ACCA

Paper

F1

Accountant in Business

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Syllabus and study guide

Aim

To introduce knowledge and understanding of the business and its environment and the influence this has on how organisations are structured and on the role of the accounting and other key business functions in contributing to the efficient, effective and ethical management and development of an organisation and its people and systems.

Main capabilities

On successful completion of this paper, candidates should be able to:

A   Explain how the organisation is structured, governed and managed by – and on behalf of – its external, connected and internal stakeholders

B   Identify and describe the key environmental influences and constraints on how the business operates in general and how these affect the accounting function in particular

C   Describe the history, purpose, and position of accounting in the organisation and the roles of other functional areas

D   Identify and explain the functions of accounting systems and internal controls in planning, monitoring and reviewing performance and in preventing fraud and business failure

E   Recognise the principles of authority and leadership and how teams and individuals behave and are managed, disciplined and motivated in pursuit of wider departmental and organisational aims and objectives

F   Recruit and develop effective employees, using appropriate methods and procedures, while developing constructive relationships through effective communication and interpersonal skills

Rationale

The *Accountant in Business* syllabus acts as an introduction to business structure and purpose, and to accountancy as a central business function. The syllabus commences with an examination of the structure and governance of businesses, briefly introducing ethics. It then looks at business in the context of its environment, including economic, legal, and regulatory influences on such aspects as governance, employment, health and safety, data protection and security. From there, it focuses on accounting, how it originated, how it is organised, its critical importance in business planning and control, and how it affects other business functions.

The syllabus then introduces students to the accounting profession and to certain aspects of the regulatory framework as they affect accounting, auditing and governance. The syllabus also covers accounting, auditing, and internal control as specific business functions and how these should be supported by effective management information systems. Finally, the syllabus introduces key management and people issues such as individual and team behaviour, leadership, motivation and personal effectiveness.

Syllabus

A   Business organisation structure, governance and management

1   The business organisation and its structure
2   The formal and informal business organisation
3   Organisational culture in business
4   Stakeholders of business organisations
5   Information technology and information systems in business
6   Committees in the business organisation
7   Business ethics and ethical behaviour
8   Governance and social responsibility in business

B   Key environmental influences and constraints on business and accounting

1   Political and legal factors
2   Macro-economic factors
3   Social and demographic factors
4   Technological factors
5   Competitive factors

C   History and role of accounting in business

1   The history and function of accounting in business
2   Law and regulation governing accounting
3   Financial systems, procedures and IT applications
4   The relationship between accounting and other business functions

D   Specific functions of accounting and internal financial control

1   Accounting and finance functions within business
2   Internal and external auditing and their functions
3   Internal financial control and security within business organisations
4   Fraud and fraudulent behaviour and their prevention in business.

E   Leading and managing individuals and teams

1   Leadership, management and supervision
2   Individual and group behaviour in business organisations
3   Team formation, development and management
4   Motivating individuals and groups

F   Recruiting and developing effective employees

1   Recruitment and selection, managing diversity, and equal opportunity.
2   Techniques for improving personal effectiveness at work and their benefits
3   Features of effective communication
4   Training, development, and learning in the maintenance and improvement of business performance
5   Review and appraisal of individual performance

Approach to examining the syllabus

The syllabus is assessed by a two hour paper-based or computer-based examination. Questions will assess all parts of the syllabus and will test knowledge and some comprehension or application of this knowledge. The examination will consist of 40 two mark questions, and 10 one mark questions.

Study guide

This study guide provides more detailed guidance on the syllabus. You should use this as the basis of your studies.

A   BUSINESS ORGANISATIONAL STRUCTURE, GOVERNANCE AND MANAGEMENT

1   The business organisation and its structure

(a)   Identify the different types of organisation:

(i)   Commercial

(ii)   Not-for-profit

(iii)   Public sector

(iv)   Non-governmental organisations

(v)   Cooperatives

(b)   Describe the different ways in which organisations may be structured: entrepreneurial, functional, matrix, divisional, departmental, by geographical area and by product.

(c)   Describe the roles and functions of the main departments in a business organisation:

(i)   research and development

(ii)   purchasing

(iii)   production

(iv)   direct service provision

(v)   marketing

(vi)   administration

(vii)   finance.

(d)   Explain the characteristics of the strategic, tactical and operational levels in the organisation in the context of the Anthony hierarchy.

(e)   Explain the role of marketing in an organisation:

(i)   the definition of marketing

(ii)   the marketing mix

(iii)   the relationship of the marketing plan to the strategic plan

(f)   Explain basic organisational structure concepts:

(i)   separation of direction and management

(ii)   span of control and scalar chain

(ii)   tall and flat organisations

(g)   Explain centralisation and decentralisation and list their advantages and disadvantages.

2 The formal and informal business organisation

(a) Explain the informal organisation and its relationship with the formal organisation.

(b) Describe the impact of the informal organisation on the business.

3 Organisational culture in business

(a) Define organisational culture.

(b) Describe the factors that shape the culture of the organisation.

(c) Explain the contribution made by writers on culture:

    (i) Shein – determinants of organisational culture

    (ii) Handy – four cultural stereotypes

    (iii) Hofstede – international perspectives on culture

4 Stakeholders of business organisations

(a) Define the internal stakeholder and list the different categories of internal stakeholder.

(b) Define connected and external stakeholders and explain their impact on the organisation.

(c) Identify the main stakeholder groups and the objectives of each group.

(d) Explain how the different stakeholder groups interact and how their objectives may conflict with one another.

5 Information technology and information systems in business

(a) Discuss the types of information technology and information systems used by the business organisation.

(b) List the attributes of good quality information.

(c) Explain how the type of information differs and the purposes for which it is applied at different levels of the organisation: strategic, tactical and operational.

d) Identify the different sources of internal and external information.

(e) Describe the main features of information systems used within the organisation.

6 Committees in the business organisation

(a) Explain the purposes of committees.

(b) Describe the types of committee used by business organisations.

(c) List the advantages and disadvantages of committees.

(d) Explain the roles of the Chair and Secretary of a committee.

7   Business ethics and ethical behaviour

(a)   Define business ethics and explain the importance of ethics to the organisation and to the individual.

(b)   Identify influences that determine whether behaviour and decisions are ethical or unethical.

(c)   Identify the factors that distinguish a profession from other types of occupation.

(d)   Explain the role of the accountant in promoting ethical behaviour.

(e)   Recognise the purpose of international and organisational codes of ethics and codes of conduct, IFAC, ACCA etc.

8   Governance and social responsibility in business

(a)   Recognise the concept of separation between ownership and control.

(b)   Define corporate governance and social responsibility and explain their importance in contemporary organisations.

(c)   Explain the responsibility of organisations to maintain appropriate standards of corporate governance and corporate social responsibility.

(d)   Briefly explain the main recommendations of best practice in effective corporate governance:

(i)   Non-executive directors

(ii)   Remuneration committees

(iii)   Audit committees

(iv)   Public oversight

(e)   Explain how organisations take account of their social responsibility objectives through analysis of the needs of internal, connected and external stakeholders.

(f)   Identify the social and environmental responsibilities of business organisations to internal, connected and external stakeholders.

B   KEY ENVIRONMENTAL INFLUENCES AND CONSTRAINTS ON BUSINESS AND ACCOUNTING

1   Political and legal factors

(a)   Define environmental forces in terms of political, legal, economic, social and technological factors.

(b)   Explain how the political system and government policy affect the organisation.

(c)   Describe the sources of legal authority, including supra-national bodies, national and regional governments.

(d)   Explain how the law protects the employee and the implications of employment legislation for the manager and the organisation.

(e)   Identify the principles of data protection and security.

(f)   Explain how the law promotes and protects health and safety in the workplace.

(g)   Recognise the responsibility of the individual and organisation for compliance with laws on data protection, security and health and safety.

2 Macro-economic factors

(a)   Define macro-economic policy.

(b)   Explain the main determinants of the level of business activity in the economy and how variations in the level of business activity affect individuals, households and businesses.

(c)   Explain the impact of economic issues on the individual, the household and the business:

(i)   inflation

(ii)   unemployment

(iii)   stagnation

(iv)   international payments disequilibrium.

(d)   Describe the main types of economic policy that may be implemented by government and supra-national bodies to maximise economic welfare.

(e)   Recognise the impact of fiscal and monetary policy measures on the individual, the household and businesses.

3 Social and demographic factors

(a)   Explain the medium and long-term effects of social and demographic trends on business outcomes and the economy.

(b)   Describe the impact of changes in social structure, values, attitudes and tastes on the organisation.

(c)   Identify and explain the measures that governments may take in response to the medium and long-term impact of demographic change.

4 Technological factors

(a)   Explain the effects of technological change on the organisation structure and strategy:

(i)   Downsizing

(ii)   Delayering

(iii)   Outsourcing

(b)   Describe the impact of information technology and information systems development on business processes.

5 Competitive factors

(a)   Explain the factors that influence the level of competitiveness in an industry or sector.

(b) Describe the activities of an organisation that affect its competitiveness:

(i) purchasing

(ii) production

(iii) marketing

(iv) service

C HISTORY AND ROLE OF ACCOUNTING IN BUSINESS

1 The history and function of accounting in business

(a) Briefly explain the history and development of the accounting and finance role in business.

(b) Explain the overall role and separate functions of the accounting department.

2 Law and regulation governing accounting

(a) Explain basic legal requirements in relation to keeping and submitting proper records and preparing financial accounts.

(b) Explain the broad consequences of failing to comply with the legal requirements for maintaining accounting records.

(c) Explain how the international accountancy profession regulates itself through the establishment of reporting standards and their monitoring.

3 Financial systems, procedures and IT applications

(a) Explain how business and financial systems and procedures are formulated and implemented to reflect the objectives and policies of the organisation.

(b) Describe the main financial systems used within an organisation:

(i) purchases and sales invoicing

(ii) payroll

(iii) credit control

(iv) cash and working capital management.

(c) Explain why appropriate controls are necessary in relation to business and IT systems and procedures.

(d) Understand business uses of computers and IT software applications:

(i) Spreadsheet applications

ii) Database systems

(e) Describe and compare the relative benefits and limitations of manual and automated financial systems that may be used in an organisation.

4   The relationship between accounting and other business functions

(a)   Explain the relationship between accounting and purchasing/procurement.

(b)   Explain financial considerations in production and production planning.

(c)   Identify the financial issues associated with marketing.

(d)   Identify the financial costs and benefits of effective service provision.

D   SPECIFIC FUNCTIONS OF ACCOUNTING AND INTERNAL FINANCIAL CONTROL

1   Accounting and finance functions within business

(a)   Explain the contribution of the accounting function to the formulation, implementation, and control of the organisation's policies, procedures, and performance.

(b)   Identify and describe the main accounting and reporting functions in business:

(i)   recording financial information

(ii)   codifying and processing financial information

(iii)   preparing financial statements

(c)   Identify and describe the main management accounting and performance management functions in business:

(i)   recording and analysing costs and revenues

(ii)   providing management accounting information for decision-making

(ii)   planning and preparing budgets and exercising budgetary control.

(d)   Identify and describe the main finance and treasury functions:

(i)   calculating and mitigating business tax liabilities

(ii)   evaluating and obtaining finance

(iii)   managing working capital

(iv)   treasury and risk management.

2   Internal and external auditing and their functions

(a)   Define internal and external audit.

(b)   Explain the main functions of the internal auditor and the external auditor.

3   Internal financial control and security within business organisations

(a)   Explain internal control and internal check.

(b)   Explain the importance of internal financial controls in an organisation.

(c) Describe the responsibilities of management for internal financial control.

(d) Describe the features of effective internal financial control procedures in an organisation.

(e) Identify and describe features for protecting the security of IT systems and software within business.

(f) Describe general and application systems controls in business.

4 Fraud and fraudulent behaviour and their prevention in business.

(a) Explain the circumstances under which fraud is likely to arise.

(b) Identify different types of fraud in the organisation.

(c) Explain the implications of fraud for the organisation.

(d) Explain the role and duties of individual managers in the fraud detection and prevention process.

E LEADING AND MANAGING INDIVIDUALS AND TEAMS

1 Leadership, management and supervision

(a) Define leadership, management and supervision and the distinction between these terms.

(b) Explain the nature of management:

i) scientific/classical theories of management Fayol, Taylor

ii) the human relations school – Mayo

iii) the functions of a manager – Mintzberg, Drucker

(c) Explain the areas of managerial authority and responsibility.

(d) Explain the qualities, situational, functional and contingency approaches to leadership with reference to the theories of Adair, Fiedler, Bennis, Kotter and Heifetz.

(e) Explain leadership styles and contexts: using the models of Ashridge, and Blake and Mouton.

2 Individual and group behaviour in business organisations

(a) Describe the main characteristics of individual and group behaviour.

(b) Outline the contributions of individuals and teams to organisational success.

(c) Identify individual and team approaches to work.

3 Team formation, development and management

(a) Explain the differences between a group and a team.

(b) Define the purposes of a team.

(c) Explain the role of the manager in building the team and developing individuals within the team.

        (i)   Belbin's team roles theory

        (ii)   Tuckman's theory of team development

   (d)   List the characteristics of effective and ineffective teams.

   (e)   Describe tools and techniques that can be used to build the team and improve team effectiveness.

4   Motivating individuals and groups

   (a)   Define motivation and explain its importance to the organisation, teams and individuals.

   (b)   Explain content and process theories of motivation: Maslow, Herzberg, McGregor, and Vroom.

   (c)   Explain and identify types of intrinsic and extrinsic reward.

   (d)   Explain how reward systems can be designed and implemented to motivate teams and individuals.

F   RECRUITING AND DEVELOPING EFFECTIVE EMPLOYEES

1   Recruitment and selection, managing diversity and equal opportunity

   (a)   Explain the importance of effective recruitment and selection to the organisation.

   (b)   Describe the recruitment and selection processes and explain the stages in these processes.

   (c)   Describe the roles of those involved in the recruitment and selection processes.

   (d)   Describe the methods through which organisations seek to meet their recruitment needs.

   (e)   Explain the advantages and disadvantages of different recruitment and selection methods.

   (f)   Explain the purposes of a diversity policy within the human resources plan.

   (g)   Explain the purpose and benefits of an equal opportunities policy within human resource planning.

   (i)   Explain the practical steps that an organisation may take to ensure the effectiveness of its diversity and equal opportunities policy.

2   Techniques for improving personal effectiveness at work and their benefits

   (a)   Explain the purposes of personal development plans.

   (b)   Describe how a personal development plan should be formulated, implemented, monitored and reviewed by the individual.

   (c)   Explain the importance of effective time management.

   (d)   Describe the barriers to effective time management and how they may be overcome.

(e)   Describe the role of information technology in improving personal effectiveness.

(f)   Explain the purposes and processes of coaching, mentoring and counselling and their benefits.

3   Features of effective communication

(a)   Define communications.

(b)   Explain a simple communication model: sender, message, receiver, feedback, noise.

(c)   Explain formal and informal communication and their importance in the workplace.

(d)   Identify the consequences of ineffective communication.

(e)   Describe the attributes of effective communication.

(f)   Describe the barriers to effective communication and identify practical steps that may be taken to overcome them.

(g)   Describe the main methods and patterns of communication.

4   Training, development and learning in the maintenance and improvement of business performance

(a)   Explain the importance of learning in the workplace.

(b)   Describe the learning process: Honey and Mumford, Kolb.

(c)   Describe the role of the human resources department and individual managers in the learning process.

(d)   Describe the training and development process: identifying needs, setting objectives, programme design, delivery and validation.

(e)   Explain the terms 'training', 'development' and 'education' and the characteristics of each.

(f)   List the benefits of effective training and development in the workplace.

5   Review and appraisal of individual performance

(a)   Explain the importance of performance assessment.

(b)   Explain how organisations assess the performance of human resources.

(c)   Define performance appraisal and describe its purposes.

(d)   Describe the performance appraisal process.

(e)   Explain the benefits of effective appraisal.

(f)   Identify the barriers to effective appraisal and how these may be overcome.

(g)   Explain how the effectiveness of performance appraisal may be evaluated.

CHAPTER

1

The structure of business organisations

Contents
1   Types of organisation and organisation structures
2   Functional departments in business organisations
3   Functions and characteristics of management
4   Basic concepts of organisation and management structure
5   Committees

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Types of organisation and organisation structures

- Types of organisation
- Organisation structures
- Entrepreneurial organisation
- Functional organisation (departmental structure)
- Divisional organisation structure
- Matrix organisation

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1 Types of organisation and organisation structures

1.1 Types of organisation

Accountants are employed by different types of organisation. Organisations can be divided into two main types:

- business organisations, and
- not-for-profit organisations.

Business organisations engage in commercial and industrial activities, with the purpose of making a profit.

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

- public sector organisations: these are government departments or organisations that are funded by the government
- non-government organisations: these are not-for-profit organisations that are partly or wholly funded from non-government sources. Examples are charities, clubs and societies.

The distinguishing features of different types of organisation

Each type of organisation has features that distinguish it from the other types of organisation.

- **Purpose**. They have different purposes. Business organisations exist to make a profit. Public sector organisations exist to provide a benefit to the public, such as good government or key services such as health, education, a police force, national defence, and so on.
- **Ownership**. They have different types of owner. Companies are owned by their shareholders, whereas public sector organisations are owned by the government (as the representative of the general public). Co-operatives are owned by members.
- **Funding**. Business organisations obtain the funds they need to operate from a variety of sources. A stock market company, for example, obtains its long-term

funds from a mixture of reinvesting profits in the business, issuing new shares and borrowing. Charities rely on a mixture of government grants and private donations for the money they need. Public sector organisations obtain their money from the government, which in turn gets its money from taxation.

■ **Accountability**. The management of an organisation is accountable to its owners for the performance and achievements of the organisation. The directors of a company, for example, are accountable to the shareholders for the financial performance of the company. This is the main reason why companies produce their annual report and accounts.

Co-operatives

Co-operatives are organisations in which there are members, and all members:

■ are actively involved in its activities, and

■ share in the benefits that the co-operative provides.

There are different types of co-operative.

■ In a workers' co-operative, a number of individuals co-operate to carry out related activities, such as operating a farm or a factory. They work for the co-operative and they share the benefits that the co-operative provides.

■ A number of individuals might form a co-operative for the purchase and use of expensive equipment. Each member of the co-operative is entitled to some use of the assets. For example, a number of small farmers might form a co-operative to purchase and use expensive agricultural equipment.

■ In a retail co-operative society, the members buy goods and services from the retail outlets of the co-operative society, and each year they receive a share of the profits that the society has made.

Co-operatives are more common in some countries than in others.

Examples

In the UK there is a bicycles co-operative that operates a small number of bicycle retail outlets. After one year of employment in the co-operative, every full-time employee is entitled to become a member. The profits of the co-operative are shared between its members.

The UK also has a Co-operative Society, whose activities include operating a chain of retail stores and a commercial bank. Individuals can become members by shopping in the Society's outlets, and they receive a share of the Society's annual profits. The size of their profit share depends on the amount of profits that Society has earned and the amount of shopping they have done in the Society's stores.

Co-operatives may be either commercial businesses or not-for-profit organisations. If they are commercial businesses, the profits are shared by the members. In not-for-profit co-operatives, other benefits (such as the output produced by the co-operative) are shared by the members.

1.2 Organisation structures

All types of organisations have some common features.

■ They consist of more than one person. A two-man partnership is an organisation. Similarly, a sole trader's business is an organisation if the business owner has employees working for him (or her). The work of the different people in the organisation must be co-ordinated and given direction.

■ Because they need direction and co-ordination, organisations need to be managed. There are 'managers' in all types of organisation.

'Organisation structure' is the framework within which the activities of people within the organisation are co-ordinated and managed. The examination syllabus is concerned principally with business organisation, and common forms of business organisation structure are:

■ an entrepreneurial structure

■ a functional (departmental) structure

■ a divisional structure

■ a matrix structure.

1.3 Entrepreneurial organisation

An entrepreneurial organisation is managed by its entrepreneurial owner. The main features of an entrepreneurial organisation are usually as follows:

■ The entrepreneur-leader takes all the main management decisions, and he does not delegate decision-making to other people. He is closely involved in the day-to-day operations of the business.

■ There is no formal management structure. Individuals report directly to the entrepreneur-leader, who tells them what to do.

■ The entrepreneur-leader therefore dominates the organisation.

■ The business operations are likely to be simple, because it is normally too difficult for a single person to manage a business whose operations are complex. For example, the business might make and sell a small number of products or may provide just one type of service to customers.

An entrepreneurial structure is often appropriate when a business is in the early stage of its life. In order to become profitable and grow, the business often needs a dominant personality to control it. As the business develops and grows larger, however, an entrepreneurial structure will become inefficient, and a more formal management structure/organisation structure is needed.

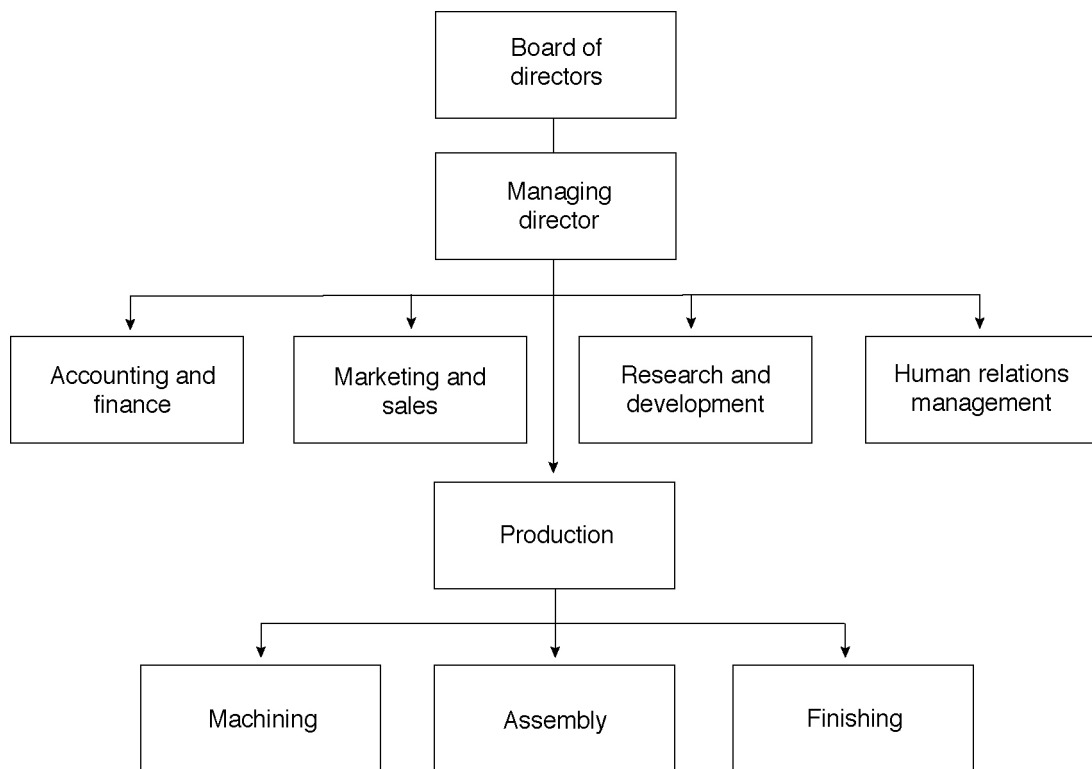## 1.4 Functional organisation (departmental structure)

A functional structure is usually the next stage in the development of a business organisation as it grows in size. The organisation is sub-divided into specialist departments, with each department specialising in a particular type of activity ('function').

The nature of the functional departments varies according to the type and size of business. The functional departments in a manufacturing business might include buying (purchasing), manufacturing operations, sales and marketing, accounting, research and development, and so on.

Within each function, the organisation might be structured as different sub-functions. For example, the manufacturing department might have sub-departments for machining, finishing and assembly. The accounting department might have separate sections for book-keeping, cost accounting, payroll and internal audit.

Each function has its own management structure and its own employees.

A functional organisation structure can be shown in an organisation chart. A simplified organisation chart for a functional organisation is shown below.

Advantages and disadvantages of a functional organisation structure

A functional organisation structure has several advantages, but there are also disadvantages.

Advantages	Disadvantages
Specialist skills are concentrated into the same department, and employees in the department can become 'experts' in the work that they do.	When an organisation is divided into functional departments, 'head office' management has the task of co-ordinating the work of all the different departments.

Specialisation might improve efficiency, because specialists should be able to do their work more quickly than non-specialists.	Co-ordination of activities can be very difficult, especially in large and complex organisations. Problems with effective co-ordination are probably the most serious weakness of a functional organisation structure. For example, the completion of a project or a customer order depends on the work of several different departments, and no single function or functional manager has responsibility for the entire project or the customer order.
Specialisation should also improve the quality of the work that is done. Functional specialists should be capable of achieving more than non-specialists.	There is a risk that a functional organisation structure will encourage the development of bureaucracy, with too much emphasis on following rules and procedures.
When decision-making and other management responsibilities are delegated, a functional organisation structure is usually a sensible arrangement for businesses that are not very large.	Good communications are essential in order to co-ordinate functional activities effectively. However, each department might develop its own 'culture' and communication between departments might be poor. For example, scientists in the research and development department might find it very difficult to communicate with accountants. Production staff and sales staff might also have communication problems.
	An organisation structure based entirely on functional departments is probably inefficient when the business has widely-diversified products or services, and operates in a number of different countries or geographical regions.

1.5 Divisional organisation structure

In a divisional organisation structure, the organisation is divided into a number of different divisions, sometimes called strategic business units or SBUs. There are two main types of divisional structure:

■ a **product division structure**: each division specialises in a different product or service (or range of products or services).

■ a **geographical division structure**: each division sells the same products or services, but in different regions or geographical areas.

e **Examples**

A manufacturer of motor vehicles might be organised on a divisional basis, with one division for motor cars and another division for trucks.

Similarly, a transport company might have separate divisions for bus travel services, railway services and air travel services. A postal services company might have separate divisions for letters and packages.
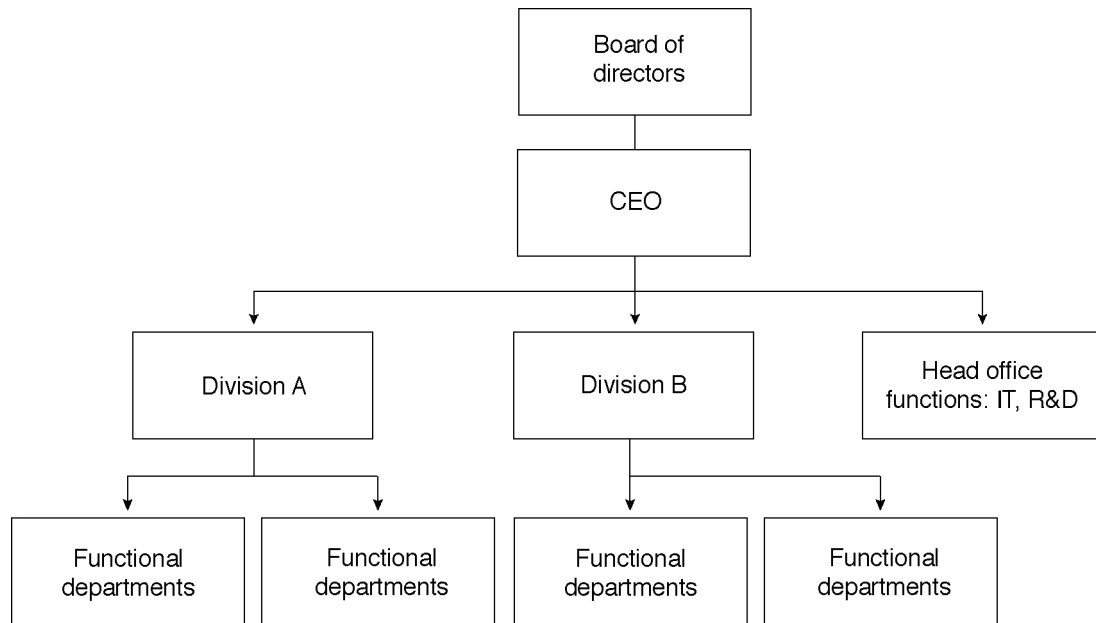
A geographical divisional structure is common in many multinational companies. For example, a manufacturer of soft drinks might have separate divisions for America, Europe, the Far East and the Rest of the World.

Authority is delegated from head office to the divisional management (led perhaps by a divisional managing director), and responsibility for the implementation of business strategy is mainly at divisional level.

■ The divisional managing directors usually have the authority to take many decisions without referring them first to head office.

■ Senior management at head office retain overall control of the business, and the divisional managing directors report to head office and are accountable to the senior management.

Each division usually contains its own functional departments, although some specialist functions might be centralised at head office. For example, a company with a geographical divisional structure might centralise research and development under the direct control of 'head office'. Similarly, in a company with either a product division structure or a geographical division structure, head office functions providing services to all divisions might include a corporate strategy department, a legal department, a public relations department, an information technology (IT) department, and so on.

A simplified organisation chart is shown below, for a divisional organisation with two divisions.

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                        ┌─────────────┐
                        │  Board of   │
                        │  directors  │
                        └──────┬──────┘
                               │
                        ┌──────┴──────┐
                        │     CEO     │
                        └──────┬──────┘
           ┌───────────────────┼───────────────────┐
           ▼                   ▼                   ▼
   ┌──────────────┐   ┌──────────────┐   ┌──────────────────┐
   │  Division A  │   │  Division B  │   │   Head office    │
   │              │   │              │   │ functions: IT, R&D│
   └──────┬───────┘   └──────┬───────┘   └──────────────────┘
      ┌───┴────┐         ┌───┴────┐
      ▼        ▼         ▼        ▼
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│departments││departments││departments││departments│
└──────────┘└──────────┘└──────────┘└──────────┘
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In practice, in large organisations each division is a company or a group of companies. 'Head office', which owns all the divisions, is called the parent company of the group. For the purpose of the examination, however, it should not matter whether divisions are all a part of a single company or whether they are separate companies within the same group of companies.

Divisional structures and responsibility for sales, profits, return on capital employed

Key features of a divisional organisation structure are that:

- A large amount of authority for decision-making is delegated to the management of each division.
- The divisional managers are accountable to senior management at head office, for the performance of the division.
- The performance of divisions is normally assessed in financial terms, such as profitability, return on capital employed and sales revenue.

Advantages and disadvantages of a divisional organisation structure

A divisional organisation structure has several advantages compared with a simple functional organisation structure, but there are also disadvantages.

Advantages	Disadvantages
Since most decisions are taken by the managers within each division, decision-making is usually quicker than in a similar organisation where decision-making is centralised at head office.	Each division has its own functional departments, such as sales and marketing and accounting. There is a risk that this duplication of functions will be more expensive.

Divisional managers are likely to be much more aware (than head office managers) of changes in the business environment for their product or geographical region. As a result, the organisation should be more capable of responding to new opportunities and new threats in the environment.

There might be a risk that head office will be larger than it needs to be, because most decision-making is done at divisional level. Head office might therefore result in unnecessary expense, unless it is reduced to a minimum efficient size.

The organisation can develop managers and employees with specialist knowledge and skills relating to their particular products or geographical area.

Senior management at head office are able to control a diverse and complex organisation on the basis of the financial performance of each division.

1.6   Matrix organisation

It was suggested earlier that a weakness of functional organisation is that no single function has responsibility for a project when several departments are involved in the work.

The problem was recognised in the 1950s in the aerospace industry in the USA. Major projects and customer orders involved the design, manufacture and testing of aircraft and their different parts (engines, wings, fuselage and so on). Construction projects were often delayed by a failure in co-ordination between the different functional departments involved.

The challenge was to complete projects on time and on budget. However, the traditional functional structure within the 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 or customer orders.

■   At the same time functional managers, such as the management of engineering, production and sales and marketing, retained their authority and decision-making power.

In this way, a 'dual command' structure was created. In a matrix organisation, the traditional 'vertical' command structure based on functional departments has an 'overlay' of horizontal authority or influence. The project manager is responsible for co-ordinating the activities of the different functions. Horizontal relationships between individuals in different functions are as important as the 'traditional' manager-subordinate relationships within functional departments.

Some entities have developed a matrix organisation structure. The matrix organisation originated in the 1950s and 1960s, in entities where it was recognised that different functions within the entity needed to work closely together. Horizontal relationships across different functions were as important as the 'traditional' reporting relationship within functions.

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).

A matrix organisation and a project organisation are similar in concept.

■ With a project organisation, the project management comes to an end when the project ends.

■ With matrix organisation, the matrix structure of authority and command is permanent.

An organisation chart for a matrix structure shows functional responsibilities in vertical columns, and cross-functional (project manager) responsibilities in a horizontal line across the different functions.

Functional managers	→	Production	Quality control	Design
Project managers ↓			Responsible to quality control manager ↑	
Project A				
Project B	Responsible to Project Manager B ←		Quality control expert	
Project C				

In the diagram above, the person shown is a quality control expert and is responsible to the quality control manager for technical aspects of the job, maintaining quality systems and so on.

The person is also responsible to the manager of Project B. That manager will be concerned with completing the project in time, within the cost budget and to the proper standard.

Obviously conflicts can arise: the project manager might want to skip some tests to make up time, but the quality control department won't want to do that. Both can put the employee under some pressure. However the matrix structure should allow the employee to ask the two managers to discuss the problem, as it is plain that they are both involved.

Overall, matrix structures should:

- encourage communication between functional departments
- place emphasis on 'getting the job done' rather then on each functional manager defending his or her own position.

Example

Another example of matrix organisation is commonly found in universities.

A university has a traditional functional management structure. Within the teaching department there are functional specialisations for teaching, such as the engineering function, art and design function, business studies function, law school, and so on. Each teaching department has a head.

However, many courses at universities are multi-functional, and teachers for each course come from a number of different functional departments. For example, an accounting degree programme might use teachers from the business studies department, law school and economics department.

In addition to the functional management structure based on heads of faculty and heads of department, there is a course-based management structure in which individual lecturers are responsible for all aspects of a particular course or degree programme. For example, the course leader is responsible for obtaining and managing the teachers from different faculties or departments, finding the lecture rooms, marking the examinations, reporting absentee students to the administration department, and so on.

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Functional departments in business organisations

- The main business functions
- Research and development
- Purchasing
- Operations function
- Marketing function
- Administration function
- Finance function

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2 Functional departments in business organisations

2.1 The main business functions

Most business organisations have a functional structure. Even divisional structures and matrix organisations use functional management structures. The number of different functions and the type of functions will vary with the nature of the business operations and activities.

Most large companies have some or all of the following functions:

- Research and development
- Purchasing
- Operations
- Marketing
- Administration
- Finance.

Outsourcing functional activities

These functions are usually carried out by specialist departments within the company. However, some functions might be 'outsourced' to a separate company. For example a company might outsource all its book-keeping and accounting to a firm of accountants that provides book-keeping services for clients. Some administration activities, such as cleaning services and security, might be outsourced to specialist companies.

2.2 Research and development

A company is likely to have a research and development function when it needs to **innovate**, and continually produce new or improved products (or processes or services). For example, pharmaceutical companies have research and development departments for developing new medicines. Food manufacturers use research and development to develop new food products or 'healthier' contents.

A distinction can be made between:

- pure research
- applied research
- development.

Pure research (also called basic research) is experimental work or theoretical work whose aim is to acquire new scientific or technical knowledge for its own sake. Pure research is not directed towards any specific application or use.

Applied research is original investigations to gain new scientific or technical knowledge that is directed towards a specific use or purpose.

Development is the use of scientific or technical knowledge to produce new (or substantially improved) products, services or processes. If the development work is successful, it will lead on to the commercial launch of a new or improved product or service, or the introduction of a new process into operational use.

Pure research is often carried out in the scientific or engineering departments of universities or in government-owned laboratories. Research in universities might be sponsored partly or wholly by a commercial company. However, companies might have their own research and development department for both applied research and development.

Example

A research laboratory might conduct original research into the link between salt in foods and heart disease in humans. This would be pure research, because there is no specific aim other than to acquire new scientific/medical knowledge.

A research department might conduct research into how to reduce the amount of salt in a food product without affecting the taste of the product in a way that people do not like. This would be applied research, because the aim would be directed towards the production of food products with a lower salt content.

A research department might use knowledge that has been gained about reducing the salt content in food products to develop a new low-salt tinned soup. This would be product development. If successful, the development work will lead to the introduction of a new soup product to the market.

2.3 Purchasing

The purchasing department in a large organisation (also called the buying department) is responsible for purchasing goods and services from external suppliers.

Provided that the annual value of purchases is sufficient to justify the cost, there are several advantages in having a specialist purchasing department.

■ The purchasing department is staffed by buyers who should have special skills in buying, such as knowledge of how to negotiate the terms of a purchase contract with a supplier, and how to arrange the shipment of goods from another country.

■ The purchasing department should maintain a record of potential suppliers for all items. Buyers should therefore know which suppliers to approach to ask for a price quotation or negotiate a purchase order.

■ When all purchase orders from a company go through the same department, it might be possible to negotiate 'bulk purchase' discounts on the purchase price for ordering in large quantities.

■ Buyers have the responsibility for ensuring that purchase orders are met, and that suppliers deliver the goods or services on time and to the required specification. When there is no purchasing department, there may be no individual in the organisation with special responsibility for 'chasing up' late supplies or making complaints to suppliers.

■ When there is a purchasing department, it deals with all purchase orders. This has the advantage of applying control over buying from external suppliers. It prevents managers in all the functional departments from making their own decisions to buy supplies whenever they want to, from suppliers of their own choice. This should improve purchasing efficiency and help to prevent wasteful spending.

The system for purchasing might vary between different organisations. Usually, however, the procedure for making a purchase of goods or services is as follows.

■ The department wishing to make the purchase prepares a purchase requisition. For regular items of inventory, the purchase requisition comes from the stores department for a re-supply of the item that is now running out of stock. The purchase requisition might be generated automatically by the inventory control computer system.

■ Other purchase requisitions for unusual and non-recurring items might come from the department that wants the goods or services. These are requests for the purchase of specified items. Each of these purchase requisitions must be signed by a manager in the functional department who has the authority to approve the purchase.

■ The purchasing department uses the purchase requisition as its authority to make the purchase.

2.4 Operations function

Every business has an operations function. The nature of this function varies according to the nature of the business.

Manufacturing businesses

In a **manufacturing business**, the operations function is manufacturing (production) and related activities.

■ A manufacturing function includes not only the activities directly concerned with producing the finished manufactured item from raw materials and

- components, but also support activities such as engineering and maintenance work, production planning and control activities, and quality checking, inspection of finished goods and quality control.

- In some businesses, pollution control and waste disposal might also be important aspects of operations.

- Manufacturing operations convert raw materials and components (many provided by external suppliers) into a finished product. At any time, there will be some inventories of raw materials and components that have not yet been used in production. These are held in a stores department that might also be a sub-function within operations.

There are often several stages in the manufacturing process, and the manufacturing function may be sub-divided into sub-functions for each of the stages or processes.

Some manufacturing businesses produce standard products. These standard products might be produced to meet specific customer orders. However, some of the finished items are transferred to a finished goods inventory, so that future customer orders can be met from existing stock.

Other manufacturing businesses produce non-standard items, to meet specific requests from customers. The non-standard items are made to specifications provided by the customer. Each customer order is treated as a separate 'job' or 'contract'.

Service operations

In a **service business**, the operations function involves the provision of the service to the customer.

- Some services involve the provision of a service to the customer by employees of the business. Other services such as the provision of a telephone service, or providing electricity, gas or water supply, do not involve employees of the business, except for installation and repair work.

- Services provided by employees of the business might be carried out at the customer's premises or at the premises of the business. For example, car repairs are carried out at the workshop of the business whereas a large amount of auditing work is performed at the premises of the client.

Direct service operations might be divided into sub-functions. For example, a firm of accountants might have sub-functions for auditing, tax consultancy and management consultancy.

2.5 Marketing function

The marketing function within a business organisation is sometimes called the sales and distribution department. The activities in the marketing function vary according to the nature of the business and the way that it sells its products or services. For example, a chemical manufacturer sells its products to other manufacturing companies. Its marketing activities differ from those of a theatre company, that sells its entertainment services direct to the 'general public'.

The activities that might be included within the marketing function include the following.

■ **Direct selling**. Sales representatives might be employed to make sales direct to customers. Direct selling by sales representatives can be expensive, because the salaries, sales commissions and expenses of sales representatives might be high. Direct face-to-face selling is therefore used only for large-value items where a large profit can be made with each sale. Manufacturers of consumer goods, for example, use sales representatives to sell their products to retail companies such as supermarket companies and department stores. Some businesses use direct selling by telephone, rather than direct selling by visiting the customer.

■ **Advertising and sales promotion**. Many businesses use advertising and sales promotions to market their products or services.

■ **Distribution** (sometimes called outward logistics). Marketing usually includes the activities involved in delivering products to the customer. This might involve the physical delivery of goods to the customer by truck. For retail companies, distribution usually involves persuading customers to visit retail stores to buy goods; however, many companies now use the internet to sell goods or services, and arrange for delivery by courier or by post.

Marketing is described in more detail in a later chapter.

2.6   Administration function

The administration function in a business organisation carries out all the tasks that are not performed by the other functional departments. The term 'administration' is also used to describe several different functional departments in large business organisations.

Examples of the work performed by the administration function are as follows.

■ **Administration relating to employees**. In many businesses, this work is performed by a human relations management department (HRM department) Some years ago, it was called the 'personnel department'. A business organisation must maintain employment records for each employee and arrange for the training of existing employees. The HRM department is also usually involved in matters such as recruitment and selection of new employees, and dealing with redundancies, disciplinary matters and claims of unfair dismissal by employees who have been dismissed.

■ Ensuring **compliance with regulations**. Many countries have regulations relating to health and safety at work. An administration activity is to ensure compliance with any such regulations.

■ **Facilities management**. This is a term used to cover a range of administrative issues, including arranging for the security of buildings and other valuable assets, office cleaning services and the purchase and maintenance of the motor vehicles of the business.

■ **Arranging insurance**. Business organisations are required to arrange certain types of insurance. In the UK for example, there is a legal requirement to arrange employer's liability insurance, which provides insurance cover against the risk of claims by members of the public for injury caused to them by its employees. There is also a legal requirement for any business to insure its motor vehicles

and drivers. Some types of insurance are voluntary, such as insurance of business premises against fire and theft.

2.7 Finance function

The main part of a finance function in a business organisation is the **accounts department**. The accounting function is described in much more detail in a later chapter.

Large companies might also have a **treasury department** within the finance function. The role of a treasury function is to manage the company's finances. Activities of the treasury function include:

■ making sure that the business has the money it needs to pay employees, lenders and suppliers on time and to finance new investments

■ managing the cash of the business: this is often the responsibility of a chief cashier and cashier's sub-department

■ obtaining new funds from the financial markets, including the negotiation of new bank loans

■ investing surplus cash

■ arranging transactions for the purchase of foreign currency (for example to pay for purchases from other countries) or sale of foreign currency (for example to convert sales income in a foreign currency into domestic currency).

Functions and characteristics of management
■ Functions of management: Henri Fayol
■ Functions of management: Henry Mintzberg
■ Principles of effective organisation and management
■ Strategic, tactical and operational management

3 Functions and characteristics of management

The organisation structure for a business can also be described as its management structure. Every business organisation has managers, who make and implement decisions on behalf of the business. In order to understand business organisation properly, it is also necessary to understand something about the functions and characteristics of management.

3.1 Functions of management: Henri Fayol

Ideas about the functions of management – what managers do – that were expressed about a hundred years ago remain relevant today. An early writer about the principles of management was Henri Fayol (1841 – 1925), a French engineer whose views were formed by his experience in the mining industry. However, he believed that there are some general principles of management that apply to all types of business organisation in all industries.

He suggested that management performed five functions:

■ **To forecast and plan**. Managers consider the future and try to forecast what might happen. They look forward and plan ahead. They select objectives. They formulate the strategies, policies, plans and procedures for achieving those objectives.

 - There is a need for unity in the planning process. The plans for different parts of the organisation must be co-ordinated so as to achieve the aims of the organisation as a whole.

 - Managers must forecast and plan for the long term and the shorter term. There should be consistency between long-term and short-term planning.

 - Forecasts need to be accurate, so that realistic action plans can be prepared.

 - Managers must also have the flexibility to deal with unforeseen circumstances that arise, and adapt plans to meet those circumstances.

■ **To organise**. Managers build up the structure of a business organisation. They acquire suitable assets and resources for the business, including employees, and decide how these should be used.

 - They create groups of jobs within departments or work sections.

 - They appoint individuals to carry out those jobs.

- They delegate authority within the management structure, and make particular managers responsible for particular tasks.

- They gather the resources – men, materials, equipment and money – to enable the tasks to be carried out.

- They also establish a system of communication and information within the organisation.

■ **To command**. Fayol suggested that managers were responsible for maintaining activity amongst employees by telling them what to do. Giving commands is a very authoritarian form of management, however, and today a more appropriate description of this function is '**to provide leadership**'.

■ **To co-ordinate**. Managers co-ordinate the activities of all the individuals within the organisation, to ensure that the activities are directed towards a common purpose.

- Managers should co-ordinate the activities of their subordinates.

- They must also co-ordinate the activities of their own work group with the activities of other work groups within the organisation.

■ **To control**. Managers make sure that actual performance conforms with policy and established procedures. They also take control measures when actual performance differs significantly from the plan or target, to bring actual performance back into line with the plan (if this is possible).

3.2   Functions of management: Henry Mintzberg

Henry Mintzberg is another modern management theorist who has written on a wide range of topics. He is particularly well-known for research that he carried out into what managers actually do. According to classical theorists such as Fayol, the role of managers is to plan, organise, command, co-ordinate and control.

Mintzberg suggested that reality is different. His research into the activities of managers made the following discoveries:

■ A lot of management work is disjointed. Planning, for example, is done on a day-to-day basis, when time permits between more urgent or immediate tasks.

■ Managers spend some of their time on routine duties of a ceremonial nature, such as meeting with important visitors.

■ Managers prefer informal verbal communication to formal written communications, such as reports and briefing notes. Communicating informally by word of mouth is much faster and more effective than communication through the formal information system.

■ Management activities and decisions are based largely on judgement and intuition. General principles of management are not relevant to management practice. In practice, managers do many of their tasks quickly and superficially.

Mintzberg suggested that managers perform three main roles.

■ **Interpersonal role**. Managers spend much of their time performing interpersonal roles:

- As a figurehead. Managers often perform a ceremonial role, representing the organisation at events and as a 'public face' of the organisation. Managers also represent their organisation in its dealings with other organisations.

- As a leader. Managers also deal with relations between individuals inside the organisation, providing leadership (hiring, firing, training, motivating and so on).

- Liaison. Managers of groups within an organisation act as a link or bridge with other groups. For example, different departments often communicate with each other through their managers.

■ **Information role**. Managers receive and disseminate information, acting as a channel of information both inside the organisation and in communicating with external bodies. Managers gather information from formal and informal sources, and develop an extensive knowledge of the organisation as a result.

■ **Decision-making role**. Managers make decisions.

- They have an entrepreneurial role, and take initiatives.

- They have a role in resolving conflicts and disputes, and other similar problems.

- They decide how resources should be used, for example what the available money should be spent on and how employees should use their time (what work they should do).

- They negotiate with others, and reach decisions through joint agreement.

Example

You have recently been appointed to a management position in your organisation, a chain of hotels. You have been appointed as the manager of one of the hotels.

Required

(a) What are the management tasks involved in organising the work of the hotel staff?

(b) What will be your role in achieving those tasks?

Answer

You might have your own ideas about what the role of a hotel manager should be, but here are some suggestions.

(a) A manager must understand what is expected from him or her. An important starting point is therefore to understand what the responsibilities of the hotel manager are, and what targets he or she is expected to achieve, in both the short term and the longer term. In other words, a manager must know the answer to the question: 'What am I expected to do?'

- A new manager must also find out what tasks are carried out by his or her employees. These will include short-term or routine tasks such as providing hotel services - bookings, reception, room service, providing food and drink, cleaning, and so on. There may also be longer-term tasks, such as ensuring that the facilities provided by the hotel are appropriate and are replaced or modernised over time.

- The manager must know what resources are at his or her disposal. In particular, how many rooms are in the hotel, what is the size of its dining room, how much money can the hotel spend, how many employees work in the hotel, and what are their skills.

- Organisation involves deciding how the available resources should be employed to carry out the tasks of the hotel, in order to achieve the targets that the manager has been set.

(b) The management tasks to achieve these tasks might be listed as follows.

- There should be plans for carrying out the tasks of the hotel. These will include short-term operational plans, such as planning the working hours of the hotel staff and making sure that there are sufficient employees available to provide all the necessary hotel services at all times. There should also be longer-term plans, possibly based on a financial plan or budget. There may also be longer-term plans for developing the hotel's facilities and services, and replacing or updating its facilities and re-decorating the rooms.

- Responsibility for carrying out the various tasks must be delegated. The hotel manager should allocate tasks between his or her subordinates.

- The manager should set targets for each of the subordinates, or possibly instruct them.

- The manager should monitor the activities of the hotel, and assess how well or badly it is performing. In order to monitor and control activities, it will be necessary to ensure that appropriate information is obtained. The manager might therefore need to ensure that there is a formal reporting system that tells him about the performance of he hotel, such as the number of guests, room occupancy, revenue earned and costs incurred. He or she should also monitor progress by carrying out regular checks on what is happening in the hotel – simply by walking round the hotel and observing.

- The manager should be available to advise, counsel and encourage employees.

- The manager should seek to develop a 'corporate culture' amongst the hotel staff, so that all the employees have a common sense of purpose.

- The manager should continually look ahead, anticipate any problems and try to deal with them in advance.

- The manager must co-ordinate the activities of all the employees. In practice, the main methods of co-ordination are likely to be setting plans and holding regular 'team meetings' or management meetings of senior staff within the hotel.

- The manager may need to resolve disputes that arise between members of staff, to handle complaints from customers (hotel guests) and to discipline members of staff for breaches of the hotel rules.

- The manager should act as a figurehead for the hotel in its dealings with outside organisations, such as travel companies and hotel booking agencies.

Within this list, you may identify references to Fayol's roles of management or Mintzberg's functions of management.

3.3 Principles of effective organisation and management

Fayol also suggested that there are 14 principles of effective organisation and management. Some of these might not be valid for every business organisation and have been challenged by subsequent writers on management theory. The 14 principles are as follows.

- **Specialisation and the division of labour**. The efficiency and effectiveness of a business organisation is improved through specialisation. Work should be divided into separate areas of activity, each with its own specialists with particular skills. By focusing on a particular skill, individuals become more efficient and produce work of a higher standard. For example, the labour required to build a house can be divided into specialisations such as bricklaying, roofing, plastering, electricity work, plumbing and decorating. Specialists in these tasks should be able to construct a better house more quickly than a team of general building employees who do not have any particular specialisation.

- **Authority and corresponding responsibility**. If a manager is made responsible for a particular aspect of operations or business activity, he or she must be given the authority that is necessary to fulfil the responsibilities properly. Having the necessary authority means:

  - having the authority to make decisions relating to the activities for which the manager is responsible, and also

  - having the necessary resources allocated to the activities in order to do the work properly. Allocated resources are budgets (for expenditure), staff and assets.

  The authority given to a manager should always correspond exactly with the responsibilities of the manager. A manager should not be given authority without responsibility, nor should he be given responsibility without the necessary authority.

- **Discipline**. Fayol argued that discipline is essential for trouble-free operations. Without discipline, standards fall and there is no consistency of action. Fayol defined discipline as 'obedience, application, energy, behaviour and outward marks of respect that are observed in accordance with standing agreements' between a firm and its employees.

- **Unity of command**. The principle is that an employee should receive instructions from one superior only. No-one should have two bosses, who might give conflicting and contradictory instructions. When an employee has two bosses, each giving instructions, he might get into a situation where one boss is telling him to do one thing and the other is telling him to do something different. Alternatively, nether boss might give instructions or direction, assuming that the other boss has given the instructions already.

It is argued that in a matrix organisation the principle of unity of command cannot apply, because individuals have two bosses. However, even in matrix organisations one boss has the ultimate authority over any individual. For example, when there are project managers in a matrix organisation, individuals report to their functional/departmental manager and the role of the project manager is to negotiate and persuade rather than to give directions.

- **Unity of direction**. An organisation and its employees should have unity of direction. This means having one agreed plan and objective for any particular group of related activities.

- **Subordination of individual interests to the general interest**. Fayol argued that the interests of any one person or group of employees must not be allowed to prevail over the interests of the organisation as a whole. He assumed that everyone in an organisation should have a shared set of values and that the interests of the organisation as a whole are reasonable and can be identified. A weakness of this principle is that there might be disagreement about what the 'general interest' of the organisation should be. Is it to maximise profits? Or should considerations of ethical behaviour or business risk affect the general interest? And if so, how might business ethics and concern for risk affect the interests of the organisation?

- **Remuneration of employees**. Fayol's principle was that the remuneration of staff should be 'fair'. As far as possible employee remuneration should satisfy both the employees and the employer, as the 'price of services rendered'.

- **Centralisation**. Fayol argued that some form of centralisation/ centralised control over the business is essential for an efficient and effective organisation. Centralisation and decentralisation are considered in more detail later.

- **Scalar chain/line of authority**. The scalar chain in an organisation is the chain of command and communication that runs from senior management at the top of the organisation down to the employees at the bottom. Fayol argued that the chain of command and reporting relationships must be sensible and clearly understood.

- **Order**. This is another principle of organisation and management that might be challenged. Fayol argued that employees need to have a sense of order in their work. They need to know where they fit into the organisation structure and understand what the organisation expects them to do. They need policies, rules and instructions that are understandable. Having order in the work place implies that any changes to procedures and processes should be gradual and evolutionary, rather than radical (because radical change will provoke anxiety amongst employees). This principle is not accepted by those who argue that radical changes to processes and business systems are often essential for a business to maintain or improve its competitiveness.

- **Equity**. A sense of fairness and justice should exist throughout an organisation.

- **Stability of tenure**. An employee needs time to get used to a job and perform it effectively. Employees should therefore be given stability of tenure in their job, and should not be moved continually from one job to another. Stability of tenure also promotes employee loyalty to the organisation.

- **Initiative**. If employees at all levels in the organisation are given scope to show initiative, there will be much more enthusiasm and energy. This principle of Fayol is supported by management theorists such as Tom Peters who have

argued that the performance of an organisation is improved by 'empowering' employees to use their initiative and make decisions for themselves.

■ **Esprit de corps**. In an efficient and effective organisation, there is a strong sense of belonging to a team. Team work and interpersonal relationships are strong and positive.

3.4   Strategic, tactical and operational management

The decisions taken by managers within a business organisation can be categorised into levels. Robert N Anthony identified three levels of management activity:

■ strategic level

■ tactical level

■ operational level.

He described these three levels of management as a hierarchy, with the strategic level at the top and the operational level at the bottom.

This diagram also indicates that decisions at the highest level (strategic decisions) are fewer in number or frequency than tactical decisions, as the most common type of management decision is taken – on a daily basis – at the operational level.

Strategic level

At the strategic level, management is involved mainly in setting objectives and policy-making for the organisation as a whole. At the strategic level, management is concerned mainly with the long term.

Business strategy should evolve continually, and new strategies should be developed to meet changing conditions in the business environment and product markets. However, large businesses usually have a repetitive cycle of strategy management that involves:

■ Stage 1: strategic position analysis

■ Stage 2: making decisions about strategic objectives and corporate strategy

■ Stage 3: making decisions about business strategies to support corporate strategy

■ Stage 4: implementing the strategies that have been selected.

Strategic position analysis involves a study of the business environment and how it is changing, to identify any threats or opportunities that might be emerging, and how these might affect future strategy. It also involves a study of the competition in the entity's markets, and the strengths or weaknesses that the entity has in relation to its competitors. One of the purposes of strategic position analysis is to recognise the competitive strengths ('competitive advantage') that the entity enjoys and should exploit.

Strategic objectives should be selected after a position analysis has been made. For a business organisation, selecting strategic objectives involves deciding on the products or services that the organisation should be providing and the markets in which it should operate, in order to obtain a suitable financial return.

Having decided the strategic objectives, decisions have to be made about **suitable business strategies** for achieving those objectives. For example, a company that has decided on a strategy of growth in a particular market or industry should then consider the most suitable strategy for achieving growth – internal development of the business, acquisitions of other companies or strategic alliances with other companies.

Decisions must then be made about how the chosen business strategies should be implemented. For example, a strategy of growth by acquisition will require a plan for financing the acquisitions, and implementation of the strategy will involve raising the finance required to make the acquisitions.

Tactical level

Strategies are usually long-term in nature, covering a period of several years. Strategic plans have to be converted into detailed plans of action, which are much more short-term in outlook.

Anthony suggested that below the strategic level of decision-making, there is a tactical level. At the tactical level, management is responsible for the formulation of plans and policies and for establishing standards.

If a strategic plan covers the next five years, tactical planning is concerned with the detailed plans of how to achieve the five-year targets, with particular emphasis on the next year or two. Examples of tactical plans include:

- annual budgets
- setting annual sales targets
- planning the activities needed to launch a new product on to the market.

At a tactical level, managers are also responsible for achieving the tactical planning targets, such as annual performance targets. There should be a system of regular performance reporting, so that actual performance can be compared with the planned targets, and targets can be compared with revised forecasts of what is now expected to happen.

Operational level

At an operational level, managers are involved with the detailed planning and control of operational activities. Operational plans are generally fairly short-term in nature, and include scheduling work. Control at an operational level might include supervision of employees and the inspection of finished work.

Levels of management and the organisation structure

Anthony's three levels of management are identifiable within large organisations as 'top management', middle management' and 'junior management and supervision'.

The roles associated with senior, middle and junior management can be broadly differentiated as follows.

Senior managers and top managers	Middle managers	Junior managers and supervisors
Set the organisation's objectives	Involvement in short-to-medium term plans	Work assignments within a fairly limited area of operations
Forecast and plan for the medium-to-long term	Functional responsibilities	Technical direction of work activities
Decide strategy	Co-ordination of activities of subordinates	Short-term planning
Establish policies	Co-ordination with other work groups and functions	Efficiency control, quality control, control of waste, avoiding unnecessary spending
Approve annual financial plans (budgets)	Monitoring and control	Measuring results, reporting to middle managers
Organise resources on a 'global' scale for the organisation	Reporting to senior management	Employee discipline and morale
Provide leadership and create the organisation culture		
Represent the company at a senior level		

These lists are indicative of what managers do at each level, but the lists are not comprehensive.

Although it is possible to link management levels with positions in a management hierarchy, this is not always what happens in practice. In smaller organisations, there might not be a middle management level. In an entrepreneurial organisation, there might be just one manager, the owner of the business. When there is just one manager, management decisions at all three levels must be taken by the same person.

Basic concepts of organisation and management structure
■ The direction and management of a business
■ Span of control
■ Authority and responsibility
■ Scalar chain
■ Centralisation and decentralisation

4 Basic concepts of organisation and management structure

This section considers some basic concepts of organisation and management structure, and the advantages and disadvantages of different structures.

4.1 The direction and management of a business

Business organisations have both directors and managers. In some businesses, the directors and managers are the same people. This happens for example in many entrepreneurial businesses and business partnerships. However, directors and managers need not be the same individuals. The distinction between direction and management is perhaps most easily understood by looking at large companies.

Direction

The direction of a company is the responsibility of the board of directors, under the 'leadership' of the company chairman. A board of directors should have a list of matters that are reserved for its own decision-making that should not be delegated to the management of the company. The matters reserved for decision-making by the board should be those that are concerned mainly with **giving direction to the company** and **ensuring that its broad strategic objectives are achieved**. Many decisions at a **strategic level** are taken by the board, although strategy implementation is delegated to the company's management. They should include the following:

■ setting the strategic objectives for the business

■ deciding the major business strategies

■ making the more important investment decisions, such as approving major capital expenditure projects and major new acquisitions of other companies

■ making any decision to withdraw from a market or shut down the production of a major product

■ deciding any major new financing initiative, such as a new share issue or major borrowing programme, and setting total borrowing limits for the company

■ deciding dividend policy.

The directors are accountable to the shareholders of the company for the direction they have provided, and for the success or failure of the company in achieving its

strategic aims. They are also responsible to the shareholders for the overall management of the company.

Communications between a company and its shareholders are channelled through the board of directors or individual members of the board, such as the company chairman.

Management

Management are responsible for the operational activities of their organisation. Managers are also called 'executives'. They make strategy decisions that have been delegated to them by the board, and are also responsible for all decision-making at a tactical and operational level (unless operational decisions have been delegated even further to non-management employees). Management is therefore responsible for implementing the strategic decisions of the board of directors.

The leader of the management team in a company is usually the chief executive officer or CEO, who is also a member of the board of directors.

The term 'managing director' is also used in smaller companies. In large companies with a divisional structure, there may a managing director for each division or strategic business unit (SBU) and the CEO is the overall head of the management team.

Separation of direction from management

In large companies, particularly large stock market companies, there has been a separation of direction from management, and the different responsibilities of the board of directors and the executive management team have been recognised.

■ Some directors are also executive managers, and they have responsibilities for both the direction and management of their company. In large UK companies, for example, it is usual for several executive managers to be company directors, including the CEO and the finance director.

■ However, some directors are not managers of the company. They are **non-executive directors** or NEDs, appointed from outside the company. The role of a non-executive director includes attending board meetings and some other committee meetings, but the role is not full-time. Typically, a NED might commit about 30 days each year to the company.

■ The **company chairman** is often a non-executive and part-time appointment.

It is argued that executive directors have strong personal interests in their company, which provides them with most of their annual income. There is a risk that their decision-making could be affected:

■ partly by the desire to protect personal interests and

■ partly because they might have a narrow view of the strategic position of the company, since they spend most of their time working in it.

Independent non-executive directors can improve the strategic decision-making by a board, and help to give better direction to the company. This is because they do not have strong self-interest in the affairs of the company, and they can use their external experience and knowledge to contribute positively to strategic discussions at board meetings.

4.2 Span of control

The span of control refers to the number of subordinates for whom a manager is directly responsible and over whom the manager has authority. For example, if a manager has six subordinates who report directly to him, the span of control for that manager is six.

In an organisation structure, or in the organisation structure for a particular function or department, there is often a similar span of control for managers at the same level in the management hierarchy. For example, if a Grade 3 manager in the marketing department has four subordinates, it is often the case that the span of control for all managers at Grade 3 level in the marketing department is about four.

It is therefore often possible to describe an organisation structure as one that has either:

■ a narrow span of control, where managers have only a small number of direct subordinates, or

■ a wide span if control, where managers have a large number of subordinates reporting directly to them.

In the diagram A below, the span of control is 3, which is narrow. In diagram B, the span of control is 8, which is much wider.
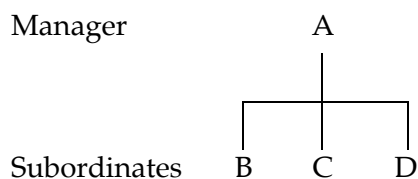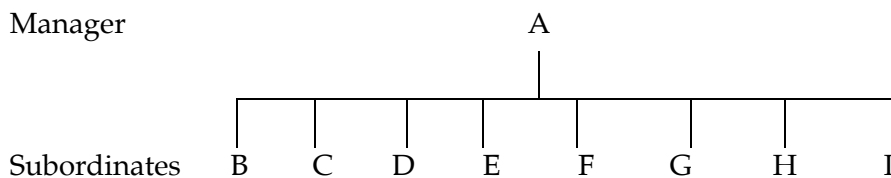
Diagram A: narrow span of control

Manager   A

Subordinates   B   C   D

Diagram B: wider span of control

Manager   A

Subordinates   B   C   D   E   F   G   H   I

In some operations, the span of control might be very wide. For example, a supervisor in a telephone call centre might be directly responsible for a large number of call operators ('customer service staff').

Factors affecting the size of the span of control

When the span of control is narrow, a manager can spend more time with each subordinate, providing guidance and leadership, or monitoring the work that they are doing. A narrow span of control might therefore be associated with close supervision and management control over individual subordinates.

Alternatively, when the span of control is narrow, managers can spend less time on supervising subordinates and more time on technical work or other management tasks such as forecasting and planning.

When the span of control is wide, managers do not have as much time to spend with each individual subordinate. However, subordinates often take up much of a manager's time: the manager needs to give work to each subordinate and discuss operational problems, consider training and development for each subordinate, give performance reviews, discuss disciplinary matters or personal problems that the subordinate wants to resolve (such as arranging holiday dates or reporting grievances). The manager might have insufficient time for other responsibilities, such as planning and forecasting.

Several factors influence the most appropriate size of the span of control for a manager.

- The size of the organisation. In very small organisations, the span of control will be narrow because the number of employees is limited.

- The complexity of the work and the knowledge required to do the work. When the work is complex, or there is a high risk of mistakes by subordinates, a manager should give each subordinate a reasonable amount of time and attention, and should try to apply close control over the quality of the work. A narrow span of control might therefore be appropriate. When the work is fairly simple, a smaller amount of supervision is required and the span of control can be much wider.

- The geographical spread of employees. When employees are spread over a wide geographical area, the span of control should not be so wide that a manager spends most of his time travelling between the different locations where the subordinates are working, because excessive travelling time is often a waste of valuable management time.

- The type of individuals and the culture of the organisation. When employees are highly skilled and highly motivated, they can often be left to get on with their work without too much supervision. Responsibility for much of the decision-making might also be delegated to these individuals, making a wider span of control appropriate. However when employees lack confidence and are uncertain about what they should be doing, close supervision and a narrow span of control is more appropriate.

  In some organisations, there is a culture in which employees are encouraged to use their initiative and make their own decisions, without having to wait to be told what to do. In these organisations a wider span of control is appropriate, compared to an organisation in which there is a culture of authoritarian management.

Disadvantages of a wide span of control and a narrow span of control

The disadvantages of a wide span of control and a narrow span of control are summarised in the following table.

Disadvantages	
Wide span of control	**Narrow span of control**
Manager spends much of his time managing people, and has not enough time for other responsibilities.	Supervision and control over subordinates might be excessive. Subordinates are not given as much decision-making authority as when the span of control is wider.
The manager might have insufficient time to spend with individual subordinates.	When the span of control is more narrow than it needs to be, there will be an excess number of managers. This is inefficient and expensive.
Communication between a manager and a subordinate is likely to decrease as the span of control widens.	Close supervision might be de-motivating for subordinates.

4.3 Authority and responsibility

Authority and delegation

Authority is the ability to give orders or guidance to others, and to expect the orders to be obeyed or the guidance to be followed.

In formal organisations, managers are given authority to make decisions relating to a certain area of the organisation's activities. Authority is delegated from top management. In a traditional bureaucracy, authority is delegated down the management hierarchy or line of command (the scalar chain).

The authority of managers is also associated with power. Managers in a position of authority also have power over the individuals who work for them, through the ability to reward or punish individuals, and through their control over resources of the organisation (such as control over spending decisions).

According to 'classical' management theorists of the early 20th Century, managers in a bureaucracy have a right to command others that comes from the authority they have been given, and individuals have a duty to obey the instructions of their manager.

A more modern view of management is that managers have authority delegated to them, but that they should exercise their authority through good communications with their employees, and through personal qualities of leadership.

Although management authority comes from delegation and the position of the manager in the organisation, individuals may exercise authority in other ways, such as:

■ personal authority (the respect of others for the individual) or moral authority

■ expert 'power'. An individual might have authority over others through the recognition by others of the individual's particular expertise or skills.

Responsibility and accountability

Responsibility is the duty of a manager to carry out the tasks and achieve the goals for which he or she has been given the delegated authority.

■ Individuals should be responsible for the use of the authority that is given to them.

■ Responsibility is exercised through accountability – a manager having to account for his performance to his or her superior, and to explain any poor performance or failure to carry out his responsibilities properly.

As stated earlier, one of Fayol's principles of effective and efficient organisation and management related to authority and responsibility.

■ An individual should not be held responsible and accountable for aspects of work over which he has no authority.

■ Authority can be delegated to subordinates, but responsibility cannot be delegated. A manager remains responsible to his own boss for the activities and performance of his subordinates.

e **Example**

Authority has been given to the head of a sales and marketing department to manage the selling and marketing activities of the organisation. He has been given sales targets to achieve for the entire company. There are three sales regions, each with its own regional sales manager. These regional managers have authority over selling activities within their region and have sales targets for the region. The South Area sales region is divided into four sales areas, each with an area sales manager who has authority over selling activities within the area and who is given area sales targets.

■ Authority is delegated from the top management of the company to the head of the department. Authority is delegated further to the regional managers and then to the area sales managers.

■ The area sales managers should be held accountable for the sales that are actually achieved in their area, but should not be held responsible or accountable for sales in any other sales area. Responsibility and accountability should be matched with authority.

■ Although authority is delegated to the area sales managers, each regional sales manager should be accountable to the head of department for the sales in the entire region. Similarly, although authority has been delegated to each regional sales manager, the head of department is accountable to senior management for
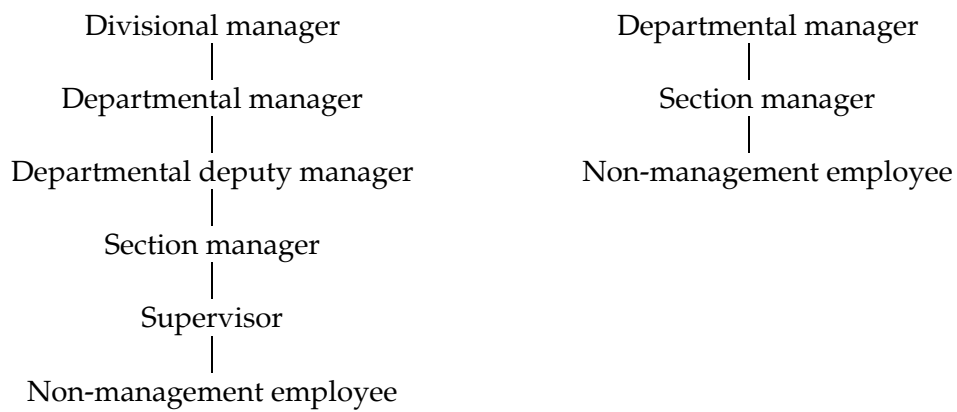
the sales of the company as a whole. This is because although authority is delegated, responsibility is not delegated.

4.4 Scalar chain

The scalar chain describes the number of different reporting levels through which communications are passed and decisions are passed in an organisation.

In a bureaucratic organisation, the scalar chain refers to the number of levels in the management hierarchy, between the most senior managers at the top of the organisation and ordinary employees at the bottom.

Two examples of the scalar chain are shown below.

Divisional manager	Departmental manager
Departmental manager	Section manager
Departmental deputy manager	Non-management employee
Section manager	
Supervisor	
Non-management employee	

The scalar chain in the example on the left is longer than the scalar chain in the example on the right, because there are more levels of management between the top and the bottom of the organisational hierarchy.

- The scalar chain might be described as the line of command within an organisation, through which senior management issue their instructions. For example, a divisional manager might give directions to a departmental manager, who then gives instructions to his deputy, who instructs a section manager who gives directions to a supervisor, who then instructs an employee.

- The scalar chain might also be described as the management structure that is used to delegate authority from senior management down to more junior management levels.

- It is also useful to think of the scalar chain in terms of formal communications and information flow within an organisation. Information can flow both ways, from senior management down to employees, but also up from junior management levels to more senior management.

Tall and flat organisations

Organisation structures might be referred to as being 'tall' or 'flat'.

- A tall organisation is one in which the scalar chain is long, and there is a large number of levels in the management hierarchy.

- A flat organisation is one in which the scalar chain is short, and there is only a small number of management levels.

The appropriate length of the scalar chain

The length and nature of the scalar chain should be appropriate to the particular business organisation, and should be neither too long nor too short. The purpose of an organisation and management structure should be to create an efficient and effective organisation, in which communications are effective.

■ The scalar chain should normally be short in a small business organisation, because there should be no need for many levels of management in an organisation with only a small number of employees.

■ In any organisation structure with several levels of management, the managers at each level in the organisation should be able to justify their existence. The salaries they are paid (and the other costs they incur) must be justified by the benefits they provide to the organisation.

The table below lists the disadvantages of having more or fewer levels of management in a large business organisation.

Disadvantages of more levels in the management structure (a tall organisation)	Disadvantages of fewer levels in the management structure (a flat organisation)
Communications between the top and bottom of the organisation might be poor. Information from top to bottom, or from lower levels up to the top, might be ineffective, slow or even non-existent.	In a flat organisation structure, there are fewer opportunities for career development through promotion. It might therefore be difficult to attract and retain talented young managers.
Senior management can become remote and far-removed from the business activities.	The business might rely too much on a small number of key individuals in the management structure.
The remoteness of senior management can create an 'us-and-them' attitude amongst non-management employees and junior managers.	There might be a lack of adequate supervision and control. This is because in a flat organisation, the span of control might be wide.
Managers at middle levels in the hierarchy might not add value. Their cost might exceed the benefits they provide to the organisation.	If there are not enough managers, there is a risk that the activities of the business will not be properly planned, co-ordinated and controlled.
Decision-making can be slow, where the decisions are considered at every level in the management hierarchy before they are implemented.	
There might be too many people managing a task that one individual could manage.	
It is more difficult to delegate decision-making to employees, and to 'empower' employees in a tall organisation.	

4.5 Centralisation and decentralisation

The terms 'centralisation' and 'decentralisation' refer to the extent to which authority within an organisation has been delegated.

- In a centralised organisation, a large amount of authority and decision-making responsibility is retained at the 'centre' of the organisation. This usually means that top management retains many of the control and decision-making powers.

- In a decentralised organisation, most authority and decision-making responsibilities have been delegated to others at a 'lower level' in the organisation. Top management allow others to make decisions, but monitor their performance and provide leadership.

There are different degrees of centralisation and decentralisation, ranging from the total centralisation at one extreme (where all decisions are taken by the top person) to total decentralisation at the other (where very few decisions are taken by top management).

Computer systems can support either a centralised or a decentralised management structure.

- In a centralised management structure, computer networks make it possible for information collected at lower levels of the organisation, or in distant geographical areas, to be accessed by managers at 'head office'. They can then use this information to make informed management decisions.

- In a decentralised management structure, information held on central computer files or databases can be accessed immediately by managers anywhere in the organisation, to help them with their decision-making.

Example

With decentralisation, there is less need for a large management team at head office. An extreme form of decentralisation is a company where the head office consists of a small administrative group supporting the company chairman and chief executive officer.

The board of directors retain responsibility for some strategic decision-making, but the authority for most strategic decisions is delegated to the managers of strategic business units (SBUs). Head office sets financial targets and other strategic targets for each division, but the SBUs operate independently. The head of each SBU is accountable to head office for the financial performance of the division.

Head office is responsible for preparing the financial reports and accounts for the company, and for presenting these to the company's shareholders.

Advantages of centralisation and decentralisation

The extent to which decision-making is centralised or decentralised depends partly on the attitude of senior management and their philosophy of leadership. In addition, the efficiency and effectiveness of an organisation can depend on where

management decisions are taken and whether authority is centralised or decentralised.

There are situations where decentralised decision-making is needed, because immediate decisions have to be taken at a local level to deal with events as they happen in the business environment and in the market place. There are also situations where centralised control is needed to ensure that standards and procedures are applied in the same way across the entire organisation.

Advantages of centralisation can also be described as disadvantages of decentralisation. Similarly, advantages of decentralisation can also be described as disadvantages of centralisation. The table below sets out the advantages of centralisation, and compares these with the advantages of decentralisation.

Advantages of centralised decision-making	Advantages of decentralised decision-making
Centralised management decision-making might give senior management more control over the activities of the business, so that activities are co-ordinated more effectively.	Management at a local level are able to respond more quickly to changes in business conditions and events. Decentralisation is usually desirable in a fast-changing and unpredictable business environment.
Centralised management is more effective at applying standardisation of products and procedures across the entire organisation. This can be important in some industries.	When a business operates over a wide geographical area, some decentralisation is necessary because head office managers are too far from the business operations. A global business, for example, operates in many different time zones.
With a centralised management structure, managers at head office are able to apply a 'corporate view' to the entire business, such as a view of business ethics and standards.	When decision-making is delegated to lower levels of management, conditions might be more favourable for encouraging innovation.
A centralised management structure might be cheaper than a decentralised structure, because fewer managers might be needed.	Delegating decision-making to lower levels of management can help to develop junior managers with initiative and talent, and prepare them for future promotion to more senior management positions.
In a centralised management structure, it is possible to use specialised management support teams for the entire organisation, such as IT specialists and business planning /forecasting specialists.	Delegation of authority and decentralisation might be necessary to reduce the workload of central management at head office.

Table continues

Advantages of centralised decision-making	Advantages of decentralised decision-making
Some centralisation of management decision-making is essential where the business is trying to promote a global brand image.	Delegation of authority to more junior levels can help to motivate junior managers, who have more authority and are able to use their initiative instead of getting instructions about what to do.
	In a diverse and complex business, some delegation is essential because head office management cannot understand the entire business in sufficient detail to control it closely. This is a reason why divisional organisation structures developed.

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Committees

- The nature and purpose of a committee
- Types of committee
- Committees and management responsibility
- Advantages and disadvantages of committees
- Role of the committee chairman
- Role of the committee secretary

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5 Committees

5.1 The nature and purpose of a committee

A committee is a group of individuals who are formally appointed to perform a specified function collectively.

- The normal purpose of a committee in a large organisation is to bring together representatives from different parts of the organisation. The members of a committee therefore represent a range of different interests and points of view.

- By bringing together individuals from different departments, or with different interests, a committee can be used to discuss problems that affect all departments or interests, with a view to reaching an agreement or consensus that represents the views of all the different interests.

- Some committees represent a number of different organisations, and consist of members who are drawn from a range of organisations that have an interest in the matters for which the committee has a responsibility.

5.2 Types of committee

Committees are established for a particular purpose. In business organisations, for example:

- There may be a **budget committee** that meets to organise the annual budgeting process. The budget committee members are managers from different divisions or departments within the organisation.

- **Risk management committees** may meet to consider the risk management systems within an organisation, or to discuss the risks that are facing the organisation. Members of a risk management committee should include representatives from all the departments that are affected by the risks for which the committee is responsible.

- A company might have a **health and safety executive committee** to consider the health and safety risks within the company, and the measures that are taken to deal with them.

- Committees might be established to review the progress on inter-departmental projects. For example, responsibility for the oversight of a project to develop a major new information system/information technology system (IS/IT system, or

computer system) might be given to a **project steering committee**, which includes representatives from the IT department and 'user' departments for the new system.

Committees might be established permanently, with responsibility for the oversight of a particular process that occurs at regular intervals. Permanent committees are sometimes called **standing committees**. Examples of permanent committees are the budget committee and risk management committees.

Some committees are established for a specific purpose, such as investigating a particular problem and preparing a report. The committee is disbanded when its job is completed. Another example of a temporary committee is a project steering committee, which has oversight over a major new project development and is disbanded when the project work is completed.

5.3   Committees and management responsibility

Committees are usually required to investigate problems or supervise new developments. They might be required to prepare reports and **make recommendations** to a decision-making body. For example, a budget committee will make recommendations to the board of directors.

Occasionally, a committee might be given decision-making powers, but this is risky. When committees are given the authority to make decisions, the decision-making can be very slow and poor in quality. This is because a committee often looks for a solution that will satisfy all its members, whereas this is not always the solution that is best for the organisation.

The term 'management by committee' is sometimes used to mean the poor quality of 'consensus' or 'conservative' decision-making by committees.

5.4   Advantages and disadvantages of committees

The potential benefits of committees are as follows.

- They encourage **co-operation** within an organisation, by including representatives from different departments or different parts of the organisation.
- They can provide well-considered advice to decision-making bodies, such as the board of directors.
- They are a way of communicating information and sharing information.
- When a committee reaches agreement, this represents a **consensus** of the views of different departments of different interests within the organisation. Committees can be used to bring together groups with different opinions and different interests, with a view to finding a common agreement.
- Committees are useful for reaching agreement on policy issues that affect the entire organisation.
- Using committees can be 'politically' desirable, since the views of many different groups or interests can be considered, by including their representatives on the committee.

- Committee members are able to explain the views of the committee to others. They can therefore be a useful way of communicating views and opinions throughout an organisation.

There are some potential problems with committees, however:

- They can become a focal point for conflict when some of the committee members have very different views.

- Committees cannot meet in permanent session. Committees are therefore an ineffective way of implementing plans and controlling activities. Committees are not a substitute for management.

- Committees may fail to reach agreement, especially if they are poorly managed by their chairman. Since all committee members will expect to have an opportunity to express their opinions, decision-making can be very slow.

- They can become a 'talking shop' where people exchange views but reach no conclusions. This is a particular problem with large committees consisting of a large number of members. When this happens, they become a waste of time and money.

- There can be serious problems when a committee is given decision-making responsibility. This is because when a committee reaches a decision, it is a collective decision by a number of different individuals. No single individual is responsible for implementing the decision, and no individual is responsible if things go wrong. When things go wrong, no one accepts the blame.

5.5 Role of the committee chairman

The chairman or 'chair' of a committee is responsible for getting the committee to achieve its purpose. The chairman is therefore responsible for ensuring that the committee:

- Reaches agreement about a plan of action, if this is the reason why the committee is established. For example, it is the responsibility of the chairman to ensure that a budget committee reaches agreement about the budget plan for the next financial year.

- Reaches agreement about recommendations, if the purpose of the committee is to investigate a problem and make recommendations about how the problem should be dealt with.

- Produces a report, if the committee is required to present a report to the board of directors, or to a senior person, in which the committee presents its findings or opinions.

The functions of a committee chairman are as follows.

- The chairman acts as the leader and spokesperson for the committee.

- He arranges the dates for the committee meetings.

- He leads the meetings of the committee.

- He decides the agenda for each meeting, although this should include 'any other business' for items that have been omitted from the agenda (usually items of lesser importance).

- He is responsible for ensuring that every member of the committee is provided with the information that is needed to contribute fully to the committee discussions.

- Where appropriate, he might be involved in decisions to replace committee members, to remove individuals from the committee or to make new appointments to the committee.

- He is responsible for ensuring that actions agreed by the committee are properly carried out.

An important function of the chairman is to lead committee meetings. To fulfil this function properly, the chairman should:

- encourage every member of the committee to contribute to discussions at the committee meetings and present their opinions

- give adequate time at meetings for the discussion of each issue

- ensure that meetings do not become a 'talking shop' where members engage in lengthy discussions without reaching any consensus or agreement, so that time is wasted in achieving little or nothing: the chairman is responsible for ensuring that the meeting progresses and gets through its agenda

- ensure that the committee meetings are completed within a reasonable time

- attempt to arrive at a consensus: the chairman is responsible for identifying when the committee members appear to have reached agreement on a particular issue, and asking for confirmation from the committee members that consensus has been achieved

- where the committee members do not reach unanimous agreement, put one or more proposals to the committee for a vote, and state the results of each vote

- express the decisions of the committee, and ask the committee members to confirm that these are the decisions that have been agreed.

The chairman is also responsible for ensuring that when a committee member has been asked to do something before the next meeting, that the required actions are carried out. The **minutes of committee meetings** can be used to make sure that individuals do what they have been asked to do.

Minutes of committee meetings

The minutes of a meeting are an official record of the discussions at a meeting, the decisions that were reached at the meeting, and the actions that committee members have been asked to carry out.

The minutes should take each item on the agenda in turn, and provide a record of discussions, agreements and action points for each individual agenda item.

The minutes of the previous meeting are presented to the next committee meeting, and the committee members are asked to confirm that the minutes are a true and proper record of the previous meeting. The chairman then signs the minutes, which become the official record of the deliberations of the committee.

After agreeing the minutes of the previous meeting, the chairman should consider any **matters arising** from those minutes. Matters arising include:

- bringing the committee members up-to-date about any developments that have occurred since the previous committee meeting, and

- where the minutes contain action points for individual committee members, asking the member to explain what action he has taken and what the results of the action have been.

In this way, the chairman is able to ensure that action points are dealt with, and that decisions by the committee are not subsequently ignored.

5.6 Role of the committee secretary

Every committee should have a secretary. The term 'secretary' should not be confused with typists or personal assistants. A committee secretary is usually an experienced and senior administrator. For example, in large companies the secretary of major committees of the board of directors (the audit committee, remuneration committee and nominations committee) is often the company secretary, who is the senior administrator within the company.

The role of the committee secretary is to provide administrative support to the committee chairman. The secretary usually has the following responsibilities.

- To prepare the papers for each committee meeting, and produce a copy of the agenda for the meeting. The papers should include a copy of the minutes of the previous meeting.

- To distribute these papers to the committee members in good time before the meeting.

- To arrange the venue for the meeting and ensure that all practical arrangements are made (for refreshments, for making formal presentations, for any videoconferencing arrangements, and so on).

- To write the minutes of the meeting (and produce them in a form for presentation and distribution after the meeting has ended).

- To keep the official minutes, signed by the chairman, in a formal record – the 'minute book'.

- To deal with any queries and requests from the chairman: the secretary is the first person that the chairman should ask for practical assistance with any issues relating to the committee.

- To deal with queries or requests from the committee members.

CHAPTER

2

Marketing. Information technology and information systems

Contents
1   Marketing
2   Information systems (IS) and information technology (IT)
3   Management and information

Marketing
■ The marketing concept in business
■ The marketing mix
■ The marketing plan and strategic planning

1 Marketing

An accountant in business needs an understanding of two important business functions:

■ marketing

■ information systems management. Most formal management information systems are computerised, and the term IS/IT is often used. IS/IT stands for 'information systems/information technology'.

This chapter provides an introduction to both these business functions.

1.1 The marketing concept in business

The term 'marketing' is normally used to describe the marketing approach to business strategy and business thinking.

The marketing concept can be compared with two other approaches to business strategy, which are no longer used in competitive markets. These two discredited approaches to strategy are the manufacturing concept and the selling concept.

■ The manufacturing concept of business is that there is a shortage of products and there are large numbers of customers wanting to buy whatever products are available. All a business needs to do is to manufacture any products and customers will buy them.

■ The selling concept is that customers have to be persuaded to buy the goods that businesses produce, but they can be persuaded to purchase goods by effective selling – a combination of the 'hard sell' by sales representatives, supported by advertising and sales promotion activities.

The manufacturing concept and the selling concept were rejected by competitive business many years ago, in favour of the marketing concept.

The marketing concept is based on the following ideas.

■ Most markets are very competitive, and rival businesses compete with each other in their markets.

■ They compete by trying to offer products or services to customers that seem more attractive than the competing goods or services of rival producers.

■ Successful businesses are able to offer goods or services in a way that appeals to a sufficient number of customers, who prefer the company's products to those of competitors.

■ Successful businesses must therefore understand what customers need and want, and offer a product or service that meets those needs or wants more successfully than competitors.

In the marketing approach to business, the 'consumer is king', and the aim of a business should be to **identify customer needs and wants**, and offer a 'value proposition' to customers that meets those needs and wants successfully.

Customer needs and wants

What customers need and want, it might be supposed, are the best-quality products at the cheapest price. However, things are not quite so simple. Business entities can try to offer customers better products at lower prices, but some customers are often happy to accept lower quality for a cheaper price, and other customers are prepared to pay more for something they consider better in other respects.

A product or service is marketed as a 'value proposition'. It is a product or service that offers a variety of features to a customer that ought to be unique and different from any other competing product in the market. A value proposition for a product consists of an item that:

■ performs a particular function or several functions

■ has a particular selling price

■ has particular design features

■ achieves a certain level of quality or performance

■ has value because of its 'brand name'

■ is readily available when the customer wants to buy it, and can be purchased conveniently.

Definition of marketing

The core concept in marketing is therefore **meeting customer needs and wants** more successfully than competitors.

■ It might be supposed that the aim of marketing is to maximise sales revenue, but this is not the case. If a business entity is able to offer products that meet customer needs and wants better than competitors, it should succeed in achieving a satisfactory level of sales and profits. However, marketing is not about maximising revenues.

■ It might also be supposed that marketing is about trying to persuade customers to buy the products or services of a business entity. However, making customers aware of a product and persuading them to buy is only a part of the marketing process. Unless the product or service meets customer needs and wants more successfully than competitors, it will be very difficult to 'persuade' customers to buy them.

The marketing process can be described as the process of:

- finding out what customers need and want, for example through market research and also by analysing customer spending patterns and spending habits

- targeting all customers in the market, or just a particular segment of the market

- developing products or services that meet the needs of customers (in the market or market segment) better than any rival firm – offering a unique 'value proposition'

- persuading customers to buy the products or services, and to buy again in the future.

1.2 The marketing mix

The marketing department in a business organisation is responsible for marketing the organisation's goods and services. Marketing activities are a combination of several different elements. Together, these elements should succeed in selling goods to customers (persuading customers to buy). The elements in marketing are commonly referred to as the **marketing mix**.

In marketing goods, there are main elements in the marketing mix. These are sometimes referred to as the '4 Ps' or product, price, place and promotion.

Product

The actual and perceived features of a product are a very important element in the marketing mix, because it provides the value for customers. There are many different aspects to product design. Some add value to a particular product, others do not. Features of product design that might be relevant to marketing are:

	Comment/example
Its functions	What does it do? Does it do what customers want it to do?
Comfort	For example, some chairs are much more comfortable than others
Convenience	For example, a mobile telephone that fits into a pocket or a small handbag has the attribute of convenience. Ready-to-cook meals are convenient for people who do not want to cook meals themselves, or who do not have time to cook.
The quality of its materials	Customers will pay more for a diamond ring than for a plain gold ring
Useful life	A long-life battery has more value than a short-life battery
Reliability	How often will it break down or fail to function properly?
	Trust can also be an important perceived quality for many services, such as banking and insurance, and medical services.

■ Safety	With some products, health and safety issues might be important - for example, some consumers are concerned about the healthiness of food products.
■ Uniqueness/ brand name	Some customers will buy an entirely new product, for the prestige of being one of the few owners. Many consumers buy goods on the strength of the brand name, and the image of quality or status that the brand name is associated with.
■ Packaging	For some products, the wrapping or packaging can add to their appeal to consumers. Features of packaging include design, convenience of carrying and using, and the amount of protection it gives to the product.
■ Product warranties and guarantees	Although these might also be considered as features of 'price' rather than the product itself.
■ After-sales service	Customers might value a product for the after-sales service and customer service associated with it.

Price

The price of a product or service is often an important factor in the buying decision of customers. As a general rule, customers will buy more of a product if the price is lower. Pricing can also be used as a means of selling products or services. For example:

■ commercial customers might be attracted by good credit terms and bulk purchase price discounts

■ consumers might be attracted by money-back coupons of two-for-the-price-of-one offers, or short-term price discounts in supermarkets and stores

■ for products such as cars that are often bought with a personal loan (for example on hire purchase), the terms of the finance deal might be important. For example, customer might be attracted by offers of six months' interest-free credit.

Place

'Place' refers to the channels of distribution through which goods or services are sold and then delivered to the customer. It refers to the way in which the customer is able to acquire the product.

■ Many consumer products are made available to consumers through retail outlets, such as supermarkets, stores and shops. For consumer goods manufacturers, place strategy will involve developing an adequate distribution network for its products, so that customers can easily find a retail outlet that sells its products. (This is important, for example, in the case of motorcar manufacturers, and manufacturers of consumer durable goods such as washing machines).

- For many consumer products, customers expect to find the products whenever they visit a supermarket. A key element of marketing for supermarkets is to ensure that the products are always available on its shelves.

- Some manufacturers of consumer products might base their place strategy on delivery of the product to the customer's home or office. (For example, Dell computers will deliver and, if required, install PCs at the customer's address).

- Most goods sold to other businesses are delivered to the premises of the customer.

- Many goods are sold through the internet. Some items can be downloaded through the internet, such as theatre tickets, travel tickets and holidays. Other goods are ordered through the internet and then physically delivered to the customer's address, by delivery van or by post.

- Some items are made available where customers find them convenient to buy. For example, product such as soft drinks, hot drinks and confectionary are sold through vending machines. Newspaper might be sold outside railway stations.

- In recent years, in countries such as the UK, there has been a substantial growth in e-commerce (internet shopping) and internet banking.

The choice of distribution network can be particularly important for entities that rely on export sales, but do not have foreign subsidiaries or foreign branches. They will rely on agents and distributors in other countries, and the control over the distribution and availability of its products might therefore be restricted.

A 'place strategy' might be used to gain a foothold in a market. A business entity might seek to sell its product by offering it in a place (through a distribution channel) that rival companies do not use. A current example is the development of the market for music, and the use of the internet by consumers for purchasing and downloading selected music. This new method of selling music is already having significant impact on the music industry.

Promotion

Promotion refers to the activities associated with making customers aware of a product and trying to persuade them to buy it. Promotion activities include selling activities, advertising and sales promotion.

- **Selling activities**. Sales activities involve selling face-to-face or by telephone. Face-to-face selling by sales representatives is fairly expensive, and is therefore more common for the selling of large-value items (such as the sale of industrial goods to other businesses) than the sale of small-value items to consumers.

- **Advertising**. Business organisations can advertise their products or services through a range of different possible media, such as television, radio, newspapers and magazines, advertising hoardings. Advertising messages might be delivered to consumers by direct mail, or electronically as pop-up ads or advertisements with search engine providers such as Google or Yahoo!

- **Sales promotions**. Sales promotions are usually associated with consumer products. Promotions include sending brochures and leaflets by direct mail, or by e-mail to a list of potential customers, or providing brochures or leaflets for customers to take. In stores and supermarkets sales promotions include two-for-

the-price-of-one offers and free trial samples. Sales promotions are often used with price offers, such as special sales prices or discounts, but 'for a limited period only'.

- **Sponsorship**. Some entities use sponsorship to increase public awareness of their product, and improve their general image. For example, many sporting events and sporting teams are sponsored. In addition, entities might use sponsorship of television programmes to ensure that their name appears on television at the same time as a popular television programme that large numbers of viewers will be watching.
- **Public relations**. The activities of public relations officers in obtaining 'friendly' news coverage for a business (or in avoiding unwelcome or damaging publicity) are another aspect of promotion.

The elements of the marketing mix are used in different ways by different businesses. For example, a 'typical' marketing mix varies according to whether the product is a consumer product or an 'industrial' product sold to other businesses.

Example

A company manufactures gloves. It makes fashion gloves for the consumer market and industrial gloves for engineering companies, construction companies and other industrial customers.

Its marketing mix will differ between consumer fashion gloves and industrial gloves.

	Consumer fashion products	**Industrial goods**
Product	Gloves must be attractive in design, especially gloves sold as 'brand name' items.	Gloves must fulfil their function, which is to protect the hands of users.
Price	For 'cheap brand' products, low prices are essential. Higher prices can be charged for 'high fashion' items.	Industrial buyers are likely to be price-sensitive, and might be attracted by bulk purchase discount offers and good credit terms.
Place	Customers will expect the goods to be available to purchase at a convenient location, such as a local store.	Industrial buyers will expect delivery of purchased items to their premises.
Promotion	Direct selling to chains of stores. Possibly advertising in fashion magazines.	Direct selling might be used. Orders might be taken by telephone or e-mail. Advertising in business magazines.

Push strategy and pull strategy

Manufacturers of consumer products might use a combination of a push strategy and a pull strategy in its promotion strategy mix.

The **push strategy** is aimed at getting distributors to buy the product for resale in their supermarkets or other retail outlets. The aim is to 'push' the product through the distributor to the end consumer. To persuade distributors to buy its products, an entity will need to use a direct sales force, and use marketing tools such as low prices and generous credit terms to persuade the distributor to buy.

The **pull strategy** is aimed at getting the end-consumer to want to buy the product, so that they expect their supermarkets or other retail store to have the product available. If consumers demand the product, distributors will be more willing to stock it because they will expect to sell it easily. Advertising and sales promotions are an important element in a 'pull' strategy.

1.3 The marketing plan and strategic planning

The strategic plans for a business should include 'product-market' strategies. These are strategies about which goods or services the business will sell and in which markets it will sell them. For example, if a company has a strategy of growing the business, it can select from a combination of the following strategies:

- selling more of the existing products in existing markets
- selling new products to existing customers and markets
- selling existing products to new markets, or new segments of the market – such as expanding into new geographical markets
- selling new products to new markets: this strategy is called 'diversification'.

A business organisation must then develop marketing strategies for succeeding in each of its chosen product and market areas. A marketing strategy should be based on:

- identifying customer needs and wants
- developing a product or service to meet those needs and wants, and
- developing methods to promote the product or service.

There is a close link between business strategy, marketing strategy, and developing a marketing mix for each product and market.

Information systems and information technology
■ Definitions: IS and IT
■ Information systems
■ Types of information system
■ Information systems and information technology
■ Computer hardware
■ Data input methods
■ Software
■ Computer networks

2 Information systems and information technology

2.1 Definitions: IS and IT

You should note the following definitions.

■ **IS = information system**. This is a system within an organisation that captures and processes data from inside or outside the organisation, and makes the information available to users. An IS is usually associated with a computer system, but an IS does not have to be computer-based.

■ **IT = information technology**. This is the equipment and software that is used to provide an information system. IT refers to computer hardware and software, and communications networks.

2.2 Information systems

Every business has information systems. Different types of information system are described later. Basically however, there are two types of information system:

■ systems that process information and store information

■ systems that produce information to help with decision-making by managers in the business.

Managers are decision-makers. Decisions have to be taken by the strategic, tactical and operational levels of management. Decisions have to be made about planning and controlling the business and its operations. Decisions must also be taken about how to deal with unforeseen problems that arise.

Examples of IS that process and store information	Examples of IS that are used to provide information for decision-making
Accounting systems (book-keeping systems)	Forecasting systems and 'modelling' systems
Sales management systems	Business planning systems (including spreadsheet models)
Inventory control systems	
Purchasing systems	
Systems for employee records	
Word processing systems	

Features of information systems

An information system has four basic elements:

■ data files (or information files)

■ input

■ processing of input and file data

■ output.
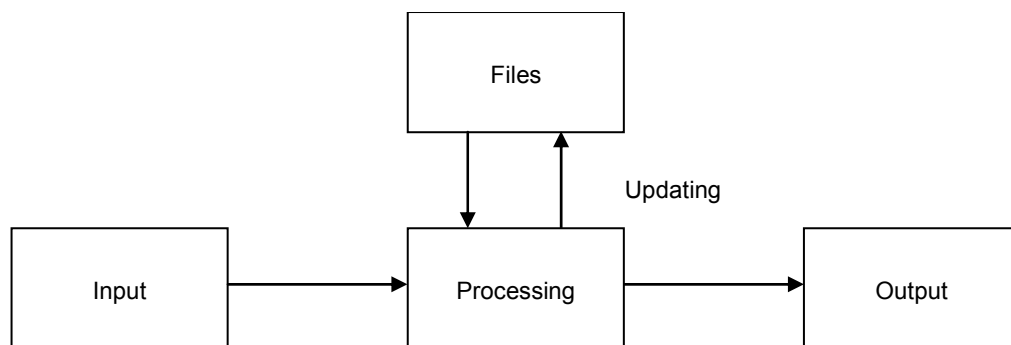
Example

An information system is used by the purchasing department to produce purchase orders. The system is computerised.

Input to the system consists of:

■ purchase requisitions

■ deliveries of purchase orders from suppliers

■ changes to suppliers' details.

These might be keyed into the system, using a keyboard and mouse.

The system will contain files holding data about:

■ suppliers and the products that each of them supplies

■ purchase orders that have been issued, and the current status of those orders.

The system processes new purchase requisitions to produce new purchase orders. The files are updated with the new purchase order details, and information about any orders that have been delivered.

Output from the system consists of new purchase orders and (probably) information for management about the value of new purchase orders that have been made.

Modular systems

Many computerised business information systems are designed as modular systems. This means that the total system is divided into sub-systems, and each sub-system can operate as a stand-alone information system. Each sub-system is a 'module' of the total system.

With modular systems, output from one module can be input automatically to another module, without any need for human intervention.

Accounting systems are usually designed as modular systems. For example, one of the modules in an accounting system might be used to calculate the payroll for employees – the monthly salaries of employees and deductions for tax - and issue automatic instructions to the company's bank to make the salary payments. In addition, output information about salary costs can be transferred automatically into another module in the accounts system (the 'general ledger' or 'main ledger' module) that is used to record expenditures of the business.

2.3 Types of information system

Information systems can be classified into several different types:

- transaction processing systems
- management information systems
- office automation systems
- decision support systems
- executive information systems
- expert systems
- knowledge work systems.

Transaction processing systems (TPS)

Transaction processing systems (TPS) are systems for processing routine transactions, often in large volumes. They are used extensively in business. Examples of TPS are shown in the table below.

Production and purchasing systems	Accounting systems
Production planning	General ledger system
Production control	Receivables/ payables systems
Inventory control	Payroll system
Purchasing system	
Sales	**Human relations**
Sales order system	Processing employee records
Delivery scheduling system	Processing training records

The advantages of transaction processing systems, compared with manual systems for processing transactions, are:

- the ability to handle much larger volumes of transactions
- cost-effectiveness
- much faster processing
- fewer errors in processing
- efficiency in storing/filing data records.

Management information systems (MIS)

Management information systems (MIS) provide information to management, of a routine or non-routine nature, by analysing data and converting it into organised information.

MIS provide management information in regular or routine reports, which management can use for planning and controlling activities.

In many cases, management information is produced from systems that also process transactions. For example, sales reports can be produced from a sales order processing system, and financial reports can be produced from a general ledger accounting system.

Management information systems provide structured information, and can help managers to make fairly routine or standard decisions. They are not well-suited for assisting managers with more complex decisions.

MIS may also rely mainly on data obtained internally, from within the organisation, rather than on external data obtained from outside sources.

Office automation systems (OAS)

Office automation systems, as the name suggests, are systems that automate office processes. They include:

- word processing systems
- database systems for desk-top PCs
- electronic filing systems
- systems with e-mail facilities and a link to the internet.

Decision support systems (DSS)

Decision support systems (DSS) are systems that provide support for managers in making decisions for unstructured or semi-structured problems. (In comparison, MIS can help managers with reaching decisions for structured problems.)

A DSS consists of data analysis models, and may have access to a database to extract data for analysis. It should provide the user with information about a number of different alternatives or different possible outcomes.

- A DSS may include a forecasting model that allows the user to prepare forecasts from available data, and to consider possible variations in the forecast using sensitivity analysis or statistical analysis.

- A DSS may provide a planning model that allows the user to prepare draft plans and then carry out sensitivity analysis on the data. (A spreadsheet model is a form of DSS.)

Executive information systems (EIS)

Executive information systems (EIS) are information systems for senior executives. They have access to data from sources both inside and outside the organisation. The system has the ability to analyse the data in a variety of ways, so that senior executives can obtain selected information on demand, analysed at a suitable level of detail. EIS are also called executive support systems (ESS).

A key feature of an EIS is that it provides information to executives in summarised form, for example information about performance in relation to critical success factors and key performance indicators, but which also allows the user to 'drill down' to extract more detailed information.

For example, an EIS may provide an executive with current data about sales volume, which can be compared with targets. If actual sales are below target, the executive can drill down into the sales figures to find out more details – for example, which products are selling less than target, or which sales regions are performing badly.

External data for an EIS may be provided from financial information providers (for example, information about share prices, exchange rates, interest rates and so on).

Although information can be presented to executives in the form of tables, or even narrative, EIS incorporate the facility to present information in a more user-friendly form, for example in the form of graphs, bar charts or pie charts.

Expert systems

Expert systems are a type of artificial intelligence system. The purpose of an expert system is to provide expert information to the system user.

An expert system covers a specific area of expertise. It allows a user to interrogate the system to obtain information, advice or possible solutions to a problem. Examples of expert systems are legal advice systems, investment advice systems, medical diagnosis systems and tax advice systems.

An expert system has several components:
- a knowledge base, that holds all the facts and rules relating to the area of expertise
- a knowledge acquisition program, through which the knowledge base is kept up-to-date

■ an 'inference engine', which is the software that responds to inputs from the user, and draws on the knowledge base and applies reasoning to provide a response

■ an explanation program that provides an explanation of the reasoning that has been used by the system to reach its conclusion and produce its advice.

Expert systems can be used by experts to reinforce their opinion or give them suggestions. For example:

■ Professional lawyers can use a legal expert system to obtain information about relevant legislation or court decisions.

■ Similarly, doctors can use a medical expert system to obtain a diagnosis, or several possible diagnoses, of a patient's medial symptoms.

■ An investment analyst can use a financial investment expert system to find suitable investments to recommend to a client.

Knowledge work systems (KWS)

Knowledge work systems are systems that are used to create new knowledge or integrate new knowledge into an organisation. They include computer-aided design (CAD) systems and virtual reality systems.

2.4 Information systems and information technology

IT systems are an essential part of operations in many organisations.

■ Computer systems might direct and control operations, for example in transport and shipping companies.

■ They are an essential part of product design in other companies, for example in the design of engineering products

■ They are also used to process transactions, for example in retail organisations.

■ They are used extensively to provide management information.

Major developments have occurred, and continue to occur, in computing and communications. These have a significant impact on how information is captured, filed, processed, communicated and used.

■ Over time, the computer has become smaller, more powerful, cheaper and much more user-friendly. Computer literacy has increased. For example, many computer users are familiar with Microsoft's 'Windows' operating software and 'Windows' application software such as MS Excel for spreadsheets and MS Word for word processing.

■ Communications technology and computer technology have merged together: developments in communications have included fibre optic technology, satellite communications and mobile phones (for the transmission of data and images as well as voice transmission).

■ It is possible to capture and store huge amounts of data, process it and use the processed information and communicate it quickly to many different users.

Some of the significant developments in the past 10–20 years are described briefly below.

The internet

The internet is a world-wide communications network that can be used for holding information and making information available to other users (on websites), for data processing from remote locations and for obtaining information.

Internet users are able to gain access to many different sources of information from other organisations, both commercial and non-commercial (such as professional organisations and government departments).

Search engines such as Google and Yahoo! help users to locate information on different websites. Much of the information can be accessed free of charge. However, some business entities have recognised the commercial value of their information, and make a charge for access to it.

The speed of access to and transmission of information on the internet has also improved for many users, as they switch to the faster broadband services.

E-commerce (electronic commerce)

E-commerce is a term that means trading electronically.

The term 'e-commerce' can be used for organisations that have EDI links between their computer systems. EDI stands for Electronic Data Interchange. This is a facility that allows two entirely different computer systems to communicate with each other.

EDI might be used by a company and a major supplier: the company can place purchase orders through its EDI link on standard (electronic) order forms, and the supplier can confirm purchase orders and submit invoices electronically.

E-commerce is more commonly associated with buying and selling on the internet. Internet users can access the website of a supplier (for example a retailer), place an order for goods which is immediately confirmed, and pay for the goods using a secure payments system and a credit card or debit card. The supplier can also transmit a confirmed purchase order/receipt, for accounting and records purposes.

- Trading between businesses through the internet is known as a B2B (Business to Business) trading.
- Selling to consumers via the internet is known as B2C (Business to Consumer). For example, consumers can buy airline tickets, book hotel rooms and order home deliveries of supermarket items via the internet.
- Buying and selling between consumers (C2C or Consumer to Consumer) also occurs, using website services such as 'ebay.com'.

Intranets and extranets

An **intranet** is an internal computer system within an organisation that uses the internet to link distant terminals to a central 'server' (central computer) for the system, and which also enables users to access the internet.

Intranets usually have a central 'web server' to which all employees are connected via their computer terminals (PCs) and software that provides a very user-friendly 'interface'. The interface is an in-house website and has all the features of an external website. Access to this internal website is usually restricted to the organisation's employees. However, the organisation may allow access to their internal network to some external users, such as major suppliers or customers. An intranet that also provides access to some external users is called an **extranet**.

Information stored or communicated on an intranet may include:

■ The name, location and contact details of all employees

■ Latest company news

■ Policies and procedures

■ Job vacancies within the organisation

■ Corporate events

■ The company's financial results

Intranet and extranet systems also usually provide e-mail facilities for all users.

E-mail

E-mail (electronic mail) is the communication of messages electronically over the internet (or within an internal communications network). E-mail makes communications 'immediate' and convenient.

■ It has replaced many communications by letter/post. E-mail messages can be printed out and so are a substitute for letters sent by post. They have the advantage of immediate delivery.

■ They are a useful alternative to communication by telephone. An e-mail message can be sent at any time and read by the receiver of the message at a convenient time. With telephone calls, there is always a risk that the other person will not be available, and a message has to be left on voice mail or recorded message service.

■ E-mail makes global communications much more convenient and efficient. Since messages can be read at any time, many of the problems of working in different time zones are removed.

■ E-mail can be used to transmit documents in electronic files, as attachments to the e-mail message. This improves the communication capabilities of an organisation.

There are problems with e-mails, however:

■ It is difficult, if not impossible, for organisations to control the content of messages sent by employees by e-mail. In some cases, organisations can be made

liable for the content of e-mail messages. For example, in 2002 an investment bank in the US was accused of giving false investment advice to its clients, on the basis of e-mail messages by an analyst of the bank. The e-mail messages gave a very low opinion of companies whose shares the same analyst had recommended to clients.

■ An e-mail user might receive large amounts of unwanted messages from external sources (in the form of 'spam' messages or 'pop-up' advertisements).

■ Computer viruses might be transmitted in e-mail messages (in attachments to messages). A computer virus, unless detected and isolated, can wipe out or damage computer programs or files.

■ Employees might waste time sending unwanted e-mail messages to each other. E-mail users might receive large numbers of messages that take time to check, and it can be difficult to identify important messages in the long list of messages.

Mobile computing and telecommuting

Mobile computing is a term to describe the ability to use computers whilst travelling and in different locations. **Laptop/portable computers** enable users to work away from their normal office locations, such as customers' premises and in hotel rooms, aeroplanes and trains. The mobile computers can also be linked to the organisation's Intranet from any location in the world, for example using satellite technology.

Also many more people work from home using a computer system linked to their office systems. Working from home via a communications link to the organisation's computer system is known as '**telecommuting**' (= going to work via telecommunications link).

Mobile computing and the internet also make it possible to create a 'virtual organisation' or '**virtual company**'. This is a company that does not have a physical centre or location. It is simply a group of individuals (with a 'management' structure), linked together from their homes by computers and the internet.

Mobile computing, combined with the mobile telephone, have also created the '24/7' working society. Employees can be contacted at any time of the day by mobile phone or internet, and employers might expect them to respond immediately and at any time of day to requests and instructions.

2.5   Computer hardware

Computer hardware consists of the computers themselves, and all the peripheral equipment connected to a computer for input and output, and storage of data (such as printers and stand-alone disc drivers).

The computers used in IT systems range from the very large to the very small. In many systems, many different computers are connected to each other within a network.

Computer hardware configurations within a network might include:

- 'supercomputers' – used only in the very largest systems

- mainframe computers – the most powerful computers until the development of supercomputers, but still very powerful computer systems

- 'mini-computers' – less powerful than mainframes

- desk-top personal computers (PCs) – a computer placed at the user's desk with its own processing capabilities, and usually a keyboard, mouse and screen: PCs can operate as stand-alone computers, or may be linked as terminals to a network

- portable laptop and notebook computers

- hand-held computers or PDAs (Personal Data Assistants).

The globalisation of the business environment has resulted in much more widespread use of portable/laptop computers, which can be connected to the organisation's computer network or to the internet from remote locations, and hand-held computers. This means, for example, that a manager can access his e-mails or the organisation's Intranet system from anywhere in the world.

Servers

Servers are computers that are used to perform a particular function within a network system. They can range in power from 'top-end' super servers, capable of driving hundreds of terminals, to 'low-end' servers which are typically a powerful personal computer (PC).

- **File servers** are used to manage the data files that are accessible to users of the network. All the shared data files for the system are held on a file server, or are accessible through a file server.

- **Network servers** are used to route messages from terminals and other equipment in the network to other parts of the network: in other words, network servers manage and control the routing of messages within computer networks.

2.6 Data input methods

In every computer system, there must be methods of data capture and data input.

The most efficient method of capturing data and the fastest method of input is the input of data from other computer systems:

- by direct transmission via a network

- from electronic storage devices such as CDs, DVDs or other discs

- downloaded files from the internet

- files attached to e-mail messages.

However, in most computer systems, data must also be captured from other sources and input in other ways. These include:

- keyboard and mouse – probably the slowest method of input and the method where the risk of error is highest

- document scanning systems and digital cameras, in publishing systems

- special data capture systems such as optical character recognition (OCR) systems, optical mark reading systems (OMR) and magnetic ink character systems (MICR)
- plastic card systems
- bar coding systems, such as the systems in supermarkets and other retail organisations
- voice recognition systems.

2.7 Software

Computer software, essential for the operation of the hardware, may be divided into the following types:

- system software, which includes system software and communications software
- programming tools and language translators
- application software.

Application software

Application software is software written to enable computer users to process data. Application software can be classified into two broad types:

- **Off-the-shelf software** or **software packages**. This is software that can be purchased from a supplier and installed on the computer ready for use. Examples are accounting software packages, word processing packages, spreadsheet packages, database packages and modelling packages.
- **Bespoke software** or **tailored software**. These are programs that are written for a specific user, to meet the user's specific processing requirements. Bespoke software is commonly used by larger organisations for their more important computer systems.

When an organisation wishes to introduce a new computer system, it might have a choice between an off-the-shelf solution (buying a software package) and a bespoke solution (designing and developing a bespoke system).

The advantages of bespoke software are as follows.

- The purpose-written software will meet the specific needs of the user. An off-the-shelf package, on the other hand, is a standard piece of software for all buyers of the package. The bespoke software should therefore deliver more benefits to the user.
- Bespoke software can be adapted and re-written over time, to meet the changing requirements of the user. Off-the-shelf packages are updated only when the software provider decides to produce a new version.
- Bespoke software can be designed so that output from the new system can be input to another of the user's computer system, or so that the output from another of the user's systems can be input to the new system. This is only possible with off-the-shelf software when the computer user buys different

modules from the same software supplier – for example, different modules of a total accounting package.

■ There might not be an off-the-shelf solution to meet the user's particular requirements.

The disadvantages of bespoke software are as follows.

■ The cost of designing and developing a bespoke system will be high. The cost for a comparable off-the-shelf package should be much lower.

■ A bespoke system takes time to design, develop, test and implement. An off-the-shelf package is ready to install as soon as it is purchased.

■ When bespoke software is written, there is a high probability that errors in the programs will remain undetected until after the new system has been implemented. Off-the-shelf software, particularly if it has been on the market for a long time, should be largely error-free.

2.8 Computer networks

A computer network is a number of computers and other equipment (such as printers) linked together by a communications network, so that data can be transmitted through the network, processed in one or more parts of the network, and stored somewhere within the network for on-line access.

Local Area Networks (LANs)

Local area networks are computer networks within a small geographical area or location. The computers are connected by cables, and communications do not go across a long distance telecommunications network.

Since the communications do not go across a telecommunications network, there is **no requirement for modems in the network**. (A modem is a modulator/ demodulator. It is a device that converts data messages from the format used within computers to the format for transmission across a telecommunications network, and then converts them back again at the other end.)

For example, an organisation with ten geographically dispersed business units could have a LAN in each business unit for the computer users in that unit.

There are many LAN configurations; a typical structure consists of a number of PCs connected to a central server where all common data files are held. LANs have been developed to enable users within a small geographical area to share computer facilities (files, printers, and so on).

Wide Area Networks (WANs)

Wide Area Networks are similar in many ways to LANs. The main differences are that:

■ the computer network is spread over a larger geographical area: for example, WANs might be used to connect users in geographically remote business units to their head office computer systems

- since the computers are separated from each other geographically, communications between them must go over a telecommunications network, and modems must be positioned between the computers and the telecommunications network

- there are often large numbers of computers in a WAN – many more than in a LAN.

Management and information
■ Uses of information
■ Levels of information: strategic, tactical and operational
■ Qualities of good information
■ Sources of internal and external information

3 Management and information

3.1 Uses of information

Information is processed data. Data can be defined as facts that have not been assembled into a meaningful structure. Data is processed into a structured form that has some meaning: this is called 'information'.

Businesses use information in several ways.

■ Information is used to perform routine transactions, such as order processing and invoicing.

■ Information is used to make decisions.

■ Information is also developed into knowledge that can be used to improve the business.

Managers could not make decisions without information. However, information can vary in quality, and as a general rule managers will make better decisions when they have better-quality information.

Decisions are taken continually in business. Routine decisions may be taken by any employee as a part of normal procedures. However, a specific role of management is to make decisions. Managers could not make decisions without information. However, information can vary in quality, and as a general rule managers will make better decisions when they have better-quality information.

Well-designed information systems can be used to:

■ capture data from many different sources

■ store large quantities of data, which can be retrieved easily and quickly when it is needed

■ process data in many different ways to provide valuable information

■ communicate information to managers and other individuals who need it

■ improve communications within an organisation and world-wide.

## 3.2 Levels of information: strategic, tactical and operational

As explained in the previous chapter, management may be classified into three levels:

■ strategic management

■ tactical management

■ operational management.

These three classifications are based on the types of decision that are taken by management at each level. For decisions at each level of management, a different type of information is required.

The requirements of management for information vary with the level of management. This concept is set out simply in the diagram below.

Levels of management and information requirements
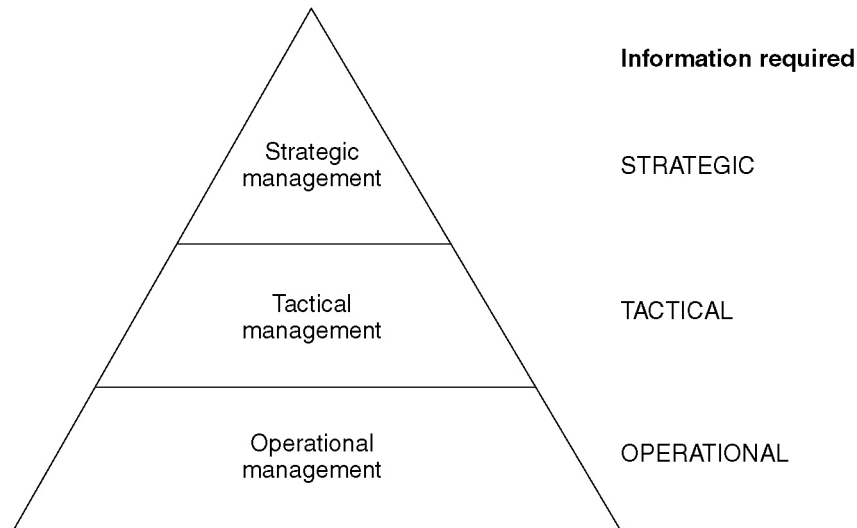
Strategic information

Strategic management needs strategic information. The characteristics of strategic information may be summarised as follows:

■ It is often information about the organisation as a whole, or a large part of it.

■ It is often in summary form, without too much detail.

■ It is generally relevant to the longer term.

■ It is often forward-looking.

■ The data that is analysed to provide the information comes from both internal and external sources (from sources inside and outside the organisation).

■ It is often prepared on an 'ad hoc' basis, rather than in the form of regular and routine reports.

■ It may contain information of a qualitative nature as well as quantified information.

■ There is often a high degree of uncertainty in the information. This is particularly true when the information is forward-looking (for example, a forecast) over a number of years in the future.

Tactical information

Tactical information is used to decide how the resources of the organisation should be used, and to monitor how well they are being used. It is useful to relate tactical information to the sort of information that is contained in an annual budget. A budget is planning at a tactical management level, where the plan is expressed in financial terms.

The general features of tactical information are as follows.

- It is often information about individual departments and operations.
- It is often in summary form, but at a greater level of detail than strategic information.
- It is generally relevant to the short-term and medium term.
- It may be forward-looking (for example, medium-term plans) but it is often concerned with performance measurement. Control information at a tactical level is often based on historical performance.
- The data that is analysed to provide the information comes from both internal and external sources (from sources inside and outside the organisation), but most of the information comes from internal sources.
- It is often prepared on a routine and regular basis (for example, monthly or weekly performance reports).
- It consists mainly of quantified information.
- There may be some degree of uncertainty in the information. However, as tactical plans are short-term or medium-term, the level of uncertainty is much less than for strategic information.

Operational information

Operational information is needed to enable supervisors and front line managers to organise and monitor operations, and to make on-the-spot decisions whenever operational problems arise.

Operational information may also be needed by employees, to process transactions in the course of their regular work.

The general features of operational information are as follows.

- It is normally information about specific transactions, or specific jobs, tasks, daily work loads, individuals or work groups. (It is 'task-specific'.)
- It may be summarised at a work group or section level, but is in a more detailed form than tactical information.
- It is generally relevant to the very short-term.
- It may be forward-looking (for example, daily plans) but it is often concerned with transactions, procedures and performance measurement at a daily level.
- The data that is analysed to provide the information comes almost exclusively from both internal sources (from sources inside the organisation).
- It is often prepared frequently, as required for daily operational needs.

■ It consists mainly of quantified information. Most of this information is 'factual' and is not concerned with uncertainty.

3.3 Qualities of good information

The quality of an information system depends on the quality of the information that it provides. Good information has several characteristics.

Relevance (and volume)

Information has no value unless it has a purpose and is useful. Information must therefore be relevant for its intended purpose.

Some information systems process large amounts of data to provide large volumes of information, but not all of it is useful. There may be more information than a user can actually make sense of. Sometimes, the information generated by an information system might not be entirely relevant, and might not tell the user everything that he or she needs to know.

Information systems may be designed to help the user to find relevant information easily and quickly, for example by searching an expert system (ES) or an executive information system (EIS).

Reliability

Information must be reliable. Reliable information must be:

■ **accurate enough** for its intended purpose and

■ **complete enough** for its intended purpose.

Sometimes, this means that information must be 100% accurate and 100% complete. However there are many occasions, particularly with strategic information used by senior management, that information is based on estimates and forecasts, or information is incomplete due to a lack of data.

There are also occasions when the users of information systems have to apply their judgement and reach a decision on the basis of information available. Expert systems are an excellent example of this. An expert system for medicine, for example, might suggest several alternative courses of treatment for a patient, and an expert system for law might indicate several different and opposing legal arguments.

For some information systems, information needs to be **up-to-date**. For example, an on-line theatre booking system or airline travel booking system must ensure that the data about seat availability is always completely up-to-date for users of the system.

The accuracy of information in a computer system can be improved, if required, by trying to reduce the amount of errors in the input data.

■ Data validation checks can be written into the system software. These carry out checks on input data and reject (refuse to accept) items for processing where there is a logical error in the input.

- Input documents can be designed to contain as much pre-printed material as possible, to reduce the number of errors in preparing the documents. Similarly, when data is input by keyboard and mouse, data screens can be designed to include as much pre-set data as possible, to reduce the risk of keying errors by the computer operator.

Sufficient but not excessive

Information should be sufficient for its intended purpose, but should not be excessive. Providing large amounts of information can lead to 'information overload'. When this happens, the user has difficulty in understanding the important items of information in the time available to study it.

One way of avoiding excess information in a report might be to highlight key information, for example in an executive summary.

Timely

Information must be available in time for its recipient to make use of it. Information will be used for a purpose. Presumably, there is an 'ideal time' for using the information.

Managers might want items of information quickly, so that they can make an immediate decision. Many information systems, such as expert systems and executive information systems, offer immediate responses to input queries.

Speed of access to data (and the speed of a system in responding to queries) is often regarded as a desirable feature of an information system.

User confidence

Users must have confidence in their systems and the information that they provide. Information must therefore be realistic.

At the moment, information systems for business have not been designed that are capable of removing the need for management judgement in making decisions. However, information does not need to be 100% accurate for users to have confidence in it. The user of information needs to know how reliable the information may be, and (as suggested above) that the information will not be completely wrong.

The value of information must be more than its cost

Information should not cost more to obtain than the value it provides.

- Some information systems may provide information at a level of detail (or accuracy) that is not required, when it would be cheaper to provide less detailed (or less accurate) information to meet the user's requirements.
- Some information systems may provide additional information that is not used at all.

■ An information system may provide information that is used, but the benefits from using the information are less than the cost of obtaining it.

Convenience of access and data security

Information should be easily accessible when it is needed. It is now common to think of 'accessible' information as information that can be obtained immediately, on demand. In particular, databases can make large amounts of information immediately available, especially when they are accessible through a computer network.

However, it is also important to protect information against unauthorised access; therefore data should also be kept **secure**. Methods of keeping data secure include the following:

■ **Physical security**. Access to computer centres may be restricted security measures such as identity cards and entry cards.

■ **Software security** to prevent (or detect) unauthorised access, using passwords, encrypted data, firewalls, and so on.

■ **Anti-virus software**, to prevent the corruption or destruction of data and software by hackers.

■ The use of **back-up files**, to ensure that data is duplicated or can be recreated. Back-up files ensure that the data will not be lost if the main copy of a file is physically lost or destroyed, or becomes unreadable.

3.4   Sources of internal and external information

Information is obtained from both internal sources within the business organisation and from external sources.

■ A large proportion of strategic information comes from external sources. Much operational level information, in contrast, comes from internal sources.

■ Large amounts of external information are readily available to users through the internet. In particular, the websites of government departments and government-funded organisations often provide a wide range of statistics, guidelines and other data.

■ Sources of information might be used regularly, or only occasionally, depending on the nature of the information and the purpose for which it is required.

■ External information is often available without cost or at very little cost. However, some external information must be purchased.

Each business organisation should ensure that it obtains good-quality information for all levels of management, and this will usually come from a mix of internal and external sources. Some of these are listed below.

Sources of internal information	**Sources of external information**
Computer systems, such as the accounting system, sales system and inventory control system.	The websites of government departments, government-sponsored bodies and other public bodies.
The accounting system is a particularly important source of information for management, especially at strategic and tactical management levels.	The government is an important source of official statistics on business and the economy.
Management reports; performance reports	Published annual report and accounts of other companies
Internal policy documents and procedure manuals	External information providers: this information must be paid for. For example, Reuters and Bloomberg provide financial markets information.
Word-of-mouth communications between employees and management On-the-spot observation	Professional bodies, such as the ACCA
	Trade organisations, which provide industry-related information to their members. Many industries have a trade organisation/trade body whose membership consists of business organisations in the industry.
	Trade journals
	General media, such as radio, television, newspapers and magazines
	Market research investigations
	Word-of-mouth communications from suppliers and customers

CHAPTER

3

Culture, ethics, governance and social responsibility

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5   Corporate governance and corporate social responsibility

> ### Organisation culture in business
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> - The significance of culture for management
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> - Edgar Schein: three levels of culture
> - Corporate culture: the views of Handy
> - Hofstede: international perspectives on culture

1 Organisation culture in business

1.1 Formal and informal organisation

Every large business entity and not-for-profit entity has both a formal organisation and an informal organisation.

The **formal organisation** is the organisation structure that has been created and maintained by its leaders. It can often be shown as an organisation chart, with job descriptions. The earlier descriptions of organisation structures in this text are descriptions of formal organisation.

In addition to the formal organisation structure, there is also an informal organisation. This develops over time, but can change as some people leave the organisation and new people enter it.

The **informal organisation** is a network of personal and social relationships. It develops from the way in which individuals meet and communicate with each other. They develop friendships and personal relationships, and they talk to each other as individuals rather than simply as other employees who are required to do a job. The focus of an informal organisation is people, not the work.

In an informal organisation, individuals begin to identify themselves with groups, and these groups develop common rules of behaviour and normal ways of doing things ('norms').

The significance of informal organisation

When an informal organisation is strong, it may become just as significant as the formal organisation. Managers might need to consider how the informal organisation affects behaviour at work – and work practice – and try to manage it.

For example, there might be a formal procedure for doing a particular task. However, a group of individuals with strong interpersonal relationships might find a different way of performing the task, which is easier or more acceptable than the formal procedure.

The informal organisation might also affect attitudes to work – whether a group of individuals are keen to complete a task on schedule, or do a job well, or agree to work overtime, or whether they are collectively hostile to management and working conditions.

- Informal organisation can therefore support the formal organisation, and help to make working practices more efficient and effective.

- On the other hand, informal organisation might sometimes conflict with the formal organisation, such as when a group of employees are hostile to their work and their managers.

- Managers might try to make use of a positive informal organisation by formalising some aspects of the informal structure, for example by changing work procedures or the methods used for communication.

1.2   Definition of culture: organisational, corporate and group culture

In addition to having informal organisation, business organisations (and other types of organisation) also develop a culture. A culture is a set of dominant beliefs, attitudes, values and norms that is shared by a number of people.

Edgar Schein suggested that employees working within a company have shared values, beliefs and ways of thinking: these interact with the policies, organisation structure and politics of the company's management system to create a corporate culture. Culture affects the expectations of employees within the company about what the company should achieve.

Schein argued that organisation culture is strong because it is regarded as something that helps the company to succeed. An organisation culture is a set of assumptions that a group of people working together have invented, discovered or discovered by learning how to deal with problems that the organisation faces, internally and in its external environment. These assumptions work well enough to be considered valid; they are therefore 'taught' to individuals who join the organisation. New entrants therefore learn the culture of the organisation and become a part of that culture.

- **Organisational culture** refers to a set of beliefs, values and attitudes that is shared by everyone in the organisation. Within an organisation, organisational culture defines 'the way we do things around here'. Peters and Waterman argued that the most excellent business organisations are characterised by particular cultural attitudes and beliefs.

- **Corporate culture** refers to the way in which organisations are **managed**. This is different from organisational culture, which is the set of values shared by all the employees. (However, the term 'organisational culture' is often used with the same meaning as 'corporate culture'.)

- **Work groups** might also have their own distinct culture. Within the same business organisation, there may be several work groups, each with a distinct 'sub-culture'. For example, the culture in the sales department might be very different from the culture in the accounts department, and both these cultures may differ from the culture of the research and development department staff.

Differences in organisational culture are probably best understood by looking at different organisations with which you are familiar. It is widely understood, for example, that business organisations are driven by a different set of priorities and concerns than not-for-profit organisations. However, if you visit two different companies in the same industry, you will probably find very noticeable differences in culture – the way people talk to each other, the way they deal with outsiders, their priorities and concerns.

How does culture differ from informal organisation?

Culture is deeply embedded within an organisation, and a common culture might be shared by everyone in the organisation. When new individuals join an organisation, they are 'taught' the organisation culture and learn to adopt it. In contrast, an informal organisation is no larger than the individuals who interact socially at work and the nature of the informal organisation can change when individuals leave or join.

Because culture is deeply-embedded, it is very difficult to change.

1.3 The significance of culture for management

Edgar Schein, a writer on organisation culture, has written: 'The concept of culture is still misunderstood in organisations, being treated too much as a superficial phenomenon'. He also wrote: 'Culture is really a very deep phenomenon and ... if managers/leaders are serious about changing culture, they must make an effort to understand how culture really 'works' and what it really is.'

An understanding of the culture of work groups is 'essential to leaders of they are to lead' (Schein). Managers need to understand the culture of the group or groups that they manage. By understanding the group culture, they can try to influence it and encourage positive attitudes to work.

Schein wrote: 'Building an effective organisation is ultimately a matter of meshing different sub-cultures by encouraging the evolution of common goals, common language and common procedures for solving problems.' He was the first person to use the term 'corporate culture'. He believed that successful managers develop a positive corporate culture.

1.4 Factors that shape organisation culture

A combination of factors shapes the culture of a work group or an organisation.

■ Formal structure and size. To some extent, the culture of an organisation is affected by its size and its formal organisation structure.

■ Leadership. The leaders of an organisation can influence culture, for example by stating the values of the organisation, and its goals and strategies.

■ Environment. Culture develops as a way of responding and reacting to the environment in which the organisation operates.

■ Events. Culture develops as a result of many events, and how a group or organisation has responded to those events.

The cultural web

An approach to analysing corporate culture has been suggested by Johnson and Scholes. They have suggested that there is a **cultural web** within every organisation, which is responsible for the prevailing culture, which they call the 'paradigm' of the organisation.

The cultural web consists of six inter-related elements of culture within an organisation.

- **Routines and rituals**. Routines are 'the ways things are done around here'. Individuals get used to the established ways of doing things, and behave towards each other and towards 'outsiders' in a particular way. Rituals are special events in the 'life' of the organisation, which are an expression of what is considered important.

- **Stories and myths**. Stories and myths are used to describe the history of an organisation, and to suggest the importance of certain individuals or events. They are passed by word of mouth. They help to create an impression of how the organisation got to where it is, and it can be difficult to challenge established myths and consider a need for a change of direction in the future.

- **Symbols**. Symbols can become a representation of the nature of the organisation. Examples of symbols might be a company car or helicopter, an office or building, a logo or a style of language and the common words and phrases ('jargon') that employees use.

- **Power structure**. The individuals who are in a position of power influence organisations. In many business organisations, power is obtained from management position. However, power can also come from personal influence, or experience and expertise. The most powerful groups within an organisation are most closely associated with the core beliefs and assumptions in its culture.

- **Organisation structure**. The culture of an organisation is affected by its organisation and management structure. Organisation structure indicates the important relationships and so emphasises who and what is the most important parts of it. Hierarchical and bureaucratic organisations might find it particularly difficult to adapt to change.

- **Control systems**. Performance measurement and reward systems within an organisation establish the views about what is important and what is not so important. Individuals will focus on performance that earns rewards.

Together, the cultural web consists of the assumptions that are 'taken for granted' within the organisation as being correct, and also the physical manifestations of the culture.
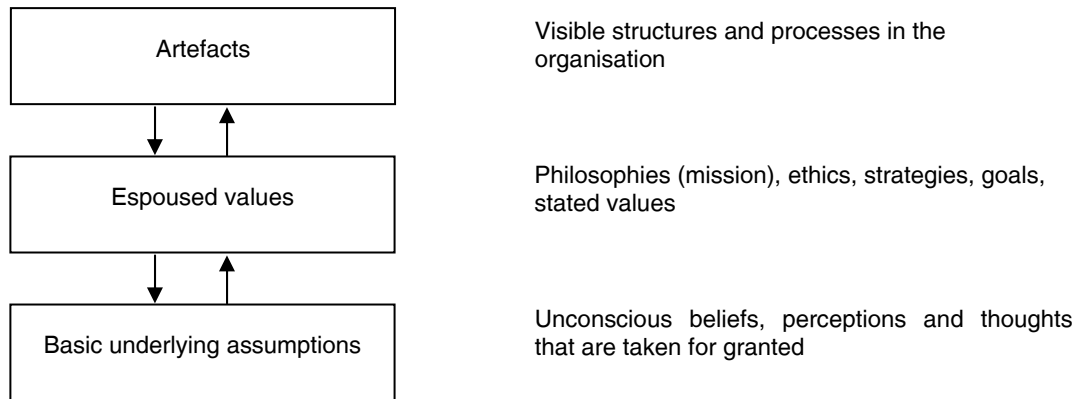
1.5 Edgar Schein: three levels of culture

According to Schein, there are three levels of culture that members of an organisation acquire:

- the outer skin, or artefacts
- the inner layer (or espoused values)
- the paradigm (basic underlying assumptions).

These are inter-related and react with each other. However, aspects of culture, particularly artefacts, are often difficult to 'interpret' and understand.

Levels of culture

Artefacts	Visible structures and processes in the organisation
Espoused values	Philosophies (mission), ethics, strategies, goals, stated values
Basic underlying assumptions	Unconscious beliefs, perceptions and thoughts that are taken for granted

The outer skin (artefacts)

At one level, the culture of a company is evident in what a visitor can see and hear by visiting the company.

■ The facilities and surroundings in which employees work help to create culture. So too does the way that employees dress. For example, some organisations insist on office workers dressing formally. In others, even senior managers go to work in casual clothes, such as an open-necked shirt and jeans.

■ Culture is also seen in the way that employees talk to each other and interact with each other. It can be heard in the language that individuals use when talking to each other, such as the use of 'jargon'.

The inner layer (espoused values)

A company might have a formal code of **ethical behaviour,** which is intended to shape the attitudes of all its members. It might have a formal code of ethical behaviour, which is intended to shape the attitudes of all its members.

Stated values and **mission statements** are often expressed in general terms, such as 'providing a service to the community' and 'providing the best quality of service to customers'.

Culture might also be expressed in the goals and strategies of the organisation.

This level of culture can be influenced by the organisation's leaders.

The paradigm (basic underlying assumptions)

'Paradigm' is a term for the shared assumptions and attitudes about what really matters, that are taken for granted and rarely discussed. These affect the way that the organisation sees itself and the environment in which it operates, and is the real 'core' culture of the organisation. Unlike mission statements and codes of ethics, a paradigm is not written down, and it is difficult to identify or explain. The 'paradigm' has also been described as the reason why the organisation exists. A police force exists to catch criminals, and a school exists as a place for learning.

A paradigm has been defined (by Capra, 1997) as: 'a constellation of concepts, values, perceptions and practices shared by a community, which forms a particular vision of reality that is the basis of the way a community organises itself.'

Schein argued that changing corporate culture is very difficult. The 'outer skin' can be changed fairly easily, with a determined effort by management, but it is very difficult to change the paradigm.

1.6 Corporate culture: the views of Handy

Charles Handy (in his book *Gods of Management*) suggested that there are four different categories of corporate culture. He described these as cultural 'stereotypes':

- A power culture, also called a club culture and a spider's web culture
- A role culture
- A task culture
- A personal culture, also called an existential culture.

Power culture

In a power culture, there is one major source of power at the centre of the organisation. Power, authority and influence spread out from this central point, along functional or specialist lines, but control remains at the central point. Handy compared the power culture to a spider's web, with the spider at the centre controlling everything. Individuals closer to the centre of the web have more influence than individuals who are further from the centre.

A power culture is often found in small entrepreneurial organisations, where the boss is usually the founder of the business and also a dominant personality, who exercises close control over activities.

- A power culture is based on trust.
- The 'boss' maintains freedom of manoeuvre, and retains power, by writing very little down and relying on the spoken word.
- The 'boss' tries to influence other people through the force of his personality, and personal charm.

A problem with a power culture is that it depends on the character of the 'boss'. As an organisation grows in size, it becomes more difficult for one person to control everything. There is a risk that the organisation will become inefficient unless the corporate culture is changed. A power culture is therefore unlikely to be efficient for organisations of more than about 20 people.

Role culture

A role culture is probably the most readily-understood of the four corporate cultures. It exists in a bureaucracy, where the responsibilities of each individual are defined by the job that he or she has, the job definition and its position in the organisational structure. There is a traditional hierarchical structure to the organisation, and each job (role) has a specific function. The organisation relies on formal communications rather than informal communication.

A role culture has been compared with a pyramid of boxes, and each box has a job description. The boxes remain in place and the culture is unchanged when the individuals in the boxes leave the organisation and are replaced.

A role culture is probably best-suited to a large organisation in a fairly stable business environment, where employees are expected to do the job that they have been given, and where enterprise and initiative are relatively unimportant. People in organisations with a role culture are 'managed' rather than 'led'.

Task culture

In a task culture, the focus is on tasks and getting tasks completed in the most efficient and effective way, and the main aim is the successful solution of problems.
In a task culture, organisation is flexible. Work teams can be formed, disbanded when a task is completed, and then re-formed into new work groups to deal with new tasks. Individuals gain respect and authority from their knowledge and skills, rather than from their 'official role' within a work team. A task culture is typically found in project teams and development groups.

A task culture is well-suited to an organisation that is continually facing new problems and challenges. This is often found in rapidly-changing organisations and industries such as IT companies and knowledge-based industries. It is also found in building and construction companies. In these organisations, work groups are often formed to deal with a particular task, and disbanded when the task has been completed.

In a team culture, personal relationships matter, and individuals are 'led' rather than 'managed'.

Person culture

In a person culture, the entire organisation structure is built around one individual or a group of individuals. The rest of the organisation exists to serve the needs of the central individual. The culture is based on the view that the organisation exists too serve the talented individual or individuals.

It is unusual for an entire organisation to have a person culture, but small parts of an organisation might be structured in this way. Examples are organisations built around individuals in the sports or entertainment industries, small management consultancies, or parts of investment banks. Firms of lawyers (barristers in the UK) and small hospitals might also have a person culture.

In an organisation with a person culture, the central individuals may share some common resources, such as a small administrative support function. However, the individuals operate independently and have some dedicated support staff of their own.

Different cultures may exist in different parts of the same organisation. The culture of an organisation, or a part of an organisation, determines how it is managed, and how individuals within the organisation think and act.

Example

According to Handy's analysis of cultural stereotypes, which one of the following should be expected to adopt a task culture?
(1)   A government department with responsibility for collecting and publishing official government statistics.
(2)   The human relations management department in a large commercial bank.
(3)   The department of a consultancy firm that specialises in providing IT consultancy services to client firms.
(4)   A small fashion business that designs high-fashion clothes.

Answer

A task culture should be expected in (3), the department of a consultancy firm that specialises in providing IT consultancy services to client firms. The IT consultants are likely to work in teams, sharing their knowledge and expertise, to provide IT solutions for clients. The team members are likely to show respect for technical skills and experience among other team members, and there should be relatively little concern for seniority or job descriptions.

A role culture should be expected in both (1) and (2). The structure is likely to be hierarchical, with clearly defined job descriptions and responsibilities. This is certainly the case with a civil service department, but is also likely to occur in the HRM department of a large company such as a bank. Roles can be clearly defined. If individuals leave, the same position is easily filled by someone else to do exactly the same job.

A fashion business might have a task culture, where designers work in teams. However, it is more usual, especially in small firms, for the organisation to be dominated by the head fashion designer. Depending on the nature of the company, a fashion business might have a power culture (where the organisation is led by the entrepreneurial owner of the business) or a person culture, where the organisation is based on providing administration support to key persons (fashion designers).

1.7 Hofstede: international perspectives on culture

In the 1980s and early 1990s, Geert Hofstede added some useful views about the effect of national cultures on organisational culture. Hofstede argued that culture is a property of groups, not individuals. There is no such thing as individual culture. Culture is the collective programming of the mind that distinguishes the members of one group from the members of another group.

He argued that national cultures are different. As a result, the culture of business organisations in one country will differ from the culture of organisations in a different country.

Multinational companies face the challenge of trying to create a common organisational culture for an organisation that operates across national boundaries.

Example

Different national cultures mean that business practices that are considered perfectly acceptable in one country might be considered unacceptable in others. For example, the following business practices are acceptable in some countries but not in others.

(a) Paying an adviser to discover loopholes in the tax laws, in order to avoid paying tax on business profits.

(b) Inspecting the product of a competitor at a trade fair, and then developing a close copy as a rival product.

(c) Paying a government official to speed up the completion of a bureaucratic procedure.

(d) Giving a gift to the purchasing manager of a large company that buys your products.

Hofstede suggested that there are five dimensions to differences in organisation culture arising from differences in national culture.

- **Power-distance** dimension. This refers to the way in which power is dispersed within the organisation. When the power-distance dimension is low, this means that inequalities in the distribution of power within the organisation are minimised. When the power-distance dimension is high, inequalities in power are regarded as acceptable and those without power look to those with the power to make the decisions for the organisation. Writing in the 1980s, Hofstede suggested that the power-distance dimension was low in countries such as Sweden and New Zealand, and high in Latin American countries and in the 'Latin' European countries such as Spain and France.

- **Individualism versus collectivism** dimension. In some countries the interests of the individual come before the collective interests of the group. (Hofstede gave Australia and Canada as examples.) In other countries, concern for the group comes before concern for the individual. (Indonesia is an example.)

- **Uncertainty avoidance**. This is the extent to which a group feels threatened and endangered by unexpected and unfamiliar happenings. When a culture of uncertainty avoidance is high, work behaviour such as precision and punctuality are highly esteemed. (Hofstede gave Japan and South Korea as examples.)

- **Masculinity versus femininity**. In some countries there is a much stronger cultural acceptance of 'feminine' qualities such as modesty, intuition and quality of life, rather than aggressive 'masculine' qualities of aggressiveness and competitiveness. Hofstede gave the US and UK as examples of 'masculine' cultures.

- **Long-term orientation versus short-term orientation**. In some countries, there is a greater focus on short-term goals and short-term results, whereas in other countries there is a greater willingness to consider the longer term. Short-termism is a feature of organisation culture in the US and much of Western Europe.

Stakeholders of business organisations
■ Definition of a stakeholder
■ Internal stakeholders
■ External stakeholders
■ The main stakeholders
■ Stakeholder mapping: Mendelow's power/interest matrix
■ Stakeholder conflicts of interest

2 Stakeholders of business organisations

2.1 Definition of a stakeholder

A stakeholder in an organisation is a person who has an interest (or 'stake') in what the organisation does, and who might therefore try to influence the decisions and actions of the organisation.

Stakeholders are individuals and other organisations, but they often have a common interest. It is therefore possible to categorise some stakeholders into groups of people with a similar interest.

Stakeholders can be either:

■ people or groups within the organisation (internal stakeholders), or

■ people, groups or other entities that are external to the organisation (external stakeholders).

2.2 Internal stakeholders

Within a business organisation, internal stakeholders can be categorised into groups as follows:

■ shareholders

■ executive directors and senior managers

■ other managers and current employees.

It might be appropriate to divide management and employees into sub-categories, where there are groups with differing interests and concerns. For example, managers and employees in different divisions of the company or in different functional departments, might have different interests and concerns.

Shareholders/owners

In large companies, the main shareholders are not usually involved in the day-to-day management (although there are some exceptions). Shareholders in a large

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company are usually investors, seeking to earn a return on their investment in the form of dividends and a higher share price.

Shareholders leave the management of their company to the board of directors and executive management team. However, they might become more closely involved in the company, and try to influence the decisions of the directors, when they feel that their interests are threatened. For example, shareholders might express their concerns about any of the following:

■ Falling profits and a falling share price

■ Lower dividend payments

■ A proposal to invest in a major project where the business risk is high

■ A proposed takeover bid for another company or from another company.

When shareholders feel that their interests are threatened, they might try to become more actively involved in the company. Major shareholders can discuss their concerns with the company chairman and other senior directors. All shareholders might be able to express their displeasure by voting against the directors at a general meeting of the company, although their rights and powers are restricted by company law.

A company might have a majority shareholder, who owns enough shares in the company that the shareholder is able to control the composition of the board and the decisions that the company's directors make. When there is a majority shareholder, the interests of this shareholder might differ from those of the minority shareholders owning the remainder of the shares. (In other words, the majority shareholder and the minority shareholders might be different stakeholder groups.)

Executive directors and senior managers

A board of directors might consist of executive directors and non-executive directors. Executive directors are usually full-time employees of the company (whereas non-executives are not).

As executives and full-time employees, executive directors are involved in the management of the company. Their interests are therefore often similar to the interests of other senior executives, who do not have a position on the board of directors.

The interests of executive directors and senior managers are affected by matters such as:

■ their remuneration, which consists of basic salary, pension rights, cash bonuses and share incentive schemes

■ power and status

■ career prospects

■ job security.

Executive directors and other senior managers often want their company to grow in size, because in a larger company, they expect larger remuneration, more power and

status and better career prospects. However, growing the company is not necessarily in the best interests of shareholders, who are more concerned about profitability, dividends and the share price.

Other managers and employees

Managers in the middle and junior ranks of a management hierarchy might have ambitions to become senior managers. However, their interests and concerns are different. Often, junior managers and other employees share common interests, such as:

- pay
- working conditions
- job security
- job satisfaction
- quality of life.

2.3 External stakeholders

Business organisations, particularly large organisations, have a large number of external stakeholders. These include:

- lenders
- suppliers
- government
- customers
- local communities
- the general public, including special interest groups and pressure groups
- non-executive directors.

Lenders

Lenders to a company include banks and bondholders. (Companies might issue bonds or debentures in order to raise finance. Interest is paid on the bonds, which represent a debt that the company must eventually repay.) The main concerns of lenders are that the borrower should be able to repay the debt, with interest, on schedule.

Lenders might therefore be concerned about heavy borrowing by a business organisation, because when a borrower gets into heavy debt, the risks increase that it will not be able to meet all the claims for interest and debt repayment, especially if profitability falls.

Suppliers

Business organisations buy goods and services from suppliers. Suppliers will usually agree to allow their customers some credit (time to pay) but their main interests are that:

- a customer will pay what is owed and will not become a bad debt
- customers will continue to buy from them
- customers will treat them fairly, and deal with them in an ethical way.

Government

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

- Businesses pay tax on profits, so government has an interest in company profitability.
- The government should want to create and maintain a strong economy. This depends partly (or largely) on new investments by business. Government might therefore want to encourage business investments.
- The government should want to achieve low levels of unemployment. Businesses are major employers.
- 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.

The government might be a significant external stakeholder in a business because of its power to introduce new laws and regulations, or amend existing laws.

Customers

Customers have a stake in a business organisation because they expect to obtain value from the goods or services that they buy. The significance of the customer for marketing and business strategy has been explained earlier in this text.

Local communities

In some cases, local communities might be stakeholders in a business organisation, especially when the organisation is a major employer in the area and the local economy depends on the work and business activity that the organisation brings to the area.

The concerns of a local community might be very strong when a business organisation proposes to close down operations in the area, and make its employees redundant. Business shutdown by a major employer in an area has a knock-on effect for other businesses, which will lose trade and income.

The general public

The general public might consider that it has a stake or interest in major companies, because the actions of these companies can affect society as a whole. Public concerns might be expressed by action groups or pressure groups. Areas of public concern might include:

- public health, especially in the case of food manufacturers and manufacturers of drugs and medicines

- protection of the environment, reducing pollution, and creating 'sustainable businesses'
- corruption in business practices (such as bribery)
- the exploitation of the consumer through mis-selling and misleading descriptions of goods
- the monopolisation of a market by one or a small number of companies. (In the UK for example there is public concern about the dominance of supermarket chains in the retail market, and the shift of retailing from town centres to out-of-town locations.)

Non-executive directors

Oddly, perhaps, non-executive directors are external stakeholders in a company. Although they are members of the board of directors, they are not full-time employees, and they are usually appointed to a company's board because:

- they bring experience and knowledge to the board that they have gained outside the company, and which executive directors often do not have
- their interests are different from those of executive directors and senior executives: they are not affected by concerns about remuneration (bonuses and performance incentives), power and status or job security.

Appointing independent non-executive directors to the board of directors of a company is good corporate governance practice, because independent NEDs can help to prevent a company from being dominated by the personal interests of the executive directors.

2.4 The main stakeholders

The main stakeholders in a business organisation, internal or external, are those who exercise the greatest influence.

The most influential stakeholders in a company are usually the board of directors, and possibly also senior executives below board level. These are the individuals with the power to make most of the decisions for the company.

The directors will often be influenced by the opinions of their shareholders, especially their largest shareholders, because shareholders can take some action against the directors if they are dissatisfied. For example, shareholders can vote against the re-election of directors (and in extreme cases can vote to have a director removed from office).

Connected stakeholders

Other stakeholder groups, other than the directors, senior management and the shareholders, might influence the decisions that directors and senior management make. The term 'connected stakeholder' means a stakeholder who:

- is not a decision-maker, or
- is not a part of the permanent (full-time) infrastructure of the organisation, but

- is nevertheless very influential in shaping the future of the organisation and the decisions of its leaders.

The main connected shareholders in a company are usually:

- non-executive directors
- employees
- key suppliers
- key customers.

The main connected stakeholders in a business organisation must have some power that they are able to use to influence decisions. Some sources of power, and the stakeholders who might have them, are listed below.

Source of power: the power comes from an external source	Example
Legal rights	Shareholders have some legal voting rights under company law.
	Lenders have legal rights under the terms of their lending agreements: for example a lender has a right to take action in the event of default by a borrower.
Publicity, and ability to influence customers or legislators	Pressure groups and protest groups might be influential. These include environmental protection groups, human rights protection groups, and animal welfare activists.
Control over key resources	A major supplier could exert influence by controlling the supply of a key resource to the organisation.
Buying power	Customers can exert influence collectively through their buying power. If they do not like what a business organisation is doing, they can switch to buying from competitors.

Source of power: the power comes from an internal source	
Position power	Individual employees might be in a position of power within the organisation, perhaps because of special expertise that they possess. Top consultants and investment bankers are examples.
Claim on resources	Power might arise from a claim or control that exists over particular resources of the business. For example the power of employees or trade union representatives might come from their ability to withhold labour in the event of a dispute with management.
Personal charisma or influence	Some individuals might exercise considerable influence through their personal qualities and charisma.

2.5 Stakeholder mapping: Mendelow's power/interest matrix

The managers of a business organisation should manage its stakeholders, particularly those with the greatest influence. Stakeholder mapping is a technique that can help senior managers to assess their main stakeholders, and consider what should be done (if anything) to win the support of particular stakeholders for particular decisions.

One approach to stakeholder mapping is to evaluate each stakeholder group using a 2 × 2 matrix. One such matrix is a stakeholder **power/interest matrix**. This is sometimes called a **Mendelow matrix**, named after the person who 'invented' it.

The matrix can be used to identify the position of each group of stakeholders in a matter affecting the organisation. The matrix compares:

■ the amount of interest that the stakeholder has in a particular issue, on a scale ranging from not at all interested (0) to very interested (+10), and

■ the relative power of the stakeholder, on a scale from very weak (0) to very powerful (+10).

Interest of the stakeholder

	Very low (0)	(5)	Very high (10)
Weak (0)		Minimal effort	Keep informed
Power of the stakeholder (5)			
Strong (10)		Keep satisfied	Key players

The recommended approach to dealing with the stakeholder group is indicated in each quadrant of the matrix. The key stakeholders are those who have considerable power or influence, and also a keen interesting the matter or decision that management is considering.

■ If a stakeholder has very little power and very little interest in a matter, minimal effort is needed trying to keep the stakeholder informed about the matter or satisfied.

■ If a stakeholder has very little power but a strong interest in a matter, the appropriate way to deal with them is to keep them informed about what is happening and why. The stakeholder should be kept informed even if they oppose what the organisation is doing.

■ If the power of a stakeholder is strong but the stakeholder has very little interest in the matter, it is important to keep the stakeholder satisfied. It is essential to avoid any course of action that will increase the stakeholder's interest, and persuade the stakeholder to exercise its power.

■ The most significant stakeholders are those with a large amount of power and a high level of interest in a matter. These stakeholders are key players and it is essential to obtain and keep their support.

e **Example**

The board of directors of a major company want to make a takeover bid for another company. Stock market rules require that the agreement of the shareholders must be obtained before any such takeover can go ahead.

In this situation, the shareholders are stakeholders with large power and a high level of interest. Clearly, the board of directors must ensure that they win the full support of the shareholders so that the takeover will go ahead.

e **Example**

The directors of a company are planning to shut down an operations centre, because it is losing money.

The employees who will be made redundant or transferred to other jobs within the company are a stakeholder group that probably has relatively little power to affect the shutdown decision. However, their interest in the matter is strong. The directors should keep the employees fully informed about developments, what the company is planning to do, and how this will affect each employee personally.

2.6 Stakeholder conflicts of interest

The objectives of stakeholders differ, but need not be in direct conflict with each other. For example, shareholders want to receive a good return on their investment. This need not conflict with the objective of executive directors and senior managers to earn high remuneration, especially if their remuneration is performance-related. Employees want a secure job, good pay and good working conditions: these objectives are not inconsistent with the objective of making profits. Customers want value for the money they spend: business organisations make profits by meeting customer needs more successfully than competitors.

A business organisation is therefore normally able to meet many of the objectives of different stakeholders, provided that some compromises are accepted. However, in some exceptional cases, there might be a strong conflict of interests between stakeholder groups in a business organisation.

Example

The board of directors of a major company might set as an objective a 20% growth in annual profits. To do this, it might have to take the following measures:

(a) reduce staffing levels and make a large number of employees redundant

(b) switch to different suppliers of key materials, who are able to supply the materials more cheaply because they use child labour

(c) increase output in a way that will substantially increase waste levels and carbon dioxide pollution.

In this example, the board of directors might face a strong conflict of interest with employees (about redundancies), the general public and customers (about buying from suppliers who use child labour) and the government, pressure groups and the public (about waste and pollution).

Avoiding serious conflicts of interest

A company's directors and senior managers should try to avoid serious conflicts of interest between stakeholder groups. One approach is to apply principles of good corporate governance and to recognise the corporate social responsibility of companies.

Corporate governance and corporate social responsibility are explained in a later section of this chapter.

Ethics
■ Ethical behaviour ■ Personal ethics and moral dilemmas ■ Business ethics ■ Corporate codes of ethics ■ The contents of a corporate code of ethics ■ Whistle blowing procedures ■ Factors that determine whether behaviour is ethical or unethical

3 Ethics

3.1 Ethical behaviour

Ethics is about morality, and acting in a way that is morally justified. Most individuals develop a sense of morality, and act in accordance with what they consider 'right' and 'wrong'. However, opinions about what is 'right' and 'wrong' can differ enormously.

Ethics apply to organisations as well as to individuals and groups of people. Companies might be driven by the profit motive, and all their actions might be determined by doing whatever is necessary to maximise profits. On the other hand, companies might recognise the need – and the benefits – of acting in an ethical way.

Accountants – both students and qualified professionals – are expected to behave in accordance with professional codes of ethics, and to maintain standards of moral behaviour that are 'expected' from a professional body.

Ethics and the law

Some unethical behaviour is against the law. However, much behaviour is not illegal but might be unethical. Problems for an individual at work can arise when he is expected to behave in a way that is illegal or in a way that he considers unethical even though it would not be illegal.

3.2 Personal ethics and moral dilemmas

Every individual acts in accordance with his or her sense of right and wrong. In practice, there are often pressures on an individual at work to 'bend the rules' and act in a way that is not ethical.

Sometimes it is not clear what the right course of action should be. When an individual thinks that something might be 'wrong', he could be faced with a decision about what to do. Making a moral or ethical decision might not be easy, especially when colleagues or bosses do not agree with you and will not listen to what you have to say.

Some individuals might take the view that when they are at work, they act according to a different set of rules and with a different moral outlook, compared to the way they think and behave in their private life. This view can be used to justify decisions or actions at work that are unethical, on the grounds that 'business is different'.

Example

You receive a call from a customer. The customer complains that an item he ordered from your company should have been delivered before now. When he placed his order three weeks ago, he was told that delivery would be in two weeks' time, but this did not happen.

You know that the item cannot be delivered for at least one more week, possibly longer.

What do you say to the customer?

Answer

One approach is to tell the truth, although the customer might want to cancel the order and might become rude and unpleasant in talking to you.

Another approach is to tell the customer a 'white lie', that the item will be delivered in the next two or three days. This might be sufficient to keep the customer satisfied for the time being.

A third approach would be to say to the customer that you do not have any information about his order, but you will get someone to call him back.

A personal moral dilemma might arise when as an individual you want to do something, but you know that a different course of action would be more appropriate in order to protect the interests of the business.

3.3 Business ethics

Business ethics are the ethics of business behaviour, and the 'rights' and 'wrongs' of:
- how individuals act at work, especially in dealing with other people, and
- how different business organisations deal with each other.

There are some aspects of behaviour in business that should be regarded as ethical and desirable.
- Honesty. Individuals should be honest and should avoid telling lies. By developing a reputation for honesty, individuals earn the trust of other people. When there is trust, people are more willing to work constructively together.
- Openness. Individuals should be open about what they are trying to do, and should not be secretive. Openness, like honesty, encourages trust.

■ Integrity. Individuals should put the requirements of their work and their job before self-interest.

■ Acting within the law.

Business ethics are different from personal ethics, because they relate to business conduct. Some people believe that the profit motive in business is unethical, but there are ethical arguments in favour of making profits.

It can be argued that when a business is profitable, many people benefit. Shareholders benefit from higher returns and dividends; employees benefit from the employment that a profitable business provides; customers benefit from the goods and services that a profitable business is able to provide (that it would not be able to provide if it did not make a profit); the general public gains from the benefits to the economy arising from profitable businesses and additional economic activity.

Business ethics can also be used to justify actions in business that might seem morally 'dubious' or 'wrong' on a personal level, such as:

■ cutting costs (including making employees redundant)

■ down-sizing (which involves making people redundant)

■ doing business in a country with a dubious political system, such as a tyrannical government.

3.4 Corporate codes of ethics

A corporate code of ethics is a code of ethical behaviour, issued by the board of directors of a company. It is a formal written statement, and should be distributed or easily available to all employees. The decisions and actions of all employees in the company must be guided by the code.

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

It has been suggested that there are three reasons why companies might develop a code of ethics. These reasons are progressive, which means that companies might begin by having a code of ethics for the first reason, but then progress to the second and third reasons as they gain experience with implementing the code and appreciating its potential benefits.

■ Reason 1: **Managing for compliance**. The company wants to ensure that all its employees comply with relevant laws and regulations, and conduct themselves in a way that the public expects. For example, companies providing a service to the general public need to ensure that their employees are polite and well-behaved in their dealings with customers.

■ Reason 2: **Managing stakeholder relations**. A code of ethics can help to improve and develop the relations between the company and its stakeholders, by improving the trust that stakeholders have in the company.

- Reason 3: **Creating a value-based organisation**. A company might recognise the long-term benefits of creating an ethical culture, and encouraging employees to act and think in a way that is consistent with the values in its code of ethics. (It could be argued that an ethical company is a more likely to be successful in business in the long term. However, there is no firm evidence to prove this point, and it is therefore a matter of opinion.)

3.5 The contents of a corporate code of ethics

A corporate code of ethics is normally quite short, dealing with each point in just a few sentences, and sometimes in just one sentence.

There is no standard format or content for a code of ethics, but a typical code contains:

- general statements about ethical conduct by employees
- specific reference to the company's dealings with each stakeholder group, such as employees, customers, shareholders and local communities.

General statements about ethical conduct

A code of conduct should specify that **compliance with local laws** is essential. In addition, employees should **comply with the policies and procedures** of the company. There might be a statement that any employee who fails to comply with the company's code of conduct will face disciplinary action.

The code might also include an **overview of business conduct**, and the need to protect the company's reputation and 'good name'.

It might also contain statements about the values of the company, such as:

- acting at all times with integrity
- protecting the environment
- the 'pursuit of excellence'
- respect for the individual.

Dealings with stakeholder groups

A code of conduct might address its main concerns about its dealings with stakeholder groups and its ethical treatment of each group.

- **Employees**. A code of ethics might include statements about:
  - human rights, including the right of all employees to join legally-authorised organisations such as a trade union or political party
  - equal opportunities for all employees, regardless of gender, race, ethnic origin, religion, age, disability or sexual orientation
  - refusal to tolerate harassment of employees by colleagues or managers
  - concern for the health and safety of employees
  - respect for the privacy of confidential information about each employee

-   company policy on giving or receiving entertainment or bribes.
■   **Customers**. A code of ethics might include statements about:
    -   fair dealing with customers
    -   product safety and/or product quality
    -   the truthfulness of advertisements
    -   respect for the privacy of confidential information about each customer.
■   **Competitors**. A code of ethics might include statements about:
    -   fair dealing with competitors
    -   the use of techniques for obtaining information about competitors (industrial spying)
■   **Shareholders**. A code of ethics might not include much about shareholders, because the relationship between a company and its shareholders might be contained in a code of corporate governance that the company follows. The key issue with shareholders is to maintain and develop trust and confidence, which might be achieved through disclosure of information (openness and transparency).

3.6 Whistle blowing procedures

'Whistle blowing' means reporting suspicions of illegal or improper behaviour to a person in authority.

In a normal situation, employees report to their supervisor or manager. If an employee has concerns about a transaction or a plan of action, and thinks that it might be unethical (illegal or against the company's code of ethical conduct) he or she should normally report the concern to the supervisor or manager.

A problem arises whenever:
■   the supervisor or manager is involved in the illegal or unethical activity, or
■   the employee has spoken to the supervisor or manager about the problem, but the supervisor or manager has taken no action and has ignored the matter, or dismissed it as something that is not important.

In these situations, the employee would have to report his or her concerns through a different reporting channel. In practice, this could mean reporting the matter to a director or a committee of the board of directors. Some companies have established procedures that allow employees to report their concerns ('blow the whistle').

3.7 Factors that determine whether behaviour is ethical or unethical

There is no universal standard of right or wrong. Opinions of individuals about right and wrong vary widely. Factors that affect ethical views (both personal ethics and business ethics) include the following:

Factor	Comment
Culture	Ethical views differ between cultures. What is immoral or even illegal in some cultures is acceptable behaviour in others.
	A major problem for multinational or global companies is achieving a common code of business ethics to apply in all countries in which the company operates.
Law	Illegal behaviour is unethical, even when the law differs between countries. Company codes of ethics typically state that the company's employees should always comply with the local law in the countries in which they operate.
Consequences	Sometimes, whether an act is ethical or unethical is judged by the consequences it will have.
Codes of ethics	When there is a formal code of ethics, behaviour can be judged in terms of whether or not it complies with the code.

Codes of ethics are also issued by professional bodies, such as accountancy bodies.

> **Professional ethics and the accountant**
>
> - Professional ethics
> - Acting professionally
> - Acting in the public interest
> - Public expectations of the accountancy profession
> - Professional codes of ethics for accountants
> - The IFAC Code (Code of Ethics for Professional Accountants) and ACCA Code
> - Fundamental principles

4 Professional ethics and the accountant

4.1 Professional ethics

The word 'professional' is associated with a highly-qualified group of individuals who carry out a particular type of highly-skilled work. Examples of professions are doctors and surgeons, dentists, lawyers, actuaries and accountants.

Each professional group is organised and regulated by a professional body. (In the UK, the professional bodies often have a royal charter. The accountancy profession has several different professional bodies.) The professional body has the power to:

- admit new members to the profession
- award qualifications to individuals who achieve a required standard of skill or competence
- expel members from the profession, for unprofessional conduct.

It is often a legal requirement that certain aspects of the work of professionals must be performed by professionally-qualified people.

Professionals and their clients

The relationship between professionals and their clients is based on several perceptions of the nature of a professional person.

- There is a **relationship of trust**. The client can trust the professional to act in a proper way, in accordance with a professional code of conduct. In return, the professional expects the client to place its trust in him (and her). For example, a client should not withhold relevant information from a professional that would affect his decisions or judgements.
- There is an assurance that the professional has attained a minimum level of **expertise and competence**. This assurance is provided, in accountancy, by the requirements to (1) pass formal examinations in order to obtain a qualification, (2) have relevant work experience and (3) continue with professional development and training throughout the accountant's professional career.

■ There is also an implication in the professional-client relationship that the professional has more concern for the client than for his own self-interest. **The professional puts the client before himself**.

4.2 Acting professionally

Professionals are expected to act in a professional way. Professional behaviour means complying with relevant laws and obligations, including compliance with the code of conduct (including the code of ethics) of the relevant professional body.

Professional behaviour is commonly associated with:

■ acting with integrity, and being honest and straight-dealing

■ providing objective opinions and advice, free from bias, influence or conflicts of interest

■ using specialist knowledge and skill at an appropriate level for the work

■ confidentiality: respecting the confidentiality of information provided by clients

■ avoiding any action that brings the reputation of the profession into disrepute

■ compliance with all relevant laws and regulations.

The ACCA Code of Ethics and Conduct states that 'the principle of professional behaviour imposes an obligation on members to comply with relevant laws and regulations and avoid any action that may bring discredit to the profession.'

Example

Karl Denning is the senior partner in a firm of accountants that specialises in preparing financial statements for clients, tax work and auditing. Mr Denning has decided to advertise the services of his firm in the local newspaper.

The advertisement states that Denning and Co is a highly experienced firm with numerous clients, including foreign and domestic companies. It adds that the services of the firm are of the highest standard, unrivalled by any other local firm of accountants.

His colleague challenges him by commenting that Denning and Co does not have any foreign companies as a client. Mr Denning replies that it is only an advertisement, and no one ever believes the marketing claims in advertisements.

Has Karl Denning acted in a professional way? If not, why not?

Answer

Karl Denning has breached the code of conduct of his profession, by:

■ failing to act honestly (and with integrity), and

■ by implication, criticising the work of other professionals.

The advertisement contains an untrue statement, that the firm has foreign companies as clients. This is dishonest.

The advertisement also states that the standards of service from the firm are better than those of any other firm in the area. This is a criticism of other accountancy professionals, and is not permitted by the professional codes of ethics.

4.3 Acting in the public interest

An aspect of professional bodies, which separates a profession from a trade, is that members of the profession are expected to act in the public interest. It is therefore a responsibility of the accountancy profession '**not to act exclusively to satisfy the needs of a particular client or employer**'.

When the demands or needs of a client or employer appear to be contrary to the public interest, accountants should consider the public interest.

So what is the public interest? Professional codes of ethics do not provide a clear definition, but it is usual to associate the public interest with matters such as:

- detecting and reporting any serious misdemeanour or crime
- protecting health and public safety
- preventing the public from being misled by a statement or action by an individual or an organisation
- exposing the misuse of public funds and corruption in government
- revealing the existence of any conflict of interests of those individuals who are in a position of power or influence.

4.4 Public expectations of the accountancy profession

The general public has high expectations of the accountancy profession.

- Many non-accountants do not have much understanding of accounting issues, but they rely on accountants to ensure that financial reporting is reliable and 'fair', and that management is not 'cheating' by presenting misleading and inaccurate figures in their accounts.
- Auditors are also seen, by many members of the public (rightly or wrongly), as a safeguard against fraud.
- The public continues to believe that the accountancy profession is an ethical profession that offers some protection to society against the 'excesses' of capitalism.

4.5 Professional codes of ethics for accountants

A role of the accountancy bodies should be to reinforce this public perception of an ethical profession. They do this by issuing codes of conduct, including codes of ethics, and expecting all their members to comply.

This point is made at the beginning of the IFAC Code: 'A distinguishing mark of the accountancy profession is its acceptance of its responsibility to act in the public interest. Therefore a professional accountant's responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest, a professional accountant should observe and comply with the ethical requirements of this Code.'

4.6 The IFAC Code (Code of Ethics for Professional Accountants) and ACCA Code

Every professional accountancy body has issued a code of conduct and code of ethics for its members and student members. It applies to accountants working in public practice (working for clients, for example as auditors) and accountants in business (for example, working for a company or government department).

Although each professional accountancy body has its own code of ethics, all codes are similar, because they are based on the IFAC Code. The IFAC Code (most recent version 2005) is issued by the Ethics Committee of the International Federation of Accountants, whose members include the professional accountancy bodies of most countries.

The IFAC Code sets our the ethical requirements for professional accountants and states that any member body of IFAC (such as the ACCA) or any individual firm of accountants may not apply ethical standards that are less strict than those in the IFAC Code.

The IFAC Code therefore establishes a minimum world-wide code of ethical conduct for accountants. The IFAC Code is divided into three parts:

- general principles and application of the code
- guidelines for accountants in public practice
- guidelines for accountants in business.

The same general ethical principles apply to all accountants. The circumstances in which ethical problems arise are different between accountants in practice and accountants in business. Accountants in practice have to deal in an ethical way with issues arising from the **client relationship**. Accountants in business have to deal with ethical issues where they are **employees** of the organisation in which the ethical problem has occurred.

The ACCA Code of Ethics and Conduct contains similar provisions to the IFAC Code, but is structured differently. It is contained in the ACCA Rulebook, which can be found on the ACCA website.

The description of professional ethics that follows is based on both the IFAC Code and ACCA Code.

The IFAC and ACCA Codes are **principles-based codes of ethics**. A principles-based code of ethics for accountants is a code that specifies general principles of ethical behaviour, and requires the professional accountant to act in accordance

with the principles. The accountant is required to use judgement in deciding whether in each case a particular course of action is a 'proper' or 'ethical' one.

4.7 Fundamental principles

Professional accountants are required to comply with the following fundamental principles:

- integrity
- objectivity
- professional competence and due care
- confidentiality
- professional behaviour
- technical standards.

The ACCA Code explains the fundamental principles as follows: 'Ethics is about the principles we use to judge the right and wrong of our actions…. It is about the fundamental principles that our members review and agree to each year when they renew their ACCA membership and submit their CPD (continuing professional development) return.'

Integrity

An accountant must be honest and straightforward in his professional and business dealings. This includes a requirement for 'fair dealing' and a requirement to be truthful.

Objectivity

An accountant must not allow his professional or business judgement to be affected by:

- bias (personal prejudice)
- conflicts of interest
- undue influence from others: for accountants in business, this includes undue pressure from the employer (senior management).

A very important aspect of integrity is that an accountant should not be associated with reports or any other provision of information where he or she believes that the information:

- the information contains a **materially** false or misleading statement
- the information contains a statement that has been prepared and provided recklessly, without proper care or consideration for its accuracy
- there are omissions or the information is presented in a way that makes the relevant information difficult to see, with the effect that the information could be seriously misleading.

For accountants in public practice, 'integrity' is often associated with independence of mind and judgement. For accountants in business, the concept of independence is not relevant: however, accountants in business should try to apply the principle of objectivity in all the work that they do.

For accountants in business, the concept of integrity also means observing the terms of his or her employment, but avoiding involvement in any activity that is illegal. If asked or encouraged to become involved in unlawful activity, the accountant must say no.

Professional competence and due care

An accountant has a duty to maintain his professional knowledge and skills at a level that enables him to provide a competent professional service to his clients or employer. This includes a requirement to keep up to date with developments in areas of accounting that are relevant to the work that he does.

Accountants should also act in accordance with relevant technical and professional standards when doing their work for clients or employer.

Confidentiality

Accountants must respect the confidentiality of information obtained in the course of his work. This applies to the confidentiality of information within the firm or employer's organisation, as well as to confidentiality of information about clients (for accountants in professional practice).

The requirement to keep information confidential applies:

- in a social environment as well as at work: for example, an accountant must be careful of what he says to a good friend who also happens to be a business associate, or to a wife or husband who is also a professional accountant
- after the accountant has moved to another job – confidentiality applies to information obtained when working for a former employer.

In addition, confidential information must never be used to obtain a personal benefit or a benefit for a third party.

However, there are some circumstances when the disclosure of confidential information is permitted or even required by law.

Professional behaviour

Accountants are required to observe relevant laws and regulations, and to avoid any actions that would discredit the accountancy profession.

This requirement covers advertising by accountants, which must be truthful and must not disparage the services provided by 'rival' firms.

Technical standards

A professional accountant should perform his professional tasks in accordance with the relevant technical and professional standards. Technical and professional standards include:

■ standards issued by IFAC (such as International Standards on Auditing) or a similar national regulatory body

■ financial reporting standards (IFRSs)

■ standards and regulations of the member's professional accountancy body

■ relevant legislation.

Professional accountants have a duty to carry out with care and skill the instructions of an employer or client, insofar as these are compatible with the ethical requirements for integrity, objectivity and (in the case of accountants in public practice) independence.

Example

You are an accountant working in public practice. You receive a visit from two police officers, who ask to see the files for one of your clients, a small import-export company. They show you a warrant that authorises them to take away the client files.

What should you do?

Answer

The requirement to maintain confidentiality of client information does not apply when authorities such as the police have a warrant to inspect or take files relating to the specific client.

You should be polite to the police in responding to their request, and you should check the details of the warrant before providing the files that are required. If there is any doubt about the details in the warrant, you might wish to ask for a legal opinion before handing over the files.

You should not tell the client what has happened.

Example

You are an accountant responsible for the audit of a business client. During the course of your audit work you discover that an employee of the client has probably been engaged in a fraudulent activity. You are not entirely certain that fraud has occurred.

What should you do?

Answer

The issue of confidentiality does not arise here, because the problem relates to an employee of the client. You should report your suspicions to a person of authority in the client organisation.

If the fraud appears to be minor, you might decide to leave the matter in the hands of the client. If the fraud appears to be a major crime, you should check what actions the client takes in reporting the matter to the police authorities, to satisfy yourself that appropriate action has been taken.

> ### Corporate governance and corporate social responsibility
>
> - Separation of ownership and control
> - Corporate citizenship and corporate social responsibility
> - The need for good corporate governance
> - The need for high standards of corporate social responsibility
> - Responsibility for good corporate governance and corporate social responsibility
> - Best practice in corporate governance

5 Corporate governance and corporate social responsibility

5.1 Separation of ownership and control

The need for standards of corporate governance arises from the separation in companies between the owners and the individuals who exercise effective control. In companies, control is exercised by the board of directors. In large companies, the major shareholders are investors and responsibility for governance is given to the directors.

The board of directors are responsible for achieving the objectives of the company, and they should be accountable to the shareholders for the performance of the company under their leadership. In practice, accountability to shareholders takes the form (mainly) of presenting an annual report and financial statements, and possibly other reports, to the shareholders.

Governance and management

The governance of an organisation is concerned with how it is governed. This is not the same as the way in which it is managed. Management is concerned with the effectiveness and efficiency of operations. Governance is concerned with setting objectives for the organisation and ensuring that those objectives are achieved: governance is about leadership 'at the top'.

There is some overlap between these definitions of governance and management. This is because the board of directors should make key strategic decisions, but other decisions relating to business strategies are delegated to management. Strategic management is therefore a combination of governance and management.

The management team is accountable to the board of directors (usually through the chief executive officer) and the board of directors is accountable to the shareholders for the performance of the management team.

The fiduciary duty of directors

In the UK, directors are said to have a **fiduciary duty** towards their company. This is a duty to act in the best interests of the company, without any regard to personal interests or personal benefits. It is a duty to the company (a company is a legal person) rather than to its owners, the shareholders.

This fiduciary duty is a legal duty, and in principle (although not often in practice) a company might take legal action against a director for a breach of his fiduciary duty.

Governance and stakeholders

The 'traditional' view of corporate governance is that the board of directors has a responsibility to look after the interests of the company's owners (the shareholders). Their objective should therefore be to maximise the wealth of shareholders, in terms of dividend payments and increasing the share price.

There are other views about the objectives of corporate governance.

■ An 'enlightened shareholder view' of corporate governance is that although the main objective of a company should be to increase the wealth of shareholders, the interests of other key stakeholders (especially employees of the company) should be taken into consideration as well. The decisions of directors should have regard to the interests of these stakeholders as well as the interests of shareholders.

■ A 'stakeholder view' of corporate governance is that companies exist because society allows them to exist. Companies therefore have a duty to consider the interests of all stakeholders, including society as a whole, not just the interests of shareholders.

These alternative views of corporate governance are consistent with the concept of corporate social responsibility.

5.2 Corporate citizenship and corporate social responsibility

A widely-accepted view is that companies are a part of society, and can be described as 'corporate citizens'. As citizens of society, companies have social obligations to the rest of society, and should act as responsible citizens. Companies therefore have a social responsibility, and should be expected to act with social responsibility.

There are several aspects to social responsibility.

■ Companies should meet acceptable **standards of ethical conduct** in their business. For example, they should comply with the laws of the countries in which they operate. They should comply with international agreements that condemn the use of bribery to win business contracts in other countries.

■ Companies should **show suitable concern for their employees** and should treat them properly. This means providing reasonable working conditions and paying fair wages and salaries. It might also extend to a responsibility to develop the skills and abilities of employees, for example through training and work experience. Many aspects of employment are covered by employment law, and employees are protected to some extent by the law. Socially responsible

companies go beyond the law, and do more for their employees than the law requires.

■ Companies should **respect human rights**. In recent years some companies have received adverse publicity from purchasing goods or materials from suppliers who use slave labour or child labour. Adverse publicity of this kind can damage the reputation of a company or a brand name. Some companies have a policy of refusing to buy from suppliers who use child labour.

■ Companies should **show concern for the communities** in which they operate or with which they trade. They should try to develop these communities. For example, some multinational companies provide money for health care or education in developing countries or local communities where they operate. Some companies have a 'fair trade' policy towards suppliers in developing countries.

■ Companies should **show concern for the environment**. This is now a major aspect of corporate social responsibility. Many companies recognise the need to reduce the pollution they cause, and the need to try to develop sustainable business. Carbon dioxide emissions are a major pollutant, and some companies have a policy of reducing their 'carbon footprint' or becoming 'carbon neutral'. Other companies have a policy of trying to replace the raw materials they consume (such as fish stocks or timber forests).

5.3 The need for good corporate governance

The need for minimum standards of corporate governance has been recognised – gradually – from experience. In the UK during the 1980s, there were several 'scandals' involving the collapse of large stock market companies, such as the Maxwell Communications Corporation (which owned the Daily Mirror newspaper group) and Polly Peck International.

It was found on investigation that major reasons for the collapse of these companies had been as follows:

■ A dominant leader of the board of directors, who took decisions for the company that were in his own personal interest rather than in the interests of the shareholders. The leader was able to run the company as a personal empire by holding the positions of chairman and chief executive, and having other members of the board (executive directors) who depended on the leader for their pay, status and position on the board. In other words, the failed companies had a dominant leader surrounded by 'yes men'.

■ **Misleading financial reporting**. The report and accounts of these companies gave no indication that they could be in serious financial difficulty. The financial reporting was therefore misleading. Questions were asked about the role of the external auditors, and their failure to qualify the accounts. Were they properly independent from their client company, or did their close relationship with the company persuade them to overlook questionable accounting policies?

■ It was also argued that **communications between a company and its shareholders** (and other stakeholders) should be more open and 'transparent'. The quality of company information, especially information available to

shareholders (and other investors) remains a key issue for good corporate governance.

During the 1990s, other aspects of poor corporate governance emerged, and raised the corporate governance debate in the UK.

■ **Directors' remuneration**. Concern was expressed about the focus of business leaders on short-term profits, and disregard for longer-term concerns and non-financial objectives. The 'short-termism' of senior executives was blamed on their remuneration packages. Directors were rewarded for achieving or exceeding annual profit targets. Another concern was that top executives were involved in deciding their own remuneration: for example a company chairman or CEO helped to decide how much they should be paid and what their performance targets should be (for the purpose of calculating bonuses). During the mid 1990s, a number of public utility companies (gas, electricity and water companies) were privatised and the same company leaders received very large increases in remuneration for doing the same job as before: this led to a condemnation in the UK press of 'fat cat' directors and overpaid executives.

■ **Management of risk**. Another governance issue, although one that attracted much less publicity, was concern about the management of risk in companies. Some companies appeared to be developing their businesses without giving proper consideration to the risks that they faced and the controls that were in place to manage the risks. Internal control systems and risk management systems, it was felt, should be monitored by the board of directors. The directors should satisfy themselves regularly that control systems and risk management systems were sufficient and effective.

The problems of poor corporate governance are now recognised in many other countries (but not all countries). In the USA, the financial collapse of several major corporations in 2001 and 2002 rocked the financial markets. The corporate failures included Enron and the near-collapse of WorldCom, but there were others. The causes of the corporate failures were similar to those that caused the failures in the UK in the 1980s: powerful executives running the company in their personal interests, poor communications with shareholders, misleading financial reporting and inadequate financial controls. There were serious concerns about the independence of company auditors and Arthur Andersen, the auditors of Enron and one of the world's 'Big 5' audit firms, collapsed as a result of the associated scandal.

A requirement for good corporate governance has been imposed on major stock market companies in many countries, including the US and UK. High standards of governance are expected by investors, other financial institutions (such as banks and stock markets) and government.

■ Investors want to reduce the risk of corporate failures, which damage the value of their investments in company shares. They consider that high standards of corporate governance reduce the risks of failure. If investment risks are high, investors might refuse to put their money into companies and the world's capital markets would decline.

■ Institutional investors in the US and UK have led the demand for better standards of corporate governance. Since these institutions invest in capital

markets around the world, they expect corporate governance standards to improve globally.

■ The government might want to avoid the risk of more corporate failures due to bad governance, especially in the US where many private individuals hold shares in companies.

■ It has also been argued that companies with a high standard of corporate governance are more likely to succeed and prosper (financially) than badly-governed companies. Evidence about this matter is not yet conclusive.

5.4 The need for high standards of corporate social responsibility

The need for high standards of corporate social responsibility is not as obvious as the need for good corporate governance in large companies. However, many large companies recognise the threat to their reputation from a failure to show social responsibility. **Reputation risk** can be a major risk for companies that depend on consumer support and brand recognition for their commercial success.

In the UK, major institutional investors also expect certain standards of corporate social responsibility from the companies in which they invest. As major shareholders in large companies, they are able to influence decisions by the board of directors. If the directors are aware that their main shareholders expect the company to be socially responsible, they will be more likely to take socially-responsible decisions.

In Europe, stock market companies are now required to publish a narrative report each year that discusses the company and its business, for inclusion in the annual report and accounts. This **business review** should include an explanation of the significant **social and environmental risks** faced by the company, and the measures that have been taken by the company to deal with them.

There is also recognition by many large companies of public concern for the environment. Some companies publicise their social and environmental policies and activities in a voluntary 'social responsibility report' or 'sustainability report'.

5.5 Responsibility for good corporate governance and corporate social responsibility

The board of directors has responsibility for standards of corporate governance and corporate social responsibility, although they are expected to comply with certain standards by a combination of:

■ legal requirements

■ voluntary codes of practice

■ pressure from institutional investors and other financial institutions

■ pressure from government

■ expectations of the general public.

In countries such as the UK and Singapore, there is a voluntary code of practice for corporate governance. Major stock market companies are required to comply with this code or explain any non-compliance in their annual report and accounts.

In the US, some aspects of corporate governance for major corporations are legal requirements (the Sarbanes-Oxley Act).

Corporate social responsibility is a voluntary matter. Provided that they comply with the law, companies can decide their own policies on social and environmental issues.

5.6 Best practice in corporate governance

Recognised 'best practice' in corporate governance varies between countries. However, four aspects of 'best practice' specified in the examination syllabus are:

■ non-executive directors

■ remuneration committee

■ audit committee

■ public oversight.

Non-executive directors (NEDs)

It is widely recognised that independent non-executive directors should have a prominent role in the governance of major companies. Independent non-executive directors are directors who:

■ are not full-time employees of the company, and

■ do not represent any other interests that might influence their judgement or opinion.

(Most non-executive directors are paid a fixed annual fee and might be expected to spend about 20–30 days each year with the company.)

Independent non-executive directors should raise standards of corporate governance in several ways.

■ They bring **independent opinions** to discussions of the board of directors. They are **not under the influence of the company chairman or chief executive officer**, and so should prevent a board of directors from being dominated by a powerful individual. Since they are not executive directors they do not represent the interests of executive directors or executive management (whereas executive directors have a personal interest in some issues, such as their remuneration). Independent non-executive directors therefore **improve the 'balance of power'** on a board of directors. In the UK, independent NEDs should represent at least 50% of the total number of directors on the board of the largest stock market companies.

■ They should have a wide range of knowledge and experience, gathered from outside the company. They should therefore be able to **improve the quality of debate and decision-making** at board meetings, by presenting views based on their knowledge and experience.

- They are involved in **monitoring standards of corporate governance**, such as the **remuneration of executive directors** and the **quality of financial reporting and auditing**. In the UK, main stock market companies are required to have a remuneration committee and an audit committee, whose members should all be independent non-executive directors. Independent non-executive directors should also represent the majority of committee members o n the nominations committee: this is a sub-committee of the board of directors that nominates (recommends) the appointment of new directors to the board.

Remuneration committee

A remuneration committee is a sub-committee of the board of directors. Its main responsibility is to negotiate the remuneration package of executive directors, and possibly also other senior executives of the company. The remuneration package includes basic salary, pension, cash bonuses and other performance-related incentives (such as the award of 'free' shares in the company).

The effect of having a remuneration committee of independent NEDs is that no one in the company is involved in deciding their own remuneration. (The remuneration committee does not decide the fees for NEDs.)

Remuneration committees are also responsible for ensuring that remuneration for executive directors is high enough to attract and retain executives of the required ability, but is not excessive.

In addition, the remuneration committee should ensure that the remuneration package of executives includes a substantial performance-related element, with both short-term and longer-term performance targets. If the performance targets are consistent with the overall strategic objectives of the company, the remuneration package should motivate the director to achieve levels of performance that are consistent with the company objectives.

Audit committee

The audit committee is another sub-committee of the board of directors. Like the remuneration committee it should consist entirely of independent non-executive directors.

An audit committee meets only a few times each year, and it does not have any executive or management responsibilities. The finance department (finance director) is responsible for preparing the annual financial statements and for most dealings with the external auditors at an operational level.

The role of the audit committee is to **oversee the financial reporting and auditing processes**, to ensure that:

- the financial statements are reliable and
- they have been audited to the standard required and expected.

The committee should also help to **ensure that the external auditors remain properly independent** from the executive directors of the company, because the

committee recommends the re-appointment (or replacement) of the auditors for the next annual audit, approves the audit fee and decides how much non-audit work the audit firm should be allowed to perform for the company. In addition, the audit committee provides a channel of communication between the auditors and the board of the company, in addition to the communications that the auditors maintain with the finance director and CEO.

An audit committee usually has the following responsibilities.

■ It monitors the external audit of the company, and discusses with the external auditors any issues that have arisen during the course of the audit work. The auditors should be expected to discuss any disagreements they might have with the executive management about accounting policies or estimates used to prepare the financial statements.

■ It considers whether the scope of the audit is sufficient to ensure that the financial statements are audited to the required standard. The committee will discuss the scope of the audit and the audit plan with the auditors and (probably) the finance director.

■ The committee should be asked to approve the annual audit fee that is negotiated with the auditors.

■ The committee assesses the quality of the audit work. In reaching its opinion, it might consult the finance director.

■ The committee recommends whether the auditors should be re-appointed for the next annual audit.

■ The committee should be responsibly for deciding company policy on how much non-audit work may be given to the external auditors.

■ The committee should also make recommendations about **internal audit**, and assess the quality of the internal audit department. If there is no internal audit function in the company, the audit committee should express an opinion ach year on whether the company should have such a function.

The audit committee and the remuneration committee are both committees of the board of directors, and they report to the board and submit their recommendations for board approval.

In addition, the committees should also be accountable to the company's shareholders. In the UK, the annual report and accounts should include reports from both the remuneration committee and the audit committee.

Public oversight

The general public has an interest in the proper governance of companies, because standards of corporate governance affect confidence in the stock markets.

Corporate governance systems should therefore provide for some oversight of governance standards, to ensure (in the public interest) that adequate standards are maintained. Public oversight of financial reporting and governance standards should be provided by an independent body, with responsibility for:

■ monitoring compliance with those standards

- enforcing compliance with those standards.

Such an oversight body might be called a **Public Oversight Board**. Its **main responsibilities** are **monitoring compliance** with laws, regulations and standards, and **enforcing compliance**. It might also have responsibilities for issuing new standards of reporting, auditing or corporate conduct.

In the UK, public oversight of financial reporting and corporate governance is the responsibility of the Financial Reporting Council (FRC). The FRC's responsibilities include:

- issuing and enforcing UK financial reporting standards
- issuing and enforcing UK auditing standards, and monitoring audit quality in the UK
- the review of the UK's corporate governance code for main stock market companies (the Combined Code on Corporate Governance).

CHAPTER

4

Environmental influences and constraints

Contents
1   The nature of environmental influences
2   Political and legal factors
3   Economic factors
4   Social and demographic factors
5   Technological factors
6   Competitive factors

> ## The nature of environmental influences
>
> ■ The environment of an organisation
> ■ The consequences of environmental change: threats and opportunities
> ■ Understanding environmental factors

1 The nature of environmental influences

1.1 The environment of an organisation

The environment of an organisation is a term that describes anything outside an organisation that affects what it does or how it acts. There are many influences on an organisation that come from pressures and changes in its environment. These environmental influences differ according to the circumstances of the organisation.

To provide a logical structure for analysing environmental influences and their effect on an organisation, it is often helpful to categorise them into different types. One method of analysing environmental factors is to group them into four categories:

■ **P** – Political and legal factors
■ **E** – Economic factors
■ **S** – Social, cultural and demographic influences
■ **T** – Technological factors.

This method of analysing environmental factors is called PEST analysis.

1.2 The consequences of environmental change: threats and opportunities

Environmental factors can have a significant effect on a business organisation, and can affect its activities and profitability. Changes in the environment might affect the planning and other decision-making of a business organisation.

Management should monitor developments in the business environment, and should consider how the organisation should respond to changes and developments.

Environmental scan

PEST analysis involves considering all the environmental influences on the organisation, recognising which are the most significant, and deciding how the organisation should respond to these changes or developments. This type of analysis is sometimes called an **environmental scan**.

When making an analysis of the business environment for an organisation, the initial task is to identify factors in the environment that create threats or opportunities.

- **Threats**. These are factors in the environment that might prevent the organisation from achieving its business objectives.
- **Opportunities**. These are developments that provide opportunities for the organisation, so that it can achieve its objectives more successfully.

Measures should be considered for reducing or removing significant threats.

Plans or strategies should also be considered for taking advantage of significant opportunities.

Note on strategic planning: SWOT analysis

An environmental scan is often carried out as a part of a regular formal review of the strategic plans of a business organisation. An environmental scan provides information about significant threats and opportunities arising from changes in the environment. In addition, a position analysis of factors inside the organisation is used to identify strengths and weaknesses in the resources and systems of the organisation, such as strengths or weaknesses in particular skills or in the product range of the business. Environmental threats and opportunities recognised in an environmental scan, and internal strengths and weaknesses recognised in a position analysis or resource analysis are brought together to carry out a strategic analysis of strengths, weaknesses, opportunities and threats, which is called SWOT analysis.

1.3 Understanding environmental factors

You need to be aware of the influence of environmental factors on the activities of business organisations and how their decisions and actions can be affected by changes in the environment that provide threats or opportunities.

Environmental scanning is often associated with strategic planning and strategic information, although some awareness of the business environment is needed at all levels within an organisation.

This chapter describes some of the environmental influences on business organisations. You should understand, however, that it is impossible to provide a comprehensive description of environmental factors. They differ between organisations and according to circumstances.

Your understanding of the business environment can be improved by paying attention to news about political and legal developments, economic conditions, social changes and technological developments, and their potential effect on businesses.

Political and legal factors
■ The scope of political and legal influence on business
■ Sources of legal authority
■ Employment law
■ Health and safety law
■ Data protection law
■ Competition law
■ Responding to political and legal developments

2 Political and legal factors

2.1 The scope of political and legal influence on business

Politics and the law have an extensive influence in business affairs, and political decisions and changes in the law can affect just about any aspect of business activities. Multinational companies have the additional problem that because they operate in many different countries, their activities may be affected by political conditions and legislation in each of the different countries.

Here are just a few examples of political and legal factors that might affect business.

■ **Nationalisation of industry and privatisation**. In some countries, industry is nationalised and owned wholly or partly by the state (the government). Occasionally, after a change of government, an incoming government decide to nationalise a business and take ownership of existing commercial business into ownership by the state. In other cases, a government might introduce a policy of de-nationalising an industry ('privatising the industry') and transferring ownership of state-owned businesses to commercial companies.

■ **Transport and infrastructure**. Businesses rely on the transport system to move their goods (and employees), and the quality of the road transport system depends on the infrastructure of roads. Although the transport system might be operated by commercial companies, most of the road network and possibly also the rail network are state-owned. Government policy on transport and building roads or rail networks can have an important effect on business activity.

■ **Education**. In most countries the government is responsible for most of the education system. Education policy affects the quality and skills of individuals who make up the work force of business organisations.

■ **Environmental policy**. Business organisations might be affected by changes in the environmental policy of a government, such as policy to reduce levels of pollution in the air, water or land.

■ **Taxation and subsidies**. Governments use taxation to raise income. They might also use taxation to influence behaviour, such as increasing tax on fuel in order to encourage a reduction in fuel consumption and increasing tax on the disposal of waste in order to encourage the recycling of waste. Governments sometimes encourage particular activities by offering subsidies, such as subsidies towards the cost of particular skills training.

Here are some illustrative examples of how business can be affected by government policy and the law.

Example

In 2007, oil companies operating in the Orinoco region of Venezuela were required by the government to hand over majority ownership in their businesses to the state (the government).

Example

In 2007, a large shipment of corn to Europe from the United States was found to include genetically-modified corn. Although this was legal in the US, it was illegal in the European Union. The shipment had to be returned to the US.

2.2 Sources of legal authority

Business organisations need to recognise the different sources of legal authority that have the power to introduce changes in the law. The sources of legal authority vary between countries, but usually include the following:

■ Supranational bodies

■ National government

■ Regional or local government, that exercises some powers either because it has some independence from the national government or because some powers have been delegated to the regional government by the national government.

Supranational bodies

A supranational body is a body that has responsibility or oversight of more than one country. A supranational body in some cases has the power to impose decisions on a national government. To have the ability to impose its rules, a supranational body needs the formal support of national governments.

■ In the European Union, the member countries accept that legal measures introduced by the European Council must be introduced into the national laws of each member country. (European Directives approved by the European Council must be incorporated in the national laws of each member country.) A supranational body such as the European Commission also has the power to impose certain decisions, including decisions relating to various business matters such as takeovers and monopolies.

■ In accounting, the International Accounting Standards Board is able to impose standard rules for financial reporting on companies in every country whose governments have agreed that these international accounting standards should be applied.

■ Some supranational bodies attempt to influence activities in many countries but do not have the right to enforce their wishes. Examples are the United Nations and the World Bank.

2.3 Employment law

Each country has employment laws. The purpose of employment law is mainly to provide protection to employees, against unfair treatment or exploitation by employers. Business organisations, as employers, are directly affected by employment laws. They need to be aware of the employment law in each country in which they operate, and understand the consequences of breaking the law or failing to comply with regulations.

Here are some of the aspects of employment law.

- **Minimum wage**. A country might have a minimum wage, which is the minimum hourly rate of pay that may be paid to any employee.

- **Working conditions**. A variety of laws and regulations might specify minimum acceptable working conditions, such as maximum hours of work per week or month. There might also be laws relating to a maximum retirement age and the employment of children. Working conditions are also covered by health and safety law, which is described in more detail later.

- **Unfair dismissal**. Employment law might give employees certain rights against unfair dismissal by an employer. In the UK, for example, an employee who is dismissed from work might bring a legal claim for unfair dismissal. The employer must then demonstrate that although the employee has been dismissed, the dismissal was not for a reason or under circumstances that the law would consider 'unfair'. When an employer is found guilty of unfair dismissal, it might be required to re-employ the individual who has been dismissed or (more likely) pay him or her substantial compensation.

- **Redundancy**. In the UK, dismissal of employees on the grounds of redundancy is not unfair dismissal, provided that discrimination is not shown in the selection of which individual employees should be made redundant. However, UK law requires an employer to consider transferring an employee to another job before deciding that redundancy is unavoidable. (Failure to consider transferring employees to other work would mean that the dismissals for redundancy are unfair.)

- **Discrimination**. Some countries have extensive laws against discrimination, including discrimination at work. In the UK, employers can be held legally liable for showing discrimination against various categories of employee (or customer) and also for discrimination shown by employees against colleagues. There are laws against discrimination on the grounds of physical disability, gender, race, religion, sexual orientation and age.

Changes in any aspect of these employment laws could have significant implications for business organisations, especially those where labour costs are a significant proportion of total costs.

2.4 Health and safety law

Health and safety law provides rules and regulations about minimum health and safety requirements that employers must provide in their place of business and for their employees. Standards of health and safety law vary substantially between

countries, although in countries with well-developed economies, health and safety standards are usually high.

Laws vary between different countries, and you should try to become aware of how the law applies in your own country. It is also important to recognise that health and safety regulations can impose significant requirements on employers, and the legal consequences of failure to comply with the regulations could be serious for the company or the directors, managers or employees responsible.

In the UK, employers are required by law to provide a safe place of work for their employees. A safe place of work is one where employees are not exposed to unreasonable physical dangers or unreasonable risks to health. In the UK, a safe place of work also means a place of work where employees are not subjected to discrimination or bullying. Risks to health and safety should be reviewed regularly, by means of formal risk assessments.

In addition to general laws about health and safety at work, there should also be detailed regulations specifying the minimum health and safety standards in particular types of industry or business, or particular types of business premises. For example, there should be specific minimum fire regulations for all buildings in which employees work. There should also be minimum health and safety regulations in particular industries, such as transport, food processing, building and construction and chemical processing.

There might also be voluntary health and safety codes that the government encourages but does not enforce as a legal requirement. In the UK, for example, there is a voluntary code of practice for employers aimed at reducing stress in the work place.

In a company, the board of directors has the ultimate responsibility for health and safety at work. Specialist health and safety officers might be employed by the company.

2.5   Data protection law

Some countries have fairly strict data protection laws. The purpose of data protection law is to **protect individuals** with regard to personal data about them that is held and used by other persons. Data protection legislation is designed to protect the private individual against others collecting, holding and using information about them without their permission. (The legislation does not apply to companies, however. On the contrary, it is generally argued that more information, rather than less, should be available about many companies.)

It might be considered illegal, for example, that any organisation should be able to:

- gather and hold personal data about individuals without a justifiable reason, and
- make use of that personal data without the individual's permission.

Someone holding and using personal data about individuals should also be under a legal obligation to:

■ make sure that the personal data is accurate, and

■ ensure the security of the data, so that it is not made available to or accessed by any other person who does not have any right to have it.

Data protection laws apply to any person holding personal data about individuals. This includes business organisations, which hold personal data about employees and (often) customers.

What is personal data?

Legal definitions of personal data might vary, but in European law personal data means any data about a **living private individual**, where the individual can be identified from the data. Normally this means that the personal data held about an individual should include his or her name, although this might not be essential.

European law also makes a distinction between ordinary personal data about an individual (such as name and address) and **sensitive personal data**. Additional legal requirements apply to holding and using sensitive personal data, such as details of a person's ethnic origin, political opinions, religion, trade union membership, physical and mental health and sexual habits or attitudes.

In many European countries, anyone holding personal data about individuals must register this fact with a government department, and provide details of the type of information they hold and the reasons why it is used.

Note also that data protection legislation applies only to particular categories of information that are regulated by the legislation. There is no legislative protection for non-regulated data. For example, information about an individual's consumer preferences is not regulated data. An individual might tell a market research group that he prefers black cars to blue cars, and prefers chocolate to potato chips. This type of information is outside the data protection legislation.

Legal restrictions on obtaining and using data

Organisations that hold and use personal data about individuals are required to comply with regulations relating to how the data is gathered, stored, kept secure from unauthorised access and used.

Failure to comply with the regulations could expose an organisation to legal action by the individual concerned and/or the authorities.

Principles of data protection and security

You might be required to know the main principles of data protection and security. The principles applied by UK law are as follows:

■ **Personal data must be obtained and processed fairly and lawfully**. Often this means that the individual must have given his consent for personal data about him to be held and used. Sometimes, it is lawful to hold and use personal data for specific reasons, for example in connection with performance of a legal contract (including a contract for the purchase and supply of goods or services) or to comply with the requirements of employment law on employers.

- **Personal data should be obtained only for one or more specified reasons**. It is illegal to obtain and store personal data without having a specific purpose for which the data will be used.

- **Personal data gathered and stored about individuals should be accurate, relevant and not excessive**. An organisation could be legally liable for holding or using personal information about an individual that is not accurate.

- **Data should not be held for longer than is necessary for its purpose**. When personal data no longer has a use, it should be destroyed.

- **Personal data should be processed in accordance with certain specific rights of individuals**. For example an individual has a right to object to the use of personal data being used for direct marketing by a business organisation, and has the right to ask an organisation to stop sending him direct marketing materials (such as brochures or e-mail marketing messages). In addition, any individual should have the right to access and check personal data that is held about him.

- **Personal data that is held about individuals should be kept secure**. Unauthorised access to this data should be prevented (as far as is reasonably possible).

- Personal data should not be transferred to any country where the standards of data protection are not as strict (or more strict).

Business organisations in countries where strict data protection laws apply should keep data processing systems under review, to ensure that:

- the rules about gathering, holding and using personal data continue to be applied, and that the regulations are not being broken, and

- personal data is kept secure from authorised access.

This task can be much more difficult than it might seem, given that the law applies to personal data held unofficially as well as in formal data processing systems. For example it includes personal data about individuals in e-mails or e-mail attachments. To apply the data protection laws properly, it is therefore necessary to educate all employees in the requirements of the law and try to ensure that all employees comply with legal requirements.

2.6 Competition law

Some countries have laws to encourage fair competition in markets and avoid anti-competitive practices.

Monopolies

There might be a law to prevent a company from acquiring monopoly control over a market. A 'monopoly' of a market is theoretically 100% control of a market, where only one entity supplies a product or service to the entire market. In practice, 'monopoly' is usually defined as a significant influence, such as control of over 30% of the market.

When a company has a monopoly of a market, it might engage in unfair business practices, such as charging higher prices than they would be able to charge in a more competitive market. The serious risk of anti-competitive behaviour from monopolies is the main reason for laws restricting them.

When a company grows to the point where it becomes a monopoly, a government organisation might carry out an investigation, with a view to deciding whether measures should be taken to protect the public.

Similarly, when two companies propose a merger that would create a new monopoly, a government organisation might investigate the proposed merger with a view to recommending whether it should be allowed to happen, and if so whether any conditions should be placed on the merger in order to protect the public.

In the UK, these investigations are carried out by a Competition Commission.

Anti-collusion regulations

Collusion occurs when two or more business entities secretly agree to so something for their mutual benefit that is against the public interest. Typically it is a secret agreement to raise prices, and avoid competition on process. In many countries, collusion is a criminal offence.

Price controls

In some countries, the government might impose price controls on certain key products or services, such as the price of essential services to consumers – water, electricity or gas. Official bodies might be established to monitor the activities of 'utility companies' (providers of water, sewage, electricity and gas services) and might have powers to restrict their activities. Official approval might also be required for any increase in prices.

2.7 Responding to political and legal developments

Business organisations need to recognise the significant political and legal factors that affect their business, and they have to decide how these factors should affect what they do. They should be alert to:

- changes or potential changes in each of these factors, and
- changes in the significance of each factor, including the growing importance of factors that were previously relatively unimportant.

Lobby groups

Large companies often use lobby groups to represent their interests by communicating with politicians and government officials. A lobby group is a group of individuals or a specialist firm that actively represents the interests of a company with politicians, government bodies and government officials.

In the UK for example, companies use specialist firms to represent their interests by speaking to UK politicians and government officials, and also to officials in the European Commission (the managing government body of the European Union).

Lobby groups can help companies to argue either for or against proposed changes in the law, and to get politicians and government officials to understand the interests of the companies they represent.

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3 Economic factors

3.1 Macroeconomics and macroeconomic policy

If you have studied economics, you should be familiar with the content of this section of the chapter, and can move on immediately to the next section.

Economics is the study of the choices made by societies and by individuals and firms. Individuals and societies make use of limited economic resources ('scarce resources') to satisfy needs and wants.

Macroeconomics is the study of the total economy or aggregate economy. It is more usual to study macroeconomics at a national or a regional level, but macroeconomics can also be studied at a global level. It is concerned with issues such as employment and the level of unemployment, the amount of economic wealth that is created (measured by national income) and economic growth, and the rate of inflation.

Macroeconomics considers the aggregate economy. Microeconomics is concerned with the study of economic choices by individuals and firms, and how individual economic decisions are driven by prices, costs and 'satisfaction'.

There are links between macroeconomics and microeconomics. For example, if the level of unemployment in a national economy is very high, this will affect the availability of additional labour for individual firms within the economy.

Economic policy

A government develops a macroeconomic policy. The aim of government economic policy is normally concerned with objectives such as achieving economic growth, full employment, stable prices and a sustainable balance of payments.

Developments in the national economy, and government policy to influence the state of the national economy, can have an important effect on businesses and individuals (who are often referred to in economics as 'households').

3.2 Measuring activity in the national economy

'National income', 'gross national product' and 'gross domestic product' are all measures of total economic activity during a given time period, usually one year, for a particular country (or region). At this stage in your studies, you need not be concerned about the technical differences in how each is measured.

There are three broad approaches to the measurement of total economic activity during a given time period:

- **Expenditure approach**. One way of measuring economic activity is to calculate the total amount of spending there has been in the economy. This includes spending on consumption by individuals and firms, spending on capital investment and government spending.

- **Income approach**. Another way of measuring economic activity is to calculate the total income that has been earned by everyone in the economy during the period, such as income earned by individuals and profits earned by companies.

- **Output approach**. A third approach to measuring economic activity is to measure the value of output by all industries and other economic activity. This includes service industries as well as agricultural, mining, construction and manufacturing industries.

We do not need to go into the detail of how national income or gross national product is calculated using each of these approaches. In practice, the three approaches produce different 'answers' because of the problems of government statisticians in collecting complete and accurate data. In principle, however, the three approaches to calculating national income should all produce the same figure.

The expenditure approach to calculating economic activity

The expenditure approach to the calculation of national income or gross national product can be presented as a fairly short equation. This equation provides some insight into how a national economy can grow, and key factors that affect economic growth.

Economic activity $(AD) = C + I + G + (X - M)$

where:
C = the amount of **consumption** on goods and services
I = the amount spent on **investment** in long-term assets
G = the amount of **government spending**
X = the amount of **exports** of goods and services
M = the amount of **imports** of goods and services
$(X - M)$ is the difference between exports and imports of goods and services, and this is sometimes referred to as the balance of payments.

Economic activity in this formula is sometimes called **total demand** or **aggregate demand** (AD) in the economy.

Government economic policy aims

The main aim of government economic policy is usually to increase economic wealth and achieve something close to full employment. If economic growth and full employment are achieved, the wealth of the country as a whole will increase, and everyone benefits. A government economic policy aim is therefore to increase aggregate demand in the economy, and achieve a steady annual growth in national income.

Economic activity, and so economic wealth, is increased as a result of an increase in any of the items in the equation above. AD is increased by any increase in consumer spending, investment, government spending or increase in the balance of payments (X – M). However, the issue is not so simple, because increases in any item in this equation might lead to a reduction in other items. For example:

■ An increase in government spending G provides an increase in national income, but if the extra government spending comes from higher taxation, and the higher taxation leads to falls in consumption C and investment I, the end result might not be beneficial.

■ Similarly an increase in consumption will provide an increase in national income, but the extra money spent on consumption might be diverted from spending on investment (so I will fall), or the goods might be purchased from other countries (so M will increase) or might be goods that would otherwise have been exported (so X will fall).

A link between national income growth and inflation

Another problem is that there are limits to the annual rate of increase in national income that can be achieved. A country should be able to increase the total output from its economic activities, but does not have the resources to grow in 'real terms' above a certain rate.

For example, national income can be increased by getting more unemployed people into work, because these individuals will then become productive and will create economic wealth. However, reducing unemployment by 1%, say, is unlikely to increase national income by more than 1%. National income can also be increased by introducing more new technology into business: however, the introduction of new technology takes time, and will only help to improve national income gradually.

When total spending in the economy increases at a faster rate than the economy can grow in real terms, the inevitable result is price inflation. For example, if national income (as measured by total expenditure in the economy) grows by 8% but the 'real' economy – for example actual output of goods and services – increases by just 2%, the difference of 6% must be inflation – higher prices rather than higher output.

3.3 The economic cycle

The economic cycle is a term used to describe how, in general, the national income of a country increases or fall from one year to the next.

■ When national income increases from one year to the next, there is **economic growth**.

■ When national income falls from one year to the next, there is **economic recession** (or in extreme cases, economic decline).

An economic cycle consists of several years of economic growth, with national income each year being higher than in the previous year, following by economic recession, which is a period of years during which national income is falling.

Government economic policy usually tries to achieve continued economic growth, but if recession becomes unavoidable, policy is then aimed at making the recession as short and as minor as possible.

3.4 Impact of inflation

Inflation is the increase in price levels over time. The rate of inflation is measured using one or more price indexes or cost indexes, such as a consumer prices index or a retail prices index or an index of wages costs.

Businesses are affected by inflation, because inflation means that they have to pay more for resources, such as materials and labour. They will try to pass on their extra costs to their customers, by raising the prices of their own goods and services. Individuals have to pay higher prices for goods and services, so they need more money to pay for them. If they are in work, they might demand higher wages and salaries.

The 'inflationary spiral' can go on indefinitely, with increases in materials and wages pushing up prices of finished goods, which in turn leads to higher wages and materials costs.

It is also recognised that the rate of inflation is affected by **inflationary expectations**. This is the rate of inflation that businesses and individuals expect in the future. Inflationary expectations affect demands for wage rises, and decisions by businesses to raise their prices.

Implications of high inflation and inflationary expectations for the national economy

Inflation also has implications for the national economy and economic growth.

■ Increases in national income are the result of two factors:

- an increase in the 'real' quantity of goods and services produced and the 'real' spending on goods and services, and

- increases due to higher prices and costs.

■ It is possible for measured national income to increase when the real economy is in recession. For example, suppose that measured national income increases

from one year to the next by 3% but inflation during the year was 5%. This indicates that the 'real' economy has gone into recession, and is 2% lower.

■ Experience has shown that when the rate of inflation is high, and inflationary expectations are high, the 'real' economy is likely to stagnate or go into recession.

A government might therefore take the view that some inflation is unavoidable (although in some countries there has been deflation – a fall in retail prices). However, the rate of inflation and inflationary expectations should be kept under control, to give the 'real economy' an opportunity to grow.

Implications of inflation for the distribution of wealth

However, although some inflation might be unavoidable, it has unfortunate social and economic implications, because it results in a shift of economic wealth.

■ In a time of inflation debts such as bank loans fall in real value over time. Borrowers gain from the falling real value of debt. At the same time, lenders and savers lose because the value of their loan or savings falls. For example, an individual with cash savings might be earning 3% after tax when inflation is 5%: if so he is losing 2% in real terms each year. The effect of inflation is therefore to shift wealth from savers and lenders to borrowers.

■ Another effect of inflation is to reduce the real value of households on fixed incomes or incomes that rise by less than the rate of inflation each year, such as many pensioners. The rich might get richer (because their income is often protected against inflation, for example by salary rises) whilst the poor get poorer.

3.5 Impact of unemployment

When there are many people who are unwillingly out of work, this means that there are not enough jobs for the people who want them. Business organisations ('firms') could take on more labour if they wanted to, but they choose not to.

When there is economic recession and demand for goods and services is falling, many firms will make some employees redundant because their profits are falling and some aspects of their business are no longer profitable.

High levels of unemployment are unwelcome in an economy because:

■ individuals who want jobs cannot get them (and high unemployment is damaging to society and the welfare of the people)

■ economic growth is less than it could be: if the unemployed individuals could be given work, output in the economy would increase and there would be economic growth.

A **very low level of unemployment** might also be unwelcome because:

■ firms that want to take on more labour might struggle to find suitable people, and

■ the shortage of labour might push up the cost of wages and salaries.

An additional problem is that although the level of unemployment might be high, there could be a **shortage of skilled labour**. As the technological complexity of industry increases, the demand for low-skilled jobs might fall even as the demand for skilled labour rises. A shortage of skilled labour can only be overcome through:

- better standards of education

- more training

- if necessary, moving jobs to other countries where there is a better supply of skilled labour.

Types of unemployment

Unemployment can be analysed into categories. These are some categories that might be used for analysis.

- **Transitional unemployment**. This happens when an employee has left one job in order to start at another. If there is a gap of time between leaving one top and starting the next, this is transitional unemployment. For example, a teacher might leave a job at one school in order to start at anther school in three months time. During the three month gap, unless one of the schools pays him, he is transitionally unemployed.

- **Frictional unemployment**. This is short-term unemployment when individuals are dismissed from their work, for example because they have been made redundant or because they did not like the job they were doing. It might take them a little time to find a new job. Until they do, they are unemployed. However, the unemployment should not last long.

- **Structural unemployment**. This is unemployment that arises because of a significant change in the structure of the economy, and in particular decline and collapse of industries that used to be major employers. For example, there might be structural unemployment because the mining industry used to employ many people, but is now in decline. When an industry goes into decline and large numbers of people are made unemployed, the consequences can be very serious. Finding new jobs in other industries for all the unemployed workers can take a very long time. There might be a demand for labour in other industries and other parts of the country, but the unemployed people available for work are of the wrong type, and have the wrong skills, or are in the wrong part of the country and do not want to move their home.

- **Technological unemployment**. This occurs when technological changes mean that some types of workers are no longer needed, so that large numbers are made redundant. The new technology replaces manual labour. This can happen when manufacturing processes are automated. Technological unemployment can add to structural unemployment.

- **Regional unemployment**. This is unemployment in a particular region of the country. Levels of unemployment can vary from one region to another, especially when there is no **mobility of labour** and individuals are reluctant to move to other regions to find work.

- **Seasonal unemployment**. This is unemployment, often within a particular industry, because the demand by firms for labour is higher at some times of the year than at the other. For example, the demand for agricultural labour might be

very seasonal, and there might be high levels of unemployment in the industry in the low-season periods.

- **Cyclical unemployment**. When the national economy is growing, demand for labour increases and unemployment should fall. When the economic cycle goes into recession, the demand for labour fills and unemployment increases. Governments try to deal with cyclical unemployment by managing the economy and trying to achieve real economic growth.

3.6 Impact of economic stagnation

Economic stagnation occurs when national income is not increasing, but economic activity is at a much lower level than it could be. Economic growth should be possible, but is not happening.

A feature of economic stagnation is under-used economic resources, such as land and capital equipment. Unemployment is high and there is little or no new capital investment. Companies do not want to invest large amounts of money, because they see no way of making a satisfactory return.

When a country or region of the world suffers from economic stagnation when other countries are enjoying economic growth, it is becoming more poor relative to those other countries. Households may therefore live in relative poverty, and many individuals might look for ways of migrating to other countries where economic wealth is greater.

Depressed countries of the world that suffer from economic stagnation often need help from wealthier countries to develop their national economies.

Worldwide economic recession: protectionism

When the rate of economic growth in the world as a whole is falling, individual countries might still try to increase their own national income. However, if the world economy is not growing, any increase in a national economy has got to be at the expense of other national economies.

This can create a risk of 'trade wars' and 'protectionism'. Protectionism takes the form of government measures to discourage or prohibit imports of foreign goods.

In many countries, some industries are protected against foreign competition by government measures against imports, such as:

- the imposition of **high import taxes** on goods coming into the country
- setting **quota limits** on the amount of goods that can be imported
- putting a **ban on imports** of some types of goods.

Attempts to promote 'free trade' internationally are promoted by the World Trade Organisation (WTO).

3.7　International payments and international payments disequilibrium

International payments

International payments are the flows of money between different countries. The main elements of international payments are:

- payments arising from international trade in goods and services (which might be referred to as the 'balance of trade' or 'balance of payments'), and

- movements of capital between countries.

For every country:

Surplus or deficit on trade in goods and services = Net outflow or inflow of capital

For example, if a country has a surplus of $10 billion on its foreign trade in goods and services, it also transfers $10 billion in capital flows to other countries. Similarly a country with a deficit of $25 billion on its trade in exports and imports receives net transfers of $25 billion in capital.

International payments and foreign currencies

Payments between different countries (unless they are in the same currency area, such as the eurozone in Europe) give rise to an exchange of currencies. Here are just two examples.

- A UK company buys goods from a US supplier and agrees to pay in US dollars. There is an international payment in dollars from the UK buyer to the US supplier. To make the payment, the UK buyer has to arrange with a bank to buy US dollars in exchange for pounds sterling in order to make the payment. The trade in goods leads to a transaction in British pound/US dollar.

- A German investor decides to invest capital in the US. There are different ways of investing. One is to buy shares in US companies or US government bonds ('Treasuries'). To make these investments, the German investor has to pay for them in US dollars. To obtain the dollars to make the purchase, he has to sell some euros. The international investment therefore leads to a transaction in euros/US dollars.

International payments disequilibrium

In an ideal world economy, each country would achieve equality between the value of its exports and the value of its imports. When this happens, there is also equality between inflows and outflows of capital. In practice, however, this ideal state is never achieved:

- There are always some countries that have a surplus on their balance of payments between their exports in goods and services and their imports.

- There are always some countries that are net recipients of international capital, and some who transfer capital to other countries.

Disequilibrium in international payments occurs when these imbalances between balance of trade and international capital flows become excessive. This is the current situation at the time of writing, with regard to the United States and China in particular.

■ The United States has a very large balance of payments deficit in its trade in goods and services. It imports far more than it exports. This huge deficit is financed by capital investments in the US dollar by other countries, particularly China.

■ China has a very large surplus in its balance of trade in goods and services, exporting far more than it imports. This huge surplus is invested in other countries, particularly the US. Investments in the US include purchases of US government debt (Treasury bonds).

A serious concern is that such a large disequilibrium in international payments cannot continue indefinitely. There will presumably come a time when people and governments in other countries will decide to stop investing in US dollar capital assets. If the capital flows into the US fall, the US will have to cut its balance of payments deficit in goods and services. If the US stops importing goods and services from other countries, this could have a devastating effect on the economies of exporting countries and on world trade generally.

Foreign exchange rates and international payments disequilibrium

In theory a disequilibrium in international payments could be rectified by a change in foreign exchange rates, and a fall in the exchange value of the currency of countries that have a deficit in their balance of payments in goods and services.

If there is a fall in the value of the exchange rate, a currency becomes cheaper relative to other currencies.

■ Exports from the country therefore become relatively cheaper and buyers in other countries will buy more of them.

■ Imports from other countries become relatively more expensive. Domestic buyers will therefore buy fewer imported goods (and might switch to buying more domestically-produced goods).

■ If exports go up and imports fall, the balance of payments position in goods and services will improve.

However, a very substantial change in foreign currency exchange rates is needed to rectify a very large disequilibrium in international payments.

Example

At the time of writing this text, there is considerable concern about the international payments disequilibrium affecting the US and China in particular. The probability of a substantial fall in the value of the dollar is quite high, but the consequences would be hugely damaging for international trade and the world economy.

However, the value of the dollar is sustained by the willingness of foreign investors to buy dollar assets, and maintain the international payments disequilibrium.

A fall in the value of the dollar would also damage the wealth of foreign investors in the dollar. For example, suppose that a German investor buys US assets costing $100 million when the exchange rate between the dollar and the euro is €1 = US$1. The investment would cost €100 million and would be worth $100 million.

Now suppose that there is a sharp fall in the value of the dollar, so that €1 = US$2, and there is no change in the dollar value of the investment. To the German investor the investment is still worth US$100 million but if he cashed it in and exchanged the dollars back into euros, he would receive only €50 million. He would have lost €50 million. The loss to the German investor would be a capital gain to the US.

3.8 National economic policies

A national government has responsibility for economic policy, and the aims of a country's economic policy are usually economic growth and possibly also full employment. Economic growth is usually given priority, because a reduction in unemployment should follow on from economic growth.

Economic growth should be 'real growth'. Some inflation is probably unavoidable in order to achieve economic growth, but real growth is achieved if the increase in national income each year exceeds the rate of inflation. Although a government has an ultimate economic objective – sustainable growth and full employment – it needs to establish intermediate economic targets. In other words, in order to achieve economic growth it might be necessary to achieve some other economic targets first, such as:

■ a low rate of inflation: with high inflation there is a risk of economic recession and also a fall in the exchange rate for the country's currency

■ a stable exchange rate (or a target exchange rate against major world currencies such as the US dollar or euro).

Fiscal policy

Fiscal policy is government policy on taxation, spending and government borrowing. Government spending is a part of national income, but in order to spend a government must raise the money in tax, and borrow any excess of spending over tax revenue.

A government might also try to encourage investment by the private sector (companies). It can try to do this by offering special tax incentives or subsidies (cash payments). In the UK, government policy includes a 'private finance initiative' which encourages private sector investment in state investments, such as the state transport system, and state schools and hospitals.

Monetary policy

Government uses monetary policy as well as fiscal policy. Monetary policy involves trying to establish monetary conditions that will be favourable to economic growth.

In the US, eurozone and UK, monetary policy is similar. The government seeks to encourage long-term economic growth by keeping the rate of inflation within limits. The rate of inflation is managed through control over interest rates.

The effect of managing interest rates

In the US, eurozone and UK the management of interest rates is the responsibility of the central bank. The central bank is able to control short-term interest rates (on the dollar, euro or sterling respectively) and can raise or lower interest rates as it considers appropriate.

If the central bank is concerned about rising inflation, it can raise short-term interest rates. When the central bank raises its own interest rates, other commercial banks do the same to their interest rates.

There is then a **transmission mechanism** that slowly works through the national economy. The effects are by no means immediate, and a change in interest rates could take months, if not two years or more, to have an eventual effect. In principle, however, higher short-term interest rates will mean that borrowers have to pay more interest to borrow (and in the UK, borrowers with variable interest rate mortgage loans on their homes are affected immediately). Higher short-term interest rates could eventually lead to higher long term investment rates, and the market value of investments in shares and bonds might fall. Higher borrowing costs might make some individuals and companies less willing to borrow. If individuals are borrowing less and everyone feels less wealthy, spending on consumption will also fall (both domestically-produced goods and imports). All these changes might take some of the inflationary pressures out of the economy.

Example

When a government is satisfied that inflation is under control, but is dissatisfied with the slow rate of economic growth, it might consider several measures to boost the economy in order to increase national income and reduce unemployment.

- It might use **fiscal measures**. It could borrow money and spend the money it has measured in order to invest in economic activity, such as new capital projects (a new railway line or a new runway at the country's main airport). **Higher government spending** in order to increase economic activity is sometimes referred to as 'Keynesian economics' after the famous 20th Century economist John Maynard Keynes.

- It might use **monetary measures**. If it manages the economy through interest rates, it would **reduce short-term interest rates**. In time, this would work through the economy (by means of the transmission mechanism). Eventually, there might be more consumption spending and investment in capital projects.

Economic policies to achieve social or environmental objectives

It is worth remembering that governments sometimes use economic policies to achieve political, social or economic objectives.

For example, the countries of the United Nations might agree to a trade embargo with a specific country, in order to persuade that country to change its policies. An example is the UN trade embargo against Iran from 2006, which was intended to persuade Iran to abandon its nuclear power development programme.

Governments might also try to discourage unhealthy behaviour through taxation, for example by imposing high levels of taxation on tobacco (smoking).

Example

In 2007, the US government tried to persuade the World Trade Organisation to issue a ban on subsidies for deep sea fishing. The purpose of such a ban would be to make deep sea fishing less profitable, and so help to preserve the world's stocks of deep sea fish.

3.9 International economic policies

Wealthy economic nations recognise the need to help poorer countries to develop their economies and efforts are made (with varying degrees of success) to provide help. Much help is provided through supranational organisations such as the World Bank (however, international aid is provided in a variety of ways).

When a supranational organisation develops a policy for providing economic aid to developing countries, the main policy targets are often as follows:

■ Investment in infrastructure, such as roads and railways and investment in the development of systems of telecommunication and for supplying energy and water (dam construction, irrigation systems and so on).

■ Investment in education and health, to improve standards of the national labour force.

■ Capital investment in particular industries. This could involve investment in the development of major industries or in providing economic support to small producers, such as small farmers. If there is investment in economic infrastructure, and improvements in labour skills, multinational companies might become interested in increasing their investment in the countries concerned.

3.10 The impact of economic policy measures

Macroeconomic policies of government, and changes in the condition of the national and world economies, affect businesses and individuals directly.

As you should imagine, firms and individuals will react to economic changes according to the circumstances and the nature of the change.

Example

The government raises tax on income from 20% to 25%. How would you expect individuals or households to react?

Answer

Higher taxation means less after-tax earnings for spending. Individuals must either reduce their consumption or borrow more. In practice, at least for the short term, they might do both.

Example

The government increases interest rates from 4% to 5%. How would you expect companies to react?

Answer

Companies are only affected if they borrow money at a variable rate of interest from their bank, with a bank loan or overdraft.

After a large increase in interest rates, they might try to borrow less (but reducing borrowings might take some time). They might try to pass on some of the higher costs to customers by raising the prices of their products or services. Or they might try to cut some costs, such as reducing labour costs by making some employees redundant.

Example

A company believes strongly that the national economy will grow strongly in the next few years, and that profits in its own industry and markets will grow. What do you think the company should do?

Answer

The company should review its strategic position, and consider increasing its investment in the industry.

Social and demographic factors
■ The nature of social and demographic factors in the environment
■ Ageing population and other demographic changes
■ Government policy for demographic change

4 Social and demographic factors

4.1 The nature of social and demographic factors in the environment

Social factors in the environment refer to changes in habits, tastes, values and preferences. In the short term social attitudes and habits are also affected by fashion.

Demography is concerned with a specific aspect of society – the size, spread and distribution of society.

Business organisations need to respond to changes in society, including demographic changes. If they do not, they will continue to offer products and services that are increasingly less relevant to the needs of customers.

The marketing concept in business requires that all successful businesses must keep up to date with and aware of social and demographic change, and respond accordingly.

Examples

Here are just a few examples of social and demographic change in the UK in recent years.

■ A very high proportion of the population expect to travel to other countries regularly, at least once a year for their summer holiday.

■ Large numbers of individuals are concerned about health and weight. Interest in fitness, healthy eating and diets has increased.

■ The average age at which children leave their parental home has increased. Many children are staying on at home until they are 25 or 30 years old – a much higher number than in the past.

■ There has been an increase in the number of 'single–parent families' – individuals living with one or more children but without a partner.

■ There has been a large number of people entering the country as migrants and a large number emigrating to live in countries such as Spain and Australia.

4.2 Ageing population and other demographic changes

Ageing population

For some Western countries, especially countries of Western Europe, there is an ageing indigenous population. The birth rate is historically low, and the number of new babies per woman of child-bearing age has fallen. Many women are leaving it until much later in life to try to have children.

At the same time, average life expectancy has been increasing. More people are living until an older age than in the past.

As a consequence, there is an ageing population, which means that a larger proportion of the population than in the past will be of an older age – say past normal retirement age.

Governments are aware that the consequence of this demographic change is that in the future, there might be a relatively small working population and a relatively large number of people in retirement. The 'few' in work might be expected to support the 'many' in retirement, for example by paying taxation to fund state hospital services and many thousands of retired civil servants.

The ageing population of countries such as the UK, Italy and France has been referred to as a 'demographic time bomb'. The view is that the younger generation might refuse to accept the economic burdens that government might try to impose on it.

Other demographic patterns

Other countries have other demographic problems.

- Some countries suffer from very high rates of mortality, particularly due to disease. In these countries the population on average is very young and there are very few older people.
- Some countries have high rates of child birth but low rates of economic growth. In these countries, large numbers of people might try to migrate to other countries with a wealthier economy.

4.3 Government policy for demographic change

A government might try to develop a policy for social and demographic change. For example, in a country with an ageing population, the government might consider the following measures.

- Permitting immigration of people from other countries, possibly under a controlled immigration scheme, in order to increase the size of the population at working age.
- Increasing the average age at which individuals may retire with entitlement to a state pension.
- Encouraging individuals to work beyond their normal retirement age.

■ Providing some form of subsidy or tax-incentive to individuals/couples who have children.

Business organisations are affected by social and demographic change, and by government policy. As a population changes, in age or ethnic origin, the needs and wants of consumers will change. Businesses must respond to those changes.

In addition, the nature of the work force – its age distribution, availability and skills – will also change. Issues such as education and training take on importance for ageing employees as well as young employees, if companies intend to employ them beyond their normal retirement age.

<table>
<tr><td>Technological factors</td></tr>
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- The impact of technological change on working methods
- The impact of technological change on products and services
- The impact of technological change on organisation structure and strategy

5 Technological factors

5.1 The impact of technological change on working methods

Over the years, machines have replaced man for mechanical tasks. Computers have replaced man for many mental tasks and intellectual jobs. The impact of computers on business organisations has been considered in an earlier chapter. Briefly however:

- Computers have replaced man for many data processing and information analysis tasks
- Humans have been used for the 'higher level' intellectual tasks and skills tasks that computers have not been able to perform
- Computers are taking over from humans even some high level intellectual and analytical tasks.

5.2 The impact of technological change on products and services

The point should be fairly obvious, but you should also remember that technological change has a huge impact on the nature of products and services that businesses offer to customers.

Companies need to maintain technological developments in the design and manufacture of products, and in the provision of services, in order to remain competitive.

e Example

A current example has been the competition between manufacturers of televisions, such as Sony and Toshiba, to achieve a technological lead in the development of televisions with the latest 'flat screen' technology.

5.3 The impact of technological change on organisation structure and strategy

Technological change has also had an effect for many businesses on their organisation and strategy. Computerisation, communications technology and other aspects of technological change have led to major developments in business such as:

- downsizing

- de-layering
- outsourcing.

To some extent, these developments in business organisation are inter-related.

Downsizing

Downsizing means the reduction in size of a business organisation. It does not (necessarily) mean that the business organisation is selling fewer goods or services. It means that its business activities are conducted by a smaller number of people.

Technological change makes downsizing possible, because tasks that were performed previously by humans can now be performed by machine or computer.

De-layering

'De-layering' means removing one or more levels of management in the organisation structure. It could mean removing all layers of middle management entirely, leaving just senior managers and front-line managers and supervisors.

De-layering is made possible by high-quality communications, provided that senior management can delegate sufficient authority to junior managers, and expect junior managers to meet their responsibilities.

When an organisation goes through a de-layering, middle managers are made redundant, and there is consequently some downsizing.

Outsourcing

Outsourcing means arranging for other business organisations to perform some administrative tasks, or management tasks, instead of having to employ individuals to do the task internally, as part of the organisation's own activities.

For example, the following tasks might be outsourced.

- A company might arrange for an external accountancy firm to take over the administration of the payroll, and administer wages and salaries for the company's work force.
- A company might arrange for an external building services company to take over responsibility for cleaning and security in all its buildings.
- A company that produces motor cars might outsource the manufacture of most (or even all) of the component parts, so that its only 'in-house tasks' are product design, assembly, testing and marketing.
- Many companies outsource their IT requirements to specialist IT firms.
- Some companies outsource most of their office administration tasks, such as record keeping and word processing.

The reason why outsourcing is now popular in many countries is that it can take advantage of specialisations. The conceptual argument in favour of outsourcing is as follows.

- A business succeeds in its competitive markets because it is more successful at doing some things than its competitors. A successful business has some **core competences** that enable it to succeed and do better than rivals.

- A business also has to do other tasks that support its main activities, such as office administration, IT support, building and facilities administration and payroll. It does not have any particular skills in these activities, and there are other companies that can do these tasks just as well, and in some cases much better.

- When a business performs all these 'non-core' activities itself, this diverts management attention away from the core competences. Management should focus on its strengths, not the routine and ordinary.

- It should therefore outsource 'non-core' activities and concentrate on its core activities, to make sure that it maintains or improves its competitive advantage over rivals.

Outsourcing is made much easier by high-quality telecommunications and computer systems, because data and information can flow easily between a business and the other organisations to which it has outsourced activities.

Virtual company

Taken to an extreme form, a business organisation can outsource almost all its activities, leaving just one or two individuals at the centre managing the business.

A virtual organisation is an organisation that has no physical hub or centre of operations. Instead, it is a network of individuals linked by computer and telecommunications network (such as the internet). The individuals need not be employees of the business: they might be part-time workers or self-employed individuals.

Each individual in the virtual company or virtual organisation might work from home. Data and information is transferred between them, and each performs particular tasks – with no office, no substantial assets and few (if any) full-time employees.

The virtual company has been made possible by developments in IT technology.

Competitive factors
■ The competitive environment ■ The Five Forces model ■ Threat from potential entrants ■ Threat from substitute products ■ Bargaining power of suppliers ■ Bargaining power of customers ■ Competitive rivalry ■ Achieving competitiveness: adding value ■ The concept of the value chain ■ Adding value

6 Competitive factors

6.1 The competitive environment

In addition to understanding the broader business environment and the significant opportunities and threats that the environment contains, business managers also need to understand the nature of competition in their industry and markets.

If a business organisation operates in a market where there are no significant competitors, it is a **monopoly**. When a business has a monopoly share of its market, it is usually able to charge higher prices and make larger profits than it would in a competitive market.

As a general rule, business organisations operate in a competitive market. Customers in a market are able to choose between the products or services of rival suppliers, and they can choose the product or service that appears to offer the best value, in terms of price, product characteristics, convenience and so on.

Managers need to understand who their competitors are, and what sort of competitive threat they provide. They need to know how customers decide whose products to buy.

6.2 The Five Forces model

A well-know business model for understanding the nature of competition in an industry, and the strength of the competition in an industry, has been provided by Michael Porter (in *The Competitive Environment*). This model for analysing competitiveness in an industry or market is called the Five Forces model, because Porter is identified five factors ('five forces') that determine competitiveness.

These are:

■ threats from potential entrants

- threats from substitute products or services
- the bargaining power of suppliers
- the bargaining power of customers
- competitive rivalry within the industry or market.

When competition in an industry or market is strong, firms must supply their products or services at a competitive price, and cannot charge excessive prices and make 'supernormal' profits.

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                    ┌──────────────────┐
                    │   Threats from   │
                    │ potential entrants│
                    └──────────────────┘
                             │
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┌──────────────┐    ┌──────────────┐    ┌──────────────┐
│  Suppliers'  │───▶│ Competitive  │◀───│  Customers'  │
│bargaining power│  │   rivalry    │    │bargaining power│
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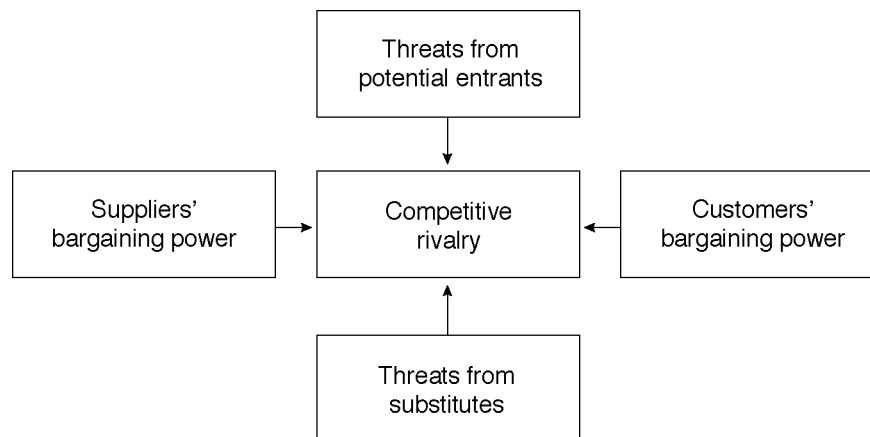
When any of the five forces are strong, it is difficult for a business entity to obtain a dominant position in its market, and profitability for businesses in the industry or market will therefore be low.

6.3 Threat from potential entrants

Competition in a market is affected by the threat of new business entities coming into the market and adding to the competition. When new entrants are able to come into the market without much difficulty, prices of products in the market will be low. If prices went up and company profit margins improved, new firms would be tempted to come into the market in order to benefit themselves from the higher profits. The new competition would force down prices and profit margins.

Because of this threat, firms that are already in the market keep their prices and profits low, and competition in the market is strong.

Competitive forces are reduced when it is difficult for new entrants to break into the market – in other words, when the 'barriers to entry' are high. A number of factors might help to create high barriers to entry:

- **Economies of scale**. Economies of scale are reductions in average costs that are achieved by producing and selling an item in larger quantities. In an industry where economies of scale are large, and the biggest firms can achieve substantially lower costs than smaller producers, it is much more difficult for a new firm to enter the market. This is because it will not be big enough at first to achieve the economies of scale, and its average costs will therefore be higher than those of the existing large-scale producers. There are many examples of

industries where the major companies have achieved a dominant market position through the size of their operations so that they can make their products cheaply and sell them at a low price.

- **Capital investment requirements**. If a new entrant to the market would have to make a large capital investment in assets such as factory premises and equipment, this will act as a barrier to entry, and deter firms from entering the market. This is because they would lose a substantial amount of money if their new business venture failed and they might not want this 'investment risk'.

- **Access to distribution channels**. In some markets, there are only a limited number of distribution outlets or distribution channels. If a new entrant will have difficulty in gaining access to any of these distribution channels, the barriers to entry will be high.

- **Know-how.** It be time-consuming and expensive for a new entrant to a market to acquire the 'know-how' and experience to be successful.

- **Switching costs**. Switching costs are the costs that a buyer has to incur in switching from one supplier to a new supplier. In some industries, switching costs might be high. For example, the costs for a company of switching from one audit firm to another might be quite high, and deter a company from wanting to change its auditors. When switching costs are high, it can be difficult for new entrants to break into a market.

- **Government regulation**. Regulations within an industry, or the granting of rights, can make it difficult for new entrants to break into a market. For example, it might be necessary to obtain a licence to operate, or to become registered in order to operate within an industry. Companies that already operate within an industry might have the benefit of patent rights that prevent new competitors from 'copying' the products that they make.

6.4 Threat from substitute products

Competition within a market or industry will be higher when customers can switch fairly easily to buying alternative products (substitute products).

The threat from substitutes varies between markets and industries, but a few examples of substitutes are listed below:

- Domestic heating systems. Consumers might switch between gas-fired, oil-fired and electricity-fired heating systems. This means that the ability of a manufacturer of gas central heating systems to charge higher prices for its products will be restricted by the threat that customers might switch to oil-fired or electricity-powered systems. Similarly, providers of gas supply are restricted in their ability to charge higher prices for gas by the threat of customers switching to electricity.

- Transport. Customers might switch between air, rail and road transport services. This means that the competitive strength of a rail company is restricted by the threat of competitive actions by air transport companies or bus companies, and also by the costs of private motoring.

- Food and drink products. With many food and drink products, consumers might switch between similar products, such as rice, pasta and potatoes. For example, the competitive strength of a manufacturer of a branded coffee is

therefore affected not only by other manufacturers of similar coffee products, but also by producers of tea.

6.5 Bargaining power of suppliers

In some industries, the competitive position of a business entity might be affected by the bargaining strength of its major supplier or suppliers. When this occurs, the suppliers might charge high prices to their business customers that these businesses are unable to pass on to their own customers (by charging higher prices for their own products). As a result, profitability in the industry is low.

Example

An example of supplier power is possibly evident in the industry for personal computers. Software companies supplying the computer manufacturers (such as Microsoft) have considerable power over the market and seem able to obtain good prices for their products. Computer manufacturers are unable to pass on all the high costs to their own customers for PCs, and as a consequence, profit margins in the market for PC manufacture are fairly low.

Porter suggested that the bargaining power of suppliers might be strong in the following situations:

- when there are only a small number of suppliers to the market
- when there are no substitutes for the products that are supplied
- when the supplier's product is an important component in the end-products that are made with it.

6.6 Bargaining power of customers

Customers can reduce the profitability of an industry when they have considerable buying power. Powerful buyers are able to demand lower prices, or improved product specifications, as a condition of buying. Strong buyers also make rival firms compete to supply them with their products.

In the UK, a notable example of buyer power is the power of supermarkets as buyers in the market for many consumer goods. They are able to force down the prices from suppliers of products for re-sale, using the threat of refusing to buy and switching to other suppliers. As a result, profit margins in the manufacturing industries for many consumer goods are very low.

Porter suggested that buyers might be particularly powerful in the following situations:

- when the volume of their purchases is high relative to the size of the supplier
- when the products of rival suppliers are largely the same ('undifferentiated')
- when the costs of switching from one supplier to another are low.

6.7 Competitive rivalry

Competition within an industry is obviously also determined by the rivalry between the competing business entities. Strong competition forces rival firms to offer their products to customers at a low price (relative to the product quality) and this keeps profitability fairly low.

Porter suggested that competitor rivalry might be strong in any of the following circumstances:

- when the rival firms are of roughly the same size and economic strength

- when there are many competitors in the industry or market

- when there is only slow growth in sales demand in the market, so that firms are competing for a fairly fixed total amount of sales and customers

- when the products of rival firms are largely the same ('undifferentiated')

- when the costs of withdrawing from the industry are high, so that even unprofitable companies are reluctant to leave the market.

6.8 Achieving competitiveness: adding value

In order to succeed in a competitive industry, firms need to be competitive and do some things better than their rivals. They do this by 'adding value'.

Value relates to the benefits that a customer obtains from a product or service. Customers are willing to pay money to buy goods or services because of the benefits that they expect to receive from them. The price they are willing to pay puts a value on those benefits.

Business entities create added value when they make goods and provide services. For example, if a business entity buys a quantity of leather for $1,000 and converts this into leather belts, which it sells for $10,000, it has created value of $9,000.

In a competitive market, the most successful business entities are those that are most successful in creating value. The only reason why a customer should be willing to pay a higher price than the lowest price in the market is that he sees additional value in the higher-priced product, and is willing to pay more to obtain the value.

- This extra value might be real or perceived. For example a customer might be willing to pay more for a product with a well-known brand name, assuming that a similar non-branded product is lower in quality. This difference in quality might be imagined rather than real; even so, the customer will pay the extra amount to get the branded product.

- The extra value might relate to the quality or design features of the product. However, other factors in the marketing mix might persuade a customer that a product offers more value. For example, a customer might pay more to buy one product than a lower-priced alternative because it is available immediately (convenience) or because the customer has been attracted to the product by advertising.

6.9 The concept of the value chain

A value chain is a series of activities, each of which adds value. The total value added by the entity is the sum of the value created by each stage along the chain. Johnson and Scholes have defined the value chain as: 'the activities within and around an organisation which together create a product or service.'

Within an business entity:

- there is a primary value chain, and
- there are support activities (also called secondary value chain activities).

Primary value chain

Porter identified the chain of activities in the primary value chain as follows.

Inbound logistics	Operations	Outbound logistics	Marketing and sales	Service
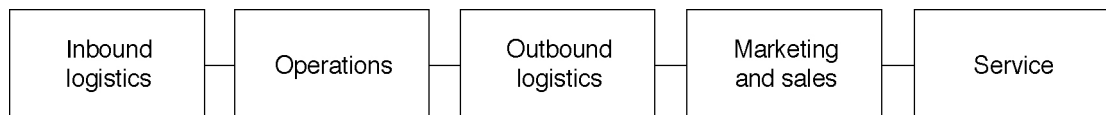
This value chain applies to manufacturing and retailing companies, but can be adapted for companies that sell services rather than products.

Most value is usually created in the primary value chain.

- **Inbound logistics**. These are the activities concerned with receiving and handling purchased materials and components, and storing them until needed. In a manufacturing company, inbound logistics therefore include activities such as materials handling, transport from suppliers, inventory management and inventory control.

- **Operations**. These are the activities concerned with converting the purchased materials into an item that customers will buy. In a manufacturing company, operations might include machining, assembly, packing, testing and equipment maintenance.

- **Outbound logistics**. These are activities concerned with the storage of finished goods before sale, and the distribution and delivery of goods (or services) to the customers. For services, outbound logistics relate to the delivery of a service at the customer's own premises.

- **Marketing and sales**. These are the activities associated with the '4Ps' of marketing that have been described earlier.

- **Service**. These are all the activities that occur after the point of sale, such as installation, warranties, repairs and maintenance, and providing training to the employees of customers. An important aspect of service is often the work of customer call centres or customer service centres.

The nature of the activities in the value chain varies from one industry to another, and there are also differences between the value chain of manufacturers, retailers and other service industries. However, the concept of the primary value chain is valid for all types of business entity.

Secondary value chain activities: support activities

In addition to the primary value chain activities, there are also secondary activities or support activities. Porter identified these as:

- **Purchasing**. These are activities concerned with buying the resources for the entity – materials, plant, equipment and other assets. Successful buying often means lower purchase costs, or achieving a secure source of supply for key materials or components.

- **Technology development**. These are activities related to any development in the technological systems of the entity, such as product design (research and development) and IT systems. Technology development is an important activity for innovation. 'Technology' also includes acquired knowledge: in this sense all activities have some technology content, even if this is just acquired knowledge.

- **Human resources management**. These are the activities concerned with recruiting, training, developing and rewarding people in the organisation.

- **Corporate infrastructure**. This relates to the organisation structure and its management systems, including planning and finance management, quality management and information systems management.

Support activities are often seen as necessary 'overheads' to support the primary value chain, but value can also be created by support activities. For example:

- Purchasing can add value by identifying a cheaper source of materials or equipment.

- Technology development can add value to operations with the introduction of a new IT system.

- Human resources management can add value by improving the skills of employees through training.

- Corporate infrastructure can help to create value by providing a better management information system that helps management to make better decisions.

6.10 Adding value

Business entities should look for ways of adding value, because this improves their competitiveness (and gives them a 'competitive advantage' over rival firms).

- Management should look for ways of adding more value at each stage in the primary value chain.

- Similarly, management should consider ways in which support activities can add more value.

There are different ways of adding value.

- One way of adding value is to alter a product design, and include features that might meet the needs of a particular type of customer better than products that are currently in the market. A product might be designed with added features.

- Value can be added by making it easier for the customer to buy a product, for example by providing a website where customers can make purchases.

Bookstores can add value to the books they sell by providing sales outlets at places where customers often want to buy books, such as airport terminals.

■ Value can be added by promoting a brand name. Successful branding might give customers a sense of buying products or services with a better quality.

■ Value can be added by delivering a service or product more quickly. For example, a private hospital might add value by offering treatment to patients more quickly than other hospitals in the region.

■ Value can also come from providing a reliable service, so that customers know that they will receive the service on time, at the promised time, to a good standard of performance.

New product design (**innovation**) is also concerned with creating a product that provides an appropriate amount of value to customers.

It is also important to recognise that value is added by all the activities on the primary value chain. Customers might be willing to pay more for a product or a service if it is delivered to them in a more convenient way. For example, customers might be willing to pay more for household shopping items if the items are delivered to their home, so that they do not have to go out to a supermarket or a store to get them.

CHAPTER

5

History and role of accounting in business

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2   Laws and regulations governing accounting
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- Limited companies, financial reporting and external auditing
- The accountancy profession
- Cost and management accounting
- Computerisation of accounting processes
- Accounting standards
- Finance
- Other developments in accounting and finance
- The role and functions of the accounting department

1 History and function of accounting

1.1 The origins of accounting: double-entry book-keeping

The accounting and auditing profession has a long history, although most of the developments in the profession have occurred from the middle of the 20th Century

The origins of accounting go back to the early days of organised trading and the need to keep financial records of business transactions. Evidence has been found of simple accounting records in the days of the Ancient Egyptian empire. However, the 'father of modern accounting' was Father Luca Pacioli, who introduced double entry book-keeping into Western Europe at the end of the fifteenth century, just over 500 years ago.

Double entry book-keeping is a system of recording the financial value of business transactions. These records can also be used to prepare a statement of the profitability of the business during a given period of time (an income statement) and a statement of the assets and liabilities of the business at any given point in time (a balance sheet).

1.2 Limited companies, financial reporting and external auditing

The next major development in accounting followed from the emergence of limited companies. Limited companies are a form of business organisation, but they differ from other types of business (sole traders and partnerships) in several ways.

- They are legal persons. A limited company is recognised in law as a person that can own assets and owe money in its own name. A limited company is separate in the law from its owners, the shareholders.
- The owners of a company are often not the individuals who manage it. There is a separation of ownership (the shareholders) from control (the board of directors and management). The shareholders in large companies allow the directors and managers to run the company on their behalf.

■ The shareholders should therefore expect the directors to account to them for their 'stewardship' of the business, and to inform them how the company has performed and about its financial position.

From the middle of the 19th century in the UK (with the Companies Act 1844), limited companies were required to produce an annual report and accounts for the shareholders. These were the origins of **company financial reporting**.

The shareholders of limited companies also needed reassurance that the financial statements that were presented to them by the directors were reliable. A legal requirement was therefore also introduced that the financial statements of companies should be checked by **external auditors**, who should provide an independent opinion about whether the statements gave a true and fair view of the financial affairs of the company.

1.3   The accountancy profession

The accountancy profession also originated during the nineteenth century, for example with the recognition of the Institute of Chartered Accountants in England and Wales. At this time, accountancy work was divided into two different parts:

■ the accounting work done within companies (and other businesses) by accounting clerks and managers

■ the external accounting services provided by 'professional' experts.

The focus of the accounting profession at that time was the provision of external professional services, particularly external auditing services and insolvency work. During the nineteenth century, the profession earned much of its income from insolvency work.

The purpose of the professional accountancy bodies is to represent the interests and present the opinions of the accountancy profession, to the public generally but also in dealings with business and government. Accountancy bodies also developed their role as a regulator of members of the profession.

1.4   Cost and management accounting

Financial reporting is concerned mainly with providing information about the financial performance and financial position of a company to its shareholders. Information about profitability is also of value to management. However, managers need much more detailed information about profitability. They need to know what individual products and activities cost. They also need to plan for the future: this involves preparing financial plans or budgets.

Cost accounting arose from the need for management information about costs and profits, and for information that helps managers to prepare financial plans. It began to develop from around the end of the nineteenth century.

The Great War of 1914–1918 also provided some external pressure for information about costs. Governments wanted to be certain that they were paying reasonable

prices to manufacturers for goods for the war effort, and manufacturers were therefore very cost-conscious at this time. Cost accounting enabled them to monitor their production costs.

As the demand for internal information about costs grew, and some new methods of analysing costs and providing financial information emerged, 'cost accounting' eventually changed its name into 'cost and management accounting' and then just 'management accounting'.

1.5 Computerisation of accounting processes

In the second half of the twentieth century, from the 1960s, many accounting processes that had been done manually began to become computerised. At first, computerisation was limited to large organisations, large computers and transaction processing (such as ledger accounting systems and invoicing systems). With the development of smaller personal computers and standard software packages for accounting, computerisation extended to smaller businesses.

Computerisation has enabled businesses to process more data much more quickly. It has also enabled systems to hold much more data, and managers to extract much more information from data than had been possible previously.

1.6 Accounting standards

With the growth of stock markets in the second half of the twentieth century, investors demanded financial information about companies that was both reliable and comparable. (This demand for reliable, relevant and comparable financial information still exists today!)

The need for better accounting information in the financial statements of companies led to the development of statements of standard accounting practice (accounting standards). Initially, the professional body or bodies of an individual country developed national accounting standards.

Since then, with the emergence of global investment, national accounting standards have been giving way to international accounting standards (International Financial Reporting Standards). International standards have been adopted in many countries, and their use should extend still further in time.

1.7 Finance

The developments described so far relate to financial reporting and internal management information about costs (cost and management accounting).

As the world's stock markets and other investment markets have grown, finance has become a major aspect of business management. Briefly, finance is concerned with raising finance for business and other organisations (at the lowest possible cost), and investing the finance to obtain a suitable return on investment.

Raising and using finance are often regarded as a specialist stream of accountancy. Within companies, the role of the finance director covers both accounting activities within the company and also finance.

The department in a large company with responsibility for finance (and the management of a company's finances and financial risks) is often called the **treasury department**.

1.8 Other developments in accounting and finance

Some other developments in accounting and finance are worth noting.

■ There have been (and continue to be) problems with poor financial controls and fraud within businesses. Many companies have established an **internal audit department** whose main function is to test accounting systems and procedures, to ensure that controls are effective and are properly applied.

■ Firms of external auditors provide consultancy and advice services, in addition to audit services. For example, audit firms often give advice to companies on tax and on proposed takeovers or mergers with other companies.

- **Tax evasion** is a criminal activity. It involves breaking the law by not declaring income or profits for tax, and so not paying taxes that ought by law to be paid.

- **Tax avoidance** is not a criminal activity. It involves designing 'tax-efficient schemes' whereby companies, particularly multinational groups of companies, are able legitimately to avoid the payment of tax. All the major firms of accountants offer tax avoidance services ('tax advice') to client companies and wealthy individuals.

■ Originally the accountancy profession itself had the responsibility for accounting standards. Although the accountancy profession is closely involved in developing new accounting standards and revising existing standards, responsibility has passed to government or public bodies. In the UK for example, responsibility for accounting standards has been given to the Financial Reporting Council (FRC), which has oversight of the Accounting Standards Board.

■ At an international level, responsibility for international accounting standards rests with the IASC Foundation and International Accounting Standards Board (IASB). The purpose of the IASB is to ensure consistency in financial reporting by companies worldwide, by issuing international accounting standards. The IASB has support from governments around the world: for example, stock market companies in the European Union are required by law to comply with international accounting standards.

1.9 The role and functions of the accounting department

The role of the accounting department in a large organisation might be summarised as follows:

■ **Financial accounting**

- Recording financial transactions, such as sales or purchases. Systems for recording and processing financial transactions, and performing other

standard financial administrative processes, are commonly called **transaction processing systems**.

- Providing financial information to external users (particularly the annual report and accounts for a company)

- Performing administrative activities such as credit checking, collecting payment from customers, administering the payroll

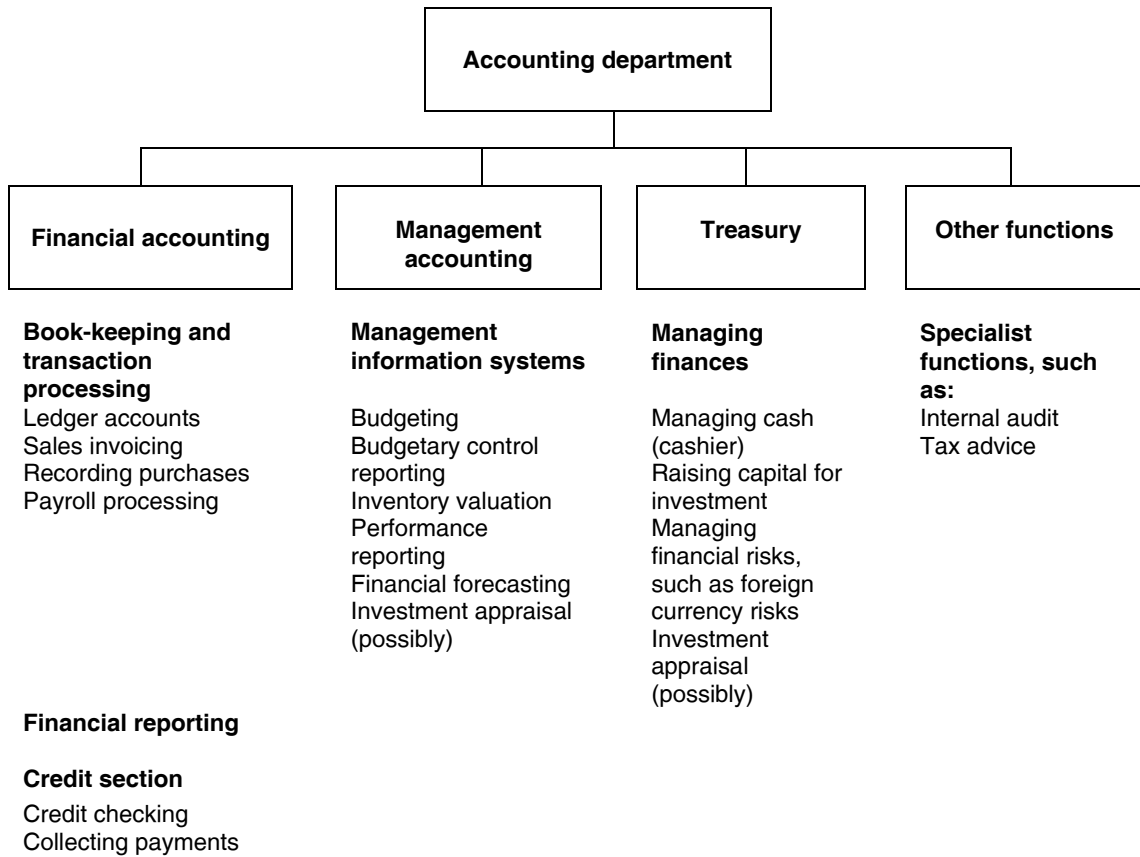- Check the reliability of the financial information and the robustness of financial controls (internal audit)

■ **Management accounting**

- Providing information to all levels of management, at strategic, tactical and operational levels. This information is largely, but not exclusively, financial in nature.

- Assisting with the preparation of financial plans, such as business plans and budgets

- Providing control information to management, such as budgetary control reports

- Management accounting systems are **management information systems** because they provide information to management for planning or control (such as budgetary control reports).

■ **Finance (treasury department or cashier's department)**

- Managing the finances of the organisation efficiently, including its cash

- Assisting with raising fresh capital in the capital markets or by borrowing from banks

The role of an accounting department within an organisation is set out in a simplified form in the following table.

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                    ┌─────────────────────────┐
                    │  Accounting department  │
                    └────────────┬────────────┘
        ┌────────────────┬───────┴────────┬────────────────┐
┌───────────────┐ ┌──────────────┐ ┌────────────┐ ┌────────────────┐
│   Financial   │ │  Management  │ │  Treasury  │ │Other functions │
│  accounting   │ │  accounting  │ │            │ │                │
└───────────────┘ └──────────────┘ └────────────┘ └────────────────┘
```

Book-keeping and transaction processing
Ledger accounts
Sales invoicing
Recording purchases
Payroll processing

Management information systems

Budgeting
Budgetary control reporting
Inventory valuation
Performance reporting
Financial forecasting
Investment appraisal (possibly)

Managing finances

Managing cash (cashier)
Raising capital for investment
Managing financial risks, such as foreign currency risks
Investment appraisal (possibly)

Specialist functions, such as:
Internal audit
Tax advice

Financial reporting

Credit section
Credit checking
Collecting payments

Laws and regulations governing accounting
■ Company law: accounting records
■ Company law: duty to prepare financial statements
■ Company law: duty to file the annual report and accounts
■ Company law: the requirement for audited accounts
■ Laws, regulations and the format and content of company accounts
■ The purpose of accounting standards
■ Stock market regulations

2 Laws and regulations governing accounting

2.1 Company law: accounting records

The duty of companies to keep accounting records of their business transactions should be an element of national company law. Although the details of national law vary between countries, the essential requirements should be broadly the same in every country.

In the UK for example, company law states that companies must keep 'adequate' accounting records. 'Adequate' means that the accounting records should be sufficient to:

■ show and explain the company's transactions

■ disclose (with reasonable accuracy) at any time the financial position of the company, and

■ enable the directors to prepare financial statements for the company, as required by the law.

In particular, accounting records should contain:

■ day-to-day records of all money received and spent and transactions in respect of which receipt and expenditure will take place

■ a records of all the assets and liabilities of the company

■ where the company holds inventory, a record of the inventory held as at the end of the financial year and a record of all goods bought and sold (except in the retail trade) in sufficient detail for the identity of suppliers and customers to be identified.

(Records of credit transactions with individual customers are recorded in a sales ledger or receivables ledger. Records of transactions with individual suppliers are recorded in a purchase ledger or payables ledger.)

It is a **criminal offence** to fail to keep accounting records. In the UK, any officer of the company (director or company secretary) found guilty of this offence could be liable to imprisonment or a fine.

This legal requirement applies to companies only. However, **tax law** requires the owners of sole trader businesses and business partners to maintain sufficient accounting records so that their tax liability on the profits of their business can be calculated.

2.2 Company law: duty to prepare financial statements

Companies are also required by law to prepare financial statements, usually for each financial year of the company. The financial statements must be approved by the directors of the company, who must be satisfied that they **give a true and fair view** of assets, liabilities, financial position and profit or loss of the company for the year.

■ With some exceptions, every company must prepare its own financial statements. These are called **individual company accounts**.

■ Companies that own one or more subsidiary companies are called 'parent companies' of a group of companies. Parent companies are required to prepare **consolidated accounts** for the group as a whole, also called **group accounts** as if the group of companies were a single operating company.

Financial statements consist of:

■ A **statement of financial position** (sometimes called a **balance sheet**), showing the assets, liabilities and owners' capital ('equity capital' or 'share capital and reserves') of the company

■ an **income statement**, showing the profit or loss for the financial period (financial year)

■ a **statement of cash flows**, showing the cash received and paid out by the company during the year

■ a **statement of changes in equity**, showing how the component elements of the owners' capital has changed during the year

■ some **additional information, in notes** to the financial statements. For example, UK company law requires companies to provide information about employee numbers and costs.

In the UK, there is also a legal requirement for companies to prepare a **directors' report** in addition to the financial statements and a **report by the external auditors**.

A company's directors are required to provide a copy of the annual report and accounts to each shareholder (and any other person entitled to receive a copy).

In most countries, **public companies** must present the annual report and accounts to the shareholders in an annual general meeting of the company.

2.3 Company law: duty to file the annual report and accounts

Although the regulations vary for different types of company, there is a general requirement for companies to submit a copy of their annual report and accounts

with a government body. In the UK, companies are required to 'file' their annual report and accounts with the Registrar of Companies.

Members of the public may (on payment of a suitable fee) obtain access to these filed accounts, for the purpose of inspecting them.

2.4 Company law: the requirement for audited accounts

With some exceptions, a company's annual accounts must be audited by independent ('external') auditors, and the accounts must contain a statement by the auditors (the auditors' report) about whether in their view the accounts give a true and fair view.

External auditing is explained in more detail in a later chapter.

2.5 Laws, regulations and the format and content of company accounts

National laws vary in the amount of detail that they specify concerning the format and content of company accounts (the financial statements and notes to the statements).

The law might specify how a statement of financial position or income statement should be presented, and the minimum items that it should contain. However, guidance on the format of the statement of financial position and income statement is also provided on one of the international accounting standards.

Financial statements are prepared in accordance with some long-established principles of accounting, such as the going concern concept and accruals concept. These principles of accounting are not contained in company, but all businesses are expected to comply with them when preparing financial statements.

Some regulatory bodies responsible for preparing accounting standards have produced a statement of principles and guidelines. The most important of these is the **Framework for the Preparation and Presentation of Financial Statements**, which has been produced and published by the International Accounting Standards Board.

Accounting standards also specify much of the content of financial statements, but **they do not provide a comprehensive set of rules**.

2.6 The purpose of accounting standards

As stated earlier, national accounting standards are issued in some countries by a national standard-setting body. International accounting standards (now called International Financial Reporting Standards or IFRSs) are issued by the International Accounting Standards Board (IASB).

The stated objectives of the IASB include the aim of developing a single set of global accounting standards that:

■   are of a high quality, understandable and enforceable, and

- will require high quality, transparent and comparable information in financial statements.

In other words, the IASB aims to achieve consistency and comparability in financial reporting, throughout the world, through the adoption of its IFRSs by every country.

IFRSs can be made enforceable by national law. As mentioned earlier, the requirement for stock market companies to use IFRSs to produce financial statements is already included in company law throughout the European Union.

IFRSs deal with a range of different matters:

- Some IFRSs require the inclusion of an additional financial statement in the report and accounts. For example, one IFRS requires business entities to include a cash flow statement in their annual accounts.

- Some IFRSs deal with the accounting treatment of specific issues, such as accounting for leases, asset impairment and reporting earnings per share.

- Many IFRSs specify additional information that should be provided in notes to the financial statements.

Enforcement of IFRSs

The International Accounting Standards Board does not have any powers to enforce its accounting standards.

Enforcement comes through the adoption by national governments of IFRSs for company reporting, and the enforcement of national regulations by the national authorities.

2.7 Stock market regulations

Companies whose shares are traded on a stock market must comply with certain regulations. These regulations might be issued by the governing body responsible for supervision of the financial markets in that particular country. In the UK for example, stock market regulations are issued by the Financial Services Authority which is the government body responsible for supervision of the financial markets in the UK.

Most stock market regulations do not concern accounting and financial reporting. However, some regulations might include a requirement for stock market companies to include specific items of information in their published financial accounts. Regulations might also specify the maximum period of time within which a company must prepare its annual report and accounts after the end of its financial year.

The main financial systems in business
■ Business systems and financial systems
■ Accounting for purchases
■ Sales invoicing system
■ Payroll system
■ Credit control system
■ Cash and working capital management
■ Controls for business and IT systems

3 The main financial systems in business

3.1 Business systems and financial systems

Every business organisation has operational systems for achieving its purposes and applying its policies. The main operational systems make up the value chain, and include purchasing, manufacturing or service provision, and marketing and sales.

These business activities are supported by administrative systems, such as human relations management systems ('personnel management') and accounting systems. This section provides a brief description of the main financial/accounting systems.

3.2 Accounting for purchases

In large business organisations, there is a specialist buying department with responsibility for purchasing supplies (raw materials, components, office supplies and other items) from external suppliers.

A typical purchase transaction (in a large organisation) goes through the following stages.

Purchase requisition	A request (properly authorised) is sent to the buying department, asking it to purchase a quantity of a particular item. The requisition might come from the manager of the stores department.
Purchase order	The buyer places an order with a supplier, probably after checking prices and delivery terms with a number of different suppliers.
Delivery note	The supplier delivers the goods. The person making the delivery provides a delivery note, as evidence that the goods have been delivered. This is signed by the person receiving the goods.

Goods received note	The delivery note is used to prepare an internal document, called a goods received note (GRN). This includes details of the goods received, including the inventory code for the item. A copy of the GRN is sent to the accounts department.
Purchase invoice	An invoice is received from the supplier. Suppliers normally give customers a specified length of time for making the payment (the '**credit period**'). The supplier's invoice, called the **purchase invoice**, specifies the goods supplied, their cost and the date by which payment is required.
Accounting record for the purchase invoice	The first accounting entry is made for the purchase transaction. The accountant or book-keeper matches the purchase invoice with the GRN and a copy of the purchase order, to make sure that the details agree. If they do agree, a record is made in the accounting system for the invoice received (the amount payable).
Accounting record for the payment	The invoice is eventually paid (by the accounts department). A record of the payment must be entered in the accounting system.

The accounting system also records goods returned to suppliers, for example because they are faulty. The supplier gives a reduction in price for returned goods, and acknowledges this in a document called a **credit note**. Details of credit notes are also entered in the accounting system.

At any time the accounting system for purchases can provide information about:

■ the total cost of purchases in a given period of time, such as for the year to date

■ the amount currently owed to suppliers, both individually and in total.

Inventory records

The purchasing system for accounting might also be linked to a system for recording inventory (an inventory control system). The inventory control system records quantities of inventory received and used, and the cost of the inventory. It also provides a record of the quantity and value of inventory currently held.

The purchases system might be linked to the inventory control system, because details of goods received can be transferred from the purchases system into the inventory control system.

3.3   Sales invoicing system

A sales invoicing system is a system for producing invoices and recording sales, where goods or services are sold to a customer on credit. When goods or services

are sold on credit, the customer is allowed a period of time before they have to be paid for. A sales invoice is sent to the customer, giving details of the items sold, the amount payable and the date by which payment is due.

A sales invoicing system is used to:

■ produce sales invoices for sending to customers

■ recording the amount owed

■ recording payments received from (credit) customers.

A typical credit sale transaction for the sale of goods goes through the following stages.

Sales order	A sales order is received from the customer. The order goes through a credit check. (Credit control is explained later.) The sales order is processed.
Delivery note	The goods are delivered to the customer, who signs the delivery note. A copy of the delivery note is sent to the accounts department.
Sales invoice	A sales invoice is produced from the sales order and delivery note, and the invoice is sent to the customer.
Accounting record for the sales invoice	The first accounting entry is made for the credit sales transaction. The accountant or book-keeper records the details of the sales invoice in the accounting system.
Accounting record for payment received	When the customer eventually pays, the payment is sent or notified to the accounts department, and a record of the payment is made in the accounting system.

The accounting system also records goods returned by customers, for example because they are faulty. The amount of the reduction in the amount payable is recorded in a credit note, which is sent to the customer. A copy of the credit note is used to record the sales return in the accounting system.

At any time the accounting system for sales invoices can provide information about:

■ the total value of sales on credit in a given period of time, such as for the year to date

■ the amount currently receivable from credit customers, both individually and in total.

3.4 Payroll system

The payroll system is the system for:

■ Recording the total amount payable in wages and salaries to employees

■ Calculating the amount deductible from the pay of each employee, for tax and other items (such as pension contributions)

■ Providing employees with details of their total wage or salary for the period, the deductions and the net pay in cash

■ Issuing instructions for the payment to employees of the money they are owed. Payment might be in the form of a cheque or even cash; however, it is now common for wages and salaries to be paid directly into the employee's bank account.

■ Recording details of the wages and salary costs in the accounting system, the amounts of deductions (for tax and other items) and the amounts paid in cash to employees.

When some employees are paid weekly wages, the payroll system is operated each week. There is also a monthly payroll for salaried employees.

The accounting system must record each of the following items, for each employee individually and for the work force in total:

Gross pay (= total pay)	A
Deductions for tax and other items. Each deduction should be itemised separately	(B)
Net pay (= money paid to the employee)	A – B

In order to prepare the payroll, the payroll staff must have the following information:

■ a list of every employee, and the department in which he or she works

■ the annual salary of the employee or hourly rate of pay (for wage earners) and overtime rate

■ for hourly-paid workers, the number of hours worked in the week, including hours worked overtime

■ details of other payments, such as bonuses

■ details for making the deductions from gross pay, for tax and other items

■ details for making the payment of the net wage or salary (for example, bank account details for each employee).

3.5 Credit control system

A credit control system operates whenever goods or services are sold on credit. The purpose of a credit control system is to:

■ make decisions about allowing credit to customers

■ monitoring the payment record of credit customers

■ reviewing the amount of credit allowed to existing credit customers

■ collecting amounts overdue from credit customers.

Giving credit

When a new customer applies for credit terms, a decision has to be made about whether to allow the customer credit terms, and if so how much credit should be allowed. (If you have a credit card, you should be familiar with this process from the decision of the credit card company about how much credit to allow you when you were first given the card.)

For example, a company might have standard credit terms of allowing customers 30 days to pay from the date of the sales invoice. It might then agree to allow a new customer credit on those terms up to, say, €10,000. This is the customer's authorised 'credit limit'.

Before deciding whether to allow credit to a new customer, the credit control department should carry out a credit check on the customer. Typical methods of obtaining credit information are:

■ a credit reference from one or two other suppliers to the customer

■ a credit reference from the customer's bank

■ possibly, by paying for a credit status report on the customer from a specialist credit reference agency

■ in the case of a corporate customer, by asking for and analysing the company's financial statements.

Monitoring payment records and reviewing credit limits

When a customer is given credit, the customer's payment record should be monitored regularly, to check whether the customer has paid invoices on time and has not been allowed to exceed his agreed credit limit.

When a customer has a good credit record, a decision might be taken to raise the credit limit (or agree to raise the credit limit if the customer makes a request).

Collecting overdue payments

The credit control section might also be responsible for trying to collect overdue payments from credit customers. These are customers who have not paid an invoice within the period allowed by the credit terms.

This process involves preparing a list of overdue payments, and contacting the customer to ask for payment.

If customers continue to refuse to pay, or ignore requests for payment, further action might be considered, such as legal action to obtain payment or the sale of the amount receivable to a debt collection agency.

3.6 Cash and working capital management

Cash management

Businesses need cash to operate. If an entity does not have enough cash to make a payment when the payment is due, it might be forced out of business. (The entity might be 'insolvent' because it is unable to pay the money it owes, and it might be forced into liquidation by a creditor, through legal process. When a business goes into liquidation, its existence is brought to an end.)

It is therefore essential to manage cash, to make sure that there is always enough available for making essential payments. Or if the cash is not available, there should be an arrangement with a bank to borrow extra money immediately, for example in the form of a bank overdraft facility.

Some business entities are 'cash rich', which means that they have more cash than they need. A cash surplus might be permanent, in which case management should decide how the surplus should be used. If a cash surplus is only expected to be temporary, a decision might be taken to invest it in a short-term investment, such as a bank deposit account, to earn some interest.

Cash management involves the following activities:

■ managing the bank account or bank accounts of the business

■ making cash payments

■ banking cash receipts

■ arranging bank overdrafts

■ investing temporary cash surpluses

■ making continual forecasts of cash receipts and payments ('cash budgets') to make sure that there should be sufficient cash (or unused bank overdraft facility) to make essential payments when these are due

■ monitoring actual cash flows.

Working capital management

There are several definitions of working capital. One definition is that working capital is the amount of funding that a business entity has to support its day-to-day operational activities.

A business needs funding for its day-to-day operations for the following reasons.

■ It needs to buy raw materials and components, and inventories of materials and components represent goods that have been bought but not yet used.

■ If it is a manufacturing business, it has work-in-progress. This is inventory of items that are in the process of production, but have not yet been completed. Work-in-progress represents materials purchased and other costs incurred, for goods that have not yet been produced and sold.

■ If it is a manufacturing business, it also has inventory of finished goods. Finished goods are items that have been manufactured but have not yet been sold.

Finished goods represents materials purchased and other costs incurred, for items that have not yet been sold.

- Business entities that sell goods or services on credit have **receivables**. These are amount owed by credit customers. Amounts receivable represent items that have been produced and sold, but for which no money has yet been received.

A business therefore needs funding for all its inventories and receivables. It has incurred costs in acquiring these assets, but has not yet received payment.

To some extent, inventories and receivables are financed by amounts payable to suppliers. In other words, credit taken from suppliers helps to fund working capital. This is why a common definition of working capital is as follows:

Inventories	A
Trade receivables (money owed by customers)	B
Trade payables (money owed to suppliers	(C)
Working capital	A + B - C

Working capital ties up cash. Money has to be spent acquiring inventories and on goods that are sold to credit customers.

The management of working capital mainly involves:

- avoiding excessive inventories, for example by speeding up inventory turnover (using it more quickly)
- avoiding excessive trade receivables, for example by making sure that credit customers pay what they owe on time
- making sure that suitable credit terms are negotiated with suppliers.

By managing working capital efficiently, a business will avoid having to invest too much in inventories and receivables, and this will improve cash flow. There is a close link between cash management and working capital management for this reason.

3.7 Controls for business and IT systems

Risks

In any business system – including purchasing, production, service provision, sales, credit management and cash management systems – there are risks that something will go wrong.

A risk is the possibility that something that is expected to happen does not actually happen. In business system, the risks are often on the 'downside', which means that when something unexpected happens, it is usually unwelcome and 'bad news'.

There are many different types of risk in business operations.

■ People can make mistakes. A person might forget to do something that he should do. Omissions are mistakes. A person might also do something incorrectly or might not complete a task. Human error is very common.

■ Mistakes are normally accidental or unintentional. Sometimes however, a person might intentionally do something that he should not, perhaps with the intention of making a personal gain. Some business systems, especially those involving money, are at risk from fraud. Fraud is a criminal activity, but it appears to be widespread in business.

■ There are risks of unexpected external events, such as damage to business assets caused by fire, storms or flooding. Systems might suffer from a loss of power supply, or machine breakdown.

■ When a computer system is used, there are risks of system failures – errors and breakdowns.

Risks to IT systems include the following:

■ There might be a loss of data. Data on a computer file might be lost because of a fault in the system that corrupts the data, so that the computer is unable to read it. If key data is lost entirely, the system might not be able to operate properly.

■ Data might be corrupted by a virus. A virus can destroy programs and files if it is able to get into a computer system undetected. Viruses are written with the deliberate intention of destroying computer data or systems.

■ There might be a malfunction of the computer system. There are occasional reports in the press about large government computer systems that do not function properly when they are introduced operationally for the first time.

■ There might be a loss of connection (communication) in a computer network, or a fault in a central computer, that brings the system to a halt.

■ Individuals who are not authorised to access a computer system might gain unauthorised access. Individuals who gain access to a computer system through the internet are called 'hackers'. However, unauthorised access might be obtained by employees – for example by someone who gains access through an unattended terminal. Whenever there is unauthorised access to a computer system, there is a risk of fraud, or a risk that data might be altered, deleted or corrupted.

■ There is a risk that confidential information might be accessed by an unauthorised person. For example, a thief might steal a laptop computer containing files with confidential customer information.

Risks and controls

Business risks, including IT risks, should be controlled. Controlling a risk means:

■ preventing the adverse event from happening, or

■ detecting an adverse event when it happens and taking measures to put things right.

There should be controls both to prevent an adverse event and also to detect them when they happen. (Preventative controls are rarely 100% effective.) For example there should be controls in an IT system to prevent hackers from gaining

unauthorised access. However, in the event that a hacker does break into a computer system, there should be controls to identify that this has happened, so that measures can be taken to deal with the problem.

Controls are discussed in more detail in a later chapter, in the context of internal audit.

> ## IT applications in business
>
> - Advantages of computer systems
> - Business uses of computer systems
> - Main features of a computerised accounting system
> - Comparison of manual and automated financial systems
> - Spreadsheet applications
> - Database systems

4   IT applications in business

4.1   Advantages of computer systems

Computers and IT systems are used extensively in business. The advantages of using IT systems can be summarised as follows.

- **Speed of processing**. Computer systems can process transactions much more quickly than humans. In addition, computer systems can usually provide instant responses to queries.

- **Volume of processing**. Computer systems are also able to process large volumes of transactions. Large transaction processing systems, which can handle large volumes of transactions and process them quickly, would not be possible without computers.

- **Accuracy of processing**. Computers are much more accurate than humans. With manual processing systems, the risk of errors can be very high. With computers, the only risk of error is the possibility of an error in the program itself.

- **Storage capacity**. Computer systems are able to store very large quantities of data on file.

- **Ability to access, extract and process data**. Computer systems not only store large quantities of data. They allow computer users to access data quickly and easily and extract and process it.

- **Communication**. IT systems – computers and communications networks – enable data to be transmitted to any part of the computer network. Information can be shared by many different users.

- **Labour-saving**. Many computer systems (especially transaction processing systems) remove much of the need for human intervention. When this happens they are labour-saving and so reduce labour costs substantially.

Computer systems are also capable of providing much more management information than manual processing systems. Some types of computer system can be used for 'modelling': computer models can be used to make plans or forecasts and assist with complex decision-making.

4.2 Business uses of computer systems

Most business processes can be computerised. Computerisation is common in accounting, where computers are used for book-keeping (financial transaction processing), and preparing financial reports and budgets.

Business uses of computer systems might be divided into the following broad categories.

- **Office routines**. Computer systems can be used to assist with office routines, such as preparing letters and reports (Word processing) and sending messages (e-mails).

- **Transaction processing**. Transaction processing systems have already been mentioned. Many business entities computerise transaction processing, particularly accounting transactions.

- **Management information systems**. These are computer systems that provide management information. Information might be provided in the form of standard reports. Alternatively, a computer system might provide information on request, in response to a specific enquiry. Transaction processing systems often provide management information too. For example, a system for recording payments from customers (receivables) can also provide management information to the credit control department about overdue payments.

- **Decision support systems**. Computer systems can be used to help management make plans and forecasts, or to construct 'models' to assist with other types of decision making.

- **Expert systems**. Some computer systems are able to provide expert advice in response to enquiries. For example, there are expert systems for the law, and an expert computer system can provide legal advice or legal information in response to specific enquiries.

4.3 Main features of a computerised accounting system

Computerised accounting systems share the same general characteristics.

- Accounting data is held on computer files. There files for customers (receivables), suppliers and purchases (payables), inventory, employees (payroll) and so on. For each customer, supplier, employee or inventory item, the file contains 'standing data' and 'transaction data'.

- Data about transactions is entered into the computer system. There are various methods of data input. In microcomputer-based systems, transactions are commonly entered into the system by keyboard and mouse. When a system relies on human input by keyboard and mouse, there is a fairly high risk of errors.

- The computer program can recognise different types of input transaction, such as sales invoice data, credit note data, sales returns and cash receipts (payments received from customers) in a receivables system.

- Standing data in the files reduces the amount of data that needs to be input to the system. For example, entering the account number of a customer into a sales invoicing system is sufficient to enable the system to recognise the customer name, address and other 'standing data' on file.

Integrated accounts packages

Many accounting systems are purchased 'off the shelf' from software suppliers. Software packages are often available in the form of integrated packages or 'modules'. Each package can be purchased and used separately, but the different packages can also be used together, because they are integrated. This means that data from one package can be transferred to another automatically.

Examples of separate packages or modules in an integrated system are:

- Sales ledger system (receivable system and sales invoicing system)
- Purchases (payables) system
- Nominal ledger system
- Payroll system
- Inventory control system (with continuous stock records)
- Cost accounting system

An entity can introduce computerised systems gradually by purchasing one or two modules first, and then acquiring other modules later.

4.4 Comparison of manual and automated financial systems

In your examination, you might be expected to answer a question about comparing computerised and manual accounting systems.

Wherever the use of computers in business is well-established, manual accounting systems should be very rare. Even small businesses can use a small personal computer (PC) and an off-the-shelf accounting software package to computerise their accounting system.

Setting up a computerised accounting system for the first time involves some capital expense. There is the cost of the computer itself and associated hardware (such as a printer), and there is the cost of the software package.

The benefits of computerisation, however, are substantial. As indicated earlier, computerised systems (in comparison with manual systems) are better because:

- errors do occur (especially when input is by keyboard and mouse) but are less likely to happen than in manual accounting systems
- the processing of transactions takes less time, and so operating costs are lower.

4.5 Spreadsheet applications

A spreadsheet is a computer software package that allows users to build mathematical 'models' in spreadsheets. A spreadsheet is a large table with rows and columns. The rows and columns make a large table of boxes or 'cells', and each cell has a unique identity reference number.

A cell can be used to enter any of the following:

- text
- symbols ($, %, € and so on)
- numbers
- formulae

Where a cell contains a formula, the spreadsheet model produces a number from the formula. For example, a formula in cell D6 might state that the value of the cell is the number in cell B6 multiplied by the number in cell C6. The formula in cell D6 might be '=B6*C6'. If B6 contains the number 5 and C6 contains the number 10, cell D6 will show the number 50. If the number in cell B6 is altered from 5 to 7, the value in D6 will change to 70.

The main features of spreadsheets that you need to understand for your examination are as follows.

- Spreadsheet software is used to construct spreadsheet models.
- A spreadsheet model is used to produce a table of figures, with rows and columns suitably labelled.
- Accounting information is often provided as figures in a table. Spreadsheets are therefore particularly well-suited to accounting applications. Spreadsheets can be used, for example, to prepare numerical forecasts and financial plans. They can also be used to analyse data and make a financial evaluation of data. Examples of the use of spreadsheets in accounting include spreadsheets for sales forecasting, cash flow forecasting, preparing budgets (financial plans) and control reporting (comparing actual performance with planned performance). Spreadsheets can also be used for cost analysis and the financial evaluation of proposed capital expenditure projects.

When a spreadsheet model has been constructed, it can be used to test different possible 'scenarios' by asking 'what if..?' questions. For example, with a spreadsheet model for a cash flow forecast, it is possible to analyse the effect on cash flows of any possible variation in possible future events, such as:

- What if customers take 14 days longer on average to pay?
- What if the rate of interest on the bank overdraft goes up by 1%?
- What if we have to pay for a new machine two months earlier than originally expected?

4.6 Database systems

There are many different definitions of a database. Most definitions assume that a database is computerised, but the term can also be applied to paper-based files. Several definitions are listed here.

- A database is 'a collection of information that has been systematically organised for easy access and analysis' or 'a collection of data that is organised so that its contents can easily be accessed, managed and updated'.

- A database is 'a collection of data organised so that various programs… can access the information.'

- A database is 'a collection of… data stored in one or more computerised files in a manner that can be accessed by users or computer programs via a database management system' or 'a collection of electronic records having a standardised format using specific software for computer access.'

There are several points to note about these definitions.

- A database improves access to data, and provides a common set of data files for all users of the system.

- The data in a database can be accessed for use by many different users and programs. A database can be used by application programs, as well as for extracting information.

- The data in a database has to be organised and in a standard format.

- A computerised database is accessed and controlled by special software, a database management system.

- A database may be held on the same computer file, but a database may also be distributed between several computers in a network.

Database management systems (DBMS)

A database management system (DBMS) is the software that manages a database, dealing with all aspects of access to data, file maintenance and data security. The facilities provided by a DBMS include:

- the ability to add new records, and amend or delete existing data on the database

- the ability to retrieve data for processing or information to help with decision-making

- the ability to update the database without requiring modifications to any of the applications programs that use data on the database

- the ability to present data on the database in different combinations and in different forms

- the ability to control access to parts of the database, though the use of passwords.

A database management system provides for the:

- integrity
- independence and
- integration of data.

Integrity of data

The 'integrity' of data refers to the way in which the data is kept, and:

- the security of the data against unauthorised access

- making sure that there is an effective system for restricting access to some parts of the database to authorised individuals

■ making sure that the data is accurate and up-to-date (for example by means of extensive data validation checks in the software on insertions and amendments to data)

■ restricting the authority to insert, amend or delete data to approved individuals.

A database administrator is the individual responsible for making sure that data is accurate, and for monitoring access rights to the system and the database.

Independence of data

A key feature of database systems is that the data on the database is independent of the applications programs that use the data.

■ A change to the data in the database does not mean that there must be amendments to the application programs that use the data.

■ Similarly if a change is made to an applications program that uses a database, there is no requirement to amend the database.

Integration of data

A key objective of database systems is data integration. The aim of data integration is that data should be stored and maintained in a single file location within the organisation.

■ If six different IT applications need the same or similar data, they should all use the same data record. Each IT application system should not have its own, separate data file.

■ When data is held in a single location, for use by all IT applications, there is no risk that the data used by each application may be different (due to discrepancies between the data files of the different systems).

■ Integration also avoids the duplication of data on different system files. (It **avoids 'data redundancy'**). Data has to be entered into the system once, and once only. In contrast, if six systems each have their own data files, holding the same or similar data items, new data would have to be entered six times, once into each of the separate systems.

Data in a database is referred to as 'shared data' or 'corporate data'.

Advantages and disadvantages of database systems

The advantages and disadvantages of database systems are set out in the following table.

Advantages of database systems	Disadvantages of database systems
Independence of data: the data is available for all users in the organisation, and is available for different uses. Data is not just for individual departments or applications.	Integrity of data. It is extremely important that the data in a database should be reliable, and so sufficiently accurate. Ensuring the integrity of the data may be a difficult task.
Integration of data: data only needs to be input once. There is no duplication of data in different systems. Because it is only input once, there is consistency of data and information throughout the organisation.	The initial development costs for a database may be high. However, standard software is available for creating simple databases.
A database is available for new uses and applications. The database is therefore a valuable resource for the organisation.	
A database can be very flexible, allowing data to be accessed and extracted in many different ways and forms.	

Example

An example of a database might be a set of files containing inventory records. The same inventory database might be used by different departments in the organisation:

- by the sales department, to check the availability of finished goods items for a customer

- by the accounts department, to record transactions involving inventory in the accounting system

- by the stores or purchasing department, to record inventory items on order, inventory items delivered from the supplier and transfers of inventory from store to user departments

- by the purchasing department, to record details of suppliers of each particular raw material item or component item

- by senior management, to obtain data on inventory turnover for the purpose of working capital management.

> ### Relationship between accounting and other business functions
>
> - Accounting and purchasing (procurement)
> - Financial considerations in production
> - Financial issues in marketing
> - Costs and benefits of effective service provision

5 Relationship between accounting and other business functions

Accounting has been described so far largely as a system for recording financial transactions, preparing financial statements and measuring costs of products, services and activities.

Accountants in business should also be providers of extensive management information. As providers of information, they should be involved with the managers of functional departments and business processes.

This section looks at the relationships that might exist between the accounting function and the managers of other business processes.

5.1 Accounting and purchasing (procurement)

The purchasing department is responsible for buying goods and services from external suppliers. The buyers are responsible for deciding which suppliers to use, and agreeing a price and other conditions of purchase.

Accountants are involved in preparing the annual financial plan or budget for the business. An element of the budget should be a materials purchases budget, which is the budget for the quantities of materials that will be purchased in the next financial year and their cost. In order to prepare the budget, the accountant should therefore discuss prices with the purchasing department.

The performance of the purchasing department should be assessed largely on the basis of how good they have been at buying. One aspect of buyers' performance is whether they obtained good prices from suppliers. The accounting department is often responsible for producing management information about prices, by comparing:

- actual prices paid, with
- expected or budgeted prices.

The difference between actual and expected purchase prices might be called a price variance.

Cost estimating

In some businesses, cost estimations or price quotations are prepared regularly for customers. For example, in contracting industries, contracting companies are often asked to tender for major contracts, by submitting bids. Tendering for contracts, and quoting prices to a customer, might involve both management accountants and the purchasing department, together with production management.

Monitoring purchase quantities

The accountant might also be asked to provide information to senior management about inventory control, for the purpose of working capital management. A business should try to avoid excessive inventories, because these have to be funded and tie up cash. Large inventory levels and slow inventory turnover are also associated with other costs such as losses through damage, deterioration and theft.

One of the reasons for excessive inventory levels might be excessive order quantities. Management accountants might be expected to consider suitable purchase order quantities to minimise costs, and discuss these with the buying department.

Example

An example of excessive buying is often found with print orders. When a quantity of books or brochures is ordered, the cost per unit is much lower for large order quantities. For example, it might cost $2,000 to print 500 books but only $10,000 to print 5,000 of the same books.

The cost per book is therefore $4 for an order of 500 and only $2 for an order of 5,000. A buyer might be tempted to buy 5,000 units in order to keep unit costs low. However, if only 500 books are used, the remaining 4,500 will be thrown away and the 'saving' in unit costs becomes excess spending of $8,000.

Monitoring buying procedures

Internal audit is a completely different aspect of the relationship between accountants and the purchasing function. Controls are applied to the buying process, to make sure that unauthorised buying does not take place (or that payments are made for goods that have not been purchased at all).

Internal auditors might check that controls over purchasing have been properly applied – for example that all purchases are properly authorised and recorded. (Internal audit is described more fully in a later chapter.)

5.2 Financial considerations in production

In manufacturing businesses, accountants record the costs of production and calculate the cost of closing inventory at the end of each financial year.

Accountants also provide management information about production costs for the following purposes.

■ Accountants are involved in preparing the annual budget. This should include the expected costs of production during the financial year.

■ They might also be involved in calculating expected units cost of production for each product item, where standard items of product are manufactured. Expected unit costs might be prepared as **standard costs** per unit.

■ They also produce control reports throughout the financial year, providing information about actual production costs incurred. Actual production costs might be compared with the expected or standard costs, and the differences reported as cost variances.

In addition to preparing financial plans and control reports, accountants might be involved with production management in assessing the costs of various aspects of production, and considering ways in which costs might be reduced. Here are a few illustrative examples.

■ Production management should look for ways of using resources efficiently and productively. This means making efficient use of resources such as materials and labour. Materials should be used efficiently, to avoid unnecessary wastage. Management should also try to improve labour productivity, for example by reducing time lost due to bottlenecks in production and late deliveries of materials. Production management should also consider ways of making the best use of available capacity, such as machine time. The accountant can help production management by estimating the costs of inefficiencies or the financial benefits of improvements in efficiency or capacity utilisation.

■ When production managers are considering whether or not to purchase a new item of machinery or equipment, accountants can help by providing a financial assessment of the costs and benefits of the capital investment.

■ A manufacturing business might be faced with a decision about whether to continue to make a product 'in-house' in its own production department, or whether to 'outsource' production and buy the items from an external supplier instead of making them. Management accountants can assist by providing information about the expected costs and financial benefits of any such 'make or buy' decision.

■ Similarly, management might be considering a decision about whether to shut down a production facility because it seems unprofitable. Management accountants can assist with the decision by providing reliable financial data about the costs and financial benefits of closure.

5.3 Financial issues in marketing

Accountants should provide information to assist marketing management.

The marketing managers (and senior management) make pricing decisions, and decide how much should be charged for goods or services. Accountants can assist with pricing decisions by providing information about costs and 'gross profit margins' (Gross profit is the difference between the sales price of an item and its cost of sale.)

Total profit depends partly on the profit margin per unit sold and partly on the volume of sales. Suppose that the cost of selling an item is $5.

■ If it is sold for $7 and sales volume is 10,500 units, total profit will be $21,000.

■ If it is sold for $7.50 and sales volume is 8,000 units at that price, total profit will be $20,000. In this example, the lower price of $7 would seem preferable.

The point to note, however, is that accountants can help marketing management with pricing decisions, by estimating total profit at different price levels.

Accountants should also be involved in the preparation of marketing budgets, and providing control report information that compares actual marketing spending with the budget.

In addition to assisting with the preparation of marketing budgets and preparing budgetary control reports for marketing activities, accountants might also be involved with marketing management in assessing the financial costs or benefits of certain courses of action, such as whether to open up a new channel of distribution; for example whether to start selling goods on the company website.

5.4 Costs and benefits of effective service provision

Business entities that sell goods (rather than provide services) also provide a service to their customers. The service associated with a product is a part of the 'value consideration' that the customer buys.

Some entities provide a better service than others. The effectiveness of service can be measured in several ways:

■ **Promptness**. Good service is often associated with providing a prompt service. An example is the speed with which a maintenance or repair engineer comes to fix a reported fault (such as a car broken down on the motorway, or a leak in the plumbing).

■ **After-sales service**. Some manufacturers provide a good after-sales service, in the form of warranties and guarantees, training in the use of the item for the buyer's employees, and maintenance and repair services.

■ **Friendliness**. Customers are often impressed by a friendly personal service.

■ **Skills of the service provider**. A service can only be effective if it is provided properly and without mistakes.

A problem for businesses that provide a service to customers is to decide on the appropriate standard or quality of service. Providing a better service often costs more money. However, a better service should improve customer satisfaction, which in turn might lead to more sales (such as repeat orders).

Accountants might be asked to assess the costs and benefits of service provision.

Better service provision

Costs	Benefits
More resources (such as more employees to provide the service)	Some revenue benefits (for example a maintenance contract with the customer, or a system support service for a customer's IT system
Cost of providing warranties or guarantees	More customer satisfaction from better service quality, greater promptness and speed, or greater reliability
Costs of training own staff to provide a good standard of service	The financial benefits of customer satisfaction should come from higher sales
Costs of training customer's staff	

Concluding remarks

This section has tried to show that there are financial aspects to every business system or business process, and accountants are often involved in providing management information for the management of the system or process.

Accounting is more than just a matter of recording costs and calculating annual profits!

CHAPTER

6

Functions of accounting and internal financial control

Contents
1   Specific functions of accounting
2   External and internal auditing
3   Internal financial control
4   IT system security and controls
5   Fraud and fraud prevention

Specific functions of accounting
■ The broad functions of accounting and finance
■ Financial accounting and reporting
■ Management accounting and performance management
■ Finance and treasury function

1 Specific functions of accounting

1.1 The broad functions of accounting and finance

The main objective of a business entity is financial in nature. As specialists in accounting and finance, accountants are involved in helping to set financial targets, and in developing financial policies and accounting procedures that should contribute towards the achievement of targets.

■ At a strategic level, the accountant should provide advice to management about setting profit targets and other financial targets.

■ For many business entities, the annual budget is an important system for planning and control. The accountant is involved in preparing the annual budget and in providing advice on financial targets within the framework of the budget.

■ Many business entities have reward schemes for managers (and possibly other employees). For example, individual managers might be awarded an annual bonus for the achievement of specific targets. The accountant is often involved in providing information and advice to senior management about suitable performance targets and the potential cost of bonus schemes.

■ Accountants have direct responsibility for the finance function, and contribute to funding policy decisions and activities connected with raising new funds, the payment of debt obligations (interest to lenders) and cash management.

The accountant also contributes towards control within an organisation.

■ Accountants should establish financial controls within an organisation, and they may also be required to check whether these controls are effective.

■ The accountancy function is usually responsible for performance reporting systems, providing reports on actual performance and comparing this with targets. Performance reporting systems are used for control purposes, as well as for bonus incentive schemes.

The contribution of the accounting function to an organisation can be summarised as:

■ Record-keeping and preparing financial statements

■ Providing management information and giving advice to management

■ Direct responsibility for finance (funding and cash flow)

■ Checking controls, particularly financial controls, and compliance with those controls.

1.2 Financial accounting and reporting

The financial accounting function is concerned with record-keeping and financial reporting.

■ All transactions of a financial nature are recorded in the book-keeping system. Accountants (or book-keepers) keep the records, which are prepared from source documents such as invoices, credit notes, receipts and payroll records.

■ When transactions are recorded in the accounting system, they are coded and categorised so that the nature of the transaction can be analysed and entered into the appropriate accounts in the system.

■ Some transactions must be processed after they have been entered in the accounting system. For example, invoices from suppliers are entered into the accounting system, and must subsequently be paid. Similarly after invoices are sent to customers and recorded in the accounting system, subsequent processing is needed to record the receipt of the payment.

■ The information in the accounting system also provides the starting point for the preparation of the financial statements (balance sheet and income statement).

1.3 Management accounting and performance management

A cost and management accounting function should exist in all large entities, but might not exist in smaller organisations. Its main purpose is to provide management information.

Cost accounting

Cost accounting is a system for providing management with detailed information about costs. The financial accounts record transactions about sales and expenses, from which a profit or loss can be calculated. However, the financial accounts do not provide detailed information about sales, costs and profits for individual products or activities.

For example, for a company that manufactures cars, the cost accounting system should provide information, for each model of car produced, about:

■ what raw materials and components were used in the production of a car, and how much these materials cost

■ how much labour time went into the production of a car, and what the labour time cost

■ other costs incurred in the production of the car.

Costing systems are also used to establish costs of individual jobs or contracts, or costs of manufacturing processes, or costs of business activities such as order processing and order delivery.

Detailed information about costs can help management to plan and control expenditures, and to measure the profitability of individual products, services or activities.

Providing management information for decision-making

Management accountants also provide information to management that should help management to make well-informed decisions. The information is mainly financial in nature, although some management accounting systems provide information of a non-financial as well as a financial nature.

Examples of management accounting information include the following:

■ estimates of profitability at different selling prices, which helps management to make pricing decisions

■ information about the costs and benefits of closing down an operation, which helps management to decide whether the operation should be closed down

■ information that helps management to make the most profitable use of scarce resources, where business activity is restricted by a limited resource (such as skilled labour)

■ information about the expected costs and benefits of a proposed new capital investment.

Budgeting and budgetary control

The management accounting function assists with the preparation of the annual budget, which is a detailed financial plan for a specified period, usually a financial year. Budgeting (budget preparation) involves a large number of managers, but management accountants are often responsible for integrating the budgets of the many different functional and departmental managers into a comprehensive 'master budget' for the entire business.

For example, the budget for a manufacturing company co-ordinates the following functional and departmental budgets:

■ a material purchases budget for production

■ a labour budget for production activities and each production department

■ a budget for other production expenses

■ departmental or functional budgets for each department in administration, sales and marketing

■ a sales budget.

Budgets are based on detailed estimates of costs and sales revenues. Within the budgeting process, management accountants are involved in establishing budgeted costs for particular products and activities, or standard costs.

Many business organisations have a system of budgetary control. **Budgetary control** is based on regular reporting (typically every month) of actual sales, costs and profits, and comparing these actual results with the budget for the same period.

Differences between actual performance and budget are reported as **variances** to the managers responsible. These managers are then expected to:

■ explain why the variance happened

■ explain the measures that he is taking to deal with the cause of the variance (if it is adverse or unfavourable).

Other performance reporting systems

A budgetary control system is a form of performance reporting system, because it compares actual and budgeted performance. Other performance reporting systems might be used, without the need for a budget, in which actual performance by individuals, groups or departments is compared with a target or plan.

The management accountant is usually involved with gathering and reporting information about actual performance within these systems.

1.4 Finance and treasury function

The finance function is sometimes called the treasury function or treasury department. It has direct responsibility for funding and cash management.

Funding

Funding refers to long-term financing for a business entity. A business entity must have capital (long-term financing), because capital provides essential financial stability. Long-term finance for a company comes from two main sources:

■ equity capital, also called shareholders' capital, and

■ long-term debt capital.

Equity capital is obtained by issuing new shares. The shares are purchased by investors, who become shareholders of the company. The money they pay for the new shares provides capital for the company.

Equity is also obtained by making profits. Some of the profits earned by a company are paid to shareholders as dividends on their shares, but some profits are retained within the business (and reinvested). These retained profits add to shareholders' capital.

The treasury function is not responsible for deciding how much profit to retain. However, when new capital is raised by issuing new shares, the treasury function is likely to be involved in the preparations for the share issue.

Long-term debt capital can be either:

■ bank loans, or

■ borrowing in the form of bonds, debentures or loan stock.

A company might issue bonds or debentures to investors as a form of long-term loan. It pays interest on the bonds, and eventually redeems the bonds and repays the capital borrowed.

When companies borrow through bank loans or by issuing bonds, the finance/treasury function is involved in the process. The finance director or treasurer will try to obtain funds at a low cost, for example by borrowing from a bank on the best terms that can be negotiated. Having borrowed money, the treasury function is also responsible for ensuring that interest payments are made on time, and that the loan capital is eventually repaid as scheduled.

Large and growing companies often need to obtain new finance regularly. The finance/treasury function provides advice to senior management on the most appropriate method of obtaining new funds – as equity or debt capital.

Cash management

The treasury department is responsible for the management of cash. In a large business organisation, the cashier's section is a part of treasury, and the cashier controls the business bank accounts. It controls payments into and out of the bank.

It is also responsible for monitoring cash flows and ensuring that there is always sufficient cash (or unused bank overdraft) available to make payments when these fall due.

The cashier's department should prepare regular **cash budgets** that forecast cash receipts and cash payments in the near future. In some companies, cash budgets are prepared on a weekly or even a daily basis. The purpose of a cash budget is to check that there will be enough cash to make essential payments. If there will not be enough cash, measures can be taken to find the amount required (for example by selling investments or negotiating a larger bank overdraft).

Some companies have temporary cash surpluses. A treasury function is responsible for investing the surplus securely in short-term investments, so that the cash earns some return until it is eventually needed.

Working capital management

Working capital management involves monitoring the total investment in working capital. This should be a treasury concern, because working capital must be financed.

Some of the responsibility for working capital management rests with operational managers. Inventory control for example is the responsibility of operational managers (and possibly also the purchasing department). The finance/treasury department might also have some direct responsibility for working capital management.

■ The purchasing department is responsible for negotiating payment terms with suppliers, but actual payments to suppliers are made by the cashier.

- The credit control section might be a part of the finance/treasury department, rather than a section within financial accounting. If so, the treasury department would have direct responsibility for the control of credit and for debt collection (collecting amounts receivable from customers that are overdue).

Treasury risk management

The finance/treasury department is responsible for the management of treasury risk. Treasury risk is the risk from adverse movements in conditions in the financial markets. Two major treasury risks are interest rate risk and foreign currency risk.

- **Interest rate risk** is the risk of an unexpected change in interest rates.
- **Foreign currency risk** is the risk of an unexpected and significant change in one or more foreign exchange rates, for example that exchange rate for sterling against the US dollar or euro.

These risks can be very high, particularly for companies that borrow extensively (interest rate risk) and companies that trade extensively in foreign markets (foreign exchange risk).

Interest rate risk management involves making decisions about whether to borrow at a fixed rate of interest (in which case there is a risk from falling interest rates, which would make fixed rate borrowing expensive) or at a variable rate of interest (where there is a risk of higher interest payments if the interest rate goes up).

Foreign exchange risk management involves decisions about which currencies to hold (cash can be held in any exchangeable currency) and how to limit the risk from unexpected exchange rate changes.

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External and internal auditing

- The meaning of audit
- The statutory external audit
- Regulation of external auditing
- The main functions of the external auditor
- The nature of internal audit and role of the internal auditor
- Internal and external audit compared

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2 External and internal auditing

2.1 The meaning of audit

An audit is an official or formal examination. The term is commonly applied to the formal examination of the accounts of an entity by an auditor. The objective of the auditor is to obtain enough information to enable him or her to express an opinion about whether the financial statements of the entity are prepared in accordance with the requirements of national law, accounting standards and accepted accounting principles.

- An audit of the accounts of a business entity might be carried out by an independent auditor from an audit firm. This is an **external audit** by an **external auditor**.

- An audit of the accounts of a business, or a part of the accounts, might be carried out at the request of management by individuals who are employees of the entity. This is an **internal audit** by an **internal auditor**.

2.2 The statutory external audit

All countries require **companies** by law to have an annual external audit of their financial statements. This is called a **statutory audit**. (The requirement for a statutory audit does not apply to sole trader businesses or partnerships, and might not apply to small companies but these business entities may choose to have a voluntary external audit.)

External auditors must belong to a recognised professional accountancy body, such as the ACCA.

A statutory audit has several important characteristics.

- It is carried out by an **independent** auditor. It is essential that the external auditor should be independent from the company, so that he can provide an independent audit opinion.

- The external auditor carries out a check of the accounting system and financial statements of the company, in order to reach an opinion. This opinion is whether, in the auditors view, the financial statements give a **true and fair view**

(or **fair presentation**) of the financial position of the company at the end of its financial year and the financial performance of the company during the year.

■ The auditor does not give an opinion about whether the financial statements are 100% correct or accurate. The opinion is whether the financial statements give a true and fair view '**in all material respects**'. Audit opinions are based on the concept of '**materiality**'.

■ This opinion is set out in an **auditor's report**. The auditor's report is **addressed to the company's shareholders**, and is included in the report and accounts produced by the company for the financial year.

The main responsibility of the external auditor is therefore to ensure that the financial statements of the client company are reasonably accurate and free from bias.

It is important to understand what the external auditor does **not** do, and is **not** responsible for.

■ The **external auditors do not prepare the company's financial statements**, and the auditors are not responsible for the information in those statements. The company prepares the financial statements itself and the directors are responsible for the information that they contain. The external auditor simply provides an independent professional opinion about them.

■ **It is not a responsibility of the external auditors to discover fraud**, where fraud has occurred. The auditors might discover fraud in the course of their audit work, in which case they will report it. However, they do not plan an audit with the intention of looking for fraud, and it is quite possible that a fraud will go unnoticed by an external audit.

■ It is not the responsibility of the auditor to make sure that the company complies with the regulations relating to preparing the financial statements on time, or submits a copy for filing to the government authorities. This is a responsibility of the directors of the company.

2.3 Regulation of external auditing

External auditors are appointed by the shareholders of the company (on the recommendation of the directors), and the audit fee is paid by the company.

However, external auditors are regulated by the accounting profession and other bodies. They are required to carry out their audits in accordance with accepted standards of practice and a professional code of conduct.

Many aspects of external audit work are covered by **auditing standards**.

■ There are International Standards on Auditing (ISAs). These are produced by a committee of the International Federation of Accountants (IFAC) and published by the International Audit and Assurance Standards Board (IAASB). The purpose of auditing standards is to ensure that audit work is performed to a high quality standard, so that shareholders and investors and the public generally can have confidence in that financial statements provide a fair presentation of a company's financial position and performance.

- There are also national auditing standards, produced by a regulatory body of the particular country. National auditing standards should be consistent with the international auditing standards.

Professional accountants are also required to comply with **ethical standards** and **rules of professional behaviour**, as specified by the professional accountancy bodies. For the ACCA, these are set out in its Rules of Professional Conduct.

A regulatory body might also issue ethical standards for external auditors. In the UK, the Auditing Practices Board has issued some ethical standards that are mandatory for external auditors.

2.4 The main functions of the external auditor

The function of the external auditor is to examine the financial statements of the client company. The exact nature of an external audit varies according to circumstances, and the auditor will plan the audit in a way that should provide him with the information he needs to reach an audit opinion.

An audit usually consists of a combination of three types of test or examination:

- tests of control and tests of compliance
- substantive tests
- analytical procedures (a type of substantive test)

Tests of control and compliance

An accounting system contains a number (usually a large number) of controls and checks. These controls are intended to prevent errors or fraud, or to discover errors or fraud when these occur. The external auditors will examine the controls that exist, and reach a view on how good or how weak they are: these are tests of control. They will also carry out checks to establish whether the controls are applied properly in practice: these are tests of compliance. Tests of control and compliance enable the auditor to reach a view about how reliable the accounting records should be.

Substantive tests

In addition to tests of control and compliance, the auditor will also carry out some substantive tests. **Substantive tests are tests by an auditor to establish whether a figure in the financial statements is correct –** such as the figure for sales, cost of sales, inventory or value of plant and equipment.

Most substantive tests are tests of the accuracy of details, particularly in relation to sales, purchases and payroll transactions and assets such as cash, inventory and 'capital assets' such as property and plant and equipment. The auditor is looking to establish whether transactions that are recorded in the accounts did actually occur and whether they have been recorded accurately. They also need to check whether transactions have been omitted from the accounts. They need to check whether

assets that the company includes in its accounts do really exist and whether they have been correctly valued.

Substantive tests are carried out mainly by taking a sample of transactions or assets and checking them in detail for existence, completeness and accuracy. A problem with substantive testing – which is why they are not used more extensively – is that a large sample of transactions or assets is often needed to carry out the audit to a sufficient level of confidence in the audit results. Substantive tests are therefore time-consuming, so they are very expensive. (Auditors charge companies for the time spent by their staff on the audit.)

Analytical procedures

Another form of substantive testing is analytical procedures. This involves performing an analysis of the financial statements using ratio analysis and trend analysis, to see whether there is anything that seems unusual or 'different'. When this analysis reveals something unusual, this should indicate the need for more detailed (substantive) testing.

Analytical procedures have been described as carrying out a 'quick and dirty review' and a 'looking at the big picture' for any features of the financial statements that seem unusual and out-of-the-ordinary.

Other auditor assessments

The external auditor must also be satisfied that other aspects of the financial statements are satisfactory. In particular, the auditor will look at the accounting policies that have been used by the company, and they will also look at any estimates or judgements that have been used by the company's management. (Financial statements include numbers based on estimates and judgements, as well as verifiable numbers from the accounting records.)

Ensuring the independence of the external auditor

It has been recognised that although the external auditor is required to provide an independent professional opinion, there are factors that could make it difficult for the auditors to maintain their objectivity.

The auditors are paid by the company for their work. In some cases, the audit fee is very large, and it should be expected that audit firms should want to retain their audit clients each year, in order to earn revenue for their business. If an auditor is concerned about retaining an audit client, there may be a reluctance to challenge the company's management and disagree with the information in the financial statements.

One aspect of good corporate governance is that companies should establish an **audit committee** of non-executive directors. One of the functions of the audit committee is to monitor the external audit and discuss aspects of the audit with the auditors. The audit committee should also recommend to the board of directors

whether the audit firm should be re-appointed for the next financial year, and should approve the proposed audit fee.

The external auditors communicate mostly with the company's executive managers – the finance director, chief accountant and other members of the accounts department in particular. However, the audit committee should reduce the dependence of the external auditors on the company's management, and help to protect and ensure the independence of their opinion. If they disagree with management about any aspect of the financial statements, they can discuss their concerns with the audit committee.

2.5 The nature of internal audit and role of the internal auditor

The directors of a company and the senior management are responsible for the reliability of the financial statements. They are responsible for making sure that the financial controls are sufficient for preventing, limiting or detecting errors and fraud.

They might use internal audit to monitor systems of control within the accounting system and the controls in other operations and procedures. Internal audit can help management to obtain assurance that the controls that exist are adequate and are properly applied and complied with. Where controls are weak, or are not applied properly, an internal auditor can recommend improvements – such as new controls or better procedures for enforcing compliance.

Internal audits are carried out by internal auditors. A company (or other business entity) might ask an external firm of accountants to provide staff for internal audit work. However, many companies employ their own internal auditors, and there is an internal audit department or section within the company.

Internal audit: not a legal requirement

There is no legal requirement for internal audit, and many companies do not have an internal audit department or internal audit section.

However, some codes of corporate governance require large stock market companies that do not yet have internal auditors to consider each year whether they should have them. This is a requirement, for example of the Combined Code on corporate governance in the UK.

'The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.' (Extract from the Combined Code).

The nature of internal audits

Internal audits are initiated at the request of management, and an audit can be a formal check of anything. Internal audits are usually divided into three types:

- Financial audits: see below.

- Operational audits: these are audits into any aspect of operations, such as health and safety procedures, and security arrangements. The audit should provide assurance to management that the objectives of the operation are valid, that the control information produced from the system are reliable and that operational activities are economical, efficient and effective.

- Compliance audits: these are audits to check on compliance with important aspects of regulation, to make sure that the regulations are implemented.

Another type of audit is a **management audit**. This is a check on the effectiveness of management and organisation structures in achieving the objectives and applying the policies of the company. Management audits should be carried out by someone at a senior management level (or by external consultants).

Within the context of corporate governance, the role of internal audit can be described as follows:

- To review controls, and report to the directors of the company on the effectiveness of the control system. These could be financial controls, controls in the operating system or controls to ensure compliance with regulations.

- To report both to directors and management of the company, presenting the findings of the audit and making recommendations for the improvement of controls or better compliance with existing controls.

The syllabus for the examination specifies financial controls; therefore the main aspect of internal audit for the purpose of the examination is financial audits.

There are several types of **internal financial audit**.

- The **'traditional' internal audit is a financial audit** into the effectiveness of financial controls and the accuracy of accounting records. In this respect, internal audit duplicates the work of the external auditors. The external auditors might be able to rely on some of the work of the internal audit department in reaching their audit opinion for the external audit, which means that their own audit checks do not have to be as extensive. A traditional internal audit might take the form of a systems audit, a compliance audit or substantive testing.

- A **systems audit** is another name for a test of controls. A system and the controls in the system are investigated and documented. The controls are then assessed and weaknesses are identified. The internal auditor then makes recommendations for improvements in the control system. The basis for a systems audit is that if the controls in a system are adequate, the risk of errors or fraud should be reduced to a tolerable level.

- A **compliance test** is a test to check whether the controls in a system and the established procedures are properly complied with. Non-compliance increases the risk of fraud or error. Compliance tests involve selecting a number of

transactions and following them through the system, to make sure that all the necessary controls were properly applied.

- A **value for money audit** or **VFM audit** is an investigation into an area of operations, to assess its economy, efficiency and effectiveness:

  - Economy is concerned with whether spending has been kept under reasonable control, and has not been excessive. It is an audit of spending and prices paid.

  - Efficiency is concerned with whether resources have been used efficiently and productively. The VFM audit looks at material usage/wastage rates, machine utilisation and labour productivity.

  - Effectiveness is concerned with achieving objectives and targets. An audit of effectiveness is a check into whether the purposes or objectives of a process or activity are being achieved. Resources might be used very efficiently, but they might still fail to achieve their intended purpose.

- **IT audits**. Internal audits are often audits of IT systems, to carry out checks on the effectiveness of controls in the system.

The internal auditor

The internal auditor is an employee of the company. There is no requirement for an internal auditor to be a qualified accountant or a member of a recognised professional accountancy body. There is an Institute of Internal Auditors, but membership of this institute is voluntary.

An internal auditor might be a member of a professional accountancy body such as the ACCA. If so he or she must comply with its code of professional conduct.

Even so, the internal auditor, as an employee of the company who relies on senior management for decisions about remuneration and career development, there are obviously problems with independence and objectivity. It is very difficult for an internal auditor, for example to criticise an accounting system and control weaknesses if the person responsible for financial controls is the finance director and the internal auditors report to the finance directors.

Internal auditors should be made as independent as possible, within the limits of the fact that they are also employees. Ways of making the internal auditor sufficiently independent are:

- to make the internal auditor report to a very senior level of management – possibly the finance director, and

- in addition make the internal auditor directly accountable to the board of directors or the audit committee (which is a sub-committee of the board of directors).

2.6 Internal and external audit compared

The differences between the external auditor and internal auditor might be summarised as follows.

	External audit	Internal audit
Role	To express a professional opinion on whether the financial statements give a true and fair view.	To examine systems and controls, and to assess the risks and controls with a view to making recommendations to management
	External audits are audits of the financial statements.	Internal audits may be financial, operational or compliance audits.
Report to	The shareholders	Management
Appointed by	The shareholders, on the recommendation of the directors	Management
Employed by	External audit firm	The company
Duties set out by	Company law (statute)	Management
Qualification to perform audits	Set out by statute: membership of professional accountancy body required	No professional qualification required
Audit practice	External auditors must comply with auditing standards.	Internal auditors should be encouraged to comply with auditing standards, but do not have to.
Focus on	Financial statements and whether these give a true and fair view	The management and control of risks – identifying areas of risk and recommending ways of improving risk management and control systems. Internal audit might look at operational and compliance risk, and strategic (business) risk, as well as financial risk.

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Internal financial control

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- Internal control
- The five elements in a system of internal control
- The consequences of weak internal financial control
- Risks and internal financial controls
- Features of effective internal financial controls

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3 Internal financial control

3.1 Internal control

Internal control within an organisation is the system of control within the organisation that has been put in place in order to:

- prevent the system from getting out of control and failing to achieve its purpose, and so
- help the organisation to achieve its objectives and policies.

A useful definition of internal control was provided in 1992 in the US by the COSO Framework (COSO is the Committee of Sponsoring Organizations of the Treadway Commission). This defined internal control as: 'a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives' in three particular areas: the effectiveness and efficiency of operations, the reliability of financial reporting, and compliance with applicable laws and regulations.

- Risks to the effectiveness and efficiency of operations are 'operational risks' and controls designed to limit operational risks are 'operational controls'. (These controls are tested by operational audits.)
- Risks affecting the reliability of financial reporting, as well as risks of financial fraud or error, are 'financial risks', which can be mitigated by 'financial controls'. (These controls are tested by traditional financial audits.)
- Risks of non-compliance with important aspects of the law or regulations are 'compliance risks', which can also be controlled by appropriate measures.

The purpose of internal control is therefore to apply control to the system by internal means and internal procedures and arrangements.

3.2 The five elements in a system of internal control

The COSO Framework identified five elements in a system of internal control. These are elements of internal control that must be in place and sufficient in order for internal control to be effective:

- a suitable control environment
- risk identification and assessment

- the design and application of internal controls
- information and communication
- monitoring

A control environment

A control environment is the control culture within the organisation, and the attitude of its employees toward ensuring that controls are adequate and properly applied. Individuals within an organisation will not take control seriously unless they are given direction form their bosses. The company's directors are therefore responsible for the control environment, and the board of directors must establish policies on internal control. There should be a culture of control throughout the organisation, from the board down to all employees, but the leadership must come from the board, which sets the 'tone at the top'.

Within this general control environment, an internal control system consists of four elements. These can be seen as four sequential stages in a control system.

Risk identification and assessment

There should be a system for the regular review of risks, identifying new risks and re-assessing existing risks. Risks that have been identified should be measured, to assess their significance (in terms of probability of an adverse event and the amount of loss that might be incurred if an adverse event happens).

Risk assessment can be carried out by means of a systems audit. Tests of control in the external audit are also a form of risk assessment of current risks and existing internal controls

Control activities (internal controls)

Controls for reducing risks should be designed and implemented. In financial reporting, the main risks are risks of error and fraud. Controls should be designed to eliminate a risk, but before effective controls can be designed, they must first be identified and assessed. Management need to know what the risk is and how serious it might be if it is not controlled.

Internal controls are a part of normal day-to-day operational activities and procedures. The features of internal financial controls are explained in more detail later.

Information and communication

An effective internal control system must have effective channels of communication, to ensure that all employees understand their responsibilities for control and that all relevant information reaches the individuals who need it. Controls cannot be applied effectively unless the individuals responsible for the controls are kept properly informed.

Monitoring

There should be regular monitoring and review of the effectiveness of the system of internal control. One way of monitoring internal control is to have an internal audit department, for carrying out reviews and reporting to senior management.

3.3 The consequences of weak internal financial control

When internal financial control is weak, there is a high risk of errors and fraud in the accounting records and the financial statements.

■ When there is a large error, or an accumulation of smaller errors, the financial statements will not be reliable.

■ Weak internal control makes it easier for fraudsters to operate. Fraud is a criminal activity, and is damaging to company, its shareholders and possibly also its customers.

■ In extreme cases, companies might operate in a condition close to insolvency without its management or its shareholders being aware of the problem. Weak corporate governance and weak financial control have been identified as the main causes of major corporate collapses in the past – and will probably be the cause of more corporate failures in the future.

3.4 Risks and internal financial controls

Financial risks

Financial risks have been described so far as the risk of an error in the accounts or deliberate fraud. It is useful to think about what types of error might occur in the accounting system. (Fraud is described in more detail later.)

■ A transaction might be omitted from the accounts entirely. For example, a sale of goods on credit to a customer for $25,000 might not be recorded. If not, total sales will be under-stated by $25,000 and the amount owed by customers will also be under-stated by the same amount.

■ A transaction might be recorded twice. For example a credit sale of $25,000 to customer X might be recorded twice, so that total sales are recorded as $50,000.

■ A transaction might be recorded with the wrong value. For example, an item of machinery that is purchased for $20,000 might be recorded in the accounts with a value of $30,000.

■ Numbers might be added up incorrectly. For example the total amount of money receivable from credit customers might be stated incorrectly in the financial statements because the amounts owed by each customer are added up incorrectly.

■ A transaction might be recorded as the wrong type of transaction. For example a sale to a customer might be recorded as a purchase, or as a sales return.

Types of internal controls

Internal financial controls are designed and implemented to deal with financial risks. There are two broad types of internal control.

- **Preventative controls**. These are controls that are designed to prevent the error (or fraud) from happening.

- **Detective controls**. These are controls that are designed to identify an error (or fraud) when it happens. When there are detective controls, there should also be **corrective measures** for correcting the error or dealing with the fraud.

3.5   Features of effective internal financial controls

Effective internal financial controls are controls that provide a high level of assurance that errors or fraud will be prevented or will be detected when they happen.

In addition, the cost of an internal control should not exceed the benefits obtain from implementing it. (The benefits are the losses that might otherwise occur if the control did not exist.)

You will learn more about internal financial controls as you progress through your accountancy studies. However, various types of internal control procedure are explained below. The analysis of internal controls is based on a mnemonic that was used some years ago by the UK Auditing Practices Committee. It is no longer used, but is nevertheless a helpful introduction to the subject.

Internal financial control procedures can be divided into eight types or categories, which might be remembered by the mnemonic SPAMSOAP.

S	Segregation of duties	Work should be divided between individuals (segregated) so that work done by one individual acts as a check on the work done by another. See '**internal check**' below.
P	Physical controls	There should be controls to ensure the **physical safety or protection of assets**. For example, cash and valuable documents might be kept in a safe and rooms containing valuable assets such as lap-top computers should be kept locked when unoccupied.
A	Authorisation and approval	These are controls to ensure that transactions should not go ahead unless they have been properly authorised. For example, purchases and other **spending transactions** above a certain value might have to be authorised by a manager with sufficient seniority.
M	Management	Management have a responsibility for exercising control on the basis of the information they receive.
S	Supervision	Work done by individuals might be monitored and checked by a supervisor.

O	Organisation	Controls can be applied by the way in which work is organised and authority is delegated, and how the work of different groups is co-ordinated.
A	Arithmetic and accounting controls	Checks on arithmetical accuracy and other checks within the accounting system help to identify errors.
P	Personnel controls	There should be controls over the selection and training of employees, to ensure that they are aware of the need for accuracy and the need to apply controls.

Internal check

An internal check is a type of internal control. An internal check is intended to prevent errors or fraud, or to detect them quickly when they occur. In financial accounting, an internal check involves arranging accounting tasks and duties so that no single task is performed from beginning to end by just one person. In this way, the work of each individual is subject to an independent check in the course of the work that is done by somebody else.

Internal checks are included in the SPAMSOAP list above as 'segregation of duties'.

Example

An example of segregation of duties is a purchase transaction.

A purchase transaction begins with a purchase requisition, which must be properly authorised. A buyer checks that the purchase requisition is valid and had been properly authorised, before sending a purchase order to the supplier.

A warehouse manager or goods inwards manager is responsible for checking that purchase orders are delivered from the supplier, checks the items on receipt against the purchase order and delivery note, and takes custody of the goods.

The purchase invoice is received by an accounts clerk and checked against a copy of the purchase order and delivery note. The purchase invoice is then recorded in the accounts.

The cashier is responsible for making the payment, and is responsible for ensuring that the amount paid is the amount on the invoice.

The payment is recorded by the accounts clerk in the accounting system. The clerk checks that the correct amount has been paid by the cashier.

Example

Another example of segregation of duties is a system in which the individual responsible for sending out sales invoices and recording the sales and amounts receivable in the accounting system should not be the same person who receives and processes the payments from the customers.

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Example

Internal controls can be categorised as preventative controls, detective controls and corrective controls. Here are some examples:

Type of internal control	Examples
Preventative	Segregation of duties helps to prevent fraud.
	Authorisation controls help to prevent improper spending.
	Passwords in computer systems prevent unauthorised access.
Detective	Segregation of duties helps to identify errors
	Reports of unusual amounts, values or transactions in **exception reports** can bring possible errors to the attention of management.
	Reconciliation checks within an accounting system can detect errors (when figures do not reconcile properly).
	Supervisory checks can detect errors by accounts clerks.
Corrective	Management action on receiving information about errors or variances from plan.

IT system security and controls
■ Threats to IT system security
■ General controls and application controls
■ General controls in IT
■ Application controls in IT
■ IT system audits

4 IT system security and controls

4.1 Threats to IT system security

Business organisations rely on IT systems to function. For example, accounting systems are often computerised, and might contain large amounts of confidential data. Computer systems need to be kept secure from errors, breakdown, unauthorised access and corruption. Maintaining system security, even for small home computers linked to the internet, is a permanent problem and the risks must be managed continually.

Some of the major risks to IT systems are as follows:

■ **Human error**. Individuals make mistakes. They may key incorrect data into a system. In some cases, they may wipe out records, or even an entire file, by mistake. Human error is also a common cause of lapses in system security – leaving computer terminals unattended is just one example.

■ **Technical error.** Technical errors in the computer hardware, the software or the communications links can result in the loss or corruption of data.

■ **Natural disasters**. Some computer systems may be exposed to risks of natural disasters, such as damage from hurricanes, floods or earthquakes.

■ **Sabotage/criminal damage**. Systems are also exposed to risk from criminal damage, or simply theft. Risks from terrorist attack are well-publicised. Losses from theft and malicious damage are much more common.

■ **Deliberate corruption**. All computer systems are exposed to risk from viruses. Hackers may also gain entry to a system and deliberately alter or delete software or data.

■ The **loss of key personnel** with specialist knowledge about a system (for example, the risk that a senior systems analyst will leave his job in the middle of developing a complex new system)

■ The **exposure of system data to unauthorised users** (for example hackers) and industrial espionage.

In addition, there are risks within the computer software itself:

■ The software might have been written with mistakes in it, so that it fails to process all the data properly.

■ The software should contain controls as a check against errors in processing, such as human errors with the input of data from keyboard and mouse. The software might not contain enough in-built controls against the risk of input error and other processing errors.

4.2 General controls and application controls

Controls in IT can be divided into two categories:

■ general controls, and

■ application controls.

General controls are controls that are applied to all IT systems and in particular to the development, security and use of computer programs. Examples of general controls are:

■ physical security measures and controls

■ physical protection against risks to the continuity of IT operations

■ general controls within the system software such as passwords, encryption software, and software firewalls

■ general controls over the introduction and use of new versions of a computer program

■ the application of IT Standards.

Application controls are specific controls that are unique to a particular IT system or IT application. They include controls that are written into the computer software, such as **data validation checks** on data input.

4.3 General controls in IT

Physical access controls

Physical controls in an IT environment are the physical measures to protect the computer systems such as:

■ putting locks on doors to computer rooms and keeping the rooms locked when there are no authorised staff in the room.

■ putting bars on windows, and shatterproof glass in computer room windows, to deter a break-in.

Protection against physical disaster: protection against risks to business continuity

Computer systems are vulnerable to physical disasters, such as fire and flooding. Risk control measures might include:

■ locating hardware in places that are not at risk from flooding and away from locations that are in low-lying areas

- physical protection for cables (to provide protection against fire and floods)
- back-up power generators, in the event of a loss of power supply
- using shatter-proof glass for windows where the computer is located
- installing smoke detectors, fire alarms and fire doors
- regular fire drills, so that staff know what measures to take to protect data and files in the event of a fire
- obtaining insurance cover against losses in the event of a fire or flooding.

Note that in some organisations, risk measures have also been taken to counter the risk to computer systems from terrorist attack, and ensure that the computer system will continue to operate even if there is a damaging attack. For example, two companies might agree to allow the other to use its mainframe systems to operate key computer systems, in the event that one of them suffers the destruction of its system in a terrorist attack.

Passwords

A computer password is defined as 'a sequence of characters that must be presented to a computer system before it will allow access to the systems or parts of a system' (British Computer Society definition).

Typically, a computer user is given a prompt on the computer screen to enter his password. Access to the computer system is only permitted if the user enters the correct password.

Passwords can also be placed on individual computer files, as well as systems and programs.

To gain access to a system, it may be necessary to input both a user name and a password for the user name. For example, a manager wanting to access his e-mails from a remote location may need to input both a user name and the password for the user name.

However, password systems are not always as secure as they ought to be, mainly due to human error. Problems of password systems include the following:

- Users might give their passwords to other individuals who are not authorised to access the system.
- Users are often predictable in their choice of passwords, so that a hacker might be able to guess, by trial and error, a password to gain entry to a system or program or file. (Typically, users often select a password they can remember, such as the name of their father or mother, or the month of their birth).
- Passwords are often written down so that the user will not forget it. Copied passwords might be seen, and used, by an unauthorised person.
- Passwords should be changed regularly, but often-poor password control management means that passwords go unchanged for a long time.

A system of password controls should operate more successfully if certain control measures are taken.

■ Passwords should be changed regularly frequently, and employees should be continually reminded to change passwords.

■ Users should be required to use passwords that are not easy to guess: for example, an organisation might require its employees to use passwords that are at least 8 digits and include a mixture of letters and numbers.

■ A security culture should be developed within the organisation, so that the user's staff are aware of the security risks and take suitable precautions.

Encryption

Encryption involves the coding of data into a form that is not understandable to the casual reader. Data can be encrypted (converted into a coded language) using an encryption key in the software.

A hacker into a system holding data in encrypted form would not be able to read the data, and would not be able to convert it back into a readable form ('decrypt the data') without a special decryption key.

Encryption is more commonly used to protect data that is being communicated across a network. It provides a protection against the risk that a hacker might intercept and read the message. Encryption involves converting data into a coded form for transmission with an encryption key in the software, and de-coding at the other end with another key. Anyone hacking into the data transmission will be unable to make sense of any data that is encrypted.

A widely-used example of encryption is for sending an individual's bank details via the Internet. An individual buying goods or services from a supplier's web site may be required to submit credit card details. The on-line shopping system should provide for the encryption of the sender's details (using a '**public key**' in the software for the encryption of the message) and the decryption of the message at the seller's end (using a '**private key**' for the decryption).

Preventing or detecting hackers

Various measures might help to prevent hacking into a system, or to detect when a hacker has gained unauthorised access. However, the fight against hacking is never-ending, and computer users must be alert at all times.

Controls to prevent or detect hacking include:

■ physical security measures to prevent unauthorised access to computer terminals

■ the use of passwords

■ the encryption of data

■ audit trails, so that transactions can be traced through the system when hacking is suspected

- **network logs**, whereby network servers record attempts to gain access to the system
- firewalls.

Firewalls

Firewalls are either software or a hardware device (between the user's computer and modem). Computer users might have both.

The purpose of a firewall is to detect and prevent any attempt to gain unauthorised entry through the Internet into a user's computer or Intranet system.

A firewall:

- will block suspicious messages from he Internet, and prevent them from entering the user's computer, and
- may provide an on-screen report to the user whenever it has blocked a message, so that the user is aware of the existence of the messages.

In spite of the preventive measures that are taken, there is a very high risk that computers attached to the Internet will suffer from unauthorised access. An organisation would be well advised to carry out regular tests on its computers, to search for items that have been introduced without authority and illegally, and to get rid of them.

Firewalls can be purchased from suppliers. Some software is provided with in-built firewall software. Some firewall software can be downloaded free of charge from the Internet. There is no excuse for a computer user with Internet access not to have a firewall.

Firewalls are necessary for computers with Internet access because:

- they are continually exposed to corrupt messages and unauthorised access for as long as they are connected to the Internet (which may be 24 hours a day) and
- the volume of 'suspicious' messages circulating the Internet is immense.

Computer viruses

Viruses are computer software that is designed to deliberately corrupt computer systems. Viruses can be introduced into a system on a file containing the virus. A virus may be contained:

- in a file attachment to an e-mail or
- on a backing storage device such as a CD.

The term 'virus' might also be used to describe other methods of corrupting a system.

Trojan horses	Whilst the user thins that the system is carrying out one program, the Trojan horse secretly carries on another.
Worms	This is corrupt data that replicates itself within the system, moving from one file or program to another.
Trap doors	A trap door is an entry point to a system that bypasses normal controls to prevent unauthorised entry.
Logic bombs	This is a virus that is designed to start 'working' (corrupting the files or data processing) when a certain event occurs.
Time bombs	This is a virus that is designed to start 'working' (corrupting the files or data processing) on a certain date.

Viruses vary in their virulence (the amount of damage they may cause to software or data. The most virulent viruses are capable of destroying systems and computers (by damaging its operating system).

Viruses are written with malicious intent, but they may be transmitted unwittingly. Since a virus does not always begin to corrupt software or data immediately, there is time for a computer user to transmit the virus to another computer user, without knowing.

New viruses are being written continually. Some software producers specialise in providing anti-virus software, which is updated regularly (perhaps every two weeks) to include software for dealing with the most recently-discovered viruses.

Anti-virus software is able to:

- detect known viruses in a file
- report the virus to the computer user
- isolate the virus so that it is not able to corrupt software or data in the computer.

There are a number measures that might be taken to guard against computer viruses. These include the following:

- The computer user should buy and install anti-virus software. Since new viruses are written daily, the anti-virus software must be updated regularly. Providers of anti-virus software allow customers to download updated versions of their software regularly.

- The computer user might restrict the use of floppy disks and re-writable CDs, because these are a source of viruses. The computer user may even install computer terminals that do not have a CD drive or floppy disk drive, to eliminate the risk of a virus being introduced on a disk.

- Firewall software and hardware should be used to prevent unauthorised access from the Internet. This will reduce the risk from e-mails with file attachments containing viruses.

- Staff should be encouraged to delete suspicious e-mails without opening any attachments.

- There should be procedures, communicated to all staff, for reporting suspicions of any virus as soon as they appear.

When a virus is detected in the computer system, it may be necessary to shut the system down until the virus has been eliminated.

IT Standards

A range of IT Standards have been issued. For example, the International Standards Organisation (ISO) has issued IT security system standards. There are also IT Standards for the development and testing of new IT systems.

IT Standards are a form of general control within IT that help to reduce the risk of IT system weaknesses and processing errors, for entities that apply the Standards.

4.4 Application controls

Application controls are controls that are designed for a specific IT system. One example of application controls is data validation. Data validation checks are checks on specific items of data that are input to a computer system, to test the logical 'correctness' of the data. If an item of data appears to be incorrect, the system does not process the data: instead it issues a data validation report, so that the apparent error can be checked and corrected if appropriate.

Just a few examples of data validation checks are set out below, as illustration.

- A transaction for a sales invoice input to the accounting system must include an amount for the sales value/amount owed. If a transaction is input to the system without any value for the amount receivable, an error report should be produced.

- A transaction for the purchase of goods from a supplier input to the accounts system should include a code number for the supplier. If all supplier codes are in the range 2000 – 3999, an input purchase transaction containing a supplier code outside this range can be reported as an error.

- Key code numbers can be designed to include a 'check digit'. This is an additional digit in the code that enables the program to check the code against an input error (such as entering a customer account code as 12354 instead of 12345).

Application controls of this kind are unique to a particular IT system, but are a way of preventing errors from entering the computer system for processing, and reporting errors so that they can be corrected.

4.5 IT system audits

Internal auditors might be used to perform IT system audits. The purpose of an IT system audit is to:

- assess the various risks to the system, such as the vulnerability of the system to hackers (unauthorised access) and the risk of processing errors

- assess the adequacy of the general and application controls for dealing with those risks

- recommend improvements in general or application controls to reduce the risk of error or fraud.

> ### Fraud and fraud prevention
>
> - Definition of fraud and types of fraud
> - Circumstances where fraud is more likely
> - The consequences of fraud
> - Detection of fraud
> - Prevention of fraud

5 Fraud and fraud prevention

5.1 Definition of fraud and types of fraud

Fraud is an intentional act involving deception, carried out by one or more individuals with a view to obtaining a personal gain.

There are several types of fraud in accounting:

- Theft of assets, including cash
- Unauthorised use of company assets, such as the use of a company car to operate a private business
- Deliberate falsification of documents and records, with a view to presenting misleading financial statements (financial reporting fraud) or avoid payment of tax (tax evasion).
- Computer fraud, which is fraud carried out using a computer system or within a computer system.

A distinction is also made between:

- **internal fraud**, which is fraud committed by one or more employees of the entity, and
- **external fraud**, which is fraud committed by someone outside the entity, such as a hacker into a computer system.

Fraud might be committed by an individual acting on his or her own. Alternatively, fraud might be committed by two or more people acting together: this is called **collusion**.

Fraud is different from error. Errors are unintentional mistakes. Fraud, on the other hand, is deliberate/ intentional. It is also a criminal activity.

Examples of the different types of fraud are set out in the table below.

Type of fraud	Examples
False accounting	Deliberately increasing the reported profit by false means, in order to increase the share price (and sell shares at a profit). Deliberately increasing the reported profit by false means, in order to earn a larger bonus. Deliberately reducing the reported profit in order to evade the payment of tax: falsifying records for tax purposes.
Theft	Direct theft of cash, inventory or other assets. For example, an employee might sell goods to a customer for cash and keep the money. Making false expense claims Payroll fraud: arranging for payments of wages or salaries to non-existent employees.
IT fraud	Hacking/ unauthorised access into a system to transfer money out of another person's account (for example, hacking into an online banking system) Selling goods on a web site (and taking payment) without any intention of delivering the goods to the customer.
Collusion	An arrangement between an employee and a customer to supply goods without the customer paying for them or with the customer paying a much-reduced price. An arrangement between an employee and a supplier to pay for goods that have not actually been delivered, or to pay an excessively high price.

Example of fraud: teeming and lading

A common form of internal fraud is **teeming and lading**.

With this type of fraud, an employee sets up a personal bank account, normally using a false business name, which is very similar to the name of the business that he works for.

He might receive a payment from a customer, say for $200, and pay this money into his own personal bank account. This 'missing money' will be detected unless the fraudster hides what he has done. So when a payment is received from another customer for about $200, he records this as the payment from the first customer.

This means that the payment by the second customer is 'missing', and to cover this missing money, the fraudster will record another payment from a third customer as the payment by the second customer.

This process can go on indefinitely, often with increasing sums being diverted into the fraudster's personal bank account as he gains in confidence.

Another form of teeming and lading applies to suppliers, where a fraudster diverts payments to suppliers into his own personal bank account, and hides the missing payments by reporting subsequent payments to another supplier as payment to the first supplier.

5.2   Circumstances where fraud is more likely

Fraud is more likely to occur in entities where some of the following circumstances exist.

- The senior executive managers are dominant and domineering, and are not sufficiently monitored by independent non-executive directors. This increases the risk of financial reporting fraud.

- Remuneration for management is based on profit performance.

- There are high rates of staff turnover in jobs that perform an important control function (such as supervisory staff).

- Employees in the purchasing or stores department have been in their jobs for a very long time.

- There is not enough segregation of duties, so that internal checks are weak or non-existent.

- Key staff work very long hours, often on their own in the office at the beginning or end of the day; and they do not delegate work and do not take holidays.

- Internal controls are weak or not applied. For example, passwords to computer systems are not changed frequently or access to sensitive areas is not restricted to authorised personnel.

5.3   The consequences of fraud

Fraud is carried out with the intention of making a personal gain

- Fraud with the intention of committing theft, both internal and external fraud, results in **financial losses** for the employer. Money or other assets are taken by the fraudster. For example, if a hacker gains entry to the bank account of an individual with an on-line bank account, and takes money from the account, the bank will usually be held liable for the loss.

- False accounting fraud might result in losses for the employer (due to the payment of bonuses that are not properly deserved) or for investors (who might be persuaded to buy shares in the company at a price that is not justified by the 'real' profit).

When fraud is discovered, particularly internal fraud, this can have an **adverse effect on the morale** of other employees (who might feel that the fraudster has been taking advantage of their own honest efforts).

If the existence of fraud becomes public knowledge, this could have an a**dverse effect on the reputation of the entity**. It has been reported that many incidents of fraud are allowed to go unpunished because after its discovery, the employer is unwilling to risk the bad publicity that might arise during a criminal prosecution of the fraudster.

The discovery of fraud can also be **disruptive**. Senior management are likely to want an investigation into how the fraud occurred and why it was not detected sooner. Investigations or audits of this time take up time and divert attention away from normal day-to-day operational activities.

5.4 Detection of fraud

The directors of a company and senior management are responsible for detecting or preventing fraud (internal and external). Fraud can be difficult to detect, because a fraudster hides his illegal activities, and fraud might not be discovered until someone actually looks for fraud, or until the losses become so large that they cannot be covered up any more.

Example: consequences of fraud and failure to detect

A very well-known example of fraud arising due to weaknesses in internal control is the collapse of Barings Bank, Britain's oldest merchant bank, in 1995. The collapse of the bank was the direct consequence of fraudulent activity by a rogue trader, Nick Leeson.

In 1992, Leeson was transferred to the Singapore office of the bank as a general manager. He then qualified to become an authorised trader on the Singapore exchange (SIMEX). The branch also relied on his administrative abilities, and he took on the responsibility for 'back office' administration. He therefore acquired a powerful position in the Singapore branch as general manager, head trader and effective head of back office operations.

Leeson and his team engaged in two types of trading:

- They handled client orders and traded in financial derivative instruments (futures and options) for the bank's clients.

- They also traded speculatively, seeking to make profits from price differences in similar derivatives traded on the SIMEX exchange and Japan's Osaka exchange.

Leeson took unauthorised speculative positions in futures and options, and he hid his trading activities and trading position in an unused error account, number 88888.

He lost money on the speculative trading. Account 88888 had losses of £2 million by the end of 1992, and these rose to £23 million by the end of 1993 and £208 million by the end of 1994. In all this time, the losses were not noticed by the bank's senior managers. Barings management were totally unaware of the situation.

Early in 1995, Leeson felt that he could not hide the losses any more. They had now risen to over £800 million He boarded a plane for Kuala Lumpur and left Singapore.

Weak controls and procedures within the bank help to explain why Leeson's losses were able to continue for so long without notice. Leeson had to pay large sums of money to SIMEX to cover his losses, but he was able to obtain the cash from other parts of Barings and from client accounts by falsifying accounts and other documentation. Leeson reported to more than one 'boss' in London, but his lines of

reporting were not clear and none of his managers assumed direct responsibility for monitoring his activities.

Leeson and his staff were able to profit personally whilst the bank was making huge losses. This was because the huge losses in account 88888 were not reported, but Leeson did report 'profits' that he booked to other trading accounts for the bank, and the bank aid annual bonuses on the basis of these reported profits.

Better internal control should have either prevented the situation from arising, or should have detected the problems much sooner.

5.5 Fraud prevention

The directors and senior management are responsible for preventing fraud as well as detecting it when it occurs. Fraud prevention measures should consist of a combination of:

- internal controls and
- developing a culture of fraud awareness and a culture of control.

Internal controls for preventing fraud are often the same as the controls for preventing errors:

- individuals should be 'screened' before they are taken on as employees
- all employees should be given training (including 'refresher' training from time to time) in anti-fraud policies and whistle-blowing procedures
- senior management should ensure that other managers and employees remain fully aware of the need to apply controls to prevent errors and fraud
- fraud risks should be identified (as part of the regular review of financial risks) and suitable controls for preventing fraud should be designed and implemented.

Whistle-blowing policy

An entity should have a policy to encourage whistle-blowing. Whistle-blowing is the reporting by an employee of suspicious activities by one or more other employees that cannot be reported through normal reporting lines. For example:

- a subordinate might wish to report a suspicion of fraudulent activity against his boss
- when someone reports suspicions of fraud by a colleague to his boss, the boss might refuse to believe the allegation and do nothing about it.

When an entity has a whistle-blowing policy, it provides a procedure for any employee to report suspicions of fraud or illegal activity to a senior person or a committee of senior individuals. The allegations should then be investigated.

There have been some notorious examples of whistle-blowing. Suspicions reported by an individual in the accounts department of US corporation Enron (Sharon Watkins) eventually led to the discovery of fraud by senior management, which in turn led to the collapse of the company in 2002.

However, in practice there have been problems with whistle-blowing procedures.

■ Some reports of suspicious activities by another person might be malicious and deliberately untruthful

■ If a whistle-blower's claims are dismissed, the whistle-blower might be exposed to victimisation by the individual or individuals against whom he made the allegation. Or example, if a subordinate reports suspicions of fraud by his boss, which are dismissed, the boss might 'get his revenge' by refusing to recommend the subordinate for any annual bonus or career promotion.

CHAPTER

7

Management and leadership

Contents	
1	Definitions: leadership, management and supervision
2	The nature of management: classical theories
3	Modern theories of management
4	Leadership style
5	Theories of leadership: contingency theories
6	Leadership qualities

Definitions: leadership, management and supervision
■ Definition of leadership
■ Definition of management
■ Definition of supervision

1 Definitions: leadership, management and supervision

Earlier chapters in this text described business organisation and governance. An organisation consists of many individuals, who should be working towards common goals or objectives. Individuals are given direction and co-ordinated by their managers and leaders. This chapter looks at the role of the leader, manager and supervisor, and how these roles differ.

1.1 Definition of leadership

It is often assumed that 'leadership' and 'management' mean the same thing. In business organisations, individuals are put into positions of formal authority, and in that position they are expected to provide leadership to subordinates or team members. It is certainly the case that in formal business organisations, managers are expected to provide leadership. However, leadership and management are different, and not all managers make good leaders.

Leadership means giving a lead to others. A leader gives guidance and direction, and other ('followers') follow the lead that they are given.

It might be tempting to think of a leader as someone who tells other people what to do, but there are different ways of leading, and 'telling' is just one of them.

Followers look to their leaders for direction and guidance. Leaders also influence others, and can inspire them and motivate them.

1.2 Definition of management

Management is about planning, controlling, putting appropriate organisation structures in place (organising), as well as communicating and co-ordinating. The roles of management can be listed as follows:

- set objectives
- plan for the achievement of those objectives
- organise resources for the achievement of planning objectives (including organising employees)
- establish controls for activities and operations
- co-ordinate activities
- establish effective communications between people both inside and outside the organisation
- monitor actual performance

■ take corrective action where necessary

■ review actual achievements and establish new planning objectives.

Giving leadership to employees is an element of management. Leadership is not the same as management, but it is an aspect or feature of management. Planning, organising, co-ordinating and communicating all require leadership, because they involve giving guidance and direction to employees.

Several writers have analysed in detail the difference between leadership and management. The ideas of some of these writers are explained more fully later in this chapter.

1.3   Definition of supervision

Supervision means 'looking over' someone else. It is management by overseeing the performance or activities of an individual or group of individuals, and making sure that the work of the group or individuals is performed properly.

Supervision is also called 'front line management' and 'supervisory management'. It is the lowest level of management in an organisation structure.

The main function of supervisors is to provide administrative management. However, in addition to performing an administrative task, supervisors might also be expected to:

■ develop staff, possibly by 'empowering' them and encouraging them to take on responsibility, and

■ help to train them (through 'on-the-job-training').

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The nature of management: classical theories

- Scientific and classical theories of management
- F W Taylor (1856 – 1915) and scientific management
- Henri Fayol (1841 – 1925) and principles of management
- Weber (1864 – 1920) and bureaucracy
- Elton Mayo (1880 – 1949) and the human relations school
- Classical and human relations theories of management: a summary

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2 The nature of management: classical theories

2.1 Scientific and classical theories of management

An earlier chapter on organisation introduced some of the classical theories of management, in particular the ideas of Henri Fayol.

Early theories of management were concerned with:

- the roles of the manager and
- how managers might perform their roles better and more effectively.

These theories focused mainly on the management of work (rather than the management of people at work). 'Classical' theories of organisation and management are associated with theorists such as:

- Taylor and the scientific school of management
- Fayol, and
- Weber.

2.2 F W Taylor (1856 – 1915) and scientific management

Frederick Taylor was a US engineer who is considered the founder of 'scientific management'. Scientific management is concerned with applying scientific techniques of analysis and experimentation to improve the efficiency of work.

Taylor studied the relationship between people and the tasks that they perform. His approach was to analyse the tasks that individuals perform at work, and break them down into smaller units of work. Each small unit of work was then analysed to find ways in which they could be performed with the greatest efficiency (in the shortest time). Experimentation was used to find ways of improving efficiency for each small unit of work, and Taylor measured the time that it took to carry out each small task.

Taylor is considered the originator of 'time and motion study'. Scientific management resulted in:

- dividing larger tasks into much smaller units,
- employing individuals to specialise in each small unit of work, and therefore
- increasing efficiency through the division of work and specialisation.

Taylor is probably best known for the experiments he carried out into shovelling coal at the Bethlehem Steel Works in the US. Taylor succeeded in improving productivity through:

■ analysing the tasks involved in shovelling coal

■ experimenting with different types of shovel (for example, different sizes of shovel and shovels with different lengths of handle) and the amount of coal that should be shovelled in a single action, and

■ introducing work specialisation within shovelling operations.

The four underlying principles of scientific management

Taylor suggested that there should be four underlying principles in scientific management.

■ There should be a science of work, based on the analysis of work methods and work times, with a view to finding the most efficient way of carrying out tasks. A fair level of performance or efficiency can be identified. Workers should be rewarded through higher pay if they succeed in performing more efficiently than the expected or standard level.

■ Workers should be selected carefully. They should have the skills and abilities that are well-suited to the work. They should also be trained in how to do the work efficiently.

■ The scientifically-selected and trained workers and the science of work should be brought together for the best results and greatest efficiency.

■ There should be an equal division of work between the workers and management, and workers and managers should operate closely together. (This was not the normal practice at the time, in the US in the late 1800s.) The management should take over all the work from the workers for which they are more capable.

Criticisms of scientific management

Scientific management is still associated with work study and time and motion study. It has been strongly criticised because it results in dull, repetitive and monotonous work. Tasks are reduced to such small units, such as tasks on a large production line in a factory, that they demoralise the workers who do the jobs. There is a risk that when employees are doing dull, repetitive work, their efficiency will be low because they are not at all interested in what they are doing.

However, some of the principles of scientific management are valid, and continue to be applied. In particular, the scientific study of work can help to improve the organisation of work procedures and methods.

2.3 Henri Fayol (1841 – 1925) and principles of management

The ideas of Henri Fayol are probably close to the ideas that many individuals hold about management and the functions of management. Fayol argued that managers are given formal authority within an organisation structure and they are responsible (to their superiors) for the effective use of their authority.

Fayol suggested that there are five main tasks of management:

- to plan (and look ahead)

- to organise

- to command: today, the word 'command' should probably be replaced by 'provide leadership'

- to co-ordinate, and

- to control (by monitoring performance and inspecting output).

He believed that there are principles of good management that apply to all types of organisation, and that these principles should therefore be applied consistently. These principles were described in a previous chapter and are not repeated here.

2.4 Weber (1864 – 1920) and bureaucracy

Max Weber was a German sociologist, who studied the growth in the number, size and power of large bureaucratic organisations. He suggested that bureaucracy provides an organisation structure in which human activity is 'rationalised' and co-ordinated.

He argued that an 'ideal' bureaucracy has the following characteristics.

- There should be a hierarchy of authority, from top management down to workers at the bottom. Offices (management positions) should be ranked in hierarchical order, with information flowing up the chain of command and instructions and directions passing down the chain.

- An ideal bureaucracy should operate in an impersonal and impartial way. There should be a clear statement of duties, responsibilities, standardised procedures and expected behaviour.

- There should be written rules of conduct.

- There should be promotion of individuals within the organisation, based on their achievement.

- There should be division of labour and specialisation of work.

- The ideal bureaucracy will achieve efficiency in operations.

Weber was also interested in authority, and how men and women claim authority over others, so that others will do what they ask. He defined authority as 'getting things done by giving orders, and having those orders accepted as justified and legitimate.' (He made a distinction between authority and power. Power is getting things done by using force or the threat of force or punishments.)

He identified three types of legitimate authority.

- **Traditional**. Weber suggested that authority based on tradition pre-dates modern society. Traditional authority is associated with the hereditary power of royal families and chieftains and the 'head of the household', with leadership passing from father to son when the father dies.

- **Rational-legal**. This form of authority is associated with bureaucracies. Authority is rational, because it is used to achieve clear goals with maximum efficiency. It is legal, because it is based on an impartial system of rules and procedures, and is exercised through the management position that the individual in authority occupies.

■ **Charismatic**. Authority is based on charisma when the individual has special personal qualities that inspire others to do what the individual asks. Weber argued that authority based on charisma depends on the individual for its existence, and so is inherently unstable and short-lived.

Weber believed that bureaucracies would continue to grow in number and size, because they provide a rational organisation for co-ordinating human activities, based on a hierarchy of authority. He recognised, however, that large bureaucracies lead to the 'depersonalisation' of work.

Bureaucracy is often condemned because of 'red tape', 'pen-pushing' and 'soul-destroying work'. However, in spite of the criticisms, many large organisations today are bureaucracies. Government organisations in particular are usually bureaucratic, because bureaucracy operates with clear and impartial rules and procedures. Weber's comments on the 'ideal' bureaucracy may therefore remain valid, even today.

Rosemary Stewart on bureaucracy

Rosemary Stewart is a modern (UK) writer on management theory. She has summarised the four main features of bureaucracy as follows:

■ **Specialisation**. There is specialisation of work, but this applies to the job, not the individual who does the job. This means that there is continuity. When one person leaves the job, the job continues, and another person fills the same position.

■ **Hierarchy of authority**. There is a distinction between 'management' and 'workers'. Within management, there is a hierarchy with clearly-defined levels of authority and 'ranks' of managers.

■ **A system of rules**. The rules of a bureaucracy provide impersonal and efficient rules and procedures. Individuals within a bureaucracy must know what the rules are to do their job successfully.

■ **Impersonal**. In a bureaucracy, the exercise of authority and the system of privileges and rewards are based on a clear set of rules.

Stewart also suggested reasons for the growth of bureaucracy.

■ The **growing size of organisations**. Large organisations need some bureaucratic structure to function efficiently.

■ **Greater complexity of work**. Complexity makes it necessary to have specialisation of tasks within an organisation. Job-holders often need to be 'experts' in their work to deal with the complex issues involved.

■ **Scientific management**. A scientific approach to management is widely used. This approach supports a rational way of organising work and having formal procedures for getting work done.

■ The **demand for equality of treatment**. Citizens expect to be treated equally by organisations. Bureaucracies provide impartiality and should ensure equal treatment for all.

2.5 Elton Mayo (1880 – 1949) and the human relations school

Elton Mayo is regarded as the founder of the human relations movement of management theory. Between 1927 and 1932, he was involved in a set of experiments on productivity at the Hawthorne Works in Illinois (USA). The Hawthorne works were a production site of Western Electric, a manufacturer of telephone equipment.

The original aim of the experiments was a scientific management study into the effect on productivity of changes in working conditions, such as lighting, rest periods during the day, the length of the working day and pay incentives. Six individual workers were selected to take part in the experiments, and their conditions of working were varied in various ways, to see how the changes would affect their productivity. The results of the experiments were unexpected. Even when the working conditions for the six workers were changed back to 'normal' (for example, when they were given shorter rest breaks and longer working hours), their productivity continued to rise. Mayo tried to explain why productivity continued to rise when working conditions were made worse.

Mayo suggested that the reason for improving productivity among the workers could be explained by:

- the motivation and commitment of the individuals in the experiment, and

- the relationship between the employees and management.

Productivity had improved, he argued, because the six workers had become a team, who developed social relationships with each other as well as a work relationship. The team responded positively, because the workers felt that they were contributing freely to the experiments, without any coercion from management.

Mayo developed several arguments, all related to the effect of positive motivation on productivity.

- Work has a social value for workers. Mayo disagreed with the view of F W Taylor, that workers are motivated only by self-interest. The 'informal organisation' is important in affecting workers' attitudes.

- The productivity of workers is affected by their self-esteem. In the Hawthorne experiments, the self-esteem of the six individuals increased because they had been selected to do the experiments.

- Work satisfaction lies in recognition, security and a sense of belonging, rather than money rewards.

- Motivation (and productivity) is affected by the relationship between management and workers. Managers need to communicate with workers. When there is no communication, conflicts are inevitable, and workers resent the focus of management on cutting costs and improving efficiency. Management must therefore develop and apply 'people skills' in order to motivate their workers.

Mayo concluded that a lack of attention to human relationships was a major weakness in earlier theories of management. Managers should become more involved with their workers, and earn the respect of the workers. The result would be improved motivation amongst workers and higher productivity.

It is worth considering that although the ideas of Mayo might seem 'obvious' today, he was the first management theorist to draw attention to the social aspects of working and the effects of motivation on performance.

2.6 Classical and human relations theories of management: a summary

The early writers on management theory suggested that there is a set of concepts and rules that apply universally to all managers and management tasks. Scientific management was based on the belief that certain principles should be applied to the study of work and work methods, in order to improve efficiency. Fayol argued that all managers have a similar role in organisations, no matter what the type or size of organisation, and there are principles of good management that should be applied in every organisation. Weber identified the characteristics of an ideal bureaucracy. Mayo identified the significance of human relations, and argued that it applies to all individuals at work.

Modern writers on management theory have questioned whether 'universal rules' of good management do exist. Various ideas have been put forward that challenge 'classical theories'.

> ## Modern theories of management
>
> - Peter Drucker (1909 – 2005)
> - Rosabeth Moss Kanter
> - Henry Mintzberg
> - William Ouchi: Theory Z
> - Differences between classical and modern theories of management

3 Modern theories of management

There are many writers on management theory, and there is no single 'modern theory' of management. The ideas of some well-known writers are described here.

3.1 Peter Drucker (1909 – 2005)

Peter Drucker was a leading writer on management theory for many years until his death in 2005, and he wrote on a wide range of subjects.

He suggested that there are five areas or categories of management responsibility:

- **Setting objectives.** Managers set objectives for the organisation, and decide on targets for the achievement of those objectives, which they then communicate to other people in the organisation.
- **Organising work.** Managers organise the work that is done, by dividing it into activities and jobs. They integrate the jobs into a formal organisation structure and select and appoint people to do the jobs.
- **Motivating and communicating.** Managers need to motivate their employees. They must also communicate with their employees so that they can do their work.
- **Measuring.** Managers measure performance, perhaps by comparing it against a target or yardstick (benchmark). They analyse and assess performance, and communicate their findings, both to their superiors and their subordinates.
- **Developing people.** Managers need to develop their employees and also themselves. Drucker wrote that the manager 'brings out what is in their employees or he stifles them. He strengthens their integrity or he corrupts them.'

Drucker disagreed with the views of Fayol that general principles of management apply to managers in all types of organisation. He argued that managing a commercial business is different from managing other types of organisation, because the business manager has a key responsibility for the economic performance of the business. Managers perform well and justify their existence and their authority only if they produce the economic results (for example, profits) that are expected.

Drucker therefore suggested that there are three aspects to the responsibilities of managers in business:

- **Managing the business**. Business managers are responsible for matters such as innovation and marketing. Drucker was one of the first management theorists to

argue for 'putting the customer first' – a basic concept on which modern ideas of marketing are based.

- **Managing managers**. Managers need to be managed. One way of doing this is to give them targets for achievement and monitoring their performance. Drucker was the first theorist to use the term 'management by objectives'.
- Managing workers and the work.

3.2 Rosabeth Moss Kanter

Kanter has written widely on management topics, but is probably best known for her work on the inefficiencies of modern bureaucracy, and what organisations need to do to succeed in the modern business environment.

She argued that over time, traditional bureaucratic organisations had become unacceptably slow. A long hierarchical chain of command meant that information passed slowly through the organisation, and decisions took a long time to make.

The world of business had changed, economic circumstances were different, competition had increased, the pace of change was much faster and new technology (particularly developments in computerisation and communications technology) had made the 'old ways of doing things' within a bureaucratic organisation very inefficient.

In her book *Teaching Elephants to Dance* (1989) she argued that today's 'corporate elephants' need to learn to dance as nimbly and speedily as mice if they are to survive in an increasingly competitive and rapidly changing world:

'If the main game of business is indeed like Alice in Wonderland croquet, then running it requires faster action, more creative manoeuvring, more flexibility and closer partnerships with employees and customers than was typical in the corporate bureaucracy. It requires more agile, livelier management that pursues opportunity without being bogged down by cumbersome structures or weighty procedures that impede action. Corporate giants, in short, must learn to dance.'

Kanter argued that the re-birth and success of business organisations will depend on:

- innovation (developing new products, services and operating methods)
- entrepreneurship (taking business risks)
- participative management (encouraging all employees to participate in making decisions about work).

Kanter has argued in favour of 'empowerment', which means giving more authority and power to the individual worker, instead of relying on managers to tell their workers what to do. Empowerment is needed to get the best out of individuals at work.

She has also argued in favour of 'flatter' organisation structures, and getting rid of the hierarchies of management and long chains of command that characterise large bureaucracies. (When workers are empowered and given more authority to make decisions for themselves, the need for supervision by management is reduced. Empowerment and flatter organisation structures are therefore consistent with each other.)

3.3 Henry Mintzberg

Henry Mintzberg is another modern management theorist who has written on a wide range of topics. He is particularly well-known for research that he carried out

into what managers actually do. According to classical theorists such as Fayol, the role of managers is to plan, organise, command, co-ordinate and control.

Mintzberg suggested that reality is different. His research into the activities of managers made the following discoveries:

■ A lot of management work is disjointed. Planning, for example, is done on a day-to-day basis, when time permits between more urgent or immediate tasks.

■ Managers spend some of their time on routine duties of a ceremonial nature, such as meeting with important visitors.

■ Managers prefer informal verbal communication to formal written communications, such as reports and briefing notes. Communicating informally by word of mouth is much faster and more effective than communication through the formal information system.

■ Management activities and decisions are based largely on judgement and intuition. General principles of management are not relevant to management practice. In practice, managers do many of their tasks quickly and superficially.

Mintzberg suggested that managers perform three main roles, which can be further analysed into 10 different functions. Together, these ten roles provide an integrated picture of what managers do.

Mintzberg: managerial roles		
Interpersonal	**Informational**	**Decision-making**
Figurehead	Monitor	Initiator or improver, and changer
Liaison	Disseminator	Disturbance handler
Leader	Spokesman	Resource allocator
		Negotiator

■ **Interpersonal role**. Managers spend much of their time performing interpersonal roles:

- As a **figurehead**. Managers often perform a ceremonial role, representing the organisation at events and as a 'public face' of the organisation. Managers also represent their organisation in its dealings with other organisations. Other people might refuse to deal with anyone except the manager, because of the manager's formal position and status.

- As a **leader**. Managers also deal with relations between individuals inside the organisation, providing leadership (hiring, firing, training, motivating and so on).

- **Liaison**. Managers of groups within an organisation act as a link or bridge with other groups. For example, different departments often communicate with each other through their managers. Managers therefore fulfil a role of obtaining information from other sources and other groups.

■ **Information role**. Managers also have an information role.

- **Monitor**. Managers build and use 'intelligence-gathering' systems and monitor the information they receive. They gather information from formal and informal sources, and develop an extensive knowledge of the organisation as a result.

- - **Disseminator**. Managers disseminate information, acting as a channel of information within the group and with others.

  - - **Spokesman**. Managers act as a spokesperson for the group, in a 'public relations' capacity.

- ■ **Decision-making role**. Managers make decisions.

  - - **Initiator of change or improvements**. They have an entrepreneurial role, and take initiatives.

  - - Disturbance handler. They have a role in resolving conflicts and disputes, and dealing with other similar unexpected problems.

  - - **Resource allocator**. They decide how resources should be used, for example what the available money should be spent on and how employees should use their time (what work they should do).

  - - **Negotiator**. They negotiate with others, and reach decisions through joint agreement.

Mintzberg and organisation structure

Mintzberg also challenged the view that the bureaucratic organisation structure is the ideal form of organisation in all circumstances. He suggested that there are five elements or 'building blocks' in an organisation, and the way that the organisation operates depends on which of these elements is dominant.
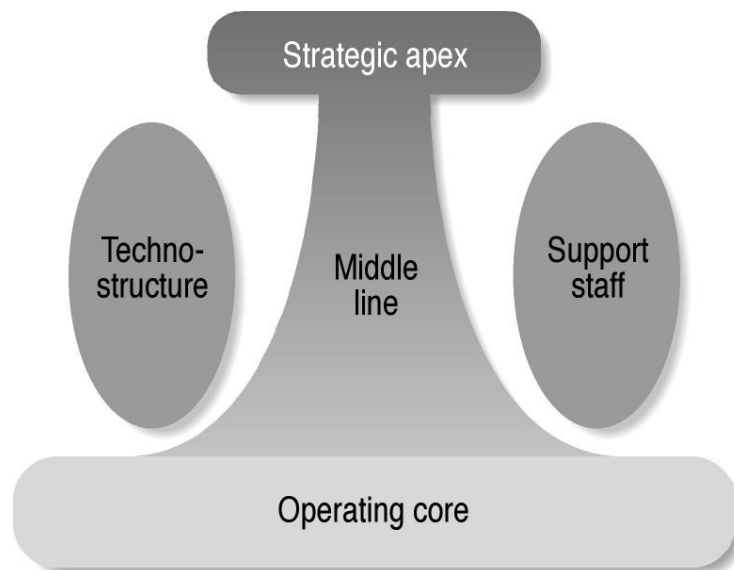
- ■ **Strategic apex**. This is the top management in the organisation.
- ■ **Operating core**. This represents the basic work (basic operations) of the organisation, and the individuals who carry out this work.
- ■ **Middle line**. These are the managers and the management structure between the strategic apex and the operating core.
- ■ **Support staff**. These are the staff who provide support for the operating core, such as secretarial staff, cleaning staff, repair and maintenance staff, and so on.
- ■ **Technostructure**. These are staff without direct line management responsibilities, but who provide technical support to the organisation. They include accountants and IT specialists.

Mintzberg argued that the way in which an organisation functions depends on which of these five groups has the greatest influence.

- When the strategic apex is powerful, the organisation is entrepreneurial. The leaders give the organisation its sense of direction and take most of the decisions.

- When the technostructure is dominant, the organisation often has the characteristics of a bureaucracy, with organising, planning and controlling prominent activities The technical exerts have a strong influence over the way the organisation is managed. The organisation continually seeks greater efficiency.

- When the organisation is divisionalised and local managers are given extensive authority to run their own division in the way that they consider best, the middle line is dominant.

- Some organisations are dominated by their operating core, where the basic 'workers' are highly-skilled and seek to achieve proficiency in the work that they do. Examples might be schools, universities and hospitals, where the teachers and doctors can have an exceptionally strong influence.

- Mintzberg identified a type of organisation that he called an 'adhocracy'. This is an organisation with a complex and disordered structure, making extensive use of teamwork and project-based work. This type of organisation will be found in a complex and dynamic business environment, where innovation is essential for success. These organisations might establish working relationships with external consultancies and experts. The 'support staff' element can therefore be very important.

3.4 William Ouchi: Theory Z

William Ouchi made a study of Japanese companies and compared them with companies in the US. His aim was to identify the reasons why Japanese companies performed better than US companies, and in particular why Japanese companies produced better-quality products than their US competitors and achieved much better productivity.

His study of Japanese companies found that in Japan, managers have a high level of trust in their workers, and assume that workers have a strong loyalty towards their company and are interested in team working. Companies in turn show loyalty to their employees, who have employment for life; however, promotion and career progression is slow. Decision-making in Japanese companies is also 'collective', with workers participating in decision-making and management trying to achieve universal agreement and acceptance before decisions are taken.

Ouchi was not the first management theorist to suggest that companies in other countries could learn from the success of Japanese companies. However, his work is notable because he suggested that the most efficient type of organisation for the US might be one that combined features of 'typical' US and Japanese companies.

He called his recommended approach to management 'Theory Z', and he put forward his ideas in a book *Theory Z: How American management can meet the Japanese challenge* (1981).

The essential features of Theory Z, and how Theory Z compares with typical US and Japanese management practice, is set out below.

Typical American company	Typical Japanese company	Theory Z
Short-term employment	Lifetime employment	Long-term employment: not necessarily for life, but much longer than the current average in the US
Decision-making by individual managers with the authority to decide	Collective (or 'consensual') decision making	Collective (or 'consensual') decision making
Individual responsibility	Collective responsibility	Individual responsibility (Notice that here, Ouchi favours the American model over the Japanese model)
Rapid promotion. Quick career progression	Slow evaluation of performance and slow promotion. Take time to learn the business	Slow evaluation of performance and slow promotion
Formal control mechanisms and control measures	Implicit (informal) control mechanisms	Implicit(informal) control, but with explicit (formal) control measures
Specialised career path for employees	Non-specialised career path	Moderately specialised career path
Concern for the employee as an employee	Wider concern for the employee as a person	Wider concern for the employee as a person, including concern for the family of the employee

3.5 Differences between classical and modern theories of management

Classical theories of management attempted to identify general rules of management and organisation that should apply to all types of organisation.

Modern theories of management have successfully challenged many of the ideas in classical management theory. However some aspects of classical management theory are still valid – for example, a scientific management approach to improvements in efficiency has some validity, and the ideas of Mayo have been substantially developed and extended by more modern writers.

Modern theories include the view that the most suitable approach to management varies according to circumstances, and what is best in one situation is not necessarily the best in another. Each organisation, and each management problem, should therefore be considered according to the circumstances. This approach to management is called '**contingency theory**'.

Leadership style

- The importance of effective leadership
- Effective leadership and leadership style
- Trait theories of leadership
- Lippitt and White's leadership styles
- Blake and Mouton's grid
- Tannenbaum and Schmidt's leadership continuum
- The Ashridge model
- Likert's leadership styles

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4 Leadership style

4.1 The importance of effective leadership

Leadership involves interpersonal skills and an ability to motivate others. Effective leadership within an organisation involves:

- guiding and directing others to achieve the goals of the organisation
- making the best use of the knowledge, skills and talent of others in the organisation
- developing the knowledge, skills and talent of others in the organisation.

Effective leadership therefore increases the effectiveness of the organisation, by getting the best out of employees to achieve the aims and objectives of the organisation.

4.2 Effective leadership and leadership style

Since leadership is an aspect of management, it is necessary to establish whether there are any particular skills that a manager should have to be an effective leader. What makes a person a good leader? Are people born to be leaders? Can leadership skills be taught and learned?

Several writers have considered whether effective leadership is a matter of how the leader behaves –the leader's style – and there are differing views about what personal characteristics or style might make a good leader.

There are several types of theory about effective leadership style:

- **Personal characteristics** ('**traits**' or '**qualities**'). There is a view that a leader must possess certain personal qualities of leadership. The best leaders are 'charismatic'. These characteristics are natural, and some individuals are born with them. They cannot be taught.

- It depends on **circumstances**. 'Contingency theories' of effective leadership take the view that the requirements for effective leadership vary according to circumstances. Different styles of leadership are the most effective in different circumstances and situations.

- Leadership styles range from domineering (autocratic or authoritarian) to democratic or even 'laissez-faire'. The most suitable leadership style depends on circumstances.

- Some writers have argued that there is a 'best' leadership style.

- Others have argued that the most appropriate leadership style depends on circumstances ('**contingency theory**' of leadership).

The differing views about effective leadership can probably be appreciated by looking at several theories of leadership style.

4.3 Trait theories of leadership

A trait theory of leadership is that there is a set of personal qualities and characteristics that make a good leader. Individuals either have these qualities or they do not. Some people are therefore 'born leaders'.

Trait theory may have an immediate 'popular' appeal. Descriptions of great leaders in history often refer to the leader's personal qualities that distinguished him or her as someone special and a natural leader.

However, a serious problem with trait theory is that there are many different traits that could be attributed to an effective leader. Some of the more 'obvious' traits are listed below:

- Physical vitality and energy
- Intelligence and good judgement
- Eagerness to accept responsibility
- Enthusiasm and self-confidence
- Competence in the tasks
- Understanding their followers and their needs
- Skill in dealing with people (interpersonal skills or 'soft skills')
- Having a powerful need for achievement
- A capacity to motivate others
- Decisiveness
- Trustworthiness
- Assertiveness
- Flexibility.

It is not necessarily obvious which of these traits are more important than the others in making an effective leader.

Another problem with trait theory is that if leadership skills are natural skills that an individual either has or does not have, this means that leadership skills cannot be learned. Organisations would therefore have to look for natural leaders and promote them, without being able to do anything to improve leadership skills through training and development.

Trait theories of leadership are now largely discredited as a means of identifying leaders. However, if an effective leader is identified and described, it is almost certain that he or she will possess some of the traits in the above list.

4.4   Lippitt and White's leadership styles

In 1938/1939 Lippitt and White carried out an investigation into leadership styles, using groups of schoolchildren working on arts and crafts projects, such as making masks. Three different types of leaders were assigned to the groups, and the behaviour of the children with each of the different types of leader was studied.

The three types of leadership style for the groups were:

■   **Authoritarian** or **autocratic leadership style**. The leader continually gave orders and instructions without offering any consultation.

■   **Democratic style**. The leader offered guidance and encouragement to the children, and participated actively with the group.

■   **Laissez-faire style**. The leader gave the children the knowledge they needed to do the work, but did not become involved and did not participate in the activities of the group.

The study looked at the effects of the different leadership styles on the behaviour and the output of the group members. Their findings are summarised below.

Groups with democratic leaders	Groups with autocratic leaders	Groups with laissez-faire leaders
Morale was high.	Two types of behaviour were found in group members:	These were the worst-performing groups.
Relationships between the group members and between the group members and the leader were friendly.	*Aggressive behaviour:* These individuals were rebellious. They constantly demanded attention from the leader and often blamed others when things went wrong.	Productivity (quantity produced) was low. Quality of output was low. Satisfaction of group members was low.
The group members showed themselves capable of working independently, with the leader out of the room.	*Apathetic behaviour:* These group members placed few demands on the leader and showed not much interest	Group members were unable to work independently.
There was a reasonable amount of originality in the work done by the group members	The quality of the output of cildren in this group was less than the quality produced by groups with a democratic leader.	Group members did not co-operate with each other.
The quality of their output was higher than the quality produced by groups with an authoritarian leader.	The quantity of their output was higher than the quantity produced by groups with a democratic leader.	
The quantity of their output was lower than the quantity produced by groups with an authoritarian leader.		

The conclusions from the study were that:

- The democratic style of leadership was 'best', providing high quality of output, reasonable originality and productivity, and high satisfaction of group members.

- However, some of the boys in the study preferred the authoritarian style of leadership.

4.5 Blake and Mouton's grid

Robert Blake and Janet Mouton (1964) argued that there are two basic elements in leadership behaviour:

- **Concern for the task**. This includes a concern for achieving targets, the volume of output, work efficiency and so on.

- **Concern for people**. This includes personal commitment, ensuring good working relationships with others (particularly subordinates), maintaining good interpersonal relationships, and keeping the trust and respect of the group.

These two concerns are independent of each other, and a leader or manager can be either weak or strong in showing either concern.

Blake and Mouton devised a grid, often known as Blake's grid, which shows these two elements of leadership, one on each axis of the grid. Each axis of the grid is numbered from 1 to 9.

- A score of 1 indicates lowest level of concern.

- A score of 9 indicates the highest level of concern.

- Individual managers or leaders can be placed on the grid, according to their concern for the task and their concern for people.
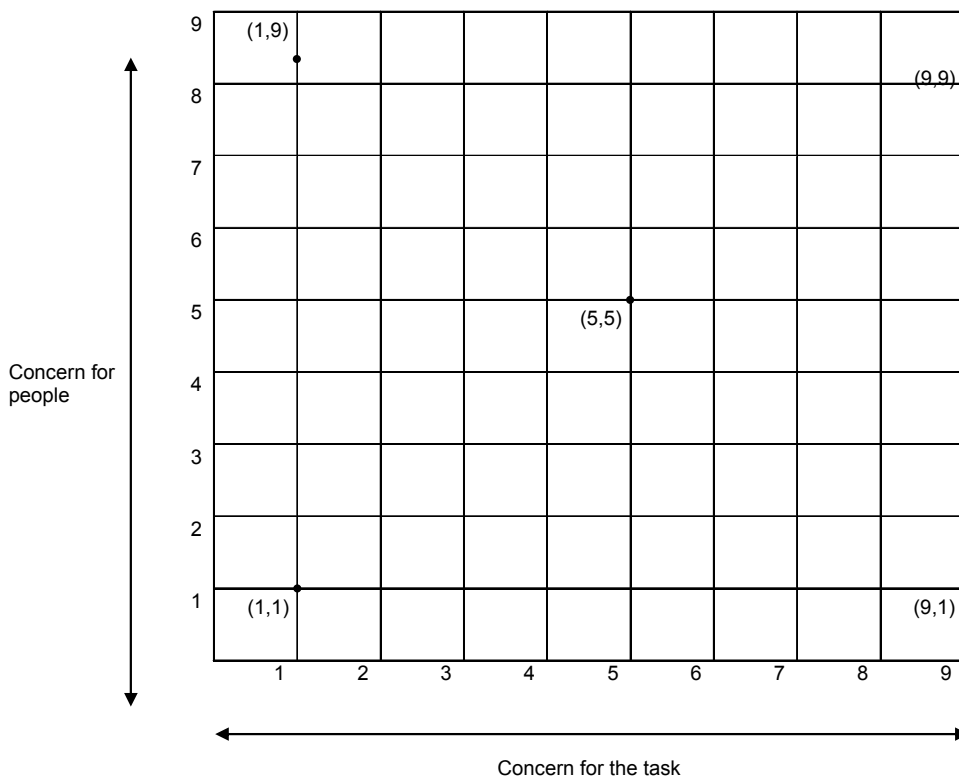
Style

(1,1): Impoverished style	The leader gives little effort to getting work done and has a lazy approach. The worst type of leader possible.
(1,9): Country club style	Low concern for getting the task done, but high concern for people and maintaining good relations.
(9,1): Authoritarian, compliance style	The leader concentrates on efficiency, and getting the work done, with little concern for people. Will seek to eliminate people from the work if at all possible (for example through automation).
(5,5): Middle-of the road style: 'organisation man'	Does enough to get the job done, buy may not be pushing to extend the boundaries of what is possible.
(9,9): Team management	High concern for the task and high concern for people. Provides effective leadership to the team. The most effective type of leader.

Managers/leaders show differing amounts of concern for the task and concern for people, and so may be laced anywhere on the grid.

Blake and Mouton argued that the most effective leaders show high concern for both the task and for people.

4.6 Tannenbaum and Schmidt's leadership continuum

Tannenbaum and Schmidt (1958) developed a model to describe different styles of leadership. They did not argue that one style was the best. Instead, they suggested that leaders might start with one style (an authoritarian or autocratic style), and then change their style (towards more delegation of authority to subordinates) as the group members gain experience and become more mature.

They argued that providing leadership has two main elements:

■ Leaders may exercise their authority and make all the decisions for the group. Leaders who behave in this way are authoritarian.

■ Leaders might also give the group members freedom to make their own decisions. A democratic leader delegates decision-making, although they also identified an 'abdicates' style of leadership, which is similar to a laissez-faire style.

Tannenbaum and Schmidt described the balance between using authority and allowing freedom to subordinates as a continuum or spectrum. The balance can range from strict authoritarian leadership at one end of the continuum to delegation of virtually all decision-making responsibilities at the other end.

Their continuum is shown in the diagram below. Every leadership style involves a varying balance between using authority and giving freedom to subordinates.
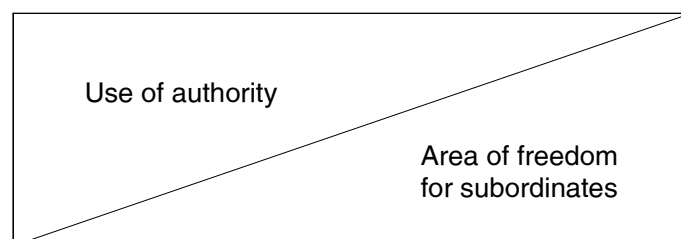
It is important to remember that although the leader delegates authority, he must always retain responsibility for the decisions, actions and performance of his subordinates.

A task of the leader is to develop the individual members of the team and the team as a unit. He should therefore delegate authority and ask the team to make decisions according to the level of their abilities and maturity. **Over time, however, a leader's style should move from the left of the continuum towards the right hand side.**

Tannenbaum and Schmidt identified seven levels of delegated freedom on their continuum.

	Level	
1	Tells	The manager takes the decisions and announces his decision to the team.
2	Tells and sells	The manager takes the decisions, but then 'sells his decision to the group. He explains the reasons for the decision, emphasising the benefits for the team.
3	Tells and talks	The manager takes the decision, presents his decision to the team with the background ideas that led to the decision, and then invites questions. This makes it easier for the team to understand the decision and agree with it, and to understand the issues involved and the implications of the decision.
4	Consults	The manager announces a provisional decision and invites the group members to discuss it. The manager then takes into consideration the views of the team members, and may change his decision. The team members therefore have some influence over the decision.
5	Involves	The manager presents the problem to the team, perhaps suggesting some options. He asks for suggestions about what should be done. He then decides. The team members are therefore closely involved in the decision. This style is appropriate when the team has a high level of knowledge and experience.
6	Delegates	The manager explains the situation to the team, defines the parameters and asks the team to decide. The manager therefore delegates the decision-making entirely, within the stated limits. This leadership style requires a mature team.
7	Abdicates	The manager allows the team to identify the problems, develop options, make a decision and develop action plans for a solution – within the stated limits of his own authority.

4.7 The Ashridge model

A research team from Ashridge College in the UK identified and explained four different styles of leadership:

- Tells
- Sells
- Consults
- Joins

Tells style

A 'tells' style of leadership is dictatorial. The leader makes decisions and imposes them on his subordinates, expecting them to be obeyed without question.

The main advantages of the 'tells' style are:

- Speed of decision-making: the leader does not need to consult anyone before making the decision.
- It will probably result in better decisions when the subordinate is inexperienced or lacks the required understanding to contribute usefully to discussions of problems.

The disadvantages of a 'tells' style are greatest when there is no requirement for fast decisions and the subordinates have experience and skills that they can contribute to discussions. When the leader has a 'tells' style:

- The views of subordinates are ignored
- Any initiative or creativity the subordinates might contribute is lost
- There is too much dependence on one person, the leader.

Sells style

A 'sells' style of leadership is autocratic. An autocratic leader makes his own decisions but then tries to 'ell' them to his subordinates. This means that there is a small amount of consultation about decisions, but not much.

The advantages of a 'sells' style are that:

- Subordinates at least know why certain decisions have been made
- The leader is not dictatorial

However, with a 'sells' style the leader is imposing his views on subordinates and the communication is largely one-way.

Consults style

A 'consults' style is a democratic style of leadership. The leader asks for comments from subordinates before making a decision, and the comments from subordinates might persuade him to change his mind or alter his view about something.

The advantages of a 'consults' style are:

- Greater interest and involvement for subordinates
- Therefore possibly stronger motivation amongst subordinates
- The ability of subordinates to contribute their knowledge and experience to the decision-making process
- The opportunity for subordinates to gain better insights and understanding through being involved in the decision-making discussions.

The disadvantages of a 'consults' style are that:

- Subordinates might not have sufficient knowledge or experience to contribute effectively
- The decision-making process might be slowed down too much, and is unlikely to be desirable at times of crisis when quick decisions are needed.

Joins style

A 'joins' style of leadership is called a 'laissez-faire' style by some management theorists. With this style, the subordinate is allowed to get on with his work and do whatever he likes, within established guidelines and constraints.

The potential advantages are high motivation and commitment from subordinates.

The potential problems are that:

- Individuals often need guidance from a leader.
- Co-ordination between subordinates might be poor.
- There is a risk that the actions of subordinates might undermine the authority of the leader.
- The potential risks are too great if the subordinates are insufficiently knowledgeable and experienced.

Conclusion

Research by an Ashridge College team concluded that:

- Subordinates prefer a 'consults' style of leadership.
- The worst style of leadership is inconsistency in style.

4.8   Likert's leadership styles

Writing in the 1960s, Rensis Likert identified four different leadership styles.

Leadership style	Features of the style
Exploitive authoritative	The leader has a low concern for people. He uses threats and other fear-based methods to get others to do what he instructs. Communication is almost entirely a downward process, from the leader to the subordinates.
Benevolent authoritative	The leader is authoritarian, but also shows concern for people. He is a 'benevolent dictator'. He uses rewards to encourage performance. He listens to concerns of people lower down in the organisation, but he is often told by subordinates what they think he would like to hear. Most decisions are taken by the leader. There is not much teamwork among the subordinates.
Consultative	The leader makes a genuine attempt to listen to his subordinates. He has substantial trust in his subordinates, but not enough to let them take major decisions (which he takes himself). There is some two-way vertical communication between leader and subordinates, and some horizontal communications between subordinates, with a moderate amount of teamwork and co-operation.
Participative	The leader engages subordinates in the decision-making process. He has complete confidence in his subordinates, who feel a responsibility for the organisation's goals. People are psychologically close and work well together. Subordinates receive economic rewards based on achieving goals that have been set with their participation.

Likert argued that a **participative style** of leadership was ideal for the profit-oriented, human-concerned organisation.

Theories of leadership: contingency theories

- The nature of contingency theory
- Fiedler's contingency model
- Hersey and Blanchard: situational leadership theory
- Handy's best fit approach

5 Theories of leadership: contingency theories

5.1 The nature of contingency theory

Contingency theory of leadership is based on the view that the most effective leadership style in a given situation will depend on the situation. In other words, the most effective leadership style is 'contingent upon' the circumstances of the situation.

Contingency theories of leadership have been developed by:

- Fiedler
- Hersey and Blanchard
- Handy.

5.2 Fiedler's contingency model

Fred Fiedler's contingency theory of leadership was developed from research he conducted in the 1960s into two leadership styles, and which style was the more effective. He began by identifying two leadership styles:

- task-orientated leadership, and
- relationship-orientated leadership.

These styles could be related to Blake's grid and 'concern for the task' and 'concern for people'.

Fiedler developed a system for deciding whether a leader was task-orientated or relationship-orientated, based on getting leaders to reply to a questionnaire about their 'least favourite co-worker'.

Having categorised the individuals in his research into one or the other categories of leader, he then tried to establish which style of leadership was more effective.

He concluded that the effectiveness of a leader depends on:

- the leader's style, and also
- the extent to which the work situation gives the leader control and influence.

The work situation depends on three factors:

- The **relationship between the leader and the subordinates**: If the leader is liked and respected, he is more likely to have the support of his subordinates.

- The **structure of the task**. If the task is clearly defined, with clear goals, methods of working and standards of performance, it is more likely that the leader will be able to exert influence.

- The **position power of the leader**. If the organisation gives power to the leader, for the purpose of getting the job done, this is likely to increase the influence of the leader.

For example, the leader may have to be authoritarian in his approach when a quick decision is needed, or when employees are used to being told what to do.

The work situation can be favourable to the leader, unfavourable to the leader, or something in between (intermediate favourableness). Fiedler defined a favourable work situation as:

- good relationship between leader and subordinates

- a highly-structured task, and

- a large amount of position power for the leader.

So which leadership style was most effective? Fiedler found that it seemed to depend on the circumstances:

- When the work situation is favourable, a task-orientated leader is more effective.

- When the work situation is unfavourable, a task-orientated leader is also more effective.

- When the work situation is somewhere between favourable and unfavourable ('intermediate'), a relationship-orientated leader is more effective.

Fiedler was therefore one of the first management theorists who argued that the effectiveness of leadership style depends on the circumstances.

He went on to argue that individual leaders are task-orientated or relationship-orientated **by nature**, and it is **impossible to change them**. An organisation should therefore assess whether a work situation is favourable, unfavourable or in between, and try to appoint a leader with the more appropriate style for the work situation.

5.3   Hersey and Blanchard: situational leadership theory

Paul Hersey and Kenneth Blanchard (1968) developed another contingency theory of leadership, which they called situational leadership theory.   Like Fiedler's contingency theory, their theory states that the most appropriate leadership style depends on the work situation.

Some of the assumptions in their theory are that:

- A leader should adjust his or her leadership style to meet the requirements of the work situation. Leaders must be able to use any leadership style, and should switch from one style to another as circumstances require. (In this respect their views differ from Fiedler's. Fiedler did not believe that individuals can change their leadership style, because this is 'personal' or 'natural' to each individual. It was therefore necessary to pick an individual as leader who could bring the most suitable leadership style to the job.)

- Subordinates or team members are at different levels of personal development. Some are more mature psychologically than others and some are more mature

(experienced and skilled) in the job than others. The appropriate leadership style depends on the extent to which the subordinates are mature. For the purpose of their theory, Hersey and Blanchard identified subordinates' maturity in terms of:

- competence in their job and their ability to undertake successfully the tasks they are given – job maturity

- confidence in their ability to deal with the challenges of the task

- commitment to the organisation's goals and commitment to undertake the task – psychological maturity.

They referred to the maturity of the team members as their '**functioning maturity**'.

Leaders are involved in:

- **directive activity** – giving guidance and direction: this is similar to 'concern for the task' and can be described as 'task behaviour'

- **supportive activity** – giving emotional and social support to subordinates: this is similar to 'concern for people' and can be described as 'relationship behaviour'.

The amount of involvement by leaders in directive activity and supportive activity can range from low to high. The appropriate level of activity required from an effective leader varies with the work situation, which in turn depends largely on the maturity of the subordinates or team members.

Hersey and Blanchard identified four leadership styles, which can be presented in the form of a 2 x 2 matrix.

AMOUNT OF DIRECTIVE ACTIVITY (TASK FOCUS)

		LOW	HIGH
AMOUNT OF SUPPORTIVE ACTIVITY (RELATIONSHIP FOCUS)	LOW	**Delegating style** Responsibility for decision-making given to subordinates	**Telling/directive style** Close supervision by the leader
	HIGH	**Supportive/participating style** Leader shares decision-making with subordinates, and asks them for input	**Selling style** Leader makes the decision but explains them to subordinates and gives opportunities for asking questions

The four leadership styles are explained in more detail below, together with the views of Hersey and Blanchard about which leadership style is most effective for a given work situation.

Leadership style	Characteristics	Most effective when subordinates have…
Telling	High task focus, low relationship focus. The leader defines the roles and tasks of subordinates and supervises them closely. Decisions are announced by the leader. Communication is mainly one-way, from the leader down to subordinates.	Low competence High commitment

Selling	High task focus, high relationship focus. The leader defines the roles and tasks of subordinates. He seeks ideas and suggestions from subordinates, so communication is two-way. The leader makes the decisions.	Some competence Some commitment
	Subordinates may need direction because they are inexperienced. They also need support and praise from the leader to build their self-esteem.	
Participating	Low task focus, high relationship focus. The leader delegates some day-to-day decisions to subordinates (for example, work scheduling). The leader facilitates and participates in discussions about other decisions with subordinates.	High competence Variable commitment
	Subordinates are competent in their work, but lack the psychological confidence of motivation. Some support is necessary from the leader to boost confidence and motivation.	
Delegating	The leader is involved in discussions about problem-solving and decision-making, but control is with the subordinates. The subordinates decide how and when the leader will be involved. The subordinates can do the work themselves with little supervision or support.	High competence High commitment

5.4 Handy's best fit approach

Charles Handy described his contingency approach to leadership styles as a best fit approach.

There are four factors that influence the effectiveness of a leader:

■ **the leader** himself – his personality and character, and also his leadership style

■ **the subordinates** – the personalities of the individuals in the group, the character of the group as a whole, their preferences for a particular leadership style

■ **the task** – what are the objectives of the group's tasks, what methods of working are used?

■ **the environment** – this factor covers a wide range of possible issues, including the organisation structure, the culture and norms of the organisation, the technology of the organisation's operations and the variety of tasks performed by subordinates in the group.

Leadership styles range between autocratic and democratic. A leader's style is not necessarily one or the other. It can be somewhere in between the two extremes.

The characteristics of the subordinates in a group range between having a low opinion of themselves (and wanting to be told what to do) and having a high

opinion of themselves (and so liking challenging work and freedom from supervision). Most groups are somewhere between these two extremes.

The tasks that are done by a work group can range between all routine and repetitive tasks at one extreme and all complex work at the other extreme. Normally, the characteristics of the work is somewhere between these two extremes.

Handy described a 'best fit' spectrum, in which the three factors of leader, subordinates and tasks are placed on a range or spectrum, each between two extremes. He called these two extremes 'tight' and 'flexible'.

	TIGHT ← →	FLEXIBLE
The leader	Prefers an autocratic style	Prefers a democratic style
	Low opinion of subordinates	High regard for subordinates
	Dislikes uncertainty	Accepts a reasonable amount of uncertainty
Subordinates	Low opinion of their own abilities	High opinion of their own abilities
	Like certainty. Like to be told what to do	Like challenging work
	Prefer autocratic leaders	Prefer democratic leaders
	See their work as unimportant	
The task	The work requires no initiative. It is routine and repetitive, and trivial	The work involves important tasks with a long timescale for completion and results
	Short timescale for completion	Complex work, involving problem-solving or decision-making

Handy suggested that in any work situation there is a best fit of leader, subordinates and task (and environment, which is not on the spectrum). The best fit occurs where all three items – leader, subordinates and task – are at the same position on the spectrum.

Whenever there is a mismatch on the spectrum of leader, subordinates and task, and change will be required to create a new best fit for the altered work situation.

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Leadership qualities

- What do leaders do?
- Adair's action-centred leadership
- Warren Bennis: leaders as enablers and originators
- John Kotter: what leaders really do
- Ronald Heifetz: leadership as an activity

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6 Leadership qualities

6.1 What do leaders do?

The leadership theories described so far in this chapter have considered leadership style and which particular style of leadership is the most appropriate. Other writers on leadership have considered what leaders do, and what makes leadership different from management. Some of these theories are described in this section.

6.2 Adair's action-centred leadership

John Adair's action-centred leadership model is based on the view that effective leaders need full command of three aspects of leadership:

- achieving the task and meeting the demands of the task
- managing and maintaining the team or group
- managing individuals within the group and meeting the needs of individuals in the group.

A good leader keeps each of these three elements of leadership in balance. Adair argued that in any work situation, a leader is faced with problems and issues that will require the use of the three leadership skills. However, the particular skills that are needed to deal with any given situation will vary according to its nature. In other words, the skills required to deal with each problem will depend on the nature of the problem. An effective leader needs skills in all three areas.

Adair argued that all three aspects of leadership skills can be learned through training and development.

Sometimes a leader must show one of the leadership skills to deal with a problem, and sometimes he must show two of the skills or all three skills. The action-centred leadership model, indicating the skills required by the leader, can therefore be shown as three overlapping circles, which Adair calls the 'three circles diagram'.
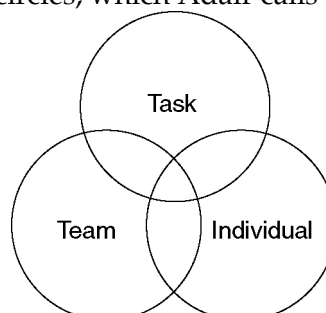
The leadership skills required for each of the three areas of leadership are summarised below.

Achieving the task	Managing the team	Managing individuals
Define the task and the objectives/goals	Agree standard of performance/behaviour	Understand the team members as individuals (personality, skills, needs)
Make the plan for achieving the task	Establish the culture of the group	Assist individuals
Identify and acquire the resources needed	Maintain ethical standards and discipline	Give support to individuals
Establish responsibilities for group members	Resolve conflicts between group members	Give praise to individuals
Set standards and target performance standards	Change the balance/ membership of the group when necessary	Agree individual responsibilities and objectives
Establish reporting systems	Develop the ability of the team members to work together	Make use of the strengths and skills of the individual
Control actual performance by comparison with the targets	Build team morale. Motivate the group as a team	Reward individuals (for example with more responsibility or higher status)
Monitor performance	Develop the collective skills and maturity of the group	Train and develop individual team members
Review on completion of the task	Facilitate communications – within the group and externally	
	Consult with the group	
	Give the group feedback on its performance	
	Provide group training	

The emphasis that a leader gives to each of these skills will obviously vary according to the situation, but a well-trained and effective leader is able to make use of the appropriate skills for each situation.

Note: Adair's 50:50 rule

Adair suggested a 50:50 rule that applies to his thinking about leadership. Leadership is influential, but effective leadership on its own is not sufficient.

■ 50% of motivation comes from within the individual. The other 50% of motivation comes from influences outside the individual, including the influence of the leader.

■ 50% of building a successful team comes from the team members and 50% comes from the leader of the team

6.3   Warren Bennis: leaders as enablers and originators

Warren Bennis, writing from the 1980s, made a distinction between managers and leaders.

- The role of the manager is to administer and maintain systems in order. Managers focus on systems and controls. Their main concern is for the 'bottom line' (short-term profit). He referred to management as **transactional leadership,** which is '**doing things right**'.

- The function of the leader is to innovate and develop. Leaders focus on people, not systems. Their main concern is for the longer-term, not the short-term profit figure. Bennis referred to leadership as **transformational leadership**, which is '**doing the right things**'.

His comparison of managers and leaders is summarised in the table below.

Managers	Leaders
Transactional leadership	Transformational leadership
Doing things right	Doing the right things
Administer	Innovate
Maintain	Develop
Focus on systems and structures	Focus on people
Reliance on control	Inspire trust
Short-range view	Long-range perspective
Imitates	Originates
Accepts the status quo (no change)	Challengers the status quo

Bennis has argued that leaders must get involved if they are to provide leadership. Here are two quotations from his work, suggesting how leaders should provide innovation (a 'vision') and earn trust from his followers.

- 'It's not a question of giving speeches, sending out memos and hanging laminated plaques in offices. It's about living the vision, day in day out – embodying it – and empowering every other person in the organisation to implement and execute that vision in everything they do.'

- 'Leadership will have to be candid in their communications and show that they care. They've got to be seen to be trustworthy human beings. That's why I believe most communication has to be done eyeball to eyeball, rather than in newsletters or videos or via satellite broadcasts.'

Leadership at all levels

Bennis argued that leadership is needed at all levels in an organisation, and believes that everyone has the capacity and ability to provide leadership. He is **opposed** to the trait theory' that leadership is a natural talent and that there are 'born leaders'.

He has argued that the role of the leader is not to be an all-knowing problem-solver who knows the answer to every problem. Instead, a leader is someone who stimulates the group, encourages its creativity and maintains an atmosphere or culture in which the group members can find the solutions to the problems together.

6.4 John Kotter: what leaders really do

John Kotter also considered what leaders do (His most well-known book is entitled 'What Leaders Really Do'.) He has argued that leadership is largely concerned with:

■ anticipating change

■ dealing with change, and

■ 'adopting a visionary stance' – in other words having a vision about what the organisation is trying to achieve and what it must do to get there.

More change demands more leadership, and Kotter advocated the creation of a culture of leadership within business organisations.

Like Bennis, Kotter has compared management (transactional leadership) and leadership (transformational leadership), as follows.

	Managers Transactional leadership	**Leaders** Transformational leadership
Creating the agenda	Planning and budgeting (Develop a detailed plan and create a detailed map of how to achieve planning targets.)	Establishing directions (Develop a vision for the organisation, and identify the direction in which it should go. Concern with strategy.)
Human relations aspects	Organise the work and fill staff in the positions (Decide which individual best fits each particular job.)	Align the people with the vision. (There is a communication problem – getting people to understand and then believe in the 'vision')
Execution of tasks	Control. Problem-solving leadership	Motivate and inspire
Outcomes	Produces a degree of predictability in outcomes	Produces change – often dramatic

6.5 Ronald Heifetz: leadership as an activity

Heifetz has argued that leadership is an activity, not a personal quality. We often confuse 'leadership' with 'authority'.

■ Authority is often seen as the possession of powers based on a **formal management role** within an organisation The manager has the right to tell subordinates what to do, because he is simply exercising his 'legitimate power'. Subordinates do what the manager tells them, to avoid dismissal, demotion or other disciplinary measures.

■ However, employees may follow an individual, not because of his formal authority, but because the individual shows leadership qualities. A leader is someone who has the ability to make sense of situations that are out of the ordinary, and know how to act in these situations. Leadership of this kind gives the individual **informal authority**.

Successful leaders need this informal authority as well as the formal authority granted to them by their position.

Heifetz ('Leadership Without Easy Answers, 1994) suggested that there are two types of challenge for leaders in business. Each type of challenge needs different leadership qualities. The two types of problem are as follows:

■ **Technical problems**. These are problems that have a relatively simple answer. Current knowledge can be applied to find a solution to the problem.

■ **Adaptive problems**. These are problems where the answer involves a need for people to change – change their culture and outlook. People are resistant to change; therefore the solution to the problem involves getting people to learn new ways.

Technical problems can be solved by managers (transactional leaders). For adaptive problems, transformational leadership is needed. Heifetz has referred to problems requiring significant change as 'adaptive work'.

Six principles of leadership and adaptive change

Successful leadership depends on judgement, and making decisions about when to act, and how far to go each time. Change should not be introduced too quickly, but only at a pace that individuals can accept. Leaders must act within the context of 'permission to change' from the people affected and 'restraint' – not going further at any time than other people are willing to tolerate.

Heifetz suggested that there are six principles of leadership for adaptive change.

1	Get on the balcony	A leader must have an ability to observe changes that are happening and to mobilise others to respond. It should be as if the leader is on a balcony with a clear view of all the entity's activities. The leader must then be able to mobilise the right people in the right way to do the required adaptive work.
2	Identify the adaptive challenge	A leader has to see what response is needed to the new challenge and change. Heifetz used as a comparison an example of a band of chimpanzees that knows how to respond to a threat from a leopard, but does not have the leadership to know how to respond to a new challenge from a human with a gun.
3	Regulate distress	Having identified the adaptive challenge, the leader must generate just the right amount of 'distress' among other people in order for everyone to see and understand the need for change. Change and progress must be introduced at the right pace – a leader must progress at the ace that other people are willing to accept. The leader must always point others in the right direction by asking them key questions.

		(Heifetz even suggested that the assassination of a political leader is a failure of leadership. A political leader who tries to bring in changes too quickly might expose himself to assassination, from people who dislike the pace at which the changes are happening.)
4	Maintain 'disciplined attention'	The leader must get conflict out into the open and use this as a source of creativity. Constructive conflict among individuals leads eventually to collaboration and agreement. The leaders most likely to succeed are those who make followers aware of their responsibilities.
5	Give work back to the people	Leaders should not control and direct. They should provide support and allow people to find the solutions to problems through their own efforts. Change is a collaborative process.
6	Protecting voices of leadership from below	Leaders should give a voice to other people in the organisation, and should allow others (below them in the 'hierarchy') to raise contentious issues.

CHAPTER

8

Individual and group behaviour: team management

Contents

1	Individual and group behaviour in business organisations
2	Teams and team roles
3	Team formation and development
4	Effective and ineffective teams

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Individual and group behaviour in business organisations

- Characteristics of individual behaviour at work
- Characteristics of work group behaviour: formal and informal groups
- Individual and team approaches to work
- The role of management in team building

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1 Individual and group behaviour in business organisations

This chapter looks at the role of individuals in work and the role of work groups. You should be able to relate many of the ideas in this chapter to your own experience, either at work or in other entities, such as a business school or college.

1.1 Characteristics of individual behaviour at work

Individuals go to work for a reason. The main reason is the need to earn money in order to have a good life outside work. Many individuals have a keen interest in the type of work that they are doing, and enjoy the work that they do.

Working in a business affects behaviour, but individuals behave in different ways.

- Individuals might think that when they are at work, the employer regards them as someone who is paid to do a job. They might therefore decide that they need to get on with the job they have been given, and perform the job adequately, so that they don't get into trouble from their boss.

- Some individuals have a pride in their work, and try to do their job to the best of their ability.

- Some individuals need to be told what to do by their boss; others are much happier using their initiative and getting on with their work without having to be told what to do.

- Individuals do not work in isolation, on their own. They work with colleagues, and individuals differ in the way they interact with their colleagues. Some enjoy communicating with other people, and like this aspect of their work. Other individuals do not communicate well with other people, and so might concentrate on their work and even refuse to join in conversations in the work place.

- The behaviour of individuals can also be affected by the prospects of promotion, career advancement or higher pay.

1.2 Characteristics of work group behaviour: formal and informal groups

Individuals work with other people. A work group is a group of employees who act with a common purpose and a sense of identity. There are two types of work group:

- informal work groups, and
- formal work groups.

Informal work groups

An informal work group is a group of employees that does not have a formal or an official identity. It is a group of individuals who get on well with each other and interact socially. They might have lunch together regularly, or might talk about personal interests and family matters over a cup of tea or coffee. Some informal groups might meet together outside work, on a social basis.

Informal work groups often develop a collective attitude to their work. This attitude might be positive, or it could be hostile to management.

Informal work groups can also be important because of the way they communicate with each other. Sometimes, news of an event or a new development at work gets around much more quickly through informal communications (e-mail messages to colleagues and phone calls) – 'through the grapevine' – than it does by more formal communication channels.

Formal work groups

Formal work groups are created in order to organise work. The employer establishes work groups to perform specific roles or functions. Each work group has a number of jobs to be performed, and employees are appointed to fill the job vacancies. When one employee leaves his job, another person is appointed in his place, and the formal work group continues unchanged.

Employees work together in their work groups, each performing their own job within the group. The work group has a formal leader (a manager or supervisor), and will develop its own characteristics and 'culture'.

The purpose of a formal work group

The purpose of a formal work group is to:

- combine the efforts of several employees, working together,
- to achieve a common goal.

Teams are established because individuals working on their own would be unable to achieve the same output or end results.

Comparison of formal and informal work groups

The differences between a formal work group and an informal work groups are set out below.

Formal work groups	Informal work groups
Members of the formal work team are appointed by management.	An informal work group comes together through the social interaction of its members.
Membership of a formal work group is	Membership of an informal work team

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'permanent' . Employees continue to work in the group until they leave their job or until they are moved to other work by the employer.	depends on the social interactions between members. New members may join the group at any time, and existing members may leave.
A formal work group has a clear set of work tasks, with specific objectives. These are set by management.	An informal work group is not organised by management and does not have a specific objective or tasks.
The work group has a formal existence.	The informal group does not exist in a formal or clearly-defined sense.
Work group members have formal roles and job titles.	Informal work group members do not have set roles or titles.
A formal work group has a formal decision-making structure. Decisions are commonly taken by the group leader.	Informal work groups might not make any decisions that affect their work. However, if they do, the group members will reach a collective agreement.
Management assess the performance of a foirmal work group by its performance (efficiency and effectivess in carrying out its tasks)	An informal work group is not assessed. However, its collective attitude to management can range from supportive at one extreme to hostile at the other. Employee attitudes to management can be determined by the shared attitudes of informal groups.
Formal work groups work together through established procedures and systems.	Informal work groups can be much more efficient (than formal methods) in communicating information.

1.3 Individual and team approaches to work

A function of management is to get the best performance possible from the employees who work for him (or her). There are two approaches to achieving effective performance.

■ The **individual approach**. This approach is based on the view that work should be properly organised, and employees should be appointed to carry out specific job functions. If each individual performs his job effectively, the entire work group will perform effectively. The effectiveness of the work group is the total sum of the effectiveness of each group member.

■ The **team approach**. This approach is based on the view that a work group will be more effective if its members work together as a team. Effectiveness comes from the ways in which the group members work with each other, as well as from the way that individuals perform their own job. A task of management should therefore be to develop an effective team, not just effective individuals.

A useful way of comparing these two approaches might be to think about a football team or any other type of sports team. The effectiveness of the team depends to a large extent on the individual talents and skills of the team members, and their ability to perform the function for which they are in the team, such as goal keeper or

goal scorer. However, the team will not be successful unless its members can also play well together.

- When team members do not work together well, the effectiveness of the team as a whole is less than the effectiveness of each team member taken individually.

- When team members work well together, the collective effectiveness of the team as a whole can be much greater than the effectiveness of each team member taken individually.

The effectiveness of individuals is important. However, the effectiveness of teams could be even more important.

1.4 The role of management in team building

A role of management is to provide leadership to teams and work groups, so that the team is successful. More specifically, in addition to the more general tasks of a manager, team management involves:

- Bringing together a suitable group of individuals to form the team

- Allowing and encouraging the team to develop

- Assessing the performance of the team and, where appropriate, rewarding the team as a group for the performance it has achieved.

Teams and team roles
■ The differences between a work group and a team
■ A successful work team
■ Team roles: the ideas of Belbin

2 Teams and team roles

2.1 The differences between a work group and a team

For the purpose of your examination, you should make a distinction between a work group and a team. A team is a work group, but not all work groups operate like a team.

A team is a work group in which the team members work effectively together, and:

■ all the team members identify with the team and see themselves as part of a team, and

■ **the team reaches decisions by agreement and consensus**.

Decisions taken by a team have the support of the entire team, which means that a team cannot exist in a group where decisions are taken by the group leader (manager or supervisor) and imposed on the group, whether the group members agree with the decision or not.

■ Since teams take decisions by consensus, it is impossible for large work groups to act as teams. In a work environment, teams are often quite small.

■ For a similar reason, it is difficult to build a team when the work group members are spread across different geographical locations. Team members need to meet and communicate on a regular basis.

Project teams

The word 'team' may be used to mean a project team. A project team has the following characteristics:

■ A project team is created to perform a specific task, and is then disbanded. The team is often made up of individuals from different functional areas of the organisation (the team is 'multi-disciplinary').

■ Other work groups are more permanent, and are established to fulfil specific roles. They may be organised by function (for example work groups in production, in marketing, in accounting, and so on).

2.2　A successful work team

A successful work team has several characteristics. Some of the characteristics of a successful team apply to effective work groups in general. Others relate more specifically to teams.

- The team should have a clear purpose.

- Its area of authority should be clearly defined. The team members should know what they can do, and what they do not have the authority to do.

- The team should have effective leadership. One of the tasks of the team leader is to create an effective team: team leadership skills are therefore essential.

- If the team is a project team that is required to complete a specific task, there should be a clear time scale for completion of the task.

- The team should be given the resources that it needs (equipment, materials, money) to complete its tasks successfully.

- The team members should have the necessary skills or experience to complete their task successfully. Every individual does not need all the necessary skills; however, collectively, the team members should have all the skills, expertise and experience required.

- The team members should have the motivation and commitment to achieving the objectives of the team.

- There should be good communications between the team members. There should be an effective and rapid exchange of all relevant information.

- Each member of the team should perform a role that adds to the effectiveness of the team. The role of team members is partly to carry out technical or operational tasks. Team roles are also concerned with adding to the effectiveness of the way in which the team functions as a unit. Team roles are described below.

- There should be strong team loyalty and good teamwork. Morale or team spirit should be high, and there should be respect for the team manager.

- The work of the team should produce benefits for the business. Providing benefits to the business is essential, because this defines 'success'.

2.3　Team roles: the ideas of Belbin

An important contribution to ideas about the management of teams was made by **Belbin**. Belbin studied the behaviour of individuals in teams and the 'team role' that each individual plays. He defined a team role as 'our tendency to behave, contribute and interrelate with others in a particular way'.

He suggested that in a successful team, the team members should have a balance of certain behavioural skills. He identified nine types of behavioural characteristics that team members should have between them. (An individual may have more than one behavioural characteristic, which means that a team can possess all nine characteristics without the need for nine team members.)

The nine team roles are grouped into three broad groups:

- **Doing/acting**. Some team members are good at getting things done. When they see what needs to be done, they do it or encourage others to do it.

- **Problem-solvers and thinkers**. Teams are often confronted with problems and difficulties that need to be resolved. Some team members need to be good at finding answers to problems.

- **Showing concern for people**. A team is a group of individuals acting together in a work environment. A successful depends needs members who have skills in bringing the team together, by showing concerns for others, by helping others or through communicating well with others and showing a concern for the team as a unit.

The nine team roles are as follows.

General nature of the role	Team role	Description
Doing/ acting	**Implementer**	A well-organised and predictable person. He takes basic ideas and makes them work in practice. However, he can be slow.
	Shaper	A person with energy, and full of action. He challenges other members of the team to move forward and make progress. However, he can be insensitive to the feelings of others.
	Completer/ finisher	A person who is reliable in **seeing a task through to the end** and getting it finished. He sorts out minor problems and makes sure that everything is working well. However, he can worry too much and may not trust other people.
Problem solving/ thinking	**Plant**	A person who **solves difficult problems** with original and creative ideas. However, he is a poor communicator and may ignore details.
	Monitor/ evaluator	A person who **'sees the big picture'**. He thinks accurately and carefully about issues. However, he may lack energy and an ability to inspire other people.
	Specialist	A person who is **driven by a pursuit of knowledge and information**, and wants to go into detail. The 'specialist' role is a behavioural characteristic rather than functional specialism. However, he becomes an expert in some key areas and will solve problems in those areas. He may be disinterested in all other areas of the team's activities.
Concern for people and feelings	**Co-ordinator**	A respected leader who **helps everyone else** in the team to focus on their particular tasks. However, he may be seen as wanting to control things too much.

Team worker	A person who cares for individuals and the team, and who is a good listener. He works hard to resolve social problems between other team members. However, he may find it hard to take difficult decisions.
Resource-investigator	A person who explores new ideas and possibilities with **enthusiasm**, and discusses them with others. A good 'networker'. However, he may be over-optimistic and may lose energy after an initial period of enthusiasm.

None of these nine roles is the role of team leader. The co-ordinator in a team may be the team leader, but this is not essential.

A useful way of trying to learn the nine team roles identified by Belbin is to think about the consequences for a team of not having a team member capable of performing any one of the roles in the list.

Managing a team: using the ideas of Belbin

Belbin suggested that teams will work most successfully when there is a suitable balance between these nine roles amongst the team members, and when team members:

- understand their role in the team
- work to their strengths, and
- try to manage their weaknesses.

A team manager can use the ideas of Belbin when developing a team to perform a particular function or task. The manager can assess the role or roles played by each team member, and look for roles that the current team members do not fulfil. These gaps should then be filled by recruiting new members to the team, or by encouraging existing team members to fulfil the missing role (if this is possible). If necessary, some existing team members should be replaced by new members who will perform the missing roles.

Belbin's ideas can be applied in practice fairly easily. Questionnaires have been developed that enable individuals to assess which behavioural characteristic (or characteristics) they have, and which team roles they can perform well. Management can use this assessment of individuals to ensure that teams consist of individuals who together possess all the characteristics of a successful team.

Team formation and development
■ The ideas of Tuckman on team development
■ The value of Tuckman's analysis

3 Team formation and development

3.1 The ideas of Tuckman on team development

Bruce Tuckman (1965) provided an analysis of how small teams develop and change character over time. The appropriate form of team leadership changes as the team goes through each new stage of development.

In Tuckman's original analysis, there were four stages of team development:

■ forming

■ storming

■ norming

■ performing.

In 1977, he added a fifth stage:

■ dorming (also called adjourning, de-forming and mourning).

Forming

In the initial stage of its existence, a team is forming. The team is a collection of individuals, but their individual roles and responsibilities within the team are unclear. There is a high level of dependence on the team leader for guidance and direction. The team leader must therefore direct the team members, and tell them what to do.

Storming

The second stage in team development is storming. During this stage, decisions do not come easily. There is usually conflict between team members, and the attitudes, norms and preconceptions of individuals are challenged by other team members. Team members compete with each other for status and position within the team. There may be cliques and factions, and power struggles between them. However, there is an improvement in the clarity of the purpose of the team and its goals. The role of the leader is to act as coach to the team members, and to encourage them to focus on the team's tasks rather than on relationships and emotional issues. The leader also encourages team members to find compromises to settle conflict.

Norming

During the norming stage of team development, the team develops norms of behaviour and operating. The roles of the team members become clear. The way in which decisions are taken is also established. Major decisions are taken by the team collectively, with all team members contributing to the decision-making process. Commitment to the tasks of the team and team unity is strong. The team leader can use a participative style of management, so that team members take on greater responsibility for decisions.

Performing

During the fourth stage of team development, performing, the team operates at its full potential. The team members are strategically aware and they understand why the team exists and what it is trying to achieve. The team members are also able to get on with their jobs without interference from the team leader, and do not need to be told what to do. The role of the team leader is to delegate new tasks and oversee performance. Disagreements may occur between team members, but these are resolved in a friendly and constructive way.

Dorming (adjourning)

In 1977, Tuckman added a fifth stage of team development to his earlier analysis. There are various ways of describing this phase.

- The group may break up, having achieved its purpose. The members of the team may feel a sense of loss, and the break-up of the team may be stressful for them, particularly if it is unplanned and unexpected.

- Alternatively, the team may lose its efficiency, and might lose its ability to make good decisions. Members of the team may share common views that ignore developments in their business environment and changing circumstances. Keeping the group in existence becomes the prime objective of the team members, rather than achievement of the team's work objectives. It may be necessary to break up the team.

3.2 The value of Tuckman's analysis

Not all teams go through all the stages of development, and some teams progress more quickly than others to the performing stage. Others get stuck and fail to reach the performing stage.

However, Tuckman's analysis is useful for the management of small teams for the following reasons.

- Management should be aware that it takes time to develop a new team, and should be patient in allowing the team to progress to the 'performing' stage of its development.

- However, it should also be possible to identify when a team is not progressing as it should and is stuck, for example, in the norming stage of development.

- Tuckman's analysis also gives some insight into the style of management that might be best-suited to the team at each stage of its development, in order to encourage the team to develop as rapidly as possible.

e **Example**

Three years ago a research team was established in the business school of a university. Six members were appointed to the team. The purpose of the team is to identify research projects, obtain funding for the projects from commercial sponsors, carry out the research and prepare research papers for publication. Initially, there was a lot of uncertainty about what the group should do, or how it should set about the task of obtaining funding for their work.

As the team gained experience, the team became more confident about what it was doing and what it was trying to achieve. However there were some arguments between the team members about the work that each of them should be doing. They carried out their research as a group, but some team members were better at some tasks than others. Eventually, the group began to operate much more efficiently. Each member of the group adapted to a function, and each group member understood instinctively what each of them should be doing. Decisions were taken collectively as a team, by mutual agreement and consensus.

Recently, three team members left, one to take up a job in another business school and the others retiring from the business school for family reasons. Three new team members have been appointed.

The team leader needs to recognise that the team has reached a new stage in its development. Having gone through the forming and storming stages of development, and having reached the norming stage, the change in team membership has taken it back to a new forming stage. The team will have to go through the forming and storming stages again, to become as effective as it was before the three team members left.

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Effective and ineffective teams

- Characteristics of effective and ineffective teams
- Evaluating team performance: success in achieving objectives
- Tools and techniques for building team effectiveness

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4 Effective and ineffective teams

4.1 Characteristics of effective and ineffective teams

An objective of a team manager should be to create an effective team. He needs to understand what makes and effective team, and why a team might be ineffective, so that he can assess the effectiveness of his own team.

Many writers on the theory of business management and organisation have suggested what the characteristics of effective and ineffective teams are. Some of these characteristics are shown in the table below.

Effective work teams	Ineffective work teams
Success. An effective team is one that is successful at achieving its goals or objectives. Teams that are only partially successful are	**Lack of success**. An ineffective team fails to achieve its objectives or goals. likely to be ineffective in some ways.
Focus. An effective team is aware of its goals and objectives, and keeps these in mind all the time. They use their time and resources well.	**Lack of focus**. An ineffective team sometimes loses sight of its objectives. Team members might allocate their time badly.
Collective decision-making. An effective team reaches decisions through discussion and agreement.	**Decision-making is dominated by one team member**. In an ineffective team, one person (or perhaps a very small group) makes the decisions, by imposing his views on the rest of the team. Other team members might disagree, but do not speak out.
Good communication. In an effective team, the team members communicate with each other well, and keep each other well-informed. They are also truthful in communicating with each other.	**Lack of communication**. In an ineffective team, communication might be poor. Team members might not be fully truthful with each other.
Collaboration. In an effective team, the members will co-operate and collaborate.	**Doing your own job**. In an ineffective team, the team members do not give

Each team member will do whatever is necessary to get the job done, even if this means doing work that is unfamiliar and outside their normal experience.

each other support. Each team member does his own job and is unwilling to do anything that is not specified in the job description.

Positive conflict. Positive conflict occurs when there is disagreement, but the team members are willing to discuss their differences fully, and reach a suitable agreement about what the solution should be. Some conflicts are inevitable in teams: the way that the conflicts are resolved is important.

Failure to resolve differences. In an ineffective team, the team members fail to resolve their differences properly. Disagreements are not discussed fully. They are often resolved by an ineffective compromise that 'patches up' the differences of opinion, and the compromise might not last for long.

Mutual support. In an effective team, each team member is aware of the contributions provided by the other team members.

Lack of mutual support. In an ineffective team, the team members are not properly aware of what the other team members have achieved.

Team spirit. In an effective team, team members identify themselves with the team and feel a part of the team. Team spirit and team loyalty is strong.

Lack of team spirit. Members of an ineffective team do not have any team spirit and simply get on with their job.

4.2 Evaluating team performance: success in achieving objectives

One of the tasks of management is to evaluate the performance of the work group for which they are responsible. Performance evaluation is linked to planning, co-ordination and control. Measuring and evaluating team performance is also necessary when there is a system of team incentives and rewards.

There are various ways of measuring and evaluating performance. Three basic approaches to performance measurement are measurements of:

■ economy

■ efficiency, and

■ effectiveness.

Economy is measured by the success of the team or work group in controlling its costs. Cost control may be judged by comparing actual spending with the planned spending limit. (There is often a spending limit for each work group or team in the annual budget for the organisation.)

Efficiency (or productivity) measures the amount of resources used for the tasks that have been achieved. For example, the productivity of a work group may be measured by the output per member of the team during a period of time, or the output per labour hour. Alternatively, productivity may be measured by the sales achieved per member of the team (for example, annual sales revenue per member of the sales team).

Effectiveness measures success in achieving goals and targets. Targets may be short-term or long-term. They may also be:

- quantitative – measuring the volume of work achieved or the size of results

- qualitative – measuring output in terms of quality (percentage of rejected items, level of customer satisfaction, and so on)

- time scale for achievement – whether a particular task is completed before a target date for completion.

Team performance may also be measured in other ways, such as the level of job satisfaction amongst team members. However, it is doubtful whether a clear link exists between work satisfaction and achieving the goals of the organisation.

4.3 Tools and techniques for building team effectiveness

The effectiveness of a team can be improved through good team management. A team leader should try to build a team by appointing individuals to fulfil all the necessary roles, and he should give it time to develop.

The manager should keep the team aware of its objectives and targets. He should encourage openness in communication and a full discussion of problems and ideas. As the team develops, he should allow the team to reach its own collective decisions.

Team-building tools

There are some training tools that may be used by team leaders to encourage the development of the team. These involve various types of team activities on training courses, such as 'outward bound' activities.

The purpose of this type of team training is to enable the team members to get to know each other and go through shared experiences outside the work environment. In addition, the tasks they are given force the team members to rely on each other in order to accomplish these tasks. Team members have to work for the 'good' of the team in order to benefit themselves.

The experience of such training courses should continue after the course has ended, so that team members work better together when they return to their work.

Motivation and incentives

It might also be possible to improve team effectiveness by offering incentives for the successful achievement of team objectives and targets. Motivation and reward systems are described in the next chapter.

CHAPTER

9

Motivation

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2   Reward systems and motivation

> ## Theories of motivation
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1 Theories of motivation

Theories of motivation are concerned with identifying the factors that affect the attitudes of employees (including managers) to their work and the amount of effort that they put in to doing their work.

If managers understand the factors that motivate their employees, they might be able to take measures to improve motivation and effort.

Theories of motivation also help us to improve our understanding of our personal motivation to work and what we hope to get from our job.

1.1 Content theories and process theories of motivation

There are many different theories of motivation. It might help to make a distinction between:

- content theories of motivation, and
- process theories of motivation.

Content theories

Content theories concentrate on what motivates individuals in their work.

There is often an assumption that the same things motivate everyone. Rewards will satisfy a need and individuals will be motivated to obtain those rewards.

Examples of content theory are:

- Maslow's hierarchy of needs
- Herzberg's hygiene and motivator factors
- McClelland's motivational needs theory (although there are also elements of process theory in motivational needs theory).

Process theories

Process theories of motivation concentrate on the process by which individuals are motivated, and the strength of that motivation. In other words, the key question is: 'how are people motivated?'

It is argued that individuals are motivated differently, and the strength of their motivation depends on a variety of factors, such as:

■ needs

■ personality

■ perceptions about whether more effort will result in achieving goals

■ the rewards

■ expectations about whether the rewards for achieving the goals will actually meet the individual's needs.

Rewards and perceptions of rewards are usually a key factor in process theory.

Examples of process theory include:

■ Vroom's expectancy model

■ Handy's motivational calculus.

1.2 Maslow: the hierarchy of needs

In the 1950s, US psychologist Abraham Maslow developed a theory of the motivation of individuals at work. He argued that individuals have seven in-built needs, and his theory is concerned with the motivating power of each of these needs.

Two needs are needs of a 'higher order' that must be met before the other five needs can be satisfied. These higher order needs are:

■ a need for freedom of inquiry and expression: social conditions must allow free speech and encourage justice, honesty and fairness

■ a need for knowledge and understanding: a need to explore and experiment.

The other five needs can be arranged in a hierarchy of five levels. The need at a lower level is dominant until it has been satisfied. When the need at one level has been satisfied – and only then – the need at the next level becomes dominant.

■ A need that has been satisfied no longer motivates the individual.

■ An individual is motivated by the need at a level in the hierarchy that has not yet been satisfied.

■ The highest level of need – self-actualisation – can never be fully satisfied.

The hierarchy of needs (the five levels of need) is usually drawn as a pyramid.
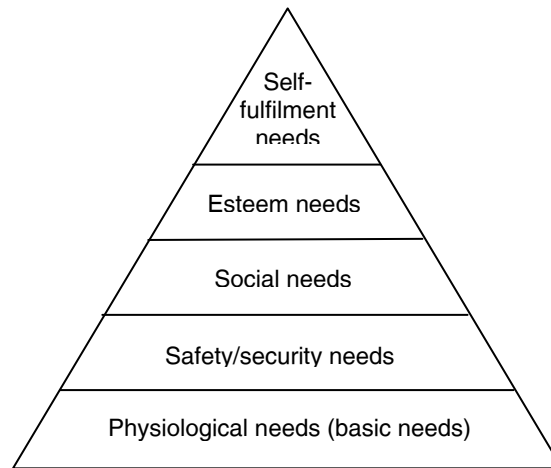
Physiological needs (basic needs)

These are the needs for food, shelter, clothing and everything else that we need to stay alive. These needs can be satisfied by money.

Safety needs or security needs

Safety needs are the needs for security in work. Individuals want to feel safe against the risks of unemployment, and they want protection against the consequences of illness or having to retire. People also want fair treatment at work. These needs can be satisfied by:

■ employment legislation and

■ the employer's arrangements for a pension scheme for its employees and for the treatment of its employees who are affected by illness or injury.

Social needs

Social needs are the needs to interact with other people, and to be part of a group. At work, social needs can be met by working with other people. However, the way in which work is organised has an important effect on whether the social needs of employees are fully met.

Esteem needs (or ego needs)

Esteem needs are the needs for the esteem of other people, and to feel good about one's own value or importance. Esteem needs can be met by promotion and by the status of the job. However, promotion only offers short-term esteem. In the longer term, individuals get esteem from their work by having some say in how their work is organised.

Self-fulfilment needs (self-actualisation needs)

These are the needs to achieve something worthwhile in life. This need is never fully satisfied. An individual at this level in the hierarchy needs continuing success and achievements.

The significance of Maslow's ideas

The significance of Maslow's ideas is that it suggests an approach that management should take to improving the motivation of employees. Management must make sure that lower-level needs are satisfied before they try to motivate employees with initiatives aimed at the satisfaction of higher-level needs.

For example:

- Pay is extremely important, because it satisfies basic needs. Employees must be paid enough to satisfy their basic physiological needs (whatever these are perceived to be).

- Unless employees feel secure in their job, there is no point in trying to increase motivation through job design that improves social interaction.

- Making individuals feel part of a group must come before satisfying needs for esteem and status.

Limitations of the hierarchy of needs

The hierarchy of needs is a simple and logical idea about human motivation, but it has significant weaknesses and limitations. The main problem is its assumption that needs are the same for all people and can be satisfied for everyone in the same way.

- Individuals have different needs, and they are not necessarily in the hierarchical order suggested by Maslow.

- Many individuals may seek to satisfy several different needs at the same time.

- The same need may cause different reactions and responses from different individuals.

- There is an underlying assumption that the objectives of the organisation will be achieved if individuals receive rewards of higher status (promotion) or self-fulfilment. Maslow does not show any link between self-fulfilment and improved organisational performance.

- Maslow's model is vague about the nature of self-actualisation or self-fulfilment needs. More modern theories of motivation go into much more detail about the nature of high-level needs and their satisfaction.

- It is a 'content theory' of motivation. It does not explain the strength of motivation, nor the effect on motivation of people's perceptions. (Content theory is explained later.)

The theory also fails to recognise that self-actualisation is not always possible. The environment in which the organisation operates may not be suitable for self-fulfilment – for example the nature of the product or service of the organisation, its technology or environment might mean that organisations should not (and cannot) offer their employees the satisfaction of self-actualisation needs. An example might be working on the factory floor. It is difficult to achieve self-actualisation working in a low-level job in a factory environment

1.3 Herzberg and motivation-hygiene theory (two-factor theory)

In the 1950s, Frederick Herzberg carried out some research into the factors that motivate individuals in their work, by interviewing 200 engineers and accountants. He developed a two-factor theory of motivation, which he set out in his book *The Motivation to Work* (1959).

Herzberg identified two groups or categories of factors: those causing dissatisfaction with work and those causing satisfaction. He called these:

■ **hygiene factors** (= the factors causing dissatisfaction) and

■ **motivator factors** (= the factors causing satisfaction).

The most significant hygiene and motivator factors were as follows:

Factors causing dissatisfaction	Factors causing satisfaction
Hygiene factors	**Motivator factors**
Company policy	Achievement
Supervision	Recognition
Relationship with the boss	The work itself
Working conditions	Responsibility
Salary	Advancement
Relationship with colleagues	Growth

It might be supposed that factors causing dissatisfaction and factors causing satisfaction are opposites. However, Herzberg argued that this is not the case.

■ The opposite of dissatisfaction is not satisfaction: it is not being dissatisfied.

■ The opposite of satisfaction is not dissatisfaction: it is not being satisfied.

The conclusion from Herzberg's analysis is that management need to deal with two different categories of factors affecting the concerns of employees in their work.

■ Management need to make sure that hygiene factors are given proper attention. If employees are content with their hygiene factors, they will not be dissatisfied. For example, employees need to feel that they are being paid well enough in order to prevent them from being dissatisfied. However, satisfying the hygiene factors only prevents dissatisfaction, it does not create satisfaction.

■ In order to motivate individuals, the motivator factors need to be satisfied. Creating motivation therefore means providing conditions at work that will make individuals feel a sense of achievement and recognition. According to Herzberg, a key factor in creating motivation is **job enrichment** – making the work itself more interesting and fulfilling.

1.4 McGregor: Theory X and Theory Y

Douglas McGregor (in *The Human Side of Enterprise*, 1960) suggested that there are two different approaches to managing people. Each approach is based on a different view of whether individuals can be motivated at work. McGregor called the two management approaches Theory X and Theory Y.

Theory X

The Theory X approach to management is an authoritarian style. The manager instructs his employees and tells them what to do. The Theory X approach is based on the following views about people at work:

■ The average person dislikes work and will avoid having to do any if at all possible.

■ Individuals must therefore be forced to work towards the organisation's objectives, with the threat of punishment for not working properly.

■ The average person prefers to be directed, wants to avoid responsibility, has no ambition and wants security more than anything else.

Theory Y

The Theory Y approach to management is a participative management style, in which the manager encourages his employees to participate in decision-making. The Theory X approach is based on the following views about people at work:

■ Putting effort into work is as natural as play.

■ Individuals will apply self-direction and self-control to work towards the objectives of the organisation, without the need for constant supervision or the threat of punishments.

■ The strength of an individual's commitment to the organisation's objectives is related to the rewards associated with achieving those objectives.

■ Individuals usually accept and then seek responsibility.

■ At work, the intellectual potential of the average person is only partly utilised. Individuals have much more potential that could be utilised.

The implications of McGregor's theory

The Theory Y approach to management is consistent with a participative approach to decision-making, where the manager gives all the relevant information to his employees and encourages them to contribute to solving problems and deciding what should be done.

McGregor suggested that a Theory Y approach is not always possible, or advisable.

■ Theory Y is difficult to put into practice in a factory environment.

■ There will be some situations when the manager must exercise his authority, because this is the only way of getting results. (For example, a manager must decide what to do when his subordinates cannot agree and are arguing amongst themselves.)

However, McGregor argued that Theory Y can often be used to manage managers and professionals. When it is possible to get the commitment of employees to the objectives of the organisation, it is better to explain problems fully to them. The employees will exert self-direction and self-control to do better work and achieve better results than if they are told what to do by an authoritarian manager.

For a Theory Y approach to management to work, employees must be positively motivated to work and emotionally mature, and the work must be sufficiently responsible to allow them some flexibility (some choice in how they set about the work). In these circumstances, a Theory Y approach will lead to much better results for the organisation than a Theory X management style.

1.5 Argyris on motivation (immaturity/maturity model)

Chris Argyris advocated a **participative style of management**. He believed that by involving employees in the decision making process, managers can achieve much better results for the organisation.

He argued that a Theory X style of management is widely applied by managers in practice. Many people at work are therefore treated as immature people.

Individuals are immature when they are infants, but mature as they get older. According to Argyris (immaturity/maturity theory) individuals go through seven personality changes as they move from immaturity as infants to maturity as adults.

Personality change		
1	Passive state to active state	Individuals mature from a passive state in infancy to an active state as adults.
2	Dependency to independence	Individuals move from being dependent on others as infants to a state of being relatively independent as adults.
3	Behaving in a few ways to behaving in many ways	Individuals behave in only a few ways as infants. Mature adults can behave in many different ways.
4	Shallow interest to deeper interests	As infants, individuals have shallow and erratic interests. As they mature, individuals develop deeper and stronger interests.
5	Short to a longer time perspective	The time perspective of infants is very short, and infants care only about the present. As people mature, they develop a longer time perspective and are aware of the past and the future as well as the present.
6	From subordinate position to higher position	Infants are subordinate to everyone else. As they develop into adults, individuals move to a position of equality or even superiority over others.
7	From no awareness of self to awareness of self	Infants lack any sense of 'self'. Mature adults are not only aware of self: they can also control it.

Argyris argued that few individuals, if any, develop to full maturity in all seven aspects of their personality. However, as mature adults they are capable of doing and achieving much more than they could as immature infants.

Argyris used his immaturity/maturity theory to criticise management practice in many organisations. He argued that:

- People are kept from maturing in their work by the management practices in organisations.

- In some organisations, employees are encouraged to be passive, dependent and subordinate. Employees therefore often behave in an immature way.

- Keeping employees in an immature state is built into formal bureaucratic organisation structures. In these organisations, jobs are designed first, and then people are found to fit into the jobs. Job design is based on specialisation, a chain of command, unity of command and concepts of the span of control – all concepts of classical management theory. Jobs designed in this way are often over-simplified, and they are routine, boring and lacking in any challenge for the job holders. Power and authority remain in the hands of the senior management at the top of the organisation.

Bureaucratic and democratic organisations

Argyris compared two different types of organisation.

- A bureaucratic organisation or pyramid organisation. This is the equivalent of an organisation based on Theory X management.

- A democratic or humanistic organisation. This is the equivalent of an organisation based on Theory Y management.

The differences between the two types of organisation are set out below. It should be apparent that Argyris argued for a democratic style of organisation, because this type of organisation is, he believed, more effective in achieving its objectives.

	Bureaucratic organisation	**Democratic organisation**
	(Pyramid organisation)	**(Humanistic organisation)**
General description	Relationships between people are shallow and mistrustful, and are not authentic.	Relationships between people are trusting and authentic.
	There is widespread mistrust, inter-group conflict and rigidity in behaviour.	There is greater competence in interpersonal relationships, more inter-group co-operation and flexibility in attitudes and behaviour.
	The organisation is not very successful at problem-solving.	People are treated as mature human beings with an opportunity to develop to their fullest potential.

Important human relationships are:	Those related to achieving the objectives of the organisation – getting the work done.	Those related to getting the work done. In addition, other important relationships are also those related to maintaining the organisation's system and adapting to the environment.
Effectiveness in human relationships	More effective when the work is rational, logical and clearly communicated. Less effective when behaviour is more emotional.	Effective. All relevant behaviour is conscious and can be discussed and controlled.
Most effective method of controlling human relationships	Authoritarian: giving directions and applying controls. There is also a system of rewards and penalties based on rational behaviour and achieving goals.	A system of rewards and penalties based on rational behaviour and achieving goals. Management is democratic: managers influence others through authentic relationships and internal commitment to the organisation's goals.

1.6 Adams: equity theory of motivation

Another view of motivation was suggested by Adams (1963). This is the 'equity theory' of motivation, where 'equity' means 'fairness'.

Equity theory states that we all seek a fair balance between what we put into our work (inputs) and what we get out (outputs). We get our ideas about what is a fair balance by comparing our own situation to reference points or examples in the 'market' – for example, what someone else is earning and what they have to do to earn it. We are also influenced by the views of colleagues and friends in deciding what our reference points should be.

Inputs and outputs in equity theory might be any of the following:

Inputs		Outputs
Effort	There should be a fair balance between inputs and outputs	**Tangible outputs:**
Loyalty		Financial rewards
Hard work		Bonuses
Commitment		Pension rights
		Other benefits such as company car
Skill and ability		**Intangible outputs:**
Flexibility		Recognition
Tolerance		Reputation
Enthusiasm		Praise and thanks from others
Determination		Interest
Trust in the boss		Responsibility

Giving support to colleagues and subordinates

Personal sacrifices

Training and development

Travel

A sense of achievement

Promotion

Adams argued that:

■ People compare what they receive for the effort they put into work with what others receive for the same amount of effort.

■ If they believe that someone else is getting more for the same amount of effort, they feel a sense of **inequity**.

■ The greater the inequity, the greater the individual's sense of unfairness and anger.

The greater a person's sense of anger, the more he or she will work to try to restore a sense of equity (fairness). There are several ways in which this might happen. If an individual has a feeling of negative inequity, he or she can:

■ reduce the inputs – for example, put in less effort and commitment

■ change the amount or the nature of the reward required

■ change the basis for comparison, and use another example or reference point for comparison

■ distort the comparison psychologically, for example by convincing oneself that the inputs are less or the outputs are more than they really are

■ leave the job.

Adams therefore argued that what people do at work is driven by a sense of inequity as well as a belief in equity.

1.7 Vroom: expectancy theory

Victor Vroom published his ideas on expectancy theory in 1964. Expectancy theory is a theory for predicting the strength of an individual's motivation to put in effort at work.

Vroom argued that our behaviour is the result of conscious choices that we make between different alternatives. We each have our own personal goals and needs for satisfying those goals. Some of these needs may be satisfied through work. We can be motivated to work if we believe that:

■ there is a positive correlation between the efforts we make and the performance that is the result of our efforts – in other words, the more effort we put in, the better the performance will be, and

■ good performance will result in a desirable reward, and

■ the reward will satisfy an important need.

Effort → Performance → Rewards → Satisfaction of needs
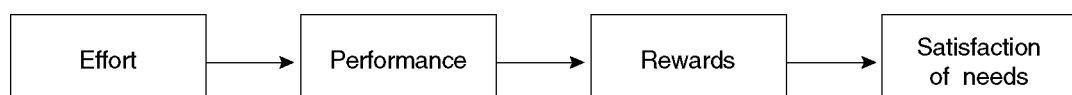
Rewards may be a mixture of:

- **extrinsic rewards** – pay, bonuses, and so on

- **intrinsic rewards** – promotion, sense of achievement, sense of recognition, and so on.

The motivation to obtain rewards is an important aspect of the theories of writers such as Vroom, Handy and McClelland, and it is important to understand that 'rewards' can consist of both extrinsic and intrinsic rewards. The distinction between these two types of reward is explained in more detail later.

Vroom also argued that there are two or three specific factors that determine the strength of an individual's motivation;

- **Valence**. Valence is the strength of the individual's need for rewards.

- **Expectancy**. Expectancy is the strength of the individual's belief that by putting in more effort, he will improve his performance.

- **Instrumentality**. Instrumentality is the belief of an individual that by achieving a certain performance target, rewards will be obtained.

In a simplified version of the expectancy model, expectancy is defined as the belief of the individual that by putting in more effort, he or she will get the desired rewards. In this simplified model, expectancy is therefore a combination of expectancy and instrumentality.

Vroom's expectancy model for measuring the strength of an individual's motivation is:

Motivation (Strength of motivation)	=	Valence	×	Expectancy

Implications of expectancy theory

Expectancy theory has several implications for management.

- Motivation depends partly on **valence**, which is the strength of an individual's desire for particular rewards. Managers should therefore try to find out what their employees do want.

- Motivation also depends on **expectancy**. Some individuals do not believe that they are able to achieve better performance by trying harder. They may lack self-confidence, or lack training. (Alternatively, they may not be in a position to affect performance, in which case motivation will be very low, and possibly nil.) Management must consider ways of trying to increase the expectancy of their employees, for example by providing training and development, giving them the resources they need to do the job, or by providing supervision and guidance.

- Instrumentality may also affect motivation. Managers must keep the promises that they have given of rewards for performance – and try to make sure that employees believe that the managers will keep their promises.

1.8 Handy: motivation calculus and psychological contracts

Motivation calculus

Charles Handy suggested that there is a motivation calculus. His ideas were similar to those of Vroom. He argued that the strength of an individual's motivation is dependent on three factors:

■ **Needs**. These are the needs of the individual. They might include any of the needs in the Maslow hierarchy of needs. Needs are also affected by the personality characteristics of the individual, and by outside pressures and influences.

■ **Results/rewards**. Individuals must be able to measure the effect that their individual efforts have on results. If the individual is motivated to put in more effort, how will this affect results and rewards?

■ **Effectiveness**. This is the perception of the individual that the rewards that have been earned meet the needs of the individual.
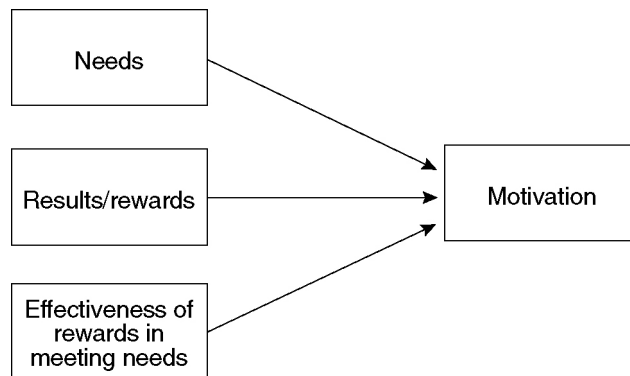
Psychological contracts

Handy argued that the motivation calculus applies to every type of 'psychological contract' between an individual and an organisation to which the individual belongs.

Every individual has a psychological contract with any organisation to which he or she belongs. This contract normally takes the form of implied and un-stated expectations about:

■ the returns or rewards that the individual will receive

■ in return for putting in a certain amount of effort and talent.

Similarly, organisations have expectations of:

■ what they expect individuals to do, and

■ the rewards that they will give to individuals in return.

There are three types of psychological contract:

■ **Coercive contracts**. This is a contract that is not freely entered into. The organisation is ruled by a small number of people who are in charge and in control. An example of a coercive contract is the relationship between a prisoner and his prison.

■ **Calculative contracts**. This is a contract that is freely entered into, but where management retain control through their ability to reward individuals with extrinsic rewards, such as pay and promotion. Individuals enter these contracts believing that what they receive justifies the amount of effort they put in. The relationship between many employees and their employer is a calculative contract.

■ **Co-operative contracts**. A co-operative contract is a contract between 'equals'. The individual identifies with the goals of the organisation and works hard to achieve them. In return, the individual is rewarded fairly, and is given a chance to participate in setting the organisation's goals and deciding on the ways to achieve them. Some organisations have adopted this approach to their employees, but the relationship must be freely entered into by the employees.

1.9 McClelland: motivational needs theory

David McClelland (1917 – 1998) put forward a motivational needs theory, which he developed into a needs-based motivational model.

He argued that there are three needs that are found in all employees. Everyone displays all three needs, but one of the three needs is often dominant in affecting the individual's attitudes and behaviour. The three needs are:

■ a need for achievement ('n-ach')

■ a need for authority and power ('n-pow')

■ a need for affiliation ('n-affil').

He identified the characteristics of individuals who are motivated mainly by the needs for achievement, power and affiliation, as follows:

■ **N-ach person**. This person seeks achievement. Targets for achievement should be **realistic** but **challenging** goals. The person also seeks advancement in the job, and has a need for:

- feedback: this is information about his achievements and progress towards the goals – the individual needs to know whether or not the goals are being met

- a sense of accomplishment from achieving the goals.

■ **N-pow person**. This person needs to be influential and effective, and to make an impact. He has a strong need to lead, and for his ideas to be accepted rather than the ideas of others. He needs status and prestige.

■ **N-affil person**. This person needs friendly relationships and is motivated by interaction with other people. He needs to be liked and held in high regard. He makes a good 'team player'.

McClelland argued that n-ach people make the best leaders. However, they can demand too much from their employees, because they often assume that everyone else is motivated by the same need for achievement that they have.

- N-affil individuals are usually poor leaders. This is because their need to be liked will often affect their objectivity and prevent them at times from making unpopular but necessary decisions.
- N-pow individuals are also poor leaders. They are often determined individuals, with a strong work ethic and a commitment to their organisation and its goals. However, they often lack 'people skills' (skills at dealing with other people) and also lack flexibility.

Achievement-motivated individuals are usually the ones who make things happen and get results.

- They set goals that they can influence (so the goals are achievable): this is a characteristic of successful businessmen and entrepreneurs.
- They consider achievement more important than financial rewards.
- Achieving a goal or successfully completing a task gives them more satisfaction than praise or thanks from others.
- Security and status are not prime motivators for them in their work.
- They are constantly looking for ways to do things better.
- Crucially, however, they need feedback about their performance. They must be told about their actual performance and what they have achieved.
- For achievers, pay is a form of feedback about their performance. High pay and bonuses are a measurement of their success in achieving goals.

Reward systems and motivation
■ Extrinsic and intrinsic rewards
■ What managers can do to motivate staff
■ The reward system and motivation
■ Constructive feedback and motivation

2 Reward systems and motivation

2.1 Extrinsic and intrinsic rewards

For an individual, rewards from doing a job can be both extrinsic and intrinsic.

Extrinsic rewards are rewards that are outside the control of the individual. Another person, often the individual's boss, has the power to provide extrinsic rewards. The main examples of extrinsic rewards are:

■ basic pay (and the size of a pay increase)

■ cash bonuses and incentive payments

■ when the employer is a company, rewards in the form of share options or a gift of some shares

■ pension benefits

■ free medical insurance (and other forms of insurance, such as disability insurance, or even life assurance)

■ the award of a company car, or a company helicopter or jet

■ subsidised loans (these are loans from the company at an interest rate that is lower than the normal market rate).

Intrinsic rewards are rewards that are within the control of the individual himself. They include:

■ a sense of achievement in doing the work

■ a sense of recognition for doing the work

■ enjoying the status that the job provides

■ pride in doing the work

■ personal satisfaction from doing the work

■ a sense of responsibility, that the individual enjoys.

According to theorists such as Vroom and Handy, the strength of the motivation of an individual depends partly on how strongly the individual wants these rewards – and how big are the expected rewards.

2.2   What managers can do to motivate staff

There are differing views on how individuals are motivated. Consequently, there are differing views about what management can do to improve the motivation of their employees.

- There is a view that management must **get the 'basics right' first**: they must offer a fair pay structure for staff and fair employment policies – to meet the physiological needs and security needs of their employees (Maslow) or to prevent dissatisfaction from employees (Herzberg).

- Herzberg argued that management should take some measures to prevent dissatisfaction, but that a completely different approach is also needed in order to create motivation. Herzberg believed that **job enrichment** was a key to better motivation.

- Adams argued that the **rewards system** should be seen to be fair: however, rewards can be intrinsic rewards as well as extrinsic rewards such as higher pay.

- McGregor and Argyris argued in favour of a **participative style of management**, and getting employees involved in problem-solving and decision-making. They argued that this management style gets more out of employees, and this improves the performance of the organisation.

- McClelland argued that the best leaders were individuals with a **need for achievement**. Management should therefore try to identify and develop high achievers.

- One of the factors affecting the strength of motivation is the belief that the individual's efforts will lead to better performance. Managers should therefore try to increase the strength of this expectancy. Vroom argued that managers should give encouragement and advice to their employees, give them the resources they need to accomplish their tasks and, where necessary, give them suitable training.

- It can also be argued that managers can motivate staff by providing inspiring **leadership**.

The ability of managers to motivate their employees may also be affected by the differing needs of different employees. Whereas some content theorists (Herzberg) argued that all individuals were motivated by the same needs, there are differing views that:

- different people have different needs (for example, McClelland, Vroom)
- these needs can change over time (for example, Maslow).

It seems clear, however, that:

- managers can influence the motivation of their employees
- needs as well as rewards are an important factor in motivation, therefore
- managers must try to understand what the needs of their employees are, and what rewards – intrinsic as well as extrinsic – will help to satisfy those needs.

2.3 The reward system and motivation

The reward system refers to the system of 'extrinsic' rewards that an organisation can give to its employees. The most significant extrinsic rewards are usually:

■ pay (remuneration), and

■ promotion or advancement.

Elements of pay include basic pay, bonuses, commissions, premium pay for working overtime, pension rights and so on.

It is generally agreed that individuals need to be kept satisfied about their pay, in order to avoid feelings of dissatisfaction or inequality and unfairness. Dissatisfaction about pay will affect the attitudes and behaviour of individuals in their work.

It is not certain, however, whether offering pay incentives will increase the motivation of employees. (It is also not certain that extra motivation will lead to better performance.)

■ McClelland would have argued that pay rewards might be seen as a measure of recognition and goal accomplishment by high achievers. Rewards in the form of higher pay or bonuses may therefore be an important motivator.

■ It may also be argued that getting paid more for better performance (for example receiving a cash bonus) is important for many individuals, because the money can be used to fulfil some important needs.

■ Process theories of motivation often place strong emphasis on financial rewards, because money can be used to buy satisfaction of many needs.

■ There is also a view that group reward systems are able to improve the collective motivation of teams.

However, as explained already, there is also a view that in many organisations, pay systems do not provide motivation, and employees can be motivated by other things, such as participation in decision-making or an 'enriched' job.

Performance-related pay for individuals

Even so, many organisations in practice do have systems for rewarding individuals for the achievement of certain levels of performance or performance targets.

Performance-related pay may be cash bonuses or other forms of incentive.

■ **Cash bonuses** are payments in cash that are related to meeting short-term targets, such as meeting budget targets such as achieving or exceeding a profit target. Sales representatives may be paid a sales commission based on the value of sales they have won during a period of time. Performance targets do not have to be financial targets: cash bonuses might be paid to an individual who achieves a specific non-financial target, such as completing a particular task on time or before a specified date.

■ **Incentives** for the achievement of longer term goals are often paid to senior managers, often in the form of **company shares or share options**.

If companies use a system of performance-related pay, they presumably believe that the pay incentives are successful in motivating employees. If they did not think that this was the case, there would be no point in offering the incentives!

It is also important to remember that rewards are not always given in the form of pay. Promotion and recognition may be equally important to an individual. However, there is a limit to the number of individuals who can be rewarded with promotion, especially in small business entities.

Performance-related pay for groups

Cash bonuses might be paid to groups of workers, such as all the employees in a department, section or project team. For group bonuses to be effective as a motivator, however, it is important that individuals should identify themselves with the group and should believe that the efforts of the group as a whole are capable of earning a bonus.

A problem with group bonuses, however, is to decide how the total bonus for the group as a whole should be divided between the individual group members. If the basis for sharing the bonus is seen as unfair, a bonus payment might create resentment and arguments rather than act as a motivator.

Company-wide bonuses

Sometimes a company pays a bonus to all its employees, particularly if it has had a highly profitable year. For example in 2007, UK stores group Marks and Spencer announced strong profits growth for the previous year and a £91 million bonus to be shared by all its employees as a reward. Such a bonus might help to persuade employees to remain with the company, but it is doubtful whether it can be effective in motivating individual employees to do their work more efficiently or effectively.

Bonuses and performance

For a cash bonus scheme to be effective, the payment of a bonus should be clearly linked to the performance of an individual (for individual bonuses) or a group (for group bonuses). A clear link can only be established when the following conditions apply:

- The performance of the individual or group can be measured.
- The individual or group can affect the measured performance through efficient or effective working. As stated in some of the earlier descriptions of motivation theory, there should be a connection between effort (motivation) and outcome.

2.4 Constructive feedback and motivation

Process theories of motivation emphasise the importance of:

- the link between putting in more effort and improving performance (or reaching targets), and
- the link between reaching targets and obtaining rewards.

Individuals need to know how they are performing, and whether they are on course for achieving their goals.

If they are not on target for achieving their goals, they need to be given advice and guidance from their boss.

The process of providing information to individuals about their performance is an example of **feedback**. Feedback should be constructive and helpful, rather than critical, to maintain the motivation of the individual. If individuals are criticised in a negative way for failing to reach their goals, their motivation will disappear.

A system for providing constructive feedback about performance (but not the only system) is a system of **job appraisal**. This was described in an earlier chapter.

CHAPTER

10

Recruitment and selection

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1   The recruitment and selection process
2   Effective recruitment
3   Job descriptions and person specifications
4   Job analysis
5   The changing nature of employment
6   Selection methods
7   The selection decision
8   The selection interview
9   Equal opportunities and the management of diversity

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The recruitment and selection process

- The importance of effective recruitment and selection
- Stages in the recruitment and selection process
- Roles and responsibilities for recruitment and selection
- Recruitment and the HR plan
- Reasons for ineffective recruitment and selection
- Evaluating the recruitment and selection process

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1 The recruitment and selection process

1.1 The importance of effective recruitment and selection

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 on retirement.
- Employees who have acquired enough skills and experience might be moved on to other jobs within the organisation that make better use of their developing talent.
- The labour requirements of the organisation will change, as new jobs are created and old jobs are no longer required. People are recruited to fill the new jobs, with new skills. Some existing employees might be made redundant.

Changes in the work force must be properly managed, in order to make sure that the work force 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.

1.2 Stages in the recruitment and selection process

Recruitment and selection are two stages in the process of filling job vacancies.

- **Recruitment** starts when a job vacancy is identified. It is the process of obtaining a supply of suitable possible candidates to fill the vacancy. When job vacancies arise, an organisation needs a number of individuals to choose from, and these individuals:
    - must seem able to do the job and
    - should also want to do the job.
- **Selection** is the process of appointing the most suitable candidate to a job vacancy, by choosing the best individual from the candidates available.

Recruitment is therefore concerned with quantity – getting candidates to apply for job vacancies – and selection is concerned with quality – choosing the individual who seems the best for the job.

An outline of the recruitment and selection process is shown in the following flowchart.
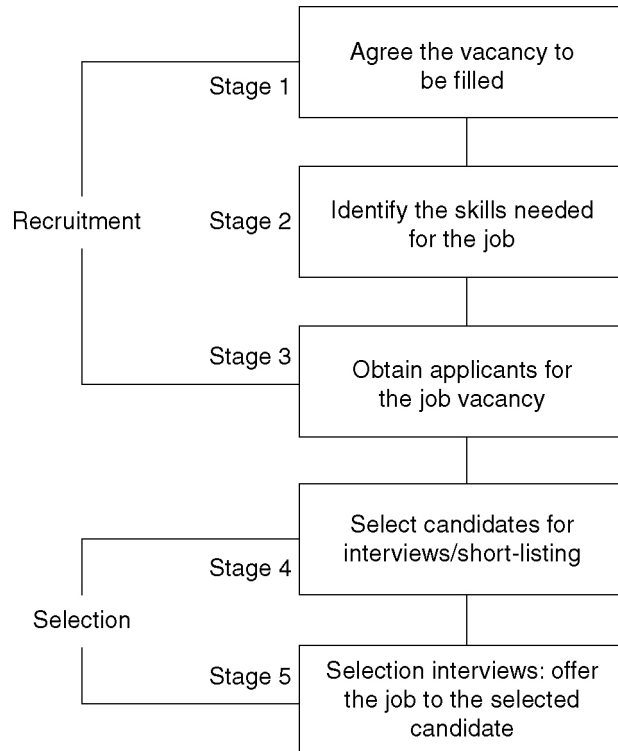
1.3 Roles and responsibilities for recruitment and selection

In a large organisation with a human relations (HR) department, the roles and responsibilities for recruitment and selection are normally shared between:

- operational management ('line' management) and
- staff in the HR department ('staff' specialists).

Operational managers should be involved in the recruitment and selection process in several ways:

- They should report any vacancies arising in their department or section, or should agree any vacancies with the management responsible for the human resources plan.
- They should identify individuals working for them at the moment who might be suitable candidates for a job vacancy, as part of the process of developing and promoting staff internally.
- They should be involved in specifying the nature of the job, and the skills that the job holder should have in order to do the work properly.
- They should normally be involved in the process of selecting individuals from the candidates who have applied for a job in their department or section.

HR 'staff' specialists should be involved in the recruitment and selection process in a larger organisation in the following ways.

■ They should be involved in HR planning, and identifying the vacancies that are expected to arise throughout the organisation in the future.

■ They should have specialist skills in recruitment and selection. They may know more than operational management about the best methods of recruiting for particular job vacancies and about advertising job vacancies. They should also have specialist knowledge about selection methods.

■ Typically, they work with line management, taking on responsibility for ensuring that enough candidates apply for vacancies. They are also involved in the selection process. For example, HR staff may arrange selection interviews and carry out selection interviews jointly with line management colleagues.

In some cases, an organisation might use the services of an **external recruitment agency** (or firm of 'head hunters') to identify potential candidates for job vacancies. However, although the recruitment process may be delegated to an external agency, the selection process should be the responsibility of the organisation's own management.

1.4 Recruitment and the HR plan

Large organisations may have a human resources plan for the organisation. This is a plan for:

■ how many employees the organisation expects to have by the end of the planning period

■ what types of job they will be doing

■ how many employees the organisation has now

■ how many employees it expects to lose, for example due to resignation or retirement.

The plan will also include estimates of the number of job vacancies that are likely to be filled by internal promotion, and so how many jobs will need to be filled by external recruitment.

Before advertising a job vacancy, a check should therefore be made with the HR department to confirm that recruiting to fill a job vacancy is consistent with the HR plan.

1.5 Reasons for ineffective recruitment and selection

The recruitment and selection process might be ineffective, with the result that not enough people apply for job vacancies, unsuitable individuals are selected, or individuals do not stay in the job for long after their appointment.

There are several reasons for poor recruitment and selection procedures.

Poor recruitment

The reasons for a failure to attract a sufficient number of suitable applicants for a job may be any of the following.

- The requirements of the job are not properly considered before the job is advertised, so that the vacancy is advertised to individuals with unsuitable skills. (In other words, there is a failure to do a proper job analysis.)

- There is a failure to agree the **minimum acceptable** requirements for the job, only the ideal requirements. Potential applicants may be deterred because of the high level of skills and experience that the employer says it wants from the successful applicant for the job.

- The job itself is not attractive enough, or the pay is too low, so that not many people apply for the vacancy.

- The job vacancies are advertised in an unsuitable way, so that the vacancy does not come to the attention of people who might apply if they knew about it.

Poor selection

The reasons for poor selection could be any of the following.

- The application form for the vacancy is badly-designed, and applicants do not provide enough relevant information about themselves. A candidate may therefore be offered the job when there is insufficient relevant information about him or her.

- The selection techniques are inappropriate.

- The individuals making the selection (for example, the individuals doing the selection interviews) are not trained in selection, and do not have the necessary skills to do the task well.

- The effectiveness of the selection process is not monitored and reviewed regularly, so that the need to improve the selection system is not recognised.

As a result, the best applicants are not selected, and in some cases unsuitable candidates are offered the job.

<table>
<tr><td>Effective recruitment</td></tr>
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- A plan for the recruitment process
- Advertising the vacancy
- Methods of advertising vacancies
- Job application form
- References

2 Effective recruitment

2.1 A plan for the recruitment process

Recruitment should be properly planned. The main aspects of recruitment are as follows:

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          ┌─────────────────┐
          │  Job analysis   │
          └────────┬────────┘
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         ▼                   ▼
┌─────────────────┐ ┌──────────────────────┐
│ Job description │ │ Person specification  │
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      ┌──────────────────────────┐
      │   Advertise the vacancy  │
      │   (internally and/or     │
      │        externally)       │
      └────────────┬─────────────┘
                   │
      ┌────────────┴─────────────┐
      │     Provide a job        │
      │ application form for      │
      │   applicants to fill in   │
      └──────────────────────────┘
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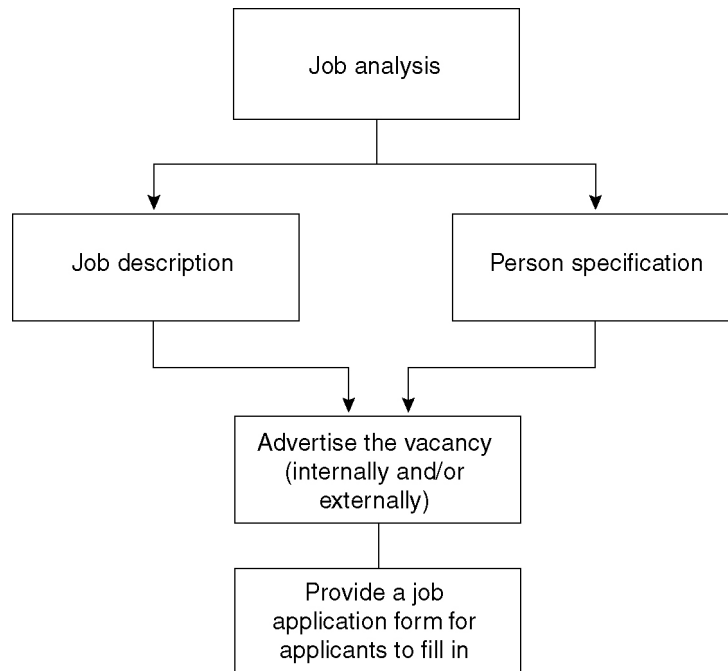
Job analysis

A job analysis involves looking at a job and identifying what it consists of (or what it will consist of). The purpose of a job analysis is to recognise what tasks the job holder will be expected to do, and what tasks will take up most of the job-holder's time. An analysis of the job will also show what particular skills are required to do the job.

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 do the job (a '**person specification**').

Job descriptions and person specifications are described in more detail later.

2.2   Advertising the vacancy

Jobs must be brought to the attention of individuals who might want to apply for them.

Internal and external recruitment

A job vacancy might be 'advertised':

- within the organisation (internally) to existing employees
- externally, to people outside the organisation
- both internally and externally.

Both internal promotion and external recruitment have their advantages.

Internal promotion advantages	External recruitment advantages
Internal promotion can help to improve the morale and motivation of the work force.	The organisation might not have employees with the skills required for the job.
Internal recruitment may be preferred over external recruitment in order to provide a career development opportunity to existing employees. Good employees might leave to find work somewhere else unless they are given promotion opportunities.	External recruitment may be desirable to introduce 'fresh thinking' and new ideas into the organisation.
The employer will know quite a lot about its existing employees – how they have performed at work so far, and the nature of their strengths and weaknesses. Making appointments internally may therefore be less risky than an external appointment.	Recruits from other organisations will bring their knowledge and experience of working practices in those other organisations.
Existing employees will understand the culture of the organisation and how it operates. Training requirements for a promoted person should not be extensive.	There may not be an existing employee who is the right person for the job. Appointments to senior management positions, for example, are often made by external recruitment.
The employees may already know the people they will be working with, if they are successful in getting the job.	There might be more vacancies than there are candidates to fill them by internal promotion.
Internal promotion is an inexpensive method of recruitment – avoiding the costs of advertising or recruitment consultants' fees. Internal recruitment may also be much quicker.	The vacancies may be for junior jobs that existing employees do not want to apply for.

Internal appointments are often made to fill the vacancy for a supervisor. This is because supervisors usually need a detailed understanding of the operations and procedures they will supervise. Existing employees often have this detailed knowledge.

2.3 Methods of advertising vacancies

The methods used to advertise job vacancies should depend on:

■ whether the vacancies are advertised internally or externally, and

■ the nature of the job or jobs.

The aim should be to:

■ select an effective method of advertising, so that there will be a suitable number of applicants for the job, and

■ avoid excessive spending: choose a cost-effective method of advertising.

Several methods of advertising the same job vacancy (or vacancies) might be used.

You should already be familiar with the various ways of advertising job vacancies. The main methods are described briefly below.

Recruitment agencies

An organisation may notify its job vacancies to an external recruitment agency. The agency attracts individuals looking for a job, and tries to match individuals 'on its books' with the job vacancies.

Many recruitment agencies specialise in finding applicants for particular types of job, such as:

■ jobs in book-keeping and accountancy

■ secretarial work

■ information technology (IT) workers.

Some recruitment agencies ('head hunters') specialise in finding suitable external applicants for senior management positions.

The government may have an employment service for unemployed job seekers, and vacancies can be notified to the local office of this government service. An advantage for employers of using a government recruitment service is that it is likely to be much less expensive than using a commercial recruitment agency.

Media advertising

An organisation (or a recruitment agency) may advertise job vacancies in the media.

- A **national newspaper** may be used to advertise vacancies for managers, some professional staff and some senior technical staff. A specific national newspaper may be used to advertise vacancies in a particular industry, because many individuals looking for jobs in that industry buy the newspaper. For example in the UK, the Financial Times newspaper is often used to advertise senior vacancies in banking, and the Guardian newspaper is often used by firms in the media industry to advertise their job vacancies.

- A **local newspaper** may be used to advertise jobs where only local people are expected to be interested in applying. Advertisements in local newspapers are much less expensive than national newspaper advertisements, but the circulation (number of copies distributed) is also much smaller.

- **Specialist journals and magazines** are used to advertise job vacancies in particular industries. Most industries have their own specialist journals or magazines, that are read or seen by a large number of people in the industry. A particular advantage of advertising in 'trade magazines' is that the advertising is focused at readers who are involved in the industry, and so who are most likely to be interested in vacancies for technical jobs in that industry.

- **Radio** or **television** might be used to advertise job vacancies, but this unusual – especially TV advertising. These forms of media are usually very expensive, because of the large numbers of viewers or listeners. At the same time, many viewers or listeners will not be interested in any job vacancies that are advertised. Radio and television advertising are therefore both expensive and usually ineffective.

Media advertising or recruitment agency?

When jobs are advertised externally, the main methods of recruitment are using a recruitment agency or advertising the vacancy in the media. Only one, not both, of these methods should be used for the same job vacancy at any one time.

- Recruitment agencies usually operate on a 'no win, no fee' basis. An agency will charge a high fee if it is successful. However, it is not usually paid a fee unless it is successful in finding an individual who is subsequently appointed to fill the job vacancy.

- Advertising is less expensive than using a recruitment agency, but only if it attracts applicants and only if the job vacancy is then filled. If an advertisement is unsuccessful, the spending on the advertising is 'lost' or 'wasted'.

Other methods of recruiting

Other methods may be used to attract applicants for job vacancies and identify individuals to include in the selection process.

- **The internet**. Many organisations advertise job vacancies – both internally and externally – on their own web site. Advertising on the organisation's own web site is inexpensive. Many recruitment agencies also advertise job vacancies on the internet, as another way of attracting individuals to contact them and use their services to find a job.

- An organisation may keep a list of individuals who have written in the past to ask for a job, or who applied for a vacancy in the past and were not employed because a better candidate was offered the job. These individuals can be contacted, asked if they are still looking for a job and invited to apply for the vacancy that now exists.

Identifying candidates for internal recruitment and selection

When vacancies are filled by internal recruitment, the following methods may be used, individually or together:

- **Performance reports and appraisals of individuals**. Senior managers might recommend, as part of the regular process of performance appraisal of staff, whether particular employees are now ready for promotion. Employees who are ready for promotion may be invited to apply for a more senior job when a vacancy arises.

- The **'in-house' or company magazine**. Some organisations publish an in-house magazine. This may be used to advertise job vacancies internally.

- The organisation's **website**. The website can be used to advertise job vacancies to existing staff as well as externally.

2.4 Job application form

Applicants for a job are often asked to fill in a job application form. This is usually a standard application form, used by an organisation for all its job vacancies. Each applicant for the job fills in an application form, providing some basic information about himself or herself. In many cases, the applicant for a job is also asked to write a **covering letter** to accompany the job application form, stating briefly why he or she is applying for the job.

An application form usually asks questions about the following.

- **Personal details** about the applicant – name, address, contact telephone number or e-mail address, age.

- **Details of education** and educational qualifications, or other formal qualifications (diplomas, certificates and so on).

- **Details of the individual's current job** (possibly including details of the applicant's current wage or salary) and **previous work experience**

- The applicant's **social and leisure interests** and activities.

An application form also includes a question asking the applicant to explain why he wants the job, or what he is hoping to achieve in his future career. The form should leave enough space for the applicant to provide a lengthy answer to this type of question.

The purpose of a job application form

A job application form serves several useful purposes.

■ It provides basic details about the applicant for a job, so that the organisation is able to contact him or her.

■ It gives the applicant for a job an opportunity to 'sell' himself or herself to the organisation. The way in which the application form is filled in, and the information it provides, could make the difference between getting a selection interview and not being invited to an interview.

■ When a job is advertised externally, there are often many more applicants than the organisation has time or resources to interview. The job application forms from all the applicants are compared, and the numbers invited for an interview can be restricted to a manageable number.

■ The organisation is able to use the job application forms from all the applicants to make an initial comparison of the candidates, and to rank them in order of preference for interview into:

- 'probables': candidates to invite for interview

- 'possibles': candidates to invite for interview only if the 'probables' decide not to come for interview or if the 'probables' are interviewed and none of them are found suitable

- 'definitely not' – individuals who are clearly unsuited for the job, for example because they are not sufficiently qualified.

The effectiveness of a job application form

Job application forms have only a limited value.

■ They usually contain only superficial information about the applicant. Although this information might be used to rank the applicants, and identify individuals who are clearly not suitable for the job, the application forms cannot be used to identify the best candidate for the job. For example, they cannot be used to assess the qualities of the applicants, such as their intelligence, motivation and social/inter-personal skills.

■ Applicants might provide false information, particularly about their qualifications and experience. It is impractical to check every application form for honesty. However, checks ought to be carried out on the information that has been provided by the individual who is eventually selected to fill the vacancy – simply to make sure that it is correct.

2.5 References

On a job application form, applicants for a job are often asked to provide the name and address of one or two 'referees'. The preferred referees are typically:

■ a former employer, senior manager or supervisor that the applicant has worked for in the past, or the applicant's current employer or boss, or

■ if the applicant has not had a job before, a senior teacher or course tutor who has taught the individual, or

■ an eminent person who knows the applicant socially, such as a religious leader, a solicitor, a doctor or an accountant.

The application form might state that the organisation reserves the right to contact the referee to obtain a reference about the individual, and an opinion about the suitability of the individual (the applicant for the job) for employment. The organisation should normally ask for these references only if it intends to offer the job to the individual. Alternatively, an individual may be offered the job 'subject to satisfactory references'.

A reference is usually in a form of a letter from the referee. Alternatively, the referee might be asked to complete a special questionnaire.

A reference may provide useful information about the applicant, and may:

■ confirm matters of fact that the applicant has stated in the application form and in the selection interview, such as facts about his or her education, qualifications and previous employment

■ confirm impressions about the character of the individual and his or her suitability for the job. For example, a previous employer may give an opinion about the applicant's skills and attitudes towards work, and about his or her performance in the previous job.

The problem with references

The main problem with references is that the referee may not give an honest opinion about the individual. In particular, a referee may be reluctant to write anything critical about the individual, not wanting to damage his or her chances of getting the job. (There may also be a risk of legal action against the referee by the applicant, if the information in the reference is unfair. This concern may prevent the referee from writing anything worse than mildly critical.)

Job descriptions and person specifications
■ Definitions
■ Job descriptions
■ The purpose of a job description
■ Person specifications
■ Rodger: seven-point plan
■ Munro Fraser: five-point plan

3 Job descriptions and person specifications

3.1 Definitions

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

A **person specification** is a formal statement of the personal qualities and characteristics of the type of person who should be expected to do the job well.

Both job descriptions and person specifications may be used in the selection process, to identify the most suitable applicant for a job vacancy.

3.2 Job descriptions

A job description, as its name suggests, is a formal specification of a job. The contents of a job description include:

■ the job title

■ the date the job description was prepared

■ the name of the department or section in which the job is located, and/or the physical location of the job

■ the relationship of the job to other jobs in the organisation structure: in particular:

   - who is the 'boss' of the job holder?

   - who, if anyone, are subordinates of the job holder?

   - what is the relationship between the job and other jobs in the organisation?

■ is the job a part of a team, and if so, what is the size of the team?

■ the purpose of the job, and the objectives of the job in relation to the overall objectives of the department or organisation

■ the tasks associated with the job: the key tasks and principal duties. These tasks should ideally be listed in order of importance. In addition, the job description should indicate which tasks will take up most of the job holder's time

■ the responsibilities associated with the job

- limits to the job holder's authority
- the accountability of the job holder
- the salary range or wage range for the job
- conditions of employment – hours of work, whether weekend working or night-time working might be required, the number of days of holiday entitlement each year, and so on.

The job description may also specify the working conditions in which the job is performed, for example an office environment or a type of factory environment.

If the job involves physical activity, such as carrying loads, the job description should specify what these activities are.

It may also indicate future job opportunities and career development opportunities that should be available to the job holder. (This information is relevant if the job description is used to advertise the job for recruitment purposes.)

3.3 The purpose of a job description

A job description can be used for several purposes.

- It can be used in a **job evaluation exercise**. By preparing a job description for an existing job, or for a new job that is being created, it should be possible to assess whether the job involves too little or too much work for the job holder, and what the rate of pay for the job ought to offer.
- A job description can be given to the job holder, so that he or she is aware of the exact requirements of the job.
- It can be used to **advertise a vacancy for the job**, particularly if the vacancy is being advertised internally within the organisation. For external advertising of job vacancies, some of the information in the job description can be included in the job advertisement.
- A job description might be used with a person specification in the **recruitment and selection of staff**. The job description might help an employer to identify the personal qualities that the job holder needs to do the job well. The employer can then try to match the job with the most suitable individual. (This approach to selection is described in more detail later.)

3.4 Person specifications

A person specification is a formal statement of the personal qualities that the job holder should have in order to do the job well. It is based on:

- the job description and
- experience – an analysis of successful and unsuccessful job holders in the same or similar jobs in the past.

The specification might include characteristics for the job holder such as qualifications, work experience, age, physical characteristics, numerical or reading ability, an ability to communicate, an ability to get on well with other people, and so on.

A person specification is used in recruitment and selection:

■ to advertise a job vacancy, the job advertisement may specify what are the desirable or expected personal qualities of the individual who will be the successful applicant

■ in the selection process, applicants can be judged on the basis of whether they seem to have the appropriate personal qualities for the job.

Two different approaches to the design of person specifications are:

■ the seven-point plan of Alec Rodger, and

■ the five-point plan of J Munro Fraser.

3.5 Rodger: seven-point plan

Alec Rodger (1952) provided a framework for collecting and analysing information about a person's individual strengths and weaknesses at work. He grouped the personal characteristics into seven categories, and he suggested that interviewer could use this analysis during the selection process for a job vacancy.

By asking questions relating to the seven categories of personal quality, the interviewer could build up a personal profile of the candidate.

Roger suggested that the employer should identify the personal qualities required to do the job well, and by comparing the personal qualities required for the job with the personal qualities of the applicants, it should be possible to identify the most suitable applicant for the job.

The seven points or seven categories of personal qualities in Rodger's model were as follows:

■ **Physical make-up**. Does the applicant have an important physical defect? How agreeable are the individual's appearance, bearing and speech. (This means that the interviewer will take note of what the individual is wearing and his or her general appearance.) For some jobs, height might be an important physical characteristic.

■ **Attainments**. Attainments refer to the education, qualifications and work experience of the individual. What type of education has the individual had, and what are his or her academic qualifications? Does the individual have any occupational qualifications, or professional qualifications? What is the occupational training and experience of the individual?

■ **General intelligence**. How much general intelligence does the individual have? In the selection process, applicants might be tested for their general intelligence, particularly where the employer believes that a high level of intelligence is a necessary requirement for the job.

■ **Special aptitudes**. The individual may have some special aptitudes, such as:

- a mathematical ability

- manual dexterity

- an ability with words or figures.

- **Interests**. The individual's interests are included as a category of personal characteristic. These can be classified as intellectual (for example, playing chess), practical, physically active (for example, sports), social or artistic. Interests therefore help to define an individual's personality.

- **Disposition**. 'Disposition' refers to the way in which an individual thinks and behaves, particularly in relation to other people. A person might be open and honest, or quiet and secretive. A person might have a manner that makes it easy (or difficult) for other people to accept him. An individual might be dependable, or self-reliant.

- **Circumstances**. 'Circumstances' refer to the domestic circumstances in which the individual lives. For example, does the individual live alone or with a large family? The circumstances in which an individual lives might affect his or her availability for work at different times of the day or week.

Rodger suggested that the personal characteristics of job applicants should be matched with the personal requirements for the job holder. He grouped the personal requirements for the job into five categories:

- intellectual requirements
- practical requirements
- physical activity requirements
- working with other people
- artistic requirements.

Rodger's seven-point plan might seem logical, but it has limitations and weaknesses.

- It matches individuals with jobs on the basis of superficial information about the individual.

- It matches individuals with jobs on the basis of assumptions about the qualities required to do a job well, but these assumptions might be incorrect.

- It ignores individual choice. It is important to consider the type of job that an individual wants to do, not just the type of job that he or she seems well-suited for.

3.6 Munro Fraser: five-point plan

Another approach to matching personality with jobs was suggested by J Munro Fraser (1958). This approach, which he called a Five Point Plan, was based on grading candidates for a job vacancy according to five personal qualities.

- **Impact on other people**. This is the impact or effect that the individual has on other people. An individual's qualities are graded according to factors such as physical make-up and appearance, way of speaking and general manner.

- **Qualifications**. These are the acquired knowledge and experience of the individual, including academic education and qualifications, work experience, vocational training and vocational or professional qualifications.

■ **Brains and abilities**. The individual is also graded according to his or her abilities, such as 'brains', quickness of understanding, aptitude for learning and so on.

■ **Motivation**. The individual is graded according to:

- his or her determination and motivation to pursue and achieve individual goals, and

- his or her success rate in achieving them.

■ **Adjustment**. 'Adjustment' refers to the emotional stability of the individual and his or her ability to get on well with other people and to handle stress.

Munro Fraser suggested, in a similar way to Rodger, that to select an individual for a job, the personal qualities of the individual should be matched with the personal characteristics required to do the job well.

> ## Job analysis
>
> - Definition and purpose of job analysis
> - Methods of job analysis
> - The information gathered for analysis
> - The skills required for job analysis
> - Justifying the use of job analysis

4 Job analysis

4.1 Definition and purpose of job analysis

Job analysis involves an examination of the characteristics and requirements of a job. There are many definitions of job analysis. Some useful definitions are given below.

- Job analysis is 'the determination of the essential characteristics of a job in order to produce a job specification' (British Standards Institute). Note: a job specification is a job description, but might also include the personal qualities that the job holder requires.

- Job analysis is 'a detailed examination of a job to determine the duties, responsibilities and specialised requirements necessary for its performance' (NASA).

Some definitions of job analysis emphasise the use of job analysis to produce both job descriptions and person specifications for a job.

- Job analysis is 'the first step in the employee recruitment process and [it] involves gaining the correct information relating to the vacant job, to allow an accurate job description and person specification to be drawn up.'

- Job analysis is 'the systematic, formal study of the duties and responsibilities that comprise job content. The process seeks to obtain important and relevant information about the nature and level of the work performed and the specifications required for an incumbent to perform the job at a competent level.'

On the other hand, the definition of job analysis might emphasise the analysis of the job content rather than the personal characteristics that the job holder needs:

- Job analysis is 'the process of collecting, analysing and setting out information about the content of jobs in order to provide the basis for a job description and data for recruitment, training, job evaluation and performance management. Job analysis concentrates on what job holders are expected to do.'

The purpose of job analysis

Job analysis may have any of the following purposes.

- It is a starting point for **preparing a job description and person specification** for a job. It is therefore useful for recruitment (advertising a job) and selection.

- It is used for **job evaluation**. Job evaluation is the process of studying a job, and comparing one job with other jobs, to decide what the job is 'worth' in terms of:
  - salary or wage, and
  - in a large organisation, ranking or grading.
- By identifying the responsibilities for a particular job, it can help with organisation structure, and deciding what the boundaries of authority for each job should be.
- By identifying the specialised skills for a particular job, it can help management to plan a training programme for the job holder.
- Job analysis can also be used when job content is reviewed. When changes are planned in the content and responsibilities of jobs, a useful starting point is to identify the current content and responsibilities of jobs, so that the changes that are needed can then be identified and made.

4.2 Methods of job analysis

Job analysis involves finding out answers to the following questions:

- What are the tasks of the job holder?
- How much time is taken up by each task?
- Which tasks are the most important?
- What skills are required to do the tasks properly?
- What decisions does the job holder have the authority to make?

There are three main ways of obtaining this information, and all three methods might be used for the same job analysis. These methods are:

- **Observation**. The analyst can observe the job holder at work over a period of time, and record what the job holder does in that period.
- **Interviews**. The analyst can ask questions about the job and what the job holder does, by interviewing:
  - the job holder, and
  - the job holder's boss.
- **Questionnaires**. The job analyst might use questionnaires or checklists when conducting interviews, to make sure that all the important questions are asked and nothing is forgotten. Questionnaires might also be used without interviews, to obtain information from large numbers of job holders. The job holders can be asked to answer the questions in the questionnaire and submit the completed questionnaire for analysis.

A systematic approach to job analysis might be carried out in four stages. These four stages apply where the job is not currently vacant.

- **Stage 1**. Collect all the available documentation about the job and its content. Analyse this documentary evidence.
- **Stage 2**. Interview the manager (or managers) in charge about the job, and what he or she considers to be the nature of the job, its importance, and the tasks and responsibilities involved.

- **Stage 3**. Interview the job holder and ask the same questions about the job. Compare any differences of perception between the manager and the job holder.

- **Stage 4**. Observe the job holder doing the job.

The information gathered at all four stages of the process should then be analysed, and a job analysis prepared.

4.3 The information gathered for analysis

The information gathered during a job analysis exercise can be divided into eight categories:

Category	Comment
Purpose	The reason for the job or activity. The purpose of a job should be described within the context of the organisation as a whole and its objectives.
Content	The tasks that the job holder is required to perform.
Accountability	What results or performance is the job holder responsible for, and to whom is the job holder accountable?
Performance criteria	What are the measurements of performance by which the job holder is judged? What is used to assess whether the job holder is performing well or badly?
Responsibility	What is the decision-making responsibility of the job holder? To what extent are these decisions routine ('programmed') and to what extent does the job holder need to use discretion or judgement?
Position in the organisation	Who does the job holder report to? Does the job holder have line management responsibility, or is the job holder a staff adviser?
Career development	What job development and career development opportunities are available for the job holder?
Environmental factors	Environmental factors relate to the working conditions, such as working surroundings, hours of work, health and safety issues, and so on.

4.4 The skills required for job analysis

A job analysis might be carried out by senior management, or the boss of the job holder. However, job analysis calls for some specialist skills. The job analyst needs to know what information to look for, and what questions to ask. The analyst must also be able to carry out the analysis, and apply the analysis to its specific purpose, such as:

- preparing job description and person analysis for the job, or
- evaluating the job, and deciding what level of wage or salary is appropriate, and how the job should be ranked or graded in the organisation hierarchy.

The individuals who carry out job analysis may even be external management consultants. External analysts have the advantage of impartiality and objectivity in their analysis. External agencies should also have a well-established method of job analysis that has been proved from experience to work well.

4.5 Justifying the use of job analysis

Job analysis is a time-consuming exercise, and can be expensive. It is only justified if the expected benefits from analysis are greater than the costs.

The benefits of job analysis come from the information that is obtained about the content of a job and the personal qualities that the job holder requires.

Job analysis is difficult to justify when …	Job analysis may be justified when …
Job content is already well-defined, and there are already formal job descriptions and person specifications for jobs.	Creating job descriptions and person specifications will improve the quality of recruitment and selection.
Job content within the organisation is continually changing, because the organisation exists in a rapidly-changing environment. Job analysis might be difficult to justify if it will become out-of-date within a short time.	The organisation wishes to carry out a job evaluation exercise, to review wages and salaries and job grades, or in order to re-design the content of some jobs.
There are a lot of jobs to analyse, and the cost of analysis might therefore be very high.	

The changing nature of employment
■ Changing attitudes to work
■ Charles Handy: the shamrock organisation

5 The changing nature of employment

5.1 Changing attitudes to work

In some countries, attitudes to work are changing. The pace of change varies between different countries, but in some countries (such as the UK) they are affecting the type of work that individuals want to do, and the type of employee that organisations want to recruit and use.

For workers, a significant development has been the increasing reluctance of individuals to work full time for large and formally-structured organisations.

■ More people are choosing to work from their home. It is relatively easy for individuals to set up an 'office' at home, with internet and telecommunications links.

■ They are seeking more job satisfaction, possibly through flexible working.

■ There is likely to be an increase in **portfolio working**, where individuals do part-time work or contract work for a number of different employers.

■ There may be an increase in **downshifting**, where individuals are prepared to sacrifice some income (and earn less money) in return for a better quality of life with much less stress.

Attitudes of employers are also changing.

■ The concept of a 'job for life' is less prevalent than in the past. Employees might expect new recruits to remain with them for only a short time, perhaps a few years, before most of them move on to another job with another employer.

■ There is a growing trend towards 'flatter organisations' with fewer layers of management in the organisation hierarchy. Flatter organisations are more efficient and responsive to change, because communication and decision-making are much quicker and are not held up as they go up and down through a chain of command.

■ As technology advances, employees must have relevant skills and education. As long as the world economy is growing, there is likely to be a shortage of skilled labour. One way of dealing with the shortage is to use individuals part-time or to outsource activities to sub-contractors.

5.2 Charles Handy: the shamrock organisation

Charles Handy (in the Age of Unreason, 1989) identified changes in the nature of organisations and employment, and predicted a movement towards 'shamrock organisations'.

A shamrock organisation is an organisation with three types of person working for it. Handy used as a comparison a shamrock with three leaves, each leaf representing a different type of worker.

■ The first leaf represents core workers.

■ The second leaf represents a flexible work force of 'in-sourced workers'.

■ The third leaf represents individuals who do work for an entity as outsourced sub-contractors.

Core full-time workers

Handy suggested that an organisation needs a core of full-time professionals, technicians and managers to deal with the general day-to-day running of operations. The core workers are essential, because they have a detailed knowledge and understanding of the organisation, its aims, objectives, policies and procedures. They are paid a high salary and other rewards, but in return are expected to commit themselves to the organisation, and often work long hours.

Handy suggested that the size of the core work force is shrinking, and employers are increasingly using the other two types of workers. This is partly because employers continually seek to reduce costs, and shedding full-time jobs is often an effective method of cost-cutting because cheaper alternative sources of labour exist.

Flexible workers: temporary and part-time workers

The second 'leaf' in Handy's shamrock organisation consists of flexible workers, who are either part-time workers or temporary workers. They do work for the employer when the work is required, and are not paid at other times. They might be on permanent employment contracts (as part-time employees) or on fixed-term contracts, so they are not independent of the employer organisation.

Outsourcing: sub-contractors

The third 'leaf' in the shamrock organisation consists of independent sub-contractors or entities that provide services on an outsourcing basis. Many activities can be outsourced – advertising, research and development, IT services, building management (cleaning and security), vehicle fleet management, delivery services, payroll administration, and so on.

Sub-contractors are paid fees, and fees are negotiated on the basis of results achieved ('outputs') rather than time worked.

Selection methods
■ Alternative methods of selection
■ Application forms
■ Interviews
■ Tests
■ Group selection methods
■ Usefulness and weaknesses of selection methods

6 Selection methods

6.1 Alternative methods of selection

Selection is the process of identifying the best candidate to fill a job vacancy, from among all those who have applied.

Sometimes, selection may involve identifying several suitable candidates to fill a job vacancy and offering the job to the 'best' of the suitable candidates. If the individual who is offered the job rejects the offer, the 'next best' candidate on the list is offered the job. The job is offered to each suitable candidate, in order of preference, until one of the candidates accepts the offer of the job.

There are various methods of selection. You may be familiar with some or all of them from your own personal experience.

6.2 Application forms

Application forms and references were described in the previous chapter, in the context of recruitment. Application forms are used by applicants to apply for a job vacancy, and in doing so to provide some information about themselves. They may be submitted in paper form or electronically, via e-mail or the employer's web site.

The forms are used in the selection process.

■ Application forms can be used in a **'first screening' process**, to make an initial assessment of the applicants and their suitability for the job.

- When there are more applicants for a job than the employer is able to interview, the application forms can be used to classify the applicants into separate categories, such as 'definitely to interview', 'possibly to interview' and 'definitely not to interview'.

- The application forms can be used to identify applicants who are clearly unsuitable for the job. The decision is therefore to take the application no further, and to notify the applicant that his or her application has been rejected.

■ Application forms can be used in selection interviews. The information provided by the applicant on the form can be used as a basis for asking further questions in the interview.

As explained in the previous chapter, if an applicant is offered the job, and accepts, the offer should be subject to **satisfactory references**. The individuals to approach for a reference are identified on the application form.

Letters of application

Instead of using application forms, an employer may ask applicants for a job to submit a letter of application, written in the applicant's own words. The purpose of asking the applicant to write his or her own application letter (or a covering letter to an application form) is to obtain an insight into his or her character.

Application forms provide factual information. Application letters reveal more about the personality of the applicant, his or her reason for wanting the job, and his/her ability to express himself/herself and communicate in writing.

6.3 Interviews

Applicants who get through the first screening process may be invited to a selection interview. A selection interview is a face-to-face interview at which the applicant is asked a number of questions, and is assessed by the quality of his or her answers.

Face-to-face interviews can take different forms:

■ The applicants may be interviewed by one person, such as the manager or supervisor with authority over the work group where the vacancy exists.

■ The applicants may be interviewed by an 'interview panel' of two or more people. Interview panels may consist of six, seven or even more interviewers. However, applicants are often intimidated by large interview panels, and it is good practice to keep an interview panel fairly small

■ The applicants might go through a succession of face-to-face interviews, each with a different person.

Interviews may be conducted in either an informal setting, or in a very formal setting. An informal setting should help to put the applicants at their ease. However, if the employer wants to observe the applicants under pressure, the setting might be very formal, with an interview panel sitting behind a large table and the interviewee sitting on a chair facing the panel.

Stress interviews

A stress interview is a type of face-to-face selection interview, where the interviewers deliberately put the applicant under stress, for example by asking questions in an aggressive manner and criticising the applicant's answers. Stress interviews may be used to interview applicants for a senior management position, in the belief that it will show how well each applicant stands up to stress, aggression and criticism. However, they are of doubtful value: it is not necessary to be aggressive to obtain useful information about a candidate for a job. A major disadvantage of stress interviews is that they might put off good applicants from wanting to take the job even if they are offered it.

Problem-solving interviews

A problem-solving interview is another particular type of face-to-face interview. The applicant for the job is given a hypothetical problem by the interviewer and asked to solve it. For example, the interviewer might ask a question: 'What would you do in the following situation…?'

A difficulty with this type of interview is that it may be difficult to assess and compare the answers of the applicants, and decide which applicant has given the best answer.

6.4 Tests

An employer may require applicants for a job to take a test or series of tests. Testing could be used as another stage of screening, to eliminate unsuitable candidates before interview. Alternatively, tests may be used in addition to an interview.

The purpose of tests is to learn something about the applicants for the job. The type of test that is used depends on the type of information the employer is looking for.

There are four main types of selection test:

- Intelligence tests
- Aptitude tests
- Competence tests
- Personality tests (psychometric testing).

Intelligence tests

These are tests (such as a general IQ test) to establish the general level of intelligence of the job applicants. They may also test the problem-solving skills of the job applicants, and their speed of thought. Candidates are usually required to complete the test, or as many questions in the test as possible, within a limited amount of time.

Aptitude tests

These are tests designed to establish a particular aptitude or ability of the job applicants. For example, an aptitude test might test the mathematical ability, or manual dexterity, or artistic ability of the candidates.

Competence tests

A test of competence is a test to establish whether the candidate has reached a certain level of competence in a specific area. It tests what the candidates have learned in the past. For example, an applicant for a job in word processing might be given a competence test to establish his or her level of skill and ability in word processing. A candidate will not be considered for a job vacancy unless he or she has reached a minimum level of competence.

Personality tests or psychometric tests

There are tests designed to analyse personality and character. A test is commonly in the form of a series of multiple choice questions. Candidates are asked in each question about their likes and dislikes, what they would do in a particular situation, their preferences and attitudes, and so on. The purpose of a personality test is to identify candidates who have suitable personality characteristics for the job.

6.5 Group selection methods

Group selection is an alternative method of selection that can be used either:

- instead of individual interviews and testing, or
- in addition to individual interviews and testing.

In a group selection process, a number of people from the organisation observe a number of applicants for a job as they go through a series of specially-designed activities. The activities may include role play, where each applicant is required to perform a particular role in a work-related scenario.

The candidates are observed, and compared with each other. The tests provide useful comparisons of ability, and supporters of group selection methods argue that the best applicants for a job can often display their greater ability and potential in work-related scenarios.

6.6 Usefulness and weaknesses of selection methods

Each of the main selection methods has some usefulness and value, but also some weaknesses. These are summarised briefly below.

Application forms

Usefulness	*Weakness*
Useful as a first screening process in selection, to eliminate applicants who are clearly unsuitable.	The information provided on an application form is not enough (except perhaps for very junior or low-level jobs) to make a selection decision.

Individual interviews

Usefulness	*Weaknesses*
Interviews give the employer an opportunity to see and listen to the applicants.	Not all interviewers have the skills to conduct a good interview. Poor interviewing technique leads to poor selection decisions.
Interviews, if well-conducted, should reveal more about each applicant than testing can reveal.	Some individuals are good 'professional interviewees', who can perform well in interviews (they can 'talk the talk') but they cannot actually perform well in a job. The interviewer might be fooled and misled.

| It is unusual to offer a job of any importance to an applicant without first having an interview. | Interviewers might be biased (consciously or unconsciously) against or in favour of particular candidates. |

Tests

Usefulness	*Weaknesses*
Tests are precise and can be used to obtain measurable or quantifiable information about job applicants.	It is not clear that the test results will show which candidates are best-suited to the job. A clear link between good test results and ability in the job has not been clearly proved.
Tests should be objective, and free from bias (unlike interviews)	Although tests should be objective, it is often impossible to exclude bias entirely from the testing process. Some types of individual perform better than others in particular types of test.
Tests can be administered to applicants in groups, and so the testing process is quicker than interviews.	It might be possible for candidates to improve their test scores by coaching and practice before the formal test. (For example, individuals may be coached in IQ tests.)
	Test conditions are artificial, and might not give candidates an opportunity to demonstrate their ability in an actual working environment.
	Candidates might guess the correct answer to some questions. A test should be designed with in-built checks: for example there may be two or more similar questions, and if the candidate has not used guesswork, all the answers should be consistent with each other. Even so, it is often possible to identify the correct answer to a multiple choice question by using common sense.
	The results of tests often need experts to interpret their meaning.
	Tests can also be expensive to administer: the costs include preparing the tests or hiring external experts, arranging and carrying out the tests, and arranging the marking and analysis of results.

Group selection methods

Usefulness	*Weaknesses*
They provide the employer with an opportunity to compare the candidates directly.	They are expensive to administer and time-consuming. Group selection methods are generally only appropriate when the employer is trying to fill several similar and senior vacancies. For example, group selection is often used to select individuals for a trainee management programme.
They can be used to study the candidates in work-related scenarios.	

The selection decision

- Involvement in the selection decision
- Skills in selection
- The importance of good selection
- The offer of employment
- Obtaining references

7 The selection decision

7.1 Involvement in the selection decision

The selection decision is made by either:

- the manager with authority over the job where the vacancy exists
- staff in the human relations (HR) department
- a committee of individuals, possibly a mixture of line management and HR staff experts.

There are no rules about who should make the selection decision, but as a general guide:

- If the vacancy is for a low-level job and there are only limited prospects of career development, the selection decision will be taken by a manager with direct authority over the job.
- If the vacancy is for a job where the successful candidate will have good career development prospects, the HR department should be involved in the selection decision. This is because the selection decision will affect the long-term human resources plan of the organisation.
- External experts, such as recruitment consultants or a 'head hunting' agency, might offer advice on selection. However, the actual decision should be taken by the organisation's own managers.

7.2 Skills in selection

Individuals involved in the selection process need to possess the relevant skills for identifying suitable candidates for a job vacancy.

An organisation may therefore need to give individuals **training in selection skills**, before they are actually involved in selection.

An organisation may also employ individuals in the HR department (human relations department) who have been trained in recruitment and selection.

Note: The skills required to conduct successful selection interviews are described later.

7.3   The importance of good selection

Good selection decisions improve the quality of employees within the organisation. When an organisation has high-quality employees, it should perform better. Good selection is therefore an important factor in improving the assets of the organisation (employee quality) and helping the organisation to be more successful in achieving its objectives.

Poor selection decisions have the opposite effect:

■ The individuals offered employment are not the best people available. After their appointment, they might perform badly in their job, or might need training to bring them up to an acceptable level of competence.

■ The capabilities of the organisation will be less than if better people had been selected. Development of the business will be slower. Competitor organisations with high-quality employees might perform much better.

■ The individuals given the jobs might be disappointed with the work, which does not live up to the expectations they were given during their interview.

■ Because the individuals who are selected either perform badly or are disappointed with their job, labour turnover might be high. If individuals leave their job soon after their appointment, the expensive and time-consuming process of recruitment and selection must be undertaken again.

■ It might become necessary to dismiss some employees for incompetence. The performance of poor-quality new recruits may have to be monitored closely, to decide if (and when) dismissal is the most appropriate option.

■ Poor selection decisions could affect the long-term human resources plan of the organisation, because fewer employees than expected develop their careers and progress to more senior management positions.

■ Difficulties with selection might take up significant amounts of senior management time and attention.

7.4   The offer of employment

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

The employer may not be sure whether or not 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 preference. 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 in the list accepts the offer of the job.

When the job has been accepted, the arrangement should be confirmed in writing (subject to satisfactory references), and accepted by the successful applicant in writing. Employment legislation might require that the new employee should be given a formal written contract of employment.

In addition to offering the job to the successful applicant, the employer should also contact the unsuccessful applicants, usually in writing. The unsuccessful applicants should be thanked for their interest in the job, and for their application.

7.5 Obtaining references

As mentioned earlier, it is common practice to ask every applicant for a job to provide the names and addresses of two referees, who will be asked to provide a reference if the applicant is offered the job. At least one referee should be a former employer or manager of the applicant. If the applicant is young and has not had a job before, a reference may be required from his or her former school or university.

There are problems with references. The referee is unlikely to write anything harmful or damaging about the applicant, except perhaps in unusual circumstances. References therefore cannot be relied on to give an indication of the successful applicant's suitability for the job.

However, references are necessary. Their greatest value should be to provide the employer with some evidence that the applicant has given honest information about himself or herself. Unless references are obtained, it could be very easy for 'bogus' applicants for a job to get away with telling lies.

A reference from a former employer provides evidence that the applicant did (or does) actually work for that employer, and:

■ earns the salary that he or she claims to earn

■ has worked or did work for that employer for the length of time that the applicant stated on the application form for the job.

- Purpose of the selection interview
- Key skills needed for selection interviewing
- Reasons for ineffective interviewing
- The importance of interviewing in the selection process

8 The selection interview

8.1 Purpose of the selection interview

The selection interview is a formal procedure in which one or more people from the organisation ask questions to an applicant for a job. The purpose of the selection interview is to:

- assess whether the applicant is suitable for the job
- make sure that the applicant understands the nature of the job and (if appropriate) the further career opportunities it might offer
- compare and rank in order of preference all the candidates who have been interviewed and are considered suitable for the job.

Some interviews might end with the interviewer offering the job to the applicant, and discussing terms of employment (such as salary and starting date). However, in a formal selection interview process, the employer will interview all the applicants before making a decision, and will then notify the chosen candidate by letter (or possibly telephone).

It should also be an aim of the interviewers to make the applicants feel that they have been treated fairly in the interview, and have been given an opportunity to show their motivation, interests and abilities.

In order to assess whether each candidate is suitable for the job, and to rank suitable candidates in order of preference, the interviewers must also use the interview to:

- confirm some of the information in the candidate's application form, and obtain additional details
- assess the candidate's personality and motivation
- assess the candidate's experience and understanding of the work
- discuss any relevant factors in the candidate's circumstances that might affect his or her ability to do the work. For example, the candidate might live in a place that would make getting to and from work difficult.

8.2 Key skills needed for selection interviewing

To conduct selection interviews successfully, and use the results of interviews to identify the best candidate for a job, an individual needs skills in:

- **communication**, so that an interviewee understands the questions that he or she is being asked in the interview

- **listening**: an interviewer must listen to the answers that an interviewee gives, in order to assess properly what the interviewee is trying to say. (Unfortunately, some individuals are poor listeners!)

- **understanding character and personality**: an interviewer must be able to assess the answers that an interviewee gives, to obtain an insight into his or her personality and character

- **knowledge of the job itself**: an interviewer must know something about the job that the applicants are applying for, in order to assess the potential ability of each applicant to perform well in the job.

When the selection process includes testing, the interviewer must also have skills in the interpretation of test results – or must be able to take advice from experts on test results.

Preparation

A good interviewer is also well-prepared for the interviews. He or she should have studied the application forms of the candidates before the interview, and should prepare questions in advance. The planned questions may differ for each candidate. The aim of the questions should be to find out the information that the interviewer needs to make a proper and fair assessment of the candidate.

The interviewer may ask additional, unplanned questions during the interview. However, by planning questions in advance, the interviewer knows what information he or she is looking for, and can check before the interview is finished that it has all been obtained.

In order to plan suitable questions, the interviewer must have a clear idea about:

- the job that the candidates have applied for, and the nature of the work

- the qualities that the successful candidate will need to do the job well

- the type of person that the successful candidate is likely to be (for example, whether the successful candidate should have strong motivation and career ambitions).

Ability to make assessments and comparisons

A successful interviewer also needs the ability to:

- make sensible assessments of the abilities and potential of each candidate, in order to decide whether the candidate is suitable for the job, and

- compare the strengths and weaknesses of the candidates, and rank suitable candidates in order of preference.

8.3   Reasons for ineffective interviewing

The purpose of a selection interview is to identify the best candidate for the job and to appoint that candidate. Interviewing is ineffective if it fails to achieve this end-result. Ineffective interviewing may therefore result in:

- a failure to identify any suitable candidate at all
- choosing a candidate for the job who is unsuitable
- choosing a candidate for the job who is not the best among all the candidates who are interviewed
- offering the job to a candidate who then rejects the offer.

Ineffective interviewing may therefore result in either poor selection or failing to persuade the chosen candidate that the job is worth having.

Some of the possible reasons for ineffective interviewing are suggested below.

Poor selection	Rejection of the job offer by the candidate
Poor short-listing of candidates from those submitting an application form.	The candidate does not feel comfortable in the interview and develops an adverse opinion of the organisation.
Interviewers are untrained and unskilled in interview techniques.	The candidate decides that he or she does not want the job because the job is not what he or she had thought it was.
Interviewers do not prepare for the interview, or do insufficient preparation. Consequently not all the relevant and important questions are asked.	The interviewer fails to 'sell' the job to the candidate, and the candidate prefers to take a job with a different employer.
There is poor communication between the interviewer and the candidate during the interview.	
The interviewer is influenced by 'first impressions', such as the dress and appearance of the candidate, or the candidate's manner of speech.	
The interviewer, consciously or unconsciously, is prejudiced in favour of or against particular candidates.	
The interviews are too short, and there is not enough time to conduct them properly.	

Comparing face-to-face interviews and panel interviews

Face-to-face interviews are interviews of a candidate by just one person: this is a common type of selection interview.

With a panel interview, there are two or more interviewers – sometimes as many as five or six, or even more. Panel interviews are commonly used in selecting for senior management positions.

Each of these types of interview has its benefits, but also its weaknesses.

Face-to-face interviews	Panel interviews
Strengths	*Strengths*
In a one-to-one interview, the candidate is usually able to feel more comfortable and so is able to talk more freely.	The differing views and opinions of the interviewers are shared, so that they can agree on the candidate for the job. There is less risk of bias.
They are easier to organise than panel interviews, because there is just one interviewer who has to find the time to do the interviews.	
Weaknesses	*Weaknesses*
There is just one interviewer, whose views might be subjective and biased.	The interviewers might disagree about who is the best candidate.
When there is just one interviewer, some important questions might be forgotten	One of the interview panel might dominate his or her colleagues.

8.4 The importance of interviewing in the selection process

Interviewing is an important part of the selection process because it is the final stage in the process, before a selection decision is made. Interviews are also important because:

- the employer is able to take a good look at each short-listed candidate, and
- each candidate is able to find out more about the employer, the job and the career prospects.

This two-way communication cannot be achieved with application forms and selection testing.

Since the selection interview has an important influence on the selection decision, it is important that interviewing should be effective:

- If the interviewers fail to identify a suitable candidate, the job will remain vacant and the selection process must start over again.
- If the interview results in the selection of unsuitable candidates, the problem will become apparent after the successful candidate has been appointed. Eventually, the new employee may be dismissed or may decide to resign.
- If the interview results in failing to select the best candidate, or in a rejection of the job offer by the best candidate, the successful candidate will be 'second best'. The best individuals will presumably go to work for other organisations, possibly competitors.

Equal opportunities and the management of diversity
■ The nature of equal opportunities
■ Discrimination
■ Anti-discrimination policies
■ Equal pay and equal value
■ Equal opportunity legislation
■ Managing diversity

9 Equal opportunities and the management of diversity

9.1 The nature of equal opportunities

The employees in an organisation have a wide variety of different learning experiences, attitudes and perceptions. They also have varied personalities and come from different racial and cultural backgrounds. A well-managed organisation should be able to combine the varied talents of its different employees, from all backgrounds, to develop its business successfully. However, the differing backgrounds and characteristics of the work force can become a problem, and the organisation may suffer from discrimination.

'Equal opportunities' refers to the general principle that every individual should have the same opportunity to make the best of their abilities at work. They should not suffer discrimination from their employer on grounds of social, economic, cultural or other factors.

'Equal opportunities' is therefore the idea that everyone in an organisation should have an equal opportunity to:

■ apply for jobs in the organisation

■ be selected for jobs for which they apply

■ receive training

■ achieve promotion

■ be treated fairly at work

■ have their employment terminated fairly, when termination becomes necessary.

The idea of equal opportunities is also that employers should discriminate between employees and applicants for jobs only on the basis of:

■ ability

■ experience, and

■ potential.

In their treatment of employees, organisations (and their managers) should have no regard to differences of sex, race or culture, disability, religious beliefs, age or marital status.

9.2 Discrimination

Discrimination against individuals might be on the grounds of:

- sex (and sometimes marital status)
- race or cultural background
- disability
- religious belief
- sexual orientation
- age.

Example: sex discrimination

When discrimination occurs on the grounds of sex, an employer usually treats a woman less favourably than a man. (There have been cases involving discrimination against men and in favour of women, but these are fairly unusual.) Examples of discrimination on the grounds of sex include:

- consistently selecting a man to fill a job vacancy in preference to a woman
- giving promotion to a man rather than to a woman who is better qualified
- paying men a higher wage or salary than women for the same or similar work.

Types of discrimination

Discrimination can also be classified as:

- direct discrimination
- indirect discrimination
- victimisation.

Direct discrimination is treating an individual more or less favourably than others, on the grounds of sex, race, religious beliefs, disability, and so on. For example, a woman might be dismissed when she gets married: this would be an example of direct discrimination on the grounds of marital status. Similarly, an individual might be overlooked for promotion because he has a speech impediment: this would be direct discrimination on the grounds of disability.

Indirect discrimination occurs when the same conditions for selection, training, and promotion apply to all employees, but one type of employee has a much better chance of meeting those conditions than another type. For example, an organisation that expects all its managers to work long hours and at weekends is probably discriminating against women, because many more women than men have domestic and family responsibilities that prevent them from working long hours consistently. Similarly, an employer is guilty of indirect discrimination if it

advertises a job vacancy, stating that the selected applicant will be at least 1.9 metres tall and will have been in continuous employment for at least four years. This would indicate a clear preference for a man rather than woman.

Victimisation is discriminating against an individual who has started formal proceedings or who has been a witness in another discrimination or discipline case at work. The individual is therefore ignored for training and promotion opportunities because of his or her 'act of betrayal' or 'whistle-blowing'.

The law on discrimination at work varies between countries. In the UK, direct discrimination and much indirect discrimination is illegal (details are given later) and employers are also liable for victimisation of their employees, either by the employer itself or by other employees.

9.3 Anti-discrimination policies

Organisations might adopt formal policies against discrimination. The purpose of such a policy is to:

- give notice that the organisation will not tolerate acts of discrimination, or a culture of discrimination
- indicate ways in which the anti-discrimination policy should be applied.

Sex discrimination policy

The purpose of a sex discrimination policy is to try to ensure equal treatment for employees of both sexes in recruitment and selection, training, promotion, pay and benefits and dismissal.

As part of this policy, managers might be expected to ensure that there is no sexual harassment of female employees at work by their male colleagues.

Such a policy should also include provisions for equal pay for men and women. Equal pay is discussed in more detail later.

Race relations policy

Similarly, the aim of a race relations policy should be to ensure equal treatment for employees in recruitment and selection, training, promotion, pay and benefits and dismissal, regardless of their race.

Disability discrimination policy

A disabled person is someone who has a physical or mental disability that is both substantial and long-term in nature, that affects his or her ability to carry out normal day-to-day activities.

A disability might affect, for example, an individual's:

- mobility (so that he or she is in a wheel chair)
- manual dexterity

- ability to see, hear or speak

- ability to concentrate.

A disability discrimination policy should ensure:

- equal treatment in selection, training, promotion and dismissal for disabled individuals, and also

- that the working environment does not contain physical hazards for disabled people – such as steps preventing people in wheelchairs from entering or leaving buildings or rooms, or a lack of access by lift to different floors of a building.

Examples: anti-discrimination practices

An organisation with anti-discrimination policies might apply some of the following practices:

- Recruitment. Job advertisements should not discriminate on the grounds of sex. For example, it would be appropriate to advertise a vacancy for a 'sales person' rather than for a 'salesman'. In some countries, it is illegal for job advertisements to contain any discriminatory wording or other material.

- Selection. Interviewers at selection interviews should avoid questions such as: 'Do you intend to get married and have children soon?' (sex discrimination), or 'Are you able to work on religious holidays?' (discrimination on the grounds of religious belief).

- Management responsibility for preventing harassment. Managers should be made directly responsible for preventing harassment of employees for whom they have responsibility. For example, they must prevent (or punish) lewd, insulting or threatening behaviour by employees to female colleagues, or colleagues from a different racial background.

- Applying policies for selection, training and promotion based strictly on the ability, experience and potential of employees.

- Applying an equal pay policy (see below).

9.4 Equal pay and equal value

The concept of equal pay is that women and men should receive equal pay for 'like work', or 'equal value' or the same 'work equivalent'. Paying women less than men for work of an equivalent nature or value is an example of sex discrimination.

- **'Like work'** is work of a broadly similar nature. There is no difference in practice between the tasks performed by men and the tasks performed by women. An example of 'like work' is the work done by men and women book-keepers in the accounts department, and the work done by men and women traffic wardens.

- **'Equal value'** and **'work equivalent'** describes work of a different nature, but where each job provides equivalent value to the organisation. The concept of 'equal value' is to prevent organisations from paying low wages for one type of job that is mainly done by women and higher wages for other jobs that are done mainly by men.

Example

A company manufacturing cotton towels employs women in the weaving department, where the towels are woven, and men in its warehousing department, where the towels are stored and then despatched to customers.

■ If there is sex discrimination, the women weavers would be given low wages and the male warehouse staff would be paid much more.

■ If the company has an equal pay policy, it might assess the different jobs and calculate their value to the company. There are methods that can be used for work evaluation, based on a points scoring system. The pay of the weavers and warehouse staff would then be set according to the relative value they provide to the company.

When an organisation adopts an equal value policy for pay, it will demonstrate that its pay structure is free from sexual discrimination.

9.5 Equal opportunity legislation

Management in organisations need to be aware of the laws relating to equal opportunities and against discrimination in employment. Equal opportunity legislation varies between different countries, but in many countries there are provisions in employment law against unfair discrimination by employers. Employers failing to comply with the law might have to pay large amounts in damages or fines for unfair discrimination.

The notes that follow use UK legislation as an illustrative example. In the UK, employees who believe that they have been the victims of unfair discrimination are able to take their case to an employment tribunal. If the tribunal considers that the employer has been guilty of illegal discrimination, it may award damages, payable by the employer to the individual.

Sex discrimination legislation

The UK has equal pay legislation, requiring women to receive the same pay as men for the same work. The UK also has a Sex Discrimination Act that makes it illegal for an employer to discriminate against individuals on the grounds of sex or marital status. However, it is often difficult for a woman to prove discrimination, and that a man has been preferred for a job vacancy on the grounds of his sex/gender, or that a man has been offered a higher salary for the same work.

The law might also recognise discrimination on the grounds of sex when a woman is subjected to harassment from male colleagues at work.

Race

Discrimination against individuals on the grounds of race, like discrimination on the grounds of sex, is illegal in the UK, but is often difficult to prove in specific cases.

Disability

In the UK, it is illegal for an employer to discriminate against individuals due to the fact that the individual has some form of physical or mental disability. Disability is different from other areas of discrimination such as sex and race, because employers are required by law to make reasonable adjustments to the work environment and working arrangements to prevent disabled people from being placed at a disadvantage.

Religious belief

In the UK, a law was introduced in 2003 against discrimination on the grounds of religious belief. Employers are now required to deal seriously with requests from employees to accommodate their religious belief. Since the new law came into force, one employee (a Christian) successfully appealed to a tribunal against a decision by her employer to alter her work rota so that she had to work on Sundays, which prevented her from attending church. In another case, an employee (a Muslim) successfully appealed against a decision by his employer to suspend him for taking extended leave to make a pilgrimage to Mecca, even though he had informed his employer of his intentions in advance.

Sexual orientation

In the UK, a law was introduced in 2003 against discrimination on the grounds of sexual orientation. Since the new law came into force, there has been a case involving a homosexual man successfully claiming unfair discrimination by his employer on the grounds of sexual orientation. In this case the employment tribunal awarded substantial damages against the employer and in favour of the individual.

Age

In the UK, a law was introduced from December 2006 making it an offence for an employer to discriminate against individuals on the grounds of their age.

9.6 Managing diversity

The application of anti-discrimination policies is often seen as a way of preventing discrimination rather than promoting equal opportunities. The concept of managing diversity is that an organisation should seek to exploit the differences in learning experiences, attitudes, perceptions and personalities of all its employees, of both sexes and of all races, cultures, and religious backgrounds.

Whereas anti-discrimination policies seek to prevent discrimination, a policy of managing diversity is much more 'active', and seeks to ensure that there is a suitable amount of diversity amongst its managers and workers.

■ The organisation and its management will actively combat prejudice and harassment.

■ The organisation will also have a policy of having the right person in each job, regardless of sex, race, religious belief, disability and so on.

Diversity assessment

A diversity assessment is a formal review of the structure of the work force and its management, to check whether or not there is an appropriate mixture of people from different backgrounds and with different cultural and religious views.

For example, a diversity assessment might find that there are very few women or very few men from a particular racial or religious background in senior management positions. Measures for correcting this imbalance can then be considered – for example by asking why the imbalance has arisen and then taking measures to deal with the problem.

The management of diversity is particularly important for multinational companies that employ individuals from many different countries.

Diversity policy

Many companies and other organisations have a formal diversity policy. The purpose of a diversity policy is partly to incorporate anti-discrimination law within formal policy. In addition, a diversity policy makes it clear to employees that the employer regards itself as a fair employer who will promote diversity in all aspects of employment policy – recruitment and selection, promotion and career development, training and so on.

Example

The Royal Bank of Scotland has commented on its 'Managing Diversity' policy as follows. These comments indicate the potential benefits of such a policy to an employer.

'"Managing Diversity" is a more effective way of dealing with equal opportunities issues. It emphasises the business and personal benefits that accrue from valuing the differences between people, rather than just complying with the law. Organisations that grasp the additional business opportunities generated by managing diversity effectively are far more likely to enjoy sustained competitive advantage than those who do not.'

The Bank went on to specify some of the benefits of a diversity policy.

■ The employer has a wider 'pool' of potential recruits, from which it can try to attract the most talented individuals.

■ In an increasingly diverse society a diversity policy is essential for attracting the best employees and in many cases maintaining the goodwill of customers.

■ The motivation of employees is increased if they feel valued by their employer.

e **Example**

The Age Diversity web site, a UK government website, has provided the following comment by South Wales Forgemasters in its age diversity policy.

'Older workers bring a degree of maturity to the work place. There is a degree of hands-on knowledge one gains from age and experience - so there is an advantage in having someone a little older to do this particular work. In anything we do in terms of human resources we never think about age at all. Older workers are often reliable, more committed, take less time off, are generally more financially stable and with less worries, have fewer personal problems and come to work because they enjoy coming to work. All of these qualities are very important.'

CHAPTER

11

Individual effectiveness and effective communication

Contents
1   Making employees effective
2   Personal development plan
3   Time management
4   Coaching, mentoring and counselling
5   Effective communication

Making employees effective

- Methods of making employees effective
- Information technology and personal effectiveness

1 Making employees effective

1.1 Methods of making employees effective

When employees are recruited and selected, the employer does not expect them to be fully effective in their job from the day that they start work. The individual employee, the employer and the employee's colleagues all have a responsibility for making the employee more effective.

There are various ways in which an employee should be made more effective. The methods that will be described in this chapter and the chapter that follows are:

- equipping the employee to be effective
- personal responsibility for improvement: a personal development plan and time management
- providing personal support to the individual, through coaching, mentoring and counselling
- other methods of training and development
- performance appraisal schemes.

1.2 Information technology and personal effectiveness

The effectiveness of an individual is improved by providing him or her with ready access to information technology – computers and communications.

- Many business activities and operations are now performed by computer system. Computers improve the speed, processing volume and accuracy of individuals using them.
- Some managers and employees are given portable/laptop computers that give them continual access to computer technology. They can therefore work when they are out of the office, at home or when travelling.
- Access to the internet and e-mail allow employees to communicate and obtain information at any time. With portable computers, mobile telephones or personal organisers, they are able to communicate at any time and from any place, by voice, or by data or image transmission.

IT therefore gives employees access to information, communication systems and processing power.

Personal development plan
■ Definition of a personal development plan
■ Aims of a personal development plan
■ Preparing a personal development plan
■ Analyse the current position
■ Establish goals for personal development
■ Prepare and agree action plans

2 Personal development plan

2.1 Definition of a personal development plan

When an employer has a formal system for the personal development of its employees, targets for an individual's development can be established as a personal development plan, in writing (or held on computer file). This plan should be reviewed and updated regularly.

A personal development plan can be defined in the following ways.

■ A personal development plan is a formal action plan for an individual, setting out a wide range of development targets and opportunities for the individual, including formal training requirements. The personal development plan should link the employee's need for development to the needs of the organisation.

■ A personal development plan is a structured and supported process undertaken by an individual to reflect upon his own learning, performance and/or achievement and to plan his personal, educational, training and career development.

The individual himself has the main responsibility for preparing and using a personal development plan, which can be kept throughout his time of employment with the employer. The individual's boss should provide support and assistance, by discussing personal development action plans for the individual, including training requirements.

Personal development record

A personal development plan has some similarities with a personal development record, which is simply a record that is kept over time by an individual of the work he has done and the experience he has gained, together with the specific training he has received. Professional accountancy bodies require their qualified members to maintain such a record, as evidence of their **continuing professional development (CPD)**.

2.2 Aims of a personal development plan

A personal development plan differs from a personal development record, however, because it should provide a regular assessment by the individual of his training and development needs, and action plans for meeting these needs.

The aim of a personal development plan may be summarised as follows. It enables an individual to:

■ recognise the learning that he has acquired (with written evidence, such as records of training courses attended) and monitor his own progress.

■ review, plan and take responsibility for his own learning and development, the aspects of his work and personal development where he is strong

■ recognise and define his own training and development needs, in consultation with his boss

■ understand his personal strengths and weaknesses, and prepare action plans for development, to address his weaknesses (for example through training) or demonstrate and make use of his strengths (for example through work assignments or projects).

2.3 Preparing a personal development plan

There are three steps or stages in preparing a personal development plan. These steps might be taken by the individual and his boss together, although both should carry out their own analysis of the individual's strengths and weaknesses, and development needs, before they begin their discussions.

■ Step 1: analyse the current position

■ Step 2: establish goals for personal development

■ Step 3: prepare and agree action plans

An employer might have a standard format that individuals should use to maintain their personal development plan, and provide personal development plan software to simplify the task of maintaining the record..

2.4 Analyse the current position

The first step in preparing a personal development plan is to analyse the current position. This involves an analysis of the job and the requirements of the job, as well as the individual's strengths and weaknesses. The analysis should include looking at the following:

■ The skills that the job holder will require in the future to do the job. This is important when the nature of the job and the job requirements are expected to change.

■ Weaknesses of the individual in the current job. One way of doing this is to carry out a 'faults analysis', which is an analysis of what mistakes the individual makes regularly (with a view to agreeing measures with the individual to deal with the problem.

■ What parts of the job the individual likes doing and does well, and what parts he/she does not like doing and does badly.

- One way for the boss to analyse a subordinate's skills is to prepare a 'personal SWOT analysis' for the individual. SWOT stands for strengths, weaknesses, opportunities and threats. A SWOT analysis can be prepared as a 2 × 2 table, showing 'likes and dislikes', and weaknesses and strengths.

		Individual's performance in this aspect of the work	
		High	**Low**
Strength of the individual's liking for certain skills and aspects of his work	**High**	Likes the work and does it well	Likes the work but does it badly
	Low	Dislikes the work but does it well	Dislikes the work and does it badly

If the individual's boss prepares a personal SWOT analysis, it can be used as a basis for discussing the individual's future personal development. For example, if the individual agrees with the analysis that the boss has provided, there might be a discussion about how the job can be altered to give the individual more work that he likes doing and does well, and to take away work that he dislikes and does badly. It should also be possible to discuss ways of helping the individual to improve his skills in the work that he likes doing but currently does badly.

2.5 Establish goals for personal development

The second step in preparing a personal development plan is to establish goals for the individual's development in the current job. These goals should be to eliminate weaknesses or deficiencies in current skills and to set targets for personal development.

It may also be appropriate to consider future changes that will occur in the job and the work that the individual will be required to do, in order to decide whether any new skills training is necessary.

A training plan should be agreed, setting out the desirable training for the individual to receive.

2.6 Prepare and agree action plans

The third step in preparing a personal development plan is to draw up an action plan for the next few months (or one year at most). This will specify what measures should be taken for the development of the individual in the period covered by the plan. The most urgent training should be provided first, and so should have a high priority in the action plan.

The next time that the individual discusses personal development with his or her boss, the action plan from their previous discussions should provide a basis for review and an assessment of the progress that has been achieved.

e Example

A simplified version of a personal development plan, as it might be updated at a review stage, is set out below.

Page 1	Current assessment		
Skills	**Skills required for the current job**	**Current ability**	**Gap**
Personal			
Technical			
IT skills			
People skills			
Management			

Page 2	Action plans		
Skills	**Objective**	**Plan for achieving this objective**	**Time frame for achieving the action plan**
Personal			
Technical			
IT skills			
People skills			
Management			

Page 3	Action plan review		
Skills	**Objective of previous plans**	**Progress achieved**	**Assessment**
Personal			
Technical			
IT skills			
People skills			
Management			

<table>
<tr><td>Time management</td></tr>
</table>

- Ineffective use of time
- Barriers to effective time management
- Planning and prioritising time
- Delegating and time management
- Controlling the work environment

3 Time management

3.1 Ineffective use of time

Most individuals use their time ineffectively, both at work and in their private life. Ineffective use of time at work can also affect an individual's private life, if work that has not been done in the office has to be done instead at home in the evening or at weekend. Common excuses for ineffective use of time include the following:

- getting distracted by something unexpected that happens at work
- having to deal with a large number of e-mails
- not allowing enough time to get a job finished
- wasting time on unimportant matters.

The need for individuals to manage their time, so as to make effective use of their time, is well-recognised. (For example there are numerous training courses in time management.)

The management writer Peter Drucker once wrote: 'Time is the scarcest resource of the manager. If it is not managed, nothing else can be managed.'

The Pareto Principle (80:20 rule)

It has been suggested that the Pareto Principle or 80:20 rule probably applies to the use of time at work. This is the principle or rule that the most important 80% of items require only 20% of the total effort or cost.

In the context of time management, the 80:20 rule is that 80% of the important work we do takes up only 20% of our time.

Put another way, this would mean that we spend 80% of our time on only 20% of the work we do that matters.

3.2 Barriers to effective time management

Many individuals use their time ineffectively because they are disorganised.

- They do not plan their time or prioritise their work effectively.

- As a result they spend too much time on trivial matters.
- They do not control the use of their time.
- They do not delegate enough.
- They do not control their work environment.

3.3 Planning and prioritising time

Individuals should plan the work they are going to do each day and each week or month. It often helps to **keep a diary**, to record key dates (such as dates for meetings) and work schedules for tasks that have a set completion date.

It is impossible to plan the use of all time in advance, because urgent and unexpected matters arise that have to be dealt with. However, some future time can be allocated to planned work, and individuals should protect this planned time so that it is not taken up with unplanned matters.

Individuals should also learn to distinguish between matters that are important and those that are unimportant, and should give priority to work that is important. Important tasks can be prioritised, to ensure that they are completed by the time required.

It is also useful to keep a record of how time has actually been spent each day, in order to recognise how much time has been wasted or used ineffectively, and how. This can help individuals to learn from their past mistakes.

Urgent and important matrix

Some writers on time management have suggested that an urgent and important matrix might help individuals to plan and prioritise their time more effectively. Tasks can be put into one quadrant of a 2×2 matrix, indicating their urgency and importance.

One side of an urgent and important matrix represents the urgency of an item of work – urgent or not urgent. The other side of the matrix indicates the importance of the work – important or not important.

	Importance	
	Not important	Important
Urgent	Urgent but not important	Important and urgent
Not urgent	Not urgent and not important	Important but not urgent

The matrix can be used by an individual to assess how he or she is using time.

- Tasks that are important and urgent must take priority. They are often unexpected tasks arising from an unforeseen event, calling for a 'fire-fighting' response.
- Time spent on tasks that are not urgent and not important is **time wasted**.

- Time must be planned for doing work that is important but not urgent. Unless time is planned and allocated to this work, it will eventually become urgent as well as important.

- Tasks that are urgent but not important include dealing with unexpected telephone calls where an immediate response is unavoidable, or responding to some e-mails. Time spent on this work should be controlled and this work should not be allowed to take up too much time.

Controlling time at meetings

The chairman of a meeting should learn how to control the length of time that meetings take. Some chairmen of meetings make a point of announcing, when the meeting begins, when he expects it to end.

Progress at a meeting can be made more quickly:

- if the meeting is planned, with an agenda
- if relevant information is given before the meeting to all the people who will be attending it
- if the meeting makes use of 'action points' and discusses what needs to be done and the outcome of action points from previous meetings.

3.4   Delegating and time management

Some managers are inefficient and waste time because they fail to delegate enough work to individuals who report to them. Delegating tasks frees up the manager's time.

A manager who has staff to whom work can be delegated should expect to delegate a substantial proportion of the tasks for which he has responsibility.

3.5   Controlling the work environment

Some individuals make inefficient use of their time because they fail to control the work environment within which they operate.

- **Reading and responding to e-mails**. Many individuals set their computer so that they are notified immediately any e-mail message is received, and they take time to read it (and possibly respond to it) – no matter how unimportant the message might be. It has been suggested that large amounts of time could be saved by not reading e-mail messages immediately, but allocating some time during the day to read and respond to messages that have accumulated in the in-box.

- **Filing**. Data and documents should be filed in a logical filing system, so that they can be found immediately when required. Some individuals spend time looking for data or documents that they have mislaid.

- **Keeping a tidy desk**. Some writers on time management argue that keeping a tidy desk, with few items on the desk top, promotes efficiency and better use of time.

e Example

Various writers and trainers on time management have suggested guidelines or principles for effective time management. Here is one such list of seven rules.

1	Identify your personal and work-related priorities.
2	Convert these priorities into concrete goals for achievement, divided if necessary into component activities.
3	Set deadlines or intermediary time limits ('milestones') for achieving these tasks or components of tasks.
4	Think of a monthly calendar, diary or planning notebook as a time-saving device. Mark important dates in the calendar.
5	Learn to say 'No' to opportunities and requests that will use up your time but will not move your work forward towards its objectives.
6	Identify your own personal barriers to the effective use of your time. What causes your resistance to time management?
7	Try to achieve a balance in your work between 'doing' and 'being' – you need time to be yourself and have some enjoyment from your work. 'Doing' all the time does not provide enjoyment.

Coaching, mentoring and counselling
■ Coaching
■ Mentoring
■ Counselling
■ The need for counselling at work
■ The benefits of offering a counselling service
■ The role of the manager as counsellor

4   Coaching, mentoring and counselling

Individuals are able to improve their personal effectiveness at work through coaching, mentoring and/or counselling.

4.1   Coaching

Coaching is on-the-job training given to an individual by a person with knowledge and experience, who might well have been trained in coaching skills. For example, an individual might be taught how to do the job by an experienced colleague or by a supervisor. The teacher or coach:

■ shows the individual how the work should be done

■ watches the trainee doing the work, and

■ gives advice and instructions when necessary.

A widely-understood form of coaching outside the work place is being taught how to drive. Another well-known type of coaching is sports coaching and the use of 'personal trainers' for leading sports stars.

There are some advantages of coaching as a method of improving personal effectiveness.

■ The coaching is directly related to work and the coach teaches the individual how the work should be done. When effective, coaching should improve an individual's effectiveness in a job very quickly.

■ The coach can direct his advice at aspects of the work that the individual is not doing well. This will help the individual to learn more quickly.

4.2   Mentoring

The skills and effectiveness of individuals in their work can be improved by mentoring. Mentoring means giving guidance and advice.

■ A mentor is a wise and trusted adviser who gives help to an inexperienced person.

■ Mentoring is advice and guidance from a respected person to someone who needs help.

Mentoring arrangements can be either informal or formal. A formal mentoring system is designed to enhance the development of individual employees.

■ A newcomer to an organisation may be paired with a more experienced person, who gives guidance and advice, and acts as an example or 'role model'.

■ Mentoring may also be used to prepare 'high-flying' junior managers for leadership roles in the future. A junior manager may be attached to a senior manager, who gives guidance that will help him to develop his management skills. For top-quality junior managers, mentoring may be provided by the organisation's chairman or chief executive officer.

A formal mentoring system may therefore be defined as:

■ a structured one-to-one relationship that focuses on the needs of the person who is being mentored, or

■ a supportive relationship sustained over a period of time between a 'novice' and an 'expert', with the intention of supporting the 'novice' through a learning process and helping him or her with career development.

Whereas coaching helps an individual with technical skills, mentoring helps an individual with management skills. Mentoring encourages individuals to develop to their full potential. In business organisations, mentoring is particularly valuable in grooming individuals for senior management positions.

4.3 Counselling

Counselling means providing guidance, advice and support to another person or group of people. It has been defined by the British Association of Counselling as follows: 'People become engaged in counselling when a person occupying, regularly or temporarily, the role of counsellor offers … time, attention and respect to another person or persons temporarily in the role of client.'

Counselling may be given to individuals who feel stressed in their work, and the aim of the counselling would be to reduce the anxiety and depression that the individual is feeling.

The aim of counselling is to address and resolve specific problems, usually of a **personal nature**, where other methods of dealing with the problem have failed or are non-existent. Discussions during a counselling session should usually be kept **confidential**.

The term 'counselling' may also be used to describe giving **career development advice** or work-related mentoring to a colleague or subordinate. (You should be prepared to recognise this type of advice within the definition of counselling in answering any examination question on the topic.)

In a counselling arrangement, one person acts as counsellor to the colleague or subordinate, and gives up time to discuss that person's problems or difficulties. The counsellor needs to be sympathetic, and capable of discussing another person's problems and looking for solutions and a way forward. The counsellor must therefore have a high level of interpersonal skills.

4.4 The need for counselling at work

A need for counselling at work may arise for various reasons:

■ Problems relating to the individual and his behaviour in work

■ Problems in the work that are having a demoralising effect on the individual, or that are causing stress to the individual

■ Problems that the individual is facing outside work, but that affect his or her behaviour at work.

Problems relating to the individual and his behaviour in work

An individual's behaviour in work may become a matter for concern.

■ An individual may feel depressed in the work he is doing, possibly due to a sense of frustration or a lack of job satisfaction. He may be wondering whether he is in the right job. He may be frustrated by a lack of career development and a sense that there is no point to what he is doing. The individual may welcome counselling if he is depressed or frustrated.

■ An individual's behaviour may be causing annoyance or resentment amongst work colleagues. For example, an individual may act in a rude manner to colleagues, or may act in an arrogant manner. His manager may decide to give him counselling advice if he is annoying his colleagues.

Problems in the work that cause stress

Individuals may benefit from counselling when there are problems in the work that are causing them stress. Examples of work-related stress are:

■ having to work continually to deadlines for completing tasks

■ having to work excessive hours of overtime

■ not having enough work to do

■ worrying about the risk of redundancy and what will happen to the job

■ worrying about having to retire in the fairly near future.

Problems outside work that affect the individual at work

Individuals may have problems outside their work that are still on their mind throughout the working day. Although the cause of the stress is not work-related, their work is affected. Examples of these problems are:

■ problems in a marriage

■ problems with children

■ problems with alcohol consumption

■ problems with taking drugs

■ problems with excessive debts.

4.5 The benefits of offering a counselling service

There are several reasons why an organisation should arrange for counselling to employees suffering from stress, anxiety or depression:

■ Counselling is an ethical issue. An organisation should offer support to its employees if it believes that it has a responsibility for their well-being. Counselling demonstrates a commitment by an organisation to its employees.

■ A willingness to help employees may result in stronger loyalty from employees to the organisation.

■ Counselling is a method of resolving problems. Counselling is often a last resort, when all other methods of dealing with a problem have failed.

■ It may be particularly effective in dealing with some types of problem, such as the worries of employees about their career development, or about retirement or redundancy.

■ If counselling succeeds in reducing an employee's problems, the employee is likely to perform more effectively at work.

4.6 The role of the manager as counsellor

A large organisation may recognise that many of its employees will inevitably have problems that they find difficult to resolve, where counselling may help them. It may therefore employ a small group of full-time counsellors who are available to discuss certain types of problem that employees are facing, such as problems with children, marriage and money (personal debts).

However, when an individual's problems are work-related, or are affecting the employee's colleagues, it is often appropriate for the manager to act as counsellor, because the manager is in a good position to discuss problems that the subordinate is having with the work, or with his career development.

A problem with managers acting as counsellor, however, is that the relationship between a counsellor and a client is very different from the relationship between a manager and a subordinate.

Effective communication

- Formal and informal communication in the workplace
- The need for effective communication
- Communication models
- Attributes of effective communication
- Barriers to communication
- Methods of communication
- Patterns of communication: vertical and lateral communication
- Other patterns of communication

5 Effective communication

5.1 Formal and informal communication in the workplace

In work, as in all aspects of living, people must communicate. They have to give instructions, provide information, obtain information, communicate ideas, listen to the ideas of other people, announce decisions (tell other people what they intend to do), and so on.

The effectiveness of an organisation depends to a large extent on the effectiveness of communication by its managers and employees.

Information is exchanged in two ways, formally and informally.

- Formal communication is communication that is passed through official 'channels' established by the organisation. Examples of formal communication are reports and instructions by a manager to a subordinate. Formal communication passes through the formal management structure and 'chain of command'. Individuals receive and give information because of their position in the organisation.

- Informal communication is communication between individuals in an organisation that does not pass through an official channel. Instead, the information is passed by individuals in general conversation, sometimes as gossip or as rumour. Often informal communication passes as unofficial e-mails between colleagues.

Example

Mega Company dismisses its finance director on Monday. It makes a formal announcement to staff about the dismissal on Friday of the same week. However, most people had already heard about the dismissal, because the news had been 'leaked' and passed from person to person within the organisation.

In this example, the informal communication system has operated more quickly than the formal communication. If it is accurate, it is therefore more efficient. Unfortunately, informal communication may be inaccurate.

Comparison of formal and informal communication

All organisations rely on a mixture of formal and informal communication to operate effectively.

Formal information is often slow in coming. Organisations therefore often rely on informal communication for the transmission of information, when the formal system is slow and bureaucratic, or where senior managers are autocratic and do not believe in sharing information with subordinates.

Informal information usually passes between individuals very quickly. A problem with informal information is that management have no control over it. They control formal communication channels, but not informal communication. With informal information, it is sometimes a matter of chance who gets the information and who does not: some individuals might be totally ignorant of what most of their colleagues already know.

In an effective organisation, there should usually be an efficient formal communication system, so that accurate information is passed in good time to everyone who needs it. When formal communication is reliable, relevant and timely, employees will trust it.

However, even with the most efficient formal communication system, informal communication systems always exist. People talk to each other unofficially and socially: they exchange stories, rumours, gossip and so on, and they don't always communicate with each other in their 'official capacity'. Even in their work, individuals often prefer to communicate informally, in face-to-face conversations, or by telephone or e-mail, rather than by more formal methods such as memos and reports.

5.2 The need for effective communication

Effective communication at work is the exchange of information that individuals need to do their work properly. It needs to be clear (understandable), relevant, reliable and timely. Effective communication is essential so that:

- Instructions and guidelines are properly understood.
- Individuals know what they are expected to do.
- There is better co-ordination between people and groups in the organisation.
- Managers are able to plan and control operations more effectively.
- Individuals are more willing to work together in teams or groups, because they are being told what is happening and where their contribution fits in.
- Secrecy, misunderstanding and mistrust are eliminated. Open communication increases trust.
- Arguments and conflicts in the work place are reduced.

5.3 Communication models

Communication models are sometimes used to study the effectiveness of communication. A problem in organisations is often that communication is ineffective or inefficient. People do not receive the information they need, or they get the information too late. In many cases, the person receiving information or an instruction misunderstands what the sender of the message is trying to say.

Effective communication occurs when the receiver of information gets the information from the sender, and understands completely what the sender of the message intended.

Communication models can be used to look at the reasons for ineffective communication, or what is needed to make communication more effective.

Early communication models

Early communication models were developed in the 1930s to understand the effectiveness of political propaganda. These models are simple, but still relevant.

A simple communication model considers the following elements in communicating an item of information or a decision:

- Who sends the information? This is the 'source' of the communication.
- What is the content of the information? This is the 'message'. What does the message say?
- By what method has the information been given or sent? What is the channel of communication? Has the information been given verbally, in a face-to-face discussion or by telephone? Has it been sent by e-mail or by letter? Is it in a report? Is it in a published book or journal? Television? Radio? Web site?
- Who is the information sent to? This is the 'destination' of the information.
- What effect has the communication had on the recipient? Is this the intended effect?
- Does the sender of the message expect any response to the message? If so, how clear or effective has the response been?

The basic elements in a communication system are shown in the diagram below. The effectiveness of a communication system depends on the effectiveness of each element in the system.

```
┌─────────────────────────────┐
│                             │
│           Source            │
│                             │
└──────────────┬──────────────┘
               │
┌──────────────┴──────────────┐
│                             │
│           Message           │
│                             │
└──────────────┬──────────────┘
               │
┌──────────────┴──────────────┐
│                             │
│           Channel           │
│                             │
└──────────────┬──────────────┘
               │
┌──────────────┴──────────────┐
│                             │
│         Destination         │
│                             │
└──────────────┬──────────────┘
               │ ▲   Feedback
┌──────────────┴──────────────┐
│                             │
│  Effect: intended and actual│
│                             │
└─────────────────────────────┘
```
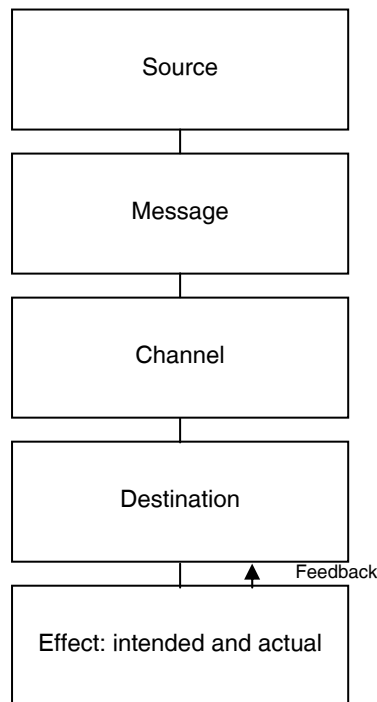
Feedback

In the context of a communication model, feedback involves the recipient of a message confirming with the sender of the information that he has got the message, and checking that he has understood the message correctly. The sender of the message is able to confirm that the recipient has understood it properly, or can try to correct any misunderstanding.

The value of this model is that it is possible to look at the causes for ineffective communication by looking at each element in the communication.

e **Example**

Manager X, sent an e-mail message to a subordinate Y, giving him some information and asking him to carry out a particular task. Subordinate Y did not do what manager X wanted.

To find out why the instruction was not followed, we can look at each element in the communication link:

■ Was the instruction not followed because manager X did not actually send it?

■ Was the instruction not followed because subordinate Y did not read his e-mail messages, or because the e-mail system was not working?

■ Was the instruction not followed because the content of the message from manager X was unclear or misleading?

■ Was the instruction not followed because subordinate Y did not understand what manager X was telling him to do, even though the message was clear?

- Was the instruction not followed because subordinate Y was fed up of getting instructions from his manager that he considered a waste of time, and so he did not bother to act on the instruction?

- Was the instruction ineffective because the sender of the message did not receive feedback, to inform him that the instruction had been carried out successfully?

Shannon and Weaver's communication model

Another communication model was developed by Shannon and Weaver in 1949. They were interested in how information seems to get lost or changed or misunderstood in transmission, and they studied telephone messages from one country to another.

Their model introduced the concept of **noise**. Noise is anything that distorts a message or makes it difficult to understand. The term comes from the noise of interference on a telephone line or in a radio message that makes the voice of the sender impossible to hear.

```
┌─────────────────────────┐
│   Information source     │
└─────────────────────────┘
              │
┌─────────────────────────┐
│      Sent message        │
└─────────────────────────┘
              │
┌─────────────────────────┐
│       Transmitter        │
└─────────────────────────┘
              │
┌─────────────────────────┐
│       Sent signal        │
└─────────────────────────┘
              │
┌─────────────────────────┐      ┌─────────────────────────┐
│   Noise distorts the     │◄─────│         Noise            │
│       message            │      │                          │
└─────────────────────────┘      └─────────────────────────┘
              │
┌─────────────────────────┐
│     Received signal      │
└─────────────────────────┘
              │
┌─────────────────────────┐
│        Receiver          │
└─────────────────────────┘
              │
┌─────────────────────────┐
│    Received message      │
└─────────────────────────┘
              │
┌─────────────────────────┐
│       Destination        │
└─────────────────────────┘
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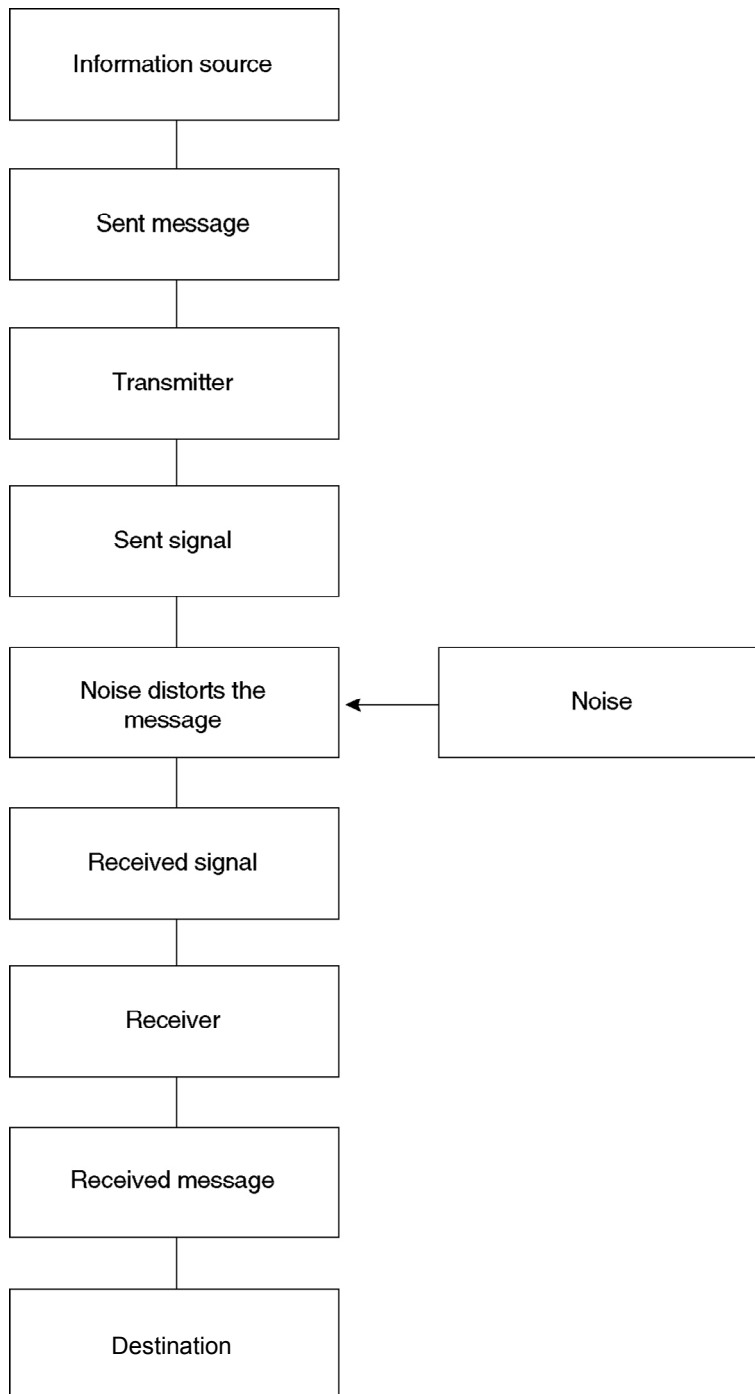
The obvious cause of noise is technical failure or technical problems. For example an e-mail message might fail to reach its destination for any of the following reasons:

■ The server (computer) for the e-mail system is temporarily out of service.

■ The message is sent to an invalid or incorrect e-mail address.

■ The e-mail message is treated by the recipient's anti-'spam' software as an unwanted message, and is diverted automatically into an unwanted messages box.

Noise is also caused by a failure of the sender and the receiver of a message to communicate properly. If there are problems with communication, the problem may be a distortion in the message in transmission.

Redundancy

One cause of 'noise' may be that the person receiving a message does not understand it properly, or understands it but does not give it much attention and so forgets about it.

- A message might be unclear because the sender has failed to make the message clear enough, or has even made a mistake in the message.

- Another reason for 'noise' is that the receiver of the message does not understand the message from the sender, possibly because it is too 'technical' or complex.

- A message might be ignored simply because the receiver does not believe it, and thinks that the sender 'must have got it wrong' or is deliberately trying to tell an untruth.

One approach to getting round the problem of lack of understanding in a message is **redundancy**. Redundant information is information that is repeated. The information should be unnecessary, because if it has been given once, there should be no need to give it again. However, it may be more effective to give the message twice, three times or even more times, to make sure that the messages gets through clearly to its intended recipient.

An example of redundancy in information is advertising. A person who sees an advertisement once has got the message, but the message may not have any effect unless the person sees the advertisement many times.

The attitude of the recipient of information

Some communication models consider the effect on communication of the knowledge, attitudes and behaviour of the recipient of the information. A message might fail to prompt the intended response in any of the following situations:

- The recipient of the message wasn't paying proper attention.

- The recipient does not have the knowledge or experience to understand the message.

- The recipient has a personal dislike of the sender, or is in conflict with the sender.

- The recipient gets the message but then forgets it.

5.4 Attributes of effective communication

Effective communication depends to a large extent on the quality of the information that is communicated. The qualities of good information are described in an earlier chapter.

Other attributes of an effective communication system are as follows.

- Messages get through quickly and without difficulty when they are sent. Or information is available to individuals when they need it. 'Noise' should not disrupt the sending of messages.

- Messages should be understood, and their content and intention should be clear.

■ Messages should achieve their intended purpose. The intended purpose of a communication might simply be to inform other people. However, a communication might be intended to make someone act, respond to the message or reach a decision.

■ An efficient informal communication system should supplement the formal communication system.

■ Every individual within the organisation should feel **confident** that he or she is receiving all the information needed to do their job.

5.5 Barriers to communication

A barrier to communication is anything that stops information from:

■ getting to its intended recipient(s)

■ being understood by the recipients, and

■ being acted on in the way intended.

Communication models can be useful in identifying barriers to communication. However, you may be familiar with the following barriers to communication from your own experience:

■ The sender of the message might think and express his ideas in a different way from the recipient. For example, people of different generations often find it difficult to communicate with each other and understand each other.

■ The sender of information might use **technical words ('jargon')** that the recipient does not understand. For example, accountants might talk to non-accountants in technical terms that the non-accountant does not understand.

■ The sender of the message and the recipient of the message might speak different languages.

■ Personal dislike or antagonism between individuals, and a lack of trust between individuals, will make it difficult for them to communicate effectively.

■ There may be **technical 'noise'**, such as a breakdown in the communication system itself.

■ **Information overload**. The recipient of information might be given so much information that he cannot take it all in, and so does not understand any of it.

■ The sender of the message and the recipient might have different perceptions of what the information is for.

■ The recipient of the information may be biased, and may interpret the message so that the information 'means' what he would like it to mean.

■ The recipient of the information might misunderstand the message.

■ The sender of the message might get the information wrong. The distortion of information in a message could be either intentional or accidental!

■ Difficulties in communication may arise because of the **distance between the sender and the recipient**. For example, someone in Hong Kong may have problems communicating with someone in the US because of time differences.

■ The information is sent by a channel that the recipient does not like or does not use, so that the message does not get through. For example, a person might send

a message to the mobile phone of someone else, who does not use the phone much and leaves it switched off or who does not check his text messages.

■ The information is sent using a medium or format that the recipient finds difficult to use or understand. For example, a manager might be sent information in a written report containing nothing but words. He might prefer to receive the information in a summarised form (to reduce information overload) and in a more easily-understood form, such as in tables of figures, charts and graphs.

It should be apparent from this list of barriers to communication that the barriers may be either:

■ **personal barriers**, caused by interpersonal matters and the inability of the sender and recipient to communicate properly, or

■ **technical barriers**, such as faults in the transmission system, information overload, and the geographical distance between the sender and recipient.

Overcoming barriers to communication

When there are significant barriers to communication, it is important to:

■ identify what those barriers are, and

■ consider ways of dealing with the problem.

The solution to a communication problem depends on the nature of the barrier.

5.6   Methods of communication

You will be familiar with many different methods of communication:

■ face-to-face discussion

■ discussion by telephone

■ video conferencing

■ e-mail

■ web sites

■ fax messages

■ formal speeches or lectures

■ public address systems

■ notices on a notice board

■ communication in electronic form, between computer systems

■ communication between a computer system and individuals through keyboard, mouse and computer screen

■ films, radio or television, including transmission of images by computer or phone

■ in written form, such as reports, letters, notes (memoranda), journals and magazines

■ in words, pictures, charts or graphs.

The choice of medium or the way of formatting the information should be suitable, so that the information is communicated effectively.

5.7 Patterns of communication: vertical and lateral communication

A pattern of communication is the direction and frequency of information. Who sends out information and how frequently? And who receives the information?

In a teaching group of six students, the pattern of communication may be described as:

■ a lecturer providing information to students for 70% of the time

■ students asking questions for 30% of the time

■ of the six students, one asking twice as many questions as two other students, and the other three students saying nothing at all.

Within a work team, one of the tasks of the leader should be to make sure that everyone in the team communicates as they should, and that communications are not dominated by a relatively small number of individuals in the group.

Vertical communication and lateral communication

In hierarchical business organisations, information flows:

■ vertically and

■ laterally (horizontally).

Vertical communication is communication down the scalar chain or chain of command. A boss communicates with subordinates.

■ Downward communication is information or a command given by the boss to one or more subordinates.

■ Upward communication is information moving from subordinates to the boss.

When the leader is autocratic, most communication is downward.

Lateral or horizontal communication is communication between people at a similar level in the organisation's management hierarchy. It is communication between individuals in the same work group, and also between individuals in different work groups.

Purpose of vertical communication	Purpose of lateral communication
To give instructions/direction	To co-ordinate the activities of different individuals and groups
To delegate responsibilities	
To control activities of subordinates	To develop and maintain social relationships at work

e **Example**

An organisation has four grades of manager, from level 1 (the most senior) to level 4 (the most junior). Manager A and manager W are both Level 3 managers. Manager A has a team of four level 4 managers, managers B, C, D and E. Manager W has a team of three level 4 managers, managers X, Y and Z.

The patterns of communication in these work groups may be the following.

■ Manager A might be autocratic, so that most communication is vertical and one-way (downward).

■ Manager W may be democratic, so that there is extensive two-way vertical communication between Manager W and his three subordinates.

If, on the other hand, both managers have a participating style, and encourage two-way vertical communication, they would probably also allow and encourage some lateral communication.

■ Each manager would encourage communication between the managers in their own team – for example manager A would encourage communication between B, C, D and E.
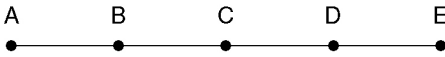
If the two work groups needed to co-operate in some aspects of their work, the Manager A group and the Manager W group would need to communicate with each other.

■ All communication between the two management groups might be between Manager A and Manager W.

■ Alternatively, whilst Manager A and Manager W might communicate regularly, they may also encourage communication and co-operation between the Level 4 managers in their groups, for example between Manager B and Manager X.

The pattern of communication in an organisation affects the way that people work together and co-operate with each other. In this example, if the two management groups work together regularly, the most effective communication pattern would be to allow and encourage horizontal (lateral) communication at the junior management level (Level 4).

5.8 Other patterns of communication

Within a work group or a management structure, other patterns of behaviour might be identified. The most efficient pattern of communication should be a pattern that achieves effective communication.

Pattern					Description
Chain A B C D E					A communicates with B,
					B communicates with A and C,
					C communicates with B and D,
					D communicates with C and E,
					E communicates with D.
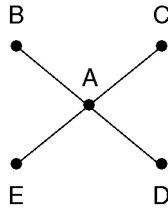
This pattern may be found in a 'traditional' bureaucracy, with A at the top and E at the bottom of the chain of command.

Wheel

A communicates with B, C, D and E.

B, C, D and E all communicate with A only, and not with each other.

This pattern is typical in a group led by an autocratic and authoritarian boss. A controls all communication.

The Y
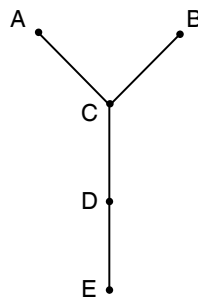
C communicates with A, B and D.

A and B communicate with C only.

D communicates with A and E.

This is similar to a combination of a wheel and a chain system of communication.

Circle
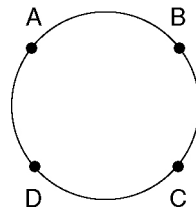
A communicates with B,

B communicates with A and C, C communicates with B and D, D communicates with C and A.

This is unusual in formal communication systems, but may well occur in informal communication networks.

All-channel
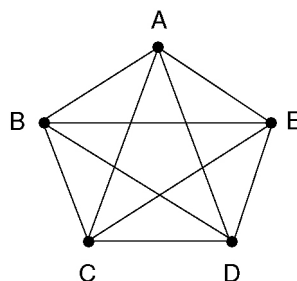
Everyone communicates with everyone else. This pattern is typical of a democratic work group or project team.

The chain, wheel and Y systems of communication system are found in many formal organisation structures. The speed and effectiveness of communication in each of these patterns depends on the communication abilities of particular individuals in the system.

- A chain communication structure is likely to be slow and inefficient. In the diagram above, the ability of A to get a message to E depends on the efficiency and competence of B, C and D. This is because a message must go through B then C then D before it van get from A to E.

- A wheel structure is a much quicker way to send a message, because all messages go directly to or from the person at the centre. In the diagram above, A can send a message to everyone. For B to get a message to C, it must go through A, but there are only two stages in the communication of the message.

- The speed of sending messages, and the effectiveness of communication, in a Y structure depends on the length of the chain or 'stem' of the Y pattern. In the diagram above, the chain in the stem of the Y consists of just three individuals, C, D and E. However, this chain could be much longer.

- Similarly, the speed and efficiency of a circle network depends on the number of people in the circle. When there are many people in the circle, it can be a very long time before an item of information reaches everyone.

- An all-channel system of communication is the quickest and most efficient, but it is not suitable for a formal communication structure in a formal hierarchical organisation structure.

CHAPTER

12

Learning, training and development and performance appraisal

Contents
1   Learning in the workplace
2   The role of training and development
3   Training needs
4   Methods of training and development
5   The evaluation of training
6   Competence assessment and performance appraisal
7   The appraisal process

Learning in the workplace
■ The process of learning
■ David Kolb: learning styles and experiential learning theory
■ The significance of Kolb's different learning styles
■ Kolb's experiential learning theory (ELT) model
■ Learning styles: Honey and Mumford
■ Barriers to learning

1 Learning in the workplace

1.1 The process of learning

Well-motivated individuals learn about doing their work, and get better at what they do over time. Organisations benefit from learning by individuals, because employees become more efficient and more effective as they learn.

The learning curve

One way of learning is to do a task many times, and to learn from experience. When an individual does a repetitive task, he or she should get better and faster at doing it as experience is gained and the individual becomes familiar with the work.

The term 'learning curve' or 'experience curve' is used to describe this learning process. According to learning curve theory, when an individual begins a new task (where the time to do the work depends on the skill of the individual rather than the pace of a machine or an item of equipment), he or she will do the job more quickly with each repetition of the task. Eventually the learning process comes to an end when the individual is fully familiar with the work.

Learning through training and development

Well-motivated individuals also learn through training and 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 give the individual a new insight into an aspect of their work.

■ Development is a process of learning through experience and doing work. Development is not a learning curve effect: the learning curve applies when the same task is repeated many times. Individuals learn as they develop by doing different things at work and gaining new experiences.

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

A well-designed programme of training and development will:

■ give employees the knowledge, ability or insight that they need to do their work better, and

■ in a way that is the most effective.

To plan an effective training and development programme, it is useful to know something about how different individuals learn. There are several 'models' that describe the way in which individuals learn.

1.2 David Kolb: learning styles and experiential learning theory

David Kolb (1984) developed a learning theory that identifies four different learning styles or preferences. Each individual has a natural preference for one of these four styles.

The four learning styles are related to a four-stage learning cycle, which Kolb identified as the process by which learning takes place. This is shown in the diagram below.
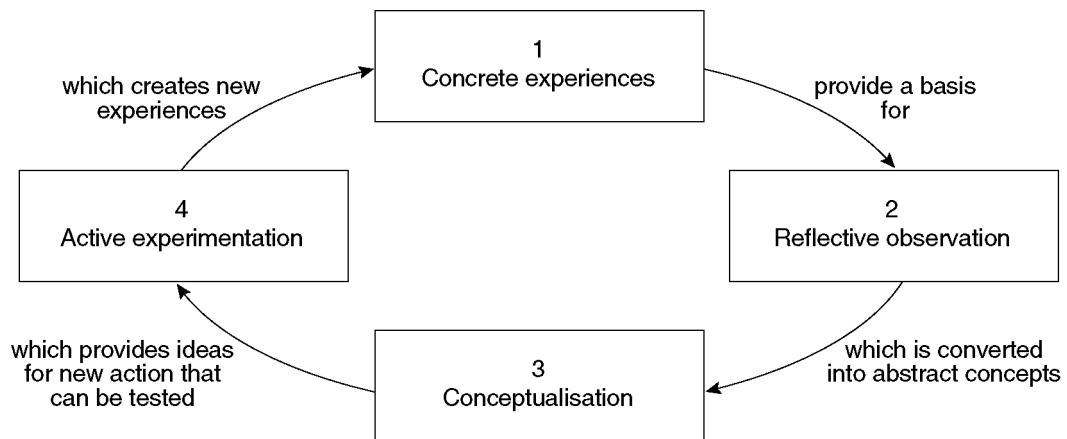
This four-stage learning cycle can be summarised as:

■ Experiencing – **feeling**

■ Reflecting – **watching**

■ Developing concepts – **thinking**

■ Acting – **doing.**

The four learning styles that Kolb identified are based on this learning cycle. Each learning style is a combination of two elements of the learning cycle. The four learning styles are:

■ Accommodating – feeling and doing

■ Diverging – feeling and watching

■ Assimilating – thinking and watching

■ Converging – thinking and doing

	DOING Active experimentation (AE)	WATCHING Reflective observation (RO)
FEELING Concrete experiences (CE)	Accommodating (Feel and do = CE + AE)	Diverging (Feel and watch = CE + RO)
THINKING Abstract conceptualisation (AC)	Converging (Think and do = AC + AE)	Assimilating (Think and watch = AC + RO)

■ Doing and watching are at two opposite ends of a 'perception continuum'. Individuals have a preference either for observing things before they reach a decision, or a preference for action and doing things.

■ Feeling and thinking are at two opposite ends of a 'processing continuum'. Individuals have a preference for reacting to things in an emotional way, or a preference for looking at things logically.

Kolb's four stages in the learning cycle and his four learning styles can also be presented as follows:
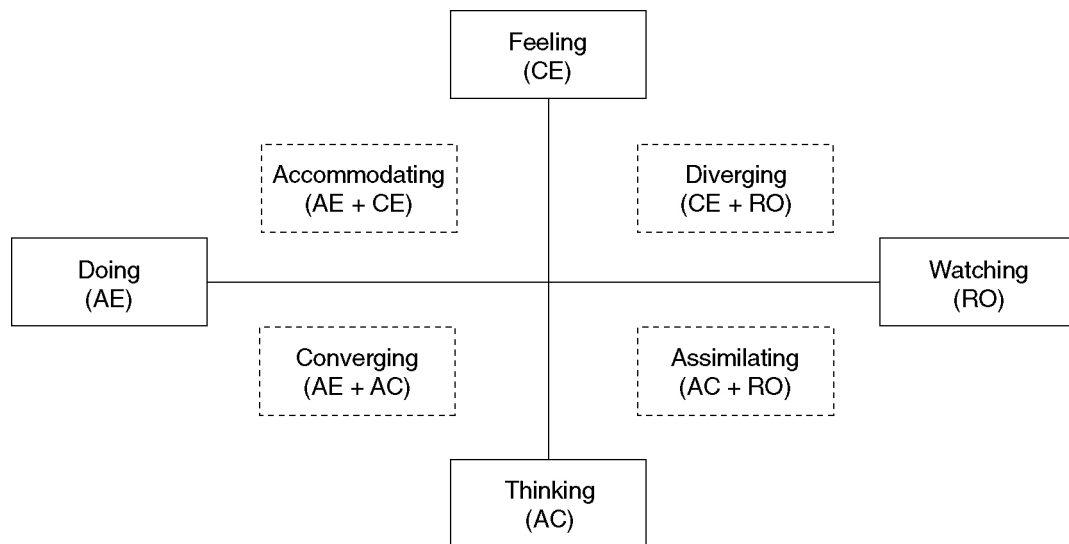
1.3 The significance of Kolb's different learning styles

The significance of different learning styles is that different individuals learn more effectively in different ways, both through training and development.

Accommodating (feel and do)

These individuals are 'hands on' in their approach and they also use their intuition rather than logic. They rely on 'gut instinct' rather than logical analysis, and will often rely on others for getting information rather than doing their own analysis. They like new challenges and experiences, and prefer working in teams to get tasks completed.

Individuals with this learning style are often very useful in roles at work that call for action and initiative.

Diverging (feel and watch)

These individuals are good at looking at issues from different perspectives and in different ways. They are sensitive to the feelings of others, are interested in other people and are often emotional. They prefer to watch and observe rather than to take action. They are able to gather information and use their imagination to create new ideas. They prefer working in groups (and are good, for example, in 'brainstorming' sessions) and will listen to others with an open mind.

Assimilating (watch and think)

These individuals have a preference for a logical approach to problems, and are more concerned about ideas and concepts than about people. They like to have a clear explanation about something rather than to find out by practical experience, and they are more attracted to logical theories than approaches based on practice and experimentation. They excel at taking a large amount of varied information and putting it into a logical structure.

When learning, they prefer reading, lectures and studying analytical models, and they like to have time to reflect and think.

Converging

These individuals can solve problems and use their learning to find solutions to practical problems. They prefer technical tasks, and are not so interested in people and interpersonal aspects of work problems. They enjoy experimentation and excel at finding practical applications for ideas and theories.

1.4 Kolb's experiential learning theory (ELT) model

Kolb also developed an experiential learning theory (ELT) model. This states that individuals go through three stages of learning as they gain experience and mature. As we get older and more mature, we are better able to integrate all four learning styles. The three stages in learning through experience are as follows:

- **Acquisition** (from birth to adolescence): individuals develop basic abilities.
- **Specialisation** (during school years and early working years): we develop a particular learning style. The learning style we develop is influenced by social and education circumstances, and also by the organisations in which we learn and work.
- **Integration** (from mid-career to later life): individuals are able to integrate and use all four learning styles.

1.5 Learning styles: Honey and Mumford

A similar approach to identifying learning styles was developed by Peter Honey and Alan Mumford (1982). Honey and Mumford were aware of the work that was

being done at the time by Kolb, and they have commented that: 'The similarities between his model and ours are greater than the differences.'

Honey and Mumford, like Kolb, identified four different learning styles and they argued that each individual has a preference for a particular style of learning. They therefore suggested that:

■ individuals need to understand what their 'natural' learning style is, and

■ they should seek opportunities to learn in that style.

However, Honey and Mumford also argued that to be a very effective learner, individuals should develop an ability to learn in the other styles too.

A feature of Honey and Mumford's work is that they developed a questionnaire that enables individuals to identify their preferred learning style.

The four learning styles in the Honey and Mumford model are:

■ **Theorist**: This individual likes to understand the theory that supports the practice. Theorists learn with facts, concepts and models.

■ **Reflector**: This individual learns by observing and thinking about what he has seen. Reflectors prefer to avoid 'jumping in' to a task, and prefer to watch from the sidelines.

■ **Activist**: This individual learns by doing and acting. Activists like to 'get their hands dirty'.

■ **Pragmatist**: This individual likes to see how theory is put into practice in the 'real world'. Pragmatists find abstract theories and concepts of no use unless they can see their relevance to practical action.

A feature of Honey and Mumford's model is that it provides suggestions about the best ways for individuals to learn. The most effective learning methods are different for each learning style.

Reflectors: effective learning methods

Reflectors like to stand back and look at a problem from different perspectives before reaching any conclusion. They like to collect data and think about it, and they enjoy watching other people and listening to their ideas before they offer any ideas and opinions of their own.

Reflectors learn best when:

■ they can watch others at work

■ when they are not given tight deadlines for writing reports

■ when they have time to think and reflect.

Reflectors do not like learning when:

■ they are given tasks to do and complete without time to plan or think

■ in a training situation, when they are asked to act as the leader or to play a role in front of others.

Activists: effective learning methods

Activists like to be involved in new experiences. They are enthusiastic about new ideas, but will get bored with the detail of their implementation. They enjoy action, and will often act first and consider the implications later. They enjoy working with other people, but they also like to be the centre of attention.

Activists learn best when:

- they are involved in new experiences and opportunities
- they work with others in team tasks: in a training situation, they enjoy role play
- they are 'thrown in at the deep end' and are expected to get on with a task
- they are leading discussions or chairing meetings.

Activists do not learn well when they are required to:

- listen to lectures and long explanations
- read, write and think on their own
- follow precise instructions about what to do.

Theorists: effective learning methods

Theorists are able to observe, think about what they have seen and convert their observations into complex and logical ideas and theories. They think in a detached and analytical way, rather than in an emotional and subjective way. They work through problems logically and are often perfectionists who like to have a rational explanation for every detail.

Theorists learn best when:

- they are put into complex situations where they have to use their skills and knowledge
- they have an opportunity to look at the ideas involved in a problem.

Theorists do not learn well when they are required to:

- participate in situations where emotions and feelings are important
- take part in an unstructured activity
- do things without knowing the concepts or principles involved.

Pragmatists: effective learning methods

Pragmatists like to try out ideas and concepts in practice. They are practical and 'down to earth', and get impatient and bored with lengthy discussions.

Pragmatists learn best when:

- they have an opportunity to apply ideas and techniques in practice, and are then given feedback on how well they have done
- there is a model that they admire and can copy (such as a boss who acts as a 'role model').

Pragmatists do not learn well when:

- there is no obvious immediate purpose to what they are learning, and so no immediate benefit
- the learning is 'all theory'
- there are no practical aspects or practical guidelines in the learning.

The preference of individuals for training methods therefore differs according to their learning style. Applying Honey and Mumford's model, the different preferences may be summarised as follows.

Preferred training methods

Reflectors	Theorists	Pragmatists	Activists
One-to-one discussions	Models	Discussions	Group discussions
Interviews	Statistics	Case studies	Case studies
Observing activities	Background information	Problem solving	Brainstorming
Feedback from others			Role play
Coaching			Puzzles, competitions
Taking time out to think			

1.6 Barriers to learning

Individuals are able to learn through experience and training. Unfortunately, the learning process is not always as effective as it could be. Within an organisation, employees often fail to achieve their full potential.

The barriers to learning within an organisation can be analysed into three categories:

- the motivation of the individual
- the opportunities for learning from the employer
- weaknesses in the teaching.

Barriers to learning: the motivation of the individual

Many factors can deter an individual from wanting to learn.

- **A heavy work load**. The individual might have too many pressures at work, and the job might take up too much time, leaving no time for learning new things.
- **Low morale**. The individual and the work force in general might have low morale, and so do not have the motivation to do their work better.
- **Lack of interest**. An individual might not be interested in the subject and so does not want to learn anything more.

- **Lack of support and encouragement**. An individual's supervisor or boss might show no interest in the individual's learning and development. This will discourage the individual from making an effort to learn.

- **Under-achievement at school**. An individual might have done badly at school and achieved very disappointing results in examinations. Failure at learning in the past may deter an individual from trying to learn in later life, because of a fear of failing again.

- **Family commitments**. The individual might have heavy demands on his or her time outside work hours, for example due to family commitments with ageing parents or young children. This might leave the individual with no time for training in out-of-work hours.

Barriers to learning: the organisation

The organisation might be responsible for the failure of its employees to learn as effectively as they could. A failure by the organisation and its management would be due mainly to giving insufficient attention and resources to the task, and a failure to provide an environment for learning.

- The organisation might be unwilling to give employees time off work for training.

- It might not commit enough resources (money and employees' time) to training.

- It might be unwilling to give employees money for external training.

- There might be no plans for employee development: for example there might be no plans for job rotation.

- Supervisors and managers might show no interest in staff development.

- There might be no appraisal system, or the system of appraisal might be ineffective.

Barriers to learning: the training itself

Training is an important method of learning, but training may be badly designed and badly delivered.

- Training rooms might be over-crowded or uncomfortable.

- Training programmes might be badly designed, for example by delivering too much training content in too short a time.

- The training methods might not be well-suited to the learning style of the trainees.

- The quality of the trainers might be poor.

- The quality of the training materials might be poor.

It has been suggested that there are three fundamental problems that create barriers in the learning process:

- The learning programme tries to teach individuals without using the object that the training is all about. For example, a training course in computer skills will not be effective unless the trainees have computers for learning with.

■ The learning programme puts the trainee on a 'learning gradient' that is too steep and unreasonable. In many cases, the trainee has not mastered the basic skills before going on to learn more complex and difficult items. If the individual is not familiar with the basics, it is extremely difficult to learn more advanced things.

■ Training materials are badly written, and the reader does not understand (or misunderstands) important words. When this happens, the trainee may reach the end of a page or chapter of reading and not remember or understand anything about what he or she has read.

To develop the skills and abilities of its work force, organisations must deal with all of these barriers to learning.

The role of training and development
■ Definitions: education, training and development
■ Benefits of training and development
■ Role of the training manager

2 The role of training and development

2.1 Definitions: education, training and development

The terms 'education and training' and 'training and development' are often used.

■ Education and training have some similarities, and education can be an element in training.

■ There are also similarities between training and development, and training can be an element in the development of an individual.

Training is a planned process to improve knowledge or skill, or to amend attitudes or behaviour through learning experiences. The aim of training is to improve work performance in an activity or a range of activities. Training therefore has a work focus.

Training differs from education. Training is related to a work environment and improving performance at work. **Education** improves basic knowledge, skills and attitudes, but does not have an immediate work-related purpose.

Examples

An individual must have basic abilities in reading, writing and mathematics to perform non-manual and skilled tasks. The teaching of basic skills is education.

Student accountants are required to learn a range of subjects before they can qualify as professional accountants. Some of the topics they study are directly related to their work: this aspect of their studying can therefore be called training. However, some of the topics they study are not related to the work they do. This studying might therefore be considered as education rather than training.

Development is concerned with gaining experience and providing career development. Individuals learn and develop through experience in different work situations and by having extra responsibilities or opportunities to use their own initiative. However, one of the ways that individuals can develop their skills and abilities is through training.

Together, training and development improve the abilities of individuals in their immediate job and longer-term career, and they enable individuals to learn through their work.

2.2 Benefits of training and development

Training and development have benefits for both the employer and the employee.

Benefits for the employer

The benefits of training and development **for the organisation** are as follows:

- Training and development create a more talented and skilled work force. The benefits of a better work force may include:
  - higher productivity, therefore lower costs of output
  - less waste
  - better performance by employees in their jobs; therefore higher standards of achievement
  - less need for close supervision of subordinates by their managers
  - an ability to compete more effectively with business rivals.
- Providing employees with training and planned development will improve their morale, and increase their commitment to the organisation. It should be easier to retain talented staff. If employees are not given the training and development they want and expect, they may resign and go to work for a different employer.
- Organisations that offer training and career development should find it easier to attract external applicants for job vacancies.

Benefits for the employee

There are also benefits of training and development **for the individual**:

- Learning through training and development improves the motivation of the individual, and gives him or her a sense of being more valuable.
- Career development increases job satisfaction.
- Training and development, by raising the level of skills and abilities, improve the individual's prospects for promotion and higher pay.

Since an individual gains personal benefits, and at the same time there are benefits for the organisation, training and development can help to create compatibility between the personal objectives of individual employees and the corporate objectives of the organisation.

2.3 Role of the training manager

Many large organisations employ training managers. These might work in the human relations (HR) department. Alternatively, they may be line managers with added training responsibilities for a group of employees.

The role of the training manager is to plan, implement, monitor and control the training and development process.

- **Identify the training needs** of the organisation. The purpose of the training manager is to identify the **objectives** of training for the employer, so that training programmes can be designed or selected that will help these objectives to be achieved. The analysis of training needs is discussed in more detail later.

- **Plan training programmes**. Training programmes should be planned that will enable the organisation to meet its training needs. This involves deciding the nature and the amount of training required and the training methods that should be used. Where formal training programmes are used, these must be **designed** (if the programmes or delivered in-house or as an outsourced contract to a training organisation) or **selected** (if the 'standard' courses of external training providers are used).

- **Implement the training programmes**

- **Monitor the implementation** of the training programmes

- **Evaluate the benefits** of the training and consider whether the objectives of the training programme have been achieved. This might be referred to as the **validation** of the training.

- **Consider ways of improving** the training.

The training manager is also responsible for the training budget, and achieving the objectives of the training plan with the available resources for training and within the budgeted spending limits.

> ### Training needs
>
> - Analysing training needs: the training gap
> - Meeting training needs

3 Training needs

3.1 Analysing training needs: the training gap

A responsibility of the training manager (or human relations manager) is to analyse training needs. This analysis of training needs should be linked to the human resources plan for the organisation, which provides a forecast of the numbers of employees the organisation expects to have through the planning period, and the types of job that they will be doing.

Training needs are the training requirements to ensure that the organisation has an appropriate number of employees with the required level of skill, knowledge and ability to do the jobs in the HR plan.

The training gap

Training needs can be estimated by comparing:

- the skills, knowledge and abilities that the organisation will require from employees in all its jobs, with
- the skills, knowledge and abilities that the organisation's employees will have if there is no training, and allowing for:
  - the promotion of some employees to more senior positions
  - movements of employees between jobs in the organisation
  - staff turnover, as existing employees resign or retire and are replaced.
  - changes in the job structure and total employee numbers
  - recruiting employees from outside the organisation, who already have the required skills and abilities.

The **training gap** is the difference between the skills that the work force will have if there is no training and the skills that the organisation expects that it will need.
A responsibility of the training manager is to plan how to eliminate the gap.

In addition, there might be some **legal requirements** to provide particular types of training. For example, it might be a legal requirement for employers to give all employees regular training in fire drill and the procedures to follow in the event of a fire in the premises. Similarly, there might be a legal requirement for banks to give employees training in anti-money laundering procedures.

Legal requirements for training must be included in the training needs analysis.

3.2   Meeting training needs

Training needs can be met by a combination of a 'top down' and a 'bottom up' approach. However, the training plans must be kept within the spending limits allowed for training in the organisation's budget, and total spending on training should not exceed the budgeted spending limit.

Top-down planning

Top-down planning involves planning training programmes by the training manager or training department, with the intention that all employees in each category of employees should go through a particular training programme.

For example, it might be a policy that all employees in the accounts department above a certain rank or grade must become qualified accountants. If so, the training plans should include plans for training accounts staff for their professional qualifications.

Similarly, it might be the organisation's policy that a certain number of 'high flying' young managers should be sent on an MBA course to develop their management skills and abilities.

With top-down planning, the training department or training manager provides training programmes and may also identify the individuals who must be given the training.

Bottom-up applications for training

Employees may be encouraged to apply for training.

- The need for training might be identified from the appraisal process (described later). Managers might notify the training manager of training requirements for each of their employees, and ask whether the required training can be provided.

- Individuals might be responsible for their own personal development plan. This should identify gaps in their development that might be filled by training. If so, individuals might discuss training needs with their boss on the basis of their own training needs analysis in their personal development plan.

- Alternatively, the training manager may notify employees and their managers about training programmes that will be available, and invite applications from individuals to attend any of the programmes.

The training manager can try to meet requests for training from a mixture of in-house courses, external training and possibly CBT.

Methods of training and development
■ Methods of training
■ Methods of development
■ Job design: job enrichment and job enlargement
■ Self-development
■ Skills development programmes

4 Methods of training and development

4.1 Methods of training

Methods 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

- external, where the training is provided by an external trainer or training firm, and the trainees come from different organisations

■ Computer-based training

■ Training in the work place. Training in the work place is a method of development of individuals, as well as a method of training. Work place training is training in technical or practical skills, whereas work place development helps the individual to gain experience and develop personal skills, such as skills of management and leadership.

■ Induction.

In-house training may be provided by the organisation's own trainers and experts. Alternatively, in-house training may be provided by an external trainer or training firm, hired to deliver the training programme.

Formal training may end in an examination, leading to a qualification or certificate – such as a professional accountancy qualification or an MBA degree (Master in Business Administration) with a business school.

Formal training

Formal training within a training room environment can take any of the following forms:

■ **Lectures or talks**, often with projectors and screens, and possibly electronic whiteboards. Formal lectures are well-suited to training in which the trainees have to learn large quantities of technical detail (such as accountancy training).

■ **Group discussions**

■ **Training films**. Training films might provide practical training, for example of health and safety regulations and procedures. However, training films might also be used to teach 'soft' skills, such as interpersonal skills and management

skills. When films are used for training 'soft skills', watching the film is usually reinforced by group discussions afterwards.

- ■ **Case studies**. Case studies can be used as a basis for group discussions. For example trainees might be divided into several groups, and each group asked to consider their views on a case study. The differing views of each group then form the basis for subsequent discussions by the entire class.

- ■ **Role-play activities**. Role play activities are particularly useful for the development of **interpersonal skills**, including selling skills, negotiating skills and counselling skills.

- ■ **Business games**. Business games are used to provide training in team-building as well as management skills.

- ■ Using CCTV to **film delegates** and then playing back the film. This is particularly useful for training in **presentation skills** and **selling skills**.

Training programmes may be delivered in a single form, or as a mixture of several of these different forms.

Some formal training may be reinforced by testing. For example, it is common to use tests to reinforce learning in training courses for accountancy examinations.

Computer based training (CBT) and e-learning

Computer-based training (CBT), also called computer-assisted learning (CAL) is training delivered through the trainee's computer. The term 'e-learning' refers to computer-assisted learning that is downloaded from the internet.

In its simplest form, CBT is little more than a training book displayed as pages on the computer screen. Many CBT programmes involve some inter-activity, where the trainee is required to input responses to prompts or questions that appear on screen. Some CBT programmes include sound, or sound and film.

An advantage of CBT is that the trainee can access the training material through a desk-top computer or a laptop/portable, at a time to suit his or her convenience. It can therefore be used for learning in the work place, learning at home or learning while away from the office on business trips.

Training in the work place

Training in the work place is directly related to the work that the trainee will be doing. It helps the individual to acquire technical or practical skills for doing particular jobs. Work place training might be provided by a coach (a skilled and more experienced colleague) or the supervisor.

Work shadowing. The individual learns by watching an experienced colleague do the work, and asking questions about what he or she sees and hears. The trainee is 'shadowing' or following the experienced colleague in order to learn how the job is done. An example of work shadowing is training traders in the financial markets by getting them to watch an experienced trader at work.

Induction

Induction means 'leading in'. An induction training programme might be given to individuals who have just joined an organisation. The purpose of induction is to teach the individual about the organisation and its business operations, and about the work that is done in each division or department of the organisation.

An induction programme might consist of talks by senior managers in different divisions or departments, and site visits to see operations in action.

4.2 Methods of development

Development improves the skills, knowledge and abilities of an individual through experience in working. Unlike on-the-job training, however, development is not so much concerned with teaching the individual how to do a particular task or job. It is more concerned with giving the individual more experience and responsibilities, so that he or she is able to improve and become a more valuable employee.

Development programmes are commonly associated with managers. They benefit from development to become better managers, capable of moving on to more senior positions.

Methods of development include the following:

- **Job rotation**. Job rotation means moving an individual from one job to another at fairly regular intervals, so that the individual gains familiarity with the work done in each job. For example, a trainee accountant in the accounts department might be given a job for three months or six months in the payables ledger section, before being moved to the receivables ledger, then to the payroll department, then to the costing department, and so on. Job rotation gives the individual a broad range of experience in the activities of the organisation. This should be useful when he or she is eventually ready for promotion to a more senior position.

- **Secondment**. An individual might be 'seconded' to work somewhere else for a period of time. Secondments are periods of time spent away from the normal working environment, in another department or as part of a project team. For example, an accountant might be seconded from the accounts department to work with the sales team for a while. Similarly, an accountant might be seconded to join a project team that has been set up to design and implement a new computer system. Individuals benefit from secondments because they gain experience from working with people from different parts of the organisation, or with external consultants.

- **Deputising for a manager or supervisor**. An individual may be given the opportunity to deputise for his or her boss when the boss is absent from work for an extended period, on holiday or due to illness. The individual gains experience by doing the job of the boss for a period of time.

- **Delegation**. A boss who wants to develop individuals will give the individuals additional responsibilities, and delegate authority to the individuals to make their own decisions. Individuals will gain experience from their additional authority and responsibility, and will be accountable to their boss for how they have carried out their additional responsibilities.

- **Mentoring**. An individual might be given a 'mentor'. The mentor provides guidance and assistance to the individual, and may occasionally discuss the individual's work and work problems.

- **Appraisals**. Formal appraisals are a part of a system of development. Appraisals are described in a later chapter.

4.3 Job design: job enrichment and job enlargement

Employees can be given opportunities for development through careful job design. Job design involves looking at the current jobs in an organisation or department, and considering whether they can be altered (designed) in a way that gives more fulfilment and greater experience to the job holder.

Two methods of re-designing a job are:

- job enrichment, also called 'vertical job enlargement'
- job enlargement, also called 'horizontal job enlargement'.

Job enrichment

Job enrichment means making the job 'richer' by building more responsibility into it. When a job is enriched, the job holder is given more authority (authority for a higher level of decision-making).

Example

An editor in a small publishing company may be responsible for preparing the 'final copy' artwork for a book, to send to the printer. The editor might also be responsible for sending the artwork to the printer and checking the delivery date for receiving the printed books from the printer.

This job might be enriched by giving the editor the additional responsibilities for:

- negotiating printing prices with the printer, to obtain the best prices, and
- ensuring that the printer meets the agreed dates for delivery of the printed books.

The additional responsibilities might enrich the job by giving the job holder a higher level of authority, that the job did not have before.

Job enlargement

Job enlargement means giving the job holder more tasks to do, but without any additional authority. All the additional tasks are at the same 'level' as the existing tasks in the job.

For example, in a school the job of a mathematics teacher might be altered, to include responsibility for teaching a sport and for running a 'homework club' in

mathematics after school. All the work is still at the same level of 'teacher', but there is more variety in what the teacher is required to do.

Job enlargement might be used:

■ to increase the work load in a job where the job holder is under-worked, or

■ to give the job holder a greater variety of tasks, in order to reduce the monotony and dullness of carrying out the same repetitive tasks.

Job enrichment promotes the development of individuals in their work. Job enlargement may provide some development by giving the job holder experience of more varied tasks. However, there is a risk that job enlargement will simply mean giving the job holder several boring tasks to do instead of just one boring task!

4.4 Self-development

Many individuals have some ambition and want to develop their career. Some individuals have a lifelong career with the same employer, but many individuals do not. They move from one employer to another during the course of their working life. Many individuals change their job to advance their career.

Individuals who want to develop their careers cannot always rely on their managers to promote them, or to give them jobs that will help with their development. If a person wants to be successful, the main responsibility for achieving success is his or hers. (This is one of the benefits of having personal development plans.)

'Self development' is a term for the activities and learning that provide **lifelong** personal development, and at the same time contribute to the individual's professional competence or the achievement of the organisation's goals.

The goal of self-development is to increase your readiness and potential for a position of greater responsibility.

Enhancing self-development

There are several ways in which individuals can try to achieve more self-development:

■ They should use the staff appraisal system to agree targets for achievement and initiatives for training and development.

■ They should follow up on their appraisal interview. They should try to achieve the objectives they have been set, or try to ensure that they get the training or development that they agreed with their manager.

■ If they do not get the training they want from their employer, they could arrange for some training in their own out-of-work time – for example, some individuals in senior management positions might pay for their own MBA degree programme at a business school.

4.5   Skills development programmes

Individuals who want to develop themselves and their career are often able to benefit from skills development programmes.

Organisations may have a formal skills development programme to make sure that their work force will always have the skills that the organisation needs. Examples of skills development programmes are:

- **Training needs analysis**. Training needs analysis involves a comparison of the current skills of the work force with the skills that the organisation requires now or will require at some time in the future. A training development programme is then designed to 'close the gap' and make sure that the missing skills are obtained through training the work force.

- **Management development programme**. Similarly, an organisation may have a management development programme. This is based on the future requirements of the organisation for management talent. Unless the organisation plans to recruit all its senior managers externally, it must be able to ensure that there is a flow of managers from junior positions into more senior positions, to fill the gaps created by the growth of the organisation, and by resignations and retirements. A management development programme identifies the management skills that will be required, and arranges training and development initiatives to groom existing managers for promotion.

- **Graduate recruitment programme**. A large organisation with a large management structure may have a graduate development programme. This is a formal programme for recruiting graduates from university and training and developing them for senior positions in the future.

The skills of individuals can also be improved by **mentoring**. Mentoring was described in an earlier chapter in individual effectiveness.

The evaluation of training
■ The need for evaluation of training ■ Kirkpatrick: four levels of evaluation

5 The evaluation of training

5.1 The need for evaluation of training

An organisation should evaluate its training, to assess how effective it has been and whether it has provided good value for the time and money spent. The process of evaluation is necessary to:

■ check whether the training needs were met

■ if the training failed to achieve its aims, identify in the ways in which it failed and the reasons for the failure

■ decide whether improvements can be made in training provision in the future.

5.2 Kirkpatrick: four levels of evaluation

Kirkpatrick (1959) developed a goal-based approach to the evaluation of training. A goal-based approach focuses on the aims or goals of training, and finding out whether these aims have been achieved.

Kirkpatrick identified four 'levels' of evaluation that could be used. These are based on four simple questions about the training: each question translates into a level of evaluation.

The question about training	The level of evaluation
What did the trainees think about the training course or training programme?	Reaction
Were the objectives of the training course actually met?	Learning
Has the training altered the behaviour of the employees in their work?	Behaviour
Have the benefits from training exceeded the costs of providing it?	Results or Impact evaluation

Reaction

This method of training evaluation is the most commonly-used in practice. It involves finding out from trainees, usually as soon as the training course has ended, what they thought about the course.

Obtaining reactions from trainees often involves asking the trainees to fill in a questionnaire or 'happy sheet'. For example:

- What did they think of the lecturer?
- What did they think of the role play sessions?
- What did they think of the business games?
- What did they think of the training materials?
- How did they find the training venue?
- Did they think that the course was (a) too long (b) just the right length or (c) too short?

The training manager uses the feedback from the trainees to make adjustments to the future provision of the courses, for example, by using a different lecturer, and adjusting the materials, the pace of the course, the methods of training used and the training facilities.

Learning

This method of evaluation can be used when it is possible to measure the results of the course and compare these with the training objective. Trainees can be tested on what they have learned.

The tests might be specially-written by the training provider. Alternatively, trainees might be required to take an external test or examination (such as a professional accountancy exam!). The success of the training is evaluated by comparing the actual pass rate against the target pass rate, or the actual average score in the test with the target average score.

Behaviour

To evaluate training at this level, the manager or supervisor of the trainee should be asked, at some time after the training programme has ended, whether there has been any noticeable change in the individual's job performance.

The reason for evaluating training at this level is that the training programme might satisfy the trainees and the training might have achieved its learning objectives, but the training has no effect on the behaviour of the individuals in their actual work.

What individuals learn on a course is not a predictor of what they will do when they get back to their job. Training needs to be reinforced and supplemented by:

- development (of the individual)
- support for the individual from his or her supervisor or manager, and
- good job design.

Results (impact evaluation)

At this level of evaluation, the benefits obtained from training are compared with the costs of providing it. The benefits of training might be measured quantitatively, in terms of reduced costs or increased output. Alternatively, the benefits might be seen in better quality of work or output, fewer mistakes, greater efficiency and better time management.

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Performance assessment and performance appraisal

- Performance assessment
- Competence
- The nature of performance appraisal
- The main components of staff appraisal
- The benefits of performance appraisal
- Barriers to effective performance appraisal

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6 Performance assessment and performance appraisal

6.1 Performance assessment

The success of an entity in achieving its objectives depends on the performance of its employees, and senior management should assess the performance of its work force.

Performance assessment is an evaluation of performance, where performance is measured and compared with some form of target or benchmark. For example, the performance of an entire company or the performance of a division within a company might be measured in terms of profit per employee or sales revenue per employee.

At a departmental, labour performance can be assessed by measures of productivity or output per employee. For example, in the production department of a manufacturing company, performance might be assessed in terms of units manufactured per labour hour or per machine hour.

In addition to assessing the performance of the work force as a whole, or the performance of departments and work groups, there should be a system for appraising the competence and the performance of individual employees.

6.2 Competence

Competence is the ability to do something. An assessment of competence is an assessment of what a person is capable of doing. Competence may relate to an individual's:

- technical skills
- practical ability
- judgement and insight
- ability to work with others
- ability to provide leadership.

Competence assessment may be an assessment of an individual's ability to:

- do his or her current job to a satisfactory standard
- do a different job: for example it may be an assessment of whether the individual is ready for promotion.

Competence is usually **measured on a scale** between 'not competent' to 'very competent'. It is not usually measured as either 'competent' or 'incompetent' (= one thing or the other, with nothing 'in between').

Competence and performance

Competence is often judged according to the performance of the individual in his or her job. The individual may be considered competent if he or she has been doing the job well.

However, competence can be measured by the individual's **potential** to do something as well as by his or her **actual performance**.

For example, in the medical profession, the competence of a doctor can be measured either by:

- his ability to treat patients for a particular condition, as demonstrated perhaps by his training record, and
- his ability to treat patients for the condition as demonstrated by his actual medical work.

Competence can be measured by education and examination. For example, the competence of accountants can be assessed by professional examinations. However, this chapter is concerned mainly with assessing the competence of individuals in their work.

Competence and performance are often assessed within a system of staff appraisal.

6.3 The nature of performance appraisal

Performance appraisal (staff appraisal) is a formal process for reviewing and assessing the competence of individual employees, and considering what might be done to develop them.

The appraisal process involves an interview or discussion between the employee and a manager. Usually, staff appraisals are between the employee and his or her immediate manager. However, a more senior manager may carry out the interview.

Appraisal interviews should be carried out within a formal appraisal system. In many organisations, there are **annual appraisal interviews** for every employee, or every employee in a management position.

The aim of an appraisal interview should be to have a discussion between the employee and his or her manager, in which the following matters are discussed:

- How are things going?

- What has gone well?
- What has gone badly?
- What have been the problems and difficulties?
- What is needed to develop the employee and improve his or her competence?
- What can be done to meet these needs?

In addition to the appraisal interviews, there should also be a system for:

- recording the outcome of the appraisal interview, and keeping these records
- agreeing measures for training or development, in order to improve the employee's competence
- agreeing targets or standards for future performance, that will be used for future appraisals
- implementing the agreed measures for training and development.

6.4 The main components of staff appraisal

A staff appraisal may have three different components.

- **A reward review**. The annual appraisal interview may be seen as an opportunity for the employee and his or her manager to discuss pay and other rewards. The employee may have an opportunity to ask for more pay, or express a wish for promotion. The manager might use the appraisal interview to say what the individual's pay will be for the next 12 months.

  However, although rewards will be discussed in an appraisal interview, it is normally inappropriate to combine the annual appraisal interview with the annual pay review. This is because the interview will then focus on pay to the virtual exclusion of everything else. The annual pay review – telling the employee what his pay and bonuses will be – should be a separate process.

- **A performance review**. An appraisal system might be used to assess the performance of the employee since the previous appraisal. One way of doing this is to agree a target or objective for the individual, and to compare the individual's actual performance against this objective or target at subsequent appraisal interviews. The target that is set for an individual may be a target to complete a particular task. Alternatively, it might be a more general target, such as getting on better with colleagues in the work team. For a trainee accountant, the target might be to get through a particular examination within the next 12 months.

- **Potential review**. Staff appraisal interviews can also be used to discuss the employee's potential for career development and promotion. However, to make this discussion meaningful, there has to be a system of reporting to senior management and making recommendations that particular employees:

  - should be considered for promotion, or
  - should be considered for development, with a view eventually to promotion.

6.5 The benefits of performance appraisal

Staff appraisal can have benefits for both the employer (the organisation) and the employee.

Benefits for the employer

There are several possible benefits of staff appraisal for the employer.

■ It provides a formal system for assessing the performance and potential of employees, with a view to identifying candidates for promotion.

■ It provides a system for identifying ways of improving the competence of employees, in order to raise the general level of efficiency and effectiveness of the work force.

■ In a large organisation, it is therefore a valuable system for human resource planning, and ensuring that employees are ready for promotion, to fill management job vacancies that arise.

■ If it is well-managed, it can improve communications between managers and their employees, and so improve working relationships.

Benefits for the employee

Staff appraisal also offers benefits to the employee.

■ The employee gets feedback about his performance at work, and an assessment of his competence.

■ A formal appraisal system offers the employee an opportunity to discuss his future prospects and ambitions.

■ An appraisal interview may be used as a basis for considering pay and rewards.

■ Appraisal can be used to identify and agree measures for further training and development, to improve the employee's competence.

6.6 Barriers to effective performance appraisal

However, performance appraisal systems are often ineffective, and fail to achieve their potential benefits. There are several possible barriers to having an effective system. By far the most significant barrier is the lack of full support for the system from senior management.

The system must have a purpose that everyone understands. It must be seen to work and to achieve results. This cannot happen unless the staff appraisal system is fully integrated into the systems for rewards and staff promotion and development.

Barriers to an effective appraisal system are:

■ **It has no purpose**. Employees see the appraisal interview as nothing more than an informal chat with the manager. Nothing happens as a result of the interview, which is badly organised. The entire process is seen as a waste of time and a pointless exercise.

- **Confrontation**. Employees see the appraisal interview as an occasion for criticism from the manager. The manager (interviewer) might use the interview as an opportunity to tell the employee about his weaknesses and failures. When this is the attitude, the appraisal interview is a confrontation, and the employee is on the defensive throughout the interview, or uses the interview to argue back and to accuse the manager of failure. These interviews do not have a constructive outcome.

- **The interview is one-sided**. Staff appraisals might be one-sided, with the manager telling the employee about his strengths and weaknesses, and giving him an assessment of his competence. Employees will often resist a system of appraisal in which they do not have an opportunity to answer back and give their own opinions.

- **Annual event**. The appraisal process might be seen as an annual event, that happens every 12 months, and nothing more happens afterwards until 12 months later. To have any purpose, appraisal systems must include:

  - follow-up action after the appraisal interviews and

  - procedures for monitoring results.

- **Lack of training in appraisal interview techniques**. A system might be ineffective because managers are not given proper guidance or training in what they should be doing in the appraisal interview, and how they should organise any follow-up action that is agreed with the employee.

- **Lack of a records system**. There must be formal records for an appraisal system. Records should be kept of each appraisal interview, and what was agreed in the interview. If the employee and interviewer agree on targets or objectives for the employee, these should be recorded so that they can be discussed at the next appraisal interview. Similarly, a record should be made of any agreement about training that the employee needs or about work that the employee should be given to encourage his development. Records provide a basis for follow-up action and feedback.

The appraisal process
■ Approaches by management to the appraisal interview
■ Preparing for an appraisal interview
■ Recording the results of an appraisal interview
■ Feedback from the appraisal interview

7 The appraisal process

7.1 Approaches by management to the appraisal interview

The effectiveness of the appraisal process depends largely on the skills of the managers who carry out the appraisal interview. It is vitally important that the employee should accept the appraisal process and its outcome. In other words, employees should 'engage' in the process.

The interviewer may approach the interview in any of four ways:

■ Tell and sell method

■ Tell and listen method

■ Problem-solving method

■ 360 degree approach: this is only practicable when there is a well-established system of formal performance appraisal.

Tell and sell method

The interviewer tells the employee how the assessment will be made. He then gives his assessment, and makes suggestions for an improvement plan or development plan for the employee. The appraisal will often include some criticisms of the employee, but this should be constructive criticism in order to:

■ avoid confrontation and

■ motivate the employee to want to improve.

The employee does not have much opportunity to reply to the appraisal by the interviewer. This approach to appraisal calls for a high level of management skills and interpersonal skills from the interviewer, in order to 'engage' the employee and avoid confrontation.

Tell and listen method

The interviewer tells the employee how the assessment will be made, but then invites the employee to respond to the assessment. The interviewer must then listen to the comments from the employee, and encourage the employee to become involved in a constructive discussion.

For example, the interviewer might invite the interviewee to discuss his job, problems in the job and expectations about the future. The interviewer might ask some questions to prompt the interviewee to discuss these matters fully. Having listened to what the interviewee has to say , the interviewer then offers suggestions and guidance about how performance might be improved in the future.

Problem solving method

The interviewer and the employee must agree in advance as to what the appraisal interview should try to achieve, and how it should be conducted. The approach to the interview is based on the joint agreement that there is a problem: how to develop the employee or how to improve the competence of the employee.

The interview is then conducted as a joint attempt to find answers to the jointly-recognised problems.

360 degree approach

With the 360 degree approach the performance appraisal interview is based on:

- an assessment of the individual by a number of other people ('raters') who are familiar with the individual's work, and
- a self-assessment by the individual.

There should be at least 3 to 5 raters, and all of them should be 'credible' to the individual they are appraising. Each rater is asked to complete a questionnaire about the performance of the individual. The opinions and assessments of each rater are kept confidential, to avoid the risk of resentment and arguments if the individual finds out how any particular rater assessed him.

The assessments by each rater are collated by the manager who carries out the appraisal interview. These assessments are compared with the individual's self-assessment, and this provides the basis for the discussion at the interview.

7.2 Preparing for an appraisal interview

An appraisal interview is likely to be more effective if both the employee and the interviewer (manager) prepare for the interview in advance. To help with the planning:

- the organisation should issue guidelines to both the interviewer and the employee, and
- there should be documents for the interviewer to look at in advance of the interview, containing information that can be used as the basis for questions in the interview.

Questions for the employee to prepare

The employee should prepare for the annual appraisal interview by considering the following questions:

- What have been the achievements during the year with which the employee is pleased?

- How do the achievements during the year compare with previously-agreed objectives or action plans?

- In what respects does the employee consider that further improvements can be made?

- What factors outside the employee's control have affected his or her performance? Do these factors still affect performance? If so, what can be done to remove the problem?

- What extra training or new work experience will help the employee to do the job better?

- What personal aspirations and ambitions would the employee like to discuss, with a view to deciding how these ambitions might be met?

Questions for the interviewer to prepare

If the interviewer wants to encourage a dialogue with the employee, the questions to prepare in advance should be related to the following issues:

- What do you think were your most significant achievements during the year?

- What aspects of your job caused you the most difficulty?

- Have you met the targets or objectives we discussed at the previous appraisal interview?

- What should be your objectives or targets for the next period?

- What training or coaching do you need in order to improve your performance and abilities?

- What are your career ambitions? Is there anything that we can (reasonably) do to help you to achieve them?

- Are there any other issues about your work and your job that you would like to talk about?

Location of the interview

The location for an appraisal interview should be appropriate, and should encourage the employee to feel that the appraisal is important for the employer as well as for the employee.

- If the interview is held in the manager's office, the employee must be notified well in advance and should have an official time for the interview to begin. Enough time should also be allowed for the interview, so that the discussion is not rushed or finished abruptly.

- In some cases, the organisation may prefer to emphasise the importance of the appraisal process by selecting a special location for the interviews, such as a small conference room in a local hotel.

The documents for an appraisal interview

As part of the preparation for an appraisal interview, the interviewer should obtain and look at the following documents:

- The **job description**. This sets out the purpose and contents of the job. The interviewer can use this to ask the employee which aspects of the job have been performed well and which aspect have been performed less well.

- **Records of previous appraisals**. The interviewer needs to know what was discussed and agreed at the previous appraisals of the employee, in order to ask questions about the progress that has been made since then.

- **Self-assessment form**. A part of the appraisal process may include a requirement for the employee to complete a self-assessment questionnaire before the interview. The interviewer can compare the replies to the questions in the questionnaire with his or her own opinions about the employee. Any differences of opinion can be discussed in the interview.

- **Other comments about the employee**. There may be other comments about the competence and performance of the employee, such as letters from customers or suppliers about how they have been treated by the employee. (These could be either favourable or adverse.)

- **The employee's HR record**. The interviewer may use the employee's employment record to check for any notable aspects of behaviour, such as a formal warning or any other disciplinary measure since the previous appraisal interview.

Interviewing skills

Whatever approach a manager takes to the interview, he or she must remember to give praise to the employee for work that has been well done and for the successful achievement of objectives or targets. Giving praise as well as constructive criticism will help to avoid confrontation, and will also help to make the interview fair and objective.

It is the responsibility of the interviewer to make the interview a success. The interviewer in an appraisal interview must therefore have some interviewing skills. The following are 'common sense' requirements for good interviewing:

- Ask questions that allow the employee to give full answers. Do not ask 'closed questions'. (These are questions where the answer is a short 'Yes' or 'No'.)

- In a 'tell and listen' or a 'problem-solving' interview, give the employee time to ask questions and give opinions.

- Don't ask complicated questions.

- Ask follow-up questions to clarify answers to initial questions. Try to develop conversation.

- Listen. Don't talk too much.

- Keep the discussion focussed on relevant issues.

- Handle difficult areas with sensitivity and consideration.

- Let the employee know that you are listening and that you have understood the points that he or she is making.

- Look for constructive solutions to problems, and look for ways to develop the employee.

7.3 Recording the results of an appraisal interview

A record should be taken of every appraisal interview. This should include details of what was discussed, and what training and development measures were agreed.

The appraisal might also include some form of scoring system or assessment system of the employee. However, although appraisal scoring systems are used, they may be subject to bias and should be used with care.

Criteria for assessment

Whatever appraisal method is used, the employee needs to be clear about the criteria for appraisal. What are the aspects of performance and ability that will be used to make the assessment? They could be any of the following, or a combination of any of the following factors:

- The **volume of work** produced by the employee within a given time period, **personal time management**, evidence of working well under pressure and **meeting deadlines**.
- **Knowledge of the work**. Also, how this has improved since the previous appraisal, due to training or additional experience.
- **Quality of work produced**. This could be measured in terms of error rates or wastage rates for junior staff. At a higher level (management level) the quality of work could relate to the technical complexity of the work that has been done, or its accuracy.
- **Management skills**. These relate to factors such as the ability of the employee to communicate with colleagues or subordinates, the ability to delegate work to others, an ability to motivate subordinates, and the ability to plan and control operations.
- **Personal qualities**. Personal qualities relate to factors such as judgement, the ability to show initiative, self-confidence, interpersonal skills, adaptability and flexibility, and self-motivation and ambition.
- **Performance targets**. Whether the performance targets agreed with the employee at a previous appraisal interview have been met, and if not, what are the reasons?

Techniques of assessment

One way of recording the results of an appraisal interview is to record what was discussed and agreed.

The appraisal record should possibly also contain an assessment of the competence of the employee by the interviewer. The purpose of making this assessment is that it provides an 'official' record of the individual's competence and achievements. The progress (or lack of it) in the individual's development over time can be monitored by studying the historical records, and comparing them with the current assessment.

There are several ways of measuring the interviewer's assessment of the employee:

- **Ranking**. When employees are interviewed by the same manager, the manager can rank them in order of competence. This method of appraisal establishes which members of the team are better than the others, and this can help with any decisions that might be taken about promotion. However, this method of appraisal is also subject to bias, and is only practical when there is a fairly small number of employees to compare.

- **Scoring**. An organisation may use rating scales to score the competence of an employee. In a scoring system, each employee may be given a numerical score (up to a maximum) for each of a number of different competence factors or performance factors. The overall competence of each employee is then calculated by adding up the scores for each factor.

- **Grading**. A similar approach to appraisal is to give the employee a grade or rating on a non-numerical scale – such as excellent, very good, good, satisfactory, below average and poor.

- **Critical incident method**. Another method of appraisal is to focus on any critical incident that has occurred during the time since the previous appraisal interview. The basis of assessment is based on a discussion about how the employee dealt with the critical incident (well or badly) and whether any lessons can be learned for the future.

- **Performance-related assessment**. The competence of an employee may be based on a comparison between the targets or objectives that had been set for the employee (at the previous appraisal interview) and whether those targets have been achieved.

7.4 Feedback from the appraisal interview

An important barrier to effective appraisal can be the view of employees that the annual appraisal is not treated as something important, and that nothing is done after an appraisal interview has finished.

To prevent this from happening, there must be a system of follow-up and feedback.

- There may be agreement between the interviewer and the employee in the appraisal interview about further training that the employee needs, or ways in which the employee can be developed. These agreements should be recorded as part of the official record of the appraisal interview.

- The action plan that has been agreed with the employee should be reported to senior management and the HR department.

- The interviewer is normally the manager of the employee. He or she should follow up the appraisal report and should arrange the training or development that has been agreed.

- At the next appraisal interview, the interviewer and the employee should discuss whether the agreed training or development was provided, and what has been its effect. Has the training, job rotation, secondment etc helped with the employee's development, and if so in what ways?

Q&A

Practice questions

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1 Types of organisation

Organisations can be categorised into the following types:

(1) business organisations

(2) public sector organisations

(3) non-government not-for-profit organisations.

To which category or categories of organisation do the following entities belong?

(a) A charity receiving 60% of its annual funding from central government.

(b) A school

(c) A state-owned electricity company.

2 Span of control

Would you expect to find a wide or a narrow span of control for the following managers?

(a) Head of research in a small pharmaceuticals company

(b) Site manager on a building construction site

(c) Head of a department store

(d) Fashion manager in a fashion design team.

3 Management levels

Using R N Anthony's division of management decisions into strategic level, tactical level and operational level decisions, at which level of management will the following decisions be taken?

(a) Dealing with a breakdown in the computer system for inventory control.

(b) Deciding to expand business operations by moving into the North American market.

(c) Replacing an existing computer system for production planning with a new purpose-written computer system for the planning and control of production processes.

(d) Preparing a sales plan.

4 Centralisation and decentralisation

Within the same business organisation, some decision-making might be centralized, with decisions made by senior management. Other decisions might be decentralised, and taken by managers or employees involved in operations.

A company owns and operates five private hospitals. It has a head office, a management team and staff in each hospital. Staff include the medical staff – doctors and nurses. Would you expect the following decision-making to be made:

(1) by head office management

(2) by the management of each hospital

(3) by staff in each hospital?

(a) Decisions about the medical treatment or surgical treatment for individual patients.

(b) Establishing policy on hygiene standards in the hospitals.

(c) Scheduling operations in the operating theatres of each hospital.

(d) Discharging patients from hospital.

(e) Deciding the visiting times for patients in each hospital.

(f) Prescribing drugs for the treatment of patients.

(g) Hiring new staff, such as hospital porters and nurses.

(h) Dealing with payments from insurance companies for the treatment of insured patients.

5 Criticisms of committees

Identify four major criticisms of many committees.

6 Marketing mix

A marketing mix consists of four elements: product, price, place and promotion. Which of these four elements is each of the following?

	Company	
(a)	Manufacturer and supplier of computers (PCs)	Providing free Microsoft software with every PC supplied
(b)	Car manufacturer	Displaying a new model of sports car at a motor show/exhibition
(c)	A company that installs domestic gas boilers	Offering to take the customer's old boiler in part-exchange for a new boiler
(d)	Television company	Offering downloads of TV programmes to customers' home computer via the internet

7 Uses of information

List three broad uses of information.

8 Qualities of information

Below there are five statements about the quality of good information. None of these statements is fully correct.

You are required to amend each of the statements to make it more 'true'.

(1) Information should be accurate.

(2) Information should be made available as soon as possible.

(3) Information should be complete.

(4) Information is worth obtaining if it has some value.

(5) Information should be easy to understand.

9 Formal organisation

List briefly three reasons why formal organisations exist.

10 Schein and culture

(a)
  (i) What are the three levels of culture identified by Schein?

  (ii) Which of these levels of culture is the most difficult to interpret and understand?

  (iii) Which of these levels of culture is the most difficult to change?

(b) A music publishing company operates from a single office building. Everyone in the company calls each other by their first name or familiar name. All meetings between employees or with clients and customers are held in a cafeteria on the second floor of the building, and there are no meeting rooms or other meeting spaces.

Which of the three levels of culture, as identified by Schein, do these features of the company represent?

11 Handy and culture

Charles Handy identified four types of culture that are found in organisations. Which of these cultures is most likely to exist in each of the following organisations? Give your reasons.

(a) A large department store with fifteen departments spread across six floors of a building, with an accounts and administration office.

(b) A rail transport company providing passenger transport services.

(c) A firm of architects specialising in the design of small office buildings: the founder of the firm is the senior architect, and there are six other junior architects, none of them partners in the firm.

(d) A software company with a team of eight software experts, providing bespoke software to corporate and government clients.

(e) A school providing education to children between the ages of 7 and 18.

12 Four cultures

What did Handy mean by 'cultures' of an organisation. Briefly describe the four cultures identified by Handy and give an example of each.

13 Hofstede and culture

Hofstede identified ways or 'dimensions' in which the culture in organisations differs between countries. In each of the following four cases, which of the dimensions identified by Hofstede would explain the differences in culture between the two countries?

(a) In Country A, it is usual for the senior management of stock market companies to defer major expenditures in order to improve the reported current year profits. In Country B, it is common for the annual report of major stock market companies to explain at length the company's strategies and commitment to plans for capital expenditure.

(b) In Country C, it is usual for investment banks to pay large annual cash bonuses to individual bankers on the basis of their performance in the year. In Country D, it is usual for similar banks to determine annual cash bonuses on the basis of performance by groups or teams within the bank.

(c) In Country E, a much-praised quality of office workers such as accountants is an ability to turn up for work on time every day, regardless of difficulties with transport or weather. In Country F, late arrival at work due to transport problems is accepted as a normal fact of life, and poor time-keeping does not matter as long as the work gets done.

(d) In Country G, it is normal practice for decisions to be taken collectively and by consensus of management and employees. In Country H, it is the usual business culture for decisions to be taken by the boss without consultation with anyone else.

14 Stakeholders

(a) Define 'connected stakeholders'.

(b) Explain at least one way in which each of the following stakeholders might affect important decisions taken by the board of directors of a large stock market company.

    (i) Employees of the company

    (ii) Suppliers

    (iii) Customers

    (iv) A pressure group or special interest group.

15 Business and professional ethics

(a) Explain the main differences between business ethics and professional ethics for accountants.

(b) Explain the nature of whistleblowing.

16 Accountant's behaviour

Scott is a qualified accountant who works for a major manufacturing company. He was involved in the following incidents recently. For each incident, explain whether Scott has failed to act properly in accordance with professional accountancy ethics. If you consider that Scott is in breach of a fundamental ethical principle, state which principle has been breached.

(a) Scott's managing director has asked him to prepare a forecast of production costs for the next three months. As he is preparing the forecast the production director visits him to discuss the forecast. The production director tells him

that unless Scott can reduce his forecast of costs by about 5%, the production director will get into serious trouble with the managing director. Scott and the production director have been good friends for several years, and Scott agrees to do what he can to reduce the cost forecast.

(b) The chairman of the company has purchased some expensive evening gowns for his wife at a Paris fashion show. He tells Scott to record the cost of the evening gowns as a company expense, as the cost of new protective clothing for workers in the production department. Scott does what he has been told.

(c) The managing director asks Scott if he can construct a spreadsheet model for analysing costs. Scott has never constructed a spreadsheet model, but he does not want the managing director to give the work to a junior accountant in the department. He therefore says that he can construct the spreadsheet. He thinks that if he takes the work home, his sister will be able to help him: he knows that she is good with spreadsheets and will probably help him if asked.

(d) Scott attends a party at the weekend where he mentions to a friend that he thinks his company is getting into serious financial trouble because it is about to lose a major contract. The friend later mentions his concerns for Scott's future to another person at the party, and explains why Scott might be about to lose his job. The person that the friend speaks to is a senior manager in a rival company to the company that Scott works for.

17   NEDs

Describe **three** significant contributions that should be made by independent non-executive directors to the corporate governance of a major stock market company.

18   Audit committee: true or false?

Explain whether each of the following statements about the audit committee of a major stock market company is true or false.

(a) Statement 1. An audit committee can instruct the external auditors to insist that there must be a change of accounting policy in the company's financial statements, in a situation where the external auditors are in disagreement with the company's finance director.

(b) Statement 2. The audit committee can appoint the external auditors of the company.

(c) Statement 3. The audit committee can prevent the external auditors from providing tax advice to the company as non-audit work.

19   Currency risk

In May 2007, the president of Japanese car making company Honda stated that his company would not expand its production capacity any further at its factory in the UK. This factory produces Honda cars for the European market. He explained that the reason for this decision was the currency risk. The company was concerned

about its competitiveness in the European market. It had a 5% share of the UK cars market, but only a 1% share of the market in the rest of Europe.

Explain what the company president meant by the 'currency risk'.

20 Interest rate rise

Explain how a manufacturer of computer games might be affected by a 0.5% rise in interest rates by the central bank.

21 Monopoly

Explain why monopoly control over a market might be undesirable, and suggest three ways in which the government might act against monopolies.

22 Ageing population

The UK currently has an ageing population. At some time in the fairly near future, there will be about twice as many individuals in the UK who are past the normal age for retirement as there are individuals between 18 and 65 years of age.

Describe the possible consequences of an ageing population for a UK company that currently employs about 5,000 people.

23 Downsizing and de-layering

(a) Explain the difference between downsizing and de-layering.
(b) Explain the possible connection between outsourcing and downsizing.

24 Personal data

In 2007 Google, owner of the internet search engine, announced that it had plans to accumulate a comprehensive database about web searches by every individual, which could be used to analyse their interests and buying preferences. This announcement provoked a hostile response from internet privacy groups, but regulators in several countries stated that they had no concerns about data protection rights.

(a) Define 'internet privacy' and explain why Google's plans might affect internet privacy.
(b) Define data protection rights and explain why Google's plans should not affect these rights.
(c) Suggest three reasons why countries might have data protection laws.

25 Short questions

(a) State whether each of the following statements is **True or False**.
Statement 1. Health and safety regulations require employers to meet specific safety requirements in the work place.

Statement 2. Safety requirements in the work place must be reasonable in view of the risks, allowing for the cost of safety measures.
Statement 3. The employer has the sole responsibility for safety in the work place.
Statement 4. Health and safety regulations vary between different industries.

(b)   Which of the following is the direct concern of fiscal policy? (One answer only)

A   Taxation

B   Interest rates

C   Unemployment

D   Foreign exchange rates

(c)   Which of the following increases national income? (More than one answer is required.)

A   Investment

B   Taxation

C   Imports

D   Government spending

E   Savings

(d)   Health and safety regulations are primarily aimed at protecting:

A   The general public

B   Visitors to the employer's work place

C   Employees

(e)   Brigstock has a large balance of payments deficit and its central bank has very small foreign currency reserves. Which of the following might be a consequence of the balance of payments deficit? (More than one answer is required.)

A   Brigstock can no longer afford to pay for its imports.

B   Brigstock has to reduce its ownership off foreign assets

C   Brigstock will suffer economic stagnation as a consequence of the balance of payments deficit.

D   Brigstock's currency is likely to increase in value against other currencies.

E   Brigstock is attracting capital from investors in other countries.

26   Five forces

According to Porter, what are the five forces that determine the level of competition in an industry or a market?

27 Basic legal requirements

List the basic legal requirements in relation to keeping and submitting proper accounting records and preparing financial statements.

Explain how a legal requirement might exist for some types of company to prepare their annual financial statements in accordance with International Financial Reporting Standards (IFRSs).

28 Consequences

What will be the likely consequences of a failure by a company to keep proper accounting records, if this failure is discovered by the authorities?

29 Accounting standards

Give three reasons why the accountancy profession regulates itself through the establishment of accounting standards (financial reporting standards).

30 Credit control

List four elements of the work of a credit control function in a large company.

31 Payroll routines and purchasing routines

(a)   List the main elements of regular payroll routines.

(b)   Put the following documents in the order in which they are processed during the purchasing cycle:
1   cheque
2   purchase invoice
3   delivery note
4   material requisition note
5   goods received note
6   purchase order
7   credit note

State when a book-keeper will make accounting entries during the purchasing cycle.

32 Working capital

A business entity has inventory of $20,000. Its receivables are $18,000 and its payables are $7,000. It also has $2,000 in cash. How much working capital does it have?

33 Spreadsheets

(a) List three types of financial statement that might be prepared using a spreadsheet, and explain how spreadsheets can be useful for the purpose of financial risk analysis.

(b) A spreadsheet model includes the following values in seven of its cells.

Cell	Value
C8	2
D8	7
E8	3
G27	D8/C8
H45	G27*6
J6	H45/E8
J7	J6 + G27

(i) What numerical value will appear in cell J7?

(ii) What numerical value will appear in cell J7 if the value in cell D8 is changed from 7 to 10?

34 Database

Explain the meaning, in the context of a database system, of the following:

(a) data independence

(b) data integration

(c) data integrity

(d) data redundancy.

35 Accounting function

State which function or section in the accounting department is responsible for each of the following:

(a) Informing senior management that sales revenue next year must be at least $6 million in order for the company to make a profit.

(b) Recording the receipt of a payment for $2,000 from a customer.

(c) Writing a report that contains a recommendation that the individual who receives and records purchase invoices from suppliers should not be the same individual who makes the payments to suppliers.

(d) Arranging with a bank for the purchase of $25,000 at a future date, to pay a US supplier, at a rate of exchange that is agreed now.

36 Audit

(a) Explain the role of the following in the preparation of a company's annual financial statements:

      (1)   accounting department

      (2)   finance director

      (3)   board of directors

      (4)   external auditors

      (5)   internal auditors

      (6)   audit committee.

(b)   A company has external auditors. Explain why it should need internal auditors in addition to external auditors.

37   Types of internal audit

Explain briefly the different types of audit that might be carried out by internal auditors.

38   Audit work

(a)   Describe briefly the different types of test that are carried out during a statutory audit by the external auditors.

(b)   The external auditors of a company want to test the following items:

      (1)   the existence of a company's inventory at the end of its financial year

      (2)   that the company's liability to its individual suppliers are correctly stated for the purpose of preparing the balance sheet.

    Suggest a detailed test that might be carried out by the auditors on each of these items.

(c)   Explain what the external auditors should do if they consider an internal financial control to be weak.

39   Internal control, internal controls and internal checks

(a)   Explain the difference between a system of internal control, internal controls and internal checks.

(b)   List the five elements of a system of internal control.

(c)   Describe briefly three main types of internal control.

40   IT risks and IT controls

(a)   List six of the main threats or risks to an IT system.

(b)   Describe briefly the two main types of internal control for IT systems.

41   Fraud

(a)   Define fraud

(b)   Describe briefly the main types of fraud.

(c)   Explain briefly the consequences for a company of the discovery of a major fraud within its accounting department.

42   Fayol and Mintzberg

(a)   List the five main duties of management, as identified by Fayol.

(b)   List the roles of management, as stated by Mintzberg.

(c)   Suggest (with reasons) which view of the role of management you consider more realistic.

43   Mayo

What were the main conclusions of Mayo from the Hawthorne experiments?

44   Authority and responsibility

Explain the difference between authority and responsibility.

45   Continuum

Describe Tannenbaum and Schmidt's continuum of leadership styles, and suggest how it might have relevance to the practice of management.

46   Action-centred leadership

Describe the main elements of Adair's concept of action-centred leadership.

47   Hersey and Blanchard

(a)   What are the four leadership styles described by Hersey and Blanchard?

(b)   Explain the potential relevance of their views to the practice of management.

(c)   Explain how the views of Hersey and Blanchard differ from those of Fiedler.

48   Composition of a team

(a)   According to Belbin, what was the ideal size of team?

(b)   What might happen if the team is missing some of the critical characters or characteristics identified by Belbin?

49   Increasing a group size

What would be the likely effects, according to Belbin and Tuckman, of increasing the size of a project team after 18 months from three to nine people?

50 Participation

(a) In what circumstances is a participative style of leadership more likely to motivate employees?

(b) In what circumstances is a participative style of leadership unlikely to motivate employees?

51 Pay as a motivator

Discuss briefly whether pay is a motivator factor that will encourage individuals to work harder to achieve work objectives or performance targets.

52 Calculus

What are the main elements in the motivational calculus, as described by Handy?

53 Needs theory

Briefly explain motivational needs theory.

54 Blake, Mouton and McGregor

Compare the views about leadership of Blake and Mouton with those of McGregor.

55 Stages

List and describe briefly the stages in the recruitment and selection process, after a job vacancy has been identified.

56 Application form

Explain briefly how recruitment forms are used in the recruitment and selection process.

57 Seven point plan

You work for an international company that has extensive business operations in the UK, France and Germany. You have been interviewing candidates for a vacancy as junior information technology (IT) manager within the company, based in the UK.

When you interview each candidate, you record relevant facts and opinions about the individual under one of seven headings, corresponding to the seven items in Rodger's seven-point plan.

Required
State which category applies to each of the following items of information about one of the candidates.

Information	Category

The candidate has a university degree in chemistry.

He plays football for a local amateur team.

He has been learning to speak German for several years, and has passed some formal examinations in the language. It is his intention eventually to work in Germany or for a German company.

He can speak German with reasonable fluency.

He has a certificate in Information Technology, which he obtained after attending a course of evening classes at the local college.

He is currently looking after his aged mother, since he is an only child and his father is dead. This means that he cannot be away from home for an extended period; for example, he cannot go on business trips that require overnight stays.

58 Ineffective interviews

What are the potential consequences of ineffective interviews?

59 Discrimination

An equal opportunities employer will seek to prevent discrimination in the work place. Explain briefly the nature of:

- direct discrimination
- indirect discrimination
- victimisation
- harassment.

60 Wheels and circles

(a) What is the difference between a wheel and a circle pattern of communication? Give an example of each.

(b) What do you think would be the features of a 'Y' pattern of communication?

61 Formal and informal

(a) What is the difference between formal and informal communication?

(b) Give examples of each, and explain why both are essential for an organisation to operate efficiently and effectively.

62 Vertical and lateral

(a) Explain the difference between vertical and lateral (or horizontal) communication. In what circumstances or situations would you expect to find very little horizontal communication?

(b) What are the main problems with vertical communication when the leadership style is authoritarian?

63   Learning and training

Explain the views of Kolb and Honey and Mumford about learning, and explain how they are relevant for training individuals.

64   Methods of training

Shown below are four types of training programme and four methods of training. You are required to match each of the training methods with the type of training programme to which it is probably best suited.

Training programme
Training staff in the customer relations department how to deal with customer complaints
Management training for 'high flying' management trainees
Training for accountancy examinations
Training in health and safety procedures

Training method
Case study
Lecture
Film
Role play

65   Training and development

Explain briefly the difference between training and development.

66   Effectiveness of training

In what ways might the effectiveness of training be monitored? Use Kirkpatrick's model to provide an answer.

67   Job enrichment, enlargment and rotation

(a) Briefly define:
- job enrichment
- job enlargement
- job rotation.

(b) Which of these might be an objective of a job analysis and job redesign exercise?

68   Appraisal

Describe the three main elements of staff appraisal.

69   Competence

Suggest how the competence of an employee might be assessed.

Q&A

Answers to practice questions

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1 Types of organisation

(a) A charity is a non-government not-for-profit organisation, even when it receives most of its funding from the government.

(b) A school is a public sector organisation when it is owned by the government. However, there are also private schools. Private schools in the UK are currently established as charities and are funded by school fees: they are non-government not-for-profit organisations. In some countries schools may be operated by business organisations, whose purpose is to make a profit.

(c) A state-owned electricity company is a public sector organisation. However, it might be required to operate at a profit, in which case it is also a business organisation.

2 Span of control

As a general rule, the span of control will be narrow when the manager has to spend a large proportion of his time with individual subordinates, for example time spent on monitoring and discussing work. A span of control is also likely to be narrower in a small organisation than in a large one, although this is not always true.

Using these assumptions, the answers to the question are as follows. (Your own views might differ, but you should have reasons for your opinion.)

(a) A narrow span of control. In a small research department, the head is likely to work closely with the other departmental members on research projects, and the span of control probably has to be fairly narrow. A manager may be appointed for each research project or each group of similar research projects.

(b) A wide span of control. A site manager might have a fairly large number of individuals and team foremen reporting to him, particularly on a large site.

(c) A wide span of control. A head of a department store probably has the head of each department reporting to him. In a large department, this could be a fairly large number of departmental heads.

(d) A fashion design team is probably fairly small; therefore the head of a fashion design team will have only a narrow span of management control.

3 Management levels

(a) This is an operational matter, involving a day-to-day operational problem.

(b) This is a strategic decision, involving the selection of a business strategy for achieving the strategic objective of business growth.

(c) A decision to introduce a major new computer system begins as a strategic decision. It is concerned with the implementation of business strategy. Having made the strategic decision to develop a new computer system, tactical plans must then be developed (a budget and timetable for the development project, and the preparation of detailed system specifications). Tactical planning for the project will then be converted into more detailed operational plans as the development project progresses.

(d) A sales plan is made at a tactical level of management when it covers a longer-term period such as one year. A tactical sales plan must then be converted into

detailed sales targets for the next week or month, possibly for individual sales representatives or sales areas.

4 Centralisation and decentralisation

(a) These decisions will be taken by medical staff – the doctors.

(b) Policy on hygiene standards should be set by head office, because common standards should be applied in all five hospitals. Responsibility for enforcing the standards should be delegated to hospital management.

(c) Scheduling operations in the operating theatres should be the responsibility of the hospital management. However, in a centralised organisation, these decisions might be taken at head office.

(d) Decisions about discharging patients should be taken by medical staff.

(e) The policy on visiting times for patients might be decided centrally by head office management. However, policy on visiting times might be delegated to hospital management, with each hospital allowed to decide its own visiting times.

(f) Drugs should be prescribed by medical staff. However, head office might establish policies on drugs that should not be used in the hospitals – for example because they are too expensive.

(g) Hiring employees might be the responsibility of head office (in a centralised management structure) or hospital management (in a decentralised structure).

(h) Dealing with medical insurance companies about payments for patients is likely to be the responsibility of an accounts department at head office, because all five hospitals would otherwise have to deal separately with the same insurance companies.

5 Criticisms of committees

Four common criticisms of committees are as follows.

(a) When committees are given authority and responsibility, no individual has personal responsibility for what the committee does – not even the committee chairman. Effective management usually depends on **individuals** accepting responsibility.

(b) Decision-making is usually slow, especially when committees are large. For example, it is often difficult to arrange dates at short notice for meetings when most committee members can attend.

(c) Committee meetings take up a lot of time for a lot of individuals. They can therefore be very expensive.

(d) Committees might spend a long time debating issues without reaching any consensus or decision. Committees that are little more than 'talking shops' are a waste of time because they fail to achieve their purpose.

6   Marketing mix

(a)   **Product**   The software is an additional feature of the item that is offered to customers. It is a part of the product.

(b)   **Promotion**   Trade exhibitions are an example of promotions.

(c)   **Price**   Offering to 'trade' an old gas boiler in part-exchange for a new one is a way of reducing the selling price and is therefore an element of price. (It could also be argued that offering to take away and dispose of the old boiler is a part of the product.)

(d)   **Place**   Downloading TV programmes through the internet is the channel of distribution for delivering the product to the customer.

7   Uses of information

(a)   To inform. Information might be communicated simply to make someone aware and knowledgeable about something.

(b)   To make decisions.

(c)   To confirm the validity of earlier decisions. For example, information might compare what actually happened with what was expected, and the person obtaining the information can judge whether the original decision was the right one.

8   Qualities of information

	Corrected statement	**Comment**
(1)	Information should be sufficiently accurate for its purpose.	100% accuracy is not always necessary.
(2)	Information should be available to users in time for them to use it.	Information should be timely. This does not necessarily mean making it available as soon as possible, because it might not be needed immediately.
(3)	Information should be complete enough and relevant for its purpose.	It is not always necessary to have all the available information.
(4)	The cost of obtaining information should be justified by the benefits or value that it provides.	It is not worth obtaining information if the cost exceeds the benefits obtained.
(5)	Information should be clear and comprehensible	Complex information might not be 'easy' to understand, but information should be clear and comprehensible.

9 Formal organisation

Here are four reasons.

- To co-ordinate the efforts of several (or many) individuals towards a common purpose.
- To achieve objectives that individuals on their own could not achieve, for example through combining their effort and other resources (such as money).
- To increase efficiency and productivity through specialisation and the division of labour.
- Occasionally, to satisfy the needs of individual members for social relationships.

10 Schein and culture

(a)

   (i)   The three layers of culture are (1) the outer skin or 'artefacts' (2) an inner skin or 'espoused values' such as the formal mission, stated corporate values and declared strategies, and (3) an inner core or paradigm, representing basic underlying assumptions and unconscious beliefs.

   (ii)   According to Schein, the artefacts are the most difficult to interpret and understand.

   (iii)   The paradigm is the most difficult to change.

(b)   The customer of calling everyone by their first name or familiar name, and the custom of holding all meetings in the staff cafeteria are examples of artefacts – the outer layer. They are a part of the superficial culture of the company, but it is difficult to extract much meaning from them.

11 Handy and culture

(a)   The department store is likely to have a formal organisation structure, with hierarchical lines of authority from store manager to floor workers and administrators, and clearly-defined roles for each employee. A role culture will apply here.

(b)   For similar reasons to those in (a), the rail transport company will have a role culture. Other cultures might possibly exist within parts of the company.

(c)   The firm of architects is most likely to have a power culture (spider's web culture), because the founder of the firm is the senior architect and none of the other architects seems to have similar status or seniority. The founder of the firm is therefore likely to dominate decision-making. If the founder/owner of the firm is 'democratic' in outlook, a task culture might exist. A person culture will not exist, because there are junior architects doing some professional work, and the role of the other employees is not solely to provide services to the founder/owner.

(d)   The software firm is fairly small, and a task culture might well exist. Work for clients is probably performed by project teams, and project team working encourages a task culture.

(e) A school has a role culture. Each employee has one or more clearly-defined roles, such as teacher, subject head, head of department, and so on. The nature of teaching in schools means that a task culture is difficult to achieve.

12 Four cultures

The culture of an organisation consists of the attitudes, norms and values held by the people within it. It affects the way that people behave and the way that the 'leaders' and the 'led' relate to each other.

Handy identified four different cultures. Each can exist within a different part of the same organisation.

■ **Power culture.** There is one major source of power within the organisation and power and influence spreads out through the organisation from this power source in the centre. A power culture is often found in a small organisation that is owned and managed by an active and dynamic individual.

■ **Role culture.** Individuals see themselves as performing a role, often according to a job description. They are job-holders carrying out a designated function. The role culture is associated with bureaucracy and most large organisations. Examples are government departments.

■ **Task culture.** Individuals describe their work in terms of what they do rather than the function they perform. The focus is on the end-result rather than the method of working. The task culture is associated with project teams in business organisations. A task culture might also be found in some sports teams, such as the crew for a round-the-world sailing yacht.

■ **Person culture.** The organisation is built around an individual and the individual's needs. Very rare in practice. An example might be the entourage of a playboy prince or a film star.

13 Hofstede and culture

(a) The differences between business culture in Country A and Country B can be explained by short-term orientation (in Country A) versus long-term orientation (in Country B).

(b) The differences between business culture in Country C and Country D can be explained by individualism (Country C) versus collectivism (Country D).

(c) The differences between business culture in Country E and Country F can be explained by uncertainty avoidance. When the desire to avoid uncertainty is high, work habits such as punctuality and predictability are given high praise (as in Country E).

(d) The culture in Country H where decisions are taken by a boss without consultation is an example of masculine culture. The culture in Country G of collective decision-making and consensus is more feminine. (In addition, it could also be argued that the differences in culture are explained by the power-distance dimension.)

14 Stakeholders

(a) Connected stakeholders are stakeholders in an entity, such as a company, who are not decision-makers and do not have full-time association with the entity, but who nevertheless have a strong influence over the major decisions made by its leaders. Examples might be employees (who are not the decision-makers) and non-executive directors (who are not full-time with the company).

(b)

    (i) Employees might be able to influence the decisions of the directors of the entity by threatening to go on strike or take other disruptive industrial action.

    (ii) A supplier might be able to control decisions by a customer's board of directors, but only if it is a monopoly supplier of an essential product or service, or if the product or service is in short supply. For example, a major supplier of crude oil might have a strong influence over strategic decision-making by an oil refining and distribution company.

    (iii) Customers might be able to control decisions by a board of directors, especially if they are major buyers. For example, supermarket companies might have a strong influence over strategic decisions by manufacturers of consumer goods that are sold mainly through supermarkets.

    (iv) Pressure groups or special interest groups might not be able to influence decisions by an entity directly, but they might have indirect influence because of their ability to raise public and political awareness, or their ability to disrupt a company's strategy by means of legal/judicial action. For example, airline companies and airport authorities might be influenced by the activities of anti-pollution and 'clean air' campaigners.

15 Business and professional ethics

(a) Professional ethics for accountants focus on six fundamental ethical principles: integrity, objectivity, professional competence, confidentiality, professional behaviour and adherence to technical standards. Business ethics should also be based on concepts of correct behaviour, such as integrity and fair dealing: however, business ethics also consider broader issues such as employee welfare, environmental and social concerns and human rights.

In addition, business ethics focus on the activities of the business and the concerns of its major stakeholders. Professional accountants in practice must also have regard to the public interest, and should be prepared to act in the public interest even if this is counter to the specific interests of a client.

(b) Whistleblowing is the reporting by employees of suspected unethical or improper activity by colleagues, managers or other individuals. A whistle-blower is unable to make the report through normal channels of reporting (to a manager or supervisor) either because the report has been ignored or because the manager or supervisor is involved in the improper activity. The

whistleblower must therefore report his suspicions outside the normal formal reporting channels. A special channel for whistleblowers to report their concerns might be provided by an employer.

(The eventual financial collapse of US corporations Enron and WorldCom in 2002 was initiated partly by reports from whistleblowers in the accounts departments of those companies.)

16   Accountant's behaviour

The fundamental ethical principles for accountants apply to accountants in business as well as accountant in practice.

(a)   A fundamental ethical principle in accountancy is that an accountant should be objective, avoiding bias and undue influence. It seems that he has allowed his friendship with the production director to affect his forecasts of costs, and so he is in breach of the principle of objectivity.

(b)   The chairman has asked Scott to prepare a false accounting record and Scott has done so. This is a criminal act, as well as being unethical. Scott has failed to use professional behaviour (a fundamental ethical principle) by failing to comply with the law.

(c)   Scott should act with professional competence and due care. He should also act with integrity. By telling a lie to the managing director about his ability with spreadsheets, he has not shown integrity. If he (or his sister) is unable to construct a suitable spreadsheet model, he will also be acting without professional competence and due care.

(d)   Even in his private time and social life, Scott should not divulge confidential information to anyone who is not authorised to receive it. The information Scott gave to his friend and his friend passed on should be considered confidential. Scott should have kept quiet.

17   NEDs

Benefits that independent non-executive directors should bring to the governance of a major stock market company include the following.

(a)   They should provide a better 'balance of power' on the board of directors, representing the interests of the shareholders. They should help to prevent the board from being dominated by the chairman, chief executive officer or a group of executive directors, who might act in their personal interests rather than in the interests of the shareholders.

(b)   They bring knowledge and experience of affairs outside the company, and they are able to use their differing backgrounds and insights to contribute to the discussions of the board of directors. This should help to improve the quality of decisions made by the board.

(c)   Independent non-executive directors are able to take responsibility for matters dealt with at board level in which executive directors might have a conflict of interests. For example, as members of the remuneration committee independent non-executive directors should negotiate the remuneration of

executive directors. As members of the audit committee, they should help to protect the external auditors from undue influence by some of the executive directors.

18 Audit committee: true or false?

(a) Statement 1. False. The auditors should reach their own opinion independently. The audit committee should be informed of the disagreement between the auditors and the finance director, and members of the audit committee might discuss their concerns at a full board meeting. However, the audit committee does not give instructions to the external auditors. The members of the audit committee probably do not have sufficient auditing expertise to be able to do this anyway.

(b) Statement 2. False. The audit committee should recommend to the main board whether the current external auditors should be re-appointed next year, or whether new auditors should be appointed. The full board should make a decision to recommend the choice of auditors to the shareholders. The formal re-appointment or appointment of auditors should be taken by the shareholders. The shareholders will usually accept the directors' advice.

(c) Statement 3. True. The audit committee should have the responsibility for deciding the company's policy on giving non-audit work to the external auditors. (This is regardless of any guidelines from the audit profession on the type of non-audit work that the external auditors may perform.)

19 Currency risk

The president probably had two related issues in mind.

(1) Expenditure on cars manufactured in the UK in British pounds and cars are sold in Europe for euros. If the value of the pound is high relative to the euro, Honda must charge higher prices in euros to cover its costs and make a profit. The relatively low market share of Honda in Europe is probably due partly or largely to the relatively high prices that have to be charged.

(2) Honda is probably also concerned that the pound might increase still further in value against the euro. This would make selling cars in Europe even less profitable, or prices would have to be increased even more, and market share would be lost.

In view of the fact that the UK market for cars is small in comparison with the market in the rest of Europe, Honda would probably prefer to have a factory in a country in the eurozone rather than in the UK.

20 Interest rate rise

The manufacturer might be affected directly in three ways.

(1) If it has borrowed money at a variable rate of interest, for example a medium-term bank loan, its borrowing costs (interest charges) will rise and its profits will be affected.

(2) If the company has been planning new investments, it might re-consider the decision to invest if it is intended to finance the investments by borrowing.

(3) The increase in interest rates might result in a stronger currency, with the country's currency rising in value against other currencies. This would make any exports more expensive to foreign buyers. The manufacturer might therefore suffer a fall in export orders.

The manufacturer might also be affected eventually by the effect of a higher interest rate on the economy generally, through the transmission mechanism. Higher interest rates might eventually result in a fall in consumer spending. If this happens, demand in the domestic market for computer games is likely to fall.

21 Monopoly

Control over a market by a monopoly firm can be undesirable because of the effects of monopoly on customers.

(a) When a monopoly firm controls a market, the prices charged are likely to be higher than they would be in a competitive market.

(b) Because prices are higher than in a competitive market, demand to buy the product is likely to be lower. Monopoly has the effect of both raising prices and reducing output to the market.

(c) When there is a monopoly, there will be less variety and choice for customers.

A government might act against monopolies in the following ways.

(1) It might set up a committee or department to investigate companies that are suspected of being a monopoly (as defined by law or regulations), and recommend actions that the company should be forced to make in order to reduce its monopoly power. (For example, the monopoly company might be required to sell off some of its assets to rival firms.)

(2) It might prohibit takeovers or mergers between companies that would create a monopoly, or allow a takeover to go ahead only under certain conditions.

(3) It might appoint a commission to regulate the prices charged to consumers by the monopoly (for example prices of energy and water supply).

22 Ageing population

The company might eventually be affected by an ageing population in any of the following ways.

(a) It might need to persuade some employees reaching retirement age to continue in work past their retirement age.

(b) Unless the need for labour is reduced (for example by technological developments), the company might need to consider attracting employees from other countries or it might need to consider re-locating operations in another country where a problem of an ageing population does not exist.

(c)   As the population gets older, the demand for goods and services will change. (For example, the demand for running shoes might fall and the demand for golf clubs increase.) The company might need to adapt its products or services to meet this changing demand.

(d)   The company might also need to consider the effects of an ageing population on its employees. It seems likely that employees in the future will be required to pay more in taxes to support the cost (state pension costs and medical costs) of the retired population. This is likely to affect employee attitudes to issues such as wage and salary levels.

23   Downsizing and de-layering

(a)   Downsizing is a deliberate reduction by an employer in the number or people it employs. De-layering is a reduction in the number of levels of management in an organisation structure. Downsizing is likely to result in de-layering hen it happens in a large organisation. However, downsizing can happen without any de-layering, and de-layering doesn't necessarily result in downsizing.

(b)   Outsourcing means using an external organisation or sub-contractor to carry out operations that were previously done internally by an entity's own employees. Operations that might be outsourced include IT services, cleaning, security services, vehicle fleet management and payroll administration. When large operations are moved from an internal operation to an outsourced operation, there will be a significant loss of jobs in the entity. The entity will therefore reduce in size.

24   Personal data

(a)   Internet privacy means privacy of information about how individuals use the internet – such as what web sites they visit, how often they visit them and how long for. Some people argue that the internet activities of individuals (or terminals with internet access) should not be monitored and analysed for each individual internet user. Google's plans to build a database of the internet activity of every individual would therefore be a threat to internet privacy.

(b)   Data protection rights are rights of living individuals with regard to personal data that is held about them by any other person or organisation. The rights of individuals might include the right to give approval for anyone to hold such data about them. There should also be rights relating to the uses that are made of personal data, its confidentiality and its security.

        The plans of Google do not threaten data protection rights because these rights relate to data about identifiable living individuals. The database planned by Google does not require individuals to be recognised by name.

(c)   Data protection laws exist in many countries for the following reasons.
        (1)   To prevent identity theft (or reduce the risk of identity theft).
        (2)   To restrict the uses by other people of information about specific individuals.

(3)   To protect the confidentiality of personal data (such as medical records and criminal records).

(4)   To prevent users of personal data from holding and using data that is out of date or otherwise incorrect.

25   Short questions

(a)

Statement 1 is false. Health and safety regulations on the whole are not **specific**, although there are certain minimum requirements for example with regard to fire regulations. There are also regulatory guidelines for various industries.
Statement 2 is correct.
Statement 3 is false. Employees are also required to show due care with regard to health and safety matters.
Statement 4 is correct. Different regulatory guidelines are issued for a large number of different industries.

(b)   A Taxation

(c)   A and D. National income is the sum of consumer spending, government spending, investment and the excess of exports over imports of goods and services.

(d)   C. Although regulations seek to protect the public and visitors to an employer's premises, they are mainly concerned with protection for employees.

(e)   B and E. If there is a balance of payments deficit in goods and services (that cannot be financed by foreign currency reserves of the central bank) there must be a net inflow of capital that matches the balance of payments deficit. Capital inflows occur when residents of the country sell off foreign assets that they own or foreign investors invest capital in the country. When there is a balance of payments deficit, the currency is more likely to fall in value than rise in value. There is no reason why the economy should stagnate.

26   Five forces

(a)   Threat of new entrants (new competitors) to the market.
(b)   Bargaining power of suppliers
(c)   Bargaining power of customers
(d)   Threat from substitute products
(e)   Competitive rivalry in the industry.

27 Basic legal requirements

Legal requirements apply to companies, not to other types of business organisation. However, sole traders and partners in business partnerships are required to prepare financial statements for tax reasons.

Although there are exceptions, the basic legal requirements are as follows:

(a) Companies are required to keep and maintain accounting records.

(b) Companies are required to prepare annual financial statements.

(c) Companies have a duty to file a copy of their annual financial statements with the appropriate government department. (In the UK this is the Registrar of Companies.)

(d) The financial statements must be audited by independent external auditors.

(e) The directors should provide a copy of the financial statements to all shareholders, and should present the financial statements to the shareholders at an annual general meeting of the company.

The legal requirement for companies to prepare financial statements in accordance with IFRSs can only be introduced by national law.

28 Consequences

National laws vary. However, the officers (directors) responsible for the failure to keep proper accounting records will be criminally liable. The company itself might be liable to pay a fine.

29 Accounting standards

(a) To standardise the accounting treatment of certain matters, such as the valuation of assets.

(b) To specify additional information that should be provided, often in notes to the financial statements.

(c) To make the financial statements of different companies much more comparable. This benefits users of accounts.

(d) Some accounting standards specify a requirement to provide financial statements in addition to those required by law. (A requirement for a cash flow statement is an example.)

Note: Accounting standards, taken together, are not sufficient to specify how all aspects of financial statements should be prepared.

30 Credit control

(a) Assessing new customers to decide whether to allow them credit, and if so deciding a credit limit.

(b) Dealing with specific requests from customers for credit.

(c) Reviewing the payment performance of existing customers, and re-assessing their credit limits.

(d) Where customers are late in making payments, a credit collection section is responsible for taking action to 'chase' the customers and obtain payment.

(e) Advising senior management when an unpaid debt is unlikely to be collected, and so should be treated as a 'bad debt'.

31 Payroll routines and purchasing routines

(a) On or before each payment date for payroll, the payroll section must:

(1) Establish a current list of employees.

(2) Obtain details of any 'one-off' or unusual payments to individual employees, such as details of overtime hours for overtime payments, any bonus payments and any salary increases.

(3) Calculate for each employee the gross pay for the period.

(4) Calculate for each employee the various deductions from gross pay (for example tax on income, pension contributions).

(5) Pay the net pay (gross pay minus deductions) to the individual employees, possibly direct to their bank account.

(6) Provide each employee with details of their pay and deductions for the period.

In addition, there should be routines for:

(1) Making payments of the deductions, to the tax authorities, pension scheme and so on, at the appropriate time.

(2) Providing information about payroll costs so that these can be recorded in the accounting system. (The payroll section might do this work itself.)

(3) Providing detailed information about payroll costs to the cost and management accounting section, for analysis of labour costs.

(b)

Sequence of documents:

1 Material requisition note

2 Purchase order

3 Delivery note

4 Goods received note

5 Purchase invoice

6 Credit note

7 Cheque (payment).

However, a credit note might be issued after payment has been made, so (6) might be cheque and (7) credit note.

The book-keeper makes a record of purchase invoices received, credit notes and payments made to suppliers.

32 Working capital

	$
Inventory	20,000
Receivables	18,000
Cash	2,000
	40,000
Payables	(7,000)
Working capital	33,000

33 Spreadsheets

(a) Spreadsheets can be used to:

(1) prepare forecasts, such as sales forecasts

(2) prepare budgets and other financial plans

(3) prepare financial statements

(4) make various financial calculations and assessments, especially where there is some uncertainty about the value of some of the items in the calculation. (An example is using a spreadsheet to assess the financial return from a proposed major capital investment.)

An important aspect of spreadsheets is that values in a spreadsheet model can be altered quickly and easily, and a new financial statement or forecast can then be produced immediately with the amended values included. This feature of spreadsheets allows management to carry out 'sensitivity analysis' or risk analysis on their forecasts, plans or estimates.

(b)

(i) $G27 = 7/2 = 3.5$

$H45 = 3.5 \times 6 = 21$

$J6 = 21/7 = 3$

$J7 = 7 + 3.5 = 10.5$

(ii) $G27 = 10/2 = 5$

$H45 = 5 \times 6 = 30$

$J6 = 30/3 = 10$

$J7 = 10 + 5 = 15$

34 Database

(a) **Data independence** means that the data held in a database file is independent of the various uses or applications for which the data is used. Changes can be made to the application software without affecting the database files.

(b) **Integration of data** means that the data used by different departments or other users in an organisation is brought together in a common file or set of

files, and the same files are used by all the different users for their particular data processing requirements.

(c) **Data integrity** means 'honesty' of the data. Data on a database file needs to be accurate and reliable.

(d) **Data redundancy** means holding the same data in two or more different places. Through data integration, a database eliminates data redundancy, because there is no need to duplicate the same data in different files.

35 Accounting function

(a) Management accounting function

(b) Financial accounting/book-keeping function

(c) Internal audit function

(d) Treasury/finance function

36 Audit

(a)

(1) The accounting department will provide the figures from the accounting records that are needed to prepare the financial statements, and staff will assist the individual who prepares the draft financial statements. This might be the finance director or the chief accountant.

(2) As head of the finance and accounting department, the finance director has overall executive control over the preparation of the financial statements. The finance director might actually prepare the draft financial statements, although this work may be delegated – for example to a chief accountant.

(3) The board of directors has overall responsibility for the financial statements, and must approve them before they are published/sent to the shareholders.

(4) The external auditors carry out a statutory audit on the financial statements of a company and prepare a report for the company's owners (shareholders). The external auditors are required in their report to give an opinion as to whether the financial statements give a true and fair view or fair presentation, in all material respects, of the financial performance of the company for the period covered by the statements and the financial position of the company as at the end of that period.

(5) The internal auditors have no responsibility with regard to the reparation of the financial statements, except to the extent that their audit work might be relied upon to some extent by the external auditors.

(6) The audit committee has no responsibility for the preparation of the financial statements, but it acts as a watchdog over the audit process. It will discuss with the external auditors issues that are of some significance or concern relating to the financial statements and the audit, and report its views to the full board of directors.

(b)

A company is not required to have internal auditors. However, if it does not have internal auditors, the board of directors (or audit committee) of a stock market company might be required each year to consider whether there is a need for an internal audit function. (This is a requirement for listed companies in the UK, for example.)

The role of an internal audit department might be to:

(1)   provide reassurance to the company's management that the financial control system is adequate and that the financial statements produced by the company should be reliable

(2)   carry out audit work that is not required by law, and that the external auditors do not perform (unless asked to do so by the company's management).

37   Types of internal audit

(a)   **Financial audit**. This is the 'traditional' type of internal audit. It duplicates some of the work of the external auditors. A financial audit examines the financial controls, and reports on whether these are satisfactory and are being complied with. Some detailed testing (substantive tests) is also carried out. Some of this work might be relied upon by the external auditors, who might therefore do less audit testing for the purpose of the statutory audit than they would if there had been no financial audit by the internal auditors.

(b)   **Systems testing**. This is the testing of a system's controls.

(c)   **Value for money audit**. This is an examination of any process or operation in order to establish whether it provides sufficient value for money – economy, efficiency and effectiveness.

(d)   **Operational audit**. This is an audit of a non-financial operation, to establish the effectiveness of its controls and the operation generally.

(e)   **Compliance audit**. This is an audit to establish whether certain regulations or required procedures are being complied with.

(f)   **IT audit**. This is an audit of an IT system or IT operations generally.

(g)   **Management audit**. This is an audit of the effectiveness of management or a group of managers. This type of audit might be performed by senior management or external consultants, rather than internal auditors.

38   Audit work

(a)

(1)   **Tests of control**. These are tests of the internal controls in a system, to establish whether they are satisfactory and adequate.

(2)   **Tests of compliance**. These are tests to check whether controls which appear satisfactory 'on paper' are actually being complied with. If

controls are ignored and not complied with, the system of control will be weak.

(3) **Substantive tests**. These are detailed tests into the accuracy of accounting records for transactions and asset and liability values.

(4) **Analytical procedures**. These are another form of substantive testing, where ratios and trends are analysed to see whether there appears to be anything unusual in the financial statements.

(b)

To check the existence of inventory at the balance sheet date, there should be a physical count of inventories at the end of the financial year.

To check that recorded amounts owed to suppliers are accurate, the auditors can check the regular (usually monthly) statements sent to the company by each supplier, itemising purchases and payments since the previous statement, and the amount currently owed by the company to that supplier.

(c)

They should first consider the effect that the weakness in control might have on the financial statements, and whether it might have a material effect (so that the financial statements would not give a true and fair view).

They should consider how the weakness in control might be removed. A recommendation should be made to management, suggesting a new control or an improvement in existing controls. An improvement in controls should have an impact for the future.

For the purpose of the current year's financial statements, an improvement in control is too late. The auditors need to consider how much detailed testing (substantive testing) will be needed to establish whether the financial statements give a true and fair view. In other words, a weakness in controls makes it necessary to carry out more substantive tests.

39　　Internal control, internal controls and internal checks

(a) A system of internal control is the entire system that is established within an entity to ensure that financial systems, operational systems and compliance systems function as they are expected to. The system of control should ensure that risks are recognised and controls are established to deal with them, and that errors and omissions (deliberate or accidental) do not occur.

(b) There are five main elements to a system of internal control.

1　A control environment, including a culture that recognises the importance of control and the need to apply and comply with controls.

2　A system for identifying risks and assessing the significance of risks.

3　Internal controls for dealing with the significant risks that have been identified.

       4   Communication and information. Information about risks, controls, responsibility for controls and compliance or non-compliance with controls should be properly communicated to everyone who needs to know about them.

       5   Monitoring. There should be monitoring of the effectiveness of controls and the overall system of internal control.

(c)   Three types of internal control.

       1   **Preventative controls**. These are controls that are intended to prevent errors from happening.

       2   **Detection controls**. These are controls for identifying errors when these occur.

       3   **Corrective controls**. These are controls or procedures for ensuring that corrective action is taken when an error is detected.

Note: You might have chosen to take three of the SPAMSOAP categories of internal controls as the basis for your answer. This would be an acceptable alternative answer.

40   IT risks and IT controls

(a)

    (1)   Unauthorised access to the computer system, including unauthorised physical access to terminals and unauthorised access to data files and programs.

    (2)   Risks of human error, such as errors in the input of data to a system.

    (3)   Errors in the computer software, so that data is not processed properly.

    (4)   Technical errors in the system, such as breakdown of a central computer/server, or loss of a communication link.

    (5)   A loss of confidentiality of data, for example due to unauthorised access to computer files.

    (6)   Deliberate or accidental corruption of data or loss of data/data files.

    (7)   Criminal damage to computer equipment, or damage caused by a natural disaster such as a fire.

    (8)   Loss of IT personnel, leading to a loss of knowledge and understanding of an IT system.

(b)   The two main types of controls for an IT system are:

    (1)   **General IT controls**. These are controls that are applied to all IT systems and users, and to IT operations generally. They include physical access controls, the use of passwords and encryption of data, anti-virus software and firewalls, IT Standards for operating computer systems (including backing up computer files).

    (2)   **Application controls**. These are controls that apply to specific IT application systems (such as a payroll system or inventory control

system). They include data validation checks: these are checks carried out within a computer program on specific items of data input to the system.

41   Fraud

(a)   Fraud is an intentional act involving deception, carried out by one or more individuals with a view to obtaining a personal gain. It usually involves theft or false accounting, but might also involve the wrongful use of a company's assets. Fraud is a crime.

(b)   The main types of fraud are:

(1)   **internal fraud**, which is fraud committed within an entity by one or more employees

(2)   **external fraud**, which is fraud committed by one or more individuals who are not employees of the entity.

(b)   The consequences of a major fraud within a company are as follows.

(1)   The company will usually suffer a loss. The loss might involve theft from the company.

(2)   Alternatively fraud might result in the company having a liability to customers or other people. For example fraud might involve having to pay back money or other assets stolen from the company's customers. This is often the case when external fraud is discovered in a banking system.

(3)   The company might be unable to recover from the fraudster the money it has lost.

(4)   If the company's shares are traded on a stock market, a fraud could affect the share price adversely.

(5)   If a major fraud becomes public knowledge, the company's reputation might be adversely affected.

(6)   There might also be some loss of morale amongst employees, after the discovery that they have been working with a criminal.

(7)   There might be some disruption to operations, as auditors or other investigators look into how the fraud happened and what needs to be done to prevent a similar occurrence in the future.

42   Fayol and Mintzberg

Fayol identified the five main duties of a manager to be:

- Planning (looking ahead)
- Organising
- Commanding
- Co-ordinating
- Controlling

Mintzberg identified the main roles of managers differently.

- **Interpersonal roles**
  - Acting as a figurehead for the organisation in its relationships with external bodies
  - Acting as a leader for employees within the organisation
  - Providing a liaison role in dealing with other work groups or sections in the organisation.

- **Information roles**
  - Monitoring performance and obtaining information.
  - Disseminating information to others
  - Acting as a spokesperson.

- **Decision-making roles**
  - Entrepreneurial role (taking initiatives)
  - Handling disturbances and resolving conflicts
  - Allocating resources
  - Negotiating.

Mintzberg's analysis is probably more relevant because there is a strong emphasis in most organisations on the interpersonal roles of managers. The role identified by Fayol – commanding – is probably too authoritarian in most types of organisation (possibly with some exceptions, such as the armed forces).

43   Mayo

- There is a social purpose to working. Individuals do not work just for money. Work satisfies social needs through work groups.
- Productivity can be improved if the work group is motivated to perform well.
- To motivate employees, managers must communicate effectively with them. For effective communication there must be a positive relationship between the manager and the employees.

44   Authority and responsibility

Authority refers to the amount of power or discretion of an individual or job-holder to make decisions within an organisation. In a formal organisation, the scope of the authority of each manager is decided by his position within the organisation. Authority within a formal organisation is delegated from the 'top down'.

Responsibility is an obligation to make sure that something gets done. If the actual result or outcome is disappointing, the person responsible 'takes the blame'. In a formal organisation, managers are responsible for an aspect of the organisation's performance. They are accountable to their superiors for their actions and results.

Authority is delegated through the management hierarchy. Responsibility cannot be delegated. A senior manager might delegate some authority to a junior, but remains responsible for the results and performance of the junior.

45 Continuum

Tannenbaum and Schmidt identified seven different levels of delegation that might be practised by managers:

■ Tells (extreme authoritarian management)

■ Tells and sells

■ Tells and talks

■ Consults

■ Involves

■ Delegates

■ Abdicates.

They argued that as a team becomes more established and gains experience, the manager will trust them much more. Consequently, the manager's style will move along the continuum and the manager will delegate an increasing amount of authority.

The relevance of this approach to practical management is that the appropriate level of delegation within a team or an organisation may depend on the time that the team has been together, and on the skills and experience it has acquired.

46 Action-centred leadership

Adair argued that a manager must show concern for:

■ the job

■ managing his or her team or group and

■ managing each individual within the team or group.

The requirement to show concern for the job, for the group or for individuals varies with the work situation. Sometimes a job-centred focus is more important, and sometimes the need to provide leadership for the group as a whole or for individuals is more important.

Adair argued that a manager should be able to show concern for all three aspects of management, and should be able to alter the emphasis of his or her leadership to meet the requirements of the particular work situation.

47 Hersey and Blanchard

(a) Hersey and Blanchard argued that managers may be involved in directive activity (giving directions and instructions) and supportive activity (supporting subordinates and helping them through guidance,

encouragement and suggestion). The four leadership styles they identified are based on differing degrees of supportive and directive activity of the manager.

Style	Directive activity	Supportive activity
Delegating style	Low	Low
Telling/directive style	High	Low
Selling style	High	High
Supportive/participative style	Low	High

(b) Hersey and Blanchard argued that managers should adapt their management style to the requirements of the situation, and vary the amount of their supportive activity and directive activity. For example, they suggested that the 'selling' style, where the manager give a large amount of direction and support, is appropriate when the manager's employees have some competence in their work, but are:

- relatively inexperienced (therefore need direction) and

- lacking in confidence (therefore need support and praise from the leader to build their self-esteem).

(c) Fiedler argued that managers by nature are either authoritarian or democratic, and the most appropriate leadership style varies with the work situation. In this respect his views are similar to those of Hersey and Blanchard. However, unlike Hersey and Blanchard, Fiedler did not believe that individual managers could adapt their style to suit the needs of the work situation. Fiedler argued that managers with the appropriate style should be appointed according to the needs of the situation. For example, when a work situation calls for authoritarian leadership, an individual who is naturally authoritarian should be appointed: a democratic type of leader would be ineffective in the same situation.

48 Composition of a team

Belbin did not suggest that there is an ideal number of people to make an effective team, although if a group becomes too large it will lose the characteristics of a team (social interaction and team work). He suggested that in the most effective teams, the team members share a number of character types (he originally identified eight and then added a ninth, the specialist). One individual might possess several character types, so that a team of less than nine people can still be effective.

He argued that without some of the character types present within the team, the team would not perform as effectively as it might. For example, without a finisher/completer, some important details might be overlooked. Without a shaper, there might be inadequate progress with the team's work. Without the monitor-evaluator, the team might reach ill-judged decisions – and so on.

49   Increasing a group size

The main effect of increasing a group from an established team of three to a new size of nine is that the old team is effectively brought to an end and a new team is put in its place.

Since there is a new team with new team dynamics, it will have to go through the stages of formation and development identified by Tuckman – forming, norming and storming, before it can start performing. Since three of the new team members have been doing the work for some time, the team might succeed in getting through these stages fairly quickly – although much will depend on how the team members get on with each other.

The larger team might eventually become more effective than the previous team of three. This is because they are more likely as a group to share the 'essential' characteristics of team members for an effective team – as identified by Belbin. However, the nine team members need to adopt their appropriate roles, and this will only happen if the team comes together as a positively-minded group.

50   Participation

A participative leadership style is one where the leader (manager) involves all the members of his or her 'team' in decision-making. There are differing degrees of participation, from consulting with team members to allowing team members to make the decisions themselves. A key element of participation is that the team members are able to contribute ideas and suggestions in a way that makes them feel that they are contributing to the decision-making process, and that their ideas and opinions are respected.

A participative style of leadership is therefore most likely to be effective in motivating employees in situations where the employees are able to contribute to decision-making and enjoy involvement in the decision-making process. This is most likely to happen where:

■   the employees have skills or experience that they can bring to the decision-making process, and

■   decisions have to be made regularly which are 'non-standard', so that thought and judgement have to be used in arriving at the final decision.

This type of situation often arises in development project work and entrepreneurial activities, and in small teams of experienced or well-educated employees.

A participative style of leadership is unlikely to work in situations where the work is standardised and repetitive, and employees need relatively few skills and little training to do their work. This type of situation arises in highly-automated production operations. (You might argue that it also arises in some aspects of accountancy work!).

51 Pay as a motivator

There are different views about the extent to which the prospect of higher pay (through higher basic pay, bonuses, promotion or other forms of reward) acts as a motivator to individuals to put in more effort to their work, or to try to achieve performance targets.

Herzberg argued that pay is perhaps more likely to be a hygiene factor rather than a motivator factor. Individuals need to feel that they are being paid fairly, and will be dissatisfied if they believe that their pay is unfair. Maslow argued that pay is important because it can satisfy needs at some levels (including status needs), but cannot satisfy the highest-level need for self-actualisation.

Many organisations, however, use reward systems and bonus systems, and obviously believe that these systems do motivate individuals to perform better. This is because money can satisfy many of the needs of individuals, particularly needs in their private life. If the money rewards are high enough, many individuals will probably be motivated to achieve the targets or performance levels they need to reach in order to obtain the rewards that might be available. Pay is therefore a significant element in many 'process' theories of motivation, such as those of Vroom and Handy.

52 Calculus

Handy's motivational calculus is a 'process' theory of motivation. Handy argued that there are several factors that affect whether an individual will be motivated at work.

■ **The individual's needs**. An individual works in order to satisfy certain needs. These needs vary from one individual to another. The nature of an individual's needs can vary and the strength of their needs can also vary.

■ **Rewards and the satisfaction of needs**. Another key factor is whether the individual considers that the rewards or potential rewards from working will lead to the satisfaction of those needs. Work may provide rewards that satisfy needs wholly, partially or perhaps not at all.

■ **The link between effort and reward**. A third key element in Handy's calculus is the individual's perception of whether putting in more effort at work (being more motivated) will have an effect on results, and whether achieving these results will lead to the rewards.

53 Needs theory

McClelland developed motivational needs theory. He argued that individuals have three needs that can be met by working: a need for achievement, a need for authority and power and a need for affiliation with other people. All individuals have these needs to a greater or lesser extent, but one of the three needs is likely to be dominant in his or her character.

The most successful individuals in work, and the individuals who make the best managers, tend to be individuals whose need for achievement ('n-ach people) is strongest.

54 Blake, Mouton and McGregor

McGregor suggested that there were two management styles, Theory X and Theory Y. Theory X managers were authoritarian leaders, and McGregor suggested that these individuals focused on the requirements of the job and had little concern for the concerns of their subordinates. Theory Y managers are much more concerned about the needs of their employees, and seek to involve them in decision-making.

Blake and Mouton argued that managers need not be either job-focused or people-focused. They can show high or low concern for the needs of the job and high or low concern for people. For example, they can show:

- high concern for both the job and for people

- low concern for both the job and for people

- a high concern for the job and lower concern for people

- a high concern for people and a lower concern for the job.

In practice, many managers show a medium level of concern for both aspects.

55 Stages

The stages in the recruitment and selection process are as follows, after a job vacancy has been identified.

- **Job description**. Prepare a job description, setting out details of the job such as the tasks and responsibilities of the job, its location, the rate of pay for the job and so on.

- **Person specification**. Prepare a person specification, setting out the characteristics or personal qualities that the job holder will require in order to do the job well.

- **Advertise the job vacancy**. The vacancy should be advertised, and applicants invited to apply. The advertisement may be placed directly in an advertising medium such as a newspaper, magazine or journal, or it may be advertised through an external employment agency. Alternatively, the job may be advertised internally within the organisation, on the intranet web site or in the organisation's in-house magazine.

- **Application form**. Applicants should submit their applications on an application form (or possibly in the form of an application letter). This provides some information about the applicant, and may be used as a first screening device – for example to reject applications immediately in cases where the applicant is clearly not suited to the job.

- **Selection process**. This may take the form of interviews, or tests, or a combination of interview(s) and test(s).

- **Selection decision**. The preferred applicant is selected. A short-list of acceptable candidates may be drawn up, in the event that the preferred applicant turns down the offer.

- **Offer procedure**. The preferred candidate should be offered the job, subject to satisfactory references. When the job offer has been accepted, unsuccessful applicants should be notified and thanked for their interest in the vacancy. On

acceptance, a formal contract of employment should be prepared by the employer.

56 Application forms

Recruitment

Application forms are used in the recruitment process to enable individuals to submit an application for a job. It is the first communication from the applicant to the employer, and provides the employer with a basic amount of information about the applicant – including contact details.

Application forms are convenient for an employer because they require all applicants to provide the information that the employer requires.

Selection

Application forms are used in the selection process.

■ They are often used for an initial screening of job applicants. When there is a large number of applicants, the information provided on application forms is used to identify the individuals who should be interviewed and those individuals whose application should be rejected without interview.

■ The information on an application form can be used as a basis for asking further questions at selection interviews.

57 Seven point plan

Information	Category
The candidate has a university degree in chemistry.	*Attainments*
He plays football for a local amateur team.	*Interests*
He has been learning to speak German for several years, and has passed some formal examinations in the language. It is his intention eventually to work in Germany or for a German company.	*Disposition*
He can speak German with reasonable fluency.	*Special aptitude*
He has a certificate in Information Technology, which he obtained after attending a course of evening classes at the local college.	*Attainments. Also disposition*
He is currently looking after his aged mother, since he is an only child and his father is dead. This means that he cannot be away from home for an extended period; for example, he cannot go on business trips that require overnight stays.	*Circumstances*

58 Ineffective interviews

The potential consequences of ineffective interviews might be any of the following.

- Failure to identify any suitable candidates for a job.

- Offering the job to an individual who is not suitable, and who will do the job badly.

- Offering the job to someone who is adequate, but not the best from amongst all the applicants who were interviewed.

- Offering the job to the best candidate, who rejects the offer and takes a job somewhere else.

In strategic terms, ineffective interviewing means that the organisation will not have the best quality of employees that it would have had if its selection processes had been more effective. This will affect the efficiency and effectiveness of the organisation in the long term, and reduce its competitiveness.

59 Discrimination

Direct discrimination is treating an individual less favourably than others, consciously or otherwise, because of that person's sex, race, religious beliefs, disability or even age or sexual preferences.

Indirect discrimination occurs when a condition of work applies equally to everyone, but one group of individuals is much more likely to be able to meet the condition than another group. For example, it might be a condition of having a job that the job-holder must be over six feet tall. This condition will favour men over women, because many more men than women are over six feet.

Victimisation is discrimination against an individual who has brought proceedings in a previous case of discrimination or discipline at work. For example, an individual who has reported a colleague for racial discrimination in the work place might be overlooked for promotion or might not receive an annual bonus when colleagues get one.

Harassment involves abuse of an individual by work colleagues, often on the basis of the individual's sex, race, religious beliefs and customs, disability or sexual preferences.

60 Wheels and circles

(a) In a **wheel pattern** of communication, one person at the centre communicates directly with everyone else in the group, and the other group members communicate only with the individual at the centre and not with each other.

A wheel pattern occurs when there is a dominant or authoritarian leader who retains all decision-making powers.

In a **circle pattern** of communication, each individual communicates with two other people, and eventually the communication links come back to the point at which they started. For example, if six people communicate with each other:

- B might communicate with A and C

- C might communicate with B and D
- D might communicate with C and E
- E might communicate with D and F
- F might communicate with E and A, and
- A would communicate with F and B.

This type of communication pattern might be typical of some informal communication links, so that information gets passed on from one person to another, and eventually arrives back at the original source.

(b) In a **Y pattern** of communication, there is a chain of communication that splits into two at the end. For example, in a Y pattern involving 6 people:

- A communicates with B
- B communicates with A and C
- C communicates with B and D
- D communicates with both E and F
- E communicates only with D and F also communicates only with D.

This type of communication pattern in found in an organisation with an authoritarian and hierarchical management structure.

61 Formal and informal

Formal communication is the communication of information through formal communications links in the organisation. Formal communications might be made by means of reports, policy documents, official planning documents and the formal communication of management decisions.

Informal communications are communications that are not formal. Information is communicated informally by means of face-to-face conversations, telephone conversations, e-mails and text messages.

Both types of communication are essential in an efficient and effective business organisation:

- Formal communications help to provide management structure, so that individuals know what is expected from them and know how they have actually performed. For example, an organisation needs plans, procedures, policies and performance reports.

- Informal communications are a feature of co-operation between individuals. People need to communicate in a way that promotes constructive working relationships. Informal communication is often much quicker than formal communication channels, and also is often a more reliable method of conveying information.

62 Vertical and lateral

(a) Vertical and lateral (horizontal) communication are associated with hierarchical organisations. Vertical communication flows up and down the scalar chain, from boss to subordinate and from subordinate to boss. Lateral communication flows between colleagues or between different sections and departments.

(b) Very little formal horizontal communication may occur in an organisation that is managed in an authoritarian style. This is because the manager 'at the top' wants to know everything that is happening, and wants to be involved in all decision-making. Information must therefore be passed up to the top manager so that decisions can be passed back down to someone else.

(c) The problem with vertical communication in an organisation with authoritarian leadership is that the communication is largely one-way (downwards). The manager at the top makes the decisions and passes them down, and is not interested in the views or ideas of subordinates. As a result, subordinates may simply tell their boss what they think that he or she wants to hear, rather than what the subordinate considers to be correct. A strict authoritarian boss may therefore easily become detached from 'reality' and unaware of what is actually happening.

63 Learning and training

Kolb suggested that there are four learning styles:

■ Accommodating – feel and do
■ Diverging – feel and watch
■ Assimilating – think and watch
■ Converging – think and do

'Feel' means have some experience of the thing that is being learned.

Kolb suggested that at a younger stage of their career, individuals have a particular learning style that is best suited to them.

Honey and Mumford developed a similar argument. They identified four learning styles that individuals might have, and a method that enables individuals to identify what their own best learning style is. Their four styles are:

■ theorist – learn by understanding the theory
■ reflector – learn by observation
■ activist – learn by 'hands on' experience
■ pragmatist – learn by seeing the practical application of theory.

The relevance of these theories for training is that since individuals have different ways of learning most effectively, training programmes should perhaps be planned (as much as possible) to fit the individual to the most appropriate type of training programme.

64　Methods of training

Training programme	Training method
Training staff in the customer relations department how to deal with customer complaints	Role play
Management training for 'high flying' management trainees	Case study
Training for accountancy examinations	Lecture
Training in health and safety procedures	Film

You could argue that a film would be suitable for training customer relations staff, but probably not unless the film is supported by a lecture or talk and group discussions.

65　Training and development

Training involves providing a means by which employees can acquire new knowledge and skills. Although much training is done outside the work place, 'on the job' training is also common. The aim of training is that employees should acquire some identifiable skills.

Development is a process usually associated with individuals at a management level (or trainee management) within organisations. The purpose of development is to increase the experience and improve the judgement of an individual, so that the individual is able eventually to progress to a higher level or more responsible level within the organisation. Development is achieved largely through work experience. An individual is developed by gaining experience of different aspects of work, perhaps through (1) job rotation or (2) by standing in for a boss when the boss is absent from work, or (3) by assignment to special project work or (4) secondment to other departments.

Whereas training should have an identifiable learning objective, the aims of development of an individual are more difficult to specify and often take longer to achieve.

66　Effectiveness of training

Kirkpatrick's goal-based approach to the evaluation of training identified four levels of evaluation that can be used:

Level			Method of evaluation
1	Reaction	What did trainees think about the training course or programme?	Questionnaires ('happy sheets')
2	Learning	Were the objectives of the	Formal examination, or

		training actually met?	post-course testing
3	Behaviour	Has the training improved the way in which the employee performs his or her work?	Appraisal of the individual
4	Results (impact evaluation)	Do the benefits from the training justify the costs incurred?	Cost-benefit analysis, possibly carried out by the Human Relations department

67 Job enrichment, enlargement and rotation

Job enrichment involves putting more responsibilities or opportunities into a job so that it becomes more satisfying for the job-holder. This may involve delegating more decision-making authority to the job-holder, or it may involve giving the job-holder more opportunities for working with other people.

Job enlargement involves giving more tasks to the job-holder, and a wider range of activities or responsibilities. The job-holder therefore has more things to do, but all the different tasks are at the same level of competence and responsibility.

Job rotation means moving an individual from one job to another, in order to gain experience of all the jobs in a department or section.

Job rotation does not involve any re-design of jobs. However, both job enrichment and job enlargement could be objectives of a job analysis and job re-design exercise.

68 Appraisal

The three main elements of staff appraisal are:

■ Reward appraisal

■ Performance appraisal

■ Potential review.

Reward appraisal is an appraisal of what the individual's rewards should be. This may involve a discussion about what the employee's pay will be in the next 12 months, or a discussion about bonus payments or other rewards for the year just ended.

Performance appraisal involves an appraisal of the employee's performance since the previous performance appraisal. The focus of attention is whether or not the employee has achieved what was expected of him or her during the period. It may involve comparing the actual performance of the individual against a formal target or objective.

Potential review is concerned with how the individual employee has developed and with his or her potential for further career development in the future. The focus of attention is on the prospects for promotion and development, and with what might be done to improve the individual's prospects or opportunities.

All three aspects of appraisal might be dealt with in the same appraisal interview. However, it is often argued that the reward appraisal should be separated from the

potential review, and possibly also the performance appraisal. If all three aspects are discussed in the same review, it is probable that the reward appraisal will dominate the conversation, possibly to the exclusion of the other two elements of the appraisal.

69 Competence

The competence of an employee is his or her ability to perform at an appropriate standard. An employee is competent if he or she can perform certain tasks at a suitable level of ability.

Competence might be assessed either by:

■ identifying standards of competence or levels of competence, and then comparing the individual's actual performance with those standards, or by

■ comparing the performance of employees with the performance of their colleagues.

Standards of competence can be established for different aspects of work. For example, some professional bodies with examination systems identify the levels of competence that they expect examination candidates to demonstrate in their examination, in order to obtain a pass mark. The required levels of competence in different subjects and topics may vary from a basic understanding (demonstrating knowledge) up to an ability to analyse and evaluate a fairly complex problem and put forward recommendations.

Setting standards of competence in the work place calls for a careful analysis of jobs and the actual requirements of the job. An employee is judged competent if he or she can perform the tasks that are required to do the job to a satisfactory standard.

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