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Study Text Vol. I



SHAPING FUTURE BUSINESS
AND FINANCE LEADERS

PRC - 3

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NATURE OF BUSINESS

IN THIS CHAPTER

AT A GLANCE

SPOTLIGHT

- 1 Understanding the nature of business

SELF-TEST

AT A GLANCE

Understanding the basic structures, organisation, and key forces is important for the survival and success of a business.

In a fast-changing environment, change is the only constant. Businesses that understand the functioning of major variables influencing their growth and profitability will succeed in the long-run.

This chapter will focus on key elements for understanding the nature of business such as:

- Purpose - profit and not-for-profit
- Vision, mission, goals and objectives
- Factors of production
- Stakeholders – internal and external

1 UNDERSTANDING THE NATURE OF BUSINESS

1.1 The nature of business

A business is an organisation that strives to earn **profit** by providing goods and services desired by its customers. Businesses meet consumer needs by providing household essentials, clothing, medical care, transportation, banking, communication, and many other goods and services.

Goods are tangible items that can be held, touched, stored, manufactured, or traded by businesses, such as laptops.

Services are intangible offerings provided by businesses that cannot be held, touched, or stored. Examples include physicians, lawyers, hairstylists, car washes, and airlines.

Businesses also sell products or provide services to other organisations, such as hospitals, retailers, and governments, by supplying machinery, goods for resale, computers, and thousands of other items.

Thus, businesses create the goods and services that form the basis of our standard of living. The standard of living in any country is measured by the quantity of goods and services that people can purchase with the money they have. This also provides a basis for comparing standards of living among different countries.

Businesses play a key role in determining our quality of life by providing jobs, **goods and services** to society. Quality of life refers to the overall level of human well-being, measured through factors such as life expectancy, education, health, sanitation, and leisure time. Building a high quality of life is a combined effort of businesses, government, and not-for-profit organisations (explained later). Different regions and countries are ranked and compared based on these quality-of-life standards.

The profitability of a business is measured by key factors such as revenue, costs, and profit.

Revenue is the money a company earns from selling goods or providing services to customers.

Costs are the expenses a company incurs for rent, salaries, supplies, transportation, and many other items related to creating and selling goods and services. For example, some of the Microsoft's costs in developing its software include salaries, facilities, and advertising. If money remains after covering all costs, the company earns a **profit**. Conversely, when a company's costs exceed its revenues, it incurs a **loss**. There is always a risk of loss if a business fails to achieve its goals due to inefficient use of resources and/or ineffective business strategies in responding to market competition.

When a company, such as Microsoft uses its resources intelligently, it can increase sales, hold costs down, and earn a profit. Not all companies earn profits, but that is the inherent risk of being in business. There is a direct relationship between risks and profit: the greater the risks, the greater the potential for profit (or loss).

Not-for-Profit Organisations

Not all organisations exist to make a profit. A **not-for-profit** organisation is established to achieve objectives other than the traditional business goal of earning profit. Examples may include charities, hospitals, educational institutes, social service organisations, non-governmental organisations (NGOs), civic groups, and religious bodies.

Like their for-profit counterparts, these groups set goals and require resources to achieve them. However, their goals are not centered on profits. For example, a not-for-profit organisation's goal might be feeding the poor, preserving the environment or advocating for the rights of an underprivileged community.

1.2 Purpose of a business

The primary goal of any business is to earn a profit. Businesses have the right to retain and use their profits as they choose, within legal limits, because profit is the reward for the risks they assume in providing products (i.e. goods and services). Profits benefit society by generating employment, which in turn provides income that is reinvested in the economy. Moreover, profits should be earned in an ethical and socially responsible manner.

To earn a profit, businesses need management skills to plan and organize operations, marketing expertise to identify consumer needs, and financial resources to fund and expand their activities. They must also comply with laws, act ethically, and adapt to changing circumstances. Not-for-profit organisations also engage in similar practices.

To remain profitable, businesses must produce quality products, operate efficiently, and act in a socially and ethically responsible manner towards stakeholders such as customers, employees, and investors. Many businesses are also concerned about the environmental impact of their products.

As part of a strategic review, management should regularly re-consider the purpose of the entity they manage and what it is trying to achieve. In the strategic planning process, goals, objectives and strategies should be formulated with the aim of fulfilling the entity's purpose. A business entity should maintain a hierarchy of aims and plans. A useful way of presenting this is shown below.

Level	Description
Future Outlook	Vision
Overall Purpose	Mission
General Aims	Goals
Specific Aims	Objectives
Detailed Longer-Term Targets	Strategies / Strategic Aims
Implementation Targets and Budgets	Tactical Plans / Aims
Action Plans and Targets	Operational Plans / Aims

An important aspect of managing a business is establishing its purpose and providing clear communication to stakeholders. This can be achieved through the creation of a mission statement and a vision statement.

Vision and Vision Statement

A vision statement focuses on the future, outlining what an organisation aspires to become. It is an inspirational statement meant to motivate employees and clearly communicate the organisation's goals to stakeholders.

The vision should avoid describing the current state and instead focus on future aspirations, ensuring it is clear, optimistic, and realistic. An unrealistic vision, such as a small store claiming it will become the largest retailer in a short period, would not be effective. A strong vision statement should be brief, simple, specific to the business, and free from ambiguity.

► For example:

A technology sector company's vision statement could be:

"To become a leading provider of sustainable and innovative technology solutions that improve the way people live and work worldwide."

Mission and Mission Statement

A mission is the purpose of an organisation and the reason for its existence. Many entities give a formal expression to their mission in a mission statement. A mission statement defines what an organisation is, why it exists and its reason for being.

A mission statement describes an organisation's core function in society, outlining the products and services it provides to customers. It focuses on the present, detailing how a company plans to achieve its objectives and why it is doing so, while communicating this to employees, shareholders, and other stakeholders. Although small businesses may sometimes overlook it, large organisations invest significant time and resources in crafting their mission statement. This is particularly important for growing businesses, especially where the owner cannot personally convey the company's mission to all stakeholders. A good mission statement should be clear and concise, answering key questions such as: What is our business? What value do we offer customers? What will our business be? What should our business be? Some mission statements may also include the role of employees or address ethical considerations.

► *For example:*

A technology sector company's mission statement could be:

To deliver innovative and reliable technology solutions that empower businesses and individuals to achieve more, while promoting sustainability and ethical practices in all our operations.

Commercial entities often emphasize the ethical aspects of their mission, sometimes as a way to motivate employees.

The relevance of the mission statement

A mission statement can serve several different purposes:

- to provide a basis for consistent strategic planning decisions
- to assist in translating broad intentions and purposes into corporate objectives
- to provide a common purpose for all groups and individuals within the organisation
- to inspire employees
- to establish goals and ethical standards for the organisation
- to enhance the understanding of and support for the organisation among external stakeholders and the public.

A company might have a goal of maximizing the wealth of its shareholders. Its objective, therefore, could be to double the share price within the next ten years.

Objectives can be expressed as a hierarchy of corporate and strategic objectives:

- A corporate objective might be to double the share price within the next ten years. This represents the overall objective for the organisation.

Some strategic objectives are more important than others, forming a hierarchy of strategic objectives. However, the main strategic objectives are often identified as critical success factors, each with corresponding key performance indicators.

Goals and objectives can therefore be used to translate an entity's mission into specific strategies with strategic targets for achievement within a strategic planning period.

Who decides mission, goals and objectives?

When an entity defines its mission in a mission statement, the statement is issued by the leaders of the organisation. In a company, this responsibility typically lies with the board of directors. Similarly, the formal goals and objectives of an organisation are determined by its leaders.

However, a board of directors' decisions regarding the goals and objectives of an organisation are influenced by the company's governance structure and the expectations of its stakeholders.

How to set effective goals

Techniques for setting effective goals include:

- Participating in the goal-setting process
- Ensuring that the goals involve intrinsically motivating work
- Establishing a system that provides feedback on the achievement of goals
- Ensuring that goals are SMART (see above)
- Aligning personal and commercial goals
- Stating goals positively when recording them
- Setting priorities

Examples of Goals and Objectives:

Variables	Goal	Objectives
Growth and Profitability	Increase net profit by 15% by growing revenue while controlling expenses	• Increase annual sales by 25% • Add five new customers each month • Reduce the annual utility bills by 5%
Customer Care	Reducing customer complaints by 30% and improve resolution time by one day	• Hire two new customer service employees within next 12 months • Respond to customer complaints within two business days
Staff Retention	Improving staff retention to fewer than three employees leaving in six months	• Provide training for new employees within the first 90 days • Count bi-weekly one-on-one meetings
Efficiency	Reduce shipping times from five to two days	• Add a new shipper • Improve production time by two hours

1.3 Key Stakeholders in a Business

Understanding Stakeholders

A stakeholder is anyone who has an interest in, or is affected by, a business. Stakeholders can be individuals, groups, or organisations. Their interests and involvement can either influence the business or be influenced by the business's decisions and activities. Stakeholders are essential to a company's success and must be carefully considered when making strategic decisions.

Categories of Stakeholders

Stakeholders can be classified into three main categories based on their relationship with the business:

1. Internal Stakeholders

Internal stakeholders are directly involved in the company's day-to-day operations. They are individuals who work within the organisation and whose interests are closely tied to its success or failure.

Examples of Internal Stakeholders:

- Employees

Employees are directly involved in the day-to-day operations of the business. Their stake is tied to job security, fair wages, good working conditions, and opportunities for career progression. Their performance directly affects the productivity and profitability of the business.

- Managers / Directors

Managers oversee the daily activities and decision-making processes of the business. Their stake lies in ensuring smooth operations, achieving business goals, and maintaining efficiency. Success can lead to rewards such as bonuses and promotions, while failure can impact their career progression.

2. Connected Stakeholders

Connected stakeholders are those who have a direct financial relationship with the business but are not part of its daily operations. They interact with the business through transactions and exchanges, and their interests are closely linked to the business's performance.

Examples of Connected Stakeholders:

- Shareholders/Owners

Shareholders, often the owners of the business, invest capital into the company and expect a return on their investment. Their primary stake is profitability, as they rely on the company's success to increase the value of their shares and receive dividends. Shareholders can influence major business decisions through voting rights.

NOTE: In a company form of organisation, if shareholders are part of the board of directors, they may be considered internal stakeholders. The same applies to sole-proprietors and partners in a partnership.

- Customers

Customers purchase goods and services from the business. Their stake is to receive quality products at fair prices. They expect good service, reliability, and value for their money. Satisfied customers are more likely to become loyal, which in turn increases business revenue.

- Suppliers

Suppliers provide the raw materials, goods, or services necessary for the business to operate. Their stake lies in maintaining a stable business relationship, receiving timely payments, and securing long-term contracts. A reliable partnership benefits both the supplier and the company.

- Creditors

Creditors lend money or extend credit to the business. Their stake is to receive timely payments with interest and to ensure the company is financially stable enough to repay its debts. Creditors closely monitor the financial health of the business.

- Labour Unions

Labour unions represent the collective interests of employees. Their stake is to ensure fair wages, safe working conditions, and secure benefits for their members. They may negotiate on behalf of employees and influence business policies related to workforce treatment.

3. External Stakeholders

External stakeholders are not directly connected to the business through employment or financial transactions, but they are still impacted by or have an interest in the company's operations. Their relationship with the business is often indirect, but their influence can still be significant.

Examples of External Stakeholders:

- Government

The government regulates businesses through laws, policies, and taxation. It has a stake in ensuring companies comply with legal requirements, pay taxes, and contribute to the country's economy. Governments also focus on promoting ethical behavior and minimizing negative environmental impacts.

The government has an interest in all business organisations, for a wide range of reasons.

- a) Businesses pay tax on profits, so government has an interest in company profitability.
- b) The government want to create and maintain a strong economy. This depends partly (or largely) on new investments by businesses. Government may therefore encourage business investments.
- c) The government seeks low levels of unemployment and businesses are major employers.
- d) The government regulates many different aspects of business activity: employment law, environmental law, health and safety regulations and company law are just a few examples.

- Community/Public

The community where the business operates is affected by its presence. The local community has a stake in the business creating jobs, supporting local economies, and ensuring that it operates responsibly without causing environmental harm. A positive relationship with the community can enhance the company's reputation.

- Environmental Groups

Environmental groups advocate for the protection of natural resources and ecosystems. Their stake lies in ensuring that businesses operate sustainably, reduce pollution, and minimize environmental damage. Businesses that engage in responsible environmental practices can build trust with these groups and avoid negative publicity.

Stakeholder Interests and Business Balance

Balancing the needs of all stakeholders is one of the most challenging aspects of running a business. Different stakeholders often have conflicting interests. For instance, shareholders may prioritize profitability, which could mean cutting costs, but employees and labour unions might demand better wages and working conditions. Effective stakeholder management ensures that the business addresses these diverse interests while remaining profitable and ethical.

Why Managing Stakeholders is Important

Understanding stakeholders is essential because:

- It helps identify those who can influence the business's success.
- It allows the company to allocate resources efficiently.
- It fosters strong relationships and trust between the business and its stakeholders.
- It ensures that the business operates ethically and responsibly.

Conclusion

Stakeholders play a crucial role in shaping the direction and success of a business. Their interests, influence, and relationship with the company can significantly impact decision-making and strategy. Understanding the interest and power of various stakeholders helps businesses prioritize actions and resources effectively.

This is where Mendelow's Matrix becomes an essential tool, as it helps categorize stakeholders based on their level of interest and level of power, enabling companies to manage stakeholder relationships strategically for better outcomes.

SELF-TEST

For the following questions select the best answer.

1. A business is an organisation that strives for _____ by providing goods and services desired by its customers. Which of the following completes the statement?
 - a) Profit
 - b) Satisfaction
 - c) Efficiency
 - d) All of the above
2. The Board of Directors are the most powerful decision makers of a business. If this is true, what factor can influence the decision of the Board of directors. Choose the best answer from the following:
 - a) Opinion of customers
 - b) Knowledge of the business
 - c) Employee feedback
 - d) Opinion of shareholders
3. Which of the following are not considered as External Stakeholders of a company:
 - a) Managers
 - b) Government
 - c) local communities and pressure groups
 - d) Environmental groups
4. TRUE OR FALSE: The general public has a stake or interest in major companies, because the actions of these companies can affect society as a whole.
 - a) TRUE
 - b) FALSE
5. Which of the following is a reason why the government has an interest in all business organisations,
 - a) Businesses pay tax on profits, so government has an interest in company profitability.
 - b) Government wants to encourage business investments.
 - c) The government is interested in regulating business activity
 - d) All of the above
6. They provide the raw materials, goods, or services that the business needs to operate:
 - a) Suppliers
 - b) Creditors
 - c) The government allows sales on credit
 - d) Business entities
7. How does an employee's performance affect the business?
 - a) It influences the business's marketing strategy.
 - b) It directly affects the productivity and profitability of the business.
 - c) It has no impact on the business's financial success.
 - d) It mainly affects customer satisfaction.

8. Which of the following is NOT a reason for government interest in business?
 - a) Businesses pay taxes on profits, affecting government revenue.
 - b) The government wants to encourage business investments to promote economic growth.
 - c) The government seeks to reduce business profitability.
 - d) The government is interested in ensuring businesses create job opportunities.
9. Which of the following is a goal of the government fulfilled by encouraging new businesses to set up?
 - a) Earning profit
 - b) businesses reduce the country's unemployment
 - c) Paying salaries of government employees
 - d) Investment in country's infrastructure
10. What is the primary stake of shareholders in a business?
 - a) To ensure employee satisfaction and welfare.
 - b) Profitability, to increase the value of their shares and receive dividends.
 - c) To minimize the company's environmental impact.
 - d) To monitor customer satisfaction levels.
11. How can shareholders influence major business decisions?
 - a) By providing feedback on employee performance.
 - b) Through voting rights.
 - c) By managing day-to-day operations.
 - d) By controlling the company's marketing strategy.
12. What impact can failure have on managers?
 - a) It can affect the profitability of the business.
 - b) It can negatively influence their career progression.
 - c) It can result in increased employee benefits.
 - d) It has no impact on their career.
13. Within a business organisation, internal stakeholders can be categorised into groups. Which of the following are NOT internal stakeholders?
 - a) Mr. Masood who owns 20% shares of the company
 - a) Executive directors and senior managers
 - b) Finance managers
 - c) Supplier of machinery
14. By using the _____ efficiently, a company can produce more goods and services with the same resources. Fill in the blank to complete the sentence.
 - a) Machinery
 - b) Human resources
 - c) Factory space
 - d) Factors of production

15. TRUE OR FALSE: A mission describes the organisation's basic function in society, in terms of the products and services it produces for its customers.
- a) TRUE
 - b) FALSE
16. TRUE OR FALSE: A vision statement has more to do with the future and really describes what an organisation plans or hopes to be in the future.
- a) TRUE
 - b) FALSE
17. What is the key question to answer when developing a mission statement?
- a) What is our business?
 - b) What is our value to the customer?
 - c) What will our business be?
 - d) All of the above
18. _____ are the people who combine the inputs of natural resources, labor, and capital to produce goods or services with the intention of making a profit or accomplishing a not-for-profit goal. Fill in the blank to complete the statement.
- a) Factory labour
 - b) Employees
 - c) Directors
 - d) Entrepreneurs
19. What is the single element that sets a mission statement apart from a vision statement?
- a) When considering a mission statement vs. a vision statement the key aspect to remember is the current vs. future context
 - b) Mission statement is longer than a vision statement
 - c) Mission statement is shorter than a vision statement
 - d) Vision statements are considered to be more important than mission statements
20. Which of the following is NOT mentioned as a factor that affects an employee's stake in the business?
- a) Job security
 - b) Stock options
 - c) Fair wages
 - d) Opportunities for career progression

ANSWERS TO SELF-TEST	
1	a
2	d
3	a
4	a
5	d
6	a
7	b
8	c
9	b
10	b
11	b
12	b
13	d
14	d
15	a
16	a
17	d
18	d
19	a
20	b

AT A GLANCE

SPOTLIGHT

OWNERSHIP OF BUSINESS

IN THIS CHAPTER:

AT A GLANCE

SPOTLIGHT

1. Organisation of business
2. Types of business organisations

SELF-TEST

AT A GLANCE

To achieve the goals and objectives of a business effectively and efficiently, the first step for the owner(s) is to decide on the type of business organisation, that is, the form of business ownership, such as a sole proprietorship, partnership, or limited liability company.

1 ORGANISATION OF BUSINESS

Definition of Organisation

In general, an organisation is a tool used to arrange individual or combined resources for a specific purpose in an efficient and effective manner. Working independently may not allow individuals to achieve the desired outcome.

A business organisation is an entity formed to carry out activities necessary to achieve its goals and objectives. It can be seen as a process of dividing tasks efficiently and effectively to enable a system of co-operative activities among two or more people. Together, these activities contribute to the accomplishment of the common goals and objectives of an organisation, whether operated by an individual or a group.

Since people from diverse backgrounds work together, organisations are strongly influenced by the individuals who comprise them. Their personalities, attitudes, perceptions, behaviours, and expectations significantly affect the functioning of an organisation.

2 TYPES OF BUSINESS ORGANISATIONS

When entrepreneurs establish a business, they must decide on the form of business ownership. There are three basic forms: (i) sole proprietorship, (ii) partnership, and (iii) corporation or limited liability company. The choice of form can affect the firm's growth, profitability, risk, and overall value.

The basic design features of an organisation depend on its type, the environment it operates in and the nature of its business. For example, forming a bank or an insurance company requires compliance with specific regulatory requirements. Each type of organisation has features that distinguish it from others.

- a) **Purpose.** Organisations have different purposes. Business organisations exist to make a profit, while public sector organisations aim to provide benefits to the public, such as good government or essential services like health, education, policing, national defence, etc.
- b) **Ownership.** Organisations have different types of owners. Companies are owned by their shareholders, public sector organisations are owned by the government (as a representative of the general public) and co-operatives are owned by their members.
- c) **Funding.** Business organisations obtain the funds they need to operate from a variety of sources. For example, a publicly listed company secures long-term funds through a combination of reinvesting profits, issuing new shares and borrowing from lenders. Charities rely on a mix of government grants and private donations to meet their funding needs. Public sector organisations are funded by the government, which raises money through taxation.
- d) **Accountability.** The management of an organisation is accountable to its owners for achieving the organisation's goals and objectives. For example, the directors of a company, are accountable to the shareholders for its financial performance. This is the main reason why companies produce annual reports and accounts.

Broadly speaking, organisations can be classified into two main categories:

- Business organisations, and
- Not-for-profit organisations

2.1 Business organisations:

This type of organisation engages in commercial activities, with the primary purpose of making a profit.

The main types of business organisation are:

2.1.1 Sole Proprietorships

A sole proprietor is an individual who owns and operates his or her own business, though they may employ a small number of people. No legal formalities are required to establish a sole proprietorship. Any profit made, after tax, belongs entirely to the owner. The proprietor has full control and is free to make all decisions. This independence is one of the key attractions of running a business as a sole proprietor.

Typical examples of sole proprietorships include a local restaurant, a construction firm, a barber shop, a laundry service, and a clothing store.

Sole proprietors must be willing to accept full responsibility for their business's performance. The pressure of this responsibility can far exceed that of any employee. They must also be prepared to work flexible hours, remain on call at all times and sometimes substitute for a sick employee. Their responsibility for the success of the business encourages them to continually monitor operations. Sole Proprietors must exhibit strong leadership skills, stay well organised, and communicate effectively with employees.

Many successful sole proprietors have previous work experience in the market in which they are competing, often as an employee in a competitor's firm. For example, restaurant managers commonly go on to establish their own restaurants. Prior experience is critical for understanding the competition and the behaviour of customers in a particular market.

2.1.2 Partnerships

A partnership exists when the ownership of a business is shared by at least two people. In most cases, the maximum number of partners is 20, although there are some exceptions, e.g. accountants and solicitors.

A business co-owned by two or more people is referred to as a partnership. The co-owners of the business are called partners and together they form the 'firm'.

The parties agree, either orally or ideally in writing, to share the profits and losses of a joint enterprise. A written partnership agreement, spelling out the terms and conditions of the partnership, is recommended to prevent later conflicts between partners. Such agreements typically include the partnership's name, its purpose, and each partner's contribution (financial, assets, skills/talent, etc.). It also outlines the responsibilities and duties of each partner and their compensation structure (salary, profit and loss sharing, etc.). Furthermore, the agreement should contain provisions for the admission of new partners, the sale of partnership interests, and procedures for resolving conflicts, dissolving the business, and distributing its assets.

There are two basic types of partnership: general partnership and limited partnership. A general partnership involves full sharing in the management of the business. In a general partnership, each partner has unlimited liability for the business's debts. Professionals such as lawyers, accountants, and architects often form general partnerships.

A limited partnership has at least one general partner, who assumes unlimited liability, and at least one limited partner, whose liability is limited to his or her investment in the business. Limited partnerships are often used for high-risk investment projects where the chance of loss is significant. General partners accept the risk of loss; while limited partners' losses are restricted to their initial investment. Limited partners do not participate in the management of the business but share in the profits in accordance with the terms of the partnership agreement. Usually the general partner receives a larger share of the profits after the limited partners have recovered their initial investment. Common examples include oil-drilling partnerships and real estate partnerships.

There are also limited liability partnerships (LLPs), which are similar to general partnerships, except that partners are not personally liable for the business's debts and other liabilities.

2.1.3 Limited Companies or corporations

The main feature of a limited company is that it has a separate legal identity from its owners. All owners have limited liability. If the company fails, they cannot be forced to use personal funds to pay off business's debts. They only lose the amount they originally invested in the company.

A company, also known as a corporation, is a legal entity, created under government regulations, whose assets and liabilities are separate from those of its owners. As a legal entity, a corporation has many of the rights, duties, and powers of a person, such as the right to receive, own, and transfer property. Corporations can enter into contracts with individuals or other legal entities, and they can sue and be sued in a court of law. Because a limited company has a separate legal identity, all owners have limited liability. If the company fails, they cannot be forced to use personal funds to pay off business's debts and only lose the amount they originally invested.

People become owners of a company by purchasing shares. Many small companies are privately held, meaning ownership is restricted to a small group of investors, and are called **private limited companies**.

Most large corporations are publicly held, meaning that shares can be easily purchased or sold by investors. These companies are called **public limited companies**. Shareholders of publicly held companies can sell their shares when they need money, are disappointed with the company's performance, or simply expect that the share price will not rise in the future. Their shares can then be sold to another investor who wants to invest in that company.

A private limited company that requires additional funds to expand or to take advantage of opportunities may need to obtain financing by "going public" through an **initial public offering (IPO)**. This means becoming a public limited company by selling shares that can then be traded on public markets.

Publicly held companies can obtain additional funds by issuing new ordinary shares. This means that either their existing shareholders can purchase more shares, or new investors can become shareholders by buying shares in the company. By issuing new shares, companies can raise the funds required to support business expansion.

Structure of a Company / Corporation

A company is created or incorporated through a charter or articles of association. Its organisational structure typically has three key components: shareholders, directors, and management.

Shareholders (or stockholders) are the owners of a company, holding shares that provide them with certain rights. They may receive a portion of the company's profits in the form of dividends, and they can sell or transfer their ownership in the company (represented by their shares) at any time. Shareholders can attend annual general meetings, elect the board of directors, and vote on matters that affect the company in accordance with its articles of association. Each share generally carries one vote.

The shareholders elect a **board of directors** to govern and oversee the overall management of the company. The directors set major corporate goals and policies, appoint senior officers, and supervise the company's operations and finances. Small companies may have as few as three directors, whereas large companies usually have between 10 and 15 directors. The boards of large companies typically include both executive directors and non-executive directors (not employed by the company) chosen for their professional and personal expertise. Non-executive directors often bring a fresh perspective to the company's activities because they are independent of its management.

Appointed by the board, the *executives/officers* of a company form its top management and include the president and chief executive officer (CEO), chief financial officer (CFO), vice presidents, treasurer, and secretary, who are responsible for implementing policies and achieving corporate goals. Officers may also serve as board members and, in some cases, be shareholders.

2.1.4 Summary of Advantages and Disadvantages of Major Types of Business Organisation

Sole Proprietorship	Partnership	Company (Corporation)
Advantages:		
Ease and low cost of formation	Ease of formation with relatively low organisational cost	Limited liability of shareholders
Secrecy	Greater ability to raise funds due to more owners	Ease of transferring ownership
Distribution and use of profits solely by owner	Combined knowledge, skills and managerial expertise	Unlimited life - continuity not dependent on any owner
Greater flexibility and direct control	Flexibility in decision making	Tax benefits and deductions
Fewer government regulations	Less regulatory burden than companies	Easier access to capital markets for growth
Lower taxation	Business income taxed as personal income of each partner	Ability to attract employees with specialized skills
Ease of dissolution	--	--

Sole Proprietorship	Partnership	Company (Corporation)
Sole Proprietorship	Partnership	Company (Corporation)
Disadvantages:		
Unlimited liability of the owner for all business debts and obligations	Unlimited liability of partners for business debts and obligations	Higher cost and complexity of formation
Difficulty in raising funds, which may inhibit growth	Complexity in profit and loss sharing	Double taxation of corporate profits and dividends
Limited managerial skills and expertise	Difficulty in exiting or dissolving the partnership	Greater regulatory control and compliance requirements
Lack of continuity	Potential for conflicts among partners	--
Difficulty in attracting qualified employees due to limited long-term opportunities	Limitation of growth	--

2.2 Not-for-profit organisations

Not-for-profit organisations do not seek to make a profit, although they must operate within the limits of the funding and financial resources available to them. They can be divided into the following main types:

- Public Sector Organisations:** These are government bodies funded by the state to achieve the country's social objectives. Examples include providing quality education for all, ensuring the availability of basic healthcare facility, and guaranteeing access to clean drinking water for every citizens.
- Non-Government Organisations:** These are not-for-profit organisations that are partly or wholly funded from non-government sources. Examples include charities, clubs and societies.
- Clubs and Societies:** These non-profit making organisations, such as sports and social clubs, exist because their members are drawn together by a common interest. The assets of clubs and societies are collectively owned by the members, and most income is derived from members' subscriptions. Clubs and societies produce income and expenditure accounts, rather than profit and loss accounts which show either a surplus or a deficit of income over expenditure, as they do not aim to make a profit.
- Cooperatives:** These are association of persons, usually of limited means, who voluntarily come together to achieve a common economic goal through the formation of a jointly controlled business organisation. Members make equitable contributions to raise capital and accept a fair share of both risks and benefits. A cooperative is not formed with profit as its guiding objective but to render services to its members and to society at large.

SELF-TEST

For the following questions select the best answer.

1. An entrepreneurial organisation is an entity that is managed by its entrepreneurial owner. Which one of the following can be a feature of an entrepreneurial organisation:
 - a) the Board of Directors takes all the main decisions and does not delegate decision-making to anyone else
 - b) there is a formal management structure
 - c) operations and processes are likely to be complex and there is too much to handle for a single owner
 - d) None of the above
2. _____ can be seen as the process of dividing up activities in an efficient and effective manner to enable a system of co-operative activities of two or more persons.
 - a) Business
 - b) A company
 - c) Process
 - d) Organisation
3. There are no legal formalities needed to set up a business. This statement is true about which of the following?
 - a) Sole Proprietor
 - b) Partnership
 - c) Private Limited Company
 - d) None of the above
4. Clubs and societies, non-governmental organisations, Cooperatives and Public sector organisations fall in the same type of organisations. What is a term used to refer to these types of organisations?
 - a) Social Organisations
 - b) Not-for-Profit Organisations
 - c) Revenue Organisations
 - d) Social sector Organisations
5. A business that is co-owned by two or more persons is referred to as a _____. The co-owners of the business are called partners and they collectively form the _____.
 - a) Firm, partnership
 - b) Partnership, firm
 - c) Partnership, shareholders
 - d) Firm, proprietors
6. Professionals such as lawyers, accountants, and architects often join together in **general partnerships**. What is one distinctive feature of a general partnership over limited partnerships?
 - a) All partners are owners of the firm
 - b) Assets of the firm are divided as per the agreement between partners
 - c) All partners in a general partnership have unlimited liability
 - d) All of the above

7. The shareholders elect a _____ to govern and handle the overall management of the company.
- a) Board of Directors
 - b) Board of Stakeholders
 - c) Council
 - d) Committee
8. TRUE or FALSE: Limited partners do not participate in the management of the business but share in the profits in accordance with the terms of a partnership agreement.
- a) TRUE
 - b) FALSE
9. TRUE or FALSE: The main feature of a limited company is that it has a separate legal identity from that of its owners.
- a) TRUE
 - b) FALSE
10. Companies must pay income taxes on their profits. In addition, any profits (dividends) paid to shareholders are taxed as personal income. Which of the following terms explains this regulation on companies?
- a) Double regulation
 - b) Double taxation
 - c) Unlimited taxation
 - d) Unlimited liability

ANSWERS TO SELF-TEST	
1	d
2	d
3	a
4	b
5	b
6	c
7	a
8	a
9	a
10	b

AT A GLANCE

SPOTLIGHT

ORGANISATION OF BUSINESS

IN THIS CHAPTER:

AT A GLANCE

SPOTLIGHT

1. Organisational structures
2. Types of Organisational Structure
3. Key elements of Organisational Structure

SELF-TEST

AT A GLANCE

An organisational structure is a formal arrangement of activities that ensures efficiency and effectiveness in achieving business or organisational goals.

An organisational structure is based on several key elements such as specialisation, levels of management, chain of command and spans of control. A formal structure, whether based on traditional or contemporary approaches, brings order, discipline, and control to the overall decision-making process and helps shape the organisation, whether tall or flat.

1 ORGANISATIONAL STRUCTURES

An organisational structure is the formal arrangement within an organisation that defines how activities and tasks are divided and how processes and information flow within this structure, in order to achieve the goals and objective of the organisation.

The purpose of having an organisational structure is that it:

- Divides the work to be done into specific jobs and departments.
- Assigns tasks and responsibilities to individual jobs.
- Coordinates diverse organisational activities.
- Groups jobs into functional units.
- Establishes relationships among individuals, groups, and departments.
- Establishes formal lines of authority.
- Allocates and deploys organisational resources.

Put simply, an organisational structure describes how a company, division, team, or other organisation is built, and how its various components fit together.

An organisational structure consists of activities such as task allocation, coordination and supervision, which are directed towards achieving organisational aims in an effective and efficient manner.

Importance of Management Structure

Choosing the correct management structure ensures an organisation's sustained growth, satisfied employees and profitable returns for shareholders. Conversely, choosing the wrong structure can create tensions between employees and managers, allow inefficient work practices to develop and reduce company profitability. In the worst case an inappropriate management structure may even lead to the closure of the organisation.

Unfortunately, many managers assume that their organisation's management structure is correct, fixed and does not require change. However, such assumptions are naïve. As the pace of change accelerates, it becomes increasingly important to continually assess the suitability of a company's management structure. A dynamic structure provides flexibility and offers a ready means for growth.

2 TYPES OF ORGANISATIONAL STRUCTURES

Organisational structures vary between entities. The organisational structure of an entity should be suited to its size, the nature of its operations, and its objectives. Most importantly, the organisational structure must enable the entity to develop plans and implement them both effectively and efficiently.

There are several different types of organisational structure. Within a single entity, particularly in a large one, there may be a mix of different structures, with distinct approaches adopted in different parts of the organisation.

An organisational structure may be based on following approaches:

- Nature of work such as Skilled, Unskilled, Specialized, Management, etc.
- Traditional departmentalisation such as Functional (finance, operations, marketing, etc.), Product (credit cards, mortgages, auto loans, etc.), Process (assembly, shipping, etc.), Customer (automotive, airline, etc.), and Geographic (Europe, USA, Canada, etc.). These are generally more rigid.
- Contemporary and team-based approaches such as Matrix (also known as the project management approach) and Committee structures (e.g. executive risk committee, business continuity committee, audit committee, etc.) which are more dynamic and allow employees to respond quickly to changing business environments.
- Outsourcing of non-core activities to specialised vendors such as accounting or IT functions.
- Virtual networks of independent companies, including suppliers, customers, and other stakeholders, interconnected through IT platforms represent a new trend.

The following are the basic organisational structures that might exist within an entity or within part of an entity:

- a) an entrepreneurial structure
- b) a functional structure
- c) a divisional structure
- d) a matrix structure

Entrepreneurial Organisations

An entrepreneurial organisation is an entity managed directly by its entrepreneurial owner. The main features of such an organisation are usually that:

- a) the entrepreneur takes all the key decisions and does not delegate decision-making to anyone else.
- b) the organisation is therefore centred around the entrepreneur and lacks a formal management structure.
- c) operations and processes are likely to be simple, and the entity will typically offer just a small range of products or services.

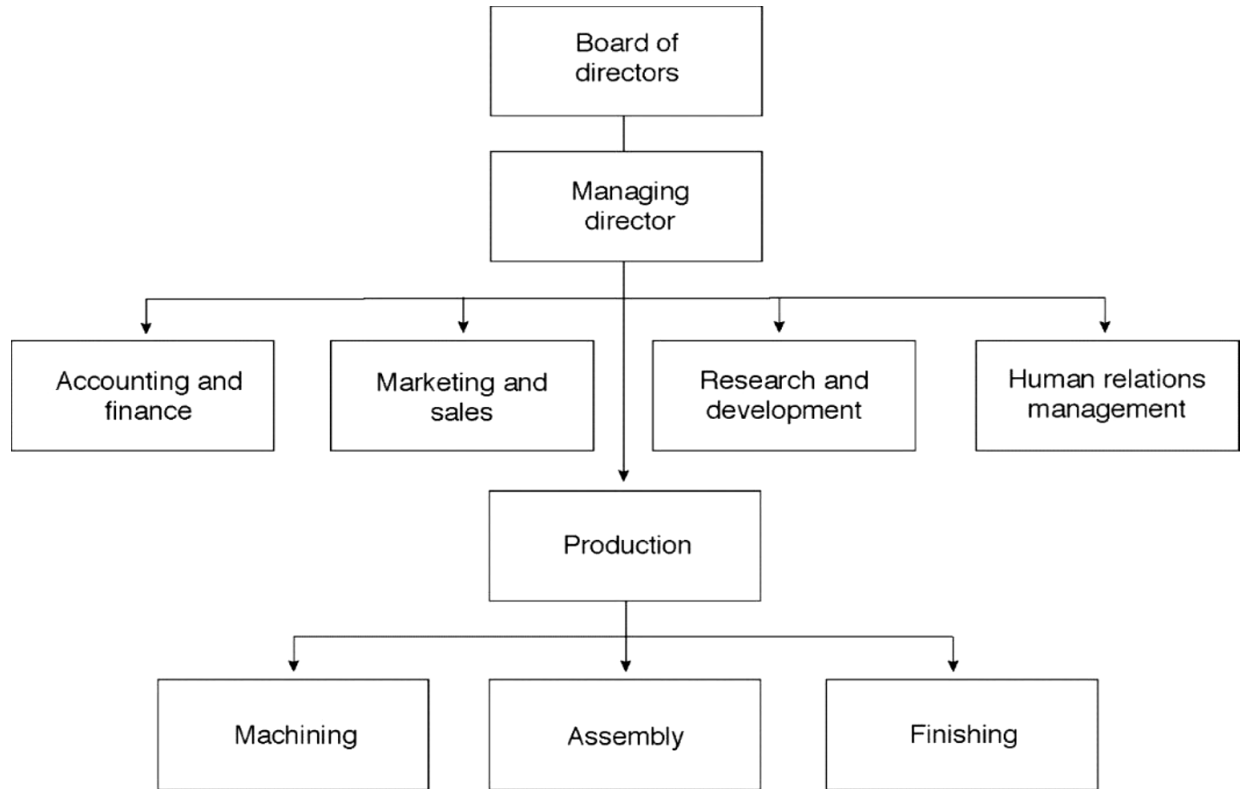
An entrepreneurial organisational structure is most appropriate during the early phases of an entity's life, when the entrepreneur maintains a direct connection with employees. However, as it expands, this structure becomes increasingly inefficient, and the introduction of a formal management structure becomes necessary.

Functional organisations

A functional organisation groups together people who possess similar skills and perform related tasks. This form of organisation is fairly typical for small to medium-size companies, which group their employees by business functions: for example, accountants are grouped together, as are professionals in finance, marketing and sales, human resources, production, and research and development. Each function is headed by a specialist with expertise in that area. Examples of typical functions in a business enterprise include human resources, operations, marketing, and finance. Similarly, business schools are often structured around functions typically found in a business.

There are several advantages to the functional approach. The structure is simple to understand and enables the staff to specialise in particular areas; for instance, everyone in the marketing function is likely to share similar interests and expertise. Homogeneity also has its drawbacks: it can hinder communication and decision making between units and may even promote interdepartmental conflict. For example, the marketing department might clash with the accounting department, since marketers generally wish to maximise advertising expenditure, while accountants seek to control costs.

Each function within the organisation has its own management structure and dedicated staff. An organisation chart showing a simple functional structure is shown below.



Divisional organisations

Large companies often find it unruly to operate as one large unit under a functional organisational structure. The sheer size of the entity makes it difficult for managers to oversee operations and serve customers. To rectify this problem, most large companies are structured as **divisional organisations**. They are similar in many respects to stand-alone companies, except that certain common task, like legal work, tends to be centralized at the headquarters level. Each division functions relatively autonomously because it contains most of the functional expertise (production, marketing, accounting, finance, human resources) needed to meet its objectives. The challenge is to find the most appropriate way of structuring operations to achieve overall company goals. Divisions may therefore be formed according to products, customers, processes, or geography.

Product division: A product based structure means that a company is organised according to its product lines. For example, General Motors, has four product-based divisions: Buick, Cadillac, Chevrolet, and GMC. Each division has its own research and development team, manufacturing operations, and marketing unit. This allows individuals in the division to focus entirely on the products produced by that division. A downside is that it results in higher costs as corporate support services (such as accounting and human resources) are often duplicated across the divisions.

Customer Division: Some companies prefer a customer division structure because it enables them to better serve their various categories of customers. For instance, an organisation in the healthcare sector may group its operations into three customer-based business segments: consumer business (personal-care and hygiene products sold to the general public), pharmaceuticals (prescription drugs sold to pharmacies), and professional business (medical devices and diagnostics products used by physicians, optometrists, hospitals, laboratories, and clinics).

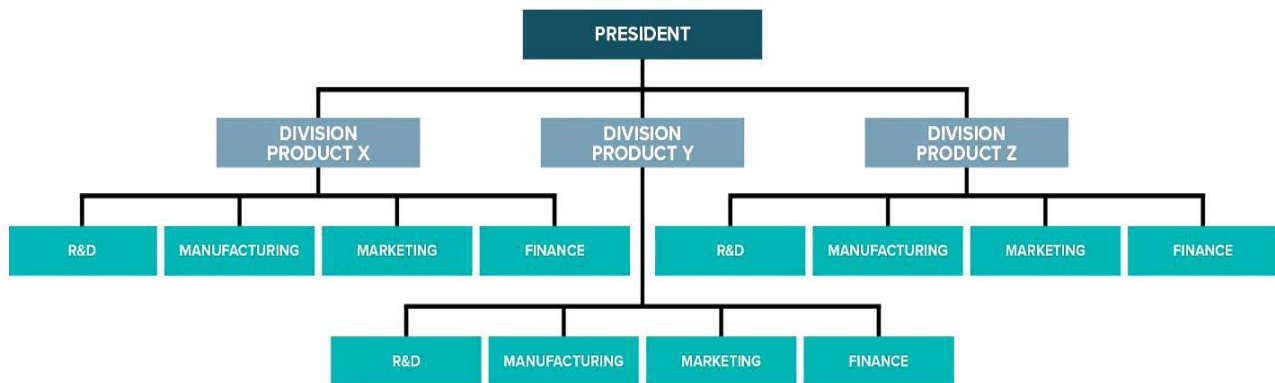
Process Division: If goods move through several steps during production, a company might opt for a process division structure. For example, a Canadian company in the forestry sector may harvest trees and then process the wood into newsprint and pulp. The first step in the production process is harvesting and stripping trees. Then, large logs are sold to lumber mills and smaller logs are chopped up and sent to Company's mills. At the mill, wood chips are chemically converted into pulp. About 90 percent of the pulp is sold to other manufacturers as raw material for home and office products, and the remaining 10 percent is further processed into newsprint. In this way, the company's operations can be divided into three process-based divisions: tree cutting, chemical processing, and finishing.

Geographical Division: This structure enables companies that operate in several locations to be responsive to customers at the local level. For instance, a multinational organisation may divide its operations into regional segments such as North America, Europe, Asia-Pacific, and Latin America. Each regional division manages its own operations and reports its performance separately.

Summing Up Divisional Organisations

Divisional organisations come with both advantages and disadvantages. On the one hand, a divisional structure generally enhances the ability to respond to changes in a firm's environment. On the other hand, if services must be duplicated across units, costs can be higher. In addition, some companies have found that units tend to focus on their own needs and goals at the expense of the organisation as a whole.

A divisionalised organisation with two divisions, where IT and Research and Development (R&D) serve as head office support functions, is shown below.



Note: There could be a Corporate or Head Office function providing shared services to all divisions.

Organisational Structure for Product Innovation

XYZ maintains a structure that addresses corporate needs in managing product types across the world. As a leading consumer goods firm, it has an organisational structure that suitably supports diversified global operations and adapts to changes in the consumer goods industry and global markets.

Features of XYZ's Organisational Structure

XYZ has a **product type divisional** organisational structure. The organisation is divided into components based on their product focus. For example, the company has a division for personal care products and another for home care products. The following are the main characteristics of XYZ's organisational structure:

1. Product type divisions (most significant feature)
2. Corporate executive teams
3. Geographic divisions (least significant feature)

Product Type Divisions. A product type division functions as a unit that enables XYZ to manage the development, manufacturing, distribution and sale of its consumer goods. For example, corporate managers use this feature of the organisational structure to match market needs with appropriate products.

An advantage of this structural characteristic is that it facilitates the company's efforts to apply product differentiation, which is XYZ's generic strategy for competitive advantage. This corporate structure is particularly beneficial, because the company already has a diverse portfolio of products. XYZ maintains the following product type divisions in its organisational structure:

1. Personal Care
2. Foods
3. Home Care
4. Refreshment

Corporate Executive Teams. Corporate teams are a secondary characteristic of XYZ's organisational structure. This structural feature is based on business functions.

For example, XYZ has a team for finance and another team for marketing communications. These teams collectively form the XYZ Leadership Executive (XLE) group.

Geographic Divisions. Geographic divisions are a minor feature of XYZ's organisational structure. The company uses this structural characteristic to support regional strategies. For example, XYZ's marketing strategies for Europe differ from those applied in Asian consumer goods markets.

Also, this corporate structure feature is used to analyse the company's financial performance. The following geographic divisions are maintained in XYZ's organisational structure:

1. Asia/Africa, Middle East, Turkey/ Russia, Ukraine, Belarus)
2. America
3. Europe

XYZ's Corporate Structure – Implications, Advantages & Disadvantages

An advantage of XYZ's organisational structure is its support for product development and innovation. For example, each product type division has semi-autonomous capabilities to develop products that directly suit the needs of consumer goods market segments. This corporate structure is also advantageous because it enables XYZ to differentiate its products despite the large scale of its global operations.

A disadvantage of XYZ's organisational structure is its minimal support for regional strategic implementation. Even though geographic divisions are one of its structural features, the company focuses more on product type divisions. As a result, there is limited support for market-specific or regional strategic initiatives. Thus, to improve this organisational structure, XYZ should increase its emphasis on geographic divisions to empower regional managerial teams. Such a structural change would enhance strategic effectiveness in regional consumer goods markets.

Matrix organisations

A matrix organisation has been defined as: ‘any organisation that employs a multiple command system that includes not only a multiple command structure but also related support mechanisms and an associated organisational culture and behaviour pattern’ (Davis and Lawrence 1977).

Unlike the other structures discussed so far, a matrix organisational structure does not follow the traditional, hierarchal model. Instead, all employees have dual reporting relationships.

The matrix organisation is also referred to as the project management approach to organisational structure. It combines functional and product departmentalisation, complementing their respective strengths and weaknesses, and brings together people from different functional areas of the organisation (such as manufacturing, finance, and marketing) to work on a special project. Each employee has two direct supervisors: the line manager from her or his specific functional area and the project manager.

Matrix and project organisation structures were both first used in the defence and aerospace industries, where companies were required to carry out major projects for customers, such as producing a number of aircrafts for a government client.

The challenge was to complete projects on time and within budget. However, the traditional functional structure in construction companies meant that no one was responsible for the project as a whole. A matrix organisation or project management organisation was introduced to overcome the problem.

- Project managers were appointed with overall responsibility for individual projects. Project managers had to organize the efforts of individuals across all the different functions.
- At the same time, functional managers such as those responsible for engineering, production and sales and marketing, retained their decision-making authority.

In this way, a dual command structure was created. In a matrix organisation, the traditional vertical command structure is overlaid with horizontal authority or influence.

CEO / President			
	Head of Production	Head of Sales & Marketing	Head of Finance & Admin
Project Manager A	Production Supervisor A	Sales Representative A	Manager Finance A
Project Manager B	Production Supervisor B	Sales Representative A	Manager Finance B
Project Manager C	Production Supervisor C	Sales Representative A	Manager Finance C

The difference between a matrix organisational structure and a project organisation is that with a project organisation, the project management comes to an end once the project is completed. In contrast, in a matrix organisation, the matrix structure of authority and command is permanent.

Overall, matrix structures should:

- encourage communication
- place emphasis on ‘getting the job done’ rather than each manager defending his or her own position.

► Examples of matrix organisations are as follows.

- A large company in which there are:
 - divisional managers responsible for a geographical market or a particular product, and for the profitability of the market or the product, and in addition
 - functional managers at head office responsible for the major functions across the entire entity such as production, marketing and sales, human resources management, and so on.

- A university in which there is a traditional command structure based on heads of faculty and heads of department, but in addition a course-based management structure exists, in which individual lecturers are responsible for all aspects of particular courses or degree programs, for example, organising and managing the teaching staff from different faculties or departments, arranging lecture rooms, marking examinations, and so on.

The Virtual organisations

The virtual company or virtual organisation does not have an identifiable physical existence, in the sense that it does not have a head office or operational premises. It may also have no employees or assets.

A virtual organisation is operated by means of:

- a) IT systems and communications networks, normally telephone and e-mail
- b) Specialized business partners for outsourcing key operations.

Many small businesses operate as virtual organisations. For example, a house builder might run his business from home. When asked to build a new house, he can hire all the labour, both skilled and unskilled, needed to do the work, supervise it and check it. He can employ an accounting firm to handle invoicing and payments. The builder does not require an office or full-time employees. His core competence is his personal skill and experience, which he should leverage to give his firm a competitive advantage over rival house builders.

In the same way, there is no reason why a larger business should not be operated as a virtual company. For example, a company that sells branded footwear could operate as a virtual company, using its brand name as its major core competence. It could outsource all its value chain and support activities. Manufacturing could be outsourced to producers in developing countries; warehousing companies could be used to hold inventories. A network of self-employed sales representatives might be used to sell the footwear to retail organisations, and marketing activities might be outsourced to an external agency.

One person, or a small number of individuals, can operate a virtual organisation and indirectly control the actions of many 'external' entities and individuals.

A key to a successful virtual organisation is the effective management of all the different external relationships, and co-ordination of their activities.

3 KEY ELEMENTS OF ORGANISATIONAL STRUCTURE

In this section, we will examine the vital components or building blocks that can be arranged to create an organisational structure.

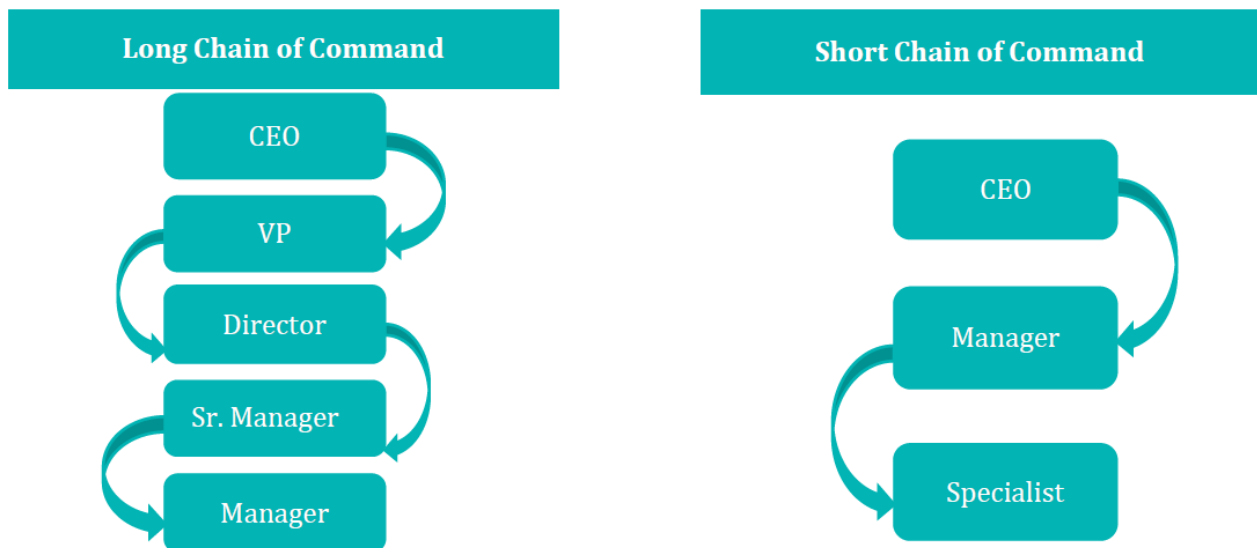
The following elements are generally considered when designing an organisational structure:

- Departmentalisation,
- Chain of command,
- Span of control,
- Levels of management,
- Centralisation or decentralisation of decision making, and
- Work specialisation

As explained below, some elements, such as chain of command, span of control, and centralised or decentralised decision-making, are fundamental and applicable to every type of organisation.

4.1 Chain of Command

One of the most basic elements of an organisational structure, the chain of command is exactly what it sounds like: an unbroken line of authority that extends from the top of the organisation (e.g. the CEO) all the way down to the bottom. The chain of command clarifies who reports to whom within the organisation.



4.2 Span of Control

Span of control refers to the number of subordinates a superior can effectively manage. The higher the ratio of subordinates to superiors, the wider the span of control.

Span of control depends on:

- The manager's capabilities (physical & mental limitations)
- The nature of manager's workload
- The nature of the work undertaken (how routine it is)
- The geographical dispersion of subordinates
- The level of cohesiveness within the team.

There can be a tall-narrow or wide-flat span of control

- a) **Tall-narrow.** In this type of structure, each manager has a small number of subordinates reporting directly to him/ her. As a result, in a large organisation, there are many layers of management from the top down to the supervisor level. The span of control is narrow, and the shape of the organisational structure is tall, because of the many layers of management.
- b) **Wide-flat.** In this type of structure, each manager has a large number of subordinates reporting directly to him/ her. As a result, even in a large organisation, there are only a few layers of management from the top down to supervisor level. The span of control is wide, and the shape of the organisational structure is flat because of the small number of management levels.

4.3 Centralisation and Decentralisation

Who makes the decisions in an organisation? If decision-making power is concentrated at a single point, the organisational structure is centralised. If decision-making power is distributed across different levels, the structure is decentralised. In many situations, junior ('local') managers have far better knowledge than senior management about operational conditions.

Tactical and operational decisions are often better when taken by local management, particularly in a large organisation. Delegating authority to managers at divisional level and below also helps to motivate the management team.

Decisions made by management are more likely to take into account the corporate objectives of the entity as a whole. There is a strong argument in favour of making strategic decisions centrally. Key decisions are likely to be coordinated more effectively if taken centrally. In a crisis, it is also easier to make important decisions from a central point.

By level of decision-making:

- Centralised – decisions are made by senior management (e.g. functional, entrepreneurial).
 - Decentralised – decision-making is delegated to lower levels (e.g. matrix, geographical).
- a) In a centralised organisation, senior management retain most (or all) of the authority to make important decisions.
 - b) In a decentralised organisation, the authority to make major decisions is delegated to the management of units at lower levels in the organisational structure, such as Strategic Business Unit (SBU) managers, and divisional managers.

The choice between a centralised and a decentralised organisation depends, to some extent, on the preference of senior management. However, the size and complexity of the entity also influence the extent to which decision-making, planning and control are centralised or decentralised (devolved). It is difficult to control a large and complex entity from head office, without delegating substantial authority to divisional managers.

Key Elements	Tall	Flat
Work specialisation	High degree	Low degree
Departmentalisation	Rigid (more traditional structure)	Loose (more contemporary structure)
Management layers	Many levels	Few levels
Span of control	Narrow	Wide
Decision-making	Centralised	Decentralised
Chain of command	Long	Short

For example, armed forces are typically tall in their organisation, whereas universities are flat.

In reality, most organisations fall somewhere between these two classifications. An organisational structure also depends on the entity's overall goals and objectives. In addition, the size of the organisation and the stability of its external environment play a key role in determining an appropriate organisational structure.

SELF-TEST

For the following questions select the best answer.

1. Any organisation that employs a multiple command system and related support mechanisms including an associated organisational culture is a:
 - a) Factory organisation
 - b) Functional organisation
 - c) Matrix organisation
 - d) All of the above
2. _____ refers to the number of subordinates a superior can effectively manage.
 - a) Span of control
 - b) Tall structure
 - c) Short structure
 - d) Control ratio
3. TRUE OR FALSE: Tactical and operational decisions should be centralised at the local management level, particularly in a large organisation.
 - a) TRUE
 - b) FALSE
4. AB Limited has an organisational structure focused on its different line of businesses such as Consumer Products, Industrial Consumers, Retail Business and Customer Services. What type of structure below best describes AB Limited's structure?
 - a) Matrix Organisation
 - b) Narrow Organisation
 - c) Functional Organisation
 - d) Divisional Organisation
5. Which of the following is true for a Centralised decision making?
 - a) Decisions by management are more likely to be taken with regard to the corporate objectives of the entity as a whole. There is a strong argument in favor of making strategic decisions centrally.
 - b) Decisions by management should be coordinated more effectively if all the key decisions are taken centrally.
 - c) In a crisis, it is easier to make important decisions centrally.
 - d) All of the Above.
6. Which of the following can be an advantage of centralised decision making in an organisation?
 - a) Decisions by senior management are always correct junior management cannot be trusted.
 - b) Decisions by management could be coordinated more effectively if all the key decisions are taken centrally.
 - c) In a crisis, the management will have no-one to answer to.
 - d) All of the Above
7. Which of the following, if any, can be a feature of a decentralised organisation structure?
 - a) In many situations, junior ('local') managers have much better knowledge than senior management about operational conditions.
 - b) Giving authority to managers at divisional level and below helps to motivate the management team.
 - c) Decisions can be taken more quickly at a local level, because they do not have to be referred to head office.
 - d) All of the above

8. _____ an unbroken line of authority that extends from the top of the organisation (e.g. a CEO) all the way down to the bottom.
- Chain reaction
 - Chain of command
 - Hierarchy
 - Span of control
9. Which of the following stands true about the Chain of Command?
- Chain of command makes an organisation too complex
 - Chain of command cannot exist in a functional organisation
 - Chain of command clarifies who reports to whom within the organisation.
 - All of the above
10. The span of control is wide, and the shape of the organisation structure is flat, because of the small number of management levels. This statement is true for:
- Wide-flat structure
 - Tall-narrow structure
 - Tall-flat structure
 - Wide-short structure
11. A _____ organisation groups together people who have comparable skills and perform similar tasks.
- Matrix
 - Functional
 - Geographic
 - Complex
12. The AZ Co. has organised its workforce based on their expertise. Which organisational structure does the company follow?
- Divisional Organisation
 - Functional Organisation
 - Matrix Organisation
 - Cannot be determined from the given information
13. TRUE or FALSE: The size and complexity of the entity influence the extent to which decision-making, planning and control are centralised or decentralised.
- TRUE
 - FALSE

ANSWERS TO SELF-TEST

1	c
2	a
3	a
4	d
5	d
6	b
7	d
8	b
9	c
10	a
11	b
12	b
13	a

AT A GLANCE

SPOTLIGHT

SOURCES OF BUSINESS FINANCE

IN THIS CHAPTER:

AT A GLANCE

SPOTLIGHT

1. Financial Management
2. Sources of Short-term Financing
3. Sources of Long-term Financing
4. Debt Versus Equity Financing
5. Conventional and Islamic banking

SELF-TEST

AT A GLANCE

To achieve the goals and objectives of a business, financial management is critical in deciding which type of financing is required to maximise shareholders' value. This can be achieved through a mix of debt or equity, or short-term and long-term financing. The ultimate financing decision should be based on optimal capital structure and the maximisation of value for shareholders.

Any company, whether a small grocery shop or a large fast moving consumer goods company, needs money (funds) to operate. To make money (funds inflow) through sales, a company must first spend money (funds outflow) on inventory and supplies, equipment and facilities, and employee wages and salaries. Therefore, finance is critical to the success of all companies. Although, it may not be as visible as marketing or production, the optimal management of a company's finances is equally essential to its success. Accordingly, the role of the financial manager is critical for the overall success of the company.

1 FINANCIAL MANAGEMENT

Financial management is the art and science of managing a company's funds to ensure it can meet its goals and objectives. The science aspect involves analysing data and cash flows, while the art aspect concerns the optimal use of resources. All business decisions have financial consequences. Managers in all departments must work closely with finance personnel. For example, a sales representative will be affected by the company's credit and collection policies, while the head of the IT department must justify any requests for new computer systems or employee laptops. Therefore, all stakeholders, directly or indirectly, are involved in the financial management of a company; it is not solely the responsibility of the finance department.

Knowledge of accounting and finance plays a critical role in understanding the concept of financial management. A company's financial statements such as the Balance Sheet, Income Statement, and Cash Flow Statement are a key sources of information for financial management, and are mostly prepared by professional accountants. Financial managers focus on financial planning and the management of cash flows.

Financial management is the art of effectively managing a company's funds to achieve its goals, blending the science of analysing data and cash flows with the art of resource optimisation. Every business decision has financial implications, making it essential for managers across all departments to collaborate with finance personnel. For instance, sales teams are affected by credit policies, while IT heads must justify technology purchases. Thus, financial management is a shared responsibility among all stakeholders, not just the finance department. A sound understanding of accounting and finance, particularly through financial statements such as the Balance Sheet, Income Statement, and Cash Flow Statement, is crucial for effective financial planning and cash flow management.

The following is a basic structure of a Balance Sheet presented in a report format, which shows how the sources of finance (liabilities and shareholders' equity) and the uses of finance (assets) of a company are summarized at a specific date such as the financial year-end:

Balance Sheet As at 31 December 20XX	
Assets	Liabilities and Shareholders' Equity
Current assets (short-term): which are convertible into cash within one year	Current liabilities (short-term): obligations due within one year
Non-current assets (long-term); which are of a more permanent nature	Non-current liabilities (long-term) are obligations that are due beyond one year
	Total liabilities
	Shareholders' equity (permanent): including capital and retained earnings
Total assets	Total liabilities and Shareholders' equity

An important aspect of financial management is the choice of financing methods for a company's assets. Companies use a variety of sources of finance and the aim should be to achieve an efficient capital structure that provides:

- A suitable balance between short-term and long-term funding
- Availability of adequate cash for day to day expenses
- An appropriate balance between equity (funds raised through the sale of ownership in the business) and from debt (borrowed funds) within the long-term capital structure.

1.1 Role of a Financial Manager

In today's fast-paced global economy, managing a company's finances has become increasingly complex. Financial managers, particularly chief financial officers (CFOs), must go beyond traditional tasks such as financial planning, investing, and raising funds. They are integral members of the top management team, requiring a deep understanding of their company's business and industry, as well as strong leadership and creativity. Their primary objective is to maximise the company's value for its owners, typically measured by the share price. This involves both short-term responsibilities, such as managing cash flow, and long-term decisions, such as assessing new projects and determining the optimal financing methods. Financial managers also navigate the risk-return trade-off, where higher risks demand higher returns, using tools such as scenario analysis to evaluate potential risks, including shifts in market demand, interest rates, and broader economic conditions.

The key activities of a financial manager, to achieve his/her primary goal, are:

- **Financial planning:** Preparing a financial plan for project's revenues, expenditures and financing needs over a given period.
- **Investment** (spending funds): Investing the organisation's funds to projects and securities that provide high returns in relation to their risks.
- **Financing** (raising funds): Securing timely funding for the organisation's operations and investments while seeking an optimal balance between debt and equity.

1.2 Sources of Finance

Corporations often need to raise external funding or capital to expand their businesses into new markets or locations, invest in research & development, or finance campaigns to remain competitive. While organisations aim to use revenues and profits from ongoing business operations to fund such projects, it is often more appropriate to seek external lenders or investors. Despite the vast differences among companies across industries worldwide, there are only a limited number of sources of finance available to all organisations.

Debt Capital (financing)

Like individuals, organisations can also borrow money. This can be done privately through bank loans, or publicly through a debt issue. These debt issues are commonly known as corporate bonds, which allow a wide range of investors to become lenders (or creditors) to the organisation. The main drawback of borrowing is the interest that must be paid to the lender; failure to pay interest or repay the principal can result in default or bankruptcy. However, the interest paid on debt is typically tax-deductible and often costs less than other sources of capital.

Equity Capital (financing)

An organisation can also raise capital by selling its ownership in the form of shares to interested investors, whether existing or new. This is known as equity funding. The benefit of this type of funding is that investors do not require interest payments like bondholders do. The drawback is that future profits must be shared among all shareholders (including new ones) in the form of dividends. Moreover, shareholders typically have voting rights on important matters of the organisation, which can dilute management control as the number of shareholders increases. Another way of equity financing is through retained earnings, where the company reinvests profits instead of fully distributing them as dividends.

Sources of finance can also be classified based on time-duration or maturity. This results in two types of financing:

- Short-term Financing
- Long-term Financing

2 SOURCES OF SHORT-TERM FINANCING

Short-term finance, typically needed for less than a year, is used to finance working capital and support day-to-day operations. It appears as a current liability on the balance sheet and can be either secured or unsecured based on the company's creditworthiness. Such financing is often required due to cash flow fluctuations, seasonal business patterns, or specific one-time orders, and is commonly used to finance inventory and accounts receivable.

2.1 Short-term Financing Options

Few examples of short term financing are as follows:

- Trade Credit (Accounts Payable)
- Bank Loans
- Committed lines of credit
- Operating leases
- Factoring / discounting of receivables

Trade Credit (Accounts Payable)

Accounts Payable represent amounts owed to vendors or suppliers for goods or services received but not yet paid. Generally, this is an unsecured mode of financing. An organisation should try to negotiate favourable credit terms with its suppliers. Trade credit has no direct cost, and is therefore an attractive method of short-term finance. However, organisations are expected to honour their credit arrangements and pay suppliers on time at the end of the agreed credit period. It is not a sound strategy to increase trade payables by taking excessive credit and making late payments.

Bank Loans

Short-term bank loans may be arranged for a specific purpose, for example to finance the purchase of specific items. Unlike an overdraft facility, a bank loan is granted for a defined period, and follows a set repayment schedule.

Various types of business loans are generally available. The specific type of loan that an organisation obtains may depend on the purpose of the funding or the duration for which the funds are required.

Another common type of business loan is a term loan, typically used to finance the purchase of fixed assets such as machinery. The term of such a loan usually ranges from three to ten years. Such loans are considered long-term loans and can be either secured or unsecured.

Committed lines of credit

A committed credit line is a legal agreement between a financial institution and a borrower setting out the conditions of the credit facility. Once signed, the agreement requires the financial institution to lend money to the borrower, provided that the borrower does not break the conditions.

This allows the organisation to borrow up to a specified amount of money within a specified period of time. For example, a line of credit may allow an organisation to borrow up to Rs1,000,000, but it must pay off the credit within one year. A line of credit is especially useful when an organisation expects that it will need funding in the future, but does not know exactly when and how much it will need.

Operating leases

A lease is a contractual agreement whereby one party, the owner of an asset, grants the other party the right to use the asset in return for periodic payments. In simpler terms, leasing is the renting an organisation's asset for a specified period.

In some cases, operating leases might be an alternative to obtaining short-term finance. Operating leases are similar to rental agreements for the use of non-current assets, although they may have a longer term (rental agreements are usually very short term).

Factoring / Discounting of Receivables

In discounting, a firm sells its accounts receivable outright to a factor, which is a financial institution (often a commercial bank or finance company) that buys accounts receivable at a discount. Discounting is more expensive than a bank loan, however, because the factor buys the receivables below their actual value, but provides quick access to funds.

For businesses with a steady flow of orders but a lack of funds to make payroll or other immediate payments, discounting is a popular way to obtain financing by selling its invoices to a third-party.

3 SOURCES OF LONG-TERM FINANCING

The funds that are paid back after a period of more than one year are referred to as long term finance. Certain long term finance options form a direct part of the permanent capital of an organisation, where no repayment obligation arises. The primary purpose of obtaining long-term funds is to finance capital projects and carry out operations on an expansionary scale e.g. modernisation, expansion, diversification and development of business operations. Such funds are normally invested in avenues from which greater economic benefits are expected to arise in the future.

Generally, companies resort to sources of long-term finance when they have an inadequate cash balance and need funds to carry out its operation over a longer period of time. Some objectives of long-term finance may be to:

- purchase new asset or equipment
- finance the permanent part of the working capital
- enhance the cash flow of the company
- invest in R&D operations
- construct or build new projects
- develop a new product
- design marketing strategies or increase facilities
- expand business operations

The long term financing could be done internally, i.e. within the organisation (equity) or externally (debt), i.e. from outside the organisation

3.1 Types of Long-term Financing options

Long-term financing sources include both debt (borrowing) and equity (ownership). Equity financing comes either from selling new ownership interests or from retaining earnings. Financial managers aim to select the mix of long-term debt and equity that achieves the best balance between cost and risk.

The types of long-term financing are as follows:

- Debt financing
- Equity financing

3.2 Debt Financing

The term 'debt finance' is used to describe a type of finance where the borrower:

- receives funds, either for a specific period or possibly in perpetuity.
- acknowledges an obligation to pay interest on the debt for as long as it remains outstanding; and
- agrees to repay the amount borrowed when the debt matures (reaches the end of the borrowing period).

Few examples of debt financing are as follows:

- Term loans
- Bonds
- Finance lease

Term Loans

For Term Loans, refer to the section on Bank Loans.

Bonds

Bonds are long-term debt instruments involving two parties- the borrower (issuer) and the lender (buyer or investor). The borrower can be the government, a local body or a corporation. Bonds generally provide fixed interest payments at periodic intervals and are redeemable on a predetermined date in future. The issuer of a bond must pay the buyer a fixed amount of money called interest, stated as the coupon rate, on a regular schedule. The issuer must also pay the bondholder the amount borrowed called the principal, or par value at the bond's maturity date (due date). A bond certificate is issued as proof of the obligation. Bonds are normally issued against collateral and are therefore a highly secured form of long term finance.

Financial Lease

A financial lease is another way of providing finance, where effectively a leasing company (the lessor or owner) buys the asset for the user (usually called the hirer or lessee) and rents it to them for an agreed period.

Simply, the finance lease is a type of lease in which the lessor transfers all the risks and rewards (control) associated with the asset to the lessee before the lease agreement expires. The ownership could be transferred at the expiry of the lease agreement under mutually agreed terms.

Financial leases are more common for the acquisition of assets such as computers and electronic equipment, which become obsolete more quickly due to rapid technological developments in the sector. It is very important, when making a leasing decision, to compare the cost of leasing the asset with the cost of owning it.

Short-term Financing vs. Long-term Financing

Businesses can obtain short- or long-term finance to fund their operations. Ultimately, the type of finance a business uses depends on its requirements.

Comparison of Short-term Finance and Long-term Finance

A comparison of Short-term and Long-term Finance	Short-term Finance	Long-term Finance
Duration (maturity)	Typically repayable within one year or less.	Have a longer time span, varying from 1 to 30 years.
Requirements	Obtained to fund temporary shortfalls in working capital, repayment of current liabilities etc.	Obtained to fund the growth, purchase of property, plant and equipment, or capital projects on a large scale.
Collaterals	Do not create a charge on the assets of the company.	Collateral is generally a primary requirement for obtaining long term finance.
Terms of loan	Interest rates are unstable and vulnerable to inflationary forces. Terms of loans are not very flexible.	Interest rates are generally stable and the terms of the loan offer flexibility, such as prepayment options, re-negotiation of interest rates upon improvement in credit rating etc.
Volume of funds	Used to raise funds in limited amounts since they are repayable in the near future.	A large volume of funds can be obtained. However the same is restricted by the nature of securities provided, the credit rating of borrower, etc.
Examples	Overdraft, Credit Cards, Line of Credit.	Leasing, Term Loans, Public Deposits, Bonds.

	Short-term Financing	Long-term Financing
Approval Process / Chances	Simple and fast process with higher chances of approval – less to verify	Complex and slow process with slightly harder chances of approval – more to verify
Repayment Schedule	Lower flexibility	Higher flexibility
Financing Cost	Higher interest rate	Lower interest rate
Selection Criteria	Short-term financing is preferable if the borrower is in a liquidity crunch and needs funds quickly to bridge timing gaps in cash flows.	Long-term financing preferable if borrower is stable and need funds for strategic goals at best interest rate due to better credit position.

3.3 Equity Financing

Equity refers to the owners' investment in a business. In corporations, the preferred and common shareholders are the owners. A company obtains equity financing either by selling new ownership shares (external financing) or by retaining earnings (internal financing).

Few examples of equity financing are as follows:

- Retained earnings
- Issuing shares for cash
- Preference shares

Retained Earnings

Retained earnings represent the portion of a company's profits, after taxes and preference dividends, that is reinvested back into the business instead of being distributed to shareholders. This reinvestment can be used for purposes such as paying off debt or purchasing capital assets. The board of directors determines how much of the company's earnings should be retained or distributed as **dividends** to shareholders, which may be paid in cash or stock. By retaining profits, the company increases its equity reserves, which are reinvested to foster further growth and profitability.

Increasing long-term capital by retaining profits has several major benefits for companies.

- When new equity is raised by issuing shares, there are large expenses associated with the costs of the issue. When equity is increased through retained earnings, there are no such costs because no new shares are issued.
- The finance is readily-available, without having to present a case to a bank or new shareholders. Shareholder approval is not required for the retention of earnings.

However, there may be a limit to the amount of earnings available for retention. There are three main reasons for this.

- The company might not earn large profits. Earnings can only be retained if the company is profitable.
- Earnings are either retained or paid out to shareholders as dividends. By retaining earnings, a company is therefore withholding dividends from its shareholders. Retained earnings must be used efficiently, to provide a suitable return on investment. Unless retained earnings contribute to future growth in earnings and dividends, shareholders may demand higher dividends and lower earnings retention.

Issuing Shares for Cash

Companies can raise equity capital externally by issuing new shares for cash, but the opportunity to do so is much more restricted for private companies than for public companies.

The main difference between a private vs public company is that the shares of a public company are traded on a stock exchange, whereas a private company's shares are not. Accordingly, the worth of ownership is measured by the share price (for public companies) or the value of shares (for private companies).

Private companies cannot offer their shares for sale to the general investing public, and shares in private companies cannot be traded on a stock market. They can sell shares privately to investors, but it is usually difficult to find investors willing to invest cash in private companies. The existing owners of a company might not have enough personal capital to buy more shares in their company. Existing shareholders are therefore a limited source of new capital.

Public companies may offer their shares to the general public. Many public companies arrange for their shares to be traded on a stock market. The stock market can be used both as a market for issuing new shares for cash, and also a secondary market where investors can buy or sell existing shares of the company.

There are three main methods of issuing new shares for cash:

- Issuing new shares for purchase by the general investing public: this is called an **initial public offer** or IPO
- Issuing new shares to a relatively small number of selected investors: this is called a **placing or private placement of shares**.
- Issuing new shares to existing shareholders in a **rights issue**.

There are mainly two types of shares that a company may issue to raise equity. These are known as Ordinary Shares and Preference Shares.

Preference Shares (Preferred Stock)

Another form of issuing new shares as a form of equity is **preference shares**. While both preference shares and ordinary shares give shareholders ownership in a company, they carry different shareholder rights. Preference shares, have the advantage of a higher priority claim to the assets of a company in the event of insolvency and receive a fixed dividend distribution. These shares often do not carry voting rights and can sometimes be converted into ordinary shares.

The basic features of preference shares are as follows:

- Most preference shares are issued with a fixed rate of annual dividend.
- Preference dividends are paid out of after-tax profits.
- Preference shareholders are entitled to receive dividends from profits before any remaining profit is distributed to ordinary shareholders as equity dividends.
- If the company goes into liquidation, preference shareholders rank ahead of ordinary shareholders, but after providers of debt finance, in the right to payment from the proceeds of the company's assets.
- Preference shares are relatively uncommon, with a few exceptions.

For the issuing company, preference shares are more expensive than debt because their dividends are not tax-deductible, and their claims are secondary to those of debtholders but less expensive than ordinary shares.

4 DEBT VERSUS EQUITY FINANCING

As per the 'pecking-order theory', a company should prefer to finance itself in the following order:

- First, internally through retained earnings, which signals to the market that the company is performing well.
- Second, through debt, which signals to the market that management is confident that the company can meet its obligations.
- Finally, and as a last resort, through the issuing of new equity, which is normally a negative signal that the company is overvalued and seeks funds before its share price falls.

However, the ultimate financing decision should always be based on an optimal capital structure and value maximisation for shareholders.

► **Example:**

Suppose an aerospace company plans to spend \$2 billion over the next four years to build and equip new factories for manufacturing jet aircrafts. Top management will assess the pros and cons of both debt and equity financing and then consider several possible sources of the desired form of long-term financing.

The major advantage of debt financing is the deductibility of interest expenses for income tax purposes, which lowers its overall cost and cash out flow. In addition, there is no loss of ownership. The major drawback is financial risk: the chance that the company will be unable to make scheduled interest and principal payments. The lender can force a borrower that fails to make scheduled debt payments into bankruptcy. Most loan agreements include restrictions to ensure that the borrower operates efficiently.

Equity, on the other hand, is a form of permanent financing that places few restrictions on the company. The company is not required to pay dividends or repay the investment. However, equity financing gives ordinary shareholders voting rights that provide them with a voice in decision-making. Equity is costlier than debt. Unlike the interest on debt, dividends paid to shareholders are not tax-deductible.

A summary of the major differences between debt and equity financing is shown in the table below:

Major Differences between Debt and Equity Financing

Areas	Debt Financing	Equity Financing
Have a say in Management	Creditors typically have none, unless the borrower defaults on payments. Creditors may be able to place restraints on management in the event of default. Financial covenants can also be added in debt agreements such as maintaining minimum current and quick ratios.	Ordinary shareholders have voting rights.
Have a right to income and assets	Debt holders rank ahead of equity holders. Payment of interest and principal is a contractual obligation of the company.	Equity owners have a residual claim on income (dividends are paid only after paying interest and any scheduled principal) and no obligation to pay dividends.
Maturity (date when debt needs to be paid back)	Debt has a stated maturity and requires repayment of principal by a specified date.	Equity has no maturity date; the company is not required to repay it.
Tax Treatment	Interest is a tax-deductible expense.	Dividends are not tax-deductible and are paid from after-tax income.

5 CONVENTIONAL AND ISLAMIC BANKING

5.1 Conventional Banking

Conventional banks operate on traditional financial principles. They follow standard practices of lending, borrowing, and saving within a capitalist framework. The key characteristics of conventional banking include:

- i. **Interest-Based System:** Conventional banks lend money to customers at an interest rate, and they also pay interest to depositors. This interest is the primary source of income for banks.
- ii. **Profit Maximisation:** The main objective of conventional banking is to generate profit by charging higher interest rates on loans than those paid to depositors.
- iii. **Risk and Return:** Conventional banks are allowed to engage in speculative trading and investment activities, which may involve a higher level of financial risk.
- iv. **Regulation:** Conventional banks are generally regulated by central banks or government bodies. Regulations usually focus on financial stability and ensuring liquidity, but they do not specifically address ethical considerations.
- v. **Financial Products:** Conventional banks offer a wide range of financial products such as personal loans, mortgages, credit cards, savings accounts, and investment products

SELF-TEST

For the following questions select the best answer.

1. _____ management is the art and science of managing a company's funds so that it can meet its goals. Which of the following completes the statement?
 - a) People
 - b) Revenue
 - c) Financial
 - d) Data
2. Which of the following is/are features of an efficient capital structure?
 - i. A suitable balance between short-term and long-term funding
 - ii. Availability of adequate cash for day to day expenses
 - iii. A suitable balance between equity and debt in the long-term
 - a) i only
 - b) i and iii only
 - c) ii only
 - d) i, ii and iii
3. Which of the following is the best summary about the role of a financial manager?
 - a) To maximise the value of the business for its shareholders
 - b) To organise the finance department
 - c) To manage salaries and overheads of the business
 - d) None of the above
4. Revenues from sales of product or services should be the primary source of funding. But funds from sales does not always come in when required. TRUE or FALSE?
 - a) TRUE
 - b) FALSE
5. Corporations are often required to raise external funding, or capital. Which of the following may be reasons for requirement of additional funding?
 - a) to expand their businesses into new markets or locations
 - b) to invest in research & development
 - c) to spend on competitive market campaigns
 - d) All of the above
6. Sources of finance can also be classified based on time duration. TRUE or FALSE?
 - a) TRUE
 - b) FALSE

7. What are the key activities of the financial manager?
 - a) Preparing the financial plan, that projects revenues, expenditures, and financing needs over a given period.
 - b) Investing the company's funds in projects and securities that provide high returns in relation to their risks.
 - c) Obtaining timely funding for the company's operations and investments and seeking the best balance between debt and equity
 - d) a, b and c
8. Preference shares often do not have voting rights and can be converted into common shares. TRUE or FALSE?
 - a) TRUE
 - b) FALSE
9. Which of the following is NOT a feature of preference shares?
 - a) Most preference shares are issued with a fixed rate of annual dividend.
 - b) Preference dividends are paid out of after-tax profits.
 - c) Preference shareholders will be entitled to receive dividends out of profits before any remaining profit can be distributed to equity shareholders.
 - d) If the company goes into liquidation, preference shareholders are paid after equity shareholders.
10. Which of the following is a feature of preference shares?
 - a) Most preference shares are issued with a variable rate of annual dividend.
 - b) Preference dividends are paid out of after-tax profits.
 - c) Preference shareholders will not be entitled to receive dividends.
 - d) a and c
11. Which of the following is a key characteristic of Islamic banking?
 - a) Earning interest on loans and paying interest on deposits
 - b) Profit is generated through interest-based transactions
 - c) Profit is generated through profit-and-loss sharing agreements
 - d) It does not require adherence to ethical guidelines
12. In conventional banking, how is profit typically generated?
 - a) By engaging in partnerships with clients and sharing profits
 - b) By charging interest on loans and paying interest on deposits
 - c) Through asset-backed financing only
 - d) By avoiding investments in speculative markets

ANSWERS TO SELF-TEST

1	c
2	d
3	a
4	a
5	d
6	a
7	d
8	a
9	d
10	b
11	c
12	b

INFORMATION SYSTEMS

IN THIS CHAPTER:

AT A GLANCE

SPOTLIGHT

1. Role of Information Systems
2. General System Concepts of Information Technology
3. Key Elements of Information Systems
4. Types of Information Systems
5. Levels of Information Systems

AT A GLANCE

In an increasingly technological world, every business faces both new opportunities and unique challenges. Information is critical for effective and efficient decision-making, and for achieving the goals and objectives of a business. This chapter focuses on the use of Information Systems (IS) in business organisations, including their roles, types, and levels.

The overall objective of this chapter is to equip students with a basic understanding of IT based management information systems and to enable them to understand:

- Basic computer hardware i.e., input, output, storage of information and networks
- The concepts of information technology and information systems
- The role and types of information systems in business
- Key elements of an information system:
 - Data
 - Data entry – batch, online, real-time
 - Database
 - Database Management System
 - Networks
 - Integration
 - Security and privacy
- The use of information systems at different levels of management – operational, middle and senior.

1 ROLE OF INFORMATION SYSTEMS

An information system (IS) collects and processes data into meaningful information which is then provided to users for strategic planning, decision making, performance monitoring, and production. These systems give both companies and consumers access to vast amounts of information and also facilitate communication between management, staff and both internal and external stakeholders. Consequently, they help companies increase revenue and reduce expenses through the optimisation of time and resources. They have also enabled new companies to compete in geographically dispersed markets. Today, virtually all companies use some type of IS to store, access and analyse information; to improve communication with customers; and to enhance collaboration among employees.

If a company determines how to use information technology to improve its efficiency, it can reduce its expenses and increase earnings. Similarly, by using information technology to attract more customers or to offer additional products, it can raise revenue and further enhance earnings. However, investing in information systems can be costly; therefore, it is important to carry out a cost-benefit analysis before committing to technologies. This ensures that investments are likely to provide a net positive return within their relatively short useful lives, given the rapid pace of technological change

2 GENERAL SYSTEM CONCEPTS OF INFORMATION TECHNOLOGY

2.1 Information technology and information systems

Uses of information systems

Irrespective of the level of information (strategic, tactical or operational), information is generally used in one of five ways.

Use	Description
Planning	Helps establish appropriate resources, time scales and forecast alternative outcomes.
Controlling	Ensures that processes are implemented as planned.
Recording transactions	Used to record transactions throughout a business e.g. sales, purchases, errors, returns, customer complaints, quality control inspections, deposits and cash movements.
Performance measurement	Compare actual versus planned (budgeted) activity to identify variances and take corrective action as necessary.
Decision making	Support managers in making a wide range of decisions, such as purchase and production volumes, pricing, whether to manufacture a component internally or buy it from a supplier, whether to switch suppliers, when to replace assets and how to organise operations to minimise tax liabilities.

Information technology

Information technology refers to the application of computers and telecommunications equipment to store, retrieve, transmit and manipulate data.

The term is typically associated with computers and computer networks. However, its full definition also encompasses other forms of information distribution technology, such as television, telephone and radio.

Information system

An information system describes complementary networks of software and hardware that individuals and organisations use to collect, filter, process, create and distribute data and information.

Within organisations, information systems support operations, management and decision making.

The term 'information system' is broader than 'information technology' as it encompasses not only the information and communication technology (hardware and software) itself, but also the ways in which people interact with that technology to support business processes.

In summary:

- System – a set of interacting components that operate together to accomplish a purpose
- Business system – a collection of people, machines and methods organised to accomplish a set of specific functions
- Information system – all systems and procedures involved in the collection, storage, production and distribution of information
- Information technology – the equipment used to capture, store, transmit and present information
- Information management – the planning, environment, control and technology involved in managing information

3 KEY ELEMENTS OF INFORMATION SYSTEMS

The key elements of an information system are as follows:

- Data (raw, unorganized facts that are processed into meaningful and useful information for specific purposes)
- Database (an electronic filing system used to collect and organise data and information)
- Database Management System – DBMS (a software that enables the users to enter, store, organise, select, and retrieve data from a database)
- Networks (systems that allow computers and devices to connect and share data)
- Integration (provides a holistic view of data and information available within an organisation across different areas and functions)
- Security and Privacy (measures to protect data and information from unauthorised access, misuse, or loss)

Data:

Data are a set of values of qualitative or quantitative variables relating to one or more persons or objects. They can exist in various forms: as numbers or text recorded on paper, as bits or bytes stored in electronic memory, or as facts retained in a person's mind.

Business data encompass all the information relevant to a company, such as sales figures, customer contact details, and even website traffic statistics. Such data are processed into meaningful and useful information, which can then be used for specific purposes, such as business analysis, monitoring, and decision-making.

Database:

A database is an electronic filing system that collects and organises data and information. It forms the core of business information systems. Key users access databases to obtain the information they need, whether for placing inventory orders, scheduling production, or preparing long-range forecasts.

For example, a customer database containing name, addresses, payment methods, products ordered, prices, order histories, and similar data provides information to many departments. Large companies often use very extensive databases, known as data warehouses and data marts, to store and manage vast amounts of information.

DBMS:

A Database Management System (DBMS) is software used to quickly and efficiently enter, store, organise, select, and retrieve data in a database. The DBMS primarily functions as an interface between the end user and the database, while simultaneously managing the data, the database engine, and the database schema to facilitate the organisation and manipulation of data.

There are different types of databases and DBMS available depending on the needs of a business organisation.

The main types of DBMS are:

- Hierarchical database
- Network database
- Relational database
- Object-Oriented database

Popular DBMS examples include cloud-based database management systems, in-memory database management systems (IMDBMS), columnar database management systems (CDBMS), and NoSQL in DBMS.

Networks:

Most businesses use networks to deliver information to employees, suppliers, and customers. A computer network is a group of two or more computer systems linked together by communications channels to share data and information. Modern networks often link thousands of users and can transmit audio and video as well as data. The best-known computer network is the internet.

Computer networks support a vast range of uses including:

- The world wide web (internet)
- Sharing software applications such as databases and Worksheets
- Email
- Sharing devices such as printers, fax machines and scanners
- Online booking systems
- Instant messaging
- Internet-based communication

Virtual Private Network (VPN):

Many companies use VPN to connect two or more private networks (such as LANs) over a public network, such as the internet. VPNs employ strong security measures to ensure that only authorised users can access the network and its sensitive corporate information. For organisations with geographically dispersed offices, a VPN is often a more cost-effective option than building a network with purchased networking equipment and leasing expensive private lines.

Integration:

Companies are realising that they cannot operate effectively with a series of separate information systems designed to solve specific departmental problems only. Integration requires a team effort and involves employees across the entire organisation. Company-wide Enterprise Resource Planning (ERP) systems, that bring together human resources, operations, and technology are increasingly becoming an integral part of business strategy. Equally important is managing the collective knowledge contained within an organisation, often through the use of data warehouses and other technological tools.

An integrated IT system is one in which all modules are linked and function together in a coordinated manner.

For example, an integrated finance system would connect a number of underlying modules such as

- Accounts payable control
- Accounts receivable control
- Accruals and prepayments
- Bank and cash
- Inventory
- Purchases
- Sales

For example, a new sales order would be simultaneously recorded in the accounts receivable, sales, and inventory modules.

Security and Privacy:

Unauthorised access to a company's computer systems can be costly, not only in monetary terms but also in terms of reputational risk. The most damaging categories of threats include worms, viruses, and Trojan horses; computer theft; financial fraud; and unauthorised network access.

Computer criminals are becoming increasingly sophisticated, continually finding new ways to penetrate even ultra-secure sites. Whereas early cybercriminals were typically amateur hackers working alone, today's offenders are more professional and often operate in gangs to commit large-scale internet crimes for substantial financial gain. The internet, where criminals can hide behind anonymous screen names, has raised the stakes and expanded the opportunities for identity theft and similar offences. Working remotely also increase cyber security concerns.

Firms are taking steps to prevent costly computer crimes and related problems, which generally fall into several major categories:

- Unauthorised access and security breaches.
- Computer viruses, worms, and Trojan horses.
- Deliberate damage to equipment or information.
- Spam
- Software and media piracy

Creating formal written information security policies to set standards and provide the basis for enforcement is the first step in a company's security strategy. Without such strategies in place, companies often spend too much time in a reactive mode, responding to crises, rather than focusing on prevention.

Another growing concern is the privacy of individuals which is challenged by the collection of personal information across various platforms. The key challenge for companies is to strike a balance between collecting the information they need and protecting the rights of individual consumers. Many companies now state in their privacy policies that they will not misuse the information they collect. Regulators are increasingly taking action against those that fail to respect consumer privacy.

4 TYPES OF INFORMATION SYSTEMS

As discussed earlier, Information Systems (IS) collect and store a company's key data and generate the information that users (e.g., managers) need for analysis, control, and decision-making.

For example, IS are used in factories to automate production processes, track and manage inventory and monitor operations. Most companies use them to process customer orders, manage billing and handle vendor payments. Banks rely on a variety of IS to process transactions such as deposits, ATM withdrawals, and loan payments.

There are several types of IS such as:

- Transaction Processing System (TPS)
- Management Support System (MSS)
- Decision Support System (DSS)
- Executive Information System (EIS)
- Expert System (ES)
- Office automation systems to improve the flow of communication.

Each type of information system serves a particular level of decision-making: operational, tactical, or strategic.

Transaction Processing System (TPS)

The Transaction Processing System (TPS) is the foundation of an integrated information system, receiving raw data from both internal and external sources and preparing it for storage in a large central database. This database, managed by a Database Management System (DBMS), stores and organises the data, allowing users to query the information when required.

TPS automates routine tasks such as accounting, order processing, and financial reporting. In doing so, it helps reduce clerical costs and provides quick operational insights. Data entry can be performed manually or through technology-based methods, such as optical character recognition or magnetic ink character recognition.

Data entry refers to the techniques used to record data into a system. Examples of data include:

- Sales information
- Purchase information
- New employee details
- Updates to existing employee details

A database can be updated in two main ways: (i) Batch processing, and (ii) Online, or real-time processing.

Batch processing:

Batch processing involves collecting a group of similar transactions over a period of time and processing them together as a single batch. It is often used for tasks such as monthly payroll processing. While traditionally associated with centralised mainframe systems, batch processing has become less dominant with the development of more advanced processing methods. However, it remains important, as many modern systems still rely on batch processing for certain applications.

Real-time processing:

Real time processing refers to the handling of individual transactions as they occur, without the need to group them into batches. This method allows user to update master files immediately. Although it is a more expensive approach, real-time processing is essential for applications where up-to-date information is critical, such as airline information systems or online banking.

- Advantages
 - Information is always up to date, providing better management information.
 - Greater ability to keep data available online.
- Disadvantages
 - Higher costs, as the system is more complex to develop and maintain.
 - Requires increased hardware capacity, which further adds to costs.

► **Examples of TPS**

Finance and accounting TPS

The major functions typically include:

- Budgeting
- The nominal ledger
- Invoicing
- Management accounting

The system may be divided into a number of modules, such as:

- Nominal ledger
- Accounts payable
- Accounts receivable
- Budgeting
- Treasury management

Human resources TPS

The major functions typically include:

- Personnel records
- Benefits
- Salaries
- Labour relations
- Training

The system may be divided into a number of modules, such as:

- Payroll
- Employee records
- Employee benefits
- Career path systems (appraisal)

Management Support System (MSS)

Management Support Systems (MSS) use the internal master database to conduct high-level analyses that assist managers in making informed decisions. At the core of an MSS is an information-reporting system that generates regular and special reports using summary data from the Transaction Processing System (TPS), with report details tailored to user needs.

MSS also incorporates specialised decision-making tools, including data warehouses, which collect, secure, and analyse data for various purposes such as customer relationship management, fraud detection, product-line analysis, and asset management. For example, retailers use data warehouses to understand customer demographics and shopping patterns, while banks utilize them to detect fraud and analyze usage trends. Ultimately, an MSS processes raw data into actionable information to support effective decision-making.

A management information system is characterized as follows:

- Supports structured decisions
- Reports on existing operations
- Has little analytical capability and is relatively inflexible
- Focuses on internal operations
- Generates regular reports and typically allows online access to a wide range of users
- Incorporates both current and historical information

Decision Support System (DSS)

A Decision Support System (DSS) is a set of related programs and data designed to assist with analysis and decision-making within an organisation. Developed to overcome the limitations of management information systems, a DSS provides quantitative data and predictive models to aid problem-solving. It allows managers to make decisions using interactive models that simulate real-world processes.

While a DSS relies on internal database data, it focuses on specific information relevant to the issue at hand. It is particularly useful for answering "what if" questions, as managers can input different values into models and immediately see the projected outcomes. For example, marketing executives may use a DSS to forecast customer furniture preferences based on sales data and demographic trends.

The characteristics of decision support systems include:

- Assists managers at the tactical level particularly when intelligent estimates or judgments are required
- Uses formulas and equations to enable mathematical modelling
- Operates as real-time systems, enabling managers to solve problems through queries and modelling
- Allows users to input queries and variables for models through an intuitive user interface
- Often includes a natural language interpreter for easier querying of the system
- Provides an interface that integrates data management and modelling software
- Can be developed using tools such as spreadsheet packages, which support modelling and analysis

Executive Information System (EIS)

An EIS, similar to a DSS, is customized for an individual executive. These systems provide specific information for strategic decisions. For example, a CEO's EIS may include special spreadsheets that present financial data comparing the company to its principal competitors, as well as graphs showing current economic and industry trends. An EIS incorporates both internal and external data and tends to be more forward-looking rather than backward-looking.

EIS typically emphasise graphical displays and simple user interfaces with a 'high-level' executive summary styled dash-board. Executives can then drill-down into various components of the dashboard to extract more detailed information if required.

Other characteristics of EIS include:

- Helps senior managers make unstructured decisions with many contributing factors, such as price fixing
- Tends to be very expensive and real-time
- Often limited in use to a small number of senior managers within the business

Expert System (ES)

An ES is a computer program that simulates the judgement and behaviour of a human or an organisation that has expert knowledge and experience in a particular field. It contains a database of accumulated experience and scenarios, as well as a set of rules for applying the knowledge to each particular situation described by the program. Examples include legal diagnostics, medical diagnostics, processing a loan application, and, on a social level, programs that play chess!

An expert system gives managers advice similar to what they would get from a human consultant. Artificial intelligence enables computers to reason and learn to solve problems in much the same way humans do, using what-if reasoning. Although they are expensive and difficult to create, expert systems are increasingly being adopted by companies as more applications are discovered.

Expert systems have also been used to help explore for oil, schedule employee work shifts, and diagnose illnesses. Some expert systems replace human experts, whereas others assist them.

Expert systems are most effective when the following preconditions exist:

- The problem is reasonably well-defined
- The expert can define some rules
- The problem cannot be solved through conventional transaction processing systems
- The expert can be released to focus on more difficult problems
- The investment is cost-justified

In addition to the above types of IS, some other specialised systems are also in use as follows:

Financial Reporting System (FRS)

Financial accounting and reporting involve:

- Maintaining a system of accounting records for business transactions and other items of a financial nature; and
- Reporting the financial position and financial performance of an entity in a set of 'financial statements'.

Many businesses use a book-keeping or ledger accounting system to record their transactions, forming the foundation of their financial reporting system. The data recorded in this system is periodically analysed and summarised, usually annually, to create financial statements. These statements provide insights into the financial position and performance of the entity. Financial reporting systems must be reliable, accurate, and complete, with access to data entry restricted to authorised personnel only.

Enterprise Resource Planning (ERP)

ERP is a cross-functional system driven by an integrated suite of software modules supporting the basic internal processes of a business.

The system incorporates a real-time view of core business processes such as:

- Order processing
- Inventory management

Productions Business resources

ERP systems track business resources such as:

- Cash
- Raw materials
- Production capacity
- Personnel

Commitments

ERP systems also track the status of commitments such as:

- Purchase orders
- Employee costs
- Customer orders

Tracking is continuously updated, irrespective of the department that entered the information – hence the term ‘enterprise’.

ERP Systems Used by Small, Medium, and Large Firms in Pakistan

The following are some commonly used ERP systems by small, medium, and large firms:

Small Firms:

Small firms in Pakistan typically use affordable and simple ERP systems like QuickBooks for accounting, inventory management, and payroll.

Medium Firms:

Medium-sized businesses often adopt more advanced solutions such as SAP Business One, Microsoft Dynamics 365, and Odoo, offering features for finance, CRM, inventory, and operations.

Large Firms:

Large enterprises use high-end ERP systems like SAP S/4HANA, Oracle ERP Cloud, and Microsoft Dynamics 365 for Finance and Operations, which handle complex operations such as global finance, procurement, HR, and supply chain management with advanced analytics and real-time processing.

5 LEVELS OF INFORMATION SYSTEMS

Information systems are found in virtually every corner of a business, whether in finance, operations, human resources, or marketing. Information systems assist employees across all levels of the business.

The information requirements of a business organisation can be grouped depending on different user needs and levels of decision-making. A typical business organisation is divided into operational, middle, and senior levels. Accordingly, the type of IS is assigned to each level of users.

The following table illustrates various levels of IS in a typical business organisation.

Levels of Management	Nature of Decision-making	Types of IS
Senior Level	Strategic management	EIS
Middle Level	Tactical management	MIS, DSS
Operational Level	Operational management	TPS

Operational Level:

The operational level is concerned with performing day to day business transactions such as cashiers at a point of sale, bank tellers, nurses in a hospital, customer care staff, etc. They have defined rules that guide them while making structured decisions.

Middle Level:

The middle level users generally oversee the activities of operational management. This includes middle-level managers, heads of departments, supervisors, etc. They take tactical, unstructured decisions partly based on set guidelines and judgmental calls.

For example, a credit manager in a bank can check the credit limit and payment history of a customer and decide to make an exception to raise the credit limit for a particular customer. The decision is partly structured in the sense that the credit manager has to use existing information to identify a payment history that benefits the organisation and an allowed increase percentage.

Senior Level:

Senior level users make unstructured, strategic decisions. They are concerned with the long-term planning of the organisation. They use information from tactical managers and external data to guide them when making strategic decisions.

- **Strategic information** relates to long-term decision making e.g. over a 3–5-year time horizon. Strategic information is useful to senior management and directors for establishing the overall strategy of the business. It therefore incorporates both internal information as well as external information about competitors, the market and the general business environment.
- **Tactical information** assists managers in making short-term tactical decisions such as:
 - establishing a fee to quote on a particular order
 - deciding whether to offer discounts on a particular product to help reduce excess inventory
 - deciding whether to switch suppliers
- **Operational information** relates to the day to day activities of an organisation. Examples might include:
 - daily sales reports
 - daily production reports
 - latest inventory levels
 - details of customer complaints

SELF-TEST

For the following questions select the best answer.

1. Which of the following is NOT typically considered part of Information Technology (IT)?
 - a) Computers and computer networks
 - b) Television and radio as information distribution technologies
 - c) Telecommunications equipment used for transmitting data
 - d) Traditional paper-based filing systems
2. Which of the following is a key function of Information Systems within organisations?
 - a) To focus solely on hardware and software without considering human interaction
 - b) To support operations, management, and decision-making through the collection and processing of data
 - c) To limit the use of technology to specific departments within an organisation
 - d) To reduce the need for communication technologies like the internet and telecommunications
3. What is one potential benefit of a company using information technology effectively?
 - a) Reducing revenue
 - b) Increasing customer dissatisfaction
 - c) Reducing expenses and increasing earnings
 - d) Decreasing product variety
4. What does business data get processed into?
 - a) Ideas
 - b) Meaningful and useful information
 - c) Data storage units
 - d) Basic facts
5. What does batch processing involve?
 - a) Processing transactions one by one in real-time
 - b) Collecting a group of similar transactions and processing them together
 - c) Storing transactions without processing them
 - d) Automatically rejecting transactions based on predefined rules
6. Which of the following is a function of a DBMS?
 - a) It only stores data but does not organize it
 - b) It acts as an interface between the user and the database, managing data and schema.
 - c) It processes large amounts of data offline.
 - d) It eliminates the need for any data retrieval.

7. Which of the following is a feature of high-end ERP systems?
 - a) Real-time processing and advanced analytics
 - b) Storing customer feedback
 - c) Only managing email communications
 - d) Limited processing capacity
8. The key feature of real-time processing is:
 - a) To store the transaction stored before processing
 - b) To update the master files immediately
 - c) Master instrument for character recognition
 - d) Magnetic illustrator for complex results
9. Which of the following is an example of an application that uses real-time processing?
 - a) Airline information system
 - b) Monthly payroll processing
 - c) Inventory batch updates
 - d) Archiving customer data
10. Most businesses use computer networks:
 - a) To store large amounts of data locally
 - b) To deliver information to employees, suppliers, and customers
 - c) To control hardware functions
 - d) To avoid using the internet
11. Which of the following is the best-known computer network?
 - a) A Local Area Network (LAN)
 - b) The internet
 - c) A cloud storage system
 - d) A virtual private network
12. The primary purpose of a VPN (Virtual Private Network) is:
 - a) To increase internet speed
 - b) To connect private networks over a public network securely
 - c) To replace all networking equipment
 - d) To provide free internet access to users

13. What type of decisions do senior-level users typically make?
 - a) Operational decisions
 - b) Unstructured, strategic decisions
 - c) Tactical decisions
 - d) Daily, routine decisions
14. The primary tasks involved in financial accounting and reporting:
 - a) Managing employee payroll
 - b) Creating marketing strategies for the business
 - c) Maintaining a system of accounting records for business transactions
 - d) Conducting product research and development

ANSWERS TO SELF-TEST

1	d
2	b
3	c
4	b
5	b
6	b
7	a
8	b
9	a
10	b
11	b
12	b
13	b
14	c

BUSINESS ETHICS

IN THIS CHAPTER:

AT A GLANCE

SPOTLIGHT

1. Ethical considerations in business decisions
2. Understanding ethical issues
3. Situations involving business ethics
4. Corporate Social Responsibility
5. Consequences of unethical behaviour
6. Managing ethical behavior in business

SELF-TEST

AT A GLANCE

In addition to the primary goal i.e., value maximisation for shareholders, businesses are responsible not only for the bottom-line, but also for providing goods and services in an ethically responsible manner. A proper governance process must be put in place to achieve the key goals and objectives of an organisation through ethical decision-making, and socially responsible management.

This chapter will focus on:

- Personal and professional ethics
- Tools and techniques for creating ethical awareness and setting ethical standards
- The concept of individual and corporate responsibility

1 ETHICAL CONSIDERATIONS IN BUSINESS DECISIONS

What is ethics?

Ethics is defined as the “discipline dealing with what is good and bad and with moral duty and obligation”. It is a set of moral standards for judging whether something is right or wrong.

The ethics of doing business are different from the ethics of normal social behaviour. Businesses compete with each other, and many decisions are taken for commercial reasons, regardless of their effects. For example, organisations will close down loss-making operations, regardless of the impact on the employees who are made redundant. Misconduct can take on many forms within the business environment, including deceptive business practices and the withholding of important information from investors or consumers.

Business ethics

Business ethics are a set of moral principles that guide organisations on what is right, wrong, and appropriate in the workplace.

Every organisation, including nonprofits, has to manage the ethical behaviour of its employees and other stakeholders in the overall operations of the organisation.

2 UNDERSTANDING ETHICAL ISSUES

Recognising ethical issues is the most important step in understanding business ethics. An **ethical issue** is an identifiable problem, situation, or opportunity that requires a person to choose from among several actions that may be evaluated as right or wrong, ethical or unethical. In business, such a choice often involves weighing monetary profit against what a person considers appropriate conduct.

Ethical issues in business are generally associated with the following aspects of behaviour:

- Acting within the law. In international business, ethical behaviour often means compliance with accepted international codes of behaviour, such as a code against bribery, by organisations seeking to win a major contract from a customer.
- Fair and honest dealing with suppliers and customers.
- Acting fairly towards employees and showing due concern for their welfare.
- Showing respect and concern for the communities in which the business entity operates.
- Showing respect for human rights, and refusing to deal with any entities that do not show concern for human rights. A significant issue for some organisations in recent years has been public pressure to avoid dealing with.
- Suppliers in developing countries who use child slave labour.
- Showing concern for the environment and the need for sustainable businesses practices.

Suppose an organisation awards a construction contract to a firm owned by the father of an influential person while the organisation is under investigation. If this construction award has the potential to shape the outcome of the investigation, a conflict of interest has occurred.

A conflict of interest, one of the most common ethical issues identified by employees, exists when a person must choose whether to advance his or her own personal interests or those of others. Insider trading is an example of a conflict of interest. Insider trading involves the buying or selling of stocks by insiders who possess material information that is not yet public.

3 SITUATIONS INVOLVING BUSINESS ETHICS

Every day, managers and business owners make business decisions based on what they believe to be right and wrong. Through their actions, they demonstrate to their employees what is and is not acceptable behaviour and shape the moral standards of the organisation. Some common examples that may be considered ethical issues are illustrated below.

1. ***Taking things that do not belong to you.*** The unauthorised use of someone else's property or taking property under false pretences is taking something that does not belong to you. Even the smallest offence, such as using the postage meter at your office for mailing personal letters or exaggerating your travel expenses, falls into this category of ethical violations.
2. ***Saying things, you know are not true.*** Often, when trying for a promotion and advancement, fellow employees may attempt to discredit their coworkers. Falsely assigning blame or inaccurately reporting conversations constitutes lying. Saying things that are untrue is an ethical violation.
3. ***Giving or allowing false impressions.*** The salesperson who permits a potential customer to believe that cardboard boxes will hold the customer's tomatoes for long-distance shipping, when the salesperson knows the boxes are not strong enough has given a false impression. Similarly, a car dealer who fails to disclose that a car has been in an accident is misleading potential customers.
4. ***Buying influence or engaging in a conflict of interest.*** A conflict of interest occurs when the official responsibilities of an employee or government official are influenced by the potential for personal gain.

Suppose an organisation awards a supply contract to a company owned by a close friend of the procurement manager. If this contract could affect the manager's personal gain or influence business decisions, a conflict of interest has occurred.

5. ***Hiding or divulging information.*** Failing to disclose the results of medical studies that indicate your firm's new drug has significant side effects is the ethical violation of hiding information that the product could be harmful to consumers. Similarly, taking your firm's product development or trade secrets to a new place of employment constitutes the ethical violation of divulging proprietary information.
6. ***Taking unfair advantage.*** Many current consumer protection laws were introduced because numerous businesses took unfair advantage of people who were not educated or were unable to understand the nuances of complex contracts. For example, credit disclosure requirements and new regulations on car leasing were implemented because businesses misled consumers who could not easily follow the jargons of long, complex agreements.
7. ***Committing improper personal behaviour.*** Although the ethical aspects of an employee's right to privacy are still debated, it has become increasingly clear that personal conduct outside the workplace can influence performance and organisation's reputation. For example, an organisation's driver must abstain from substance abuse due to safety concerns.
8. ***Abusing power and mistreating individuals.*** A supervisor may subject employees to humiliating corrections or reprimands in front of customers. In some cases, laws protect employees. Many situations, however, involve interpersonal abuse that constitutes an ethical violation.
9. ***Abusive or intimidating behaviour is one of the most common ethical problems for employees.*** This can include anything from physical threats, false accusations, insults, yelling, harshness, and irrationality to ignoring someone or simply being annoying.
10. ***Permitting organisational abuse.*** Many multi-national organisations with operations overseas, have faced issues of organisational abuse. Unfair treatment of workers in international operations can take the form of child labour, inadequate wages, and excessive working hours. Although a business cannot change the culture of another country, it can either perpetuate or prevent abuse through its operations there.

11. **Violating rules.** Many organisations use rules and processes to maintain internal controls or respect the authority of managers. Although these rules may sometimes seem inconvenient to employees trying to serve customers, a violation may be considered an unethical act.
12. **Condoning unethical actions.** Suppose you witnessed a fellow employee embezzling organisation funds by forging her/his signature on a cheque? Would you report the violation? Tolerance of others' unethical behaviour is in itself, unethical.
13. **Misuse of Organisation Time.** Theft of time is a common area of misconduct observed in the workplace. One example of misusing time at work is engaging in activities that are not necessary for the job.

4 CORPORATE SOCIAL RESPONSIBILITY

A business enterprise is an important part of society and should conduct its operations and earn profits in ways that meet society's expectations. The social responsibility of a business refers to its obligations to make decisions and take actions that are desirable in terms of the objectives and values of society. It is the idea that businesses should balance profit-making activities with initiatives that benefit society. It involves developing businesses with a positive relationship with the society in which they operate.

Social responsibility in business, also known as corporate social responsibility (CSR), pertains to people and organisations behaving and conducting business ethically and with sensitivity towards social, cultural, economic, and environmental issues.

A business may receive the following advantages from being socially responsible.

- Being a socially responsible organisation can bolster its image and build its brand.
- Social responsibility empowers employees to leverage the corporate resources at their disposal to do good.
- Formal corporate social responsibility programs can contribute positively to employee morale and lead to greater productivity in the workforce.
- Embracing socially responsible policies can help attract and retain customers, which is essential to an organisation's long-term success.

Customers may be encouraged to pay a premium for some products knowing that part of the profits will be channeled towards social causes that are important to them.

Principles of Corporate Social Responsibility

Corporate social responsibility has five main aspects. For any organisation, some of these aspects might be more significant than others.

1. An organisation should operate in an ethical way and with integrity. A organisation should have a recognised code of ethical behaviour and should expect everyone in the organisation to act in accordance with the ethical guidelines in that code.
2. An organisation should treat its employees fairly and with respect. The fair treatment of employees can be assessed by the organisation's employment policies, such as providing good working conditions and providing education and training to employees.
3. An organisation should demonstrate respect for basic human rights. For example, it should not tolerate child labour.
4. An organisation should play a responsible role in its community. Responsibility to the community might be shown in the form of investing in local communities, such as local schools or hospitals. This can be an important aspect of CSR for organisations that operate in under-developed countries or other regions of the world.
5. An organisation should do what it can to sustain the environment for future generations. This could take the form of:
 - Reducing pollution of the air, land or rivers or seas
 - Developing a sustainable business, whereby all the resources used by the organisation are replaced
 - Cutting down the use of non-renewable (and polluting) energy resources such as oil and coal, and increasing the use of renewable energy sources (water, wind)
 - Re-cycling waste materials.

► *Examples of Socially Responsible activities*

- **Environmental efforts:** One primary focus of corporate social responsibility is the environment. Businesses, regardless of size, have large carbon footprints. Any steps they can take to reduce those footprints are considered beneficial for both the organisation and society.
- **Philanthropy:** Businesses can practice social responsibility by donating money, products or services to social causes and non-profits. Larger organisations tend to have significant resources that can benefit charities and local community programs. It is best to consult with these organisations about their specific needs before donating.
- **Ethical labour practices:** By treating employees fairly and ethically, organisations can demonstrate their social responsibility. This is especially true of businesses that operate in international locations with labour laws that differ from those in the developed world.
- **Volunteering:** Attending volunteer events demonstrates an organisation's sincerity. By doing good deeds without expecting anything in return, organisations can express their concern for specific issues and their commitment to certain organisations.

5 CONSEQUENCES OF UNETHICAL BEHAVIOUR

Poor business ethics can create a very negative image for an organisation, be costly for the entity and/or the executives involved, and may result in bankruptcy or imprisonment for the offenders.

Acting ethically reduces risk. There are several possible consequences of unethical behaviour.

- When business conduct is illegal or in breach of regulations, there is a risk of being 'found out'. The consequences could include the payment of fines to the authorities or compensation to individuals who have suffered as a result of the illegal behaviour. In some cases, individual directors might be liable to imprisonment for illegal conduct.
- When businesses act legally but in a way that the general public considers 'immoral', there is a risk of government action to make such conduct illegal.
- Businesses that act in an unethical way are also exposed to reputational risk.

6 MANAGING ETHICAL BEHAVIOUR IN BUSINESS

People choose between right and wrong based on their personal code of ethics. They are also influenced by the ethical environment created by their employers. Many individuals have considerable control over their personal ethics outside the workplace, but are influenced by the behaviour of their co-workers and superiors, who exert significant control over choices at work through authority and example.

Organisations can reduce the potential for ethical behaviour by educating their employees about ethical standards, providing up-to-date information on ethical issues, leading by example, and implementing various informal and formal programs.

Corporate Code of Ethics

A corporate code of ethics, is a formal written statement of ethical behaviour, and should be distributed to or easily accessible by all employees. The decisions and actions of all employees in the organisation must be guided by the code.

Many public organisations have a published code of business ethics. For example, in the UK, most leading organisations have a code of ethics.

The effectiveness of a code of ethics depends on the leadership of the organisation, including its directors and senior managers. These individuals must be seen to comply with the ethical code themselves; otherwise other employees will see no purpose in adhering to the code. The culture of an organisation drives its ethical behavior, and a code of ethics provides useful guidance.

If ethical codes are to be effective, then:

- They must be strongly endorsed from the top of the organisation. (There are many examples of entities that had an ethical code, but the board of directors chose to overrule it.)
- Training must be given. If not, many employees might not even be aware that it exists, let alone know how to apply it.
- The code must be kept up-to-date.
- The code must be available to all, for example, through the corporate intranet.

Code of Ethics for Chartered Accountants

The Institute of Chartered Accountants of Pakistan (ICAP) is a member of the International Federation of Accountants (IFAC). IFAC is a global organisation of the accountancy profession comprising more than 175 members and associate organisations in 130 countries and jurisdictions, representing nearly 3 million professional accountants.

IFAC develops and issues in the public interest high-quality ethics standards and other pronouncements for professional accountants for use around the world. The member bodies of IFAC are also encouraged to adopt high standards of ethics for their members and to promote good ethical practices globally.

Accordingly, ICAP has adopted IFAC's Code of Ethics. ICAP members are required to adhere to the requirements of the Code of Ethics and to exhibit the highest standards of ethics and professional conduct expected of the accountancy profession.

Ethical behaviour by chartered accountants plays a vital role in ensuring public trust in financial reporting and business practices, as well as in upholding the reputation of the accountancy profession.

The Code requires that chartered accountants comply with five fundamental principles of professional ethics which are as follows:

- integrity
- objectivity
- professional competence and due care
- confidentiality
- professional behaviour

The fundamental principle of integrity requires chartered accountants to be straightforward and honest in all professional and business relationships.

A chartered accountant at a firm is in the process of inviting quotations for the supply of machinery for their new factory. It is expected that the machinery installation will be subject to inspection. The commencement of operations is estimated to take 2–3 months. The Human resources department has also initiated the process of hiring staff for the new factory, and the chartered accountant is part of the interview panel.

A candidate has been shortlisted for one of the positions. He matches the job description and is requesting a salary within the organisation's budgeted amount. During the interview, he mentioned having another job offer and that, due to financial needs, he can only wait for two months; otherwise, he will accept the other offer.

The HR manager asked the candidate to refuse the other offer as the organisation will commence its operations within two months. The chartered accountant advised the HR manager that it could take more than 2 months to commence operations and told the candidate he should accept the other offer if he wishes to.

In this case, the chartered accountant has abided by the principle of integrity.

Objectivity

Objectivity involves not compromising professional or business judgments because of bias, conflict of interest or undue influence from others.

A chartered accountant at a firm, is a manager in an organisation that manufactures soaps and detergents. He authorises payments to suppliers for raw material purchase only after ensuring that the required documents are in order, such as purchase order, goods received note (GRN) and payment requisition from the relevant department.

He has received a requisition for payment to a supplier who is the brother of the Chief Financial Officer (CFO). The goods have not yet been delivered; however, the CFO advised authorising the payment, which is against organisation policy. The manager refused, stating that the payment shall not be made unless the GRN is received, despite the CFO's instructions.

In this case the manager has abided by the principle of objectivity.

Professional Competence and Due Care

It means to:

- i. attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation; and
- ii. act diligently and in accordance with applicable technical and professional standards.

A senior finance manager at a firm qualified as a chartered accountant in 2016 but still refers to the 2016 edition of the International Financial Reporting Standards (IFRS), which she used to prepare for her exams.

She is in violation of the fundamental principle of "Professional Competence and Due Care" as she does not provide her professional services based on current edition of the IFRS.

Confidentiality

It means to respect the confidentiality of information acquired as a result of professional and business relationships.

A company secretary at an organisation becomes aware of all policy matters requiring Board approval.

Each year, the board of directors approves salary adjustments and HR promotions during June/July. In a recent board meeting, the secretary discovered that his friend's promotion had been approved by the Board. He shared this information with his friend immediately after the meeting, even though the HR department had not yet issued any official notification.

The secretary is in violation of the fundamental principle of "Confidentiality".

Professional Behavior

It means to comply with relevant laws and regulations and avoid any conduct that the chartered accountant knows or should know might discredit the profession.

Two CFOs from rival beverages organisations were invited to a talk show on national television. During the discussion, a question led to a heated debate, and both CFOs lost their temper, engaging in a verbal altercation.

This behaviour demonstrates a violation of the fundamental principle of Professional Behaviour.

SELF-TEST

For the following questions select the best answer.

1. _____ is defined as “discipline dealing with what is good and bad and with moral duty and obligation”
 - a) Ethics
 - b) Business Ethics
 - c) Legal Ethics
 - d) Corporate Social Responsibility
2. _____ is defined as “set of moral principles which guide organisations what is right, wrong, and appropriate in the workplace.”
 - a) Ethics
 - b) Business Ethics
 - c) Legal Ethics
 - d) Corporate Social Responsibility
3. _____ is defined as “conducting business ethically and with sensitivity towards social, cultural, economic, and environmental issues”
 - a) Ethics
 - b) Business Ethics
 - c) Legal Ethics
 - d) Corporate Social Responsibility
4. Ethically speaking, a car dealer can sell a car without disclosing that there was an accident as far as the car was repaired and tested by a reputed mechanic. TRUE or FALSE?
 - a) TRUE
 - b) FALSE
5. Ethically speaking, a builder can bribe the Building Control Authority to build few extra unauthorised floors as far as there is a genuine commitment to buy 100 ambulances for a Trust. TRUE or FALSE?
 - a) TRUE
 - b) FALSE
6. XYZ Organisation has decided to install a hand-made carpet factory in an underdeveloped locality. They plan to hire underage students as workers paying them below minimum wage. They believe it is their social responsibility to help poor students and their families. TRUE or FALSE?
 - a) TRUE
 - b) FALSE
7. I saw that there is a vacancy for HR, and my cousin has education and experience in this area. I think she could fit in the organisation. I do not see any conflict here. What is the best course of action?
 - a) I should talk to HR and ask them to give priority to my cousin, as she is the best candidate.
 - b) I will ensure by speaking to other colleagues that she will get the position.
 - c) I can ask my cousin to apply online and use my name as referral.
 - d) As I am sure that my cousin will get the position, I can tell her to join me and my colleagues for breakfast in the office next morning.
8. Which of the following statement is true in testing ethical decision-making for a project?
 - a) Select only if mirror test is cleared
 - b) Select without considering mirror test
 - c) Select if legality is not obvious but can find a consultant to fix it.
 - d) Select if primary objective of shareholders' value maximisation is certain ignoring mirror test

9. Which of the following statement is not an advantage of being socially responsible?
 - a) Being a socially responsible organisation can bolster an organisation's image and build its brand.
 - b) Social responsibility empowers employees to leverage the corporate resources at their disposal to do good.
 - c) Formal corporate social responsibility programs can contribute positively to employee morale and lead to greater productivity in the workforce.
 - d) Embracing socially responsible policies cannot help in attracting and retaining customers, which is essential to an organisation's long-term success.
10. Which of the following is an example of socially responsible activities?
 - a) Environmental efforts
 - b) Volunteering
 - c) Both (a) and (b)
 - d) None of the above
11. Which of the following statement is not True?
 - a) Evidence for reputation risk is conclusive
 - b) Environmental efforts is one of the primary focus of CSR
 - c) Mirror testing is a technique for ethical decision-making
 - d) Avoiding conflict of interest is a consideration for business ethics
12. Organisations that have been exposed to reputation risk include:
 - a) Organisations accused of buying from suppliers in developing countries that use child labor or slave labor
 - b) Organisations accused of polluting the environment
 - c) All of the above
 - d) None of the above
13. Which of the following are not the key consequences of unethical behaviour:
 - a) Labour practices
 - b) Conflict of interest
 - c) All of the above
 - d) None of the above
14. Which of the following statement is True for corporate code of ethics?
 - a) It may be formal or informal
 - b) In UK very few top organisations have it.
 - c) You cannot train people. It is a natural instinct.
 - d) Strongly endorsed from the top
15. ICAP code of ethics requires:
 - a) Professional competence
 - b) Integrity
 - c) Confidentiality
 - d) All of the above
16. Following are the ways organisations can reduce the potential for ethical consequences by:
 - a) Educating their employees
 - b) Leading through example
 - c) All of the above
 - d) None of the above

ANSWERS TO SELF-TEST

1	a
2	b
3	d
4	b
5	b
6	b
7	c
8	a
9	d
10	c
11	a
12	c
13	d
14	d
15	d
16	c

CONCEPTS OF BRANDING AND MARKETING

IN THIS CHAPTER:

AT A GLANCE

SPOTLIGHT

1. Marketing
2. Branding

SELF-TEST

AT A GLANCE

Marketing plays a key role in the success of a business by generating sales revenue, supported by branding and selling activities. Marketing is a broad term that includes the process of identifying the needs and wants of potential buyers and customers, and then providing goods and services that meet or exceed their expectations.

This chapter will focus on:

- Marketing concepts and strategy
- The importance of branding and its key elements

1 MARKETING

Marketing is a key component of a firm's overall strategy, requiring coordination with other functional areas such as operations, finance, and management. It plays a vital role in generating revenue and building long-term customer relationships based on trust. While businesses aim to respond to consumer needs and anticipate market changes, predicting consumer behavior is challenging due to unclear motives, fragmented markets, and evolving demands for customised products and improved services. Marketing is not about manipulating consumers or simply selling and advertising; it is a systematic approach to meeting consumer needs through planning, pricing, promotion, and distribution.

1.1 The Marketing concept

Marketing is a crucial part of any business, involving activities that create, distribute, price, and promote goods, services, and ideas to facilitate transactions. It adds value by helping individuals and organisations obtain what they need and want. A business cannot achieve its goals without offering something valuable to customers. However, in today's competitive market, it is not enough to simply create an innovative product; it must be conveniently available, well-priced, and effectively promoted.

The core of marketing is exchange, where businesses provide goods, services, or ideas in return for money or credit from customers. This exchange can also involve non-monetary elements, such as recognition for volunteering. Companies build their strategies around creating a mutually beneficial exchange for both the business and the customer.

A common misconception is that marketing and sales are the same, but they are distinct elements of a company's strategy. Sales involve the actual exchange of products or services for money or credit, while marketing focuses on communicating the value of a product or service to customers, encouraging them to make a purchase.

The marketing concept centers on using marketing data to address customer needs and wants, which in turn helps achieve organisational goals and creates value for the business. It involves identifying customer needs and producing goods, services, or ideas that satisfy them. The marketing concept has three key components:

- Focusing on customer needs and wants to differentiate products from competitors.
- Integrating all organisational activities, including production and promotion, to meet these needs.
- Achieving long-term goals by satisfying customer needs legally and responsibly.

Ride hailing services found that their customers were unable to get products or items delivered. Therefore, they started a delivery and logistics service using their existing fleet of cars and motor bikes. Many established food chains offer loyalty points or membership cards to regular customers to retain them and attract them away from new entrants.

One key to understanding the marketing concept is that it involves creating a product based on market research that identifies the needs and wants of customers. Products are not simply created by production departments, with marketing then expected to identify ways to sell them based on the research. An organisation that truly utilises the marketing concept uses data about potential customers from the very inception of the product to develop the best possible good, service, or idea along with marketing strategies to support it.

When thinking of marketing products, one may initially consider tangible items such as electronics, household appliances, or books. What most consumers want, however, is a way to get a job done, solve a problem, or gain some enjoyment. For instance, a vacuum cleaner is purchased not simply to own the appliance but because the customer wants clean carpets. Similarly, premium coffee shops provide more than just coffee. They offer convenience, quality, and an inviting environment.

Thus, the tangible product itself may be less important than the benefits or image associated with it. This intangible "something of value" could be the capability gained from using a product, the image it evokes, or even the brand name. Examples of memorable brand names may include a popular skincare product, a well-known laundry detergent, and a classic automobile model. A brand or label can also serve as a conversation starter in social settings, much like widely recognized slogans from major beverage brands.

Marketing focuses on a complex set of activities that must be performed to accomplish objectives and generate exchanges. These activities include buying, selling, transporting, storing, grading, financing, market research, and risk taking.

Buying. Everyone who shops for products (including consumers, stores, businesses, governments) decides whether and what to buy. A marketer must understand buyers' needs and desires to determine what products to make available.

Selling. The exchange process is facilitated through selling. Marketers usually view selling as a persuasive activity achieved through promotion (including advertising, personal selling, sales promotion, publicity, and packaging).

Branding. Branding is an activity undertaken by the marketing department to increase sales and promote products. Branding also helps to differentiate the product from competing alternatives (e.g., a logo, a registered trademark, or a unique product name can serve as a branding method).

Transporting. Transporting is the process of moving products from the seller to the buyer. Marketers focus on transportation costs and services.

Storing. Like transporting, storing is part of the physical distribution of products and includes warehousing goods. Warehouses hold certain products for extended periods to create time utility and optimise their availability. This is particularly relevant for seasonal goods such as orange juice. Fresh oranges are only available for a few months each year, but consumers demand juice throughout the year. Sellers must arrange cold storage for orange juice concentrate to maintain a steady supply at all times.

Grading. Grading refers to standardising products by dividing them into subgroups and labeling them so that consumers can clearly understand their nature and quality. Many products, such as meat, steel, and fruit, are graded according to standards often set by the government .

Financing. For many products, especially large items such as automobiles, refrigerators, and new homes, the marketer arranges credit to facilitate the purchase.

Marketing Research. Through research, marketers ascertain the need for new goods and services. By gathering information regularly, marketers can detect emerging trends and changes in consumer preferences.

Risk Taking. Risk is the chance of loss associated with marketing decisions. Developing a new product carries the chance of loss if consumers do not accept the product or its promotion as intended. This creates the risk of losing all costs related to product development and associated investments.

1.2 What is a Product?

Before discussing each of the above activities in detail, it is important to understand the concept of a product or service, for which the entire marketing process is developed by any business.

"Anything that can be offered to a market for attention, acquisition, use or consumption that might satisfy a want or need. It includes physical objects, services, persons, places, organisations and ideas".

-Kotler and Armstrong

A **product**; whether a good, a service, an idea, or some combination, is a complex mix of tangible and intangible attributes that provide satisfaction and benefits. A good is a physical entity that can be touched. Examples of goods may include a luxury car, a printer, and a kitten available for adoption at an animal shelter

A product—whether a good, a service, an idea, or some combination—is a complex mix of tangible and intangible attributes that provide satisfaction and benefits. A good is a physical entity that can be touched. Examples of goods include a luxury car, a printer, and a bicycle available for purchase at a store.

A **service** is the application of human and mechanical efforts to people or objects to provide intangible benefits to customers. Examples of services include air travel, dry cleaning, haircuts, banking, insurance, medical care, and child care.

Ideas include concepts, philosophies, images, and issues. For example, a legal professional may, for a fee, advise you on your rights in a contractual dispute. Other marketers of ideas include environmental organisations, advocacy groups, and educational institutions.

A product has emotional and psychological, as well as physical characteristics, that include everything that the buyer receives from an exchange. This includes supporting services such as installation, guarantees, product information, and commitments for repair.

Products usually have both favorable and unfavorable attributes; therefore, almost every purchase or exchange involves trade-offs as consumers try to maximise their benefits and satisfaction and minimise unfavorable attributes. Products are among a firm's most visible contacts with consumers. If they do not meet consumer needs and expectations, sales will be difficult, and product life spans will be brief. The product is an important variable, often the central focus, of the marketing mix; the other variables (price, promotion, and distribution) must be coordinated with product decisions.

Characteristics of a Product

- A product needs to be *relevant*: the users must have an immediate use for it. A product must be functionally able to do what it is supposed to, and perform with good quality.
- A product needs to be *communicated*: Users and potential users must know why they need it, what benefits they can derive from it, and what difference it makes to their lives. Advertising and 'brand building' are the best ways to achieve this.
- A product needs a *name*: a name that people remember and relate to. A product with a name becomes a brand and helps it stand out from the clutter of products and names.
- A product should be *adaptable*: with trends, time and change in segments, the product should be able to adapt to remain relevant and maintain its revenue stream.

Types of Products

Marketers must understand how consumers view the types of products their companies sell so they can design the marketing mix to appeal to the selected target market. To help define target markets, marketers have divided product into two main categories: consumer products, and industrial products.

Consumer Products

Products that are purchased by the end user are called **consumer products**. They include electric razors, sandwiches, cars, stereos, magazines, houses etc.

Most products produced for consumers can be classified as convenience products, shopping products, or specialty products.

- **Convenience products** are widely available to consumers, purchased frequently, and easily accessible. Examples include milk, newspapers, soda, and chewing gum.
- **Shopping products** differ from convenience products because they are not purchased frequently. Before buying shopping products, consumers usually compare the quality and prices of competing products. Furniture and appliances are examples of shopping products.
- **Specialty products** are those that certain consumers consider unique or highly desirable, prompting them to make a special effort to purchase. Examples include a luxury watch or a high-end car. When buying specialty products, consumers base their decision mainly on personal preference, rather than on comparative pricing.

Industrial Products

These are products used as inputs for manufacturing other products. Unlike consumer goods, they are not intended for direct consumption and are meant for business and non-personal use. Examples of industrial products include raw materials, machines, tools, etc.

Industrial products have a limited number of buyers, as they are not consumer goods. Examples include paper, diamonds, gold, silver, etc. Gold is used for making jewellery, while paper is used in printing. Industrial goods are purchased for production or business purposes rather than for direct consumption by the buyer.

The four broad categories of Industrial goods are as follows:

- **Raw Materials:** Raw materials are unprocessed and untreated materials. For instance, potatoes, salt, and cooking oil are raw materials for a company that produces chips. Similarly, meat is raw material for a kebab-maker and sand is raw material for a brick-maker. Raw materials are processed and worked upon to create the final product.
- **Manufactured Parts:** Some raw materials take the form of manufactured parts or components. For example; car companies use manufactured parts such as tyres, batteries, lamps, pistons, radiators, and air conditioning assemblies to produce cars. These parts are not further processed; rather, they are assembled into the final product as they are.

However, some manufactured materials are ‘worked upon’ or further processed to create an end product. For example; cotton yarn is processed to make apparel; and iron rods and wires are used by fabricators. A component or part can be distinguished from a material by whether it undergoes a change. Components are used without any change in the end product, while materials undergo a transformation.

- **Capital Items:** This category of industrial products includes capital items used in the production process. What sets capital items apart from others is that they are long-term assets such as plant, machinery, and equipment.

For instance, an assembly line or welding robots in an automobile factory are capital items that last for years and help generate revenue. Capital items can belong to a factory or an office. For example; a lift truck or welding machine belongs to a factory, while a computer or fax machine belongs to an office.

- **Supplies:** Products in this category are usually indirect items that contribute to the production of the end product. These products are also called consumables. Supplies are necessary for smooth operations; their presence may not directly affect the product, but their shortage can have a significant impact.

For instance, oil and grease used for machine lubrication often receive little attention, but an un-lubricated machine can significantly affect productivity. A small-priced item like cotton cloth is used to wipe dust during the quality inspection process of a car, yet its price does not reflect its significance in ensuring quality. Supplies used in offices include paper, mops, cleaning agents, pencils, and files. Supplies are also used in services. For example; repair and maintenance service fall into this category.

Services

A service is the intangible part of a product. It is an action or effort aimed at fulfilling a demand or satisfying customer needs. It cannot be stored or owned and is consumed at the point of sale. For instance, if you visit a doctor, he provides his services to treat a condition. Other examples of services include banking, postal services, education, and many more.

Digital Products

A digital product is created in a digital format as a file, which may or may not be for sale. A person can download or stream it using a computer or other electronic devices. Digital products may include audio or video files, eBooks, desktop or mobile applications, downloadable templates, graphics, fonts and PSD files. Consumers who purchase these digital products are known as digital buyers.

Difference between industrial and consumer products		
Basis	Industrial products	Consumer products
Meaning	These products are used for the further production of other goods.	These products are used for final consumption by the end consumers.
Number of buyer	The buyers of industrial goods are limited.	The buyers of consumer goods are numerous
Buying decision	Decisions of buyers are influenced by technical specifications and goodwill.	Decisions of buyers are influenced by advertising and various sales promotional schemes.
Nature of demand	These products have derived demand.	These products have direct demand.

1.3 Developing a Marketing Strategy

To implement the marketing concept and manage customer relationships effectively, a business needs to develop and maintain a marketing strategy; a plan of action for developing, pricing, distributing, and promoting products that meet the needs of specific customers. This definition has two major components: selecting a target market and developing an appropriate marketing mix to satisfy that target market.

1.3.1 Selecting a Target Market

A market is a group of people who have a need, purchasing power, and the desire and authority to spend money on goods, services, and ideas. A **target market** is a more specific group of consumers whose needs and wants a company focuses its marketing efforts on.

For instance, a clothing brand initially focused on women aged twenty five and above as the target market for its products. Later, the brand expanded to cater to women of all ages as well as men and children. This strategic focus allowed the company to tailor products to attract specific demographics successfully. In recent years, the company has even diversified into home linen and accessories and created spin-off brands for a more experimental group of consumers within its target market.

Identifying a target market helps a company focus its marketing efforts on those who are most likely to buy its products or services. Concentrating on potential customers lets the firm use its resources efficiently.

Target markets can be broadly classified as **consumer markets** or **industrial markets**. Consumer markets exist for a range of consumer products and services such as cameras, clothes, and household items, while industrial markets exist for products purchased by firms such as plastic and steel. Some products such as tyres can serve either consumer markets or industrial markets, such as car manufacturers. However, classifying markets as consumer or industrial provides only a broad description of the types of customers who purchase products. Consequently, firms attempt to define their target markets more precisely.

Market Segmentation

Some firms use a **total-market** approach, in which they try to appeal to everyone and assume that all buyers have similar needs and wants. Sellers of salt, sugar, and many agricultural products use a total-market approach because everyone is a potential consumer of these products. Most firms, though, use market segmentation and divide the total market into groups of people. A **market segment** is a collection of individuals, groups, or organisations who share one or more characteristics and therefore have relatively similar product needs and desires.

Market segmentation is the process of separating, identifying, and evaluating the layers of a market to identify a target market. For instance, a target market might be segmented into two groups: families with children, and families without children. Families with young children are likely to buy hot cereals and presweetened cereals, while families without children are more likely to choose health-oriented cereals. A business market may be segmented by large and small customers or by geographic area.

Common traits used to describe a target market segment include the consumer's gender, age, and income bracket, but there may also be other factors, such as:

- *Demographic*: age, sex, race, ethnicity, income, education, occupation, family size, religion, social class. These characteristics are often closely related to customers' product needs and purchasing behavior, and they can be readily measured. For example, clothing and fragrances are often segmented by sex or gender, while toys are frequently segmented by age.
- *Geographic*: climate, terrain, natural resources, population density, subcultural values. These factors influence consumers' needs and product usage. For example, climate affects consumers' purchases of clothing, automobiles, heating and air conditioning equipment, and leisure activity equipment.
- *Social factors*: personality characteristics, motives, lifestyles, faith and belief systems. Soft drink marketers offer their products in various types of packaging, including two litre bottles and cases of cans, to cater to different lifestyles and motives.

1.3.2 Creating a Marketing Mix

Marketers use a number of different "tools" to develop products or services that meet the needs and wants of their customers, provide excellent value, and satisfy those customers. The next step in developing a marketing strategy is to determine the five components of marketing. These components are known as "the Five Ps" of marketing. They encompass the methods, tools, and processes used by marketers to develop and promote products.

These five tools are also referred to as "the marketing mix." They have traditionally been known as the 4Ps. Some recent texts also include 'People' or 'Packaging' as the 5th P of the marketing mix:

Product

A product is something offered in exchange, and for which marketing actions are undertaken and marketing decisions are made. Products can be goods (physical things such as smartphones); services, (such as the telecommunications required for a smartphone to function); ideas (such as the thought that being constantly connected through telecommunications is absolutely crucial in today's society).

All products have both tangible and intangible aspects. Every product is produced at a cost and sold at a price. The price that can be charged depends on the market, the quality, the marketing and the target segment. Each product has a useful life after which it requires replacement, and a life cycle after which it must be re-invented. Firms must continually improve existing products and develop new products to satisfy customers over time. In doing so, firms generate high sales growth, which normally increases their value.

Price

Price is a value that a consumer is willing to give up in exchange for a product. It may be monetary or non-monetary such as waiting in long queues for a restaurant or donating blood at a local blood bank. Price can take various forms such as rent, fees, charges, and others.

Marketers, however, view price as much more than a means of assessing value. It is a key element of the marketing mix because it relates directly to the generation of revenue and profits. Prices can also be adjusted quickly to stimulate demand or respond to competitors' actions. A sudden increase in the cost of commodities, such as oil can lead to higher prices or a decrease in consumer demand for a product.

Place

Place refers to the process of distribution or making products available to customers in the quantities they desire. For example, consumers can rent DVDs and video games from a physical store, a vending machine, or an online service. Intermediaries, typically wholesalers and retailers, perform many of the activities required to move products efficiently from producers to consumers or industrial buyers. These activities include transporting, warehousing, materials handling, and inventory control, as well as packaging and communication.

Promotion

Promotion includes methods for informing and influencing customers to purchase a product. It includes several components: traditional advertising, sales promotion, public relations, personal selling, social media, and e-commerce. Promotion is often mistaken for marketing because it is the most visible part of it; however, marketing encompasses much more than just promotion. The aim of promotion is to communicate directly or indirectly with individuals, groups, and organisations to facilitate the sale of a product.

People

This refers to the process of utilising an organisation's employees to support the company's marketing strategies. All products have both tangible and intangible aspects. People, as a marketing strategy, are crucial to the development of a product's intangible aspects.



2 BRANDING

The word "brand" originates from the Old Norse term "brand," meaning "to burn," referring to the practice of producers marking their products by burning their symbol onto them. Italians were among the first to use brands in the 1200s, applying watermarks on paper. In mass marketing, branding emerged in the 19th century with the rise of packaged goods.

During the Industrial Revolution, as production moved to centralised factories, products such as soap were branded with logos on barrels to distinguish them. These marks became trademarks, signalling quality and trust. Early branded products included a popular soup company, a famous soft drink, a well-known chewing gum, and a major oatmeal brand.

Branding is a way to identify products and distinguish them from competitors, typically through a name and symbol. A trademark is a brand's legally protected identifier, preventing other businesses from using it. Some trademarks become so widely recognised that they are used to refer to the product itself, such as a popular cola for any soft drink or a leading baby nappy for any diaper. In some cases, symbols are more recognisable than the brand name, with companies having iconic symbols that are instantly recognised worldwide.

2.1 Importance of Branding

Branding is crucial for a business because it shapes perceptions, attracts new customers, and increases brand awareness. Effective branding goes beyond just names, logos, and trademarks. It encompasses every aspect of a customer's experience with a company or product, including design, quality, service, and the purchasing experience. Successful branding requires a deep understanding of customers and their experiences, along with a long-term commitment to delivering the brand's unique value. Strong branding can influence consumer decisions, determine pricing, and help introduce new products by leveraging positive perceptions of the existing brand. This ongoing effort leads to long-term profitability.

2.2 Key Elements of Branding

The key concepts of branding are the pillars, that help companies promote their brands to their target customers.

- **Brand Positioning:** Branding positioning is all about creating an image of the product in the minds of customers.
- **Brand Attributes:** Brand attributes are a set of features and characteristics that highlight the personality of the brand. These attributes are developed through actions, imagery and advertising.
- **Brand Elements:** Brand elements are the components that create a brand's identity, such as name, slogan, colour, character, symbol, sound, jingle, shape, graphics, taste and movements. For example, a distinctive symbol, a memorable slogan, a recognisable character, a signature colour or a familiar jingle are all examples of brand elements that contribute to creating a brand.
- **Brand Ownership:** A brand owner may seek to protect proprietary rights in relation to a brand by registering it as a "Registered Trademark." Also, a firm or licensor can grant the right to use their brand name, patents or commercial knowledge in exchange for some form of payment.
- **Brand Personality:** Brand personality includes all the characteristics that represent a business's culture, purpose, mission, vision and goals.
- **Unique Selling Propositions (USP):** USPs are the key characteristics and factors, that highlight why a company's product is superior to other similar products available in the market.
- **Brand Image:** Brand image is the customer's perception of a specific brand.

SELF-TEST

For the following questions select the best answer.

1. _____ is a systematic approach to satisfying consumers' needs.
 - a) Selling
 - b) Branding
 - c) Accounting
 - d) Marketing
2. Marketing focuses on many activities including _____ and _____ that foster exchanges.
 - a) Planning & Pricing
 - b) Branding & Budgeting
 - c) Marketing & Transporting
 - d) Selling & Paying
3. Which one of the following is not included in complex set of activities for marketing?
 - a) Transporting
 - b) Storing
 - c) Grading
 - d) Accounting
4. Which one of the following is not a classification of a product?
 - a) Goods
 - b) Service
 - c) Idea
 - d) Relevance
5. Which of the following are considered characteristics of a product?
 - a) Name
 - b) Adaptable
 - c) All of the above
 - d) None of the above
6. Which of the following are considered types of products?
 - a) Banking
 - b) Manufacturing
 - c) All of the above
 - d) None of the above

7. Which of the following product type can be sub-divided into convenience, shopping, or shopping products?
 - a) Industrial
 - b) Banking
 - c) Manufacturing
 - d) Consumer
8. Capital items and supplies are sub-categories of which product type?
 - a) Industrial
 - b) Banking
 - c) Manufacturing
 - d) Consumer
9. Which of the following is an _____ intangible part of a product?
 - a) Goods
 - b) Service
 - c) Idea
 - d) Relevance
10. A consumer who purchased an eBook on Kindle is known as a _____ buyer.
 - a) Technical
 - b) Advanced
 - c) Contemporary
 - d) Digital
11. One of the characteristics of industrial products is that it has:
 - a) Derived demand
 - b) Direct demand
 - c) Local demand
 - d) Foreign demand
12. One of the characteristics of consumer products is that it has:
 - a) Many buyers
 - b) Limited buyers
 - c) Local buyers
 - d) Foreign buyers
13. Which of the following is not a factor to describe a target market segment?
 - a) Demography
 - b) Geography
 - c) Equality
 - d) Specialty

14. Traditionally, the market mix has 4Ps. Which of the following is considered the 5th component?
- a) Product
 - b) Price
 - c) All of the above
 - d) None of the above
15. _____ is method of identifying products and differentiating them from competing products.
- a) Selling
 - b) Competing
 - c) Branding
 - d) Inspecting
16. A brand owner protects proprietary rights related to their brand by :
- a) Selling the brand outright
 - b) Registering the trademark to make it a "Registered Trademark"
 - c) Sharing the brand name without any legal agreements
 - d) Offering discounts on the brand's products
17. _____ is considered the most important element of branding in terms of recognition.
- a) The company's website
 - b) The logo
 - c) The marketing strategy
 - d) The product packaging

ANSWERS TO SELF-TEST

1	d
2	a
3	d
4	d
5	C
6	d
7	d
8	a
9	b
10	d
11	a
12	a
13	c
14	d
15	c
16	b
17	b

AT A GLANCE

SPOTLIGHT

HUMAN RESOURCE STRATEGIES

IN THIS CHAPTER:

AT A GLANCE

SPOTLIGHT

1. Human Resource Management overview
2. Recruitment
3. Selection
4. Training & Development
5. Employees retention

SELF-TEST

AT A GLANCE

Successful human resource management is based on a company's ability to attract and hire the best employees, equip them with the knowledge and skills they need to excel, compensate them fairly, and motivate them to reach their full potential and perform at high levels.

Human resource management is a key function in an organisation to achieve its strategic goals and objectives, through creating a strategy for meeting current and future human resource needs.

This chapter will focus on key elements of the human resource management function such as:

- Strategy and planning
- Job analysis and description
- Recruitment and selection process
- Training and development activities
- Compensation and benefits
- Retention strategies

1 HUMAN RESOURCE MANAGEMENT OVERVIEW

Human resources (labour) is one of the four traditional factors of production. It refers to the economic contributions of people working with their minds and body. The success of a business entity depends on the skills and experience of its human resources. A critical success factor for an entity might be to have at its disposal sufficient human resources with the necessary skills. Without the key skills, it might be impossible to develop the business successfully.

1.1 The objective of human resource strategy

A responsibility of the human resource management function is to:

- assess the quantity and quality of human resources currently available, including strength and skills.
- estimate the quantity and quality of human resources that will be needed in the future, including numbers and skills.
- consider ways of 'filling the gap' and ensuring that the entity has the human resources that it needs.

The key objective of a human resources strategy is to ensure that human resources are available, as required. In some cases, it might also be necessary to consider reducing the numbers of employees whose skills are declining in importance, through programs of **redundancy**, **re-training** or **relocation**.

1.2 Human Resource Planning

A human resource plan consists of a forecast of the human resources that will be required at a given time in the future, and plans for ensuring that the required numbers and skills are available. A plan will typically look forward about three to five years. Beyond five years, it might be difficult to forecast requirements with any accuracy or reliability.

A human resource plan of a business enterprise would cover the following areas:

- Job analysis and design
- Human resource requirements – skills and strength
- Recruitment of new staff
- Training and development to improve skills
- Performance appraisal, to monitor and control the development of skills
- Promotion and rewards
- Motivation strategy
- Redundancies, where some employees will be surplus to requirements, and
- Re-training.

The plans should be realistic, and should therefore take into consideration environmental factors such as:

- population trends, and the total size of the work force in each country where the entity has its operations
- government policy, such as changes in the retirement age of workers
- the educational system and the number of students progressing from elementary school to college and university education
- the availability of individuals trained in a particular skill or vocation
- changing patterns of employment, possibly with increasing numbers of part-time or home-based workers
- competition for highly skilled human resources from competitors and other businesses such as programmers
- trends in sub-contracting and outsourcing
- trends in IT and other technological changes that might affect labour requirements

1.3 Job Analysis

Job analysis involves the observation and study of pertinent information about a job: the specific tasks that comprise it; the knowledge, skills, and abilities necessary to perform it; and the environment in which it will be performed. Managers use the information obtained through a job analysis to develop job descriptions and job specifications.

Job analysis is performed as part of human resource management which includes defining the scope of jobs, writing job descriptions, holding performance appraisals, selecting and promoting staff, performing a training needs assessment and as the basis for compensation and organisational planning.

The purpose of a job analysis is to:

- produce a detailed specification of the job (a 'job description'); and
- produce a specification of the qualities needed from the individual who will perform the job (a 'person specification').

Job Description

A job description is a formal, written explanation of a specific job that usually includes job title, tasks to be performed (for instance, receiving customers at the front desk), relationships with other jobs, reporting lines, physical and mental skills required (such as communication with sales staff or daily MIS reporting), duties, responsibilities, and working conditions. Every job description should also include the position (e.g., AVP, VP) within the company's organisational hierarchy and the range of annual remuneration.

*A **job description** is a formal account of a job, its purpose and scope, and the formal duties and responsibilities of the jobholder.*

Job Specification

A job specification describes the qualifications and skills necessary for a specific job, in terms of education (some jobs require a college degree), experience, personal characteristics (job advertisements frequently request outgoing, hardworking individuals), and physical characteristics.

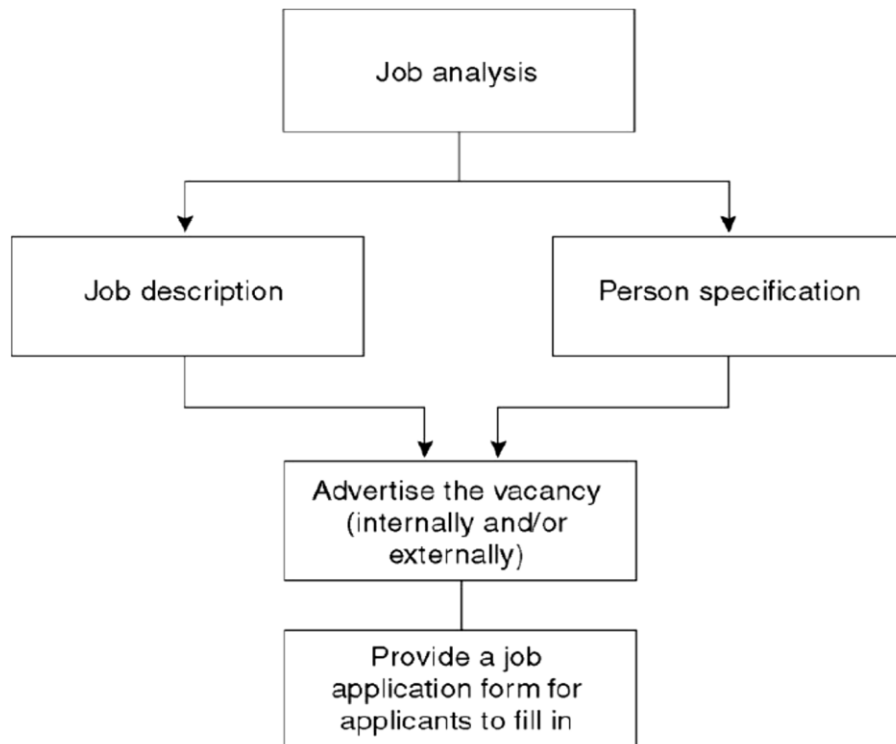


Figure – A plan for the recruitment process

2 RECRUITMENT

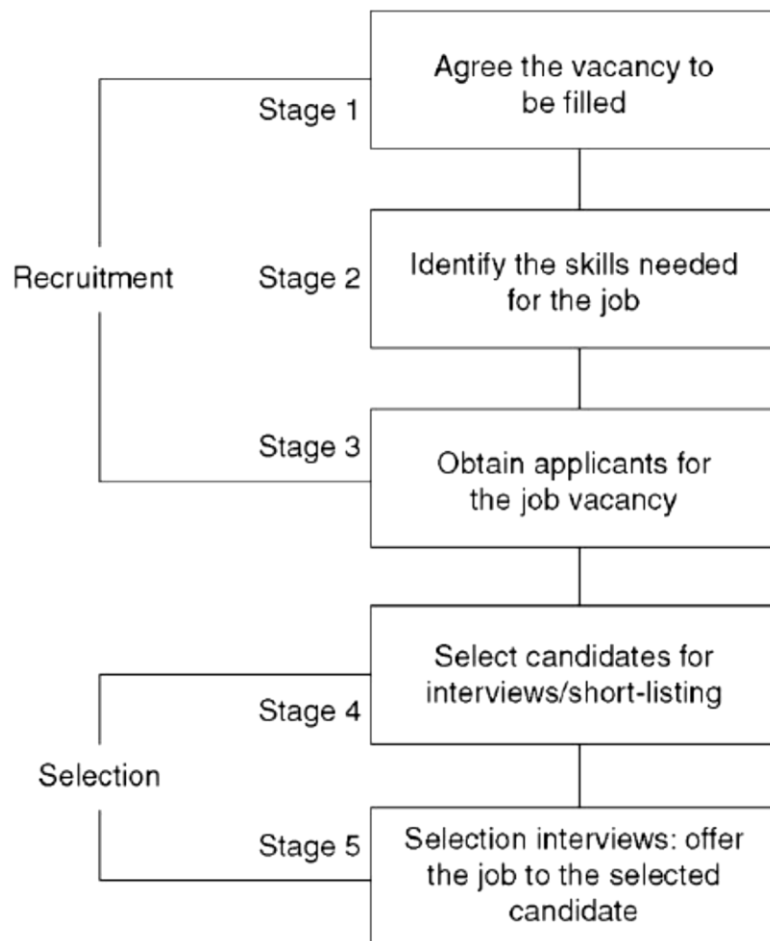
The people who work for an organisation are extremely valuable assets. Without its employees, an organisation would not exist and could not operate. The efficiency and effectiveness of an organisation depend on the skills and abilities of its employees.

Over time, changes occur in the work force.

- Some existing employees leave the organisation, for example, to take a job somewhere else or due to retirement.
- Employees who have acquired sufficient skills and experience might be moved to other jobs within the organisation that make better use of their developing talent.
- The labour requirements of the organisation will change, as new skills are needed and old skills are no longer required. People are recruited to fill the new jobs, with the necessary skills and some existing employees might be made redundant.

Changes in a workforce must be properly managed, to ensure that it remains efficient and effective. It is therefore important to make sure that job vacancies are filled when they occur. It is also important to make sure that suitable individuals are appointed to do the jobs. This is where the function of recruitment and selection come in.

Recruitment starts when a job vacancy is identified. It is the process of obtaining a supply of suitable candidates to fill the vacancy.



Jobs must be brought to the attention of individuals who might want to apply for them. A job vacancy might be 'advertised':

- Within the organisation (internally) to existing employees;
- Externally, to people outside the organisation; and
- Both internally and externally.

3 SELECTION

Selection is the process of collecting information about applicants and using that information to decide which ones to hire. It includes the application itself, as well as interviewing, testing, and reference checking and other tools organisations may use to filter out the most suitable applicants from the recruitment pool.

Selection is the process of appointing the most suitable candidate to a job vacancy, by choosing the best individual from the candidates available.

Whereas recruitment is concerned with quantity – getting candidates to apply for job vacancies – selection is concerned with quality: choosing the individual who seems the best for the job.

Selection steps or hurdles are described below:

1. Initial Screening

During initial screening, an applicant completes an application form and/or submits a résumé, and has a brief interview of 30 minutes or less. The job application includes information about educational background, previous work experience, and job duties performed. Another key discussion point is remuneration expectations, to avoid wasting time and effort.

2. Employment tests

Another step in the selection process is testing. Ability and performance tests are used to determine whether an applicant has the skills necessary for the job. Aptitude, IQ, technical, or personality tests may be used to assess an applicant's potential for a certain kind of work and his or her ability to fit into the organisation's culture.

Used individually or together, the tests can assess cognitive ability (ability to learn, adapt, and solve problems), motivation potential (attitude, behaviour performance, and productivity), and knowledge and skills (math, verbal, data entry, software proficiency).

3. Selection interview

The tool most widely used in making hiring decisions is the selection interview, an in depth discussion of an applicant's work experience, skills and abilities, education, and career interests. For managerial and professional positions, an applicant may be interviewed by several people, including the line manager for the position to be filled. This interview is designed to determine a person's communication skills and motivation. During the interview, the applicant may be presented with realistic job situations, such as dealing with a disgruntled customer, and asked to describe how he or she would handle the problem.

4. Background and reference check

If applicants pass the selection interview, most firms examine their background and check their references. In recent years, an increasing number of employers, want to research applicants' backgrounds, including their legal history, reasons for leaving previous jobs, their creditworthiness (credit check) and general conduct to assess job suitability.

5. Physical exams and medical exams

A firm may require an applicant to have a medical checkup to ensure he or she is physically able to perform job tasks. Some jobs such as those in the Airline industry or law enforcement may place more emphasis on physical fitness and mental agility. Other companies may ask candidates to submit medical tests (including drug test for certain jobs) to minimise medical insurance risks and related productivity issues.

6. Decision to hire.

Once the screening is completed, the top candidate can be selected from the list and offered the job; the remaining qualified applicants can be considered if the top candidate does not accept the offer.

If an applicant progresses satisfactorily through all the selection steps (or clears all of the selection hurdles), a decision to hire the person is made; however, the job offer may be contingent on passing a physical examination and/or general medical tests. The manager of the new employee plays a major role in the final decision to hire.

By the time the steps for screening applicants are completed, the application list should have been reduced to a small number of qualified candidates. Some firms take their hiring process (and the related effort and cost) very seriously because they recognize that their future performance is highly dependent on the employees they select.

7. Offer of employment

The selection process ends with an offer of employment and the acceptance of the offer by the chosen applicant.

The employer may not be certain whether the individual who is offered the job will accept it. It is therefore prudent to identify a short-list of acceptable applicants, listed in order of reference. If the candidate at the top of the list refuses the job, the next person on the list can be made an offer, and so on until someone on the list accepts the job offer.

Once the job has been accepted, the arrangement should be confirmed and accepted in writing. Employment legislation might require that the new employee is given a formal written contract of employment.

4 TRAINING & DEVELOPMENT

Training is a process in which individuals are taught something specific. A training programme should have a particular objective, to teach the individual some theoretical or practical knowledge, or to provide the individual with new information or skills related to their work.

Development is a process of learning through experience and performing work that augments an employee's skill set and prepares him/her for growth. Individuals learn as they develop by undertaking different tasks at work and gaining new experiences.

Development is achieved through gaining experience and, consequently, advancing in one's career. Individuals learn and develop through experience in different work situations and by taking on extra responsibilities or opportunities to use their own initiative.

Organisations benefit from the training and development process, because it produces a better work force, and there should be programmes of training and development for employees at different levels.

4.2 Tools of training

Tools of training can be grouped into the following categories:

- **Formal training** in a training room environment:
 - 'In-house', where all the trainees are from the same organisation. (In Pakistan it is common for 'in-house' training courses to be delivered by colleagues.)
 - 'External', where the training is provided by an external trainer or training firm, and the trainees come from different organisations.
- **Computer-based training (CBT)** where trainees work at their own pace from a computer training package. CBT is highly interactive and typically integrates information and learning-based components with short, frequent tests.
- **Training in the work place.** Training in the work place is a method of developing individuals, as well as a method of training. Work place training focuses on technical or practical skills, whereas workplace development helps the individual gain experience and develop personal skills, such as management and leadership.
- **Induction.** In-house training may be provided by the organisation's own trainers and experts. Alternatively, in-house training may be delivered by an external trainer or training firm, hired to run the training programme. Formal training may conclude with an examination, leading to a qualification or certificate.

4.3 On the Job Training

When an employee learns a job at the actual work site in real life situations, rather than a simulated environment, it is called on-the-job training, also known as job instruction training. This type of training is the most commonly used method. Under this approach, the individual is placed on a regular job and taught the skills necessary to perform it. The trainee learns under the supervision and guidance of a qualified worker or instructor.

On-the-job training has the advantage of providing first-hand knowledge and experience under actual working conditions. On-the-job training methods include job rotation, coaching, mentoring or training through participation in cross-functional team assignments. Some types of on-the-job training are listed below:

- Orientation
- Coaching
- Mentoring
- Job instruction manuals
- Apprenticeships
- Work shadowing

4.4 Off the job Training

Off-the-job training is conducted in a location specifically designated for training. It may be near the workplace or away from work, at a special training centre or a resort. Conducting the training away from the workplace minimises distractions and allows trainees to devote their full attention to the material being taught. Some training programmes also require special tools or facilities that may not be available at the workplace. Organisations may invest in their own training centres outside work premises to send employees for certain courses. For example, newly hired trainees in the banking sector may attend a specialised and intensive course at a national training institute before starting actual work.

Some avenues of off-the-job training may include:

- Class room lectures and courses
- Audio visual films and presentations
- Seminars
- Simulation Centres
- Game theory sessions
- Case Study sessions
- Team-Building meets and activities
- Programmed Instruction
- Online courses

4.5 Tools of development

Development improves the skills, knowledge and abilities of an individual through real work experience. Unlike on-the-job training, development is not primarily concerned with teaching the individual how to perform a specific task or job. Instead, it focuses on providing the individual with greater experience and responsibilities, so that he or she is able to improve and become a more valuable resource (employee).

Development programmes are commonly associated with managers. They benefit from such programmes by becoming better managers, capable of progressing to more senior positions.

5 EMPLOYEES RETENTION

Employee retention is crucial for organisations, as failing to retain employees after significant investment in recruitment, selection, and development can be costly. It can lead to issues such as insecure coworkers, increased workloads, and the need to invest time in recruiting, hiring, and training new employees. Employee retention involves encouraging employees to remain with the organisation for as long as possible, ideally until the completion of a project. Retaining employees benefits both the organisation and the employees themselves.

5.1 Employee Turnover

Employee turnover, which occurs when employees leave voluntarily or are dismissed, results in lost productivity, recruitment costs, training and development expenses, and socialisation costs for new hires. While some turnover is inevitable due to factors such as retirement, promotions, or death, most organisations aim to optimise turnover rates to ensure smooth operations. A well-organised HR department seeks to minimise separations and transfers, as recruiting and training new employees is costly. High turnover may indicate issues with selection, training, compensation, or the work environment.

To reduce turnover, organisations use strategies such as job enrichment, greater job flexibility, and improved employee benefits. Understanding the reasons why employees leave is key to developing strategies that enhance satisfaction and reduce voluntary turnover.

Why employees leave?

Employees may leave their jobs for various reasons. Some are personal factors beyond the employer's control, such as family relocations, caregiving responsibilities, career changes, pursuit of higher education, or the desire for higher salaries. However, many reasons for quitting are influenced by the employer, such as workplace culture, the employee's perception of their role, and the opportunities available for growth and development. Key factors that can lead to employee turnover include:

- Poor relationships with supervisors and coworkers
- Unchallenging, monotonous or repetitive tasks
- Financial concerns
- Personal and family issues
- Ending of a fixed-term contract
- Financial instability of the organisation
- Lack of flexible work hours

5.2 Employee Retention Strategies

To reduce employee turnover, companies need to go beyond offering a good pay cheque and focus on strategies that foster long-term commitment. Here are key strategies HR departments can employ:

1. A well-defined career path:

Employees seek clear growth opportunities, both vertical and lateral. Companies should offer a variety of experiences and clearly defined career paths to retain employees and keep them engaged.

2. Compensation

Compensation is a critical factor in employee retention, as it constitutes the largest part of the retention process. Employees have high expectations regarding their compensation packages, which can vary across industries. An attractive and competitive compensation package is essential for retaining employees. Key components to consider when designing compensation packages include:

- **Salary and Monthly Wage:** This is the largest component and often the most compared factor among employees. It reflects the employee's skill level and experience. Regular increases based on performance and contributions to the organisation help maintain satisfaction.

- **Bonus:** Typically given at the end of the year or during festivals, a bonus serve as an additional reward for employee performance.
- **Economic Benefits:** These can include paid holidays, travel concessions, and other financial benefits that improve the employee's overall compensation experience.
- **Long-term Incentives:** Stock options or grants are offered, particularly in startups, to incentivize employees to stay longer and contribute to the company's growth.
- **Health Insurance:** This valuable benefit provides employees with financial security and peace of mind, showing that the company cares about their well-being and that of their families.
- **Post-Retirement Benefits:** These include gratuity, the Employee Provident Fund (EPF), and other retirement payments that provide financial security after an employee leaves the organisation.
- **Miscellaneous Compensation:** This may include additional benefits such as employee assistance programs (e.g., psychological counseling, legal aid), discounts on company products, or use of company assets such as cars.

3. Work Relationships

Positive relationships with supervisors and co-workers are critical. Managers should be fair, offer flexibility, recognise employee contributions, and support career development. Strong co-worker relationships also foster a positive work environment, reducing turnover.

4. Job and Work-Life

Job security has declined over the past decade due to downsizing, layoffs, mergers, and organisational changes, leading to reduced employee loyalty and retention. As employees witness layoffs, anxiety increases, causing them to consider leaving before they are affected. Organisations with higher job security tend to have better retention rates.

Job design plays a significant role in retention. Mismatches between employees' skills and job requirements, whether through overqualification or underqualification, can lead to turnover. Dissatisfying job accomplishments, stressful workloads, and poor work-life balance can also affect retention. Furthermore, factors like work schedule timing and job location may contribute to burnout, influencing employees' decisions to stay or leave.

5. Work-life balance:

Irrespective of their industry, it is important for working professionals to maintain a work-life balance. While high-paying jobs often demand longer hours, organisations should implement flexible working hours and work from home policies while respecting their core office culture. Practices such as occasional work from home days, flexible work arrangements, 'ME time' (reserving a portion of their time to pursue a hobby of their choice) are ways to help employees maintain a healthy work-life balance.

6. Organisational Environment

It is not just about managing retention; it is about managing people. If an organisation manages people well, employee retention will take care of itself. Organisations should focus on managing the work environment to make better use of the available human capital. People want to work for an organisation that provides:

- Appreciation for the work done
- Ample opportunities to grow
- Friendly and cooperative environment
- A feeling that the organisation is second home to the employee

Organisational environment includes:

- Culture
- Values
- Company reputation
- Quality of people within the organisation
- Employee development and career growth
- Encouragement of risk taking
- Use of leading technologies
- Trust

7. Recognition and feedback:

Typically, bosses are quick to give feedback when issues arise. However, appreciation is rare when things go smoothly. Letting employees know that their efforts are valued, recognising and highlighting impactful outcomes and providing timely feedback is crucial. Similarly, obtaining feedback from employees and engaging in meaningful dialogues to address obstacles is equally important.

8. Transparent and fair reviews:

Enabling transparent and clear reviews and appraisals help employees achieve more, providing a clear understanding that rewards are based on merit. The review process should celebrate key milestones in an employee's career within an organisation where the focus is on highlighting key achievements, strengths and development areas, followed by a mutually agreed goal setting discussion.

Motivation

Motivation is crucial for employee retention, as it directly impacts job satisfaction, engagement, and loyalty. Motivated employees are more likely to be satisfied with their work, remain committed to the organisation, and perform at higher levels. Motivation helps reduce turnover by fostering a positive work environment, encouraging career growth, and preventing burnout. Recognition, rewards, and opportunities for development also help maintain employee motivation and loyalty. Furthermore, providing work-life balance and flexibility can further enhance retention. In essence, motivated employees are more engaged, productive, and likely to remain with the organisation long-term.

SELF-TEST

For the following questions select the best answer.

1. Human resources cover following types of employees?
 - a) Full-time
 - b) Part-time
 - c) All of the above
 - d) None of the above
2. Which of the following is not a responsibility of the human resource management function?
 - a) assess the quantity and quality of human resources currently available
 - b) estimate the quantity and quality of human resources that will be needed in the future
 - c) encourage employees of low performance to leave
 - d) consider ways of 'filling the gap' and ensuring that the entity has the human resources that it needs
3. The ideal duration of a human resource plan is:
 - a) three to five years
 - b) three to seven years
 - c) below three years
 - d) over three years
4. Which of the following is not an area to be covered in a human resource plan?
 - a) Staff recruitment
 - b) Performance appraisal
 - c) Marketing campaign
 - d) Redundancy
5. Human resource plans should be _____, and should therefore take into consideration environmental factors.
 - a) simplistic
 - b) critical
 - c) realistic
 - d) idealistic
6. Which of the following is not the purpose of a job analysis?
 - a) Job description
 - b) Job specification
 - c) All of the above
 - d) None of the above
7. Which of the following is not a stage of recruitment?
 - a) Agree the vacancy
 - b) Select the candidate
 - c) Identify the skills
 - d) Obtain applications

8. Which of the following is not a stage of selection?
 - a) Agree the vacancy
 - b) Select the candidate
 - c) All of the above
 - d) None of the above
9. Requesting a candidate's credit cheque is part of which of the following human resource management activity?
 - a) Recruitment
 - b) Selection
 - c) Development
 - d) Retention
10. Which of the following is not a tool of training?
 - a) CBT
 - b) SAT
 - c) All of the above
 - d) None of the above
11. Which of the following is not a type of on-job-training?
 - a) Orientation
 - b) Job instruction manuals
 - c) Simulation
 - d) Apprenticeships
12. Which of the following is a tool of development?
 - a) Secondment
 - b) Delegation
 - c) All of the above
 - d) None of the above
13. Which of the following is generally not a reason of an employee's decision to leave?
 - a) Financial instability of a company
 - b) Bad relationship with manager
 - c) Bad relationship with secretary
 - d) Boring work
14. Which one of the following is not included in an annual package?
 - a) Bonus
 - b) EPF
 - c) Air Tickets
 - d) Appraisals
15. Employee turnover is defined as:
 - a) Staff joining the job
 - b) Staff leaving the job
 - c) Staff increasing the revenue turnover
 - d) Staff increasing the sales turnover

ANSWERS TO SELF-TEST

1	c
2	c
3	a
4	c
5	c
6	c
7	b
8	a
9	b
10	b
11	c
12	c
13	c
14	d
15	b

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