfer it to lower-cost sources of financing and pay it off as soon as possible!

INVEST CAREFULLY IN REAL ESTATE

Should you rent or buy? The answer to that question involves a variety of considerations, including life stage, family needs, career, financial situation, and preferred lifestyle. If you decide to buy, you must ask yourself how much house you can afford. To answer that question, you need to ask several questions about your personal financial condition and your capacity for borrowing. Buy wisely.

Step 1: Don't spend beyond your means!
Step 2: When signing a mortgage deal, look around and compare; even a minor interest rate reduction (0.25 percent lower) translates into significant savings.

TABLE D.2 Tips for Personal Financial Wealth

1. Develop a Financial Plan
2. Understand the Time Value of Money & Never Forget the Rule of 72!
3. Use Credit Cards Responsibly
4. Invest Wisely in Real Estate
5. Cash Out from (Legal) Tax Avoidance
6. Protect Your Net Worth

CASHING OUT FROM (LEGAL) TAX AVOIDANCE

Take advantage of all the various government programs and rules to cut your tax bill. Some of the most important methods for tax relief and/or untaxed accumulation of funds include *registered retirement savings plans (RRSPs), tax-free savings accounts (TSFAs), and registered education savings plans (RESP).*

Lower your tax bill, increase your personal equity.

PROTECT YOUR NET WORTH

With careful attention, thoughtful saving and spending, and skillful financial planning (plus a little luck), you can build up your net worth over time. However, every financial plan should consider steps for preserving it. One approach involves the risk–return relationship. Do you prefer to protect your current assets, or are you willing to risk them in return for greater growth? At various life stages, and whenever you reach a designated level of wealth, you should adjust your asset portfolio to conform to your risk and return preferences—conservative, moderate, or aggressive.

Another approach is life insurance. From a personal-finance perspective, the purpose of life insurance is to replace income upon the death of the policyholder. Accordingly, the amount of insurance you need depends on how many other people rely on your income. Insurance, for example, is crucial for the married parent who is a family's sole source of income. On the other hand, a single person with no financial dependents needs little or no insurance and will probably prefer to put money into higher-paying investments.

Buy the right life insurance and the right amount. For an explanation of the difference between term and whole life insurance, refer to the online site.

APPENDIX E

Insurance as Risk Management

To deal with some risks, both businesses and individuals may choose to purchase one or more of the products offered by insurance companies. Buyers find insurance appealing for a very basic reason—in return for a relatively small sum of money, they are protected against specific losses, some of which are potentially devastating. With insurance, individuals and businesses share risks by contributing to a fund out of which those who suffer losses are paid. Insurance companies are willing to accept these risks for other companies because they make profits by taking in more in **premiums** than they pay out to cover policyholders' losses. Although many policyholders are paying for protection against the same type of loss, it is unlikely that all of them will suffer such a loss.

INSURABLE VS. UNINSURABLE RISKS

Like every other business, insurance companies must avoid certain risks. Insurers thus divide potential sources of loss into *insurable* and *uninsurable risks*.[1] Obviously, they issue policies only for insurable risks, which must satisfy the four criteria of *predictability, casualty, unconnectedness*, and *verifiability*.

Predictability The insurer must be able to use statistical tools to forecast the likelihood of a loss. For example, an auto insurer needs information about the number of car accidents in the past year to estimate the expected number of accidents for the following year. With this knowledge, the insurer can translate expected numbers and types of accidents into expected dollar losses. The same forecast also helps insurers determine premiums charged to policyholders. Cyberattacks on companies like Sony are difficult for insurance companies to deal with, since it is very difficult to determine the likelihood of a cyberattack and the costs that will be incurred by one.[2]

Casualty A loss must result from an accident, not from an intentional act by the policyholder. For example, an insurer does not have to cover damages if a policyholder deliberately sets fire to a business. To avoid paying in cases of fraud, insurers may refuse to cover losses when they cannot determine whether policyholders' actions contributed to them.

Unconnectedness Potential losses must be random and must occur independently of other losses. No insurer can afford to write insurance when a sizable percentage of those exposed to a particular kind of loss are likely to suffer such a loss. One insurance company, for instance, would not want all the hail coverage in Saskatchewan or all the earthquake coverage in Vancouver. By carefully choosing the risks it will insure, an insurance company can reduce its chances of a large loss.

Verifiability Finally, insured losses must be verifiable as to cause, time, place, and amount. Did an employee develop emphysema because of a chemical to which she was exposed or because she had smoked 40 cigarettes per day for 30 years? Did the policyholder pay the renewal premium before the fire destroyed his factory? Were the goods stolen from the company's office or from the president's home? What was the insurable value of the destroyed inventory? When all these points have been verified, payment by the insurer goes more smoothly.

THE INSURANCE PRODUCT

Some insurers offer only one area of coverage—life insurance, for example—while others offer a broad range. In this section, we briefly describe three major categories of business insurance—*liability, property*, and *life*.

Liability Insurance Liability means responsibility for damages in case of accidental or deliberate harm to individuals or property. **Liability insurance** covers losses resulting from damage to people or property when the insured party is judged liable. A business is liable for any injury to an employee when the injury arises from activities related to occupation. When workers are permanently or temporarily disabled by job-related accidents or disease, employers are required by law to provide **workers' compensation coverage** for medical expenses, loss of wages, and rehabilitation services.

Every year in Canada, well over $1 billion is lost to insurance fraud. The insurance industry estimates that between $10 and $15 of every $100 you pay in premiums goes to cover fraud losses. The Insurance Bureau of Canada (IBC) is an industry association that represents Canadian companies that provide car, home, and business insurance. The IBC protects honest policyholders by monitoring insurance claims

PREMIUMS Money paid to an insurance company by customers in return for being covered for certain types of losses should they occur.

LIABILITY INSURANCE Covers losses resulting from damage to people or property when the insured party is judged liable.

WORKERS' COMPENSATION COVERAGE Compensation for medical expenses, loss of wages, and rehabilitation services for injuries arising from activities related to occupation.

Losses are reduced or prevented when this security specialist uses electronic surveillance (left), when valuables are stored under lock and key (middle), and when workers are reminded to wear safety gear at this construction site (right).

Left: Andrey Popov/Shutterstock; Middle: Mile Atanasov/Shutterstock; Right: Morgan Rauscher/Fotolia

and determining which ones are fraudulent. Two areas of particular concern are organized crime rings and fraudulent injury claims. One popular scam is the "staged accident." The swindler purposely (but carefully) runs into, say, a telephone pole, and then everyone in the car claims they are suffering from whiplash. After the accident is reported, the insurance company contacts the car's occupants and sends them accident benefit packages. Sometimes people who aren't even insured are paid benefits because they use counterfeit "proof of insurance" cards.[3] The IBC also lobbies the government to make legislative changes that will deter insurance fraud. Visit the IBC website at www.ibc.ca.

Property Insurance

Firms purchase **property insurance** to cover injuries resulting from physical damage to real estate or personal property. Property losses may result from fire, lightning, wind, hail, explosion, theft, vandalism, or other destructive forces, such as hurricanes. For example, in the 2017 IBC report, it was revealed that Canadian insurers paid out $5 billion in the previous 12 months to individuals and firms. It was a particularly difficult year due partially to the major wildfires in Fort-McMurray that burnt over 2500 buildings and properties and displaced 90 000 people.[4]

In some cases, loss to property is minimal in comparison with loss of income. A manufacturer, for example, may have to close down for an extended time while fire damage is being repaired. During that time, the company is not generating any income, but certain expenses—such as taxes, insurance premiums, and salaries for key personnel—may continue. To cover such losses, a firm may buy *business interruption insurance*.

Life Insurance

Insurance can also protect a company's human assets. As part of their benefits packages, many businesses purchase **life insurance** for employees. Life insurance companies receive premiums in return for the promise to pay beneficiaries after the death of insured parties. As with other types of insurance, a portion of the premium is used to cover the insurer's own expenses.

Life insurance can, of course, also be purchased by individuals. For many years, Canadian life insurance companies have sold insurance policies to Canadians, but now they are rapidly expanding overseas, particularly in China and India. Sun Life Financial, for example, formed a joint venture with Aditya Birla Group to sell life insurance and mutual funds in India. As a result of this partnership, Sun Life is the second-largest privately owned life insurance company in India.[5] But in 2011, both Sun Life and Standard Life Assurance decided to stop selling individual life insurance policies in the United States because low interest rates and volatile stock markets made it difficult to make a profit selling such policies.[6] In some areas of the world, unstable and dangerous situations have motivated entrepreneurs to sell special kinds of insurance. For example, the Al-Ameen Insurance Co. pays out $3500 to beneficiaries of people killed as a result of insurgent activity in Iraq. The annual premium is about $35.[7]

Most companies buy **group life insurance**, which is underwritten for groups as a whole rather than for each individual member. The insurer's assessment of potential losses and its pricing of premiums are based on the characteristics of the entire group.

PROPERTY INSURANCE Covers injuries to firms resulting from physical damage to or loss of real estate or personal property.

LIFE INSURANCE Insurance that pays benefits to survivors of a policyholder.

GROUP LIFE INSURANCE Life insurance underwritten for a group as a whole rather than for each individual member.

Catastrophic losses like those caused by fire are avoided when a business buys property insurance. The cost of the rebuilding will be paid by the insurance company. But interruption of the firm's normal operations will also be harmful, so many businesses buy business interruption insurance as well.

Cary Ulrich/Alamy Stock Photo

SPECIAL FORMS OF BUSINESS INSURANCE

Many forms of insurance are attractive to both businesses and individuals. For example, homeowners are as concerned about insuring property from fire and theft as businesses are. Businesses, however, have some special insurable concerns—the departure or death of key employees or owners.

Key Person Insurance

Many businesses choose to protect themselves against loss of the talents and skills of key employees. If a salesperson who brings in $2.5 million of sales revenue dies or takes a new job, the firm will suffer loss. It will also incur recruitment costs to find a replacement and training expenses once a replacement is hired. **Key person insurance** is designed to offset both lost income and additional expenses.[8]

Business Continuation Agreements

Who takes control of a business when a partner or an associate dies? Surviving partners are often faced with the possibility of having to accept an inexperienced heir as a management partner. This contingency can be handled in **business continuation agreements**, whereby owners make plans to buy the ownership interest of a deceased associate from his or her heirs. The value of the ownership interest is determined when the agreement is made. Special policies can also provide survivors with the funds needed to make the purchase.

KEY PERSON INSURANCE Insurance that protects a company against loss of the talents and skills of key employees.

BUSINESS CONTINUATION AGREEMENT An agreement in which owners of a business make plans to buy the ownership interest of a deceased associate from his or her heirs.

ENDNOTES AND SOURCE NOTES

ENDNOTES

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